THE INFLUENCE OF CORPORATE GOVERNANCE ON ATTRACTING FOREING DIRECT INVESTMENTS (FDI) – IN ROMANIA

STANILA Cosmina Adela
Accounting and Auditing Department, Faculty of Economics and Business Administration, West University of Timisoara, Timisoara, Romania
stanila_adelacosmina@yahoo.com

Abstract: *Within an economic entity, regardless of its organizational form, public or private, different interests are manifested between managers and other stakeholders. Corporate governance deals with the way in which these interests can be harmonized to make work more efficient by using equitable distribution of rights and responsibilities between all stakeholders. All corporate governance requires trust-based relationships between all structures and various stakeholders. In the context of globalization and internationalization of economies, in order to effectively attract the financial and intellectual capital needed for the sustainability of a business, corporate governance mechanisms must be based on gaining the trust of all stakeholders. A healthy business environment focuses on providing information in a transparent and faithful way, and in the business environment the existence of good corporate governance is significant as importance in improving the capacity of an organization to create value. These goals require a climate based on accountability, fairness, transparency and efficiency, where ethical principles should govern behaviours spread throughout the entity. Starting from these goals, the empirical research aims to identify the effects generated by corporate governance in terms of the evolution of foreign direct investments in Romania. These goals requires the existence of entities in which management and control processes are adequate, giving them a high level of transparency and credibility in dealing with capital owners, investors and other stakeholders. The research has reconfirmed that the proper governance of an entity can only be achieved by knowing and applying corporate governance principles, rules and practices with responsibility. According to corporate governance theories, if they are well-known, understood and applied, they can increase the credibility of entities, better and faster access to capital markets, capital costs reduction, efficient use of resources, sustainable business development, and, also, a healthy economic environment. In order to achieve the public interest, new challenges and trends, it is important for management and control systems to reconfigure the objectives in which the achievement of global performance has implications for social responsibility and environmental protection.*

Keywords: *corporate governance; financial performance; foreign direct investments; Romania; globalization; Bucharest Stock Exchange.*

JEL Classification: *G30; L25.*

1. Introduction

Corporate governance, as a component part of modern management, has become a key tool in achieving performance goals and reducing company risks. In the current era of knowledge, the economic environment is constantly changing, and the information is moving at an amazing speed.

Addressing the concept of performance is an important concern in the company's management. In order to adapt to the new conditions, management decisions are taken in a short time, based on accounting information.
The financial dimension of the entity is a major coordinate of the entity. We cannot talk about efficient governance without considering the contribution of accountancy. Based on certain principles and regulations, accountancy processes and transmits financial information, representing today a formalized communication language in the business environment. The accuracy and relevance of financial-accounting information used in decision making has a decisive influence on the future of the company.
The quality of decision-making process is an essential parameter in a globalized market where competition is strong and changes occur rapidly, generating a large amount of unstructured information. The basis for decision-making process is the information provided by the financial-accounting system, and their increasing complexity makes it difficult to process and disseminate knowledge.
The big financial scandals were generated to a great extent by the deformation of the economic reality, fact that has increased the requirements for the quality of the reported financial-accounting information. At the same time, compliance with accounting regulations and corporate governance practices has been enforced. The external financial reporting should present a complete picture of the entity's performance and financial position, and provide predictions about the company's future development. Modern techniques of processing the accounting information and the implementation of accounting standards make possible getting information on past performance, its current position and the future evolution of the firm.
In Romania, the introduction of corporate governance principles in order to increase the economic and financial performance of companies is absolutely new. Moreover, in parallel with the delayed regulation and implementation of the core elements of the corporate governance code, the Romanian economy has gone through several difficult steps in the political, economic, legal and social reforms. The effects of these delays were found in the decision-making processes of capital investment or disinvestment, these non-conformities and partial reflections of the economic reality represented have direct or indirect effects on all sectors of the economy with serious and multiple implications.
In the given context, in the light of the benefits to investors, there is a growing need to extend the principles of corporate governance and the level of medium- or small-sized economic entities, given their level even if they are not quoted on a capital market. However, at present, due to more or less objective factors, such extrapolation is not possible and, in some cases, unnecessary, if we refer to economic and financial considerations.
The objective of the research is to investigate, based on statistical data, the link between the level of foreign investments and corporate governance in Romania. From the methodological point of view, the research is mixed, theoretically-applicative, the theme being approached from an ethical and positivist perspective. The study includes both a qualitative and a quantitative approach. The qualitative approach made creates a complex image of the corporate governance phenomenon and shows how the foreign direct investments affects the performance. The quantitative analysis was used to complete and substantiate the qualitative approach and based on data officially published by the Bucharest Stock Exchange, the

