Tomasz Latocha

Technical University of Łódź
Chair of World Economy and Textiles Marketing
E-mail: tlatocha@p.lodz.pl
Internet: www.p.lodz.pl/k413

Foreign Capital in the Polish Textile-Clothing Industry: An Attempt at Analysis Based on the Foreign Direct Investment and Location Theories

Abstract
This article aims to analyse the inflow of foreign capital to Poland as a determinant of the textile-clothing industry's growth in the integration process into the European Union. The author attempts to verify the theoretical aspects of the impact of foreign investment on economic activities in the enterprises acquired. Additionally, factors underlying the decisions to locate foreign direct investments are examined.

Key words: *textile clothing industry, foreign direct investments.*

Introduction

With the emergence of the science-based industries in the twentieth century, the invention of new products to meet specific demands gained importance [17, p. 97]. At the initial stage of manufacturing, such products secured high profits. Over time, however, this kind of product became a labour-intensive and low-profitability item, whose production yielded lower and lower wages. Finally, manufacturing processes were transferred to the Third World countries. A classic case in point is textiles. They powered the industrial revolution in the UK and USA, but today they are a standard product group made in the Third World.

Activities undertaken by trans-national corporations on the global market result from their interest in seeking new markets and cutting operational costs. An indicator of the transnationals' external expansion is their involvement in Foreign Direct Investments (FDI). If FDI are typically represented by 'green field' projects and joint ventures in developing countries, in the industrialised countries they take the form of mergers and acquisitions (M&A).

The involvement in FDI activity is especially encouraged by several factors: building up competition, new technologies, government policies and privatisation processes in countries that are making the transition to a free market. It is especially these transition (Central and East European) countries which have been struggling to attract foreign capital. Direct investments play an important role in that region of Europe, as an instrument which compels competition and the restructuring of a national economy. They also contribute to the greater integration of these markets into the EU market.

This article aims to analyse the impacts of foreign capital on the growth of Polish textile and clothing industry, while the country is merging with the European Union. The author has focused his research on statistical data characterising foreign-owned enterprises that employ over 50 persons.

Theoretical Aspects of Multinationals' Location Decisions

There are a number of theoretical explanations as to why FDIs are made. In recent years, the literature on the subject has provided around 40 various reasons for FDI activity [8, p.8]. Some of them seem to combine the already existing attempts to define this phenomenon [see 5,12,14,15,20]. The author herein presents only those theories that address location decisions made by multinationals (MNs).

One theory that tries to elucidate the phenomenon of FDI in relation to the location factors is the portfolio theory, which states that capital goes to countries where the rate of return on invested capital is higher than in a corporation's home country and other host countries [12, p.70].

The traditional capital-flow theory has undergone various modifications. Attempts have been made to add new factors that might make it clearer why direct investments are pursued. One example of such factors may be the different levels of economic development in particular countries [16, p.259] and the investment risk stressed by portfolio theory and the exchange rate exposure of MNs [10, p.223].

Another theory that can serve as an explanation of FDI location decisions is the product life-cycle theory. This has been formulated on the assumption that each product's life cycle can be broken down into several stages, such as a new product stage (a product is introduced to a market), a mature product stage and a standardised product stage that can develop into a product withdrawal and market exit stage. As the new product reaches maturity, transnational corporations start moving the production outside their home country. Standardised production is massive, which offers economies of scale and scope. When relocation of production to a foreign site is considered, an important location determinant is lower manufacturing costs, especially lower labour costs [8, p.8].

According to Dunning's eclectic OLI paradigm (ownership, localisation, internalisation), a corporation takes up direct foreign investments when three conditions are met at the same time [4, p.266]:

1. The corporation to start the FDI holds ownership advantages over other corporations in the host country;
2. The costs of transferring the ownership advantages abroad are lower within a company's structure (internalisation) than are the costs of selling them or leasing to other firms (externalisation);
3. There are factors that make a given host country more attractive for locating manufacturing processes compared with a company's home country, or other countries willing to receive direct investments. Such factors are [20, p.86]:
   - a market size and its growth prospects;
   - labour costs;
   - availability of natural resources;
   - innovations, new technologies;
   - a given country's political stability and investment risk;
   - the government's policy towards foreign investors;
   - tariff barriers, the degree of trading freedom allowed between an investor's home country and the host country;
   - geographical location and related costs of transport (proximity of major importers);
   - technical and economic infrastructure;
   - the degree of cultural dissimilarities (psychological distance and language gap).

