One out of every three dollars invested abroad in 2013 originated in firms from developing and emerging countries. These companies have become major sources of foreign direct investment (FDI) and increasingly salient players in global markets. Yet we still have a limited understanding of the factors driving their impressive rise and their patterns of internationalization. *New Voices in Investment: A Survey of Investors from Emerging Countries* sheds light on the characteristics, motivations, strategies, and needs of emerging-market investors.

Drawing on a survey of more than 710 investors and potential investors, *New Voices in Investment* shows that outward FDI from emerging markets is primarily market seeking. Emerging-market firms consider not only the size of the host economy, but also the opportunities for regional market expansion, when taking location decisions. However, these firms confront significant transaction costs from investing in distant, culturally dissimilar markets, which result in a strong regional bias in their internationalization strategies. This regional concentration is stronger for investment in the services sector, where firms face higher transaction costs associated with geographical and cultural differences.

Several aspects of the policy and business environments also influence the location decisions of investors from emerging economies. International trade and investment agreements increase the perceived attractiveness of a host country to potential investors.

Far from being immune to political risk and cultural uncertainty in host markets, those firms that are more averse to these conditions seem to self-select out of foreign investment. Investors, in turn, value political stability and transparency more than corruption control and fair elections in the host country.

Overall, the new transnational companies (TNCs) from emerging economies do not differ dramatically from their predecessors in previous waves of outward FDI. Yet, these new TNCs are more active participants in global markets and international production networks. By maintaining market-friendly, liberal trade and investment policies and pursuing international economic agreements, the governments of developing countries can increase their attractiveness in the eyes of these firms. Providing a stable and transparent regulatory environment would contribute not only to expand investment from incumbent firms, but also to attract inflows from new investors. Investment promotion agencies (IPA) in developing countries also have an important role to play, by more effectively promoting investment opportunities and addressing the informational asymmetries confronted by new investors.

New Voices in Investment will be a useful book for development practitioners, academics, and policymakers involved in the design of investment promotion initiatives.

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A WORLD BANK STUDY

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A SURVEY OF INVESTORS FROM EMERGING COUNTRIES

Laura Gómez-Mera, Thomas Kenyon,
Yotam Margalit, José Guilherme Reis,
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Preface

This book was prepared by staff and consultants in the World Bank's Trade and Competitiveness Global Practice in response to a new reality, namely, the impressive rise in South-South and South-North capital flows, almost surpassing traditional North-South investments. Indeed, almost one out of every three dollars invested abroad in 2013 originated in multinationals from developing countries. This process has been materializing over the last two decades as large developing countries have become important sources of outward foreign direct investment (FDI).

Yet, we have limited knowledge about the factors behind the rise of these new global players, and our understanding of their patterns and strategies of internationalization are similarly lacking. What are the main characteristics of firms that invest abroad and how do they differ from those that don't? What are the principal motives for emerging-market transnational companies (TNCs) to invest abroad? What factors influence their choice of investment destinations? And to what extent (if at all) do these firms and the strategies they follow differ from those of TNCs from developed countries? This study contributes to answering these questions using data from a rich survey conducted by the United Nations Industrial Development Organization (UNIDO) and the World Bank on investors, potential investors, and noninvestors from four emerging or newly emerged economies, namely Brazil, India, South Africa, and the Republic of Korea.

Many of our reviewers and colleagues provided extremely useful comments. We would particularly like to thank Vincent Palmade and Thomas Farole for their keen insights as they reviewed the book. We are also grateful to David Bridgman, Theodore Moran, Chunlin Zhang and Leonardo Iacovone for their insightful feedback in the early stages of the project. Michael Ferrantino and Swarnim Wagle, from the International Trade Unit of the World Bank, and Roberto Echandi, Robert Whyte, and Peter Kusek, from the International Financial Corporation, generously contributed their ideas. Mona Haddad, practice manager of the International Trade Unit, was consistently supportive and provided overall guidance and the resources essential to making this book a reality.

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His past positions include Secretary for Economic Policy with the Ministry of Finance in Brazil, 2001–02, and Chief of Economic Advisors with the Ministry of Planning and Budget, 1999–2001. He holds a master's degree in economics

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Executive Summary

The last two decades have seen large developing countries become important sources of outward foreign direct investment (FDI). Looking only at firms from the "BRICS" (Brazil, the Russian Federation, India, China, and South Africa), their outward direct investments rose from $7 billion in 2000 to $145 billion in 2012 and $200 billion in 2013. Moreover, firms from developing economies generated almost one third of global FDI outflows in 2013. Yet, we still have a limited understanding of the factors driving the impressive rise and expansion of firms from emerging and developing economies.

This study sheds light on the characteristics, motivations, strategies, and needs of emerging-market investors. It uses data from a survey of investors and potential investors in four emerging economies: Brazil, India, the Republic of Korea, and South Africa. A joint project with United Nations Industrial Development Organization (UNIDO), the "Potential Investor Survey" includes interviews with 713 firms, randomly drawn from registries that contain all firms with revenues of at least $25 million and operating in one of five sectors: finance and insurance, manufacturing, wholesale trade, retail trade, and transportation and warehousing. While UNIDO implemented the survey in India, South Africa, and Korea, the World Bank was responsible for conducting it in Brazil.

While most existing surveys of foreign investors focus exclusively on companies that are engaged in foreign investment, our sample includes also firms that considered investing but decided not to, and firms that never even considered investing abroad. The data, thus, allow us to reveal differences in incentives and obstacles faced by investors, potential investors, and noninvestors. In addition, the survey provides information on the different characteristics and motivations of investors across the four countries included in the sample. Finally, the survey produces data on the actual experiences of investors on the ground and their perceptions of what needs to be addressed to improve the business climate in host countries. This information is particularly useful for national investment promotion agencies (IPAs), enabling them to focus and target promotion efforts more efficiently.

Who Are the Investors and Where Do They Go?

Our findings reveal significant differences among companies that invest in developing countries and those that don't. Firms that are publicly listed, owned by domestic capital, and are larger in terms of their labor force are more likely to invest in developing countries. Moreover, investors are significantly more dependent on international trade than noninvestors. Indeed, the greater the proportion of earnings that a firm derives from international trade, the more likely it will be to consider investing abroad. The links between trade internationalization and the tendency to invest abroad highlight the complementary nature of international trade and FDI for emerging economies. As emerging economies increase their exposure to international competition, their firms enhance their competitiveness and develop firm-specific advantages, becoming outward investors.

Although companies in our sample have investments in all regions of the world, there is a clear regional and cultural bias, particularly in services. This regional concentration suggests that firms from emerging markets face substantial informational costs when host markets are dissimilar or distant from home markets. Among the firms in our sample, Indian companies are the most globalized, with a considerable proportion of firms investing in East Asia, the Middle East, and Africa. By contrast, South African and Brazilian firms are strongly concentrated in their regions. These differences in geographical reach appear to reflect asymmetries in sophistication and competitiveness levels among companies in our sample.

Why Do Firms Invest Abroad?

Outward foreign direct investment (OFDI) from emerging markets is primarily market seeking. These findings contradict claims by some recent work on emerging-market OFDI that the new transnational corporations follow asset augmenting strategies, driven by the goal of accessing technology, brands, and managerial and organizational competencies. Indeed, accessing new markets was claimed to be the main motivation for almost 70 percent of investors in the sample. For 20 percent of investors surveyed, lowering production costs was the most important motive for investing abroad. Acquiring natural resources and inputs, conversely, was only selected as the main motivation for investment by 5 percent of firms.

Expanding regional and host markets emerged as the most important factor influencing the location of investments. Almost one fourth of respondents selected the size of the regional market as the top location factor, followed by the presence of key clients, with almost 20 percent of responses. Taken together, the presence of a variety of potential counterparts, including not only clients but also competitors, partners for joint ventures, and other foreign investors, was ranked as a top motivation by almost 30 percent of respondents. By contrast, low labor costs were identified as the most important factor influencing the location of investments by only 12 percent of respondents.

Korean companies, much more integrated in the global marketplace and in global and regional value chains than those from Brazil, India, or South Africa, are much more efficiency seeking than the rest. They are more concerned with lowering production costs and gaining access to cheap inputs than their Brazilian, Indian, and South African counterparts. The greater emphasis that Korean companies place on the cost of inputs may also reflect, first, their geographical position in what is known as "Factory Asia;" second, Korea's rising wages relative to other countries in the region; and last but not least, the fact that they face lower nonpolicy-related costs of trading than firms from the three other countries. The relative ease with which Korean firms can trade with other countries makes OFDI for the purpose of market expansion less necessary than for their Indian, Brazilian, and South African counterparts.

Do Geographical and Cultural Barriers Offset the Attractiveness of a Large Market?

Emerging-market firms face binding costs of investing in distant, culturally dissimilar markets, resulting, in practice, in a trade-off between market size and market familiarity. Our empirical findings show that the combination of gross domestic product (GDP) per capita and population of the destination market are significant determinants of the probability of investing in a particular market. At the same time, physical distance between markets reduces the probability of investing in a given destination, while transaction and information costs associated with different languages, lack of a common colonial history, or not sharing borders are, jointly, negative contributors both to the probability of investing, and to the number of investments in a given market. Interestingly, investments from Korean and Indian firms that have had a longer tradition in international investments show a relatively broader geographical scope.

Transaction costs associated with geographical and cultural differences have a greater impact on firms in the services sector, which exhibit a stronger regional bias. In line with the literature, we demonstrate that relative to manufacturers, investors in services show a preference for relatively similar and closer host markets, revealing that in services, in-depth knowledge of the host market is more valuable than in manufacturing. Indeed, taking Brazilian investors as a benchmark, the investment sensitivity to distance for service sector investors is close to 80 percent greater than for manufacturers. Within services, it is in transport and warehousing services where the sensitivity to distance seems greatest.

How Do International Trade and Investment Agreements Influence Firms' Decisions to Invest?

Bilateral investment treaties (BITs) partly offset the costs associated with investing in faraway and/or unfamiliar markets. Having a BIT with a particular destination country increases the likelihood of investing there. Most BITs contain commitments

to protect foreign investors in the host country, ranging from assurances of fair, equitable, and nondiscriminatory treatment to undertakings to observe investment contracts and other investment-related obligations. These protections are accompanied by a powerful international arbitration mechanism that allows investors to bring claims directly against the host state. Thus, by providing stable and clear rules, BITs facilitate cross-border investments. It is also possible, however, that BITs are signed between countries that already have close ties and implicit mechanisms for better conflict resolution.

International trade agreements also increase the perceived attractiveness of a host country to potential investors. Experimental data drawn from the survey suggests that, while the host country's participation in international trade and investment treaties may not be the *most* prominent factor influencing the choice of an investment location by transnational companies (TNCs) from emerging markets, it is taken into account by a sizable share of foreign investors. Firms prefer investing in countries that are members to trade and investment agreements because these treaties allow them to benefit from lower barriers of access to other countries' markets and to export back to the home country. These market-enhancing effects of international agreements appear to be more relevant than their role as signaling mechanisms, or as commitment devices constraining predatory behavior by host governments.

Do Political Risk and Poor Governance Hinder Investment?

Political risk and uncertainty constitute binding constraints that deter emerging-market firms from investing in developing markets. This result contrasts with claims that firms from emerging economies may be relatively immune to political instability in host markets because they are typically more exposed to these conditions in home markets. Evidence reported here suggests that the extent to which political factors are identified as a constraint differentiates investors and noninvestors. Investors are less concerned than noninvestors about political risk and instability in developing countries. Firms that considered investing in developing countries but decided against it also exhibited greater concern with political risk than investors, suggesting concerns over political conditions may be discouraging some firms from entering developing markets. Yet, our findings also show that concerns over political and institutional factors are not as important as market and business opportunities in determining the location of investments.

Investors value political stability and transparency more than corruption control, fair and regular elections, and risk of expropriation in the host country. Firms from emerging markets do not seem deterred by irregular or corrupt practices, the low quality of democracy, and insecurity, as long as these issues are predictable and can be anticipated. This finding is more in line with the hypothesis of the "adversity advantage" that firms from emerging markets that self-select into foreign investment activities face relative to competitors from advanced economies. In the light of the various results reported here, this

"adversity advantage" may apply to some "adversities," but not others, and may be held by some, but not by all, firms from emerging markets. These findings also echo results from recent survey evidence pointing to regulatory uncertainty as a major deterrent to foreign investment.

How Effective Are Investment Promotion Agencies (IPAs) in Facilitating Investment from Emerging-Market Multinationals?

IPAs play only a marginal role in raising awareness of investment opportunities in developing countries, and may be particularly ineffective in many African countries. Less than 2 percent of firms became aware of opportunities for investment in the host country through direct contact with these national agencies. IPAs in many African countries appear to be particularly ineffective in generating awareness among potential investors. Our survey results indicate that rather than relying on IPAs, firms investing in Africa rely on domestic customers and suppliers, and existing foreign investors to obtain relevant market information and learn about investment opportunities.

Nevertheless, IPAs appear to be a widely used and useful resource for investors once they have made the decision to enter a specific market. Almost 70 percent of firms with investments in developing countries reported having relied on the services provided by IPAs upon deciding to invest in a particular developing country. Indeed, IPAs seem to be particularly useful for companies at an early stage in the decision to invest, by providing information on procedures and regulations of doing business as well as on corporate taxation and incentives.

IPA services tend to be more valuable for *smaller* and less productive firms, for which access to information is more costly. The marginal benefit of interacting with IPAs decreases with the opportunity cost of firms' time. This is revealed by the negative association between labor productivity and perceptions of usefulness of IPA services. Characteristics such as involvement in international trade and sector of operation are positively associated with a firm's decision to use IPA services but not with the perceived usefulness of these agencies.

How Do Emerging-Market Investors Differ from TNCs in Earlier Waves of FDI Expansion?

Overall, the new TNCs from emerging economies do not differ dramatically from investors from developed and developing countries in previous waves of OFDI. Several scholars have stressed the qualitative differences in the sectoral composition, geographical scope, motivations, and strategies of emerging-market investors in the 2000s and TNCs in the 1960s and 1970s. The data from the survey, however, find little support for these claims. According to our analysis, much of the OFDI from emerging economies continues to be mainly market seeking and efficiency seeking. While the new wave of OFDI from emerging markets has allegedly concentrated in the tertiary sector, in our sample, we find a significantly stronger tendency by manufacturing firms to invest abroad. Finally,

while the literature highlights the increasingly global geographical reach of the new TNCs from emerging countries, the survey reveals a strong regional bias, particularly in services. A critical message of our survey, therefore, is that foreign investors from emerging economies have similar priorities and needs as more traditional TNCs from developed countries.

However, the similarities should not be overstated. The acceleration of economic globalization in the last few decades has certainly modified the environment in which international firms operate. The new TNCs from emerging markets, unlike their predecessors, are active participants in the process of globalization, being integrated in global value chains. While still mainly focused on their regions, firms from some countries, such as India and Korea, appear to be increasingly broadening their geographical reach.

What Can Developing Countries Do to Attract More FDI from Emerging-Market Firms?

Maintain market-friendly, liberal trade and investment policies. Investors are primarily interested in accessing markets through which they can take advantage of the opportunities of an increasingly globalized economy. By maintaining market-friendly, liberal trade and investment policies, the governments of developing countries can offer greater opportunities for investors to participate in global and regional production networks, thus increasing the attractiveness of the host country.