National Bank of Romania, the National Trade Register Office and the National Institute of Statistics.

2. Conceptual Delimitation of Corporate Governance in the Context of Foreign Direct Investment

Corporate governance defines a set of principles, rules and control mechanisms applied to protect and harmonize the interests of all categories of players in the economic plan. We remember that the interests that develop within corporations are often contradictory.
In a particular approach, corporations are very complex social organization systems, with the status of legal persons, having the legal authority to issue or transfer shares and bonds. According to the Oxford Dictionary, a corporation is a company or group of companies authorized to work together as one entity (Oxford Dictionaries, 2014). The way a corporation is run to increase its value and to constantly adapt to the requirements of modern economics is closely linked to corporate governance. This concept refers to a whole system through which entities are driven to achieve objectives, involving many stakeholders such as transnational processes, technologies, procedures and codes of good practice.
The level of investment in general and the level of foreign direct investment (FDI) are particularly important elements of good corporate governance. FDI is considered to be the primary economic development, with most countries trying to attract investment from multinational companies (Talamo, 2011). They can promote economic growth for both industrialized countries and developing countries, and corporate governance is one of the key elements for their level. It is a driver of growth, by providing new capital, technology transfer and managerial know-how, increasing marketing skills, organizational efficiency, and focusing on profitability (Hardi & Buti, 2012).
An important tool for the FDI level is the real estate of the company. An inefficient management of this may lead to massive losses in the number of shares held by investors. Foreign investors need to know how the company's fixed assets are used to improve productivity and consolidate the entity's financial base (Oladokun & Aluko, 2012).
Amongst the problems faced by companies when operating abroad are:
• High agency costs;
• Political risks;
• Cultural and linguistic differences:
• Unknown market;
• Foreign exchange risk.
In recent decades, globalization has led to major changes in all areas, with most developing countries trying to attract investment from multinational companies. The world economic system has been restructured due to the increase in international capital flows, i.e. foreign investment and loans. So, direct exports have have been replaced by foreign affiliate sales to host countries, which has led to the replacement of international trade with foreign investment, in particular FDI, the amount of international capital flows growing considerably over the last three decades (Gurbuz & Aybars, 2010). Currently, the rapid expansion of FDI is positively influencing the performance of firms that have internal resources and strong capital returns (Chang & Rhee, 2011). They can enter many markets, gaining new experiences and

