

What Investors Want

Perceptions and Experiences of Multinational Corporations in Developing Countries

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Abstract

This paper discusses the results of a survey of multinational corporations with affiliates in developing countries. The paper explores corporate perspectives and decision making across the stages of the investment cycle: attraction, entry and establishment, operations and expansion, linkages with the local economy, and, in some cases, divestment and exit. Through interviews with 754 executives, the survey finds that political stability and a business-friendly regulatory environment are the top two factors influencing multinational corporations' investment decisions in

developing countries. Investors seek predictable, transparent, and efficient conduct of public agencies. The survey results also show that investors are heterogeneous, and their perceptions vary with motivation and size. Multinational corporations that are involved in efficiency-seeking investment are more selective than investors motivated by other considerations, and that relatively smaller multinational corporations are more sensitive to host country characteristics and investment climate factors than large firms.

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What Investors Want: Perceptions and Experiences of Multinational Corporations in Developing Countries

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JEL classification: International Economics, Industrial Organization, Microeconomics

I. Introduction

Developing countries compete to attract foreign direct investment (FDI) because of its potential benefits for the local economy, which include technology transfer, stronger managerial and organizational skills, increased access to foreign markets, and export diversification. FDI can enhance productivity, increase investment in research and development, and create better-paying and more stable jobs in host countries. But these benefits are not guaranteed, nor do all types of FDI have the same potential impact. Thus, host governments must adopt the right policies to maximize their gains from different types of FDI.

The *Global Investment Competitiveness Survey* (GIC Survey)—whose aggregate results were first reported in the *Global Investment Competitiveness Report 2017-2018*—offers practical evidence to help policy makers design policies and prioritize reforms that investors value. Through interviews with 754 executives of multinational corporations (MNCs) that have investments in developing countries, the survey measures the role in influencing FDI decisions of such investment climate variables as investment incentives, promotion, FDI regulations, and administrative processes. By identifying variables that are most valued by investors, the survey provides practical guidance to where policy makers in host countries can focus their efforts to attract and retain FDI and maximize its gains for development.

Policy reform initiatives must consider that FDI is heterogeneous, driven by different motivations and having different economic, environmental, and social impacts. MNCs possess different characteristics that influence their perspectives and decisions. One such characteristic is based on an FDI typology that builds on a framework proposed by Dunning and Lundan (2008). The framework contends that MNCs are lured to a particular location with a predominant motivation in mind: accessing domestic markets, seeking increased efficiencies of production, taking advantage of natural resources, and acquiring strategic assets. This paper extends the use of this typology to explore how various policy instruments influence investors differently depending on their FDI motivation, and how the impact of investment on the host economy varies by type of FDI.

This paper provides a corporate perspective on the investment decision making of MNCs across the stages of the investment cycle: attraction, entry and establishment, operations and expansion, linkages with the local economy, and in some cases, divestment and exit. The survey reveals how MNCs decide on FDI and how they identify and select a country for investment. It also looks at MNCs' operational, reinvestment, and expansion experiences, as well as their encounters with political risks and their decisions to shut down foreign affiliates.

This paper investigates difference in perceptions and behavior between relatively smaller MNCs and larger ones. Foreign investments by relatively smaller firms play an increasingly important role in the global economy. Despite relatively small amounts invested, they represent a large number of investment projects. As this paper shows, relatively smaller MNCs also source more of their inputs from local companies compared to large investors, thus enhancing FDI's benefits for the local economy. Governments, particularly in low-income countries, are encouraged to attract such FDI to contribute to need and opportunities in host countries such as economic diversification (UNCTAD 2011).

The remainder of the paper is structured as follows. The next section describes the survey data and methodology. Section III includes descriptive statistics of the sample. Section IV discusses the heterogeneity of FDI and how it affects MNCs' perceived importance of the legal and regulatory environment relative to other country characteristics, and of various investment policy-related factors. Section V presents the results of the survey, and is organized according to the life cycle of investments—

selecting a location, entering a country and establishing an investment, running and expanding operations, and considering divestment. Concluding remarks and policy implications are offered in Section VI.

II. Data and Methodology

The data used in this study are from the *Global Investment Competitiveness Survey*. The GIC Survey captures perceptions of international business executives on the role of investment climate factors in their FDI decisions. The World Bank Group commissioned Kantar Public, a global survey firm, to conduct 30-minute computer-assisted telephone interviews with 754 business executives involved with the operations of their MNC in developing countries. The sample frame consisted of nearly 8,000 eligible companies in the commercially available Dunn and Bradstreet database. The 754 respondents were investors with existing affiliates in at least one developing country. The interviews consisted of a screener phase, to ensure the eligibility of respondents. Respondents were a combination of executives at the global headquarters and executives at a foreign affiliate.

The interviews were conducted in 13 languages: Arabic, Bahasa Indonesia, Chinese, English, French, German, Italian, Japanese, Korean, Portuguese, Russian, Spanish, and Turkish. The interviews were conducted between February and June 2017.

The survey complemented other existing investor surveys by focusing on investment climate variables, such as administrative and legal barriers, rather than broader economy-wide factors. These specific investment climate variables were areas actionable for policy makers.

The survey was composed of four sections:

1. *General information on the company and respondent*, including sector, number of employees, and position of the respondent in the company.
2. *Importance of factors in investing in a developing country*, where respondents rated the importance of country characteristics and investment policy factors on a scale from 1 to 4 from “not at all important” to “critically important.” “Critically important” means it is a deal-breaker—by itself, it could change the company’s decision about whether or not to invest in a country.
3. *Political risks and investment exit*, where respondents identified experiences of political risks and the company’s course of action. They were also asked whether they had shut down a foreign affiliate in a developing country and their reasons for doing so.
4. *Investment in a specific developing country*, where respondents selected a specific developing country where they were most familiar with the process of establishing an affiliate. Questions on the specific investment included sector, activity, motivation, reinvested earnings, efficiency of government agencies, incentives received, sources of inputs, and corporate programs for suppliers.

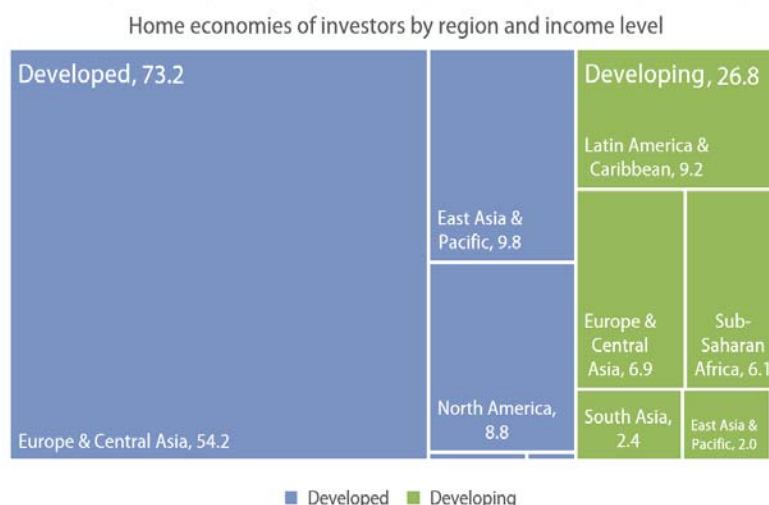
The survey was designed to provide a broad understanding of corporate perspectives and investor behavior and was not intended as a benchmarking tool to compare countries. Results are not representative at a country level.

III. Descriptive Statistics

Among the 754 responding MNCs, 73 percent were headquartered in high-income countries and 27 percent in developing countries (Figure 1). Over half of respondents had headquarters in Western Europe. As previously noted, all responding companies had affiliates in developing countries. The list of respondents by country is in Annex A.

Figure 1. MNCs Come from Various Regions and Levels of Development

Share of respondents (percent)



Source: Computation based on the GIC Survey.

Note: Respondents were asked to identify the location of their global headquarters. The classifications of developing and developed are based on the World Bank Group's income level classifications as of June 2017. High-income economies are considered developed economies, while low-, lower-middle-, and upper-middle-income economies are considered developing economies. The analysis for this paper is not disaggregated into income groups owing to the small sample size.

The sampling method considered whether the source economy was developed or developing but did not aim to make the composition of respondents representative at a country level. Practical considerations such as sample size and translations to local languages precluded the survey methodology from obtaining a representative sample of companies globally. The sampling method also considered that respondents should comprise a large enough sample of developing economies as source countries of FDI. Table 1 compares the composition of respondents from developed and developing economies with global outward FDI stock in 2016.

Table 1. Composition of Respondents Compared with Global FDI Stock

Location of headquarters	Percentage of respondents	Share of global FDI stock
Developed economies	73.21	76.31
Developing economies	26.79	23.69

Source: Computation based on the GIC Survey and UNCTAD statistics.

