Foreign Direct Investment and Transnational Corporations in the Economy of Slovakia

Ľubica Lesáková

Matej Bel University, Faculty of Economics
975 90 Banská Bystrica, Tajovského 10, Slovak Republik
E-mail: lubica.lesakova@ umb.sk

Abstract: Foreign direct investment is the way by which transnational corporations increase its profitability by getting the share on a new foreign market, by reducing the production costs or by exploiting other factor inputs (such as availability of raw materials for production and others). The drivers, or push and pull factors, exist both in home and host countries. The aim of the article is to present the role of foreign direct investment and transnational corporations in the economy of Slovakia. The article is divided into three parts. In the first part is explained the economic view and the main motivators for foreign direct investment. In the second part we present the impact of foreign direct investment on the host country Third part of the article is presented the analysis and evaluation of foreign direct investment and transnational corporations in the economy of Slovakia. The paper was elaborated as a part of VEGA project 1/0654/11 „Innovative small and medium enterprises as a part of knowledge-based economy in Slovakia“.

Key words: foreign direct investment, transnational corporations, development, Slovakia

1 Economic view of foreign direct investment

Foreign direct investment (FDI) is defined as an “investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy in an enterprise resident in an economy other than that of the foreign director investor” (UNCTAD). FDI comprises the initial transaction between the two entities and all subsequent transactions between them and among foreign affiliates [4].

There are some contemporary theories of FDI. Monopolistic advantage theory is an economic view of FDI that argues that FDI should occur only when foreign companies have unique competitive advantage over local companies. That means, FDI occurs when the foreign company is superior in areas such as technology, management, economies of scale, brand name, or financial assets. The prime motivation for FDI then is to keep control of these competitive advantages while using them in other countries.

Internationalization theory begins with the assumption that operating in a foreign country is likely more costly that operating at home. Foreign companies are unlikely to have the local contacts and same knowledge of local customs, cultures and business practices as local competitors. If a company has something of value, why not export the product or licence the production process to local companies to take advantage of their local expertise?

Dunning´s eclectic theory focuses on three advantages that a company must have to succeed with FDI. These advantages consider both the internal characteristics of the transnational corporations and the local environment in which it operates [2].

1. Ownership advantages. As with monopolistic advantage theory, the eclectic theory argues that a company must have some strategic competitive advantages over local companies. Otherwise, without something like a superior technology or internationally recognized brand name, a foreign competitor could not compete with the locals.
2. Internationalization advantages. A company must gain some cost savings over exporting its product or service or licensing its production processes or brand name.
3. Location advantages. This means that there must be some profit motive to produce in another country. Usually, this comes from lower-cost production that can serve either local or home markets. Cost savings, and thus higher profits, can also come from reduced transportation costs in serving local markets.

These theories broadly explain some of the motivations for FDI. However, the strategic decision on how to enter a market is quite complex. At the macroeconomic level, the following variables are seen as motivating for FDI [10]:

- economic growth: the rate of growth within the host economy is important and generally has a positive relationship with the level of FDI;
- market size: the size of the host economy has a generally positive effect on the level of FDI. Many studies have indicated that market size is the most influential factor on FDI. Market size influences exploitation of scale economies and standard factor specialization, allowing cost minimization and market growth;
- stage of economic development: the more developed a stage, the better the level of infrastructure and the more able will be the state to generate wider agglomeration effects;
- human capital: for labour-intensive and export-oriented FDI, the quality and quantity of human capital is pivotal;
- governmental policies: many governments consider FDI as important antidote to high unemployment and introduce policies to encourage FDI. These can take form of tax incentives, subsidies, regulation and privatization.

In addition to the above, there are other motives for FDI such as the degree of openness, labour costs, trade linkages and borders, risk and macroeconomic stability and so on.

It is becoming increasingly evident, that the major conventional determinant of FDI (the size of national market) has decreased in importance as globalization has matured [8]. At the same time, cost differentials between locations, the quality of infrastructure, the ease of doing business and the availability of skills have become increasingly important. Traditional economic determinants such as natural resources, low labour costs and the size of the market protected from export competition also remain important, but the relative importance of location determinants for competitiveness enhancing FDI is shifting. Firms are seeking a competitive advantage based on a combination of wages, skills and productivity when deciding on the location of FDI. The emergence of regional markets is also important and, in some cases, these are superseding national markets as important FDI determinants. This depends on how well the state is integrated into the regional bloc in terms of policy harmonization and physical accessibility.

2 The impact of foreign direct investment on the host country

The basic motivation for capital to employ FDI in a global market economy is to increase its profitability by getting the share on a new market, by reducing the production costs or by exploiting other factor inputs, such as availability of raw materials for production [7].

