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DIPLOMOVÁ PRÁCE

Outward Foreign Direct Investment

**Comparative Study of the Development in the Czech
Republic and Slovakia**

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Prohlášení

Prohlašuji, že jsem diplomovou práci vypracovala samostatně a použila pouze uvedené prameny a literaturu.

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.....

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ABSTRACT

Tato práce se zabývá problematikou přímých investic českých a slovenských podniků v zahraničí. Cílem práce je analyzovat, které faktory přispěly k pozdějšímu vzestupu přímých investic slovenských firem do zahraničí v porovnání s českými podniky. Práce ukazuje, že slovenské podniky byly znevýhodněny v porovnání s českými, protože české vlády vytvořily lepší podmínky pro místní podniky usilující se o investice v zahraničí. Dalším faktorem, který přispěl k opožděnému odlivu přímých zahraničních investic ze Slovenska hned z několika důvodů, byl opožděný příliv přímých zahraničních investic. Případová studie poukazuje na to, že podobnost národních kultur může být důležitým faktorem při úvahách o internalizaci podniků a že blízkost národních kultur nevede nutně k blízkosti podnikových kultur.

This thesis deals with the issue of direct investments of Czech and Slovak companies abroad. The aim is to analyse which factors have contributed to the latecomer position of Slovakia in outward foreign direct investments in comparison with the Czech Republic. It is argued that Slovak companies have been disadvantaged in comparison with Czech companies since Czech governments have created better conditions for local companies aiming to invest abroad. In addition, belated inflows of foreign direct investment also contributed through more channels to the latecomer position of Slovakia in outward foreign direct investment. It is also shown that proximity of national cultures can be an important factor in internalization considerations of companies and that closeness of national cultures does not necessarily imply closeness of corporate cultures.

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1 INTRODUCTION

At the beginning of economic transformation, companies in post-communist economies suffered demand and supply shocks and they had to adapt to a new situation. Many of those which survived the transition shock and were successful in their business activities, started searching for new markets abroad. There are a couple of ways how companies can become players on international markets. In the first years of economic transition, international presence of local companies was established mainly through exports, joint ventures or inward foreign direct investments, when local companies with new foreign owners became part of multinational enterprises. Another way how companies can establish their presence internationally, which is the other side of the coin, is through establishing their own subsidiaries abroad.

Foreign direct investments of local companies from transition economies have been subject only to a small number of academic studies, due to their low levels, especially in comparison with amounts of inward foreign direct investment (IFDI or inflows of FDI). Also, a growing trend in foreign direct investment of local companies (outward foreign direct investment or OFDI) has been observed since 1997 only, in some of the transition economies even later. At the same time, theory and also experience of other countries suggest that OFDI will sooner or later become an important way of internationalization of local companies. Also, OFDI could be considered as one of the indicators of success of post-communist economies or more specifically of their local companies on the international scene. Thus despite of the fact that the amounts of OFDI are significantly smaller than those of IFDI and the question of OFDI does not seem to be so urgent, we consider this topic to be of an increasing importance for our understanding of the process of transformation and restructuring in transition economies and their development towards fully-fledged market economies.

The focus of this thesis will be on OFDI from the Czech Republic and Slovakia. The primary question of our research which arose from the analysis of statistical data is why the Slovak Republic is a latecomer in terms of volumes of OFDI in comparison with the Czech Republic. This question is even more interesting in the light of the fact that a similar trend has been observed in relation to inflows of foreign direct investment – Slovakia has been lagging behind the Czech Republic as well. Another

finding from the statistical analysis – the two countries are mutually the most important destinations of OFDI – led us to further questions about the reasons for such a development and motives of Czech and Slovak investors.

The empirical analysis of Czech and Slovak OFDI is supported by the theory of Investment Development Path (IDP), developed by John Dunning, which suggests that such a situation might be a natural consequence of differences in the level of economic development of the two countries. IDP is a theoretical tool relating the level of economic development with flows of foreign direct investments in individual economies. Five stages of economic development are connected with different ratios of IFDI and OFDI, starting from low levels of IFDI and no OFDI in the first stage, through increasing IFDI but still low OFDI in the second stage, gradually increasing OFDI in the third stage which then overtakes the levels of IFDI in the stage four. In the stage five, the flows of IFDI and OFDI approximately equal at very high levels.

This theoretical framework thus gives us an idea what the relationship between the level of development and amount of investment flows is. At the same time, the IDP framework is idiosyncratic, specific for individual countries and their development not only in economic, but also historical, political and sociological terms and their international position. Our research is thus focused on these specificities and on a more thorough analysis of factors which matter for companies in transition economies in their successful development and their decision to expand abroad via foreign direct investment. The aim of the thesis is to analyze in which aspects, important for successful restructuring and expansion of companies, has Slovakia been lagging behind the Czech Republic, to what an extent these aspects can be influenced and what are the ways through which a country can contribute positively to internationalization of local companies through OFDI. The closeness of the two countries and at the same time their different performance allow for a more detailed comparison of these aspects.

According to the mainstream FDI theory, companies invest abroad when three conditions are satisfied. When they possess an ownership advantage which makes them be competitive *vis-à-vis* their foreign competitors even if they start producing in a new environment, when the benefits of internalization of the operation abroad exceed costs of it and when these companies find a country with locational features

which are advantageous for the companies. To cut a long story short, companies invest abroad when their benefits of the foreign direct investment exceed the costs.

Conditions in transition economies, in which companies found themselves, might to a great extent influence their ability to achieve ownership and internalization advantages, which companies have to possess when they decide to invest abroad. Companies in some countries can be better prepared for investments than in other countries in terms of their default conditions but also subsequent developments. Our question is, which home country conditions have the potential to benefit local companies and motivate them and which, on the other hand, represent obstacles for them.

We will focus on two sets of home country conditions which might influence on OFDI. The first is flows of IFDI to an economy. IFDI have been chosen on the one hand because they are part of the IDP framework used in this thesis as a theoretical background and IDP indicates the existence of a relationship between IFDI and OFDI. On the other hand, the results of our previous research show that IFDI have a great potential to influence transition economies to which they flow, be it the development of market economy institutions such as corporate governance or the regional economic development. IFDI are thus considered as a factor which can influence OFDI through more channels.

The other set of factors are government policies *vis-à-vis* local companies with ambitions to invest abroad. Home economies can support internationalization of local companies indirectly, through creation of a favourable business environment in which companies successfully expand their production up until they reach the point when the domestic market is limiting them and they decide to internationalize. A contrary situation is when companies face unfavourable conditions which either inhibit them from investing abroad or rather push them to search for a more friendly business environment. In addition to indirect support or even handicap, home economy governments can also support potential investors directly, ranging from removing obstacles for investors, through passive investment promotion to active investment promotion. We will compare the home country conditions which were created for OFDI in the Czech Republic and in Slovakia and they will be set in the context with conditions in other transition economies.

The case study of a Slovak company which invested to a manufacturing firm in the Czech Republic will supplement our statistical findings and clarify them, and will shed more light on the motives of investors in transition economies. It will also help us understand the importance of proximity of the two economies, be it cultural, geographical or historical, in the positive or negative way. We will also show that despite of the closeness of national cultures, investors might face a challenge in differences of corporate cultures and these might potentially decrease success of cross-border mergers and acquisitions.

The empirical research of Czech and Slovak OFDI was to some extent limited by the availability of the data which is not reported in the same structure, detail and extent in the two countries. Some information which would be needed to assess OFDI thoroughly have not been collected at all, some are partially available only from the press. Because of these limitations we perceive this thesis as a starting point for further research of OFDI from the Czech Republic and Slovakia, with a couple of potential topics suggested through the thesis.

The thesis is organized as follows. In the second chapter, the overview of theories and results of empirical research about determinants of OFDI in transition economies will be summarized. The purpose of the third chapter is to analyse statistical data of OFDI, setting OFDI from the Czech Republic and Slovakia in a broader context of post-communist economies which became member states of the EU, further analyse developments of OFDI of the two countries into more detail and then compare them. In the fourth chapter, factors influencing OFDI will be discussed on the basis of comparison of the Czech Republic and Slovakia and in the chapter five, focus will be on a more qualitative analysis of the investments from the Czech Republic to Slovakia and *vice versa*.

2 THEORETICAL PERSPECTIVES ON OUTWARD FOREIGN DIRECT INVESTMENT

Foreign direct investment (FDI) can be perceived as an alternative form of internationalization of companies in addition to export and transfer of sources based on the contract.¹ There are two features which distinguish FDI from export and contract-based relationships and also from portfolio investment – ownership of assets or equity control and strategic managerial control (Letto-Gillies, 2005). The ownership criterion is defined as percentage of assets owned by the foreign investor but different jurisdictions use different benchmarks. In general, the 10 per cent benchmark is used, some jurisdictions use higher limits, up to 25 per cent (Letto-Gillies, 2005). This condition is necessary, but not sufficient, since only the strategic managerial control ensures that investors can pursue in the invested companies their long-term strategies and interests at a distance.²

FDI can be analyzed from a macroeconomic and a microeconomic perspective. Each of these two approaches uses different theories and analyses different sets of issues. The macroeconomic view perceives FDI as a form of capital flows across borders, recorded in the balance of payments. The microeconomic perspective focuses on the motivations of investors and consequences of their decision-making on the investing firm and its affiliates, on the home and the host economy (Lipsey, 2001).

2.1 Theories explaining FDI flows

A major advancement in the theories of FDI was when John Dunning formulated an eclectic framework known as the OLI paradigm. He himself describes it as an envelope for theories of multinational enterprises' activity, rather than a theory in itself (Dunning, 2000). The explanations and predictions of the eclectic paradigm are based on a set of business and economic theories, each of them explaining one or more aspects, or answering some questions about FDI. Eclectic paradigm covers both microeconomic and macroeconomic issues connected to internationalization of

¹ Among the transfers of sources based on the contract are for example franchising, licensing, alliances, joint ventures or subcontracting.

² The FDI definition used in the Czech National Bank is the following: A direct investment enterprise includes directly and indirectly owned affiliates. These are divided – according to the investor's percentage ownership of the ordinary shares or voting power – into subsidiaries (more than 50%), associates (10%–50%) and branches (wholly owned permanent establishments or offices of a direct investor; land and structures directly owned by a foreign resident; or mobile equipment that operates within an economy for at least one year). In addition to shares in equity capital, foreign direct investment covers reinvested earnings and other capital, including lending transactions with a direct investor. (Czech National Bank, March 2006).

companies. An important aspect of the eclectic paradigm is that it is strongly contextual (Dunning, 2000).³

The framework was developed to provide answers on questions why and when a company decides to produce abroad directly and where its investment might be directed. Dunning provides three sub-paradigms, or sets of factors, the interaction of which is decisive in the company's internationalization strategy. The first set are ownership advantages, which are related to a particular company and represent its unique and sustainable competitive advantage. Possessing of such an ownership advantage enables the company to produce abroad and compete with other producers in host economies. The condition for the FDI to take place is that the company must possess "*net ownership advantages vis-à-vis firms of other nationalities in serving particular markets*" (Dunning, 1980, p.275).

The second set of factors are locational advantages, which aim to explain where the investment should be directed, or in other words what are the features making some countries attractive host economies for foreign investors. Such countries must offer special locational advantages which can be used in connection with the firm-specific ownership and internalization advantages. The third set of factors, internalization advantages, are again related to specific companies and cover those aspects which make it for the company more advantageous to produce internally in hierarchies, than through external markets.

In order to make his theory easier to grasp, or to operationalize it⁴, Dunning (2000) distinguishes between four types of motives for FDI, which then help to connect the types of FDI with more specific features from the OLI paradigm and thus narrow down the choice of variables to analyse. The first motive why companies decide to invest abroad is *resource seeking*, when companies aim to gain access to natural resources or in other words are supply-oriented. The second motive is *market seeking*, or demand-oriented, when an investor intends to extend the presence on

³ The context is searched for in "*the economic and political features of the country or region of the investing firms, and of the country or region in which they are seeking to invest; the industry and the nature of the value added activity in which the firms are engaged; the characteristics of the individual investing firms, including their objectives and strategies in pursuing these objectives; and the raison d'être for the FDI.*" (Dunning, 1980, p.164).

⁴ In his article from 1980, Dunning lists at least 20 possible ownership advantages, at least 11 internalization advantages and at least 16 location-specific advantages; in each case the list can increase when sub-categories are considered. As he admits in his article from 2000, there is a danger of slipping into "shopping list of variables" which might endanger the explanatory and predictive power of the OLI approach.

a particular foreign market. The third is *efficiency seeking*, designed to promote a more efficient division of labour or specialization of an existing portfolio of foreign and domestic assets by multinational enterprises, or also rationalized FDI. The last motive is *strategic asset seeking*, when a company endeavours to protect or augment its existing ownership specific advantage and/or to reduce those of their competitors. Particularly the first two rationales behind OFDI tend to explain majority of the first-time OFDI, mainly in developing countries (Dunning, 2000).

Antaloczy and Elteto (2002) in their paper about Hungarian OFDI expanded the Dunning's list, or rather redivided some of the empirical motives of Hungarian investors to a different, more specific structure, in order to reflect more precisely the incentives of Hungarian companies behind their investments abroad, what is useful for the topic of this thesis. *Market share motive* and *resource seeking motive* remain the same as in the Dunning's structure. *Cost reduction* is another motive, followed by *company growth motive* which is according to Antaloczy and Elteto particularly useful for bigger companies quoted on the stock exchange. Two further motives are connected to tax optimisation - *tarrif jumping and tax regulations motive* and *offshore tax avoidance*. The last motive named by authors is "*follow the customer*", which occurs when a company decides to serve a domestic partner already present abroad in the foreign country directly, rather than supplying him from the home economy.

Another factor, which has recently been observed in Central Europe for example in case of the automotive industry, are so-called *localization economies* and *agglomeration economies*, which belong to the sphere of interest of economic geography. While the first arise as a consequence of concentration of the same industry, the latter evolve from the clustering of a large number of economic activities. Clusters of economic activities then motivate potential investors by economies of scale and scope in terms of infrastructure, pooled labour markets, accumulation of knowledge and information and learning experiences (Armstrong and Taylor, 2000).

In addition to defining potential motives of investors and thus reducing the number of theories which can be applied in individual cases, Dunning further developed the OLI paradigm by dynamizing it. The resulting theory was named Investment Development Path (IDP) and its major contribution has been that unlike other theories which show the effect of FDI on economic development, Dunning has shown how the level of

economic development of a specific country influences its international investment activities, or rather how these two trends are connected together.

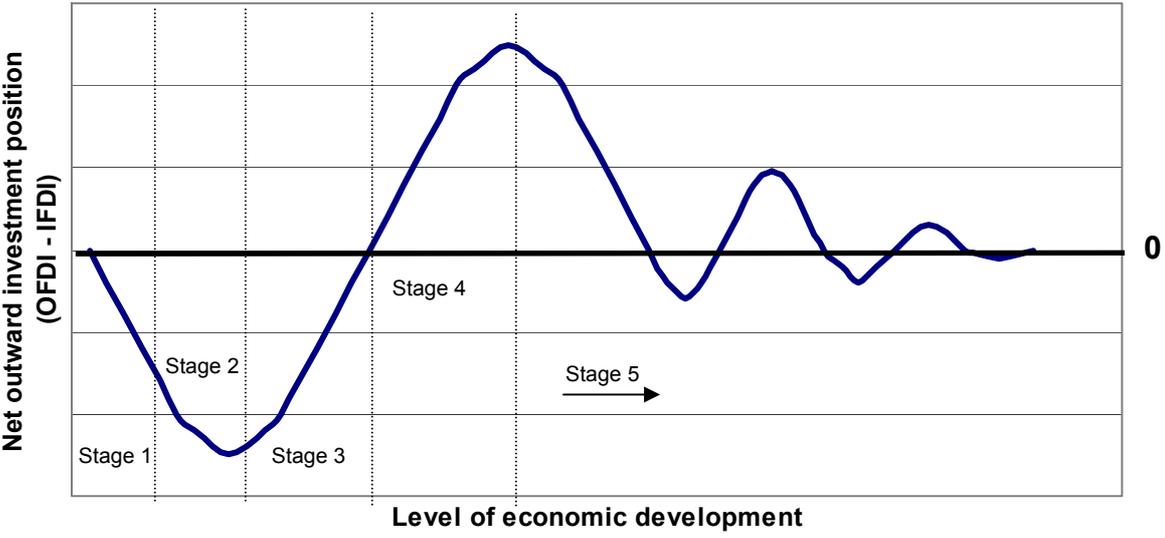
2.2 Investment Development Path

The key assumption of the IDP model is that the development of a country leads to changes in conditions for both domestic and foreign firms, thus influencing flows of investments. The relation between the level of economic development (represented by GDP/capita) with the level of international investment activities (represented by international investment position of a country) has been structured into five stages, differing from one another in the level of development of the economy and in different ratios of IFDI and OFDI (Dunning, 1981).

In the first stage, the levels of both IFDI and OFDI are very low. The home economy can be characterised by inadequate infrastructure and mainly unskilled workforce. In addition, the market in the home economy is small. In general, there are insufficient location-specific advantages offered, which is gradually changed by development through policies of local governments. Their improvement then leads to the Stage 2. In this stage, there are significant inflows of FDI to the economy and low levels of OFDI. The reason for the upsurge of IFDI are improving location-specific advantages; more investments also flow to the economy aiming at the domestic market. Outward investments are still very low, since the domestic firms lack ownership advantages.

This gradually changes in the Stage 3, when outward investments catch up with inward investments. Domestic firms become more competitive and stronger in both domestic and international markets. The inflows of FDI might be gradually slowing at the same time. In Stage 4, OFDI exceed IFDI. The ownership advantages of domestic firms become so strong that the firms tend to exploit them internally within hierarchies involving the invested companies abroad rather than from a domestic location. The economic structure and intra-industry trade in the home economy resemble more and more other countries. In the Stage 5, amounts of both IFDI and OFDI are very high and of similar volumes, thus they balance each other and the net investment position fluctuates around zero.

Figure 1: The Idealized Investment Development Path



Source: Dunning and Narula (1996, p.2)

The empirical research, notwithstanding that rather limited, has proved that the IDP is an idiosyncratic framework, specific for every individual country.⁵ As the countries differ from one another in terms natural resources, market size, political situation and government policies, so differ conditions for both inward and outward investors. Dunning and Narula (1996) outlined three main variables determining the shape of IDP of specific countries:

1. the extent and the nature of created and natural assets in those countries;
2. their strategy of economic development;
3. the role of government.

These three points seem to be intertwined, for example government can through its strategy of economic development contribute to the development of created assets.

Other factors which can also influence the flows of FDI are membership of the particular country in a grouping of countries and also political changes in other

⁵ What can be seen in individual countries' studies of Austria (Bellak, 2000) and Portugal (Buckley and Castro, 1999) . Dunning and Narula (1996) themselves in their reassessing analysis of stages of IDP conclude that IPD probably varies more than had been originally thought. The factors, which seem to influence variations most are the economic structure of countries, and development strategies and macro-organizational policies of governments.

countries. Jaklic and Svetlicic (2001) conclude on a basis of a research of outward investing companies from five transition economies, that more similarities than differences of internationalization of small less developed countries occur, irrespective of systemic origin. Thus, transition does matter in relation to OFDI, but other factors, such as size of the economy, timing, external environment and history, seem to matter more.

According to Bellak (2000), all these other factors undermine the relevance of the IDP framework. In comparison with the original IDP model, other variables are increasingly used in the studies of net investment position of different countries, ranging from structural features of home and host economies to factors promoting agglomeration or dispersion of firms. Bellak (2000) even proposes that factors such as geographical and industrial structure of the countries and the policies pursued matter for IDP more than the general level of development, and thus a situation can easily arise that single industries can be already in Stage 5, whereas the country as a whole is in a different, lower Stage. In order to capture the real situation in different economic sectors and *vis-à-vis* different countries in the case of Austria, Bellak uses concepts of structural and bilateral IDP⁶, and uses them as complementary to the macroeconomic IDP perspective. These concepts will also be used in the statistical analysis of Czech and Slovak IDP.

We have so far introduced two related theoretical frameworks. The OLI paradigm sheds more light on the motivation of individual companies or alternatively on their interaction with host economies. The IDP framework speaks about international investment position of home and host economies from the macroeconomic perspective and the factors influencing individual IDPs. What remains unexplained is the interaction of foreign investing companies with their home economies. The following part, based on the literature review, summarizes findings about this relationship.

⁶ The structural IDP reflects an industry's position *vis-à-vis* all its competitors abroad. It compares ownership advantages of local firms with those of competitors worldwide, by comparing OFDI in a specific industry with inflows of FDI to the same industry from the rest of the world. Bilateral IDP reflects a net outward investment position of a country *vis-à-vis* another country and thus is location-advantage driven. To cut it short, structural IDP covers a single industry and all the countries, bilateral IDP covers all industries in relation with one country. Source: Bellak (2000).

2.3 OFDI and their home economies

Antaloczy and Elteto (2002) name two sets of contrastive background conditions in home economies which can lead companies to their decision to invest abroad. The first group are adverse domestic circumstances, among them socio-political, economic or regulatory - these might force domestic producers to relocate their production abroad. The second group involves favourable domestic conditions which enable local expansion of the enterprises to such an extent, that their investment abroad becomes a necessity, if they want to grow further.

UNCTAD (2006) denotes these conditions as home country drivers and divides them into four groups. The first are *market and trade conditions* and involve mostly size of the home market. Thus companies operating in countries with rather small domestic market might be pushed to invest abroad in order to exploit economies of scale and/or find new opportunities. The second are *costs of production*; the most often pronounced are labour costs but inflationary pressures can also play some role as a push factor. The third group of home country drivers are *local business conditions*, such as competitive pressure but also adverse business conditions which force local companies to relocate their production abroad. Varga (2005) extends this list also to exchange rates, which when appreciating, can lead the situation that local acquisitions of foreign firms are more expensive and on the contrary, foreign acquisitions of local firms are more advantageous.

The last group of home country drivers are *home government policies*, which can be general or specific. The purpose of general policies is to create a favourable business environment and they mostly cover areas which influence competitiveness of local companies. They overlap with favourable domestic conditions characterized by Antaloczy and Elteto (2002), as defined above. Specific government policies on the other hand are directly connected to OFDI and not so much to the general business environment.

Kalotay (2004) suggests that government policies can play a major role, "*especially in reducing the market entry barriers in areas and countries where in an initial phase, private institutions would be reluctant to be involved.*" He orders the government policies which can influence OFDI into three stages. The first is capital account

liberalization, the second is passive investment promotion⁷ and the third is active promotion of OFDI.

Active promotion can take form of an investment guarantee scheme, a development finance institution or an outward investment promotion agency. Services of such institutions range from information and promotional services, feasibility studies and project development and last but not least financing and guarantees. As Kalotay adds, if such a range of active promotion services prevails in the leading outward investing countries, it is very likely that companies in transition economies, where OFDI is a very recent trend, need such a support as well. It is important to note that these three stages do not necessarily follow each other, since not fully liberalized capital account can coexist in an economy together with an active investment promotion.

Letto-Gilles (2005, p.164) argues that the support of home economies for their local companies aiming to invest abroad grows with experience of these home economies with OFDI. *"In countries with a long tradition of outward foreign investment we are likely to witness the generation of external effects and benefits some of which are specific to the home country and are linked to learning from the experience of past FDI."* To such home country features belong establishment of governmental and/or private agencies promoting FDI at home and abroad as well, trade missions and foreign policy, private consultancy companies, but also spillover effects on the workforce.

Similarly to the case of investment incentives for IFDI, active promotion of OFDI also requires wide discussion, since preferential treatment of certain companies might lead to economic distortions. OFDI can result in direct or indirect benefits for the home economy but at the same time represent risks. UNCTAD (2006, p.233) summarizes this need for careful approach to active promotion schemes in the following way: *"Policies need to reflect a country's stage of development, comparative advantages, geopolitical position, structure and capabilities of the business sector, and, of course, the government's overall development strategy."*

The relationship between foreign investing companies and their home economies is by far not straightforward. Bohatá and Zemplerová (2004) suggest, that from

⁷ involving bilateral investment treaties and double taxation treaties;

a short-term perspective OFDI can be perceived as a rather negative thing, due to potential adverse impacts on the home economy. Among these are for example structural and regional unemployment, due to moving of production abroad and decrease of the domestic capital available which further limits the potential of job creation and economic growth. All these consequences can lead to social tensions and political backlash towards foreign investing companies.

