CONTRIBUTION OF FDI TO THE PRIVATISATION IN THE MANUFACTURING SECTOR IN ROMANIA. SUCCESS AND FAILURE STORIES

MARIA BIRSAN¹, CAMELIA MORARU², ROMANA CRAMARENCO³, STELA ANDREI⁴

ABSTRACT. The aim of the present study is to provide a picture of some aspects concerning the FDI contribution to the privatization process in the manufacturing sector in Romania. First part of the study analyses statistics on FDI presence in different sectors in Romania. Successful or failure cases illustrate different stories in the privatization process. Investigations were made, based on questionnaires, on the situations in 7 large FDI companies in the manufacturing sector. The second part of the study presents findings concerning the impact of FDI on the human capital issues in the respective foreign companies. Given the limited investigated sample, the findings are to be taken as examples, and not to be generalised.

Key words: Foreign direct investments, privatisation, and human capital

JEL Classification: E24, F23, J 24

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Introduction

In most of CEECs, FDI have played an important role in the privatisation of the state sector and, consequently, in promoting the market economy. These countries are generally characterised by many attractiveness reasons for FDI such as comparative lower labour costs, along with educated and skilled labour force, an encouraging fiscal regime as well as other significant promotion measures that are aiming to attract foreign investments. Usually, the ways in which the foreign investors enter these economies are full new investment (green field investment), as participant at the privatisation process (brown investment), and by mergers and acquisitions of already existing private or state owned companies. Regardless the ways of penetration, FDI have certainly had a significant impact on the host economies. Issues such as the impact of FDI on modernization of economic structure and exports, on technology and management skills transfer, the impact on balance of payments, the trade off between FDI and exchange rate etc. were widely examined and debated in the literature in the field.

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In Romania the evolution of FDI has fluctuated because of the slow economic reform: the privatisation of the state sector started later than in the other CEECs; the specificity of privatisation process (mass privatisation) was not favourable to FDI’s participation in the first stage, and the business climate was not encouraging and friendly for many years. (see, Chiritoiu; Dumitriu and Hunya, 2002, Voinea, 2003).

From 1996, the situation has changed, and important foreign investors participated in the privatisation process (ARIS, 2004, p. 5). Even if there is an increasing trend of FDI in Romania, the size of FDI, and the FDI/capita are comparatively placed on a lower position that those existing in other countries in this area, and certainly less than Romania’s needs.

Based on statistics and on various documentary materials, our study presents, in the first part, short comments concerning the FDI orientation on sectors. Two cases – one on metallurgy and the other one in the food sector - illustrate the success and failure in the privatisation process with FDI participation. The second part of the study deals with the results from field investigation concerning the main reasons of investing in Romania, and on human resource issues in a number of 7 foreign companies. The last part presents our conclusions.

1. FDI on economic sectors – Success and failure stories

Statistic investigations made by the National Institute of Statistics and the National Bank of Romania provide us with information concerning the FDI* orientation by sectors in 2003.

<table>
<thead>
<tr>
<th>Economic sectors</th>
<th>% of FDI orientation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>100.0</td>
</tr>
<tr>
<td>Manufacture, out of which</td>
<td>51.8</td>
</tr>
<tr>
<td>- metallurgy</td>
<td>11.8</td>
</tr>
<tr>
<td>- food, drinks and tobacco</td>
<td>9.7</td>
</tr>
<tr>
<td>- chemical industry</td>
<td>8.6</td>
</tr>
<tr>
<td>- transportation equipment</td>
<td>5.3</td>
</tr>
<tr>
<td>- machinery and equipment</td>
<td>4.6</td>
</tr>
<tr>
<td>- textiles and leather goods</td>
<td>4.3</td>
</tr>
<tr>
<td>- wooden goods, including furniture</td>
<td>2.6</td>
</tr>
<tr>
<td>- computers, electrical apparatus, radio-TV, communications</td>
<td>2.2</td>
</tr>
<tr>
<td>- other manufacture sectors</td>
<td>2.4</td>
</tr>
<tr>
<td>Mail services and telecommunications</td>
<td>14.9</td>
</tr>
<tr>
<td>Trade</td>
<td>11.4</td>
</tr>
<tr>
<td>Financial and insurance mediations</td>
<td>9.2</td>
</tr>
<tr>
<td>Services provided to companies (real estate transactions, renting etc.)</td>
<td>6.6</td>
</tr>
<tr>
<td>Other activity</td>
<td>6.3</td>
</tr>
</tbody>
</table>