becoming more competitive. Countries less open to foreign investment are characterized by property restrictions and weak corporate governance mechanisms (Talamo, 2011). Open markets and investment regimes are two powerful instruments to attract investment, in general, and foreign direct investment, in particular.
Consequences of foreign direct investment:
• Use local labour force;
• Introducing new know-how;
• Forcing local firms to improve their management systems;
• Promote technological and industrial development;
• Domestic firms may be bankrupt by foreign firms;
• The cost of production factors may increase as a result of foreign direct investment.
Developments in developing countries are associated with a more liberal economy and more merited FDI. They are a growth engine by providing new capital, transferring technology and managerial knowledge, marketing skills, organizational efficiency, and focus on profit. There are two ways companies can accumulate Foreign Direct Investments, merging and acquisition, both having their own advantages and disadvantages (Burker et al., 2011). Their wealth represents important financial sources for developing countries. However, investment in developing countries has more impact on performance than investment in developed countries (Yang et al., 2013). Internationally, FDI has received much attention from economists because they involve high-profile investments that characterize multinational firms (Chang & Rhee, 2011). Following an investment process, foreign firms acquire an important advantage over entities that have been purchased (Petkova, 2009).
The main objective for attracting foreign investment is to improve the efficiency of production by differentiating and geographically separating the production stages or conducting individual business activities benefiting from competitive advantage over local economies. A large number of companies from different countries can take part in the internationalization of businesses, which can thus come into possession of new technologies and knowledge (Derado, 2013). At the same time, the emergence of FDI requires monitoring of operations by global corporations (Lian & Ma, 2010). Firms that have always been privately owned work better than state-owned firms (Schweiger & Friebel, 2013) and are more likely to attract FDI. Foreign investment management can affect the value of the firm, and firms with less stable incomes are more valued than stable income firms (Al-Khouri et al., 2004). Another role in the FDI dimension is played by the convergence of National Standards with International Standards Financial Reporting (IFRS). They increase the value of the firm and promote FDI, as they reduce the cost of processing information for foreign investors. The positive effect of reduced information costs is felt strongly in partner countries whose accounting systems have greater differences as they enhance the beneficial role of convergence (Ding et al., 2011).
Since the value of the firm depends on the quality of decisions made by the management committee, foreign investment can improve the decision-making process. When investments are made by entities with internal resources and higher skills, they can improve performance and increase the value of the firm. At the same time, in the case of expanding companies, managers should consider market uncertainty and the competitive pressures they offer (Chang & Rhee, 2011).

3. Empirical Presentation of the Evolution of Foreign Direct Investment in Romania

For Romania, the number of corporations with foreign involvement in 2017 was 5.837 according to the National Office of the Romanian Trade Register (see figure no.1). Among the reasons for the profound changes in the capital structure of Romanian entities are: access to resources, new outlets and lower transaction costs (Mihai, 2012).
According to the National Bank of Romania (BNR) report, the net foreign investment flow in 2017 was 4.794 million Euros.

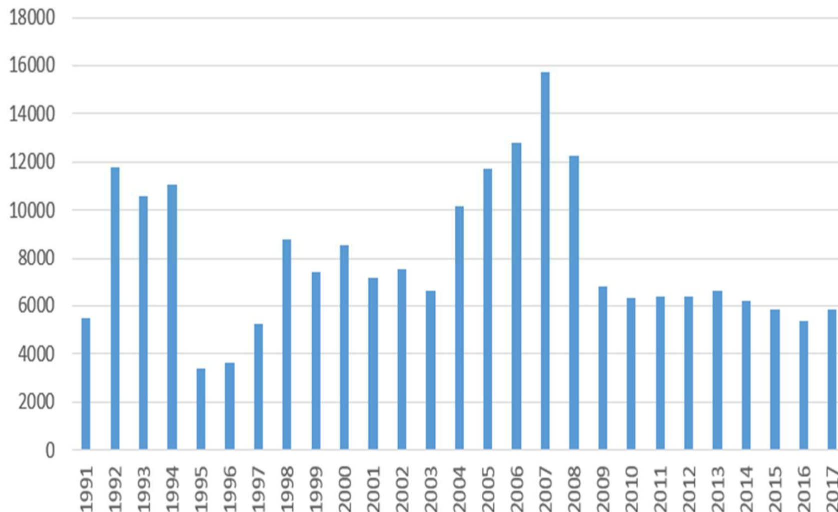

Figure 1: Number of companies with foreign participation in capital between 1991 - 2017 in Romania
Source: National Trade Register Office, available at:
http://www.onrc.ro/index.php/en/statistici?id=254 accessed on 01.03.2019

The total FDI in 2017 was 75,851 million Euros. The top five countries ranked according to the share held in the FDI balance in Romania (see figure 2) at 31 December 2017 are:
• The Netherlands (25.90 percent);
• Germany (12.80 percent);
• Austria (12.60 percent);
• Italy (6.20 percent);
• France (6.20 percent);
As regards to the order of the first five countries of direct investment, for the first five countries the hierarchy has remained unchanged since 2009, and Italy surpassed France and Cyprus, ranked fourth.