Jaklic and Svetlicic (2001) argue on the basis of a survey of foreign investors from selected post-communist countries, that companies by investing abroad manage to keep some jobs in the home economy, which would otherwise be lost. Even more importantly, these companies have not crowded out domestic investments, but to the contrary, they have increased the volume of production and investment activity, improved quality and differentiation of products, their adaptation and innovations. This all promotes in the long run technological restructuring of the companies. In addition, companies which invest abroad tend to be domestic market leaders and apply these improvements in home economies, thus increasing competition and forcing local companies to restructure their production as well. The authors conclude that companies from transition economies which invested abroad enhanced this way the process of their restructuring and thus stimulated the transition process.

To conclude this chapter, in addition to factors covered by OLI paradigm, home economies have the potential to influence OFDI as well, indirectly, through general economic and business conditions in which companies exist (and which influence the level of economic development as well), or through more direct policies. The latter belong to those country-specific features which can then contribute to differing IDP frameworks of individual countries and thus weaken the regularity in the original relationship between the level of economic development and FDI flows. In the next chapter, we will analyze IDP of the Czech Republic and Slovakia in the context of other post-communist economies. Home economy policies as potential factors which can influence Czech and Slovak IDP, or more precisely their OFDI, are subject of the chapter 4.

3 OUTWARD FOREIGN DIRECT INVESTMENT IN THE CZECH REPUBLIC AND SLOVAKIA

3.1 OFDI in Central and Eastern Europe

After many decades of isolation, with the start of the transition, the Central and Eastern European countries began also the process of their reintegration into the world economy. The first vehicle in this process was trade liberalization, followed by inflows of FDI. The importance of the latter increased so rapidly and substantially that Kalotay (2004, p.3) stated that IFDI at the end of the 1990s have become *"the sole most important engine of successful reintegration into the world economy"*. From 1997, OFDI started slowly gaining on significance as the third vehicle of internationalization of economic actors from these economies.

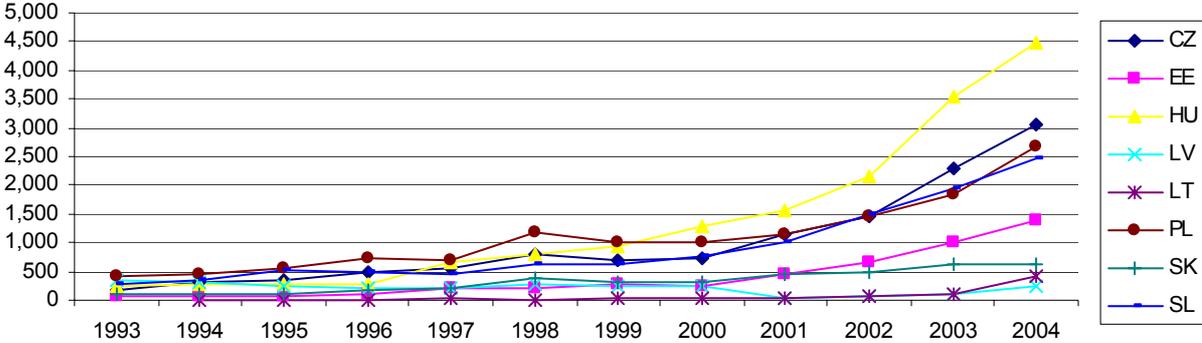
The role of home economies of multinational corporations is not completely new for these countries, since the so-called "red multinationals"⁸ existed also before 1989. However, the rationale and conditions for the existence of transnational corporations established in these countries have been different from what the Central and Eastern European transnational corporations have to cope with nowadays. Parent companies of these enterprises have been state-owned companies, particularly foreign trade organizations. On the basis of statistics, Andreff (2003) concluded that most of these investments were located in developed market economies and they preferred to invest in trade, banking and finance, rather than in other services. Smaller amounts of investments flew also to developing countries, where their focus was primarily on industries based on raw materials and power consumption. In most cases, the foreign invested companies were hardly profitable or even loss-making.

In the first years of transition, the amounts invested abroad declined rapidly. The development of OFDI was rather unstable, characterized by swings, due to small base and due to the fact that many companies which invested abroad, were undergoing restructuring themselves which led to withdrawal of their investments. Also, according to Bohatá and Zemplerová (2004), many of the investors who attempted to invest abroad after 1989 lacked capital, experience and also knowledge about the economic environment of the host economies what eventually led to their withdrawal from the foreign host economies.

⁸ The term used by Andreff (2003).

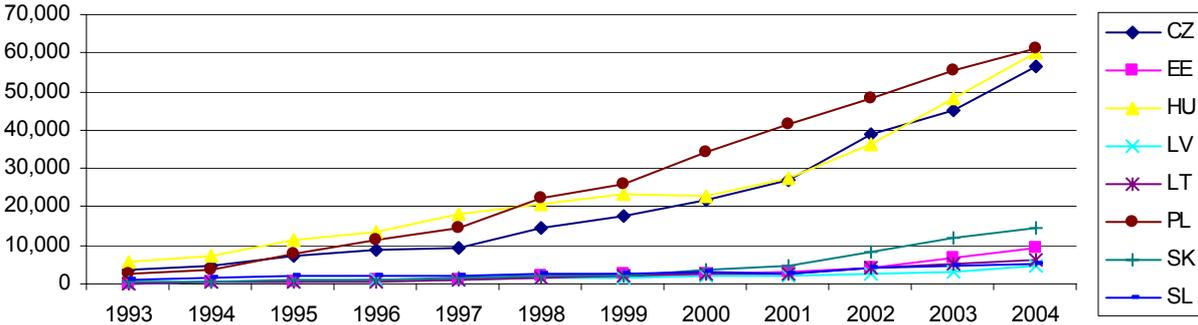
The following figures bring an evidence of the development of OFDI and IFDI in the post-communist economies which already became member states of the European Union (EU).⁹

Figure 2: The stock of OFDI in selected transition economies (mil. USD)



Source: Author’s calculations based on the data from UNCTAD

Figure 3: The stock of IFDI in selected transition economies (mil. USD)



Source: Author’s calculations based on the data from UNCTAD

When comparing the Figure 2 and Figure 3, we can see that the flows of OFDI and their stocks abroad are significantly smaller than flows of IFDI in all the selected countries. The figures also reveal some common features shared by all these economies. All the countries are net recipients of FDI, since IFDI is much larger than OFDI. Trends of growth of OFDI are in certain periods moderated or even interrupted by fluctuations.

In aggregate terms, the country with the highest amount of OFDI is Hungary, which has had the leading position since the year 2000. It is followed by the Czech

⁹ The data on the per capita basis can be found in Figure 13 and 14 of appendix 1.

Republic. Slovakia is among the countries on the last position in terms of OFDI stock from the selected economies. In comparison on a per capita basis, Slovenia is the leading country, followed closely by Estonia, and there is a rather big gap to the third position of Hungary. Kalotay (2004) argues that the early growth of OFDI in the case of Hungary, Estonia and Slovenia, was based on four key factors:

- a) These economies started very early with the privatization process of the major enterprises, what created conditions for their early consolidation and strengthening of their financial position.
- b) The size of these economies has forced many of their companies to internationalize in order to remain competitive in the open trading environment.
- c) Companies in these countries have been in a good position when investing in other transition economies, because of their knowledge of these markets and in many cases because of cultural and personal links.
- d) Manufacturing firms are the engines of OFDI.

The second and third argument of Kalotay hold for the majority of the Central and Eastern European (CEE) countries, but not for Poland, which thus partly explains, why Polish enterprises have not searched so much for foreign presence. The size of the Polish market has provided enough opportunities for the companies to expand.

Kalotay's last point about the importance of manufacturing firms for the development of OFDI leads us to a brief look on the structure of the OFDI in the selected CEE economies. For example Kalotay (2004) brings an evidence that the Hungarian OFDI to the CEE region have been concentrated in manufacturing, whereas the investments to the Western European economies have been more towards the trading presence of the companies. The author also points to an interesting feature of OFDI in some of the CEE countries¹⁰ where service industries – especially trading and banking – have dominated OFDI. This is according to him an interesting feature since in the developed countries, OFDI in manufacturing firms usually precede those in service industries and he explains it by the nascent stages of OFDI in these countries.

¹⁰ Czech Republic, Poland and Estonia

Jaklic and Svetlicic (2001) argue, that OFDI in these economies correlates with development level, they thus confirm what would be predicted by the IDP model. At the same time, they suggest, that external and internal political developments can influence OFDI significantly.¹¹ The fact that companies from these eight countries mostly choose host economy from this region as well shows that among other important factors in the decision-making about OFDI is the past experience of companies with exports within the region and close economic ties, but also their historical, geographical and cultural proximity. Jaklic and Svetlicic also suggest, that in general, these economies are significantly lagging behind in OFDI volumes, even when compared to other selected smaller industrial economies.

Andreff (2003) brings an interesting evidence, that multinationals from this region share a lot of common features with transnational corporations from the Third World countries in the early stages of their development. According to the author, multinational corporations from the post-communist countries are today in a situation similar to that of multinational corporations from the Third World countries at the beginning of 1980s.¹² They are small in size and with fewer affiliates than outward investing companies from developed economies,¹³ they primarily invest within the region where they come from. Many similarities can also be found in the motives for the investments.¹⁴ Andreff suggests that in case of transition economies, similarly to the case of developing countries, OFDI tends to be motivated by home country rather than host country factors.

Another factor which influences the flows of FDI and is common for most of these countries (except for Poland) is that they are small open economies. Bellak (2000) suggests that net outward investment position (OFDI - IFDI) is different for small open economies, because of specific features these economies possess *vis-à-vis* the

¹¹ Their example is the stabilization of the political situation in successor states in the former Yugoslavia, which led to upsurge of investments of firms from Slovenia in this region. Another example is privatization process in the different countries within the region.

¹² Among the most well-known multinational corporations from these countries are for example Daewoo, Petrobras, Hyundai, Samsung. Source: Andreff, 2003.

¹³ There are few rare exceptions of big outward investing companies from post-communist economies in general, such as Lukoil for example. The situation was similar in the Third World countries, where a few corporations were active investors on the international scene already in 1970s. Source: Andreff, 2003.

¹⁴ Andreff (2003) for example similarly to many Latin American countries, companies from Hungary or Estonia have been forced to invest abroad due to small size of their domestic market. Also, the economic recovery and perspectives of growth were other motive for multinationals from Latin America, which can be according to Andreff seen also in transition economies.

rest of the world. For example, these countries have low geographical diversification, i.e. majority of the trade of these countries is realized only with a small number of countries, mostly with their neighbouring countries. Also, volumes of export are relatively large to the volumes of production, these countries are highly dependent on the external environment and their industrial structure is less diversified than is common in big economies.

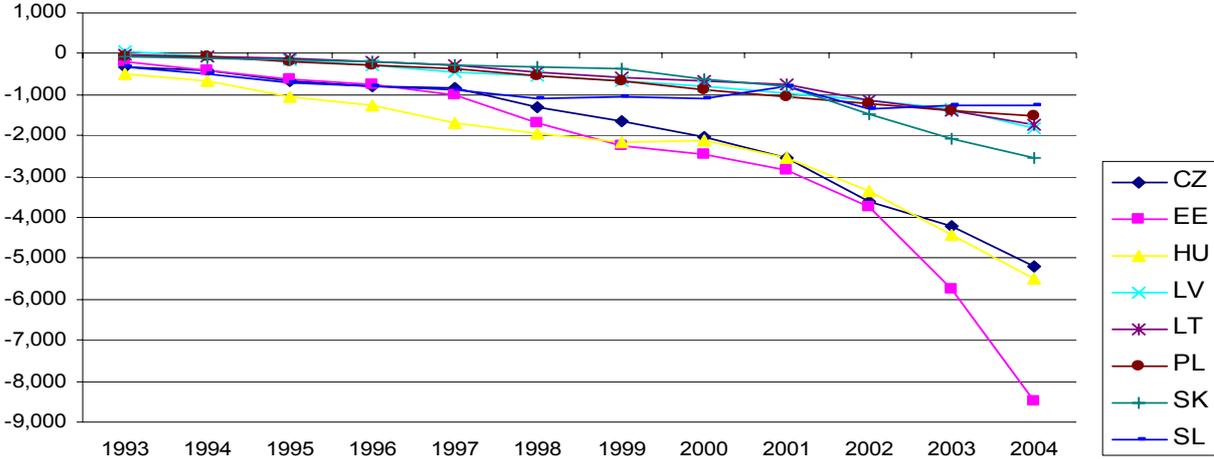
Altzinger (2004) names two additional features of these economies, which contribute to low levels of OFDI. The first is that there is a high level of foreign brown-field investments in comparison with green-field investments, what limits the potential for outward internationalization in the short run. The other reason is that there is only small confidence that domestic firms could be competitive on the markets abroad. Kalotay (2004, p.16) points that companies in these economies are also disadvantaged by the missing historical knowledge accumulation of themselves and their home economies with OFDI: *"The accumulation of historical experience and expertise in this area was interrupted twice, once when communist parties took over power, and again when they lost it. Hence the patterns of outward FDI are determined more by present-day and future-oriented considerations than in other regions."*

Antaloczy and Elteto (2002) propose that IFDI can also play an important role in the OFDI development, since OFDI can originate not only from the domestic companies (the so-called direct investment), but also from the affiliates of foreign-controlled companies (the so-called indirect investment). Varga (2005) brings an evidence, that while in case of Hungary, the majority of OFDI were direct investments, in case of Estonia, many of the firms are foreign-controlled and serve as a "springboard" for the further international expansion of parent companies. The difference between these two is in the motives for their investments. Kivits and Purju (2004) argue that whereas indirect investors expand further abroad due to market seeking, for direct investors labour cost motives are more important. At the same time, the authors argue that foreign company's affiliate in the indirect home country will be affected only marginally.

Concerning the national policies, not that much research has been realized in this area. As has been mentioned above, Kalotay (2004) argues that early privatization in certain economies is one of the reasons why these belong to frontrunning countries.

Jaklic and Svetlicic (2001, p.78) argue that OFDI of transition economies are rather resulting from "a bottom-up initiative than as an ex ante planned macroeconomic strategy." And finally Varga (2005) brings an evidence that regional OFDI represents a healthy expansion rather than capital escape resulting from deteriorating home conditions.

Figure 4: Net outward investment position p.c. (USD) in selected CEE countries



Source of data: Author's calculations based on the data from UNCTAD

When the development of OFDI in the eight new EU member states from the CEE region is confronted with the Dunning's IDP model, we find out that all the countries have negative net outward investment position and thus are in the Stage 2 of their IDP. Kalotay explains this situation by a combination of a latecomer status of the transnational corporations incorporated in these economies and transition shock. He further hypothesizes that the entry of these countries to the EU might postpone the transition from the Stage 2 to the Stage 3. This is because the EU will on the one hand offer these firms an easier movement within the EU, but at the same time, the same holds for the firms from the old EU member states and they might increasingly invest in the new EU member states from the CEE region.¹⁵ The period since the accession is still short to assess what its effects on OFDI from these countries were but in a couple of years' time, it will be interesting to see, what impact the accession to the EU had on internationalization of companies from post-communist economies.

¹⁵ A similar situation occurred after the accession of Austria and Portugal to the EU, when IFDI grew faster than OFDI.

3.2 OFDI from the Czech Republic

As has been shown in the previous section, the Czech Republic belongs to the most successful post-communist economies in terms of volumes of OFDI. The purpose of this section will be to analyse more deeply the structure and development of the Czech OFDI. The analysis is based on the data published by the Czech National Bank (CNB). The data about OFDI have been published since 1993, but the definition of OFDI used by the CNB changed in 1998 – the criterion for the benchmark of equity ownership changed¹⁶. Also, since 1998 data in a more detailed geographical and sectoral structure have been available and thus we have chosen this year as a starting point for our statistical analysis. The FDI data in the CNB are collected under the following structure: equity capital, reinvested earnings and other capital. The CNB collects the data on the basis of reports of companies or commercial banks about flows of capital above 1 million CZK¹⁷, according to the Foreign Exchange Act.

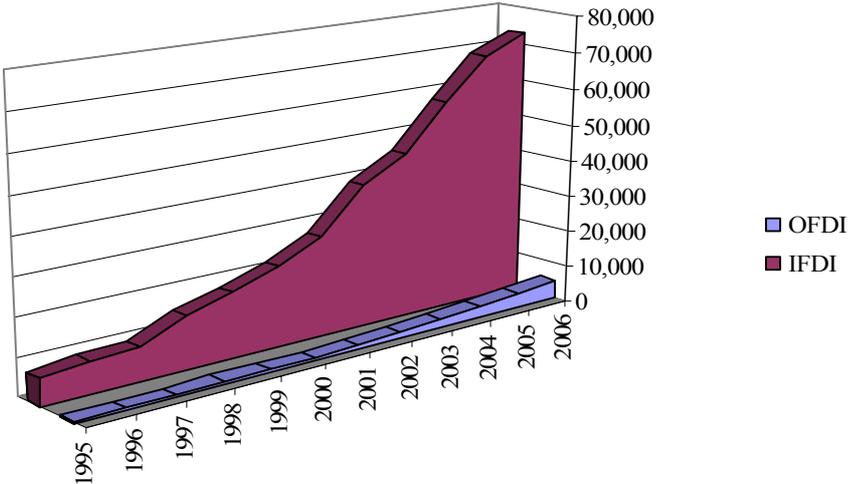
As can be seen on the Figure 5, the volumes of OFDI are very low in comparison of IFDI. In addition to the explanation which would be provided by the IDP theory, that the level of economic development is low, Bohatá and Zemplerová (2004) provide two other explanations. The first could have been a discriminatory approach of the Czech government to IFDI. The second is particularly connected to the decline of OFDI in 2001, which was according to them caused by liquidation of former foreign trade companies.¹⁸

¹⁶ According to Bohatá and Zemplerová (2004), the benchmark for the OFDI of 10% equity share has been applied since 1998 only.

¹⁷ Which was as of 29.12. 2006 approximately 47,900 USD.

¹⁸ This has also been confirmed by the Czech National Bank (2002).

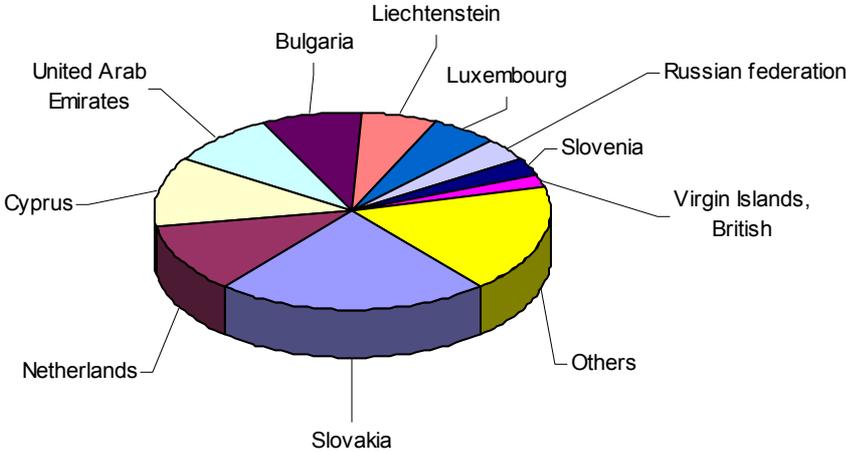
Figure 5: Comparison of the volume of Czech IFDI and OFDI (stock in mil. USD)



Note: The data for years 2005 and 2006 are only preliminary and were obtained by adding the flow data about the IFDI and OFDI flows for the two years, to the stock data as of 31.12.2004. As for the year 2006, the data cover only the first nine months of the year.

Source: author’s calculations based on the data from the Czech National Bank

Figure 6: Geographical structure of OFDI from the Czech Republic as of 31. 12. 2004

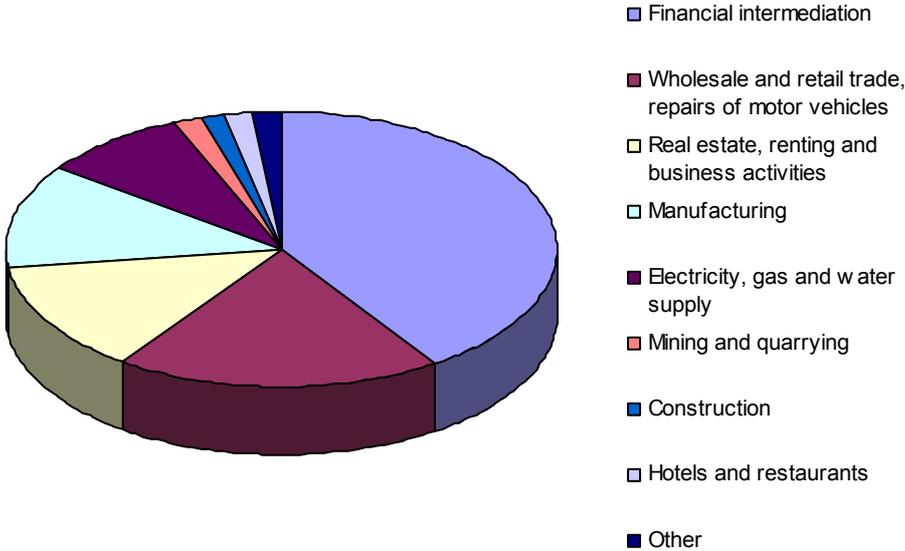


Source: author’s calculations based on the data from the Czech National Bank

It can be seen from the Figure 6 that at the end of 2004, Slovakia was the main destination of Czech OFDI. Big amounts of OFDI flow from the Czech Republic for the purpose of optimization of taxes, particularly on British Virgin Islands, Liechtenstein and Cyprus. It is likely that due to similar reasons, local companies establish their affiliates also in the Netherlands and Luxembourg (Czech National

Bank, March 2004). According to the same analysis of the CNB, majority of the Czech OFDI were aimed at investing free funds and for securing trade activities abroad. Domestic companies also set up special purpose entities abroad which are for example used to manage assets or to obtain funds from foreign capital markets.

Figure 7: Sectoral structure of OFDI from the Czech Republic as of 31. 12. 2004



Source: author’s calculations based on the data from the Czech National Bank

In terms of structure, financial intermediation represents the highest volumes of OFDI, which is in line with the findings of the CNB, that many investors invest in specific countries for the purpose of tax optimization. Services in general represent a much higher share of OFDI than any other sectors. This is in line with the argument of Kalotay (2004) about the CEE economies where services are ahead of manufacturing (and this confirms their nascent stage of development of OFDI), but at the same time it is interesting in comparison with Slovakia, where as will be shown, manufacturing is the most important source of OFDI.

The Czech Republic is in the Stage 2 of the Investment Development Path. This can be clearly seen on the Figure 16 in Appendix 3, since the stocks of IFDI are still increasing at a rate bigger than the stocks of OFDI. The net outward investment position is thus increasingly negative. Interesting in the Czech IDP is that the line relating the GDP per capita and the stock of IFDI is twisted in certain points. This is due to temporary decrease of GDP per capita in years 1997, 1999 and 2000, and growth of IFDI stock at the same time.

As has been already mentioned in the chapter 2, Bellak (2000) in his analysis of Austrian IDP uses the concept of structural IDP, since he assumes that particular industries can be on a higher level of development than others and thus these individual sectors can be in different stages of IDP than the rest of the economy. We applied the concept of structural IDP on the five biggest sectors investing abroad as of 31.12.2004¹⁹ to see, in what stage of the structural IDP the most successful outward investing sectors are. The results of the analysis in years 1998 – 2004 can be found in Appendix 3, in Figures 17 - 21.

It is clear from all five figures that all the sectors are in the Stage 2, with a similar twist in the relationship of GDP per capita with the stocks of IFDI as can be found in case of the general IDP. The only exception in the development is the sector Electricity, gas and water supply, where the rate of growth of OFDI stocks has been in recent years greater than the rate of growth of IFDI and the negative outward investment position is not increasing. This is very likely due to the expansive investment policy of the biggest Czech electricity producer CEZ, which is expanding abroad significantly.

It can thus be concluded that the Czech economy as well as its most successful sectors in terms of OFDI are in the Stage 2 of their IDP. However, the situation in some of the sectors, particularly in Electricity, gas and water supply can change in the coming years and this particular sector could enter Stage 3 of the IDP, while the rest of the economy will stay in the Stage 2 for a longer period of time.

