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GOALS OF THE INVESTING ACROSS BORDERS INDICATORS

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Abstract

Nowadays doing business internationally implies dealing with different types of national regulations and relationships. This paper analyses two types of indicators from the perspective of starting a business in a foreign country, and investing in a specific sector in a foreign country. Investing across borders indicators herein developed provide only a part of the picture of economies' investment climates and have to be used in conjunction with other tools to analyse business environments. In the last part, it is presented a case study about Romanian business environment from a foreign investment perspective.

Key words:
Foreign direct investment, national regulations, business environment

JEL Codes:
F23, G38

Introduction

Globalisation has seen a dramatic increase of capital movements, including notably of foreign direct investment (FDI).

FDI represents an important source of productivity gains and plays a crucial role in establishing and organising businesses abroad.

Every country has its own economic environment. When doing business at the international level, one has to consider the different types of governments, relationships, and levels of risk that it will be bound to deal with.

The liberalization of both trade and investment and the fact that doing business internationally had become more simplified, all these have contributed to the development of the international business over the last half of the twentieth century.

The quality of business environments has been very much improved by the existence of the investing across borders (IAB) indicators. These indicators are based on the analysis of the laws, regulations, and practices which affect FDI and can provide a starting point in order to analyse to what extent various policy approaches and policy reforms can bring their contribution to outcomes such as FDI, competitiveness, and development.

The IAB indicators consider the features of the laws and regulations and the way they may be implemented.

The aim of these indicators is to reward good regulation and efficient processes. The existence of clear, predictable, and effective laws and regulations is essential in order to guarantee that foreign investment leads to a win-win situation for all those involved in the process i.e. investors, host countries, and their citizens.

1. Investing across borders indicators

The IAB indicators assess FDI regulation in many specific policy areas measuring the way in which foreign companies can establish local companies, and invest across sectors.

The indicators related to starting a foreign business consider time, procedures, and regulations involved in setting up a local subsidiary of a foreign company in the form of a limited liability company while those related to investing across sectors evaluate the extent to which domestic laws permit foreign companies to set up or purchase local firms.

The investors need to confide in a firm, consistently applied legal framework as to be certain of the security of their property, investments, and rights.

The existence of the IAB indicators is not intended to reduce all regulatory obstacles; on the contrary, they are aimed to improve understanding of how to take full advantage of the development benefits of FDI by means of suitable regulatory frameworks.

2. Starting a foreign business indicators

Each country has its own specific establishment procedures when it comes to domestic enterprises. The investment process may be significantly affected by a country's regulatory framework. Companies' investment decisions are to a large extent influenced by the complexity and difficulty of fulfilling various requirements when starting a foreign business.

Governments can implement positive changes by means of which to *ease business start-up.* It is common knowledge that in most countries setting up a domestic company takes a shorter amount of time and requires fewer steps than establishing a foreign company.

Furthermore, when it comes to establishing foreign-owned subsidiaries, *legal and administrative requirements* differ in terms of extent and strictness. Usually, foreign investments need to cope with official approvals or registration requirements which can cause further difficulties. Regarding the approvals matter, every country has its own system: some have centralized their approvals in a single agency; others require multiple-agency approvals at the same time as there are still some that require approvals given by a minister or prime minister. The entire approval process which may take months or even years in some countries as well as the uncertainty of the result may discourage potential investors from applying.

When establishing a business in foreign countries, companies try to avoid administrative obstacles. The *foreign investment approval* is among the most frequent *additional procedure required* of foreign companies**.**

The starting a foreign business indicators include 3 elements:

- *time required* the number of days necessary to go through each of the procedural steps for setting up a subsidiary of a foreign company;
- *procedural steps needed* the number of procedural steps involved in setting up a wholly foreign-owned subsidiary; both pre- and post-incorporation procedures that are officially required for a foreign investor to formally run a business are recorded;
- *regulatory regime for establishing a foreign owned subsidiary* concentrate on the following areas:
  - restrictions to the composition of the board of directors or appointment of managers;
  - requirements compelling the use of a local third party (counsel, notary, investment promotion agency) during the establishment process;
  - possibility to accelerate establishment procedures by means of an official channel (availability of fast-track procedures);
  - requirement of an investment approval (nature of investment approval requirement, possibility of appeal, minimum required size of investment, period of validity);
  - limitations of the business registration process;
  - restrictions on holding a foreign currency commercial bank account;
  - minimum capital requirements;
  - availability of electronic services (online laws, regulations, documents, and registration).