*FDI as total investments included: social capital; reinvested net profit, net credit

Table 1.
Metallurgy was one of the largest industrial sectors in Romania. As one may see, the metallurgy is one of the top sectors with FDI participation. It was one of the largest industries in terms of production volume and number of employees. Moreover, in many cases, the respective industry provided jobs for almost the entire community where big companies were placed, creating an extremely high economic dependence on one single company. Consequently, any downsizing measure led to social movement on large scale. Anyway, important restructuring was needed, including downsizing. The sector benefited from state aid (write-offs and debt rescheduling) in order to implement restructuring (Atanasiu and Oprescu, 2004). Because of the sector’s size, the overstuffed structures, the inappropriate management and losses accumulated in several years, and because of the large budget drains (black holes), the state-owned companies in the sector were also difficult to privatise, as potential investors were discouraged. Only very strong investors could undertake such huge problems.

During the accession negotiations between Romania and the EU, the state aid awarded to the steel industry was one of the most sensitive issues. Romania has to remove any kind of state aid, including those already stipulated in the privatisation contracts.

The sector also faced huge environment problems, which needed big investment for a real step change. The above mentioned existed in all state steel companies. It also happened in companies like Sidex in Galati, and Tepro in Iasi, which are presented in the following case boxes. So, it is obvious the need for strategic investors and when such investors were missing, the privatisation actually failed (see, CS Resita, which was sold to a very small-sized American company, which was unable to fulfil its contractual obligations, because of cash flow problems (SAR, Early warning report Romania 3/2003, p. 12).
The SIDEX case has been the most important privatisation in Romania. The company is the biggest steel manufacturer in South-Eastern Europe and its production represented about 4% of the national GDP in the year 2001 when the company was privatised; yet, because of inefficient management and wrong market orientation, the company had become one of the biggest "black holes" of the Romanian economy. Among the state owned companies, it had the highest losses and debts; it was also a very important employer at national level - over 36,000 employees by the end of 1996 (www.amadeus.bvdep.com). This situation made the SIDEX case one of the top issues of privatisation in Romania. Even if many questions have been rising around the privatisation process of Sidex, it remained a successful story in the steel industry, as the production has increased, and the downsizing was realised due to the restructuring process and without negative social impact. In 2003, two years after the privatisation, the company has reported a 3,687,980 mil ROL profit before tax (www.amadeus.bvdep.com).

The buyer of the SIDEX was LNM ISPAT (MITTAL STEEL after a merging process in October 2004), one of the major steel manufacturers in the world. The company is known as having important expertise on restructuring state owned big companies, and was involved in privatisation cases all around the world in the steel industry. The ISPAT experts started by cutting costs and changing the marketing strategy. The main changes operated by the new owners of the company were the total withdrawal of the barter system, the renegotiations of all major contracts, development of a network of authorised dealers and investments in technology.

ISPAT avoided social problems associated with the restructuring of the company. The government prevented negative social impact of the downsizing by remittances schemes (including the RICOP, a scheme under the PHARE pre-accession programme). Thus, only 7400 employees left the company, in change of generous social remittances (SAR, 2003, p.29). LNM ISPAT highly invested in technology and restructuring the company - the investments in 2004 reached $ 100 million, from a total of $ 240 million investments since 2001 (Adevărul economic, nr. 48 (658), 1-7 Dec 2004). However, the generous facilities and incentives from the state made the privatisation a good business for ISPAT (facilities regarding VAT exemptions for acquisitions, the transformation of state debts into shares, a three-year postponing for paying the employees' social contributions to the state). The EU-Romania negotiation results regarding competition will probably lead to the re-negotiation of the initial privatisation contract regarding the indirect subsidies – which will cover the entire steel industry. The national strategy for the metallurgy sector also stipulates the downsizing of the major companies, the most affected being SIDEX ISPAT (www.rri.ro).