3.3 OFDI from Slovakia

Unlike the Czech Republic, Slovakia belongs to latecomers in terms of OFDI among the CEE countries. Similarly to the previous section, we will analyze into more detail Slovak OFDI to see the position of Slovak economy and its sectors in their IDP. The analysis is based on the data published by the National Bank of Slovakia (NBS). Similarly to the CNB, the NBS receives the data on the basis of Foreign Exchange Act, from reports of companies or commercial banks about capital flows exceeding 1 mil. SKK.²⁰ The data has been published since 1993, but in a slightly different

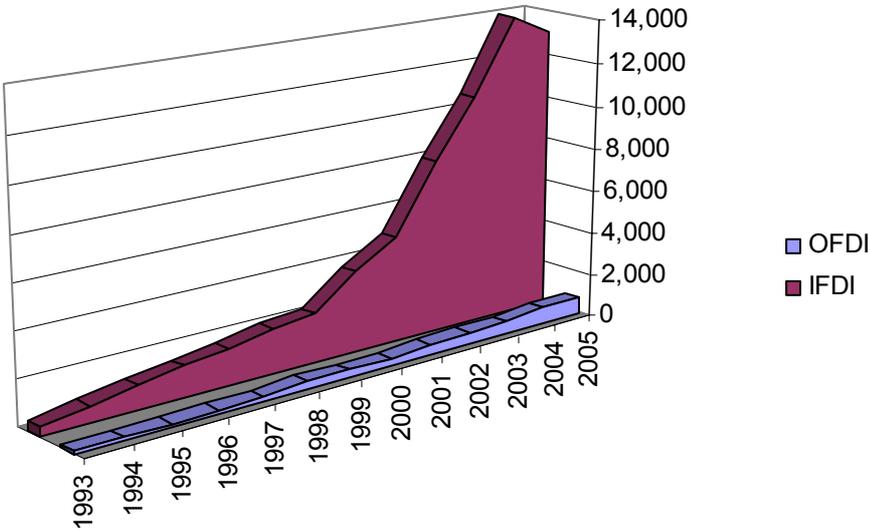
¹⁹ which are financial intermediation; wholesale and retail trade and repair of motor vehicles; real estate, renting and business activities; manufacturing and electricity, gas and water supply.

²⁰ As of 29.12. 2006, it was 38,101 USD. The reporting obligation is not directly from the Foreign Exchange Act, but a Public Notice to this Act No. 399/1999. Interestingly, at the end of December

structure than that of the CNB – until now only equity capital and reinvested earnings have been published. Currently, the NBS has been revising the data under a new structure but this data were not available until the end of December 2006 and thus could not be involved in the analysis.

It can be seen from the Figure 8 that stock of OFDI has been significantly smaller than stock of IFDI. In 2004, the relative difference between the IFDI and OFDI stock was approximately the same as in the Czech Republic.

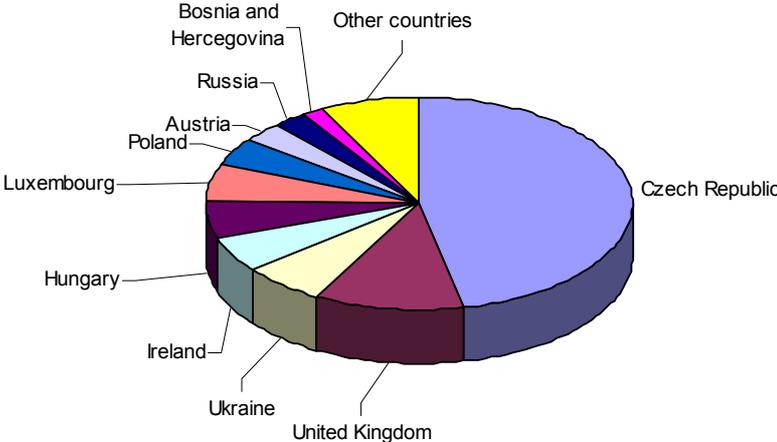
Figure 8: Comparison of the stock of Slovak IFDI and OFDI (mil. USD)



Source: Author’s calculations based on the data from the National Bank of Slovakia

2006, the NBS announced that the requirements on reporting of direct investment capital flows have been lifted and commercial banks do not need to report about FDI capital transfers, by announcement No. 691/2006. This is an interesting situation which can be on the one hand understood as further liberalisation of investment flows but at the same time leads to questions about sources of collection of data for statistical purposes.

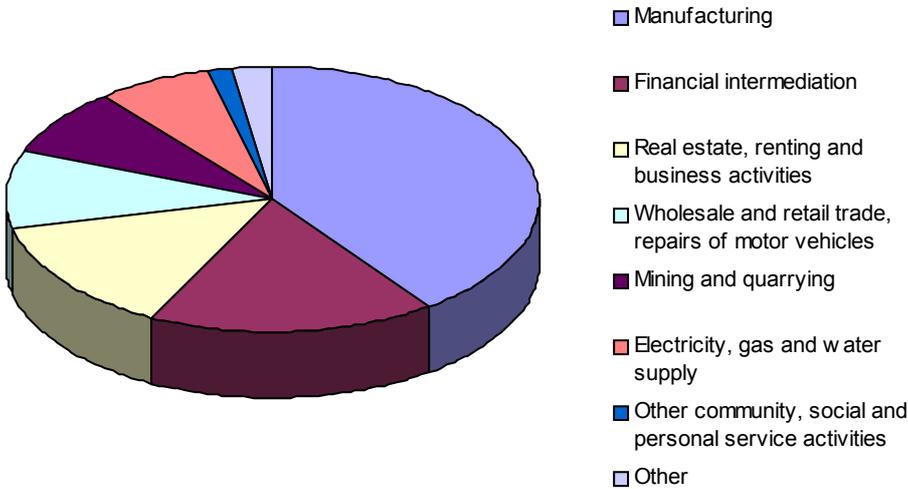
Figure 9: Geographical structure of OFDI from Slovakia as of 31. 12. 2004



Source: Author’s calculations based on the data from the National Bank of Slovakia

The major destination of Slovak direct investments has been the Czech Republic. The main difference between the Czech and Slovak OFDI is that not such a big volume of OFDI goes to the countries advantageous for tax optimization purposes and more is invested within the CEE region. Another major difference can be seen from the comparison of sectoral structure of OFDI. In the Slovak case, manufacturing creates the major share of OFDI, unlike in the Czech Republic, where manufacturing is less important than investments in services. In Slovakia, volumes of OFDI in services are approximately the same as the total of OFDI in manufacturing, mining and quarrying and electricity, gas and water supply.

Figure 10: Sectoral structure of OFDI from Slovakia as of 31. 12. 2004



Source: Author’s calculations based on the data from the National Bank of Slovakia

Slovakia is also in the Stage 2 of the Investment Development Path. This can be clearly seen from the Figure 22 of the Appendix 4, since the stocks of IFDI are still increasing at a rate bigger than the stocks of OFDI. The net outward investment position is thus increasingly negative as well. Similarly to the Czech case, a twist occurs at one level of GDP per capita, where despite of its decrease, the levels of IFDI increased. In Slovakia, this situation occurred in years 1999 and 2000.

The analysis of structural IDPs of the 5 most important sectors as of 31.12.2004 on the basis of the same methodology as in the Czech case yields similar results.²¹ None of the sectors is in higher than Stage 2 of IDP. It can thus be concluded that the Slovak economy as well as its most successful sectors in terms of OFDI are in the Stage 2 of their IDP.

3.4 Mutual OFDI between the Czech Republic and Slovakia in numbers

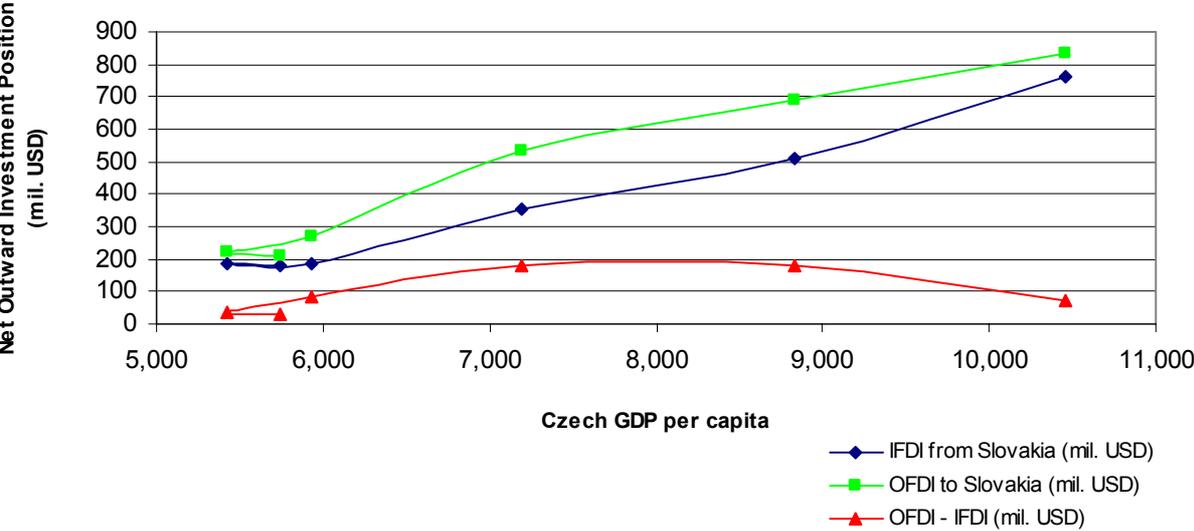
The comparison of mutual flows of Czech and Slovak OFDI yields some unexpected results. The analysis is framed in the so-called bilateral IDP, the purpose of which is to trace development of investment flows between two countries.²² The focus of our

²¹ The results of the calculations of Structural IDPs in Slovakia can be found in Appendix 4, Figures 23–27.

²² This methodology is also from Bellak (2000). In his study about Austrian IDP, he analyses the relationship of Austria and Germany in terms of FDI flows.

analysis has been on flows since 1999²³ and the analysis has been made from the Czech perspective, i.e. the comparison of IFDI from Slovakia to the Czech Republic and OFDI from the Czech Republic to Slovakia. This is because the Czech data is more complete, involving equity capital, reinvested earnings and other capital, whereas the Slovak data involve only the former two. Bilateral IDP has been measured in absolute terms, but also normalized²⁴ so that the size of each country is taken into account.

Figure 11: Bilateral IDP between the Czech Republic and Slovakia (from the Czech perspective)



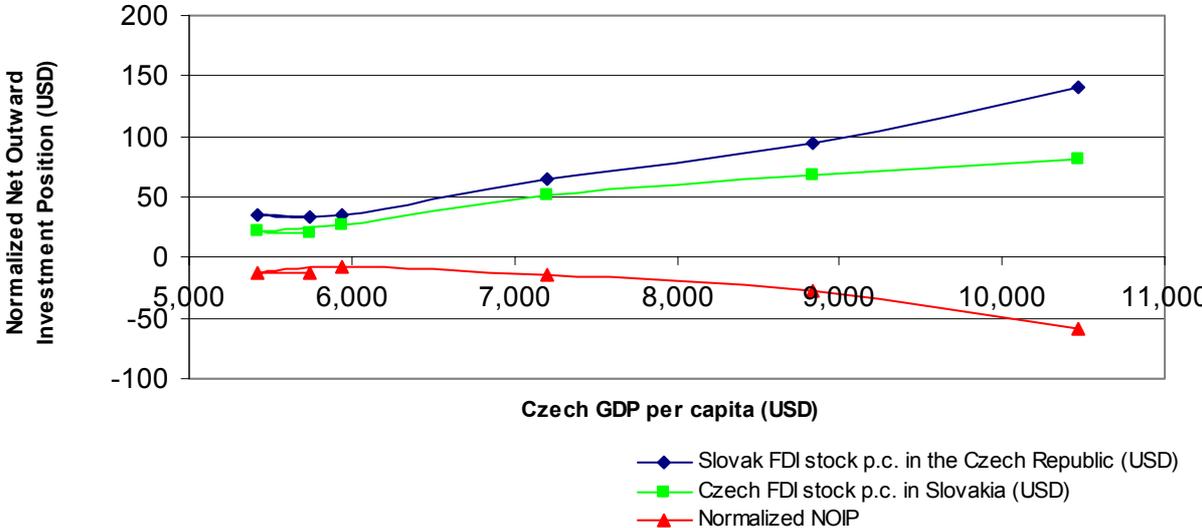
Source: Author’s calculations based on the data from the CNB and UNCTAD

From the figure above, it can be seen that in absolute terms, Czech firms invest to Slovakia more than *vice versa*. The development has not been linear but has undergone some significant changes in the trends. The greater difference between the stock of IFDI from Slovakia and OFDI to Slovakia occurred in years 2002 and 2003.

²³ The starting year 1999 was chosen because since this year, the data for the two countries were available in the same structure.

²⁴ In per capita terms of the country, from which the FDI comes from.

Figure 12: Normalized bilateral IDP between the Czech Republic and Slovakia (from the Czech perspective)



Source: author’s calculations based on the data from the CNB and UNCTAD

Normalized bilateral IPD yields an interesting result in that it shows that per capita IFDI from Slovakia to the Czech Republic is higher than per capita IFDI from the Czech Republic to Slovakia and the difference has even been increasing. To be able to assess better the importance of OFDI among these two countries, correlation coefficient between the total NOIP and NOIP to the Czech Republic or Slovakia has been evaluated and the results are the following:

The correlation coefficient between the Czech total stock of OFDI and the stock of OFDI to Slovakia is negative and has the value -0.54496 . This means that with the higher level of OFDI, the share of OFDI to Slovakia decreases. Since we have already shown that with an exception of three years the relationship holds that the higher the level of economic development, the higher the volume of OFDI, it can be concluded that with increasing level of economic development in the Czech Republic, the share of OFDI to Slovakia from the total OFDI decreases.

The correlation coefficient between the Slovak total stock of OFDI and the stock of OFDI to the Czech Republic is positive and has the value 0.976096 . This can be interpreted that the Czech Republic is a very important destination and the higher the level of economic development, the higher the flows of OFDI to the Czech Republic from Slovakia. This analysis thus shows the importance of mutual flows of

investments from these two countries and brings an interesting finding that Czech Republic is a relatively more important destination for Slovak investors than vice versa. This fact will be analyzed more deeply in the last chapter.

The purpose of this chapter was to see IFDI and OFDI from the Czech and Slovakia from different perspectives. In the first part, we have compared the two countries with other CEE countries to see indeed, that the Czech Republic belongs to the most successful countries and Slovakia is rather a latecomer. However, both countries are in the Stage 2 of their Investment Development Path.

In the second part, we came down from the from the bird's eyeview to a more detailed analysis of the development of FDI flows and geographical and sectoral structure of OFDI. We have found interesting features of OFDI from the two countries. The character of their flows differs significantly, in terms of geographical focus but also sectoral structure. While Czech companies invest much more to services and more to developed countries, Slovak investors focus more on manufacturing and stay more within the CEE region.

The analysis of the most successful sectors in terms of OFDI both in the Czech Republic and Slovakia has shown that all the sectors are in the Stage 2 of their IDP. However, the situation in some sectors develops in such a direction that they might progress to further stages, such as the example of energy in the Czech Republic. Also, although the highest flows of OFDI from the Czech Republic are to Slovakia and from Slovakia to the Czech Republic, Czech Republic is a relatively more important destination for Slovak investors than vice versa. This was shown on the basis of so-called bilateral IDP. This statistical data provided us a lot of food for thought in terms of determinants of OFDI from transition economies and factors which caused a latecomer position of Slovakia. The purpose of the next chapter is to shed more light on these factors.

4 FACTORS INFLUENCING THE LATECOMER STATUS OF SLOVAKIA IN OFDI

As has been written in the chapter 2, IDP framework describes the relationship between the level of economic development and international flows of direct investments represented by both IFDI and OFDI. The explanation of this relationship is a puzzle, where its pieces involve external factors determining the level of economic development or flows of FDI or both, but among the pieces can also be the level of economic development and flows of FDI themselves, since they have the potential to influence each other.

The obvious complexity of the task to explain the relation and the idiosyncratic character of the IDP framework for each specific country have led us to choose only a limited number of puzzle pieces. The focus of this chapter is on two sets of factors, which might to some extent explain the latecomer status of Slovakia in OFDI. The first set of factors covers inflows of FDI and discusses what impact can they have on OFDI; the second are activities of Czech and Slovak governments towards OFDI. These will be analyzed into more depth for both countries and their comparison aims to shed more light on aspects which matter for OFDI in transition economies.

4.1 Inward foreign direct investment as a factor influencing OFDI

As has been shown in the chapter 3, Slovakia in comparison with the Czech Republic has been belated both in IFDI and OFDI. This leads us to considerations about the relation of these two developments. One potential explanation is that belated flows of FDI in both directions have been to some extent influenced by the same determinants. This will be discussed in the first part of the chapter, where the knowledge about the determinants of IFDI in transition economies will be summarized and used in the discussion whether and which of these IFDI determinants could have influenced also levels of OFDI.

The other potential explanation is that IFDI themselves have had an impact on OFDI, via more channels. IFDI can influence business environment and economic development in general, and thus influence the conditions in which local companies operate, and/or IFDI can lead to so-called indirect OFDI. This will be discussed in the second part of this chapter.

4.1.1 Factors influencing IFDI

IFDI have been considered by policymakers and academicians to be an indicator of progress in reforms and development of a fully-fledged market environment in transition economies. In this subchapter, the development of IFDI in the Czech Republic and Slovakia will be compared in order to see, which locational advantages or disadvantages have played an important role in IFDI and which of them could have also influenced OFDI.

4.1.1.1 Empirical studies about IFDI determinants

The following table summarizes findings of Bevan and Estrin (2000 and 2003) and Bevan et al. (2004) about determinants of IFDI in transition economies.²⁵ This table will be used as a starting point of comparison of those features of the Czech and Slovak economy, which are statistically significant and which are not applicable on individual investments only²⁶ and can be generalized. We can see that in addition to a general business environment involving size of the market, costs of inputs (be it capital or labour) and geographical distance which have an impact on transportation costs, institutional factors play an important role in the decision-making of foreign investors.

²⁵ There is a number of studies analysing determinants of IFDI in transition economies. For example Benáček (2000) analyses the case of the Czech Republic. In this study, he also summarizes studies about IFDI determinants written in 1990s. The study of Bevan and Estrin (2000 and 2003) and Bevan et al. (2004) have been chosen for this thesis since they belong to the latest studies and also, they analysed indicators, which are publicly available (EBRD Transition progress indicators), which allowed us to compare the development in the two countries.

²⁶ Such as host country size, distance between the home and host economy.

Table 1: Impact of various factors on IFDI inflows

Variables	Impact on IFDI
Panel 1	
Source market size (GDP)	+***
Host market size (GDP)	+***
Relative cost of capital	+
Share of transition economy imports from EU (in per cent of GDP)	+
Transition economy risk	-
Distance between source and host country	+***
Unit labour costs in host country	-***
Panel 2	
Transition index (aggregate of reported indicators)	+*
Small-scale privatisation	+*
Large-scale privatisation	+*
Banking sector reform	+**
Non-bank financial sector reform	+
Price liberalisation	+
Foreign exchange and trade liberalisation	+***
Competition policy	+
Legal development	+***

+ or – indicates a positive or negative correlation and *, **, *** show that the regression coefficient is significant at the 10, 5 or 1 per cent level respectively.

Source: The table summarizing results of the studies published in EBRD (2003).

The first group of IFDI determinants, particularly **source market size**, is relevant also for OFDI and belong to the first group of home country drivers of the UNCTAD division (UNCTAD, 2006)²⁷. No need to say that Slovakia has been disadvantaged in comparison with the Czech Republic in terms of market size. This fact on the one hand makes the country less attractive for IFDI, but on the other hand represents an impetus for expanding of successful local companies abroad. At the same time, the importance of market size to some extent decreased with the accession of both countries to the European Union.

Hourly **labour costs** in the Slovak Republic are lower than in the Czech Republic.²⁸ In terms of labour productivity, without which the hourly labour costs do not have such a relevance, Slovakia has had higher labour productivity per hour worked than the Czech Republic since 2000. An indicator measuring the development of relation

²⁷ The home contry drivers divided according to the UNCTAD were already explained into more detail in chapter 2.

²⁸ The macroeconomic indicators for the two countries can be found in the appendix 6 and comparison of the labour costs in the appendix 7.

between the remuneration of employees and productivity of employment – real unit labour costs growth – has had in both countries unstable development – in some years labour costs increases exceeded productivity growth, in some years the situation was opposite.

From this analysis it can be seen that in Slovakia, the conditions in terms of labour costs are actually better than in the Czech Republic, the labour force is cheaper and has had in the last years also higher productivity. This fact is attractive both for efficiency-seeking IFDI and also for local companies, for which labour force is an important production factor. Companies from Slovakia would thus have less motivation to leave the country for the purpose of efficiency seeking in terms of labour costs than Czech companies.

From the geographical structure, it can be seen that Slovak companies have not been investing significantly to countries with lower labour costs and thus it is possible to conclude that efficiency-seeking OFDI has been in minority in comparison with the other three types of OFDI. With the exception of Slovakia and Bulgaria, Czech companies also have not been investing significantly to countries with lower labour costs. Since a more detailed sectoral structure of OFDI flowing to these two countries has not been available, we could not conclude whether the OFDI to Bulgaria and Slovakia have or have not been for efficiency-seeking purposes and whether labour costs have been a push factor for Czech OFDI.

In terms of **cost of capital**, we have proxied it by cost of debt and as can be seen from the Appendix 6, costs of debt as represented by inter-bank offered rates have been higher in Slovakia throughout the whole observed period. This might have had negative effects on the inflows of IFDI, and also it might have influenced negatively situation of domestic companies in comparison with Czech companies. As for the inflationary pressures, it cannot be clearly concluded which of the two countries provided a more stable environment.

Results of the Panel 2 clearly show that in addition to more general features of business environment, institutional development of host economies is also an important aspect in considerations of investors and thus deserves our attention. It is important to say at the beginning, that creation of formal institutions was influenced by the fact that both countries were aspiring to become and later became members

of the European Union. This ambition increased pressure on both countries to implement institutions involved in *acquis communautaire*.

In some areas, the level of institutional development was approximately the same in the two analyzed years of 1997 and 2005²⁹, such as in the development of **market and trade institutions** and **private sector development**. In other areas, however, Slovakia was in a more disadvantageous position – for example in 2005, Slovakia was still lagging behind particularly in **banking and development of financial institutions**. In terms of **legal development**, a numerical comparison of the two countries was available for the year 1997 only, when Slovakia was significantly lagging behind the Czech Republic, and in fact, this area was the biggest weakness of Slovakia from all the analyzed areas. In 2004, both countries have still been criticised for shortcomings in legal development and persistence of corruption.

4.1.1.2 Other factors influencing IFDI inflows

In both cases, the development of microeconomic foundations of market economies was criticised as insufficient. Until 1998, Slovak governments did not take advantage of relatively favourable macroeconomic situation particularly in 1994-1995 to advance in the reforms and it was only the government of Mikuláš Dzurinda elected in 1998 which started radical reforms in the Slovak economy (Morvay, 2000). In the Czech Republic, Kouba (2005) also criticised that the Czech Republic did not take advantage of its favourable macroeconomic starting conditions.

In Slovakia, among the most striking legal problems from the viewpoint of investors were insufficient protection of minority shareholders, weak enforcement of rights of creditors via bankruptcy proceedings, corruption in public administration, lacking publication of financial and other information from the side of corporations.³⁰ Marcičín (2000) suggests that one of the most important causes of low inflows of FDI has been corruptness of courts. Another obstacle for potential foreign investors related to legal

²⁹ To compare the development of institutions, indicators from EBRD Transition Reports were used. The specific indicators were taken for the years 1997 and 2005 and their detailed explanation and comparison can be found in the appendix 5. The year 1997 was chosen for the comparison since it was the last complete year before a breakthrough year in the process of transition in Slovakia and also in this year, the amounts of OFDI in transition economies set on a growth path after the period when they reached only small amounts. The year 2005 is the last in which we have the EBRD transition indicators available.

³⁰ A more detailed evaluation was found in the material of the Government of Slovak Republic (2000).

development were the legal requirements in terms of what foreign investors were expected to fulfill in order to be allowed to invest in Slovakia.