Economic Consequences of a Foreign Capital's Inflow to the Host Country: Theoretical Aspects

The impacts of direct investments on a host country's economy have not been encapsulated in a simple formula of advantages and disadvantages to date. One of the reasons why the presentation of such a theory is simply impossible is the frequent contradiction of the investors' and the host countries' motivations that shape their foreign investment-related hopes. We can only indicate that host country's expectations may be driven principally by its needs to [9, p. 192]:

- compensate for capital shortages resulting from an insufficient level of domestic savings;
- raise the technological level of the economy and to disseminate state-of-the-art management methods;
- increase its export capacity;
- reduce unemployment by generating a demand for labour;
- economically stimulate less developed regions, etc.

The degree to which the expectations are met (largely dependent on their alignment with investors' motivations) shows the actual importance of direct investments for the host country.

The literature on the subject gives examples of both the negative and positive economic effects of foreign investors linking up with a host country's economy [4, p. 74]. FDIs are assumed to be a source of economic development through transfer of technologies, creation of jobs and links with the economic environment [2, p. 84].

When a part or the whole of an enterprise is acquired by a foreign company, it stops being a domestic entity and begins to represent an integral part of an international organisation. An acquisition of a company by a foreign organisation may [13, p. 26]:

- modify the import and export structure of an entity that has become an affiliate; while its export may grow to supply other affiliates, there is a probability that imports will rise even more strongly, as it will buy more products manufactured by other affiliates;
- expanded turnover within a corporation, meaning that affiliates trade with each other outside the market, which in turn allows transfer pricing; as a result divisions & associated companies avoid taxes and transfer profits abroad, which further implies reduced budget revenues, an underpaid local workforce and inflated prices of products. Such schemes are used by enterprises not only because of tax factors, but also to compete on the local (domestic) market;
- a changed operational strategy followed by a division of a transnational corporation; the key strategies operated world-wide are:
  - specialisation, i.e. the liquidation of certain plants or cessation of manufacturing certain products (directly connected with new lines of products and technological changes);
  - concentration, i.e. an enterprise targets a specific group of buyers, a range of products or a geographical segment of the market (believing that it can provide a better service to its market segment than can competitors operating on a larger scale);
  - diversification, represented by a high variety of products & services, and the introduction of a unique production to the market (diversification may involve patterns, product qualities, technologies, after-sales service);
  - a strategy of seeking a foreign or domestic product/market niche - the stimulus for setting up a division can be a transnational corporation's wish to gain a new market (a logical consequence of the acquisition of Polish enterprises by investors from developed countries has been a slice of a new market; in the case of non-EU investors, the possibility of accessing a single European market should also be added).

More and more frequently, the issue of services' importance for economy is raised and their higher proportion of the GDP is postulated. So it is a matter of potential interest to investigate whether subsidiaries do in fact contribute to the development of new types of services and to their larger weight in an economy. In a developed country, the process of economy 'servicisation' is brought about by [3, p. 77]:

- high productivity, that allows the manufacture of higher numbers of products with lower inputs, especially of labour;
- consumer preferences; with growing disposable income, people spend less on durables, while services such as health care, trips abroad and restaurants attract more money;

- the importance of production-related services growing in real terms, e.g. designing and marketing;
- the increasing significance of IT services.

FDIs' impacts on basic macro-economic values such as the availability of factors of production (labour, capital and technology), productivity, GDP, GNP, income distribution, trade balance and the balance of payments depend not only on the behaviour of foreign investors, but also, and to a large extent, on determinants in the host country and its economic policy. Besides, an inflow of FDIs produces mostly positive so-called external effects (technological and financial) in the host country's economy [21, p. 349].

An analysis of the OLI paradigm shows that a prerequisite for a company to start its FDI is holding specific ownership advantages. These advantages stem from the possession of intangible assets such as access to their own patents and technology, managerial expertise built in the course of company operations, product reputation, and consumers' identification with a product that results from trust generated by expenditures on advertisements. As a result of an FDI influx, a host country may benefit from subsidiaries without having to make relevant investments [20, p. 160].

A region obtaining FDI receives positive impulses from clusters, that is, spatial concentrations of similar activities. In a host country, specialised clusters may basically develop in two different ways [2, p. 93]:

- by co-operation between a transnational corporation's division and the local enterprises, and
- by development of divisions with their own R+D activities.