Join international trade and investment agreements. We find that both preferential trading agreements and BITs have a positive effect on investors' choices. In contrast to recent studies that see international trade agreements as crucial commitment and signaling mechanisms, our evidence shows that these trade deals are primarily valued for the market opportunities they create. BITs, in turn, by providing clear rules and arbitration procedures, appear to reduce uncertainty and information asymmetries, therefore partially offsetting the costs of geographical and cultural barriers to investment. Signing and implementing international economic agreements can thus help developing countries to lure investors from emerging economies.

Provide a stable and predictable political and institutional environment. Our findings indicate that, far from being immune to political risk and cultural uncertainty in host markets, those firms that are more averse to these conditions seem to self-select out of foreign investment. Policymakers should take special stock of these novel findings, which illuminate the obstacles confronted not only by incumbent firms, but also by the self-selected non-investors. By deepening trade and investment liberalization and expanding opportunities for participation in regional production networks, the governments of developing countries can help increase investment by existing firms. Yet, attracting new firms—populating the 'once-desert land' with hippos and not just with camels—requires addressing other binding constraints, such as poor governance, a weak regulatory and legal environment, and high informational and transaction costs associated with

cultural specificities. Our results suggest that a progressive reduction of transaction costs and political risk could turn potential investors into actual investors. This is crucial, given that much of the growth of emerging markets FDI happens along the extensive, rather the intensive margin.

Revamp IPAs and increase their effectiveness in raising awareness of investment opportunities and meeting investors' needs. The findings of the study point to several areas in which these agencies have been unsuccessful in meeting the needs of actual and potential investors. They suggest that much could be gained if IPAs in developing countries stepped up their efforts to promote investment opportunities and bridge the informational gap that exists for many potential investors that aspire to reach global markets. At the same time, given the importance of existing investors in attracting new firms, there is much to be gained from IPAs developing close relationships with the existing FDI base by, for example, improving services in the implementation and operation stages. Services such as facilitating access to utilities and infrastructure, providing information on additional sources of financing, and promoting linkages with suppliers and buyers could help attract new investors.

Abbreviations

BIT	bilateral investment treaty
BRICS	Brazil, the Russian Federation, India, China, and South Africa
EPZ	export processing zone
FDI	foreign direct investment
GDP	gross domestic product
GDPPC	gross domestic product per capita
GVC	global value chain
IDP	International Development Path
IFC	International Finance Corporation
IPA	investment promotion agency
IPI	investment promotion intermediary
IT	information technology
ITPO	Investment and Technology Promotion Office
M&A	mergers and acquisitions
MAOTRI	market access overall trade restrictiveness indicators
NTB	nontariff barrier
OECD	Organisation for Economic Co-operation and Development
OFDI	outward foreign direct investment
OLI	Ownership, Location, and Internationalization
OLS	ordinary least squares
R&D	research and development
SAR	special administrative region
SEZ	special economic zone
TNC	transnational company
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organization

Note: All dollars are U.S. dollars unless otherwise indicated.

CHAPTER 1

Introduction

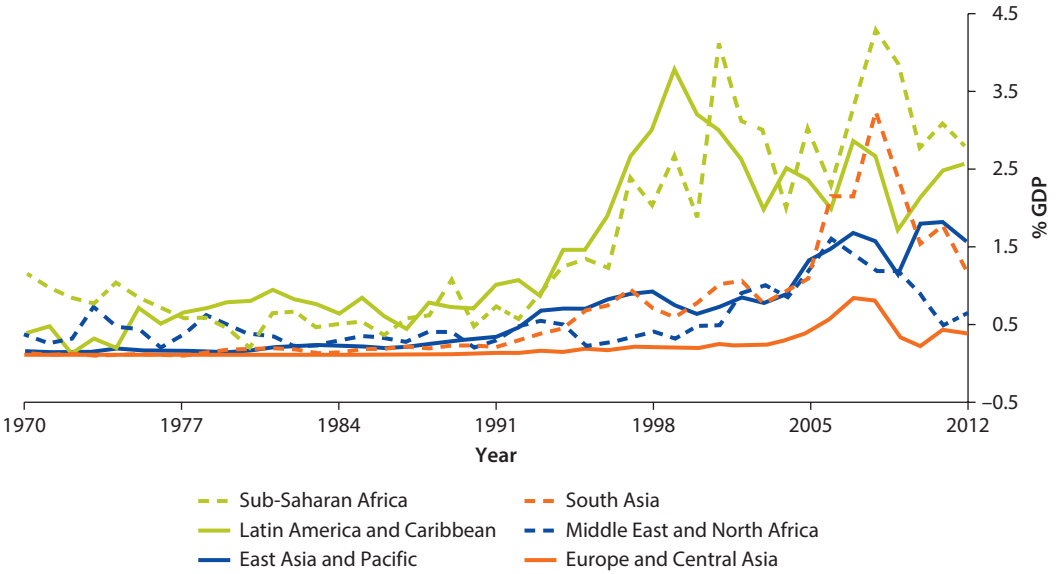
Context and Rationale

The last two decades have seen a sharp rise in the importance of multinationals to developing countries, both as a source of external finance and in their contribution to growth through capital formation, technology transfers, the diffusion of management and organizational practices (see figure 1.1 for the trends of net foreign directive investment [FDI] inflows into different regions). International trade and global production are becoming increasingly organized in highly fragmented and geographically dispersed global value chains. At the same time global buyers and global investors are constantly reassessing their operations and location decisions, and evaluating the business climate in countries all over the world.

An extensive body of literature has examined various aspects of the growth in FDI to the developing world, including its drivers, its economic and social impact, and the factors explaining its uneven distribution among different countries. Much less attention has been paid to another important recent phenomenon, namely, the rise of outward FDI from developing and emerging economies themselves. Outflows from developing economies increased more than tenfold in ten years, reaching $147 billion in 2000. By 2006, outward FDI from developing economies reached $242 billion, accounting for 17 percent of total FDI outflows. The share of developing economies in global FDI flows has continued to increase in recent years, reaching 32 percent in 2012. In terms of stocks, in 2011, firms from developing economies accounted for 1 out of every 5 dollars of equity held by multinationals worldwide, almost tripling the same ratio during the early 1990s (see figure 1.2).

The observed increase in outward flows of FDI from emerging economies partly reflects their growing importance in the global economy. The share of global gross domestic product (GDP) by the so-called "BRICS" (Brazil, the Russian Federation, India, China, and South Africa), rose from 7 percent in 1991 to 18 percent in 2010 (Figure 1.3). In addition, a number of factors, such as the acceleration of economic globalization, the spread of trade and investment policy

Figure 1.1 Net FDI Inflows



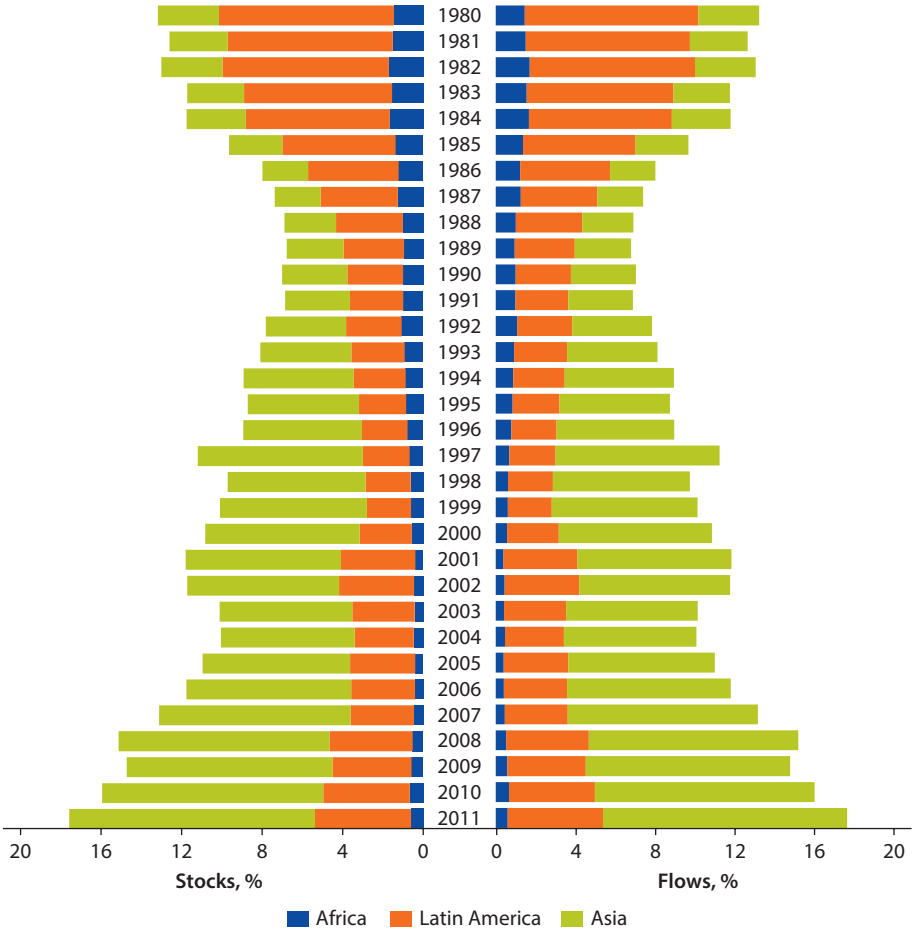
Source: World Development Indicators.

reforms, and the surge in international trade and investment agreements have contributed to the outward expansion of transnational companies (TNCs) from these emerging economies. Through a gradual accumulation of technological capabilities and firm-specific advantages, these TNCs have become increasingly important competitors in the global economy.

Indeed, outward FDI from the BRICS alone reached $145 billion in 2012, with China alone accounting for almost 57 percent ($84 billion) of these flows. Chinese outward FDI flows reached an annual average of $50 billion in 2005–12. Russia was the second main investor among the BRICS countries during this period, with an annual average of $45.4 billion, followed by India ($13.6 billion), Brazil ($6.9 billion) and South Africa ($1.5 billion). In 2012, however, outward foreign investment by South African companies reached $4.3 billion, surpassing outward FDI by Brazilian companies, which divested in net, registering a negative outflow of $2.8 billion (UNCTAD 2013).

Yet, we have limited knowledge of who these new global players are, the factors behind their rise, and their patterns and strategies of internationalization. What are the main characteristics of firms that invest abroad and how do they differ from those that don't? What are their principal motives for emerging-market TNCs to invest abroad? What factors influence their choice of investment destinations? And to what extent (if at all) do these firms and the strategies they follow differ from those of TNCs from developed countries? This study contributes to answering these questions, using data from a survey of investors and potential investors in four emerging economies: Brazil, India, the Republic of Korea, and South Africa.

Figure 1.2 Evolution of Outward FDI from Developing Regions



Source: World Bank based on UNCTAD.

Following the recent literature on emerging-market TNCs, we explore a number of hypotheses on the characteristics, motives, and strategies of these firms:

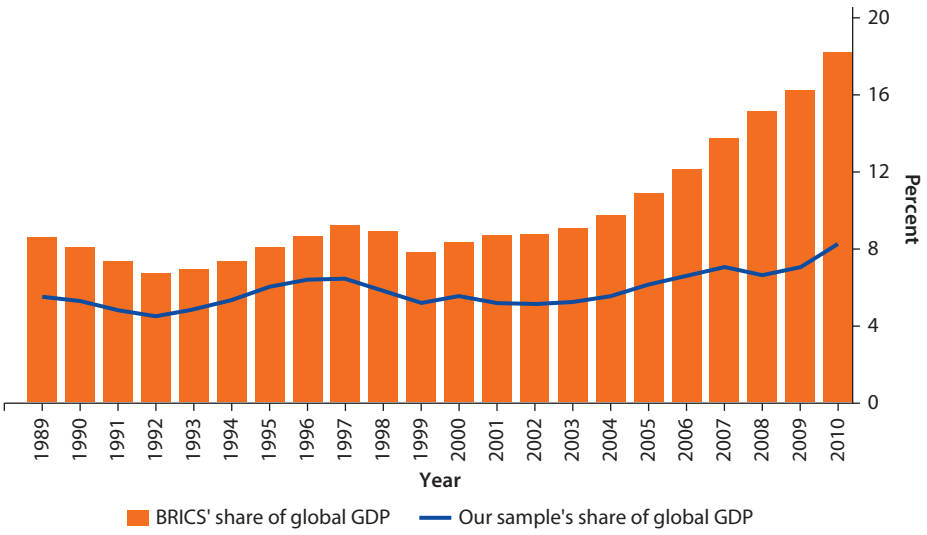
1. **Characteristics of Investors**: Emerging-market investors are larger and more dependent on international trade than noninvestors.
2. **Sectoral Composition**: Emerging-market firms invest not only in the manufacturing sector but also in the services industries, including business services, trade, finance, and transport.
3. **Destinations**: Although increasingly global in scope, outward foreign direct investment (OFDI) from emerging markets faces substantial informational costs when host markets are dissimilar or distant from home markets, resulting in a sizable regional bias.
   a. This regional bias is stronger for firms in the services sector.

4. **Motives and Drivers**: OFDI from emerging markets is primarily market and efficiency seeking. Accessing new (domestic and regional) markets is a fundamental motivation for emerging-market TNCs.
   a. Membership in international economic agreements increases the perceived attractiveness of a host developing country by providing opportunities for investors to access new markets and to export back to the home country.
5. **Adversity Advantage**: Given their experience in volatile economic and political environments, TNCs from emerging markets are less averse to political risk, institutional instability, and regulatory uncertainty in the developing world.

We also explore the role of investment promotion agencies (IPAs) in developing awareness of investment opportunities and providing assistance to potential investors, thus alleviating some of the main institutional and informational obstacles to investment:

6. **IPAs** are a useful resource for TNCs from emerging markets, providing valuable services at the various stages of the investment process (decision, entry, implementation, and operation phases).
   a. The roles and usefulness of IPAs depend on the characteristics and motivations of the foreign investors.
   b. Small firms, for which access to information is more costly, find IPA services more useful than their larger counterparts.
   c. Firms that invest in Africa tend to find IPA support less relevant and useful.

Figure 1.3 BRICS' Share of Global GDP, 1989–2010



Source: World Bank based on World Development Indicators.
Note: BRICS = Brazil, Russia, India, China, and South Africa; GDP = gross domestic product.

Methodology

A joint project with United Nations Industrial Development Organization (UNIDO), the "Potential Investor Survey" includes interviews with 713 firms from four countries: Brazil, India, South Africa, and Korea. The firms interviewed in the study were randomly drawn from registries that contain all firms that have annual revenues of at least US $25 million and that operate in one of five sectors: finance and insurance, manufacturing, wholesale trade, retail trade, transportation, and warehousing. While UNIDO implemented the survey in India, South Africa, and Korea, the World Bank was responsible for conducting it in Brazil. The rationale for excluding natural resources and focusing largely on manufacturing and services was twofold. First, this decision partly reflected the industrial mandate and priorities of UNIDO, which completed the first round of surveys in India and South Africa. But in addition, while investment in natural resources continues to account for a significant proportion of total FDI, its drivers and patterns of geographical expansion tend to differ markedly from investment in manufacturing and services.