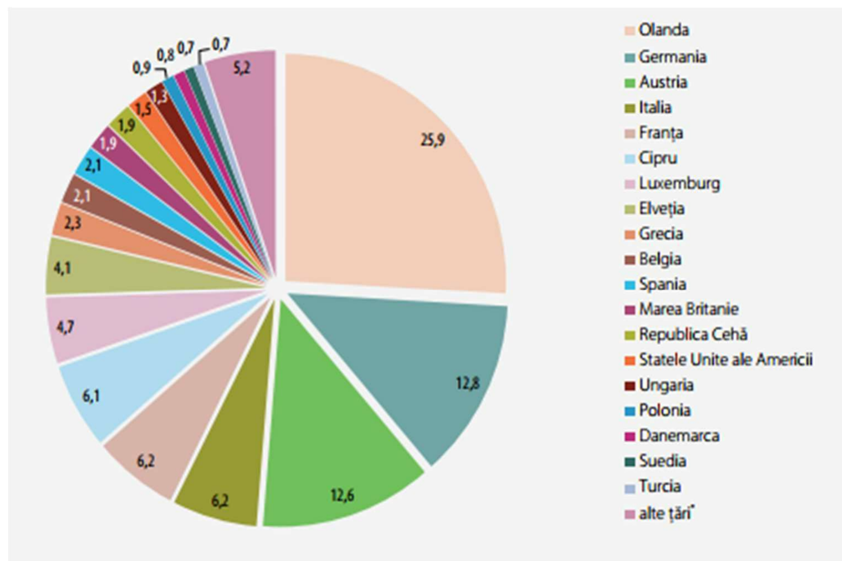

Figure 2: The share held by the countries of origin of the main foreign investors in Romania in 2017
Source: National Bank of Romania, available at: www.bnr.ro accessed on 01.03.2019

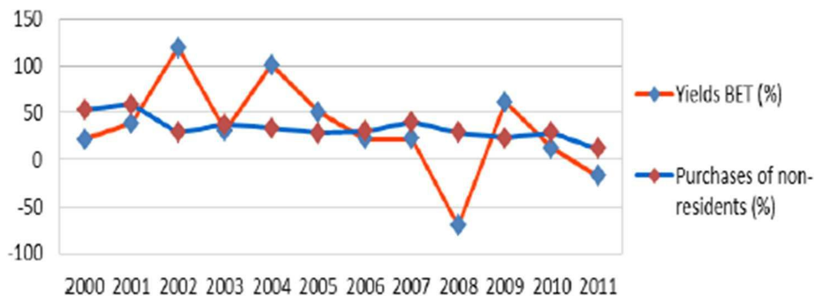

Figure 3: Comparison between BET gains and foreign investor acquisitions between years 2000 - 2011
Source: Bucharest Stock Exchange, available at: www.bvb.ro accessed on 01.10.2016

Until 2012, the Bucharest Stock Exchange (BVB) reported the share of non-resident investors for total purchases and sales. Figure no. 3 shows the correlation between the evolution of shares and transactions of foreign investors. Under these circumstances, we have built the BET monthly earnings data series (as a measure

of the performance of the listed shares) and the monthly acquisitions of shares, the total purchases by non-resident investors, taking into account the period from 2000 to 2011.
According to the BSE, the BET index "Bucharest Exchange Trading", launched in 1997, the prices of the first ten shares that are traded on the stock exchange are moving, having their liquidity as the main criterion for their classification.
We found an interesting fact, more precisely, the connections between BET earnings and non-residents are not significant because non-resident investors take into account not only the tendencies of the shares but also the financial performance, tangible and intangible strong resources of the entity, brand, financial deficit and business environment competition.

