

## FOREIGN INVESTORS FROM EMERGING ECONOMIES: THE GEOGRAPHY OF TURKISH INVESTMENTS IN ROMANIA

**István EGRESI**

Department of Geography, Fatih University,  
Karaağaç Köy Yolu, Büyükçekmece, 34500, Istanbul, Turkey, e-mail: [iegresi@fatih.edu.tr](mailto:iegresi@fatih.edu.tr)

**Fatih KARA**

Department of Geography, Fatih University,  
Karaağaç Köy Yolu, Büyükçekmece, 34500, Istanbul, Turkey, e-mail: [fatihkara@fatih.edu.tr](mailto:fatihkara@fatih.edu.tr)

**Abstract:** This study investigates the main characteristics and patterns as well as the geographical distribution of Turkish investments in Romania. The study found that Turkish investors came in three different waves, each with its own characteristics and geographical distribution. Most of the Turkish investments were found to concentrate in the southern part of Romania which is closer to Turkey suggesting the importance of geographical and cultural factors in location decision. The study also found that Turkish investments cluster not only in some more developed counties (such as Bucharest or Ilfov) but also in some counties which may qualify among the poorest in Romania.

**Key words:** FDI, geographical distribution, internationalization theory.

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### INTRODUCTION

The literature on the geography of foreign direct investment (FDI) in the transition countries of Central and Eastern Europe has proliferated over the last 20 years. However, most of the published studies are on the more developed countries from Central Europe, the so-called Visegrad Group, that includes Czechia, Slovakia, Hungary, and Poland (Pavlinek, 1998; Pavlinek and Smith, 1998; Murphy, 1992; Michalak, 1993; van Hastenberg, 1999; Jermakowicz, 1995; among many others) and the countries of the former Soviet Union (Zimin and Rautio, 2012; Bradshaw, 2002, 1997; Johansen et al., 2000) while the study of FDI in Romania has not received adequate attention from geographers (Guran-Nica, 2002).

FDI refers to the situation in which an investor residing in a country acquires at least ten percent of the ordinary shares or voting powers of an enterprise situated in a different country (IMF, 2003). The foreign direct investor plays an active role in the enterprise and has total control of the acquired shares even he does not control the entire company (Jermakowicz, 1995). The FDI that is entering the country is referred to as inward FDI and the FDI that is leaving the country is recorded as outward FDI.

Countries are competing to attract more FDI for the numerous advantages they are supposed to bring to host countries, such as investment capital and jobs (Dicken, 2011). Putting this issue in the context of Central and Eastern Europe, it is argued that attracting FDI could stimulate economic growth in the less developed regions in Central and Eastern Europe (Neuhaus, 2005). Moreover, in the case of Central and Eastern Europe, FDI has also played an important role in the economic, political and social transformation of this region, 'creating deep systemic changes in the fabric of post-socialist lives and geographies' (Pickles and Smith, 2005, 28).

Until 2004, FDI flows to Romania had been limited, especially when compared to other countries in Central Europe. In 2004 annual inward investment exceeded US\$3 billion (from less than US\$1.3 billion in 2003). This growth continued until 2008 (almost US\$6 billion) after which, due to the world economic crisis it started to decrease. In 2012, the total amount of inward FDI was US\$3.68 billion (National Trade Register Office, 2013).

### **HISTORICAL OVERVIEW**

Before 1980 the organization of the Turkish economy was based on import substitution industrialization. This basically generated a closed economy in which imports were discouraged by high tariff- and non-tariff-barriers (Selekler-Gökşen and Uysal-Tezölmez 2007. After 1980 Turkey has made important steps towards joining the globalization movement (Central Bank of the Republic of Turkey, 2002) and the economy has since become increasingly dependent on foreign trade (Erdilek, 2003). In terms of integrating into the global FDI flows, however, the process has been much slower than in other emerging economies (Erdilek, 2003). Until very recently inward FDI flows lagged behind due to a multitude of economic and non-economic reasons. Among these factors the most important were: excessive bureaucracy and red tape, corruption, high inflation rates, weak and unpredictable legal system, economic instability, problems with the protection of intellectual property rights, the use of internationally unacceptable accounting standards, failures in the privatization process, political instability and internal conflicts, and distrust of foreign economic presence (Erdilek, 2003, 80, 83). However, the situation changed dramatically after the Justice and Development Party has become the sole governing party in 2002 as this party openly favours an increased role of FDI in the economy (Erdilek, 2003, 92).

