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FDI - IMPORTANT FORM OF BUSINESS' INTERNATIONALIZATION

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Abstract

Investments play a central role in the economy of a country, both in the production of goods and services and in the sphere of consumption, being a factor which influences not only the demand, but also the supply. The purpose of this research is to identify the effects of FDI on the economy of a country and analyze their evolution in Romania. The research results show that FDI inflows have fluctuated in the period 1990 - 2012, being influenced by certain internal and external factors. The FDI stock generally had an increasing tendency, except for the years 2010 and 2011.

INTRODUCTION

According to the OECD, for a transaction to be considered a foreign direct investment, it is necessary for the resident economy (direct investor) to invest money in order to establish a long-term interest in the company (the company receiving the direct investment), which is a resident in a different economy. The interest on long-term requires a long-term relationship between the direct investor and the company to benefit from the direct investment, but also from a considerable level of influence from the direct investor in the company's management (OECD, 2008). It is known that, for an investor to have control they must have more than 50% of the votes and a considerable influence in the company if they have between 10% and 50% of the vote (IMF, 2007).

Foreign direct investment (FDI) can be defined as those investments involving a long-term relationship reflecting a lasting interest and control of a resident entity in one economy (natural or legal). Attached FDI investment flows consist of:

- paid-up capital for the purchase of shares in a foreign economic entity;
- reinvested profits derived from activities abroad;
- loans in the company (particularly those provided by the parent company, subsidiary).

According to some authors, FDI can be seen as a transfer of an " industrial package including capital, technologies, methods of industrial organization, managerial expertise, marketing knowledge etc., that allows the investor to exercise the right of control over the investment" (Negriţoiu, 1996).

In general it can be accepted that any placing of funds in the economic, social, cultural, administrative, military field, etc. can ensure regeneration or growth in assets, labor coverage of activities or promotion of the organizations' objectives or businesses is an investment (Zaiț, 2008.).

All definitions have in common the control exercised by the investor over the assets in which the investment was made. There is some freedom in the definition of control, generally considering the FDI as a participation of the foreign ownership exceeding 10 to 25%. Even if the criteria for defining differ between countries, this limit does not affect the essence of the phenomenon. The key difference from an investment portfolio (where the investor receives only dividends, without any right to control management or enterprise where they invested) is given in the case of foreign direct investment by the direct participation in company management and control of its business (Negriţoiu, 1996).

FDI - IMPORTANT FORM OF BUSINESS INTERNATIONALIZATION

FDI is a feature of multinational companies and can not be regarded as just a transfer of capital, because the activity on a foreign market requires not only capital flows but also technology transfer, experience and "know-how". According to international regulations, FDI is a border investment made by a resident entity in one state (direct investor) to another entity in another state (other than that of the investor) in order to obtain a long-term engagement (direct investment). It is believed that the participation is a long-term one if the direct investor owns more than 10% of the company's capital in which they invested or of the voting rights.

A direct investment is a registered company or a branch in which the resident investor owns more than 10% of the voting rights or the capital subscribed and paid.

Direct investment consists of capital being paid both in cash and in kind, the part of the company reserves being due to the foreign investor; reinvested earnings and net credit namely loans from direct investment from the foreign direct investor, less loans direct investment foreign direct investor or its other affiliates.

FDI produce important driving effects in the economy of the host country (infusion of new technologies, jobs), but also in the balance of payments, through export promotion. Thereby, it circulated the idea of an opposition relationship between exports and FDI as a means of penetrating a market, the latest being ways to bypass customs barriers used primarily by transnational corporations. Moreover, investments require the existence of guarantees of a favorable environment, given the long-term relationship implied. Many developing countries combine high commercial protection with incentives for investment, due to the boost of exports effect that international affiliates bring.

Most studies note, however, rather a complementary trend than a substitution one between exports and FDI. Pfaffermayer highlights in a study on Austrian exports and investment, the fact that an increase in FDI is accompanied by an even stronger enhancement of the exports, but an export growth is followed only by a very weak amplification of FDI (Pfaffermayer, 2000).

