ASPECTS ON FOREIGN DIRECT INVESTMENTS, DEFINING ELEMENTS, CLASSIFICATION

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Abstract

Foreign Direct Investments a complementary category to domestic investments is one of the important resources for the achievement of a strategy for economic development and modernization of a country. The accumulation of capital (internal, external) signifies a priority condition of economic progress, the stake being the achievement of investments.

The paper approaches, succinctly, concept elements of this economic category as outlined in the definitions of some specialists and international bodies, in the categories of foreign investments practiced and the particularities that differentiate them.

The definitions given are multiple and various and refer to the objectives pursued, the role played in the economic development and the relations between the participants.

The categories of Foreign Direct Investments are presented according to criteria related to the relations between the economic agents, the purpose pursued, the way to participate with capital, as well as characteristics that distinguish between the different types of international investments.

The paper ends with some conclusions on the aspects presented.

Key words: Foreign Direct Investments, resources, capital, classification.

Jel classification: F21, H54

1. Introduction

In the current stage, one of the priority conditions of economic development and progress for a country is represented by capital accumulation (both domestic and by attracting Foreign Direct Investments), at stake being the realisation of investments.

Complementary to autochthonous investments, this category constitutes itself as reliable support for elaborating an economic development and modernisation strategy, predominantly in the case of developing countries.

Due to the effect of the shifting changes of the economic reality in the present stage, the approach regarding Foreign Direct Investments might be perceived in relation to economic growth, development, and prosperity, and, also, to the display of economic freedom supported by adequate mechanisms and institutions.

2. Conceptual approaches, definitions of Foreign Direct Investments

Foreign Direct Investments (FDI) represent external sources of capital supplementing domestic capital being a basic support for realising the development and modernisation strategies of the national economies.

Over time, there were a series of approaches as regards Foreign Direct Investments whose definitions related to aspects linked to "share held by subsidiaries, capital contributions (participation with equipment from a direct investor […])" (Bonciu, 2009).[3]

b Their definitions are multiple and varied, depending on the pursued objectives and the role played for economic development, are formulated in papers of experts, as well as in documents of international bodies, as for instance:

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⇒*In relation to the goal pursued by the foreign investor, the presence of Foreign Direct Investments in economic development, technology and know-how transfer,* these represent:

- "The ownership of a foreign resident on some assets […] with the purpose of controlling the use of these assets"[1] (Graham şi Krugman, 1989).
- "[…] the active factor of development and of adjusting the economy to market, competitiveness demands […]"[2] (Moise, 2005, p. 19).
- "[…] are not a simple transfer of capital, but rather an extension of the enterprise from the origin country into a foreign host-country"[3] (Negriţoiu,1996, p. 54).
- "[…] are complex international flows including financial, technological, managerial and organisational expertise resources that overlap the long term interest and entrepreneurial control of the firm, or of the investing natural person, with the purpose of developing some productive activities in another economy than the one in which the respective firm or individual is resident"[4] (Horobeţ; Popovici, 2017, p. 6).

⇒*International bodies* capture in the definitions of Foreign Direct Investments various aspects characterizing them (the relationship between stakeholders, goal and objectives aimed at etc..):

➢ *Banca Naţională a României* (*BNR*) "long-lasting investment relationship between a resident entity and a non-resident entity; as a rule, it involves the exercise of significant managerial influence, by the investor, within the company in which he/she invested"[5], expressing the control held by the investor (BNR, 2018, p. 5). In the area of foreign direct investments are comprised: "share capital paid up and reserves pertaining to a non-resident investor having a participation share of at least 10 percent of the votes, or from the subscribed share capital of a resident company, the credits between this investor, or the group to which he belongs and the resident company in which he/she invested, as well as the reinvested profit made by him/her"[6] (BNR, 2018, p. 5).

➢ *International Monetary Fund* - "a category of international investments reflecting the purpose of an entity residing in a country (the direct investor), in obtaining long-term interest into a company residing in another country" (IMF: How Countries Measure FD1, 2001)[7]; thus, the inclusion of Foreign Direct Investments into the category of international investments is revealed, the long-term interest that a direct foreign investor pursues, based on the relationship with

