

## Strategic Considerations For Foreign Direct Investments Penetrating A Foreign Market

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**Abstract:** *The globalization of the world economy has created great opportunities for countries, one of them being that of attracting foreign investments. They play a key role in global business, being a fundamental part of the economic system and its development. Despite the fact that the debate over FDIs varies from opinions that claim that they substitute internal investments and they expatriate a great deal of the capital at the disadvantage of the host country to opinions that argue in favor of the benefits of FDIs for host countries, increased efforts to attract FDIs by national economies can be noticed. With this in mind, this paper analyses the strategic preferences of foreign investors when choosing a new market and tries to establish a set of criteria that represent the main attraction characteristics when the decision to invest is made. The paper explains, at first, concepts such as strategic management, the strategies of entering a foreign market and the foreign direct investments, and then correlates these concepts in order to highlight the factors that contribute to the making of an investment decision and the ways through which foreign capital can be introduced on a new market. And last but not least, we made an analysis of the foreign capital flows in Romania, highlighting the advantages and disadvantages that the Romanian economy presents for potential investors interested in this country.*

**Keywords:** foreign direct investment, foreign market, investment decision, strategic management, international investment

**JEL Classification:** F21, F23, D81

## Introduction

For the economic growth and wellbeing of any country, the technologic process is defining, and the fast changes that occur in this field in developed countries can enlarge the gap between them and developing countries. Thus, it is imperative that developing and underdeveloped countries find solutions in order to narrow the gap, and by doing so, directing their economy towards sustainable development and reducing poverty[1]. With this purpose, the globalization of the world economy has created great opportunities for countries, including that of attracting foreign investments. Foreign direct investments have an important role in the global business, being a fundamental part of the economic system and its development. In the last thirty years, they have become a major form of capital transfer on a world scale, and currently, the subject of FDIs is a major talking point both on an international and a national level.

The objective of this study is to analyze the strategic preferences of foreign investments and to determine a set of criteria that determine foreign investors to choose an economy over another, when they decide to invest in another economy than the one they're from.

In order to achieve this, I've found it necessary to start by analyzing two categories of theoretical concepts in parallel: strategic management and the strategies of accessing a foreign market on one hand, and FDIs on the other. Then I correlated these concepts in order to pinpoint the means through which the investor can introduce capital on a new market in the form of an FDI, and the factors that come into play in the decision of investing in a foreign market.

This paper is based upon ideas from specialized literature, data from reports

compiled by international economic organizations relevant towards research and predictions from FDI and strategic management specialists. In my research, I have used sources of both qualitative and quantitative. The latter part of this study is based upon statistics and pertinent standardized measurements, in which I have analyzed the flows of FDIs in Romania, and the advantages and disadvantages that the Romanian economy presents towards potential foreign investments.

### 1.Strategic management. Strategies for accessing a foreign market

Strategic management is defining for an enterprise that targets expansion, even more so if it wants to direct capital towards another economy, and its prediction function contributes in a decisive way in the process of decision making and it favors companies that are faced with the need of fast changes.

Through strategic management, the leadership of a company develops strategic plans, and then, executive managers develop the tactical and operational components needed to achieve its objectives. The strategic management process can be divided into multiple phases, but on a simple approach it contains the following elements: strategic analysis, formulating a strategy, implementing the strategy and strategic control [2].

These elements can be presented in other forms. For example, L. Rue and Ph. Holland have elaborated a more detailed model of the process of strategic management. This is also split in 4 stages: the analysis of the current state of the company, examining future perspectives, determining the future evolution and applying the strategy. Each of these stages is made up of steps needed to be followed in order to complete the process [3].

The strategic analysis usually implies analyzing the company's position, the development of its purpose and the view of its future path, and last but not least, analyzing the internal and external conditions of the enterprise. And in the aforementioned model, the authors position the analysis of the internal and external conditions right after establishing the long term objectives, thus confirming the fact that it is an important component.

The analysis of the internal and external conditions is essential due to the fact that the objectives that are set must correspond with the company's capabilities and those of the market that it functions in. If the objective of the internal analysis is to identify assets, resources and capabilities and to make a scan of the enterprise from the perspective of the competitive advantages and disadvantages that it possesses, the analysis of the external environment is tasked with identifying the opportunities and the threats that the company may encounter in the market that it operates in and in a new market, presuming that an expansion has been set as a company objective. The variables used in this type of analysis include economic, politic, legislative, technologic, social-cultural and environmental factors and other factors specific to every enterprise. This type of analysis shows the management if objectives that have been set are realistic, the companies utilizing specific instruments, such as the SWOT or the PEST/PESTLE analysis [2].

