

desire of maximization of economic effects of structural help through directing them to the leading domains and regions.

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REASONS FOR FOREIGN INVESTMENTS IN POLAND

Abstract: The paper presents Poland's attractiveness for foreign investors. The Author studied the reasons those made foreign investors to invest in Poland based on the multiple recent reports. Starting from main definitions of foreign direct investment, the Author shows determinants and risk of foreign investments, then researches are presented comparing Poland attractiveness for foreign investments with other countries' situations.

Keyword: foreign investment, attractiveness

Introduction

There are many definitions of foreign investments in the literature concerning the subject. Anyway, most of them are based on the model definition of Organization for Economic Co-operation and Development (OECD). According to OECD, foreign direct investment reflects the objective of obtaining a lasting interest by a resident entity in one economy ("direct investor") in an entity resident in an economy other than that of the investor ("direct investment enterprise"). In the text of this article, the term "foreign investment" is used instead of "foreign direct investment" for the simplification. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated.

The numerical guideline of ownership of 10 per cent of ordinary shares or voting stock determines the existence of a direct investment relationship. An effective voice in the management, as evidenced by an ownership of at least 10 per cent, implies that the direct investor is able to influence or participate in the management of an enterprise; it does not require absolute control by the foreign investor.¹

Determinants and risk of foreign investments

Foreign investments have increased dramatically in recent years. However, the distribution of foreign investments is highly diverse and to explain differences in foreign investments inflows among countries, it is necessary to understand how foreign investors choose investment locations. There are many determining factors that induce foreign investors to take up business activity in a different countries. Those determining factors are presented in many varied ways, therefore, I decided to present determinants of foreign investments from the host country side.

¹ Benchmark Definition of Foreign Direct Investment, Third Edition, OECD, Paris 1996

According to World Investment Report prepared by UNCTAD, foreign investment takes place when three sets of determining factors exist at the same time¹:

- the presence of ownership of specific competitive advantages in a transnational corporation,
- the presence of location advantages in a host country
- and the presence of superior commercial benefits.

If the ownership of specific advantages (e.g. proprietary technology) of a firm is exploited optimally, then can compensate for the additional costs of establishing production facilities in a foreign environment and can overcome the firm's disadvantages vis-à-vis local firms. The ownership of specific advantages of the firm should be combined with the location advantages of host countries (e.g. large markets or lower costs of resources or superior infrastructure).

To the main host country determinants that influence investor's decision belong²:

I. Policy framework for foreign investments

- Economic, political and social stability
- Rules regarding entry and operations
- Standards of treatment of foreign affiliates
- Policies on functioning and structure of markets (especially competition and M&A policies)
- International agreements on foreign investments
- Privatization policy
- Trade policy (tariffs) and coherence of foreign investments and trade policies
- Tax policy

II. Economic determinants

A. Market- seeking

- Market size and per capita income
- Market growth
- Access to regional and global markets
- Country-specific consumer preferences
- Structure of markets

B. Resource / asset-seeking

- Raw materials
- Low-cost unskilled labor
- Skilled labor
- Technological, innovatory and other created assets (e.g. brand names), including as embodied in individuals, firms and clusters
- Physical infrastructure (ports, road, power, telecommunication)

C. Efficiency-seeking

- Cost of resources and assets listed under B, adjusted for productivity for labor resources
- Other input costs, e.g. transport and communication costs to/from and within host economy and costs of other intermediate products
- Membership of regional integration agreements conducive to the establishment of regional corporate networks

¹ UNCTAD, World Investment Report 1998, Trends and Determinants, New York and Geneva, 1998

² ibidem

III. Business facilitation

- Investment promotion (including image building and investment-generating activities and investment-facilitation services)
- Investment incentives
- Hassle costs (related to corruption, administrative efficiency, etc.)
- Social amenities (bilingual schools, quality of life, etc.)
- After-investment services

The review of host country determinants begins with policy framework for foreign investments. Foreign investments policies consist of rules and regulations governing the entry and operations of foreign investors, the standards of treatment accorded to them, and the functioning of the markets within which they operate. Trade policy plays the most prominent role and other related policies include privatization policies and policies determined by the international agreements a country has signed. Privatization is a special case of acquisition, as it involves purchases of firms from the state. International investment agreements provide an international dimension to national foreign investments policies. Some of them focus on insurance and protection, while others deal with broader issues.

