Foreign Direct Investment in Romania:

Factors that influenced the decision making of the foreign investment in Romania in the period 1993-2003

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“Do not believe something because others may believe so. Examine and experience your self.”

The Budha
Abstract

The present work deals with different factors that determined the foreign direct investments in Romania in the transition period, the period analyzed is 1993-2003. The topic is addressed both in a descriptive and empirical manner. The paper takes into consideration the theoretical background of the problems that transition countries had to deal with to become a stable and secure environment for foreign investors.

In the beginning of this work the different types of foreign investment with its advantages and disadvantages are described that a foreign investor is exposed to when choosing one or another. The centre of this analysis is the careful description of the Romanian environment based on different literature sources, Romanian and international. The description of the Romanian environment shows that foreign investors were exposed to a continuously economic and political instability which is due to a high level of corruption and bureaucracy. Furthermore a survey is conducted interviewing different foreign companies that invested in Romania in the mentioned period. The survey points out that foreign investors found bureaucracy the most difficult obstacle to overcome where as corruption influenced the process of investment in a neutral way. In addition, it becomes clear that several other aspects hindered foreign investors to penetrate the Romanian Market. Those were especially the lack of information about the Romanian market, no geographical proximity to the home market of the investor, bureaucracy which slowed down processes and political and economical instability. Those were the main reasons why foreign investors chose to defer their investment in Romania.
Declaration of independent work

Hereby I confirmed that I compose this work on my own, and that I did not use any other material and resources than the ones quoted.

(CRISTINA TURCU)
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1. INTRODUCTION

Foreign direct investment is a topic of the last century. It started with FDI in the developed countries like the case of the Japanese car producers that invested in the US, continuing with foreign investments in transition countries like the case of post communist countries after the fall of the Berlin wall, and the massive investments in developing countries. This indicates that the approach towards foreign direct investment has changed significantly over the last decades.

The transition economy countries are a special example of adaptation and flexibility. They had to catch up economically and socially in order to close the huge gap which existed between them and the western developed countries when turned into democracies.

The process of transition starts when the society shifts away from one fundamental set of characteristics to another one; in the case of Romania from a socialistic planned economy into a capitalistic one.

Even in a country with a strong communist dictatorship in place until the last minute like Romania, just removing the administrative barriers was enough that development started in the private sector. Capitalism does not need to be forced into the society with any program or implanted by a political party, just by removing the barriers capitalism would start to develop although the process would obviously be much slower.

In Eastern and Central Europe we can see in the transition period that some of the countries were able to have a faster development and growth than others due to foreign investments, governmental policies and other factors that determined this expansion. Some of the countries succeeded in a major proportion and some others are still struggling with different problems. The governments that have been in power have developed and promoted different policies to attract foreign investors.

The central and eastern European countries (CEE) adopted different ways of moving towards a capitalistic economy and especially Romania had a very difficult and special journey from a planned economy to a market economy.

After communism collapsed, a couple of facts happened namely: the output fell, a reorientation of the market had to take place since the structure had to be more flexible and
open to a market economy, the (often state controlled) industrial giants collapsed and with them came the transition costs, a high inflation and an unemployment rate that the state couldn’t keep under control.

The only chances for a post communist country to recover was to make the economy work, but with the transition conditions and with a western market expanding towards the east the national products, more costly and lower quality, couldn’t succeed on the market anymore.

It was expected that the stabilisation programmes rehabilitate the balance of trade and foster the GDP. Additionally, it was anticipated that structural reforms would help to foster the GDP but unfortunately, the output fell more than expected even in the Central European countries. In countries like Romania and Bulgaria where the same expectations existed, the output has been falling even worse than expected. However, either the stabilisation therapy wasn’t fully applied or it was managed with political struggles and internal interruptions.

The governments knew that the only chance to pass this period with a small percentage of unpleasantness for the population was to attract foreign investors and thereby create new employment, to raise revenues generated by profit taxes, export taxes and to increase the import of new technology and know-how.

The main factors to attract foreign direct investments and benefits for the investors are presented by Dunning as follows:

- market-seeking: one of the reasons of establishing a business that serves a certain market is because of the market size or to overcome the trade barriers;
- resource-seeking: when investors are attracted by the availability of the natural resources in the host country;
- efficiency-seeking: in order to be more efficient, foreign companies are taking advantage of local cheap and qualified labour resource.

Keeping this in mind and taking into consideration what was known about Romania after the communism fell, the country should have been one of the most attractive ones. Romania being the second biggest market with reference to the number of inhabitants after Poland, and with an important quantity of different natural resources not disregarding the high educated labour force that the communistic system left behind.

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1 Lavigne Marie: The economics of transition 2nd edition, 1999; ch 7 Macroeconomic stabilisation
But things didn’t work out like theory suggests. Obviously, other factors were the predominant ones in attracting or keeping the foreign investors away.

1.1. Problem Statement

The present paper undertakes a research on the Romanian market for the period form 1993 to 2003 - ten years of transition. The percentage of foreign direct investment in the Romanian market, the political, economical and social factors which influenced the development and whether these factors played an important role in attracting foreign direct investment are analyzed.

It has been ascertained that there is a positive relationship between FDI and the economic stabilization of the economy (Laski 1997).³

Due to these criteria the question I rise to answer is:

Which are the determinant factors to attract foreign direct investment and why Romania wasn’t capable to attract more FDI in the period 1993-2003?

In order to be able to answer this question, an overview of the theory beginning with what does foreign direct investment mean and the influence on the host economy is presented. Furthermore, a presentation of different types of foreign investment like: Acquisition, Greenfield, Joint Venture and Mergers are analyzed with its impact on the host market and the profitability from the perspective of investors.

Further on a broader analysis about the Romanian conjuncture and the determinant factors in attracting investment will be conducted.

The initial conditions made the economic and the political transformation unique, some of the initial condition were: the level of economic development, how long the communistic regime lasted, the share of the private sector in the national economy, the openness to other capitalist countries, the level of the political liberalization before the communistic regime collapsed and the quality of the legal system and the institutions (Dabrowski⁴).

³ Kazimier Laski and Amit Bhaduri, Lessons to be drawn from main mistakes in the transition strategy, march 1997
⁴ Marek Dabrowski, Different strategies of transition to a market economy: how do they work in practice
Due to these conditions the present paper starts by analyzing the starting situation of Romania being a hyper centralized economy.

Romania is considered to have had two transition periods: the first one from 1990 to 1996 - a gradual transition phase and a second one after 1997 called shock therapy. This is due to the change in political power in 1996 from the PDSR (Partidul Democrat Socialist Roman), a socialistic wing, to a coalition formed by UDMR, PNTCD and PNL (a coalition called in the following CDR), a left wing.

The factors analyzed in this paper are the political environment (the public administration, the legislation, the judicial system, the corruption), the economical environment (privatization, foreign investors, the Romanian market) and the social point of view (privatization and the impact on the population, the unemployment, the educational level of the workers and the poor infrastructure of Romania in the transition period)

When taking into consideration the **political environment**, the **legal framework**, the **public administration** and the **institutions** as well as the **judicial system** will be discussed. The legal framework is consider part of the political environment due to the fact that after the revolution everything was controlled by the state and the politicians were the ones taking decisions for public institutions and persons, as well for the judicial system, knowing that this institutions were the servants of the political power and not of the people. This subchapter is about the **corruption** phenomenon that extended in Romania due to this servile system, servile with the political powers.

From a political point of view, Romania was a show case for the inapplicability of social cleavage analysis and the political instability\(^5\); The question whether political instability played a major role when foreign investors thought about choosing Romania will be discussed.

For sure, Legislation in Romania was ailing in the post communistic Romania. This is another reason why to or not to invest in this country and therefore another factor which will be considered in this research.

Legislation regarding taxation on foreign direct investment plays another role in the decision making regarding investment in Romania. In the literature it is said that the taxation on FDI

\(^5\) William Crowther: The handbook of political change in Eastern Europe, second edition. Romania pg 363-414
plays an important role for attracting foreign investment\textsuperscript{6}. Had this an impact in attracting foreign direct investments in Romania?

Played institutions an important role in the transition from a planned economy to a market economy? Galt Vour’s\textsuperscript{7} work states that an effective transition would have occurred if more attention would have been drawn to the evolutionary nature of the institutions. Whether institutions are a major factor in attracting foreign capital is another issue which gets examined in this paper.

Corruption in Eastern Europe is mentioned by many authors that conducted researches regarding post communist countries. In this investigation the impact that this could have in attracting foreign investments will be studied.

Speaking about the economic environment the slow privatization process, the private sector, and the percentage of foreign investments in the private sector, the capital market, the monetary union and the country risk and the scores of Romanian will be examined. P. Matin and Straubahaar\textsuperscript{8} state in their paper that the country had the most closed economic structure within the eastern European countries. It is especially characterized by the heavy industry, the Romanian giants that couldn’t be privatized easily and the fact that they weren’t competitive from an international point of view. Specific problems of privatization, of the restructuring and of the costs connected to this long process will be investigated.

Due to the fact that privatization in Romania was still lacking a political base and the implementation of the privatization laws has been controversial, the fact that the implementation was contentiously delayed could be one of the reason why Romania couldn’t attract more foreign direct investment. Furthermore, foreign investors could bid just the minority stakes in several companies (Gabor Hunya\textsuperscript{9}).

Another question to be analyzed is whether the hyperinflation that occurred in Romania in the beginning of the transition period and the difficult stabilization after 1993 affected adversely the capability of the country to attract FDI.

\textsuperscript{6} J.Bayer, Please invest in our country- how successful were the tax incentives for foreign investment in transition countries?
\textsuperscript{7} Ibrahim G, Galt V: Bye-bye planning, hello market hiccups: institutional transition in Romania
\textsuperscript{8} Philip Martin, Thomas Straubhaar: Best practice options: Romania
\textsuperscript{9} Gabor Hunya, Large privatization, restructuring and foreign direct investment, march 1997;
Because of the inflation the Romanian exchange rate was very uncertain in 1992 and very unstable in the following period. Nina Budina, Wojciech Maliszewski, Georges de Menil and Geomina Turlea conclude from their research that inflation in Romania between 1992 and 2000 was largely a monetary phenomenon. Could the economical instability have been another major factor that determined the foreign investments? This is another issue which will be investigated.

The lack of a capital market, a free exchange rate, and the liberalization of the prices were a characteristic of the transition period for Romania. Based on a literature research it will be studied whether these factors influenced the volume of foreign investments.

Many rating agencies classified Romania being an unstable and dangerous place to start or move a business. This is due to the political instability, the lack of implementation of reforms, the high inflation and a high rate of unemployment. Did the ranking scores influence the foreign investor’s decision in choosing Romania is another point analyzed in this paper.

In the subchapter social environment the privatization the unemployment, the education level and the labor productivity and the infrastructure is analyzed that characterizes Romania in the period 1993-2003.

In the article by Daniela Andrén, John S. Earle and Dana Săpătoru it is stated that education received during the socialist period lost value when market reforms were introduced and that newly acquired education after 1990 was consistently valued much higher in the labor market. In the literature divergences regarding the education level are found.

The correlation between FDI and productivity is close and Kazimierz Laski in his work says that the Romanian labor productivity is the lowest one from the seven countries the author analyzed.

Labor productivity will be analyzed from a social point of view, what the economical implications were and how these factors influenced investment in the period 1993-2003.

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10 Nina Budina, Wojciech Maliszewski, Georges Menil, Geomina Turlea; Money, inflation and output in Romania, 1992-2000;  
11 Daniela Andren, John S. Earle, Dana Sapatoru, The wage effects of schooling under socialism and in transition: Evidence from Romania 1950-2000  
12 Kazimier Laski and Amit Bhaduri, Lessons to be drawn from main mistakes in the transition strategy, march 1997
John Bessant and David Francis\textsuperscript{13} mention that the host countries employees need to manage to change their way of working due to the requirements of the new investor / system. The long-run effects of the education and the lack of the reforms regarding the education of unemployed people that the privatization and the restructure process left behind will be discussed.

Another point of investigation regarding the social environment is the Romanian infrastructure and the role it played in attracting foreign direct investments. The infrastructure includes the roads and the telecommunication infrastructure existing. After the revolution, Romania had 0km of highway due to the policy that Ceausescu adopted. This today is still visible because this topic wasn’t a major issue for politicians who came to power after 1989.

In order to be able to find out the main factors that made the foreign investors choose Romania, a survey is conducted interviewing foreign companies that invested in Romania in the period between 1993 and 2003.

\subsection{Methodology}

In order to achieve the purpose of this paper, the methodology that has been used can be resumed as follows.

Regarding the political, social and economic factors, the investigation is based on a literature research that was very abundant. Those results will be compared with the conclusions of a qualitative research conducted with four foreign companies who invested in Romania. One foreign company was interviewed in person, the three other foreign companies that invested in Romania where interviewed via a web based questionnaire.

This will explain the reasons why foreign investors chose to invest in Romania and what the problems were they had to deal with before the investment was made and after they established their production plants in the country.

The research shows the steps a foreign investor chose in order to penetrate the instable Romanian market, keeping in mind that many foreign investors didn’t want to risk too much.

\footnote{John Bessant and David Francis: Using learning networks to help improve manufacturing competitiveness}
in the beginning and they could have opted for a partnership contract with a Romanian partner.

The decision of why to pick this period between 1993 and 2003 is due to the fact that Romania was invited to the adhesion to the European Union in 1993 to the meeting in Copenhagen when the member countries of the European Union showed interest in helping the ex-communistic countries to develop themselves towards the western standards. The end of this period investigated is the year 2003 since this is the year then the European Union decided upon the next 2 countries whether they will join the Union in 2007. This means that the year 2003 was like an end point where Romania had to show that it passed the transition period and can be accepted as a member of the union with a functioning market economy.

Finally, the paper concludes from the literature analyzed and the survey research what Romania was lacking especially in order to attract more foreign direct investment and which factors that influenced the most the decision of foreign investors to choose to invest in Romania over other countries.
2. THEORETICAL APPROACH OF THE FOREIGN DIRECT INVESTMENT

Foreign direct investments in Central and Eastern Europe are an issue of discussion in the literature especially after the fall of the communism. Before 1989 we can find small investments in countries like Bulgaria and Hungary (Grindea, 1997, pg 43). Some of the important issues of the transition period to the countries in CEE were the liberalization of markets.

