

Determinants of Direct Foreign Investment as a Means of International Market Entry: A Review

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Abstract

Foreign Direct Investment (FDI) is currently used as an important tool in the International Market environment by global investors for entering into an economy. It is also one of the key factors that supports and accelerates economic growth of the host economy. With the growing interest on FDI worldwide in the recent years, the literature on FDI is also expanding in many folds. This review is an attempt to provide an insight into the empirical studies done in the past to analyse and explore the determinants playing a major role in attracting investors. The study infers that there are similarities, dissimilarities, significance, insignificance and ambiguity in explanatory variables that determine FDI inflows.

Keywords: FDI, Market Entry; Determinants; Economies; Socio-economic; Political determinants

1. Introduction

Worldwide foreign direct investment (FDI) represents a major source of funding for capital intensive projects. Developing countries like India have made significant strides as Asia-Pacific's most competitive host for foreign capital. In international business research direct investment ventures are extensively studied. There are numerous factors including economic, social, political etc any international organization considers before entering into a new market. The literature available on foreign investment is mainly rooted in economics and is very extensive. The Classic Location theory and International Trade theory are most often referred to as the early contributors [1]. However, the work done by Hymer [2] is always regarded as the landmark in the study of FDI. We all know that foreign direct investment has multiple effects on the economy of a host country. There are numerous factors motivating investment and it is more complicated when the investment comes from a developed country to a developing economy such as India. However the rapidly changing investment environment is providing opportunities for foreign investors and in turn emerging as an important medium of productive capacities in developing countries. Transition and developing economies in transition are thus becoming primary FDI destinations as evident from the UNCTAD (United Nations Conference on Trade and development) Global Investment Trend Monitor Report 2011, where developing and transition economies, for the first time, received more than half of global FDI flows [See Figure 1]. In addition to this the developing countries continued to account for nearly half of global FDI in 2011 as their inflows reached a new record high of \$684 billion (UNCTAD's Global Investment Trend Monitor Report, 2012), also the rise in 2011 was driven mainly by investments in Asia. Thus, there are growing trend that industries from more countries are expanding in another countries through direct investment especially in emerging economies than ever before, and virtually all economies now compete to attract multinational enterprises (MNEs), hence the literature on FDI has been growing over the years for identifying the various determinants of FDI with respect to a particular country [3-7]. In an interesting study Fedderke and Romm [8] suggested that in case a country does not have the requisite technology, resources and skills, these can be provided by FDI through the spillover effect. However, one need to understand that a host country absorb these resources and generate growth successfully particularly in context to its policies. This has led to these FDI determinants becoming chaotic and misleading. After carefully reviewing

the past literature it is apparent that there are various determinants of FDI inflows to emerging countries that pay a key role in attracting foreign investment and require frequent assessment due to their dynamic and critical nature.

2. Literature review

FDI refers to the worlds increasing integration of economies particularly through trade, financial flows, the movement of the workforce, and technology. It has assumed a greater importance in the last decade. Economic globalization encompasses not only the internationalization of consumption through cross-border trade in goods and services, but also the global integration of capital markets and the internationalization of products. In the global perspective, FDI is sensitive to the economic variables and policies of a country. Foreign investments positively affect a country's economy and are observed to be one of the principal factors supporting accelerated economic growth. Nowadays, virtually most of the countries are actively seeking to attract FDI, due to the expected favorable effect on income generation from capital inflows, advanced technology, management skills and market know-how. In developing countries like China and India, they consider attraction of foreign capital as a necessary means for their economic growth. It is widely recognised that FDI provides economic benefits to the recipient countries by providing capital, foreign exchange, technology and by increasing competition and access to foreign markets [9-11]. Athukorala [12] recently suggested that issue related to the determinants of FDI is multidimensional. Dunning [13] identifies four main reasons of motivation for investment abroad by multinational enterprises from various industrialised countries: resource-seeking, market-seeking, efficiency-seeking and strategic asset- or capability-seeking.

Many theories have been built on the determinants of FDI over the years, these include the Neoclassical Trade Theory and the Heckscher-Ohlin model positing that capital movement can be attributable to differences in capital returns [14-15]; the Proximity-Concentration Hypothesis [16-18] suggest that greater transaction costs resulting from higher trade barriers and transportation cost, lead to horizontal cross- border production expansion and thus, stimulate international investment; the Factor-Proportions Hypothesis, theory of international fragmentation or vertical FDI model [19-23] predict that the international trade and investment are complements, as firms take advantage of factor price differences through cross-border vertical production integration.; the risk diversification model [24-26] that identifies determinants of FDI according to the diversified FDI; Ownership advantages such as monopolistic [27-29] and the Internalization theory [30-31] based on imperfect competition models; the Knowledge Capital Model [32]; as well as the Ownership, Locational and Internalization (OLI) model [33, 34] that brought together traditional trade ownership advantages and internalization theory.