A company's success relies a great deal on the realism and quality of its strategy, and on the depth of the analysis that has been performed in order to establish that strategy [3]. Thus, any company must pay a great deal of attention to the external conditions and their analysis, as the environment represents

the objective and subjective reality and is a determinant factor in the decision-making process.

An investment will achieve the investors' objectives depending on the context, and the context is influenced by facts [4]. Theodore Levitt in his study "Marketing Myopia" offers several more revealing examples about the importance of context (internal and external conditions) in relation with company strategy. One of these examples reveals the perception about the context of the London rail industry from around the time the study was made, the 1960's. This study claims that railways have stopped being built even though the demand for freight and passenger trains has grown. The railway infrastructure has started being outdated, not because the demand was satisfied by other means of transport, but because the demand was not satisfied by the rail industry itself. Furthermore, the British Railways company has neglected the transport services consumer market exactly because of its erroneous position regarding the industry tasked with providing the railway materials rather than the transport sector, which provides services. The reason that the industry was incorrectly defined in this case is the orientation towards production and not the consumer, which means that the market's realities were not taken into account [5]. This example is probative in showing the importance of context analysis and the analysis of the environment in which a company wishes to do its business.

Besides the analysis of the external environment, special attention needs to be drawn to specific reviews, specifically the evaluation of the industry's state according to the company's profile and that of the competition within that certain industry. On the basis

of the results from the analysis of these two elements, the company's state can be evaluated from the perspective of its competitive position in relation to the market's realities (advantages/disadvantages) [3].

The strategies of expanding in a new market and accessing that market and their implementation are essential elements that test the efficiency of a company's management, as they not only imply the creation of a new company in another company, but also taking in account the new environment, with its benefits and downsides.

When a company has set its target on expanding in a new country it must establish two important elements, the identity of the market that it will access and, more importantly, the way through which it plans on doing this.

There are several ways of accessing a market, namely: through exports, through contract or by investments. Penetrating a market through exports can be done through direct or indirect exporting. The upside of this type of trade is that it is one of the easiest ways of marketing in a foreign economy and it implies only small risks. However, the profits generated are generally small due to commercial barriers and the exchange rates between the host country and the country of the investor (if the currency from the country of the investor is more potent, then the investor will record significant losses).

The second means of expansion of foreign markets is making a contract through which the investor allows other companies to have control over the managerial decisions, over financial administration, production and marketing. Meaningful examples for this way of accessing a market are franchises and licensing.

The third way of accessing a foreign market are investments, that can be materialized either through mixt entities, new companies or the acquisition of existing companies. A mixt company refers to the situation in which two companies work together in order to access a foreign market, splitting the risks and the income. New units refer to the situation in which a company opens a new subsidiary in another economy than that from which it originates and acquisitions refers to the acquirement of a national company or certain parts of one by the investor [6].

## **2. Foreign direct investments – definition and characteristics**

There are numerous theoretical works that analyze FDIs in detail since the 80's, when they started to be used on a larger scale becoming a major source of capital transfer.

FDIs were interpreted over time in the specialized literature in different ways. They are defined in various ways, starting from companies that poses and control commercial activities in more than one country (Brooke and Remmers in 1970 and Dunning in 1971) and advancing to definitions that include only the companies that have a joint management and a strategy regarding their internal and external operations (Perlmutter, 1969; Behrman, 1969). Some researchers introduce more pragmatic restraints such as the number of countries in which a company operates (Vernon, 1972) or the proportion that the investor possesses from the total sales, assets or the number of employees of the company in which the foreign investment is made (Bruck and Lees, 1966) [7].

Taking these approaches into account, international organizations such as the

Organization for Economic Co-operation and Development (OECD), the IMF or the United Nations Conference on Trade and Development have chosen to give FDIs an ampler definition.

The OECD defines direct investments as being a category of investments made over the border of states that are made by a resident of an economy with the purpose of creating long term interest in a company that resides in another economy. The direct investor is interested in a long-term strategic relationship with the enterprise in which it has invested with the purpose of obtaining a significant influence over its management. This long-term interest is visible when an investor obtains at least 10% of the stock in the company in which it has invested. The objectives of a direct investment are different from those of portfolio investments, as the investors don't desire to gain influence over management of the company. Also, the direct investment companies are corporations, subsidiaries (over 50% of the stock is owned by the investor company), associated companies (between 10% and 50% of the stock is owned by the investor or quasi corporations (branches of some corporations that are 100% owned by the original companies) [8].