Despite of the above-mentioned shortcomings, what makes ISPAT a 'happy story' of privatisation? First of all, because the investor succeeded to “save” a company which otherwise would be damned to death. The technology has been improved, and the environmental standards strengthened. The productivity increased, and there were no significant employment problems. The company succeeded to reverse the trend of increasing annual losses, and to become profitable (Sursa www.amadeus.bvdep.com.). Therefore, the company is going to contribute to the state budget.
**Box 2**

SC TEPRO SA IASI is a Romanian company operating in the metallurgy industry, one of the industries facing huge problems after the collapse of the communist regime. The company’s main products are longitudinally welded steel tubes, cold-formed profiles, steel guardrails for highways and other types of roads.

In 2001, the Authority for Privatisation and Management of State Ownership (APMSO, later called APAPS and now AVAS) informed on the opportunity to invest in TEPRO. At that moment, the company’s situation was quite dramatic because the financial debts and the stock of goods kept on growing, the number of employees decreased constantly (fortunately that led to the increase of labour productivity) and the demand of metallurgical products was reducing, both on the external and internal market. After four unsuccessful auctions, the chosen privatisation method was the direct negotiation with the Czech company **ZELEZARNY VESELY**, instead of privatisation through the capital market. The most criticised aspects of that method were: the total assets were under-evaluated, the negotiation process lacked transparency (the trade unions and the shareholders claimed that they hadn’t seen the Czech offer), the Evaluation Commission assessment methods were questionable and the post-privatisation conditions didn’t include the necessary provisions regarding the lay off policies. Even if another company, respectively **PAS-Privat TEPRO IASI** (an association of no less than 3053 employees from TEPRO who chose to buy an important part of the company’s stock) was offering a similar price/share, they were turned down and the Czech company was preferred.

According to Gabor Hunya (2000, p.31) „the investor did not fulfil its contractual obligations: no investment has been made, the equipment was exported as scrap metal, more than agreed number of employees has been laid off”. Finally, the conflict was solved by the Romanian Supreme Court of Justice, which considered the contract null and void. The Supreme Court’s decision meant that the partners of the contract were to step back to the situation before contract: APMSO gets back the 51% of the shares and **ZELEZARNY VESELY** gets back the money invested (Ovidiu Nemteanu, Ziua de Iasi, March 11/2005). The media got also involved by running many investigations that revealed some controversial aspects - APMSO was accused of postponing the enforcement of the contract nullification until the general elections and the failure of this privatisation was unfortunately connected to the death of Virgil SAHLEANU (the former union leader). The attempts of the APAPS to elude the payments to the Czech company finally cost the Romanian government over 1,2 million dollars (Ovidiu Nemteanu, idem).

Later on, the company was taken over by LNM Holdings NV from India, now renamed **Mittal Steel** (the company has 74% of the company’s stock), which also invested in Sidex Galati.

The case of **SC TEPRO SA IASI** revealed the difficulties of the privatisation process, especially the impact of delays. The labour force was strongly affected by the lack of a coherent strategy regarding the lay offs and the remittances offered to the employees.
Another sector that attracted the interest of FDI was the food sector. Initially, food and drinks sector lagged behind, as the companies (usually state-owned) were overstaffed, had low productivity, and lacked the necessary equipment to respond to the market and to EU quality standards. The agro-food industry attracted many FDI, both greenfield and brownfield investments (according to the National Bank of Romania, the FDI in food industry represents 9.7% of the total FDI in the manufacturing industry, on the second place after the metallurgy industry with 11.8%). Many important foreign investors in Romania operate in the food industry (beer manufacturers, soft drinks manufacturers, diary producers and sweets manufacturers). Among the top 100 foreign investors in Romania there are: Interbrew Central European Holding (Netherlands), Sucre-Est Developpment SA (France), Efes Breweries International BW (the Netherlands), SABMiller(USA) - Ursus SA – now, Compania de Bere România, Coca-Cola HBC Romania, Kraft Foods International (USA). Many companies in the food-industry are almost 100% oriented towards the domestic market. Contrary to the general perception, the opinions of some important investors (Compania de Bere România SA (beer production, privatisation), Kraft Europe (sweets and similar products, privatisation) and Dorna Lactate SA (diary products - part of Natural Dorna Investment Holding SA, greenfield) revealed that the labour costs and the quality of the labour force do not represent the main reasons for investing, and reasons such as the Romanian market opportunities and raw materials availability (for the diary products) prevailed. They highly invested in technology improvement. The competition in this sector became quite strong, due to the entrance of the multinationals. Since the sector was overstaffed, the number of employees was reduced, mainly because of structural changes. The foreign company Kraft Romania represents one interesting successful experience in this sector.