International Corporations, Their Development and Motivations

According to UNCTAD estimations in 2001, the amount of FDI-related stock in the world-wide economy was almost $1.5 trillion [19, p. 6]. That this activity is expanding dynamically can be evidenced by the fact that in 1999 the value of capital transfers under FDIs was over $800 billion [18, p. 9]. In the annual stream of FDI, mergers and acquisitions (M&A) prevail more and more often. In the 1990s, global M&As grew fivefold [11, p. 21]. Its expansion has to be attributed to the technological progress that makes it possible to simultaneously manage a number of divisions in many foreign locations and to adjustments on the capital market. In Europe the introduction of the euro has reduced both transaction costs and the foreign exchange risk. M&As mainly target the banking sector, insurance, automotive, tobacco, chemical, pharmaceutical and telecommunications industries. About 90% of all M&As are concentrated in the OECD, with the USA, UK, France, Germany and the Netherlands being the leaders of the activity [11, p. 21]. In Central and Eastern Europe, Poland has turned out to be the most attractive country for M&As, receiving investments estimated at USD 6 bn in 1999. Latin America absorbed $43 bn, with Argentina alone accounting for $21 bn [11, p. 21].

All countries determined to host FDI (including Poland) have to face strong competition from other countries that also wish to attract foreign investors. Consequently, a would-be host region endeavours to adjust factors underlying decisions on FDI and their location. Of the three groups of factors identified and described by Dunning's eclectic paradigm OLI, a host country may acquire only some [21, p. 351].

By the end of 2001, Poland had received $56.9 bn in foreign direct investments. The previous record year had been the year 2000, when $10.6 bn was transferred to the country[1].

Direct Foreign Investments in the Textile and Clothing Industry

We have been able to observe an inflow of investments, mainly to the manufacturing industry. This may be connected with the treatment of this region of Europe as a stepping stone to economic expansion into markets in Eastern Europe. In the case of non-European investors, their interest in Polish industry arises from the unfolding economic integration between the CEE countries and the European Communities where free trade is expanding.

Particular branches of industry show significant differences in terms of foreign capital absorption. When viewed through the terminology used by the European Classification of Activities (ECA), the textile industry in 2000 comprised 236 companies with foreign capital, whose initial capital totalled PLN 87.4m (foreign capital accounted for 81.1% and Polish for 18.9%). Regarding production of fabrics, foreign holdings in companies' equity represented only 5.8% in that year, that is, almost twice as low as the average for all manufacturing activity [6].

Using the same ECA terminology, in 2000 the clothing industry comprised 651 enterprises with foreign capital, whose initial capital totalled PLN 174.1m (with foreign capital representing 85% of that amount). Regarding the clothing and fur product industries, the involvement of foreign capital in companies' equity varied, but in the year in question it reached 13.8%, that is, above the average characterising all manufacturing activity [6].

An indicator that characterises operations of enterprises in a national economy is the level of their profits. The textile industry, particularly production of textiles and leather products, belongs to those industries where both domestic and foreign enterprises incurred losses during the period of time examined (1993-2000). In 2000, sales' profits of plants held by international corporations accounted for 3.6% of the profits made by the Polish industry as a whole [6].

An alarming phenomenon connected with the inflow of foreign direct investments is the relatively significant contribution of foreign capital to the formation of a negative visible balance of trade, despite much stronger export activities in this group of enterprises. The phenomenon of higher export activities in foreign affiliates than in domestic organisations can be explained by the higher quality of their products, their better international competitiveness (arising, for instance, from lower manufacturing costs), as well as the utilisation of modern marketing methods or already existing business connections with foreign markets to distribute their products. The large import share represented by this group of enterprises has two sources: 1) unavailability of products at an adequate level of quality and up-to-dateness on the domestic markets, and 2) purchases of intermediate goods.

In all Polish export sold mainly to the EU countries, textile products represented c. 12%, and products of the clothing industry accounted for 6.27% [6].

Foreign affiliates pursue investment-based growth policies more actively than Polish enterprises. In Polish light industry, though, foreign organisations make marginal investments, which is particularly true of the production of textiles and clothing. The probable main reason for this situation is the different use of Poland's competitive advantage in that area, which is called outside processing [22, p. 298].

Foreign associates play an increasingly important role in Poland. According to Table 1, in the year 2000 11% of people employed in the 'production of textiles' section and almost 28% of workers in the 'production of clothing and fur articles' section worked for companies with foreign capital. After 1993 employment in plants increased. This situation may be explained by the relaxation in the mid-1990s of regulations restricting foreign investors. However, it should be stressed that compared with 1993, the textile and clothing industry employment grew in foreign-owned enterprises and dropped in domestic ones. An analysis of employment in all sections of manufacturing in Poland provides grounds for another conclusion; despite a general decline in employment in manufacturing, the number of jobs in foreign companies increased.