On the other hand, the same unfavourable economic and political factors that discouraged foreign companies from investing in Turkey are, partly, responsible for the increasing out-migration of the Turkish capital (Kaya, 2009; Erdilek, 2003). Previous studies have found that the entry strategy of Turkish companies is dependent on the level of uncertainty of the host economy and on the cultural differences that exist between the home and the host economies (Anıl Keskin et al., 2012).

At the other end, the changes affecting countries in the former socialist sphere have provided great opportunities for the expansion of Turkish companies. The fact that these Turkish companies have developed during times of great economic and political instability provided them with great ownership specific assets that allowed them to operate successfully in transition economies such as the post-1990 Eastern European and Central Asian countries (Erdilek, 2003; Egresi and Kara, 2015).

Since 1989, Romania has undergone important political and economic changes. More than forty years of Communism had left deep scars on the Romanian economy and society. Private property had been almost completely eliminated and, more importantly, the spirit of entrepreneurship had been lost. Also, like other transition countries in the region, Romania lacked the necessary capital, technology and know-how to restructure its economy. Attracting foreign direct investment was seen as a legitimate way to solve this problem.

However, during the first years of the transition, companies and individuals from the more developed countries in Europe and North America were reluctant to invest in Romania because of political and economic instability and unpredictability. On the other hand, small investors from the Middle East and Turkey were among the few to know how to navigate these 'murky waters' and were willing to take the risk.

Based on primary and secondary data, this study takes a historical view to examine how Turkish foreign direct investment in Romania has evolved over the last 23 years to become one of the most important players in the Romanian economy. The evolution of the Turkish FDI is interpreted in the larger context of international investment flows into Romania. A special attention is also given to the analysis of the geographical distribution of Turkish FDI in Romania. We contend that historical links and cultural and physical proximity play an important role in the location decision of Turkish FDI in Romania.

Most theories on FDI (including Dunning's eclectic theory) are based on empirical evidence of foreign investors from advanced economies and may not adequately account for the experiences of foreign direct investors from developing countries. A number of recent studies have started to shed more light on the motivations and strategies of multinational companies from emerging markets (Kedron and Bagchi-Sen, 2012; 2011; Pradhan, 2011; Wang et al., 2012; Gattai, 2009) but more studies are needed to unpack the motivations and strategies used by these companies when investing in the transition countries of Central and Eastern Europe.

This study is structured as follows. In the next section we will shortly review the existent literature on the motivation for international investment and on the process of FDI expansion focusing on those theories which we believe are more relevant for the particular situation discussed in this study. Following this, we will discuss the methods we used to gather data and information. In the fourth section we will present an overview of Turkish investments in Romania and we'll examine their main characteristics. Finally, in the last section, we will summarize the main findings emphasizing the main contributions of this research and its theoretical implications.

## **THEORETICAL FRAMEWORK**

The first theories that tried to explain why investors decide to go abroad and how they select the location of their investment were developed in the 1960s (Hymer, 1976; among many others). Hymer (1976) noted that, when investing abroad, foreign companies have to compete with domestic firms in a business environment they are not familiar with and in very different legislative and regulatory conditions. Moreover, there are many other disadvantages when operating in an unfamiliar market such as: lack of knowledge about local traditions and customs, as well as local tastes, differences in the social and business behaviors and added operating costs due to distance. Thus, investing

abroad comes with certain costs and the decision to invest abroad is reached only when the advantages outweigh the costs. These advantages may include the size of the firm, the capacity to generate economies of scale, its market power and marketing skills, technical expertise or access to cheaper sources of finance (Hymer, 1976).

