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International conference European Financial Systems 2012 focused on prevailing scientific inquiries in the area of global financial markets and financial systems. Particular attention was paid to the European financial and sovereign debt crisis, comprising the possibilities of its resolution and options of its prevention in the future. Fruitful discussions covered recent findings and trends in banking, insurance, financial engineering, and financial management alongside with developments in accounting practices and taxation systems.

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TABLE OF CONTENTS

Dorota Adamek-Hyska, Piotr Tworek – Cost budgeting methods in construction projects in Poland	6
Beáta Blechová – The analysis of the corporate financial and tax accounting in the EU and their harmonization.....	12
Gábor Bóta, Mihály Ormos – A Nonparametric Serial Correlation Test of the Central and Eastern European Stock Markets.....	18
Viktória Čejková, Svatopluk Nečas – The Insurance Market in Europe	24
Petr Červinek, Jana Hvozdenská – Empirical Test of the CAPM Using Linear Regression	30
Oleg Deev, Veronika Kajurová, Daniel Stavárek – Stock market bubbles investigation in the Czech Republic	35
Michal Fabus – The application of OCA criteria on the European Monetary Union	41
Monika Foltyn-Zarychta – Biases in Contingent Valuation Method Used for Investment Project Appraisal	45
Monika Garguláková – Analysis of bankruptcy and secure risk management models and application for their extension	51
Radim Gottwald – Impact of Selected Factors on the Dividend Policy of Joint-Stock Company	57
Igor Hudák, Eva Kafková – Determination of the general value of selected engineering enterprises.....	62
Zdenek Hustak – The Alternative Investment Funds Managers Directive and the Regulation on Venture Capital Funds - selected comments	67
Erika Mária Jamborová – Agency theory and its application in the business of the financial sector in Slovakia	73
Magdalena Jasiniak – The effects of domestic and foreign enterprises' financial activity in host country economy – comparative analysis.....	79
István Joó, Mihály Ormos – Disposition Effect: Do Hungarian investors keep their mistakes?	85
František Kalouda – Claim Paid Position in Rank of Alternative Source of Funding.....	91
Mária Klimiková, Martin Vovk – The Banking Sector under the Conditions of the Crisis.....	97
Veronika Krsikova, Lukas Rybka – Audit Risk in the Context of the Audit Profession.....	102
Jan Krajíček – Banks and Cash Management	107
Veronika Křelinová, Jiřina Krajčová, Pavla Vanduchová – Application of operations research method to solve increase in unemployment.....	113
Zuzana Křížová, Eva Hýblová – Changes in Reporting of Goodwill in Mergers & Acquisitions.....	119
Katarzyna Lewkowicz-Grzegorzczuk – Tax progression as an instrument of income redistribution	125

THE EFFECTS OF DOMESTIC AND FOREIGN ENTERPRISES' FINANCIAL ACTIVITY IN HOST COUNTRY ECONOMY – COMPARATIVE ANALYSIS

Magdalena Jasiniak

ABSTRACT

The main purpose of this article is to compare the financial effects of foreign and domestic enterprises' activity in the host country economy including domestic enterprises producing only for the internal market and domestic enterprises producing on both the domestic market and foreign markets. As a result of the researches carried out by the author of this article: a survey and a comparative analysis of the enterprises' financial data it appeared that Polish enterprises producing both for the internal market and external markets are able to compete successfully with foreign firms on the domestic scene.

KEYWORDS

the effects of financial activity, financial analysis, foreign enterprises' activity

JEL classification: G32

INTRODUCTION

Foreign investors have been present in the Polish economy since the mid-1970s the 19th century. Nowadays enterprises with participation of foreign capital are an integral part of the Polish economy and market relations. Moreover the activity of foreign enterprises in the host country economy is the main subject of many scientific studies in Polish literature.

The main purpose of this article is to compare the effects of financial activity of enterprises owned by foreign investors, domestic enterprises producing only for the internal market and domestic enterprises producing both for the internal market and external markets in host country economy.

