

**Country Risk and Its Impact on Foreign Direct Investment Decision Making  
Process: A Bulgarian Perspective**

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### **ABSTRACT**

This paper examines the impact of country risk on Foreign Direct Investment /FDI/ inflows in Bulgaria. The paper attempts to answer the question: How important is country risk and to what degree it may impact foreign investment decisions? Based on a comprehensive analysis of the FDI inflows in Bulgaria for the period 1992 – 2006 the paper provides evidence that foreign direct investment is of crucial importance to the process of transition from a planned to a market economy for the Central and Eastern European (CEE) countries in the global marketplace. Using the data from a survey of 132 foreign companies invested in Bulgaria during that period, we evaluate the specific impact of different country risk components on the FDI decision-making process from a Bulgarian perspective. Factors such as type of investment, cost of entry mode, opportunities and risks arising from the investment and overall business climate play a decisive role in the company's strategy to enter a foreign country. In support of similar studies, we find that market size, low skilled labor cost, avoidance of trade barriers, geographical proximity, and prospects for market growth are the most important incentives for FDI in Bulgaria. What is more, the paper explores the specific obstacles that foreign investors and foreign MNEs face during the establishment of their FDI projects in a transition economy, such as Bulgaria.

Keywords: country risk, transition economy, foreign direct investment, multinational enterprise

JEL classification: F21, F23

## INTRODUCTION

This paper examines the impact of country risk on Foreign Direct Investment (FDI) in Bulgaria. FDI in general refer to long-term cross-border investments with a substantial influence on the investing multinational enterprise. According to Hauser (2005) the principal difference between foreign direct investment and other forms of investment is that the purpose of foreign investment is to acquire lasting interest in enterprises operating outside of the economy of the investor. The investor's purpose is to gain an effective share in the management of the enterprise. According to the International Monetary Fund (IMF) a direct investment relationship is established when the direct investor has acquired 10 percent or more of the ordinary shares or voting power of an enterprise abroad.<sup>1</sup> The main feature that differentiates the foreign direct investor from the portfolio investor is the existence of a long-term relationship and a significant degree of influence on the management of the enterprise. According to Shaheen (2005), and following Jensen (2003), FDI is the investment of a Multinational Enterprise's privately owned capital into a foreign country.

Any type of risk reflects on investor's decision of whether to invest or not, how, and when. What kind of risk is country risk? How can we define it? Is it a precisely calculable probability, that could be easily integrated into the investment valuation equation, or does it fall into the uncertainty category? There are a huge variety of definitions of country risk in economic literature. For Meldrum (2000) many of the occurrences composing country risk are more or less attributable to uncertainties, rather than well-defined statistical risks. According to White and Fan (2006) country risk is the unanticipated downside variability in a key performance indicator, or significant strategic target, which results from engaging in international business transactions. Hoti and McLeer (2002) define country risk as the

likelihood that a sovereign state or borrower from a particular country may be unable or unwilling to fulfill their obligations to one or more foreign lenders.

FDI is an investment decision and as such, the investor needs to consider and obtain a quantitative measure of risk, in order to incorporate risk into the investment equation. Country risk assessment evaluates economic, financial and political factors, and their interactions in determining the risk associated with a particular country. Country risk may be prompted by a number of country-specific factors or events.<sup>2</sup> According to White and Fan (2006) country risk can be decomposed into the following subcomponents: political, economic, financial and cultural risk. Hoti and McLeer (2002) restrict the sub-components to political, economic and financial risk. Meldrum (2000) separates country risk into six main categories – economic risk, transfer risk, exchange rate risk, location and neighborhood risk, sovereign risk and political risk. According to him, some risk categories contain a much higher degree of risk for Multinational Enterprises (MNEs) than others, due to the longer time horizons applicable to FDI.

How important is country risk and to what degree may it impact foreign investment decisions? To answer that question Hauser (2005) examines the impact of country risk on the following FDI decisions: Greenfield investment versus acquisition, entry or no entry, timing of entry, and vertical or horizontal FDI. He points out that a multinational enterprise has two ways to enter a foreign market – through acquisition or Greenfield investment. Previous studies (see Caves, 1996) on the topic signify that takeovers are less risky than Greenfield investments and appropriately yield lower rate of return. The more uncertain the environment, however, the more degree of control the investor would require. Following this logic, the decision of entry via acquisition or Greenfield investment could also be driven by uncertainty in the host country.<sup>3</sup>

When the impact of country risk on timing of entry comes into consideration, different theories suggest different driving forces. Some authors (e.g., Buckley and Casson, 1981) argue that the “optimal” timing of FDI depends on the differences in the cost structure of alternative market strategies, such as exporting and licensing, and market development via direct investment. Other authors analyze the optimal timing of FDI and find Ownership-Location-Internalization (OLI) advantages (see Dunning, 1993) to be determinants of the timing of market entry under uncertainty.<sup>4</sup> Hauser (2005) compares the entry decision to an American call option. He presents the decision maker as having the right and not the obligation to undertake the investment at an exercise price which is the sunken cost of investment.

In respect to different types of FDI, a vertical FDI occurs if a multinational enterprise (MNE) geographically separates stages of the production process. A horizontal FDI takes place if the MNE produces the same goods or services in multiple countries in order to serve the local market. Aizenman and Marion (2004) study the impact of uncertainty on different types of FDI and show that higher volatility of supply increases the expected profits associated with horizontal FDI and reduces the expected profits from vertical FDI. According to a recent study (Levasseur, 2006) FDI responds to two large motivations. They can be market-seeking (local market-oriented) or efficiency-seeking (export-oriented). Local market-oriented FDI is set up by horizontally integrated MNEs in order to penetrate a market, increase their market share, diversify the source of sale, and minimize competition risk. Export-oriented subsidiaries are set up by a vertically integrated MNE in a host economy with the aim to lower production costs or to seek, secure and diversify resources.<sup>5</sup>

It is clear that, as every type of uncertainty, country risk has an impact on FDI and should be incorporated in long-term investment decisions of MNEs. But is country risk the only determining factor behind FDI? Shaheen (2005) studies the extent to which geographic,

economic and demographic features of a host economy could attract FDI. In addition to this, Shaheen (2005), following Oneal (1994), defines some other non-market determinants of FDI, such as regime type and political climate. He claims that MNEs tend to invest in countries with transparent, liberal and democratic governance. Janicki and Wunnava (2004) find that the key factors determining FDI inflows in Central and Eastern European (CEE) countries are size of the host economy, host country risk, labour costs in host country, and openness to trade. The study proves that international trade is perhaps the most important determinant of foreign investment.<sup>6</sup> Similarly, Bevan and Estrin (2000) argue that countries that are more liberal in their trade approach tend to export more, and this situation represents an attractive opportunity for foreign firms, especially ones which are considered export-driven.

Blažić and Vlahinić-Dizdarević (2006) also review the factors determining FDI, but their study concentrates on Southeastern European (SEE) countries, in particular. According to them the most important FDI determinants, regardless of FDI type or country, include market size, prospects for market growth, degree of development of the host country, location and the progress made in the process of transition. They find that larger economies provide larger economies of scale and spillover effects. Proximity to home country has been proven to be a major factor as well. The closer the geographical and cultural proximity, the greater the trade flows. It has also been documented that the progress in the general process of transition, especially institutional development, represents a very important FDI determinant.

This paper investigates the major factors (market and non-market) that determine the size and the quality of FDI inflows in a transition economy, such as Bulgaria. The study evaluates the specific impact of different country risk factors on the FDI decision-making process from

a Bulgarian perspective. What is more, the paper explores the specific barriers that foreign investors and foreign MNEs face during the establishment of their FDI projects in Bulgaria. The rest of the paper is organized as follows. The next section presents a comprehensive analysis of the FDI inflows in Bulgaria for the period 1992 – 2006 and compares them with foreign investments in other Central and Eastern European (CEE) countries. Section 3 details the methodology used to study the impact of country risk on FDI in Bulgaria. The survey includes more than 130 large and midsize foreign MNEs, grouped in two categories depending on the size of their investment projects. The data from the survey is used in section 4 to analyze the specific impact of country risk factors on FDI decisions from a Bulgarian perspective. Section 5 deals with the improvements in the Bulgarian business environment the foreign investors should expect to see in the next five years. Some concluding remarks are offered in the final section.

## **FDI INFLOW IN BULGARIA: A CASE STUDY**

The study compares the size and the quality of FDI inflow in Bulgaria with other Central and Eastern European (CEE) countries. According to Levasseur (2006) FDI inflows are an important engine for convergence of all CEE countries with their more advanced Western European neighbors, and are major determinants in their economic growth. Foreign MNEs also contribute to the upgrading of production capacities in those countries by carrying out technically demanding production functions. For this reason it is important to investigate the investment climate in Bulgaria and evaluate the attractiveness of the economy for foreign investments. It is clear that Bulgaria offers unique advantages to foreign investors, coming in the same package with its unique disadvantages, obstacles, barriers and risks.

One of the most important determinants that have influenced the FDI flows in transition economies is the process of privatization.<sup>7</sup> However, the FDI inflow in Bulgaria does not start

growing until after the late 1990s. Even though the process of privatization began in 1990, by 1996 only 11% of the state assets were privatized. The low level of FDI inflow in the early period of transition (until 1997) could be explained by the high investment risk related to overall instability in the country and the slow political, economic and institutional reforms. For the 5-year period between 1992 and 1997, the FDI inflow amounted to US\$ 766.7 million, while for 1997 only, the FDI inflows were US\$ 636.2 million and they continued to increase.<sup>8</sup> According to Zafirova (1999) over one-third of the companies that have invested in Bulgaria during that period chose to take part in the privatization process, and 53% focused on building of new production capacity, and/or expanding of the existing ones. The third selected entry mode of FDI was acquisition of already private property and amounted to 22% of all transactions. Large FDI inflow entered Bulgaria via a small number of deals with large foreign companies.

The investment climate in Bulgaria became more favorable after 1997 because of the Encouragement of Investment Act, which was introduced at that time. An important incentive for FDI is the fact that the Encouragement of Investment Act equally applies to Bulgarian and foreign investors. This is beneficial for foreign MNEs seeking to invest in the country, since they will not be discriminated and offered harder conditions in any way; they just have to provide more constructive conditions than the domestic investors. The new Encouragement of Investment Act (2004) sets forth preferential treatment for investment meeting certain criteria specified in this law as follows:

- The investment to be in fixed assets acquisition with the purpose of creating new or enlarging or modernizing existing production of goods and/or services;
- New jobs to be created;
- The investment project to be implemented within 3 years.<sup>9</sup>



The continuous and rapid increase of FDI inflow in Bulgaria, especially in the period 1997-2004, is due to the on-going structural reforms and the increasing economic stability. For example, in 1995-1996, the net increase in foreign direct investment is still weak - FDI rose by 1% of GDP. However, in 1997-2004, the net increase is much higher, reaching 6% of GDP. As the World Bank (2004a) report states yet, the FDI per capita in the country has already surpassed the \$500 mark, indicating that new FDI-driven investments are reaching a critical mass needed in order to have a sizable impact on Bulgaria's improved capacity to compete in external markets. Another factor that is important for attracting new FDI flows in the country is that in 2005, before its accession to the EU, Bulgaria reduced its corporate tax from 19.5% to 15%. Moreover, the Bulgarian government announced a legislation that simplifies the acquisition of real estate by EU residents after accession but keeps restrictions on agricultural and forest land.<sup>10</sup>

According to the Eurocapital Finance (2006) report Bulgaria has, as a whole, a favorable regulatory environment for FDI. Foreign investors enjoy low taxation on corporate profits (10% from 2007) and Bulgaria has double taxation treaties with a number of jurisdictions. There are no restrictions on foreign currency transactions and the repatriation of profits. FDI inflow to the country has grown substantially the last three years, topping US\$ 2.8 billion at the end of 2005 with the leading recipients of FDI in recent years being the energy sector and transportation, and communication infrastructure.

In order to assess the size and quality of FDI inflows in Bulgaria we analyze them by type of investment, the country of origin and by sectors.

### **FDI Inflow By Type Of Investment**

The data in Table 1 shows that FDI inflow from privatization is not the most significant type of foreign investment, except for 2004 when the government sold to foreign investors

the national telecommunication company BTK, as well as some of the electrical distribution plants. Moreover, the FDI from privatization depends on the government intentions and decisions, and disappears when the privatization process is finally completed.<sup>11</sup> That is why the Greenfield investment and the expansion FDI projects are more important for the economic growth and sustainable development of the country. According to the data in Table 1 since 1999 the FDI flows, especially those from Greenfield investment and expansion, grow with a higher rate, amounting to more than US\$ 1 billion for the year of 2000, and surpassing US\$ 2 billion after 2003. In the third quarter of 2006, the total FDI inflow in Bulgaria reached the level of US \$17.6 billion, of which 81.5% were in Greenfield investments and expansion projects.