Although largely ignored in neo-classical economic accounts, non-economic factors are seen by some as critical in influencing the flow and direction of FDI. Buckley and Casson (1976) noted that not only geographical distance but also the existence of dissimilar environments leads to an increase in communication costs. By dissimilar environments the authors refer to different social and economic conditions as well as different languages. Due to these economic, cultural and social differences, communication between 'encoders' (those who transmit information) and 'decoders' (those who receive information) is more difficult, with misunderstanding requiring additional firm spending.

In this sense, a number of studies contend that FDI flows are more regional than global (Dicken, 2011) and that a high percentage of FDI actually comes from and flows to neighbouring countries (Lafourcade and Paluzie, 2005). This shows that, while a few large companies have expanded globally, most of the small and medium sized companies look more at the regional rather than global level when time comes to expand. Even within a country, foreign investors may have preferences for certain regions based on the level of familiarity with those regions (O hUallachain and Reid, 1992).

While some of the earlier theories pointed out the disadvantages of operating in a dissimilar environment which had to be overcome by firm-specific advantages they did not capture the reality that most internationalizing companies actually preferred to invest in countries and geographic locations with relatively similar environments where their investment faced fewer risks.

Reducing investment risks was especially relevant for companies investing in post-Communist Central and Eastern Europe. Most theories on internationalization of firms are based on models from the developed world where the change is, in general, slow and the markets are characterized by predictability. The Central and Eastern European markets, especially during their first decade of transition were characterized by quick and unpredictable changes. For this reason they were perceived as riskier than the western markets on which most internationalization models are based (Marinov et al., 2003). Here the human and cultural similarity factor between the company's home and host country or region was often considered more important than the company's ownership advantages.

This is in line with the main argument of the internationalization theory developed by Jan Johanson and collaborators (see, for example, Johanson and Vahlne, 1977) that foreign companies often invest in certain countries due to historical or cultural ties rather than economic efficiency. This model stated that, as a determinant of FDI, physical distance between home and host country is less relevant than psychic distance, which refers to cultural and linguistic communalities between home and host economies. According to this theory, firms start their internationalization in countries that are closest in psychic terms to the country of origin. They may then choose to enter more distant markets as they gather more information about them. The validity of this theory is supported by a great number of empirical studies that have clearly

emphasized the importance of cultural affinities between investors and host countries in determining FDI in Central and Eastern European countries (Altzinger, 1998; Paas and Scannell, 2001; Johansen et al., 2000; Bandelj, 2002; Lu, 2012; Gao, 2005; Meyer, 1998 and others).

Finally, the theory that tried to cover all facets of FDI is the eclectic theory. Formulated by John Dunning (Dunning, 1993; 2000), the eclectic theory is a blend of different theories on FDI circulating in the literature. It refers to the three types of advantages (ownership, location and internalization) that a company must possess, which added together determines whether the company will invest abroad or not<sup>1</sup>. Although earlier versions of the model paid less attention to the importance of psychic distance in explaining FDI location, later studies have incorporated the arguments of the internationalization theory into the model (Dunning and Lundan, 2008). Dunning and Lundan (2008: 93) thought that the internationalization model was “particularly suited to explaining the internationalization of relatively small and inexperienced firms from developing countries”.

### **DATA AND METHODOLOGY**

Data on FDI in Romania is collected by ONRC (Oficiul Național al Registrului Comerțului, or, in English, the National Trade Register Office), a governmental organization under the Ministry of Justice. The report received from ONRC was based on the financial data of a number of 4430 companies with Turkish capital of the total number of 11,520 that were registered between December 1990 and January 2010. Unfortunately, the statistical data received from the ONRC is somewhat flawed by the fact that the country of origin for each registered company is based on the origin of the capital. However, as is also the case with other foreign investors, many Turkish companies have invested in Romania through their foreign (especially Dutch) affiliates and therefore were registered as non-Turkish investments. In order to overcome these shortcomings we decided to corroborate the data received from ONRC with another set of data that we received from the Economic Office of the Turkish Embassy in Romania. This second set of data was a compilation of 761 Turkish companies operating in Romania as of October 2011. Benefiting from the input of the Association of Turkish Businessmen in Romania, the list also included those Turkish companies that invested in Romania through a third country. Although these 761 companies represent only 11% of the total active Turkish investments in Romania, they explain more than 97% of the total amount invested by Turkish firms in Romania.

