The Impact of Country Risk on the Dynamics of Foreign Direct Investments in Romania

Sorcaru Sergiu-Lucian[1]

Abstract: The main objective of the scientific approach consists of country risk analysis to substantiate the Foreign Direct Investments (FDI) in Romania. The thesis proposes a new approach and analysis regarding the risks to which foreign investors are subjected to, both in terms of concepts and theoretical understanding of the phenomena. As a method of analysis we have used qualitative research as it focuses on cultural studies of the place chosen for investment; on the sociological survey and it covers an extensive interdisciplinary field. The motivation of approaching so an important topic on country risk and the importance it has in the location of foreign investments in general, and especially the direct foreign investments, is justified on the one hand by the scarcity of studies in the field, and, furthermore, the impact of economic policies that it can have such research. The results or our approach are correlated with statistical data analysis, which allowed the creating a general framework on the country risk influence on FDI. The added value lies in the approach particularly complex due to the multitude of variables involved, and the risk management is an absolute necessity in today's economy.

Keywords: country’s rating; commercial policies; transnational; EU; UNCTAD

1. Introduction

At international level, the concept of country risk takes on a significant magnitude. In the context of economic globalization and crises caused by capital movements. Businesses and financial, willing to invest and expand externally manifested a strong need for accurate information on the profile of the country in which they invest and the risks involved in the investment environment.

[1]PhD in progress, “Alexandru Ioan Cuza” University of Iasi, Faculty of Economics and Business Administration, Specialization Economics and International Affairs, Romania, Address: 20 Carol I Blvd., No. 20, Iasi, Romania, Tel.: +40232 20 1070, Corresponding author: sorcarusergiu@univ-danubius.ro.

AUDRI, Vol. 9, no 2/2016, pp. 28-38

Due to economic changes in the world and the challenges of globalization, where distances and borders are disappearing and internationalization of companies tends to be a necessity in their survival in this context, the definition and country risk management strategy is crucial foreign investment. Although the subject of risk management is one of topical country in the global economy, quantification is difficult due to numerous variables that it involves. Treating some new facets of the concept of risk and constant adaptation to the changing economic environment and requirements are essential sustainability of an economic entity.

Future developments and unexpected changes in the economic environment, and the economic collapse of 2008, when foreign investment declined. However direct investment flow analysis can help a country's economy in such situations. After the fall of the totalitarian regime, foreign direct investment took a magnitude fabulous, both worldwide and especially in South-Eastern Europe, the only thing that has slowed development of foreign direct investment was the economic crisis of 2008, due to insecurity and FDI economic deficit suffered.

Country risk is considered a means of prediction and evaluation, analysis of which is crucial in a foreign direct investment.

At the same time we try to show the importance that FDI plays in the global economy. Against this background, global flows of foreign direct investment remain one of the main manifestations of globalization, which is easily demonstrated if we reflect on the fact that over 50% of everything that happens in the world, be it product or services are performed by subsidiaries of transnational companies, i.e. companies resulting from FDI.

FDI through globalization has become a daily life of each of us, either by products or services purchased or even through work or through their communication or leisure.

The economic crisis has highlighted how foreign direct investment has played an important role in the transformation of developing countries in source countries capital (obvious examples in this regard are China and India), but also in shaping a new world economic order, characterized by other relations of forces. **(**Bonciu, 2012).

2. The Issues Facing Transnational Company's Strategy of Expanding into a New Market

Definition of risk management includes the idea of danger, risk and cost notion designates the seriousness of the risk with the idea of a regular event and the deliberate presentation of the hazard determined in order to obtain an advantage.

In the context of globalization, international activities have become increasingly challenging due to many factors competitiveness and present event that deserves special attention and revolutionized the conduct of international activities. (Horobeț, 2005, p. 47)

In the literature meet the classification and grouping risks in different ways depending on their perspectives on risk analysis: internal risks and external risks (Bagdonas, 1997), direct risks and risks of virtual risks and risks subjective goals (Adams, 1999), risks of local and global risks, macro and micro-risks (JH Dunning, 1997), country risks, corporate risks, project risks (Vass, 2001), pure risk, price risk and interest (Harrington & Niehaus, 1999). (Militaru, 2009, p. 77)