There are many risk factors of investment projects in the literature of the subject. According to the article written by Duncan H. Meldrum, analysts have tended to separate country risk into the six main categories. It should be noted that these categories overlap each other, given the interrelationship of the local economy with the local political system and with the international community. These categories are¹:

- Economic Risk
- Transfer Risk
- Exchange Rate Risk
- Location or Neighborhood Risk
- Sovereign Risk
- Political Risk

Foreign Investments in Poland

The foreign capital coming into the Polish economy has fulfilled a very important role in the process of privatization and restructuring. The majority of foreign investment to Poland has taken the most desirable form- Foreign Investment. Such investments have meant new companies starting from scratch or enterprises already existing on the Polish market being taken over.

During the latest months a lot of reports evaluating countries' attractiveness for foreign investors were published. In most of them Poland remains the most attractive country for investments, what is more Poland is the most interesting country among new EU members.

The consulting firm Ernst & Young has analyzed the level of investment attractiveness of the countries worldwide in 2005. This unique survey is based on opinions expressed by several hundred executives and evaluates the attractiveness of Europe and the attractiveness of countries within Europe. According to the "European Attractiveness Survey 2005" Poland is making spectacular progress and joins the podium. As it can be noticed on the figure 1 below, Poland has been ranked 4th and as a result of this, is among the most attractive countries for foreign investors.²

¹ Duncan H. Meldrum "Country Risk and Foreign Direct Investment" January 2000.

http://www.findarticles.com/p/articles/mi_m1094/fs_1_35/ai_59964458, viewed on 2006-04-07

² Ernst & Young, Report "European Attractiveness Survey" 2005, www.ey.com, viewed on 2006-02-09

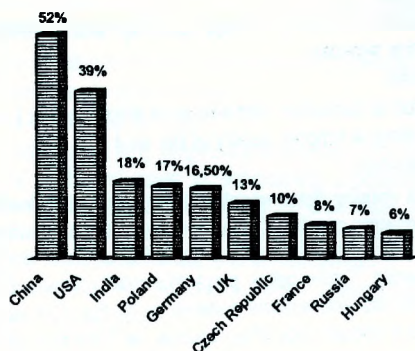


Figure 1 The top 10 countries indicated by foreign investors as a place attractive to take up business activity

Source: Ernst & Young, Report "European Attractiveness Survey" 2005, www.ey.com, viewed on 2006-02-10

17% of foreign entrepreneurs indicated Poland as the most attractive localization for investment. When focusing on specific countries within their regions of choice, the executives selected three Western European and four Central and Eastern European countries among the top 10. It can be noted that for 2005 Poland (17%) is now ahead of the three most attractive countries (Germany, the United Kingdom and France).

According to this survey, the centre of gravity for investments in Europe has moved eastwards, and is now located between Germany (16%) and Poland (17%). This perception, although not precisely reflecting the reality of investment choices, is a sign of the individual attractiveness of these countries. It also provides an intuitive indication of the most interesting investment targets for decision-makers in the near future.¹

The intuitive investors positively marked Poland in terms of availability of sites and cost of land, Poland is in the lead in this category.

