FOREIGN DIRECT INVESTMENT IN THE SLOVAK ECONOMY AND ITS INFLUENCE ON THE BUSINESS SECTOR

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The Economics Faculty of the Technical University in Košice in the course of 2002 undertook a questionnaire survey at selected Slovak enterprises owned wholly or in part by a foreign investor[1]. The aim of this survey was to analyse foreign direct investment (FDI) in Slovakia and its influence on the business sector – in particular from the aspect of the position and relations of Slovak branches of a foreign owner in the framework of a network of firms having a multinational owner, the relations of a Slovak branch with other firms in Slovakia and the expected trends in these fields.

Partial results of the survey

In the first phase of the survey 314 questionnaires were sent to firms having foreign participation, 76 (24.2%) of which were completed and returned by the end of August 2002. The survey was anonymous and provided the following results:

• Of the firms monitored in 69% of cases the foreign investors held a 100% ownership stake in the firm.

• From the aspect of the level of product processing, end products dominate, in particular in the consumer goods industry (textiles, electro-technical equipment, furniture, clothes, paper, metal constructions). While intermediary products represented the lowest percentage, they do however have a high share in terms of volume (the automobile industry, metal processing).

• In the field of decision-making competences, all responsibility for individual areas of activity we can see a gradual positive trend in the shift of responsibility of foreign partners into the hands of Slovak management, and this in all areas of activity with the exception of the technical development of products and strategic planning.

Domestic management competences are highest in the fields of accounting and financial management (86%), and approximately the same situation can be observed in the field of product management (in this field in the initial phases of FDI input the foreign owner conducted most of the decision making). The competences of the Slovak management are somewhat lower (83%) in the field of operations planning. Other areas of competence held by the Slovak management included: supply and logistics (76%), price setting, investment planning, sales distribution (59%), market research (56%). In other fields the responsibility of the Slovak management is also relatively high, in the range 50 – 55%.

• With the entry of foreign investors the significance of domestic research generally fell. In particular in the framework of large concerns research is concentrated in the parent organisations, something which however is a worldwide trend. A typical example is the automobile industry, where the concept of a “Slovak car” is at present unrealistic. There is however here the chance to develop an end product in the structure of programmes, which achieve a higher level of sophistication. On the other hand, smaller firms make use also of domestic research, for example in electro-technical fields, the food or paper industry.

• In almost all the sectors monitored it may be stated that there has undoubtedly been an expansion in the number of product ranges following the entry of a foreign partner. The range of goods in the food, textile, rubber, plastic, metal construction, machinery and equipment industries expanded markedly.

The number of product ranges in individual organisations is influenced either exclusively or to a prevailing extent by the foreign investors, especially in the sectors textiles, metal constructions and electrical machinery. In the field of business activities in the organisations monitored decision-making competences (in terms of the domestic management versus the foreign owner) are approximately evenly balan-

[1]The project “EU Integration and prospects for balancing differences in the economic development of the countries of Central and Eastern Europe. Setting the determinants of productivity gaps) is supported by the European Commission in the framework of Contract no. HPSE 2001-00065 (http://www.tuke.sk/ekf/prodgap/main_sk.html)

[2]The number of product ranges is understood to be the number of clearly different products that a firm produces. Products are sufficiently different from one another if they fulfil essentially different consumer needs. A service is also understood to be a product.

ced. In this respect differences between sectors can be observed. For example, decision-making at a domestic level dominates in the field of raw materials extraction, textiles (50%), rubber and plastics products (100%), and other non-metal products (100%). Decision-making by the foreign investor dominates in particular in the food sector, timber industry, metal constructions and communications.

• As regards the level of importance of a firm's financing sources, own revenue is seen as being the most important, followed by the foreign owner's resources. Also other domestic sources (banks, firms etc) are relatively important. Financing from (other) domestic branches of the foreign owner is seen as being the least important.

• An interesting finding can be seen in the survey's results on the significance of individual fields for a firm's competitiveness (a scale of 1 – 5 was used, 1 being the least important):

– Quality – is rated in almost all sectors as extremely important (five) or very important (4).

– Licenses, patents, research and development – the evaluation of the importance of these is lower, the evaluation important (3) or of little importance (two) dominated. The reason lies apparently in the fact that in not all organisations is there used a form of licences.

– Human resources – here there dominated the evaluation very important (4) and important (3). The evaluation 5 was given in only a few cases and the lower evaluations 1 and 2 almost did not occur at all. On the basis of the research carried out in 2001 foreign investors evaluate the workforce in Slovakia very highly, in particular from the aspect of technical level, but also recently in the field of management. Slowly language barriers are diminishing.