It is also important to note, that the same level of development of private institutions³¹ does not necessarily mean that private ownership of Slovak or Czech companies was available to foreign investors. Although Slovakia was on the same level of development of private institutions as the Czech Republic, this did not secure the same conditions for foreign investors. The attitude of Slovak governments towards the privatization to foreign hands was rather negative. In the process of privatization, governments used to prefer local managers and not infrequent was cronyism and other non-transparent methods. Foreign investors were virtually excluded from the process of privatization (EBRD, 1998).

In the study of the Slovak government from August 2000, it is even stated that the earlier Slovak governments were perceived by investors to have been purposefully delaying the process of entry of foreign investors by retaining a difficult and non-transparent process of registration. Another factor, which shook the confidence of investors was that Slovakia was excluded from the first wave of NATO enlargement and from the so-called first group of EU membership candidate countries (EBRD, 2005).

The situation changed after the year 1998, when the government of Mikuláš Dzurinda came into power and began immediately a process of improvements of economic environment. In relation to investments, the situation improved significantly thanks to measures supporting investors such as tax rebates and tax holidays, acts on the support of building of industrial zones and parks and furthermore an act on investment incentives which in addition to introduction of 10-year tax holidays introduced also the possibility of subsidies on requalification of employees and job creation.

Consequently, the volumes of IFDI to Slovakia after the year 1998 increased significantly, in spite of persistent problems with law enforcement and business environment (Jakoby, 2002). In 2005, new investment incentives were introduced to support more diversified inflows of FDI and IFDI to poorer regions.³² Inflows of FDI

³¹ Which was shown in the previous section on the basis of EBRD Transition Report indicators.

³² EBRD Transition Report 2005, p.178

reached very high levels also in years 2003 and 2004, when car manufacturers Peugeot-Citroën and Hyundai-Kia chose Slovakia as a host economy for their major investments. These investments underlined the substantial improvements in the business environment in Slovakia (EBRD, 2004).

Despite of the criticised problems in the development of legal infrastructure and corruption, and the lost momentum in further reforms in the Czech Republic, the confidence to the Czech economy was for a long time much bigger than to the Slovak. The Czech Republic became the first post-communist member state of the OECD as early as in 1995, what also meant that the Czech government was bound to meet certain standards of equal treatment of foreign and domestic investors (UNCTAD).³³ Also, in comparison with Slovakia, the Czech Republic started with the support of IFDI earlier and provided better conditions for foreign investors.

The attitudes towards foreign investors were different in the Czech Republic. Czechinvest, an investment and business development agency which serves today as a "one-stop shop" for foreign investors, was established already in 1992. In the first half of 1990s, Czech governments chose to support IFDI indirectly, through creation of a stable economic and political environment, rather than through discretionary industrial policy (Benáček and Zemplerová, 1997). This attitude of indirect support started to change in 1998 when the Czech government introduced investment incentives schemes (EBRD, 2003).

Concerning the participation of foreign investors on the privatization in the Czech Republic, their access was rather restricted in the first half of 1990s, however, they had numerous opportunities in the second round of privatization.³⁴ Mejstřík (1996) suggests that opportunities were created particularly in large-scale privatization by standard methods.³⁵ According Benáček and Zemplerová (1997) voucher privatization (as a non-standard method) did not meet the expectations about its potential impact on the foreign capital flows in general.

³³ In the Slovak case, entering the OECD took place 5 years after the Czech Republic. The Czech Republic which became the OECD member already in 1995 was with few exceptions obliged to liberalize capital flows. In Slovakia, significant capital account liberalization took place in 1998. Sources: EBRD (1998).

³⁴ Source: UNCTAD

³⁵ Quoted in Benáček and Zemplerová (1997, p.3).

To conclude, among the most important factors which influenced negatively inflows of IFDI to Slovakia was virtual exclusion of foreign investors from the privatization up until 1998. In addition, privatization methods not only did not allow significant inflows of IFDI, but they were also non-transparent and the new owners of privatized property in many cases maximised their own wealth rather than profit and long-term prosperity of the companies, which was possible thanks to political environment in Slovakia until 1998. On the contrary, foreign investors were provided better conditions in the Czech Republic.

The unstable political environment leads us to another group of factors which have had negative impact on inflows of IFDI to Slovakia and that was political instability, lacking support of investors and negative perception and lacking confidence about Slovakia from abroad. Investors have had a bigger confidence in the Czech economy which was in many cases a frontrunner from the post-communist economies in terms of integration to international bodies and also provided more generous support for investors. This have not only indicated better conditions for both local and foreign companies but also meant that Slovakia lost a couple of years of economic development involving foreign investors in comparison with the Czech Republic. Consequences of the IFDI latecomer position of Slovakia will be analyzed in the next two subchapters.

4.1.2 Influence of IFDI on the level of economic development

The debate about the influence of IFDI on economic development and attitudes towards IFDI have gone through many stages. Whereas in the 1960s and 1970s, the development literature did not consider IFDI to be the way for the developing countries to catch up³⁶, today IFDI is considered to be crucial for the economic development. A general attitude towards IFDI in the period of 1970s and early 1980s which can be characterized by the then debate of "dependentistas" and "non-dependentistas"³⁷, when governments were highly critical towards IFDI, has been replaced by a period of very positive perception of FDI.³⁸ In transition economies

³⁶ Knell and Radošević (2000). The authors say that developing countries at that time usually preferred joint ventures over FDI, licencing over joint ventures and direct purchase over licencing, what stemmed from their belief that an equity relationship would lead to higher social costs than benefits.

³⁷ One of the important contributors to this debate was Theodore H. Moran (1978).

³⁸ It is important to say, however, that some authors warn about a too positive perception of IFDI, such as Woodward (2001). In his book, he re-examines the positive effects often ascribed to IFDI and comes to following conclusion:

a general agreement about positive influence of IFDI has prevailed – IFDI has been seen as a solution to close capital stock gaps, technology gaps and the lacking entrepreneurship (for example Mihályi, 2000/2001).

There is a general consensus in the literature that the influence of FDI on the economic development and restructuring depends on three variables (for example Dunning and Narula, 1996):

1. the type of IFDI undertaken
2. the structure of the indigenous resources and capabilities of the particular countries
3. the macroeconomic and organizational policies pursued by governments.

Although the influence of IFDI is strongest in relation to the foreign affiliates and subsidiaries, it does not have to stop at their boundaries.

4.1.2.1 Influence of foreign owners on the invested companies

Foreign investor represents for the invested company a contribution in many areas.

Among the most important are:

- supplies of capital;
- organizational knowledge;
- advanced technologies;
- tacit knowledge;
- access on world markets.

It has been shown in empirical studies that foreign-owned companies have performed better than domestic companies.³⁹ Benáček (2000) even pointed that as early as in 1993, we could witness what he calls a "*dual economy*", where on the one side of the economy are prospering and growing companies connected to foreign capital and on the other side are domestic, undercapitalized former state-owned companies struggling with ownership structure. Among the potentially negative

- Creation of jobs by FDI might be off-set by a reduction of employment of locally owned enterprises;
- Technology transfer is unlikely to extend the boundaries of the foreign-owned firms;
- Developing countries are competing away much of the benefits of FDI;
- Relatively few cases, when the negative effect of FDI on the balance of payments was off-set by the positive spill-over effects in the host country.

The author also draws parallels with previous financial crises and raises questions whether the current overall optimism might not contribute to the creation of another financial crisis.

³⁹ For example World Bank (2001), EBRD (2001) or Jakoby (2002) for the case of Slovakia, Benáček (2000) for the case of the Czech Republic.

impacts of the foreign ownership on invested companies is for example downsizing of production capacities in the invested companies as a way to fight competition.

Another empirically proved fact is that companies with foreign ownership undergo a deep or strategic restructuring to a much greater extent than is the case of companies without foreign strategic owner.⁴⁰ This is because the foreign owner brings to the company physical capital, management capabilities and tacit knowledge about the ways how to find new markets, how to change the production structure in order to increase the company incomes, how restructure the company and its equipment and thus increase the productivity of labour, quality and decrease costs.⁴¹

Additionally, foreign investors in many cases do not limit their presence in the local economy only to one company but extend their presence in the host economy, either through supplies from the local companies or by acquiring other companies, or both ways (Hošková, 2001). Through their cooperation with local companies, they can spread the positive effects on these companies and wider economy. Thanks to this potential, they are considered to be among the main sources of restructuring of companies in transition economies and the economies as such as well (Marcinčin, 1998).

4.1.2.2 Spillovers from foreign-owned to domestically-owned companies

Görg and Greenway (2001) name numerous examples how foreign investor can support local companies. These can range from help to prospective suppliers to set up production facilities, technical assistance or information to raise the standard of quality, reliability and speed of delivery of suppliers' products or to facilitate innovations, to provide assistance in purchasing raw materials and intermediaries, training and help in management and organization, assistance to suppliers to diversify by finding additional customers, financial assistance to help firms qualify as suppliers. It has also been shown that through the cooperation with local companies, IFDI are an important source of changes in corporate governance practices in transition economies (Jánošíková, 2003).

⁴⁰ Empirical evidence can be found for example in Nollen (2002) or de Mortel (2002).

⁴¹ Jakoby (2002) for example suggests that in 2000, it was only companies with foreign or mixed ownership which increased the labour productivity increasing the labour force at the same time, whereas the firms with Slovak ownership attained better labour productivity only through layoffs.

The evidence about spillover effects in transition economies varies in results but also in the subject of analysis. The spillovers can range from those having impact on productivity of local companies, through wage and export spillover effects to entry spillovers, which influence the entry of domestic firms to the sectors involving foreign-owned firms or to sectors linked through backward and forward linkages with foreign-owned companies. The most often analyzed are productivity spillovers. Görg and Greenway (2001) in the summary of findings of theoretical literature name four main channels, through which positive productivity spillovers can spread to local economies – imitation, acquisition of human capital, competition and enhanced export propensity. In the review of empirical research about spillovers, they find a mixed evidence about productivity spillovers, at the same time emphasizing, that host country characteristics could also play an important role, for example the country's absorptive capacity or its relative backwardness.

The empirical research in transition economies about productivity spillovers brings a rather mixed evidence. Djankov and Hoekman (2000) in their analysis of impact of foreign firms on the productivity of Czech firms between 1992 – 1996 on firm-level data show that both joint ventures and FDI have negative spillovers on local firms without foreign ownership. When they analyzed FDI alone, they found out that the spillover effects become less significant and smaller. Another study of firms in the Czech Republic between 1995 and 1998 by Yuko Kinoshita (2001) supports to some extent conclusions of Djankov and Hoekman in that Kinoshita does not find on average any positive technology spillovers on local companies, with the exception of electrical machinery and radio & TV sectors, where positive spillovers were found. This led to his considerations about the importance of absorptive capacity for creation of spillover effects.

Study by Damijan et al. (2003) which focuses on a number of transition economies⁴² brings slightly different results. On the one hand, they came with a surprising finding that in the Czech Republic in the analyzed period, foreign affiliates were lagging behind the local companies in terms of total factor productivity. On the other hand, the authors found significant (but fairly low) positive horizontal and vertical spillovers on local companies in the Czech Republic and Slovakia. One of their main findings is that on average in the countries analyzed, the most important productivity spillovers

⁴² Eight countries involving Bulgaria, Czech Republic, Estonia, Hungary, Poland, Romania, Slovakia and Slovenia.

are provided by the foreign company directly to their affiliate, and these spillovers are larger by about factor 50 than is the impact of backward linkages of FDI and by about factor 500 larger than the impact of horizontal linkages of FDI.

In addition, the impact of vertical spillovers is more important than that of horizontal spillovers, by about factor 10. They suggest that this fact might be explained by foreign firms' ability to protect their capabilities from competing local firms, but also by the research technique used to explain horizontal spillovers. The authors also do not find support for propositions of importance of innovation capability and absorptive capacity for positive spillover effects in the Czech Republic, which is contrary to findings of Kinoshita. However, they found out that in case of Slovakia, this absorptive capacity of local firms played an important role in spillovers.

From the empirical research so far, it is not possible to make a clear conclusion about productivity spillover effects of foreign firms on local domestically-owned companies. Among other analyzed spillover effects were wage and export spillover effects, but these were analyzed only marginally and not in transition economies. Recently, a paper was written by Ayyagari and Kosová (2006) which focuses on entry spillovers, or in other words on influence of IFDI on domestic entrepreneurship in the Czech Republic.

In this paper, the authors compare two possible effects of foreign investors on local companies – *entry barrier effect*, which means that foreign investors raise barriers to entry, particularly technological barriers - and thus prevent local companies from entering the market; and *demand creation effect*, which on the contrary to the previous means that foreign invested companies create new business opportunities for local companies. They show that foreign presence leads to positive spillover effects on the entry of domestic firms. In addition, they find out that spillover effects through vertical backward and forward linkages are of a much higher magnitude than horizontal spillover effects; while the 10% increase in foreign presence leads to 9.4% entry rate in backward domestic suppliers, and 13.1% entry rate in forward domestic suppliers, it leads only to 1.6% increase of local firms in horizontal relation with foreign invested companies.

Similarly to conclusions of other papers, Ayyagari and Kosová emphasize that results also vary with the type of industry – spillover effects are much stronger in services

sector than in manufacturing. In fact, there are no significant positive spillovers in latter and the authors suggest that this might be due to high entry barriers in manufacturing. Also, whereas horizontal intra-industry spillover effects exist mainly in uncompetitive industries, in competitive industries vertical inter-industry spillovers prevail.

4.1.2.3 Influence of foreign investments on host economies

On the macroeconomic level, IFDI can positively influence the level of aggregate investments and balance of payments of the economy, unemployment rate in the country and the structure of economy (Brada et al., 2000). Benáček (2000) also adds that IFDI improve institutional system of host economies. In addition to increased competition, foreign investors can serve as an indicator of success of reforms and stability of host economies and thus draw attention of other potential foreign investors. In tough competition for foreign investors, as the one which has been observed in the CEE region, local governments can be motivated or even forced to create more advantageous local conditions. Benáček suggests that in this respect, IFDI can be considered to be public goods with vast externalities.

One of potential negative effects of IFDI on the host economy as a whole is their uneven regional distribution, which can lead to development of dual economy also in terms of regions or increased regional instability. The gap which usually exists between the more developed and less developed regions can be then further increased. Such a development can be potentially avoided by government policies, which would improve the conditions in the less developed regions in terms of infrastructure connection, industrial parks or provide investment incentives to foreign investors which would come to these regions.⁴³

To conclude this subchapter, empirical research in some areas (such as spillovers) is still limited but it can be concluded that there are numerous ways how host economies can benefit from the presence of foreign investors. As Benáček (2000) points, majority of the potential negative effects belong to common problems of open economies which accompany their economic dynamics and relocation of factors of production; often the effects are connected with creative destruction.

⁴³ For more on this topic, see for example Pavlínek (2004) or Jánošíková (2005).

4.1.3 Indirect OFDI

Another way, through which IFDI can influence the level of OFDI are the so-called indirect OFDI. They occur when a company with a foreign owner, which is incorporated in a particular economy, is used a "springboard" for further investments of the owner abroad. Since in such cases, these foreign invested companies also invest abroad, whether due to their economic success or due to the strategy of their foreign parent, they also belong to OFDI. And since their controlling ownership stake is in foreign hands, they are called indirect OFDI.

It is difficult to quantify the amounts of indirect OFDI. There is an academic discussion about the criteria for OFDI to be considered indirect OFDI, since the majority ownership stake of a foreign owner in a company does not necessarily mean that the foreign owner controls or initiates the strategy of the subsidiary to invest abroad. Antaloczy and Elteto (2002) consider control to be the criterion, and the fact that strategic decisions about investments are made abroad. For example in their estimate of the amount of Hungarian indirect OFDI, they use the argument of "gold share" which the Hungarian state retained in some of the strategic companies, which were otherwise majority foreign owned and which made investments abroad, to argue that these were not indirect OFDI.

Bohatá and Zemplerová (2004) attempted to quantify the volume of indirect OFDI in the sample of Czech firms. In 1999, as much as 75% of the analyzed firms were small- or medium-sized enterprises with Czech majority owner. Out of 360 companies which invested abroad in this year, 70 were foreign-owned but at the same time, these indirect investors belonged to those with the highest invested volumes.

4.1.3.1 Estimate of Indirect OFDI in the Czech Republic and Slovakia

The data provided by the CNB or the NBS do not involve share of foreign- or domestically-owned OFDI, or the number of companies with foreign or domestic ownership, not to speak about control in foreign invested companies. Since the data of specific companies investing abroad collected by the CNB or the NBS were also not available and in press, only the most outstanding investments are mentioned, it

was also not possible to make a more detailed case-by-case analysis. We thus only analysed sectoral statistical data of IFDI and OFDI to see, whether there might be some trends which suggest relationship between IFDI and OFDI in specific sectors and thus existence of indirect OFDI.

In the Czech case, all the sectors with the highest volumes of OFDI as of 31.12.2004 are still in the Stage 2 of IDP, which means that IFDI reach much higher levels than OFDI. The CNB publishes a more detailed sectoral structure of manufacturing FDI than the NBS and it is thus possible to involve in the comparison also the most important manufacturing subsectors.⁴⁴ Figures in the Appendix 9 depict the volumes of Czech IFDI and OFDI in different sectors and subsectors as of 31.12.2004. It can thus be seen that more than half of the sectors occur in both the major IFDI and OFDI sectors – it is the case for financial intermediation which is in both cases the sector with the highest volumes; trade and repairs; real estate and business activities; electricity, gas and water supply; petroleum, chemical, rubber and plastic products; food products and manufacturing of other non-metallic mineral products. Although it is not possible to conclude that high volumes of IFDI and OFDI in certain sectors mean that OFDI might be indirect, it is a suggestive fact which could lead to further, more detailed research of these sectors.

In case of the Slovak Republic, no analysis about direct or indirect OFDI has been done yet and the data provided by the NBS are not so detailed as those provided by the CNB for the Czech Republic. We can thus only see general tendencies in the sectoral structure⁴⁵ - manufacturing represents the highest volumes of both IFDI and OFDI, followed by financial intermediation in both cases. Among the seven most important sectors in both IFDI and OFDI are also trade and repairs; mining and quarrying and electricity, gas and water supply. If we wanted to conclude that more detailed research of certain sectors might be useful, as has been done in the Czech case, a more detailed data of the structure of manufacturing IFDI and OFDI would be needed.

⁴⁴ The sectoral division of the Czech OFDI presented in the chapter 3 did not involve a more detailed division of manufacturing subsectors. The reason for use of a more aggregated division was comparability of such a data with the data provided by the NBS about Slovakia. In this section, a more detailed structure involving manufacturing subsectors, is useful and thus is used it in addition to the original one.

⁴⁵ Sectoral structure of IFDI to Slovakia can be found in appendix 10.

4.2 OFDI and government attitudes and government support

In the chapter 4.1.1, we compared the factors influencing inflows of IFDI in the Czech Republic and Slovakia. This comparison, in addition to showing which factors led to latecomer position of Slovakia in IFDI, also yielded an overview of home country conditions for local companies of the two countries. These belonged to the first three groups of UNCTAD division of home country drivers – market and trade conditions, costs of production and local business conditions. The purpose of this chapter is to cover the last one, home government policies.

4.2.1 General attitude towards OFDI

As has been mentioned in the theoretical overview, Kalotay (2004) orders government policies *vis-à-vis* OFDI into three stages: capital account liberalization, passive investment promotion and active investment promotion. The first stage has been almost on the same level, however, the Czech Republic was thanks to OECD requirements faster in implementation of capital account liberalization than Slovakia. In both countries, investments abroad were at the beginning of economic transformation subject to a case by case approval. This situation has been changing due to the gradual capital account liberalization. Nowadays, most of restrictions on capital flows are eliminated. Foreigners do not need to apply for approval, except in banking and insurance and at the same time, capital export and outward foreign direct investments are liberalized, reporting of investments is done only for statistical purposes.

In passive investment promotion, the Czech Republic has been more initiating than Slovakia. At the end of 2005, the Czech Republic had 79 bilateral investment treaties (BITs) and 73 double taxation treaties (DTTs), whereas Slovakia had only 44 BITs and 59 DTTs.⁴⁶ The Czech Republic occurs on the 12th position in the number of concluded BITs and on the 21st position in the number of concluded DTTs worldwide. Slovakia is on the 40th and 34th position, respectively (UNCTAD).

As has been already specified in the text above, active investment promotion can take many forms. Services of supporting institutions (e.g. development finance institution or an outward investment promotion agency) can be restricted to providing

⁴⁶ For a more detailed development of the number of treaties see appendix 8.

of information and trainings but can also offer financial assistance, in form of insurance or guarantees, preferential loans, equity finance, export credits or tax incentives.

Since active promotion can cover many areas, its comparison in the two countries is not so straightforward. In our research, we have also encountered the fact that the level of active promotion in different transition economies differs more than the capital account liberalization and passive investment promotion and these differences seem to be correlated with levels of OFDI in the specific countries - the frontrunner Hungary has been more active than the Czech Republic, Slovakia or Poland. Comparison of the active investment promotion in the following part thus covers not only the Czech Republic and Slovakia, but Hungary and Poland have been involved as well, to have a more complex picture about the situation in these two countries.

4.2.2 Active promotion of OFDI

Czech Republic⁴⁷

Financing of OFDI can play an important role in the decision-making of firms whether to invest abroad and what should be the size of the investment. Such a support might be decisive for small and medium enterprises in particular.⁴⁸ In the Czech Republic, there are currently two agencies offering products for outward foreign investors – the Czech Export Bank (Česká exportní banka, CEB) and the Export Guarantee and Insurance Company (Exportní garanční a pojišťovací společnost, a.s., EGAP).

The CEB provides a long-term financing of investments abroad to Czech corporate entities or foreign corporate entities, in which Czech corporate entities have capital participation. The purpose of the financing is to support activities of Czech entrepreneurs aiming to establish and develop business abroad or already existing foreign subsidiaries (Proposal of export strategy of the Czech Republic for 2006 – 2010⁴⁹). This product has been offered to Czech companies investing abroad for

⁴⁷ This section, if not stated otherwise, was based on the e-mail from Ing. František Nepraš.

⁴⁸ In an interview focused on explaining the new Czech export strategy, a representative of the Czech Ministry of Industry and Trade emphasized the importance of support for small- and medium-sized enterprises which usually have more difficult access to financing. Thus they are considered to be a priority group in terms of provision of finance. Source: “České firmy musíme ve světě podpořit kvalitnějšími službami.”, Právo, 28.11.2005

⁴⁹ Návrh exportní strategie České republiky pro období 2006 – 2010, a document which we obtained as an attachment to the email from Mr. Nepraš

a couple of years already.⁵⁰ Originally, it was offered only for transactions, where the debtor was a Czech corporate entity. The current situation is that it can also be given to foreign corporate entities, has been valid only since 2004.

Mr. Nepraš of the CEB suggested that in the portfolio of the CEB has always been only a small number of transactions of OFDI financing.⁵¹ However, these operations have in most cases been of medium to large volumes, which means that their weight in the total portfolio of credits of the bank has been relatively larger than their number would suggest. In the last couple of years their volume reached about 2 billion CZK of countervalue, which means they create 10% of the credit portfolio of the CEB.⁵² The long-term financing itself is aimed to provide supported capital for establishing, acquiring or increasing the share of the investor in a foreign entity, or for the purpose of expansion of business activities of this foreign entity. The period for the credit to be paid back is at least three years. The investment can take a form of cash funds or other assets which can be assessed in cash means⁵³ and property rights⁵⁴.

The structure of financing of an investment abroad can take for example the following two forms:

1. A Czech company has won a privatization tender on a couple of energy resources in one post-communist country. The acquired energy resources are now owned by the Czech company through its foreign subsidiary, established for this purpose. The investor is thus the Czech company, the debtor (i.e. the entity which will receive funds to pay for investment, that is the purchase price of the energy resources) is its foreign subsidiary, which will also pay the credit back from the revenues from sales of electricity.
2. A Czech company which established a subsidiary in one post-communist country – a joint ventures which is a legal entity. This subsidiary has acquired a licence on production of ceramic materials and will run a factory to proceed these materials. Financing of the construction of the factory was provided by the CEB. In this case, unlike in the previous, the debtor will be the Czech company,

⁵⁰ UNCTAD mentions that in 1999, the CEB reported having an investment guarantee scheme.

⁵¹ In 2005, there were 4 such transactions pending.

⁵² In terms of the territorial structure, post-communist countries are mostly the target of the investments co-financed by CEB.