[Insert Table 1 here]

In 2006, despite the rapidly growing FDI inflow, Bulgaria still occupies the fourth place in Southeastern Europe, after Turkey, Romania, and Greece (see Figure 1). According to the Southeastern Investment Guide 2006, FDI flows in the region reached a historic record in 2005 of nearly € 20 billion.<sup>12</sup> This remarkable increase in FDI flows is mostly due to the finalization and re-launching of delayed privatization deals, more stable macroeconomic and business environment, and low investment risk.

[Insert Figure 1 here]

The data on FDI inflow, when measured as a share of GDP, take in to account the size of the economy and indicate the relative importance of foreign investment in the country. Since all CEE countries, including Bulgaria, could be classified as small economies in economic terms, it is to be expected that foreign capital would represent an important part of the country's gross national product. The data for Bulgaria show that while in 1998 FDI inflow was only 4.4% of GDP, in 2006 it amounts to 16.4% of gross national product (an increase of 53.7% compared to 2005). Although the country is still behind the other countries in the

region in terms of total amount of FDI inflow, Bulgaria is a leader in Central and Eastern Europe when the FDI inflow is taken as percentage of GDP (see Table 2).

[Insert Table 2 here]

A fast growth of cumulative FDI in Bulgaria is also observed, especially after the year of 2002. The accumulated FDI is 9.4 times higher in 2006, than in the year of 1998 (see Figure 2).

[Insert Figure 2 here]

The data for FDI inflow in per capita terms show that Bulgaria takes the fourth place in 2005 after Estonia, the Czech Republic and Hungary.<sup>13</sup> According to the Bulgarian National Bank (2007) statistics, in 2006 the country attracted € 4.02 billion, or US\$ 5.06 billion, of foreign direct investment. This places the country second in the region after Croatia in terms of per capita FDI. Now, after the Bulgaria's accession in the EU, an influx of over € 11 billion from EU cohesion and structural funds in 2007-2013 is expected for improvements in roads and other essential infrastructure.<sup>14</sup>

### **FDI Inflow By Country of Origin**

According to the United Nations Conference on Trade and Development (2006) report the inward FDI flows to Bulgaria for the period 1990 - 2000 are the lowest, only US\$ 301 million (see Table 3). Moreover, the outward FDI flows are negative, - US\$ 4 million, which testifies for the huge trade current account deficit at that time. In the subsequent years, both the inward and the outward FDI flows in Bulgaria grow substantially. Despite that growth the other countries' FDI increases more rapidly. Considering the inward FDI flows in 2005, Bulgaria is the second to last one in the group of SEE countries, with Croatia being the last one and the other two countries being ahead. An exception is 2004 when Bulgaria is second with higher FDI inflow than the Russian Federation and Croatia. On the other hand,

comparing just these four countries (Bulgaria, Romania, Croatia, and the Russian Federation), the FDI stocks of Bulgaria are the highest in the 1990s. However, from 2000 onwards, Croatia's FDI stocks surpass Bulgaria's FDI stocks, leaving Bulgaria again on the last place among those four countries. Regarding the inward FDI flows as percentage of GDP, Bulgaria is a leader both in the region and in Europe (see Table 3).

[Insert Table 3 here]

When FDI inflow is analyzed by country of origin, the data show that in the period 1992 – 1999, the country that had invested the largest amount of capital in Bulgaria was Germany - 12.9% of the total FDI, followed by Belgium, USA, and the Netherlands. However, after 1999, Austria and Greece began to catch up with this group of countries, eventually being among the top three countries in terms of total invested capital by 2006. The UK invests the largest FDI amount in 2006 – US\$ 862 million, or 17.1% of total FDI. The followers are the Netherlands, which invests US\$ 842 million, and Austria devoting US\$ 554 million to FDI in Bulgaria (see Table 4). As the data from the table shows the country that has invested the most for the whole period 1992 – 2006 is Austria (16.2 percent), followed by the Netherlands (10.1 percent), Greece (9 percent), and the UK (7.9 percent).

[Insert Table 4 here]

### **FDI Inflow By Sectors**

According to the World Bank (2004b) report, during the period 1998 – 2003, a large share of the FDI flows was in the services sector or inward-oriented activities, and only a small share is in the tradable sectors. Hence, FDI flows in tradables have not reached a sufficient critical mass to have a robust positive impact on productivity. On average, in same the period, about 60% of FDI in Bulgaria was located in services, with more than half of these flows in the financial sector, and only about 30% of FDI was in tradables, nearly all in manufacturing. To some extent this can be explained by the fact that some of the best opportunities in

Bulgaria for foreign investors have been in sectors that dominate the domestic market, such as banking, business services, and electricity distribution. This has resulted in a strong inward orientation of FDI. However, it also reflects impediments to outward-oriented investment.

Blažić and Vlahinić-Dizdarević (2006) study on the distribution of FDI by economic activities finds that most of the FDI in Southeastern European (SEE) countries has been concentrated in financial services, telecommunications and trade and manufacturing. Service-related FDI flows into Southeastern and other transition countries have followed the trend of growth in services worldwide and in the region itself. At the same time the United Nations Conference on Trade and Development (2006) reports that not all FDI projects in the region have high-tech content. In some cases, low wages attract FDI projects in low value-added activities such as assembly manufacturing. For example, between 1998 and 2004, low wages in Bulgaria attracted US\$ 226 million worth of FDI in ‘cut and make’ textiles, in which costumers provide all inputs except labor. However, with the end of Multi-Fiber Arrangement (MFA) quotas and Bulgaria’s accession in EU in 2007 foreign investors in textiles, such as Miroglio (Italy) and Rollman (Germany), can no longer rely on wage competitiveness alone, and are upgrading their factories from simple assembly to higher value-added activities.

According to Bank Austria Creditanstalt (2007) report, in 2006 the efficiency-directed FDI seeks de-localization and re-export FDI represents around one third of total FDI stock in Bulgaria, while market-seeking FDI mostly focused on local needs in the services sector accounts for the remaining two thirds. Traditional sectors seem to be among the most relevant targets for FDI expansion, with food and beverages and textiles reporting a particularly strong presence of foreign companies. A big share of FDI, dedicated to manufacturing, is oriented to the sectors producing intermediate goods, like petroleum, chemical, rubber and plastic products, metallurgy and metal products, mineral products and other inputs for the construction industry, which is growing quickly in the last two years. Electricity, gas and

water supply are also among the most attractive sectors for foreign investment and are expected to grow even more in the years to come.

The data in Table 5 support these findings. According to InvestBulgaria Agency (2007d) report the largest share of FDI inflow in 2006 is in the real estate and business services sector, amounting to US\$ 1,579.6 million, which is 2.15 times higher than the inflows in 2005. The leading sector of FDI inflow is followed by the financial intermediation with US\$ 906 million, trade and repairs –US\$ 559.9 million, construction – US\$ 523.1 million, and metallurgy and metal products – US\$ 502.8 million. Moreover, the investments in construction are 2.8 times more than those in 2005. Interestingly, metallurgy and metal products manufacture have brought inflows of almost 10% of the total FDI inflow for 2006 and are the leaders in the processing industries. The financial intermediation sector has attracted the highest amount of foreign investment (US\$ 3,414.7) over the period 1998 – 2006.

[Insert Table 5 here]

## **RESEARCH METHODOLOGY**

The research methodology of this study is based on a questionnaire used to collect information about country risk assessment and the investment decision-making process in Bulgaria. Our purpose is twofold: first, to study the impact of country risk on FDI inflow in Bulgaria, and second, to identify the entry barriers that foreign investors consider in deciding whether or not to invest in a transition economy, such as Bulgaria. The study also attempts to identify the major factors of the business environment that foreign companies examine before entering the Bulgarian market. Previous studies (Bitzenis, 2006 and 2007, and Blažić and Vlahinić-Dizdarević, 2006) on FDI in transition economies find that foreign MNEs examine

the same factors to become familiar with the host country's business environment and have more successful investments. We do support these findings.

### **Sample Design**

As a first step of our methodology, we have established criteria to determine the population for our survey on foreign MNEs in Bulgaria. With the help of the InvestBulgaria Agency (IBA) – an official partner of our research project – a list of 90 large companies that, according to the IBA statistics, have invested over BGN 10 million between 1993 and 2006, has been created. These companies belong to the top 109 foreign investors in Bulgaria at the end of 2006 (ranked by the size of investment). According to InvestBulgaria Agency data the total capital invested by these largest MNEs amounts to US\$ 11,769 million (or 58.84%) of the total volume of foreign investment in Bulgaria for the period 1993 - 2006. For the purposes of our study we extended this list to 132 foreign investors, adding another forty two companies with the amount of invested capital at the end of 2002 between BGN 1.0 million and BGN 10 million. As companies of this size are not included in the IBA's official database of large foreign investors in Bulgaria, the data for these 42 foreign MNEs was collected from the Bulgarian Privatization Agency.

Our sample is representative of the real economic situation in Bulgaria as it consists of foreign companies that have invested a significant amount of capital relative to the size of the Bulgarian economy. Each represents a significant percent of the total FDI inflow in the country. Examples of such successful foreign investors are the US Tishman Management Company which has invested more than € 200 million (or US\$ 251.4 million) in Sofia Airport Center, and Mercury Group with € 80 million (or US\$ 100.6 million) invested in a shopping mall in Sofia. The sample is also representative because we managed to collect and analyze data in all the sectors of industry, trade and services. The questionnaire was initially

developed following the methodology used by the La Trobe University, Australia<sup>15</sup> in a similar research study of the largest Australian companies as foreign investors. The questionnaire was enriched and updated according to the specificity both of the Bulgarian business environment and the type of foreign investors.

The second step of the research methodology was to divide the foreign investors included in the sample in different groups following Bitzenis (2003). The companies were grouped based on different characteristics - country of origin, type of investment (entry mode), and by sectors.

The sample includes foreign MNEs of different origin. Among the 132 companies twenty-five MNEs (18.9 percent) are of German origin, 15 foreign MNEs (11.4 percent) are from Austria, and 13 MNEs (9.9 percent) are of US origin (see Table 6). These are among the top ten countries that have invested the largest amount of capital in Bulgaria in the period 1992 – 2006 (see Table 4). The total number of countries represented in our sample is thirty. Eighty-five percent of the projects implemented by foreign MNEs from these countries (e.g., Solvey, Belgium, Shell, UK, American Standards, USA, Umicore, Belgium and the Netherlands, etc.) are Greenfield and expansion projects. Almost the same is the share of Greenfield and expansion projects (72 percent) implemented by the other 42 foreign companies in the sample (mostly small and midsize enterprises).

[Insert Table 6 here]

Table 7 presents the distribution of FDI projects by type of investment, as implemented by the foreign MNEs included in the sample.<sup>16</sup> Of 572 investment projects in total 466 (or 81.5 percent) are Greenfield and expansion projects, and only 101 (or 17.7 percent) are acquisitions, mainly through privatization. Bulgaria is placed second among Southeastern European (SEE) countries after Rumania when the total number of FDI projects is considered. The largest number of Greenfield projects (68, or 11.9 percent) was implemented



in 2001. Only 19 new Greenfield and expansion projects were initiated in 2006 by the same companies. The total number of mixed projects (Greenfield plus acquisition) for the whole period is only five.

[Insert Table 7 here]

Next, we distribute the total FDI projects by sectors (see Figure 3). The largest share of FDI inflow is in financial intermediation sector (68 projects, or 11.9 percent), followed by food products (51 projects, or 8.9 percent), petroleum, chemical, rubber and plastic products (50 projects, or 8.7 percent) and trade and repairs (48 projects, or 8.4 percent). These four sectors have brought 10.9 percent of the total FDI inflow in Bulgaria for 2006. While the FDI projects, implemented by the top 90 foreign investors follow the same distribution, data for small and midsize MNEs in the sample show a different pattern. The preferable sectors of investments are petroleum, chemical, rubber and plastic products (31 projects), textile and clotting (23 projects), followed by wood products and paper (18 project), and machine building (15 projects). This can be explained by the fact that most SMEs set up their investment projects in sectors with low unskilled labor cost and lack of local competition.

[Insert Figure 3 here]

The new Encouragement of Investment Act (2004) sets forth preferential treatment for investment projects meeting certain criteria specified in this law. One of these criteria is the number of new jobs created.<sup>17</sup> The analysis of the projects, implemented in the period of 2004 – 2006 by thirty of the largest foreign investors (see Table 8), shows that 26 projects have been certified as projects of class 1, one project – of class 2, and 3 projects – of class 3 (depending on the size of the investment project as specified in the Regulations for Application of the Encouragement of Investment Act<sup>18</sup>), with the amount of invested capital in the range of BGN 17.0 million to BGN 2,049.0 million. The total number of new jobs to be created by these projects is 12,253. The largest number of jobs (2,280) is expected to be

created by Carrefour Bulgaria's project for establishing a hypermarket and trade center in Sofia (see Figure 4).