FDI is the way, by which multinational enterprises and transnational corporations increase their profitability and global market share. It is a tool enabling them to take advantage of and to intensify global competition [4].

Multinational enterprises (MNEs) are global business organizations, regardless of the existence of their national or multinational identity, whose activities are defined by the transcendence of distance and borders in the above explained sence.

Transnational corporations (TNC) are enterprises comprising parent enterprises and their foreign affiliates. A parent enterprise controls assets of their entities in countries other than its home country, usually by owning a certain equity capital stake. An equity capital stake of 10 % or more of the ordinary shares or voting power for an incorporated enterprise, or its equivalent for an unincorporated enterprise, is normally considered as a threshold for the control of assets. A foreign affiliate is an enterprise in which an investor, who is resident in another economy, owns a stake that permits a lasting interest in the management of that enterprise.

In the discussion on pros and cons of FDI, the most emphasized potential benefits are benefits in terms of managerial expertise, worker trainings, technological know-how transferred outside the company, increase in supplier efficiency, knowledge of international markets, contribution of accounting and auditing standards and improvement of country´s performance motivating other investors to invest in the host country (demonstration effect). On the other side, often discussed negative effects of FDI are uncertainty of those benefits the demonstration of which depends on local conditions, uneven spread of these benefits in host country and most of all, sinking level of labour and social protection due to the increasing pressure on a country to create the most competitive conditions for foreign investors [2].

It can be summarized, that the FDI impacts upon the host economy´s welfare, development and growth in a number of ways [4].

- First, the investment increases the productive capability of the economy through investment in capital and labour.
- Second, the multinational enterprises will invest in the development of local networks within the host country to supply inputs and offer distribution channels for outputs. These enterprises have the potential to stimulate production in supplier and distribution firms within the host and can operate as a channel for technology transfer [1].
- Third, affiliates of the MNE can create local spillover effects on local firms through stimulating an improvement in the performance of local firms.
- Finally, there are potential increases in employment and income driven by FDI, which can be further enhanced by multiplier effects. However, employment effects and other benefits can be offset in the FDI results in the crowding out of domestic industry.

Overall, the extend and nature of these effects directly derives from the scale of the initial FDI; the technology used; the number of people employed; the training and wages offered; the market organization of affiliates; the extend to which affiliates buy goods and services locally, and the ratio of profits reinvested. All of these factors are compounded by the state of the host economy. The form and nature of these benefits is a reflection of the state of the development of both host and home economies.

Host states are motivated to FDI attraction due to potential increases in employment and income after the entry of FDI on their national market. Investment projects might result in multiplier effects on the entire host economy by stimulating domestic businesses and provision of better services. However, it may have also opposite impact. The extend of these effects for a host economy depends mainly on the size of the received FDI, transfer of the technology, number of employed people, the extent to which the TNC affiliates procure goods and service inputs locally, and the proportion of reinvested profits. The need of jobs in the region creates preconditions for race to the bottom in social and labour regulation as well as in the level of wages. However, "evidence" on TNC operations worldwide suggests that, in general, workers directly employed by foreign affiliates enjoy better wages, working conditions and social security benefits than those employed by domestic firms [5].

3 Foreign direct investment in the economy of Slovakia

In the year 2002 was created by the government of the SR Slovak Investment and Trade Development Agency (SARIO), governmental funded investment-promoting agency seated in the capital city of Bratislava. In following years SARIO provided significant institutional support for foreign investors. Under the care of SARIO there were many investment projects in automotive sector, in electronics, in chemistry, rubber and plastics and in machinery implemented [3].

The stimulation of the FDI inflow was prioritized as a one of the main goals. Strengthening of competition state in SR was achieved by legal regulation, which stipulated conditions of an state aid to chosen foreign investors: tax credit, discounted price for land, financial subsidies for acquiring tangible and intangible assets related to the investment, grants for the creation of new jobs and other forms of direct and indirect financial, institutional and legal support. One of the official reasons for state aid and other significant benefits for foreign investors was the need of capital in the country to create jobs and get the economy started.

The comparative advantage of Slovakia was the excellent strategic geographical position and a tax system privileging foreign capital. As the greatest advantage Slovakia considered its "cost effective" and well educated labour force, including its intellectual capital. This has been considered as a great comparative advantage of the country, one of the factors that foreign investors enjoyed maximizing their profit on.