– Business management – the evaluation very important (4) and extremely important (5) prevailed, where lower evaluations occurred only in a few exceptional cases.

• The expected course of development was seen as being mostly stabilised, to a lesser extent was growth expected; and this in a practically all the cases monitored. We recorded only a negligible fall in the fields extraction, foods and textiles.

As regards sales and exports, growth is forecast in the foods and textile sector, and in the timber and rubber industry. No change is expected in the production of televisions, metal constructions and machinery and equipment. In the sector of other non-metal components, communications, metal constructions and machinery and equipment changes are not expected.

In the field of business activities (other than sales) growth is forecast in the textile, timber and electrical and machinery sectors. In the sector of other non-metal components, communications, metal constructions, machinery and equipment changes are not expected.

In the field of manufactured products growth is forecast in particular in the rubber and metal constructions sector. In the sectors textiles, chemicals, communications, machinery and equipment production sectors change is not expected.

• The contribution of a foreign partner to the manufacturing activity of Slovak enterprises is great. The lowest evaluation of this is given in the field of domestic sales (73%). In other indicators monitored the contribution of foreign partners increases substantially – value of exports (82%), productivity level in manufacturing processes (88%), technological level of manufacturing machinery and equipment (82%), production quality (88%).

• Exports according to the individual sectors monitored generally exhibit a growing trend. An exception is the extraction industry and raw-materials processing, other services, food production, printing, production of non-metal minerals, the hotel industry and communications. Other sectors are pro-export oriented. Production is in most cases intended for the foreign partner, or other foreign customers, and only to a lesser extent domestic branches or other domestic customers.

Results are conditioned by the fact that Slovakia is a country with a small domestic market. Foreign investors must be pro-export oriented in order to sufficiently capitalise their investments in manufacturing. An advantage is at present lower production costs, our main comparative advantage of which is the cheap workforce (though however this cannot be considered a permanent factor) and strategic position. The foreign investor in many cases significantly supports exports also through the fact that it makes foreign markets available.

• Imports and domestic sales according to individual suppliers exhibit trends similar to those of exports. The share of exports from Slovak suppliers has grown recently, which is a positive trend. This is true in particular in services, animal produce, parts of the chemical industry, the manufacturing of non-metal products, the production of metals, metal constructions, parts of machinery and components production and in furniture manufacturing. Other sectors are from the aspect of imports more proportionally divided between suppliers from aboard and domestic partners.

In essence however the import of raw-materials and semi-finished goods remains high even in those sectors where domestic raw-material sources could be used, such as the furniture, paper, textile industries, as well as in a part of the machinery and electrotechnical industry.

Labour productivity and added value in SR industry

Labour productivity

In 2001 we recorded growth in labour productivity for the SR of 8.3%, which though, in comparison with the year 2000 (15.5%), represents a slowdown in growth by 6.7 percentage points.

As regards individual sectors, the slowdown in labour productivity growth can be seen in the tanning and timber industry, in the production of glass, metals and metal constructions and in the production of optical instruments. A growth trend can also be observed in food production, in the textile industry, labour productivity has risen significantly in the pharmaceutical industry, in the office equipment and computers sector and in the production of radio, television and connection equipment.

Recently there has also been observable a deepening effect on domestic industry from the operation of enterprises in 100% (or less) foreign ownership. Besides the direct input of FDI in individual Slovak manufacturing organisations, multiplier effects can also be seen in the case of cooperation relations, where the parent organisation exerts influence also on the employees of sub-supplier firms in order that the same level of production and labour productivity is met.

Volkswagen, Bratislava, can be said to be an example of this, where the level of labour productivity in the year 2000 was 12.3 million SKK/employee, which according to experts already represents the level of labour productivity of the concern and in certain cases even exceeds it. Volkswagen in the framework of Slovakia currently interlinks its business fully with Slovak small and medium-sized enterprises in the production of components, and this for the whole concern (not simply for the Bratislava branch), which represents approximately 150 enterprises.

Also in the chemical industry enterprises with foreign participation, in particular larger enterprises, achieve above-average results in labour productivity, for example Slovnaft, a.s., Bratislava achieved in the year 2000 10.5 million SKK/employee and Henkel Slovensko, s.r.o. 10.0 million SKK/employee. There are in this field also very good results in the food industry, primarily at RAJO, a.s., Bratislava, achieving labour productivity in the year 2000 of 9.2 million SKK/employee. Other enterprises with FDI in the given sector achieved lower results, ranging from 4 – 6 million SKK/employee, but are recording continuous and relatively fast growth. The situation can be said to be worse in Slovak enterprises, which are undercapitalized and are therefore unable to keep up with their foreign competitors. Remarkable results were achieved in the paper industry SCA Hygiene Products, s.r.o., Gemerská Hôrka achieving in the year 2000 labour productivity of 9.4 million SKK/employee, representing rapid rate of growth against the previous period.