The survey relied on face-to-face and phone interviews, carried out in 2009–11. The instrument contains a number of subjective and open-ended questions that required familiarity with the company's investment strategy. It also includes a set of survey experiments to test competing findings in past research. Respondents were presented with a set of vignettes, each representing a hypothetical investment scenario, which they were asked to evaluate on a five-point scale. The vignettes were constructed in such a way as to allow variation on our factors of interest, while controlling for others. Kenyon and Margalit (2012) use this data to draw inferences about the relative importance of international trade and investment treaties in company decision making.

Scope

This survey is complementary to others conducted by the World Bank and similar organizations (for example, the Doing Business indicators, Enterprise Surveys, and the World Economic Forum's Global Competitiveness Index). Many of the questions in our survey instrument (in particular those relating to aspects of the investment climate) are constructed so as to allow direct comparison with responses from the Enterprise Surveys. And like the Enterprise Surveys, our data will allow researchers and policy makers to explore the relationship between investor characteristics and their preferences and requirements.

Our survey differs from prior benchmarking efforts in an important respect, however. While most existing studies only focus on companies that are engaged in foreign investment, we analyze the strategic decisions of both actual and potential investors. Our sample includes three types of companies: (a) TNCs that already have operations in multiple foreign countries but are thinking of either moving or establishing new operations in new locations; (b) those potential investors that do not have a foreign presence but are thinking of establishing

operations for the first time in another country (or have considered doing so and decided not to); and (c) companies that have never considered establishing a foreign presence.

The distinction matters. As Hausmann and Velasco (2005) have pointed out, if you are in a desert (or a developing country) and ask camels (or existing investors) about the difficulties of living there, you will get a very different idea than if you interview hippos (or potential investors). The problem facing most researchers, including users of the World Bank's Enterprise Surveys, is that there are no hippos in the desert. Our survey interviewed "hippos" in their countries of origin. In other words, by broadening our sample to include those firms that are *not* investors, we minimize selection bias problems and are able to gain a better understanding of the factors that influence the decision to invest or not in a developing country.[1]

Analytical Framework

Our premise is that developing countries can best compete for FDI by understanding the factors that lead investors to choose one location over another. We assume that this location decision reflects a rational calculus and that a potential investor weighs the expected benefits of internationalization against its perceived costs. A number of specific factors influence a firm's perceptions of the returns of investing abroad, including the availability and costs of inputs, the nature of business and market opportunities, the presence of social networks and cultural affinities, as well as several aspects of the business climate and the regulatory environment (figure 1.4). Indeed, factors such as an inadequate business environment, corruption, political and macroeconomic instability, and cultural dissimilarities may work to deter foreign investment.

Moreover, how a firm responds to these location factors depends not only on its specific characteristics but also on its objectives and motives for seeking to invest abroad. A firm that is primarily motivated by lowering production costs and increasing efficiency, for example, will be particularly attracted to locations where the cost of labor is low. Firms with less mobile investments will presumably pay greater attention to the quality of domestic institutions and the stability of the regulatory environment (see table 1.1).

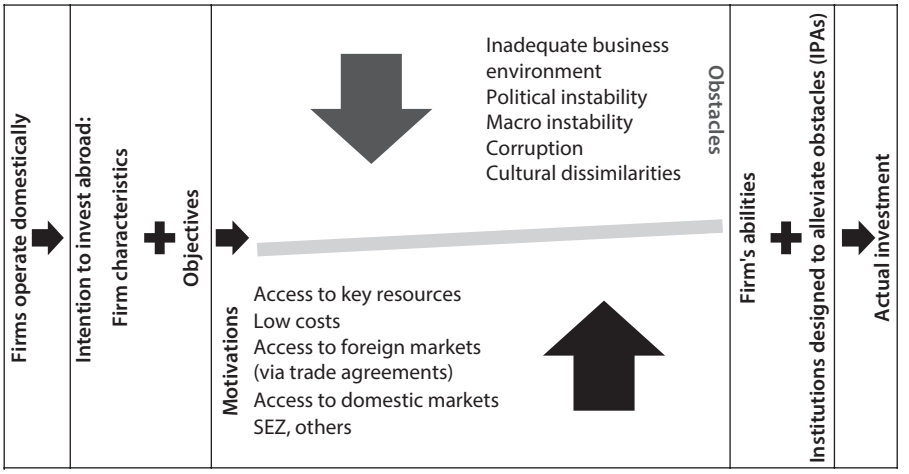
In addition, the governments of host countries can also use a range of policy variables to influence their perceived attractiveness in the eyes of investors. Policy choices such as the signing of regional trade agreements and the availability of special economic zones and of dispute settlement mechanisms may work to increase the appeal of specific destinations. Conversely, government agencies and other bodies tasked with the promotion of foreign investment may help mitigate the costs and obstacles confronted by potential investors, thus also shaping firms' decisions. Investment promotion agencies (IPAs) both in the home and host countries are fundamental in that sense. IPAs provide services that may alleviate market failures, reduce informational costs, and compensate for deficiencies in

Table 1.1 Factors Commonly Influencing FDI Decisions

Availability and costs of inputs	**Business climate and regulatory environment**
• Low labor costs	• Political stability
• Availability of skilled labor	• Elections held regularly and fairly
• Availability of raw materials	• Risk of expropriation
• Availability of local suppliers.	• Security (crime, theft, and so on)
Business Opportunities	• Transparency of business regulations and legal framework
• Availability of business assets for purchase	• Corruption
• Regional market	• Macroeconomic stability
• Availability of export processing zones	• Unfair domestic competition.
• Presence of key clients/buyers.	
Social Networks and Cultural Affinity	
• Locals knowledge of the language	
• Historical ties between the countries.	

Source: World Bank based on literature surveys.

Figure 1.4 Snapshot of the Analytical Framework



Note: IPA = investment promotion agencies; SEZ = special economic zone.

the institutional framework and bureaucracies of developing countries. These agencies are key partners for foreign firms during the investment process, serving as an intermediary with national or local government agencies.

Following this analytical framework (schematically illustrated in figure 1.4), the questions included in the survey are designed to probe the influence of at least three sets of factors on firms' location decisions:

- **Characteristics of firms:** country of origin, sector of operation, size, and in particular, their investment motives.

- **Characteristics of host country:** business opportunities, availability, and cost of inputs, business climate and regulatory environment, social networks and cultural affinity, and so on.
- **Policy instruments:** participation in regional and international trade and investment agreements, special economic zones, investment promotion services, and so on.

In addition, the survey contains questions aimed at probing firms' perceptions of the role of IPAs in mobilizing and assisting FDI within their respective countries. Specifically, the survey asked investors about the following:

- **The role of IPAs** in host countries in raising awareness about investment opportunities there
- **The quality of the different services provided by IPAs**, including the provision of information on markets, on the relevant sector and industry, and on corporate taxation and incentives in the host country; the facilitation of company registration and licensing; and the provision of aftercare services.

Note

1. While we expect this study to make a significant contribution to understanding the drivers and patterns of outward foreign direct investment from emerging economies in general, our findings and claims are limited to the sectors and countries included in the survey.

CHAPTER 2

Literature Review

Drivers and Motives

The traditional explanation for companies to invest abroad relies on Dunning's (1977) "eclectic" paradigm. The so-called "OLI" (Ownership, Location, and Internationalization) framework emphasizes three potential sources of advantages that may influence a firm's decision to internationalize. Ownership advantages refer to the intangible firm-specific assets, such as product development, technology, patents, and marketing/managerial skills, which can be applied to production at various locations. Location advantages include the benefits of locating closer to final buyers and other business counterparts and/or gaining access to cheaper inputs. Finally, internalization advantages are derived from the firm's managerial, organizational, and institutional capabilities to directly control the exploitation of its ownership activities.

As Dunning (2000) recognized, the configuration of OLI advantages and the ways in which firms respond to these variables is, to a large extent, contextual. Indeed, the literature on foreign direct investment (FDI) identifies a number of "drivers" or contextual factors that influence a firm's decision of whether and where to invest. "Push" factors include characteristics of the home country and of the investors themselves. A limited domestic market, increased competitive pressures from domestic and foreign firms, and increases in production costs may push companies to consider investing abroad. Characteristics of the host country ("pull" factors) including the size of the market, business opportunities, availability and costs of inputs, the regulatory environment and the presence of social networks, also significantly shape companies' decisions. In addition to specific government investment policies, such as financial and tax incentives, a host country's participation in bilateral and regional trade agreements and the existence of special economic zones may influence the choice of host country locations.

But ultimately, to fully understand the choice of an investment location, one needs to consider the specific characteristics of firms, including their objectives and strategies. Dunning (1993) distinguished among four main types of motives for foreign-based transnational company (TNC) activity: to seek and access new

markets (market seeking), to lower production costs and increase efficiency (efficiency seeking), to gain access to new resources (resource seeking), and to protect or augment existing ownership specific advantages (strategic asset seeking). The fourth type of motivation, also known as asset augmenting strategy, is used by TNCs not to exploit available assets but to compensate for limited competitive advantages by acquiring strategic assets, such as technology, brands, distribution networks, managerial skills, and research and development (R&D) facilities.

These theoretical insights were developed to explain the rise of FDI and TNCs from developed countries, however. How applicable are these theories to the case of TNCs from emerging and developing economies? What explains their rapid emergence, their strategies, and their patterns of internationalization?

The combination of worldwide liberalization of FDI regimes, advances in transport, communication and information technology (IT), and the opportunities and competitive pressures of economic globalization has accelerated the internationalization process of TNCs from developing countries. According to Dunning's International Development Path (IDP) theory, as economies become more developed, their firms begin building up specific advantages and become increasingly competitive at the international level. As their income per capita grows, economies first attract increasing amounts of FDI and subsequently become outward investors (Dunning 1981, 1986). Yet, as many have observed, OFDI from emerging and developing economies has taken place at a significantly earlier stage of development than anticipated by this theory (for example, Cantwell and Barnard 2008; Sauvant 2008). This is because economic globalization has intensified pressures for emerging-market firms to engage in multinational activities (Sauvant 2005, 2008). As the latter became more open to international competition, their firms enhanced their competitiveness and developed firm-specific advantages, becoming outward investors (UNCTAD 2006).

A growing body of literature looks at the drivers and characteristics of OFDI from emerging and developing economies. Dunning, Kim, and Park (2008) compare contemporary TNCs from emerging markets with traditional developed country corporations. They find evidence of a new wave of "asset augmenting" FDI in the 2000s, which contrasts with the primarily market seeking and efficiency seeking FDI from developed economies in the 1960s–80s. Whereas the traditional developed-country companies generally invested abroad to exploit ownership-specific advantages, developing-country TNCs tend to rely instead on country-specific advantages, particularly in the services sector. Because of their limited assets and the growing competitiveness pressures they face, firms from emerging markets have incentives to access "created" assets such as brands, distribution networks, and managerial skills, in foreign countries through mergers and acquisitions (M&As) or other types of asset augmenting FDI.[1] (See table 2.1)

As noted earlier, OFDI from developing countries is not a completely new phenomenon. In 1980, developing countries accounted for 13 percent of total world FDI stock (Sauvant 2008). However, there are differences between the current wave of outward investment from emerging economies and previous

Table 2.1 Comparison of Emerging-Market and Traditional Developed-Country TNCs

	Developed-country TNCs (1960s)	*Emerging-market TNCs (2000s)*
Motivations	*Early years*: resources/market seeking	Growing significance of asset augmenting strategies
	More recently: asset augmenting	
Resources	Firm-specific ownership advantages	Country-specific ownership advantages
Form of entry	Mainly greenfield	Increasingly strategic alliances and networking
Destinations	Mainly developed countries	Largely regional
Role of government	Moderate	Active
Sectors	Primary, secondary	Preponderantly tertiary

Source: Based on Dunning et al. (2008) and United Nations Conference on Trade and Development (2006).
Note: TNC = transnational company.

ones. Not only has there been an impressive increase in the magnitude of this phenomenon, but also important qualitative changes in the composition, geographical scope, and structural characteristics of OFDI from emerging economies (Gammeltoft 2008).

Gammeltoft (2008) distinguishes between three waves of outward FDI from emerging economies. The first wave (1960s to mid-1980s) was driven primarily by the market and efficiency seeking strategies of Latin American TNCs. Geographically, investment from Latin American economies were concentrated in other developing countries and, particularly, countries within the region. These firms relied primarily on country-specific ownership advantages, such as low-cost inputs, production process capabilities, and networks. The second wave of outward FDI from emerging economies began in the mid-1980s and was dominated by Asian TNCs, which sought to gain access to the newly-industrializing economies in East Asia, as well as to increase efficiency by drawing on cheaper labor in other less developed economies. Asian companies invested not only in primary sector activities in developing countries but also in cost-competitive industries in developed economies.

In the third wave, beginning in the 1990s, there was a resurgence of OFDI from Latin America and growing flows from the Russian Federation and South Africa. While access to markets and efficiency remain the main motives, asset augmenting strategies have increased in importance. During this period, TNCs from emerging markets have relied on outward investments for the purpose of accessing technology, R&D and marketing capabilities, brands and managerial competencies. In terms of destinations, according to Gammeltoft (2008), third wave OFDI is increasingly global and reaching both developed and developing countries, particularly in the manufacturing sector. FDI in services, however, continues to exhibit a relatively higher regional bias. Asian TNCs appear to be more globalized than Latin American TNCs, which are more concentrated in neighboring countries. Finally, although up to 2001, FDI from emerging markets was mainly in the form of greenfield investment, M&As have become more common (Dunning et al. 2008). The hypothesized differences between the three waves are summarized in table 2.2.

Table 2.2 Three Waves of Emerging Economies' Outward FDI

	First	*Second*	*Third*
Period	*1960s to mid-1980s*	*Mid-1980s to 1990s*	*1990s to 2000s*
Outward investing region/country group	Especially Latin America	Especially Asia	More geographically diverse Resurgence of Latin America Inclusion of Russian Federation and South Africa
Largest outward investors	Brazil; Argentina; Singapore; Venezuela, RB; Malaysia; Philippines; Hong Kong SAR, China; Korea, Rep.; Colombia; Mexico; India	Hong Kong SAR, China; Taiwan, China; Singapore; Korea, Rep.; Brazil; Malaysia	Hong Kong SAR, China; Taiwan, China; Singapore; Brazil; South Africa; China; Korea, Dem. People's Rep.; Malaysia; Russian Federation; Chile; Argentina
Destinations	Mainly other developing countries in the same region	Mainly developing countries but increasing flows to developed economies	Increasingly global Services mainly regional destinations Mature sectors increasingly into developed economies
Types of outward FDI	Primary sector Small-scale manufacturing	Primary sector, finance, infrastructure services (developing countries) Cost competitive industries, such as automotive, IT services, electronics (developed countries)	As second wave, but with more going to developed economies
Ownership advantages	Home country specific Low-cost inputs Production process capabilities Networks and relationships Organizational structure	Home country and firm-specific Same as first wave	Home country and firm-specific In addition: economies of scale, technological, managerial, and organizational capabilities, and so on
Motivation	Resource and market seeking	Into developing: resource and market seeking Into developed: market seeking Minor asset augmentation	As second wave, but increase in asset augmenting Market power enhancing (especially natural resource related)
Policy regime	Import substitution FDI regulation	Export orientation FDI coordination and facilitation	Trade and investment liberalization FDI promotion

Source: Gammeltoft (2008).
Note: FDI = foreign direct investment; IT = information technology.