2. Findings from field investigations

2.1. Methodology
The empirical investigation was made using a questionnaire (see the Annex) that had close and open questions. The questions were grouped as to provide exact information about the company, but to reveal also the perception on several business climate aspects they operate on. The sample of companies was selected according to the companies’ size – 7 companies from top 100 foreign investments – and to the availability to respond to the questions as well. We are grateful to these companies for cooperation. Since the selected companies belong to few sectors, they do not illustrate the opinions in the whole economic spectrum and has to be taken only as examples. Extended investigations are certainly needed in order to have statistically relevant findings concerning the FDI impact on economic sectors. The investigation has been made during February-April 2005. Since the legislation is changing (e.g. Amendments to the Labour Code), certain aspects in the companies’ answers might be different after several months. We kept the answers as made in the while of investigation.
The seven companies that have been interviewed for illustrating foreign investments in Romania are: Dorna Lactate SA (Societe Generale Romania Fund), Compania de Bere România (Ursus SA – SAB Miller); Celestica SA (Celestica), Kraft Foods România (Kraft Foods International), Reromar, Rondocarton (Ganahl), Dunapak (Dunapak). Three of them are green field investments, and four are brown field investments. All the companies involved in this study have very high foreign capital share (over 90%); this situation offers the investors increased control over the company, leading to higher motivation for company development. With one exception, all investments (green-field and privatisation) had been made before 2000. The
companies come from four different industries - agri-food, electronics, footwear manufacturing and package manufacturing- and their answers illustrate not only the company’s situation, but the sector specificity as well. The investors show a very clear orientation towards domestic or external market, (over 90% of their production is oriented either towards domestic or external market). The companies generally perceive the market in their industry as more and more competitive, compared to the moment of the investment. With one exception (from the footwear industry), all the investors declared their intention to expand their business in Romania.

2.2 Main reasons for investment

According to companies’ answers, the most important reasons for investing in Romania are the quality of the labour force and the low labour costs. The market situation and perspectives represent the second important reason for investing in Romania, for the interviewed investors.

For most of the interviewees, the FDI legislation and the legal framework generally encourage investments, but it represents only a necessary background for an attractive business environment, as the comparative advantage cannot be based on state incentives.

The low labour costs are considered as a main advantage, but only corroborated with the quality of the labour force, as the expected employment needs of the investors regard medium and highly skilled labour force, especially in the context of business expansion in Romania. This opinions support the assumption that the expected EU accession of Romania in the next years will probably not lead to massive new relocation of the investments in countries with lower labour costs (maybe, excepting the very labour intensive sectors such as textile). One investor mentioned that he employed over skilled staff for certain lower positions (he hired university graduates for medium level positions. The employees were motivated by higher wages). This finding supports our assumption of foreign companies paying higher salaries than domestic ones.

2.3 Human resource development within the companies

2.3.1 Job creation/Job reduction

Following the general rule (Zaman, 2004 p. 6) downsizing would have emerged due to structural changes in privatisation cases. All Governments were very concerned about the social impact. Therefore, many privatisation contracts stipulated the investors’ commitment to maintain a certain number of employees. The investigated companies avoided to refer to specific stipulations concerning the employment commitment in the privatisation contracts.

2.3.2 Employment requirements

Most investors require mainly medium qualified employees; with one exception, no investor has an important share of low-qualified labour force. In the privatisation cases, regardless the present shares of qualifications, the investors
appreciate a future need of medium and highly skilled labour force. In the greenfield cases, the medium skilled labour force represents the main future employment need. We may conclude that the general need for labour force will target more skilled groups than in present.

2.3.3 Employees’ age and sex
The most important age group is represented by 25-34 years old segment. The people over 45 often face difficulties in getting a job, in spite of some incentives provided by the law in order to facilitate the employment of long term unemployed people.

Concerning the gender structure of employment, this is very much linked to the type of sector. Traditionally, certain sectors employ mainly male or female. However, we have noticed that sectors like agro-food industry have very diverse employment structures, despite the traditional employment policies with high share of female employees. Explanations might be the changes in terms of technology endowment, and re-allocation of labour force on the local market, in the context of very low mobility between regions.