The significant liberalisation of FDI-related capital flows between Poland and the EU at the stage of association, as well as full liberalisation of trade in textiles and clothing under the Europe Agreement, may have both positive and negative effects on the textile and clothing industry. The more significant benefits are [21, p. 349, 8, p. 17]: transfer of technologies and modern methods of management, reinforcement of restructuring processes due to the inflow of FDI; new markets gained as a result of participation in the Single EU Market; the transposition of *acquis communautaire* plus norms and standards protecting the textile and clothing sector from excessive and unfair import from countries with economies labelled as non-market (e.g. China, Russia, Ukraine, Belarus); participation in EU common trading policy, which helps improve the competitiveness and innovation of the sector's products, and also promotes export to expand markets even further. Possible threats in the period of membership include the bankruptcies of some domestic enterprises that will not be able to confront new competition.

Table 1. *Employment in manufacturing organisations with foreign capital in Poland, years 1993-2001. Source: prepared by the author based on Central Statistical Office data.*

Production of		Employed in foreign enterprises, %		Changes in employment	
		1993	2001	Total	Foreign companies
15+16	Foodstuffs. Beverages and tobacco products	10	27.3	-45301	48753
17	**Textiles**	**3.7**	**11.1**	**-58093**	**4935**
18	**Clothing and fur articles**	**16.3**	**27.9**	**-33082**	**8618**
19	**Leather products**	**3.7**	**14.7**	**-24500**	**2606**
20	Wood and wooden products	9.9	24.6	890	8660
21	Cellulose-paper	63.4	80.6	-3009	3077
22	Publishing and printing	13.7	37.1	1257	10836
23	Coke, petroleum products and derivatives	0.1	1	-3343	159
24	Chemicals and chemical products	5	25.3	-11506	22985
25	Rubber and plastic products	9.2	41.7	6665	21787
26	Products from other non-metallic raw materials	7.8	28.5	-12983	22166
27	Metals	4.8	7.1	-4316	2658
28	Metal products, without machinery and equipment	6.8	15.8	16365	11804
29	Machinery and equipment	3.8	11.4	-63199	14485
30	Business machines and computers	10.8	27	-288	546
31	Electric machines and systems	12.6	42.2	5827	25181
32	Radio, TV and telecommunications equipment and systems	21	45.7	-15208	4756
33	Medical, precision and optical instruments, clocks and wrist watches	4.1	14.9	-2165	3266
34	Motor vehicles, trailers and semi-trailers	20.9	63.4	1367	39137
35	Other transport equipment	2	7.9	-26193	4447
36	Furniture	21.7	44.9	3413	22748
37	Waste recycling	13.8	22.2	1138	626
	Total	**9.7**	**26**	**-266264**	**284236**

Final Remarks

The existing FDI and regional development theories allow us to explain the location decisions made by transnational corporations, as well as the factors that attract such organisations to specific locations. Decisions to locate a direct investment in a country or region are determined by any given MNE's characteristics and strategies, as well as the benefits a given location offers to it.

Each theory focuses on one factor which, from that theory's standpoint, is the only one to determine FDI activities. One summary theory is Dunning's OLI paradigm. This theory has been built not on one FDI determinant alone, but it takes into account a number of factors necessary for FDIs to take place. The most important is the third condition of the OLI paradigm, that is, the location advantages of the host countries. Such advantages should be interpreted as the availability of the factors of production, but also the legal, cultural, political and economic conditions.

FDIs' impacts on a country's economy are vast, and may range from the transfer of technologies, development of research activities and contribution to economic indicators (inflation, export and import, overall employment, evolution of nominal wages and investment) to a share in the revenues of domestic organisations. In addition, FDIs' effects on a national economy can be analysed in terms of their impact on the improved quality of domestic products, and the degree to which foreign organisations implement elements of human skills such as modern human resource management or know-how.

Our analysis of literature discussing FDIs' contributions to modified management techniques in the acquired organisations allows us to formulate the following conclusions:

- direct investments can modify the structure of export and import in the acquired entities;
- foreign investors typically employ new strategies to compete, such as concentration, diversification and product specialisation;
- with the inflow of capital, newly established enterprises may receive modern technologies.

Considering the globalisation trends, more and more regions in the world are receiving foreign direct investments. The inflow of FDIs into Poland's textile and clothing industry is of particular importance for the country and may affect the market of textiles and clothing products both positively and negatively. At the stage of association with the EU, Poland may benefit from FDIs by absorbing flows of capital, transfers of technologies and modern methods of management.

The Polish textile industry requires investment outlays to restructure. Without foreign capital, this sector will not be able to effectively compete on Western European markets. However, some domestic enterprises may not survive the new competitive environment, and could go bankrupt.