[Insert Table 8 here]

[Insert Figure 4 here]

## **General Questionnaire**

The executives and top level managers of the surveyed companies were asked questions in three groups: 1) assessment of general country risk and its relevance, 2) the impact of country risk factors on a firm's foreign investment decision making, and 3) the incentives for foreign direct investment in Bulgaria and expected improvements. Each category consists of subgroups of specific questions. For example, the first section of the questionnaire for assessment of general country risk includes questions about the impact of different factors of the Bulgarian business environment on foreign MNEs' long-term investment decisions, the assessment framework of country risk within the company, and the relevance of different sources of information (e.g., credit rating agencies, economic research services and databases, etc.) on the country risk assessment process. For the second group of questions the managers were asked to rate the impact of different components of country risk – political, economic, financial, and cultural risk, on their foreign investment decisions, on the scale from 1 to 5.

The questions in the last section of the questionnaire relate foreign investors' decision-making process with the major incentives for FDI in Bulgaria in order to be able to identify the types of motivation and entry barriers that foreign investors consider in deciding whether or not to invest in Bulgaria. The study also tries to identify the major improvements in the Bulgarian business environment that the foreign investors should expect to see in the next five years. Finally, the questionnaire studies the specific modes of market entry, the industry

the foreign companies are operating in, and the type of market the foreign direct investment is oriented to.

## **SURVEY RESULTS**

In order to be able to identify the impact of country risk on foreign investment decision making process, as well as motivations and barriers to inward FDI that foreign companies consider in deciding whether or not to invest in Bulgaria, the data from the questionnaire is analyzed and studied with the help of statistics. Following the methodology described above the analysis is done separately for different groups of questions included in the survey, and then, the correlation between the factors in these groups is examined.

Regarding the relevance of general country risk and its impact on FDI decisions, the results of the survey show that 87 percent of companies in the sample consider in general country risk assessment as an important component of their foreign investment decision-making.<sup>19</sup> In case of Bulgaria this percentage is even higher (95%). Eighty percent of foreign MNE managers consider the profit arising from the investment the most important factor in making long-term investment decisions, while 65 percent of them indicate the risk attached to the investment project as a very important factor. Opportunities arising from the investment are ranked third by 50 percent of the surveyed companies. Only 35 percent of the managers of the foreign companies consider the costs attached to the investment as an important factor in making strategic decisions abroad.<sup>20</sup>

When different factors of the Bulgarian business environment and their relevance to FDI decisions are considered, the foreign MNEs managers indicate high investment risk (40 percent), incoherent and unstable legal system (35 percent), unpredictability of laws and regulations (30 percent), and crime and corruption (25 percent) as the most important entry barriers in Bulgaria. Political instability (25 percent), bureaucracy (20 percent), and excessive

taxation (high value-added tax) (20 percent) are also mentioned as important obstacles the foreign MNEs face in making long-term investment decisions in Bulgaria (see Figure 5). As the analysis shows the importance of some of these factors (e.g., excessive taxation, macroeconomic instability) diminishes over time.

[Insert Figure 5 here]

There is no difference in the attitude of small to midsize MNEs (with the amount of invested capital less than BGN 50 million) and large MNEs (with the amount of invested capital between BGN 51 and 650 million) to FDI barriers as the two groups consider high investment risk, incoherent and unstable legal system, crime and corruption, and unpredictability of laws and regulations as the most important entry barriers in Bulgaria. Regarding the attitude of foreign investors towards overall business risk in the country after Bulgaria's accession in the EU in 2007 the data show that 48 percent of all surveyed companies are moderate risk takers, while 17 percents are risk neutral and 13 percent are extremely risk averse. Only 9 percent of the companies are ready to take a high level of risk when investing in a transition economy, such as Bulgaria.

The survey shows the surprising fact that 32 percent of the interviewed companies do not have a formalized function or system of country risk assessment although they assess the investment risk of the host country (in this case Bulgaria) on a regular base (77 percent of all surveyed companies). If a foreign investor does assess the risk of the host country, the frequency according to 22 percent of the surveyed companies, is less than annually, while in 26 percent of the cases it is done occasionally, that is, assess the risk only when the need arises. Only 17 percent of foreign MNEs are continuously tracking the investment project risk. Regarding the major sources of information the foreign MNEs use to assess the country risk, 30 percent of them indicate official economic data and analyses as the most relevant source of information, and reports from outside economic research services (consultants,

expert teams) are ranked second (16 percent). Other important sources of information for foreign MNEs are articles from business publications (14 percent).

Additional sources of information used by foreign investors include published data from country risk rating agencies (12 percent) and reports from on-site visits submitted by regional managers (8 percent). In 87 percent of all cases the foreign MNEs use a combination of external and internal sources of information for their country risk assessment process, while 9 percent of them rely on external sources only. Though some of the surveyed foreign companies assess the host country risk as part of their decision making process, in 50 percent of the cases they do not have any formal country risk monitoring system, that is, some type of regular reporting on the changing risk environment in the host country. Thirty-two percent of the foreign MNEs report that the general responsibility of assessing country risk belongs to the country manager or the regional manager, and in 25 percent of the cases this responsibility is assigned to a specific department or formal country risk assessment committee.

The foreign MNEs report different approaches to assessing the level of risk attached to a particular project depending on whether the company has a centralized system of risk assessment or it is done on a project-by-project basis. In most cases the project proposals include an assessment of specific risk characteristics based on feasibility studies or case analysis. Some foreign MNEs are continuously assessing investment risk through review and regular adjustment of the information collected from different relevant sources of information (country reports, official economic data and analyses, etc.). Foreign banks or their branches/subsidiaries in Bulgaria use specific models of risk assessment based on rating systems, reports from external financial analysts or risk management units to assess and continuously track the investment project risk.

The study reveals another important characteristic of the country risk assessment process. In seeking reliable information on country risk 15 percent of the surveyed companies rely on information from country risk rating agencies, such as Moody's Investor Services and Standard and Poor's (S&P) Rating Group, while another 5 percent rely on data published by Economic Intelligence Unit. The World Bank information service reports are used by 10 percent of all surveyed companies. The foreign companies prefer these sources of information because they are internationally recognized, independent, easily accessible and provide authoritative analysis and forecast. Other sources such as official economic data and analyses published by UNCTAD services, Control risk information services, ICRG political risk services, and Euromoney services are not used by around 70 percent of the foreign MNEs because they are not familiar with them.

The second group of questions investigates the impact of country risk components on a firm's foreign investment decision making. They are classified in four major groups – political, economic, financial and cultural risk. Surprisingly, 55 percent of the surveyed companies consider economic risk as the most important determinant of FDI, while 35 percent of them indicate political risk and financial risk as the most important risk factors.<sup>21</sup> Only 30 percent of the foreign investors consider cultural risk as an important country risk component in assessing their FDI decisions. When the importance of country risk components associated with investing in developed economies as compared with investing in transition economies is considered, most of the foreign MNEs find the impact of these risk components more important in transition economies (in this case Bulgaria) than in developed countries (factors' mean of 3.75 versus 2.37). One possible reason is that the business environment in transition economies is more sensitive to any unexpected changes in economic, political or financial policy.

For example, when the political risk components are taken into consideration 35 percent of the foreign MNEs evaluate internal insecurity, including criminal activity, social conflicts, and high unemployment, together with deliberate changes in economic policy and regulations as the most important risk factors to their foreign investment decisions. Thirty percent of the surveyed companies point out violation of law and order and organized crime as another important factor that impacts their foreign investment decision making. Less attention is given to factors such as acts of terrorism (10 percent) and competing political philosophies, including nationalism (5 percent). When the same risk components and their likely impact on FDI decisions in the next five years are considered, internal insecurity and violation of law and order are ranked again first by 30 percent of all surveyed companies.

In assessing the impact of economic risk of the host country (in this case Bulgaria) on their FDI decisions, 35 percent of the foreign investors consider the undeveloped infrastructure as the most important risk factor. Other economic risk components that 20 percent of foreign MNEs find important when assessing the investment risk in a particular country are bureaucratic impediments and high inflation. The deficit in current balance of payments is reported to be an important factor in the foreign investment decision-making for only 10 percent of the investors. When the same economic risk components and their likely impact on FDI decisions in the next five years are considered the role of factors such as bureaucratic impediments and high inflation diminishes, while the impact of slower economic growth and high deficit in the current balance of payments increases.

When the financial risk components are taken into consideration, 35 percent of the foreign MNEs evaluate the impact of factors such as frequent changes in fiscal and tax policy as very important, while another 15 percent consider stability of the bank system and difficulties to access credit and capital markets as critical finance factors to their foreign investment decisions. When the same risk components and their likely impact on FDI decisions in the

next five years are considered, the attitude of foreign MNE managers toward these factors is not changed.

Cultural risk is also considered important for the majority of the surveyed companies. Forty percent of them point out corruption and nepotism as the most important impact factor, while another 25 percent consider ignorance of the patterns of business behavior as a relevant cultural risk factor. Ethics and religious differences or tensions are not seen as important factors to FDI decisions, especially for foreign MNEs from neighboring countries because of their knowledge of Balkan business ethics and the cultural proximity. Only 10 percent of the surveyed companies consider language barriers as an important risk factor. When the same risk components and their likely impact on FDI decisions in the next five years are considered, corruption and nepotism, together with ignorance of the patterns of business behavior, are estimated as the most important impact factors by 40 percent and 20 percent of the surveyed companies, respectively.

Statistical analysis supports these findings (see Table 9). There are 27 country risk factors with a significance level (two-tailed test, 95 percent confidence interval) less than 0.05; in these cases we can reject with a high degree of certainty the null hypothesis ( $H_0$ ) that the mean value of the risk factors is close to, or equal 3; that is, these variables are one of the many factors that foreign investors consider in making long-term investment decisions.<sup>22</sup> When the mean difference between risk factors from different groups (political, economic, financial and cultural risk at present and in five years) is considered, the results from Paired Sample T-test (not reported here) show that in 80 percent of the cases the null hypothesis ( $H_0$ ) that the factors' means are not considerably different from each other cannot be rejected. There are only six cases in which the results are statistically significant. For example, all of the four components of country risk are considerably different from each other when their impact on FDI decisions in developed economies as compared with FDI



decisions in transition economies is assessed. In all other cases related to their expected impact in the next five years, the factors are not considerably different. One possible explanation is that the foreign investors do not expect any significant changes in the Bulgarian business environment in the years to come, which contradicts our preliminary expectations. The only two exceptions here are related to factors such as bureaucratic impediments and language barriers at present as compared with their expected impact in the next five years.

[Insert Table 9 here]

The last group of questions studies the incentives for foreign direct investment in Bulgaria and expected improvements. Figure 6 indicates that the main incentives for FDI in Bulgaria are following the client's theory (30 percent), opportunities for market growth (25 percent), market size (25 percent), efficiency (20 percent), financial aspects (20 percent), followed by low skilled labor costs (15 percent), avoidance of trade barriers (15 percent) and establishing an export basis (15 percent). For 10 percent of foreign investors incentives such as geographical proximity, links to other neighboring countries, low unskilled labor costs, unsatisfied local demand for products, and lack of local competition are of equal importance. Only 5 percent of all foreign MNE managers consider cultural closeness and exploiting existing business links as important incentives to their FDI decisions.

For small foreign MNEs, especially those from neighboring countries (Greece, Cyprus, and Turkey) factors such as low labor cost of unskilled workers, unsatisfied local demand, avoidance of trade barriers and links to neighboring countries are the most important incentives for their investment in Bulgaria. The cost factor is especially important for these companies as most of the foreign MNEs use the low costs of labor force to create an export base, and not to serve the local market. The proximity of these companies to Bulgaria, their good knowledge of the local market, low transportation costs, the size of the market, and the

lack of local competition are additional motives to exploit cost differences between these markets and the Bulgarian market.

[Insert Figure 6 here]

For Greek investors, for example, the geographical proximity is one of the major motives for their FDI activities. This can be explained by the existing strong trade relations between Greece and Bulgaria, which allows them to exploit the existing business links when entering the Bulgarian market. Thus, we can argue that trade activities and FDI are complementary for countries such as Bulgaria, Greece, Cyprus, and Turkey as import and export to and from these countries increase proportionally.<sup>23</sup> We may also expect that most of the foreign MNEs would enter the Bulgarian market in order to acquire a large market share due to the absence of significant competition. Moreover, 70 percent of foreign MNEs included in our survey are large economic entities in respect to the size of the Bulgarian economy, with strong brand name and reputation. Thus, in many cases they are indifferent to the lack of local competition.

It is also interesting to explore the FDI barriers and incentives in relation to the entry mode and the sector to which each company belongs. The data show that 42 percent of all surveyed companies have used foreign direct investment as their preferable mode of market entry. Out of these 40 percent chose acquisitions and mergers to take advantage of the opportunities that the Bulgarian privatization program had offered, and 56 percent - Greenfield and expansion projects as the best or preferred way of investing in Bulgaria. Only 4 percent of foreign MNEs in this group created joint ventures. In accordance with Bitzenis (2006b) findings the low percentage of joint ventures in our sample (2 percent of the total FDI projects) can be explained by the fact that most of these companies, created in the early years of transition, had collapsed due to insufficient cooperation of local partners with foreign investors, or because foreign MNEs acquired the remaining part of the enterprise's shares. Later

establishment of FDI projects in Bulgaria followed other forms of market entry, such as Greenfield FDI or acquisition through privatization, as foreign investors learned more about the Bulgarian business environment and the economic conditions had improved significantly. In the period 2000 – 2006 the Greenfield plus expansion projects became the prevailing mode of market entry (see Table 7).