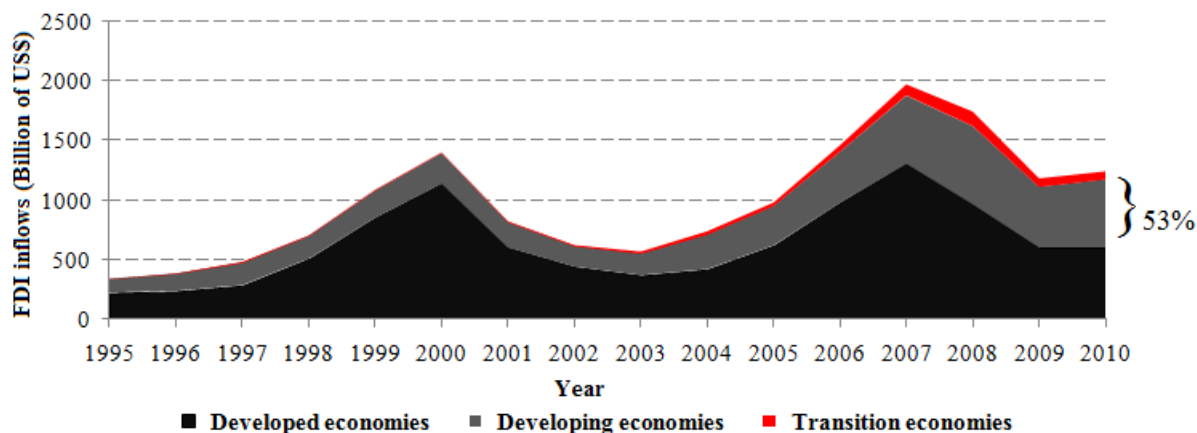
FDI flow is one of the main dynamics of globalization phenomenon thus its flow determination will contribute towards the progress and development of countries worldwide. Study of these determinant factors can be useful for international organizations and managers of global affairs, as it can help them to define, evaluate and lead future behavior in foreign markets. Furthermore such studies can be helpful for governments and policymakers since it can provide some clues regarding the best way of fostering FDI. The need to study the determinants of FDI on regular basis also is becoming necessary these days due to the volatile global environment, the fragility of the world economy, the uncertainties surrounding the future of the euro and rising financial market turbulence that will in-turn have an impact on FDI flows in the upcoming years. Empirical study with well-defined variables and new datasets are useful in clearly understanding the determinants of FDI. It is well known that major determinants of FDI keep changing particularly in the present context due to the constantly changing global scenario in advert of the financial crisis.

Keeping above in view the major focus of this study is to provide a review of the empirical studies on the major determinants of FDI that an international organization considers before investing in an emerging or transition economy. It gives an insight into the various determinants of FDI identified through

empirical research work done in the past. The study also provides an explorative view of the relationship that FDI inflows have with its determinants. Determinants of FDI have been divided into four categories namely, Economic, Socio-economic, Political and Scientific. The study quotes the determinants as used by the authors for conducting the study on FDI inflows.

Table 1 [Part (a) and (b)] gives a brief summary of the determinants covered in the current review work, and also helps in understanding the empirical results of the research work giving an insight into the significance of the determinants in influencing FDI inflows in emerging economies. Figure 2 gives a diagrammatical representation of the conceptual model based on the determinants identified in the current study.

Figure 1. FDI inflows, Global and by Group of economies, 1995-2010



Source: UNCTAD, Global Investment Trends Monitor Report 2011

3. Empirical studies

3.1 Economic Determinants

3.1.1 Market Size: The main aim of any kind of foreign investment is to capture the market of the host country. A larger market size is instrumental in attracting more FDI inflows to an economy. It is an important determinant as it helps in providing potential for local sales, increase in profitability of local sales to export sales and relatively diverse resources that ultimately makes local sourcing more feasible [35]. A large market for investors increases the opportunities for sales, profits and therefore attracts FDI [36]. According to UNCTAD [37] market size could be termed as a primary determinant of FDI inflows. Studies by Tsai [38], Clegg and Scott-Green [39], and Billington [40], have shown that market size and growth variables have significant positive effect on FDI inflows towards an economy. Few studies have also found market size to be an insignificant determinant of FDI inflows [41,42]. Garibaldi et al. [43] examined the determinants of foreign capital in 26 transition economies and concluded that FDI inflows in these economies were driven by market size. An interesting finding by Neubaus [44] revealed that market size affects a large part of horizontal FDI but does not matter for vertical FDI. Similarly, studies by Hasan [45] and Ang [46] on the determinants of FDI in Malaysia confirmed that increased size of the market results in more FDI flows into a country due to the benefits of the economies of scale. Thus, it is a factor that undoubtedly influences revenues of the investing firm. In a recent study by Srinivasan [47] reveal that market size to be one of the significant factor determining FDI inflows in SAARC countries.

Most of the author used *GDP* (gross domestic product), *GDP per capita* and *GNP* (Gross National Product) *per capita* as a proxy to study FDI inflows and have found it to have a positive impact on FDI inflows [6, 48]. Basu et al.[49] performed a panel study that included 23 countries from that period 1978 to 1996, in order to identify long run and short run effects of FDI based on cointegration estimates and found a long run cointegrated relationship between FDI and GDP for the entire panel of 23 countries. Khondoker

