

Uncovering the Attractiveness of the Romanian Market: A Data-Driven Approach

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Abstract

The purpose of this study is to examine the elements that strengthened market attractiveness in Romania, between 2000 and 2022. To fulfil this, we considered a selection of variables upon which we carried out a Principal Component Analysis that allowed to underline the factors associated with Romanian market attractiveness.

After exploring the correlation between Foreign Direct Investment, Gross Domestic Product, Labor Force Participation Rate, Logistics Performance Index and Political Stability, the PCA unveiled five components, with the first two accounting for 83.01% of the total variance in the data. Formulated on the initial variables' loadings on these components, FDI, GDP, LFPR, LPI, and POLSTABILITY appear to be significant factors that promoted market attractiveness in Romania.

Still, a more in-depth analysis and interpretation of the data is required to fully comprehend the factors that make attractive the Romanian market.

Key words: principal components, economic growth, investment, employment, market structure

J.E.L. classification: C38, O47, E22, E24, L11

1. Introduction

Over the past few years, the Romanian market has been transformed a lot due to economic reforms and becoming a member of the European Union (EU). All these were seen as real opportunities for both local and international investors.

A recent report from 2022 by the Bureau of Economic and Business Affairs from U.S. Department of State reveals that Romania is among the most rapidly developing markets in the EU, and still having a growing consumer market. The report also highlights the positive impact of Romania's EU membership, strategic location and well-educated workforce on trade and investment, pointing at the same time some issues as legislative instability, corruption, or low institutional quality.

A crucial component of the Romanian market, the retail sector, has seen a significant development in recent years. It contributed for 21.3% of the country's GDP (first half 2023 vs. first half 2022) and has been growing steadily over the past decade, as seen in a statement of the Romanian National Institute of Statistics. Increasing incomes, urbanization, and the evolution of consumer tastes and preferences were drivers for this expansion.

Another noteworthy player in the Romanian market is the thriving IT industry. According to the same statement, the IT sector is among the fastest-growing sectors in the country, with a 7.5% contribution to the country's GDP. With its proficient labor force, advantageous business climate, and competitive costs, Romania has successfully lured considerable foreign investment into its thriving IT field.

Meanwhile, the country's automotive market remains significant, boasting major industry players like Dacia and Ford, both operating large manufacturing plants within its borders. The industry's significant impact can be seen in the percentage of 10% of the country's GDP, making it a driving force for its economic growth in recent years, as seen in 2019 Annual Report of the National Bank of Romania.

Undoubtedly, Romania's bustling market presents promising prospects for local and international investors, particularly in the retail, IT, and automotive domains. The nation's conducive business climate, expansive pool of consumers, and advantageous geographical position make it a highly appealing choice for investment and enterprise development.

When talking about attractiveness, is difficult to point out exactly what needs to happen to “make it attractive”. Some may think of the strategic location, or the membership in the EU, others to consumption, or how favorable is the business environment and how many industries that country has, or simply at the qualified workforce or the low labor costs.

So, considering these factors as stand-alone might make the research more difficult, that's why a combination of those can be a better option. This combination can make the Romanian market an attractive destination for investment and business expansion, particularly for companies looking to access the rapidly growing markets of Central and Eastern Europe.

In this paper we will try to identify the underlying factors that contribute to the attractiveness of the Romanian market, taking into consideration several factors simultaneously, using Principal Component Analysis (PCA).

2. Theoretical background

The literature is vast when underlying the attractiveness of a market for foreign investment and business expansion and Romania's market has been an attractive destination for investments for several years.

It is a fact that foreign direct investment (FDI) has been a key driver for economic growth and development, the majority revealing a strong and positive correlation.

A study conducted on 42 G20 countries from 2005 to 2020 revealed that institutional quality positively influences FDI inflows, making the market attractive, increasing trade openness, and fostering industrial innovation. The role of institutional quality in FDI inflows is seen more in financial development and in the abundance of natural resources, while the tax level diminishes the inflows of FDI (Chen *et al*, 2023).

The direct relationship between FDI and institutional quality is seen in other works, too. For instance, a study conducted on 13 Organization of Islamic Cooperation (OIC) countries between 2002 – 2019 showed that the better the regulatory quality is, the higher the FDI are (Al Mustofa *et al*, 2021). In addition, they emphasized that GDP is strongly influenced by the proportion of FDI inflows, although corruption can play a huge role in increasing foreign investments.

