Sub-Sahara African Academic Research Publications
September, 2021 Editions

JMSE
Journal of Management Science & Entrepreneurship.
Vol.21, No.7, ISSN 2285-8138

A REVIEW OF THE DETERMINANTS OF FOREIGN DIRECT INVESTMENT IN DEVELOPING COUNTRIES

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Abstract
There are various theoretical and empirical studies that have been conducted on foreign direct investment (FDI). This paper reviewed the literature on the determinants of FDI in developing countries. These countries are characterized by low per capita income, high unemployment rate, dependence on primary sector and dependence on exports of primary commodities. A systematic review was carried out to gather information. Empirical findings across the developing countries identified the main determinants of FDI which include market size, larger per capita GDP, higher GDP growth rate, high proportion of international trade, business-friendly environment, natural resources, stock market performance, infrastructure and degree of openness. Thus, the economic environment in these countries has significant influence on the investment decision of Multinational Corporations (MNCs). Additional theoretical information on the FDI could guide new empirical studies. This is needed to shed more light on the determinants.

Keywords: *Review, Determinants, Foreign Direct Investment, Multinational Corporation, Developing Countries*

Introduction
Foreign Direct Investment (FDI) acquired a significant role in the international economy after the Second World War (Denisia, 2010). FDI flows increased in importance relative to other types of international capital flows, and the

resulting production increased as a share of global output (Lipsey, 2001). It is now an integral part of an effective and open international economic system and a major catalyst to economic development (OECD, 2002). FDI is made in different ways, including the opening of an associate company or a subsidiary in a foreign country, acquiring a controlling interest in an existing foreign company or by means of a joint venture or merger with a foreign company (Chen, 2021).

FDI is crucial for catching up growth in developing economies and their smoothed integration in the world economy. FDI fosters the modernization of local industries and contributes to Gross Domestic Product (GDP) growth even more than domestic investment (Borensztein, De Gregorio and Lee, 1988). This is explained by different theories and by different branches of economics. The first might be referred to as the industrial organization or micro view and the second might be referred to as the international finance or macro view (Lipsey, 2001).

FDI has been viewed through various theoretical and empirical lenses, with researchers taking different snapshots of the phenomenon. Although previous studies have identified several determinants that impact on the FDI decision of multinational corporations (MNCs); those determinants are generally applicable only to a specific context considered or else affect just the initial market entry. Thus, a comprehensive theoretical foundation that analyze determinants of FDI across developing countries has proved elusive; because the factors favouring MNCs initial investment in a country could change, prompting it to shift new investment elsewhere (Seith, Guisinger, Phelan and Berg, 2003). Hence, FDI determinants need to be examined overtime; this study reviewed the literature on the determinants of FDI in developing countries. A systematic review was carried out to gather information. This is organized in five additional sections which include conceptual review, an overview of theoretical issues, survey of empirical evidence, summary of major findings and conclusion.

Conceptual Review

A Multinational Corporation (MNC) consists of a parent firm and affiliates its own and controls (Lipsey, 2001). MNC production activities are in more than

one economy (Todaro and Smith, 2005). MNC is distinguished from economy specific enterprises which consist of all enterprises located in the same country and under the influence or control of the same owner also located in the same country (OECO, 2009).

A foreign direct investment (FDI) is the amount invested by residents of a country in a foreign corporation over which they have effective control (IMF, 1973). This is different from portfolio investment in which an investor merely purchases equities of foreign based enterprises (Chen, 2021). FDI is the purchase of a physical operating unit in a foreign country that gives the domestic firm making the investment ownership of more than 10 percent of the foreign corporation (Boyes and Melvin, 1999). There are slight differences in both the conception and definition of the direct foreign investment. For example, the United States Department of Commerce defined it to include such investments with at least 25% foreign equity participation in it. The key ingredient of the definition is that the equity participation should allow the foreign investors some operational control of the corporation (Agba, 2002).