Modern competition theory stresses the role of adaptability and innovation in taking advantage of the economies of scale and scope. In traditional industries, such as textile and clothing, competitiveness means the ability to immediately react to new market developments, as well as ceaseless concern with scientific, technical and organisational progress and perfect marketing.

References

1. *2001 data of the Polish Agency For Foreign Investments (PAIZ).*
2. *Dunning J.H. (ed.), Regions Globalisation and the Knowledge-based Economy, Oxford University Press, Oxford and New York 2000.*
3. *Dunning J.H., Governments, Globalisation and International Business, Oxford University Press, Oxford 1999.*
4. *Dunning J.H., Multinational Enterprises and the Global Economy, Addison Wesley Publishing Company 1995.*
5. *Geldner M., Przyczynek do teorii zagranicznych inwestycji bezpośrednich (A Premise TO The FDI Theory), SGPiS, Warsaw 1986.*
6. *GUS, Rocznik statystyczny przemysłu, (Statistical Yearbook of Industry),GUS, Warsaw 2002.*
7. *Klimek D., Podstawowe założenia polityki przemysłowej ze szczególnym uwzględnieniem przemysłu tekstylno-odzieżowego (Basic Industrial Policy Assumptions With Special Regard To The Textile Clothing Industry), [in:] Janusz T. (ed.), Wyzwania rozwojowe przemysłu lekkiego w kontekście integracji z Unią Europejską (Light Industry Development Challenges in the Context of Integration With the EU), PTE, Łódź 1998, pp. 7-25.*
8. *Knödler H., Albertshauser U., Globalisation, Foreign Direct Investment and Regional Perspectives: Empirical Results for West German Regions, Hamburgisches Welt-Wirtschafts-Archiv, No. 117/2001.*
9. *Kraszewski W., Przedsiębiorstwa z udziałem kapitału zagranicznego w Polsce w latach 1990-1999 (Enterprises With Foreign Capital In Poland, Years 1990-91), Toruń 2001.*
10. *Misala J., Zaangażowanie kapitału zagranicznego w gospodarkę polską w okresie 1976-1995 (Involvement of Foreign Capital in the Polish Economy, Years 1976-1995), [in:] M. Jarosz (ed.) Kapitał zagraniczny w prywatyzacji (Foreign Capital In Privatisation), Warsaw 1996.*
11. *OECD 2000, Recent Trends in Foreign Direct Investment, Financial Market Trends, No. 76/2000, p. 21.*
12. *Oziewicz E., Zagraniczne inwestycje bezpośrednie w rozwoju gospodarczym krajów Azji Południowo-Wschodniej (FDI in Economic Development of the South-East Asian Nations), UG, Gdańsk 1998.*
13. *Raport z badań empirycznych nt. Wpływ bezpośrednich inwestycji zagranicznych na zmiany strukturalne w przedsiębiorstwie (Report On Empirical Research Concerning FDI Impacts On Structural Changes In An Enterprise), Gospodarka Narodowa, No 5-6/2001.*
14. *Stehn J., Ausländische Direktinvestitionen in Industrieländern: theoretische Erklärungsansätze und empirische Evidenz, Mohr, Tübingen 1992.*
15. *Stein I., Die Theorien der multinationalen Unternehmung, [in:] S. Schoppe (ed.), Kompendium der internationalen Betriebswirtschaftslehre, Oldenburg, München 1992.*
16. *Stępniak A., Integracja regionalna i transfer kapitału (Regional Integration and The Transfer of Capital), Gdańsk 1996.*
17. *Thurow L., Przyszłość kapitalizmu (The Future of Capitalism), Wyd. Dolnośląskie, Wrocław 1999.*
18. *UNCTAD, World Investment Report 2000, Foreign Direct Investment and the Challenge of Development, N. York and Geneva 2000.*
19. *UNCTAD, World Investment Report 2002, Transnational Corporations and Exports Competitiveness, N. York and Geneva 2002.*
20. *Witkowska J., Bezpośrednie inwestycje zagraniczne w Europie Środkowowschodniej – próba interpretacji na gruncie teorii bezpośrednich inwestycji zagranicznych i teorii integracji (FDI In Central and Eastern Europe) - An Attempt of Interpretation Based On FDI And Integration Theories), Łódź 1996.*
21. *Wysokińska Z., Witkowska J., Integracja Europejska (European Integration), PWN, Warsaw, Łódź 2000.*
22. *Wysokińska Z., Witkowska J., Tendencje popytu na wybranych rynkach zagranicznych (Demand Trends On Selected Foreign Markets), WUŁ, Łódź 1998.*

Received 01.12.2003 Reviewed 16.01.2004