When starting a locally-owned company, whether small or medium, the procedures are: finding a company name; notarizing articles of association; opening a bank account; registering with a business registry; obtaining a tax identification number (tax office registration); registering with retirement and pension funds; registering for social security.

On the other hand, when foreign companies intend to enter international business transactions, there are some compulsory *additional procedures* among which we mention:

- authentication of the parent company's legal documents abroad;
- investment approval or notification;
- certificate of capital importation or registration with the central bank;
- trade (import/export) license or customs registration certificate (the supposition is that the foreign company will be willing to engage in international trade).

In some countries, it is required only a *notification* or declaration of the investment, which is usually made to a ministry of trade or commerce or the central bank.

In many countries, prior to proceeding with their intended investment, foreign investors need to undergo an *approval or authorization process***,** which may take from a couple of days up to half a year.

The composition of the board of directors, the use of local third parties, or minimum capital requirements is regulated by the laws and regulations of each country as well, as follows:

- When the *composition of the board of directors* or the appointment of *managers of a company* are imposed, foreign companies' freedom to appoint any executives considered suitable in terms of competency in managing the local subsidiary's operations is largely limited. Some countries require, in an explicit manner, managers of foreign-owned companies to be nationals or permanent residents of the country of incorporation.
- In case in which a company establishing a subsidiary in a foreign country does not seek advice from a local lawyer, in some countries it may not encounter difficulties while in others they have to go through a local counsel or an investment promotion agency for certain start-up procedures, a requirement that might encumber foreign companies with unwanted costs and extended delays.
- Unlike the case of large foreign investors, small and medium enterprises are also burdened by minimum

capital requirements for which it may represent a large impediment. As a result, high minimum capital requirements may deter companies from investing and do not offer much protection against dishonest entrepreneurs.

Usually, a foreign company is interested in *importing and exporting* goods. In many countries, those concerned are required to obtain a trade-related license or authorization in order to have the permission to import and export. Such a licence may be get without delay in case of online application or it can take days, depending on the regulations available in various countries.

In many countries, an *authorization* is needed for companies that bring foreign capital. Generally, foreign investors must have their investment capital or external loans registered with the national bank of the country in which they are investing. In many cases, this registration is necessary for the purposes of future payments abroad or the repatriation of profits when needed.

3. Investing across sectors indicators

Some countries have limited foreign ownership in some sectors due to *political, economic, security,* and *cultural* reasons. Prior to 2008 when the financial crisis occurred, the global trend was *to liberalize an increasing range of economic sectors*. In many countries the benefits of openness to foreign capital participation have *surpassed the reasons* for restricting certain sectors from foreign ownership. For every country that restricts or prohibits foreign equity ownership in certain sectors, several others with similar features allow unhindered foreign ownership.

The investing across sectors indicators are aimed to evaluate one of the essential parts of market access for FDI: legislative openness to foreign equity participation in the *primary, manufacturing, and service sectors*.

The investing across sectors indicators focus mainly on providing *detailed measures of the service sectors*, given the relative occurrence of FDI restrictions in services related to other economic sectors, as well as the increasing importance of services in the global economic productivity and FDI flows.

The investing across sectors indicators evaluates evident legislative limitations on foreign ownership of equity in new investment projects (Greenfield FDI) and on the acquisition of shares in existing companies (mergers and acquisitions).

The indicators are based on the text of *investment codes, commercial laws, merger and acquisition laws,* and other related statutes. The types of laws measured by the investing across sectors indicators consist of:

These indicators rely on the text of *investment codes, commercial laws, merger and acquisition laws,* and other connected statutes. The types of laws measured by the investing across sectors indicators include as follows:

- company and business organization laws (for instance foreign company laws, company registration laws, commercial codes);
- investment laws (for instance foreign investment acts, investment promotion laws and regulations, investment codes, laws and regulations governing sectors closed to foreign investment).
- foreign exchange laws and regulations;
- merger and acquisition laws;
- industrial policy orders;
- sector-specific laws and regulations (for instance energy law, telecommunications law);
- civil codes;
- Constitutions.

The strengths and particular benefits of these indicators are that they unambiguously, and in a visibly provable manner, name limitations on foreign companies' equity participation across sectors. Nonetheless, the indicators encounter certain restrictions, which are investigated in the methodology chapter of this report.

With respect to *sector-specific restrictions* on foreign ownership of companies the situation varies depending on each country regulations. Most of the countries have few or even no restrictions at all. For example, smaller countries have fewer restrictions on foreign ownership of companies, while larger countries (such as China, Mexico) are among those with the most. The countries which tend to be the most open to foreign ownership of companies are those in *Eastern Europe,* Central Asia, Latin America and the Caribbean.