Other preferable modes of market entry used by foreign MNEs were export activities (mainly through direct branches and subsidiaries) – 25 percent, contractual entry (mainly through manufacture and services contracts) – 26.6 percent, and portfolio investment – 6.3 percent. Seventeen percent of foreign MNEs in the sample use a combination of two and more entry modes, for example, export activities combined with Greenfield projects, or contractual agreements. The analysis shows an interesting distinction between small and large foreign MNEs in Bulgaria: while the first group of foreign investors had used contractual entry as the most preferable mode of market entry, acquisitions and mergers appeared to be the prevailing mode of foreign investment for the second group of MNEs (see Figure 7).

[Insert Figure 7 here]

According to the managers of the surveyed companies the most important factors considered in choosing a specific mode of market entry are cost of entry, potential risks and opportunities arising from the investment, availability of good and loyal partners in the host country, experience in CEE countries, and specific factors of the business environment (political climate, corruption, and legal system). An additional factor that is worth mentioning is the attitude of the Foreign Investment Agency in the host country to foreign investors, which in the case of Bulgaria, is not considered to be very supportive.

The survey shows that 17 percent of the surveyed companies (mostly banks) are currently operating in the financial intermediation sector, followed by sectors such as petroleum, chemical, rubber and plastic products (9 percent), electricity, gas, and water supply (9

percent), metallurgy and metal products (8 percent), and mineral products (8 percent). A relatively large number of FDI projects (26 percent) are in other sectors such as engineering and information technologies, transport, logistics and communications, and mining. The distribution of the companies in the sample follows the general distribution of all foreign investors in Bulgaria by sectors (see Table 5). The size of the investment is another important characteristic of FDI in Bulgaria. The data from the survey show that 35 percent of the foreign MNEs have invested more than BGN 100 million (or US\$ 60.98 million), while 13 percent of the companies invested less than BGN 10 million (or US\$ 6.10 million). The second type of MNEs are mostly small to midsize companies (SMEs) active in specific sectors of the economy with similar or identical problems to a business environment such as Bulgaria. Also, investment needed for the labor intensive and service sectors is lower than the capital investment required in other sectors.

Regarding the foreign investors' attitude towards Bulgaria's accession to the EU in 2007, 96 percent of all surveyed companies expect significant improvements in the investment climate in Bulgaria. They are related to:

- Improving infrastructure, institutional framework and legal environment;
- Improving financial and fiscal system, macroeconomic stability, and quality of life;
- Upgrading work force skills, improving professional training and vocational system, strengthening the cooperation between industry and universities;
- Facilitating the access to capital for companies investing in human resources and their training and qualification;
- Importing work force from other countries in specific industry sectors, e.g. tourism;
- Improving the social system in order to guarantee a fair social securities payment;
- Decreasing bureaucracy and corruption among the governmental officials;

- Alleviating investment/licensing regimes, decreasing income tax level, and further market liberalization;
- Accelerating the EU labor law implementation and stronger confidentiality and business intelligence law.

The survey also shows that 26 percent of the foreign companies included in the sample direct their business activities to the local market and not to foreign markets, that is, they are not export oriented. The sectors they are currently operating in are electricity, gas, and water supply, financial intermediation, trade and repairs, and mineral products. Thirty percent of the foreign companies have both import and export oriented activities. This specific feature of the Bulgarian FDI can to some extent be explained by the fact that some of the best opportunities in Bulgaria for foreign investors have been in sectors that dominate the domestic market, such as banking, real estates and business services, trade and repairs, and electricity distribution. This has resulted in a strong inward orientation of FDI. However, it also reflects impediments to outward-oriented investment and can be viewed as a major weakness of the FDI inflow in Bulgaria. The rest of the companies (44 percent) direct their activities to foreign markets. The analysis shows that 70 percent of the companies in this group are small to midsize companies.

When different types of direct foreign investment are considered the survey shows that 64 percent of the foreign investors in the sample follow the horizontal type of FDI. This could be explained by the fact that horizontal FDI is the preferable mode of investment when foreign MNEs produce the same goods or services in multiple countries in order to serve the local market. Data from the survey show that a significant number of foreign companies present in Bulgaria direct their FDI activities to the local market, or combine local with export activities. Export-oriented branches/subsidiaries are set up in the country by vertically

integrated MNEs with the aim to lower production costs or to seek, secure and diversify resources.

## **EXPECTED IMPROVEMENTS**

According to a recent study conducted by Eurocapital Finance (2006) the overall business risk in Bulgaria is relatively low due to the lack of political violence in the country's recent history and its stable democratic system. The currency board brings additional stability in the country's currency, but access to capital in domestic markets is still limited. However, the uneven quality of the physical infrastructure is presented as a potential risk. The most important risk categories that may have an impact on FDI inflow in Bulgaria, according to the report, are security risk, political risk, legal and regulatory risk, macroeconomic risk, foreign trade and payments risk, financial risk, etc. Some of them, such as government effectiveness risk, are found to be high, and some others - infrastructure risk and labor market risk, are described as moderate. These estimates of country risk components and their impact coincide with the findings from our survey.

The EU accession offers good opportunities to Bulgaria for improving its reputation with foreign investors, since those investors who decide to enter the Bulgarian market will be attracted mainly by the transport and energy sectors, and by the low labor cost. According to a recent survey conducted by Ernst & Young (2006),<sup>24</sup> Bulgaria occupies the fourth place among SEE countries with respect to the reputation among the foreign investors with 44% support. The leader in the region in this category is Romania (58%), followed by Turkey (49%), and Greece (48%), while Serbia is on the fifth place with 26% support. Yet, the survey expects that in three years Bulgaria will improve to second place among the countries in Southeastern Europe, after Romania. If the reduction of the corporate tax rate from 15% to

10% in 2007 is taken into consideration, the country may even earn first place, since this reform significantly improves the investment conditions in the country.

In addition, the Ernst & Young (2006) survey resulted in a list of expectations of foreign investors for developments in certain areas of the Bulgarian economy over the next five years. One third of the interviewed managers anticipate improvements in the transportation and the telecommunication infrastructure of the country; 27 percent of the investors expect strengthening the political stability; 25 percent of the managers expect better conformity with the EU quality standards; and almost the same percentage of investors want to see more flexible administrative procedures and less bureaucracy. Only 12% of foreign investors relate their investment decisions with improvement of the quality of life in Bulgaria.

The results from our survey support these findings. The data show that for 21 percent of the foreign investors the most important developments in the Bulgarian business environment are related to improvements in transport network and telecommunication infrastructure, 19 percent of them expect to see more flexible administrative procedures and less bureaucracy, while another 13 percent anticipate significant changes in the legal system and the fight against corruption and crime. Almost the same percentage of the surveyed companies expects changes in fiscal and taxation system that will stimulate foreign investments in Bulgaria. Other expected improvements are related to the quality of life, transparency in business and government policies, implementation of EU labor law, independence of political parties from business structures, and implementation of the rule of law. If these expectations are met in the years to come, the FDI inflow in the country is expected to increase significantly.

## **CONCLUSION**

Factors such as firm's size, type of investment (entry mode) and the sector to which it belongs play a decisive role in the company's strategy to enter a foreign country. In making

long-term investment decisions, foreign companies assess the economic and political components of the country risk as the most important determinants of their FDI decisions. Although a significant number of foreign MNEs do not have a formalized system for assessing and monitoring the host country risk, the individual projects risk assessment is a major part of their foreign investment decision-making process.

More than 110 large foreign companies have invested in Bulgaria during the period 1993 – 2006 with the total amount of invested capital of US\$ 20.0 billion. These companies are engaged in business activities that add value, create additional jobs and higher wages, improve the quality and variety of products, and contribute significantly to the growth of gross domestic product (GDP) of the Bulgarian economy. The most important incentives for these companies to invest in Bulgaria are the opportunity for market growth, market size, efficiency, financial aspects, low skilled labor costs and avoidance of trade barriers. A large number of small to midsize MNEs that have invested in Bulgaria in the same period consider low labor cost of unskilled workers, unsatisfied local demand, avoidance of trade barriers and links to neighboring countries as the most important factors in making long-term investment decisions. Other motives for foreign SMEs to invest in Bulgaria are their previous trade relations, lack of local competition at the time of investment, and unsatisfied local demand for products.

The prevailing mode of foreign market entry is Greenfield investment, followed by acquisitions (mainly through privatization) and a limited number of joint ventures. Other typical ways of investing are export (through direct branches and subsidiaries) and contractual entry (through manufacture and service contracts), or a combination of two or more modes. In respect to different types of FDI, the horizontal FDI projects prevail as most of the foreign MNEs investing in transition economies intend to produce the same goods or services in multiple countries in order to serve the local market. The majority of foreign



companies set up initially their FDI projects as local-market oriented in order to penetrate the domestic market, increase their market share, diversify the source of sale, and minimize competition risk.

A large number of FDI projects in Bulgaria have been implemented in sectors such as financial intermediation, petroleum, chemical, rubber and plastic products, electricity, gas, and water supply, metallurgy and metal products, and mineral products. Thus, we can conclude that a considerable share of FDI inflow in Bulgaria is committed to the sectors concentrated on satisfying local market needs. Traditional sectors also continue to be among the most relevant targets for FDI expansion, with food and beverages and textile sectors showing a particularly strong presence of small foreign companies. These findings are consistent with the previous studies, related to the distribution of FDI by economic activities, according to which most of the FDI flows in SEE countries have been concentrated in financial services, telecommunications and trade, and manufacturing.

Factors such as an incoherent and unstable legal system, crime and corruption, bureaucracy and poor infrastructure discourage foreign investors and decrease the competitiveness of the Bulgarian economy for FDI. However, the sustainable economic growth and political stability provide signals that in the years to come Bulgaria will enjoy substantial growth and development, and will continue to attract a significant amount of inward FDI. If these objectives are met, an increased competitiveness of the Bulgarian economy, as well as an improved quality of life should be expected in the next five years.

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**Table 1:** FDI inflow in Bulgaria by type of investment

Year	Privatisation		Greenfield + Expansion		Total by year
	USD million	%	USD million	%	USD million
1992	0.0	0.0	34.4	100.0	34.4
1993	22.0	21.5	80.4	78.5	102.4
1994	134.2	63.6	76.7	36.4	210.9
1995	26.0	16.0	136.6	84.0	162.6
1996	76.4	29.8	180.0	70.2	256.4
1997	421.4	66.2	214.8	33.8	636.2
1998	215.6	34.8	404.4	65.2	620.0
1999	226.7	27.7	592.1	72.3	818.8
2000	366.0	36.5	635.5	63.5	1,001.5
2001	19.2	2.4	793.7	97.6	812.9
2002	130.0	13.4	839.7	86.6	969.7
2003	364.1	17.4	1,732.8	82.6	2,096.9
2004	1,216.0	35.3	2,227.4	64.7	3,443.4
2005	0.0	0.0	2,883.7	100.0	2,883.7
2006	267.5	5.3	4,790.6	94.7	5,058.1
<b>Total</b>	<b>3,485.1</b>	<b>18.2</b>	<b>15,622.8</b>	<b>81.8</b>	<b>19,107.9</b>

Source: InvestBulgaria Agency Statistics (2007a)

**Table 2:** FDI inflow as a percentage of GDP, by country

<b>Country</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
Bulgaria	4.4	7.1	8.1	5.9	5.9	10.5	13.9	14.2	16.6
Romania	4.1	3.0	2.8	2.9	2.5	2.7	7.2	6.6	9.3
Estonia	10.2	3.9	6.1	5.6	2.2	8.3	8.3	21.2	12.5
Lithuania	9.5	4.8	3.0	3.3	4.8	0.9	3.4	3.9	2.8
Check Republic	6.4	10.5	8.9	9.0	11.2	2.6	4.6	8.9	4.7
Slovakia	1.2	3.5	9.8	7.3	16.3	1.8	2.3	4.2	5.9
Croatia	4.3	7.4	5.9	7.9	4.9	6.8	3.5	4.5	7.1
Latvia	5.4	4.8	5.3	2.0	4.1	3.0	3.9	4.0	8.5
Hungary	6.2	7.5	2.6	4.0	3.8	3.2	3.9	4.2	3.2
Ukraine	1.9	1.4	1.4	2.0	1.7	2.9	2.6	9.4	4.8
Poland	4.0	4.7	5.8	3.1	2.2	2.1	8.5	3.2	3.7
Slovenia	1.1	0.3	0.4	1.9	8.0	0.5	2.5	1.6	2.2
Russia	1.0	1.7	1.0	0.8	1.0	0.3	2.6	1.9	2.2