⁵³ such as goods and services

⁵⁴ such as intangible assets in the field of intellectual property, receivables and legal interests (such as mortgages or collaterals).

which will lend the funds to its foreign subsidiary. The revenues from sales of the ceramic materials will serve to pay back the debt of the Czech company (when the receivables from the future sales of this product are used as a collateral to the CEB for the credit provided to the Czech company). Furthermore, some more collateral is provided to the CEB in form of some objects of the subsidiary.

In these two credits, the CEB bears the risk of its client-debtor, but also the risk of the project, the successful realization of which is a necessary condition for the repayment of the credit. Thus one of the necessary conditions is that the credit has to be insured against credit risks (in addition to providing collateral), where the debtor is the entity insured but beneficiary of insurance settlement is the CEB. The institution providing insurance services to investors is the EGAP. The conditions in the insurance contract with the EGAP even influence the amount and conditions of the credit from the CEB.⁵⁵ The insurance offered by the EGAP covers the situation of the following risks (www.egap.cz):

- precluding of transfers of revenues from the investment
- expropriation
- politically motivated violent destruction

Again, the insured investments must be long-term, at least for three years. Interestingly, the EGAP pays attention to environmental issues, the investor has to provide information about environmental impact of his investment on the host economy, in case this impact might be negative, the EGAP can refuse to provide insurance to such investments.⁵⁶

To conclude, in the Czech Republic has existed a scheme for financing of OFDI, based on a cooperation of two state-owned institutions. The CEB provides financing as such, to a relatively small number of companies. The EGAP insures against different risks which can investors face in the host economy and this way at the same time provides one of the necessary conditions for the investor to obtain financing from the CEB.

⁵⁵ They do not necessarily need to be provided by EGAP, investor can also provide insurance of similar parameters, in case the insurance cannot be according to the law provided by an export insurance company (www.ceb.cz)

⁵⁶ EGAP also does not provide insurance for production of weapons, hazardous or highly speculative projects and for production of narcotics and psychotropic substances.

Slovakia

In the Slovak Republic, the provider of financial services to outward investors is Eximbanka, an institution similar to the CEB. However, services of Eximbanka are restricted to insurance services only, covering risks of precluding of transfers of revenues from the investment, expropriation and politically motivated violent destruction (www.eximbanka.sk). These are thus products, which are in the Czech Republic provided by the EGAP and they are identical in most of the conditions, under which the investor can obtain the insurance. There is no product similar to credits to investors provided by the CEB.

Poland

As far as we have been able to find out, there is no outward investment promotion scheme in Poland, there is even no insurance scheme for investments abroad.⁵⁷ Kalotay (2004) suggests this might be due to the fact that either local firms have not reached the stage where they would decide to invest abroad, or because the market in Poland is relatively large for the companies to find demand and opportunities to expand without going abroad or because of labour force slack which means there is sufficient workforce to expand the production at home.

Hungary

As we have seen in the chapter 2, Hungary is the leader in terms of OFDI among Visegrad countries and close to being a leader from the post-communist countries. This holds for institutional support of outward investors as well. In addition to the political risk insurance scheme provided by the Hungarian Export Credit Guarantee Corporation (www.mehib.hu), there is a specific institution, Corvinus International Ltd. which is the only institution of such kind in the Visegrad region.

Corvinus⁵⁸ was established as early as 1997, as a state-owned development finance institution to co-finance Hungarian investments abroad. Today, the sole shareholder of Corvinus is the Hungarian Development Bank and its share capital in Corvinus is

⁵⁷ We have found only export credits or export insurance (e.g. www.kuke.com, www.bgk.com), however, nothing similar to OFDI schemes in other Visegrad countries.

⁵⁸ The following two paragraphs are based on the webpage www.corvinus.hu

15 billion HUF (cca 59 mil. EUR). The portfolio of financing services covers equity investments⁵⁹, shareholder loans, shareholders' surety and advisory services.⁶⁰

The whole process of financing is based on investments of Corvinus into equity of foreign ventures owned by Hungarian companies for a given period of time and with an agreed return. General rule is that Corvinus invests into small- and medium-sized enterprises, with an upper limit of 1 million EUR, to acquire a stake 10 to 49 per cent. Exceptionally, higher investments can be made upon the approval of the Board of directors. In the invested company, the management rights remain with the investment partner, Corvinus has minority rights to be able to exercise control over the jointly-owned company. The necessary condition is that Corvinus together with its Hungarian investment partner must dispose of a majority or controlling position in the invested company.⁶¹

In this sense, Hungary is well before other Visegrad countries and it can be argued that existence of such a scheme means a great competitive advantage for Hungarian outward investors, particularly small and medium-sized enterprises in comparison with companies in other Visegrad countries. To what an extent existence of such an institution contributes to Hungarian leading position in volumes of OFDI is a question of a more detailed research.

It can be concluded that the Czech Republic is the second among the Visegrad countries when we consider services provided to OFDI. It is lagging behind Hungary significantly since there is no structured scheme for support of OFDI, including also other services besides financing.⁶² Also, the Czech scheme focuses on investments of bigger volumes rather than on small or medium-sized enterprises, where its impact on OFDI would be different. On the other hand, Czech investors are better-off than Slovak investors, for which only insurance services exist and Polish investors who seem not to have any support from the state.

⁵⁹ Involving programs "Capital investments for foreign investments", "Carpathian region capital program", "Capital program for internationalisation of SMEs" and "Individual capital investments".

⁶⁰ Antaloczy and Elteto (2002) have an evidence from the sample of firms they questioned that some companies have mixed feelings about Corvinus, not wanting a third party to be involved in their investments or not trusting this company specifically.

⁶¹ Among the projects undertaken, as mentioned in UNCTAD (2001), are investments into a Romanian bakery, a Romanian electrical engines and spare-parts production plant, a Slovakian dairy factory, a Chinese fruit processing plant, a Slovakian timber firm, and a Romanian timber firm.

⁶² and which would play a similar role as Czechinvest for IFDI

4.2.3 Changes in the attitude towards OFDI in the Czech Republic

We can recognize a movement towards a model of OFDI support similar to Hungarian. The only remaining difference is that in the Hungarian case, financing of OFDI is covered together with other information and support services (except for insurance) under one agency. Although in the right direction, this initiative comes nine years after Corvinus was established in Hungary.

The recent upsurge of OFDI has led to reevaluation of the Czech strategy towards OFDI, currently covered in the document Proposal of export strategy of the Czech Republic for 2006 - 2010⁶³. This document represents a move towards a more intensive and structured help to outward investors, in comparison with the Conception of pro-export policy 2003 - 2006⁶⁴. The project of increasing support of OFDI and acquisitions abroad was launched at the end of June 2006.

Among the most important changes in comparison with the strategy for 2003 – 2006 were the following elements: an active search and an offer of investment opportunities for the Czech companies, advising and assistance in diversification of production abroad and investment of Czech firms and improvement of availability of investment resources for quality investment projects. Except for financing by the CEB and the EGAP, there is no structured system for support of OFDI in the form as we know it for IFDI.⁶⁵ In the Export strategy for 2006 -2010, it is suggested that the capacities of the CEB and the EGAP should be connected with Czechtrade and a unified offer of services for Czech investors should be provided.

As is stated in the Export strategy, there are four groups of clients which will be targeted by the new strategy for support of investments and acquisitions:

1. financial investors – motivation of these investors is to increase yields of invested capital;
2. production investors – who want to support their price competitiveness by diversification of production (looking for investments in their field of business);
3. project syndicates – for example when such syndicates would be interested in joint projects of PPP projects;

⁶³ Návrh exportní strategie České republiky pro období 2006 – 2010.

⁶⁴ Koncepce proexportní politiky pro období 2003 – 2006. The comparison was done in the document Návrh exportní strategie České republiky pro období 2006 – 2010.

⁶⁵ Embodied by the Czechinvest agency

4. new entrants on the market – such companies for which it is more advantageous to enter the market in form of investment to sales or service network.

There are not many significant changes suggested in the area of financing of OFDI, since the cooperation of the CEB and the EGAP with investors has been working well in the last couple of years already. Novelty is that commercial banks should become more involved in the financing of OFDI, taking advantages of services of the EGAP. The CEB and the EGAP should remain to be "backbone institutions" for state-supported financing of OFDI.

The question remains open for speculation, what are the factors which determine whether a country comes up with a scheme for financing of OFDI or whether it launches such a scheme at all. Is it a level of OFDI? Is it an enlightened and forward-looking strategy of the government? With regards to the latest development in Hungary, we can also ask whether a strategy of a direct support is sustainable in the transition economies and whether a focus on fixing of a more stable macroeconomic environment should not be a priority. A deeper research would be also required to understand the impacts of OFDI on home economies and consequently to decide whether OFDI create such externalities that they deserve a direct support. Many questions arise here which would require much deeper research in terms of the way how investors other than those taking advantage of state-supported loans finance their investments, how efficient the state support is, is there any difference in success of companies who take advantage of state-supported financing and thus have to fulfill certain strict conditions and those investors who do not use it, etc.

In this chapter, we wanted to analyse factors which might have caused the latecomer position of Slovakia in comparison with the Czech Republic. We focused on two sets of factors – IFDI and government policies towards OFDI. We scrutinized three potential channels or rather ways, through which IFDI could have influenced OFDI, keeping in mind the situation that Slovakia was both a latecomer in IFDI as well as in OFDI and there might be some relation between these two facts.

First, we looked at factors which influence inflows of FDI to individual countries. The reason why we did this is that IFDI have been by many considered an indicator of

progress in economic transformation. Should there be a difference, lagging behind in the creation of market environment could have disadvantaged Slovak companies in comparison with Czech companies. We found out that Slovak governments were indeed lagging behind a creation of a business environment which would be beneficial not only for foreign investors but also for local companies, such as reforms of financial institutions and legal development. However, Slovakia in the recent years has done a great progress in reforms and belongs according to some among the most business-friendly countries in the world.

Not only have belated inflows of FDI indicated that Slovakia is not doing something right in terms of business environment, their late inflows themselves have contributed to belated flows of OFDI, through two channels. One of them is that IFDI have a great potential to influence the level of economic development and business environment - belated inflows of FDI have contributed to a slower progress in restructuring of companies (which was in the case of Slovakia made even more difficult due to complicated social situation). Also foreign affiliates in host economies can be used as a springboard for further expansion of foreign companies in the region, thus lead to indirect OFDI.

We found out that in many ways, the evidence about influence of IFDI on host economies is mixed. IFDI is first of all beneficial for the foreign invested companies. There is no clear evidence about positive productivity spillovers on local companies, but on the other hand, there is an evidence about positive entry spillovers, i.e. on creation of local companies, particularly through forward and backward linkages. From this, it can be concluded we can find many channels through which IFDI can have an impact on local companies and Slovak companies can be considered to have been disadvantaged by belated inflows of FDI.

Slovak governments have been also lagging behind in terms of a more direct support of OFDI. The Czech Republic has been ahead not only in passive investment promotion, but recently also in active investment promotion of OFDI. However, the financial support has been focused only on few large investments so it can be argued that it is not an important factor in the decision-making of companies aiming to invest abroad. It can be concluded that the Czech companies have had certain advantages over Slovak since more obstacles for investments abroad have been removed and a more pro-active policy for their support has been launched.

5 CZECH AND SLOVAK MUTUAL OFDI

The purpose of the following chapter is to analyse more deeply the mutual flows of OFDI from the Czech Republic and Slovakia. These two economies are for each other the most important destinations of OFDI. An often provided explanation for such a development is the proximity of the two countries, be it from geographical, historical or cultural perspective.⁶⁶ This explanation covers without any doubts important aspects in the decision-making of firms. The question which is raised in this chapter is whether this is the decisive factor or rather a supportive factor in considerations of firms and whether this closeness might also imply potentially negative aspects.

The issue of decision to invest rather than to use other forms of internationalization strategies is covered by the internalization subparadigm of OLI paradigm. This involves a number of theories which are not necessarily exclusive but rather approach the problem of internalization from different perspectives (Dunning, 2000). Orthodox internalization theory is based on the consideration of transaction and coordination costs, i.e. when these costs of FDI are lower than any other form of internationalization, the company invests in form of FDI. According to this theory, the geographical and cultural proximity and the knowledge of the economy can thus be seen as a factor which decreases transaction and coordination costs.

At the same time, the proximity can be considered to be an important factor for other forms of internationalization as well – many companies might for example decide to export directly from Slovakia to the Czech Republic rather than establish their subsidiary there, again due to geographical proximity, good infrastructural connection, similarity of languages, the factors which decrease costs of export in comparison with other countries as well. The explanation provided by orthodox internalization theory seems thus to be insufficient to account for high mutual flows of OFDI. A more detailed analysis of sectoral structure and a case study will provide us a better idea about potential motives of companies in their OFDI.

As has been shown in the statistical part, on the per capita basis, Slovak IFDI to the Czech Republic is even higher than IFDI per capita from the Czech Republic to Slovakia. One of the potential explanations of such a development can be sought in

⁶⁶ Examples of such explanations were provided in the chapter 2.

the limits given by the Slovak economy - one of the main reasons for Slovak companies to invest in the Czech Republic is the size of the market. A closer analysis of the structure of Slovak OFDI to the Czech Republic⁶⁷ shows that trade and repairs are only on the 3rd position after dominant manufacturing and industries connected with energy, gas and water. Market-seeking in terms of establishing a trade affiliation is thus not among the most important reasons with Slovak companies decide to invest in the Czech Republic. At the same time, market-seeking activities can take place through acquisitions of a manufacturing subsidiary or establishing production facility in the host economy.

However, this is a less straightforward way of materializing market-seeking motives for the local companies; it is not so much an increase of market for current production facilities, because the new production facility will service the market. The increase of the market could for example materialize in case the two production facilities complemented each other's production structure, rather than substituted. It can also be argued that due to higher input costs, efficiency-seeking will not play a significant role, too. The remaining two explanations are strategic-asset seeking and resource seeking motives for Slovak OFDI to the Czech Republic.⁶⁸

The following case study is an example of a Slovak manufacturing firm which invested in the Czech Republic. It will complement the statistical analysis in that it will provide us insights into motives of Slovak manufacturing investors in their investments to the Czech Republic and also of the advantages and disadvantages of the proximity of the two countries for such investments.

5.1 Case study⁶⁹

The company ŽOS Vrútky (ŽOSV) has had a long-time tradition with focus on modernization, repair and production of spare parts of train coaches. The company was privatized in 1994 and since then it has been privately owned by Slovak owners.

⁶⁷ This closer analysis of the Slovak OFDI to the Czech Republic was possible thanks to detailed data about OFDI from Slovakia to the Czech Republic provided by the NBS. The limitation of the data is in their time frame – they are available only for years 1997 – 2001. Despite of this limitation, we can trace certain interesting trends in OFDI flows from the Czech Republic to Slovakia. The data can be found in the appendix 4.

⁶⁸ Particularly the first motive, strategic-asset seeking is interesting in the light of Dunning's proposition (Dunning, 2000), that companies from countries in early stages of IDP tend to invest mainly due to market-seeking and efficiency-seeking motives.

⁶⁹ The case study is based on an interview with Ing. Viliam Dubovický, advisor to the CEO of the company ŽOS Vrútky.

In addition to its local activities, it is also active internationally. It is heading a syndicate with two Swiss companies – Stadler Fahrzeuge and Bombardier, producing electric and diesel-electric trains. The company has a very good position on the Slovak market, its main customer is a state-owned railway company with a monopoly position, Železnice Slovenskej republiky.

Similarly to ŽOSV, ŽOS Nymburk (ŽOSN) is also a rail vehicles repair firm, with production complementary to the portfolio of ŽOSV. Currently, the company employs 290 people and belongs to the most important employers in the region of Nymburk. Previously, ŽOSN was majority owned by a Swiss company, LT Trading ZUG, which owned more than 70% of shares. The situation of the company had been gradually worsening, until its biggest creditor filed a bankruptcy petition on the company at the beginning of 2004 due to high debts of the company. According to the information from press, the ŽOSN found itself in this situation since its Swiss owners were not paying back debts on time and they used to have their own train coaches repaired under price.⁷⁰

Despite of the bankruptcy proceedings, the company did not cease production and did not discharge employees⁷¹. Due to the long-term tradition, importance of the company as an employer in the region and also competitive production program, the bankruptcy trustee decided to sell the company as a whole to a new strategic partner. The process of search of a strategic partner was rather long, it lasted more than one and half years, due to ecological burden connected with ŽOSN and inability of the interested parties to find an acceptable solution to this issue. Finally, ŽOSV acquired ŽOSN via its Czech subsidiary as of 1st July 2005.

There were two main motives behind the investment of ŽOSV to ŽOSN.⁷² Most importantly, it was the complementarity of production activities of the two companies. ŽOSN disposed of technologies and complex production which fitted together well

⁷⁰ Source: “ŽOS Nymburk je v konkurzu, ale vyrábí dál i vyplácí mzdy“. (ZOS Nymburk is in bankruptcy proceedings, but it continues in production and pays also wages). CTK, 5.2.2004.

⁷¹ Significant number of employees had been already discharged in the period preceding the financial problems of the company. Source: “Jeden z největších zaměstnavatelů na Nymbursku hledá nového majitele“ (One of the biggest employers in the region of Nymburk is searching for a new strategic partner). Mladá Fronta Dnes, 26.6.2004.

⁷² It is important to mention that ŽOSN was not the first acquisition of ŽOSV in the Czech Republic. Earlier, ŽOSV acquired a company ČKD Smíchovské mosty, the production facility of which was later closed down and the production itself was moved to ŽOSV.

with the production portfolio of ŽOSV, and by connecting these two companies, the value of their joint know-how increased significantly. Another reason was that the Czech market is twice as big as Slovak in terms of railways. Since both companies have an advantageous position *vis-à-vis* their main customers – state-owned railway companies, ŽOSV in Slovakia and ŽOSN in the Czech Republic, the market increased significantly for both of them, in their particular production focus. Thus this investment can be classified to categories strategic asset seeking and market seeking⁷³.

Another important aspect was similarity of the two countries, be it from cultural, geographical or historical perspective. Similarity of languages enabled that the group of companies is managed centrally from Vrútky and every day, videoconferences take place. Majority of the senior management in ŽOSN comes from ŽOSV, many of employees responsible for technology or finance come also from ŽOSV and do not need to face language barriers. The new owner has thus better initial conditions for implementation of its corporate governance mechanisms. In addition to language similarity, the infrastructure involving both roads and railway connection of Slovakia with the Czech Republic is also advantageous. No smaller role is played by the knowledge of markets and their closeness, for example the still active contacts on the level of management.

The cultural similarity or differences between companies from different home economies can be divided into two levels – national culture and corporate culture (Weber et al., 1996). National culture can be structured according to Mičoch (1996) into a three-dimensional space of the ability to learn, inclination to collectivism or individualism and the question of existence of corruption and its acceptance in the society. Corporate culture has been defined as *"the beliefs and values shared by senior managers regarding appropriate business practices"* (e.g. Schein, 1985, quoted in Weber et al., 1996). Weber et al. (1996) on a study of a number of cross-border mergers and acquisitions conclude that differences in the national culture predict better the stress, negative attitudes towards the merger and actual cooperation than corporate cultures. At the same time, this does not downplay the importance of corporate culture – according to the authors, both are an important factor influencing process of mergers and their outcomes and this should be taken

⁷³ The increase in the market for ŽOSV could materialize thanks to complementarity, rather than substitution of production of the two companies.

into account in all the stages of transactions in order to accomplish them successfully.

As will be seen on the case study presented in this thesis, a cultural proximity on the national level does not necessarily mean also proximity in terms of corporate culture. Corporate cultures of the two companies differed significantly from each other. Different experience with economic transformation, different ownership structure and financial situation can lead to corporate culture differences which can be costly for the new owner despite of the proximity of national cultures. Convergence of corporate cultures requires not only determination of senior management which came in this case from the parent company, but gaining of trust of employees who after the period of insecurity, disappointment from the previous foreign owner and lacking discipline had to be persuaded that the new management means it seriously.

ŽOSV took over the company with all of the 290 employees claiming that they were planning to retain the production programme together with the current level of employment. The acquisition itself was connected with the necessity to co-ordinate operation of the two companies. One of the most important issues was to enhance the production efficiency in ŽOSN. The company had been in bankruptcy procedure for some time and the organization of work was inadequate. The company suffered from lack of discipline of workers, many of highly qualified workers and employees had left the company, also the capital and technologies were to a great extent obsolete.

ŽOSV started implementing their corporate culture together with a stricter supervision of production process. An important aspect of the whole process was to persuade the workers after the bad experience with the Swiss owner that ŽOSV meant to stay in the company for the purpose of its proper functioning. This has been done through investments to facilities not connected directly to production but serving for the workers, such as canteen. This way, the new owner gradually earned the creditability in the company. The presence of a new strategic partner brought results relatively quickly. Within one year, ŽOSN was stabilised in financial terms and ŽOSV also brought to the company new customers.

Another important aspect which arises in cross-border mergers in economies which are so close as the Czech and Slovak, is whether this proximity can have also

potential negative effects. The common historical experience of the two countries with centrally planned economy which belonged to the most rigid can lead to questions whether this common experience does not influence negatively the merger in comparison with what the situation would be with a foreign investor from a developed economy. The relative freshness of experience with market economies, the still developing models of corporate governance or restructuring still going on to some extent, might disadvantage local investors in comparison with those from fully-fledged market economies. This historical proximity and common experience might not allow the potentially beneficial restructuring of companies after the entry of a strategic foreign investor to take place, since the parent company might come from a similar environment and some patterns of behavior incompatible with fully-fledged market economies might survive.

This drawback can be shown on OFDI from the early years of economic transformation. As mentioned in the chapter 3, many outward direct investments from transition economies at the beginning of transformation were not successful due to lacking capital, experience or knowledge of host economies. Nowadays, the situation might be different already. In our case study, ŽOSV has experience with a long-term successful cooperation with foreign partners, the company is even the head of a consortium of ŽOSV and two other Swiss companies. ŽOSV has been privately owned since 1994 by the same owners who managed to restructure originally state-owned company to a successful corporation which has been forced due to smallness of its national market to expand abroad.

It can thus be argued that potential disadvantages of investors from post-communist economies in that they might lack some experience with developed economies necessary for successful investments abroad have been already to a great extent overcome thanks to experience with foreign partners or foreign invested companies. Additionally, the increasingly favourable business environment, particularly in Slovakia, motivates managers and owners to carry their businesses more properly, in line with the market behaviour, since they do not need to search for ways how to rely on state support, avoid rules or optimise taxation.

The answer on the question whether ŽOSV considered or even took advantage of support from side of the Slovak government, was that the behaviour of Slovak government was rather unsatisfactory. The company received no support in terms of

finance, guarantee or advice, but it is important to say, that the managers did not plan to apply for support. In addition to that, Slovak government has been also lagging behind in terms of indirect support, such as development of infrastructure – be it highways, railways or airlines. Positive side of government activities has been organisation of meetings of entrepreneurs and companies from both countries, which creates the platform for information sharing and better knowledge about conditions, development and opportunities on the both markets.

To summarize findings of the case study, one of the decisive factors for the decision of ŽOSV to invest abroad was the cultural proximity and good knowledge of the business environment in the Czech Republic. This was helpful not only during the phase of decision-making and initial phases of transaction and entry of the investor, but has played an important role due to ability of Slovak owners to govern the company centrally on a day-to-day basis and apply more easily new corporate culture. The transaction costs of the takeover but also every day operation and governance of the Czech subsidiary are smaller than would likely be in a different country.

The Slovak company saw an opportunity of an acquisition of a distressed company in the Czech Republic, which was similar in terms of production structure and well-established on the local market and thus chose the mode of entry through foreign direct investment rather than through exports on the Czech market. In addition to market seeking motives, ŽOSV also gained a strategic asset in terms of increased value of know-how of the joint group of companies with complementary production. This would not be achieved through other form of internationalization of ŽOSV.

This case supported findings of the statistical analyses, that strategic-asset seeking is an important motive of Slovak companies investing in the Czech Republic, alongside with market-seeking due to limitations of the small market in the home economy. At the same time, we have shown that cultural proximity can be considered to be among the factors working in favour of internalization aspect of OLI paradigm; the transaction costs of acquisition from a similar environment are lower and thus the penetration to this host economy through direct investment is more likely than might be to other host economies, ceteris paribus. However, differences in corporate

culture developed through different experience with economic transformation or different ownership can be for the investing company costly and can represent an obstacle in internalization. Although the common historical experience with centrally planned economies might potentially negatively influence the success of these investments, we believe that companies in both economies already have experience with market economies thanks to which they should be able to avoid many mistakes which companies used to do at the beginning of economic transformation.