2.3.4 Local labour force
All the companies have a strong majority of Romanian employees in executive positions. This is a very important finding, as it highlights, firstly that they came for the quality and the comparative labour lower cost; secondly it also shows the long-term perspective of the investors, who did not come for a temporary de-localisation, motivated by cheap labour force, but mainly because of their high confidence in the employees’ skills level and capabilities.

2.3.5 Working conditions
Three companies made clear reference to the improvements of the employees’ working conditions such as:
- safety equipment (2 companies)
- production equipment and machinery (1 company)
- canteen (2 companies)
- sanitary facilities (3 companies)
- wardrobes (3 companies)
- fitness facilities (1 company)
- health insurance (1 company), as indirect income incentive

2.3.6 Human Resource Development
With one exception, all investors offer training programmes for employees, both in executive and operational positions. The training programmes take place in Romania as well as abroad (or only abroad). These findings reveal a strong and real interest of the investors in human resource development (at all levels), as well as know how transfer, given the fact that all of them offer training programmes abroad for the Romanian employees.
2.3.7 Contracts

Full time contracts are the main employment option for all companies. Part-time contracts remain only the exception, as a result of the stipulation in the present Labour Code. According to EU Commission evaluation (European Commission, 2004), the share of part-time contracts in total contracts is only 5% in Romania. From this point of view, the investors fully adopted the general trend in Romania, regarding the types of contracts.

2.4. Productivity

All companies stated that the productivity increased, compared to the moment of the investment. The main factors that led to the productivity increase are the new technology and working condition improvements. All the answers mentioned both factors; the two-privatisation cases mentioned the restructuring process as one cause of the productivity raise.

A very interesting differentiation has emerged between the privatisation and green field cases regarding human resources development and motivation programmes. The first category obviously transferred the employees’ involvement strategies and practices from the parent company. The two cases studied showed comprehensive and coherent programmes including:

- Identification of personal objectives in the objectives of the company.
- An open performance analysis system (including information, self-assessment and constant feedback)
- Support for innovation
- Training programmes

In the green field cases, only one company answered to the question, mentioning non-financial incentives based on performance.

2.5. Law

Regarding the social contributions legislation, almost all investors perceive them as an obstacle to job creation. These answers should be considered taking into account the high level of social contributions in Romania, compared to European average. It is noticeable that only in the privatisation cases, the interviewed foreign investors made comments on this issue. They also made recommendations regarding the necessary amendments to the Labour Code in order to provide the labour market with more flexibility. We mention aspects such as: the obligation of wage guarantee fund should be removed, duration of weekly average working hours should be 48, instead of 40; the hiring and firing conditions should be more clearly stipulated for both parts; trade unions should not interfere with production organisation; bureaucracy should be reduced; training should be encouraged; change of unclear regulations regarding the fulfilment of the contract provisions.
2.6. Policy recommendations

In a few privatisation cases, the investors made comments regarding the FDI law and policy. Their recommendations concern the following issues:

- Corruption
- Fiscal facilities
- Encouragement of labour force flexibility
- The upgrade of the methodologies on the law implementation
- Differentiated facilities for FDI based on national strategic priorities
- Incentives for capital reinvestment, regardless of its origin (domestic or foreign)

The European integration is generally perceived as having a positive impact on FDI. The remarks on this issue regarded:

- The improvement of employment rate and skills of the labour force
- The increase of export opportunities, especially due to customs tax reduction
- The improvement of FDI opportunities on medium term

Conclusions

There were various experiences with FDI participation in the privatization process. However, FDI certainly represents an important contributor to the economic development in Romania, and to the human resource development as it resulted from our field investigation. We may mention the importance of foreign best practices transfer in the field of working conditions, training and development, or organisational culture.

Along with technological change, it is expected an increase of the productivity level and, accordingly, of the wage level; therefore, the differential wage gap is a temporary factor of attractiveness for FDI.

In order to keep the FDI interest, other factors must be emphasised in promotion measures such as attractive business environment, law stability, better infrastructure, corruption reduction.

