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Foreign Direct Investment in the Privatisation of the Polish Economy

In the 1990s a major change took place in the ownership structure in the Polish economy, with a dramatic shift towards the private sector. The following article examines the different ways in which privatisation has taken place, the penetration of foreign capital into the Polish economy and the role which foreign direct investment has played in the transformation process.

Foreign capital plays a crucial role in the privatisation and restructuring of the Polish economy. Due to positive spillover effects and their long-term nature, the influence of foreign direct investment on the host economy is mostly positive as it assists in the creation of an economic structure based on private capital with clearly defined ownership. The optimal level of participation of foreign capital in the Polish economy is a controversial subject. For Poland it would be best if the foreign capital contributed to sustainable economic development. In this paper, it is therefore important that foreign investments were not of a speculative nature, but thanks to their permanent presence in the Polish economy, they have helped to build globally competitive market structures. This paper analyses how foreign direct investors have participated in the privatisation process of the Polish economy, and it shows the effectiveness of the enterprises privatised with the participation of foreign capital in comparison with other types of enterprises in Poland.

Foreign capital invested in Poland during the economic transformation is predominantly of a private nature. By investing in Poland, foreign private owners have helped to build an ownership structure based on private capital. When they set up their own companies or form joint ventures with Polish capital, they speed up rank-and-file privatisation. Simultaneously foreign capital participates in the privatisation of state enterprises, the transfer of state enterprises to the private sector using legal, statutory procedures. The privatisation of state enterprises is sometimes described as real privatisation – privatisation *sensu stricto*. In Poland, it takes two basic forms – direct and indirect privatisation. Direct privatisation involves the state selling small and medium-sized enterprises as a set of assets and liabilities with simultaneous liquidation of the state enterprise. Indirect privatisation is also called capital privatisation and it has two stages. In the first stage, the state enterprise becomes incorporated, and functions as a company regulated by the commercial code. In the second stage, the shares of the corporation are sold. A brief description of the forms of state enterprise privatisation in Poland is presented in the box. Foreign direct investment, the transfer of capital to gain revenue from economic activity, is the form of foreign capital inflow that gives the best restructuring effects – FDI helps to change the ownership structure to reflect those in mature market economies.

In market economies, usually 80% to 90% of enterprises are private. As a rule, no more than 12% of the labour force is employed by state-owned companies.[1] The public sector proportion of gross domestic product is similar. This means that state enterprises may also exist in a market economy. An effective privatisation process should be complete when the public sector comprises about 10% to 20% of all entities.

At the end of 1996, there were 55,500 entities in the public sector, the national total being 238,900. At this time, the public sector controlled 23% of all entities.[2] In March 1993 this figure was 33%, and in June 2000 approximately 25%. In terms of quantity, in the period

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[1] Public companies – owned by state or regional/local governments.

[2] This number does not contain civil partnerships or enterprises owned by private individuals.

Methods of State Enterprise Privatisation in Poland

1. Indirect privatisation. At the first stage the state enterprise is transformed into a corporation where the sole shareholder is a State Treasury company (so-called commercialisation); later on the company is privatised by one of the following methods:

- *capital privatisation:* shares of the company are sold to third parties by public offering, public tender or by public invitation to negotiation – this method applies to the biggest and best companies

- *inclusion in the portfolio of the National Investment Funds*

- *privatisation with creditors:* commercialisation with the conversion of debt (liabilities) and transformation of the state enterprise into a limited liability company with participation of creditors for its financial restructuring.

2. Direct privatisation (art. 37 of the 13th July 1990 Act on Privatisation of State Enterprises, art. 39 of the Act on Commercialisation and Privatisation of State Enterprises) realised by the following methods:

- *sale* of the enterprise by public tender or after public invitation to negotiation addressed chiefly to domestic investors; only when they cannot be located are foreign investors invited (enterprises with less than 500 employees)

- *acquisition:* by method of public invitation to negotiation, the State Treasury sets up a company based on the commercial code with an outside investor who must contribute at least 25% of the value of the core capital; the State Treasury may transfer the enterprise into an existing company or into a new company set up by the Treasury and the employees of the enterprise - the employees of the enterprise are entitled to acquire at no cost up to 15% of the State Treasury share in the company

- *leasing of the enterprise to a company set up by employees is possible if:*

- more than 50% of the employees will found the company;
- the shareholders are only private persons living in Poland, unless the Ministry of Treasury allows otherwise;
- the share capital must be no less than 20% of the sum of both the initial capital offered by the shareholders and the capital of the enterprise being privatised;
- at least 20% of the shares are held by outside investors - persons not employed in the enterprise.

A specific method of privatisation which applies to some assets of the enterprises is the liquidation of the state enterprise based on the 19th article of the Act on Privatisation of Enterprises. This method is used for enterprises in poor economic condition. Some parts of the enterprise are sold to outside investors, while the state enterprise is liquidated.