The ways to develop a business beyond the country of origin are diverse and have evolved over time, from the traditional to the most sophisticated ones, which ensure the economic operator of the influence or the control over the operations.

The main ways in which an economic operator performs an international investment is the purchase of shares and bonds in a foreign market or issued by a corporation from another country, building on the "empty space" of a new company, opening another branch in another country, the granting of an economic financial loan to an economic operator from another country or to a foreign trader operating on the entity issuing market, the takeover or acquisition of a foreign company or merge with a foreign company and equity investment in the joint venture formation.

According to other authors, market entry methods can be classified in terms of international marketing in three categories as follows: export operations, cooperation (collaborative arrangements) and foreign direct investment. Joint ventures include all forms of medium and long-term association between companies based in different countries. They represent a means by which a firm conducts business in a foreign market without the need to build its own production capacity, to merge with a foreign company or to acquire it.

Joint ventures can occur as only input option on an attractive market with high potential but for which export is not a viable solution because of high transport costs or tariff and non-tariff barriers. Also, due to restrictive regulations of, acquiring existing companies or creating their own branches would not be acceptable. In addition, the investment in a joint venture is much lower than in the case of the development of their subsidiaries or purchase of a local firm. This situation is not exceptional as long as in many developing countries there are strict regulations on the participation of their experts in international business management as well as national regulations on the content of the production. But even the most protectionist governments adopt a more elegant attitude regarding a mixed society compared to imports or foreign subsidiaries. This reduces the risk of non-repatriated profits or even blocking the activity or expropriation.

Joint ventures have existed since before World War I, but their importance has grown especially since the 50s, representing in 1985 45% of American firms FDI in developing countries, being the most used method to entry the South Eastern Asian market at the time.

Without disputing the popularity of this form of direct investment, it should however be noted that joint ventures record a high rate of failure, finding that less than 50% of them survive for a long term.

A much faster market entry than the joint venture can be achieved through mergers and acquisitions, when the company that initiates the process takes a functional and professional business – a crucial advantage when entering a highly concentrated market, where demand slackens or grows very slowly. Basically, the investor buys a potential competitor in the market, taking advantage if compared to a greenfield investment opportunity. If the business is in the same area, the investor will benefit from economies of scale by reducing fixed cost unit, mainly in the case of standardized products.

Despite a nonlinear evolution in time of the value of mergers and acquisitions, it can be said that these are the main form of international affairs which is reflected in the ISD.

If we were to define mergers and acquisitions, theoretically we can make a difference between them: the acquisition is the purchase of shares in a sufficient amount to maintain control (Kogul& Singh, 2001) and the fusion is the union of two or several organizations under a single ownership, via direct acquisition by one of the organization's assets or others' liabilities (Business. The Ultimate Resource, 2002).

In practice, only friendly or aggressive character makes the difference between a merger and an acquisition (Işan, 2004). Dealing with mergers and acquisitions four types can be identified: horizontal mergers and acquisitions, vertical, circular and conglomerate (Business. The Ultimate Resource, 2002).

Transactions between companies in the same industry have as a result horizontal mergers and acquisitions.

Vertical mergers and acquisitions take place between companies from different industries, but with the motivation to ensure the ease of raw materials or control the distribution and sales.

Circular mergers and acquisitions target different industries' companies but with similar distribution channels.

Conglomerate mergers and acquisitions are based on the need to minimize the risks of production, of the interest's exchange rate and it is made between firms in different industries, without similar characteristics, with the declared aim of profit maximization.

Mergers and acquisitions are an effective way to entry the market, the acquisition of a competitor having a beneficial effect by reducing competitive pressure, thus paving an accelerated development of the company. The company that initiates the process will start on the new market from an existing development stage, with a functional business, experienced in the market, with a distribution network and well established suppliers.