The World Bank defines FDIS similarly, defining them as the net entries of investments with the purpose of obtaining at least 10% of the stock of a company that functions in another economy than that of the investor [9].

In the fifth edition of the Balance of Payment Manual of the IMF, an FDI is defined as the capital held in subsidiaries, the

stock held in branches or associated companies, short, medium and long-term loans between the parent company and the affiliated or associated subsidiaries, contributions such as providing machinery by the foreign investor and also, reinvested profits [10]

### **3. Factors that determine the investment decision on a foreign market**

There are three important factors that point towards a certain market and to the way in which foreign capital will enter that market: the specific factors of the economy in which the investment is made, the internal factors of the company and the strategic factors. The first deciding factor for transnational companies is related to the specifics of the host economy. In addition to the fact that this factor determines the investment decision, it also determines the size of the investment, the conditions and the degree of opening towards the expansion in more locations within the host economy.

In order to establish the main macro-economic factors that determine a company to invest in one economy at the expense of another when the decision to invest in a foreign market is made, the PESTLE analysis is used, implying the analysis of the market and it constitutes a part of strategic management, often used in market studies [11]. The PESTLE analysis is a useful instrument for the comprehension of the overall image of the environment that is chosen as a place of future investment. From this analysis, potential risks associated with the analyzed elements can be identified.

Table 1 The PESTLE analysis of the main factors of interest for foreign investors when choosing a foreign market

Factors of interest	Factors subcategories	Interests of the FDI in host markets
Political		- the predictability of changes following elections (as political parties following them may change laws and rules, and sensitive sectors of the country's economy, such as financial institutions, energy or communications can be controlled by the political factor)
	Tax system	- low taxation is key to attracting FDIs (for example: low income taxes, individual income tax rates, etc.)
	Tax brakes	- Subsidies and reductions - Tax exemptions - Free land/land grants - Preferential charges - Expatriation and relocations of goods and profits, etc.
	Labor legislation	- The balance between rights and obligations that the employer and the employee have towards each other
	Trade restrictions	- No trade restrictions imposed on the state in question within the international system
	Infrastructure	- Modern infrastructure, in order to facilitate the transport of merchandise, water systems, energy and communication networks
	The education system	- Quality education system which coincides with the demands on the labor market (the countries in which there is a higher graduation rate of university level diplomas obtain more FDIs in fields such as technology or finance, insurance and real estate)
	Health system	- Efficient and healthy work force in order to favor long-term profitability of the investment
	Corruption	- From the view of the investor, in pure economic terms, corruption appears as a supplementary, untransparent and unpredictable form of taxation



<b>Economic</b>	Economic growth	- Economic growth in the host country is preferred in the context of FDIs as the larger the GDP per capita is, the higher the absorption rate of FDI productivity is
	Fiscal stability	- National long-term fiscal stability plan in place in order to create a stable economic environment for investment
	Interest rates	- The interest rates should be as low as possible to enable the investor to contract loans
	Exchange rates	- If the investor is exporting goods and services, the currency of the host country should be less potent than that of the exporting country - If the investor seeks to repatriate the profit, the currency in the host country should be as potent as possible
	Inflation rates	- Preferable inflation rates depending on the products/services provided, it is important that there is a stable inflation rate
	Employers	- Employers that play a strong part in negotiations with the politicians
<b>Social</b>	Cultural aspects	- It is important that the cultural aspects of a state are adaptable to the investor's strategy
	The rate of population growth and the population's distribution by age	- The need for a younger workforce, whereas an aging population may involve a smaller and less efficient workforce and this may create additional costs on employees
	Attitude towards building a career	- Preoccupied, qualified and specialized workers formed through high-quality training
<b>Technologic</b>	Research and development	- High public investments in the field of research and development
	Automation processes	- The workforce's adaptability for using automated production means
	The acceleration of the technologic process	- The growth of the rate of technologic investments
<b>Environmental</b>	Sustainable development	- Environmental friendly constructions - Products and services that have a reduced energy consumption - Innovative ways to reuse, recycle and purify water and other resources - New technologies to remove dangerous particles from the air, etc.
<b>Legislative</b>	Consumer law	- Viability, credibility and speed in solving problems by the legal institutions
	Antitrust laws	
	Labor code	

Source: the author's conception

#### 4. Ways of entry for direct investments on a foreign market

For a company to establish on which type of market it will enter, it has to choose between different entry methods, in order to achieve its objectives. According to specialized literature, but also to the international organizations, and the form in which FDI appear in different economies, the entry on a new market, in this case, could be made in two ways:

- greenfield - building up new capacities. This type of operating on a foreign market, one that presents the most of risks, is that of building a capacity of products and/or services. Even so, this type of investment assures control over the technology and over quality, and also an increase of production. In contrast to taking over some existing companies, the investments started from scratch have the advantage of using a new, unused technology, that can be fully dedicated to certain needs of production or services of the parent company.