Various factors play a significant role in the economic growth of a nation, along with direct investments. These may include inflation rates, unemployment levels, and the strength of the financial system (Siriteanu, 2022). So, Romania's low labor cost and favorable investment climate helped to attract a relatively large number of investors that contributed to job opportunities, knowledge transfer, and increasing competition in the domestic market. In addition, it was revealed that the level of human capital, technological development, and direct investment policies can influence the relationship between direct investments and GDP.

Authors also showed that, in the long run FDI inflows is influenced in a negative manner by the trade openness of Romania between 1997 – 2019 (Rathnayaka Mudiyansele *et al*, 2021). It is also suggested that fostering innovation and creating a stable political and economic environment increases the flow of FDI. At the same time, FDI increases more when the domestic currency depreciates, creating more wealth for the foreign investors compared to that of domestic ones. The research doesn't include other variables that can significantly influence FDI inflows and the attractiveness of Romanian market, like infrastructure, political stability, or wage rate.

GDP growth rate is another variable that should be considered by an investor to make a profitable investment (Tatomir *et al*, 2011). Researchers identified a framework of macroeconomic indicators that can help the foreign investors to easily choose Romania as an attractive market. The inflation rate and industrial production are other factors to be analyzed.

One major factor that greatly enhances the attractiveness of Romania's market is the caliber of its workforce. While Romania's income per capita has seen a rise in recent years, there remains an uneven economic growth hindered by ineffective institutions, unfavorable demographics, and insufficient human capital. Additionally, experts highlight competitive markets and a skilled and educated labor force as key factors driving future growth in Romania (De Rosa, 2020). Labor force is also seen as a significant impact on economic growth, leading to an increase of welfare (Wijaya *et al*, 2021).

The logistic component was found to have a direct and significant impact on economic growth and employment rates in the EU-27 countries, mainly in 2020, during COVID-19 pandemic (Karazijienè *et al*, 2023). The study analyzed a positive correlation between economic growth and employment level and transport infrastructure expenses by road and railway.

Studies also showed a high correlation between the development of logistics and the overall development level of a country. Besides other former communist countries, Romania is far from other developed countries, as seen in this research paper about logistics performance and economic development, at EU28 level (Bîzoi *et al*, 2014). In the case of Romania, the low level of GDP per capita, lead to a low logistic performance.

A crucial role in driving economic growth, being at the same time vital for sustainable development in Romania is played by political stability (Radu, 2015). To alleviate poverty, boost employment opportunities, and uplift the standard of education in the nation, a secure and steady political atmosphere is crucial.

Not all the factors are examined at the same time, but each of the studies offer significant data regarding the relationship between them and how this can make the Romanian market attractive.

The Romanian market has been consistently depicted as a highly appealing choice for foreign investment and business growth. This is largely due to its strategic location, favorable business climate, European Union membership, proficient labor force, cost-efficient workforce, and varied economy. Despite these advantages, the literature also points out certain obstacles and potential for enhancement, including concerns about regulatory consistency, corruption, and infrastructure development.

3. Research methodology

The methodology used in this study involved analyzing the factors that contribute to market attractiveness in Romania. For this, we conduct a Principal Component Analysis (PCA) on a set of five independent indicators to point out the factors that most influence the attractiveness of the market. The five chosen variables were: Foreign Direct Investments, net inflows (FDI), Gross Domestic Product growth (GDP_g), Labor Force Participation Rate (LFPR_r), Logistics Performance Index (LPI) and Political Stability (POLSTABILITY). We gathered all the data from 2000 to 2022 from the World Bank Database.

Foreign direct investments, net inflows (FDI) measure the amount of investment capital flowing into the country from foreign sources. High levels of FDI can indicate a favorable business environment and potential opportunities for growth. Data are in current U.S. million dollars.

GDP growth, annual % (GDP_g) is the percentage change in real GDP from one year to another.

Labor Force Participation Rate (LFPR_r) is the proportion of population over 15 years old that is economically active. So, the higher the rate, the more productive the workforce, so better chances for business growth.

The Logistics Performance Index (LPI) assesses the quality of logistics infrastructure and its impact on market attractiveness. It refers to the perception of a country's logistics related to 6 variables: the efficiency of customs clearance process, quality of trade and transport-related infrastructure, ease of arranging competitively priced shipments, quality of logistics services, ability to track and trace consignments, and frequency with which shipments reach the consignee within the scheduled time (World Bank, 2023). The index gets values from 1 (worst) to 5 (best).