A number of studies have focused specifically on OFDI from BRICS (Brazil, Russia, India, China, and South Africa) countries. Sauvant (2005) finds that global economic pressures and, in particular, the need for firms to strengthen corporate competitiveness are the main factors behind the increase in OFDI from the BRICS. Within this broad objective of enhancing competiveness, the motives for OFDI include breaking into new markets and gaining access to natural resources and low-cost labor. In addition, firms from BRICS appear to engage in asset augmenting FDI, seeking to acquire technology, brand names, distribution networks, and management skills. In other words, emerging-market companies invest overseas to acquire many of the ownership advantages that they currently lack. Overall, however, the evidence suggests that asset augmenting motives for FDI are relatively less important for these countries (UNCTAD 2006).

Despite significant similarities across emerging economies, the latter ultimately vary significantly in size, structure, natural resources, and government policies. Therefore, companies from each of these countries have their own specific motivations and objectives for OFDI. Dunning et al. (2008) identify a number of commonalities across companies from the main outward investing emerging economies. In table 2.3, we summarize the main features of OFDI from the four countries covered in the present study.

Obstacles

Ultimately, the decision to engage in transnational activity reflects a rational calculus, in which companies compare the potential economic benefits with the costs of FDI. A series of noneconomic factors, including an inadequate business environment, weak governance, corruption, political instability, and cultural

Table 2.3 Characteristics of Outward FDI from Emerging Markets

	Brazil	*India*	*Korea, Rep.*	*South Africa*
Drivers and Motivations	Access to raw materials, resources, markets and distribution networks	Initially to penetrate new markets and escape government restrictions; Recently to acquire brand names and technology	Escaping high-cost and difficult labor markets at home.	Market seeking and resource seeking FDI
Sectors	Energy, mining, services. Some manufacturing (Food and beverages, petroleum and metal products)	Pharmaceuticals, agricultural inputs, manufacturing, software, IT services, broadcasting	Electrical and electronic equipment, automobile and auto parts, petrochemicals and steel	Finance, resource extraction
Recipients	Latin America & Caribbean major destination, but recent expansion into Canada	US, Russia, Southeast Asia, Sri Lanka, UK, tax heavens (e.g. Bermuda)	Asia and the Pacific, Europe, and North and South America	Neighboring countries
Example TNCs	Petrobras, Odebrecht, Embraer	NIIT, Usha, Ranbaxy	Samsung, LG Electronics, Hyundai, DSME	Illovo Sugar, MTN, AngloGold Ltd.

Sources: Based on Gammeltoft (2008), Dunning et al (2008); UNCTAD (2006); Sauvant et al (2008).

dissimilarities may work to offset the expected returns of investment. Political risk and regulatory instability, for example, may discourage TNCs from investing in a host economy, particularly given the illiquid ex post nature of FDI. Three main types of political risk may damage the profitability and hence deter foreign investment: nationalization or expropriation of foreign assets; policy instability and arbitrary regulation in FDI regimes; and war and political violence, including terrorist attacks, crime, and insecurity (Baek and Qian 2011). Indeed, empirical studies confirm that political risk and institutional uncertainty are major concerns for foreign investors, particularly in developing countries (for example, MIGA 2010; Barthel, Busse, and Neumayer 2010; etc.).

Most of the empirical literature on the effects of political risk on FDI, however, assumes that flows are predominantly North-South, or at least fails to distinguish between TNCs from developed and emerging/developing economies. Can we safely assume that political risk will influence the investment decisions of both types of investors in a similar manner? Could we perhaps argue that investors from developing countries have the know-how to deal with relatively more challenging investment climates, and so these are less costly for them?

In fact, TNCs from emerging economies may possess "adversity advantages," derived from their experience operating in a business environment characterized by poor infrastructure, corrupt officials, regulatory instability, and weak institutions (Contessi and El-Ghazali 2010). Experience dealing with such challenging conditions can give TNCs from emerging economies a competitive advantage vis-à-vis their rivals from developed countries. In addition, while their technology may be less advanced, it may be better suited to the needs and priorities of host countries (Gammeltoft 2008).

Insufficient or inadequate access to information on the host economy also acts as an important obstacle for potential foreign investors. Foreign firms typically have scarce knowledge of the business opportunities, market conditions, and regulatory framework in the host country. Informational asymmetries tend to be particularly constraining in developing economies (Harding and Javorcik 2011). Investment promotion agencies (IPAs) can contribute to alleviating these informational failures through advertising campaigns, by organizing investment seminars and missions, participation in trade shows and exhibitions, facilitating visitors of potential investors, and matching prospective investors with local partners. In addition, these agencies can assist firms as they seek to obtain licenses and approvals. Recent empirical studies in fact demonstrate that investment promotion efforts tend to be associated with higher FDI inflows, particularly in the developing world. Indeed, Harding and Javorcik (2011) find that IPAs have a greater impact on investment flows where information asymmetries, transaction costs, and corruption levels are higher.[2]

In sum, there seems to be a consensus in the literature that while OFDI from developing countries is not a new phenomenon, in the last decade there has been an impressive increase in the magnitude of this phenomenon. In addition, there are noticeable qualitative differences in the sectoral composition, geographical

scope, and motivations for OFDI from emerging markets in the 2000s and in previous waves. The literature, moreover, tends to agree that while the classic strategies of market seeking, resource seeking, and efficiency seeking explain much of the behavior of the new TNCs, the latter are increasingly driven by asset augmenting motives. Does the empirical evidence derived from the Potential Investors Survey, conducted jointly by the World Bank and UNIDO for the purposes of this book, support these conclusions?

The data collected with the Potential Investors Survey allows us to test some of these propositions and to understand better the characteristics, motives, constraints, and needs of the new TNCs from developing countries. Moreover, the survey produces data on the actual experiences of investors on the ground and their perceptions of what needs to be address to improve the business climate in host countries. This information is particularly useful for national IPAs, enabling them to focus and target promotion efforts more efficiently and to develop more meaningful partnerships with foreign investors.

Notes

1. Examples include several M&As, such as Lenovo's purchase of IBM's PC business and Tata's acquisition of the steel giant Corus.
2. Other works have focused instead on investment promotion agencies in developed countries. Head, Ries, and Swenson (1999) estimate a location choice model on 760 Japanese manufacturing establishments in the United States (U.S.) between the period 1980 to 1992 and show that investment promotion offices in Japan had no effect on entry. By contrast, Bobonis and Shatz (2007) find that the activities of investment offices in U.S. states increase the FDI stock from eight source countries. Using data of FDI inflows into 19 industries in OECD countries, Charlton and Davis (2006) find that targeting an industry increases the growth rate of FDI inflows into that industry by 41 percent.

CHAPTER 3

Survey Results

Introduction

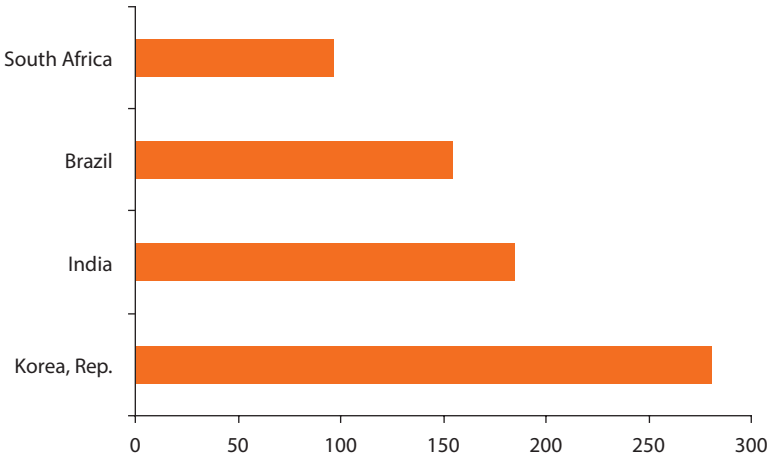
In this section, we present and discuss the main findings from the Potential Investors Survey. We begin by summarizing the main characteristics of the survey respondents. Following the analytical framework presented in chapter 1, we then look at the different factors influencing outward foreign direct investment (OFDI) flows, namely (1) the characteristics of investors and their differences with noninvestors; (2) their main destinations and geographical reach; and (3) the motives and factors influencing their investment decisions. We also consider (4) the obstacles that these firms confront and (5) the role of investment promotion agencies (IPAs) in helping firms overcome some of these barriers to investment. In the final section, we discuss the findings of an experimental exercise aimed at assessing the influence of international economic agreements on firms' decisions to invest abroad.

Survey Respondents

Home country. The 713 firms responding to the survey are from four emerging economies: Brazil, India, South Africa, and the Republic of Korea. The sample is unbalanced, with 280 (40 percent) of respondents from Korea, 184 firms from India, 154 from Brazil, and only 95 (13 percent) from South Africa (figure 3.1).

Sector of operation. Our sample was designed to focus on only a handful of sectors: manufacturing, finance and insurance, wholesale trade, retail trade, and transportation and warehousing. Extractive industries, which account for a considerable proportion of foreign direct investment (FDI) flows globally, were excluded. More than half of the companies included in the survey (405) are in the manufacturing sector, while 15 percent (105) of the respondents focus on finance and insurance services. As table 3.1 illustrates, the third main sector represented in the sample is retail trade, with 84 companies (12 percent). The majority of Indian and Korean companies included in the sample are in the manufacturing sector. The sectoral distribution of Brazilian and South African firms, instead, is more balanced, with a higher presence in financial services and retail trade.

Figure 3.1 Origin of Firms Included in the Survey



Source: World Bank based on the Potential Investors Survey.

Table 3.1 Sectors by Country of Origin

Sector	*Brazil*	*India*	*South Africa*	*Korea, Rep.*	*Total*
Manufacturing	55	150	34	166	**405**
	40.40%	82%	36.90%	59.50%	**58.70%**
Wholesale Trade	13	3	1	24	**41**
	9.60%	1.64%	1.10%	8.60%	**5.90%**
Retail Trade	22	6	25	31	**84**
	16.20%	3.28%	27.20%	11.10%	**12.20%**
Transportation and	22	0	1	32	**55**
Warehousing	16.30%	0%	1.10%	11.50%	**7.90%**
Finance and Insurance	24	24	31	26	**105**
	17.60%	13.10%	33.70%	9.30%	**15.20%**
Total	**136**	**183**	**92**	**279**	**690**

Source: World Bank based on the Potential Investors Survey.

Ownership structure. Most of the companies participating in the survey are publicly listed (542 or 77 percent), although there is significant variation across countries. While more than 99 percent of Korean respondents identified their firms as publicly listed, less than half of firms from India and Brazil did so. Only six companies in our sample are state owned.

Size. There are also noticeable differences in terms of the size of surveyed firms across countries. At the time of the survey, Brazilian firms had significantly higher revenues than their counterparts in the other three countries. Brazilian companies are also larger in terms of full-time employees, with an average of 7,603 workers. At the other extreme, Korean firms are relatively smaller both in terms of revenues and number of workers.

Table 3.2 Characteristics of Firms Included in the Survey

	Brazil	*India*	*South Africa*	*Korea, Rep.*
Revenue in USD million (median)	248	156.99	146.4	76.8
Number of employees (avg.)	7,605	3,608	2,686	509
Trade internationalization (avg., %)	9.60	22.00	13.20	31.00
High trade internationalization[a] (%)	6.60	14.20	7.30	30.20
Publicly listed (%)	43.50	84.80	42.70	99.30

Source: World Bank based on the Potential Investors Survey.
a. Percentage of firms that earn more than 50 percent of their earnings from international trade.

Internationalization. Almost 40 percent of the companies in the sample earn all of their revenues in the domestic market; the rest of the firms exhibit varying degrees of trade internationalization. Most of the surveyed companies (157) earn between 10 and 50 percent from foreign markets, while in 18 percent of the firms this proportion is higher than 50 percent. Brazilian firms appear to be the less internationalized in the sample, with 60 percent relying entirely on the home country market. In contrast, more than 30 percent of Korean firms reported earnings above 50 percent from foreign operations (table 3.2).

Characteristics of Investors

Of the 713 firms interviewed, 276 have invested in a foreign country. The majority of these firms, 230 (or 32 percent of the full sample), have invested in a developing country. While 80 companies considered investing in a developing country but did not do so, more than half of the firms surveyed (403) had never even considered this possibility. How do firms that have invested in developing countries compare with those who have not?

The literature on emerging-market transnational companies (TNCs) explains the rapid internationalization of these firms as a response to the competitiveness pressures of economic globalization. As emerging economies become increasingly open to international competition, their firms are forced to adjust by enhancing their efficiency and competitiveness. Some of these companies develop firm-specific advantages and become outward investors. We expect the larger, more productive, and more trade-dependent firms to be more likely to engage in FDI. Our findings support this hypothesis.

The results from the survey indicate that investors are slightly bigger in terms of average revenues relative to those firms that have considered investment (but have not invested) and relative to those that have never considered this alternative. As illustrated in table 3.3, investors have, on average, a higher number of full-time employees than noninvestors (5,092 vs. 1,810).

Investors are more involved in international trade. Actual investors exhibit a significantly higher degree of trade internationalization than those firms that have considered investing and those who have never considered investing in a developing country. Thirty-six percent of investors earn more than half of their

Table 3.3 Firm Characteristics by Investment Status

	Investors	*Considered investors*	*Noninvestors*
Full time employees (avg.)	5,092	2,275	1,809
Publicly listed (%)	85.6	60.00	73.30
Sector—Manufacturing (%)	74.00	50.00	51.70
Sector—Retail Trade (%)	9.00	15.00	14.00
Sector—Finance (%)	11.00	21.30	17.00
High trade internationalization[a] (%)	36.00	13.90	9.7
Trade internationalization (avg.) (%)	36.5	17.60	14.00

a. Percentage of firms that earn more than 50 percent of their earnings from international trade.

total earnings from international trade. By contrast, less than 10 percent of firms that have never considered investing abroad derive more than 50 percent of their income from foreign markets.

Investors are primarily owned by private, domestic capital and are publicly listed. Eighty six percent (197) of companies that invest in developing countries are publicly listed. Only two state-owned enterprises in our sample have engaged in outward direct investment. Only 5 percent of investors and 5 percent of firms that considered investing have higher than 50 percent ownership by a foreign entity.

Investors in our sample are predominantly in the manufacturing sector. Seventy-four percent of all investors and 50 percent of those companies considering investment are in the manufacturing sector.[1] The second most important sector among investors is finance and insurance (10 percent of all investors), followed by retail trade (9 percent). However, the strong concentration of investors in manufacturing does *not* reflect the actual sectoral composition of investment flows from the four countries surveyed. As mentioned above, our sample focuses on only five sectors, excluding others, such as extractive industries, which account for a sizeable proportion of FDI flows. Moreover, the sample is unbalanced, containing a larger number of firms in manufacturing than in the other four sectors.

However, our data seems to indicate that manufacturing firms are more likely to invest and to consider investing than firms in the other sectors included in the sample. While more than 40 percent of all manufacturing firms in our sample reportedly have invested in a developing country, a much smaller proportion of firms in the services sectors included in the sample are investors. Indeed, 75 percent of firms in transport and almost 70 percent of firms in wholesale trade never considered investing abroad (see table 3.4).

India is the country with the greatest proportion of investors, with 50 percent of Indian firms in the sample holding investments in a foreign country. However, a greater proportion of South African firms (40 percent) have invested in a developing country, compared to 35 percent of Indian and 37 percent of Korean firms. South African firms have also invested more in Africa than their counterparts from the other three countries. Almost 38 percent of South African firms reported investments in the African continent, compared to only 1.4 percent and less than 4 percent of Korean and Brazilian respondents, respectively (table 3.5).

