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Foreign Direct Investment and Competition Strategies of Domestic Firms in Poland

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Until 1990, when the construction of a market economy began, the Polish economy had been to a large extent been cut off from the outside world. Developments that took place in Poland after the Second World War were in many respects autarkic in character. Economic co-operation with other countries was not used to accelerate economic growth and increase economic effectiveness. Potential advantages arising from the international division of labour were not properly exploited. Poland's share of world exports and imports was very low. The structure of foreign trade was distorted. Exports from Poland and other CEEC to the OECD were far below levels that might be expected purely on economic grounds, while exports to the CMEA countries were much higher.

The rise of a market-led system in 1990 brought a marked opening-up of the Polish economy. This in turn brought about an accelerated development of new economic ties with foreign partners, aided by FDI inflows in particular. While the opening of the economy can be seen to have brought numerous advantages to Poland, it has also exposed it to various threats and challenges, which, if unresolved, might undermine or even destroy the advantages. FDI became one of the main features of the internationalisation of the Polish economy and its participation in the globalisation process. Poland's participation in this process is predominantly that of a host country.

In the post-communist countries the processes of internationalisation are of a specific nature. They occur in conditions of very deep restructuring of the internal system of regulation, transforming it from an administrative-bureaucratic system to a market oriented-system. In this context the following problems come into focus:

- A basis for deeper internationalisation of competitive relationships
- Evolution of the legal-institutional conditions for the inflow of foreign capital
- Polish firms' FDI strategies
- Effects of competition between foreign-owned and domestic firms
- Policy directions for the regulatory authorities

The internationalisation of the Polish economy during transformation: FDI in context

Admittedly, Polish firms did not entirely escape the internationalisation process after the Second World War during the decades of a centrally planned economy when foreign trade was a state monopoly. However, the transformation of the Polish economy into a Western market-led system at the beginning of the 1990s created a much wider scope of opportunity for the broadening and intensification of the internationalisation process. It should also be noted that this process took place in the context of similar developments in most post-socialist states where programmes of fiscal and monetary stability were implemented concurrently, leading to a far-reaching liberalisation of foreign trade and investment policy.

The internationalisation of competition was enhanced by the abolition of the CMEA. This organisation, dominated by the former Soviet Union, represented an enclave of non-free market behaviour in international business throughout CEE. Although, on the one hand, it gave firms in the member states the opportunity of access to 'secure' markets and cheap resources, it offered on the other hand no incentives to innovate and upgrade their competitive position, or to improve quality and services. At the same time, the rules of international exchange in such a system (e.g. procedures for determining commodity lists, annual protocols, price determination, exchange rate determination) led to a complete obscuring of the effectiveness of such exchange. Thus the abolition of the CMEA also contributed to more market-oriented, competitive economic relations between firms in CEE.

The internationalisation of competition in Poland received a significant boost with the decision to seek membership of the EU. It is clear that EU membership will ensure a faster and deeper opening-up of the economy for EU partners. The effects of membership have already begun to be felt as Poland harmonises its own systems and institutions to the point of EU convergence. However, opportunities for Polish firms are also accompanied by threats. From a formal point of view their access to the huge EU market becomes much easier. Nevertheless, the abolition of administrative processes, customs and other barriers does not on its own guarantee success. Other factors contributing to success lie in the hands of the firms themselves. They have to prove and demonstrate their competitive advantage on a day-to-day basis. The threats facing Polish firms in this context are above all connected with the removal of protection for domestic producers (most of whom had treated this as a permanent right) and exposure to direct competition with EU member states.

The internationalisation of competition is linked to the ongoing and intensifying process of globalisation. The implementation of global strategies by individual firms changes the conditions of international competition and leads to fierce competitive conditions (Gorynia & Otta 1989). One of the premisses of globalisation is the idea of a 'world product' – an emerging uniformity of needs across national borders (Levitt 1983). The standardised product brings about economies of scale. Other factors fostering globalisation include the necessity of high R&D outlays and low transport costs (Hout, Porter & Rudden 1982). Global strategy is often defined as one that allows a multinational company to gain competitive advantage either through concentrated configuration (location of the company's various activities) or co-ordination (internationally of similar or interlinked operations of the company), or by applying both methods simultaneously (Porter 1986).