Continuing with the concept of country risk in dictionary Cambridge, country risk is defined as "the level of risk attached to doing business with another country, on whether the country will be able to pay back loans or pay for imports "and country risk in Business dictionary is defined as" the probability of loss due to the unstable economic and / or political buyer's country, resulting in an inability to pay for imports."[1]

Country risk is considered a means of prediction and evaluation, analysis of which is crucial in a foreign direct investment, companies opting for an analysis of "go-no-go" (to invest or not invest) this is seen as a misperception of Cristian Laura Peacock and because they see that an investment can be more profitable with a initiates who knows how to take risks, the key is the assessment of risk and potential gain. (Peacock & Peacock, 1999, p. 34)

A problem for country risk is the vulnerability of a country that can change suddenly due to some events, so overall country risk is indicative for FDI to assess a country we must stoop primarily the points key vulnerabilities due to regional tensions, the so-called dependence on capital inflows, exports of a single type of

[1] http://dictionary.cambridge.org/dictionary/english/country-risk, Accessed on 29.11.2016.

goods or imports of oil and political system weak in that country, however they can make a first impression for a possible investment.

Foreign direct investment is defined by UNCTAD as investment involving a long-term relationship, reflecting the lasting interest and control of an entity resident in an economy, natural or legal person of a legal entity resident in another economy.

FDI components are: paid-up capital to purchase shares at an economic entity abroad, reinvested earnings (proportional to the share capital) obtained from activity abroad, loans in the company (mainly loans to foreign subsidiaries of the company mother). (Voinea, 2007, p. 9)

They are also considered foreign direct investment, equity investments and loans from foreign companies that are entitled to vote or participate in the share capital of the company is below 10 percent, but belonging to the same group. FDI companies of second degree are those that have a foreign investor who owns at least 10% of the share capital.

FDI grew in Romanian state after the fall of communism and the democratic system and increase the adoption of increasingly more globalized world. Foreign direct investment is an opportunity for sustainable development and growth of the host country, FDI stimulate trade, create employment, promote technology transfer and improve the allocation of resources, besides all this it helps to integrate in the global economy the host country.

When we speak of FDI will inevitably country risk, even if this notion leads us first think about the losses they may suffer foreign investment, considered a connoisseur create an advantage and a first objective picture of a country.

3. Analysis of FDI Inflows in Romania

Case investor, referring in particular to transnational companies to invest abroad, are based on the country risk evaluation and analysis. Also, in the investment environment, banks are other entities that places special importance on the level and evolution of country risk when financing business across national borders.

When deciding to invest abroad play a role risk class to which it belongs host country. In this context, prestigious institutions involved assessing country risk based on economic indicators, political and social. Thus, country studies conducted by a rating agency are used to compile the rankings risk positioning is performed in each state according to the potential risk faced by international business.

An important aspect regarding developing countries who wish to strengthen their market position investments the attraction of foreign direct investment. In this context, the past two decades, in Romania, the rate of participation of foreign capital in direct investments showed a positive. They were determined by the existence of conditions generally attractive to foreign investors, who have targeted restructuring and the development of the service sector.

But looking in comparison with other EU member states, Romania's situation in terms of attracting FDI is not so advanced level, which can be seen from the representation dynamics of investment flows in Europe.

The main cause that led to the slow pace of attracting foreign capital in Romania, after the "boom", marked by 2008 was primarily instituted after the release of economic instability and economic crisis. (Anghelache, Anghelache, Nita & Jackal, 2015, p. 128)