1996-2000, the public sector grew a bit more quickly than the private sector, although the number of state and municipal enterprises was constantly decreasing.[3]

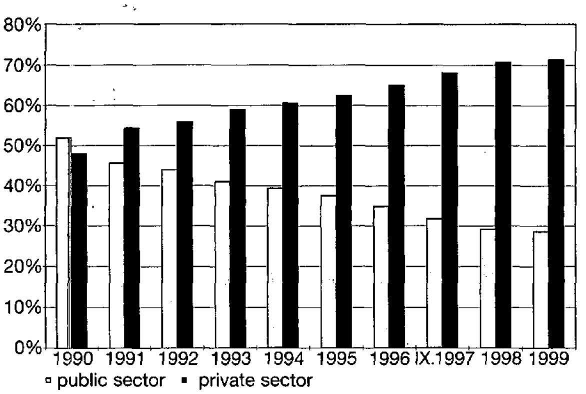
At the end of 1997, there were 261,500 entities registered in REGON[4] of which 151,800 were enterprises, co-operatives and companies. Of the latter number, 23,400 were state and municipal enterprises and co-operatives. The types of entities that had been dominant in the socialist system represented just 15.4% of the business sector in 1997. In 1992, this share was 27.5%; in 1999 only 13%.

In 1999, 28.6% of all workers employed in the Polish economy worked in the public sector and they

[3] The public sector in Poland contains different forms of entities like state, regional and local government institutions and different governmental agencies and funds as well as the companies created after the first stage of indirect privatisation i.e. the sole shareholder companies of the State Treasury and state and municipal enterprises. In recent years, the number of state and municipal enterprises was decreasing, but the total number of entities in the public sector grew. This happened due to reforms like the decentralisation of Polish government and reforms of the health-care and educational systems.

[4] REGON – The National Official Register of Nationalised Industrial Entities – is a register in which entities of the national economy are registered. The term entities of the national economy is understood as legal entities i.e. legal persons, independent organisational entities without legal status as well as persons conducting economic activity. This term is broader than the term economic entities which are entities conducting economic activity i.e. production and service activities for purposes of profit and for the entities' own account. The number in the text does not contain civil partnerships and enterprises owned by private individuals.

Figure 1
Employment in the Public and Private Sectors



Sources: Statistic Yearbook of Poland, GUS 1997 and 2000, Gdansk Institute for Market Economy.

produced 29.6% of the gross domestic product. At the end of the 1980s, about 70% worked in the so-called planned sector, state-owned and cooperative, and they produced about 80% of GDP. In 1990, the private sector in Poland employed 48% of all workers; and at the end of 1999 this figure was 71% (however, simultaneously the absolute number of people employed in the Polish economy decreased). This means that there was an important change in the ownership structure of the economy. Figure 1 shows how the relationship between public and private sectors changed in the period 1990-1999 as measured by the number of workers employed.

The share of employment in foreign companies at the end of 1999 was 5.8% of all employed while in 1996 this number was 4.6% and at the end of 1991, 1.3%. The share of foreign capital in the capital stock of all entities was 17.6% in 1999 while in 1996 it was about 9% and in 1992 about 3%. At the end of 1999, the highest penetration of foreign capital (as measured by share of foreign capital in the capital stock) was in the following branches: trade and repair – 50.5% (1996: 29%), hotels and restaurants – 32% (1996: 20%) and industry – 26% (1996: 16%). The most foreign capital was in industrial sectors – about 40% in manufacturing.[5] In banking, the share of foreign capital in equity capital was estimated in 1998 at 42%, while in June 2000 foreign capital owned nearly 70% of all the assets of the Polish banking sector.

In 1993, entities with foreign capital participation constituted about 8.63% of all the entities of the national economy, while since 1996 this indicator has been in the range of 12.2% to 12.8% (cf. Table 1, Figure 2).

Foreign investors in Poland may set up joint stock or limited liability companies. Moreover, in Poland there are also foreign small-size manufacturing enterprises – a relic of the socialist system. However the number of them is constantly decreasing. Foreign investors mainly set up limited companies – at the end of 1999 firms with foreign participation equalled almost 28.5% (27% in 1996) of all the limited companies and 14.4% (1997 – 13.7%) of all the joint-stock companies. The share of foreign capital in the initial capital of all joint-stock companies in 1996 was 65% (in 1993 – 80%), and in the initial capital of limited companies – 83% (in 1993 – 70%). This means that in terms of initial capital, the average foreign company is bigger than the average Polish company. Figure 3 shows how the share of foreign capital in the Polish economy was growing in the 1990s.