Internationalisation of competition has also been enhanced by the regulatory activity of GATT (Uruguay Round) and the work continued in the framework of WTO (Kaczurba & Kawecka-Wyrzykowska 1995). The aim of these developments is the complete liberalisation of international economic and, especially, trade co-operation. The removal of trade barriers should thus lead to a wider and more intensified process of the internationalisation of competition.

FDI inflow into Poland, especially through multinational firms, has accelerated the entry of the Polish economy into the globalisation process. The introduction of the market-led system not only opened Poland up to international competition, but revealed at the same time the low level of competitiveness of previously protected domestic industries and forced these industries to seek new sources of finance for their restructuring and growth. Facing a lack of domestic capital and a rising demand for such capital, FDI proved to be a desirable source of financing the development of the Polish economy. FDI filled the gap in the country's internal capital accumulation and stimulated industries that had hitherto been underdeveloped. Moreover, for the first time it exerted on Polish firms the pressure needed to upgrade through competition.

Evolution of the legal and institutional conditions for the inflow of foreign capital

A significant feature of the Polish economy in the 1990s was its systematic opening-up to FDI. The following factors exerted the most powerful influence in this context (Kubielas, Markowski & Jackson 1996):

- Liberalisation of legal regulations on FDI inflow
- Liberalisation of trade and currency convertibility
- Privatisation of state-owned enterprises

Before the beginning of market transformation in Poland, there existed the so-called enclave FDI model in which foreign investment was treated differently from other parts of the economy (Samonis 1992). The legal and institutional changes in the conditions for the inflow of foreign capital led to the abandoning of this model in favour of treating foreign investment in the same way as domestic investment (national treatment principle).

The 1991 Act on the operation of economic entities holding foreign capital contributed significantly to the establishment of national treatment of foreign companies operating in Poland. The most important features of the Act's regulations concerning foreign investment were as follows:

- No restrictions to be placed on the transfer of profits and start-up capital.
- Requirement to obtain official permits from the government authorities necessary only when the property of state-legal persons was to be made available to companies holding foreign capital. This referred to permission to obtain shares in an FDI-supported company by the state-legal person or to leasing or purchasing the property of a state-legal person by an FDI supported company. Permits were granted by the Minister of Finance in response to an application from an economic entity.
- Abolition of the privilege of automatic three-year tax holidays.
- Full guarantee of compensation in case of expropriation.

- Foreign entities to operate in two forms only: limited liability companies, and joint stock companies (this was an exception to the principle of national treatment, approved by the OECD).
- Foreign investment to be forbidden in lottery and gambling businesses.
- Other restrictions in observing the national treatment principle applied to the maximum share of foreign capital allowed in the start-up capital of a company in certain strategic sectors: e.g. in telecommunication services the maximum foreign share was 49%, in communications 33%, and in radio and television also 33%.

Strategies of domestically-owned Polish firms towards FDI

Not surprisingly, domestic Polish firms view foreign-owned entrants with apprehension. Their apprehension springs from the foreigners' stronger competitive position irrespective of whether this is real or perceived. According to received theory the threat of foreign competitors is usually associated separately or jointly with the following factors:

- Economic power associated with size and scope of (often global) activities which surpasses many times the potential of even the largest local competitors and leads to monopolistic behaviour on local markets.[1]
- Ownership and internalisation advantages arising from access to superior products and/or technologies, superior know-how in management and/or marketing systems, and the ability (inherent to multinational firms) to operate efficiently in many national markets and environments.[2]
- Most domestically-owned firms' lack of experience of competing in the tough conditions of a market-led system. This factor is compounded by the necessity to change the attitudes and ethos of the local management and workforce. Since this process, viewed from a psychological and sociological perspective, is prone to intense perceptual and cognitive barriers, its time frame is estimated as being medium rather than short term, especially in existing or recently privatised state enterprises.

Thus domestic firms were forced to compete, and usually adopted one of the strategies set out below.