- Acquisitions and mergers: The company can buy or can unify with already existing businesses from the market they aim to, and that have similar products to those made in the economy in which they are present. This type of investment has the advantage of being able to use an already existing brand from the market, and being able to sell it immediately after the acquisition of the company, and in the meantime, the investor could introduce new brand on the host-market. Buying a company represents the same risks as a fusion, and for the last one we can add the challenge of the foreign investor to operate in a total different culture.

#### 5. The presence of foreign investments in Romania

Although the financial, technologic and managerial needs of a country like Romania in a period of transition were extensive at the beginning of the 90's, the slow political and economic development has prevented consistent flows of FDIs from penetrating its economy until 1997. Starting with 1998, especially due to the privatization of state assets, flows of foreign capital in Romania began to increase significantly. The economic growth between 2000 and 2008 has demonstrated the existence of a functional market that provided opportunities to investors. With the integration of Romania in the EU the Romanian economy has benefited from the integration in safer economic and legislative space, favorizing the entry in the local market of some powerful companies. The favorable environment was short lived however, the Romanian economy being strongly affected by the financial and economic recession that started in 2008. Although a series of investment projects were canceled during the crisis, the number of foreign investors that withdrew from the Romanian economy is relatively low [12].

The balance of capital from FDIs in Romania grew by 5% in 2010 in comparison with 2009, reaching 52.585 million euros [12]. In 2011, the FDI flow grew again by 4.9% recording a total of 55.139 million euros [13]. The next year, 2012, the FDI flow grew again by 7.2% (59.958 million euros) [14], while in 2013 the FDI flow increase slowed down to a total of 59.958 million euros, growing by a mere 1.4% in comparison to the previous year [15]. In 2014, the low growth trend continued, totaling 60.198 million euros, only 0.4 more than 2013 [16].

In regards to the orientation of foreign companies towards certain economic



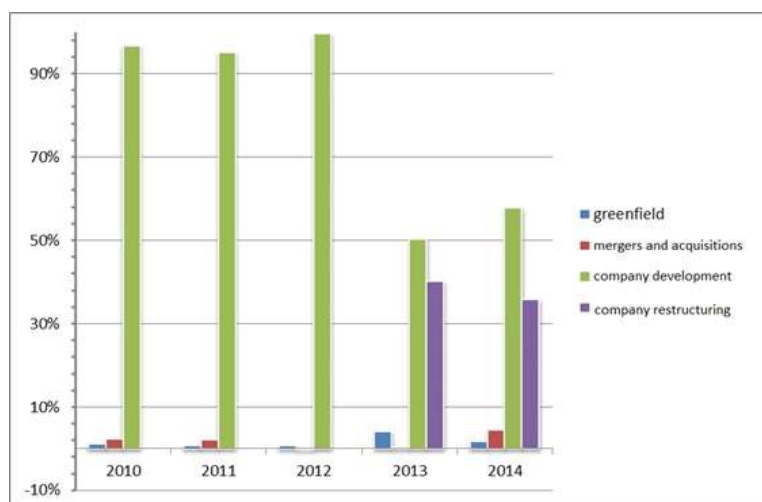
activities, in 2010, as in 2009, the highest contribution was made by the investments in the manufacturing industry (31.1% of the FDI flow in 2009 and 32% from the flow of 2010). In 2011 as well, the manufacturing industry recorded the highest share of the total FDI flow, precisely 31.5%, followed by financial intermediation and insurance (18%) and constructions and real estate transactions (10.7%) [13]. In 2012 too, the manufacturing industry (31.3%), and financial intermediations and insurance (18.5%) have been the highest contributors to the FDI flow, followed by commerce, with 11.4% [14]. In the following years, the first three industries that generated the FDI flow remained the same [15].