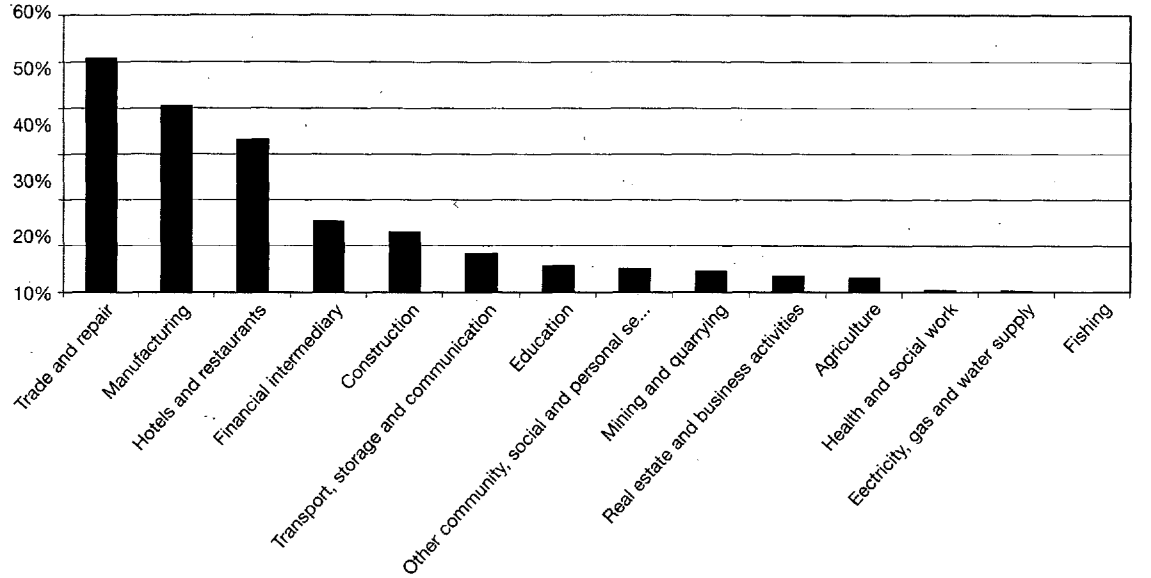
Table 1
Firms with Foreign Capital in the Polish Economy

Year	Entities of the national economy[1]	Firms with foreign capital						
		Sum	As percentage of all entities	Joint stock companies	As percentage of all joint stock companies	Limited companies	As percentage of all limited companies	Small foreign manufacturing firms
1993	183256	15814	8.63	332	10.6	14835	18.73	647
1994	196152	20324	10.6	425	10.91	19312	21.42	587
1995	210262	24634	11.72	553	11.67	23533	23.71	548
1996	238923	29157	12.20	704	12.6	27918	25.58	535
1997	261503	33460	12.80	872	13.67	32070	26.94	518
1998	295777	37355	12.63	1010	14.34	35840	27.92	505
1999	332758	40910	12.29	1092	14.43	39320	28.47	498

[1] All available forms except civil partnerships and sole traders.

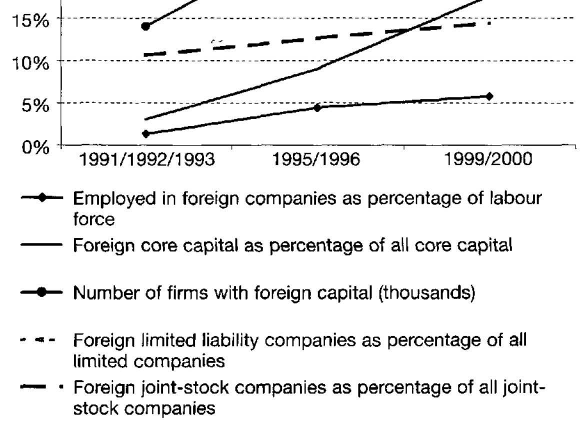
Source: Statistic Yearbook of Poland, GUS 1997, 1998 and 2000, Gdansk Institute for Market Economics.

Figure 2
Penetration of the Core Capital by Foreign Capital according to Branches



Source: Statistical Yearbook GUS 2000, Gdanks Institute for Market Economics.

Figure 3
Foreign Capital in Poland 1990 - 2000



Source: Main Statistical Office, Gdansk Institute for Market Economics.

The above data show that in the 1990s, in line with the liberalisation and restructuring of the economy, the role of the public sector decreased and the role of the private and foreign private sector grew. Simultaneously, foreign capital helped to create an economic structure based on companies regulated by the commercial code. In contrast, privatisation based on domestic capital often does not lead to the founding of corporations (most new domestic firms are not commercial code companies). This means that in Poland foreign capital assists in the transformation to a structure similar to that of mature market economies.

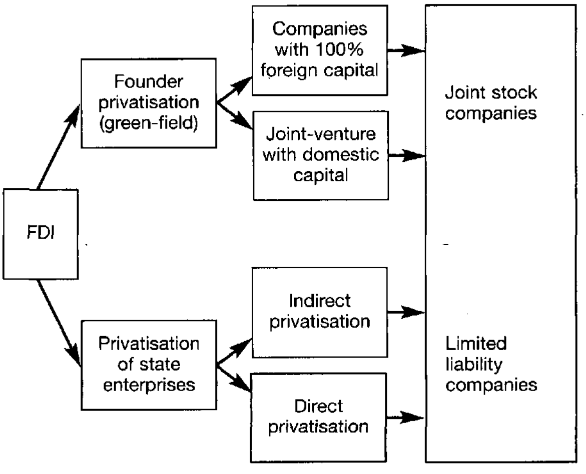
FDI as a Method of Privatisation

By participating in the privatisation of state-owned enterprises foreign direct investment accelerates the transfer of ownership rights from the public to the private sector, and by participating in founder privatisation speeds up the development of the private sector. Figure 4 shows the ways FDI participates in the privatisation process and how foreign capital contributes to the building up of an ownership-entity structure based on private capital and the commercial code.