Numerous advantages of mergers and acquisitions (in terms of available resources, economies of scale etc.) are offset by a significant number of disadvantages. The difficulty integrating the acquired business structure in the "mother" company in the light of the large differences in the level of organizational culture is the first major obstacle. Formal mechanisms of coordination "do not always work because they tend to become bureaucratic and not necessarily bring problems that arise from different orientations of the subunits of business" (Hill, 2000).

The difference between organizational cultures is also dictated by cultural differences, in which case firms use collaborative methods to entry on the market, particularly joint venture.

Direct investments in new targets (greenfield investment) imply a substantial capital allocation on behalf of the investor, but also involve a transfer of human resources, technology and know-how. The transfer of the company's resources and skills in a foreign country is achieved without the risk of losing management control.

In a market with strong competition, the presence of a new company, which creates additional pressure, is more justified when used as a business platform with adjacent markets. The construction of a new capacity on such a market is costly and can also support the company's medium term "parent" to cover financial losses.

Arrangements for international investments give rise to a **typology**. After the established foreign investment report between issuer and receiver, there are two major categories of international investment: direct and portfolio. The investment is considered "direct" if it involves the transfer by the issuing agent control and decision on the receptor's activity and a portfolio when it does not involve the establishment of such a report.

UNCTAD differentiate FDI concerning the portfolio by three dimensions: ownership, risk sharing and reward form (UNCTAD, 2012, 2013). Thus, FDI is an internalized investment flow - within the same transnational corporations, which include capital assets and tangible assets. The investor retains control of the subsidiary that he created and extracts benefits from the investment made, which increase the overall picture of the transnational group by increasing sales, reducing production costs and increasing productive efficiency of the group. Also, the foreign investor assumes the risk of his business operations. On the other hand, foreign portfolio investment represents the purchase of financial assets - shares and bonds issued by a company or by a governmental entity in a foreign country that requires the existence of capital markets, whether national or international. From the point of view of the receptor country, the portfolio investment does not result in loss of control over companies issuing financial assets, it represents a purely financial transaction. The main reasons of portfolio investors lay in seeking gain and reducing the risk through international diversification.

Besides differences, between FDI and portfolio there are a series of complementarities. Firstly, FDI are realized by transnational corporations and have a clear destination, or to a company, or to a sector of the local economy. This means that local economies can't decide the destination of these investments. Foreign portfolio investments, on the other hand, can be addressed both to local companies and transnational subsidiaries in a host country, with no specific sector destinations and are therefore interchangeable.

NBR defines **foreign direct investment** as "a long-term investment relationship between a resident entity and a non-resident entity; it usually implies that the investor exerts a significant influence on the management of the company in which he invested."(BNR & National Institute of Statistics, 2009)

FOREIGN DIRECT INVESTMENT IN ROMANIA DURING 1990-2012

The evolution of FDI flows is a natural consequence of the development of the Romanian economy. The transition start was much more difficult for Romania than for other former communist countries in Europe. The poor motivation to work and the stop of the Western technological flow as a result of the foreign debt's early repayment have deteriorated population's living standards and made Romania an underdeveloped state.

This subchapter aims to analyze FDI inflows as well as FDI inflows stock in the Romanian economy.

Until 1990, FDI inflows were almost non-existent in Romania. In the context of a restrictive legislation during the communist regime, FDI had levels below $ 1 million (Table No. 1).

During 1990 - 1993, the FDI inflows in Romania were growing, but still with a very low level, under $ 100 million per year. Note that, in 1992, FDI inflows doubled in comparison with the previous year, while in 1990 they were very small. This increased flow of foreign direct investment in 1992 can be explained by the fact that privatization was initiated, the orientation towards the market economy and other measures of evolution of the Romanian economy were decided.

In 1994, FDI inflows continued to grow. Their level reached 341 million dollars, an increase of 262% over the previous year. FDI stock in 1994 was $ 821 million. The level was high, given the fact that we talk about a stock accumulated in just four years, in 1990 being well below $ 1 million.

FDI inflows also increased in 1995, reaching $ 419 million level. In 1996, FDI inflows declined slightly to 37.23%. However the stock of foreign direct investment increased in 1996 compared to 1995, reaching a value of $ 1097.2 million (Table No. 1).