In Poland, studies on the activity of foreign enterprises, carried out at the microeconomic level are very rarely. There are also not many comparative studies on domestic enterprises and the enterprises with participation of foreign capital, particularly in the financial sphere. Such comparisons are sometimes only a part of a broader analysis. In the foreign literature studies in this sphere are carried out on a relatively advanced level. The comparative analysis are often carried out among the foreign enterprises in the host country economy, the domestic enterprises producing only for the internal market and the domestic enterprises producing for both - the internal and external markets, however, rarely from the financial perspective.

M. Grasseri indicates, inter alia, that the foreign enterprises have higher productivity and profitability of sales than domestic ones. Foreign enterprises are also more indebted than domestic enterprises producing for both - internal market and external markets.¹ D. Castellani and A. Zanfei confirm that foreign enterprises achieve better effects of their activity than domestic enterprises. However, these differences are rendered down when the comparisons are made between the foreign enterprises and domestic enterprises that operate in international scale. It appeared that domestic enterprises producing both for internal and external markets are more productive and innovative than foreign enterprises in the host

¹ M. Grasseri, *Domestic Multinationals and Foreign – Owned Firms in Italy: Evidence from Quantile Regression*, The European Journal of Comparative Economics, vol.7,n.1, 2010, s.61-86

country.² Blakeley's report indicates that foreign enterprises in relation to domestic ones are characterized by higher return of assets and higher return of capital. Foreign enterprises have also higher productivity than domestic ones, although the productivity of domestic enterprises producing for both internal and external markets is similar to the level of foreign enterprises' productivity.³

As well as the authors cited above, the authors of Polish studies (among others. M. Jaworek, W. Karaszewski, J. Rózański) point out that foreign enterprises use more advanced solutions in organizational and innovative spheres, more advanced than those applicable in the host country (assuming that the level of development of the home country economy is higher than the level of development of the host country economy), that may have a significant impact on strengthening their market position in relation to domestic enterprises and has an influence in achieving relatively high financial results.

METHODOLOGY OF THE RESEARCH

The research was carried out in 2011. The survey questionnaire was made among 100 randomly selected enterprises with 100% domestic capital (0,05 % of total population) and 100 randomly selected enterprises with 100% foreign capital (38,5% of total population), operating in the industrial processing section in the region of Lodz. The obtained return of a survey questionnaires was 118, including: 42 questionnaire from foreign enterprises and 76 from domestic ones. Among domestic enterprises were selected:

- domestic enterprises producing only for internal market (47 enterprises)
- domestic enterprises producing both – for internal and external markets (29 enterprises)

The next stage of the research was gathering the financial data of surveyed enterprises for the year 2010 and comparative analysis of selected financial indicators. The structure of enterprises was similar in terms of size, measured in number of employees⁴. In this stage domestic enterprises were also selected into two groups, those producing only for internal market and those producing for both – internal and external markets.

CHARACTERISTICS OF FOREIGN AND DOMESTIC ENTERPRISES FINANCIAL ACTIVITY – RESEARCH SURVEY

During the research enterprises were asked about the evaluation of their financial condition on the basis of chosen financial indicators, common for this kind of analysis: return of sales, general debt and current liquidity. The level of return of sales indicator in surveyed enterprises is presented in table 1.

Table 1. Return of sales indicator in domestic and foreign enterprises

Type of enterprises	Return of sales			Total
	high	medium	low	
foreign	28,6%	52,4%	19,1%	100,0%

² D.Castellani, A.Zanfei, *Internationalization, innovation and productivity: how do firms differs in Italy?*, the World Economy, n.30 (2007), s.156-176.

³ N.Blakeley, *Why do foreign – owned firms perform better than New Zealand – owned firms?*, The Treasury, Kaitohutohu Kaupapa Rawa 2009, T2009/2747s. 4-6.