Foreign direct investments are commonly made in open economies that provide a skilled labour and above – average growth prospects for the investor, as opposed to tightly regulated economies. FDI often involves more than just a capital investment or it may include technology or provision of management as well (Chen, 2021). Thus, it reflects the objectives of creating a lasting interest by a resident corporation in one country (direct investor) in a corporation (direct investment corporation) that is resident in a country other than that of the direct investor. The lasting interest indicates the existence of a long term relationship between the direct investor and the direct investment corporation and a significant level of influence on the management of the corporation (OECD, 2009).

Foreign direct investments are commonly classified as being vertical horizontal or conglomerate. A vertical investment is one in which different but related business activities from the investor's main business are acquired or established in a foreign economy. A horizontal direct investment refers to the investor establishing the same kind of business operation in a foreign economy as it operates in its domestic economy. A conglomerate kind of foreign direct investment is one where a firm or individual makes a foreign investment in a

business that is unrelated to its existing business in its domestic economy. It often takes the form of a joint venture with a foreign firm already operating in the industry (Chen, 2021). It is possible to classify FDI into three categories depending on the motive force that brings it into existence. These include export oriented; market development and government initiated foreign investment (Agba, 2002)

Developing countries are defined according to their Gross National Income (GNI) per capita per year; based on the World Bank Atlas, countries that are over the amount of 12,056 US Dollar were considered a developing country for the year 2020 (ISI, 2020). Even though these countries have different backgrounds in terms of politics, religion, demography, history, and resources, they still share a few common characteristics which include low per capita income, dependence on exports of primary commodities, high rates of unemployment, high population growth rate and dependence on primary sector (Agarwal, 2017).

An Overview of Theoretical Issues

Attempt at building theories explaining foreign direct investment behaviour rely heavily on borrowing from various disciplines such as behavioural sciences, industrial organization and economics in an electric or fragmentary basis (Meranda and Ditshweu, 2018). Various FDI theories explain the reasons for the movement of international capital. The main concern of these theories is to provide an explanation of the reason for a firm's decision to move abroad (Nayak and Choudhury, 2014). Thus, the aim is to investigate reasons why multinational companies undertake FDI and why some companies prefer to do their business activities in a particular country rather than another. (Musabeh, 2018).

FDI theories could be classified under macroeconomic and microeconomic perspectives. Macroeconomic FDI theories emphasize country specific factors and are more aligned to international economics and trade, whereas microeconomic FDI theories are firm specific, relate to internalization benefits, ownership and lean towards an industrial economics, market imperfection bias (Makoni, 2015). Another literature categorized FDI theories from the development perspective which combines both the macro and micro – level

theories, and examine the factors and policies that attract FDI and why firm's prefer to invest abroad and how they make entry to the foreign countries (Musabeh, 2018). There are many hypothesis emphasizing different macroeconomic and microeconomic factors that are likely to affect FDI (Lazondo, 1990). The macroeconomic environment comprises of openness, productivity, real exchange rate, gross domestic product and domestic investment which determine FDI inflows (Cushman, 1988).

Boddewn's (1985) capital market theory examined three positions which draw FDI to the less developed countries (LDCs): undervalued exchange rate, existence of non composed securities and restricted knowledge about host country's securities. Dynamic macro FDI theory tries to clarify how the inflow of FDI influences, the exchange rate. According to the theory, FDI is a device of exchange rate lessening (Cushman, 1988). Other macroeconomic FDI theories include theories based on economic geography and institution. Some of the theories have propounded a link between regional trade agreements and FDI. (Nayak and Choudhry, 2014).

Theories derived from the industrial organization approach gained the widest acceptance. They provided an explanation for cross – country intra industry investment and for the uneven concentration of FDI across industries. Under theories assuming perfects markets, the differential rates of return approach argued that FDI is attributed to capital flowing from countries with low rates of return to countries with high rates of return. Portfolio diversification approach focused on the role of risk; output approach considered the relevant variable to be output while the market size approach used host country's Gross Domestic Product (GDP) or Gross National Product (GNP) as a proxy for potential sales. Theories based on imperfect markets focused on issues associated with industrial organization and the internalization of decisions in a dynamic framework which highlighted oligopolistic rivalry and product cycle considerations (Lizondo, 1990).