In the period after the fall of the communism, CEE was a very uncertain place for investments due to the closed legislation regarding the foreign investments and the unpreparedness or inexistence of institutions.

In a country like Romania, considered by the majority of the literature being the most closed country after the communism period due to the communism system that Romania knew under the Ceausescu regime, the process to a transition economy took longer because the population wasn’t prepared for the change.

Romania chose a gradual therapy that became a very long process for privatization and for restitution of property. This made foreign investments almost impossible in the beginning of the transition period. The political power that came to office after the revolution chose a gradual therapy due to the fact that the population suffered already very much under the communism in the last 10 years (It was well known that the population was deprived from electricity and food). Another sacrifice would have been too much since the word ‘democracy’ meant something else for the population but not sacrifice.

In 1993 according to the Romanian Economic Newsletter (July-Sept 1993, p 4) there were 6,291 commercial companies appointed for privatization from which approximately 2,600 were considered small sized companies, approximately 2,900 were considered medium sized companies and approximately 800 were large state controlled companies.

The Romanian government chose to issue certificates of ownership that were bought by the citizens and even in 1994 the transfer of these certificates wasn’t totally completed.¹⁴

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In 1993 Romania was invited to the Copenhagen meeting regarding the adhesion to the European Union. To the meeting Romania was invited as a guest, in 1995 Romania handed in the application of membership.

The steps to be closer to the European Union were very uncertain due to the political crisis in Romania and the gradual therapy applied in the beginning of the transition process to a market economy. There were too many things to be done by the state to be able to apply the adhesion documentation. Especially the politicians didn’t show any interest in the first years of transition. Even if Romania would have had a very open legislation regarding foreign investments and the authorities would have tried to privatize as many companies as possible, foreign investors weren’t interested in Romania.

The privatization was finished with some companies due to the fact that the state gave different vouchers to the workers. In this way the company wasn’t under total control of the state any longer. These vouchers served for nothing, the workers sold them and persons with more power like the managers or different politicians bought them becoming over night the new upper class.

With regard to foreign investments, Romania made as well very slowly small steps. In 1990, Romania liberalized the import/export process and in 1991 the Romanian Parliament received a proposal regarding an allowance for foreigners to buy land. The legislation regarding the land was lacking due to the fact in the Romanian constitution a foreign person was not allowed to own land in Romania. The new legislation said that a private person could buy land or other assets. Because of this the foreign investors started with exports to Romania and after a period they chose to opt for coalitions with their partners creating joint ventures. From this process to acquisitions, mergers and building there own companies it shouldn’t be a long process but because of the political hesitation in making and applying laws which would open Romania for foreign investment, this process took a lot longer than expected.

In 1993, 10,602 foreign companies invested in Romania. However, in 1996 the number of foreign investors dropped to 3,617. This figure recovered partially by 2003 when the number of foreign companies grew again to 6,594.

After forwarding the adhesion documents in 1995 to the EU, it was easier for Romania to attract foreign investments. This is mainly due to the fact of being a potential member of the European Union The intention of the Romanian Government to fulfil the Aquis Communitaris gave more trust to the foreign companies choosing Romania as host country for their
businesses. But the changes in the legislation system scared the investors, postponing the moment of their investment, or even choosing another country.

The Romanian and the city of Bucharest’s Chamber of Commerce and Industry’s statistical official gazette (nr 12/2003, pg 2) shows the number of foreign investors by then which amounted to 3.393 in 1995 and increasing to 3.617 companies with foreign ownership in 1996 which represents a small growth of 6.6%.

2.1. Entry Strategies for Foreign Investments

The generic term of investment is usually both used in the common language as well as by science from almost all domains. What is interesting about this is that even the economists use this term with different meanings.

In some of the theories investments are defined as being the totality of expenses needed to buy capital goods.

In some of the dictionaries the investments are classified in financial and physical investments. In the economical analysis, especial in microeconomics, the term of investment is used as being the physical one because it is added to the productive capacity of the country.\textsuperscript{15}

In the MIT dictionary of modern economics, in a short description, we can find that investments are ads to the capital or to the existent personal patrimony.

From a macroeconomic point of view, investments are considered to be one of the principal economic tools of how economic development, the future economic structures and the adaptation of those to the social needs and to the technical-scientific improvement can be achieved.\textsuperscript{16}

The globalization phenomenon, due to the competitive growth and the impact of new technologies resulted at the national economic level in the need of international investments.

The foreign investment is seen as a growth to the existent capital created by another economic system. A foreign investment makes up a hypothesis of development, a growth regarding the quantity and as well regarding the quality of the capital and a better use of the existent

\textsuperscript{15} Collins Dictionary of Economics, Ediția a II-a, Harper Collins Publishers, 1993

\textsuperscript{16} Tratat de Economie Contemporană, Vol. 2, Editura Politică, 1987, pag.370
resources that are not used on the normal standards (the most eloquent case is the one of labour).

Another point of view in describing investments is found in the manual of the Economic Science Academy Bucharest: “Investments are the totality of expenses to buy capital in order to reach growth of the society.”

From an international point of view, the investment can come from:
- foreign investors, natural persons or private companies;
- governmental credits;
- grants from banks;
- grants from different financial institutions.

Further on, the foreign investments that are created by a natural foreign person or by private company that invested in Romania are analysed. These persons invested directly in a subsidiary entering into the host country with know-how, technology and financial possibilities.

Foreign Direct Investment (FDI) takes place when a company in one country (the home country) creates or expands a subsidiary, in most cases a production capacity, in another country (the host country).

FDI takes place only if three conditions are met:
- the firm must possess some ownership advantages;
- the host economy must offer some geographical advantages;
- the investor is able to internalise the profits from the host economy derived from his property knowledge.

In the emerging economies, being the case of Romania in this discussion where the privatization wasn’t finished, it was very difficult for a foreign investor to enter into the market. The investor found negotiations with the local authorities very difficult and time consuming because they had to deal with the old company’s management style and in the same time with the privatization agencies.

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17 Economie, Ediţia a V-a, (Manualul Catedrei de Economie şi Politici Economice), Editura Economică, Bucureşti 2000, pag.241
There have been created different agencies in charge of privatization or selling the until now state controlled companies which were more to some extend helpful for foreign investors.

In many cases this privatization agencies had some political objectives alined with the revenue maximization. In some cases the state wanted to keep control on the privatized companies, so in some of the companies, the state kept a share, called “the golden share” that gave the state the control of what could happen with the company. This was especially the case in some strategic industries like armament or other branches concerning the safety of the country.

The state chose this way of privatization to be sure that these manufactories will not become the place to produce some other type of products and not the one it was originally build to produce.

In some other cases the state chose to sell the shares to workers, so in this way the investor wouldn’t be the main acquirer. It needed time until the workers bought the shares but shortly afterwards the workers sold the shares again because they didn’t know about the value or what they could do with a share.

The agencies established after the communism had fallen had to privatize as many state owned companies as possible. Foreign investors weren’t interested in a big share of the big Romanian giants, they wanted to establish market share and get to know the market.

Market seeking FDI is a prime example that depends in particular an easy way to reach the local customers. A local partner can supply access to network, market intelligence and other assets that offer access to a substantial market share.

In order to build up market share the foreign investor may pursue a first mover advantage and purchase local brands or distribution networks.

The costs or searching for a suitable target company, analyzing their economic viability, the negotiation process with the management and the owners and to fulfil the conditions imposed by the government are very time consuming and difficult to meet.

In the economic literature we can find different ways of creating market share in a foreign country. The ones I will take in consideration in this work are: Acquisitions, Greenfield, Joint Ventures and Mergers.
2.1.1. Acquisition

Acquisition is the process of purchasing an asset, a division, a plant or even an entire company. The acquisition has to be of a size that it gives the new acquiring party control over the company. The new affiliate could possess, normally, production facilities, sales representatives and market share and the foreign investor controls these host assets.

When taking the decision of acquiring a plant in a foreign country an active analysis regarding the risks that the company may face and the cash flow that the investments will generate has to be done.

The acquisition process facilitates a speedy entry to a local market and gives a better access to the resources necessary for production.

In many of the cases, the acquired company is not structured to match the investor’s strategic needs and the integration of bought companies may require substantial effort.

Some of the various reasons why a company wants to buy another one, and especially one from a transition economy that could be underdeveloped from a technological and know-how point of view, are\(^\text{18}\):

- the inability to compete as an independent corporation, a company may acquire a company that produces the main resources for their main activity (vertical integration). In this way the foreign company could be independent regarding the needs of its resources;
- the desire to ensure firm survival. In the globalization process, foreign investments are a need due to the low costs of production that makes the company more competitive on the market;
- the desire to reduce the number of competitors (increase market share and reduce price competition), if the company acquired is producing the same products like the acquirer company;
- the existence of free cash flow;
- the need or desire to achieve cost savings, especially with the labour force. In transition economies, the labour costs are very low compared with the ones from a market economy;
- easier access to the resources, if the country possesses the needed resources;
- vertical and/ or horizontal functioning coalitions or economies of scale;

- the need to move to a new geographic area (especially if the current market from the home country is saturated);
- the desire to diversify into new products and services, the vertical and horizontal integration.

In the process of an acquisition the most important thing is that the target firm possesses the desired assets and a bidding company has the financial ability and/or technology that is compatible to the one of the company in the targeted sector.

In order to achieve a good acquisition price, the bidding firm (the investor) should follow some “rules”\(^{19}\):

- the buyer has to search for rare economies of scope. It is important that the managers of the bidding company needs to consider not only the value of the target firm when combined with their own company but also the value of the target form when combined with other potential bidders. This is important because it is the difference between the value of a particular buyer in relationship with the target firm and the value of other potential buyers with the same target, and this defines the size of the potential economic profits from an acquisition;

- the bidder has to keep information away from the competitors. In many circumstances keeping information private results very difficult. However, this is of great importance since the purchasing price could increase drastically when a competitive bidding occurs.

- it is better for a buyer to keep the information away from the acquired company. This is because if the acquired company knows the value to the acquiring company and the price is higher than the one they calculated themselves the target will ask more money or could inform other potential buyers, so that value of the bid can go up;

- avoid winning bidding wars: in this case the buyer should avoid buying a company were there are more bidders because the one who will purchase the target will pay at least the price equal to or the full value of the target which would result in a lower margin earned from this purchase;

- the bidder should close the deal quickly. It is indicated for the bidder to close the legal forms as soon as possible. In this way the company avoids that the information of buying a new company is spread to other potential buyers and the bid to be reopened;

- complete the acquisition in a thinly traded market. Usually in the case of acquisitions, a thinly traded market is the market were there is just one buyer and one seller.

\(^{19}\) Barney Jay: Mergers and acquisitions, ch 14
After the acquisition took place it is very important that the integration process takes place and that the corporate strategies and the companies cultures merge. This requires the acquired company to fulfil its strategic role in the investor’s network.

In the new organization it is seen as a need to create a common and compatible organizational culture, especially when it comes to the human resource side of the acquisition.

An acquisition uses internally generated capital as well as funds provided by outside investors (notably managerial capabilities) to increase the capacity of the company to deliver more goods and services to its current market and may help to penetrate new and emerging markets.

The management has to lead a new organization with different organizational levels and economic culture; they need to develop a strategy to utilize the cultures from both companies. This process could be very hard to achieve and it needs experience in acquisitions and in management of a variety of different activities, especially when you have to deal with a different mentality. The mentality of the workers is very difficult to change, to make them think about productivity and that the company is an environment where profit needs to be created and the company is not a social supporter just to pay a salary as people were probably used to in the communistic era.

The growth through the acquisition process can produce rapid expansion, but the challenges of integrating two organizations especially if the company cultures differ, can be very difficult. In fact, studies have shown that many mergers and acquisitions fail to produce the desired financial outcomes due to managerial incapability to fusion the two companies’ cultures, or to implement the culture of the investing company into the newly bought company from a transition market economy to make them more profitable and productive.

In the majority of the acquisition cases a major restructuring is required, strategically and also organizationally.

All of these changes can be problematic not just because of the different companies culture but as well due to the national culture and in countries in the transition period, being the case of Romania, the acquirer had to be involved in the cultural change. So in companies with a social way of thinking not being business oriented, the investors had to deal and to allocate time for this way of perceiving the business.

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For a company to choose an acquisition as entry mode, specific capabilities in managing acquisitions are needed. In this way the company could lower the post acquisition costs that can be very high in some of the cases.

2.1.2. Greenfield

A Greenfield project entails construction of a subsidiary from bottom up to facilitate production and foreign sale. The plant is bought locally and the workers are hired and trained using the investor’s management, technology and know-how. The local operation becomes highly integrated with the global operations of the investor. CEE couldn’t find suitable partners, and the ones investing in these countries choose a Greenfield way of investment. These investments could be deterred because of the inefficiencies that were found on the markets for corresponding resources and this conducted to substantial extra costs and delays in the production process, but once the investment was finished this brings certainty for the business.

To make a Greenfield investment work, host economy resources are needed like: real estate, local workers, supplies of intermediate goods and raw materials, business licenses, the most certain resources are labour and local raw material inputs.

A Greenfield project gives the investor the chance to create an entirely new organization to its own requirements, but in most of the cases implies a gradual market entry. This could be as well due to the fact of high costs used to analyze the suitable target companies, to analyze their economic value, to negotiate with the owners and the management and as well to fulfil the conditions imposed by the government. The gradual entry is preferable in these conditions to reduce the transition costs.

In a Greenfield investments the resources used are the ones of the investor which are combined with the assets bought locally. Because of this the costs associated with the international transfers can be very high, for example the costs for training and remunerating expatriates. The set-up costs required for a Greenfield investment are substantial; especially for the redeployment of resources within the firm. Another costly case could be the one regarding the technology transfer that has to be adapted to the local cultures and standards.
In many of the cases a Greenfield investment starts like an acquisition and after the company investing acquired enough market share, the investor decides to change everything starting from rebuilding the plant and the fabric infrastructure, to production capacity and sales facilities. Greenfield is more feasible for investors with resources that can be transferred and constitute core competences of the new business unit.