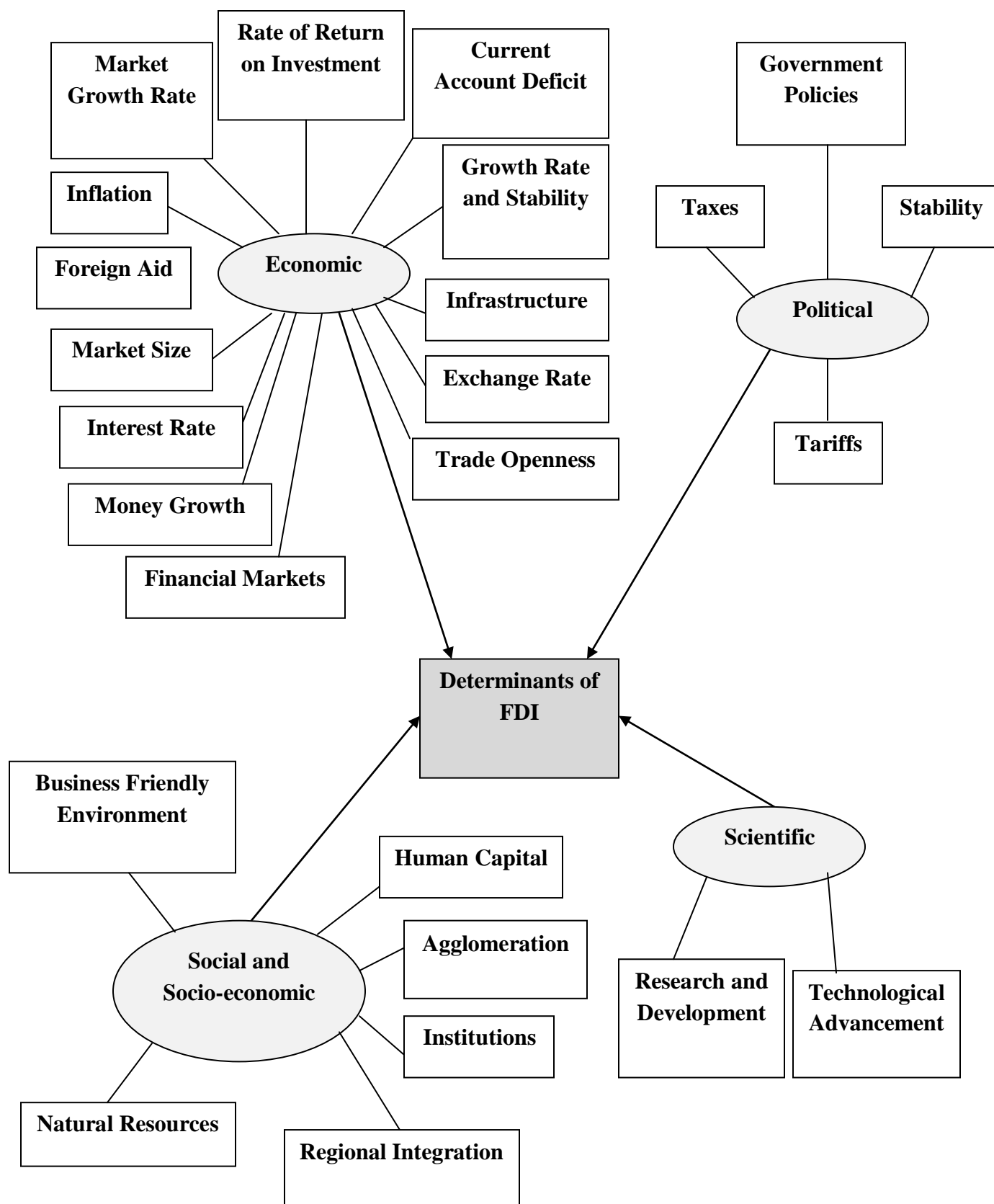
[50] conducted a study to identify the factors determining the FDI inflows to developing countries and suggested that developing countries can attract more FDI if they have high GDP. In a study by Mohamed and Sidiropoulos [51] number of people was used as a representative for market size and found it to have no effect on FDI inflows. Ngouhouo [52] and Alam & Shah [53] also concluded in their research work that market size plays an important role in attracting FDI.

3.1.2 Market Growth Rate: A strong market growth rate is a determinant that has been suggested in the literature to induce FDI inflows [54-56]. It is found to positively affect the inflow of FDI especially in developing countries. Maximum studies conducted in the past have used real *GDP growth rate* as a proxy variable to measure FDI inflows towards economies. It is however interesting to know that Nonnemberg and Mendonca [7] found that a strong market growth can influence FDI but not necessarily induce economic growth. Agrawal [57] conducted a study on economic impact of FDI in South Asia with the help of time-series and cross-section analysis of panel data from five South Asian countries (India, Pakistan, Bangladesh, Sri Lanka and Nepal) and argued that the impact of FDI inflows on GDP growth rate is negative prior to 1980, mildly positive for early eighties and strongly positive over the late eighties and early nineties. However, in few recent studies some inconclusive results have also been obtained on the relationship between FDI inflows and Market Growth rate [58, 59].

3.1.3 Inflation: Inflation in an economy is by and large a measure of degree of stability in an economy. A high rate of inflation is an indication of instability in the macroeconomic environment and the incapability of the government to manage the economy [60]. Stable economy attracts more FDI, and a low inflation environment is desirable in countries which like to promote FDI as a possible source of capital flow [61]. However, Addison and Heshmati [62] argue that higher inflation indicates higher price levels leads to increase in the amount of production activities in the host economy and attracts foreign companies to invest, resulting from higher expected level of profitability, and thus have a positive impact on FDI. Oti-Prempeh [63] identified inflation as one of the three determinants of FDI in the Malaysian Economy. Nonnemberg and Mendonça [7] considered inflation as a measure of economic instability and suggest that foreign investors prefer to invest in stable economies that reflect a lesser degree of uncertainty. Akinboade, et al. [64] also pointed out that low inflation to be a sign of internal economic stability of the host country while, high inflation suggest the inability of the government to balance its budget. Ismail [65] states that a country having a good record in managing low inflation rates could be one of the important factors for encouraging investors for investment. Thus, a negative correlation is expected between inflation and FDI (Thiago, 2010). Pradhan and Devdutt [66] found that in order to get more foreign direct investment in the economy it is important to maintain the stability in inflation rate.

Studies in the available literature have also considered variation of inflation as an indicator for economic stability in an economy and as a determinant of amount of FDI inflows in an economy. This negative relationship between variance of inflation and FDI flows is also confirmed by the research work of Akinkugbe [67], Kirkpatrick et al. [68], Sukar et al. [69] and Srinivasan [47].

