

**FOREIGN DIRECT INVESTMENT (FDI) IN BULGARIA -
THE BASIS FOR THE FORMATION OF STRATEGIC
ALLIANCES OF THE TYPE "EAST – WEST" IN THE PROCESS
OF PREPARATION FOR JOINING THE EU**

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Abstract. *Strategic alliances of the type "East-West" gain wider currency in Bulgaria. The process of their formation has begun in 1989, when market economy has been introduced. First West European investments entered our country at the same time, but their amount was quite small. After that, economic and political instability of our country which have lasted for several years already, as well as bankruptcy of some banks, start to hamper investment processes. Thus, foreign investors fall away from Bulgaria. After the foundation of the Currency Board, investment environment in our country improves. Stabilization of financial institutions is noticeable. A legal base promoting FDI is created. Amount of investment increases. Foreign investors prefer mostly alliances of the type "East-West". The following research concentrates on: assessment of the state and the trends in FDI, which are the basis for formation of strategic alliances of the type "East-West" in Bulgaria; clearing up the problems concerning FDI in the process of preparation for joining the EU.*

1. STATE AND TRENDS IN FDI IN BULGARIA

During 1992 - 1997, the total FDI in Bulgaria amounted to \$1089 million while in the last three years (1997 – 1999) only financial involvement exceeded \$2 billion (See Table 1).

A trend to growth in FDI, especially in fixed capital is noticeable. It is so obvious, so one can conclude that a process of recapitalization in economy is taking place. Considering the data on the import of goods in 2000, it can be stated that for the present period this trend has not changed.

In 1999 investments in fixed capital constituted 15.9% of Bulgaria's Gross Domestic Product (GDP), but even so, as compared with the other East European countries Bulgaria ranks low in the amount of FDI as a share of GDP.

Table 1. Amount of FDI in Bulgaria in the period 1992 – 1999 (\$Million)¹

Year	'92	'93	'94	'95	'96	'97	'98	'99	Total
FDI	34,4	102,4	210,9	162,6	256,4	636,2	620	720	2742,9

In 1997 Germany with 21.20% was the largest investor - nation in Bulgaria, followed by 45 other countries - Belgium, Holland, Great Britain, USA, Austria, Kipper, etc.

FDI as a percentage of GDP was lowest in Bulgaria - 13.6%, if compared with the average contribution of foreign investments to the gross national product in the EU, which was 19.8%.

In terms of economic branches, largest FDI was directed to industry, followed by trade and finances (See Table 2). Small was the amount of capital invested in telecommunications, agriculture and building. Of a total of \$2.7778 billion, by the end of 1999, \$1.506 billion FDI (15.21%) was invested in industry. In the second place was trade - \$543 million or 9.55%. Technologies and finances were in the third place with \$ 324 million or 11.66%. Tourism ranked fourth with \$143 million or 5.15%.

Table 2. Distribution of FDI by sectors of economy (1992 – 1997)

Sector of economy	Investment (\$)	Number of deals	FDI as % of GDP
Industry	525,3	499	47,84
Building	13,7	97	1,25
Agriculture	2,9	68	0,26
Transport	73,7	157	6,71
Telecommunications	10,9	19	18,6
Trade	204,3	45	7,36
Tourism	80,8	45	7,36
Finances	140,0	146	12,75
Others	46,5	917	4,23
Total	1098,1	9710	100,00

The main reason for such distribution of FDI is the attractiveness of mentioned sectors of economy at the current stage of Bulgaria's development. In industry the leader is "Sodi - Devnya", where the Belgium company "Solvey" has invested \$160 million. In transport the leader is "Villi Betz" - a German firm, which has bought SOMAT. The largest investor in tourism is also a German company - Ivan Zografski, which has bought hotel "Vitosha" in Sofia.

Germany and Belgium with \$426 million and \$323 million respectively were the dominant investors over the period from 1992 to 1999, says FIA (Foreign Investment Agency). Third ranked Kipper with about \$250 million. After them follow Holland, Great Britain, Russia and USA. The amount of their investments varied between \$100 and \$240 million for each country.

Over 1/3 of the investors chose to take part in privatization, and 23% focused on building of new production capacities. The third selected mode of FDI was acquisition - acquiring private firms - 22% of all transactions. Large FDI entered our country via small

¹ Uzunov, St. Bulgarian foreign investment in 1999. Trade newspaper, 17, 2 May, 2000.

number of deals with large companies. New great deals in the sector of telecommunications are expected. Foreign interest has increased, especially after 1997. In the last three years FDI amount to \$2 billion, whereas during 1992 - 1996 they were less than \$1 billion. The reason is stabilization of the political situation in Bulgaria. Legislation has become more liberal, and laws allowing foreign participation have been passed. Stabilization of the banking system is observable.