For this analysis we used data from the 2023 survey conducted on 4,090 country assessments by 652 logistics professionals in 115 countries in all World Bank regions.

Political Stability (POLSTABILITY) assesses the degree of political instability and/or violent conflict (including terrorism) in a country. This index ranges from -2.5 to 2.5 and it’s more like a perception measure. All the values were taken from the World Bank – Worldwide Governance Indicators (WGI) database.

The PCA identified the underlying structure of the data and created new variables (components) that capture the most important information in the original variables. The loadings of the original variables on the components were used to determine the most important factors that contribute to market attractiveness in Romania.

Additionally, a literature review was conducted to inform the selection of variables and guide the interpretation of the results. By combining these methods, the study aimed to provide new insights into the factors that contribute to market attractiveness in Romania.

4. Findings

Based on the data collected from 2000 to 2022, shown in Table no. 1, we used Eviews 12 to first calculate the descriptive statistics (mean, standard deviation, Skewness, and Kurtosis for the shape of the distribution) to better understand the distribution of the data and to find different outliers or issues that may affect our analysis.

Table no. 1 Independent variables that show the attractiveness of Romanian market

Year	FDI	GDP_	LFPR_	LPI	POLSTABILITY
2000	1037	2.461263459	64.41	-	-0.379039526
2001	1157	5.218136257	63.18	-	
2002	1144	5.70299165	57.77	-	0.464840323
2003	1844	2.341147329	55.93	-	0.320030123
2004	6443	10.42811302	55.6	-	0.059348613
2005	6498.650463	4.668148051	53.94	-	0.085602649
2006	11006.61484	8.028811076	54.97	-	0.148430079
2007	10103.08651	7.233807744	54.77	2.91	0.198067933
2008	13667.82424	9.307467171	54.51	-	0.180609092
2009	4637.68488	-5.517394408	54.44	-	0.359366298
2010	3213.737652	-3.90123628	54.87	2.84	0.273600399
2011	2370.097223	4.517086964	54.11	-	0.186090663
2012	3047.569714	1.924993262	54.61	3	0.082341559
2013	3854.819398	0.269963879	54.53	-	0.179133072
2014	3869.197075	4.120674963	54.87	3.26116	0.049136128
2015	4317.731472	3.16050387	54.54	-	0.181799337
2016	6252.035766	2.857546057	53.72	2.99312	0.266823202
2017	5952.909608	8.196506503	54.94	-	0.048513539
2018	7343.560129	6.029019041	54.98	3.12	0.036215875
2019	7365.441774	3.853163833	55.14	-	0.54217118
2020	3602.418172	-3.677510791	55.06	-	0.508895397
2021	11738.21741	5.708894558	51.07	-	0.581680298
2022	11882.52585	4.595360946	52.102	3.2	0.48802197

Source: (World Bank Database)

The mean GDP is 3.81 and its standard deviation is 4.06. The negative value of Skewness suggests that the distribution is leaned to the left. The kurtosis is positive, indicating that the distribution is more peaked than a normal distribution. For FDI the data is positively skewed, and the distribution is longer on the right side. The kurtosis is close to 3, so this implies a distribution close to normal. In the case of LFPR_ the distribution is also longer on the right (skewness = 2) and very peaked (kurtosis is very high). For LPI, the mean is 3.05, its standard deviation is 0.15, the distribution is close to normal (low skewness and kurtosis). Lastly, the data for POLSTABILITY show a left skewed and peaked distribution.

Table no. 2 Descriptive statistics 2000 - 2022

	GDP	FDI	LFPR	LPI	POLSTABILITY
Mean	3.81	5754.31	55.39	3.05	0.22
Median	4.52	4637.68	54.87	3	0.18
Maximum	10.43	13667.82	64.41	3.26	0.58
Minimum	-5.52	1037	51.07	2.84	-0.38
Std. Dev.	4.06	3748.89	2.93	0.15	0.22
Skewness	-0.73	0.63	2.00	0.12	-0.47
Kurtosis	3.17	2.32	6.92	1.71	3.83
Observations	23	23	23	7	22

Source: (Eviews 12, own calculation)

To sum it up, the descriptive statistics suggest that the data for the five indicators have different distributions and levels of skewness and kurtosis: the LPI data is close to normal, while the LFPR_ data has a very high kurtosis and is heavily skewed.