Other theories of foreign direct investment are based on liquidity, currency area, diversification with barriers to international capital flows etc. (Lizando, 1990). Some of the theories are corollary to trade theories under perfect condition (Nayak and Choudhry, 2014). Although there are various theories put forward to explain when and why FDI takes place; however, no single unified and

generally accepted theory explained the different types of FDI (Merandu and Ditshweu, 2018). There were modifications of these theories in order to incorporate such features as lower expatriate costs, labour disputes in the home country, familiarity with local conditions in the other countries and the role of diaspora (Nayak and Choudhury, 2014).

Survey of Empirical Evidence

At long line of empirical research have been conducted on the determinants of FDI in developing countries; Using a panel data methodology, Mohammed and Sidiropoulos (2010) analyzed the key determinants of foreign direct investment in Middle East and North Africa (MENA) Countries. The study revealed that the main causes of FDI inflows in MENA countries are the extent of the host economy, natural resources, the institutional variables and the government size. Based on panel data set pertaining the years 1990-2002, Kumari and Sharma (2017) identified key determinants of FDI inflows in developing countries. Their findings revealed that market size is the most significant determinants of FDI inflow. Maxwel (2016) examined the main determinants of foreign direct investment in Ghana. They employed time series, annual data over the period of 1980 – 2014. The study revealed that natural resources, the openness of the nation's economy, market size, infrastructure, the interest regime, the level of government's expenditure consumption in the nation were the factors that determine Ghana's FDI**.**

Rjoub, Aga, Abu Alrub and Bein (2017) examined the determinants of FDI for "landlocked countries" over the period of 1995 – 2013 in Sub-Sahara Africa; they employed panel data analysis and found that trade (Openness), domestic investment, political constraint, human capital the market size (GDP growth as a proxy) and natural resources environment had a positive influence on determining FDI flow into the sample countries. Tuman and Shirali (2017) applied a cross-sectional time series data set for 66 countries for the period of 2003 – 2010; investigated the impact of several political and economic variables on Chinese FDI in Africa and Latin American. The result found Chinese FDI is influenced by natural resources and trade flows in host countries.

Using a panel data from 68 low-income and lower middle income developing countries, AbdulMuttalab and Kalirajan (2010) identified the factors that

determined FDI inflow to developing countries. The findings demonstrated that countries with larger GDPs, higher GDP growth rates, higher proportion of international trade and more business-friendly environment were more successful in attracting FDI. Marcelo and Mario (2004) shed light on the determinants of FDI in developing countries. Based on a panel data for 38 developing countries (including transition economies) for the 1975-2000 period; The result showed closed association between FDI and stock performance; and the existence of causality that GDP led to FDI. They concluded that FDI was correlated to level of schooling, economy's degree of openness, risk and variables related to macro-economic performance and average rate of economic growth.

Boga (2019) investigated the determinants of FDI inflows in Sub-Sahara African countries. Using annual data from 23 countries for the period of 1975-2017, results revealed that GDP growth and telecommunication infrastructure were all found to be the determinants of FDI inflows in the long term. But in the short term, only GDP growth and trade openness determined the FDI inflows. In another study on the Sub-Sahara Africa, Gichanmo, (2012) identified the determinants of foreign direct investment inflow. Using a panel data of 14 Sub-Sahara Africa countries for the period of 1986 – 2010, the findings showed that trade openness, gross domestic product, inflation and lag of FDI were the most significant determinants of FDI inflows to Sub-Sahara Africa.

Asiedu (2002) explored whether factors that affect FDI in developing countries affect countries in Sub-Sahara Africa (SSA) differently. The results indicated that a higher return on investment and better infrastructure had a positive impact on FDI to non-Sub-Sahara Africa countries but had no significant impact on FDI to Sub-Sahara Africa; trade openness promoted FDI to Sub-Sahara Africa and Non-Sub-Sahara Africa countries.

Using a panel data from 60 low-income countries and lower-middle income countries, Mottleb (2007) identified the influential factors that determined FDI inflow in the developing countries. He found that countries with larger GDP and high GDP growth rate and maintained business friendly environment with abundant modern infrastructure facilities such as internet could successfully attract FDI.