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[1]Mişu Negriţoiu (1996), p. 53 quotes Graham şi Krugman, 1989; Elena Moise (2005), p. 21 quotes Graham şi Krugman, 1989;
[2]Elena Moise (2005), *Investiţii Străine Directe,* Editura Victor, Bucureşti;
[3]Mişu Negriţoiu (1996), p. 53, *SALT ÎNAINTE. Dezvoltarea şi Investiţiile Străine Directe (JUMPING AHEAD. Foreign Direct Investments and the economic development)*, Ediţie îngrijită de Valeriu Ioan-Franc, Editura PRO & Editura Expert, Bucureşti;
[4]Alexandra Horobeţ; Oana Popovici (2017), p.6, *Investiţiile Străine Directe: Evoluţia şi importanţa lor în România,* Mai 2017, Studiu realizat în parteneriat de Academia de Studii Economice Bucureşti şi Consiliul Investitorilor Străini, https://fic.ro/Documents/view/Studiu-Investitiile-straine-directe-evolutia-si-importanta-lor-in-Romania;
[5]Banca Naţională a României (2018), *Investiţiile Străine Directe în România în anul 2017*, https://www.bnr.ro/PublicationDocuments.aspx?icid=9403 BNR specifies that the research was done by Banca Naţională a României with the contribution of Institutul Naţional de Statistică, based on the methodology provided by *Manualul Balanţa de plăţi şi poziţia investiţională internaţională*, edited by Fondul Monetar Internaţional, ediţia a 6-a (BPM6) - International Monetary Fund (2009), Balance of Payments and International Investment Position Manual, Sixth Edition (BPM6);
[6]*Idem 8*;
[7]Ovidiu Serafim Trufin (2016), p. 28, qutoes IMF: *How Countries Measure FD1*, 2001;

an entity residing in another country and the participation to the management of the company (Trufin, 2016, p. 28, 29; Prelipceanu, 2006, p. 17).

➢ *The European Council Directive 88/361/EEC*[1] from 24 June 1988 regarding the implementation of Article 67 of the Treaty comprises the Regulations of the European Union in the field of foreign direct investments, by showing the instances in which these can be manifested (Trufin, 2016, p. 29):

- setting up new subsidiaries or expansion of the existing ones;
- creating new companies belonging exclusively to the investor;
- total acquisition of some existing companies;
- participating with capital within (new or existing) companies, with the purpose of establishing or maintaining long-term economic links;

➢ *The Economic Organisation for Trade and Development* regards Foreign Direct Investments as "a reflection of the goal to obtain a long-term interest into an entity residing within an economy (called "direct investment company") by an entity residing in another economy (called "direct investor"), this interest implying a long-term relationship between the direct investor and the direct investment company, as well as a significant degree of influence of the investor on the management of the enterprise receiving the investment"[2];

➢ *The Organisation for Economic Cooperation and Development (OECD)* highlights, in the "*Codes of Liberalization of Capital Movements and of Current Invisible Operation"*, the participation of Foreign Direct Investments in building economic relationships on long-term and their capacity of exercising influences in managing the respective company[3].

"*The direct foreign investor:* a legal person, natural person, or a group of persons taking concerted action, holding at least 10 percent of the votes, or from the subscribed share capital […] into an enterprise placed outside the own country of residence"[4].

"The foreign direct investment company: is a resident company with or without legal personality in which a non-resident investor holds at least 10 percent of the votes or from the subscribed share capital […]"[5].

In Romania, Art. 2 letter a) from the Law no. 241/1998 for approving the Government Emergency Ordinance (GEO) (Ordonanţa de Urgenţă a Guvernului - OUG) 92/1997, regarding "incentive direct investments"[6] shows that Foreign Direct Investments might highlight in "participating to building up or expanding a company in any of the legal forms provided for, by law, in gaining shares or stocks in a trading company, save for portfolio investments or setting up and extending in Romania, a subsidiary, by a foreign trading company"[7]. Foreign Direct Investments may be of financial nature, contributions in kind and participation in increasing the assets of a company.

[1]Ovidiu Serafim Trufin (2016), p. 29 quotes Directiva Consiliului European 88/361/CEE din 24 iunie 1988;
[2]Alexandra Horobeţ; Oana Popovici (2017), p. 4, quotes OECD documentul – *Benchmark Definition of Foreign Direct Investment*: Fourth Edition, 2008;
[3]Ovidiu Serafim Trufin (2016), p. 29 quotes Organizaţia pentru Cooperare Economică şi Dezvoltare (OCDE), *Codes of Liberalization of Capital Movements and of Current Invisible Operations*;
[4]Banca Naţională a României (BNR) (2018), *Investițiile Străine Directe în România în anul 2017*, https://www.bnr.ro/PublicationDocuments.aspx?icid=9403; BNR specifies that the research was done by Banca Națională a României with the contribution of Institutul Național de Statistică, based on the methodology provided by *Manualul Balanța de plăți și poziția investițională internațională*, edited by Fondul Monetar Internațional, ediția a 6-a (BPM6) - International Monetary Fund (2009), Balance of Payments and International Investment Position Manual, Sixth Edition (BPM6);
[5]*Idem 14*;
[6]Ovidiu Serafim Trufin (2016), p. 29, 30 quotes Legea nr. 241/1998, pentru aprobarea OUG 92/1997;
[7]Ovidiu Serafim Trufin (2016), p. 29, 30 quotes Legea nr. 241/1998 pentru aprobarea OUG 92/1997 Art. 2 lit. a;

In essence, from the above-mentioned definitions, it might be asserted that a distinctive element of Foreign Direct Investments is that they allow the investor to have control over the assets in which the investment was made. Thereby, it might be understood as direct involvement in managing and organising the production in which the investment was done. In order for an investment to be regarded as Foreign Direct Investment, it is necessary for the foreign investor to have a participation share in the companies where he/she invested between 10% and 25%. In the majority of situations, the weight held by one investor exceeds 50%. (Moise, 2005, p. 21, Negriţoiu, 1996, p. 53, 54).