There is a high variation in GDP and FDI data (GDP_ ranges from -5.52 to 10.43, and FDI from 1037 to 13667.82), so this could affect the analysis. Except for the GDP_, all the median values are lower than the mean values, so we can predict that the distribution is right skewed, suggesting that there are extreme values that influence the mean. Since the values for kurtosis are higher than 3 (GDP_, Postability), the distribution is more peaked than normal, so, there are still some factors that influence the data.

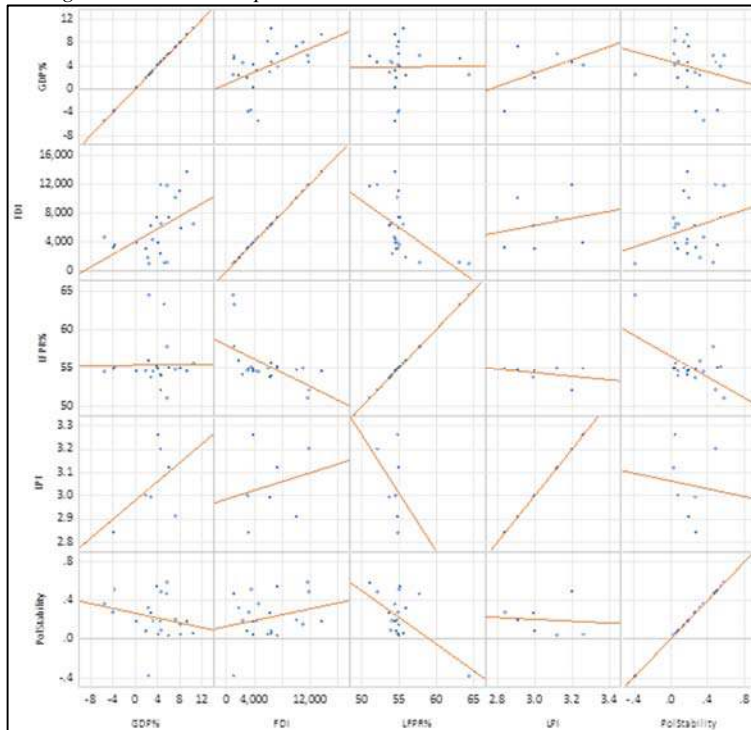
Before using these indicators for principal component analysis (PCA), we need to standardize the data (subtract the mean and divide by the standard deviation), so that each variable has equal weight in the analysis. In this way, the principal components are based on the correlation structure of the variables rather than their absolute values and the variables with larger values will not significantly influence the analysis.

To visualize the relationship between all 5 independent variables and to identify any strong relationships or any nonlinearity or multicollinearity, we created the scatter plot matrix.

The scatter plot matrix shows a linear relationship between the variables.

A correlation analysis was conducted to determine the strength and direction of the relationships between the analyzed independent variables. Correlation does not mean causation, so, other factors may influence the relationships between the independent variables.

Figure no. 1. Scatter plot matrix



Source: (Eviews 12, own calculation)

Table no. 3 Correlation matrix

	FDI	GDP_	LFPR_	LPI	POLSTABILITY
FDI	1.000000	0.658037	-0.634478	0.213925	0.579897
GDP_	0.658037	1.000000	-0.129325	0.482150	-0.171475
LFPR_	-0.634478	-0.129325	1.000000	-0.342308	-0.852023
LPI	0.213925	0.482150	-0.342308	1.000000	-0.089107
POLSTABILITY	0.579897	-0.171475	-0.852023	-0.089107	1.000000

Source: (Eviews 12, own calculation)

Between FDI and GDP_ there is a strong and positive correlation (0.65) showing the high dependence of the economic growth for foreign investments. Romanian market is attractive to FDI, maybe due to low labor costs or to a favorable business field or access to natural resources, so the government should continue focusing on creating a more favorable business environment to attract more foreign investments.

A value of -0.85 between LPFR_ and POLSTABILITY shows a strong negative correlation, meaning that political stability is very important in influencing the labor force participation. Political instability is a sign of work discouragement, uncertainty, and so a decrease in labor force participation rate. The government should be considering some measures to stimulate employment opportunities in a quiet and politically stable environment.

Investors are very sensitive to political stability, as it is seen in a correlation coefficient of 0.57, emphasizing a positive correlation between FDI and POLSTABILITY.