6 CONCLUSION

The purpose of this thesis was to contribute to a rather limited knowledge about OFDI from transition economies. OFDI in these countries have been a recent phenomenon and have not received much attention from academicians or policymakers, due to their relatively small volumes but potentially also due to their political and social sensitivity. However, the theory and experience of developed and many developing economies suggest that OFDI play an important role in the internationalization of domestic companies and with the increasing level of economic development, their volumes tend to equalize or overtake volumes of IFDI.

At the core of the thesis was a comparison of OFDI development in two countries, the Czech Republic and Slovakia. Slovakia has been lagging behind the Czech Republic not only in the in the flows of OFDI but also in the level of economic development and in the inflows of FDI. Although this might seem to be easily explained by the Investment Development Path framework, we considered such an explanation unsatisfactory and aimed to find out what underlies such a development and what is the mutual relationship between these three variables (IFDI, OFDI and the level of economic development). The proximity of the two countries, be it geographical, historical or cultural, and at the same time different development of OFDI, provides a great opportunity to deepen our understanding of determinants of OFDI in transition economies.

The analysis of the Investment Development Path of the two countries shows that both countries are in the Stage 2, in both of them, the rate of growth of FDI inflows is still higher than the rate of growth of OFDI outflows. The stocks of Czech OFDI are higher though, both in absolute terms and on a per capita basis. The analysis of the sectors with the highest volumes of OFDI in both countries shows, that these individual sectors are also in Stage 2 of economic development, however, some of them might soon move to the Stage 3, in which volumes of OFDI overtake IFDI.

A closer analysis of the data reveals that Czech and Slovak OFDI are not only different in volumes and timing, but also in sectoral structure and main geographical destinations. While Slovak companies invest mostly in the region of Central and Eastern Europe and in manufacturing, Czech investors focus more on services and the highest volumes flow to developed countries. Another interesting finding is that

the highest volumes of OFDI from the Czech Republic flow to Slovakia and from Slovakia to the Czech Republic and at the same time, the Czech Republic is a relatively more important destination of Slovak investments than *vice versa*. Our aim was to shed more light on the reasons why Slovakia is a latecomer in OFDI and what lies behind the differences between the Czech and Slovak OFDI.

The research was focused on two sets of factors, which might explain the latecomer position of Slovakia in terms of OFDI. The first were IFDI themselves, which can firstly serve as an indicator of progress in economic transformation and thus might reveal some determinants which are common for their belated inflows of FDI and for belated flows of OFDI. Slovak governments were indeed lagging behind in a creation of a business environment which would be beneficial not only for foreign investors but also for local companies, such as for example reforms of financial institutions and legal development. However, Slovakia in the recent years has done a great progress in reforms and is considered to be among the most business-friendly countries in the world. We expect that this will be reflected in increased rate of growth of flows of OFDI in the coming years.

Secondly, IFDI not only react on the level of economic development, they also have the potential to influence it positively. In transition economies, they have been considered to be one of the main engines of economic growth. Their positive impact is greatest on their affiliates and subsidiaries, in which they directly invest, but they also have a potential to influence other companies in host economies through spillover effects. Although the evidence about spillover effects in transition economies is still limited and not unambiguously positive, no proof of negative spillovers has been provided. For example, productivity spillovers have been found insignificant, but on the other hand, IFDI through demand creation support entry of local companies, particularly in the inter-industry relationships. It has also been shown in empirical studies that IFDI through cooperation with local firms belong to the most important factors influencing the development of corporate governance and corporate culture in transition economies. The Czech Republic has thus been ahead of Slovakia in terms of being exposed to and absorbing beneficial effects of the presence of foreign companies.

Thirdly, IFDI can in a more direct way influence OFDI, in case that foreign investing companies use their affiliates as a "springboard" for further investments in the region

- this phenomenon is called indirect OFDI. Since the information about ownership of companies investing abroad is not collected, we can only estimate how much indirect OFDI is from the overall volume of OFDI. However, such an approach would be very demanding since it would require a detailed knowledge of companies investing abroad. In some cases, it is possible to find sectors in which we can argue that due to one dominant investor, OFDI comes predominantly from domestic hands. An example can be investments of CEZ in the Czech Republic, which is majority state-owned and accounts for a substantial amount of OFDI in the Energy sector.

A less demanding, but also a less exact way is to analyse the relation between IFDI and OFDI on the sectoral level to see, whether some similarities in patterns of IFDI and OFDI exist. In the Czech Republic, the main target sectors for IFDI have been services and the same sectors, only in a slightly different order have also belonged to the frontrunners in terms of OFDI. A similar situation can be found in Slovakia, where the majority of FDI inflows as well as OFDI flows has been in manufacturing. Although this cannot be considered to be a straightforward evidence about the existence and prevalence of indirect OFDI, it might be perceived as an indication of a correlation between IFDI and OFDI in some sectors, and thus of existence of indirect OFDI. Additionally, should this correlation be proved significant in further research, it could contribute to the explanation of different structural and geographical focus of Czech and Slovak investors.

The analysis of IFDI has thus shown that the latecomer position of Slovakia in OFDI has been to some extent caused by its latecomer position in IFDI. Not only have belated inflows of FDI indicated shortcomings in the development of favourable business environment and their later increased inflows indicated significant positive changes in business environment, Slovak companies have also been to some extent handicapped since their more direct contact and experience with foreign companies has been delayed.

The second set of factors, which might influence the OFDI are government policies. These can be ranked from capital account liberalization, through passive investment promotion up to active investment promotion and at the same time, individual stages do not require the preceding stage to be complete. In terms of capital account, both countries are on the same level, what can be assigned to their membership OECD and requirements connected with it. In passive investment promotion, which involves

mainly bilateral investment and double taxation treaties, Slovakia has been lagging behind in the Czech Republic in the number of concluded treaties of this kind.

As for active investment promotion, the Czech Republic has been more active - local investors have the possibility to obtain not only insurance against circumstances in host economies, which is also provided to Slovak investors, but they can also obtain a credit. This scheme for financing resembles already to a certain extent the system of OFDI promotion in Hungary, a frontrunner in terms of OFDI from transition economies, where a specific agency has been established to support OFDI. However, in relation with the latest economic and political development in Hungary, feasibility of such a support can be questioned. Creation of a healthy business environment rather than direct support of specific companies might be more advisable, also in relation to the fact that adverse domestic circumstances can lead to relocation of companies to countries with more favourable conditions. This kind of OFDI has only limited potential to benefit its home economy.

Thus there have been some differences in terms of government support of OFDI between the Czech Republic and Slovakia; the former has been more active in the support of OFDI, particularly in recent years. In addition to a greater progress in passive investment promotion, the approach of Czech governments has been also changing in favour of active investment promotion of OFDI. However, the active financial support has been focused only on large investments and only on a few of them, so in the current extent, we do not consider it to be so important for Czech companies aiming to invest abroad. In general, gradual elimination of obstacles for investors has gone further in the Czech case, which can be considered to be a certain advantage of Czech companies over Slovak.

The subject of the last chapter has been a more thorough analysis of flows of OFDI between the Czech Republic and Slovakia. Such a detailed analysis was possible on the basis of detailed statistical data of Slovak OFDI flows to the Czech Republic provided by the National Bank of Slovakia and on the basis of a case study of a Slovak company which invested in the Czech Republic. The result was an interesting finding that an important motive of Slovak companies investing to the Czech Republic might be strategic asset seeking, which is a motive of companies from home economies in higher stages of Investment Development Path than is Slovakia. Companies from countries in the Stage 2 of Investment Development Path

tend to invest mainly from market-seeking and efficiency-seeking motives, which is not entirely the case of Slovak OFDI to the Czech Republic.

This was also the situation of the company ŽOS Vrútky, which acquired a company ŽOS Nymburk at the time when the latter was in bankruptcy, searching for a new strategic partner. The double size of the Czech market belonged to important considerations of owners of ŽOS Vrútky, but more importantly, through the acquisition of the Czech company with a complementary production, the value of the new transnational company increased significantly, thanks to the joint know-how. Nowadays, both companies are governed centrally from Slovakia and ŽOS Nymburk is to some extent managed by managers from the Slovak mother company.

The cultural and geographical proximity and common recent history of the home and host economies without any doubts decreased transaction costs connected with the acquisition and later also costs of the common governance of the transnational company, thanks to the common understanding. However, despite of this proximity, the new Slovak owner had to solve a situation of different corporate cultures – of a successful company and of a company in bankruptcy. At the beginning, managers from ŽOS Vrútky had to gain the trust of Czech employees and persuade them that they still saw a potential for recovery of ŽOS Nymburk and they also had to impose a stricter discipline in the company.

This case supported findings of the statistical analyses, that strategic-asset seeking is an important motive of Slovak companies investing in the Czech Republic. At the same time, we have shown that cultural proximity can be considered to be among the factors working in favour of internalization aspect of OLI paradigm; the transaction costs of acquisition from a similar environment are lower and thus the penetration to this host economy through direct investment is more likely than might be to other host economies, *ceteris paribus*. Despite of the closeness of national cultures, the Slovak investor has faced differences in corporate culture developed through different experience with economic transformation or different ownership. We have shown that these differences can be for the investing company costly and can represent an obstacle in the process of internalization. As for the common historical experience with centrally planned economies of the two countries, this might negatively influence the success of their cross-border investments. However, we believe that companies in both economies have already been exposed to mechanisms of market economies

thanks to which they should be able to avoid many mistakes which companies used to do at the beginning of economic transformation.

To conclude, we have argued that the latecomer position of Slovakia in OFDI has been to some extent caused by its latecomer position in IFDI. This is because IFDI have the potential to influence positively economic development and to promote economic restructuring in transition economies. In addition, Czech governments have created better conditions and removed more obstacles which Czech companies could encounter when investing abroad. The position of Slovak companies has thus been less advantageous in relation to OFDI and this fact has contributed to the latecomer status of Slovak OFDI. It has also been shown that cultural and historical ties can be an important factor in internalization considerations of companies, because these not only decrease transaction costs connected with acquisitions of foreign companies but also enable easier implementation of corporate governance and corporate culture practices of mother companies which are another factors important for success of foreign direct investments of companies.

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INTERVIEWS / E-MAILS

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E-mail from Ing. František Nepraš from the Department of Export and Project Financing of the Czech Export Bank - December 6, 2005, Prague.

8 APPENDICES

Appendix 1: The per capita Stock of IFDI and OFDI in Selected Transition Economies

Appendix 2: Comparison of the IFDI and OFDI stocks of the Czech Republic and Slovakia in absolute terms

Appendix 3: Czech OFDI in numbers

Appendix 4: Slovak OFDI in numbers

Appendix 5: Comparison of EBRD Transition Indicators

Appendix 6: Indicators of Macroeconomic Environment in the Czech Republic and Slovakia

Appendix 7: Labour costs

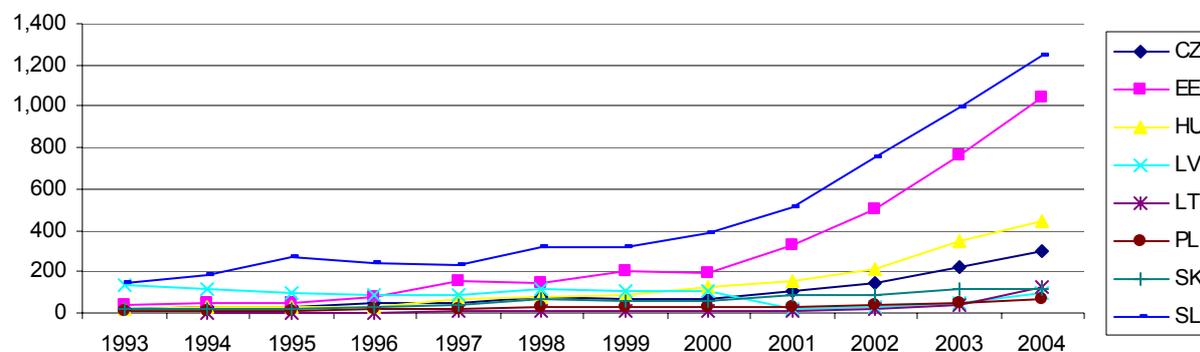
Appendix 8: Passive Investment Promotion

Appendix 9: Sectoral structure of IFDI and OFDI to the Czech Republic

Appendix 10: Sectoral structure of IFDI and OFDI to the Slovakia

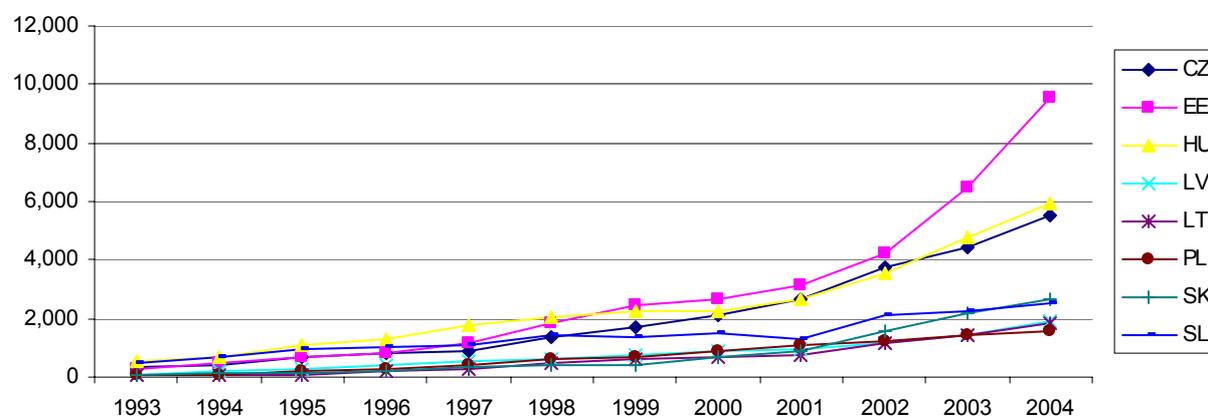
APPENDIX 1: THE PER CAPITA STOCK OF IFDI AND OFDI IN SELECTED TRANSITION ECONOMIES

Figure 13: The per capita Stock of OFDI in Selected Transition Economies (USD)



Source: Author's calculations based on the data from UNCTAD

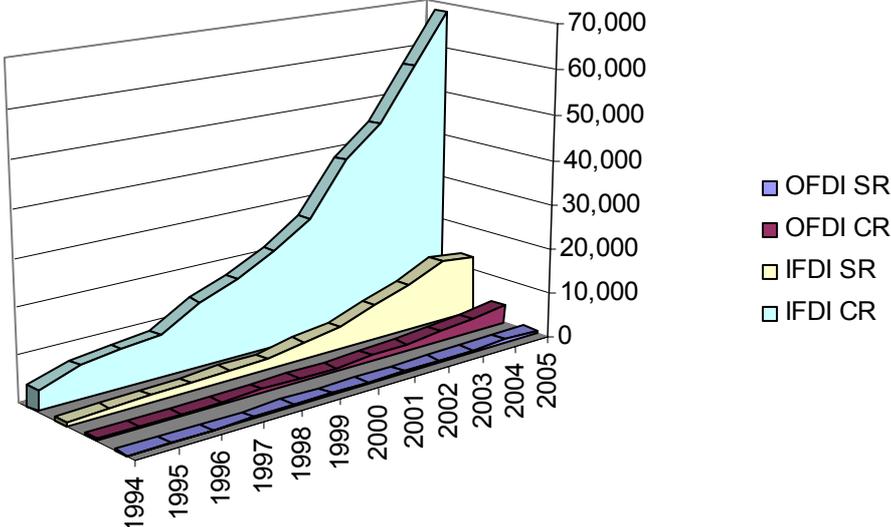
Figure 14: The per capita Stock of IFDI in Selected Transition Economies (USD)



Source: Author's calculations based on the data from UNCTAD

APPENDIX 2: COMPARISON OF THE IFDI AND OFDI STOCKS OF THE CZECH REPUBLIC AND SLOVAKIA

Figure 15: IFDI and OFDI stocks in the Czech Republic and Slovakia



Note: The Czech data for the year 2005 are only preliminary and were obtained by adding the flow data about the IFDI inflows and OFDI outflows in 2005, to the stock data as of 31.12.2004.

Source: Author’s calculations based on the data from the Czech National Bank and the National Bank of Slovakia

APPENDIX 3: CZECH OFDI IN NUMBERS

(Source: Author's calculations based on the data from the Czech National Bank and UNCTAD)

Figure 16: Investment Development Path of the Czech Republic

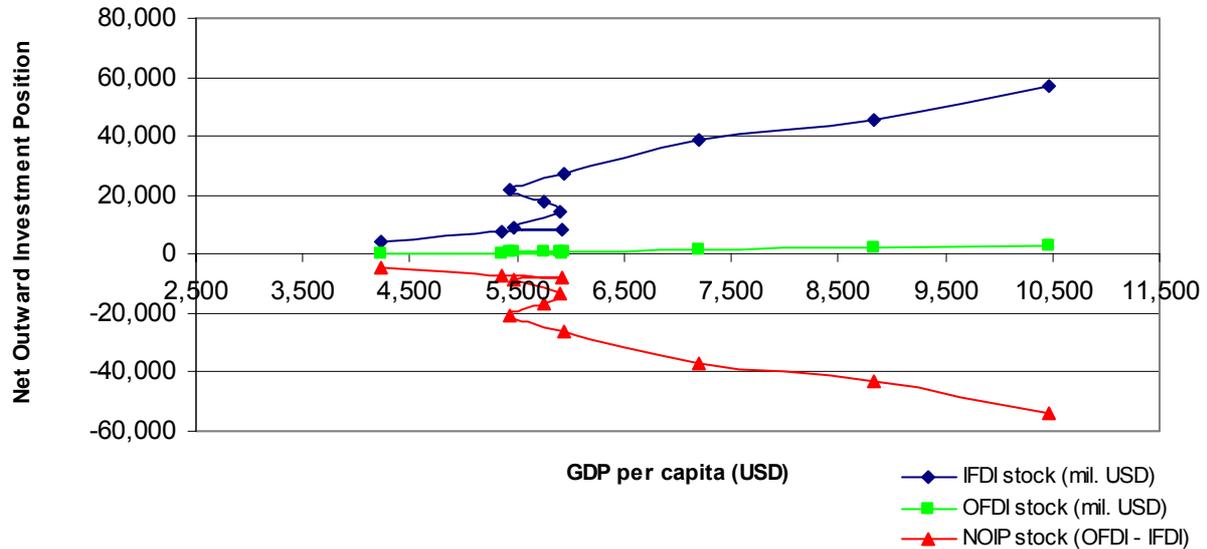


Figure 17: Structural IDP in financial intermediation

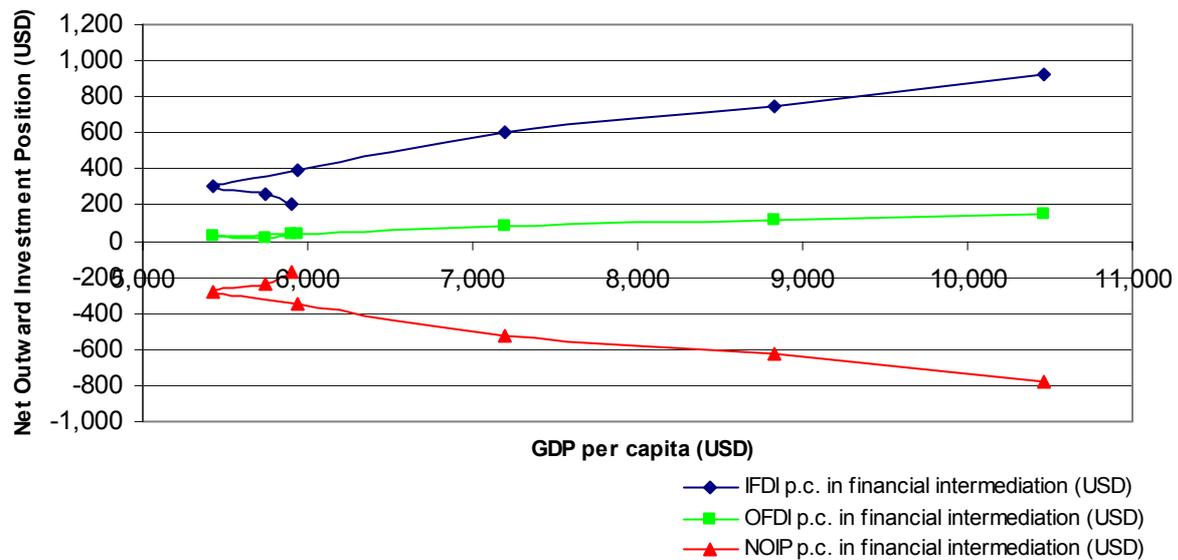


Figure 18: Structural IDP in wholesale and retail trade, repair of motor vehicles