Figure 2. Conceptual Model, Determinants of FDI



3.1.4 Exchange Rate: Exchange Rate is an important factor in determining the location choices of any direct investor. A study by Froot and Stein [70], presented an imperfect capital markets (i.e. internal cost of capital is lower than borrowing from external sources) story and explained how a currency appreciation can actually increase FDI by a firm. However, Klein and Rosengren [71], confirmed in their research work that exchange rate depreciation increases US (United States) FDI using various samples of US FDI categorised by type and country source. Goldberg and Kolstad [72] examined that exchange rate uncertainty will increase FDI by risk averse MNEs (multinational enterprises) if such uncertainty is driven by the export demand shocks prevailing in the markets that they intend to serve in future. In an interesting study Blonigen [73] finds that exchange rate effects on acquisition FDI are mainly for high-technology industries where substantial importance is given to the firm-specific assets. Empirically, many studies have concluded that relationship between exchange rate (when depreciation of the host currency is considered) and FDI inflows is significant and positively correlated [73, 74], whereas studies [75-77] have also shown that depreciation in the currency of host country decrease FDI inflows. However, Cushman [78] shows that the effects of the exchange rate on FDI may be ambiguous. The main motive behind any investing firm is to decrease the exchange rate risk. Kok and Ersoy [79] implicated that real exchange rate produces a positive effect when it is combined with openness, domestic investment and government consumption, and the effect becomes negative when domestic investment is not included. The volatility of exchange rates between the two countries involved in an FDI decision creates confusion among foreign investors on the expected return on investment and the value of assets in a host country. It could be ascertained from the literature that appreciation of the host country's currency will ultimately provide foreign investors greater returns, whereas due to depreciation source country's firms will be able to buy assets and technology at a lower price in the host country. In a study by Chen *et al.* [80] relation between exchange rate movements and FDI was investigated in terms of different motives behind FDI decisions. The results of the study indicated that a depreciation of a host country currency has a negative correlation with market-oriented FDI, whereas a depreciation of a host country currency has a positive correlation with cost-oriented FDI. It could be inferred from these studies that exchange rates and FDI relationship is crucially dependent on the motives of the investing firms. Hence, exchange rate is a determinant that needs a constant check and more analytical country specific studies for determining its role in attracting foreign direct investors. It is a determinant that largely depends on the motive of the investing firm.

3.1.5 Money Growth: Money growth refers to the increase in the availability of money in an economy and also the growth and development of the financial system, that helps in stabilizing the financial systems, boosting the confidence of foreign investors and ultimately instrumental in attracting FDI inflows in the country. A moderately strong relationship exists between FDI and a country's money growth [81-82]. Vita and Kyaw [83] study on 32 developing countries concluded FDI flows to developing countries is influenced by domestic productivity growth, whereas domestic money growth is the pull factor for foreign investors. Singhania and Gupta [56] found in their study that money growth is an insignificant determinant of FDI inflows in India. Although, several attempts have been made in the past but still no conclusive inference shows a strong relationship between the FDI inflows and money growth. In another recent study by Alavinasab [14] investigated the determinants of FDI in Iran for the period of 1991-2009 and concluded that money growth is significant in attracting FDI.

3.1.6 Trade Openness: Economic Openness is an important driver of a country's prosperity. Empirical and theoretical studies have found FDI and trade to be inter-linked. Campos and Kinoshita [84] study used 25 transition economies for the period of 1990 to 1998 and found that trade openness and low degree of restrictions to FDI inflows are highly significant. Moran, *et al.* [85] reported that the effect of FDI on the host country's growth depends largely on the host country's economic openness. It is observed that more is the liberalized economy of the host country, greater is the possibility of positive benefits of FDI, whereas more restricted economy is expected to encounter more negative impact of FDI on its growth. Trade openness encourages the foreign investors and in most of the studies it is found to be statistically significantly with a positive sign [86]. Kolstad and Villanger [87] investigated the determinants of Foreign Direct Investment in Service industry, using 57 countries industries FDI data for the period of 1989 to 2000 and indicated that trade openness to be statistically insignificant to FDI inflows. Masca [88] used the cross-sectional data of 38 developing countries for the period of 2000 to 2004 to examine the determinants of FDI in developing countries and found significant positive impact of trade openness on FDI inflows. Ismail [65] uses a Trade policy Index, which measures the score from 1 to 5 based on country's weighted average tariff rate, the lowest means very

low level of protection and found that trade policy of an economy encourages more investors to the ASEAN (Association of South East Asian Nations) countries. Their statistical results conclude that 1 per cent increase in trade increases FDI inflow by 1.41 per cent. Mottaleb and Kalirajan [89] in their study on determinants of FDI in developing countries suggest that trade positively and significantly affect the inflow of FDI to lower-middle income countries. A strong positive and statistically significant, effect is expected for the trade openness on FDI inflows as evident by most of the studies [42,52,58,59] with a few exceptions [51,56] where the results were found to be inconclusive.

3.1.7 Infrastructure: The lack of quality infrastructure in an economy is a constraint for both domestic and foreign investment. Literature shows a positive influence of infrastructure facilities on FDI inflows [5,90,91]. Many research work over the years have stressed that poor infrastructure particularly electricity, water, transportation and telecommunications can turn out to be an important determinant that discourages FDI inflows [61,92]. Dunning [93] studied the determinants of FDI inflows into European Transition Economies and concluded that institutional infrastructure and development are quite significant in this respect. Ismail [65] in his research work on the determinants of FDI in ASEAN economies concluded that social factors such as good telecommunications and infrastructure facilities encourage more investors towards a country. Hence, when the countries compete for FDI, the host economy best prepared to address infrastructure bottlenecks will be able to attract greater amount of FDI [14,53,94].

3.1.8 Economic Growth Rate and Stability: The relationship between FDI and economic growth has motivated exhaustive empirical literature focusing on both developed and developing countries. Studies conducted by Blomstrom et al.[95] and Borensztein et al.[96] found that FDI is positively correlated with economic growth of an economy. A high level of economic growth is a strong indication of prevalent market opportunities for foreign investors. An economy with a positive economic growth that is consistent over the years is more likely to pull the investors as compared to a slow growing economy. Studies on the relationship between economic growth and capital formation have concluded that gross domestic investment (GDI) influences economic growth in a country. Furthermore, Lui et al.[97] found a positive coefficient for economic growth rates, suggesting that higher economic growth attracts more FDI inflows. Khondoker [50] investigated the amount correlation between FDI and economic growth and indicated that developing countries can attract more FDI with high economic growth rate and investment friendly policies. Hence, one can observe that FDI inflows are attached towards an economy or to economy having high economic growth rate, on the other hand FDI inflows are also instrumental in increasing the growth rate in an economy. This theoretical implication indicates a bi-directional relationship between FDI inflows and economic growth rate. Most of the time economic stability and growth is associated with increase in the amount of FDI inflows, but in a research work by Botric and Skuflic [98] it was found to have a negative effect as the study used the unemployment rate as a proxy for economic stability. Similar results are expected if inflation is used as proxy to measure economic stability. Thus, this determinant by and large depends on the variable that is used as a proxy to measure its effect.