3. Classification of Foreign Direct Investments

The types of international investments in use are differentiated depending on criteria that are related to the relationship between the participating stakeholders, the pursued goal, and other elements taken into account, for instance:

→ Depending on the ***relationship which is created*** in the case of international investments ***between the issuing agent and receiving agent***, the relationships between the two lead to the difference between ***two types*** of investments:

✓ *Foreign Direct Investments (FDI)* – the issuing agent has control rights proportionally to the participation share and, respectively, decision rights on the action of the receiver (the host country) (Horobeţ and Popovici, 2017, p. 3). Foreign Direct Investments comprise "next to the financial flow […], other flows, many of them having a real consistency: technology, labour force, managerial, goods and services flows"[1].

✓ *Portfolio investments* consist in the financial placement of the issuer (purchase of some foreign securities – shares, bonds – on a financial market), and does not imply the exercise of control on the receiver. (Horobeţ and Popovici, 2017, p. 3; Moise, 2005, p. 22).

The two above-mentioned types are differentiated by (Prelipceanu, 2006, Moise, 2005, Negriţoiu, 1996):

- *Goal* - Foreign Direct Investments pursue high gains, while portfolio investments are motivated by high interest rates (Moise, 2005, p. 25);
- *The period on which they unfold* – FDI are developed on long-term, and are durable, while portfolio investments, on shorter time, pursuing rapid profit gains (Prelipceanu, 2006, p. 17);
- *The participation degree with capital* – the participation with up to 10% is regarded as portfolio investments, whereas above 10% is considered as FDI[2].
- *Company control* – the Foreign Direct Investments gives the investor the right to participate directly to the management and organisation of production where the investment was made, while in the portfolio investment the investor participates to taking decisions and receives dividends, but without control rights (Prelipceanu, 2006; Moise, 2005, p. 21, 22; Negriţoiu, p. 54).

The difference between the two types of international investments is difficult as between the two exists a "grey area" where the boundaries are hardly identifiable (Munteanu and Vâlsan, 1995, p. 9).

→ In relation to the ***goal of the direct investment*** – OECD[1] takes into account four different types by categories of the operations that they presuppose (Horobeţ and Popovici, 2017, p. 5, Spânu, 2017, p. 16, 17):

[1]Costea Munteanu; Călin Vâlsan (1995), p. 9, *Investiţii Internaţionale. Introducere în studiul investiţiilor străine directe*, Oscar Print;
[2] Raluca Prelipceanu (2006), p.17, quotes FMI Balance of Payments Manual, ed. a 5-a, 1993;

- ✓ *Mergers and acquisitions* – imply the acquisitions or sales of own capitals. It is encountered in developed countries where for production entities is pursued expansion of the business, diminishment of costs, and obtaining a better market position[2]. It might be often observed in the case of existing companies owned by the private sector. It might be encountered, seldom, under the form of "joint ventures" constituted between companies in private ownership and public-owned companies[3]
- ✓ *"Greenfield" investments* – with direct reference to investments in the receiving country. They are found in instances where the activity chosen for investment is inexistent in the receiving country or, if it exists, the market demand is unsatisfied. The used capital is foreign, joint and starts from zero. This type of investments is practiced more frequently in developing countries. It shows risks for the host country because the withdrawal of the company's projects triggers high financial damages to the host country[4].
- ✓ *Brownfield investments* consist in total or partial acquisition of some existing production utilities. Subsequent to the acquisition of existing units, these are reorganised and the personnel is restructured[5].
- ✓ *Development and expansion of existing companies* – a company entering the local market might use the alternative of expansion, by reinvesting net profit.

According to the OECD opinion, the probability of a favourable impact of increasing economic performance in the receiving country is assumed in the case of "greenfield" investments and capital expansions. It is different from mergers and acquisitions' investments that have impact on some economic indicators when the acquired company is restructured[6].

- → ***Depending on the objectives pursued by the company*** performing Foreign Direct Investments (Negriţoiu, 1996, p. 62, Prelipceanu, 2006, p 34):
  - ✓ *Horizontal integrated investments* – the company produces in the subsidiaries established in the host country, the same product that is manufactured in the country of origin. The objective is to cover local or regional demand.