*Source:* 1998-2000: Bank Austria Creditanstalt (2007a and 2007b); 2001-2006 - Bulgarian National Bank (2007)



**Table 3: FDI flows by country and by year, in USD million, and in percentage**

FDI flows							as a percentage of gross Fixed Capital Formation			
		1990-2000	2002	2003	2004	2005	1990-2000	2003	2004	2005
		(annual average)					(annual average)			
Bulgaria	<i>inward</i>	301	905	2,097	3443	2,223	18.1	54.3	68.1	35.1
	<i>outward</i>	-4	29	27	-217	316	0.0	0.7	-4.3	5.0
Croatia	<i>inward</i>	544	1,213	2,133	1262	1,695	13.1	25.2	12.5	15.4
	<i>outward</i>	51	539	108	348	187	1.2	1.3	3.5	1.7
Romania	<i>inward</i>	656	144	2,213	6517	6,388	9.4	17.4	39.9	28.1
	<i>outward</i>	2	16	39	70	-13	0.0	0.3	0.4	-0.1
Russian Federation	<i>inward</i>	423	693	1,424	1,715	7,808	5.2	13.8	11.7	45.2
	<i>outward</i>	8	-5	13	4	275	0.0	0.1	0.0	1.6
Southeast Europe	<i>inward</i>	1,603	3,877	8,457	13,283	12,445	10.7	26.8	33.2	25.4
	<i>outward</i>	55	589	174	201	496	0.0	0.7	0.6	1.2
SEE and the	<i>inward</i>	5,569	12,911	24,192	39,577	39,679	6.2	16.9	20.9	17.0
Independent States	<i>outward</i>	1,401	4,687	10,731	13,973	15,056	1.9	7.6	7.6	6.6
World	<i>inward</i>	495,391	617,732	557,869	710,755	916,277	7.6	7.3	7.7	9.4
	<i>outward</i>	492,566	539,540	561,104	813,068	778,725	7.7	7.4	9.3	8.3
FDI Stocks							as a percentage of GDP			
		1980	1990	2000	2004	2005	1990	2000	2004	2005
Bulgaria	<i>inward</i>	0	112	2,257	9,220	9,173	0.5	17.9	37.8	34.3
	<i>outward</i>	0	124	87	0	127	0.6	0.7	0.0	0.5
Croatia	<i>inward</i>	0	0	3,523	12,602	12,516	0.0	19.1	36.7	33.3
	<i>outward</i>	0	0	825	2,159	2,127	0.0	4.5	6.3	5.7
Romania	<i>inward</i>	0	0	6,480	20,523	23,818	0.0	17.5	28.0	24.2
	<i>outward</i>	0	66	136	294	242	0.2	0.4	0.4	0.2
Russian Federation	<i>inward</i>	0	0	3,875	9,606	17,209	0.0	12.4	14.8	21.1
	<i>outward</i>	0	0	170	196	466	0.0	0.5	0.3	0.6
Southeast Europe	<i>inward</i>	0	112	15,083	51,261	56,562	0.2	16.6	29.1	26.7
	<i>outward</i>	0	191	1,170	2,500	2,625	0.2	1.3	1.4	1.2
Southeast Europe and	<i>inward</i>	0	121	70,306	222,486	255,713	0.2	15.9	23.8	21.2
Independent States	<i>outward</i>	0	191	22,054	111,624	126,345	0.2	5.1	12.1	10.6
World	<i>inward</i>	561,403	1,789,303	5,802,933	9,544,887	10,129,739	8.5	18.3	23.3	22.7
	<i>outward</i>	571,226	1,791,092	6,471,435	10,325,240	10,671,869	8.6	20.5	25.2	23.9

Source: UNCTAD World Investment Report (2006)

**Table 4:** FDI inflow in Bulgaria by country of origin and by year, in USD million

No	Country	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total by Country
1	AUSTRIA	13.0	1.0	14.7	1.4	12.1	12.5	46.9	74.6	70.5	93.6	160.6	238.4	908.2	900.9	554.1	3,102.4
2	NETHERLANDS	0.1	0.5	37.9	0.9	46.3	10.8	41.3	105.6	-10.2	80.3	30.9	242.6	456.9	50.7	842.5	1,937.1
3	GREECE	0.2	5.1	3.0	29.8	14.6	16.1	3.3	2.3	99.1	240.2	239.3	224.6	255.9	256.9	331.2	1,721.4
4	UK	6.2	5.6	2.4	13.7	7.3	15.8	58.9	28.1	-3.3	20.1	0.7	96.1	67.9	327.8	862.0	1,509.2
5	GERMANY	0.1	56.6	111.0	16.2	53.1	31.4	55.7	40.4	39.0	67.4	85.4	108.5	357.7	91.3	104.0	1,217.7
6	BELGIUM & LUXEMBOURG		0.1	0.3	10.0	8.5	255.2	21.9	0.2	100.2	60.8	0.3	31.3	128.6	177.6	150.7	945.7
7	ITALY		0.2	5.2	2.3	1.2	0.4	2.1	6.9	338.3	146.5	45.2	100.5	105.2	115.7	73.6	943.2
8	HUNGARY	12.3	0.1	0.0	0.0	0.1	0.0	0.7	7.4	2.0	1.0	9.5	379.2	61.9	92.8	305.3	872.4
9	USA		10.5	16.2	16.1	20.7	46.6	38.6	54.7	58.2	44.5	56.2	128.0	145.3	71.1	116.0	822.6
10	CYPRUS	0.3	1.2	0.4	1.4	7.5	20.6	109.0	161.8	74.8	17.8	-8.2	120.9	109.5	16.6	142.3	775.8
11	CZECH REPUBLIC			0.1	2.3	2.3	4.7	0.6	0.1	0.7	2.6	62.1	-6.8	373.3	-24.3	262.2	679.8
12	SWITZERLAND	0.4	6.7	0.2	7.9	23.1	31.4	6.6	8.7	24.7	33.5	36.3	144.6	142.4	176.4	35.2	678.2
13	IRELAND			0.0	17.4	0.2	5.2	1.0	15.8	3.2	-5.8	-2.1	2.8	25.1	104.7	298.0	465.5
14	SPAIN		0.1	0.0	0.0	0.0	49.6	56.8	3.8	1.0	5.1	0.1	4.6	10.4	49.8	154.3	335.4
15	FRANCE		0.2	4.2	5.0	6.5	0.8	3.4	78.1	36.9	15.1	8.6	22.7	63.4	29.2	55.6	329.9
16	RUSSIA	0.3	1.4	2.3	15.1	14.4	2.0	14.8	99.5	21.5	-4.4	4.5	30.9	-21.1	27.3	84.9	293.5
17	TURKEY		9.8	1.3	13.7	7.3	9.9	23.8	12.3	25.4	-9.7	15.3	-5.4	73.4	17.5	49.0	243.5
18	DENMARK			1.1	0.0	0.0	1.1	1.6	-1.1	2.1	-0.5	4.1	49.2	17.0	35.2	95.9	205.6
19	ISRAEL			0.9	0.0	1.5	0.0	0.0	14.0	8.3	0.1	3.1	5.5	16.2	14.1	55.9	119.5
20	SWEDEN			0.0	0.0	1.4	2.4	0.9	0.4	2.2	5.7	28.5	6.9	10.9	30.1	19.8	109.4
21	JAPAN			0.1	0.5	0.6	1.9	1.9	1.8	1.6	3.1	13.6	0.6	1.8	18.3	49.0	94.7
22	MALTA				0.1	0.1	0.1	8.9	-1.2	0.9	2.7	1.1	8.4	4.2	10.5	47.4	83.2
23	LIECHTENSTEIN		1.1	0.1	0.0	0.0	2.5	0.8	4.8	4.0	6.9	6.4	12.9	12.8	6.3	0.4	58.9
24	CANADA					0.1				0.2	0.0	0.0	9.5	33.5	11.6	1.6	56.5
25	PANAMA							0.1	0.1	0.1	0.9	5.6	3.7	6.4	12.2	24.2	53.2
26	SLOVENIA									0.2	0.0	0.0	37.0	-3.7	6.6	7.1	47.2
27	LATVIA											0.3	1.1	0.8	8.8	34.7	45.8
28	ROMANIA											0.9	-0.1	-0.3	21.8	18.6	40.8
29	LITHUANIA										0.1		0.7	16.8	8.4	14.1	40.1
30	ICELAND														5.9	23.7	29.6
31	ESTONIA													0.7	7.5	20.2	28.5
32	NORWAY						0.1	0.2		0.6		0.2	0.1	1.0	4.2	21.7	28.2
33	LEBANON					0.3	0.7	0.0	2.4	0.3	-1.1	9.8	4.9	-0.1	2.6	2.5	22.4
34	CHINA											0.2	0.5	7.0	1.1	0.4	9.1
35	SLOVAKIA						6.5	1.8	0.1	1.7	0.4	-0.1	-3.2	-0.9	1.9	0.8	9.0
36	POLAND					1.6		-0.1	-0.1		0.4	0.9	-3.6	1.2	6.9	1.6	8.8
	Total by years	34.4	102.4	210.9	162.6	256.4	636.2	620.0	818.8	1,001.5	812.9	969.7	2,096.9	3,443.4	2,883.7	5,058.1	19,107.9

Source: InvestBulgaria Agency Statistics (2007c)

**Table 5:** FDI inflow in Bulgaria by sectors, in USD million

No	Sector	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total by sector
1	Financial intermediation	150.5	97.8	4494	122.6	133.8	501.9	238.9	813.8	906.0	3,414.7
2	Trade and repairs	111.9	134.5	116.5	121.7	229.2	485.1	364.7	255.3	559.9	2,378.8
3	Real estate and business activities	33.7	39.7	2.8	13.2	56.5	182.2	141.9	572.4	1579.6	2,622.0
4	Petroleum, chemical, rubber and plastic products	41.0	165.2	72.1	-9.5	6.5	169.7	-3.1	662.6	293.6	1,398.1
6	Electricity, gas and water supply	1.8	4.6	19.7	2.4	66.9	8.1	925.5	12.0	247.1	1,288.0
5	Telecommunications	23.2	14.1	14.9	236.8	205.0	127.3	401.6	180.4	-159.8	1,043.4
7	Construction	2.4	19.8	47.9	17.4	33.1	5.1	55.0	232.0	523.1	935.7
13	Metallurgy and metal products	13.2	72.2	17.1	81.0	-18.9	66.6	54.1	-118.5	502.8	669.6
8	Mineral products (cement, glass, etc.)	150.6	71.8	7.4	27.7	0.7	76.8	97.5	97.3	71.2	601.0
9	Food products	31.5	32.7	11.7	37.4	20.1	87.6	67.6	-6.6	13.7	295.7
11	Hotels and restaurants	17.6	16.9	26.0	17.9	7.9	27.9	15.2	61.7	79.7	270.8
10	Textile and clothing	4.4	25.1	27.3	57.7	9.3	84.3	45.7	-3.8	20.0	269.9
12	Machine building	21.3	18.0	64.7	13.2	37.6	1.1	13.8	35.9	50.9	256.5
14	Wood products, paper	37.3	24.9	38.1	2.9	17.0	69.9	-0.6	2.3	20.6	212.4
15	Transport	6.2	-11.7	10.1	5.9	8.1	45.1	29.2	43.5	53.3	189.8
16	Electrical eng., electronics, computers	11.5	5.9	28.6	28.2	17.9	29.5	-0.7	15.3	7.6	143.8
17	Mining	0.0	2.7	0.0	4.9	10.4	21.7	19.1	24.2	2.0	85.0
18	Agriculture, forestry and fishing	6.5	2.1	7.3	0.5	1.2	2.6	-1.9	5.1	16.0	39.5
19	Leather and leather products	0.7	0.0	21.2	0.1	0.5	-0.2	-2.5	3.0	0.5	23.4
20	Vehicles and other transport equipment	-0.9	1.7	0.0	5.1	2.2	2.1	-0.5	0.1	2.8	12.6

Source: InvestBulgaria Agency Statistics (2007b)

**Table 6:** Foreign companies by country of origin, 1993 -2006

<b>Country of origin</b>	<b>Top 90 companies (more than BGN 10 million)</b>	<b>Other companies (less than BGN 10 million)</b>	<b>TOTAL</b>
Germany	17	8	25
Austria	13	2	15
USA	7	6	13
Greece	7	2	9
Cyprus	1	4	5
Italy	6	2	8
Great Britain	4	1	5
Turkey	2	4	6
Belgium	4	2	6
Switzerland	5	1	7
The Netherlands	2	1	3
Czech republic	2	1	3
France	3	0	3
Spain	2	1	3
Luxemburg	2	0	2
Sweden	2	0	2
Russia	2	0	2
Hungary	1	1	2
Japan	1	1	2
Denmark	1	0	1
Iceland	1	0	1
Canada	1	0	1
South Korea	1	0	1
Malta	1	0	1
Slovakia	0	1	1
Panama	0	2	2
Lebanon	0	1	1
Slovenia	1	0	1
United Arab Emirates	1	0	1
Ireland	0	1	1
	<b>90</b>	<b>42</b>	<b>132</b>

Source: InvestBulgaria Agency (2007d) and Author calculations.