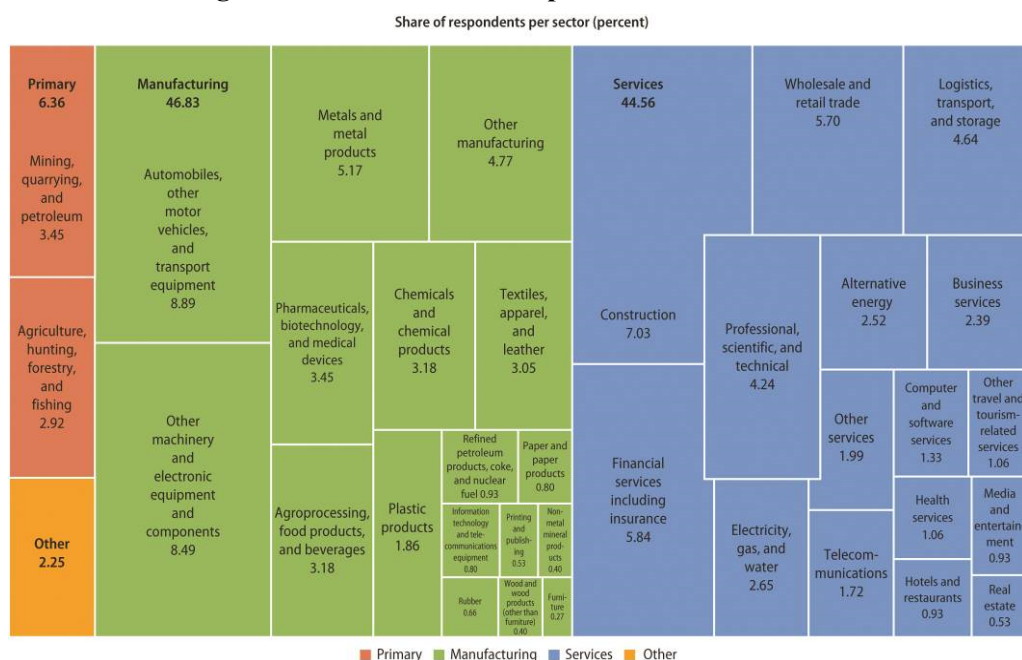
A large majority of respondents were either the Chief Executive Officer (CEO) or Chief Finance Officer (CFO), or their equivalent (Table 2). Of the 754 respondents, 401 (53 percent) were executives located at the global headquarters while 353 (47 percent) were executives of an MNC affiliate in a developing country.

Table 2. Position of Respondent in the Company

<i>Position</i>	<i>No. of respondents</i>	<i>Percentage of respondents</i>
CFO/Finance director/Treasurer/Comptroller	336	44.6
CEO/President/Managing director	146	19.4
Head of business unit/Head of department	126	16.7
Other C-level executive	61	8.1
SVP/VP/Director	26	3.4
Board member	24	3.2
Director of global operations or global manufacturing	18	2.4
CIO/Technology director	5	0.7
Other	12	1.6
Total	754	100.0

Some 47 percent of respondents were executives of manufacturing firms, 45 percent were from services, 6 percent were from extractives, and 2 percent were from “other” noncategorized sectors (Figure 2). The respondents follow a roughly similar distribution compared with the sample frame* (Annex Table A.3). Respondents have slightly more firms in trade and fewer in financial services compared to the sample frame, but the difference is only about 3 percentage points.

Figure 2. Distribution of Respondents across Sectors



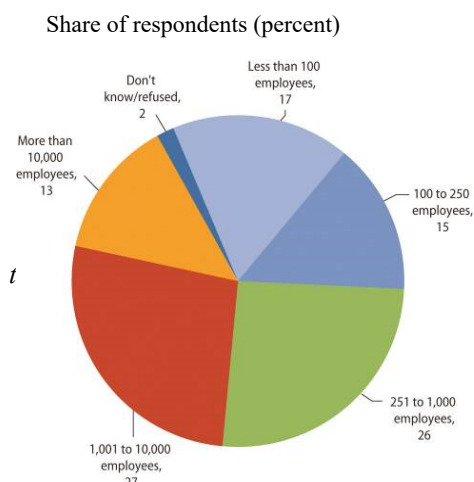
Source: Computation based on the GIC Survey.

Note: Respondents were asked to identify the main sector of their company globally, which may or may not reflect the sector of the affiliates in developing countries. About 10 percent of respondents noted that the sector in the foreign affiliate they are most familiar with is different from the main sector of the global company.

* The D&B sample frame contains many missing values (28% of records) on the NACE code. This list is calculated by the authors, drawing from a field that contains “line of business” and mapping to an NACE code.

Companies with 1,000+ full-time employees constituted 40 percent of the sample. About one-third (32 percent) of the interviewed companies had 250 employees or fewer, and 26 percent had between 251 and 1,000 employees (Figure 3). For this paper, *relatively smaller MNCs* are defined as those with 250 or fewer employees, while *large firms* are those with 251 or more employees.

Figure 3. Size of MNCs by Number of Employees



Source: Computation based on the GIC Survey.

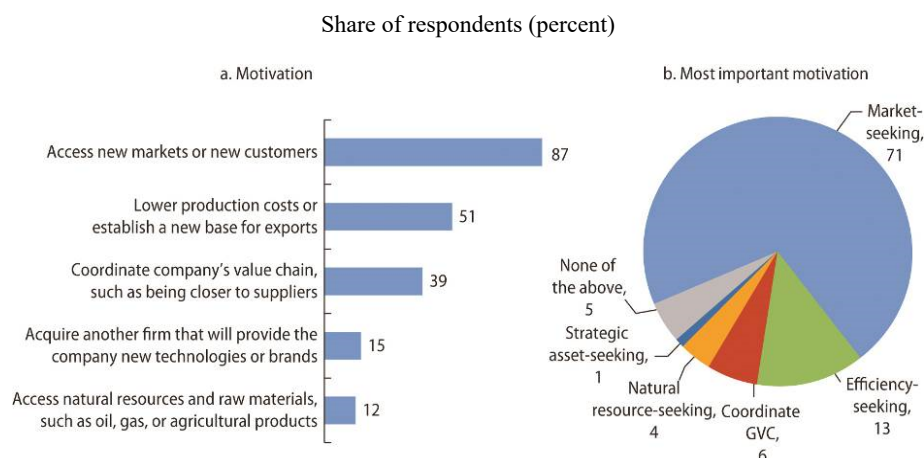
Note: MNC = multinational corporation.

IV. Heterogeneity of Investors

Investors with different motivations consider different factors in their decision to invest. According to the framework proposed by Dunning and Lundan (2008), MNCs that primarily seek access to natural resources—as in extractive industries—care more about such variables as access to land and resources they wish to exploit than other variables. Market-seeking FDI tends to prioritize the size of and purchasing power in the domestic market. Efficiency-seeking FDI values policies that facilitate the import and export of goods and services, and lower production costs. Efficiency-seeking FDI also includes firms that participate in global value chains (GVCs), an important way for developing countries to integrate into the global economy. MNCs that seek strategic assets primarily pursue technologies and brands that can enhance their operations. The GIC survey focuses on the subjective motivation by asking investors to self-identify their company's motivations in a specific investment project in a developing country.

In this survey, close to 9 in 10 investors said that accessing new markets or new customers was one of their motivations (Figure 4). About half of respondents are motivated by lowering production costs or establishing a new base for exports. The motivation to coordinate a value chain occurs for two-fifths of respondents. For those investors that want to coordinate their companies' value chain, 70 percent are also motivated to cut production costs. Few respondents identify with the motivation to acquire strategic assets (15 percent) or access natural resources and raw materials (12 percent). Critically, almost two-thirds of investors selected multiple motivations (Table 3) and when asked about which motivation prevails, most investors (71 percent) say they are market-seeking.

Figure 4. Most investors have multiple motivations and are market-seeking



Source: Computation based on the GIC Survey.

Note: The numbers on the left do not add up to 100 percent because respondents are permitted to select multiple motivations: 62 percent of respondents selected two or more motivations. Many respondents may have understood the motivation to access new markets or new customers to apply not only to the domestic market in which they were investing, but also to the regional market. In fact, this motivation was commonly selected for investments in many small developing countries with an extensive network of trade and investment agreements with other economies, suggesting that the respondents were interested in accessing new regional markets or regional consumers, rather than just the small domestic market of the host country.

Table 3. Number of motivations

<i>No. of motivations</i>	<i>No. of respondents</i>	<i>Percentage of respondents</i>
0	34	4.51
1	249	33.02
2	227	30.11
3	159	21.09
4	64	8.49
5	21	2.79
Total	754	100.00

Although some sectors are naturally linked with specific motivations (for example, the primary sector being natural resource-seeking), motivations do not correlate strongly with sectors. While about 80 percent of services firms tend to be primarily market-seeking, some are also efficiency-seeking, such as services enabled by information technology (IT). Manufacturing firms are also mainly market-seeking but include a large concentration of efficiency-seeking firms and a handful of natural resource-seeking ones.

Investors involved in efficiency-seeking FDI, relative to investors involved in other types of FDI, are more sensitive to various host market characteristics, including investment climate factors. These host market characteristics include macroeconomic stability and favorable exchange rate, labor pool, physical infrastructure, tax rates, access to land, and domestic financing sources. Among investment climate variables, MNCs involved in efficiency-seeking FDI assign a higher importance to investment protection guarantees, ease of entry, local suppliers, incentives, trade agreements, and bilateral investment treaties,

compared with other investors. This suggests that firms involved in efficiency-seeking FDI may be more responsive to policies and reforms aimed at improving the business environment. This paper also explores the differences between relatively smaller MNCs compared with large ones.

Host countries are also heterogeneous. A vast majority of survey respondents have operations in upper-middle-income countries (87 percent), about a third also in lower-middle-income countries, and very few have foreign affiliates in low-income countries (8 percent). Thus, policy implications emanating from the results of this survey are based on investors' responses mostly for middle-income developing countries, although they are likely relevant to low-income countries as well.