Figure 4 does not include all the methods of entry into the Polish market by foreign investors. Apart from setting up new entities (founder privatisation), or entry by purchase of shares in state enterprises, foreign investors may also buy assets of existing private or

[5] Penetration by foreign capital is not proportional to the absolute foreign capital invested in particular branches: at the end of 1999 most foreign capital in core capital was in : 1. Industry (Zloty 23,228.5 m. of which Zloty 22,846.9 m. in manufacturing) 2. Trade and repair (Zloty 11,635.6 m.) 3. Real estate and business services (Zloty 2,513 m.) 4. Transport, storage and communication (Zloty 2,227.3 m.)

Figure 4
FDI as a Path to Privatisation



Source: Gdańsk Institute for Market Economics.

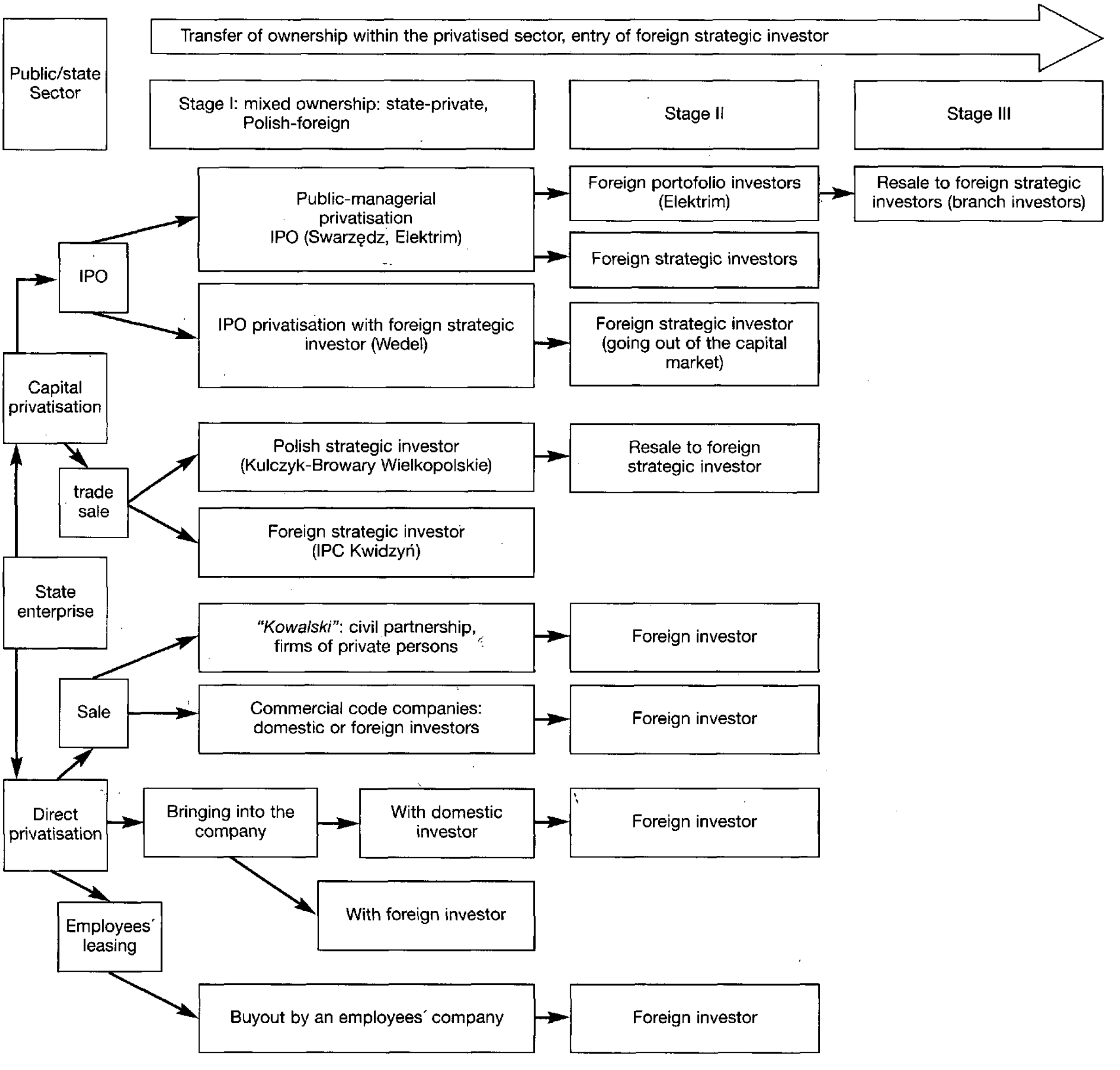
privatised (previously state) enterprises. In the latter case, there is no transfer of ownership rights from the public to the private sector, nor acceleration of the development of the private sector by the establishment of new firms. However, transfer of ownership rights occurs within the private or privatised sectors accompanied by the replacement of the domestic owner by the foreign owner. In addition, purchase/sale transactions between foreign investors themselves may also occur.