3.1.9 Interest Rates / Cost of Capital: Empirically, Interest Rates as a determinant of FDI have been observed by researches to be statistically significant [99] as well as insignificant [100] Interest rate is a measure of the cost of capital. Investors are attracted towards an economy due to the easy availability of capital at lower interest rate. A higher interest rate implies more costly investment and, therefore, the higher the interest rate, the more it is likely to defer FDI and the relationship between FDI and the interest rate is expected to be negative. Studies conducted by Coskun [101] and Schoeman et al. [102] suggest that low interest rate and high economic growth can attract foreign investors to an economy. Erdal and Tatoglu [103], amongst others, find that an increase in the interest rate leads to a decrease in FDI. Cyclical movements in interest rates in advanced countries have implications for financing FDI flows. It is a well known fact that a larger of foreign operations of FDI are funded in international financial markets and the cost of funding a foreign venture is sensitive to changes in international interest rates. For instance, low global interest rates and the resultant fall in borrowing costs during the 2003–07 periods contributed to almost 70 percent of the increase capital inflows (including FDI) into developing countries [104].

3.1.10 Rate of Return on Investment or Expected Profitability on Investment: Another key main determinant of FDI is the profitability of investment or the expected return on investment. It is quite evident that the investor evaluates the expected or actual rate of return on investment before venturing into the new markets [105]. It influences the

investment decision of any multinational organization planning to expand and capturing into new market [42]. The major decision to invest in a foreign country fundamentally by and large depends on the return on investment that is centered on profitability [106]. Profits are expected to be higher in economies where investors operate their businesses at a substantial low cost and produce at full scale with competitive prices [89]. Countries that have high sustained growth rates will yield high return on investment and will attract more FDI inflows than volatile economies [47]. However, this determinant of FDI is analysed and calculated by studying various other economic and socio economic determinants e.g. Interest Rate, Exchange Rate, Taxes, stability and policies prevalent in an economy. Thus, variables determining profit also determine the inflow of FDI to a country.

3.1.11 Foreign Aid: Schneider and Frey [48] found that among political determinants, the amount of bilateral aid coming in a country is also an important factor that explains FDI inflows. In a study conducted Kimura and Todo [107] states that developing countries receiving larger amount of foreign aid might be more successful in attracting FDI as compared to the other countries. On a larger perspective foreign aid has a significant and positive effect on inflow of FDI to developing countries. Furthermore, Motaleb and Kalirajan [89] reinvigorate the positive influence of foreign aid to developing countries in attracting foreign investors. In another recent study by Anyanwu [108] pointed that foreign aid to African has a spillover effect on the FDI decision of foreign investors in Africa.

3.1.12 Current Account Deficit : A healthier current balance of a country will always be an attractive source for pulling foreign investment [109]. A current account deficit in an economy can be reduced through foreign investments. To get more FDI in the economy, a stable current account balance is important [66]. Krkoska [110] found in his research a strong relation between the lack of FDI, current account deficits and economic crises in central European countries. FDI inflows are known be a non-debt creating financial source that becomes beneficial for an economy by reducing the current account deficit through external financing particularly in developing countries [111]. These finding supports the research work conducted by Schadler et al.[112], concluding that current account improvements affect FDI inflows and other financial flows, with a direct impact on enhancing economic growth [113]. A notable example that emphasised on the role played by FDI on current account deficit could be taken from a study on one of the developing economies India that regularly requires large FDI inflows in order to finance the current account deficit, this in turn has liberated the prevalent investment regime and off late M&As (Mergers and Acquisitions) to an extend are allowed freely [114].

3.1.13 Financial Market of the host country : Financial Markets influences are most commonly known to be associated with FIIs (Foreign Institutional Investment). But, it could turn out to be one of the determinants that have an influence on the investor's investment decision. Aoki et al. [115] research work shed light on the fact that a well-developed domestic financial market are instrumental in efficiently allocating foreign financial flows, including FDI, to competing investment projects. Whereas, it was also found that the seep domestic financial markets can provide the necessary credit to local firms when they need financing to take advantage of technological spillovers associated with FDI [116]. A fast growing market of the host country will most definitely create a positive impact on investor's mindset and help in pulling FDI.

3.2 Political

3.2.1 Taxes: Most commonly the amount of taxes imposed to foreign investors in an economy are hypothesized to have a negative effect on FDI inflows [40,117-120]. Lower corporate tax rates most definitely have a positive effect on attracting FDI as it lowers the cost of investment [121]. Cleeve [55] on the other hand found that temporary tax incentives and tax concessions to have insignificant effect on FDI inflows. Bellak and Leibrecht [122] also concluded in their study that countries with a lower tax rate attract more FDI. However, some studies have also found taxes to be a statistically insignificant determinant that does not play a major role in affecting the amount of FDI received by a country [5,123].

3.2.2 Tariffs: High tariff impositions are known to negatively affect a foreign investment decision. Trade discrimination through the imposition of high tariffs, and the use of non- tariff barriers encourage FDI, as foreign firms try to operate under shelter [124]. The higher the tariff, the greater would be the incentive for the foreign producer to produce locally in order to maintain the market. . The reduction in the amount of tariffs imposed makes a direct investment more attractive and governments directly subsidies FDI inflows by providing various forms of

insurance for international investment [125]. Tariffs could have a positive effect on FDI if they are combined with the growth rate and openness, on the other hand will produce a negative effect when combined with wages [79]. Thus, by venturing into trade globally, a country can attract more foreign investments especially FDI. Thereby a reduction in the amount tariff and non-tariff barriers in view of creating competitive situations in domestic markets becomes a challenging task. It is analysed through these studies that an efficiency seeking FDI is most benefitted by reduction in tariffs and removal of quantitative restrictions on imports as it reduces the investment cost to a great extent by and hence attract foreign investor.