There are existing three different kinds of resources that are driving the investor to choose a Greenfield form of investment when they think to invest in a foreign country. These resources are:

- knowledge with quasi-public-good character: a straight foreign investment is profitable if the firm possesses some specific assets with public character, like the fundamental knowledge to the production of a profitable viable article of trade. This type of resource can be used in a foreign operation without changing the initial sunk cost.
  This makes a Greenfield investment a natural choice for investors with a strong competitive advantage. Firms that wish to build a subsidiary which replicates the company’s production facilities already possess the key resources, the network and a distribution channel; some of these are important resources.

- managerial resources: in a Greenfield investment a programme of internal expansions is needed and this could be an important problem for the case of the managerial planning and execution.
  Through participation in different foreign markets, the firm is confronted with a broader range of demand and competition characteristics. When a company chooses to become multinational the company increases the technological capabilities and induces the firm to expand into activities that use these resources as inputs. Companies doing this usually prefer to go after a Greenfield investment.

- financial resources: financial resources controlled by the management are an advantage in investments projects. Firms with a low leverage or with internal funds for investing are choosing a Greenfield due to the fact that a raise in the cost of capital can be done in time.

In many cases the investors choose a Greenfield investment due to the fact that in emerging markets, being the case of Romanian market, a suitable plant which is available to buy can not be found. In this case the investors choose to build one from bottom up.
This is the case of the companies which find it very difficult to restructure the strategic and the organizational side of the state owned companies. In this case it is better to go for a Greenfield investment due to the fact that the investor doesn’t have to deal with this obstacles.

Greenfield investors prefer to avoid as much as possible the integration costs, but are more sensitive when it is about the reallocation of the costs associated with the international transfer of resources.

In the case that a Greenfield investor enters in a concentrated industry with many competitors, the investor with the new technology could initiate a competitive battle. Different entry barriers could exist which require a huge investment to be able to enter in the market.

Other barriers could be from the point of legislation, especially from the local regulatory. Those exist to protect the host companies. In transition countries, the legislation was very open to foreign investors. A mentioned problem in the case of Romania was the ownership of land. The constitution says that a foreign person is not allowed to own land in Romania, even if the government from the beginning of the transition phase passed a law in which it allowed a foreign company to buy land. This legislation was still an uncertain aspect when a foreign investor wanted to go for a Greenfield investment.

As Greenfield investment increases were privatization is completed, these zones become more and more important for investors. The Romanian legislation gave full control for foreign investors on their investments, especially when it is about a Greenfield.

2.1.3. Joint Ventures

As the markets of the developed countries have become more and more saturated, companies took the chance to enter the global marketplace. One of the major forms for implementing the globalization business is the process of international joint ventures.

A joint venture is the coming together of two (or more) independent businesses with the only purpose to achieve a specific outcome that would not have been achievable by any one of the firms alone.

Joint venturing is a new concept for many small business owners. The rationale for joint venturing has never been stronger, and the number of opportunities to generate such
partnerships has never been greater than they are in the present. Joint venturing can help a company to avoid missteps and achieve success faster. Joint venturing requires the company to reach out into the business world and create the kinds of close relationships 21.

Usually, the joint ventures are not a form of full integration of the formed company, but rather a form of partial cooperation for particular activities in a new market. Many observers consider them to be a major trend in the business world after the communism fell. The investors are often looking for this type of investment in a foreign country due to the merits of a purchase of control does not bring to much risk, like financial commitments and management difficulties. In exchange this brings the company investing the possibility to expand into the new markets like the countries from the communistic bloc that were once inaccessible or where the local laws and regulations dictated to an alliance with a local partner and are not allowing full control of a foreign company in the country.

Creation of a joint venture can decrease risk for the foreign investor but as well for the local partner. The risks that the partners are exposed to are: product risk, raw material risk, human resources, regulation and legal risk to operating risk. The second risk that the partners can meet is the financial risk like currency risk, interest rate risk or the risk of fraud. But thinking about the scale effect, analysis regarding joint ventures has demonstrated that the advantage resulting from this type of investment is often greater than the one from the separate efforts. The synergies created by the joint ventures result in risk reduction, economies of scale, fabrication rationalization, convergences of technologies and a better neighbouring acceptance.

An international joint venture may take the form of a partnership, franchise, or over different forms of business cooperation. The mutual nature of a joint venture is the interest of domestic and foreign companies in cooperating in business deals. In most of the cases the foreign partner contributes with know-how, brand names and managerial skills and the local partner contributes with production facilities, cheap natural resources, efficient labour resources and its established marketing network.

The international joint venture is often providing the best opportunity for competing in domestic markets within countries. A joint venture involves an international investment in the existing local operations owned by entities from a third country.

In the literature joint ventures are divided into:
- accommodative international joint ventures. This helps the partners to reallocate the risks connected with the venture and build more competent ties between suppliers and consumers;
- conventional international joint ventures. This usually has restricted contract support between partners. This type of joint venture might be less successful.

Even if some of the joint ventures are not that flourishing, a study conducted by the United Nations Commission on Sustainable Development revealed that three out of four joint ventures between foreign and local partners in emerging countries and developed countries have been successful.
The joint venture, consequently, became for foreign companies a vehicle for direct investment in new markets.

2.1.4. Mergers

In some of the economic literature the process of a merger can be seen as a dramatic event in the life of a firm because it requires the integration of two organizations into a single one.
An implication in mergers is that the organizational constitution must be reconciled from hierarchies in the companies, business units, to geographical locations. The occupational functions have to be integrated and in this case the human resources will probably have to be changed for at least one of the merging organisations.
This implies different costs starting with costs to integrate the management up to costs necessary to decrease the productivity during the transition. These costs can be higher or lower depending on the field of activity of the companies and the culture in which they operate.

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22 Valerie Smeets, Kathryn Ieruli and Michael Gibbs: Mergers of equals & unequals, working paper 06-8
There are existing at least two general sources of integration costs:
- explicit structures and policies have to be changed
- implicit policies and social structures also need to progress (this could imply the workers productivity. In many mergers the productivity fell due to the fact that the team was changed and the workers had to work with other colleagues).

An additional cost that the merger process implied subtlety and probably more difficult to achieve is the social integration issue. From the headquarter to a simple employee of both firms does exist a different corporate culture, a different firm-specific human capital and it could be that they are even coming from different industries. The employees may have different personalities coming from different cultures and a different network that after the merger has to evolve as the structure changes. This could be a very big source of conflict within the new organization.

Gaughan(1999)\(^ {23}\) says that a merger means a combination of two corporations where just one corporation survives and the merged corporation goes out of existence.
In the working paper of Smeets, Ierulli and Gibbs it is stated that the acquirer company has greater power then the acquired organisation post-merger and the more dominant in number the employees from the acquirer are, the more successful they will be in the post merger organisation. The majority does tend to drive out the minority after the merger.

Some of the reasons why companies merge are the need to expand to different business areas or geographical areas. A company can expand in their industrial area or in another business. This need to expand is the need of the company to grow, to not loose market share and to have different possibilities to find the necessary resources.

Mergers proved to be costly and difficult to implement and the management often faces sweeping changes in production of its labour force, product markets and financing the corporate culture. In some cases it was proven that the workers from the two merged companies worked against each other within the company.
Smeets, Ierulli and Gibbs conclude that the employees from the acquirer are more confident about their work and that the acquirer, which is in most of the cases the dominant company, takes decisions in favour of its original workers.\(^ {24}\)

\(^{23}\) Gaughan Patrick: Mergers, acquisitions, and corporate restructuring, 2\(^{nd}\) edition, 1999
\(^{24}\) Smeets V, Ierulli K and Gibbs M: Mergers of equals & unequals. Working paper 06-8
In the next chapter the Copenhagen criteria will be analyzed which is the starting point for foreign investors to go east. Starting point due to the fact that countries accepted to adhere to the European Union were seen to be more stable for the different forms of foreign investment. There exist different forms of investment strategies in order to enter in a country where as the ones chosen (Acquisitions, Greenfield, Joint Ventures and Mergers) are the ones that have been found most often in the CEE region and as well in Romania.

Some investment processes could be more risky for company than others and some types of investments receive different help from the state. This is to protect in a way or another different industry branches or the employees.

The foreign direct investment in the CEE block started slowly after the communistic regime period but grew when the socialistic era fell. The CEE countries liberalized their markets to attract foreign investors and the companies were attracted by the cheap labour and resources available on the market.

The foreign direct investments registered after 1990 until 1993 were almost insignificant in the Central and Eastern European region. As it is presented in the European Bank of Reconstruction and Development Transition report from 2000, just Hungary registered some more significant foreign investments before 1993.25

On of the reasons why foreign investors weren’t open to go east before was that the market was very instable. Additionally, there wasn’t too much information about these countries available.

The lack of information was a huge obstacle regarding the possibility to invest in the CEE countries, and at the beginning of the 1990’s many multinational companies were more interested in investing in Asia because of the cheap labour.

The investment process, however, changed when in 1993 the European Union with its members by then met and invited the CEE countries to adhere to the negotiation process in order to become members of the Union. The member countries promised to support the CEE countries in their development so that they will become functional market economies and will close the gap between east and west. Starting in 1993 and especially in 1994 we can see a significant growth in foreign investments per capita in the CEE block.

25 see lecture 4, 2006: FDI in central and eastern Europe, by Philipp J.H. Schroder
In June 1993, the meeting of the European Council in Copenhagen marked an important historical step regarding the extension of the EU from the actual number of twelve members (Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain and the United Kingdom) by inviting the countries from eastern and central Europe (Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Romania, Slovakia, Slovenia). Before Austria, Finland and Sweden had already been invited to negotiations in order to become members of the union.

The Copenhagen criteria, adopted in June 1993, guided candidate countries of Central and Eastern Europe along enthusiastic amendments for the EU membership.

The European Council had, when it thought about the extension, the peace and the security in Europe in mind. This goal depends on the efforts of the countries to have a functional economy with a high standard of living for a more secure environment.

The member countries promised to help the non member countries in the reform process for a functional-market economy and to become a member of the European Union in the next 10 to 15 years.

For a country from the eastern block, this was an important step to capitalism and to a functional market economy. Like the commission said, this will take time and the countries will have to show an active process with pressing ahead the reforms in order to become a member of the EU. The union established some criteria for the adhesion of the new ex-communistic countries.

At the Copenhagen meeting in 1993 three criteria had to be fulfilled for a country to become an EU member²⁶:

- the first one is the political and economic factor;
- the second one is the ability of the countries’ institutions to guarantee the democracy, justice and the human rights;
- the third criteria that coincides with the existence of a functioning market economy as well as the capacity to cope with competitive market forces in the Union.

²⁶ Hughes J, Sasse G and Gordon Claire : Conditionality and compliance in the EU’s eastward enlargement; regional policy and the reforms of sub-national government, JCMS 2004, volume 42, number 3, pp 524
Another criterion was the ability of the Union to absorb the new members and the capacity of the candidates to adopt and implement the aquis.

At this reunion Romania, like other countries from Eastern and Central Europe, was invited as well. All of them were in the same position with a big gap between them and the western members. Some of the countries started the progress like the first wave candidates (Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia). Romania was considered to be part of the second wave with a very big gap in implementing the reforms compared with the countries from the first wave, but with a clear possibility to catch up with them.

For the potential candidate to become members of the European Union, the Aquis contained 31 chapters, opened for negotiation covering the main areas of policy, from economy to legislation and social stability.

Among all factors which were considered having a democratizing influence on a country, the European Union has proven the ones mentioned above to be the most persistent, articulated and influential ones in achieving not just the democratic aims but as well the economical and political ones.

Among the EU candidate countries from CEE, Romania has proven to be a more difficult case in achieving the aquis due to a range of reasons: a more uncertain and gradual approach in the beginning of the transition, periods of political and economic crises and insufficient foreign direct investments. Until 1995, when the government of Romania officially forwarded the application of membership, the country didn’t have the EU conditionality criteria firmly implanted in the political discourse.

Like in the case of other EU accession candidates, contractual relations between Romania and the EU took place when the basic democratic criteria and institutions where, at least formally, already in place.²⁷

In this context, Romania’s admission to the Council of Europe in October 1993 has been perceived as an entrance to wider European integration.

Romania signed the European Charter for Regional or Minority Languages in July 1995. Regarding the “conditionality” influence mentioned at the Copenhagen meeting, all Romanian

²⁷ Legitimate institutions resulting from free elections and the respect for human rights
governments and the Parliament were responsive enough to the EU to secure a firm place of Romania on the accession path.

The hard work to defend minority rights in Central and Eastern Europe have received a consistent care through the “Stability Pact” initiated by the EU in 1993. The consolidation of borders and support for minority rights in Eastern Europe were to be secured by the signing of a system of bilateral treaties of friendship and good neighborliness. Consequently, Romania could claim that its human rights record was beyond reproach.

In 1995, Romania submitted the application to participate in the negotiations in order to become an EU member country.

By the end of 1997, in its first Report, the Commission concluded that, generally, Romania fulfilled the political criteria, the necessary condition for obtaining the official candidate status and therefore entered into the actual process of accession.

Since then we can consider that the “consolidation” period of Romania’s democracy begun.

At the summit of Helsinki (1999), Romania had still a couple of chapters to close from the aquis conditions. These were related more to the economical and social criteria’s, except for chapter 24, Justice and Home Affairs, there were no chapters dealing expressly with the political criterion.

The chapters which were problematic for Romania at this date were:
- Chapter 4: free movement of capital, the secondary market is not operational and the perception and behavior of the stock market operations are rather conservative and not very open for external financial participants;
- Chapter 7: agriculture, the problems appear due to the structure of work force, administration and low level of productivity;
- Chapter 10: taxation, Romania was asked to implement significant reforms, such as global income tax, the shift from direct to indirect taxes;
- Chapter 11: economic and monetary union, the Romanian economy and monetary system are underdeveloped and need to catch up.
- Chapter 13: social policy, the institutions and the legal framework had still to be decided and implemented;
- Chapter 14: energy, in the energy sector, Romania has difficulties related to the liberalization of the market and has to cope with the strong opposition represented by the energy monopoly;
- Chapter 20: culture and audio-visual policy, Romania had difficulties in implementing the quota system regarding the origin of cultural and audio-visual products;
- Chapter 23: consumer protection, it didn’t exist an adequate infrastructure to enforce the law. Besides there was a very low awareness of the rights consumers do have.
- Chapter 27: common foreign and security policy, the main problem referred to the need to secure and control the eastern border;
- Chapter 28: financial control, the system in 1999 allowed for a huge underground economy and the lack of financial discipline on the part of state companies;
- Chapter 29: financial and budgetary provisions, Romania was lacking a main institution to collect the taxes. In this field it has to be done serious efforts and technical assistance for overcoming this difficulty.