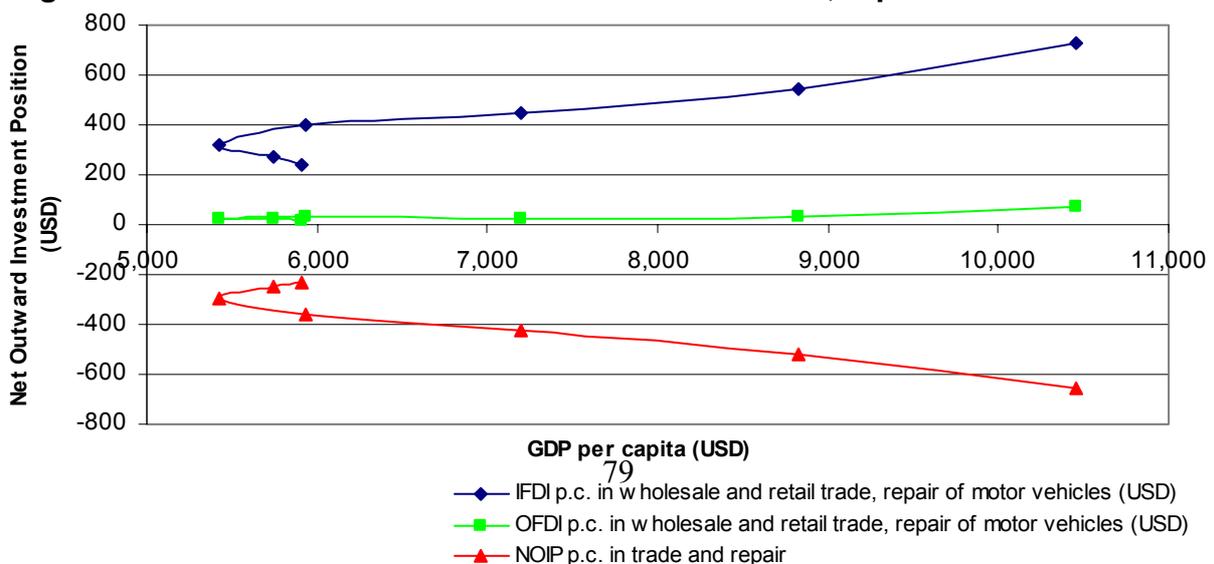


Figure 19: Structural IDP in real estate, renting and business activities

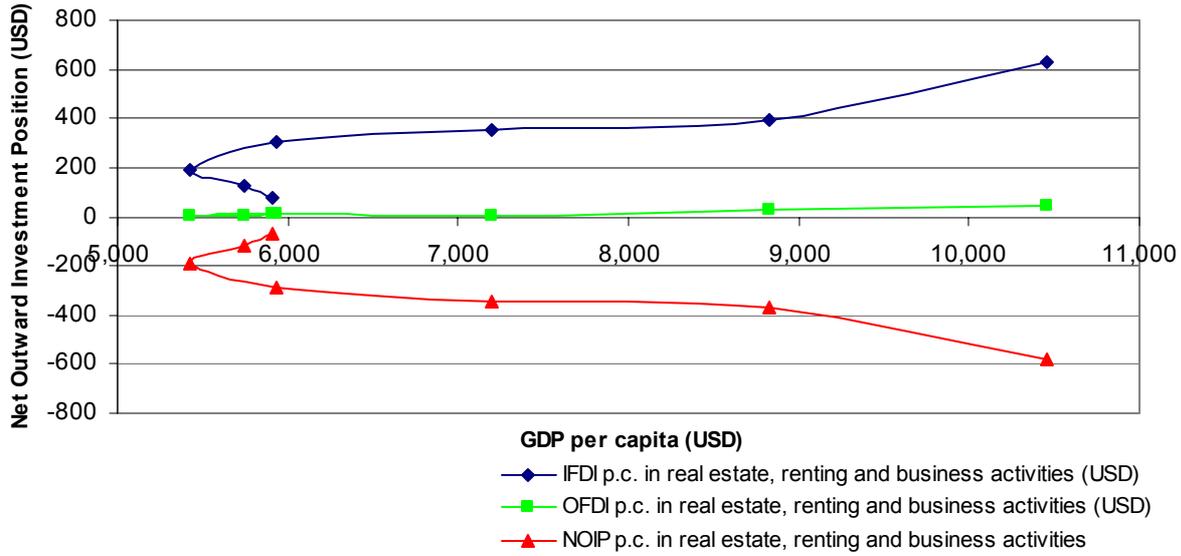


Figure 20: Structural IDP in manufacturing

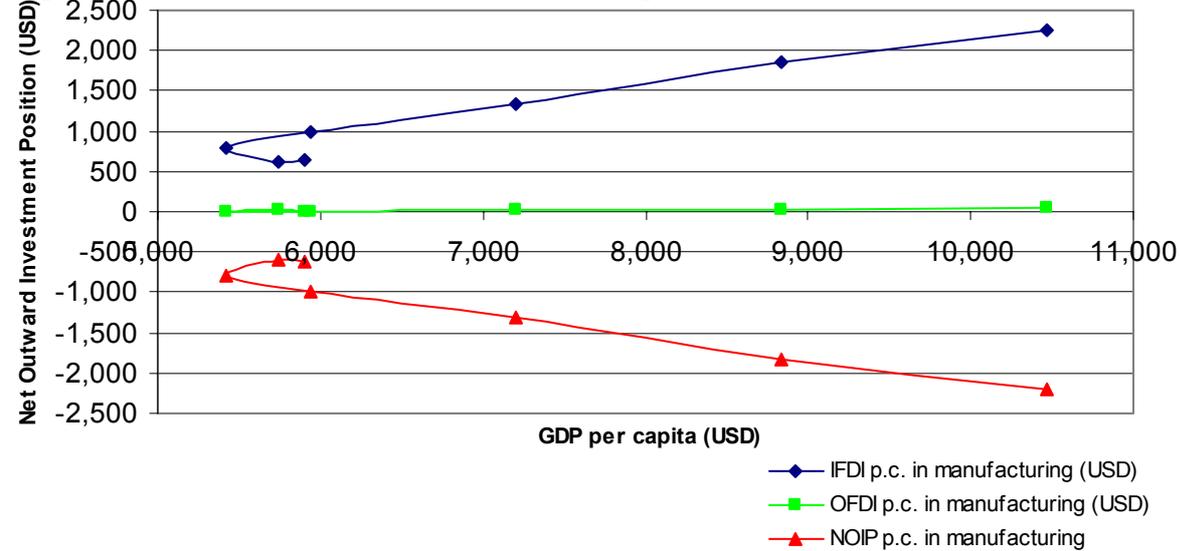
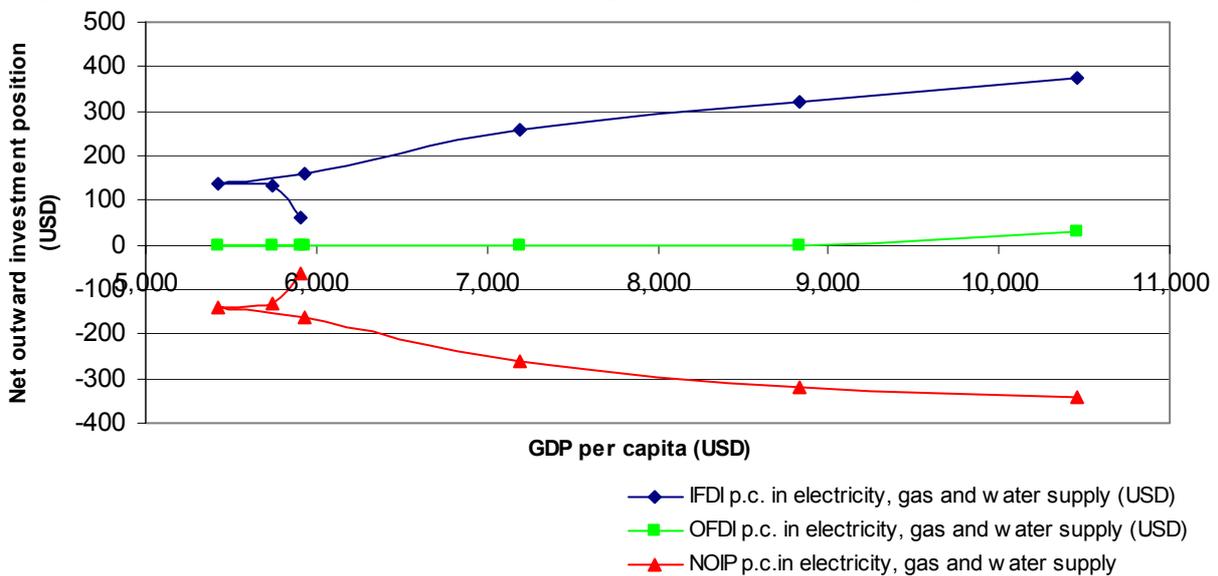


Figure 21: Structural IDP in electricity, gas and water supply



APPENDIX 4: SLOVAK OFDI IN NUMBERS

(Source: Author's calculations based on the data from the National Bank of Slovakia and UNCTAD)

Figure 22: Investment Development Path of Slovakia

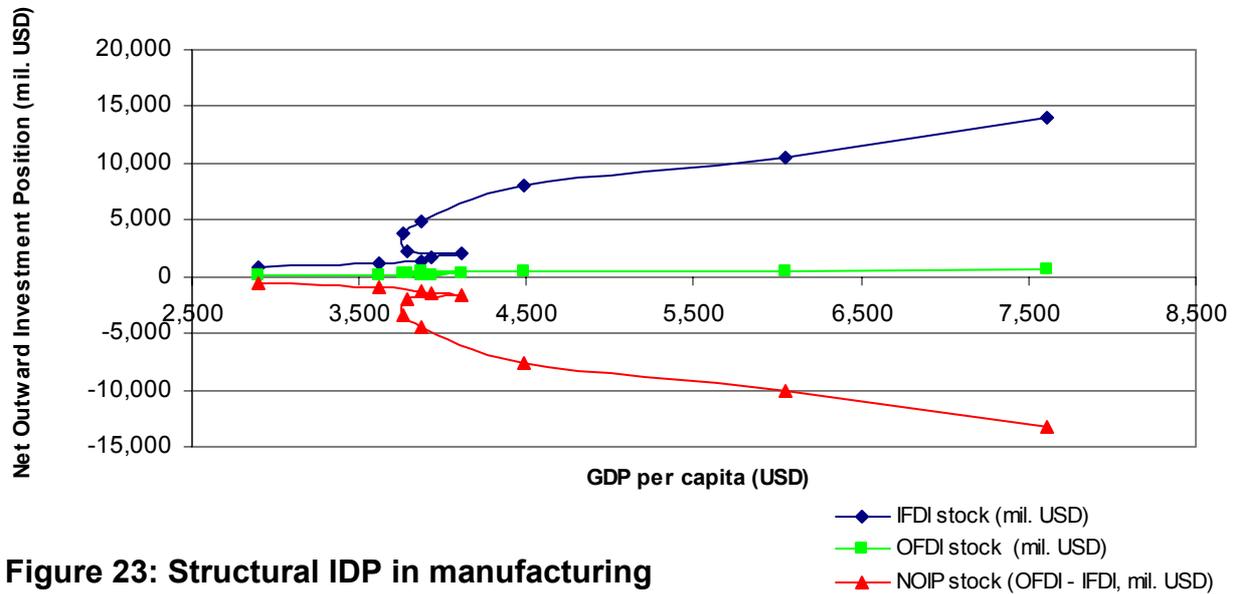


Figure 23: Structural IDP in manufacturing

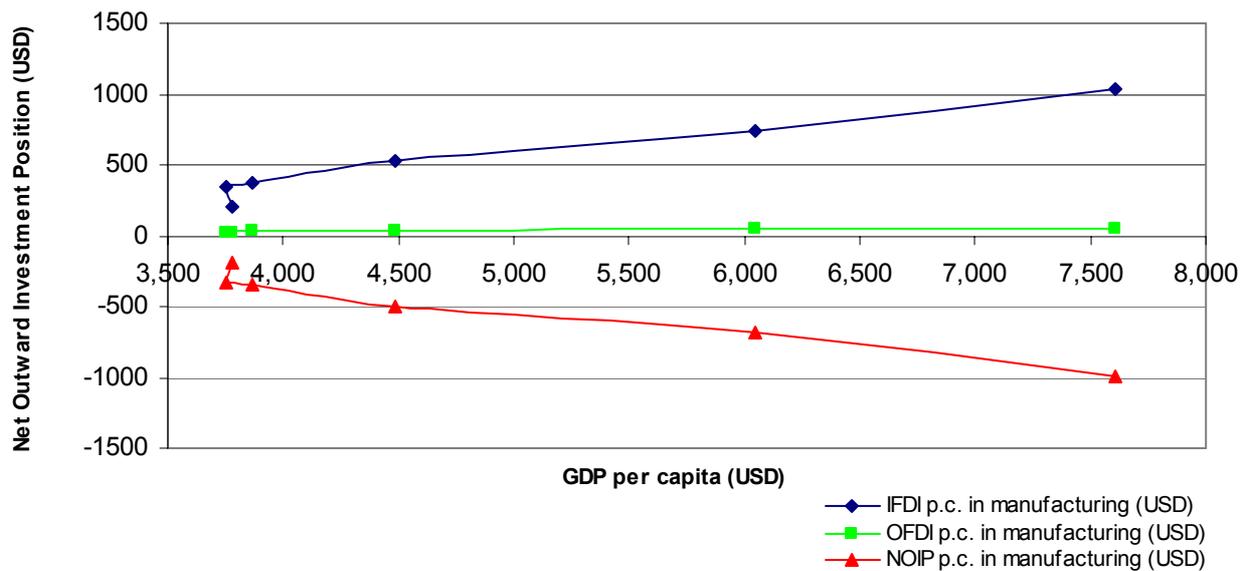


Figure 24: Structural IDP in financial intermediation

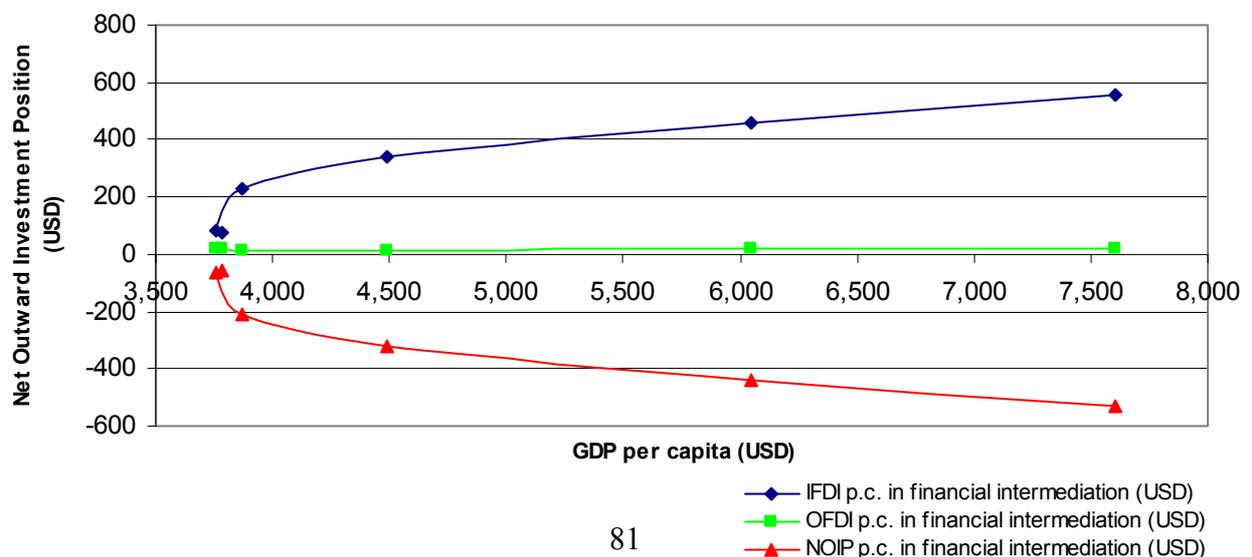


Figure 25: Structural IDP in real estate, renting and business activities

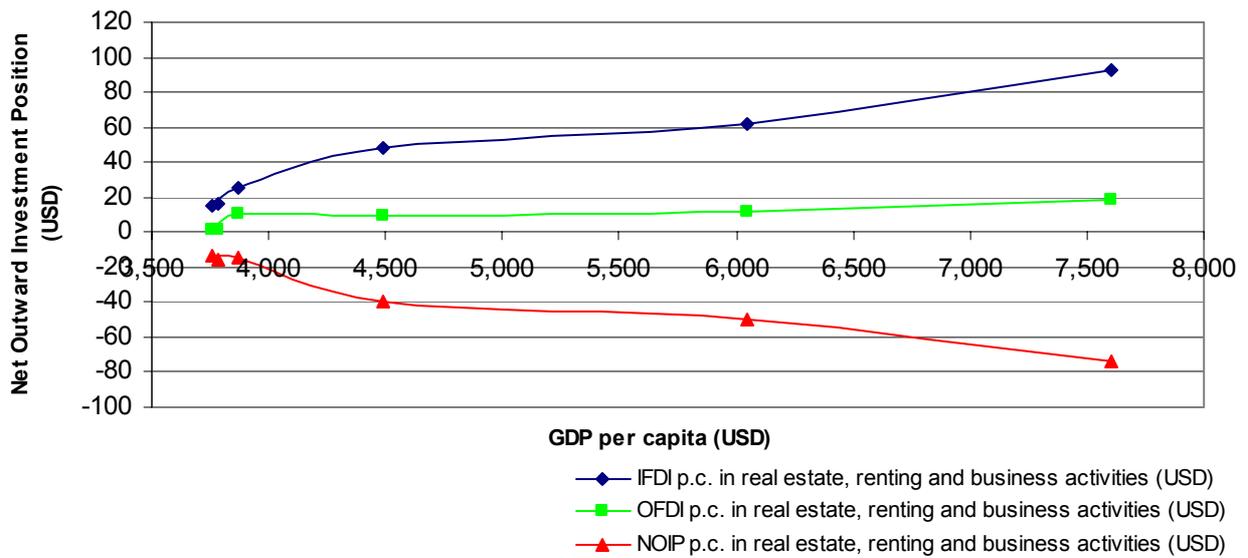


Figure 26: Structural IDP in wholesale and retail trade, repair of motor vehicles

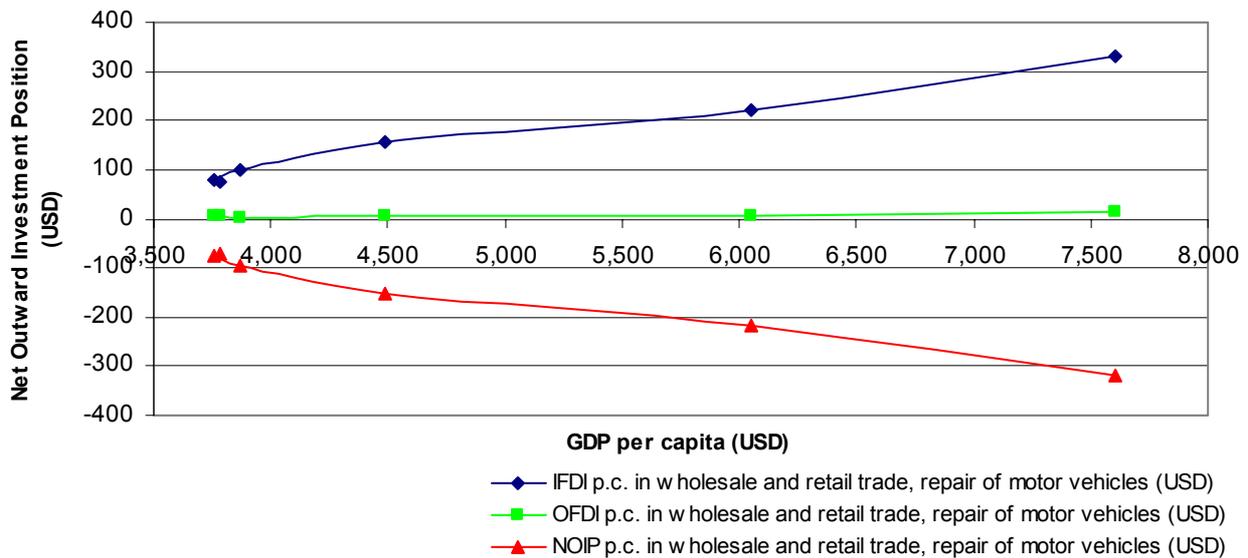


Figure 27: Structural IDP in mining and quarrying

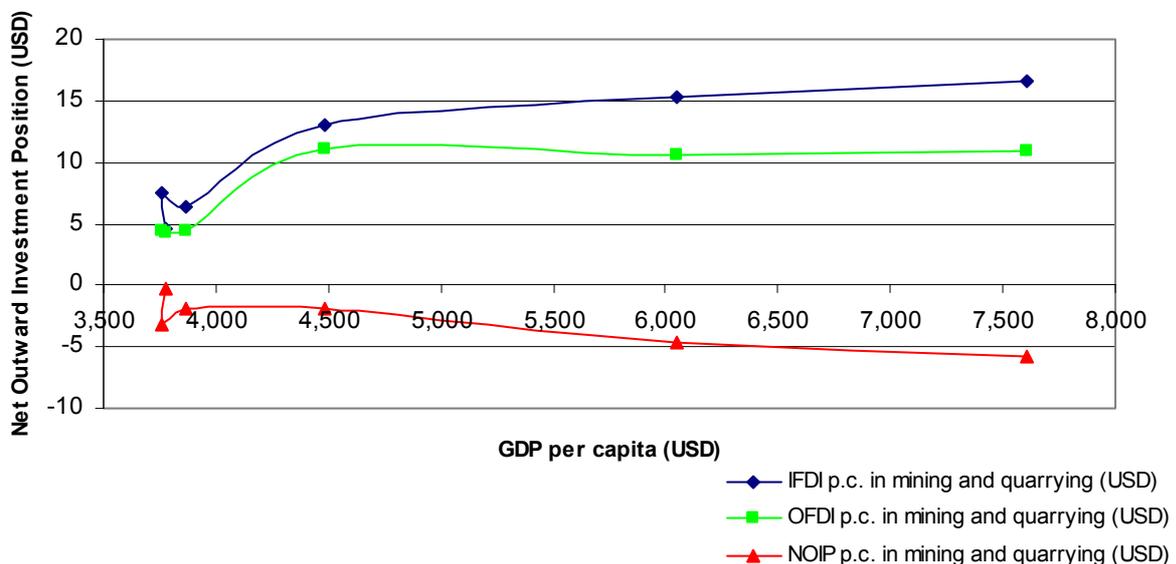


Table 2: Sectoral structure of Slovak OFDI

Sectoral structure of Slovak OFDI	1997		1998		1999		2000		2001	
	Czech Republic	Total	Czech Republic	Total	Czech Republic	Total	Czech Republic	Total	Czech Republic	Total
Agriculture and fishing	0	0	0	0	0	0	0	19	21	62
Mining and quarrying	0	0	0	0	0	0	0	30	25	1,511
Manufacturing	1,158	2,166	2,318	5,449	2,497	5,468	3,157	6,764	4,346	9,709
Electricity, gas and water	1,104	1,533	1,522	1,977	1,637	1,640	1,486	1,489	1,565	1,565
Construction	17	30	33	53	19	39	293	316	91	114
Trade and repairs	454	881	459	700	687	1,044	659	1,250	600	905
Hotels and restaurants	0	0	0	0	0	0	0	0	0	1
Transport, communication	0	166	0	166	0	163	0	163	0	163
Financial intermediation	460	470	1,099	1,109	1,240	1,634	1,409	4,581	2,055	5,016
Real Estate and Business Activities	34	49	351	2,514	214	3,085	912	1,135	838	2,844
Other services	2	100	11	146	70	319	200	366	26	131
Total	3,229	8,134	5,993	15,007	6,364	14,622	8,117	17,870	9,567	23,183

Source: National Bank of Slovakia

APPENDIX 5: COMPARISON OF EBRD TRANSITION INDICATORS

In the chapter 4.1.1, we used studies of Bevan et al. (2004) to discuss institutional factors which influence inflows of IFDI in transition economies. The authors of the study used to measure the level of institutional development transition indicators of the European Bank for Reconstruction and Development (EBRD). The purpose of this appendix is to compare, how these indicators have evolved in the Czech Republic and Slovakia in detail, the summary of the comparison was presented in the subchapter 4.1.1.

For the comparison of values of the indicators, two years were used:

- **1997** - this was the last complete year of the government of Vladimír Mečiar in Slovakia. In the following year, a government of Mikuláš Dzurinda was elected and launched new reform program, involving support for foreign investors. This year was thus the last before significant changes in IFDI inflows. Also, in 1997, the amounts of OFDI in transition economies started increasing more significantly, with a steadily increasing trend afterwards.
- **2005** - this is the latest year, for which the data from the Transition Report 2005 of the EBRD is available.

EBRD uses for comparison of transition indicators scale from 1 to 4+. For the purpose of this comparison, we adjusted them so that they rank from 0 to 1. To cope with the signs + or -, which meant in EBRD slightly better or worse performance than the value of the whole number assigns, we used the value 0.33, i.e. when the value of the indicator was 2-, we considered it to have a value of 1.66.

1. Private sector development

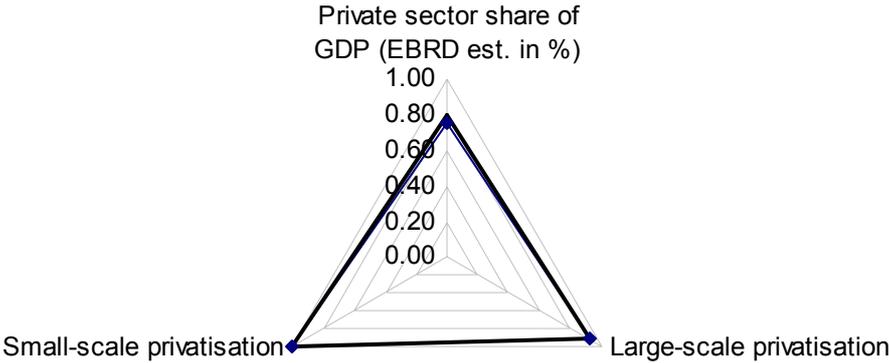
Indicators compared:

- Private sector as a % of GDP
- Small-scale privatization
- Large-scale privatization

Bevan et al. (2004) suggests that private sector development is important for IFDI because:

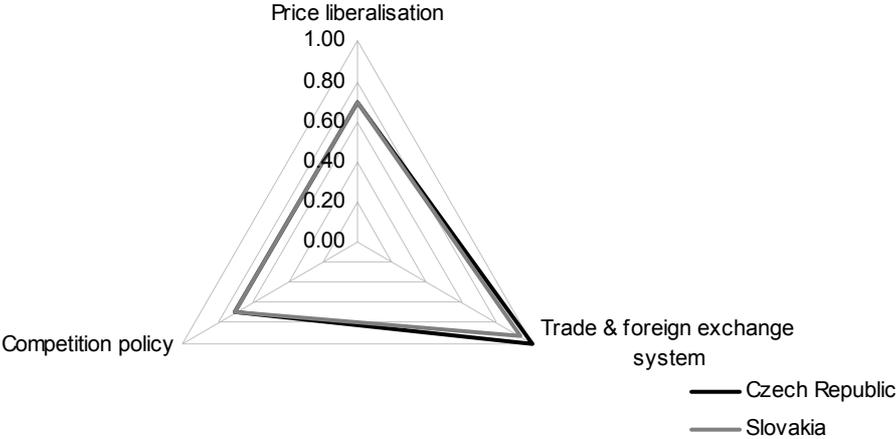
- investors find it more attractive to do business with privately owned firms, since private firms have stronger incentive to increase productivity and profitability, then their objectives are more compatible with those of foreign partners;
- private ownership encourages entrepreneurs to seek new business opportunities, some of which may be found in collaboration with foreigners;
- private firms develop corporate cultures that are more market friendly which reduces cultural distance and thus for example negotiation costs;
- privatization creates opportunities for acquisitions.