3.2.3 Stability: Political risk is a socio-political determinant that could act a major instrument driving FDI inflows. Dunning [126] shows that location-specific variables like political stability attracts FDI. Literature work has also pointed that FDI in developing countries to a great extent is negatively affected by political instability and uncertainties [92,127]. Obwona [128] finds in his research work that macroeconomic policy consistency and political stability are important drivers of FDI into Uganda. It is thus quite evident that the overall growth and development of an economy is driven by political stability, an unstable political environment will discourage investments both at the domestic and international level. Similarly, Loksha and Leelavathy [129] revealed that political stability is important for any kind of investment as compared to the other determinants of FDI. On the contrary Lemi and Asefa [130] found that political and economic uncertainties do not have a significant influence on overall FDI from all sources. Similar inconclusive results were obtained by Cleeve [55] and Mhlanga *et al.* [59] by using political and civil freedom indexes for evaluating the role of political stability with respect to FDI.

3.2.4 Government Policies : Government policies related to the macroeconomic framework, incentives, tax breaks, subsidies and easy repatriation of capital influences the type of inward FDI [121]. Government policies are a determinant of FDI as government sees FDI inflows as a source of employment and increasing the overall growth of an economy. Literature work over the years have ascertains the impact of government policies including investment incentives on FDI inflows into a host country [131,132]. Investment incentives are thus considered by authors as another determinant for FDI. However, Blomstrom and Kokko [133] suggested that investment incentives alone are not an efficient way to increasing national welfare. But, on examining the past literature it is evident that sound macroeconomic policies can act as a stimulus for FDI spillovers to domestic investment by enabling diffusion of technology and raising the marginal product of new market [134]. Thus, favorable governmental regulations and policies is a defining factor that encourages FDI.

3.3 Social and Socio-economic

3.3.1 Business-friendly environment: It was observed that during 1997, a total of 76 countries made 151 changes in their FDI-related policies, and 89 per cent of these were to create a more FDI-friendly environment [135]. Morisset [136] suggested that few African countries were able to attract more FDI by improving their business environment. Business environment of the host economy is an important factor for increasing the amount of foreign investment [106]. Developing countries around the world can attract substantial amounts of FDI by adopting an outward-oriented trade policies and creating a more business-friendly environment to foreign investors [89]. Thus, an important socio-economic determinant that plays a major role in pulling FDI is a business-friendly environment with clearly defined rules and regulations that helps in reducing the operation and other hidden costs. Another study that supports these views was conducted by Seetanah and Rojidi [137] on determinants of FDI in Mauritius and reported that Mauritius has been successful in encouraging significant export-oriented FDI due to a strong business environment with a vibrant entrepreneurial culture.

3.3.2 Human Capital: Human capital can turn out to a very important and relevant determinant, when a foreign investment is made in a sector requiring skilled workers and the level of education improves productivity and facilitates technological innovation [138]. Hence, a statistically significant and positive relation is expected with FDI. Human capital is associated with various dimensions like: *literacy levels, cost, skills* and *availability* that can have different effects on attracting FDI. *The cost of labor* in the area attracting more FDI could be higher [139,140] that might make the investors hesitant while making and investment. The low wage cost in India has also appeared to be an important factor that encourages foreign direct investment [100,141]. On the other hand a qualified labors force is an important decisive and positive determinant of FDI [96]. Labor skills become a significant factor for when capital and technology intensive investment projects are considered for investment in a particular country. The quality of

labor force available in an economy has a positive impact on foreign investment [142-144]. Thus, higher the quality of labor the more attractive a region was to FDI [145]. The quality of labor increases the capacity in adopting new technologies [65]. Similarly, skilled workforce with adequate literacy rate encourages FDI inflows [146]. Thus, for an efficiency seeking foreign investor availability of cheap and skilled labor provides a great advantage by contributing in lower the cost of investment [53,58,106]. Hence, it is quite evident from the literature that human capital with required skills and education level along with reasonable cost and availability are attractive for FDI venture.

3.3.3 Natural Resources: FDI in developing countries is said to be mostly driven by the availability of natural resources [147-149]. Rugman and Verbeke [150] suggest a conceptual framework in order to analyse the determinants of FDI and indicate that natural resource seeking FDI occurs when the investing firm identifies specific host country locations having attractive natural resources like minerals, agricultural products etc. Most of the literature on FDI determinants suggests that natural resources are found to attract FDI in an economy [54,151]. For any resource seeking FDI abundance of natural resources to be positive and significant factor [52,152]. Deichmann et al.[153] conclude that the endowment of natural resources is a necessary condition for FDI by quoting the example of Central Asia, rich in oil and natural gas, which would undoubtedly be unattractive without these resources. Availability of natural resources of better quality and for a lower real cost than in the country of origin adds to the locational advantage and increases the competitiveness of the investor [129,154]. Mhlanga et al.[59] used a dummy variable to measure natural resource endowments in SADC countries, the results were found to be inconclusive. Noorbakhsh et al.[155] also provided an interesting argument that countries relying on low-cost, low skill labor or on natural resources to attract FDI might face difficulty for inducing FDI into high value-added industries and thus suffer slower economic growth.

Nevertheless, these research findings on a border perspective these findings suggests that FDI inflow is determined by an uncontrollable factor and that natural resource deficit or small country will attract less or negligible amount of FDI, irrespective of the policies the country pursues.

3.3.4 Institutions: Institutions as a determinant of inward FDI comprises of many aspects like governance, transparency, corruption and bureaucracy. Institutional quality is considered to be an important factor that explains the differences in development between countries [156]. The quality of institutions is important in attracting FDI activity mainly for the developing economies. It plays a crucial role in the firm's entry mode decisions especially in the emerging market [157]. Research works have indicated that the quality of institutions, amount of bureaucracy and corruption prevalent in a country together with the quality of information, banking and legal institutions are significant in determining inward FDI [158,159]. They help in regulating the business environment and influences multi national's entry decisions into a prospect market [160]. Countries with a more impartial and transparent legal system and better protection of property rights attract foreign investors [161]. Lack of proper information along with institutional immaturity raises transaction costs and risk level of an investment [162,163]. A good quality institutions increases the cost of doing business in a country and increases FDI activity, on the other hand poor institutions lead to poor infrastructure (i.e., public goods), leading to the fall in expected profitability and incoming FDI [164,165].