Table 3.4 Investment Decisions by Sector

Percent

	Manufacturing	*Wholesale trade*	*Retail trade*	*Transport*	*Finance and insurance*
Investors	41.20	19.50	23.80	14.50	21.90
Considered investors	9.14	12.20	13.10	10.90	15.20
Noninvestors	49.60	68.30	63.10	74.50	62.90

Source: World Bank based on the Potential Investors Survey.

Table 3.5 Investment Decisions by Country of Origin

	Brazil	*India*	*South Africa*	*Korea, Rep.*
Number of firms interviewed	154	184	95	280
Investors (%)	19.50	50.00	44.20	40.00
Considered investors (%)	14.90	8.70	13.70	6.10
Investment in any developing country (%)	15.60	34.80	40.0	37.50
Investment in Africa (%)	3.90	11.40	37.9	1.40

Source: World Bank based on the Potential Investors Survey.

There are also differences in the sectoral composition of investors across countries. In India and in Korea, almost 85 percent of those firms that invested in a developing country are in manufacturing. Only 32 percent of South African investors are in the manufacturing sector, though. The greater proportion (38 percent) of outward investors from South Africa, in fact, is in retail trade. Financial services account for 27 percent of all South African investors. Similarly, in Brazil, almost 25 percent of investors are in finance and insurance.

To shed further light on the determinants of firms' investment profiles, we use a multinomial regression model that links firms' characteristics to their likelihood of falling in one of the three groups—investors, considered investors, and noninvestors. We discuss the econometric model in more detail in box 3.1 and present the results of the regressions in table A.1 in the appendix A.

The results are largely consistent with those obtained in the bivariate analysis. We find that compared to noninvestors, companies that have invested in developing countries are larger in terms of size of their labor force (number of permanent full-time workers). Investors are also more dependent on international trade than noninvestors. Firms that are publicly listed and owned by domestic capital are also more likely to invest in developing countries. Interestingly, controlling for other factors, firms in the manufacturing sector are more likely to invest abroad than companies in other sectors where investments tend to be more mobile, such as finance and insurance.[2] Our findings also suggest that companies that considered investing in developing countries but did not tend to be more dependent on international trade than those firms that never considered investing abroad.

Box 3.1 Profile of Investors

To examine more closely the differences between the three groups of companies (those that invested (I), those that considered investing but did not (C), and those that never even considered this alternative (N)), we conducted multinomial regression analysis. Our dependent variable (Y) is the company's investment position and contains three categories j = I, C, N. We use the group that never considered investing (N) as the baseline category. The estimable equation is:

$$log\ \frac{P_{ij}}{P_{ij^*}} = \beta_{0j} + \beta_{1j} X_i + \beta_{2j} C_i + \beta_{3j} S_i + e_i$$

for each j = Investor, Considered investing; j = non–investor*

The model estimates the log odds of being an investor (I) compared to being a noninvestor (N) and the log odds of considering investment (C) versus not investing (N), as a function of a vector X_i of firm characteristics, including size, labor productivity, dependence on international trade, and ownership status. S_i and C_i are vectors of sectoral and country dummy variables, respectively. The main independent variables are as follows:

Number of employees: as a proxy of company size, we include the average per week number of full-time employees that work there.

Labor productivity: measured as the value of the company's 2009 revenues in US dollars divided by number of full-time employees working there.

Trade dependence: the percentage of total turnover acquired in foreign markets. In the models in table A.2, however, the variable is introduced as a four-category ordinal scale, which is 0 if foreign sales as a proportion of total sales is 0, 1 if sales in foreign markets is less than or equal to 10 percent, 2 if it is higher than 10 but lower (or equal to) 50 percent, and 3 if it is higher than 50 percent.

Domestic ownership: dummy variable that is equal to 1 if the company is domestically owned, that is, if its ownership by a foreign entity is <10 percent, and 0 otherwise.

Legal status (publicly listed): dummy variable, taking the value of 1 if the company's shares are widely held and managerial control is not exercised by an individual or family holding a major stakeholder in the company.

We also examined the predictors of investing in developing countries for each of the countries in our sample (see table A.2 in the appendix A). Once again, the degree of trade dependence has a positive and significant effect on the likelihood of investing abroad for all four countries. Firm size, as measured by labor force, also appears to be associated with the likelihood of investing for companies from Brazil, Korea, and South Africa. Korean companies in the manufacturing and finance sectors also seem to be more likely to invest abroad than firms in other industries. The coefficient of domestic ownership also reaches statistical

significance for Korean companies but not for the other three countries. In the case of Indian companies, on the other hand, labor force size and reliance on foreign turnover seem to be much weaker predictors of investment profile. Controlling for other factors, South African companies in the manufacturing sector are less likely to consider investing abroad than firms in other sectors.

Destinations

According to the recent literature on OFDI from emerging economies, while in previous decades, companies from Latin America and East Asia tended to invest primarily within their regions, the new multinational corporations have significantly expanded their geographical reach. The evidence from our survey partly supports these contentions, although it shows that regional and cultural biases still exist. This suggests that emerging-market TNCs still face substantial costs of investing in dissimilar markets.

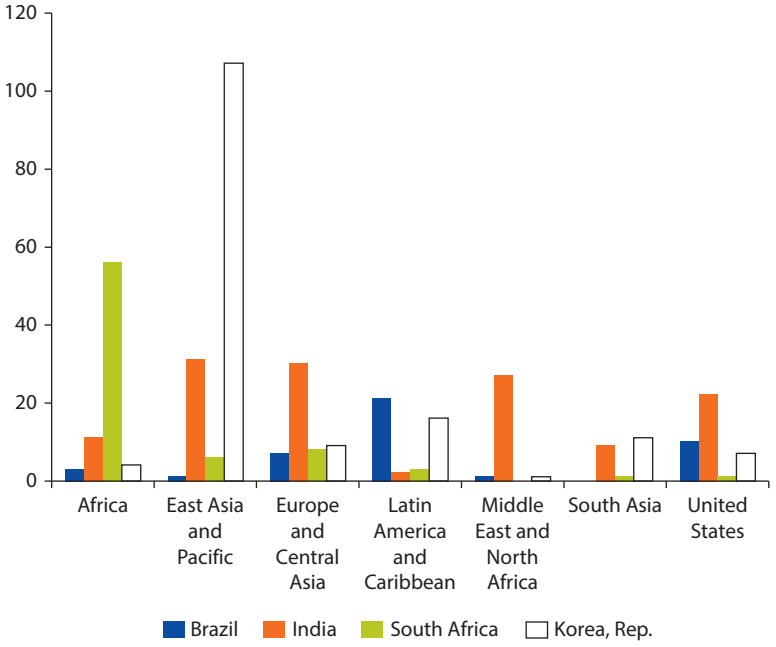
Companies from emerging markets have investments in all regions of the world. Investors were asked to identify the three countries in which they have the largest investments. Responses included a wide range of countries in the Americas, Africa, Asia, Europe, and the Middle East. China and the United States appear to be the main destination for companies surveyed. Overall, East Asia and the Pacific is the preferred region for the investors in our sample, with 145 respondents identifying a country in this region as the destination of their largest foreign investment. Africa is the second most popular destination (74), followed by Europe and Central Asia (54).

Just like in previous decades, TNCs from emerging markets invest more heavily in neighbors and in other countries in their own regions. As figure 3.2 shows, of the 74 respondents selecting a country in Africa as one of their top three investment destinations, 56 are from South Africa. Korean firms also invest more heavily in East Asia and the Pacific than in other regions, and particularly in China, Vietnam, and Cambodia. Similarly, Brazilian companies appear to be focused primarily in Latin American countries, particularly in Argentina, although a significant number of Brazilian respondents (10) listed the United States as one of the three main destinations for investment. Indian companies appear to diverge from this pattern.

India has the most globalized TNCs. In fact only 9 Indian companies chose South Asian countries as the main destination for investment, compared to 31 and 33 that invest primarily in East Asia and Europe and Central Asia (respectively). South African companies, in contrast, seem to be strongly concentrated in the African region, with only 25 percent of respondents investing outside of Africa (see table 3.6).

To shed light on firms' future investment plans, respondents were asked whether they were seriously considering investing in another developing country, and specifically, if they had considered any particular country in Africa.[3] Only 139 of the firms participating in the survey answered this question.[4] China was

Figure 3.2 Most Popular Destinations for Surveyed Companies



Source: World Bank based on the Potential Investors Survey.
Note: Number of countries where firms possess largest investment, in each region.

Table 3.6 Investment Destinations by Country of Origin

Percent

	Brazil	*India*	*South Africa*	*Korea, Rep.*
Africa	6.98	8.33	74.70	2.58
East Asia and Pacific	2.33	23.50	8.00	69.00
Europe and Central Asia	16.30	22.70	10.70	5.81
Latin America and Caribbean	48.80	1.52	4.00	10.30
Middle East and North Africa	2.33	20.40	0	0.65
South Asia	0	6.82	1.33	7.10
United States	23.30	16.70	1.33	4.52
Total	**100**	**100**	**100**	**100**

Source: World Bank based on the Potential Investors Survey.

once again the most popular candidate for future investments among respondents, with 15 firms claiming they had seriously looked at investment opportunities in this country. Of these 15 respondents, however, 12 were based in Korea. Nigeria and Vietnam were also identified as attractive alternatives, by South African and Korean firms, respectively. Among African destinations, apart from Nigeria, South African companies expressed a strong interest in investing in Botswana, Namibia, Zambia, Ethiopia, Tanzania, and Ghana.

Almost half of respondents had plans to expand their foreign investments. Forty-two percent of respondents said they were planning to expand their investments in current host markets, and only six companies (3 percent of the sample) reported plans to reduce their existing investments there. When comparing across countries, Brazilian and Indian firms seem to be on an expansion trajectory, with 52 percent and 75 percent of respondents from these countries (respectively) revealing plans to expand investments in developing countries. By contrast, almost 80 percent of Korean firms planned to maintain the same level of investments in the developing world.

Drivers and Motives

What drives the recent expansion in FDI from emerging markets? What factors shape the decision of location for outward investors? Are traditional approaches for understanding firms' decisions to internationalize useful to shed light on the recent trend of OFDI from emerging economies? Some analysts claim that while the first and second waves of OFDI from Latin American and East Asian companies were mainly resource and market seeking, increasingly, companies from the developing world are driven by the search for assets. In particular, their expansion into developed economies has been motivated by the goal of accessing technology, brands, and managerial and organizational competencies.

The third section of our survey seeks to investigate empirically these claims regarding the changes in the drivers of OFDI from emerging economies. The questions investigate the sources of information, motivations, and importance of various factors in determining companies' decision to invest or not in a developing country. Investors were first asked to identify the main motivation for their decision to invest in the developing country in which they reportedly hold their largest foreign investment. They could choose from among seven possible options: to access new markets; to lower production costs; to access natural resources; to join a specific partner; to export back to the home country; to benefit from a trade agreement; and to produce parts and components and consolidate the firm's global value chain.

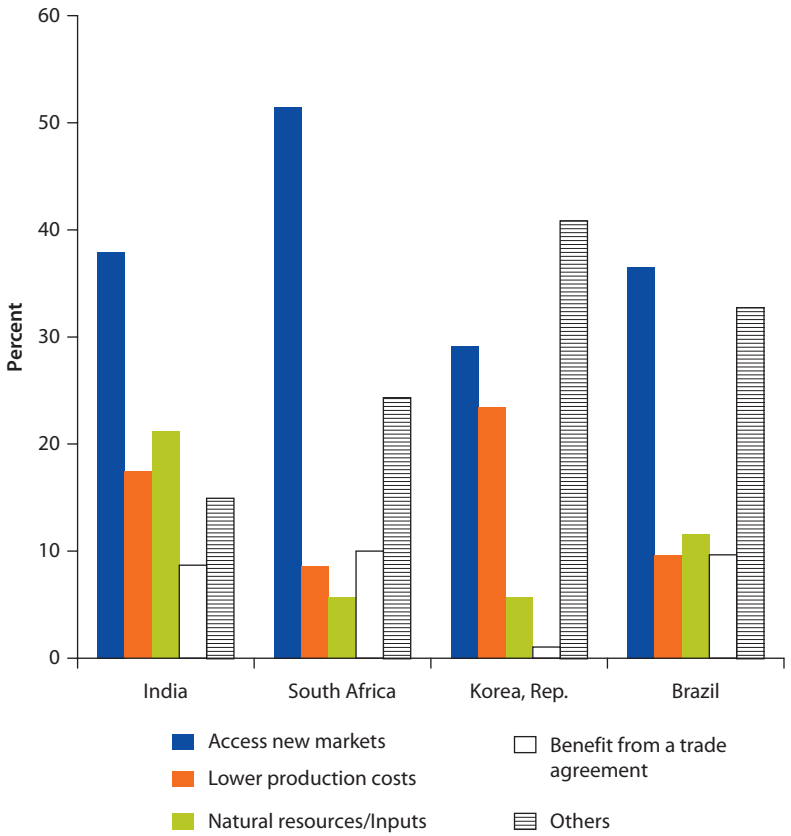
Accessing new markets is the main motivation for investing abroad. Sixty-eight percent of investors in the sample selected this as the top motivation for investment. Indeed, accessing new markets was identified as the top motivation for investors both in export-oriented manufacturing sectors and in domestic-oriented services such as finance and retail. About 20 percent (40) of respondents claimed that lowering production costs was the main motivation behind the decision to invest abroad. However, this motive is clearly more relevant for firms in the manufacturing than in the services sector. The third most cited motivation among investors in the sample is to acquire natural resources and inputs (12 firms or 5 percent). Only three companies claimed to invest in order to produce parts and components and another three respondents reportedly invested with the goal of benefiting from a trade agreement signed by the destination

country. Overall, these results suggest that much of the OFDI from emerging economies continues to be mainly market and efficiency seeking.

Gaining access to new markets was also an important factor for firms that considered investing abroad but didn't. Seventy percent of respondents selected this option as the main motive for considering investment in a developing country. Lowering production costs and gaining access to raw materials and other inputs was the top motivation for 15 percent of the firms answering this question.

Korean investors are more concerned with the cost and availability of inputs than firms from the three other countries. As figure 3.3 shows, while accessing new markets is the top motivation for companies across the four countries, lowering production costs seems to matter more to Korean firms than to their counterparts in Brazil, India, and South Africa. In fact, 37 Korean companies (about 36 percent of the total number of investors from this country) chose lowering production costs as the main motivation for investing abroad. By contrast, only 3 Indian companies and no Brazilian or South African companies identified this as

Figure 3.3 Main Motives for Investment by Country of Origin



Source: World Bank based on the Potential Investors Survey.

the top motive for foreign investment. A small number of firms from these two countries (4 and 5, respectively) chose lowering production costs as the second main motivation for the decision to invest abroad.

Respondents were then asked to assess the importance of a broad range of factors in shaping the decision to invest abroad using a scale of 1 (Unimportant) to 5 (Crucial). These location factors can be grouped under six main categories: expansion of markets, business opportunities, availability and cost of inputs, business climate and regulatory environment (political risk), and social networks and cultural affinity. Table 3.7 shows the average scores given by investors responding to the survey to each of the different location factors. Investors were then encouraged to identify the three most important among these and to rank them in order of importance.