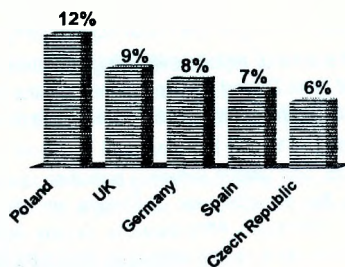


Figure 2 The top countries indicated by foreign investors taking into account cost of land and regulations

Source: Ernst & Young, Report "European Attractiveness Survey" 2005, www.ey.com, viewed on 2006-02-10

¹ *ibidem*

Investors appreciate also Poland's potential productivity. In this terms the United Kingdom is ahead, followed by Poland and Germany, Czech Republic and Spain are far behind. Additionally, Poland achieving first place due to its labor costs and the availability of industrial sites, has joined the three Western European leaders. Poland also came second in terms of potential increase in labor productivity (13%).¹

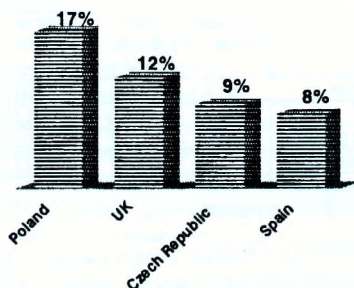


Figure 3 The top countries indicated by foreign investors taking into account labor costs

Source: Ernst & Young, Report "European Attractiveness Survey" 2005, www.ey.com, viewed on 2006-02-10

As far as the flexibility of employment regulations is concerned, Poland is the second desired localization in Europe. In terms of corporate income taxation Poland is far behind The United Kingdom and Ireland, but still as well as Switzerland ranked 3rd.

On 23rd of November 2005 Financial Times published an extensive report concerning investing in Poland. The main aim of the articles was to present current political and economic situation in Poland, especially in the light of recent parliamentary and presidential elections.

One of the priorities of a new political power is attracting new investors. The report says that in order to attract more investments the government wants to lower the taxes, simplify procedures and reduce bureaucracy.

In the report Financial Times approve of activity of Polish Information and Foreign Investment Agency, which is doing huge effort to promote Poland. Anyway, according to the article the best advertising for Poland are skilled and hardworking Poles that working abroad.

Polish workforce continues to be a very positive factor and remains the country's biggest asset. The cost of labor still remain the lowest in EU and the efficiency of the workers is very high. Also quality of education, which is very high, is a big advantage of Poland. Especially the ability to speak foreign languages other than English. The educated workforce is very large and makes Poland an attractive place to locate call centers, offshoring and services centers.

Special attention was given to the very popular low-cost airlines that operate in Poland since a short time: Ryanair, easyJet, WizzAir, SkyEurope and Central Wings. The developing Polish aviation market offers attractive possibilities of the new transport links for businessmen and travelers. As a result the better communication conditions are expected to attract foreign investors.²

Finally, the most recent opinion poll on the investment climate in Poland, commissioned by Polish Information and Foreign Investment Agency (PAIILZ), brings good news. The satisfaction from locating

¹ Ernst & Young, Report "European Attractiveness Survey" 2005, www.ey.com, viewed on 2006-02-10

² http://www.paiilz.gov.pl/nowosci/?id_news=725&lang_id=1, viewed on 2006-02-10

businesses in Poland foreigners continuously is growing. The most important factors that influence foreign investors' decision on setting up a business activity in Poland are presented in table below.

Table 1 Most important factors influencing a decision to invest in Poland according to investors from different countries

| Factors | Importance of a factor | | | | |
|---------------------------------|------------------------|--------------------------|----------------|----------------------------|-------------|
| | Germany N=239 | Great Britain N=58 | France N=55 | The Netherlands N=48 | USA N=42 |
| Size of the market | 53.1 | 65.5 | 50.9 | 56.3 | 57.1 |
| Wages | 59.0 | 46.6 | 45.5 | 66.7 | 47.6 |
| Projected economic growth | 48.1 | 51.7 | 50.9 | 58.3 | 40.5 |
| Workers' qualifications | 50.6 | 51.7 | 47.3 | 64.6 | 47.6 |
| Availability of human resources | 48.5 | 48.3 | 56.4 | 47.9 | 47.6 |