Anyanwu (2011) examined the determinants of FDI inflows to Africa. His estimation result from a panel data for the period of 1980 -2007 indicated a positive relationship between market size and FDI; openness to trade had a positive impact on FDI flows; higher financial development had negative effect on FDI inflows; high government consumption expenditure attracted FDI inflows; higher FDI moved where international remittances also moved in Africa; agglomeration had a strong positive impact on FDI inflows to Africa; natural resource environment and exploitation (especially for oil) attracted huge FDI into Africa.

Fabian (2017) investigated the determinants of FDI and FDI in agriculture in developing countries. Based on country level data of 22 developing countries; the results confirmed that the traditional variables such as economy size, infrastructure and trade openness encouraged FDI. A new variable the measured energy imports as a share of total energy use was negative for both main samples of FDI.

Ashurov, Othman, Rosman and Harun (2020) identified the determinants of FDI in Central Asian Countries, between 2000 and 2017. The result showed that five variables were robustly significant FDI determinants: FDI (previous year), GDP, labour force, trade openness and tax. Azam and Lukman (Undated) examined the determinants of FDI in India, Indonesia, and Pakistan during the study period ranging from 1971 to 2005. Empirical results revealed that market size, external debt, domestic investment, trade openness and physical infrastructure are the important economic determinants of FDI in the countries. Demirhan and Masca (2008) explored the determining factors of FDI inflows in developing countries over the period of 2000 – 2004. Based on a sample of cross-sectional data on 36 developing countries, econometric results indicated that growth rate of per capita GDP, telephone main lines and degree of openness had positive sign and was statistically significant. Inflation rate and tax rate presented negative sign and were statistically significant. Labour cost had positive sign and risk had negative sign. However, both were not significant. In another study on developing countries, Elshazly (2020) concluded that country's economic environment is more important for FDI and that tax and tariff incentives were not significant factors for foreign investors when he controlled for macroeconomic variables.

Summary of Major Findings

There are various theoretical and empirical studies that have been conducted on the FDI. Several theoretical approaches rooted in different branches of economics explained the determinants of FDI in the developing countries. However, there is no single unified and general accepted theory that explained the different types of FDI (Merandu and Ditshwev, 2018) Hence, a comprehensive theoretical foundation that analyze determinants of FDI across developing countries has proved elusive; because the factors favouring MNCs, initial investment in a country could change, prompting it to shift new investments elsewhere (Seith et al, 2003)

A long line of empirical studies identified the determinants of FDI in developing countries. Many of the findings are consistent with the theoretical expectations. Mohammed and Sidiropoulos (2010) found that the main causes of FDI inflows in MENA countries were the extent of the host economy, natural resources, the institutional variables and the government size. Kumari and Shema (2017) findings revealed that market size was the most significant determinants of FDI inflow in developing countries. Abdulmuttalab and Kalirajah (2010) results demonstrated that developing countries with larger FDI, higher, FDI growth rates, higher proportion of international trade and more business-friendly environment were more successful in attracting FDI. Marcelo and Mario (2004) results showed closed association between FDI and stock performance and the existence of causality that GDP led to FDI in the developing countries. Fabian (2017) confirmed that the traditional variables such as economy size, infrastructure and trade openness encouraged FDI in the developing countries. In another study on the developing countries Demirhan and Masca (2008) results indicated that growth rate of per capita GDP, telephone main lines and degree of openness were statistically significant. Elshazhy (2020) concluded that a developing country's economic environment is more important for FDI.

Conclusion

The goal of this study was review the literature on the determinants of FDI in developing countries. Several theoretical approaches rooted in various disciplines – such as economics, behavioural sciences, industrial organizations – explained the determinants. However, there is no single unified and generally

accepted theory that explained the different types of FDI (Merandu and Ditshweu, 2018). The factors favouring MNCs initial investment in a developing country could change, prompting it to shift new investment elsewhere (Seith, et al, 2003). Empirical findings across the developing countries identified the main determinants which include market size, larger per capita GDP, higher GDP growth rate, high proportion of international trade, business friendly environment, natural resources, stock market performance, infrastructure and degree of openness. Thus, the economic environment in these countries has significant influence on the investment decision of MNCs. Additional theoretical information on the FDI could guide new empirical studies. This is needed to shed more light on the determinants.

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