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<sup>1</sup> The ownership advantages (or firm specific advantages) are based on the competencies and assets (e.g., technology, brand name, monopolistic advantages) that a company possesses that will allow it to overcome the costs of operating in a different country and to compete successfully with domestic firms. These advantages must allow foreign companies either to earn more at comparable costs or to have the same revenues as domestic firms but at lower costs. Location advantages (or target country specific advantages) can be broken down into three categories: economic, social, and political. The costs of operating in that country (market size, labor costs and quality, transportation costs, etc.) represent the economic advantages. The socio-cultural aspect is more complex and includes: general attitudes of population towards foreigners, language, cultural match between the investor's country and host country, and perceived distance between home and the host country. Political factors refer to central and local government policies that could influence inward FDI flows. Finally, the internalization advantages determine the form through which multinational enterprises decide to venture abroad. This can happen through exports, licensing, franchising, minority joint venture, or wholly owned subsidiaries. The company weighs the benefits and the costs of entering a foreign market through each of these modes and selects the most profitable. The company will choose to internalize its production when this is more advantageous than exporting or licensing.

To supplement the statistical data, we have used a range of secondary sources of data such as newspaper articles, interviews with Turkish businessmen and with the leadership of the Association of Turkish Businessmen in Romania published both in Romanian and Turkish media.

### **TURKISH FDI IN ROMANIA**

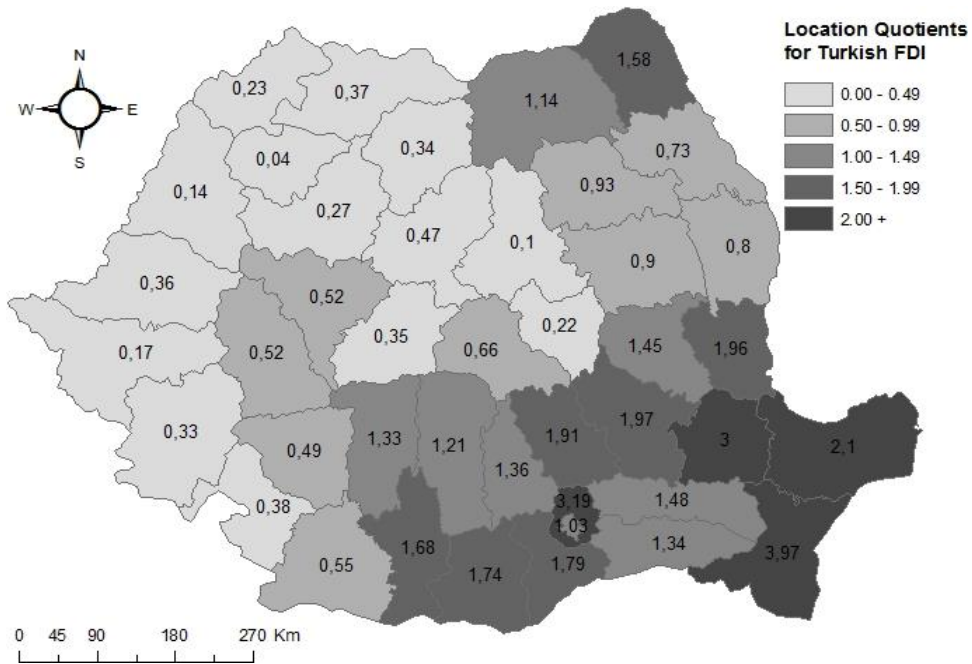
The National Trade Register Office (2010) has recorded a number of 11,520 Turkish investments in Romania between December 1990 and January 2010. This represents 6.82% of all companies with foreign capital, Turkey ranking third in terms of the number of FDI. Turkish investments in Romania amount officially to over 765.5 million USD which represents approximately 2% of the total amount of FDI in Romania over this period of time. By this criterion Turkey ranks the 13<sup>th</sup> among the investing countries in Romania. However, other sources contend that, unofficially the total amount of Turkish capital invested in Romania, including the FDI invested through third countries, must be over two billion USD (Voiculescu, 2012).