By the end of 1999, from 31 chapters to be fulfilled, Romania had to work with around eleven, the other twenty being partially closed and accepted by the European Union.

By 2002, Romania succeeded to close another 4 chapters provisionally:
- Chapter 11: monetary and economic union;
- Chapter 13: social policy and employment;
- Chapter 23: health and consumer protection;
- Chapter 27: common foreign security policy

Five more chapters had been opened for negotiations. These chapters are:
- Chapter 4: free movement of persons;
- Chapter 10: taxation;
- Chapter 14: energy;
- Chapter 20: culture and audio visual policy;
- Chapter 28: financial control.

Two more chapters were about to be opened:
- Chapter 7: agriculture;
- Chapter 29: financial and budgetary provisions.

From the main chapters opened by Romanian authorities, the financial control and the taxation system were underdeveloped.
The chapters related to the monetary and economic union as well as the foreign security policies, Romania succeeded to close them provisionally. This helped to provide the foreign investors a more secure environment.

As well provisionally, the chapter related to social policy and employment was closed. Further elaboration on this topic follows in the subchapter of Romanian’s social environment.

The European Council from Salonic in 2003 concluded that Romania is a part of the process of extension of the European Union. It was established in this meeting that Romania, if it will continue with the reforms, will become a member in 2007.

All this period was a very hard time for Romanian authorities to prove that the economy is a functional one and that the reforms do proceed.

After the first meeting in Copenhagen in 1993 until 2003, Romania succeeded to attract foreign direct investments of 9 billion dollars. This amount is a small one compared to other countries from the eastern region.

The next chapter deals with the changes that happened in all this transition period from when Romania was invited to participate as a guest in the European council meeting in 1993 until when Romania received the answer that it advanced with the reforms and it could become member in 2007 if it will continue with the reforms and will close some more chapters from the aquis.

The next chapter will analyze the Romanian environment in order to find out whether there are reasons of why Romania couldn’t attract as much FDI as other CEE which submitted together with Romania the adhesion documentation to the EU in order to become EU member states.

4. ROMANIAN ENVIRONMENT

In December 1989, capitalism meant for the majority of the Romanian people the opposite of socialism that in their meaning was a society of abundance and freedom, of possibilities and the way of normality. In this way capitalism was perceived as being a system of a country where people were free to consume whenever and whatever they wanted, but not as an economic one with disciplined and high quality labour, an efficient economy and a competitive market.

When an investor chooses to move his production plant into another market, a different country, she has to take into consideration different risk factors. These factors cannot be controlled by the company them being external factors. Furthermore, the company needs to invest resources in order to observe their influence on the project. Generally talking these factors depend on the political changes in the country, the economical environment and the social situation or difference between the home and the host country. On the next pages the Romanian political changes, economical environment and the social aspects of the Romanian market are analyzed.

In the subchapter political changes and the effects of attracting foreign investors changes in the political power that followed after the revolution in 1989 and the reforms in the period of 1993 to 2003 are discussed. In this section the legislation and the ordinance passed by the governments as well as the effects on the foreign investors are illustrated. The administration, especially the public administration, will be analyzed in this subchapter due to the fact that the public administration in Romania was subordinated to the government which is in charge of executing the reforms and changes. This was a bad aspect for the free development of the institutions and of the services that these institutions are supposed to offer to their clients, in this aspect being the foreign investors. Besides legislation and the countries institutions, judicial aspects (implementation and enforcement of the reforms) and the people operating the institutions are analyzed. The lack of enforcement of these reforms added to the growth of the corruption phenomenon to a level that the population thought it was a normal phenomenon in the market-economy. The fight against the corruption phenomenon was a used by political parties in their campaigns for presidencies, but in real terms nothing was done.
The next subchapter regarding the *economical environment* and the changes that occurred on the Romanian market describes the gradual therapy that Romanian authorities applied in the beginning of transition period. The reason why this approach was chosen in order to develop a closed to a market economy and about the shock therapy applied between 1996 and 2000 when the political power changed is described in the following. These two types of therapies are part of the economical environment subchapter because these approaches change the face of the economy, the privatization process and the micro and macro stability of Romania.

Furthermore the privatization and restructuring will be discussed and the hyperinflation that followed in Romania after these processes.

The choice to enter in a foreign market is discussed to the case of Romania taking into account advantages and disadvantages from the point of view of the state and of the foreign investors in choosing one type or another of foreign direct investment.

The monetary reforms, the non existence of a capital market and the lack of the banking industry are other topics that are discussed in this subchapter as well as the bad evolution of some of the industrial branches and their influence on the economy.

This part ends drawing a picture of the country risk and the evolution of the Romanian country score which has an important relevance for the foreign investors when they think about which country to choose for their investments.

The part related to the Romanian *social environment* emphasises the privatization seen from the point of view of the employees. The transition period showed that the managers are unskilled for a market economy and for bringing productivity to their units. Instead they played the role of the social protectors, not willing to restructure and to train the human capital. Because of this even if Romania had a highly educated labour source after the communism fell, the productivity in the transition period fell much more.

The rate of unemployment is another aspect analyzed and the connexion between this and the number of foreign investors in order to see if the number of foreign investors influenced the high rate of unemployment.

Another topic approached here is the infrastructure which is reflected by the poor quality of the roads and the railways, the inexistence of highways and the poor conditions of telecommunication and access to information. The infrastructure is discussed from a social point of view because it makes the people life in the country easier. If there is a lack of
infrastructure, the population has to suffer and the foreign investors are not willing to invest in a country before the main access ways to the people are in good conditions.

4.1 Political changes and the effects of attracting foreign investors

The capitalistic world was seen in the communistic Romania as being a bad thing. This image remained for a long time so that still in the 1990 people still said that they don’t sell their country.

The politicians had a very difficult time after the collapse of communistic era. The first political party in power after the revolution was FDSN, a leftist social democratic party. Between 1992 and 1996, the power stayed a left wing party but the party in power was PDSR, the new political party formed out of the old FDSN.

In all this time the Romanian authorities chose to go from a planned economy to a capitalistic one gradually. The first action was to eliminate the mechanisms of a centrally planned economy and the elimination of the managerial administrative system of the economy. A second step was to liberate the prices and afterwards the realization of the micro stability.

Policymakers had to be aware that what might be good for the domestic economy might not be the best to attract the foreign investors.

With the laws passed in 1991, Romania became one of the most liberal countries regarding foreign investors and the inflow of foreign capital. For the first time, foreign companies could set up wholly-owned subsidiaries and branches or different partnerships forms with Romanian juridical persons. The foreign investors could purchase shares in existing companies, could take over management of local companies, could purchase or construct their own facilities and could engage in exploration and production of natural resources.

The law provided investors with significant financial incentives in form of tax holidays and a reduction in profit taxes.

However, many western countries remained deterred by difficult operating conditions and the country’s macroeconomic and political instability. Romania was considered too unstable and isolated by most of the investors and the GDP per capita slow down the process of investments. Besides that many foreign investors thought that there was no need to rush with the investments in Romania.
Foreign investors have been affected by the development of the institutions and in the same time they influenced institutional development. Governmental policy has been essential in creating new legal structures and they indirectly changed the society which led to gradual changes.

After 1993 it was very difficult for politicians to apply reforms. They tried to discourage the role of the state in the production area because it was proven that the state made more losses then the private sector.

To come from a close economy to an open one is a long process and the enforcement of Romanian reforms were unsatisfying: the fiscal politic didn’t succeed to excel the objective; the trade policy was hesitating and confusing and the monetary policy had too many objectives without too much connection with the normal activity of the central bank.

The political power was found being the most guilty party for the very bad evolution of the economical environment in Romania due to the fact that the power postponed the reforms. Enterprise reforms were seen as two stage processes: decentralisation to be followed by sufficient investment and restructuring to allow privatization without major job losses which would have created a very high rate of unemployment.

By the end of 1992, when the new government came into power, a global reform programme was promised which was supposed to soften the social costs of transition. The programme which was well received by foreign investors aimed at changing the structure of the economy and providing the basis for sustainable growth from 1994 onwards. It strengthened private property and small and medium-sized enterprises.

The restructuring and privatization process continued to proceed slowly in 1994 and 1995. This made the life of the population change from bad to worse every day.

By 1995 due to a promising macroeconomic stability and with many of the best opportunities in central Europe, there were signs that a critical mass of investors was gathering. The presence and the interest of the foreign investors made governmental and local officials to become more attune to the needs of western companies and more realistic and experienced in handling negotiations.

Because of internal and external pressure the government approved the mass privatization programme in 1994. This caused legal and institutional uncertainty and slowed down sales of companies even more.
The main help authorities offered between 1990 and 1996 to attract foreign investors were:

- the help with different subsidies;
- the informational help. Companies were helped to access faster different information

In 1996, when the power changed to the CDR alliance, everybody expected that things will start going better but the 4 year period under their administration showed a step back with regard to the privatization process. This is due to the fact that laws and ordinances regarding subsidies and taxation in Romania which were passed in the period of government before 1996 were cancelled by the new government. This created a very instable political and economical environment that scared the foreign investors to make investments in Romania. Because of this instability a diminishing number of foreign investors can be observed.

In 2000, the new government in power was again representing the same political colour as the one from 1992, but now the political party was called PSD, being the same president Ion Iliescu.

After 2000, the legal environment brought some elucidations regarding taxes in general and especially the tax on the profit for foreign investors. The authorities cancelled some ordinances passed by the previous power. This created for foreign investors an image of more instability, at least for the beginning of the government. Due to the fact that the fiscal legislation was more open and that Romania had already attracted some foreign investors and that the USA named the Romanian economy in 2003 a market economy, more foreign investors - at least from the United States were attracted but still the amount of investments wasn’t what the government had expected.

In all of this period the political parties tried to achieve the acquis reforms in order to create a stable environment for foreign investors.

Even thought the politicians passed different laws to attract foreign investors, the legislative body of Romania was not able to pass those to the extend required by the European Union.

It was assumed that – once a law was passed - it also would be implemented. In Romania after communism this wasn’t definitely the case and very often the previous legislation has not been replaced when the new legislation was passed. This resulted in confusion and the opportunity for the citizens to avoid all the requirements of old and new laws. The consequence was a chaos in the legislative system in Romania.
It is important to ensure that the new legislation is easy to understand, implement, to enforce and to monitor. The implementation was the most difficult and least understandable of all the stages of changes and is perhaps the reason why it is so frequently not supported with the necessary resources resulting in a less than satisfactory outcome.

Even in 2002 Romanian authorities still had to work with the 13th chapter of the acquis, regarding the social policy, the institutions and the legal framework. So after 13 years of transition Romania still didn’t have proper institutions respecting the legal framework, to implement it, to control it and to monitor it. The institutions that were created were responding to the political power and to the government. They were not independent and helped the politicians in power.

The main guaranties and facilities granted to foreign investors and to their investments by the Romanian authorities, even if they suffered different changes in the last years, are:

- the possibility to invest in any field of activity and to be able to choose any type of legal company structure permitted by the law;
- the equal treatment for foreign investors as well for Romanians, the ordinance no 92/1997 brought this element; Romanian and foreign investors benefit of equal treatment regarding fiscal and custom facilities;
- guarantees offered against expropriation and nationalization;
- the right to transfer the results from the investment abroad in foreign currency as well as in Romanian currency;
- the loss-carry possibilities;
- the possibility to opt for an accelerated depreciation and the possibility to deduct the expenses with the depreciation from the taxable income;
- the possibility to deduct the expenses related to advertising and publicity from the taxable income.

The implementation stage should be accompanied by regular monitoring and control coupled with an attentiveness to make changes when it is clear that this is essential to achieve the settled objectives. Experience has shown that the implementation of making things happen is the most difficult of all processes.

One of the reasons why foreign investors bypass Romania is due to the legislative instability. The Romanian laws left too many doors open and tricks existed to defy them.
Also according to many business men the clumsy and extremely volatile legislative framework is a main source of uncertainty for the business environment.\textsuperscript{29}

In 1997, the Romanian government passed the ordinance nr 31 where it is mentioned that a foreign investor is a natural person or a legal person with the residence in a foreign country that invests in Romania in different forms.\textsuperscript{30} The foreign investor has the same rights like a Romanian investor.

In 2001 the government adopted a law on the promotion of foreign direct investments with significant impact on the economy. This law aims at guaranteeing the stability and coherence of the legal framework for foreign investments and application of international conventions in this area. Even if Romania aligned with some of the European laws, there still existed a comprehensive system of exchange controls and other restrictions on capital movements by the government.

Governments apply different policies according to the investment developing path, determined by the country’s level of development. Rumania and Bulgaria are at the stage one or two according to the investment developing path. Due to their governmental policies the government of the two countries are not doing enough to attract major inflows of foreign direct investment.

In stage one and two policies start to be more open in attracting foreign investment and only in stage three countries are considered stable and developed enough to attract FDI.

**Public administration** is an activity serving the public, dealing with processes and focuses on procedures. The public servants carry out policies derived from others.

The public administration was supposed to be the one implementing and enforcing the reforms which got passed before by the government. Since especially the enforcement of the new laws was poor, the governmental objectives became very hard to achieve.

Generally, the public administration shouldn’t be a-political body. However, this was different in the pre-capitalistic time. The change towards political independent institutions is a difficult but very necessary step to take. Realising the clear need for professionalism in public administrations highly skilled individuals should be tried to attract by offering both opportunities for their personal development in their existing roles coupled with future career opportunities at senior level within the service. The aim should be quality and not quantity.

\textsuperscript{29} Munteanu N.C.: Cu capul în traista, in Curentul, 26 august 1999
\textsuperscript{30} Investitii; investitii straine; investitii directe – legislatie, Ed Lumina lex, bucuresti, 1999
Lastly, the costs of the public administration were very high in Romania and a reform had to be implemented.

Not even in 2002 the Romanian public administration was an integrated unit that sees itself like an independent organization whose key task is to supply services to the public but which is seen as an organization employed by their respective ministry.