The Polish method of privatisation of state enterprises is characterised by the diversity of available methods and many stages. Foreign direct investment occurs at various stages of the privatisation of state property. Sometimes a strategic foreign direct investor appears just after various portfolio investors, including foreigners, have purchased the initial public offering of the enterprise. The appearance of strategic investors at different stages of privatisation, as a result of the transfer of ownership rights within the privatised sector, is proof of the indispensability of foreign capital for the effective restructuring of enterprises. FDI also makes it possible to strengthen privatisation and enhance its quality, especially from the point of view of corporate governance. An effective mechanism of corporate governance is as important as the transfer of ownership from the public to the private sector. Owners who are used to mature market economies bring in patterns as well as models of management, which when implemented in domestic enterprises may help to solve the ownership-management dilemma. Figure 5 shows foreign investors assuming the ownership rights of state enterprises along with the strengthening of the privatisation of state enterprises. Initially, privatisation may be realised according to the rules of capital privatisation (by initial public offering or sale to the strategic investor – called a trade sale) or direct privatisation (by methods of sale, employee leasing or acquisition).

The majority of foreign direct investment in Poland takes the form of joint ventures with Polish capital. In the case of founder privatisation, these are joint ventures with private capital, and in the case of privatisation of state enterprises, joint ventures with state capital (when the foreign strategic investor acquires shares in a commercialised state enterprise – for example, capital privatisation, or a National Investment Fund). The most advanced form of foreign capital expansion in a host country is the setting up of branches in which the foreign enterprise is the exclusive owner. In FDI theory, such investments give the most control over an enterprise, but they also have the highest risk. This sort of investment, as well as joint ventures, may be either green-field or brown-field. Green-field investment takes place when an investor builds the enterprise from scratch and brown-field investment when an existing firm is purchased. Any entry of foreign investors into state enterprises or previously privatised firms as well as buyout of private firms is considered brown-field investment (Figure 6).

A specific feature of the privatisation of state enterprises in Poland, at least its first stage, is a relatively small share of foreign investments made by purchasing stocks/shares of companies directly from the state. According to OECD data, foreign direct investment of this type accounted for 38% of FDI in Poland while in Czech Republic 67%, in Hungary 60%, and in Russia 63% (1997). Such a weak showing by Poland is mainly due to the slow pace of privatisation as well as the low interest shown by foreign investors in Polish state enterprises. Moreover, the majority of foreign investments that could be called green-field are in Poland small and medium–sized investments. There is a lack of large-scale green-field investments such as investments by multinational corporations, which are perceived to create the most positive spillover effects for the rest of the economy, especially in the field of technology transfer. It is estimated that more large-scale green-field investments should take place after the privatisation of state enterprises is concluded.

Figure 5
FDI in the Privatisation of State Companies



Source: Concept by J. Szomburg, Gdansk Institute for Market Economics.

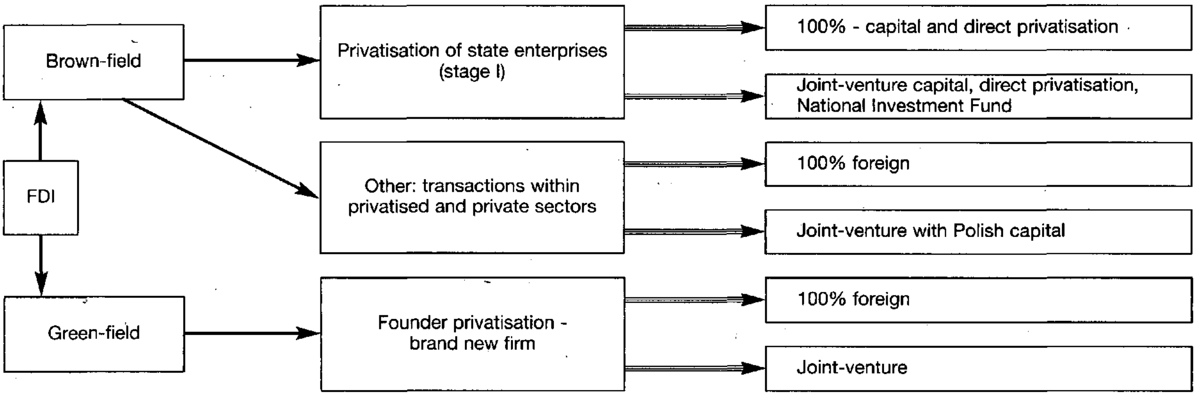
Foreign Investors in the Privatisation of State Enterprises

According to the Act on Privatisation of State Enterprises, foreign investors may participate in capital or direct privatisation, with the exception of direct privatisation by employee leasing. Foreign investors may buy shares of firms offered publicly (initial public offering – IPO), and they may also take part in tenders announced by the office responsible for the state enterprises privatisation (trade sale). Foreign investors are also entitled to set up companies to receive the property of a liquidated enterprise. Both foreign and domestic investors may either be active (strategic) or passive investors. Active investors will strive to take full control over the enterprise, while the passive exert control by their representatives in the supervisory board without participation on the board of directors (management).[6]