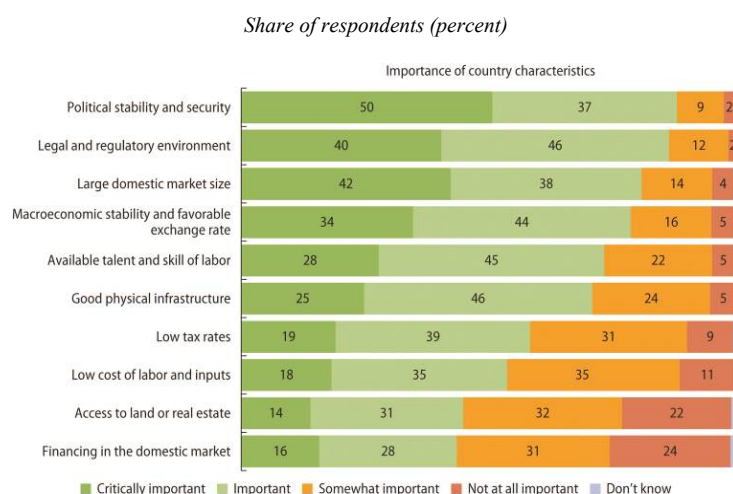
V. Results of the Global Investment Competitiveness Survey

First Phase in the Investment Life Cycle: Investment Exploration and Location Decision

What Variables Determine MNC Investment Decisions?

Investors consider a broad range of factors when deciding to invest. Based on the survey results, the most important factors are political stability and security, as well as a business-friendly legal and regulatory environment. These top other variables such as infrastructure, labor talent and skill, and low costs of labor and inputs. Among survey respondents, 86 percent find the legal and regulatory environment important or critically important, suggesting that it weighs heavily in investors' decision to invest (Figure 5).

Figure 5. Political Stability and Business-Friendly Legal and Regulatory Environment are Important for Investors

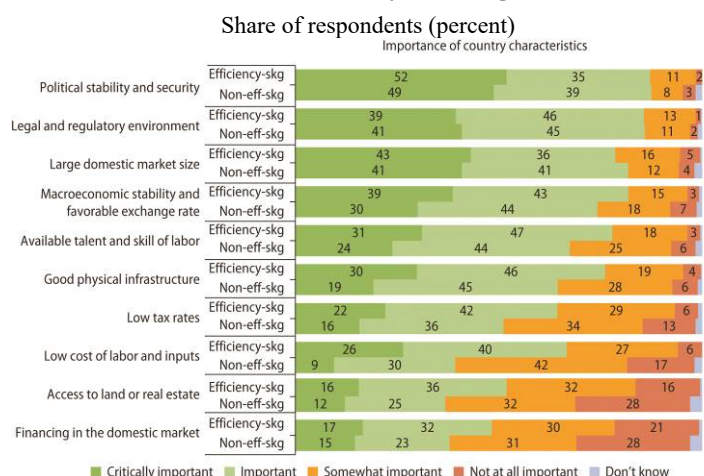


Source: Computation based on the GIC Survey.

Note: Respondents were asked, "How important are the following characteristics to your company's decision to invest in developing countries?" Factors were asked in random order. They are listed in the graph in descending order of importance, based on the combination of "critically important" and "important" in dark green and light green bars. Critically important means it is a deal-breaker; by itself this factor could change a company's decision to invest or not in a country.

Firms involved in efficiency-seeking FDI are more sensitive to a broad range of factors. MNCs seeking cost-competitive locations for their mostly export-oriented production value macroeconomic stability, labor skills, reliable infrastructure, low tax rates, low costs of labor and inputs, access to land, and domestic financing more than other investors. Because these investors are more sensitive to costs, they more carefully consider factors that directly affect their cost structure and productivity. The size of the domestic market is valued slightly more by investors without an efficiency-seeking motivation. These investors are predominantly motivated by accessing new markets. The two most important factors—political stability and security, and the legal and regulatory environment—are consistently valued highly across all types of investors (Figure 6).

Figure 6. MNCs Involved in Efficiency-Seeking FDI Are More Selective



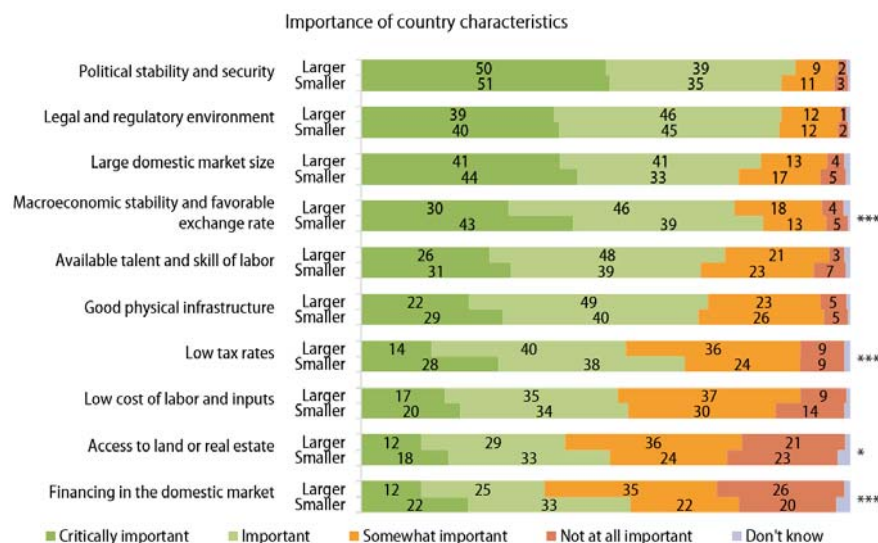
Source: Computation based on the GIC Survey.

Note: Country characteristics that have statistically significant differences between investors involved in efficiency-seeking FDI and investors involved in other types of FDI are marked on the right side of the graph. The differences between the two groups are significant at *** $p < 0.01$, ** $p < 0.05$ and * $p < 0.1$.

Relatively smaller firms are more influenced by various host market characteristics than large firms. In particular, macroeconomic stability and favorability of exchange rates are rated critically important by 43 percent of smaller firms compared to only 30 percent of large ones. Low tax rates and domestic financing are considered as critically important or deal-breakers by about twice as many relatively smaller firms as large ones – 28 vs. 14 percent on tax rates, and 22 vs. 12 percent on domestic financing (Figure 7). The latter is consistent with findings that small firms have less access to formal finance (Aterido, Hallward-Driemeier, and Pagés 2011), which highlights the importance in their decision to invest.

Figure 7. Relatively Smaller Investors are More Influenced by Various Host Market Characteristics than Large Ones

Share of respondents (percent)

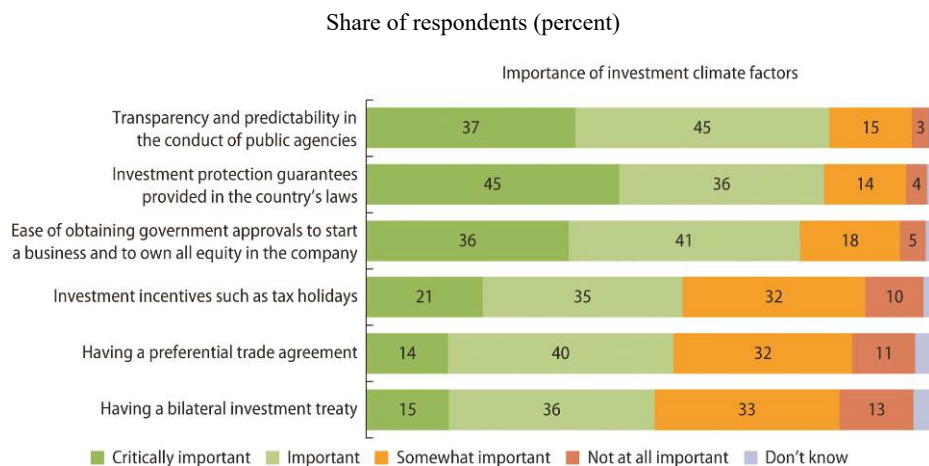


Source: Computation based on the GIC Survey.

Note: Relatively smaller firms have 250 full-time employees or fewer, and large firms have more than 250 employees. The differences between the two groups are significant at *** $p < 0.01$, ** $p < 0.05$ and * $p < 0.1$.

Among the country characteristics above, the GIC survey and this paper focus on the legal and regulatory environment affecting foreign investments. These investment climate variables comprise key policy areas that governments in FDI recipient countries can influence to improve their countries' competitiveness. Investors seek both strong legal protections and predictability and efficiency in implementing laws and regulations (Figure 8). Many developing countries have inefficient bureaucracies, opaque regulations, complex procedures, and high transaction costs that undermine their competitiveness. Not surprisingly, four out of five surveyed investors rate transparency and predictability in the conduct of public agencies, investment protection guarantees provided in the country's laws, and the ease of starting a business as important in their choice of investment location. Moreover, over a third of investors rate these as critically important, or potential deal-breakers. Transparency and predictability may be interpreted as a reflection of the overall interaction between MNCs and host governments—comprising both regulations themselves and their implementation.