At the time being in Romania there are four methods that can be identified, in which the FDIs materialize, depending on the flow of foreign participants in the capital of the FDI companies: investments that don't have a previous infrastructure – the greenfield type, the fusions and acquisitions, company development and restructuring of companies [16]. If, generally speaking, foreign investments of the greenfield type, are

concentrating on the main technological branches and occupy a significant part in the total of the FDIs from certain countries, in Romania they have a lower share, approximately 1,8% from the capital participations (77 mil. euro in 2014). Nor in the case of fusions and acquisitions Romania does not excel, taking into consideration that in 2014, their share in the capital participation was approximately 4,5% (196 mil. euro). The development and restructuring of companies, meaning approximately 94% and having the predominant share in the total of the participants to the capital of the FDI in the year 2014 (3.949 mil. euro), reveal the potential loss of the companies, that are the result of the increased share of restricting of the companies, more exactly 36% of the total of 94% [16].

It can easily be observed in Fig. 1 the relative lack of interest of foreign investors of establishing new companies, or of taking over certain companies from the residents, and in this situation, desirable being the proactive attitude of the investor, especially in the case of greenfield investments.

Figure 1. The participation of capital flows in FDI enterprises, 2010-2014



Source: BNR, investițiile străine directe în România, annual editions

## 6. Elements of the Romanian economy that attract or discourage Foreign Direct Investments

The interest of foreign investors manifests and migrates from one economy to another according to the economic advantages that it presents, but also taking into account the social and legislative aspects of each economy. The main macroeconomic factors that influence the decision to invest in a market are various and they depend on the socio-economic aspects of the host country.

The political factors are crucial to an investor's decision of choosing a country or another. If we analyze Romania from political stability point of view, we can note that joining the European Union has recorded progress in all sectors of democratic reform. The problems within the judiciary system and the fight against corruption are Romania's main weaknesses according to the latest MCV report of the European Commission, but the same document notes "signs of sustainability" regarding the progress of the judiciary reform and in the fight against corruption through high level corruption trials. The same report, tells us that public acquisitions are exposed to conflicts of interest [17]. Romania was ranked number 37 of 189 countries in the Doing Business Report of the World Bank in 2016, status that places it on the level of emerging and developing countries from Europe [18]. However, the main obstacles in the way of the development of the business environment are, according to the same report: slow access to financing, high tax rate, inadequate infrastructure, corruption and inefficient government bureaucracy. Despite all of these issues some positive measures were taken to favorize the business environment in regards to tax payment via online

local tax systems, allowing bank operations for the payment of taxes, which has been appreciated by the business environment [17].

Economic factors usually attract an investors interest. The national economy presents a steady annual growth for the past years, a growth of around 3%. The medium term economic perspectives are favorable, even though Romania is a country in which the GDP per capita (adjusted to the standards regarding buying power) is only 55% of the EU average. EBRD specialists claim that values of 4 to 5% annual growth are achievable on the condition that structural reforms are accelerated and further investments are attracted [17]. It is also worth mentioning that Romania is also confronted with transition difficulties in most of the economy's sectors. Although once joining the EU, the gap in comparison with the other member states was supposed to be narrowed, the current state of the infrastructure, the energy sector and real estate is deficient and it places Romania below the community standard. On the other hand, access to financing is limited due to the undeveloped state of the capital market that is not ready to take more risks, especially through loans to SMEs.

If we analyze Romania in regards to its resources, we will notice a series of benefits for investments. It possesses a vast array of natural resources and raw materials that even though are not present in large amounts, they are sufficient in order to maintain the continuity of production even in the times of tense international economic relations. The climate, the agricultural potential, the large forested area, the hydrographic network and the touristic potential can be determinant and highly attractive factors for foreign investors. The transportation network can present

a challenge for future foreign investors [19]. It's also worth mentioning the great potential of the human resources and their low costs, a great deal under the European standard and also the fact that the country's population constitutes an internal market of around 19 million consumers. Romania's geographic positions also offers an extremely favorable geo-economic position, at the crossroads of several important international trade routes.

The social and cultural factor are also very important for the investors in the Romanian economy, as the human and cultural development of a population determines the performance of the workforce that is targeted by a potential investment. According to the latest Human Development Index report made by the UNDP, Romania is a country with a high level of human development, ranking at 52, and from 2010 a noticeable and constant growth can be noticed [20]. There are still great differences between the occupational activities between genders, Eurostat data indicating that in 2014 women earned 9.7% less than men (the EU average is at 16.6%). There are rural areas with no access to any type of financing and only 37% of the rural population has an account opened at any financial institution; and from the urban population less than half has contracted credits. With regards to education there are also regional differences, only 58% of the people between 25 and 64 from the rural area possessing medium or superior studies in 2010, in comparison to the urban area where this percentage for the same age group rises to 91.1% [17].