In 2004, major tax reform was introduced to improve competitiveness of Slovakia among foreign investors. With regard to foreign investors, the Act on Investments stipulated a 100 % tax holiday for the first five years of operation, starting from the first profitable year and a 50 % tax holiday for the second consecutive five years. Strategic investors received 100 % tax credit for a full 10 years. Except the investor-favourable tax regime and low labour costs, Slovakia started to compete for capital by a variety of generous government incentives. The amount of the direct incentive generally depends on the region where the investment is to be located; unemployment rate in the region; the type of the investor´s activity; the amount of the investment; the qualifications of employees; and investment in modern technologies [9].

Investment incentives are available for three categories of foreign investment including: industrial production, technological centres and shared service centres. The technological centres refer to investments where company performs activities leading to the improvement of the production process and quality (research and development). Eligible costs attributable to investment incentives represent: cost of land acquisition, cost of technology and machinery acquisition, cost of building acquisition, intangible fixed assets – licenses, know-how etc.

Forms of investment incentives could be offered in various forms: cash grant, partial tax relief, contribution to new jobs – certain percentage of two-year salary costs per each new employee, transfer of the state/municipality property to the investor for a discounted price.
The total amount of the approved investment incentive as a percentage of eligible costs depends on the location of the investment in Slovakia based on four regions.

Historically, FDI inflows have been heavily concentrated in the western regions of the country, which are geographically closer to the rest of Western Europe, Slovakia´s main source of FDI. Bratislava alone has historically absorbed 60-70 % of total FDI with the industrial regions of Trnava, Kosice and Zilina.

Table 1

Foreign direct investments into Slovakia by country of investor (mill. EUR)

By country of origin	**2007**	**2008**	**2009**
FDI in Total	**24 307,1**	**26 803,1**	**30 380,1**
Netherlands	7 513,1	5 339,2	8 452,6
Austria	3 247,9	3 818,6	4 380,2
Italy	1 223,9	3 630,8	1 579,0
Germany	4 051,4	3 474,0	4 651,7
Hungary	1 795,5	2 072,5	1 950,0
Czech Republik	1 436,0	2 062,1	1 782,2
Cyprus	728,7	1 327,9	1 113,3
Luxembourg	596,1	954,5	740,0
Republik of Korea	710,5	710,3	711,2
United States	493,1	708,5	590,5
France	793,3	544,5	1 017,5
United Kingdon	451,3	400,8	597,5
Other countries	1 266,4	1 759,3	2 814,4

Source: http://www.nbs.sk

Table 2
Foreign direct investments into the SR by selected economic activities (in mill. EUR)

FDI by activities	**2007**	**2008**	**2009**
FDI in total	**24 307,1**	**26 803,1**	**30,380,1**
Manufacturing	10 200,9	10 631,8	-
Electricity, gas, water	4 049,0	5 058,5	-
Construction	349,9	298,6	-
Wholesale, retail trade	2 383,6	2 181,8	-
Transport, telecommunic.	1 228,8	1 437,5	-
Financial intermediation	4 449,7	1 023,1	-
Real estate, rent., BA	1 088,0	1 023,1	-
Other categories	557,2	600,3	-
By sectors	**24 307,1**	**26 803,1**	**30 380,1**
Bank sector	3 171,8	4 270,7	4 323,4
Enterprise sector	21 135,4	22 532,4	26 056,7

Source: http://www.nbs.sk

As to the 31 December 2009 the biggest investor in Slovakia was Netherland, which has 28 % proportion on the total amount of FDI in Slovakia. To biggest investors form Netherland belong Heineken, Phillips, ING Bank, Shell and Compaq Compute. Traditionally big investors come from Germany and Austria, these investors are located mainly in western part of Slovakia. The biggest investor is Volkswagen located in Bratislava. In the table are biggest investors according the regions in Slovakia (2011):

Table 3
Biggest transnational corporations as to the regions in Slovakia

Region	**Home country**	**TNC**	**Number of jobs**
Bratislava region	Germany	Volkswagen	9 829
Trnava region	France	Samsung Electronics	4 445
Trenčín region	Germany	Leoni Autokabel	3 600
Nitra region	Japan	Sony	2 685
Žilina region	South Korea	Kia Motors	2 700
Banska Bystrica reg	South Korea	Yura Eltec Corporat.	1 200
Prešov region	Polen	Merkury Market	607
Košice egion	USA	U.S.Steel	13 342

Source:http://www.statistika.sk
Current investment trend in Slovakia shows an increasing interest of foreign investors in region of middle and east Slovakia, as well as shifting in structure of investment into high added value investment, especially in western part of Slovakia.

Regional differencies are more visible in amount of expeted new jobs. While most of 68 548 expected new jobs have been created in Western Slovakia regions, number of new jobs is very likely to increase in middle and eastern Slovakia due to high accessibility and qualification of labour force in these regions.