In 1993 the privatization process in Romania actually began.By the end of 1996 this process underwent approximately 2,700 companies, of which 710 were medium and large companies (Table No.2). As a result of this process, at the end of 1996, the private sector was participating with 54.9% at the growth of the domestic product, compared to 26.4% at the end of 1992.

The 361.98% increase in FDI inflows in 1997 compared to 1996 is largely due to privatizations, respectively of "Romcim", taken up by "The Timken Company" and "Otelinox" taken up by "Samsung Deutschland". The value of these four privatizations was 347 million euros. The biggest privatization this year was "Romcim", taken by the French company "Lafarge" for $ 213.7 million dollars. The stock of FDI in 1997 reached a value of 2,416.64 million dollars, an increase of 120.25% over 1996 (Table No.2).

In 1998, FDI inflows have continued to increase, with 67.16% over the previous year. In 1998, "Romtelecom" was privatized, being taken up by "Oterom" for the amount of $ 375,400,000. If the price criterion is taken into account, "Romtelecom’s" privatization was the largest privatization in Romania. In the same year "Petrotel" was privatized, being taken up by "Lukoil Europe" which took on the contract investment of 200 million. Thus, FDI stock reached in 1998 $ 4,527.25 million, almost double compared to the year 1997.

During 1999 - 2000, FDI inflows declined slightly, probably due to the global slowdown and the Yugoslav conflict in Kosovo. Although FDI inflows declined in these years, the stock of foreign direct investment increased to $ 6,953,000, in 2000. Among the significant privatizations of this period we can mention "Dacia" taken by "Renault" and" Rompetrol Rafinare" which was taken up by "The Rompetrol Group" for 62.8 million euros. In the privatization contract, "The Rompetrol Group" assumed $ 825 million investment.

In 2000, reforms were implemented regarding cuts in public spending, accelerating privatization and improving the tax system, creating satisfactory prerequisites for FDI.

Since 2001, Romania has started negotiations on accession to the European Union, the privatization process has been continued and as such, the credibility of the business environment in Romania has increased significantly. These reforms have increased the attractiveness of the national economy for foreign investors. FDI inflows began to rise slightly, as well as stocks of foreign direct investment. In 2001 "Sidex Galaţi" company was privatized by the English company "Mittal Steel".

In 2002 there was a slight contraction of FDI inflows due to the unfriendly global context, but in 2003 the upward trend was restored. In 2002, the stock of FDI in Romania decreased with $ 492.82 million compared to 2001 (Table No.3).

In 2004, in Romania there was a significant increase in the volume of foreign direct investment, which reached a high level for the period 1990-2004, of $ 6,443,000. This high level of FDI inflows is explained by the registration in December 2004 of "Petrom" privatization, taken up by "OMV", one of the largest privatizations in Romania.

In 2004, Romania ranked second after Poland in Central and Eastern European region in terms of FDI inflows. The new greenfield investments in 2004 include: "Lek / Pharmatech" (the pharmaceutical industry), "Schweighofer Holzindustrie" (wood processing industry), "Medisystem Hospital" (private hospital), "Saint - Gobain" (industry glass).

In 2004, FDI inflows increased by 249% from 2003. FDI stock reached the level of $ 20,486,000 in 2004, an increase of 67.88% compared to 2003.

The period 2005 - 2006 was marked by economic development, with infrastructure investment, an environment favorable for investments. In 2005 tax reforms have been introduced, progressive taxation was removed and it was introduced the flat tax of 16%. Also, among the changes of the Tax Code in 2005 ranges the removal of restrictions on the deduction of marketing expenses, reforming the deduction of interest expense, income and expenses registration regime for contracts with payment in installments.

In 2005, Romania attracted almost half of the foreign direct investment in South - Eastern Europe, mainly due to the privatization of the energy sector. Also in 2005 the privatization of the largest commercial banks in Romania, Romanian Commercial Bank was completed , which is mirrored in 2006 statistics, when the payments were actually made. The stock of foreign direct investment has thus continued to increase in 2005, reaching $ 25,816.44.