Figure 8. Investors Seek Predictable and Transparent Conduct of Public Agencies



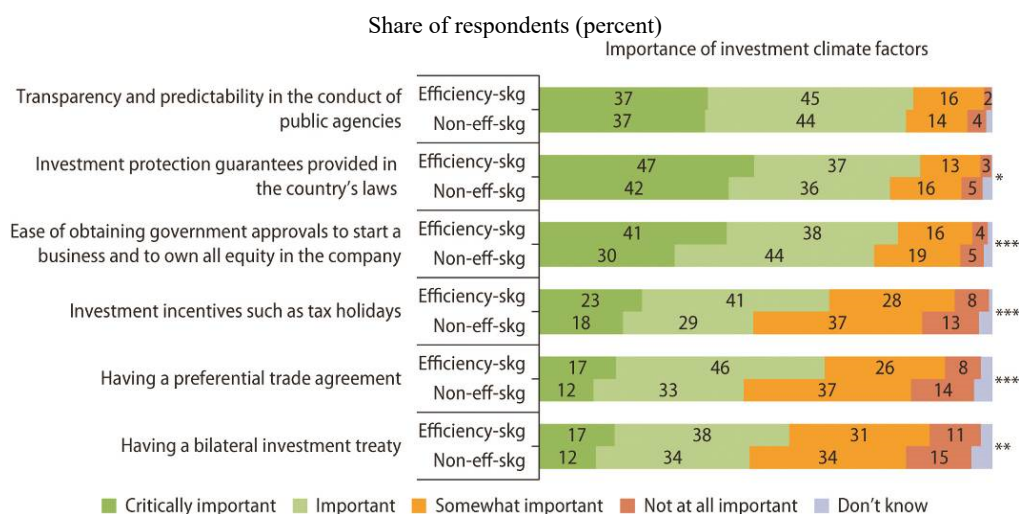
Source: Computation based on the GIC Survey.

Note: The differences between the two groups are significant at *** $p < 0.01$, ** $p < 0.05$ and * $p < 0.1$.

Investors value policies that help them expand their business more than policies to attract them. Forty-five percent of respondents rate investment protection guarantees as critically important or deal-breakers, highest among all investment climate factors. Over 90 percent of investors rate various types of legal protections as critical, including the ability to transfer currency in and out of the country as well as legal protections against expropriation, against breach of contract, and against nontransparent or arbitrary government conduct. All investors—regardless of sector, source country, or FDI motivation—find these guarantees of greatest value. These policies are bigger deal-breakers than investment incentives, preferential trade agreements, and bilateral investment treaties. These results suggest that host countries need to pay as much attention to investor aftercare as they do to attracting investors to their country. Given that respondents are investors that already have ongoing operations in developing countries and not prospective investors, this partly explains the emphasis on aftercare.

MNCs involved in efficiency-seeking FDI place more importance on investment climate factors compared to firms involved in other types of FDI. Except for transparency and predictability in the conduct of public agencies, which firms find most important regardless of motivation, firms involved in efficiency-seeking FDI value most investment policies more highly (Figure 9). This suggests that MNCs involved in efficiency-seeking FDI may be more sensitive to these factors when deciding to invest. Such results are not surprising, given that most efficiency-seeking investment is export oriented and highly selective in where it locates, hence the importance of trade agreements and investment incentives. As such, policy makers in host countries should target their initiatives to attract these investors.

Figure 9. MNCs Involved in Efficiency-Seeking FDI Value Incentives, Trade Agreements, and Ease of Entry More than Other Investors

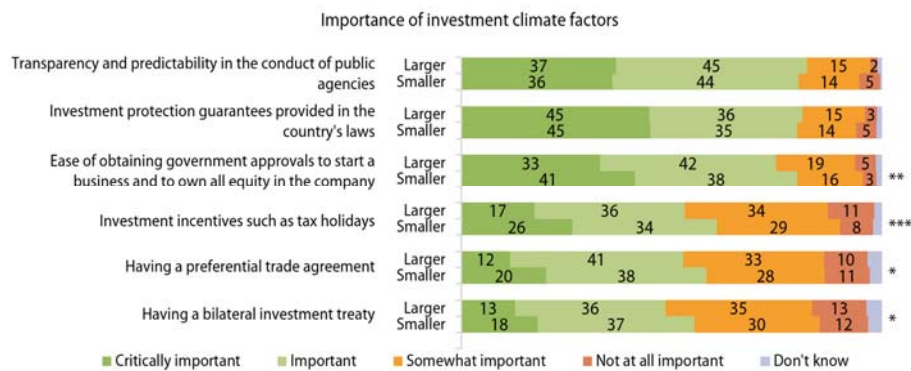


Source: Computation based on the GIC Survey.

Note: The differences between the two groups are significant at *** $p < 0.01$, ** $p < 0.05$ and * $p < 0.1$.

Similar to the earlier results on market characteristics, the survey finds that relatively smaller firms tend to be more sensitive to investment climate factors. Ease of entry, investment incentives, preferential trade agreements, and bilateral investment treaties are considered critical by relatively smaller firms compared to large ones (Figure 10).

Figure 10. Importance of Investment Climate Factors by Firm Size



Source: Computation based on the GIC Survey.

Note: The differences between the two groups are significant at *** $p < 0.01$, ** $p < 0.05$ and * $p < 0.1$.

How Critical Are Incentives in Attracting FDI?

Investment incentives to attract FDI are widespread and used by governments in both high-income and developing countries. Developing country policy makers often view incentives as necessary for their countries to compete for FDI. Incentives impose sizable costs on host countries through fiscal losses from non-collection of taxes, rent-seeking by firms, and associated tax evasion. Countries must thus walk a fine line between remaining competitive by offering incentives and ensuring that benefits outweigh their costs.

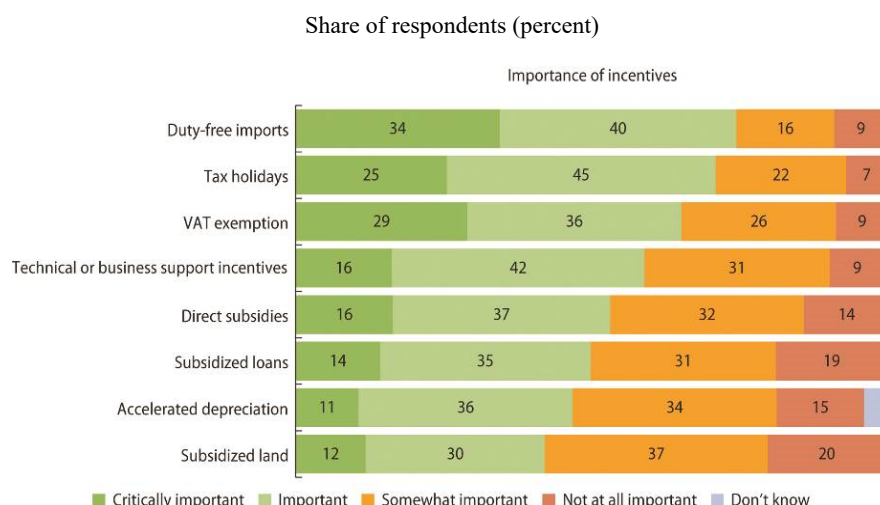
Investment incentives rank only fourth in importance to investors out of six investment climate characteristics listed in the GIC survey. They rank lower than transparent government conduct, investment protection guarantees, and ease of establishing a business (Figure 8). Overall only one in five investors finds the absence of investment incentives as a deal-breaker in deciding to invest. Another third of respondents finds incentives to be important, but not quite deal-breakers. This does not necessarily suggest that incentives can be completely eliminated but that, by themselves, they are unlikely to convince investors to shift the location of their investment. The policy fundamentals of the investment climate must be addressed before policy makers resort to incentives as a means of attracting investors.

MNCs involved in efficiency-seeking FDI, however, value incentives more than investors with other motivations. Among investors motivated by cutting production costs and finding new export platforms, 64 percent find incentives important or critically important, in contrast with only 47 percent of investors with other motivations (Figure 9). Investors involved in efficiency-seeking FDI are also granted certain incentives—duty-free imports, subsidized loans, and value added tax (VAT) exemption—more often than other investors. This suggests that they may be more responsive to incentives than investors with other motivations such as accessing new markets and natural resources.

Duty-free imports, tax holidays, and VAT exemptions are the top three most important incentives for investors (Figure 11). About two-thirds of investors who said that incentives are at least somewhat important find these three instruments to be important or critically important. MNCs involved in efficiency-seeking FDI rated all types of incentives more highly compared with investors involved in other types of FDI, with a difference of about 13 percentage points on average. They also received incentives more often in a typical investment. When asked about the specific incentives that their companies have received, respondents identified the same three types of instruments—duty-free imports, tax holidays, and VAT

exemption—as most frequently received. This suggests that the respondents’ high rating of these types may owe to their familiarity with the specific instruments.