Turkish investors came to Romania in three distinct waves (Constantin et al., 2010). The first wave arrived immediately after 1990 and was represented by individual investors with modest capital invested into small ventures mainly in the area of retail, restaurants and other services (Constantin et al., 2010). The year when the greatest number of Turkish investments (950) was registered is 1992 (National Trade Register Office, 2010). Turkish investors gained from the first mover advantages as western investors hesitated to invest during the first years of transition due to the high levels of uncertainty that accompanied those economic and political changes. The small Turkish investors were not intimidated by the ever changing legal framework, high levels of bureaucracy or the difficulty to obtain any licenses or permits as they have experienced the same problems in their country and knew how to deal with them (Culpan and Akcaoğlu, 2003). In 1995, more than 35% of the total amount of Turkish investments in Central and Eastern Europe (including the former Soviet Union countries and the Balkans) was in Romania (Culpan and Akcaoğlu, 2003)!

The second wave of Turkish investors arrived to Romania a few years later encouraged by the business success of the first entrepreneurs. These had more previous experience, better access to capital, better connections in the business world and more financial power. They invested in a variety of economic sectors from retail and wholesale to manufacturing and finance (Constantin et al., 2010). Many of these investors possessed considerable experience gained in other developing countries such as the Middle East, Libya and Pakistan and have hired inexpensive, but very talented, western educated managers and engineers (Culpan and Akcaoğlu, 2003).

The third wave of investors started coming to Romania after 2001. This year Turkey was affected by a financial and economic crisis that forced many potential investors from Turkey to postpone or even cancel their investment projects in Romania. After this year a considerable number of Turkish investors arrived from western European countries (Germany, Holland, Luxembourg, France) where a significant number of ethnic Turks has been residing for decades (the so-called Euro-Turks). Having considerable managerial experience and buying power these investors have invested in large projects throughout Romania (Constantin et al., 2010).





**Figure 2.** Location Quotients for Turkish FDI  
(Source: National Trade Register Office, 2010)

We have also hypothesized that the number of Turkish investments in each county is correlated with the number of Romanians of Turkish ethnicity residing there. However, when we tested the relationship between the two using the Pearson correlation coefficient ( $r$ ) we found no significant correlation ( $r = .277$ ). Still, Constanța County, which concentrates more than half of the Turkish and Tatar minority population in Romania, has received the highest number of Turkish investments after Bucharest (1504). An important number of Turks and Tatars also live Bucharest (2388 or 4.9% of the total number of Turks and Tatars living in Romania). However, Tulcea County (4.25% of the total Turkish and Tatar population) has received relatively few Turkish investments.

Still, while the correlation may not be statistically significant it is easy to see in figure 2 that the highest LQ are in the counties situated east and south of the Carpathian Mountains which had been under the Ottoman suzerainty for five centuries before becoming independent towards the end of 19<sup>th</sup> century. On the other hand, the counties in Central and Western Romania, historically associated with Austria-Hungary, display low location quotients for Turkish FDI.

### **DISCUSSION, THEORETICAL IMPLICATIONS AND CONCLUSIONS**

The purpose of this study was twofold. Firstly, it intended to shed more light on the internationalization process of companies from emerging countries. Secondly, it proposed to examine the dynamics, the geography and the characteristics of those companies in a transition economy. Most theories explaining the reasons behind and the process of internationalization of companies through FDI are based on empirical studies from the developed world because, for many years, only companies from the developed world had the



motivation, the capacity and the means to expand internationally. Yet over the last two decades the share of FDI from the developing countries in the global outward FDI has constantly increased (Dicken, 2011). However, within the developing world a small number of so-called 'emerging economies' concentrate the bulk of the outward FDI.