Table 3.7 Location Factors by Broad Category

Location factor	*Avg. score*
Availability of costs and inputs	
Low labor costs	3.98
Availability of skilled labor	3.25
Availability of raw materials	3.72
Availability of specialized inputs	2.99
Business opportunities	
Availability of business assets for purchase	3.85
Availability of export processing zones	3.49
Counterparts	
Presence of foreign investor already operating	3.53
Presence of direct competitors	3.34
Availability of joint venture partners	3.54
Presence of key buyers/clients	3.84
Expansion of markets	
Host market	3.47
Regional market	3.66
Business climate and regulatory risk (political risk)	
Political stability	3.62
Elections held regularly and fairly	3.39
Risk of expropriation/nationalization	3.81
Efficiency of bureaucracy	3.06
Security (crime, theft, and so on)	3.09
Transparency of business regulations and legal framework	3.55
Corruption	3.13
Macroeconomic stability	3.41
Social networks and cultural affinity	
Local knowledge of your language	1.95
Historical ties between our countries	2.75
Other companies from our country have invested here	3.57
Members of our management team are from destination country	3.27

Source: World Bank based on the Potential Investors Survey.
Note: Mean value of the 5-point Likert scale (1=Unimportant, 2=Helpful, 3=Important, 4=Very Important, 5=Crucial).

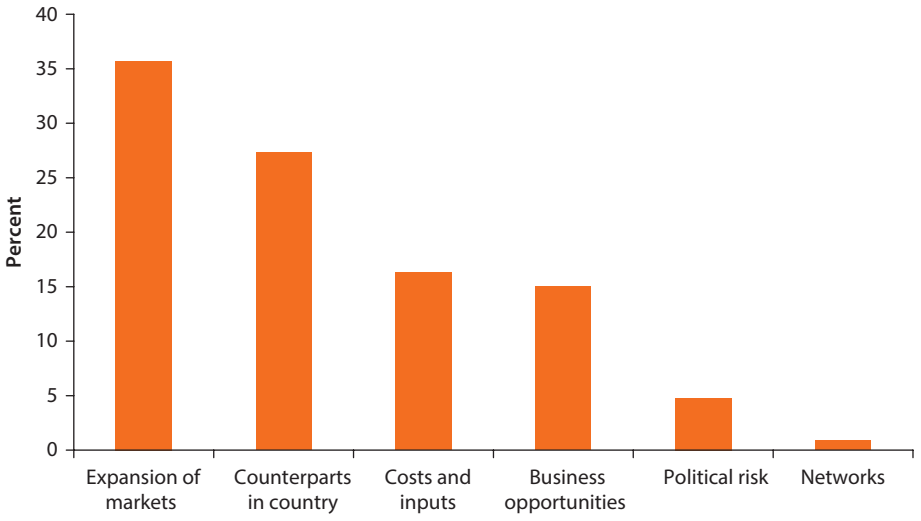
The expansion of regional and host markets emerged as the most important factor affecting firms' investment decisions. Almost one fourth of respondents (51) selected the size of the regional market as the main factor that influenced their firms' choice of a location to invest. The second most listed location factor, the presence of key clients, received almost 20 percent of responses. Indeed, taken together, the presence of a variety of potential counterparts, including not only clients but also competitors, partners for joint ventures, and other foreign investors, was ranked as the top consideration by almost 30 percent of respondents. The size of the host market and low labor costs received 13 percent and 12 percent of responses, respectively, emerging as the third and fourth most important location factors.

By contrast, noneconomic factors, such as political stability, corruption, and the efficiency of the bureaucracy were ranked highly by a much smaller number of respondents. As figure 3.4 shows, less than 1 percent of respondents identified cultural and social networks as the top factor influencing their investment decisions. A similar pattern emerges when considering the three most important factors shaping the decision to invest abroad (see figure 3.5). Interestingly, macroeconomic stability was selected as a top consideration only by firms in the finance sector.

The expansion of markets is a top consideration for investors not only in the manufacturing but also in services sectors. However, our evidence indicates that investors in services tend to place greater importance on the size of the domestic market than firms in the manufacturing sector.

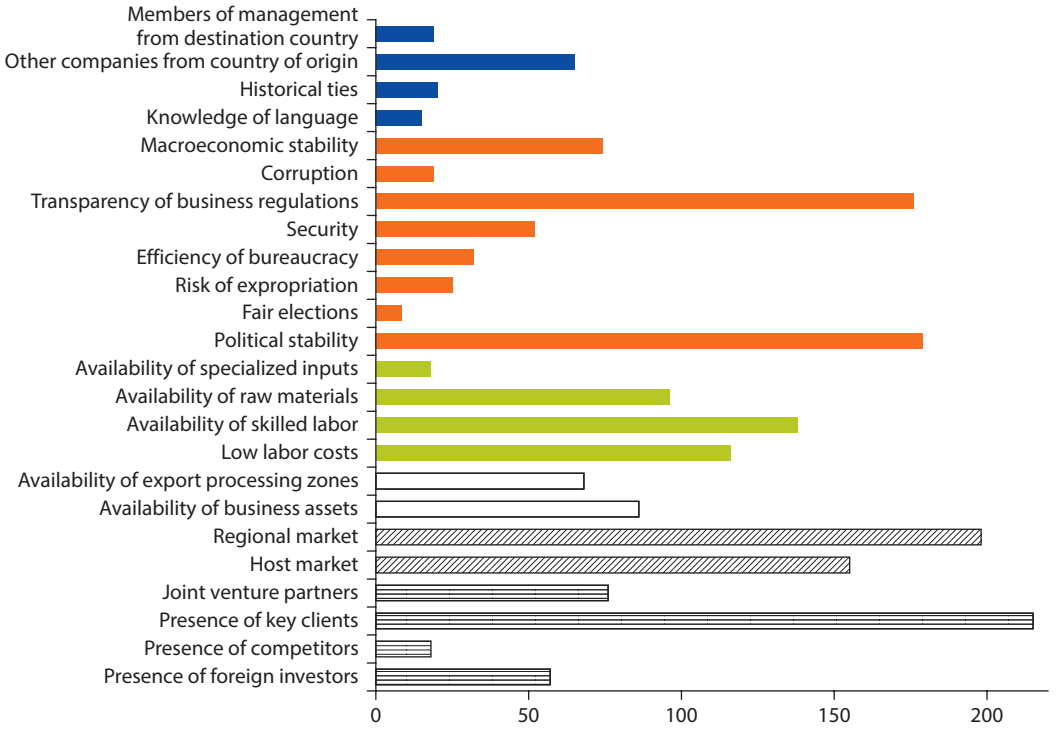
Expansion of markets is the top location factor for Brazilian, South African, and Korean firms, and the second most important factor for Indian companies.

Figure 3.4 Location Factors by Broad Categories[a]



Source: World Bank based on the Potential Investors Survey.
a. Percentage of investors that selected each category as the most important (top 1) location factors.

Figure 3.5 Top Location Factors[a]



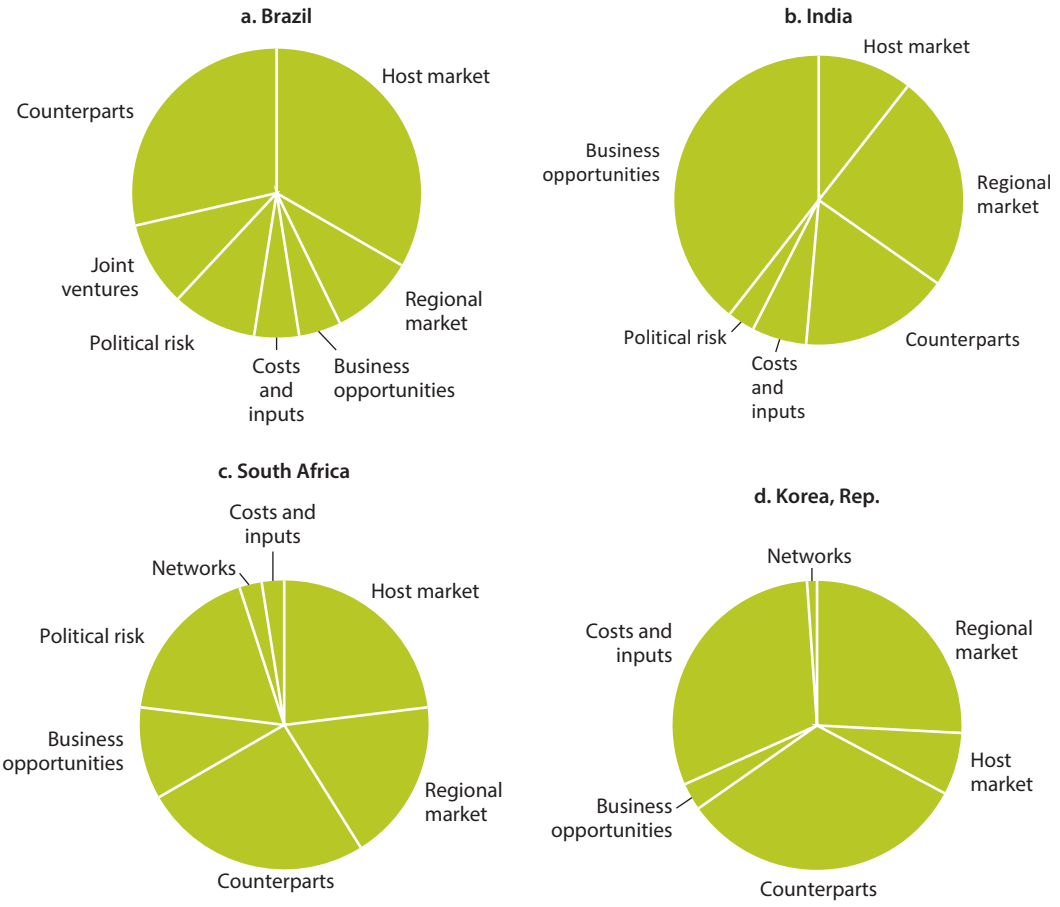
Source: World Bank based on the Potential Investors Survey.
Note: EPZ = export processing zones.
a. Number of firms that selected each of these items as one of the three most important (top 3) location factors.

For Brazilian and South African firms, however, penetrating the domestic markets of host countries seems to be more important than regional market opportunities. By contrast, Korean investors appear more interested in regional than in domestic markets (figure 3.6). While market expansion also appears to be an important factor for Indian investors, a larger proportion of respondents from this country listed the presence of business opportunities, such as business assets and export processing zones (EPZs) in a developing country as the top consideration for investing there (figure 3.6).

Korean investors also are particularly interested in the availability and costs of inputs, such as skilled labor, raw materials, and specialized inputs. Almost 31 percent of Korean firms selected these items as the most important reason for investing abroad. This contrasts with the much smaller proportion of respondents from the other three countries that mentioned costs and inputs as the main reason for investing.

A number of factors may explain these differences across countries. One plausible hypothesis for the greater emphasis of Korean firms on availability and costs of inputs is that they may be more integrated into global value chains than Brazilian, Indian, and South African firms. One way to compare the degree of integration into global value chains (GVCs) relies on examining what percentage

Figure 3.6 Top Factors Influencing Investment Decisions by Country of Origin



Source: World Bank based on the Potential Investors Survey.

of a country's exports are part of GVCs, either because of upstream (backward) links (looking back along the value chain and measuring foreign inputs/value added included in a country's exports), or downstream (forward) links (measuring the domestic inputs/value added of the country contained in the exports of other countries by looking forward along the value chain.[5] Table 3.8 presents indicators of backward and forward participation for the 4 countries considered for the most recent year in which data is available (2009). Korea is the economy that appears to be most integrated into GVCs, with backward participation reaching 41 percent of exports, and forward participation reaching 21 percent. South Africa, on the other hand, seems the least integrated in GVCs with backward participation reaching 17 percent and forward participation reaching 15 percent. While the data in table 3.8 represents an aggregate across all sectors and includes agriculture and extractive industries, which are not considered in our survey, table A.3 in the appendix A reports the participation indices for different sectors. This data shows that in the sectors included in the survey, Korea and

Table 3.8 Participation in Global Value Chains, 2009

Percent

Country	*Backward participation*	*Forward participation*
Brazil	9	27
India	22	20
South Africa	17	17
Korea, Rep.	41	24

Source: Organisation for Economic Co-operation and Development (OECD).

India continue being the most integrated economies in terms of backward and forward participation in GVCs.

Recent studies suggest that East Asian economies tend to be characterized by higher fragmentation of the production process and greater integration into GVCs than other regions. While trade in parts and components and final assembly within production networks has generally grown faster than total world trade in manufacturing, the degree of dependence of East Asia on this new form of international specialization is proportionately larger than elsewhere in the world (Athukorala 2006, 2010). As discussed earlier, Korean companies invest primarily in other countries in East Asia. Indeed 30 percent of Korean investors in our sample identified China as the main destination for their outward investment. Thus, the countries where these companies invest and with which they trade are also highly integrated into GVCs. In addition, three of the main products on which Korean investors in our sample concentrate, automobiles, footwear and clothing, and electronics, are often cited as being at the forefront of global economic integration and GVCs.

The emphasis that Korean companies place in lowering production costs, particularly, on the importance of low labor costs as a factor influencing the choice of investment locations can also be understood in reference to the rising levels of wages in this country in recent decades. Over the past two decades, wages in Korea and Hong Kong SAR, China have been rapidly approaching developed-country levels. Despite rapid growth, manufacturing wages in China and other countries in the region, such as Malaysia, Thailand, Vietnam, and the Philippines remain at a lower level. The significant wage differences among countries in the region therefore provide opportunities for a shift in production to lower-wage locations within the region and an expansion of intraregional production sharing systems (Athukorala 2010).

Finally, another difference between Korean companies and their counterparts from the other countries, which is likely to affect the cost-benefit analysis of potential investors, concerns the degree of market access faced by firms in each country. This is partly determined by policy variables, namely, the level of actual trade and nontrade barriers imposed by other countries. A cursory look at market access overall trade restrictiveness indicators (MAOTRI) does not seem to support this hypothesis.[6] In fact, Korea appears to face higher trade barriers than India and South Africa (see table 3.9).[7]

Table 3.9 Market Access Overall Trade Restrictiveness Index (MAOTRI)

Percent

	MAOTRI			*MAOTRI_T*		
	ALL	*AG*	*MF*	*ALL*	*AG*	*MF*
Brazil	12.20	35.80	4.10	4.90	13.70	1.80
India	8.40	16.00	7.40	3.70	4.90	3.50
Korea, Rep.	8.60	20.40	8.30	4.50	8.70	4.40
South Africa	5.60	21.60	4.10	3.30	7.00	3.00

Source: Kee, Nicita, and Olarreaga 2008, 2009.

Note: While MAOTRI includes both tariff and nontariff barriers, MAOTRI_T focuses only on the tariff barriers of the trading partners of each country. MAOTRI = market access overall trade restrictiveness indicators; ALL = overall trade; AG = agriculture trade; MF = manufacturing trade.

Table 3.10 Trading Across Borders Indicators, 2009

	Rank	*Documents to export (number)*	*Time to export (days)*	*Cost to export (US$ per container)*	*Documents to import (number)*	*Time to import (days)*	*Cost to import (US$ per container)*
Korea, Rep.	3	3	7	665	3	7	695
Brazil	123	7	13	2,215	8	17	2,275
India	127	9	16	1,120	11	20	1,200
South Africa	115	6	16	1,620	7	23	1940

Source: World Bank's Doing Business database.