The education system has to enforce its links with the business environment to respond better to the market needs (see the findings concerning the companies’ intention to hire more medium and highly skilled workers), and to the future EU labour market.
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Annex

Questionnaire for foreign investors:

1. General information about companies:
   1.1 Your company:
      a) Has taken over a Romanian company
      b) Developed a business in Romania
   1.2 What is your company?
      Subsidiary of a parent company
      De-localization of a foreign company
   1.3 Which is the capital share in your company? (%)
      a) Romanian capital.....%
      b) Foreign capital ......%
   1.4 When did you take over/start your business?
      .........................................
   1.5 Which industry do you operate in?
      ............................................
   1.6 Which is the destination of your production? (%):
      a) External market ........%
      b) Domestic market ......%
   1.7 Please, mention the technological level of your company?
      a) low
      b) medium
      c) high

2. Reasons for investment
   2.1 Please, rank, in order of importance, the main reasons for investing in Romania (1- the most important, 5 – the least important).
      a) Quality of labour force(Qualification level, foreign language
         PC skills, etc)
      b) Wage level
      c) Market dimension
      d) Market perspectives
      e) Fiscal regime
      f) FDI legislation
      g) Future EU accession
      h) Natural resources availability
      i) Others. Please, specify
3. Competition and market
3.1 Do you perceive the competition on the market has increased since the moment of your investment?
   yes
   no
3.2 How do you appreciate the competition in your sector?
   strong
   weak
   absent
3.3 Which are your main competitors?
   multination
   large Romanian companies
   SMEs
3.4 Please, describe your company’s strategy for the future in Romania?
   expansion
   maintenance
   downsizing
3.5 Please mention the number of your Romanian sub-contractors

4. Human resources
4.1 If your investment was the result of a privatisation contract, did it state any requirements regarding the number of employees
   a) yes
   b) no
4.2 How has the number of employees changed?
   a) increased
   b) decreased
4.3. How would you explain the increased number of employees (if the case)?
   a) Activity expansion
   b) Structural changes
   c) Others: please, mention
4.4 How would you explain the increased number of employees (if the case)?
   a) Activity reduction
   b) Structural changes
   c) Leavings upon employees’ request
   d) Lay-offs
4.5 Please, mention the structure of personnel by qualification (%)
   Low ...............%
   Medium ..........%
   High .............%
4.6 In the future, which qualification(s) will be mainly required by your company?
   a) low
   b) medium
   c) high

4.7 Please, mention the structure of personnel by age (%)
   a) Under 24 year ..........%
   b) 25-34 year .............%
   c) 35-44 year...............%
   d) 45-54 year ............%
   e) 55 and over ...........

4.8 Please, mention the structure of personnel by sex (%)
   a) male ...........%
   b) female ..........

4.9 Please, mention the structure of personnel by category (%)
   a) Operational ........%
   b) Executive ..........%

4.10 Which is the share of Romanian employees in executive positions (%)
     ........%

4.11 Which is the share of Romanian employees in operational positions (%)?
     ........%

4.12 Please, mention some measures taken by your company for the improvement of working conditions

4.13 Do you provide training programmes for your employees?
   a) yes
   b) no

4.14 Which category of employees is included in these programmes?
   executive
   operational

4.15 Location of training programmes:
   in Romania
   abroad

4.16 Please, mention the share of the market contracts?
   a) Part-time ........%
   b) Full-time ..........%

4.17 How would you appreciate your company’s relationship with the trade unions?
   a) Very good
   b) Good
   c) Satisfactory
   d) Unsatisfactory
5. **Productivity**

5.1 Did productivity increase since the moment of the investment?
   a) yes
   b) no

5.2 If yes, please mention the causes:
   a) restructuring
   b) new technology
   c) improvement of working conditions
   d) others

   Please, specify a few methods of increasing the commitment of your employees:
   ........................................................................................................................................

6. **Legal framework and FDI promotion**

6.1 Do you consider the present level of social contributions as a barrier against job creation?
   yes
   no

6.2 The new Labour Code was adopted in 2003. How do you appreciate it?
   a) Very good
   b) Good
   c) Satisfactory
   d) Unsatisfactory

   Please, comment
   ....................................................................................................................

6.3 How would you appreciate the FDI legislation?
   encouraging
   discouraging

   Please, comment
   ....................................................................................................................

6.4 How would you appreciate the impact on FDI of Romania integration into the EU?

   Please, comment.

Thank you

**Name and position of the interviewee**

Date

Signature and stamp