From the correlation matrix, we can also see the moderate positive correlation between GDP_ and LPI (0.48) that means that logistics performance played an important role in the economic growth of Romania. In this case, focusing more on improvement of logistics may be an option to make attractive the Romanian market.

A correlation coefficient of -0.34 indicate a moderate negative correlation between LPI and LFPR_u, underlying that Romania's logistics performance can be an obstacle to employment, so improving infrastructure may lead to job creation and economic growth.

In a nutshell, these correlations suggest complex relationships between the factors that contribute to market attractiveness in Romania.

Next, we will appeal to a principal component analysis (PCA) for a deeper understanding of these connections and to point out the underlying factors that lead to market attractiveness in Romania between 2000 and 2022.

The PCA will identify those dimensions that drive the variation in the independent variables, recognizing which variables are important for establishing the attractiveness of Romanian market.

PCA chooses patterns and relationships between variables. It transforms the original variables into uncorrelated variables named principal components, which are ordered by the amount of variance explained, the first component explaining the most variance.

The output of PCA for the five variables that were chosen to identify the components that drive market attractiveness in Romania is seen in Figure no. 2.

The Eigenvalues measure the variance explained by each principal component (PC). The higher the value is, the greater is the contribution of the component. Five components were extracted with the first two that have Eigenvalues higher than 1 (2.57 and 1.57 respectively) explaining 83.01% of the total variance in the data (51.49% by the first and 31.52% by the second principal component).

Although, Eigenvalue for the third component is not above 1, we can still take it into account since this explains 15.18% of the total variance.

The Eigenvectors or loadings represent the strength and direction of the relationship between each variable and each principal component. If the values are higher, the relationship is stronger.

In our case, the first PC is most highly correlated with FDI and POLSTABILITY, while the second PC is most highly correlated with GDP_u and LPI.

Figure no. 2. PCA output for Romanian market attractiveness

Principal Components Analysis					
Date: 12/22/23 Time: 13:34					
Sample (adjusted): 2007 2022					
Included observations: 7 after adjustments					
Balanced sample (listwise missing value deletion)					
Computed using: Ordinary correlations					
Extracting 5 of 5 possible components					
Eigenvalues: (Sum = 5, Average = 1)					
Number	Value	Difference	Proportion	Cumulative Value	Cumulative Proportion
1	2.574665	0.998716	0.5149	2.574665	0.5149
2	1.575949	0.817188	0.3152	4.150614	0.8301
3	0.758761	0.680251	0.1518	4.909376	0.9819
4	0.078510	0.066396	0.0157	4.987886	0.9976
5	0.012114	---	0.0024	5.000000	1.0000
Eigenvectors (loadings):					
Variable	PC 1	PC 2	PC 3	PC 4	PC 5
FDI	0.559144	0.095371	0.458610	0.482601	-0.484805
GDP _u	0.311012	0.629763	0.382908	-0.394287	0.452315
LFPR	-0.556620	0.246828	0.308233	0.646249	0.341475
LPI	0.266266	0.498501	-0.740152	0.359004	0.062372
POLSTABILITY	0.458155	-0.533738	-0.015000	0.255173	0.663234
Ordinary correlations:					
	FDI	GDP _u	LFPR _u	LPI	POLSTABILITY
FDI	1.000000				
GDP	0.658037	1.000000			
LFPR	-0.634478	-0.129325	1.000000		
LPI	0.213925	0.482150	-0.342308	1.000000	
POLSTABILITY	0.579897	-0.171475	-0.852023	-0.089107	1.000000

Source: (Eviews 12, own calculation)

The ordinary correlations explain why certain variables are most highly correlated with each principal component.

According to the loadings of the original variables on the first two principal components, we can assume that some factors are likely to contribute to Romanian market attractiveness.

FDI and POLSTABILITY are highly correlated with the first PC, which explains 51.49% of the variance, making these two important factors that contribute to Romanian market attractiveness.

POLSTABILITY has a negative correlation with LFPR and a strong correlation with FDI, pointing out a potential nuanced connection among these variables.

The crucial role of GDP as a driver for market attractiveness is shown through the negative correlation between LFPR and GDP, combined with their high correlation with the second PC (explaining an additional 31.52% of variance). Moreover, LFPR may also be an indicator of market attractiveness, particularly in terms of economic growth.