Labour productivity in Slovak footwear firms with foreign participation is higher than in Slovak enterprises and is also recording faster growth. A similar situation can be seen in the textiles, clothes and leather industry. This group of organisations in 2001 showed an overall upturn in Slovakia.

From the results of the survey it is apparent that the leaders in individual sectors are in particular organisations with foreign participation, at the majority of which labour productivity exceeds the Slovak average and approaches the European level. This concerns both enterprises with a high degree of work organisation in terms of the logistics basis – for example automobile assembly at Volkswagen, but also a simpler type of manufacturing, which is in large part automated, for example in the case of the mass production of washing powders and milk and milk products.

On the other hand there is a group of sectors in particular in the consumer goods industry with a high share of manual labour (the clothes, electronics industry), which overcame the great shock of losing former markets (CMEAS) and had to fight for new western markets. Among those first beginning to profit are enterprises with foreign participation.

Added value

As regards the level of added value achieved, which represents the actual performance of a specific organisation or sector, its share in earnings from industrial activity in Slovakia in 2001 was 25.7%, in absolute terms 176.2 billion SKK (an increase on the year 2000 by 12.6%).

This clearly points to the fact that the largest shares of added value in earnings from industrial activity are prevailingly in small and medium-sized enterprises in the consumer goods industry, specifically for the year 2001 in textile production of 38.5%, clothes production 53.6%, the leather industry 36.3%, production of radio and television receivers 27.1% and the production of optical instruments 36.9%. The common denominator is clearly a higher level of production finishing, whereas in the case of all other production sectors this largely concerns the production and assembly of manufacturing components where there is a significant share of imported raw materials and materials.

An example is again Volkswagen, Bratislava, where it achieves in Slovakia above-average labour

[3]3 Business data are taken from the publication Top Trend 2001 in Slovak industry. Year-book, supplement to the magazine Trend.

productivity as well as added value, i.e. the share in earnings from industrial activity is 19%. The results of a calculation of the inflows and outflows of transfers between the parent firm and subsidiary signal low added value. The situation is improving through a gradual increase in the sophistication of products, through the connection of Slovak enterprises to the concern's manufacturing activity and a forecast of a further positive trend is also the creation of an industrial park for the manufacture of components from domestic suppliers in the Zahorie region.

According to "Top Trend" the share of added value per employee in chemical production in Slovakia is roughly EUR 13 000 (561 million SKK for the year 2000) annually, where the figure for the EU is six times this. The respective figures for rubber and plastics production are approximately EUR 11 300 in Slovakia against EUR 45 000 in developed European countries. In both sectors this share is continually increasing, primarily in chemical production.

In the timber industry inconsistencies persist between the export of wood and its processing in domestic production. The share of added value in earnings in this sector in Slovakia is about average – 22.9% (18.5% for enterprises with FDI in 2001). The situation should continue to improve on the basis of a new programme for supporting the processing and use of wood raw-materials, and which the government approved in August 2001. The state is to subsidise loans for projects raising the level of finishing of wood processing. Good results in the sector in the years 2000 and 2001 are apparent also in the growth of investment, which in enterprises involved in the primary wood processing almost doubled and almost tripled in the case of furniture manufacturing (Svedwood has two new plants in Malacky, a Japanese investor is expected in Bučina Zvolen).

There are also signs of an upturn in pulp and paper production. The rate of value-added growth in the year 2000 was 30.5 percentage points. In the year 2001 however a slowdown was recorded but even so growth remains at 20.1%. The share of added value in earnings for the year 2001 for enterprises with FDI in this sector reached 33.6%. Growth in the volume of production, stable growth in labour productivity as well as added value puts the paper industry among the most productive in Slovakia. A large degree of the credit for these successful results should be attributed to the input of FDI into various enterprises. SCA Hygiene Products, s.r.o., Gemerská Hôrka, Assi Domän Štúrovo, BOKK-net, Kft. Štúrovo, Slovenské celulózky a papierne Ružomberok – the Austrian Neusidler AG. In this sector Slovak enterprises Papierne Slavošovce, a.s. and Tento, a.s. Žilina have also operated relatively successfully.

Organisations with FDI are achieving better results in all sectors. In Slovak enterprises there are meanwhile too big unproductive staff, obsolete equipment and differences also in the effectiveness in quality of work organisation. A common feature is the necessity of looking for ways to increase the attention given to quality production and services for the customer. Ways may also be found to increase the utilisation of the processing of raw-materials and materials from domestic sources.