**Table 7:** FDI projects by type of investment, 1993 - 2006

<b>Year</b>	<b>Greenfield and Expansion</b>	<b>Acquisition (through privatization)</b>	<b>Mixed (Greenfield + acquisition)</b>	<b>Total</b>
1993	3	1	0	4
1994	6	4	0	10
1995	3	5	0	8
1996	8	9	0	17
1997	11	25	0	36
1998	38	16	0	54
1999	42	18	2	62
2000	65	7	0	72
2001	68	5	0	73
2002	53	3	2	58
2003	55	1	1	57
2004	42	5	0	47
2005	53	2	0	55
2006	19	0	0	19
	<b>466</b>	<b>101</b>	<b>5</b>	<b>572</b>

Source: InvestBulgaria Agency (2007d) and Author calculations

**Table 8:** FDI projects and new jobs created, 2004 -2006

Number	Investor	Investment project	Investment in million leva (BGN)	New work positions created
1	Linder holding - Germany	Business park Sofia	163.6	120 direct; 6300 indirect
2	Dundee precious metals - Canada	Modernization of the "Chelopech" mine	113.6	60 (existing 760)
3	Dundee precious metals - Canada	Project "Krumovgrad"	101.7	250 - 300
4	Montupe - France	Automotive parts enterprise	71.0	700
5	Asarel Medet	Modernization of Asarel Medet AD	71.0	35 (total of 1,275)
6	MO Sofia AD - Israel	Mall of Sofia	106.0	1000
7	Bulnet - The Netherlands	Decorative roses greenhouse	113.6	240
8	Shishedjam - Turkey	Glass production	366.7	1065
9	AES Corporation - USA	New power station "Maritza Iztok" 1	2,049.0	200 (existing 2,000)
10	Cumerio - Belgium	Developing a new copper refinery	263.0	70
11	Exos energy EOOD	Wind-power generator - Murgash	156.0	23
12	Ferrie group - Spain	Developing a golf pitch	80.0	600
13	Miroglio - Italy	Establishing a new textile factory	73.7	500
14	Alpha Finance holding	Sports and tourist center - Perelik	185.0	145
15	Alpha Finance holding	Apriltzi country club	97.0	40
16	Golf club Ibur AD	Building a golf pitch - Dolna Banya	75.0	150
17	Tokushukay Medical corporation - Japan	Tokushukay hospital - Sofia	138.0	1000
18	Mitsubishi heavy industries - Japan	Kaliakra wind power AD	92.0	30 (existing 250)
19	Libher-Housgrete Maritza AD	Expanding the refrigerator production	82.8	600
20	Karfur Bulgaria AD	Hypermarket and trade center	160.0	2,280
21	Petromax refinery Bulgaria	Oil refinery - Silistra	235.8	300 (existing 1000)
22	Greentech - Denmark	Wind-power generator - Godech	120.0	60
23	Solvay Sody AD - Belgium	Heat-electric power station - Devnya	140.4	5 (min.)
24	Business park Varna AD	Business park Varna	73.7	40 (existing 4,000)
25	Kabland OOD	Black sea golf & country club	127.0	400 (existing 900)
26	Dobrinishte ski EOOD	Building a ski zone - Dobrinishte	260.0	1500 (existing 1000)
27	Keros - Spain	Tile production plant	42.0	180
28	Kaufland Bulgaria EOOD	Kaufland-Hypermarket Mladost	17.0	100
29	Hit immobilen Sofia EOOD	Hit Hypermarket Dobrich	20.0	240
30	Shneider elektrik Bulgaria EOOD	Building a new plant for electric machinery	31.0	320

Source: InvestBulgaria Agency (2007d) and Author calculations

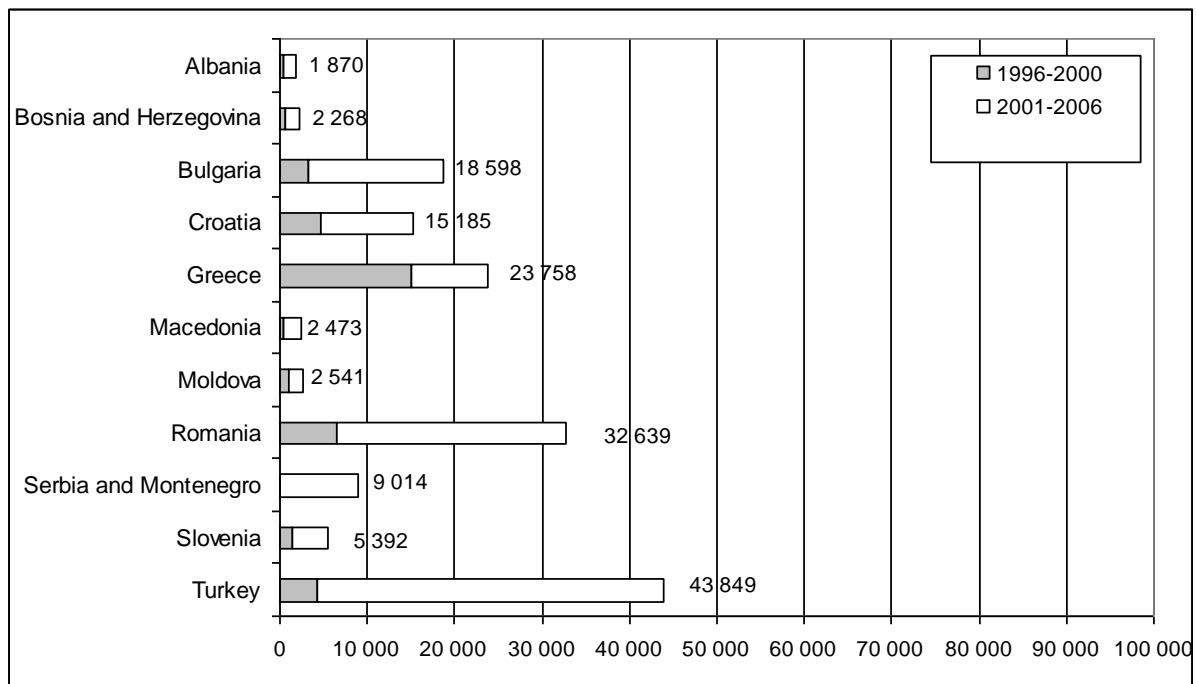
**Table 9:** Statistical results from one sample T- test of risk factors

	Test Value = 3				95% Confidence Interval of the Difference	
Factors	t-stat.	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
<b>Group 1</b>						
<i>Risk attached to the investment</i>	<b>5.151</b>	<b>38</b>	<b>0.001</b>	<b>1.300</b>	<b>0.772</b>	<b>1.828</b>
<i>Opportunities arising from investment</i>	<b>6.725</b>	<b>38</b>	<b>0.001</b>	<b>1.300</b>	<b>0.895</b>	<b>1.705</b>
<i>Costs attached to the investment</i>	<b>4.498</b>	<b>38</b>	<b>0.001</b>	<b>0.950</b>	<b>0.508</b>	<b>1.392</b>
<i>Profits arising from the investment</i>	<b>10.376</b>	<b>38</b>	<b>0.001</b>	<b>1.700</b>	<b>1.357</b>	<b>2.043</b>
<b>Group 2</b>						
High investment risk	1.983	38	0.062	0.600	-0.033	1.233
<i>Incoherent and unstable legal system</i>	<b>2.570</b>	<b>38</b>	<b>0.019</b>	<b>0.700</b>	<b>0.130</b>	<b>1.270</b>
Unpredictability of laws and regulations	1.949	38	0.066	0.500	-0.037	1.037
<i>Cime and corruption</i>	<b>2.585</b>	<b>36</b>	<b>0.019</b>	<b>0.632</b>	<b>0.118</b>	<b>1.145</b>
Political instability	0.483	36	0.635	0.158	-0.529	0.844
<i>Bureaucrasy</i>	<b>2.463</b>	<b>38</b>	<b>0.024</b>	<b>0.550</b>	<b>0.083</b>	<b>1.017</b>
Excessive taxation, highvalue-added taxes	-0.639	38	0.530	-0.200	-0.855	0.455
Macroeconomic instability	0.513	38	0.614	0.150	-0.463	0.763
High inflation rates	-0.972	34	0.345	-0.333	-1.057	0.390
Unskilled labor force	1.917	38	0.070	0.450	-0.041	0.941
<b>Group 3</b>						
S&P rating group	1.483	22	0.166	0.500	-0.242	1.242
Moody's investor services	1.750	20	0.111	0.636	-0.174	1.447
World bank information services	0.219	20	0.831	0.091	-0.833	1.015
Economist intelligence unit	1.174	20	0.267	0.364	-0.326	1.054
<b>Group 4</b>						
Political risk	1.697	38	0.106	0.500	-0.117	1.117
<i>Economic risk</i>	<b>3.928</b>	<b>38</b>	<b>0.001</b>	<b>1.100</b>	<b>0.514</b>	<b>1.686</b>
<i>Financial risk</i>	<b>4.046</b>	<b>38</b>	<b>0.001</b>	<b>0.950</b>	<b>0.459</b>	<b>1.441</b>
Cultural risk	1.236	34	0.233	0.389	-0.275	1.053
<b>Group 5</b>						
<i>Political risk in transition economies</i>	<b>3.073</b>	<b>34</b>	<b>0.007</b>	<b>0.833</b>	<b>0.261</b>	<b>1.405</b>
<i>Economic risk in transition economies</i>	<b>3.855</b>	<b>34</b>	<b>0.001</b>	<b>1.056</b>	<b>0.478</b>	<b>1.633</b>
<i>Financial risk in transition economies</i>	<b>4.486</b>	<b>34</b>	<b>0.001</b>	<b>1.056</b>	<b>0.559</b>	<b>1.552</b>
Cultural risk in transition economies	0.212	32	0.835	0.059	-0.529	0.647
<b>Group 6</b>						
<i>Internal insecurity,including criminal activity at present</i>	<b>2.496</b>	<b>34</b>	<b>0.023</b>	<b>0.722</b>	<b>0.112</b>	<b>1.333</b>
Deliberate changes in economic policy at present	0.792	34	0.439	0.278	-0.462	1.017
<i>Violation of law at present</i>	<b>2.853</b>	<b>34</b>	<b>0.011</b>	<b>0.722</b>	<b>0.188</b>	<b>1.256</b>
Changes of government at present	0.345	34	0.734	0.111	-0.569	0.791
Political instability at present	1.409	34	0.177	0.444	-0.221	1.110
<b>Group 7</b>						
Internal insecurity, including criminal activityin next 5 years	2.010	34	0.061	0.611	-0.030	1.252
Violation of law in the next 5 years	1.458	34	0.163	0.444	-0.199	1.088
Deliberate changes in economic policy in the next 5 years	0.164	34	0.871	0.056	-0.657	0.769
Political instability in the next 5 years	1.102	34	0.286	0.333	-0.305	0.972
Changes of government in the next 5 years	1.000	32	0.332	0.235	-0.264	0.734
<b>Group 8</b>						
<i>Infrastructure deficiencies at present</i>	<b>2.802</b>	<b>36</b>	<b>0.012</b>	<b>0.789</b>	<b>0.197</b>	<b>1.382</b>
<i>Bureaucratic delays at present</i>	<b>2.590</b>	<b>36</b>	<b>0.018</b>	<b>0.737</b>	<b>0.139</b>	<b>1.335</b>