This type of investments corresponds to Multinational Corporations (MNC) who are searching for outlet markets – ***companies organised on the horizontal***. These are shaped in the context in which the countries have the same endowments in production factors reflecting a relative similarity between the country of origin and the host country, in this respect (Yokota and Tomohara, 2007)[7]. By means of the local production, the investor enters on the domestic market of the receiving country and attempts to meet the demands of the market by diversifying products (Trufin, 2016, p. 55).

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[1]Alexandra Horobeţ.; Oana Popovici (2017), p.5 quotes OECD - *Benchmark Definition of Foreign Direct Investment*, Fourth Edition, 2008, p. 87;

[2] Diana – Florentina Spânu (2017), p. 16, *Factorii Determinanţi ai Investiţiilor Străine Directe în România şi Polonia 1990 – 2000*, Editura FREE, http://free.literati.ro/index.php/free/catalog/view/2/1/5-1 quotes Aiwei Wang, The "Choice of Market Entry Mode: Cross-Border M&A or Greenfield Investment", in "*International Journal of Business and Management*", 2009, Vol. 4, Nr. 5, p. 240;

[3]Diana-Florentina Spânu (2017), p. 16 quotes Maria Bîrsan, Simona-Gabriela Maşca, *Investiţiile străine directe. De la paradigma eclectică (OLI) la paradigma evoluţiei investiţiilor (IDP)*, Iaşi, Editura Universităţii "Alexandru Ioan Cuza", 2012, op. cit., p. 35;

[4]Diana-Florentina Spânu (2017), p. 17 quotes Investopedia - Green Field Investment: http://www.investopedia.com/terms/g/greenfield.asp (14 decembrie 2016);

[5]Diana-Florentina Spânu (2017), p. 17 quotes Maria Bîrsan, Simona-Gabriela Maşca, *op. cit.,* p. 35;

[6]Alexandra Horobeţ; Oana Popovici (2017), p. 6 quotes OECD *Benchmark Definition of Foreign Direct Investment*: Fourth Edition, 2008, p. 87;

[7]Ovidiu Serafim Trufin (2016), p. 55 quotes Yokota and Tomohara, 2007;

- ✓ *Investments integrated vertically* – emerge when the multinational corporation sets up new production capacities, outside the national borders for realising intermediary products used as "inputs" into the production realised in the country of origin (for instance, investments in the extractive industry). The shape has as basis the supply and exporting again to the country of origin (Prelipceanu, 2006, p. 34, Negriţoiu, 1996, p. 62). This type of investments is represented by companies searching for efficiency – ***companies organised vertically***. The companies will make investments in the host countries where the different degree of endowment with production factors might bring high profits.

→ In relation with the ***effective participation to capital*** are distinguished the following **types of Foreign Direct Investments** (Prelipceanu, 2006, p. 17, 18):

- ✓ *With equity form of investment - EFI*, of which exemplifies: greenfield investments, acquisitions, investments in a local company with the participation of the local investors, joint-ventures with EFI capital participation (Prelipceanu, 2006, p.18);
- ✓ *Non-equity form of investment* – (*NEFI*) (Prelipceanu, 2006, p.18): the franchise and licencing, sub-contracting and management contracts, turnkey contracts. This form of investments – Foreign Direct Investments *lacking effective capital participation, i.e. Non-equity form of investment* (NEFI) – emerged as reaction to the challenges of the world economy in the second half of the last century (the emergence of new stakeholders at world level, markets' liberalisation, the development and diversification of innovation). The instability of the international environment generated as reaction of the foreign investors, the search for as flexible solutions as possible for investments (Dunning and Narula, 1996)[1].

→ Other forms of ***"hybrid"*** investments which consist of different categories of shareholdings (capital, technology transfer, managerial competences) of the NEFI type (Prelipceanu, 2006, p.18).

The above-mentioned forms create interrelationships have dynamic activity and support changes by shifting from one type to the other, such as non-equity foreign investments (NEFI) to equity foreign investments (EFI) or vice-versa (Prelipceanu, 2006, p.19).

[1]Raluca Prelipceanu (2006), p. 18, *Investiţiile străine directe şi restructurarea economiei româneşti în contextul integrării europene*, Editura Lumen, Iaşi quotes Dunning and Narula, 1996;

4. Conclusions

The contribution of the foreign direct investments in development felt already by the end of the past century generated a new concept of the investment development process, the starting point being represented by the relationship between the development degree of the receiving country and the net foreign investments.

The types of international investments practiced are differentiated depending on criteria that are related to the relationship between the participating stakeholders, the pursued goal, as well as other elements taken into account. The fact must be taken into account that the existing forms interrelate and bear changes by shifting from one type to another in a dynamic process.

Realised from external capital sources, to which domestic capital is added, this economic category represents a significant support in realising the development and modernisation strategies of an economy.

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