The competitivity of the country still depends primarily on the low cost of labour and geographical proximity. But in the long term, the ability of the Romanian government to implement policies that also involve other factors such as structural flexibility, the quality of the workforce and capacities of the outlet market will be key. And from this perspective ...

Why bet on Romania today

NEW MARKETS

by Carmelina Carluzzo, Stefano Chiarlone, Debora Revoltella

Many transitional and emerging countries have been able to benefit from huge direct investments from abroad during their economic growth process. Romania is no exception. At the end of 2003 the direct investment stock drawn from oversea reached a considerable sum, according to UNCTAD (the UN body which deals with direct foreign investments) equal to about 23.4% of its GDP. It is a percentage in line with Poland (24.9%) and Bulgaria (29.1%), though lower than recordings in the Czech Republic and Hungary. In comparison to the other countries of the New Europe, Romania especially features low cost manpower combined with a potentially important outlet market (with a population of almost 22 million, even if its per capita annual income is still lower than 3,000 euros) and an old industrial tradition in certain sectors, despite the lack of an integrated production network. These specific characteristics have made this country the main destination for companies operating in sectors where labor costs have a strong impact on the final cost and have led many companies to operate, as suppliers or purchasers, in a production system on behalf of third parties, while commercial

investments, though on the increase, are still uncommon.
However, during the last year, faced with the liberalization of international commerce in the most traditional sectors, the growing penetration of Chinese products in the market and with the prospect of a fast entry into the EU, which suggests a convergence in the levels of labor costs, people have started to question the medium-long term sustainability of the competitive advantages of the Romanian production system, still largely based on the availability of a low cost workforce.
Attracting foreign investors is still considered very important for every economy. It is a known fact that the attraction of direct foreign investments has a positive impact on productivity, since multinationals import advanced technologies and organizational models. In many cases, these investments trigger "learning by doing" effects for the local workforce, thus creating competitive conditions in hi-tech sectors, like the countries of the so-called Southeast Asian miracle. At times they cause an improvement in legislative regulations and material and immaterial infrastructure and favor the rise of a private entrepreneurial sector equipped with international business models.
Italians rank among the top direct investors in Romania. Italy is the leading investor in the region in terms of number of initiatives, although it only comes fifth when considering the amount invested (409 million euros between 1995 and 2004). The discrepancy between these two figures is due to the large number of small and medium enterprises that have invested in Romania. In total, slightly less than 50% of Italian investments in Romania are concentrated in the service sector. About 30% are in the manufacturing sector, with more traditional industries prevailing. Over the last decade, Romania has played a key role as an area of delocalization and supply for Italian companies. Several thousand of these have established a direct presence in the territory and send a significant share of their third-party orders to Romania, taking advantage of the strong competitiveness of the country in terms of costs, a key feature in some sectors that characterize the Italian specialization model. Particularly important is the case of the textile industry, where numerous Italian companies operate, having delocalized their production and packaging phase (with their brand or on behalf of third parties), while maintaining their commercial and development base in Italy.
To better understand the future potential of the Romanian economy as the destination for production delocalization, we held a number of interviews with Italian businesspeople who have directly invested in Romania. We selected companies belonging to various sectors, giving preference to the production area but also assessing examples of commercial and service delocalization. We considered companies operating in both traditional and more technologically advanced sectors. Our analysis especially focused on small-medium sized firms, with some control/comparison cases based on the experience of large companies. Finally, all the companies considered offer successful examples. The sample of Italian companies