Even if the actual trade (tariff and nontariff) barriers faced by Korean companies are higher than those faced by Brazilian, Indian, and South African firms, the nonpolicy-related costs of trading are lower for Korea than for the other three countries. The examination of a number of trading across border indicators suggests that, indeed, Korean firms are in a significantly better position than Brazilian, Indian, and South African companies when trying to engage in foreign trade (see table 3.10). This would make FDI and the establishment of facilities in other countries for the purpose of market expansion unnecessary. At the same time, the extent of competition faced by potential investors in their domestic market will also influence their decision to invest abroad. Given that there are substantial transaction and informational costs of investing abroad, firms will exhaust profit opportunities domestically before internationalizing. The other side of the coin thus is that the higher the level of protection in domestic markets (the lower the level of domestic competition), the less likely they are to invest abroad.

Obstacles to Investment

The absence of market and business opportunities emerged as the main factor behind firms' decision *not* to invest in developing countries. In open-ended questions, noninvestors also cited their preference for the domestic market and the

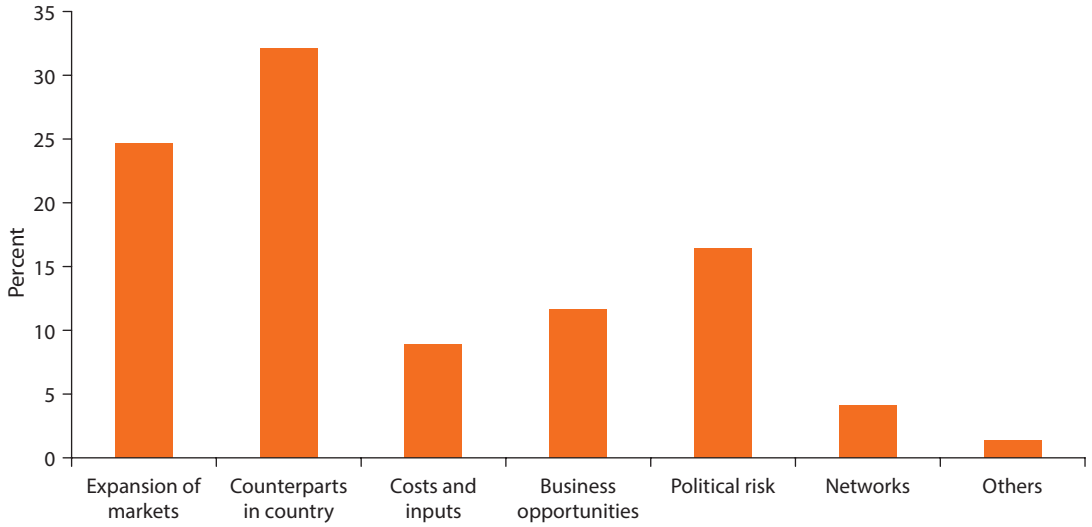
nature of their activity as important considerations. Several Brazilian and Indian firms, in particular, emphasized the extensive opportunities for expansion in internal markets. Interestingly, this appears to be the flipside of the coin of access to markets being the main driver for those who decide to invest.

Consistent with the responses to open-ended questions, for more than 30 percent of respondents, the absence of potential clients and other business counterparts was the main reason for not investing in a developing country (figure 3.7). Twenty-five percent of respondents identified the existence of limited opportunities for expanding markets as a top factor deterring investment. Not surprisingly, political risk appears to be a more relevant factor in explaining firms' decision not to consider investment in a developing and/or African country.

When asked specifically about conditions in the African continent that may deter them from considering investing there, a number of companies cited insecurity, absence of political and economic stability, institutional weakness, and problems with the rule of law as important factors. However, most respondents claimed there was nothing unique to Africa that made investing there particularly unattractive (see box 3.2).

The differences across countries are more marked when it comes to obstacles to investment. The presence/absence of key counterparts is the top factor for both Korean and South African companies. Brazilian firms, instead, seem to be more concerned about market opportunities, while a greater proportion of Indian companies cited business opportunities, including the availability of business assets and EPZs, as the top factor influencing their decision not to invest in a developing country. Political risk was important for South African and Korean companies, but less so for their Indian and Brazilian counterparts (figure 3.8).

Figure 3.7 Main Factors Affecting the Decisions of Noninvestors[a]



Source: World Bank based on the Potential Investors Survey.
a. Percentage of firms that selected each category as the most important (top 1) location factors.

Box 3.2 Profile of Investors in Africa

African countries view FDI inflows as critical to technological development, industrial diversification, and economic growth.[a] Aware of the potential for international investment, and particularly FDI, to supplement domestic savings and to expand employment, production, and exports levels, African governments have stepped up efforts to improve the business climate for foreign investors. Most African countries have indeed experienced increasing FDI inflows since the early 2000s. Nevertheless, relative to global FDI flows, Africa, and in particular Sub-Saharan Africa, is still attracting very small shares. As table B3.2.1 indicates, African countries have lagged significantly behind other developing regions in attracting FDI flows.

Large emerging markets such as Brazil, China, India, Russia, and South Africa (the so-called BRICS countries), have recently become significant investors in Africa. In 2010, the share of BRICS in FDI flows to Africa reached 25 percent, while their share in FDI stock was 14 percent (UNCTAD 2013). The data furthermore suggests that a significant proportion of this investment is in manufacturing and services, with only 26 percent of the value of FDI projects from BRICS countries being in the primary sector.

African countries have much to gain from the growing presence of emerging-market TNCs in the region. Sustained investment inflows, however, will require overcoming a variety of obstacles, including insufficient institutional reform, lack of physical security, and poor infrastructure. Our survey provides data on the characteristics of investors and potential investors in Africa, as well as on their perceptions of the business climate and the market opportunities in the region. This information is crucial for national governments and investment promotion agencies as they develop policies to encourage further investment in the African continent.

Only 10 percent (67) of investors in our sample reported having investments in an African country. A large majority of these firms came from South Africa and India (51 percent and 31 percent, respectively). As table B3.2.2 shows, 38 percent of South African firms, and 11 percent of Indian companies participating in the survey have invested in an African country. By contrast, only 3.9 percent and 1.4 percent of Brazilian and Korean firms (respectively) have investments in this region.

Table B3.2.1 FDI Inflows

US$, millions

	1990	*2000*	*2005*	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*
World	208,168	1,414,999	996,714	1,818,834	1,221,840	1,422,255	1,700,082	1,330,273	1,451,965
Developing countries	35,018	266,644	341,428	668,758	532,580	648,208	724,840	729,449	778,372
Latin America and Caribbean	8,925	98,059	78,257	211,138	150,913	189,513	243,914	255,864	292,081
Asia	22,915	158,798	231,822	396,025	323,683	409,021	430,622	415,106	426,355
Africa	2,846	9,621	31,013	59,276	56,043	47,034	48,021	55,180	57,239

Source: UNCTAD Statistics

box continues next page

Box 3.2 Profile of Investors in Africa *(continued)*

Table B3.2.2 Investment in Africa by Country of Origin

	Brazil	*India*	*South Africa*	*Korea, Rep.*
Number of Firms Interviewed	154	184	95	280
Investment in African Countries (count)	6	21	36	4
Investment in African Countries (%)	3.9	11.4	37.9	1.4

Source: World Bank based on the Potential Investors Survey.

Table B3.2.3 Percentage of Firms That Ranked Each Factor as a Top 3 Consideration

	Did not invest in Africa (%)	*Invested in Africa (%)*
Transparency	31.40	23.10
Corruption	3.12	4.62
Macroeconomic stability	12.70	13.80
Security	9.55	4.62
Efficiency of bureaucracy	5.46	6.15
Risk of expropriation	4.70	1.50
Fair elections	1.56	0
Political stability	31.80	24.60

Source: World Bank based on the Potential Investors Survey.

While we do not have information on all the different African countries where respondents have invested, we asked them to identify the country where they have the largest investment. A total of 42 firms reportedly have made their largest investment in an African country. Namibia is the most popular destination, followed by Nigeria, Botswana, and Zimbabwe. Other host countries in Africa for respondents in our survey include the Arab Republic of Egypt, Malawi, Zambia, Tanzania, Kenya, Ghana, Mozambique, Swaziland, Lesotho, Angola, and Ethiopia.

More than half (57 percent) of all investment in Africa is in the manufacturing sector. Retail trade, in turn, concentrates 23 percent of investment, followed by finance and infrastructure, which attracts 15 percent. However, there are differences across countries of origin. Almost 70 percent of South African firms with investments in Africa are in the services sector (40 percent in retail trade and 30 percent in finance and insurance). By contrast, 90 percent of Indian companies and all Brazilian firms in Africa are in the manufacturing sector.

The main motivation for firms investing in Africa is to access new markets. More than 80 percent of firms with investments in an African country selected this option among competing ones. A total of seven firms (11 percent) identified gaining access to natural resources and inputs as the main motive for investing in an African country. Only two Indian firms were reportedly driven by the prospects of joining a trade agreement or joining a specific business partner.

Access to the regional and domestic markets appear to be the most important location factors for a larger proportion of firms. While 23 percent selected the regional market as the top factor when considering investing abroad, 18.5 percent chose the domestic market. Availabil-

box continues next page

Box 3.2 Profile of Investors in Africa *(continued)*

ity of business assets and presence of key clients were deemed the most important location factor by 17 percent and 12.3 percent (respectively) of firms with investment in Africa.

Firms that invest in Africa seem to be *less* concerned about political risk and other noneconomic factors than firms that don't invest in this region. Less than 5 percent of investors in Africa selected security in the host country as one of the top 3 location factors, while almost 10 percent of those firms that don't invest there deemed this an important consideration. Transparency also appears to be more important to firms that do not invest in Africa (32 percent) than to those that invest there (23 percent). Similarly, a smaller proportion of investors in Africa view political stability, fair elections, and expropriation risk as top 3 location factors (See Table B3.2.3). This is consistent with the findings from open-ended questions, in which potential investors expressed reservations and concerns about lack of security, economic and political instability, and institutional weakness when deciding not to invest in Africa.

These results hold when we control for other factors that affect investment decisions. When controlling for firm characteristics, such as size, sector of operation, ownership structure, and country of origin, we find that firms that invest in developing countries outside of Africa are more likely than noninvestors to view political risk and political stability as top 3 location factors. By contrast, having investments in Africa has no statistically significant effect on the likelihood that a firm will select political risk, political stability, and transparency as important considerations. However, firms that invest in Africa appear to be *less* likely than noninvestors and than firms that invest in other developing countries to worry about security in the host country (see table A.6 in the appendix A).

What are the characteristics of firms that invest in Africa?

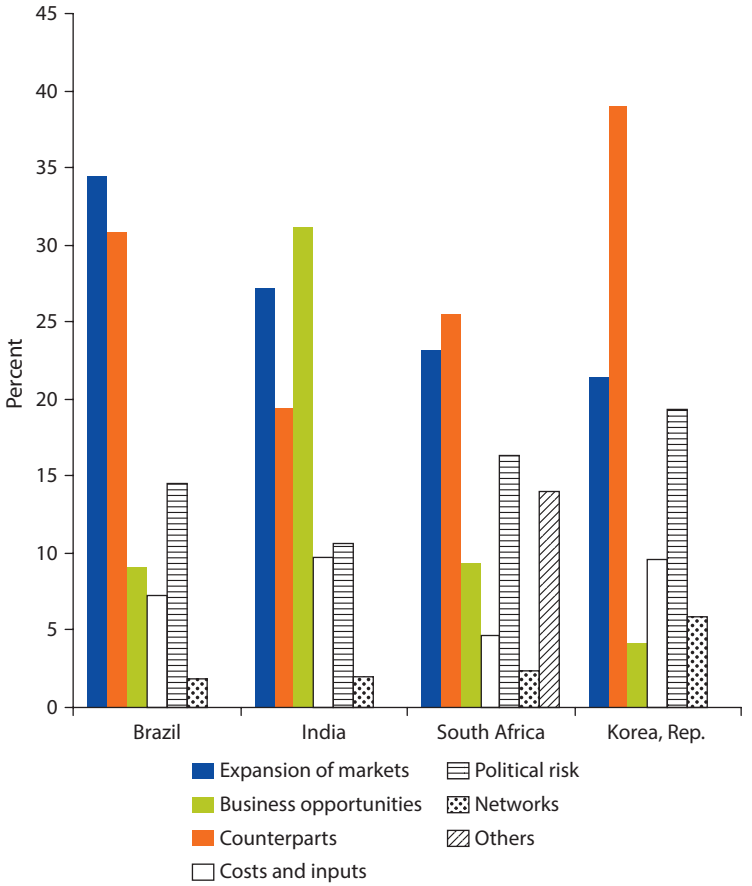
Firms that are larger (in terms of labor force), publicly listed, and with greater participation in international trade are more likely to invest in Africa. To further probe the differences between the firms that invest in Africa and those that do not, we ran a multivariate logistic regression. Our results (presented in table A.7 in the appendix A) indicate that larger firms, those publicly traded, and those that engage more in international trade are more likely to invest in Africa. In addition, the model confirms that firms from South Africa are more likely to invest in other African countries (and Korean firms are less likely to invest there) than Indian companies. By contrast, sector of operation, ownership structure, and productivity levels have no statistically significant effect on the likelihood that a firm invests in Africa. These findings are largely consistent with those obtained when examining the characteristics of investors in the developing world more generally. There seem to be few differences between firms that invest in Africa and those that invest in other developing countries.[b]

a. For an in-depth discussion and empirical analysis of the spillover effects of FDI in Sub-Saharan Africa, see Farole and Winkler (2014).
b. See column 3 in table A.6 where we estimate the likelihood that a firm will invest in a developing country outside of Africa.

As table 3.11 shows, overall, therefore, there seems to be little difference in the factors that affect the decisions of investors and those firms that considered investing in a developing country. For both groups, the expansion of markets was the top motivation to consider investing and to invest in a developing country. The presence of counterparts, including potential clients, competitors and other foreign investors was the second most important factor identified by respondents. While these two groups of firms seem to focus on market and business opportunities in the host country, noninvestors place greater emphasis on political risk and the absence of cultural networks than actual and considered investors.

Emerging-market investors appear to be less concerned about the effects of political risk than noninvestors. As illustrated in table 3.11, 16.4 percent of firms that have not invested in a developing country selected political risk as the most important factor influencing their decision not to invest. In contrast, less than 5 percent of investors viewed political risk as a top consideration when deciding whether and where to invest.[8]

Figure 3.8 Main Factors Affecting the Decisions of Noninvestors by Country of Origin



Source: World Bank based on the Potential Investors Survey.