⁴ Level of employment:

- up to 9 – microenterprises
- from 10 to 49 small enterprises
- from 50 to 249 medium enterprises
- more than 250 big enterprises

domestic producing only for internal market	21,3%	55,3%	23,4%	100,0%
domestic producing both for internal and external markets	25,0%	46,4%	28,6%	100,0%

Source: own elaboration

Among the surveyed enterprises the highest level of return of sales indicator achieve foreign enterprises - 28,6% of foreign enterprises in total. In the case of the domestic enterprises who achieve high return of sales, there is a higher share of enterprises producing for both internal and external markets (25% of the enterprises) than domestic enterprises producing only for the internal market-21,3% of the enterprises. Therefore, domestic enterprises are able to achieve the level of return of sales indicator close to foreign enterprises while they expand their activities on external markets.

Table 2 presents the structure of surveyed enterprises in terms of general debt level.

Table 2. The level of general debt of foreign and domestic enterprises

Type of enterprises	General dept			Total
	high	medium	low	
foreign	0,0%	35,7%	64,3%	100,0%
domestic producing only for internal market	2,1%	36,2%	61,7%	100,0%
domestic producing both for internal and external markets	10,7%	53,6%	35,7%	100,0%

Source: own elaboration

Domestic enterprises producing only for the internal market as well as foreign enterprises are characterized by a rather low level of indebtedness (61.7% and 64.3% indications). None of the foreign enterprises evaluate their level of indebtedness as high while among domestic enterprises producing only for internal market there are only 2.1% with high general debt. The level of general debt of domestic enterprises producing both for internal and external markets is greater in relation to other enterprises. A 64.3% of these enterprises are characterized by medium and high level of indebtedness. Probably the entry of domestic enterprises on external markets has been connected with the necessity of increasing the risk of the activity by the acquisition of additional (foreign) capital. However, the level of return of sales ratio of these domestic enterprises was relatively high, so a greater level of debt in those enterprises probably does not constitute a threat for their further activity.

The share of foreign capital in the financing enterprises' activity has a direct impact on the level of their current liquidity. The characteristic of the surveyed enterprises in terms of ability to pay off current liabilities is presented in table 3.

Table 3. The current liquidity of the domestic and foreign enterprises

Type of enterprises	Current liquidity			Total
	high	medium	low	
foreign	50,0%	50,0%	0,00%	100,0%
domestic producing only for internal market	38,3%	53,2%	8,5%	100,0%
domestic producing both for internal and external markets	17,9%	60,7%	21,4%	100,0%

Source: own elaboration

The characteristics of surveyed enterprises in relation to their current liquidity is clearly differentiated, although largely shows the relationship that occur between the level of general debt of the enterprises and the capability to pay off current liabilities. Among the foreign enterprises preserving a low level of debt, every second foreign enterprise is characterized by high level of current liquidity. Also, the relatively high level of current liquidity is characteristic for domestic enterprises producing only for the domestic market -

among these enterprises 38,3% is characterized by high level of current liquidity. Foreign enterprises as well as domestic ones producing only for internal market achieve also relatively low level of general debt. Domestic enterprises producing both for the internal and external markets have the lowest level of current liquidity. Among this group of enterprises there is 21,4% enterprises that are characterized by low current liquidity ratio. At the same time, the level of general debt of these enterprises was the highest.

The results of survey about the financial condition of enterprises in the region of Lodz indicate that:

- domestic enterprises producing for the internal market and foreign markets are similar to the foreign enterprises in terms of sales profitability, despite a higher level of debt and lower level of current liquidity in relation to foreign enterprises,
- domestic enterprises producing only for internal market achieve low level of indebtedness and rather high level of current liquidity – similar to foreign enterprises but their sales profitability is lower in relation to foreign enterprises.

These findings are essential for further comparative analysis, based on more detailed data, contained in the financial statements of surveyed enterprises.

CHARACTERISTICS OF FOREIGN AND DOMESTIC ENTERPRISES FINANCIAL ACTIVITY – FINANCIAL DATA COMPARATIVE ANALYSIS

The results of comparative analysis based on financial data of the surveyed enterprises are not always compatible with the results of the survey carried out in the same group of enterprises, especially in the case of foreign enterprises. Detailed data includes table 4.