Thiago [166] quoted that countries having positive governance and improved institutions is an indicator of efficient market structures that helps in reducing the transaction costs and uncertainty and encourages the investors. Another important aspect of institutions is the issue of transparency is mostly associated with the activity of governments and their institutions. Low public transparency have a negative effect on inward FDI flows [167-169]. However, the results have emphasised that private sector level transparency has a greater influence on FDI as compared to the public sector transparency. Similarly, corruption and the effects of bureaucratic red tape are also important institutional factors affecting direct investment. The level of corruption and bureaucracy has a considerable influence on a country's institutional quality and limits its development and constraint FDI [51,55,170]. Hence, good quality institutions with transparency and low level of corruption are significant and positively affect FDI.

3.3.5 Agglomeration: Another interesting determinant of FDI is agglomeration referring to the accumulation of economic activities leading to the positive externalities and the economies of scale [171]. The level of agglomeration is positively related to the FDI inflows as indicated in several empirical research works [5,140,149]. Coughlin and Segev [172] estimated in their study that FDI into neighboring provinces increases FDI into China and indicated it as an evidence of agglomeration externalities. Another study by Botric and Skuflic [98] analysed data on FDI inflows to

South East European countries and found FDI inflows were largely dependent on privatization, trade regime, the density of infrastructure, and agglomeration. In a recent study by Anyanwu [108] it was found that agglomeration has a strong positive impact on FDI inflows to Africa.

3.3.6 Regional Integration: There have always been contradictory views among researchers on the bilateral, multilateral and regional investment rules affecting investments. But, it could not be denied that a predictable investment environment is better than an unpredictable investment conditions. Regional integration among economies is advantageous for foreign investment as reduces barriers to trade in goods, trade costs as well as investment among members. Blomstrom and Kokko [173] pointed in their study that regional integration lead to enhancement of efficiency, higher growth and thus have a positive impact on FDI inflows. Macroeconomic policy framework that defines the fundamentals of cost competitiveness, economic stability and degree of integration with the world economy helps in attracting foreign investors 129. Aguilar and Vallejo [174] study the forces behind the bilateral FDI due to the regional integration agreement for Latin America by using a gravity model and conclude that the size and development of the host and foreign economies, distance between them and common language existence are the major determinants of bilateral FDI flows. An important component of regional integrations is the trade agreements between economies that contribute in affecting on FDI flows [175]. In a study by Banga [176] it was found that regional trading agreements like ASEAN and APEC (Asia Pacific Economic Corporation) influences FDI inflows into the region as the risks associated with investments reduces with greater regional integration. Hence, infrastructure supply systems (e.g. roads, power, telecommunication networks etc) provide regional cooperation and help in promotion of FDI inflows as well as intra regional FDI inflows. Thus, regional cooperation and harmony between countries will not only increase incoming FDI inflows but will also be a source of making the region an economic power.

3.4 Scientific

3.4.1 Research and Development: Research and Development (R&D) is an important determinant of FDI in an economy. Research work has mostly pointed out that the amount of R&D in a country has a positive effect on attracting foreign investment in a country [139,149,177,178]. FDI inflows also in turn affect growth positively by decreasing the costs of R&D through stimulating innovation in the host country [179,180]. Palit and Nawani [181] study concludes that role of advancement in technology, patents held and research orientation acts as a great force to pull FDI inflows in a country. Basu et.al.[182] conducted an in-depth analysis of the qualitative shift in the FDI inflows in India in-depth in the last fourteen years and revealed in their findings that R&D is a significant determining factor for FDI inflows for most of the industries in India.

3.4.2 Technological Advancements: Research and development activities in any organization or an economy are one of the main sources of *technological advancements* that contribute towards the progress and development. Traditionally FDI is considered to bring technological advancements in an economy. However, advance technology and high skilled labor force could also be a driving force attracting foreign investors that in turn promotes economic growth through its effects on technological progress [183]. The advancement in technology not only contributes towards increasing the productivity and its efficiency, but also increases the returns on investment that ultimately helps in making the host country an attractive destination for foreign investors. According to OECD [184] report, FDI contributes towards the economic growth and is likely to depend on the economic and technological conditions in the host country. The study Addison and Heshmati [62] suggested R&D capacity to innovate and the ability to apply this capacity using latest IT techniques as the two key determinants of FDI inflows to developing Asian countries. Thus, technological advancement is another pull factor in influencing the decision making choices of foreign investors. Palit and Nawanis [181] work on paper technological capability as a determinant of FDI inflows presents a strong case for a positive relationship between the two. Furthermore, the study quotes that superior technological capabilities and supporting infrastructure have contributed towards attracting greater volumes of export-oriented FDI. Further, his findings suggests that in the absence of strong technological foundations and well-developed communications infrastructure, liberal policies alone are not enough for drawing FDI, once initial advantages, like cheap labor becomes ineffective.

Table [Part (a)]: Studies on FDI Determinants (Last 10-12 years)