Figure 28: Comparison of the private sector development in 1997



Source: Author’s calculations based on the data from UNCTAD

Figure 30: Comparison of markets and trade institutions in 1997



Source: Author’s calculations based on the data from UNCTAD

Figure 31: Comparison of markets and trade institutions in 2005



3. Financial institutions

Indicators compared:

- banking reform & interest rate liberalization
- securities markets & non-bank financial institutions

Banking sector reform is significant because it leads to reduced transaction costs and lower risk to the investor as well as future market growth through the availability of domestic credit.

Table 3: Financial institutions reform

Financial institutions reform	1997	2005
Czech Republic		
Banking reform & interest rate liberalisation	0.69	0.92
Securities markets & non-bank financial institutions	0.69	0.85
Slovakia		
Banking reform & interest rate liberalisation	0.61	0.85
Securities markets & non-bank financial institutions	0.54	0.61

In terms of the development of financial institutions, Slovakia has been lagging behind significantly in both banking and non-banking financial institutions reform.

4. Legal development

The EBRD made an extensive legal survey in 1997 only. Although the legal development data is thus available only for this year, we still involve it in the comparison, since the year 1997 is also used as a benchmark year and in addition, the findings of the survey support our evidence from other empirical literature about the level of legal development.

Table 4: Legal development in 1997

Level of pledge, bankruptcy and company law	1997
Czech Republic	0.92
Extensiveness	0.92
Effectiveness	0.92
Overall	
Slovakia	
Extensiveness	0.69
Effectiveness	0.69
Overall	0.69

5. Governance and enterprise restructuring

Interestingly, although Slovakia was lagging behind the Czech Republic in this indicator in 1997, it has overtaken the Czech Republic by 2005.

Table 5: Governance and enterprise restructuring

Governance and restructuring	1997	2005
Czech Republic		
Governance and enterprise restructuring	0.69	0.77
Slovakia		
Governance and enterprise restructuring	0.61	0.85

APPENDIX 6: INDICATORS OF MACROECONOMIC ENVIRONMENT IN THE CZECH REPUBLIC AND SLOVAKIA

Table 6: Macroeconomic indicators in the Czech Republic

CZECH REPUBLIC	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 ⁴⁾	2005 ⁵⁾	2006
GDP per capita (in USD) ¹⁾	3,599.0	4,224.0	5,349.0	5,926.0	5,461.0	5,904.0	5,744.0	5,425.0	5,935.0	7,198.0	8,832.0	10,462.0	n.a.	n.a.
Share of industry in GDP (in %) ²⁾	33.3	33.6	33.3	32.4	34.3	35.3	35.5	36.0	37.5	38.7	39.7	41.8	n.a.	n.a.
Consumer prices (annual average; percentage change) ²⁾	20.8	10.0	9.1	8.8	8.5	10.7	2.1	4.0	4.7	1.8	0.2	2.8	2.0	n.a.
Producer prices (annual average; percentage change) ²⁾	9.2	5.3	7.6	4.8	4.9	4.9	1.0	4.9	2.9	-0.5	-0.3	5.7	n.a.	n.a.
Interest rate (3-month PRIBOR) ²⁾	8.0	12.7	10.9	12.7	17.5	10.1	5.6	5.4	4.7	2.6	2.1	2.6	n.a.	n.a.
Real effective exchange rate ³⁾	n.a.	93.0	95.6	95.3	100.0	97.8	95.5	104.3	103.2	101.1	102.2	101.6	n.a.	n.a.

1) UNCTAD

2) EBRD Transition Reports for years 2000 and 2005

3) Varga, 2005, p.39

4) Transition Report data are estimates

5) Transition Report data are projections

Table 7: Macroeconomic indicators in Slovakia

SLOVAKIA	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 ⁴⁾	2005 ⁵⁾	2006
GDP per capita (in USD) ¹⁾	2,510.0	2,893.0	3,617.0	3,874.0	3,936.0	4,113.0	3,781.0	3,757.0	3,866.0	4,487.0	6,047.0	7,607.0	n.a.	n.a.
Share of industry in GDP (in %) ²⁾	35.4	30.6	29.1	29.5	26.8	25.5	24.6	25.9	26.0	25.9	26.0	26.0	n.a.	n.a.
Consumer prices (annual average; percentage change) ²⁾	23.2	13.4	9.9	5.8	6.1	6.7	10.6	12.0	7.3	3.0	8.5	7.5	2.4	n.a.
Producer prices (annual average; percentage change) ²⁾	17.2	10.0	9.0	4.1	4.5	3.3	3.8	9.8	6.6	2.1	8.3	2.6	n.a.	n.a.
Interest rate (3-month BRIBOR) ²⁾	n.a.	n.a.	n.a.	14.9	26.5	18.3	14.3	7.9	7.8	6.0	6.0	3.7	n.a.	n.a.
Real effective exchange rate ³⁾	n.a.	90.0	93.0	99.2	100.0	108.2	106.7	106.8	112.9	124.0	128.1	130.6	n.a.	n.a.

1) UNCTAD

2) EBRD Transition Reports for years 2000 and 2005

3) Varga, 2005, p.39

4) Transition Report data are estimates

5) Transition Report data are projections

Note: Real effective exchange rate is the weighted average of a country's currency relative to an index or basket of other major currencies adjusted for the effects of inflation. The weights are determined by comparing the relative trade balances, in terms of one country's currency, with each other country within the index. It is used to determine an individual country's currency value relative to the other major currencies in the index, as adjusted for the effects of inflation (www.investopedia.com). As such it maps the movement in prices (or costs of production) of domestically produced goods, relative to the prices or costs of goods produced by main trading partners and competitor countries (Varga, 2005, p.38)

APPENDIX 7: LABOUR COSTS

Explanation to the compared indicators:

1. Real unit labour costs growth

This derived indicator compares remuneration (compensation per employee) and productivity (gross domestic product (GDP) per employment) to show how the remuneration of employees is related to the productivity of their labour. It is the relationship between how much each "worker" is paid and the value he/she produces by their work. Its growth rate is intended to give an impression of the dynamics of the participation of the production factor labour in output value created. Please note that the variables used in the numerator (compensation, employees) refer to employed labour only, while those in the denominator (GDP, employment) refer to all labour, including self-employed

2. Hourly labour costs

Average hourly labour costs, defined as total labour costs divided by the corresponding number of hours worked.

3. Labour productivity per hour worked

Gross domestic product (GDP) is a measure for the economic activity in an economy. It is defined as the value of all goods and services produced less the value of any goods or services used in their creation. GDP per hour worked is intended to give a picture of the productivity of national economies expressed in relation to the European Union (EU-15) average. If the index of a country is higher than 100, this country level of GDP per hour worked is higher than the EU average and *vice versa*. Basic figures are expressed in PPS, i.e. a common currency that eliminates the differences in price levels between countries allowing meaningful volume comparisons of GDP between countries. Expressing productivity per hour worked will eliminate differences in the full-time/part-time composition of the workforce.

Table 8: Labour costs in the Czech Republic

CZECH REPUBLIC	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Real unit labour costs growth	n.a.	2.8	1.2	-3.2	0.4	0.7	1	3.1	2.7	-1.5	-0.9
Hourly labour costs (EUR)	n.a.	2.8	2.97	3.23	3.41	3.86	4.64	5.39	5.47	5.85	n.a.
Labour productivity per hour worked ¹⁾	43.6 ²⁾	45.5 ²⁾	44.0 ²⁾	43.9 ²⁾	44.9	44.7	47.4	48.2	48.6	50.2	n.a.

¹⁾ In this case, Labour productivity per hour worked of EU (15 countries) was used as a basis, i.e. 100 and the labour productivity per hour worked in the other countries was derived as a share of this basis.

²⁾ estimated value

Table 9: Labour costs in Slovakia

SLOVAKIA	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Real unit labour costs growth	2.2	-2	3	3.4	-3.6	-0.6	-1.5	-0.3	1.1	-2.6	-1.8
Hourly labour costs (EUR)	n.a.	2.16	2.61	2.91	2.76	3.07	3.26	3.59	4.02	4.41	4.8
Labour productivity per hour worked ¹⁾	38.2 ²⁾	40.3 ²⁾	41.6 ²⁾	43.6 ²⁾	44.3	46	47.5	51.3	53.2	53.7	n.a.

¹⁾ In this case, Labour productivity per hour worked of EU (15 countries) was used as a basis, i.e. 100 and the labour productivity per hour worked in the other countries was derived as a share of this basis.

²⁾ estimated value

Table 10: Labour costs average in EU (25 countries)

EU (25 countries)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Real unit labour costs growth	n.a.	-0.7	-0.9	-0.6	0.2	0.2	0.2	-0.4	-0.5	-1	-0.6
Hourly labour costs (EUR)	n.a.	16.06	16.9	17.27	17.99	19.24	19.66	20.35	20.6	21.21	n.a.
Labour productivity per hour worked ¹⁾	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

¹⁾ In this case, Labour productivity per hour worked of EU (15 countries) was used as a basis, i.e. 100 and the labour productivity per hour worked in the other countries was derived as a share of this basis.

²⁾ estimated value

APPENDIX 8: PASSIVE INVESTMENT PROMOTION

Explanation to the compared indicators:

Double taxation treaties (DTTs)

Double taxation can be defined as the levy of taxes on income/capital in the hands of the same tax payer in more than one country in respect of the same income or capital for the same period.

BILATERAL INVESTMENT TREATIES (BITs)

Bilateral investment treaties, under the auspices of the International Monetary Fund and the Bank for Reconstruction and Development (World Bank), have been enacted in order to provide protection for foreign direct investors. BITs generally offer foreign investors additional and higher standards of legal protection and guarantees for foreign investments than those offered under national laws.

Table 11: Passive investment promotion

Passive investment promotion: treaties	1995		2000		2003		2004		2005	
	DTTs	BTTs								
Czech Republic	47	38	67	69	69	78	70	78	73	79
Slovakia	32	25	49	36	58	44	58	44	59	44

Source: UNCTAD

APPENDIX 9: SECTORAL STRUCTURE OF OFDI AND IFDI TO THE CZECH REPUBLIC

The purpose of this appendix is to show to what an extent the structure of IFDI stocks in the Czech Republic resembles the structure of OFDI stocks from the Czech Republic in sectoral terms. The comparison of sectoral structure was done on the basis of two divisions of the data. The first considers manufacturing as one sector as a whole. This approach was chosen so that the Czech data is comparable with Slovak data, which is not published with manufacturing in a more detailed division. The second division of the data takes into account also different manufacturing sub-sectors and we involved it in the analysis because it can shed more light on the potential existence of indirect OFDI.

Figure 32: Sectoral structure of OFDI stocks from the Czech Republic as of 31. 12. 2004

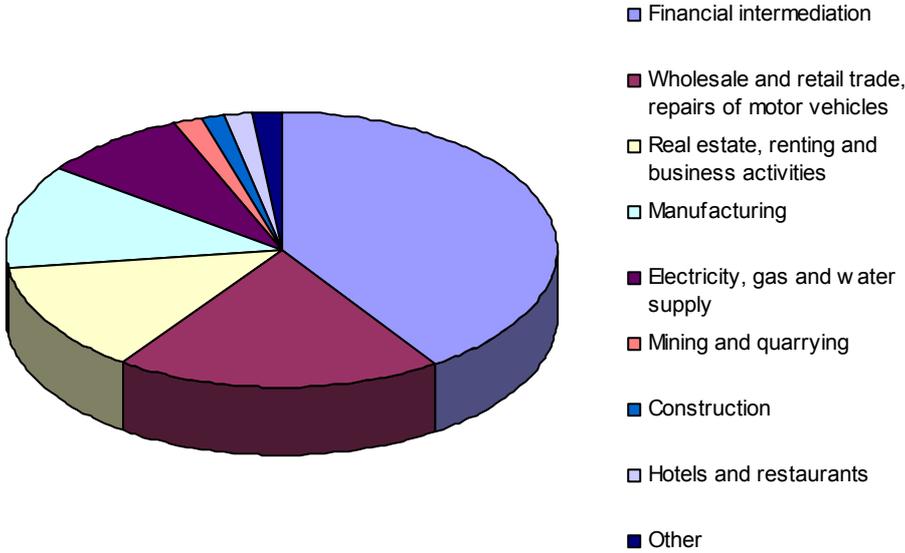


Figure 33: Sectoral structure of IFDI stocks in the Czech Republic as of 31.12.2004

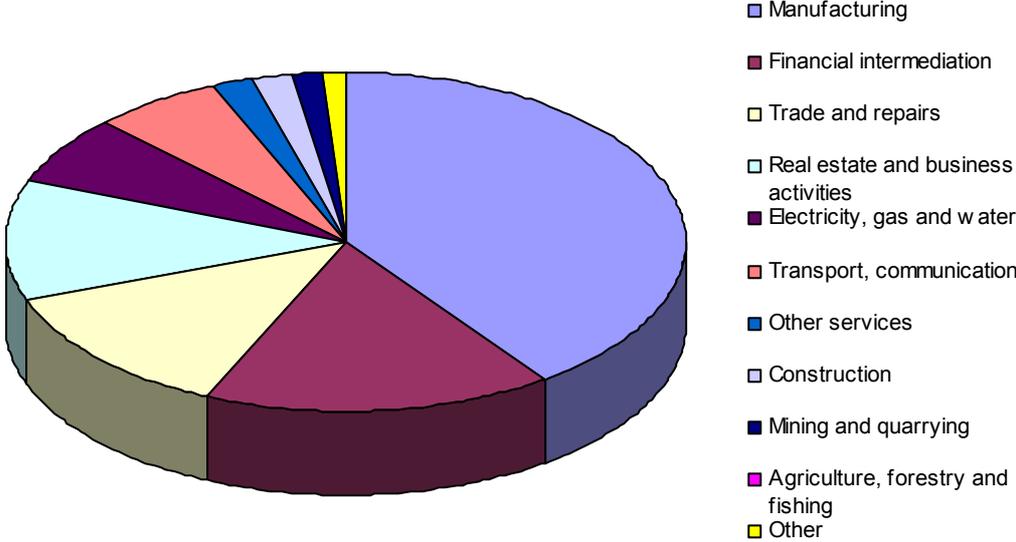


Figure 34: Sectoral structure of OFDI stocks from the Czech Republic as of 31. 12. 2004 – involving more detailed division of manufacturing subsectors

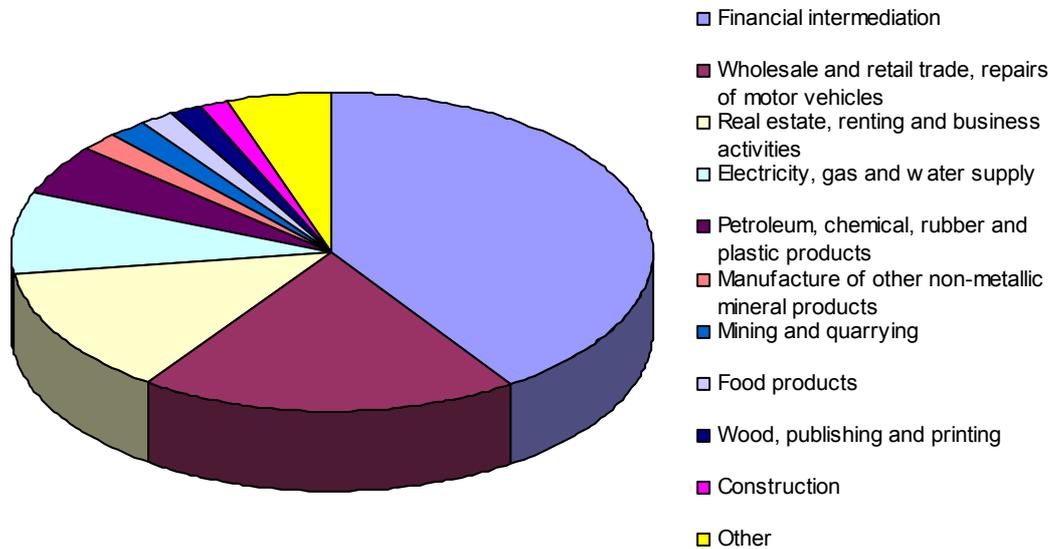
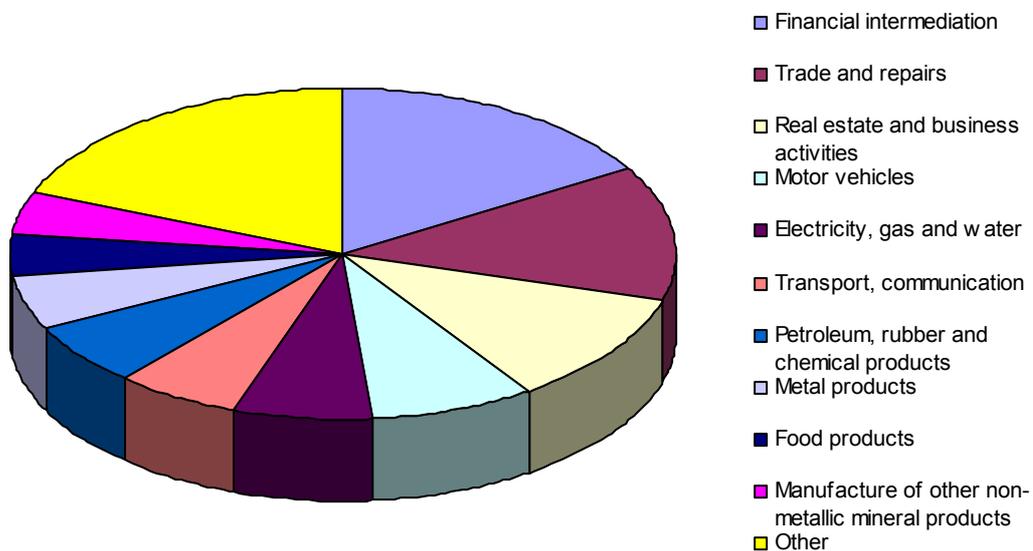


Figure 35: Sectoral structure of IFDI stocks in the Czech Republic as of 31. 12. 2004 – involving more detailed division of manufacturing subsectors



APPENDIX 10: SECTORAL STRUCTURE OF OFDI AND IFDI TO SLOVAKIA

The purpose of this appendix is to show to what an extent the structure of IFDI stocks in Slovakia resembles the structure of OFDI stocks from Slovakia in sectoral terms.

Figure 36: Sectoral structure of OFDI stocks from Slovakia as of 31. 12. 2004

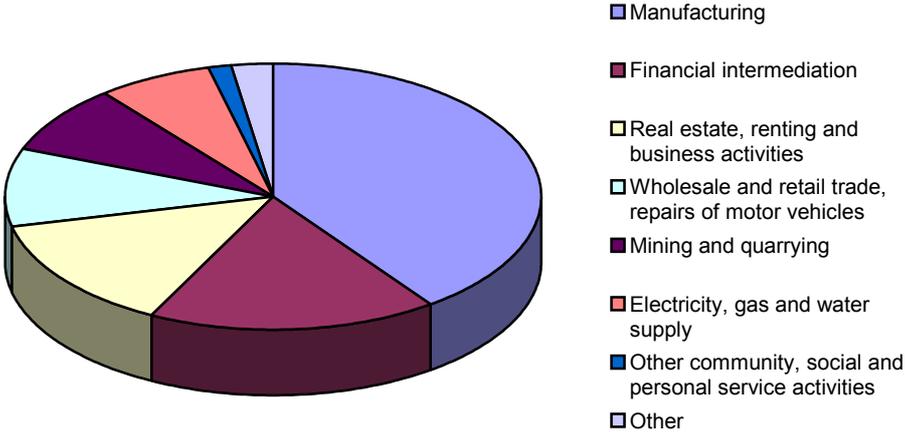
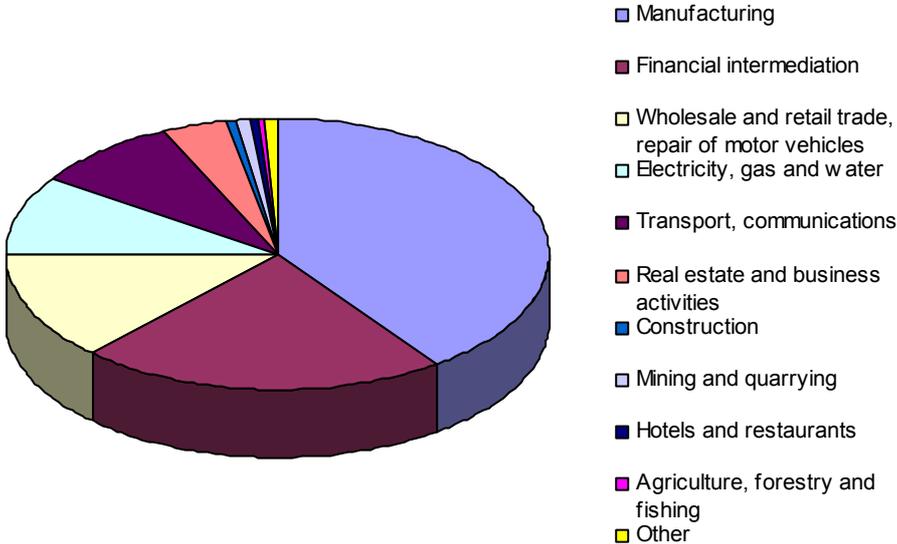


Figure 37: Sectoral structure of IFDI stocks in Slovakia as of 31.12.2004



Master Thesis Proposal

Name: Katarína Jánošíková

Consultant: Prof. Ing. Karel Kouba, DrSc.

Proposed Topic: Outward foreign investment. Analysis of the development in the Czech and Slovak Republic

Topic characteristics:

Inward foreign direct investments (IFDI) in the post-communist transition economies have been subject of a vast body of literature, covering them from many different points of view. The topic of outward FDI (OFDI) and internationalization of local companies, however, has been analyzed only in a small number of studies, particularly due to the reason that OFDI is a recent phenomenon, occurring in the region of Central and Eastern Europe (CEE) mainly from 1997.

OFDI and internationalization of local companies, as a way how these economies integrate to the world economy, are gaining on importance, thus they deserve a more thorough and detailed analysis. In my thesis, I would like to contribute to this field of research, by analysis of OFDI in the Czech and Slovak Republic. One of the main reasons for the choice of these two countries has been a slightly different development of OFDI in terms of time (similarly as in case of IFDI), where Slovakia has been lagging behind the Czech Republic.

At this early stage of my research, there are several questions, which could be potentially answered in the thesis. Firstly, I would like to describe where and why firms invest, i.e. the which factors from the OLI paradigm explain best the motivation of local firms. Secondly, the entry of the countries to the European Union might have changed to some extent features of OFDI, as predicted for example by Kalotay. Thirdly, from the statistics (for example in Altzinger) it is clear, that the Slovak Republic is lagging behind the Czech Republic in the amount of OFDI. Similar pattern has been also observed in case of IFDI. What are then the factors influencing this gap? Are they similar for IFDI and OFDI? I realize that the number of questions which can be answered is only limited, mainly due to the problems of availability of data. This aspect will be decisive for me in the further stages of my research and thus more precise hypotheses will be formulated only then.

Methodology:

To analyze OFDI in other transition economies⁷⁴, mostly the Dunning's eclectic OLI⁷⁵ paradigm has been used, together with Investment Development Path, a framework which allows to assess in which stage of economic development in terms of investment flows the economy is. I would also like to use these widespread tools to analyze and compare OFDI in the Czech and Slovak Republic, referring to it throughout the whole thesis.

⁷⁴ Studies have been to my knowledge so far written mostly about Estonia and Hungary, the most successful of the new EU member states in terms of OFDI. See Bibliography.

⁷⁵ The abbreviation OLI means Ownership, Localization and Internalization

Outline:

In the first part of the thesis, I will focus on the macroeconomic description of OFDI, their development and regional distribution in particular. Such a view is useful to see the phenomenon of OFDI in a perspective of the development of the economy as a whole and to be able to compare it potentially with other economies. The content of the second part will be dependent on the availability of data. My intention is to attempt to make a survey of firms which have invested abroad. In case this is not possible, I would like to do case studies of firms which have invested abroad. This microeconomic perspective is of importance since it will help us place the OFDI from the Czech and Slovak Republic to the theoretical framework I will use and observe the incentives behind investments abroad.

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