Source: CBM INDICATOR for PAiIZ, December 2005

The most important factors that influence foreign investors' decision on setting up a business activity in Poland are the size of Polish market and the projected economic growth in Poland. Decision about the location is also tightly bound to the human resources available at a given region. The poll results show that the evaluation of Polish staff in comparison to year 2000 has definitely improved. Moreover, the labor costs and workers' qualifications are one of the key factors attracting investors.¹

Almost three quarters of foreign investors declare that Poland's accession into the EU positively influenced business activity of companies with foreign capital. The very important factor is Polish law, that makes companies' activities easier after the accession (50.4% companies indicate that factor). Also a lot of the companies indicate simplifying the procedures of supplying goods (37.7%) and removal of customs barriers (35.6%).²

The all reports results mean that Polish economy is becoming more competitive and Poland is among the most attractive global destinations for investments. Besides all that advantages of Poland in attracting foreign capital, unfortunately there is still much to be done in order to improve the investment climate in the country.

To the major negative factors belong: unsatisfactory condition of transportation infrastructure (for example lack of highways), complicated and unstable law, high taxes, corruption and bureaucracy.³ To reduce those barriers is a priority and task for the government. However, even with those negative factors Poland still remains the most attractive country in the region.

Once again let's face the major factors that make Poland so attractive for foreign investors. To major factors that help to take up business activity in Poland belong⁴:

- size of the regional market
- stability of the market
- labor costs
- low competition from the local companies
- low prices of materials and components
- low prices of power
- large supply and easy access to components and materials.

¹ http://www.paiz.gov.pl/nowosci/?id_news=810&lang_id=2

² http://www.paiz.gov.pl/nowosci/?id_news=810&lang_id=2

³ A. Zachorowska, Wybrane aspekty zewnętrznego finansowania przedsięwzięć gospodarczych, Wydawnictwo Politechniki Częstochowskiej, Częstochowa 2002

⁴ W. Karaszewski, Bezpośrednie inwestycje zagraniczne. Polska na tle świata. Toruń 2004

In addition other very important key factors attracting investors are¹:

- geographic location
- cultural closeness
- availability of human resources
- worker's qualifications

The most important reason to invest in Poland is the market size with its highly skilled, well educated and ambitious people. Poland has the largest working population in Central Europe. It is also one of the youngest population on the continent, half of the society is under the age of 35. At the same time Poland holds second place in term of number of students. Poles are one of the best educated societies in Europe. There are 126 state higher education academies including 17 universities, 18 universities of technology, as well as 301 private schools of tertiary education. They employ over 100 thousand scientists, half of them hold a Ph.D. degree.²

Studying is becoming very popular among young people. Polish students are excellently acquainted with foreign languages. Most of them have achieved a good level of English what is really appreciate by foreign investors.

It is important to mention that one of the reasons why investors decide to take up businesses in Poland is low level of labor costs. They can take advantage of the qualified Polish labor force at competitive price.

Labor costs are not the only opportunity of lowering the overall production costs, also costs of conducting business, prices of materials, components and price of energy are lower in Poland than in Western Europe. At the same time level of living conditions for relatively lower costs equal to UE standards what is another positive factor attracting investors to Poland.

Membership in the EU makes distribution of goods more easier due to free movements of goods and gives an access to a huge market of 450 millions consumers. Investors can take advantage from the funds either directly or indirectly, because those funds are expected to contribute to a faster development of Polish infrastructure. EU membership is also a guarantee of sound economic policy in Poland, its credibility and stability, due to harmonization of Polish law to EU standards. Poland's accession into the EU enables new investors to operate in a well known legal environment.

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¹ Z. Olesiński, *Bezpośrednie inwestycje zagraniczne w Polsce*, Polskie Wydawnictwo Ekonomiczne, Warszawa 1998

² PAIiZ, www.paiiz.gov.pl