Figure 11. Duty-Free Imports, Tax Holidays, and VAT Exemptions Are the Most Attractive Investment Incentives

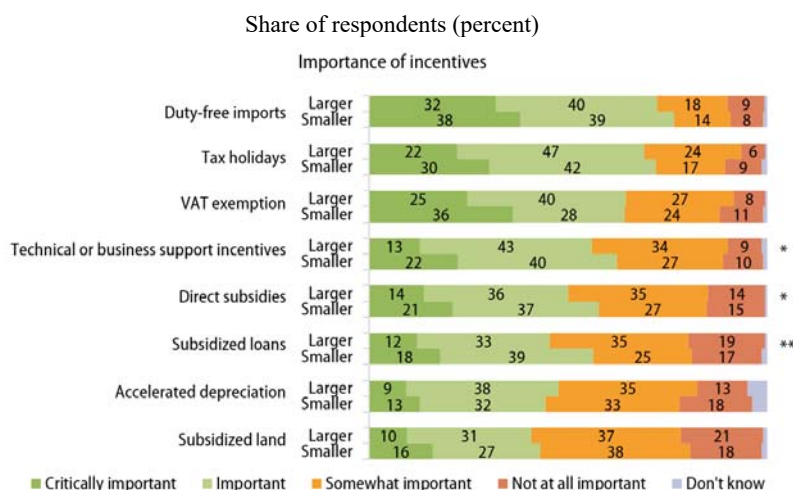


Source: Computation based on the GIC Survey.

Note: The question on incentives was answered by 663 respondents. These respondents answered somewhat important, important, or critically important on incentives in the question in Figure 8. VAT = value added tax.

Investors from relatively smaller firms value incentives more than those from large ones. Smaller investors consistently rate various instruments as more important, and the difference is statistically significant for three types—technical or business support incentives, direct subsidies, and subsidized loans (Figure 12).

Figure 12. Relatively Smaller Firms Find Incentives More Important than Large Ones



Source: Computation based on the GIC Survey.

Note: The question on incentives was answered by 218 respondents from relatively smaller firms and 435 respondents from large firms. These respondents answered somewhat important, important, or critically important on incentives in the question in Figure 8. VAT = value added tax.

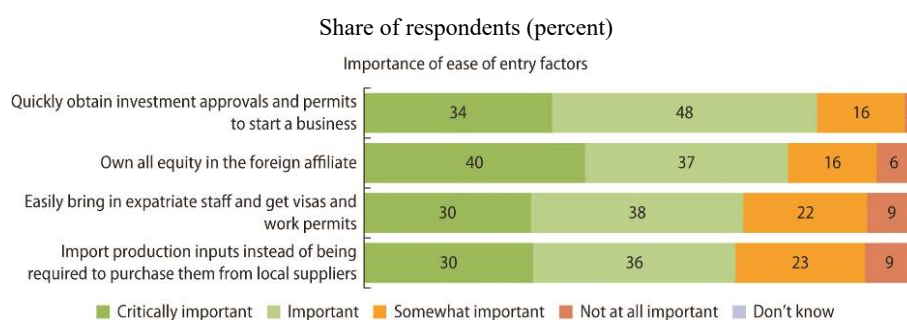
Obtaining fiscal and financial incentives typically takes three months but varies from about a week to over a year, depending on the country and type of incentive. About one-quarter of surveyed investors said obtaining incentives took less than one month, while about 6 percent noted it took more than a year.

Second Phase in the Investment Life Cycle: Investment Entry and Establishment

How Do Policies and Administrative Procedures for Business Establishment Affect FDI Decisions?

Investors strongly value business-friendly policies and efficient procedures related to business establishment. About four out of five respondents say that the ease of obtaining approvals for their investment is important or critically important, while only 2 percent say it is not at all important (Figure 13). In fact, the speed of obtaining approvals and permits ranks even higher than investors' ability to own all equity in a project, to easily bring in expatriate staff, and to import production inputs. For MNCs involved in efficiency-seeking FDI, all these characteristics are rated as more important relative to investors involved in other types of FDI. For firms involved in efficiency-seeking FDI, the ability to import production inputs is rated slightly more important (73 percent) than the ability to bring in expatriate staff (71 percent) while the reverse is true for firms involved in other types of FDI (61 and 65 percent, respectively).

Figure 13. Investors Strongly Value Business-Friendly Policies and Procedural Efficiency of Entry and Establishment of Affiliates



Source: Computation based on the GIC Survey.

Note: The questions on ease of entry were answered by 709 respondents. These respondents answered somewhat important, important, or critically important on ease of entry in the question in Figure 8.

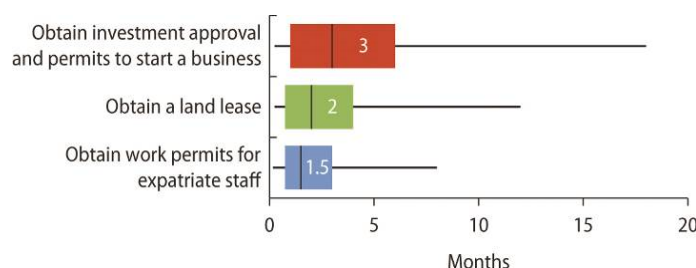
Although efficiency in obtaining permits is most important overall, restrictions on foreign equity ownership appear to be the biggest deal-breaker. Forty percent of respondents claim that owning all equity in their affiliate and not being required to share ownership with local firms or the government is critically important, highest among all policy factors considered. This result is significant in the context of foreign ownership restrictions still being relatively prevalent across developing countries, especially in services.

Obtaining investment approvals and permits to start a business typically takes three months but varies by country and type of investment (Figure 14). The variation is quite wide: on one end of the spectrum, about 10 percent of respondents say they waited less than a month while on the other end, another 10 percent of investors waited a year or longer. Respondents who value efficiency of government approvals encountered somewhat shorter waits. For this group, only 12 percent had processing times exceeding six months

compared with 25 percent otherwise. This confirms that investors who value efficiency tend to favor destinations where approvals are quicker to obtain.

The median length of time for obtaining a land lease is two months, and for obtaining work permits is about 1.5 months. The dispersion of responses for both of these formalities also appears tighter than for obtaining initial investment approvals. Fewer respondents also experience wait times longer than six months—9 percent of respondents when obtaining a land lease and only 6 percent when obtaining work permits.

Figure 14. Wait Times for Investment Approvals Vary but Typically Take Three Months



Source: Computation based on the GIC Survey.

Note: The boxplot shows the median point (with data label) as the middle bar. The ends of the boxes represent the 25th and 75th percentiles. The ends of the black lines show the 5th and 95th percentiles.

Third Phase in the Investment Life Cycle: Investment Operations and Growth

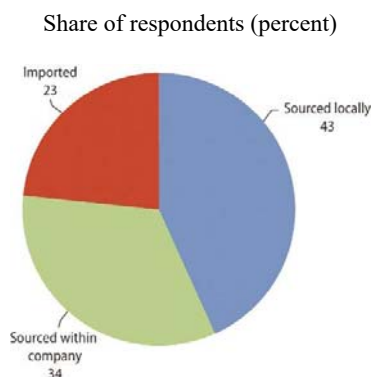
What Role Do Local Suppliers Play in MNCs' Operations?

FDI brings potential benefits to the host country through a variety of channels including linkages with the local private sector. Linkages between foreign firms and local suppliers enable knowledge and technology transfer, including know-how and practices that allow domestic suppliers to upgrade the quality and efficiency of their production. Linkages also expand the multiplier effect in the local economy. When foreign investors source inputs locally instead of importing them, they boost production of local firms and create jobs in the local economy. As such, policy makers try to promote linkages through various policies and programs. One such policy is local content requirements, where a certain percentage or absolute amount of local input is required of foreign firms. Research finds, however, that local content requirements and similar measures have a largely negative effect and discourage FDI.³

While investors resist being mandated to source their inputs locally, many of them prefer to do so if they are able to find in the local market the quality and quantity of the production inputs they need. On average, 43 percent of material inputs, supplies, and services are sourced locally, versus 34 percent of inputs sourced from another unit of the company and 23 percent of inputs imported (

Figure 15). The percentage of inputs sourced locally varies widely: about 13 percent of surveyed companies do not source any inputs locally, another 13 percent source all their inputs locally, and the rest of the firms (about 74 percent) source some portion of their inputs locally.

Figure 15. Nearly Half of Material Inputs, Supplies, and Services Are Sourced Locally

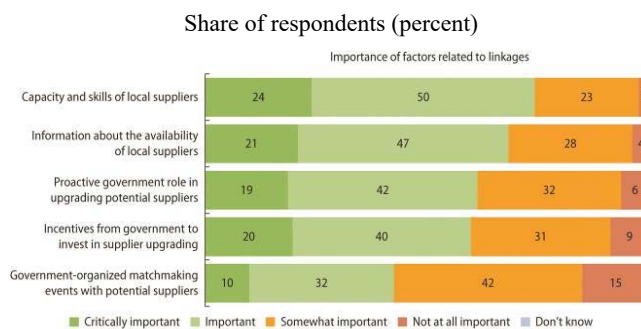


Source: Computation based on the GIC Survey.

Note: The number of respondents for each source vary and are fewer than 754 because some respondents answered “don’t know.”

Overall, 61 percent of MNCs consider linkages as important or critically important in their location decisions. Among those investors who identified linkages as at least somewhat important, 74 percent find that capacity and skills of local suppliers are important or critically important (Figure 16). Local skills and capacity are valued even more by MNCs involved in efficiency-seeking FDI (77 percent). This suggests that government initiatives to promote linkages will only be effective if local companies can offer the capacity and skills expected by MNCs. At the same time, governments of host countries have the scope to facilitate linkages. Investors value information on the availability of local suppliers, rated as important or critically important by 68 percent of respondents. About 61 percent of respondents also rate supplier upgrading as important, whether in the form of direct financial incentives for companies to invest in supplier development or governments’ own initiatives to upgrade suppliers. Only 42 percent of respondents value matchmaking events with suppliers. These government initiatives are rated as important by about 8 to 12 percentage points more by firms involved in efficiency-seeking FDI relative to other investors.