The first strategy

The first on the list of strategies adopted to counter the entry of a foreign-owned firm is based on the promotion of the 'national champion' idea. This can be seen in industries where the existing market structure has either enjoyed a national oligopoly or where the initial demonopolisation of state-owned entities (banks are a case in point here) has led, after a few years, to a reverse tendency – to consolidate by mergers, creating holding companies or strategic alliances. The 'national champion' case is best exemplified by the petroleum industry which has formed one holding company (Nafta Polska S.A.) from the major domestic producers and distributors. This strategy is being followed in strategic sectors of the Polish economy. In all its known occurrences, it has had the tacit blessing of government. It has the character of being a 'grass roots'

movement initiated by company managers and guided by their experience in operating in a market which is undergoing gradual deregulation.

Maintaining and strengthening the national oligopoly in the case of the Polish petroleum industry bears some resemblance to the situation in France in the 1960s when the expansion of United States firms into the French market raised widespread fears that the control of French industry was falling into foreign (i.e. US) hands. The French government reacted with a policy of promoting the 'national champion' idea, proposing concrete measures to support national firms so that they could effectively counter foreign competition. Amalgamations were encouraged and financial support offered to introduce new technologies and products.

Although it has the benefit of protection from FDI in manufacturing, the Polish petroleum industry has received political support in its efforts to consolidate and invest in order to modernise and expand output capacity.[3] The state-owned petroleum firms and Polish industrial policy-makers are both well aware that they have very little time left to improve their competitive position in the face of foreign multinational competitors who are already expanding their distribution networks on the Polish market, having gained a total market share of 7.8%.[4] A similar approach has also been observed in the banking sector where on 16 September 1996, with much more explicit government support, the first Polish banking group was formed with the bank PeKaO S.A. acting as the leader and dominant partner. The group consists of three state-owned banks: Powszechny Bank Gospodarczy (Łódź), Bank Depozytowo-Kredytowy (Lublin), and Pomorski Bank Kredytowy (Szczecin). The group is considered as the strongest banking entity functioning in Poland, controlling almost one quarter of the assets of the whole banking sector and 24% of all banking outlets in Poland (Ignatowicz 1996).

Because it encompasses sectors of strategic importance in the national economy, this competitive strategy is very prone to government pressure and intervention. In this context the advocates of a liberal approach to a market economy in Poland point out the cost and efficiency advantages of privately-owned Polish companies' consolidating and restructuring these sectors without government interference. Perhaps government actions should be more directed at facilitating such moves by the private sector in the form of financial and tax incentives or modification of the anti-monopoly legislation.

The second strategy

The second strategy, followed by Polish firms already faced with FDI-led competition in the Polish market, is one of aggressive response. It is interesting to observe how many Polish firms of all sizes have adopted as their priority the improvement of the quality of their products. Salient evidence of this trend is seen in the growing number of domestic firms applying for and receiving the ISO 9000 quality benchmark certificates. Furthermore, the marketing strategies of other domestic firms have also been undergoing a process of accelerated adjustment to meet the standards of their foreign competitors. This has been especially visible in the improvement of their promotional activities with a considerable increase, for example, in advertising, modernisation of packaging and expansion of distribution networks.

The principal barrier here is the obvious lack of adequate resources, experience and expertise which has placed Polish firms in a much weaker competitive position than their foreign counterparts. However, there are a few examples of firms that have succeeded in overcoming those deficiencies and increased their sales and market shares. Elektrim

is a case in point. A former state-owned foreign trade enterprise, Elektrim was privatised, bought many of the firms for which it had been a trade intermediary in the previous system, and finally undertook a strategy of conglomerate diversification.

The third strategy

The third strategy is the acceptance of the idea that if you cannot effectively compete with foreign firms, then it is best to join forces with them – even if this means relegation to a minority shareholding position and/or playing a marginal role in corporate governance, or even being deprived of it completely. This approach can be observed in the majority of manufacturing and chemical industries.