Budget revenues from privatisation of state enterprises (since 1998 – income) in the period 1991-1999

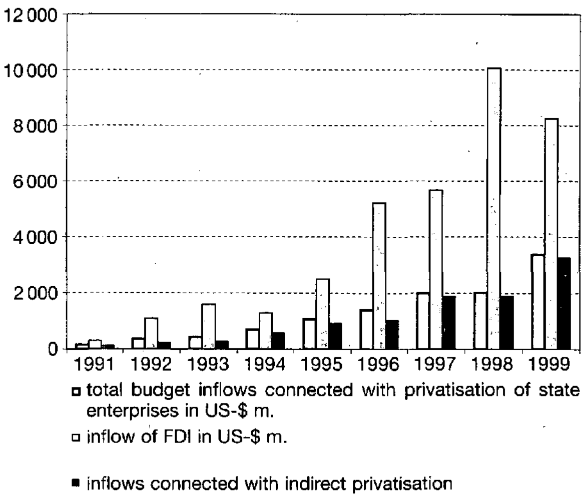
[6] Major passive investors in Poland include the European Bank for Reconstruction and Development, the Polish-American Entrepreneurship Fund and the International Finance Corporation.

Figure 6
Green-field and Brown-field Investment in Privatisation



Source: Gdańsk Institute for Market Economics.

Figure 7
Foreign Direct Investment and the Revenues from the Privatisation of State Enterprises



Source: PAIZ, Main Statistical Office, Gdansk Institute for Market Economics.

reached the amount of US $ 11.5 billion (while total foreign investment inflow reached US $ 39 billion – Figure 7). Traditionally, the biggest part of these revenues comes from capital privatisation, called trade sale of the commercialised state enterprises. Since 1992, the importance of the revenue from the sale of state banks has been growing. Foreign investors may participate in both of the above types of privatisation (cf. Tables 2, 3 and 4).

Most attractive for foreign capital is indirect/capital privatisation, which applies to the biggest and best firms. Through the end of June 2000, foreign strategic investors purchased shares in 143 of the 272 sole shareholder companies sold directly by the State Treasury. Mixed investors (domestic and foreign partnerships) bought shares in 63 of these companies. Domestic concerns bought into 129 companies. Transfer of ownership was realised by methods of: public invitation to negotiation – in the case of 181 companies, by public tender – 47 companies, by public initial offering – 44 companies.

Forty-six per cent of companies privatised by capitalisation were privatised with foreign strategic

Table 2
Budget Revenues from Trade Sales

Capital privatisation		1990	1991	1992	1993	1994	1995	1996	1997	30.06.1998
Income from sales in Zloty m.	Polish investors	2.4	22.1	5.2	95.4	121.9	341.6	591	64.6	15.9
	Foreign investors	2.1	134.6	290.9	319.4	236.2	1165.1	1139.2	1731.4	1040.6
	share of foreign investors in total	47	86	98	77	66	77	66	96	98
Investment obligations in US $ m.	Polish investors	0	6.2	19.4	333.9	145.1	361.4	720.3	194.5	11.6
	Foreign investors	0	193.8	514.9	894.9	49.1	1240.9	664.8	2000.6	1442.4

Source: KIE (Committee of European Integration), Gdansk Institute for Market Economics.

Table 3
Balance of Privatisation

Enterprises under transformation, till 30th June 2000, total		5080	100.00%
commercialisation		**1487**	**29.30%**
	privatised	924	62%
direct privatisation		**1932**	**38.00%**
	finished privatisation	1781	92%
liquidation		**1661**	**32.70%**
	finished	843	51%

Sources: The Treasury Ministry, Gdańsk Institute for Market Economics.

investors. From the point of view of revenue from capital privatisation, the share of foreign capital was higher – more than 90% of revenue came from sales to foreign investors. That was due to the fact that the average value of an enterprise bought by a foreign investor was usually higher than the average value of an enterprise bought by a domestic investor. For example, in 1996 the average enterprise bought by a domestic investor was worth seven times less than the average enterprise bought by a foreign investor (in 1997 the average value was twelve times lower). A large number of investors who buy shares during initial public offering are also foreign investors. Foreign capital participating in privatisation by trade sale originated mainly in: Germany (14% of all the enterprises privatised by this method), USA (8%), Netherlands (5%), Sweden (3%), France (3%), Great Britain (2%), Switzerland (2%), and Finland (1%).

Through the end of 1997, total budget income from the sale of companies to foreign investors was about US $ 3.6 billion so it equalled about 20% of the total FDI inflow to Poland at that time. At the end of 1996, 98% of the shares bought by foreign investors were those of manufacturing firms, mainly in the food industry (48.4%), chemical industry (15.9%), electric machinery (14.5%), wood-pulp industry (9.9%) and mineral industry (8.4%).[7]

Foreign investors also participate in the National Investment Funds programme. The NIF Programme is a form of mass privatisation in Poland. The aim of the programme is the privatisation and restructuring of 512 commercialised large and medium-sized state enterprises: allocated to 15 investment funds. In this way, a portion of state property is transferred to all entitled citizens by means of mass share certificates exchanged for shares of the national investment funds.