Figure 16. Capacity and Skills of Suppliers Are Critical Linkages-Related Features



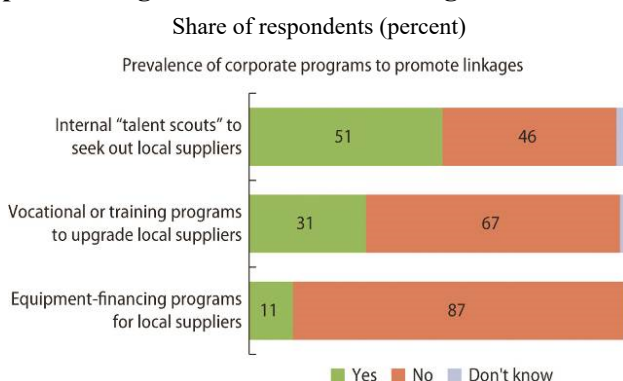
Source: Computation based on the GIC Survey.

Note: The questions on linkages were answered by 679 respondents who answered somewhat important, important, or critically important on the question, “How important are the capabilities of local firms to act as suppliers in your decision to invest in developing countries?”

When capacity and quality constraints in the local market prevent investors from finding appropriate suppliers, investors value being able to import inputs instead of being required to source them locally. This is especially true for MNCs involved in efficiency-seeking FDI and manufacturing firms. Many manufacturing MNCs invest in developing countries to reduce their cost of production, such as those seeking low labor costs. At the same time, to maintain a high quality of final products, which are often intended for export, foreign manufacturers appreciate the flexibility of importing their own inputs for production rather than sourcing them locally. In global value chains, the ability to source inputs from low-cost or more efficient producers, whether domestically or internationally, and within or beyond the firm’s boundaries, can result in cost advantages (OECD 2013). Of the surveyed manufacturing firms, 68 percent rate the ability to import inputs as important or critically important, as opposed to only 56 percent of services companies. Among firms involved in efficiency-seeking FDI, 73 percent find this attribute important or critically important while only 61 percent of firms involved in other types of FDI consider it important.

Foreign investors themselves also have an interest in promoting linkages, but company-initiated programs are uncommon. Sourcing inputs, supplies, and services locally instead of importing them can reduce costs for foreign-owned firms. Some MNCs have their own programs to promote linkages, but these are not widespread. The survey finds that, among the foreign firms that do source locally, half use internal “talent scouts” to find local suppliers. Firms involved in efficiency-seeking FDI tend to have talent scouts more often (55 percent) than investors involved in other types of FDI (45 percent). Over 30 percent have vocational or training programs to upgrade local suppliers, and 11 percent have equipment-financing programs for local suppliers (Figure 17). Among firms that have vocational or training programs, about a third sponsor certification programs and partner with local technical colleges and universities.

Figure 17. Corporate Programs to Promote Linkages Are Not Very Widespread



Source: Computation based on the GIC Survey.

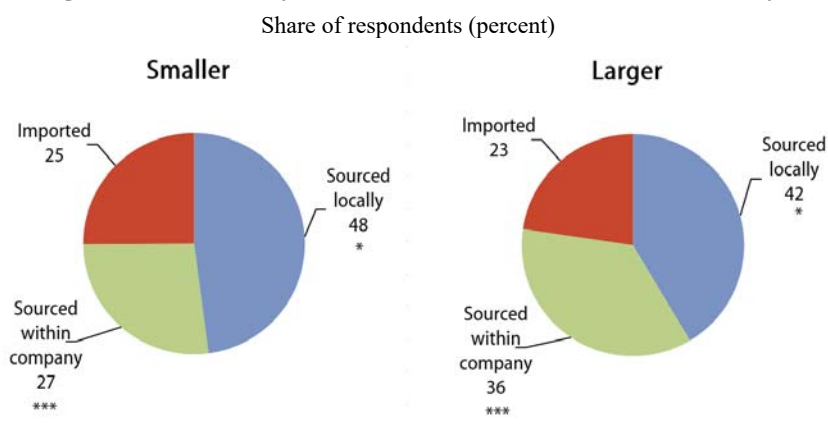
Note: These questions on corporate programs to promote linkages were answered by 454 respondents. These respondents answered somewhat important, important, or critically important on the question “How important are the capabilities of local firms to act as suppliers in your decision to invest in developing countries?” and source some or all of their inputs locally.

Relatively smaller MNCs tend to source more locally (48 percent), and source less from other units within the company (27 percent). Large firms, on the other hand, obtain inputs more commonly within the company (36 percent) and rely less on local sourcing (42 percent) (Figure 18). This

finding suggests that smaller MNCs have the potential of having greater linkages with the local economy. Despite this, they do not have as many corporate-led programs on linkages compared to large firms. Less than half have internal scouts to seek out local suppliers, and only under a quarter have vocational or training programs to upgrade local suppliers (Figure 19). Smaller enterprises likely lack the resources and capacity to promote linkages themselves, which is why they value government support more than large firms. Relatively smaller firms assign greater importance to government programs that help upgrading potential suppliers, incentives for supplier upgrading, and matchmaking events with potential suppliers (

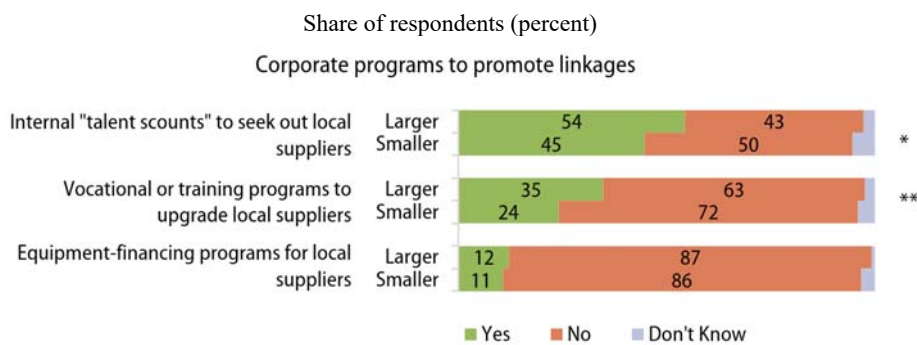
Figure 20).

Figure 18. Relatively Smaller Firms Tend to Source Locally



Source: Computation based on the GIC Survey.
Note: Totals do not add up to 100 due to rounding.

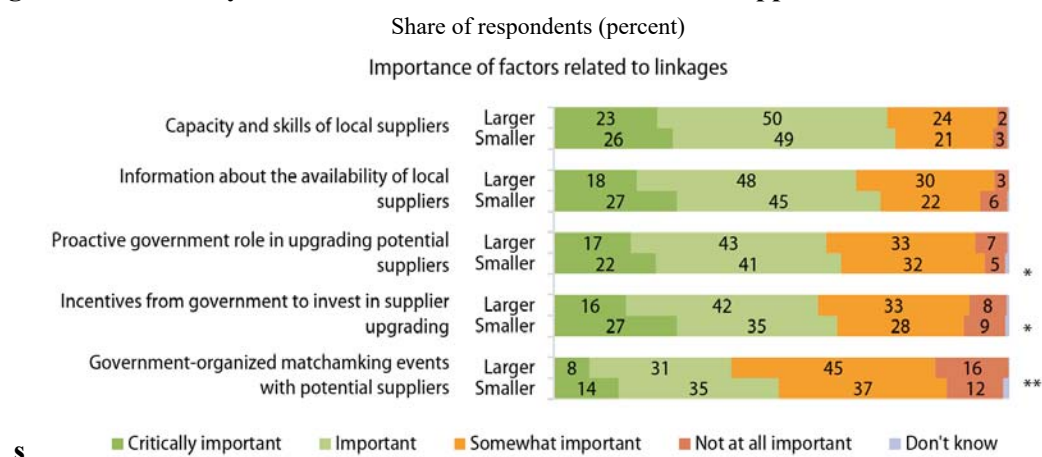
Figure 19 Relatively Smaller Firms Have Fewer Corporate Programs to Promote Linkages



Source: Computation based on the GIC Survey.

Note: These questions on corporate programs to promote linkages were answered by 150 respondents from relatively smaller firms and 296 respondents from large firms. These respondents answered somewhat important, important, or critically important on the question “How important are the capabilities of local firms to act as suppliers in your decision to invest in developing countries?” and source some or all of their inputs locally.

Figure 20. Relatively Smaller Investors Value Government Support to Promote Linkages



Source: Computation based on the GIC Survey.

Note: The questions on linkages were answered by 219 respondents from relatively smaller firms and 450 respondents from large firms who answered somewhat important, important, or critically important on the question, “How important are the capabilities of local firms to act as suppliers in your decision to invest in developing countries?”

How Much Do MNCs Reinvest in Host Countries?

Host countries not only need to attract and retain FDI, but also need to facilitate its growth to motivate investors to reinvest their earnings in the host country. Many variables may influence investors in deciding on the share of their profits to repatriate as dividends versus reinvest in growing their operations in the host country. These variables include taxation systems, transfer costs, investment opportunities in the ongoing business and elsewhere, relative costs of shifting financial resources out of the host country, and the need to expand the ongoing business. Reinvested earnings are becoming an increasingly important source of FDI, growing from less than 30 percent of FDI flows in 2007 to about 50 percent in 2015 (UNCTAD 2016). This trend is confirmed by the survey results, where over a third of respondents say that they reinvest all their profits in the host country, and another 14 percent reinvests more than half (Figure 21). This trend highlights the importance for host economies of retaining and expanding existing investments in addition to attracting new ones.