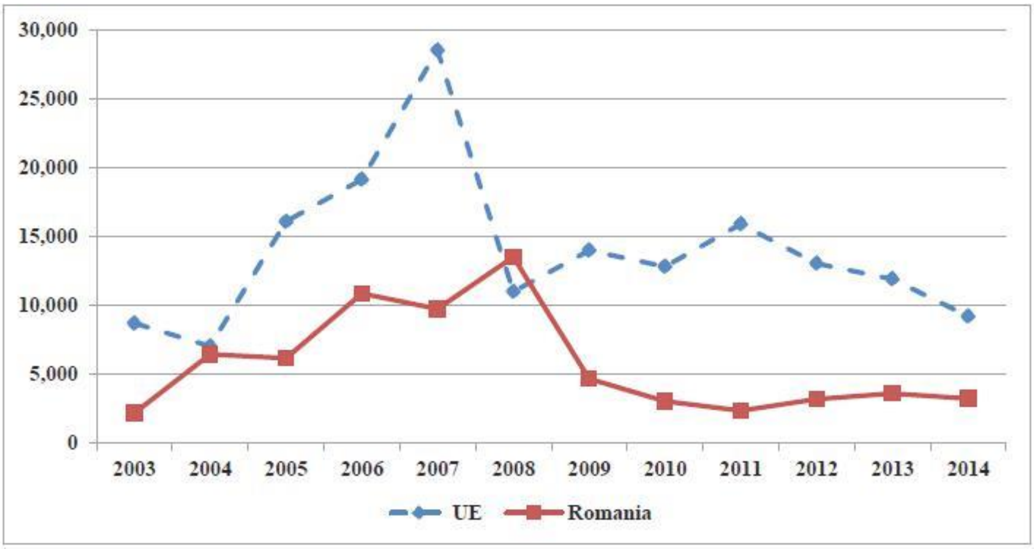

Figure 1. Dynamics of FDI attracted nationwide between 2003 -2014, compared to the EU average[1]

[1] http://www.revistadestatistica.ro/supliment/wp-content/uploads/2015/10/RRSS_10_2015_A10RO.pdf & UNCTAD Statistics, accessed on 25.11.2016.

Graphical representation highlights the evolution of FDI flows attracted by Romania compared with the average achieved at EU level.

In the period under review, it is noted that after 2003, but in 2008 it reaches a maximum foreign direct investment, which can be explained by the entry of Romania into the European Union and high confidence of foreign investors in our country. Since 2009, Romania is experiencing a decrease in investments, a fragile equilibrium is established in 2013-2014.

An analysis of the EU country that attracted FDI note that the UK has the leading position for the reference period, which can be explained by economic and political stability of this state.

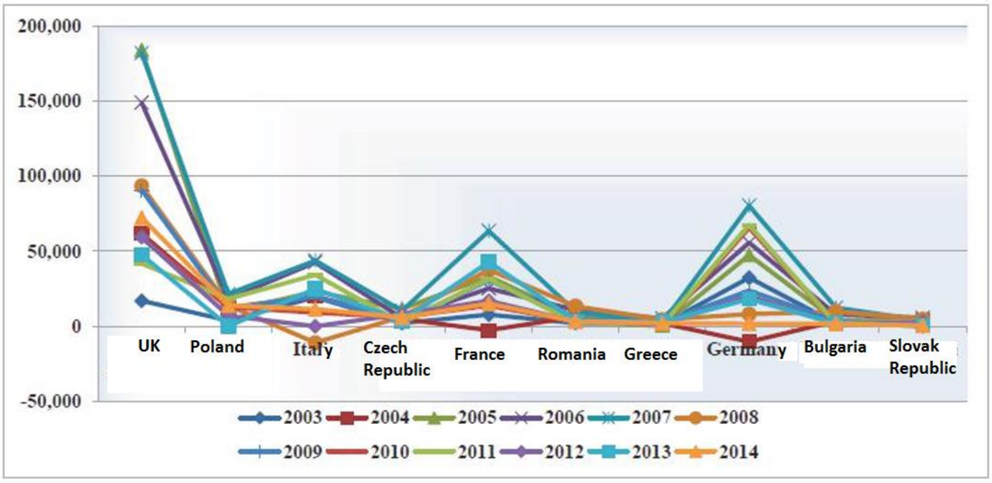

Figure 2. Evolution of FDI flows attracted by Romania compared to EU countries [1]

The importance and effects of FDI attracted in reasonably close attention to all the states, even more so in times of crisis. The competition to attract foreign capital was stressed and with it the public debate on this subject. In many countries of the world a decade ago governments they were criticized for being permitted access to foreign investors, while in 2009 - 2010 many governments are criticized for not having done enough to attract or retain foreign investors (and if have to refer back

[1]http://www.revistadestatistica.ro/supliment/wp-content/uploads/2015/10/RRSS_10_2015_A10RO.pdf & UNCTAD Statistics, Accessed on 25.11.2016.

to Romania, we remind the public reaction to the announcement of the departure of a major investor, company Nokia).