The ownership structure of the fundamental companies included in the programme after the allocation of their stocks to the funds (1995/1996) was as follows: 33% – the leading fund – having the controlling share (majority packet), 27% – other funds with minority packets (1.9% for each of the remaining 14 funds), 25% – State Treasury, 15% – company employees. The Funds are joint-stock companies, in which initially the State Treasury owned 100%, and at the end of June 1998, 69%. In June 2000, the state's

Table 4
Budget Revenues from Privatisation and Inflows of Foreign Direct Investments

	1991	1992	1993	1994	1995	1996	1997	1998	1999	till June 2000	Total
Total budget inflows connected with privatisation of state enterprises in Zloty m.	171	499	789	1615	2615	3750	6540	7069	13348	-	36395
As share of total budget revenues	0.8%	-	-	-	3.12%	3.76%	5.5%	-	-	-	.
Total budget inflows connected with privatisation of state enterprises in US$ m.	161.49	365.93	435.05	710.48	1078.49	1404.42	1993.90	2023.27	3362.09	-	11535.12
Inflows connected with capital privatisation as percentage of total	73.43	64.78	56.80	53.67	65.56	52.00	57.80	72.00	35.40	-	.
Inflows connected with privatisation of banks as percentage of total	0.00	0.80	6.90	26.70	19.70	22.10	36.80	21.70	61.60	-	.
Inflows connected with direct privatisation as percentage of total	26.50	34.40	36.60	19.60	14.80	26.00	5.40	6.00	3.00	-	.
Annual inflow of FDI in US$ m.	300	1100	1600	1300	2500	5230	5678	10064	8261	3700	39733

Sources: GUS (Main Statistical Office), PAIZ (Polish Agency for Foreign Investment), Gdańsk Institute for Market Economics.

share was between 13% and 15% (state share decreases with the exchange of the public's certificates for shares of the funds). Initially, the majority of funds employed a management firm, which was usually a consortium of Polish and foreign banks, financial institutions and consulting firms.

Foreign capital in the NIF programme appears both at the funds level – foreign banks or investment firms – as well as at the ground floor company level – as strategic investors, who buy shares of the companies by purchasing leading packets from the NIF, or by purchasing the shares of new issues.

In the period between second quarter 1996 and second quarter 1998, strategic investors bought shares of 119 ground floor companies. Quantitatively, domestic investors dominated – they bought packets in 91 companies. Yet the value of these transactions equalled only 31% of all transactions. Foreign investors bought shares in 28 companies but the value of these transactions made up 69% of the total value of the transactions.

Major foreign investors – in terms of both transaction quantity and value – were Germans, followed by French and Americans. European Union countries are the major purchasers. Foreign investors bought chiefly the stocks of the largest and most attractive enterprises. Through the end of second quarter 1998, all foreign investors buying shares of companies from NIFs were among the first fifty firms on the FORTUNE 500 list.

Foreign investors may also participate in direct privatisation, but they purchase state enterprises only when there is no domestic investor. However, an essential part of FDI in Poland is probably connected with the sale of enterprises that were previously privatised through one of the methods of direct privatisation. Direct privatisation still remains the most effective method of privatisation in Poland – through the end of June 2000, 1781 of 1932 enterprises (92%) were privatised in this manner. Budget revenues of direct privatisation take the form of cash inflows from standard sales or of leasing instalments for employee-owned companies. So far, most of the revenues came from leasing. In the period 1990-1996, leasing accounted for 66% of annual revenues. Remaining budget revenues came from the sale of enterprises and some of this comes from foreign investors.

Due to the fact that the regional state authority is entitled to decide on the sale of a small or medium-sized enterprise, it is difficult to estimate the participation rate of foreign investors. In the period 1990-1997, about 80 enterprises were privatised in this way with the participation of a foreign investor (approx. 6%).[8]

Privatisation of State Banks

An important part of privatisation budget inflows is revenue from the privatisation of state banks. Foreign capital has taken part in the privatisation of the Polish bank sector. Through July 1998, foreigners invested over US $ 2.5 billion in the Polish bank sector, which equalled about a 42% share in the stock capital. At the end of June 2000, foreign direct investment in banking reached US $ 9.2 billion, which equalled about 70% of all the assets of the sector.

Participating in the privatisation of the bank sector, either as a founder or in the privatisation of state banks, foreign investors buy into the market in order to gain corporate control. In this way, they help to build a suitable corporate governance structure, to speed up and strengthen the privatisation of state enterprises. One cannot speak of private enterprises while the shareholders are state banks. Foreign banks with new technologies may help to improve the quality of corporate governance.