Figure 21. More than a Third of Investors Reinvest All Their Affiliate-Generated Profits Back into the Affiliate

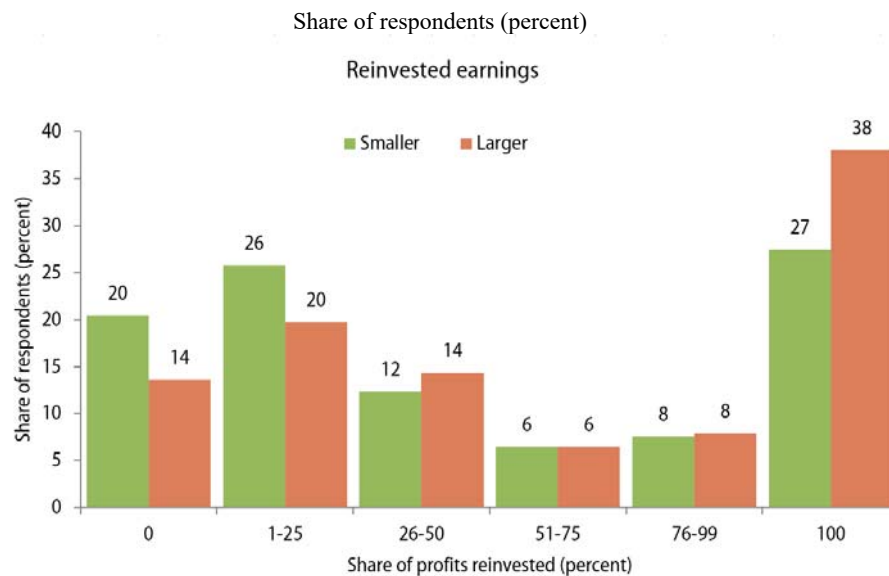


Source: Computation based on the GIC Survey.

Note: The question on reinvested earnings was answered by 597 respondents. The remaining 158 either refused, did not know the answer, or made the investment within the year. Respondents were asked about reinvested earnings in a specific developing country of their choice.

Large firms tend to reinvest a larger share of their profits back into their affiliates compared to smaller firms. Thirty-eight percent of respondents from large firms indicated that all their profits of the last fiscal year were reinvested in the affiliate, compared to only 27 percent of those from relatively smaller enterprises (Figure 22).

Figure 22. Large Firms Reinvest More Profits Back into their Affiliates



Source: Computation based on the GIC Survey.

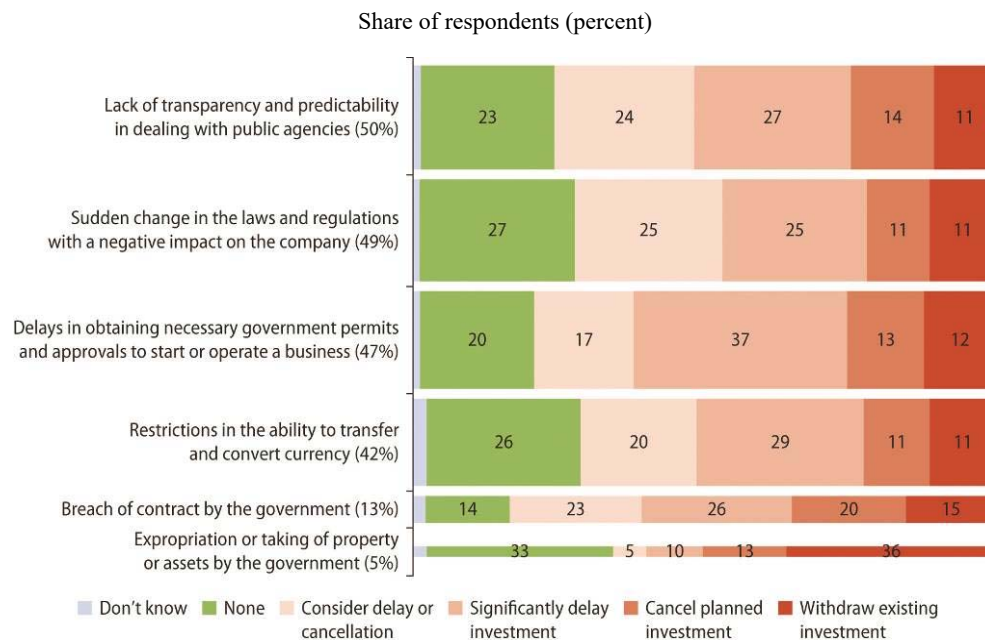
Note: The question on reinvested earnings was answered by 186 respondents from relatively smaller MNCs and 405 respondents from large firms. The remaining respondents either refused, did not know the answer, or made the investment within the year. Respondents were asked about reinvested earnings in a specific developing country of their choice. Totals may not add up to 100 due to rounding.

How Do Investors Respond to Political Risks?

Among survey respondents, 76 percent experienced political risks in their investment projects. Political risk is the probability of disruption of business operations by political forces or events, and especially by government actions. About half of respondents experienced lack of transparency and predictability in dealing with developing country public agencies. Almost half encountered adverse regulatory changes and delays in obtaining necessary government permits and approvals to start or operate a business. Over 40 percent encountered restrictions in transferring and converting currency. In these cases, about one in four investors canceled a planned investment or withdrew an existing investment owing to political risks (

Figure 23).

Figure 23. Severe Political Risks Are Infrequent but Can Have Highly Negative Effects on FDI



Source: Computation based on the GIC Survey.

Note: The height of the bars reflects the percentage of respondents that experienced disruption in any of their investments owing to the political risk identified. The risks are arranged in descending order from most frequently experienced at the top, to least frequently experienced at the bottom. The numbers across rows do not add up to 100 percent because respondents could select multiple types of disruptions that their companies had experienced. The horizontal bars show the responses of companies, with the darker red bars reflecting more severe reactions. The bars reveal the most severe reactions of companies after experiencing the particular disruption. If, for example, a company experienced withdrawing an existing investment in one country, but only delaying in another, the most severe reaction was considered and the company was included in the *withdraw* bar.

More severe cases of political risk occur less frequently but with far worse impact. Only 13 percent of respondents experienced breach of contract by the government but the impact was much greater—35 percent of those investors canceled a planned investment or withdrew an existing one. Expropriation was even more extreme: while only 5 percent of respondents experienced it, almost half of them canceled or withdrew an investment.

Investments in services tend to be more affected by political risk than manufacturing. Firms in the services sector experienced more disruptions related to political risk, particularly restrictions in transferring and converting currency, breach of contract by the government, and expropriation. Services—such as energy, telecommunications, or finance—are more tightly regulated than manufacturing, and thus more exposed to potential political interference. In particular, according to the survey results, companies in the utilities sector—including electricity, gas, alternative energy, and telecommunications—experience more frequent adverse regulatory changes and expropriation and more delays in obtaining permits. Construction and business services sectors report more frequent experiences of breach of contract by the government and lack of transparency and predictability in dealing with public agencies.

Governments should more adequately manage investor grievances. According to the survey, governments often do not effectively address grievances related to political risks. Only about one in five affected investors felt that their grievances were promptly resolved by the government, that the process of complaint was clear and efficient, or that the government introduced a systematic solution to address or prevent such grievances in the future.

Fourth Phase in the Investment Life Cycle: Potential Divestment

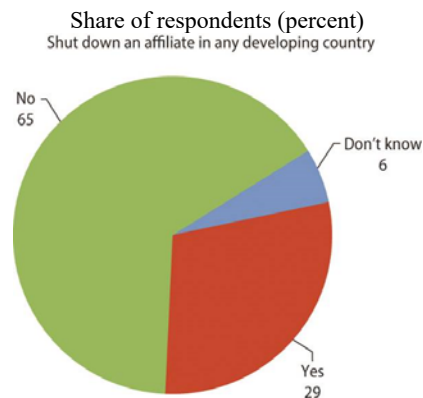
Why Do MNCs Divest from Developing Countries?

Some 29 percent of investors surveyed had shut down at least one of their company's affiliates in a developing country (Figure 24). The most common reasons were changes in the company's strategy and unstable macroeconomic conditions, including an unfavorable exchange rate. Increased policy or regulatory uncertainty was the third most common reason, which occurred in about a third of the divestment cases (

Figure 25). Arbitrary government conduct, sudden restrictions on currency transfer, and breach of contract by governments are reported as factors by more than 20 percent of investors. These results confirm that companies value transparency and predictability in the conduct of public agencies, as well as investment protections. Foreign investors in services divest more frequently than manufacturing MNCs, possibly because they are more highly regulated and thus vulnerable to political interference. Among the surveyed services companies, 35 percent had shut down an affiliate, versus just 23 percent of manufacturing firms.