LPI is most strongly correlated with the third principal component, suggesting that it may also be an important factor that contributes to Romanian market attractiveness, particularly in relation to the efficiency and effectiveness of logistics and supply chain management.

From the five components extracted, two components explain 83.01% of the total variance in the data. If we still want to take the third component, together they will explain 98.19% of the total variance.

The loadings of the original variables on these components suggest that factors such as FDI, GDP_, LFPR_, LPI, and POLSTABILITY contribute to Romanian market attractiveness.

However, the results of a PCA are not definitive and should be interpreted with caution. After all, PCA can be a useful tool for identifying underlying factors, but not a substitute for careful analysis and interpretation of the data. All the results are highly dependent on variables and data used.

For a better understanding of the factors that contribute to the Romanian market attractiveness, we can further consider factor rotation, regression, or clustering, exploring the relationships between the components and other variables, or even a comparison of the PCA with factor analysis to make sure that the results are consistent and reliable.

Considering other external factors that may influence market attractiveness can also be the subject of a future analysis.

Although we couldn't directly measure the attractiveness of the Romanian market without a dependent variable, but we still used the five independent variables to gain insights into the factors that contribute to its attractiveness.

5. Conclusions

Continuing to focus on consumption, Romania is one of the most rapidly developing markets in the EU. The stable business environment, the qualified workforce are real drivers that will put this country on the map of investments in key sectors in the years to come.

But what exactly does mean "being attractive"? Although briefly we can point out several factors, it's not so easy to answer the question, by underlining those that contribute to its attractiveness.

On the other hand, studying these factors as stand-alone will still be difficult because the environment is dynamic and reach of interdependences. This was the reason why we started the research of combining some key relevant factors assuming that the whole can make the Romanian market an attractive destination for foreign investors.

The aim of this study is to identify the underlying factors that drive market attractiveness from a pool of five variables, by conducting a Principal Component Analysis on the independent indicators: Foreign Direct Investments, net inflows (FDI), Gross Domestic Product growth (GDP_), Labor Force Participation Rate (LFPR_), Logistics Performance Index (LPI) and Political Stability (POLSTABILITY).

The correlation matrix suggested some complex relationships between the five factors. We can distinguish a strong correlation between FDI and GDP_ (as we expected), making the Romanian market attractive to foreign direct investments mainly due to low labor costs, or favorable environment. Political stability is another factor that influence the decision to invest in Romania, as

shown by the positive relationship between FDI and POLSTABILITY.

In addition, we obtained a negative correlation between LPFR_ and POLSTABILITY and LPI and LFPR_, revealing that unstable political conditions have huge effects in diminishing the labor force participation rate and, respectively, that employment and economic growth can be hindered by poor infrastructure.

Logistics contributed to the economic growth of the country, as well, being a suitable ingredient for market attractiveness.

The PCA analysis discovered those dimensions that drive the variation in the independent variables, specifying which variables are dominant in displaying the attractiveness of Romanian market.

Two out of five extracted components explained 83.01% of the total variance in the data (51.49% by the first and 31.52% by the second principal component). If we considered a third component, then we would have achieved 91.19% of the total variance explained.

Based on the Eigenvectors or loadings we concluded that the first PC is most highly correlated with FDI and POLSTABILITY, while the second PC is most highly correlated with GDP_ and LPI.

Looking at the loadings of the original variables on the first two principal components, we deduced that some factors are likely to contribute to Romanian market attractiveness.

FDI and POLSTABILITY are highly correlated with the first PC, making these two important factors that contributes to Romanian market attractiveness.

POLSTABILITY has a negative correlation with LFPR and a strong correlation with FDI, showing a potential nuanced connection among these variables.

GDP continues to be an important player for the market and in addition, LFPR may also be an indicator of market attractiveness, particularly in terms of economic growth.

All in all, the loadings of the original variables on these components urged that factors such as FDI, GDP_, LFPR_, LPI, and POLSTABILITY contribute to Romanian market attractiveness.

At the same time, we should be cautioned when putting forward these results. PCA provided a starting point for exploring the underlying most important variables related to Romanian market attractiveness. But these findings are dependent on the data and variables used.

Further exploration is required for a better understanding of the factors that lead to the Romanian market attractiveness, like factor rotation, regression, or clustering.

Even inspecting other variables that influence market attractiveness can be a topic for future research.

The absence of a dependent variable didn't allow us to directly measure the attractiveness of the Romanian market but familiarized us with the factors that contribute to its attractiveness.

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