Attracting world-famous companies such as Deloit & Touche, Price Waterhouse, KPMG, etc. as consultants also pays a favorable effect on FDI inflows.

2. PROBLEMS CONCERNING INVESTMENT ENVIRONMENT IN BULGARIA

In July 2000 KPMG carried a survey among 230 companies, including 140 largest investors, due to FIA (Foreign Investment Agency)². The survey included two issues - profile of the foreign investor, and investment conditions in Bulgaria.

The research shows that the most preferable mode of FDI is majority holdings. Only 2% of all FDI result in minority stakes of less than 2%.

Foreign companies say that their main motives for investing in Bulgaria are:

- the existence of established relations with regular customers from the region (28%);
- market potential;
- favorable geographical location of the country;
- the existence of a skilled labor force (47%) and low labor costs which are a part of the production costs (35%).

Political stability and integration in the EU also influence investors' choice. In fact, mentioned motives characterize competitive advantages of our companies. However, a lot of countries around the world have the same competitive advantages. For this reason, it is necessary to find out new factors, which could attract foreign investors.

As far as the government is interested in the quick completion of the privatization process, the price of the subjects of acquisition is low.

The survey shows that the main obstacles hampering foreign investors are:

- long bureaucratic procedures;
- high level of legal instability and uncertainty;
- limited purchasing power of population;
- Corruption.

For 72% of all questioned companies business prognoses have fulfilled.

Present changes in Bulgaria will lead to a change in the type of foreign investments in our country. A large share of FDI has been attracted due to privatization of state-owned enterprises. As far as privatization program comes to an end, capital flows with the purpose of acquiring local companies will be replaced by investments focused on promoting profitability of privatized structures, and compiling ecological projects.

However, at this moment, foreign investors' interest is directed to large Bulgarian enterprises. In the near future, it should be pre-oriented towards small and medium-sized

² KPMG: Bulgaria is attractive for foreign investment. Money, 3 October, 2000.

companies (SMEs), which act as suppliers of multinational companies. The reason is that SMEs are much more adaptable and their production expenditures are considerably lower.

Preconditions for integration of already privatized foreign enterprises with local companies - suppliers and/or consumers of their production should be created.

Table 3 shows the results from the comparison of FDI in the countries pursuing membership in the EU.

Table 3. Foreign direct investments (\$ Billion)³

Year	Bulg	Czech	Eston	Hung	Latv	Lith	Pol	Rom	Slova	Slov	Total 10
1995	0,1	2,5	0,2	4,4	0,2	0,1	3,6	0,4	0,1	0,2	11,9
1996	0,1	1,3	0,1	2,0	0,4	0,2	4,4	0,3	0,2	0,2	9,0
1997	0,5	1,3	0,1	1,7	0,5	0,3	4,9	1,2	0,1	0,3	10,9
1998	0,4	2,6	0,6	1,5	0,2	0,9	6,0	2,0	0,3	0,2	14,7
1999	0,7	4,9	0,3	1,4	0,3	0,3	6,0	1,0	0,2	0,0	15,3
2000	1,0	4,5	0,4	1,8	0,4	0,9	7,0	1,1	0,7	0,2	18,0
2001	1,0	6,5	0,3	1,8	0,5	0,8	7,0	1,2	0,7	0,3	20,0
	3,8	23,6	2,0	14,5	2,6	3,5	39,0	7,2	2,2	1,3	99,7

The conclusion is that Bulgaria's potential for future growth is relatively good but not large.

Besides, Central and East European markets comprising 480 million consumers are necessary for the West European countries to sell their goods, especially in the circumstances of increased production. Thus, Western investors will start to look for new hosts to their capital flows. Future member-states of the EU are particularly suitable for the market seeking FDI. So, there is tough competition for foreign investment among the countries around the world, and to attract investors' interest Bulgaria should offer its optimum.

Practice shows that FDI in the last member-states of the EU have rapidly increased after their joining the Union⁴. In Portugal and Spain for example, after 1986 when the countries joined the EU, risks have been reduced, and FDI have increased compared with the pre-integration period. In Spain the amount of FDI increased from \$1.8 billion per year during 1981 - 1985 to \$7.5 billion during 1986 - 1990. In Portugal investment inflows increased from \$187 million to \$1.2 billion over the same period. In Spain foreign investments as a percentage of GDP doubled, and in Portugal tripled over the comparable time.

However, the case of Greece shows that the economic environment in the country also influences FDI. Political instability, as well as poor economic policy are the reasons for small increase in the amount of FDI in Greece - during 1986 - 1990 it was 1.2% only, as compared with the period 1981 - 1985. These leads to the conclusion that economic and political development of the country is of great importance for the investment processes.