The improvement of the business environment and the effects of the flat tax registration led to a record volume of foreign investment. In 2006, in our country there has been a 75.77% increase in FDI inflows as compared to 2005, reaching the value of $ 11,393.43.

This is largely due to the privatization of the Romanian Commercial Bank, taken over by the Austrian bank Erste Bank for EUR 2.2 million. Therefore, the stock of foreign direct investment inflows in 2006 reached a value of $ 45,452.07, increasing by $ 19.635.63 compared to 2005 (Table No.3).

In 2007 there was an increase in FDI flows worldwide. Foreign direct investments in Romania this year showed a slight decrease of $ 1,468.43 million compared to 2006. Subtracting from the FDI inflows of 2006 the privatization of the Romanian Commercial Bank, namely the sum of

EUR 2.2 billion, then 2007 definitely meant an increase in terms of FDI flows. This marked the fourth consecutive year of growth of the inflows of foreign direct investment in Romania.

Among the privatizations of 2007 it should be mentioned "Automobile Craiova" taken over by "Ford" for 57 million euros, "Famos Suceava" taken by the Italian company "Top Genko" and "Electroputere" taken by the Arabic company "Al-Arrab Contracting Company Limited". FDI stock recorded a further increase by 38.52% over the previous year, reaching the level of $ 62.961.250.

In the years 2007 - 2008, Romania has passed another milestone in economic terms because in January 1st, 2007, it became a member of the European Union. With this membership, Romania began to align to European standards because of its membership in the European Union.

As it can be seen in Table No.4, in 2008 the highest amount of FDI inflows was registered, which reached the level of $ 13,883,000. In the context in which, at global level, investment flows declined in 2008 by 21%, in Romania they increased by 39.88% compared to 2007.

The FDI stock increased by only 7.86% in 2008 compared to 2007. This increase of 7.86% of the stock of FDI in 2008 shows us a very important aspect, namely: on the one hand, the volume of new foreign investment decreases, and on the other hand the existing one is being reduced due to the effects of the economic and financial crisis.

Since 2009, the global financial and economic crisis has also affected FDI inflows in Romania, respectively there was registered a decrease of 65.09% compared to 2008. FDI stock continued to rise in 2009, reaching $ 72,007.69.

Between 2010 and 2011, FDI inflows declined, reaching the level of $ 2,744,000 in 2011. The FDI stock in 2010 showed a decrease of 2.42% when compared with 2009, meaning $ 1,743,350 (Table No.3). Given that, in 2010, FDI inflows were of $ 2,941,000, the decrease of the stock of foreign direct investment cannot be explained only by the fact that some investors have decided to leave our country.

In 2011, the FDI stock increased slightly with $ 63.290.000 compared to the year 2010. This increase is very small compared with FDI inflows of 2011, which were $ 2,744,000.

The latest published data show that in 2012, FDI inflows declined, but the stock of foreign direct investment increased to $ 74,171,000. According to the World Investment Report for 2012, prepared by the United Nations Conference on Trade and Development, FDI flows have continued to decline worldwide.

Comparing the evolution of the entries and the stock of FDI the different behavior of the two indicators is observed. FDI inflows have fluctuated in the period 1990 - 2012, being influenced by certain internal and external factors. FDI stock has generally been in an increasing trend, except for the years 2010 and 2011.

CONCLUSIONS

Investments represent a real stimulus, generating new activities and aiming at the production of goods and services essential to a healthy economy. It is not exaggerated to say that, for the economy, investment is what the engine is for an active system (I. Românu and I. Vasilescu, 1997).

And, although it has become a term often used in everyday speech, the term investment is a much more complex one than it seems at first glance.

The fact that carrying out any economic activity implies the existence of a specific environment, provided by the presence of capital, demonstrates us the importance of the investment act for the companies. In fact, the term **investment** is widely used in the economic practice, regardless of the venue or type of business.