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we interviewed (15 in total) is obviously not representative of the population, but seems suitable to provide interesting insight into the future attraction that the Romanian market may hold for direct foreign investors.
Italian investors were mostly motivated by their need to reduce production costs. Having said this, businesspeople underline the importance of flexibility in contractual conditions and the quality of the workforce, which can be positively influenced by the existence of an industrial tradition in the sector specifically concerned. These factors could allow Romania to protect its competitive advantage also in the medium-term, despite the growing trend to delocalize to Asia. Production is actually slowly moving towards higher added/quality value products (even if in traditional sectors), while businesspeople specifically indicate geographical proximity as the competitive advantage of the market, compared to Asian countries, with consequent reductions in transport time and costs. For example, a large company operating in the textile/clothing sector, which over time has transferred a considerable share of its supply to Romania, is now moving the bulk of its production to other areas. Nevertheless, it continues to prefer the Romanian market, through a company that manages production contracts on behalf of third parties, for medium high quality products and for all those between collections, which require high production and delivery speed.
In contrast to other countries in the region, no important delocalization phenomena have been observed for now with regard to related businesses. Many of the foreign companies that operate in the country are small production units which produce to order for well-known Italian or international brands. It is usually the company commissioning the job, one of the main clients, that suggests delocalization to favor cost cutting.
To date, only a few companies have entered Romania attracted by the local market, although the potential is beginning to emerge. The above-mentioned textile/clothing company entered the Romanian market in the early ’90s by opening stores to sell its international catalogue. An interesting example comes

ITALIAN IDE* IN ROMANIA (1995 - OTTOBRE 2004)

Services	46%
Manufacturing Industry - “traditional”	22%
Energy	14%
Mnufacturing Industry - “non traditional”	12%
Agriculture, Forestry, Fishery	3%
Other	3%
Building	0%

*foreign direct investments

from a firm that has achieved a leading role in the local market for stationary by offering lower quality and extremely competitive products, compared to its international production, as well as its top-end range with its well-known brand.
Furthermore, in the food sector, a leading firm in the rice industry saw in Romania excellent market conditions for international expansion, thanks to the agricultural/productive prospects of the country and the potential consumer base. A company that operates in the sector for the manufacture of housing materials and integral management of residential construction worksites has also turned its eyes to the Romanian consumer market.
Finally, geography also counts when considering the geographical proximity to outlet markets. This is particularly true for those productions where transport costs significantly affect the final price. In this respect, Romania has the advantage of being close to Russia.
The second crucial point concerns delocalization strategies to understand whether localization is only a temporary event (companies relocate as soon as the advantage coming from the low cost of labor disappears) or more a result of betting on the country’s future. Many of the companies interviewed declared that they did not equip the new site by moving machinery from Italy, but by investing in new equipment. They also stated that in the future they will make new production capacity investments only in Romania or in neighboring countries with lower labor costs. At this point a clarification must be made. Some standardized and highly labor intensive productions, such as the textile industry, are probably destined to be quickly moved even further eastwards, in Europe (Moldavia or

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Ukraine) or further afield (China, for example). In other sectors, the business community has the clear intention of remaining in Romania by capitalizing on the investments in machinery, and by training the workforce or introducing the country into an integrated international network, as in the case of a manufacturer of small household appliances. It is up to the Romanian government to make the economic and production system grow quickly to guarantee that other companies find it convenient to stay in the country, not just for the cheap labor force. This trend and the search for new cheaper production sites are already underway especially for small companies which, in the absence of their own brand, manage to compete only by leveraging on price.
On the whole, it is clear that Romania's competitive advantage only based on the cost of production is bound not to last. In the short-term, there is still some potential, especially when considering some remote areas with high unemployment rates; in the long-term, though, factors such as structural flexibility, the quality of the workforce, a wide outlet market and the proximity to both western markets and the less saturated oriental markets, will be the factors based on which foreign businesspeople will decide whether to remain/go and invest in Romania or leave. We are talking about the ability to put in place policies able to attract special productions (e.g. with very short lead times) with greater added value and a higher technological content (where the productivity/cost ratio wins) compared to more traditional productions, also to favor the further growth of the Romanian industrial production capacity. Likewise, as economic growth continues, it is clear that the next step for a stable passive internationalization of the Romanian economy will be strongly affected by its transformation into a major outlet market.