	Determinant	Effect	Authors
			Economic
1.	Market Size	+ve	Pistoresi [188], Hasan [45], Ang [46], Cleeve [55], Mohamed and Sidiropoulos [51] Vijayakumar <i>et al.</i> [58], Srinivasan [47], Ngouhouo [52], Alam & Shah [53]
		NE	Asiedu [42]
2.	Market Growth Rate	+ve	Nonnemberg and Mendonca [7] Jenson [54], Cleeve [55], Mohamed and Sidiropoulos [51], Singhania and Gupta [56], Alavinasab [14]
		NE	Vijayakumar <i>et al.</i> [58]; Mhlanga <i>et al.</i> [59]
3.	Inflation	+ve	Addison and Heshmati [62]
		-ve	Tsen [109], Asiedu [170], Sukar <i>et al.</i> [69], Ismail [65], Thiago [166], Mohamed and Sidiropoulos [51], Pradhan and Devdutt [66]
4.	Exchange Rate (depreciation)	+ve	Kok and Ersoy [79]
		-ve	Tomlin [76], Chakrabarti and Scholnick [77]
5.	Money Growth	+ve	Ali and Guo [81], Chowdhury and Mavrotas [82], Vita and Kyaw [83]
		NE	Singhania and Gupta [56]
6.	Trade Openness	+ve	Pistoresi [188], Campos and Kinoshita [84], Botric and Skuflic [98], Ngouhouo [52]
		NE	Mohamed and Sidiropoulos [51], Vijayakumar <i>et al.</i> [58], Singhania and Gupta [56]
7.	Infrastructure	+ve	Biswas [189], Asiedu [170], Ismail [65], Vijayakumar <i>et al.</i> [58], Mhlanga <i>et al.</i> [59], Dhingra and Sidhu [94], Alam & Shah [53], Alavinasab [14]
		NE	Cleeve [55], Mohamed and Sidiropoulos [51]
8.	Economic Growth and Stability	+ve	Lui <i>et al.</i> [97], Khondoker [50]
9.	Interest Rates (Low)	+ve	Bende-Nabende <i>et al.</i> [99]
		NE	Banga [100]
10.	Rate of Return on Investment	+ve	Kinda [106], Mottaleb and Kalirajan [89], Srinivasan [47], Alavinasab [14]
11.	Foreign Aid	+ve	Kimura and Todo [107], Motaleb and Kalirajan [89]
12.	Current Account Deficit	-ve	Tsen [109], Schadler <i>et al.</i> [112], Pradhan and Devdutt [66], Jankovic [113]
13.	Financial Markets	+ve	Aoki <i>et al.</i> [115]
	Notes: (+ve) Positive Effect, (-ve) Negative Effect and (NE) Nil Effect on the FDI inflows by the particular determinant.		

Table [Part (b)]: Studies on FDI Determinants (Last 10-12 year)

	Determinant	Effect	Authors
Political			
14.	Taxes (High)	-ve	Desai et al.[120], Faeth [121], Bellak and Leibrecht [122]
		NE	Cleeve [55]
15.	Tariffs (High)	-ve	Coleman and Agyire-Tettey [125], Kok and Ersoy [79]
16.	Stability	-ve	Obwona [128], Lokesha and Leelavathy [129]
		NE	Asefa [189], Cleeve [55], Mhlanga <i>et al.</i> [59]
17.	Government Policies (favorable)	+ve	Mody and Antu [134], Faeth [121]
Socio-economic			
18.	Business Friendly Environment	+ve	Morisset [136], Kinda [106], Mottaleb and Kalirajan [89], Seetanah and Rojid [137]
19.	Human Capital (low labor cost, education, skills)	+ve	LuMinghong [143], Banga [100], Akinlo [144], Guha and Ray [141], Na and Lightfoot [145], Brooks et al. [138], Alam & Shah [53]
		NE	Cleeve [55]
20.	Natural Resources	+ve	Jensen [54], Asiedu [151], Mohamed and Sidiropoulos [51], Ngouhouo [52]
		NE	Mhlanga et al.[59]
21.	Institutions (quality of institutions, Transparency)	+ve	Drabek and Payne [169], Globerman and Shapiro [161], Zhao et al.[168], Blonigen [164], Kholdy and Sohrabian [165], Seyoum and Manyak [169], Thiago [166]
	Level of Corruption	-ve	Smarzynska and Wei [190], Asiedu [170], Cleeve [55], Mohamed and Sidiropoulos [51]
22.	Agglomeration	+ve	Sun et al.[149], Botric and Skuflic [98], Anyanwu [108]
23.	Regional Integration	+ve	Aguilar and Vallejo [174], Banga [176], Lokesha and Leelavathy [129]
Scientific			
24.	Research and Development	+ve	Sun et al.[149], Palit and Nawani [181], Basu et.al.[182]
25.	Technological Advancements	+ve	Addison and Heshmati [62], Palit and Nawanis [181]
	Notes: (+ve) Positive Effect, (-ve) Negative Effect and (NE) Nil Effect on the FDI inflows by the particular determinant		

4. Conclusion

International Organizations venture into new economies in order to increase their global presence and availing benefits of untapped markets in-search of profitability and maximizing return on investments. Hence many factors are considered before forming cooperative strategies in order to obtain desired results. FDI is a not only source of financing for an economy (especially when it is in phase of evolution the transition or developing phase as it helps in balancing the current account and fiscal deficit) but also a means that is equally beneficial for investing organization. Hence, due to these mutual benefits of the investing organization and host country, foreign investments have always been actively considered and researched upon. It influences many facets of an economy's growth through production, economic growth, prices, exports, imports, income, balance of payments, employment, and welfare. It is evident from the this empirical study that foreign direct investments over the years by and large

points towards a positive impact on an economy; however the amount of impact varies from country to country depending upon various factors [116,185]. FDI has an important role in creating employment opportunities, technology spillover, technology changes, development of human capital apart for generating physical capital inflows in an economy [186].

The growth of FDI in the last few decades has led to voluminous research work on defining the important determinants pulling foreign investments. It is evident from their research work that these determinants, individually and collectively, influence inward FDI, hence evaluating the significance of these variables could help in explaining the ability of some economies to consistently attract more FDI over the year [164,178,187].

Determinants that have been found to effect FDI inflows positively include market size, natural resources, skilled human capital, trade openness, low interest rates and labor cost. However, studies have also found statistically negative influence of some determinants (e.g., political instability, corruption and low economic growth rate). Furthermore, the role some determinants namely exchange rate, tariffs, taxes, trade balance and institutions were found to have a positive as well as negative consequences and need more exploratory in-depth and frequent analysis, as these controversial variables are highly susceptible to small changes the policies and investment environment. Such findings suggest that results analysed by various studies on FDI are influenced by to some factors, and inference drawn lacks robustness. The role of financial markets, foreign aid and regional integration as discussed in this review shed light on a different dimensional of FDI determinants that requires to be explored on different group of economies.

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