Within this strategy, various structural forms may be employed. We can thus have a straightforward acquisition/take-over operation whereby the domestically owned/managed firm ceases to exist and becomes a wholly owned subsidiary or branch of a foreign parent. The second possibility is that of a foreign firm merging with a Polish counterpart, leaving the former sole Polish owners with a minority share. These two forms are predominantly characteristic of the transformation of large- and medium-sized state enterprises with considerable fixed assets that are often mismanaged and/or are obsolete. It is interesting here to note that in most cases after take-overs of Polish state-owned firms with well established brand names in the consumer goods sector, the new foreign owners usually maintain these old brands and pour considerable resources into improving them.[4]

The third structural form of joining forces with foreign firms is evident in different contractual arrangements, which are closer to alliances and coalitions rather than to joint ventures and mergers. These arrangements are usually of a non-equity character (i.e. the foreign participant is not required to provide financial capital as his input into the whole operation). The Polish side in the arrangement overall forms its core and determines strategic development. It is thus perceived as the initiator and leader of such an arrangement. Foreign firms may be tapped for their particular firm-specific or industry-specific competencies or inputs such as new products, technologies, management, marketing know-how, and expertise.

Polish firms in this category are mostly newly formed and generally small- to medium-sized, indicating that they are only in their initial stages of the firm's life cycle. A case in point is firms in the computer and data processing industry which draw heavily on and co-operate with their Western multinational counterparts. The principal question here is whether the Polish firms are strong enough to maintain their identity, and whether, or how quickly, they will be bought out or taken over by their foreign partners or co-owners. At best, this is essentially a survival strategy which has at most a medium-term life span unless at some (rather early) point it is supplemented and eventually superseded by a version of the second strategy. The other limiting factor is of course the power and long-term strategy of the foreign competitor.

The fourth strategy

The fourth strategy aims at keeping foreign competition out of the country or at reducing its competitive impact for so long as possible. This requires direct or indirect actions by Polish firms (through political parties and other pressure groups) aimed at creating new

and maintaining old tariff and non-tariff barriers. This is evident especially in sectors which have a fragmented market structure (e.g. agriculture) or where the capital, managerial and technological gap separating domestic from foreign competitors has been particularly wide (e.g. insurance business). Under pressure, for example, from Polish oil refineries, the Polish government applied successfully to the EC for the right to extend the period of protection for these refineries against foreign competition until the end of 2000.[5]

The somewhat illusory nature of such a strategy stems from the fact that for large multinational firms FDI has always been a favourite device for the circumvention of trade barriers. Once inside a foreign market, these multinationals behaved like purely domestic firms, demanding continued tariffs and non-tariff protection. A pertinent example in Poland was the GM Opel Co. with its joint venture with FSO (once the largest Polish car producer). Once GM began to assemble cars in Poland, it lobbied the government not to abandon or reduce the existing level of tariff protection ahead of the schedule agreed upon with the EU. Ameritech, the strategic shareholder in Poland's first mobile telephone network, was so upset by the government's refusal to keep its promise of granting the United States firm a licence to operate a more modern GSM cellular phone system without going through the usual tender procedures, that it went to court on the issue. Thus it seems that only the existence of political barriers (in the form of political instability and marked disequilibria) as well as administrative and legal impediments are able to keep foreign competition out of the country if the economic aspects of entering its markets are favourable.

The effects of competition between foreign-owned and domestic firms

The four 'model' strategies outlined above should not be viewed as being hermetic or unconnected alternatives. Their practical application always creates room for overlapping or combining (e.g. two strategies). It is obvious that the 'national champion' strategy will not work unless it is accompanied by a strategy of actively competing with foreign companies in the domestic as well as foreign markets (unless the government creates strong protectionist barriers and grants extensive privileges to domestic firms only).

The general scale of the process whereby Polish firms meet the competitive challenge of foreign entrants has so far been relatively small in size because the still modest FDI inflow (compared with actual possibilities and expectations) through direct investment. In many cases, exposure to foreign competition in the local market has certainly produced positive effects, spurring domestically-owned firms to restructure, adjust and modernise.

However, the more typical case is the take-over of Polish firms and whole sectors coming under the control of foreign firms. This indicates that in this 'battle' the competitive advantage usually lies with the foreign-owned companies. The sectors where Polish firms have 'lost' have usually been those where the foreign entrants have been large multinational corporations. Domestic firms have been unable to compete primarily because of their wholly domestic nature. The ownership, internalisation and location advantages (as in the Dunning tradition) together with relationship marketing and network creation with suppliers and buyers (as in the Kotler approach) have led to the creation of a system which is beyond the reach of Polish firms, or at least impossible for them to emulate in a short- to medium-time span. In sectors which have not so far been penetrated by multinational firms, the Polish domestic firms have not been able to

raise effective economic barriers (as perceived by M. Porter) to the entry of foreign competitors.