High inflation rates at present	0.000	34	1.000	0.000	-0.615	0.615
Slower economic growth, including a deterioration of GDP at present	0.194	32	0.848	0.059	-0.583	0.701
Deficit in current balance of payments at present	0.398	32	0.696	0.118	-0.509	0.744
<b>Group 9</b>						
<i>Infrastructure deficiencies in next 5 years</i>	<b>2.204</b>	<b>34</b>	<b>0.042</b>	<b>0.667</b>	<b>0.028</b>	<b>1.305</b>
Bureaucratic delays in next 5 years	1.326	36	0.202	0.368	-0.216	0.952
High inflation rates in next 5 years	0.000	36	1.000	0.000	-0.482	0.482
Slower economic growth, including a deterioration of GDP in the next 5 years	0.203	34	0.842	0.056	-0.522	0.633
Deficit in current balance of payments in the next 5 years	0.416	32	0.683	0.118	-0.482	0.717
<b>Group 10</b>						
<i>Frequent changes in fiscal and tax policy at present</i>	<b>3.034</b>	<b>36</b>	<b>0.007</b>	<b>0.789</b>	<b>0.243</b>	<b>1.336</b>
Stability of bank system at present	-0.345	36	0.734	-0.105	-0.746	0.535
Restrictions/difficulties on access to credit and capital market at present	-0.865	36	0.399	-0.263	-0.903	0.376
Liquidity of capital markets at present	-0.383	34	0.707	-0.111	-0.723	0.501
Vulnerability in credit rating at present	-1.243	34	0.231	-0.333	-0.899	0.232
<b>Group 11</b>						
<i>Frequent changes in fiscal and tax policy in next 5 years</i>	<b>3.750</b>	<b>36</b>	<b>0.001</b>	<b>0.789</b>	<b>0.347</b>	<b>1.232</b>
Stability of bank system in next 5 years	-0.512	36	0.615	-0.158	-0.806	0.490
Restrictions/difficulties on access to credit and capital market in next 5 years	-0.697	36	0.494	-0.211	-0.845	0.424
Vulnerability in credit rating in next 5 years	-1.236	34	0.233	-0.389	-1.053	0.275
<b>Group 12</b>						
<i>Corruption and nepotism at present</i>	<b>2.916</b>	<b>36</b>	<b>0.009</b>	<b>0.842</b>	<b>0.235</b>	<b>1.449</b>
Language barriers at present	1.909	36	0.072	0.421	-0.042	0.884
Ethic/religious differences or tensions at present	-0.846	36	0.408	-0.211	-0.733	0.312
Differences in negotiation styles at present	-0.417	36	0.682	-0.105	-0.636	0.425
Ignorance of the patterns of business behavior at present	1.714	36	0.104	0.421	-0.095	0.937
<b>Group 13</b>						
<i>Corruption and nepotism in next 5 years</i>	<b>2.501</b>	<b>36</b>	<b>0.022</b>	<b>0.737</b>	<b>0.118</b>	<b>1.356</b>
<i>Ignorance of the patterns of business behavior in next 5 years</i>	<b>2.137</b>	<b>36</b>	<b>0.047</b>	<b>0.526</b>	<b>0.009</b>	<b>1.044</b>
Ethic/religious differences or tensions in next 5 years	-0.590	36	0.563	-0.158	-0.721	0.405
Language barriers in next 5 years	0.462	36	0.650	0.105	-0.374	0.584
Differences in negotiation styles in next 5 years	-0.615	36	0.546	-0.158	-0.697	0.381
<b>Group 14</b>						
Following the client's theory	1.407	36	0.176	0.421	-0.208	1.050
<i>Market growth</i>	<b>3.525</b>	<b>36</b>	<b>0.002</b>	<b>0.789</b>	<b>0.319</b>	<b>1.260</b>
<i>Market size</i>	<b>2.349</b>	<b>38</b>	<b>0.030</b>	<b>0.600</b>	<b>0.065</b>	<b>1.135</b>
<i>Efficiency</i>	<b>2.882</b>	<b>36</b>	<b>0.010</b>	<b>0.632</b>	<b>0.171</b>	<b>1.092</b>
<i>Geographical proximity</i>	<b>2.282</b>	<b>36</b>	<b>0.035</b>	<b>0.474</b>	<b>0.038</b>	<b>0.910</b>
<i>Links to other neighbour countries</i>	<b>2.282</b>	<b>36</b>	<b>0.035</b>	<b>0.474</b>	<b>0.038</b>	<b>0.910</b>
Financial aspects	1.714	36	0.104	0.421	-0.095	0.937
Low skilled labor cost	1.710	38	0.104	0.400	-0.090	0.890
Avoidance of trade barriers	1.278	36	0.217	0.368	-0.237	0.974
Establishing an export base	0.000	34	1.000	0.000	-0.638	0.638
Low unskilled labor cost	0.383	36	0.706	0.105	-0.472	0.682
Unsatisfied local demand for products	-0.203	32	0.842	-0.059	-0.674	0.557

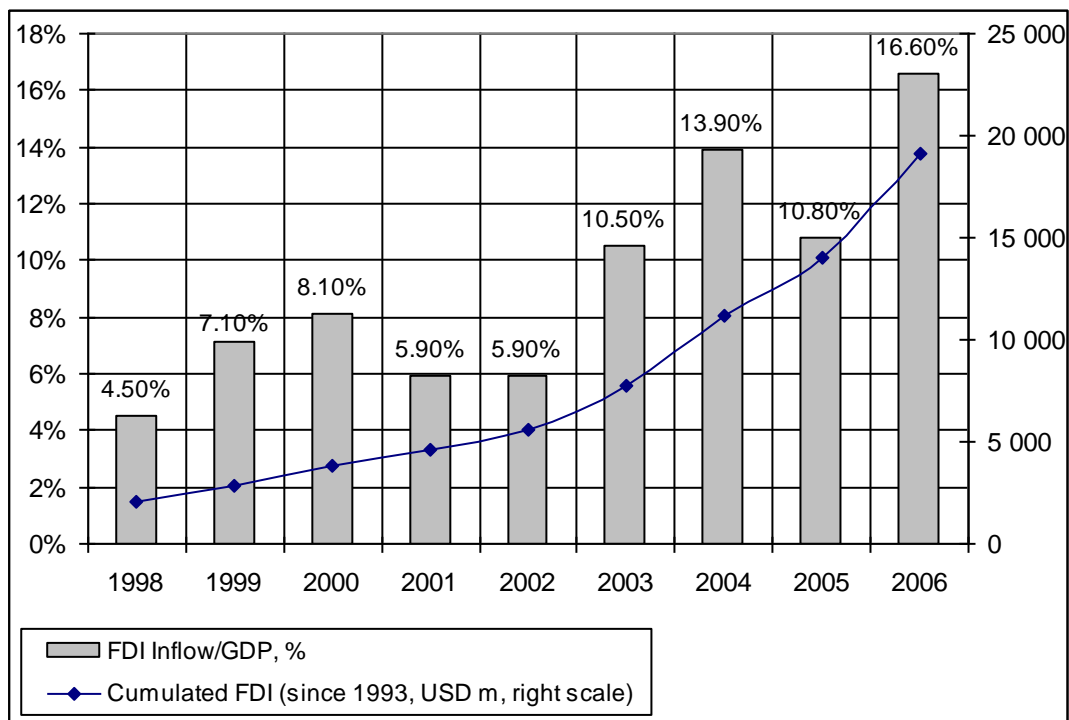


**Figure 1:** Total FDI inflow in Southeast Europe, in USD million



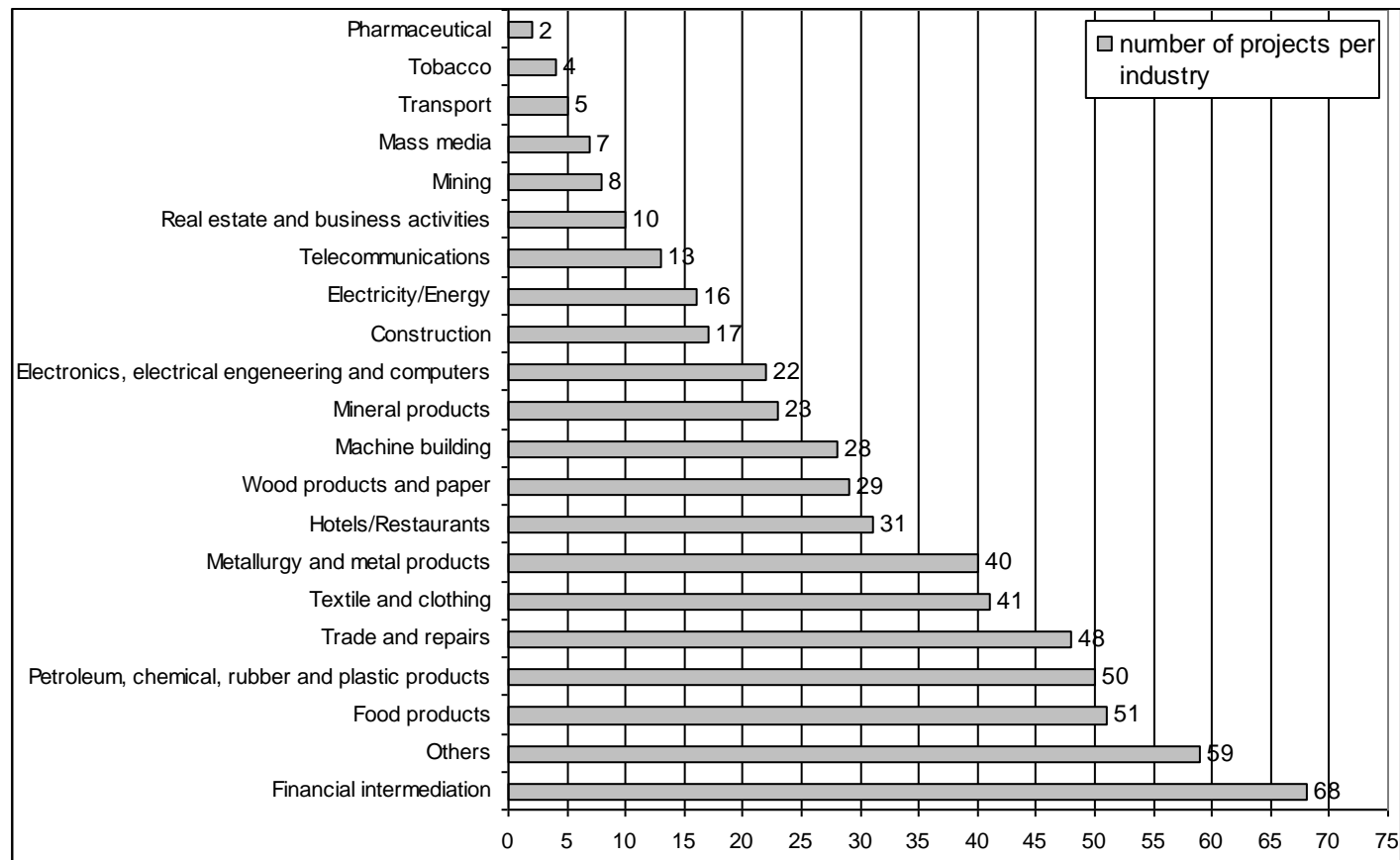
Source: Southeast Europe Economic Forum (2006) and Author calculations

**Figure 2: FDI in Bulgaria as % of GDP/cumulative FDI by year**



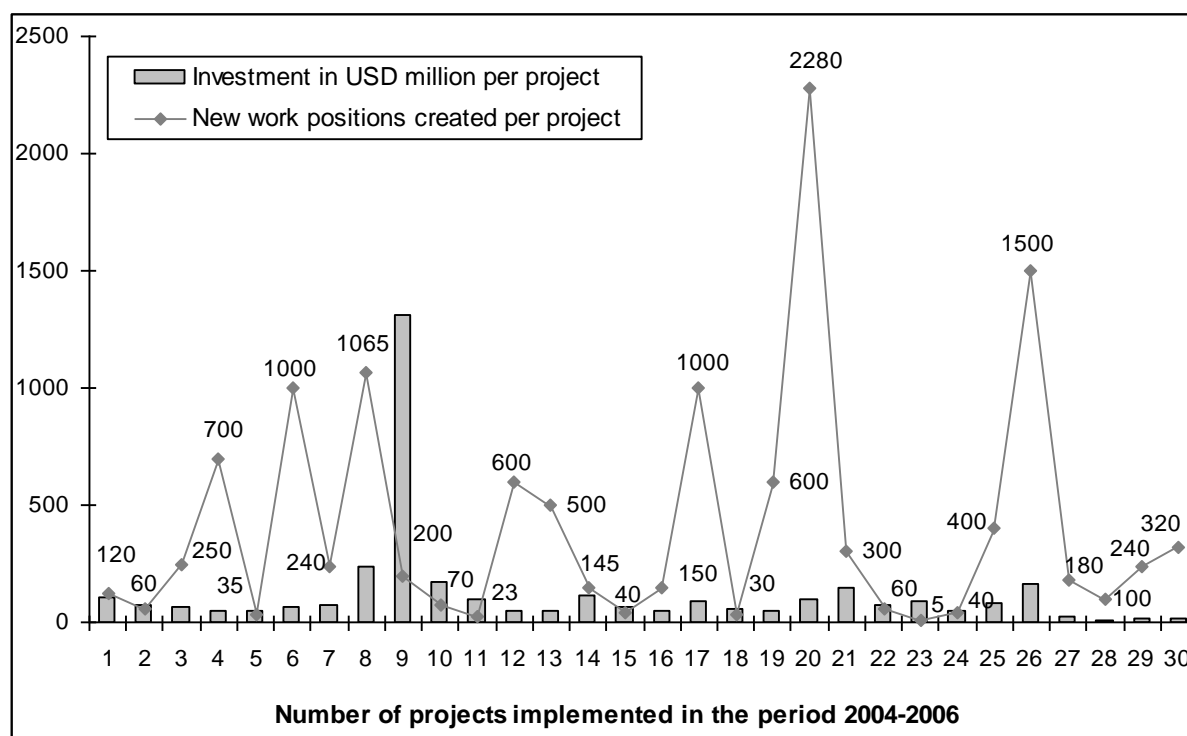
Source: 1998 to 2001: Bank Austria Creditanstalt (2007a); 2002 – 2006: Bulgarian National Bank (2007).