The public financial resources are collected from duties, taxes, and non fiscal incomes from natural and legal persons. All of these taxes are collected by different authorities and representatives of different ministries. The taxation regarding profits is paid to the Ministry of finance and taxes, the city taxes have to be paid to the cities or county authorities so after all the tax administration in Romania didn’t have a central tax administration. Despite the efforts made by the Romanian authorities to improve the system, the taxation system remained weak. This is due to the high level of corruption which has to be addressed by improving administrative practices. The development of the institutions can be the most important aspect of the host government policies since it is affecting the foreign investments.

The reforms in the administration system started in Romania in 1993 but every time the political power has changed, it had a negative impact on the continuity of the public administration. This is a key factor in the stagnating implementation of the legislative change. The early period following the fall of the communism was characterised by a constantly changing cadre of personnel within the public administration resulting in a regular loss of knowledge and experience.

To improve the public administration, training programmes for both management and the employees was needed. The change in mentality is essential to cut down the bureaucratic procedures and give the necessary authority and responsibility to the persons that shows desire to offer high quality services. This will change the system and work with less people offering better services. But due to the fact that in the administrative position people from the old system were working, the implementation of changes was difficult. This is because it is very difficult and time consuming to change a long cultivated mentality.

Difficulties exist on both sides: implementing and maintaining due to the communist doctrines that are slowly replaced as the new generation replace the old one.

A characteristic from the past that continues across the public administration is the old procedures and principles which were created to provide jobs for people. This has not
changed substantially to meet a high level of services offered by the institution. Change is essential to cut down bureaucratic procedures. All of these changes will take time and in this time many foreign investors will have to deal with a very hard bureaucratic system and with the people working in the administration system that doesn’t know that it’s clients are the people that pay there salaries and not the state.

The institution level of development is crucial to attract FDI, by reducing the transactions costs when an investor sets up a local operation in the host country. And more institutions and policies are more important when we are speaking about acquisition on the host market by a foreign investor. The main actions which needed to be taken is the separation of the institutions from the regulation, the standardisation; the accreditation and the certification functions. It is absolutely necessary to proper implement relevant directives which can only be guaranteed by a new way of thinking by the new generations. There is a clear need to allocate authority and responsibility across the public administration which should comprise a clearer strategy and set of principles for distribute authority, responsibility and accountability across the different institutions. The investors had to learn to ask where they get the authorisation for their business. The messed up Romanian legislation system is putting a lot of pressure on the judicial structure. The situation in the legislative and the judicial area are creating the favourable conditions for the public administrative bureaucracy. It exists a combination of incompetence, mistrust in their loyalty and correctness, and political interference in the decision making. This ends in most of the cases with the corruption phenomenon.

The hesitation of the foreign investors to choose Romania as a host country for their businesses is the corruption phenomenon. A business person shouldn’t have the necessity to make presents or bribe when going to an administrative authority in order to have the legal papers done.

Even many ears after the revolution in Romania, the government didn’t organize an agency with appropriate competences to effectively fight against fraud. This wasn’t wished especially by the politicians and there baron friends.
The corruption is growing where the economical power is strongly concentrated (planed economy), the interest of the population is weakly represented and the interest of change from the political and judicial representatives is insufficiently developed.

Corruption represents the abusive utilization of the public power and legislation to obtain personal advantages that wouldn’t possible to obtain if the laws were respected.

The continuous processes of legislative and political reorganization of the formerly state owned companies and the fixed assets created a favourable environment for the administrative corruption.

To stop this process an anti-corruption strategy is needed, and to be efficient it has to contain the deep understanding of different facets of the corruption. The Romanian legislation covers four facets of corruption: offering bribery, accepting bribery, receiving unrightfully goods and the traffic of influence.

But just the existence of legislation against corruption doesn’t mean that the phenomenon will stop. If there is not a good interaction between the administrative, civil, trade and the penal laws the persons involved in corrupt actions can escape very easily.

The main reasons why the corruption developed in Romania the way it did was:

• the failure of the reforms passed,
• a government in power not fully backing up the changes,
• the lack of a moral change of politicians,
• difficulties to change the old way of thinking within the institutions in order to fight to corruption,
• the existence of an insufficient and incoherent legislation which is open for fraud
• the existence and even fostering of bureaucracy and the distrust of the population in the authorities.

The corruption phenomenon deteriorate very much the credibility of the state-employed persons and institutions, going to such an extend that the major percentage of the population considered corruption a characteristic of the market economy and got used to it as being part of normality.

Because of this the political campaigns of the parties that got the power offered programs to fight against corruption, but this happened just in the campaigns. Not even one political party did something against the more extended corruption phenomenon.
This had a very bad influence on the Romanian country score. The corruption was one of the main reasons for the low score which determined the low level of trust of foreign investors in the Romanian economy and the reforms applied by the political power.

4.2 Economical Changes

At the end of the 20\textsuperscript{th} century, the Romanian economy was characterized being a state economy which was due to the communistic period. By the end of the communistic era, Romania was one of the most rigid and centralised economies in the world. The way the government set the prices in the socialistic period led to a deformation of the economical system. The prizes had as well a negative effect on the external trade because the Romanian internal prices weren’t correlated to the ones of the world market.

Generally, the Romanian economy offers a huge potential to investors and their businesses when it comes to diversification possibilities and capturing market share.

Even from the beginning of the transition Romanian politicians understood the need of restructuring the economy and the need of creating a functional-market economy.

Between 1991 and 1992 the political parties choose a ‘\textit{gradualistic’ therapy}. A ‘\textit{gradualistic}’ therapy tends to support an alternative policy opposed to the shock therapy concept. The first argument using gradual therapy is that shock therapy cannot apply to structural reforms, and a second argument is that the positive outcomes attributed to a shock therapy might have been obtained at less significant social cost.

Romania started the rebuilding process of a market economy without a proper legislation and uncertain property rights. The economy lacks the financial resources, the bureaucracy had survived the communistic period and grows more than expected, and the economy is planned by the state.

In 1995 a decision needed to be taken of how to increase the competition and to restructure and privatise the large state owned companies which still dominated the economy.

In 1996, the political power changed and chose the \textit{“shock therapy”} due to the fact that the politicians were afraid to loose the NATO integration.

The application of the shock therapy got stopped in 1997. The restructuring of the consuming industries was basically stopped and the privatization process slowed down. The consequence was that the country had to bear again the contradictory and very confusing policies.
The **privatization process** which means the transfer of ownership from the state to natural or private persons represents an essential phase for the Romanian economy on its way from a planned to a market economy. The privatization is a fundamental problem of the transition since this phase has beside advantages in the long run disadvantages in the short run. If the privatization has a bad management, like it happened in the case of Romanian, the process is followed by the reduction of productivity, a decrease of employment and of salaries.

Privatization is considered to be the critical factor in order to create a proper market-driven economy.

The percentage of the private sector in the Romanian economy is not due to the privatization process and the existence of the state owned companies success to be privatized, but due to the growth of small and medium size companies opened by private persons.

After almost 10 years of transition, Romania was dealing with a closed economy that relies in its running on the collusion of interests between the state and an exclusive category of “entrepreneurs”. This alliance sets the structural conditions for the functioning of the economy in Romania.

In order to privatize the giants of the economy the state adopted a plan in which the state owns 70% from the company’s shares. In this situation in case of failure or success the main responsible is the government. This gave the investors the possibility to ask for more subsidies or different other types of governmental help and even to influence the political reforms.

Legacy in eastern Europe has been changed due to the fact that multinational companies and the governments in the host country had to understand each other’s needs and to engage on both sides advantageous negotiation (Meyer and Jensen). In the same article the authors mention that the methods of privatization had a very long and lasting effect on institutions and on the allocation of wealth and power.

The not entirely enforced reforms and the exasperated postponement of the restructuring process of the unproductive industries drove the Romanian economy close to the collapse stage.

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31 Boari Mircea: Economia inchisa a capitalismuli etatist, in Curentul, 18 august 1999
32 Klaus E Meyer and Camilla Jensen: Foreign direct investment and government policy in Central and Eastern Europe
After the first years of transition, at the end of 1993, Romania came close to be on the edge of hyperinflation. In the same year the first signs of hope appeared, the economy boomed because of the strong performance of the partially privatised agricultural sector and by the rapidly increasing number of enterprises that were privatised.

In 1997 only Bulgaria and to a lesser degree Romania were still struggling with hyperinflation.

The fast expansion of the cash in the Romanian market, from 514 billion lei in 1990 to 90 thousands billion lei in 1998 gave way to a fast hyperinflation.33

The high inflation during the entire transition period shows that the short term policies and reforms and the actions taken after things happened instead of taking preventive actions, made the inflation to take an ascending slop and the level of social welfare a descendent slop.

Besides the foreign investments, Romania could use the internal sources to foster sustainable growth. The negative aspects of the foreign investments which are not desired by an economy could be the overheating of the economy and the acceleration of the inflation. Because of this the internal resources for investment were thought to be the most important ones for a stable and long lasting growth of the economy. The internal resources that a country could use are:

- the decrease of the public administration consumption
- the increase of the population’s savings.

The attraction of foreign investments is not just desired from an economical point of view but as well from a political-strategic one. Attitudes to foreign investment tend to roll from one extreme to another in Romania. Due to the isolation that the country experienced under the Ceausescu regime, Romanians were nervous at the prospect of selling off the companies to foreign investors, especially those in a strategic area.

Despite Romanian’s liberal investments laws, most foreign investors opted to go to central Europe. Romania was further away from western markets and had a very poor infrastructure. Because of this disillusionment and the fear of many managers of state owned companies to lose their jobs, the believe that a factory can make it alone without the help of foreign investments prevailed. With these believes and the bad privatization that took place in the first years of transition, many factories were sold by the authorities to doubtful companies without having a strategy of privatization and the state didn’t care what happened with the newly privatised companies. In a couple of years this brought the Romanian companies close to a

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collapse stage. The new investors sold as many fixed assets and capital resources of the plant as possible without investing anything in the production facilities.

The disadvantages for the Romanian state regarding foreign investments are:

- the possibility that the foreign investors will dominate an industrial branch and the investor has different interests than the host country;
- the penetration of a big foreign corporation into a strategic economic sector establishing a monopoly. This happened with the Romanian telecommunication company. It passed from the state power to a single investor and the consumers didn’t have another choice;
- the foreign investors sometimes influenced the economical policies;
- the lack of interest regarding the social effects that might occur in the host country due to the company interests.

The advantages that a country benefits from having foreign investors in the country:

- the reorganization of different industries, especially where the state owned companies are running on debts;
- the regional development, in the areas with a high concentration on one industry;
- the development of the infrastructure;
- the easiest access to financial resources;
- the creation of new working places;
- the opening to the EU market and other different foreign markets, due to the markets where the foreign investors operate;
- the growth of the economy, having a private sector and a market economy in place, the state will have to deal with high inflation or high rates of unemployment;
- the environmental protection, due to the better technologies used.

The barriers to entry on a foreign market differ depending on the way the foreign investor chooses to enter a market. If an investor chooses an acquisition she is more interested in the privatization policies and the existence of the functioning institutions.

A Greenfield investor will be more interested vis-à-vis if the central authorities are eager to attract more foreign direct investments offering different facilitates and subsidies.
Joint Ventures in 1990 were in general related to the privatization process due to the fact that foreign investors cooperated or took over the state-owned firms.

Many foreign investments in emerging markets choose the form of joint ventures. They are often portrayed as the best investment method in a foreign country. Joint ventures also helped to disguise the unpleasant truth that the Romanian industry was neither as valuable nor as efficient as some would have liked to believe.

However, joint ventures are not necessarily the most efficient or common way of doing business in Romania. Average investments are small and many joint ventures are not beginning operations.

Many investors started with a joint venture, gained experience of the local market before investing in private Greenfield projects. Foreign investors chose this way because they found that working with a local partner is more difficult than they have expected so they preferred to have full control of their operations.

Until 1995, the idea of acquiring a private company never entered the calculation of most foreign investors. In the summer of 1995 it was the first public offer of shares. Before, Romania simply didn’t have a fully-functioning capital market that would provide foreign companies with a simple mechanism to buy or sell stakes in local firms.

The acquisitions weren’t a very interesting option for foreign investors due to the fact that besides the building they were buying as well the old machineries, that most of the time couldn’t be used for anything.

Regarding acquisitions, even though Romania cannot praise itself having seen too many by then, this way of investing starts to become more and more visible in the Romanian environment.

After the communism fell, the early acquisitions that took place carried a high risk. The former state enterprises in a fast changing environment were subject to high uncertainties and the acquired businesses required a major post acquisition investment. In this case an intensive interaction between the investors and the governmental authorities was necessary.

The majority of investors now deciding to enter the Romanian market chose a Greenfield investment. The increase in Greenfield projects also reflects the country’s growing political, economical and legal stability and its improving image investors have of Romania.

In the first years of transition Romania was considered being too risky by most investors for Greenfield projects. By 1995, many foreign companies felt confident to go ahead with
property development or other Greenfield projects. Just a small problem led to confusion with the legal statuses of foreign ownership of land which is permitted under foreign investments regulation but forbidden by the constitution.

Greenfield investment has also disadvantages and is not always the most efficient way to obtain a production facility. Greenfield investments have to deal with the same bureaucracy, and the land for the investment can be often very hard to find, while building a new plant requires a large number of permits and inspections from central and local authorities.

These needs are not all the time necessarily a problem, but the attitudes to foreign investors and investments differs very much in different parts of Romania.

And despite all these problems, many of the foreign investors choose to build there own plants from bottom to top.

When it comes to mergers, the Romanian market almost never seen such a deal. This is due to the non existence of the Romanian private capital, the mergers couldn’t happen. . Romania by 2003 attracted in mergers and acquisitions just 0,4% from the GDP, being the last country from the Central and Easter Europe.

The Romanian Agency for Development in 1999 made a survey on the foreign investors and found out which were the main reasons why they chose Romania. These reasons and the level of importance are34:

- the existence of a high potential market (15%);
- the good geographical location (12,9%);
- the missing of competition in the market (10,4%);
- the qualified work force (9,5);
- the cheap labour (9,3%);
- the good possibilities to export (7,45%);
- the stability of the political environment (7,0%);
- the natural resources ( 6,1%);
- the infrastructure (4,0%);
- the favourable fiscal policies (3,8%);
- the existence of fixed assets (3,4%);
- the stability of the economical environment (3,0%);
- the tax reductions (2,8%);
- the low land price (2,7%);

34 Inventica si economie,nr 4, april 2003
• the favourable judicial system (2.3%);
• the access to financial funds (0.4%).