The long-term solution to this asymmetry depends on the Polish companies embarking on the path of growth and evolution experienced by transitional companies (i.e. consolidating and internationalising their operations). It must be stressed here that exporting alone is not enough. The key to success lies in FDI. Some Polish companies have already started to expand along this path, mostly into the neighbouring countries of EE. Many, unfortunately, still think that exporting alone will be enough to maintain their competitive positions (even in such a market as Russia). Exploiting the continuing expansion of the Polish economy, as evidenced by the rate of GDP growth, they should strive to gain a firm foothold in these markets and then selectively expand their market shares. It is much more in the EE transforming economies than in the highly developed regions of the world that Polish firms are likely to gain sizeable or dominant shares in local markets. They should seize this unique opportunity. If they lack resources for expanding individually, they should consider the formation of strategic alliances with other Polish or even Western firms.

It is worth noting here that collaboration with strong Western firms through alliances does not always imply a weaker, subservient position for the Polish partners. Indeed, the experience of Japanese and South Korean firms shows that by the development of learning processes they were able to evolve from the weaker to the dominant partner in their alliances with United States and European companies.[6] It took two decades for such an evolution to occur. It is an open question whether this is a relatively long or short time. The main lesson for Polish firms is to develop their core competencies which, embedded in new products and technologies, can form a solid base for gaining competitive advantage. None of this precludes the necessity of maintaining a presence and investing in other regions of the world, especially in the EU and in the developing countries where exports have made Polish brand names familiar.

Polish firms following a strategy of intensive competition with their foreign-owned counterparts will find that concentration on quality alone will not assure long-term market share and profit performance. Their priorities should also include such internationally acknowledged determinants as customer services, product differentiation and innovation. Dependence on low prices and traditional brand names coupled with high quality will never be enough to form firm specific core competence.[7]

Polish firms should also remember not to withdraw too rapidly from mass markets when invaded by a foreign entrant, but to retreat and concentrate on specialised, high-value niches of these markets. This lesson has been learnt many times by United States and United Kingdom firms competing on their home markets with Japanese producers. In such cases the foreign (Japanese) firm usually establishes a firm foothold in these volume markets, then acquires a dominant position and sufficient experience, cash flow and distribution capabilities to attack and eliminate the domestic firms in their niches (Doyle, Saunders & Wong 1995).

Policy prescriptions for the Polish regulatory authorities

The implications of the competitive strategies adopted by domestic Polish firms pose serious problems in decision-making for Polish policy-making and regulatory authorities. First, they must take into account the fact, as outlined above, that there has been a definite trend in the Polish legal and regulatory system towards national treatment

of foreign-owned enterprises, thus eliminating their favoured position in certain fields. But, second, there remains the predominant concern of how to maintain the increased and uninterrupted flow of FDI into the Polish economy.

With this requirement in mind the Polish authorities are faced with the following dilemma, should they favour and stimulate FDI inflow, even to the point of offering tariff and non-tariff protection to foreign entrants acquiring strategic positions in key industries? Or should they concentrate their efforts and financial resources to consolidate and thereafter expand rapidly large Polish firms which could effectively compete in domestic and foreign markets. The right solution seems to lie somewhere in between. It also seems to be at odds with the national treatment trend for foreign investors. In those circumstances a rational course of action should include:

- Creating sound macroeconomic conditions: i.e. maintaining economic growth, fighting inflation and controlling currency stability. These factors form the best medium-term incentive for FDI inflow.
- Maintaining the process of privatisation of state enterprises as a necessary prerequisite for attracting both foreign and domestic investors.
- Refraining from granting special and far-reaching concessions or privileges to large foreign firms as a prerequisite for investing in Poland. In this context the recent EU demand to abolish Poland's special economic zones is a case in point, ironically advocated by an organisation representing the home countries of many of the foreign firms operating in Poland.
- Eliminating all remaining measures and regulations which discriminate against foreign firms wanting to operate in Poland, maintaining barriers only in certain defence industries and, possibly, telecommunications.
- Offering maximum support to domestically-owned medium to large Polish firms embarking on a programme of concentrating production, introducing modern technologies and undertaking direct investment abroad. In such instances the operations of those firms should be exempted from existing anti-monopoly legislation. Support should include medium-term tax relief and preferential long-term investment credit.
- Offering support for ecological-friendly investment undertaken by domestic as well as foreign firms.