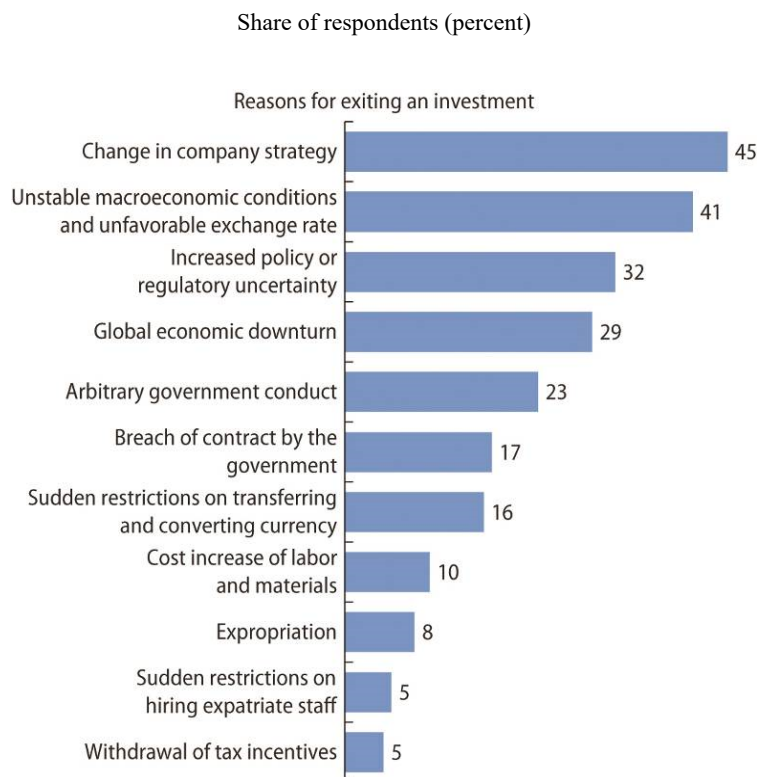
Although some reasons for exiting investments are beyond the control of governments of host countries, many are avoidable. While governments cannot do much about changes in investor firms' corporate strategies or about global economic conditions, they can influence factors in their own countries. In particular, maintaining an appropriately valued exchange rate, managing macroeconomic stability, and ensuring transparent, consistent, and predictable policies and regulations are critical in keeping investors from exiting.

Figure 24. More than a Quarter of Respondents Had Shut Down an Affiliate in a Developing Country



Source: Computation based on the GIC Survey.

Figure 25. Reasons for Exiting an Investment Are Mixed, Some Controllable and Others Not



Source: Computation based on the GIC Survey.

Note: Results are based on 219 respondents that were aware that their companies had shut down an

affiliate in a developing country. Shares do not add up to 100 because respondents could select up to five of the most relevant reasons.

VI. Conclusion and Policy Implications

To maximize the gains from foreign investments, developing country governments must adopt effective reform strategies, champion reform at the highest political levels, and strengthen interagency coordination. They must also balance the public interest with investor preferences to ensure that the host country truly benefits from FDI. The results of the survey of MNC executives highlight several priorities for policy makers in developing countries seeking to create a conducive business climate for FDI:

Targeting policies and reforms to relevant types of investors can maximize effectiveness and cost efficiency. While most investors value some characteristics across the board—such as investment protection guarantees and transparency and predictability—some policy variables are more important for certain investor types. Firms involved in efficiency-seeking FDI seem more responsive to incentives. Relatively smaller investors are more sensitive to government support and policy and regulatory uncertainty. Manufacturing firms may be more responsive to business-friendly policies on importing inputs, while services firms are more sensitive to adverse government conduct. These results reinforce the need for targeted policy approaches by governments, keeping in mind the specific types of FDI they wish to attract, retain, and harness for development.

Addressing policy reforms to attract FDI and offering aftercare services are equally important. Policy makers tend to focus on attracting FDI through investment incentives, facilitation, and proactive investment promotion. While these are important, investors say that investment protection is even more critical to them, suggesting that government efforts should also aim to encourage investors to stay in the country and expand their operations. Policy initiatives should include strengthening investor protection guarantees, providing proactive investor aftercare, managing grievances, and promoting linkages.

Predictable government conduct is at least as important to MNCs as countries' laws and regulations. Investors cited the importance of transparency and predictability in the conduct of government agencies as the most important among investment climate factors. Investors look not only at policies on paper, but also at implementation and administration of those policies. Implementation weaknesses can include bureaucratic inefficiencies, complex regulations and procedures, and unpredictable or arbitrary government conduct. Addressing these weaknesses can not only attract new investments, but also prevent divestments by existing investors.

Annexes

Table A.1. Location of Headquarters

Developed economies	No. of respondents	Percentage of respondents	Developing economies	No. of respondents	Percentage of respondents
Germany	111	14.72	South Africa	35	4.64
Spain	80	10.61	Argentina	23	3.05
United States	60	7.96	Turkey	20	2.65
Italy	53	7.03	India	16	2.12
Korea, Rep.	37	4.91	Mexico	14	1.86
Austria	36	4.77	Bulgaria	10	1.33
Japan	32	4.24	Brazil	9	1.19
France	30	3.98	China	8	1.06
United Kingdom	28	3.71	Malaysia	6	0.80
Netherlands	22	2.92	Russian Federation	6	0.80
Sweden	20	2.65	Nigeria	4	0.53
Switzerland	20	2.65	Colombia	4	0.53
Canada	6	0.80	Peru	4	0.53
Belgium	5	0.66	Venezuela, RB	4	0.53
Australia	4	0.53	Belarus	3	0.40
United Arab Emirates	1	0.13	Bosnia and Herzegovina	3	0.40
Uruguay	1	0.13	Guatemala	3	0.40
Chile	1	0.13	Romania	3	0.40
Taiwan, China	1	0.13	Serbia	3	0.40
Iceland	1	0.13	Ukraine	3	0.40
Finland	1	0.13	Kenya	2	0.27
Estonia	1	0.13	Costa Rica	2	0.27
Denmark	1	0.13	Panama	2	0.27
			Egypt, Arab Rep.	1	0.13
			Bolivia	1	0.13
			Botswana	1	0.13
			Ecuador	1	0.13
			El Salvador	1	0.13
			Pakistan	1	0.13
			Saint Lucia	1	0.13
			Sri Lanka	1	0.13
			Swaziland	1	0.13
			Thailand	1	0.13
			Uzbekistan	1	0.13
			Djibouti	1	0.13

Table A.2. Sectoral Distribution of Respondents

Sector	No. of respondents	Percentage of respondents
<i>Primary</i>	48	6.37
Agriculture, hunting, forestry, and fishing	22	2.92
Mining, quarrying, and petroleum	26	3.45
<i>Manufacturing</i>	353	46.83
Refined petroleum products, coke, and nuclear fuel	7	0.93
Agroprocessing, food products, and beverages	24	3.18
Textiles, apparel, and leather	23	3.05
Chemicals and chemical products	24	3.18
Rubber	5	0.66
Plastic products	14	1.86
Pharmaceuticals, biotechnology, and medical devices	26	3.45
Metals and metal products	39	5.17

Nonmetal mineral products	3	0.40
Wood and wood products (other than furniture)	3	0.40
Furniture	2	0.27
Paper and paper products	6	0.80
Printing and publishing	4	0.53
Automobiles, other motor vehicles, and transport equipment	67	8.89
Information technology and telecommunications equipment	6	0.80
Machinery, and electrical and electronic equipment and components	64	8.49
Other manufacturing	36	4.77
<i>Services</i>	336	44.56
Electricity, gas, and water	20	2.65
Alternative energy	19	2.52
Construction	53	7.03
Wholesale and retail trade	43	5.70
Hotels and restaurants	7	0.93
Other travel and tourism-related services	8	1.06
Logistics, transport, and storage	35	4.64
Telecommunications	13	1.72
Computer and software services	10	1.33
Financial services including insurance	44	5.84
Real estate	4	0.53
Business services	18	2.39
Professional, scientific, and technical services	32	4.24
Health services	8	1.06
Media and entertainment	7	0.93
Other services	15	1.99
<i>Other</i>	17	2.25
Total	754	100.00

Table A.3. Sectoral Distribution of Respondents Compared with Sample Frame

NACE Section		Respondents	Sample Frame
A	Agriculture, Forestry and Fishing	0.7%	0.7%
B	Mining and Quarrying	1.4%	1.7%
C	Manufacturing	37.8%	38.9%
D	Electricity, Gas, Steam and Air Conditioning	1.8%	0.8%
E	Water Supply, Sewerage, Waste Management and Remediation Activities	0.0%	0.2%
F	Construction	4.6%	3.4%
G	Wholesale and Retail Trade; Repair of Motor Vehicles and Motorcycles	11.2%	8.9%
H	Transportation and Storage	1.1%	1.0%
I	Accommodation and Food Service Activities	0.7%	0.3%
J	Information and Communication	3.2%	3.7%
K	Financial and Insurance Activities	13.7%	17.1%
L	Real Estate Activities	0.6%	0.4%
M	Professional, Scientific and Technical Activities	8.8%	7.9%
N	Administrative and Support Service Activities	3.6%	3.8%
O	Public Administration and Defence; Compulsory Social Security	0.0%	0.0%
Q	Education	0.0%	0.0%
S	Human Health and Social Work Activities	0.0%	0.0%
(blank)		9.8%	6.1%

Source: Computation based on sample frame drawn from Dunn and Bradstreet.

Note: The D&B sample frame contains many missing values (28% of records) on the NACE code. This list is calculated by the authors, drawing from a field that contains “line of business” and mapping to a NACE code.

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