These reasons were in a higher or lower measure attractive for the foreign investors, the statistical data shows that the number of foreign investors wasn’t a number Romania could be proud of. The number of foreign investors remained relatively small, even if the interviewed investors in the survey mentioned that the high potential of Romania was an important reason in choosing the country for their investments.

It can be seen from this publication that the tax reductions had a smaller impact on foreign investors, even if Romanians political power wanted to attract them offering different tax reductions and subsidies.

For a growing economy and to attract more foreign direct investments, some specialists said that Romania should liberalize the prices for the main utilities and privatize the main state enterprises. This was basically proposes since it was assumed that the different legislations passed and the subsidies or tax breaks offered by the Romanian authorities were not enough to attract foreign investors.  

The below standing table shows the number of foreign investors that made their investments in Romania in the analyzed period. The number of foreign investors presented in the table is per total foreign investments and not just for the four above analyzed ways to invest in a country. Even though the figures are representing the total number of the foreign investors it is still a small number of foreign investors.

### Table 1: The number of foreign companies investing in Romania between 1993-2003

|------|------|------|------|------|------|------|------|------|------|------|------|

**Source:** The Romanian and the city of Bucharest Chamber of Commerce and Industry, Statistical official gazette nr 12/2003, pg 2

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Fig 1: Number of foreign Companies investing in Romania between 1993 and 2003

Most of the foreign investments in Romania have been from countries within the European Union. Researching the Romanian Investment Directory 2000 36 it becomes clear that from a total number of 136 foreign companies investing in Romania in 2000 101 companies were from the European Union. Schröder (1999) concludes that countries from the CEE received the majority of its foreign investments from countries of the European Union. In the period 1993 to 2003 the most of the foreign investors were from the Netherlands. Sixteen companies from Netherlands invested in Romania, followed by Germany with 13 companies. The main foreign investors from non EU countries that interested in the Romanian market are the ones from the USA with 15 companies and from Turkey with 13 companies.

The amount of capital foreign investors brought into Romania is quite small compared to the total value of the capital investments in the Romanian private sector (see table 2). We can see that the percentage of foreign capital in the years between 1996 and 1998 was higher than in the other years. This was the period of CDR government when the shock therapy was applied and the only purpose was to privatize as many state owned companies as possible. Otherwise in the other years we can see that the percentage of foreign investors in the private sector was less than 1%.

36 The Romanian Investment Directory 2000, Ed Finmedia
Table 2: Total investments in Romania and foreign investments.

<table>
<thead>
<tr>
<th>Years</th>
<th>Total investments (ROL billions)</th>
<th>Foreign capital (ROL billions)</th>
<th>Percent of foreign investments in total investments of capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>2.821,80</td>
<td>1,00</td>
<td>0,03%</td>
</tr>
<tr>
<td>1994</td>
<td>8.004,60</td>
<td>16,00</td>
<td>0,20%</td>
</tr>
<tr>
<td>1995</td>
<td>12.995,50</td>
<td>118,00</td>
<td>0,90%</td>
</tr>
<tr>
<td>1996</td>
<td>20.945,30</td>
<td>523,00</td>
<td>2,50%</td>
</tr>
<tr>
<td>1997</td>
<td>44.134,70</td>
<td>1.751,00</td>
<td>3,90%</td>
</tr>
<tr>
<td>1998</td>
<td>60.515,20</td>
<td>795,60</td>
<td>1,30%</td>
</tr>
<tr>
<td>1999</td>
<td>83.948,10</td>
<td>675,00</td>
<td>0,80%</td>
</tr>
<tr>
<td>2000</td>
<td>12.498,70</td>
<td>37,60</td>
<td>0,30%</td>
</tr>
<tr>
<td>2001</td>
<td>20.419,50</td>
<td>103,40</td>
<td>0,50%</td>
</tr>
<tr>
<td>2002</td>
<td>27.173,50</td>
<td>86,60</td>
<td>0,30%</td>
</tr>
<tr>
<td>2003</td>
<td>35.651,20</td>
<td>150,60</td>
<td>0,40%</td>
</tr>
</tbody>
</table>

Source: INSSE and the author calculations

Fig 2: Percent of Foreign Investments in Total Investments of Capital

Source: INSSE

As we can see from the table, the capital invested by foreign investors dropped after 1997 again which is due to the new ordinance passed by the government. This set of ordinances made Romania looking like a very instable country and a risky place to invest.
Governmental influence is most explicit when the state retains minority equity which is called in many of the cases the golden share. In some of the cases the foreign investors are disturbed by this because they cannot retain all the earnings. Furthermore, they need to have major decisions approved by the governmental authorities. They usually kept this share with a social perspective rather than thinking of financial returns.

But in other cases the control of the state could be seen as a factor providing stability for the business and the foreign investors weren’t afraid of their invested money.

The key word for the success of the economical policies generally and especially for the monetary policies in Romania, is credibility. Because of this the objectives have to be ambitious and the state with the institutions should try to avoid as much as possible to use different administrative tools to control different developments the market is facing and leave the investors more freedom in what they are doing. But the state wanted to play the same role as before: controlling the prices of different products and facilities.

The Romanian state had as well control over the exchange rate. Abusing this tool was against the rules of a capitalistic economy and could have become a major issue with regard of becoming a member of the European Union.

In 1999, modest values were traded at the Romanian Stock Exchange. This didn’t show a stable financial market and a very unsure market for foreign investors.

In many of the CEE block we can find special economic zones as part of their foreign direct investment policies. These policies are focusing primarily on the provision of infrastructure or pools of labour with specific skills. Investments are tied especially in countries like Romania and Bulgaria that are further east. In Romania existed ix free trade zones, some of them were at the borders to Bulgaria and Hungary. Other free trade zones were opened in different regions of Romania where in the communistic period a whole population of one city was employed at one state owned plant. After the privatization and restructuring process, the population was unemployed. The reason for the establishment of these free trade zones in these areas was to attract foreign investors and to create new jobs.

On the industrie levels, different branches were more attractive than others for foreign direct investments.

The primarily sectors of interest for privatization were the telecommunication sector, banking and utilities. In these sectors substantive governmental regulations were needed.
The banking system was lacking in Romania due to the fact that the state didn’t privatize it. Because of the macroeconomic instability foreign banking companies didn’t dare to invest in Romania.

The metal working industry had an important advantage: the cheap labour and easy to qualify labour force due to the 50 years experience in the industrial environment.

In the textile industry, Romania was disadvantaged due to the last GATT meeting that liberalized the trade between Romania and European countries at the beginning of 2002. Until this year Romania lost the competitiveness and the contact to the market. Machineries were old and far away from being profitable. In this industrial branch being a cheap labour market foreign investors were attracted with contracts of ‘lohn’. This is a kind of Joint Venture which has the following characteristics: the foreign investor provides the raw materials, machineries and technology and the local partner provides skilled local labour and the fixed assets like buildings, infrastructure and the legal aspects in place. The ‘lohn’ contracts were in many cases Greenfield investment, but many of them started like joint ventures with the Romanian partners. With the time the foreign investors acquired the plants or build different ones but still using the local labour force.

This way of investments made Romania to register a very high rate of imports since the foreign investors were working with the natural resources from their home country and not the ones from Romania.

After years of transitions, Romania does not have a national industry branch anymore with which it could compete on an international level

The transition with a very poor implementation of reforms, Romania in 2002 was still lacking to close a couple of chapters of the acquis regarding the economical reforms. Most of them were related to monetary and economic union, common foreign security policy, taxation and financial control.

In 2000, Romania's overall macroeconomic performance has been positive. The GDP has registered a 5% annual growth in the three successive years after 2000 while inflation has constantly decreased, dropping to 14% at the end of 2003. As a consequence, all major international rating agencies have repeatedly upgraded the country's ratings which brought new hope that foreign investors will see Romania as a potential market to build their production facilities.
The country risk is the probability that a political, economical or social change in a country negatively affects the interests of foreign investors. The main factors that influence how risky a country is are:

- the economical situation;
- the country debt;
- the current account and the country reserves;
- the political environment;
- the access to capital markets;
- the balance of trade;
- the foreign investments and
- the entrance of portfolio investments.

The Romanian country risk in 1993 added up to 31.378 - one of the lowest ones in the region but still outplaying Bulgaria. After different developments in 1995 and 1996 Romania managed to catch up with Slovenia both ranging around 45.000. In 1996 the Romanian score grew to 48.162 and the Slovenian to 49.773. This period of growth of the country risk was probably because of the open politics implemented in Bucharest in attracting foreign direct investments.

By the end of 1999 the Romanian score was 33.743; the lowest one within the region, even Bulgaria’s scored was higher with 37.344. This descending way that the Romanian environment took in the period after 1996 is due the slow privatization which was stopped at a moment and due to the laws and ordinances, passed by the new government. During the entire transition period, Romania had a very low level of country risk due to the economical environment, external and internal. Some of the areas where Romania got very low scores were: the very fragile internal financial level, the high fiscal environment, a very big underground economy, a very low growth of the economy and low productivity.

4.3 Social effects after economical and political changes in the years of transition

In December 1989, the population’s intention was to recover the standard of living which suffered so much under the Ceausescu era. People weren’t prepared physically or mentally to make the sacrifices that the transition period was asking. From a social point of view the transition period was seen as the one bringing freedom and a normal way of way but not
responsibilities to be more productive and the population didn’t expect that the reforms and the privatization process will bring unemployment.

The partial implementation of the reforms which comprised the privatization of public owned companies was seen as the main reason of stagnation. Since the privatization was neither applied the way it should have been (shock therapy in stead of gradual therapy) nor finished by then, the country was lacking a capital market.

The managers of the state owned companies and governmental officials were not prepared to manage the company in the new international context and were generally inexperienced in international and economic business. This lack of experience made the population doubt that the authorities were able to apply the reforms.

The foreign investors introduced the five-day working week and started their clean up by restructuring and reorganizing the state owned companies which caused a growing number of unemployment.

This number of unemployment caused by restructuring and reorganizing made the unemployment rate rise approximately 1,4% at the end of 1999. In the industrial area the number of employed people declined from 3,3 million in 1992 to 2,2 million people in 1998.

The rate of unemployment had different changes. In 1993 the unemployment amounted to 10,4% like it is mentioned in the report of the Romanian national institution of statistics. In 1999 it increased to 11,5%. The critics were saying that these were not the real values due to the fact that many Romanians don’t benefit from any unemployment compensation. From this follows that these people are not registered as being unemployed and therefore don’t appear in this statistic. Most of the unemployed population received an average education. They graduated vocational or high schools.

The non correlation between the number of unemployed population and the percentage of unemployment is due to the fact that the percentage is calculated related to the number of unemployed people to the total employable population. The number of employable population (from 15 years to 60 women and 65 men) wasn’t the same in each year of the period analyzed. Because of this we can see discrepancies for example between the year 1993 when there were 1,165 thousand registered unemployed people and the percentage was 10,40; and the year

1998 when we have the same percentage but a number of unemployed people equal to 1.025 thousand.

**Table 3: Unemployed population**

<table>
<thead>
<tr>
<th>Time line</th>
<th>Percent of unemployed population</th>
<th>No of unemployed people (in thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>10.40%</td>
<td>1.165</td>
</tr>
<tr>
<td>1994</td>
<td>10.90%</td>
<td>1.224</td>
</tr>
<tr>
<td>1995</td>
<td>9.50%</td>
<td>998</td>
</tr>
<tr>
<td>1996</td>
<td>6.60%</td>
<td>658</td>
</tr>
<tr>
<td>1997</td>
<td>8.90%</td>
<td>881</td>
</tr>
<tr>
<td>1998</td>
<td>10.40%</td>
<td>1.025</td>
</tr>
<tr>
<td>1999</td>
<td>11.80%</td>
<td>1.130</td>
</tr>
<tr>
<td>2000</td>
<td>10.50%</td>
<td>1.007</td>
</tr>
<tr>
<td>2001</td>
<td>8.80%</td>
<td>827</td>
</tr>
<tr>
<td>2002</td>
<td>8.40%</td>
<td>761</td>
</tr>
<tr>
<td>2003</td>
<td>7.40%</td>
<td>659</td>
</tr>
</tbody>
</table>


**Fig 3: Development of Unemployment**

The graph below shows the number of foreign investors which came to Romania and its influence on the rate of unemployment.
Having a look at this graph it can be seen that the foreign investors had a direct impact on the rate of unemployment. When the number of foreign investors increased, the rate of unemployment is increasing as well. This occurred due the restructuring process that the foreign investors implemented for the growth of profitability and productivity. The only years when the number of foreign companies didn’t had an impact on the rate of unemployment as it can be can seen in Figure 4 are the years 1995 and 1999.

The nominal salary had a declining slope after the communism fell, only in 1996 an increase was observed. This could be due to the political changes where the power changed from the right to the left wing. The average salary at the end of 1993 was 832 Romanian Lei and at the end of 1997, one year after the power changed, the average salary was 9.247 Romanian Lei.\(^\text{38}\)

In the period after the revolution the goal of the management of the state owned companies was the growth of salaries and the benefits of the managers. The profitability of the company wasn’t of any interest any long.

Because of this the company’s purpose was one of social protection. This had the following consequences: the costs of production exploded, the productivity and the quality of the products went down which made the companies face the incapacity of selling their products. At this stage, the state owned plants had a negative influence on the foreign investors due to the fact that the plants were registered with a high value on paper but the market value was

\(^{38}\) Radulescu Eugen: Inflatia, marea provocare. Ed Enciclopedica, Bucuresti 1999, pg 68
very small. The foreign investors weren’t attracted in buying the buildings and the unproductive machineries.

Not too much was done regarding the quality of the human resources. The education had been totally neglected which led to a lower **productivity**. In any type of organization the human personal plays an essential role in a productive activity. Learning processes to obtain new qualifications lead to a growth of productivity and a higher profitability of the company. The Romanian state, and less the state owned companies, didn’t care about the human resources which was reflected in a downward slope of productivity. Some specialists said that after the communism fell, Romania was one of the countries from Eastern Europe with highly educated workers. Unfortunately, this changed very fast in the first years of transition so that the productivity of the workers went down. Romania ended having one of the lowest productivity levels in the area by then. Furthermore, the Romanian authorities didn’t pass any clear law concerning social protection even though it received financial aid from other European institutions.