The highest number of foreign investment projects were in the mechanical engineering industry (14), electromechanical industry (12) and automotive industry(11). The biggest transnational corporations investing in Slovakia :

US companies: US Steel, Emerson, IBM, HP, AT&T, Accenture
German companies: Volkswagen, Siemens, T-systems
Japanese companies: Sony, Panasonic, Mitsui Sumitomo, Yazaki
Korean companies: Samsung, KIA Motors, Hyundai Mobis
French companies: PSA Peugeot Citroen, Alcatel

The results of foreign direct investments are seen in many areas [6]:
On the firm level the technologies applied are being upgraded by FDI. The employees are exposed to a higher level of technology than before FDI. Another impact on firm level is the improvement of management methods. FDI improved training and qualifications of employees. A particular outcome of training and knowledge transfer is the diffusion of corporate cultures from parent company to subsidiary. Another possible result of FDI is the establishment of new supplier networks. The studies of FDI showed that investors started to develop long-term co-operation links with their domestic suppliers. Another effect is the improvement of process or service quality.

On a regional level the research showed that FDI had a positive impact on employment and average wages. *On a national level* FDI can influence the education and science system, the business sector and more widely the general society. Most subsidiaries with an R&D department had some sort of R&D co-operation. However, they have a different kinds of partners (parent, companies, public research institutes) and the intensity of co-operation with the domestic science and technology infrastructure is varies.

There are *effects* of FDI, which influence the society more widely and go *beyond the business- and research sector*. First of all FDI can develop a market milieu in society, can change the communication culture and contribute to a multicultural environment. Finally, some studies reported positive effects of FDI on environmental management and environmental situation (Siemens and OMV).

Conclusions

Slovakia has been one of the favourite destinations for foreign direct investment (FDI). These have not changed also when the global economy begins to recover, Slovakia continues to attract foreign capital.

Key drivers adopted in Slovakia include a flat tax rate, tax incentives and investor friendly legislation as well as a cheap and well educated workforce and also Slovakia´s geographical position and infrastructure network. The country has a strong heritage of engineering and mechanical production. The motivation and ability of Slovak workers, who also have good language and computer skills, has been repeatedly acknowledged by foreign companies.

Orientation on innovation which is viewed as a key factor of competitiveness in a global economy has to be crutial criteria in the process of evaluating the possible investments in a country for the future. Orientation on innovation will help in the growing competition in a world.

Bibliography

[1] Bessant, J. – Tidd, J. 2009. Managing Innovation. Integrating Technological, Market and Organizational Change. Chichester: John Wiley&Sons Ltd., 2005. ISBN 978-0-470-99810-6.

[2] Dunning, J. H. 1994. Re-evalating the Benefits of Foreign Direct Investment. In : UNCTAD Transnational Corporations, Volume 3, 1994, No. 1.

[3] Invest in Slovakia. Slovak Investment and Trade Agency. [online]. 2011. Dostupné na internete: http://www.sario.sk/?fdi-and-success-stories/

[4] Johnson, D. – Turner, C. 2010. International Business. Themes and Issues in the Modern Global Economy. Routledge : Abingdon, Great Britain, 2010. ISBN 978-0-203-86161-5.

[5] Lee, K. – Carter, S. 2005. Global Marketing Management. Oxford: Oxford University Press, 2005. ISBN 0-19-926752-9.

[6] Lesáková, Ľ. 2010. Inovácie – hybné sily rozvoja podnikania v procese globalizácie svetovej ekonomiky. In : Determinanty inovačnej activity malých a stredných podnikov v SR (2. časť). Banská Bystrica : Ekonomická fakulta UMB, 2010. ISBN 978-80-8083-935-2.

[7] Mellahi, K. – Frynas, J. G. – Finlay, P. 2005. Global Strategic Management. Oxford : Oxford University Press, 2005. ISBN 978-0-19-926615-9.

[8] Priame zahraničné investície. [online]. 2010. Dostupné na internete: http://www.nbs.sk/sk/statisticke-udaje/priame- zahranicne-investicie

[9] Slovakia Investment Climate 2009. [online]. 2009. Dostupné na internete: <http:// www.eubusiness.com/europe/slovakia>

[10] Ubrežiová, I. 2008. Medzinárodný manažment a podnikanie. Vysokoškolská učebnica.. Nitra : Slovenská poľnohospodárska univerzita, 2005. ISBN 978-80-552-0069-9.

[11] http://www.nbs.sk/

[12] http://www.statistika.sk/