According to statistics, enterprises constituting 50% of the annual industrial turnover plan to increase their investments. About 2/3 of their capital flows will be directed to private sector. Yet, the largest share of all planned investments is aimeded for

³ Choleric, M. East Europe in the way to EU: chance for dynamic development, CHT, BTA, 41, 13 October, 2000

⁴ East Europe: foreign investment flow, Economist Intelligence Unit, 5 July, 2000

reconstruction of the existing equipment. Foreign trade balance due, which is the result of the imports of investment goods mainly, will remain unchanged. This year, balance of payment is not endangered because receipts from privatization deals will cover the deficit amounting to 1 billion leva.

One of the reasons for the small amount of FDI in Bulgaria is the low rate of growth in productivity of labor in recent years as compared with the other countries pursuing membership in the EU. This makes Bulgarian enterprises quite unattractive for the investors. Although needed financial liquidity is achieved in banking sector, the number of financial institutions crediting business in Bulgaria is still small. The European Bank for Reconstruction and Development says that in 1999 credits constituted only 12% of GDP.

Taking advantage of its favorable geographical location and low labor costs, Bulgaria should create the necessary preconditions for attracting FDI. These preconditions are connected with:

- speeding up privatization in some leading economic branches such as telecommunications and power engineering;
- passing laws facilitating investments and their guarantees;
- facilitating the procedures of bank-crediting;
- tax preferences /discounts/ and other relieves in the first years after creating strategic alliances of the type "East – West".

3. FDI IN THE STRATEGIC ALLIANCES OF THE TYPE "EAST-WEST"

As FDIs were brought in Bulgaria, foundation of different strategic alliances with foreign capital participation has started. These alliances have turned out to be the main objective of the foreign investors. In our country, strategic alliances of the type "East-West" exist in various forms:

- aimed changes adaptation;
- purposed for coordination of competitive advantages and partners' activities aiming to reduce the risk and unify the efforts.

Here are the types of strategic associations, which can be formed or already exist in Bulgaria according to:

a) the amount of shares

- equal shares;
- unequal shares

b) the participation of foreign companies

- two or more foreign companies invest in one Bulgarian;
- one foreign company and one Bulgarian company join hands for a certain aim or project;
- two or more Bulgarian companies and one Bulgarian company become amalgamated;
- amalgamation of some Bulgarian and some foreign companies;
- foreign private persons invest in a Bulgarian company.

c) the degree of integration

- shared integration - two associations establish joint organization, which serves the market entries of both partners;

- total integration - two partners specialize in the production of separate parts of the final product;
 - additional integration - one of the partners join the association at the stage of product realization.
- d) the type of the newly established amalgamation
- contractual agreement - it is concluded among two or more organizations for the purpose of achieving special objective - joint usage of techniques, repairs, etc.;
 - subsidiary corporation - new corporation is established for subsidiary activities such as repairs, feeding of the staff in a canteen, etc.;
 - partnership - formal or informal agreement yielding mutual benefit - consultations, marketing, advertisement, etc.
- e) the method of exporting
- direct;
 - indirect - through some other company

4. CONCLUSIONS

After Bulgaria joining the EU, FDI will increase taking into account the fact that the country is a part of the unified European market. Investing in our enterprises will become more attractive for foreign investors. The reason is that their goods and services will be popularized in Bulgaria, as well as in some other East European countries, taking into account the proximity of the former USSR, and the large number of consumers there.

The project leads to the conclusion that it is best to invest foreign capitals in strategic alliances of the type "East-West", since the existing organizations of this type are the most prosperous in our economy. New varieties of alliances proper for Bulgarian environment are expected to appear in future. The new legislation allowing foreign ownership in our country will be a kind of guarantee for their success. It will attract new investors and capital flows to Bulgaria. Thus, our country will be accepted faster as a full member-state of the EU.

DIREKTNE STRANE INVESTICIJE (DSI) U BUGARSKOJ KAO OSNOV STRATEŠKIH UDRUŽENJA TIP "ISTOK-ZAPAD" NA ETAPI PRIPREME PRISTUPANJA EVROPSKOJ UNIJI

Zafirova Cveta Jordanova

Investicijski ambijent u Bugarskoj poboljšan je nakon uvođenja Monetarnog odbora. Pomoću direktnih stranih investicija u Bugarskoj počeli su procesi stvaranja različitih strateških udruženja s učešćem stranih kompanija. Ta udruženja koja su dosada stvorena, najuspješnijeg su razvoja te učvršćuju svoj rukovodeći položaj u našoj privredi. Data je ocena stanja i trendova direktnih stranih investicija kao osnov stvaranja strateških udruženja tipa "istok-zapad" u Bugarskoj. Definirani su problemi u vezi s njim, a na etapi pripreme našeg pristupanja Evropskoj Uniji.