The investment process is generally carried out over long periods of time and engages important resources of money, which gives the process a strategic step of great importance in the other activities within the company or society as a whole. It can be said that the success or failure of the investments depends on the future of the system in which they are made.

In the current economic climate, worldwide, there is a restriction of foreign investors' activity. Foreign investors are more cautious than in previous periods. In these circumstances, we believe it should be given more importance to the existing investors in order to maintain at least the existing stock of investments.

The evolution of the flow and stock of FDI is influenced by events taking place in the political and economic, national and international level, as well as the confidence of foreign partners in the development strategy of a country.

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APPENDICES

Table No. 1 -
Evolution of FDI inflows in Romania, 1990-1995

Indicator / Year	UM	1990	1991	1992	1993	1994	1995
FDI flows	mil. dollars	0,01	40,00	77,00	94,00	341,00	419,00
Absolut change in FDI	mil. dollars	-	39,99	37,00	17,00	247,00	78,00
Relative change in FDI	%	-	399900	92,50	22,08	262,77	22,87
FDI stock	mil. dollars	0,01	44,00	122,00	215,00	402,00	821,00
Absolute change of the stock of FDI	mil. dollars	-	43,99	78,00	93,00	187,00	419,00
Relative change of the stock of FDI	%	-	439900	177,27	76,23	86,98	104,22

Source: Processed data from the database of the United Nations Conferences on Trade and Development

Table No. 2
Evolution of FDI inflows in Romania, 1996-2001

Indicator / Year	UM	1996	1997	1998	1999	2000	2001
FDI flows	mil. dollars	263,00	1215,00	2031,00	1027,00	1057,00	1158,00
Absolut change in FDI	mil. dollars	-156,00	952,00	816,00	-990,00	-4,00	120,00
Relative change in FDI	%	-37,23	361,98	67,16	-48,75	-0,38	0,12
FDI stock	mil. dollars	1097,20	2416,64	4527,25	5673,98	6953,00	8339,19
Absolute change of the stock of FDI	mil. dollars	276,20	1319,44	2110,61	1164,73	1279,02	1386,19
Relative change of the stock of FDI	%	33,64	120,26	87,34	25,33	22,54	19,94

Source: Processed data from the database of the United Nations Conferences on Trade and Development

Table No. 3
Evolution of FDI inflows in Romania, 2002-2007

Indicator / Year	UM	2002	2003	2004	2005	2006	2007
FDI flows	mil. dollars	1144,00	1844,00	6443,00	6482,16	11393,43	9925,00
Absolut change in FDI	mil. dollars	-13,00	700,00	4599,00	39,16	4911,27	-1468,43
Relative change in FDI	%	-1,12	61,19	249,40	0,61	75,77	-12,89
FDI stock	mil. dollars	7846,37	12202,47	20486,00	25816,44	45452,07	62961,25
Absolute change of the stock of FDI	mil. dollars	-492,82	4356,1	8643,53	5330,44	19635,63	17509,18
Relative change of the stock of FDI	%	0,06	55,52	67,88	26,02	76,06	58,52

Source: Processed data from the database of the United Nations Conferences on Trade and Development

Table No. 4

Evolution of FDI inflows in Romania, 2008-2012

Indicator / Year	UM	2008	2008	2010	2011	2012
FDI flows	mil. dollars	13909,00	4844,00	2940,00	2523,00	2242,00
Absolut change in FDI	mil. dollars	3958,00	-9037,00	-1905,00	-197,00	-281
Relative change in FDI	%	39,88	-65,09	-39,31	-6,70	-11,14
FDI stock	mil. dollars	67910,34	72007,69	70264,34	71344,63	74171,00
Absolute change of the stock of FDI	mil. dollars	4949,09	4097,35	-1743,35	63,29	2826,37
Relative change of the stock of FDI	%	7,86	6,03	-2,42	0,09	0,04

Source: Processed data from the database of the United Nations Conferences on Trade and Development