Besides that, the government made another mistake. Instead of investing money in the re-education of the unemployed population in order to capacitate them for new jobs, the state paid them at once the amount of money equalling ten to twenty monthly salaries. The money that the state thought will help the population to open small-size companies didn’t have the expected effect since the population was not used to the idea to run their own business. Instead, the population used the money to buy different goods and electronics for their homes. The problem of unemployment didn’t get solved this way. New employment was difficult to find especially in regions which formerly were dominated by one state owned company which got restructured or even closed down in the course of privatization. An organization for a structured vocational training for adults was missing in Romania which is a big problem against the background of a large scale economic restructuring. Because of this many people dismissed in the restructuring process couldn’t find another job, due to the fact that they didn’t know to do nothing else than what they learned in the giant plants from the communist era.

This was another obstacle in attracting foreign investments. Romanian workers after years of transitions were known for being very unproductive. The productivity level in Romania decreased to just 10% in the transition period.
Another social characteristic which will be discussed is the **infrastructure** that became an obstacle in attracting foreign investors to Romania. Romania began the transition to a market economy with the worst infrastructure in Eastern Europe which was the heritage of the communist era. A functioning market economy couldn’t be sustained.

Even after nine years of transition Romania had just a couple of kilometers of highway, a situation unacceptable to western European standards.

A high priority should be given to the development of the infrastructure, physical and institutional, from the development of streets and highways, ports and airports to the development of telecommunication infrastructure, the banking services and the access to information.

The only working infrastructure that Romania had after the communism fell was the railway network. It was one of the most extensive networks in terms of density relative to the countries surface and population within Europe. The problem of railway transportation, however, is that it is one of the slowest means of common transportation.

The telecommunication system needed particular attention in the past years when it was attempted to upgrade and modernise it in line with the ones of other European countries. Before 1989, the country had just one phone per every 11th inhabitant.

However, a study conducted by the Romanian Agency of Development shows that the choice of placing an investment in Romania was influenced by just 4% by the condition of the infrastructure.

### 4.4 Foreign Investors Council and the recommendations

In the transition period the government created different organizations to help the foreign investors and to privatize the state owned companies.

In 1991 the Romanian Development Agency (RDA) was created which became an oasis for the foreign investors by 1992. The agency was reorganizing the former agency for the promotion of foreign investments and economic assistance.

The RDA identified investment opportunities for foreign investors, arranged meetings and visits and provided the necessary information to form a joint venture. The agency was as well advising the regional governments on all matters related to foreign investments.
The RDA had worked directly with local companies and ministries to attract foreign investors. Sadly in 1993, the role of the agency begun to diminish, and by the end of 1995 the agency was closed down.

In the beginning of 1993 a new agency was created: The State Ownership Fund (SOF). With this agency a new layer of bureaucracy was added to the Romanian environment since all deals that involved state owned companies had to be channelled through and approved by the SOF.

The new agency didn’t bring the expected help and the foreign investors weren’t satisfied with it. In 1995, different regional Chamber of Commerce were opened in order to be closer to the foreign investors offering them direct help in reaching out for Romanian companies. The chambers of commerce had as well a regional social help aspect which was to try to protect the Romanian companies.

In 2003, a new agency was created being more similar to the RDA. It is called the Romanian Agency for Foreign Investments (ARIS). The new agency is supposed to help foreign investors with economic assistance and connect them to the Romanian state companies. Another aspect was that bureaucracy should become diminish.

Even if in all this period the foreign investors had some agencies supporting them, in most cases they were receiving just the bride side of the deal they were about to conclude a contract. Besides that, the bureaucracy and the corruption phenomenon were too dominant so that in most of the cases the agencies couldn’t fulfil the foreign investor’s expectations.

So in 1997, some of the foreign investors thought about creating their own agency in order to support future foreign investors. The members of this organization were supposed to be investors which invested earlier in Romania so that they could pass on their experience. The organization they created is called the Foreign Investors Council (FIC) and was founded in 1997 to provide a better idea of the Romanian environment to other investors that are willing to invest in Romania.

In order to get a broader picture from different angles regarding the Romanian environment, FIC is issues every year document called ‘The White Book’. It provides interesting information important to foreign investors regarding the Romanian Market, legislation and provides information about different industries amongst others. At the end of 2003, FIC came
up with some recommendation for the Romanian authorities to attract more foreign investors and make the Romanian environment a more welcoming place for foreign investors. These recommendations can be split up into the following categories:

Administration: the local and national authorities, this should:

- simplify the administrative steps for the start-up of a company in order to avoid repetitive procedures, especially retract the legal requirement regarding the delivery of all authorizations upon registration of a company;
- offer an essential role for the Romanian Agency for Foreign Investments (ARIS) in overcoming bureaucratic hurdles in the investment process for both national and local authorities’ levels;
- publish guidelines for foreign investors of how to approach the Authority for privatization;
- implement electronic payment measures in export/import procedures and
- simplify by means of standardization the customs procedures in order to avoid abusive interpretations in implementing customs laws.

Political reforms and laws: The authorities were asked to:

- sustain in long-term a program to eliminate corruption;
- review the hard currency repatriation rules;
- end the unpredictable and unstable character of the tax environment;
- end the arbitrary withdrawal of tax incentives already granted;
- simplify and republish the tax legislation to ensure greater clarity;
- promote the capital market development through improvement of the structure and adjustment of current capital market regulations in order to create a coherent set of regulations.

Judicial system: The authorities were asked to:

- increase priority to judicial reforms;
- promote the education of judges in order them to be able to solve increasingly complex commercial litigation issues;
- reduce the caseload of the judges to a level where they may devote the necessary time to fully understand the dispute and are able to apply the law appropriately;

• develop the following characteristics which are vital to fight the corruption phenomenon:
  • Independence: Decisions should not be based upon personal connections, pressure or bribery; judges and other persons associated with the courts must establish an ethical culture within their peer “judicial family” which is impervious to outside pressures;
  • Integrity: Judges must act in an ethical manner in order to safeguard their own reputation and the reputation of the courts;
  • Predictability: Since precedents have much less weight in Romania’s civil law system, consistent and proper judgments are of utmost importance;
  • Efficiency: Cases must be moved through the system without inordinate delays;
  • Quality: Judgments must be accepted and responded fairly to the submissions to the court. The final decision must be fully developed with all citations in place;
  • Accountability: Decisions should be published and accessible to the public. A record of reversals on appeal should be maintained and peer review implemented.

Corruption phenomenon: In order to stop this phenomenon, the state should:
• improve the salaries;
• eliminate excessive discretionary powers and
• effectively monitor the official’s personal assets.

To conclude this chapter regarding the Romanian political, economical and social environment one can say that not to much was done to attract foreign investors. The foreign investors had to cope with a very time consuming and often not very transparent bureaucratic process, the high corruption phenomenon and unprepared employees in the administrative and judicial institutions. Politics was lacking regarding all the ordinances and laws they passed which weren’t correlated to each other and instead of fostering the overall situation for the foreign investors they created a chaos. Furthermore, the government didn’t take any monitoring or controlling actions to see if the laws passed were applied. All this together with what the ranking agencies concluded Romania being a risky country for foreign investments, the foreign investors preferred to establish their investments in other countries in Central and Eastern Europe, even though Romania was still considered a high potential market.
The next chapter will investigate how foreign investors experienced their market penetration by means of an online-based survey and compare the obtained results to what theory and literature suggest.
5. INTERVIEW AND QUESTIONNAIRE ANSWERS REGARDING THE DECISION TO INVEST IN ROMANIA

The questionnaire is constructed for this thesis research and is designed for companies that invested in Romania between 1993 and 2003. The questionnaire contains questions about the period of investment and circle around the question why they chose to invest in Romania. The survey focuses on the main political, social and economical factors that had an important impact in attracting or rejecting foreign direct investments.

5.1 Design of the survey

The questionnaire is comprises 26 questions\(^{40}\) and has open end and closed end questions. Because of different reasons this research is based on one interview and three answers to the questionnaire survey. I opted for a web-based survey offered on the StudSurvey-tool\(^{41}\) provided by the Aarhus School of Business’ IT- Department. The functionality of the StudSurvey tool comprises a complex form-builder with which questions and answers can be specified, designed and adjusted to different requirements. A survey test function, a mailing function, and functionality to analyse data online is included as well as a function to export the results into different file formats.

The research is about the factors that influenced the foreign investors’ decision to choose Romania because the literature of speciality placed Romania on the very last position within the eastern countries that attracted foreign direct investments on a per capita basis.\(^{42}\) The data for this research was collected by conducting the survey among different foreign companies that invested in Romania. From the Amadeus data base, thirty companies were chosen based on turnover criteria and the years of their investment. From these thirty companies just four responded to the request to take part in the survey.

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\(^{40}\) see Appendix 1
\(^{41}\) see Appendix 2
\(^{42}\) see Transition report 2000:EBRD
5.2 Survey Response

The first question in this survey is about the timeline to make sure that the companies taking part in this research invested in Romania between 1993 and 2003.

The question is: **When have you invested in Romania?**

From the answers received, two of the companies invested in 1997, one in 1994 and one in 1995.

It can be seen that two out of the four companies made their initial investment in Romania during the shock therapy period. This is when the highest foreign capital investments were made.

The second question is to find out if the main factors analyzed in this paper were the same ones taken in consideration by foreign investors in the decision to invest in Romania.

The second question is: **Why didn’t you invest in Romania earlier?** The question offers a range of answers that are interesting for my research and additionally provided a blank field so that the interviewee can provide other information.

Possible answers are:Political instability; Economical instability; Proximity to the war in former Yugoslavia; High corruption; Lack of information about the Romanian market; No geographical proximity; Others (please mention which ones).

**Figure 5:** Factors that influenced the Decision to Invest earlier in Romania

The received answers show that the political instability, economical instability, the lack of information about the Romanian market and no geographical proximity had the same

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43 a form of the questionnaire u can find it at ANEX no 1
importance to the decision to invest in Romania. Corruption was mentioned just once whereas the war in former Yugoslavia didn’t influence the foreign investor’s decision at all.

The third question: **Why did you choose Romania for your investment? (Please enumerate in the order of importance; e.g.: \[3] geographical location, \[1] low wages),** asks for the main reasons of attractiveness of the Romanian market. This question, like the second one, offers a range of answers from where to choose. It also offers the possibility to introduce a new aspect. The closed questions are: Geographical location; Low wages; Skilled labor; To gain market share; The competitors moved east; The suppliers moved east; To be the first one in the industry moving east; Incentives by politics (e.g.: tax brakes, subsides,…); Globalization process.

**Fig 6:** The Main Reasons why Foreign Investors chose Romania

The main characteristic that attracted foreign investments was skilled labor being mentioned three out of four times. Two times the geographical location, to gain market share and the globalization process were mentioned as reasons to move the production to Romania. The other answers like low wages, the competitors moved east and to be the first one in the industry moving east were selected once by the companies.
From this we can see that the incentives applied by the Romanian authorities weren’t a reason for foreign investors to invest in the country.

To find out if Romania was the only target country in the foreign investor’s investment plan question four is as follows: **When you chose to invest in Eastern Europe, did you think about another country?** This question is a close one with the possibility of answering yes or no.

All the companies answered yes, that they thought about other countries in Eastern Europe in their investment plan as well before choosing Romania.

To clarify if the companies were interested in the eastern region and why they didn’t choose another country, the following fifth question is: **If yes, please name the country and which were the reasons why you didn’t chose to invest in this country?**

The answers received are related to the region the investors were interested in. The companies said that they were interested in investing in the CEE block or the countries forming the CIS. A reason mentioned in the answers was the high potential of growth of these economies. One company answered that they invested as well in other countries from Central and Eastern Europe besides Romania.

In order to find out which strategy the investors chose to enter the Romanian market question sixth is addressed: **Please enumerate which development your company took after the initial market entrance.** *(e.g.: 1 export, 2 joint venture)* offering the closed end answers: Export; Joint venture; Franchise; Greenfield; Merger; Acquisition.

The variety of the possible answers replicates the market entrance strategies outlined before. From the answers received one company opted for a joint venture before building there own production plant. The other three companies acquired different formerly by the state owned productions plants and modernized them. These answers are contradictory to what theory suggests. It is stated that the best market entrance strategy to a transition economy is a Joint Venture.

The following questions are investigating the influence of the political, economical and social factors which the third chapter of this paper examines.

Question seven’s purpose is to find out if changes in the Romanian environment influenced the decision of extending current operations in Romania of the foreign companies. **Did changes in political, economical and social environment lead to an extension of your**
engagement in Romania? Just one company said that the changes on the Romanian market influenced the decision of investment; the other three companies that participated in the survey replied with no, the changes in the political, economical and social environment didn’t alter their decision of investment in Romania.

The interviewed companies, if having answered yes to the question before, were asked to indicate which the main factors were that influenced there decision to invest. Unfortunately, this company didn’t mention the main factors influencing its decision.

The ninth question is to provide a clear image regarding the sources of information when planed to invest in Romania. **From what sources stem the information you based your investment decision upon? (Please mark the relevant sources).** The question provides a series of possible answers as well as the possibility to mention other answers that are not listed. The possible answers are: From your own research; From the Romanian Chamber of Commerce; From your embassy; From the Romanian Minister of Foreign Affairs; From an industry organization; From other investors that who chose to invest in Romania; From country ratings published by banks and From publications by European institutions.

The answers are showing that foreign investors based their investment decision on their own research: All four companies said that they made their own analysis regarding the Romanian market.

The following answers were mentioned twice by the companies taking part in the survey. Companies based their decision on the different publications issued by the European institutions, the country ratings published by banks, information provided by the home countries embassies and from the Romanian chamber of commerce.

Only once mentioned were the following answers: from the industry organization and from the Romanian Minister of Foreign affairs.

From the answers to this question which are shown in Figure 7 it becomes clear that none of the interviewed company based their decision to invest on the information from other investors that chose to invest in Romania. This is due to the fact that just in 1997 the foreign investors created a council with the task to help other foreign investors. The majority of the companies participating in this survey established their investment in Romania before 1997.
To find out if the Romanian legal system supported the foreign investors the next question is as follows: **Did the Romanian legal system facilitate your entrance to the Romanian market?** The question is a closed question offering the possibility to answer: Very much; Yes; Neutral; No; Not at all.