4. Conclusions

Effective corporate governance is a holistic system that incorporates elements both inside and outside the company. An entity's management is based on certain legal concepts and regulations, including ethical, sociological and behavioural aspects, human resource management, country specificity, and various strategic elements. It involves effective control systems, accounting practices and strict monitoring mechanisms, resulting in lessening conflicts of interest between shareholders and managers, the cost of these conflicts, improving performance, and efficient use of all entity resources.
The internationalization of capital markets has led to important changes in all areas of activity. Developing countries are trying to attract foreign direct investment, the internationalization of the company being considered a strategy of economic growth and risk mitigation. Key determinants of good corporate governance, FDI and international trade can drive improvements in business performance, with the consequence of developing the business environment in general.

References

1. Al-Khouri, R., Magableh, A., & Aldamen, H. M. (2004). Foreign Ownership and Firm Valuation: an Empirical Investigation. *Finance India, 18*(2), 779-799.
2. Burker, M., Franco, C., & Minerva, G. A. (2011). Foreign Ownership, Firm Performance, and the Geography of Civic Capital. *Rochester: Social Science Research Network.*
3. Chang, S., & Rhee, J. H. (2011). Rapid FDI Expansion and Firm Performance. *Journal of International Business Studies, 42*(8), 979-994.
4. Derado, D., PhD. (2013). Determinants of FDI in Transition Countries and Estimation of the Potential Level of Croatian FDI. *Financial Theory and Practice, 37*(3), 227-258.
5. Ding, Y., Chen, C. J. P., & Xu, B. (2011). Convergence of Accounting Standards and Foreign Direct Investment. *Rochester: Social Science Research Network*. Disponibil la: http://www.jstor.org/stable/155546?seq=1#page_scan_tab_contents
6. Gurbuz, A. O., & Aybars, A. (2010). The Impact of Foreign Ownership on Firm Performance, Evidence From an Emerging Market: Turkey. *American Journal of Economics and Business Administration, 2*(4), 350-359.
7. Hardi, P. & Buti, K. (2012). Corporate Governance Variables: Lessons from a Holistic Approach to Central-Eastern European Practice. *Corporate Governance*, *12*(1), 101 – 117.

8. Lian, L., & Ma, H. (2010). Revaluation of FDI on the Economy Development of China - Is it an Entirely Unalloyed Benefit? *International Journal of Business and Management, 5*(10), 184-190.
9. Mihai, I., O. (2012). Foreign Owned Companies and Financial Performance. A Case Study on Companies Listed on Bucharest Stock Exchange. *Annals of"Dunarea de Jos"* University of Galati Fascicle I. Economics and Applied Informatics Years XVIII – no 1/2012 ISSN 1584-0409.
10. Oladokun, T.T. & Aluko, B.T. (2012). Corporate Governance and Real Estate Assets Management in Nigerian Banks, *Journal of Corporate Real Estate*, *14*(3), 182 – 195.
11. Petkova, N. I. (2009). Essays on Firm Ownership, Performance and Value. (Order No. 3354052, University of Michigan). *ProQuest Dissertations and Theses,* 138-n/a.
12. Schweiger, H., & Friebel, G. (2013). Management Quality, Ownership, Firm Performance and Market Pressure in Russia. *Open Economies Review, 24*(4), 763-788.
13. Talamo, G. (2011). Corporate Governance and Capital Flows. *Corporate Governance, 11*(3), 228-243.
14. Yang, Y., Dr, Martins, P. S., Prof, & Driffield, N., Prof. (2013). Multinational Performance and the Geography of FDI. *Management International Review, 53*(6), 763-794.
15. *** Bursa de Valori București (BVB). (2019). http://www.bvb.ro/
16. *** OECD (2012). The OECD Principles of Corporate Governance. http://www.oecd.org/daf/corporateaffairs/corporategovernanceprinciples/33647763.pdf
17. *** Oxford Dictionaries (2014). http://www.oxforddictionaries.com/definition/english/corporation
18. *** www.bnr.com
19. *** http://www.insse.ro/cms/ro/content/produsul-intern-brut
20. *** www.ifrs.com
21. *** www.onrc.ro