External limitations imposed on these suggestions are connected with, or may arise from, Poland's access to OECD and future access to full EU membership. Since Poland's core foreign economic policy is focused on these two organisations, their opposition to or concern about any moves that would create a competitive environment overwhelmingly biased in favour of Polish domestic firms and restrictive and harmful to foreign entrants, would have to be given serious consideration by the Polish regulatory authorities.

Efforts to influence and shape the competitive positions of foreign versus domestic firms by Polish government policy is also subject to pressure from various political and economic groups. As mentioned above, certain right-wing and nationalist parties demand the imposition of strict controls on FDI inflow. Small- to medium-size retailers, for example, have protested against the rapid expansion of large foreign (mainly French and German) supermarket chains, which pose a growing threat to their existence. Appeals have been made to government and parliament for the imposition of a ban on all foreign entries into this sector.

On the other hand, multinational corporations have also used their economic power to extract concessions from government in allocating their investments. A recent example is that of Adam Opel AG's greenfield investment in Poland's southern industrial region (Gliwice). On completion of a car manufacturing plant, it will enjoy a ten-year corporate income tax holiday and a 50% reduction of the tax burden for a further ten years. Daewoo, at present the largest foreign car producer in Poland, persuaded the government not to impose customs duties on imported parts which would have made their cars uncompetitive.

The existing lack of support in government regulatory policy for the competitive positions of domestic Polish firms is compounded by a critical economic factor. This is the extremely shallow internal capital market which limits the potential of Polish firms wanting to purchase state-owned enterprises or seeking to expand and modernise their output capacity and distribution and marketing systems. The general policy of the government and other state regulatory bodies should be clearly defined in a medium- to long-term framework. A general policy of this kind should consist of two strategic strands: guidelines for foreign firms, and measures designed to maintain some degree of effective competition by domestic firms. Existing and frequent recourse to ad hoc solutions and case-specific regulations is liable to create myopia, produce conflicting decisions, and finally a general lack of direction in the overall competition policy.

Conclusions

The challenges of competing with foreign-owned firms in Poland should not obscure the unquestionable contribution of foreign firms to the development of the Polish economy. Foreign capital has been the principal agent of involving and thrusting Poland deeper into the globalisation process. In the context of this process, in which domestic Polish firms have to react, foreign entrants and investors have released new layers of competitiveness in their local counterparts. Foreign entrants and investors have broken competitive barriers inherent in the old economic system. They have given local partners access to their international distribution networks, and introduced (besides capital input) new technologies, skills, modern management and marketing know-how, and expertise. In essence, they have made a salient contribution by raising the competitiveness of the Polish economy and thus making it more receptive to meeting successfully the present and future challenges of globalisation.

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Endnotes

1 This notion of economic power is congruent with the early Hymer/Kindleberger approach.

2 These advantages are viewed along the lines of J.H. Dunning's classic eclectic paradigm of international production.

3 Western multinational oil firms have been allowed to invest in marketing their end products and organising distribution systems, mostly in the form of petrol station networks.

4 A salient example is offered by the tobacco industry.

5 *Parasol 2000*. *Gazeta Wyborcza*, 7–8 December,1996.

6 In the early 1960s NEC's computer business was one-quarter the size of Honeywell's, its primary foreign partner. It took only two decades for NEC to outgrow Honeywell, which eventually sold its computer operations to an alliance of NEC and Group Bull of France (Hamel, Doz & Prahalad 1995:152).

7 This proposition has received ample confirmation in the markets of countries much more developed than Poland's. A comparative study of United States, Japanese and United Kingdom firms revealed that the British most frequently mentioned competitive advantage in having a low price, a traditional brand name and simply being British. Less than half of the United Kingdom firms in the study had any advantages in quality, service, product range or product innovation. That is why they lost ground to their Japanese competitors (Doyle, Saunders & Wong 1995:365).