After manufacturing, banking is the second most attractive branch for foreign capital. In the first half of 2000, the majority (13) of the 15 biggest and most profitable banks in Poland were banks with a foreign capital majority or banks with foreign participation. However, the biggest bank in Poland – PKO Bp S.A. is still Polish-owned. It possesses one fifth of the assets of the Polish banking system. However, foreign banks achieve the best results in annual rankings done by the Gdansk Institute for Market Economics. In 2000, BRE Bank received the highest grade: A. BRE Bank has 49% foreign capital. In the same ranking, PKO Bp received a much lower grade: D-.[9]

In the period 1997-2000, the share of foreign capital in the Polish banking system grew quickly due to the acceleration of the privatisation of state banks. In the banking sector, it is important to maintain a ratio of about 70:30 in favour of banks with majority Polish capital and minority foreign capital rather than vice

[7] M. Zarzycki: The evaluation of large foreign investors in Poland, in: Foreign Direct Investment in Poland, IKiCHZ, Warsaw 1997.

[8] W. Włodarczyk: Kapitał zagraniczny w prywatyzacji polskiej gospodarki, in: B. Durka (ed.): Inwestycje zagraniczne w Polsce, IKiCHZ, Warsaw 1998.

[9] The rating is based on different indicators measuring effectiveness and security. B. Lepczyński: Wysoka pozycja BRE Banku na tle słabszych wyników konkurencji, IBnGR, Gdańsk 2000 and B. Lepczyński, M. Karbowska: Kondycja finansowa 20 największych banków w Polsce w 1997 roku, IBnGR, Gdańsk 1998.

versa. European Union countries have attempted to maintain a similar proportion in the process of the liberalisation of their banking systems.

Effectiveness of Privatised Enterprises

The Ministry of the State Treasury has studied the financial results of the privatised enterprises in comparison with other groups of firms in the Polish economy. The conclusions of this research in terms of indicators for assessing costs, profitability and liquidity are presented below. Additionally, the privatised firms are compared with all enterprises with foreign capital in Poland.

□ *Costs.* In 1996, the cost indicator in enterprises privatised with foreign capital was higher than in enterprises privatised with domestic capital, but lower than the aggregate characterising all entities in the national economy. Moreover, it was lower than the cost indicator for all foreign firms in Poland.

□ *Profitability.* Privatised enterprises, especially those privatised through capital privatisation, are characterised by a higher profitability rate than the average entity in the national economy. Only the profitability of companies privatised by the direct method with foreign capital is lower than the national average.

State enterprises privatised by the capital method with foreign capital are more profitable than other types of foreign companies in Poland. That is because foreign investors participating in indirect privatisation tend to purchase the best companies.

The profitability of an average company with foreign capital is lower than the average private company in Poland, except for the biggest foreign firms (the top 500 list). The reason is the transfer pricing used by foreign investors. The result is that the revenue shown for tax purposes is lower than real income, and the untaxed profit is transferred abroad.

Privatised state enterprises perform better than the aggregate of all entities from the perspective of the profitability of assets and equity capital. In the years 1995-1996, however, the sector privatised with domestic capital did better than the firms privatised with foreign capital.

□ *Liquidity.* The increased liquidity indicator is used to assess an enterprise's ability to pay its current obligations. In 1995-1996 the privatised firms, especially those privatised with domestic capital, performed better in this area than other groups of firms. However, firms privatised with foreign capital were very close to the limit of safe values in this rating.

□ *Export and investment.* Privatised firms, including those privatised with foreign capital, are more active in export than other firms.

Companies privatised with foreign capital share, especially those privatised by the capital method, have a higher share of investment in financial surplus than other firms.

Summary and Conclusions

In the 1990s, Poland attracted a huge amount of foreign direct investment – about US $ 43 billion through June 2000. About 20% of this was connected with the privatisation of state enterprises and banks – their initial purchase by foreign investors. However, foreign investors also buy companies previously privatised with the participation of domestic investors. That is why it is difficult to say exactly what share of foreign direct investment was connected with the purchase of previously state property.

At the end of 1999, about 18% of the core capital of all Polish firms was foreign. In the branches of "trade and repair" and "manufacturing" these shares equalled 50.5% and 40% respectively, while the foreign share in the assets of Polish banking in June 2000 reached 70%. From 1996 to June 2000, the participation of foreign capital in the Polish economy almost doubled.

The growing role of foreign capital in Poland is accompanied by the limitation of the role of the public sector in the national economy. Foreign capital assists the transformation to an economic structure corresponding to that of a mature market economy. Foreign capital plays an essential role in the building of entity corporate structure. Moreover, it helps to create a suitable model of corporate governance in Poland.

Foreign enterprises – especially those privatised through capital privatisation – perform better in terms of export and investment than the average national enterprise. In the future this may have multiple effects on the rate of economic growth.

There is a lack of large-scale foreign green-field investment. Such investment should appear after completion of the privatisation of state enterprises.

Foreign direct investment has become a characteristic feature of the Polish transformation. FDI is sometimes perceived as a threat due to the huge trade deficit for which foreign investors are responsible, or because of transfer pricing activity. However, privatisation and modernisation of the Polish economy in the 1990s was possible to a great extent thanks to foreign capital.