4. Rating Country and FDI Developments in Romania: Study Compared with Competitor Countries in the Region

The evolution of any enterprise object causes a variety of activities and / or a larger geographical expansion plan, a firm passage across the borders of their country is the process of internationalization. The advantages of internationalization of firms in addition to a wider market exposure may constitute a significant reduction or elimination of filing fees, transport and customs. Reducing the length of time between production and marketing is another advantage taking into account fluctuations in commodity prices. Extending the life of a product type by placing it on a foreign market. For the host countries, especially if they are developing foreign investment can be a plus.

The country risk rating handle these three great companies together with institutes, and publications such as Institutional Investor, Euromoney, BERG, Japan Bond Research Institute (JBRI). In Romania, BNR requested first country risk evaluation. Romania was rated BB- notation, in 1996, first by Fitch Ratings.[1]

In Romania, the first rating agency capital drinkable Romanian, was born in 1997 under the name BERG-Bucharest Equity Research Group, the grading system used is STAAR (Scala the appreciation of the Romanian shares) rating scale is simple from one to five stars. Today agency database includes over 1,500 companies, the agency focuses specifically on risk assessment in Romania and listed shares on the stock market extra.[2]

Still we want to do an analysis and ranking of the country for Romania from other EU countries and other major powers.

[1]http://www.biblioteca-digitala.ase.ro/biblioteca/carte2.asp?id=218&idb, Accessed on 26.11.2016.
[2]http://www.rating.ro/, accessed on 26.11.2016.

Classification	Moodys	Fitch	S&P
The Highest Level	Aaa	AAA	AAA
Very High Level	Aa1,Aa2,Aa3	AA+,AA,AA-	AA+,AA,AA-
High Level	A1,A2,A3	A+,A,A-	A+,A,A-
Good Level	Baa1,Baa2, Baa3, Baa4	BBB+,BBB,BBB-	BBB+,BBB,BBB-
Speculative	Ba1,Ba2,Ba3	BB+,BB,BB-	BB+,BB,BB-
Highly Speculative Level	B1,B2,B3	B+,B,B-	B+,B,B-
Substantial Risk	Caa1,Caa2,Caa3,Ca	CCC,CC,C,RD,D	CCC+,CCC,CCC-, CC,C,D

Table 1. The quotation used by the three major rating agencies[1]

Country	Rating Agencies		
	S&P	Moody's	Fitch
Australia	AAA	Aaa	AAA
China	AA-	Aa3	A+
India	BBB-	Baa3	BBB-
Japan	A+	A1	A
Russia	BB+	Ba1	BBB-
US	AA+	Aaa	AAA
Turkey	BB	Ba1	BBB-
EU	AA		
Austria	AA+	Aa1	AA+
Belgium	AA	Aa3	AA
Bulgaria	BB+	Baa2	BBB-
	BB	Ba2	BB
Croatia	BB-	B1	B+
Cyprus	AAA	Aaa	AAA
Denmark	AA-	A1	A+
Estonia	AA+	Aa1	AA+
Finland	AA	Aa2	AA

[1] http://www.tradingeconomics.com/ accessed on 27.11.2016.

France	AAA	Aaa	AAA
Germany	B-	Caa3	CCC
Greece	A+	A3	A
Ireland	BBB-	Baa2	BBB+

Table 2. Results of rating agencies in 2016 to Romania, EU states and major global trading powers[1]

Latvia	A-	A3	A-
Lithuania	A-	A3	A-
Luxembourg	AAA	Aaa	AAA
Malta	BBB+	A3	A
UK	AA	Aa1	AA
Moldavia		*B3*	
Netherlands	AAA	Aaa	AAA
Poland	BBB+	A2	A-
Portugal	BB+	Ba1	BB+
Czech Republic	AA-	A1	A+
Romania	**BBB-**	**Baa3**	**BBB-**
Slovakia	A+	A2	A+
Slovenia	A	Baa3	BBB+
Spain	BBB+	Baa2	BBB+
Serbia	*BB-*	*B1*	*BB-*
Sweden	AAA	Aaa	AAA
Ukraine	*B-*	*Caa3*	*CCC*
Hungary	BB+	Ba1	BBB-