Despite the fact that services are responsible for an increasing share of global FDI, foreign ownership of companies is *more restricted in the service sector* than in the primary and manufacturing sectors. Worldwide, limitations on foreign ownership are the most severe when it comes to media, transportation, electricity, and telecommunications industries. Most countries allow foreign ownership of equity in alternative energy companies – except for some countries in Middle East and North Africa.

4. Case study: IAB indicators for Romania

Starting a foreign business in Romania

Establishing a foreign-owned limited liability company (LLC) in Romania (Bucharest) requires 7 procedures and 11 days, somewhat faster than the regional standard for Europe and Central Asia but much faster than the IAB global standard.

Besides the procedures necessary for a local company, the parent company establishing a subsidiary in Romania must authenticate and translate its documents. Foreign companies are not required to ask for an investment approval. Romanian legislation, applicable to both domestic and foreign investors, prohibits a sole shareholder LLC to be the sole founder and shareholder of another LLC.

Within 5 days of submission of the required documentation, the Trade Registry judge must hold a public hearing on the company's application for registration.

The registration documents can be submitted, and the status of the registration request monitored, online. Companies in Romania are free to open and maintain bank accounts in foreign currency, even though, in practice, Romanian banks provide services only in certain currencies (including EUR, USD, and CHF). The minimum capital requirement for domestic and foreign LLCs is 200 RON (around 65 USD).

Table 1. IAB indicators for Romania

Indicators		Score
Starting a Foreign Business	Time (days)	11
	Procedures (number)	7
	Ease of establishment index (0 = min, 100 = max)	89.5
Investing Across Sectors - *Foreign equity ownership indexes (100 = full foreign ownership allowed)*	Mining, oil and gas	100
	Agriculture and forestry	100
	Light manufacturing	100
	Telecommunications	100
	Electricity	100
	Banking	100
	Insurance	100
	Transportation	79.6
	Media	100
	Sector group 1 (construction, tourism, retail)	100
	Sector group 2 (health care, waste mgt.)	100

Source: Investing Across Borders 2010, World Bank Group, Investment Climate Advisory Services, Washington, D.C., http://iab.worldbank.org/

Investing across sectors in Romania

Romanian law (Government Emergency Order No. 92/1997 regarding incentives for direct investments) provides for national treatment of foreign investors concerning the establishment rights of companies.

Foreign investors are commonly permitted to invest in any sector open to private domestic companies. Therefore, except for the domestic and international air transportation industries, all sectors covered by the investing across sectors indicators are entirely open to foreign equity ownership.

Foreign capital contribution in the two above mentioned sectors is restricted to a maximum of 49%, as is the case in other European Union countries. This limitation does not affect investors from countries of the European Economic Area (EEA).

5. Stakeholders and their directions for use of IAB indicators

The IAB indicators aim to meet different stakeholders' needs in terms of information, analysis, and policy action. *Stakeholders and their directions for use* of IAB indicators can be can be summarized as follows:

- *governments and investment promotion intermediaries:*
  - identify and share regional and international good practices that help guide policy advocacy priorities;
  - motivate and advise investment policy reforms;
  - reinforce the reliability of information provided by investment promotion intermediaries by using third-party assessments of the investment climates;
  - benchmark economies against one another to refine investment promotion strategies and make public successes in improving investment climates;
- *foreign investors and site location consultants*:
  - assist decisions on global investment locations by complementing other information sources;
  - offer accessible, useful indicators on the efficiency of investment processes and the strength of investment laws as implemented worldwide and make them available online;
- *advisers and consultants on investment policy and promotion*:
  - identify legal, regulatory, and administrative obstacles to economies' attractiveness for investment;
  - analyse regional and global good practices to better target and design advisory efforts;
  - promote competition to strengthen FDI regulations by permitting economies and regions to compare themselves;
  - monitor and assess the impact of investment climate reforms.

Conclusions

Investment decisions are driven primarily by market considerations, i.e. expected gains from investments.

Yet, these decisions are deeply affected by the economic, political and legal environment of any given economy. Investors thrive in a stable, sound and predictable environment.

All things considered, an open economy cannot function as efficient as a well-regulated economy with strong investment climate fundamentals such as well-functioning institutions, economic and political stability, observing the law, and other key drivers of investment.

IAB indicators are aimed to help countries benchmark their policies against those of their peers and to use these comparisons to inform their policy decisions. The IAB indicators should encourage interest in reforms, identify good practices that countries can learn from, and develop interactions of the foreign investors with host countries.

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