**Figure 3: FDI projects by sectors, 1993-2006**



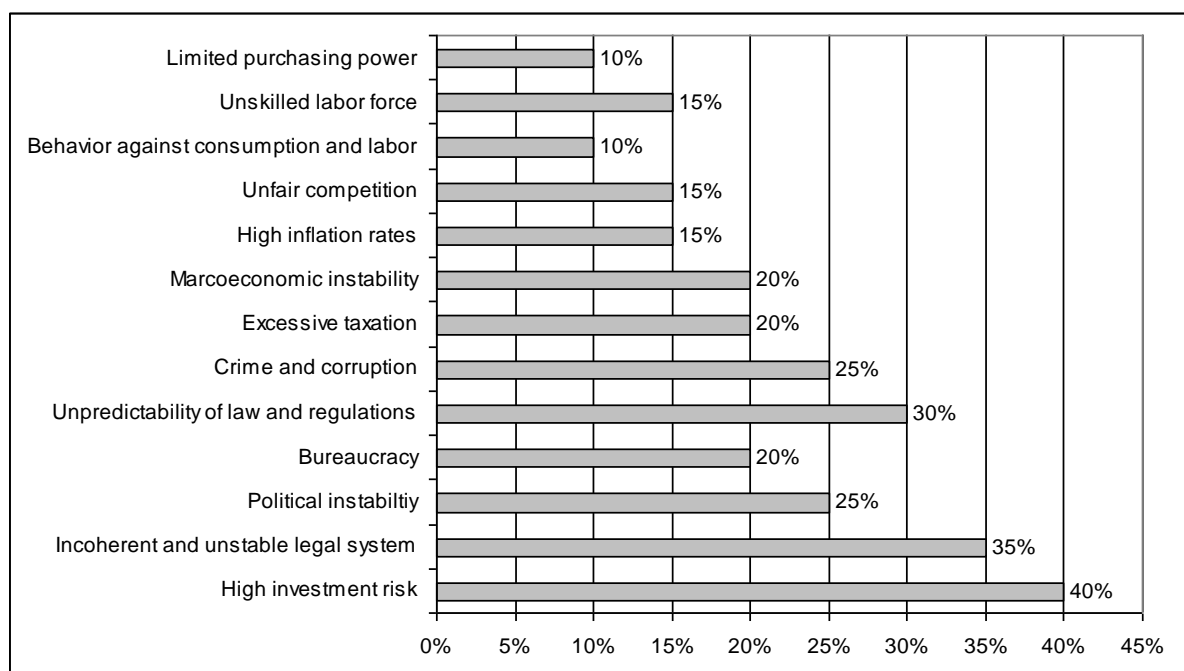
Source: InvestBulgaria Agency (2007d) and Author calculations.

**Figure 4:** New jobs created by FDI projects, 2004-2006



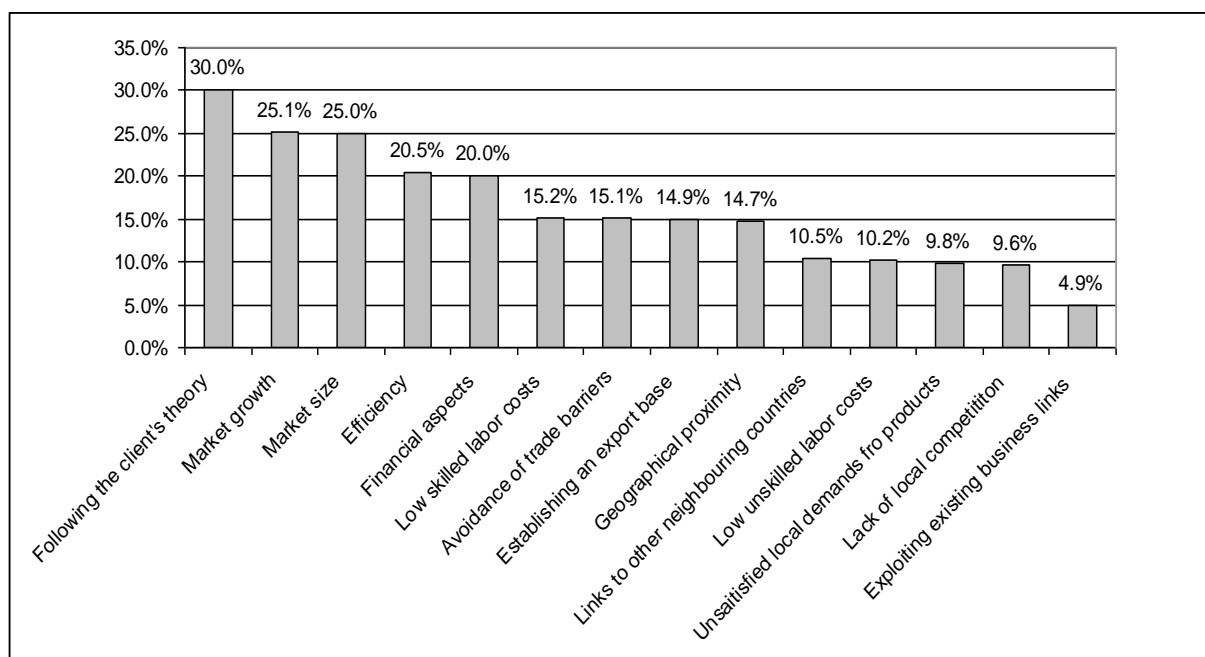
Source: InvestBulgaria Agency (2007d) and Author calculations.

**Figure 5:** Most important entry barriers to FDI inflows in Bulgaria



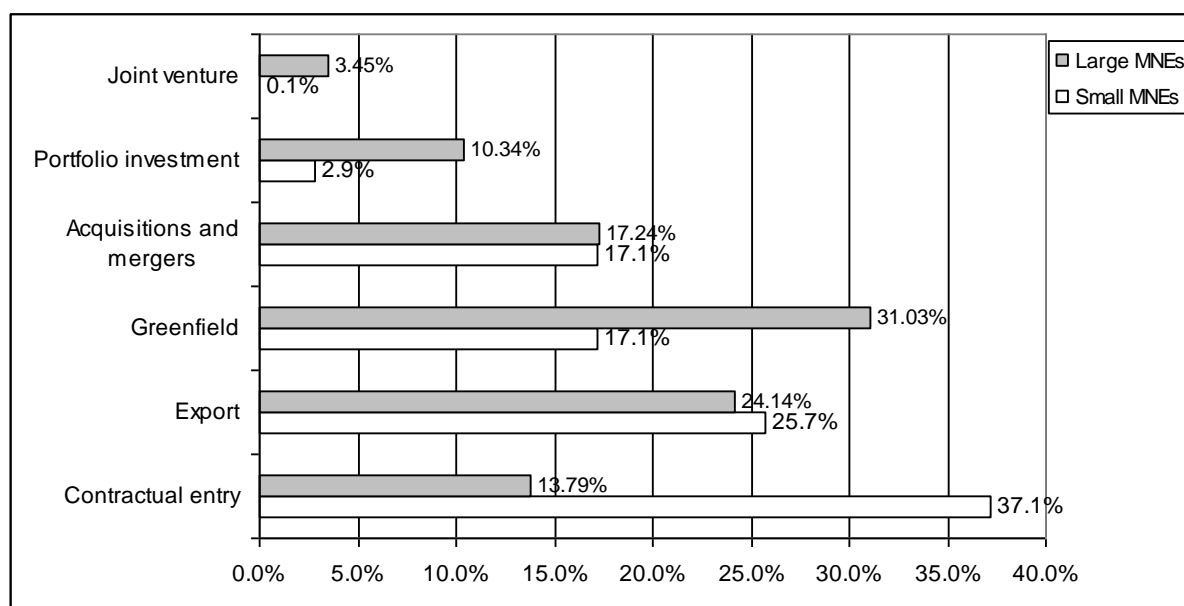
Source: Author's questionnaire research

**Figure 6:** Most important incentives to FDI inflows in Bulgaria



Source: Author's questionnaire research

**Figure 7:** Foreign investors' entry modes into Bulgaria



Source: Author's questionnaire research

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<sup>1</sup> International Monetary Fund (2003), *Foreign Direct Investment Trends and Statistics*, Statistics Department Report, p.6.

<sup>2</sup> Hauser (2005) suggests the usage of country risk indexes as a measure to country risk, whose goal is to offer investors condensed information about the level of uncertainty in host economies. The typical way of constructing an index is the usage of sub-indexes, measuring economic, financial and political risk. This enables the comparison between the levels of country risk in different countries. Damodaran (2003) points out some major pitfalls connected with the usage of indexes, and suggests several ways of measuring the risk premium that a foreign investor would require.

<sup>3</sup> Hauser (2005) has also constructed a model, by which he derives an econometric specification of the investor's decision whether to enter the foreign market at all, and if yes, which mode of entry should be chosen.

<sup>4</sup> In the presence of uncertainty the opportunity of postponing the investment and waiting for additional information could be highly valuable. In this way ownership advantages such as patents would be treated as a quasi-monopoly and allows for delayed investment. Therefore market entry should be expected to occur later.

<sup>5</sup> Blažić and Vlahinić-Dizdarević (2006) find that the horizontal model produces economies of scale for the multinational enterprise and is a major source of its advantage over domestic companies. The same research points out that vertical FDI occurs most frequently between countries with different factor endowments. The stages of production are located in different countries to take advantage of the local resources or different factor prices.

<sup>6</sup> This finding, namely that trade integration is the most significant of all variables, is supported by Deichmann's earlier research (2001), and is explained by the fact that trade and investments complement each other.

<sup>7</sup> Vlahinić-Dizdarević and Biljan-August (2005) find that the most important determinant that had influenced the choice of FDI destination in Southeastern Europe in the period 1996-2003 was the progress in privatization in these countries.

<sup>8</sup> According to Gertchev (2006) the average FDI flows for the period 1997-2004 amounted for 42% of the gross fixed capital formation, which was by far the highest ratio of the whole CEE region.

<sup>9</sup> InvestBulgaria Agency (2006), *Investment Incentives under the Encouragement of Investment Act*, p.1.

<sup>10</sup> At the same time, due to the increased FDI barriers in Bulgaria and in other CEE countries, the EU members decreased their total foreign investments in the period between 2003 and 2004. According to Eurostat Yearbook (2006) by 2004 the FDI inflows from EU countries to the candidate member countries - Bulgaria, Croatia, Romania, and Turkey – amounted to only 3% of all the FDI outflows from the member EU countries.

<sup>11</sup> Another important point here is that through this process the amount of investment does not increase, but just the ownership of the already existing enterprises is transferred to private foreign investors. In addition, the privatized companies have to comply with the Privatization and Post-Privatization Control Act, first voted in 2002, and last amended in 2005.

<sup>12</sup> The total amount of FDI in the region is approximately EUR 60 billion for the period 2001 – 2005, making a threefold increase compared to the previous five-year period (see Southeast Europe Economic Forum, 2006).

<sup>13</sup> See Mateev and Stoyanov (2007), p.6.

<sup>14</sup> See Eurocapital Finance (2006) report, p.4.

<sup>15</sup> We thank to Prof. Colin White for providing us the questionnaire used in this research.

<sup>16</sup> By project we mean the investment made by a foreign MNE in each year of the observation period (1993 – 2006).

<sup>17</sup> As the Ernst & Young (2006) survey shows Bulgaria is still behind most of the European countries in respect to the total number of new job positions created by FDI inflows. In terms of average number of job positions per FDI project Romania ranks first. Among the Southeastern European /SEE/ countries, Bulgaria occupies the second place with 217 job positions per project, followed by Turkey and Serbia.

<sup>18</sup> The foreign investors are grouped in three classes, depending on the investment project's size. The class thresholds are set forth in the Rules on the Enforcement of the Encouragement of Investment Act (2004) as follows: first class - investment over BGN 70 million; second class - investment from BGN 40 million to BGN 70 million; and third class - investment from BGN 10 million to 40 million.

<sup>19</sup> The analysis of results of the survey is based on the answers of 38 respondents (or 29%) out of 132 foreign investors included in the sample.

<sup>20</sup> Each of the factors is ranked on the scale of 1 to 5, where 1 means that the factor is of no importance, and 5 – of great importance.

<sup>21</sup> Usually country risk rating agencies and other providers give political risk component highest weight, followed by financial and economic risk (see Erb, Campbell, and Viskanta, 1996).

<sup>22</sup> The value of 3 serves as a critical test value because according to the chosen rating scale of the relevance of different impact factors this is the point where a factor is neither of high or low significance, it is just one of the many factors to be considered by foreign investors in making foreign investment decisions.



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<sup>23</sup> This complies with Bitzenis (2006b) finding that 33 percent of Greece MNEs that invested in Bulgaria before 2000 had exploited the existing business links with Bulgaria and used their FDI to establish an export base.

<sup>24</sup> See Semkova, B. (2007), p.51.