Looking at the chart above we can see that Romania is rated by the three main rating agencies with the very best for 2016. Compared with our neighbors i.e. Bulgaria-speculative, speculative Moldavia- (granted only by Moody's), Serbia - speculative, substantial risk Ukraine- Hungary speculative level, we can say according to the data above that Romania is ranked best in terms of country risk of the three agencies. When referring to the EU average, Romania is in the first half, but we must consider that we are the country bordering the European Union, we have two very large countries (former empires) and strong economic, political and military in our immediate neighborhood who the last time was in strained relations with the EU. Comparing with major world powers Turkey and Romania are ahead

[1]http://www.tradingeconomics.com/country-list/rating Accessed on 28.11.2016.

of Russia on a par with India and behind Australia, China, Japan or the United States under the securities offered by the three major rating agencies to country.

Regarding the impact of country risk on FDI dynamics, we note that transnational companies usually prefer FDI in developing a geographic location, near the mother company or near large cities to minimize transport costs first.

In Romania, the evolution of investment shows an interest of foreign investors for the region Ilfov, according NIS and NBR, in Ilfov county is more than 61% of foreign direct investment in Romania, opposite meet the South-East of Romania with 4.2 % area of interest to potential investors without foreign alongside the South West and North-West by 2.8%.[1]

Among Romania's advantages in attracting transnational territory they meet membership in the largest single market in the world that the European Union, the rating given by the three major rating agencies namely solid favorable both to neighbors and some world powers advantage Danube (the most important river in Europe for trade routes).

Another advantage may be the conflict between the EU and Turkey can attract the interest of foreign investors to Romania, which has strategic importance to Asia by opening offered by the Black Sea.

Another threat to transnational is the uncertain situation in Turkey, our goal is to attract foreign investment to our country by the advantage of geographical ownership, but also taking into account the advantages of Romania by stability, a member of the largest trading powers and a population double that of Bulgaria.

5. Conclusions

TRAND on globalization, internationalization and brought strong economic contribution of FDI in the economy of each country, we want this work to show strides made by Romania in consolidating the country's stability. Even if the National Trade Policy development was a cumbersome, by joining the EU before Romania changed the number increased exports and foreign investment. The advantage of transnational companies by choosing Romania as a potential country

[1]http://bnro.ro/Investitii-directe---principiul-direc%C8%9Bional-12332.aspx, Accessed on 28.11.2016.

for activities lies in the relationship between the common law of all EU Member States and labor remuneration with relatively low comparing with other EU countries.

Romania has a unique strategic position represented by the eastern border of the EU, access to the Black Sea can have key role to new trade routes to the shore and navigable Asia. Romania coefficient on the rating of the country and at the same time the importance of increasingly higher FDI can totally change the face of Romania on international trade relations. Even if the field requires a particularly complex due to the multitude of variables involved, approach and risk management is an absolute necessity in today's economy.

6. Bibliography

Anghelache, Constantin, Anghelache Gabriela Victoria, Niţă Olivia Georgiana, Sacală, Cristina (2015). Studiu privind evoluţia fluxurilor de investiţii straine directe - model de analiză/Study on the evolution of foreign direct investment flows - analysis model. *Romanian Statistical Review*, no. 10.

Bonciu, Florin (2012). *Investitiile străine directe înainte şi după criza economică mondială/Foreign direct investments before and after the global economic crisis.* Bucharest: Editura Universitară.

Horobeț, Alexandra (2005). *Managementul riscului in investițiile internaționale/Risk management in international investments.* Bucharest: All Beck, p. 47.

Militaru, Cezar (2009). *Managementul Afacerilor Internaționale/International Business Management*. Bucharest: Pro Universitaria.

Păun Cristian, Păun Laura (1999). *Riscul de țară/Country Risk.* Bucharest: Editura Economică.

Voinea, Liviu (2007). *Corporațiile transnationale și capitalismul global/Transnational corporations and global capitalism*. Iasi: Polirom.

Online Sources

http://dictionary.cambridge.org.

http://www.revistadestatistica.ro.

http://www.biblioteca-digitala.ase.ro.

http://www.rating.ro.

http://www.tradingeconomics.com.

http://bnro.ro/Investitii-directe.

http://unctad.org/en/.