The technologic factors are essential for the productivity of a business. An economy's access to technology not only reduces costs and improves efficiency, it also improves

productivity for the types of production that allow this. Romania's case can be characterized by reduced performance in innovation, as a result of a deficient national system of research-development-innovation, with a reduced transfer of the results of research and development to practical use, also caused by the reduced demand of innovation within the private sector. Also, "the lack of collaboration between the private sector and the research and development institutions halts the technologic transfer and also the potential to market the results of research through industry" [21]. The National Competitiveness Strategy defines technologic development and innovation as priorities in the effort to transform the Romanian economy in a competitive economy, in which scientific research is exploited in order to achieve the established objectives of economic development [21].

The environmental factors are also important, the exploitation and processing of the energy resources strongly influences them and also because sustainable development must be a priority for the country and for the commercial entities. In regards to these factors Romania should align itself to European standards. Although a new law regarding energy efficiency was adopted in 2014, according to EU directives with this purpose, for the increase of efficiency and the reduction of pollution the need for better laws and an improvement of infrastructure remains. Climate change also brings a new set of threats for several types of economic activities in Romania. More exactly, an increase of annual temperatures is foreseen that may cause hydrologic fluctuations, fluctuations that could interfere with important mining and agro-industrial projects. Furthermore, it's necessary to take into account the issue of

the irrigation systems, whose state may cause damage to the economy and the population.

## 7. Conclusions and suggestions

FDIs have constantly and significantly grown as part of the global economy, being intensely stimulated by the globalization phenomenon. Despite all this growth there are still major difficulties that sometimes are able to block investment projects of TNCs (transnational companies) or other investors. It is also worth noticing that the number of potential investment projects is significantly higher than the number of successfully implemented projects. Investors are confronted with delays when it comes to obtaining the necessary sanctions and even with the closure of some projects due to political hindrances, either administrative or legal. Investments are frequently blocked by state companies that produce similar goods and services, by conflicts between state authorities, government regulations that favor local investors, political and social protests against some projects, unclear procedure, corruption, denying the validity of some contracts signed during different political leadership, lack of liberalization of some sectors, the prevention of access of the private sector in some sectors of the economy, etc [22].

All of these issues are external to the beneficiary company, more exactly they are characteristic to the market that the company is active in or a market that it wishes to invest in. Specifically for this reason this study demonstrates the importance of the process of strategic management in the time prior to the investment of a foreign market, the analysis of the environment in the host country and the targeted industry being the first step

through which some of the risks of the investment may be eliminated.

More exactly, the economic, social and cultural environment of the host country is concerned, and on one hand the investors must include them in their analysis before choosing a location in which to invest, and on the other hand, the leaders of the host country must improve this environment before formulating a strategy to attract FDIs.

In order to at least minimize the risks caused by factors that are out of the control of the investing company, it must include in its strategic management process some detailed analysis before setting their sights on a new market, and it must also establish the size of the investment.

In the same time, countries that are interested in attracting FDIs must identify the elements that attract and those that discourage investors in order to concentrate strategies towards the areas of the economy that present certain or at least potential competitive advantages. Also, in order to attract FDIs, the executive of host countries must consolidate the social, educational, health and environmental sectors as investing companies are interested in the general development level of the country in which they wish to invest, besides the obvious economic and industry specific aspects.

In this study the factors on which the decision to invest in a non-resident entity were recorded, analysis that may be completed by further studies but also used as a guide concerning the aspects that need to be improved and taken into consideration when formulating the nations strategy of attracting foreign direct investments.

The latter part of this paper was dedicated to the FDI phenomenon within the

Romanian economy, as the relatively low level of these investments comparable to the considerable modernization and increase in efficiency demands of the economy determined us to diagnose the causes that prevent a more powerful FDI presence in our country. On the basis of a short analysis of the presence of FDIs in Romania and of the elements that attract or discourage that our country presents, we reached the conclusion that this theory is also validated on Romania's case. In the light of empirical

proof from other countries, we can identify most of the elements that are interesting for foreign investors and that make the internal market more attractive.

Beyond the benefits of Romania's geostrategic positioning and of the existing resources, it must accelerate the process of its economic, technologic, human development, administrative and juridical performance with the purpose of presenting a space that is thoroughly attractive to foreign capital.

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