The response to this question it is widely spread. Each company answered differently so the answers very much, yes, neutral, no; have been answered once. A general tendency can’t be derived from that. From these answers in connection with the knowledge of when the companies invested it becomes clear that the companies who affirmed the supportiveness of the legal system were the ones that invested after 1996 when the political power had changed, being interested to finish with the privatization process.

The next question is related to the tenth, asking a briefly for the reason why they benchmarked the legal system the way they did. The only answer obtained was mentioning the bureaucracy.

It is mentioned in the literature that the Romanian state offered subsidies and tax brakes and different other financial incentives to attract foreign investors. The next three questions of the
survey are related to the financial support that the companies were offered. To these questions the companies answered that they didn’t receive any subsidies and that they didn’t benefit from any tax breaks: neither from the state, the county, the city or from any other official authority.

To find out if the foreign investors received help from the authorities they had to deal with, the fifteenth question from my survey is: **How supportive were the Romanian authorities of the counties and cities you chose to invest in?** The answers received are showing that three out of four companies participating in the survey said that the counties and city authorities were supportive and one of the companies found these authorities very supportive. Even if the companies said that they found the authorities supportive, the foreign investors had problems with the bureaucracy.

The next question is regarding the bureaucracy: **How did you experience the Romanian bureaucracy?** This question is as well a closed one offering possible answers. The response to this question is showing that the foreign companies found the bureaucracy a hard process in an equal percentage to the ones that said that it was a normal process. Like the question regarding the legal system, this question was followed by a question where the companies were asked to mention briefly the problems the companies had to deal with because of the bureaucracy. Unfortunately, none of interviewees answered.

The following question investigates whether the old communistic way of dealing with problems in the public administration had any repercussion on the process of investment. The question is: **Did the old communistic way of thinking slow down your process of investment?** The answers showed that the companies didn’t have problems because of this. Two of the companies said that this way of thinking had a neutral influence, one of the company’s answers that it didn’t influence too much and one of them stated that it didn’t influence at all.

This question which follows the one before asks to mention briefly some problems the investors came across due to the old communistic way of thinking. The only problem mentioned is again the bureaucracy.

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44 Romania is divided into 41 counties plus the city of Bucharest. In all of these counties, around 270 cities are registered. The majority of foreign direct investments is concentrated in the western part of Romania and the city of Bucharest.
Regarding the public administration and the problems that the foreign investors had to deal with when they chose to invest in Romania, in the following question corruption is addressed. Corruption was a hot topic mentioned in the literature being one of the biggest problems regarding the incapacity of Romania to attract foreign direct investment. The next two questions are to clarify this issue: **When you invested in Romania, was corruption an important issue?** The question is a closed question offering the possibility to answer yes or no.

To this question two of the respondents said that corruption was an important issue in their decision of investment, the other two with no.

The question following: **To what extend did the rate of corruption influence the process of investment?** The possible answers are: Very much; To an important extend; Neutral; Not to much; Didn’t influence at all.

To this question two of the respondents answered that the rate of corruption influenced their decision in a neutral measure, one company said that the corruption influenced them to an important extent in the investment process and the fourth company said that the corruption didn’t influence at all the decision to invest in Romania. Even though the literature mentions corruption as one of the main obstacles in attracting foreign investments, the answers of the interviewees show that corruption didn’t influence their decision to invest to an extend the literature suggests.

After questions regarding the political environment (question ten to 21), the following questions are regarding the social environment. The main factor analyzed by the survey is the labor source that obviously was one of the most important factors in attracting foreign investors.

**Question twenty-two: To what extend did the educational level of the workers influence your investment?** The answers to this question are showing that the educational background of the Romanian labor was important to an important extend for two of the companies participating at the survey, for the other two the educational level influenced very much their investment decision.

The answers to this question are clearly showing that foreign investors were attracted by the highly skilled labor force. This result is consistent with what the literature points out mentioning that Romania after the communism fell possessed one of the highest levels of educated labor force in Eastern Europe.
The same heterogeneous picture is drawn by the following question: **Did you have to invest more resources in training the workers than you initially had expected?** Two of the companies said that yes, they had to invest more than they had expected in order to train their personnel. The other two answered that no, they didn’t have to invest more than they planned.

The question twenty-four was asked in order to find out if the training of the workers could have been a main factor not to invest in Romania. Only companies answering with Yes to the question before where asked to answer this question. **If yes, would you still have invested in Romania?**

The two companies that answered yes to the previous question said that yes, they still would have go further with their investment decision even though they would have known before that they would have had extra costs than planed. One of these two companies wrote in the blank field below the question that this is due to the high potential of the Romanian market.

In the next question the companies are asked whether they found anything more difficult than they expected it to be in the beginning of their investment: **From your today’s point of view, what did turn out to be more difficult than initially expected?** To this question just one of the companies answered saying that it was difficult to keep the skilled workers in their production units since they started to migrate to the western countries for better salaries which the company couldn’t afford to pay them. This shows that with the fall of communism also the competition for labor started to evolve which had the consequence that the labor force showed the tendency to move west as mentioned by the interviewee.

The last question gives the interviewee the possibility to mention anything what they think might have influenced their decision in any way: **Please fell free to mention what ever you think is not covered by this questionnaire.** Unfortunately, the participating companies didn’t answer to this question which would have possibly provided an interesting insight into the specific problems they have faced over the entire investment process.

Summing up it becomes clear that the foreign investors were attracted by the skilled labor and the Romanian geographical location as well as by the high potential of Romania as a Market. Other influencing factors mentioned explicitly in the literature like the high corruption and the subsidies paid by the authorities as incentives couldn’t be confirmed by the survey conducted to have a great impact on the investment decision.
Factors that influenced the investment decision adversely as mentioned in the literature like bureaucracy and the weak and unstable political system were proven to have had an important influence on the investment process.
6. CONCLUSION

A central characteristic of the transition period is the privatization of the state owned companies. The privatization in itself is not a sufficient condition for a economy to pass from planned economy to a capitalistic one, the goal is the restructuring of the firms. To make the restructuring process go faster and in better conditions Romania, like other countries from CEE, chose to open their market for foreign direct investments. The Romanian political parties that have been in power in the period analyzed applied different reforms to attract foreign investors. Some of the reforms have been in the political, economical or social environment applied. Both foreign direct investments and the Romanian environment have been examined in this paper.

While foreign direct investments have been an important and stable source of private financing in transition economies, the question is whether a transition economy like Romania offered the proper environment for the development of foreign investments.

The theory suggests different ways of entrance on a foreign market with the advantages and disadvantages that foreign investors could face when choosing them. The theory showed that it is less risky and saver to enter in a transition market with the contract of joint venture because of a lesser exposure to the economical instability of the host country. A joint venture investor is exposing its technology, but needs a local partner to deal with the local authorities and to know the market.

Even if the theory showed that the better way to invest in a transition economy is the joint venture, the literature sources and the conducted survey show that the foreign investors had chosen Romania preferred to start their own units or to acquire local companies. The chosen way of the foreign investors to enter the Romanian market is due to the fact that it was proven that they couldn’t work with the local partners. The local partners showed managerial incapacities and less responsibility to conduct the business locally.

In this case the foreign investors preferred to buy or build their own units. The survey has proven that three out four companies participating in the survey chose an acquisition entry, the other one chose after a joint venture to go for a Greenfield investment.

The work identifies a correlation between the foreign investors starting time in their decision to invest in CEE with the European Union Council from Copenhagen in 1993. The EBRD
transition report 2000 shows that just Hungary received foreign investments in a quantifiable measure before 1993. The meeting in 1993 had as its goal the invitation to adhere of the CEE countries for the Union. The Unions wish was the peace and the security in Europe and this depended on the efforts of the countries to have a functional economy with a high standard of living for a more secure environment.

The governmental authorities had to show the Union that the reforms applied are conducting the country to a functional market economy and that it has a secure political, economical and social environment.

The reforms applied in Romania in all the transition period were uncertain and instable. The literature presents that foreign investors are attracted by a secure and stable environment, by the high potential of the market and by skilled and cheap labour force.

The review of the literature sources is showing that Romania was lacking both on the secure and stable environmental aspects. The reforms were uncertain, the laws and ordinances passed were changed with the new governance and above all Romania didn’t have the skilled institutions to implement and control the reforms. The different ordinances passed by the political powers that weren’t correlated to the ones passed before, created an instable and uncertain environment for foreign investors. The ordinance number 31 passed in 1997 was confusing due to the fact that it was bringing a new legislation related to the taxation on profits, different than the one before. This confusion is shown in the decrease of foreign invested capital from 3,9% in 1997 to 1,3% in 1998.

In the literature the corruption phenomenon is presented as being an aspect for an uncertain economy and one of the main reasons why foreign investors didn’t choose Romania as host country for their business. The conducted survey has shown that the corruption wasn’t an important issue in the investment decision. Two of the companies answered that the rate of corruption influenced them in a neutral measure in the process of investment in Romania. One company said that the corruption influenced them to an important extent in the investment process and the fourth company said that the corruption didn’t influence at all the decision to invest in Romania.

Also Azizov (2007) investigating Determinants of FDI in CIS countries with Transition Economy didn’t find that corruption has a big impact on the investors decision whether to enter a transition economy market or not.
The survey has shown that the difficulties that foreign investors met were due to the bureaucracy. Two of the companies participating in the survey said that they found bureaucracy a hard process to deal with.

The literature sources are showing that bureaucracy was kept alive by the public authorities, but the survey revealed that three companies answering the survey found the Romanian authorities supportive and one company found it very supportive.

This work points out the main factors of the Romanian incapability with regard to attract foreign investors. Taking into account the limited factors analysed, the main factors why Romania couldn’t attract more FDI in the analyzed years were:

- continued economic and political instability;
- insufficient implementation of required fiscal and economic reforms by the government;
- delays in the privatization program;
- poor infrastructure;
- lack of information about the Romanian market and
- no geographical proximity.
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8. APPENDIX

Appendix 1: Complete Questionnaire

SURVEY ON FOREIGN DIRECT INVESTMENT IN ROMANIA BETWEEN 1993-2003

This questionnaire aims at investigating the determinants of foreign direct investments in Romania after 1993. In total the survey consists of 24 questions and it will take you 10 to 15 minutes to answer them. The results of this survey are used for internal purposes only, and we guarantee strict confidentiality. The English language is used as most people involved in this survey at the Aarhus School of Business are non-Romanian speaking (we apologize for any inconvenience this may cause).

1. When have you invested in Romania?

2. Why didn’t you invest in Romania earlier?

☐ Political instability
☐ Economical instability
☐ Proximity to the war in former Yugoslavia
☐ High corruption
☐ Lack of information about the Romanian market
☐ No geographical proximity
☐ Others (please mention which ones) …………………………………………

3. Why did you choose Romania for your investment? (Please enumerate in the order of importance; e.g.: 3 geographical location, 1 low wages)

☐ Geographical location
☐ Low wages
☐ Skilled labor
☐ To gain market share
☐ The competitors moved east
☐ The suppliers moved east
☐ To be the first one in the industry moving east
☐ Incentives by politics (e.g.: tax brakes, subsidies,...)
☐ Globalization process
☐ Others (please mention which ones) ……………………………………………

4. When you choose to invest in Eastern Europe, did you think about another country?

☐ Yes
☐ No

5. If Yes please name the country and which were the reasons why you didn’t choose to invest in this country?

………………………………………………………………………………………………………………………………………………
6. Please enumerate which development your company took after the initial market entrance. (e.g.: 1 export, 2 joint venture)

- Export
- Joint venture
- Franchise
- Greenfield
- Merger
- Acquisition
- Others (please mention which ones)

7. Did changes in political, economical and social environment lead to an extension of your engagement in Romania? 

- Yes
- No

8. If Yes please mention those with indicating the year? (e.g.: corruption, legislation)

9. From what sources stem the information you based on your investment decision upon? (please mark the relevant sources)?

- From your own research
- From the Romanian Chamber of Commerce
- From your embassy
- From the Romanian Minister of Foreign Affairs
- From an industry organization
- From other investors that who choose Romania
- From country ratings published by banks
- From publications by European institutions
- Others (please mention which ones)

10. Did the Romanian legal system facilitate your entrance to the Romanian market?

- 1 Very much
- 2 Yes
- 3 Neutral
- 4 No
- 5 Not at all

11. Please state briefly the reasons of your answer.

12. Did you receive any subsidies by the Romanian authorities?

- Yes
- No

13. If Yes what kind of subsidies did you receive?

- Tax brakes
- Deductions for employees
- Direct subsidies (direct cash)
- Trade subsidies
- Others (please mention which ones)
14. If you benefit from tax brakes, who did grant those?
☐ From the state
☐ From the county
☐ From the city
☐ From other official authorities (please mention which ones)………………

15. How supportive were the Romanian authorities of the counties and cities you choose to invest in?
1 2 3 4 5 .
Very supportive Supportive Neutral Not to supportive Not supportive at all

16. How did you experience the Romanian bureaucratize?
1 2 3 4 5 .
Very easy process Easy process Normal Hard process Very hard process

17. Please mention briefly the main problems you came across:
........................................................................................................................

18. Did the old communistic way of thinking slow down your process of investment?
1 2 3 4 5 .
Very much Not to much Neutral No Not at all

19. Please mention briefly the main problems you came across:
........................................................................................................................

20. When you invested in Romania, was corruption an important issue?
☐ Yes
☐ No

21. To what extend did the rate of corruption influence the process of investment?
1 2 3 4 5 .
Very much To an important extend Neutral Not to much Didn’t influence at all

22. To what extend did the education level of the workers influence your investment?
1 2 3 4 5 .
Very much To an important extend Neutral Not to much Didn’t influence at all

23. Did u have to invest more resources in training the workers then you initially had expected?
☐ Yes
☐ No
24. If yes, would you still have invested in Romania?

25. From your today’s point of view, what did turn more difficult than initially expected?

26. Please fell free to mention what ever you think is not cover by this questionnaire.

Appendix 2: Screenshots from the StudSurvey tool:

Screenshot 1: Start page and summary statistics for survey responses

Screenshot 2: the ‘Form Builder’ allows the designing of questions and answers
Screenshot 3: The list of the emails sends to the companies.