Tabela 4. Chosen financial indicators of foreign and domestic enterprises

Ratios	Type of enterprises		
	foreign	domestic producing only for internal market	domestic producing both for internal and external markets
ROS	4,4%	-0,2%	8,0%
current liquidity	1,93	1,63	1,59
general debt	52,8%	43,4%	60,3%

Source: own elaboration

The analysis of enterprises' financial data presents that domestic enterprises producing both for the domestic and foreign markets can achieve the highest level of sales profitability - 8,0%-almost twice higher than foreign enterprises for that the value of this indicator is 4,4%. In contrast, domestic enterprises, producing only for the internal market are characterized by the lowest level of sales ratio (-0.2%). Meanwhile, the survey and the analysis of literature indicate that the foreign enterprises generally are characterized by the highest level of profitability of sales. However it may be confirmed that domestic enterprises producing only for the internal market are characterized by the low profitability of sales.

In the case of comparative analysis of the current liquidity ratio the relations between type of enterprises and the level of current liquidity are similar to those observed in the survey. Foreign enterprises are characterized by the highest level of current liquidity ratio, while the domestic enterprises producing for both - domestic and foreign markets achieve the lowest level of current liquidity ratio (the value of current liquidity ratios respectively 1,93 and 1.59). The average value of current liquidity ratio for domestic enterprises producing only

for the internal market is 1,63. However, it should be noted that the average values in the range 1,5-2,0 are recognized in the literature of the subject as the most optimal values.⁵

The comparative analysis of the enterprises' general indebtedness partially confirms the conclusions of the survey carried out among the same group of enterprises. Actually the level of debt of the domestic enterprises producing both for internal and external markets is the highest among the surveyed enterprises (value of the ratio - 60.3%), however, the domestic enterprises producing only for the internal market are characterized by lowest (even in relation to foreign enterprises) value of this ratio - 43,4%. Meanwhile, in the literature it is considered that foreign enterprises are more willing to carry out the activity at higher level of risk and to realize less safe policy of debt (sometimes even at very low financial liquidity) in relation to domestic enterprises.

CONCLUSIONS

The presented results of the survey and comparative analysis of financial data among the randomly selected group of foreign and domestic enterprises in the region of Lodz tend to reach a slightly different conclusions from those presented in the literature. At first, according to the literature, foreign enterprises more frequently than the domestic ones are realize more aggressive policy of debt. Foreign enterprises generally achieve high level of general debt even at risky level of current liquidity ratios. It is also considered that the foreign enterprises achieve better effects of their activity than domestic enterprises. Meanwhile, on the basis of the carried out analysis, it can be noted that domestic enterprises producing both for the internal and foreign markets are ready to take the risks associated with a relatively high share of foreign capital in financing their activity and does not lose the ability to regulate the current liabilities. The high proportion of foreign capital in the financing the enterprises' activity (even connected with a temporary reduction of the enterprises' ability to pay off the current liabilities) can bring positive effects as a result of the use of financial leverage. If the enterprise is supported by additional (foreign) capital used for conducting investments, that profitability is higher than the cost of capital needed for their realization, it may increase its profits. Profits from the investment activity may be designed for paying off the liabilities and it secure from losing enterprise's liquidity.

The development of domestic enterprises activity on the foreign markets probably had a positive influence on increasing profits from sales. As a consequence domestic enterprises achieve higher level of sales profitability than foreign enterprises in host country economy. It may be assumed that polish enterprises producing for both internal and external markets are able to compete with foreign investors in host country economy. However it would be useful , to conduct more extensive research in this area.

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⁵ Depending on the source and the author as an optimal value of the current liquidity ratio is considered 1.5 – 2. Very often the most unfavorable situation is considered when the current liquidity ratio of the enterprise is below 1 (in some studies less than 1.2) or above 3 (in some studies more than 2.5).

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