The classical theories may not be able to fully explain why and how companies from emerging markets internationalize or how they decide where to expand. Considering the very different characteristics of emerging economies it seems plausible to assume that the companies from there may have different motivation for internationalization and display different characteristics. Another situation where the classical FDI theories may not fully work is that involving transition economies. In the early 1990s, after the fall of Communism, these countries were in dire need of foreign direct investment and were offering, in exchange, to the potential investors a market that was virtually free of competition and a labour force that was highly qualified and cheap. Yet, at a time when outward and inward FDI was growing rapidly in the western world, direct investors from developed countries were quite reluctant to invest in an unknown and politically unstable market.

The void was filled by small private and family-run companies from Turkey and the Middle East. They were driven by the difficulty of doing business in their countries where decades of protectionism have led to the creation of very large and powerful business groups which controlled all economic sectors and made the existence of small companies or the start of new ones very difficult. On the other hand their entry to the competition-free Romanian market was very easy as Romania had very low capital requirements for foreign investors and did not require visas to enter the country. The main ownership advantage of these small investors from Turkey was that they knew how to navigate in a politically and economically unstable environment.

After the 2001 financial crisis many Turkish companies have understood that their only chance to survive would be to grow outside the national borders. While the majority has decided to invest in Western Europe and North America in order to gain access to know-how and western brands, the privatization of a series of large state-owned companies in Romania has offered a great opportunity for market expansion at a very reasonable price. Also, the several agreements signed between Romania and Turkey as well as the existence of numerous Turkish- Romanian associations have facilitated cooperation and have enhanced trade and investment.

Moreover, in 2004 Romania joined NATO and was accepted to join the EU. The adoption of the *acquis communautaire* has offered more predictability of the market which attracted some of Turkey's largest companies. By investing in Romania Turkish investors also had the prospect of serving the entire EU from their Romanian base. After 2004 many Turkish investments started to arrive from third countries (mainly from the Netherlands or from another country in the EU).

Also, most of these investments are concentrated in the southern part of Romania which is closer to Turkey. The Southern and Eastern part of Romania had been under Ottoman suzerainty for centuries before independence in 1878 and a small Turkish and Tatar community has survived in two or three counties in the southeast so there are also historical and cultural linkages to consider. The larger investments coming via third countries during later stages are less to display this model.

Another interesting observation is that, contrary to the findings of most studies on Eastern and Central Europe (Pavlinek 2004; Pavlinek 1998; Pavlinek and Smith 1998; Rautio and Tykkylainen 2001), foreign direct investments from Turkey do not seem to correlate with the level of economic development. Turkish investments cluster not only in some more developed counties (such as Bucharest, 57,285 lei GDP/capita, Ilfov with 41,348 lei, Braşov 27,522 lei, Constanţa 27,068 lei and Prahova 24,595 lei) but also in some counties which may qualify among the poorest in Romania (Brăila 19,073 lei, Galaţi 15,893 lei and Buzău 15,893 lei) (RNIS 2010). When the location quotient is considered this situation is made even clearer. The more developed counties in the West (GDP/capita: 25,602 lei), North-West (21,297 lei), and Centre (22,618 lei) display very low location quotients. Even in Bucharest, the LQ is around 1. On the other hand, the poorer counties in the North-East (14,649 lei per capita), Southeast (18,739 lei) and South (19,913 lei) seem to be more important for the Turkish investors. This situation could be explained in two ways. Firstly, for the Turkish investors the non-economic factors may have been more important than the economic factors. Secondly, these counties in the east and the south have been less attractive to foreign investors from elsewhere and even for domestic investors; therefore, Turkish investors faced less competition here.

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