Table 3.11 Main Factors Affecting Decisions by Investment Status[a]

Percent

	Noninvestors	*Considered investors*	*Investors*
Expansion of markets	24.60	35.70	35.70
Counterparts	32.10	31.40	27.30
Business opportunities	11.60	10.00	16.30
Costs and inputs	8.90	12.80	15.00
Political risk	16.40	8.60	4.80
Networks	4.10	1.40	0.90
Others	1.40	—	—

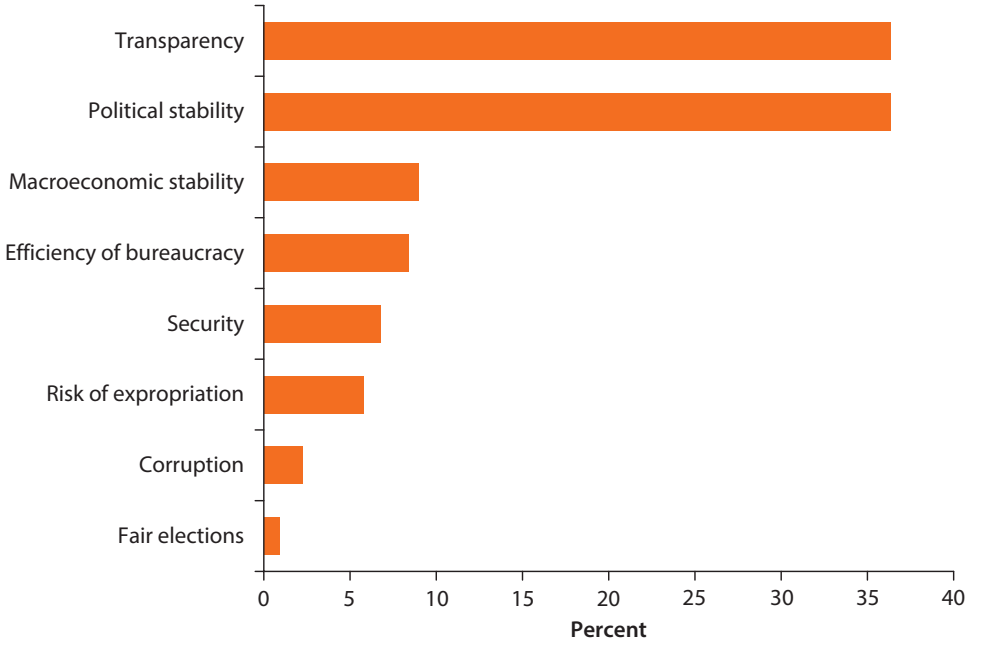
Source: World Bank based on the Potential Investors Survey.
Note: — = not available.
a. Percentage of firms that selected each category as the most important (top1) location factors.

Investors are more concerned about transparency and political stability than about fair elections, corruption control and other aspects of the business climate. It is interesting to note that there are considerable differences in the importance given by investors to the different noneconomic aspects of the business environment. Political stability, for example, is reportedly one of the three most important factors influencing location decisions for over 36 percent of investors. Another 36 percent of surveyed companies identified transparency as a top 3 consideration. By contrast, fair elections and corruption appear to be less important for investors (figure 3.9). These results suggest that firms are not deterred by irregular practices and weak institutions as long as these are predictable and can be anticipated. They are in line with the findings of recent surveys pointing to regulatory uncertainty as a major deterrent for new investment.[9]

Less than 5 percent investors expressed concerns about the possibility of expropriation of assets. Indeed, surveyed companies reportedly had limited experience with investment-related disputes with governments in their destination countries. While only 6 companies reported having suffered expropriation, 22 faced infringement violations. A greater number of respondents (37 firms or 17 percent of respondents) experienced changes in regulation or taxation that impaired the profitability of their investment. For more than half of respondents, facing these types of obstacles was an incentive to scale back operations in the developing country.

To further explore the potential impact that political risk and other specific political factors might have on investment decisions, we conducted two different sets of regressions (see box 3.3 for more details). First, we looked at the characteristics of firms and the conditions under which they are more likely to consider political risk and other political variables as one of the three most important factors in the investment decision. The results from the logistic regression models, presented in the appendix (table A.4), confirm some of the findings discussed above.

Figure 3.9 Importance of Political and Institutional Factors[a]



Source: World Bank based on the Potential Investors Survey.
a. Percentage of firms that selected each of these items as one of the three most important (top 3) location factors.

Firms that have investments in developing countries are less likely than noninvestors and than those firms that only invest in advanced economies to identify political risk as one of the most important location factors. Companies operating in the manufacturing sector and in financial services also tend to consider political risk an important factor in investment decisions. Given the less mobile nature of investments in manufacturing, it is not surprising that firms in this sector may be more wary of political conditions in host countries. Financial actors also tend to be particularly sensitive to political risk, as research on financial crises has tended to show. Our results also point to significant differences across countries, with Brazilian and South African firms being less concerned about political risk than firms in India and Korea.

Firms with investments in a developing country are more likely than noninvestors and firms with investment in advanced economies to view transparency in regulations and political stability as important location factors. Other factors increasing the likelihood that a firm will show concern for transparency and political stability include being publicly listed and operating in financial services. Firms in the manufacturing sector are also more likely to be concerned about political stability than companies in other sectors. Investors in developing countries, in contrast, are less likely than noninvestors to identify security as one of the three main factors influencing location decisions. Once again, our results show

Box 3.3 The Effects of Political Risk

To explore the role of political risk on investment decisions, we conducted two types of multivariate regressions. First, we looked at the characteristics of firms and the conditions under which they are more likely to consider political risk and other political variables as one of the most important factors in the investment decision. We used a logistic regression model, with different dependent variables in alternative specifications.

$$log\ \frac{p}{1-p} = \beta_{0j} + \beta_{1j}\ X_i$$

Dependent variables

Political risk: binary variable that takes the value 1 if the firm identified political risk as the main or one of the three main factors influencing investment decisions, and 0 otherwise.

Transparency: binary variable that takes the value 1 if the firm identified transparency as one of the three main factors influencing investment decisions and 0 otherwise.

Corruption: binary variable that takes the value 1 if the firm identified corruption as one of the three main factors influencing investment decisions, and 0 otherwise.

Security: binary variable that takes the value 1 if the firm identified security as one of the three main factors influencing investment decisions, and 0 otherwise.

Political stability: binary variable that takes the value 1 if the firm identified political stability as one of the three main factors influencing investment decisions, and 0 otherwise.

Independent variables

Invested in DC: binary variable that is 1 if the firm has investments in a developing country and 0 otherwise.

Invested in AC: binary variable that is 1 if the firm has only invested in a developed or advanced country and 0 otherwise.

The models also include some predictors used in the analysis of investment profiles, such as sector of operation, home country, legal status, and number of employees (see box 3.1 for more details on their operationalization)

We then use a multinomial logistic model, with the group of noninvestors as the baseline category, to estimate the effect of political risk and other political variables on a firm's investment profile:

$$log\ \frac{p_{ij}}{p_{ij*}} = \beta_{0j} + \beta_{1j} X_i + \beta_{2j} C_i + \beta_{3j} S_i$$

for each j = Investor, Considered investor; j = Noninvestor*

Similar to the analysis in box 3.1, we include a number of firm characteristics as predictors. The main explanatory variables in these models, however, are the binary variables used above as dependent variables: Political risk, Transparency, Corruption, Security and Political stability.

that while investors in developing countries value transparency and political stability, they are less concerned about corruption and security.

In the second set of regressions (table A.5), we used a multinomial logit model to predict the likelihood that firms that view political risk and other political factors as top location considerations fall in each of the investment categories considered in the survey (noninvestors, considered investors and investors). Our results show that, controlling for other firm characteristics, including country of origin and sector of operation, companies that have listed political risk as a top 3 concern are more likely to be investors than noninvestors. However, firms that view political risk as the most important (top 1) location factor are not more likely to be investors than noninvestors. Firms that are concerned with transparency are also more likely to have investments in developing countries. By contrast, we find no statistically significant impact of other characteristics of the business climate, such as corruption and macroeconomic stability, on the likelihood that a firm will invest or not.

Market Size Versus Cultural and Geographical Barriers

What Determines Emerging Economies' Cross-Country Investment Decisions?

A large portion of firms in the countries surveyed stated that their main motivation for cross-border investment was related to accessing the business opportunities provided by a larger market. However, our results show that a substantial regional bias exists in geographical patterns of investment: Brazilian firms tend to invest in Latin America, South African firms invest mainly in Africa, and Korean firms tend to invest in East Asia. The exception is probably India, with a more widespread reach. This is why in this section we look at revealed investment decisions and test the trade-off between market size and informational costs associated with geographical and cultural distance, as well as the role that bilateral investment treaties (BITs) may have in reducing these informational costs.

Firms face a trade-off between investing in an attractive, large, and dynamic market and investing in a familiar market, where geographic and cultural barriers may be lower. The regional bias we find in patterns of investment in our sample have long been observed in outward investment from emerging markets. For example, Ferrantino (1992) finds that transaction costs associated, inter alia, with geographic and cultural barriers, largely explained the fact that developing-country multinationals invested in other developing countries, as opposed to a preference for low-income or labor-intensive markets. More recently, as discussed in Chapter 2, Gammeltoft (2008) argues that the third wave of outward-oriented FDI from emerging economies has become increasingly global in nature, while services continued to be regionally oriented.

To what extent is distance, comprising not only physical distance but also other cultural barriers that increase the difficulty of conducting business across borders, a barrier to investment that can offset the attractiveness of a large market? Are investors from specific countries or specific sectors more sensitive to these extra transaction costs associated with distance?[10]

Of all investors in the sample, only a subset has identified the country in which they hold their largest investment. In Brazil, these are 20 firms (5 of which operate in the services sectors, and the rest in manufacturing), in India 79 (11 of which operate in services sectors), in Korea 97 (15 of which operate in services sectors), and in South Africa 44 (28 of which operate in services sectors). The implicit assumption made here, and purely driven by data availability, is that these data give a good representation of the set of destinations in which firms from these four countries invest (table 3.12 tabulates the cross-country investment counts by country of origin).

To assess the relative costs of distance and the attractiveness of market size on investment decisions, count models are estimated in which the unit of observation is the triplet "country of origin 'i'—country of destination 'j'—sector 's,'" and the dependent variable is the number of investors from country i in country j and in sector "s."[11] Formally, we estimate a hurdle model that comprises different steps for two different processes. The first uses a logit model to determine whether the count is zero or positive, the second uses a zero-truncated negative binomial model to determine the drivers of the positive count of investments.[12] Both models are assumed to follow the same specification. For brevity sake, the following equation presents the final specification:

$$Count_{ijs} = a + b_1 GDPPC_j + b_2 POP_j + b_3 DIST_{ij} + b_4 D_i + b_5 DIST^{*} D_i + b_6 Contig_{ij} + b_7 BIT_{ij} + b_8 CommLang_{ij} + b_9 Colony_{ij} + b_{10} DumSector_s + b_{11} DIST^{*} DumSector_s + b_{12} DIST^{*} BIT_{ij} + b_{13} \overline{Exp}_{ij} + e_{ijs}$$

where $Count_{ijs}$ is the count of investment projects from country i in country j corresponding to sector s, $GDPPC_j$ is the gross domestic product per capita in constant 2005 international dollars of the country of destination, POP_j is the population of the country of destination, D_i are dummies for the countries of origin (Brazil being the baseline), $DIST_{ij}$ is the capital-to-capital distance in kilometers from country of origin to country of destination, $Contig_{ij}$ is a dummy taking value 1 if countries i and j are contiguous and zero otherwise, BIT_{ij} is a dummy taking value 1 if countries i and j have a bilateral investment treaty signed and ratified, $CommLang_{ij}$ takes value 1 if the countries i and j share the official language, and zero otherwise, $Colony_{ij}$ takes value 1 if there was a shared colonial history between countries i and j and zero otherwise, EXP_{ij} are average exports of country i to country j over 2007–09, e_{ijs} is the error term assumed to be orthogonal to the regressors, and the set of "a" and "b" are parameters.

Table 3.12 Count of Cross-Border Investments

Count	*Brazil*	*India*	*Korea, Rep.*	*South Africa*	*Total*
0	779	755	762	764	3,060
1	11	23	16	21	71
2	0	7	2	4	13
3	0	3	4	2	9
4	2	0	3	0	5
5	0	2	0	0	2
6	0	0	1	1	2
8	0	0	2	0	2
9	0	1	0	0	1
14	0	0	1	0	1
15	0	1	0	0	1
17	0	0	1	0	1
Total	**792**	**792**	**792**	**792**	**3,168**

Source: World Bank based on Potential Investors Survey data.

GDP per capita and population capture the "size" attractiveness of markets, while distance, contiguity, common language, and colonial history capture the geographical and cultural distance between the pair of countries that may affect the transaction and information costs for cross-country investors. Average exports capture both size-related market attractiveness and all the gravity type of factors that impede or facilitate economic relations between a pair of countries, and control for the complementarities that may exist between investment and trade. The interactions between distance and country of origin dummies and sector dummies allow testing whether the sensitivity to transaction costs that arises due to distance is different for investors from different origins or sectors. The interactions between distance and bilateral investment treaties allow testing the extent to which bilateral investment treaties partially compensate the costs associated with dissimilarity as captured by geographic distance.

Firms tend to invest more in countries that are relatively more similar to them: that share a language, that share a colonial history, or that are contiguous. This is revealed by preliminary chi-squared tests, reported in table 3.13. The sector composition of investment needs to be taken into account when examining the trade-off between market attractiveness and transaction costs in the investment decision, since it substantially varies by country. This is because it is likely that different sectors display different sensitivities themselves to this trade-off. For example, from the subsample on which data on origin and destination of investment are available, 75 percent of Brazilian investors operate in manufacturing, while only 25 percent are in the services sectors. Instead, in South Africa, almost 70 percent of investments are actually carried out in the services sector (mainly in retail and wholesale trade, and also in finance and insurance) (Table 3.14).

Table 3.13 Cross Tabulations of Counts and Proxies of Economic Distance

Count	Different language	Common language	Total	No common colonial history	Common colonial history	Total	Noncontiguous	Contiguous	Total
0	2,551	509	3,060	3,044	16	3,060	2,991	69	3,060
1	49	22	71	69	2	71	58	13	71
2	7	6	13	12	1	13	11	2	13
3	6	3	9	6	3	9	7	2	9
4	5	0	5	5	0	5	4	1	5
5	0	2	2	1	1	2	2	0	2
6	1	1	2	1	1	2	1	1	2
8	2	0	2	2	0	2	2	0	2
9	1	0	1	1	0	1	1	0	1
14	1	0	1	1	0	1	1	0	1
15	0	1	1	1	0	1	1	0	1
17	1	0	1	1	0	1	1	0	1
Total	**2,624**	**544**	**3,168**	**3,144**	**24**	**3,168**	**3,080**	**88**	**3,168**
P-Value Chi Sq. Test of Indep.:			0			0			0

Source: World Bank based on Potential Investors Survey data.

Table 3.14 Investments by Country of Origin and Sector

	Finance and insurance	Manufacturing	Trade	Transportation and warehousing
Brazil	3	15	1	1
India	5	69	6	0
Korea, Rep.	5	82	4	6
South Africa	11	13	17	0

Source: World Bank based on Potential Investors Survey data.

Results

Results from estimating the models discussed above are reported in the appendix A, in table A.8 (for the logistic model) and in table A.9 (for the zero-truncated negative binomial model).

There is a visible trade-off in the data between market size attractiveness and the transaction costs associated with entry into dissimilar and distant markets. The combination of GDP per capita and population of the destination market appear, across all specifications, as significant determinants, both of the probability of investing in a particular destination, and of the number of investments in that market. At the same time, physical distance between countries reduces the probability of investing in a given market, while transaction costs associated with different languages, lack of a common colonial history, or not sharing borders are, jointly, significant determinants both of the probability of investing, and of the

number of investments, suggesting that these transaction costs matter in the investment decision.

Services sectors are more sensitive to transaction costs associated with geographical and cultural differences. In line with the literature (see, for example, Gammeltoft [2008]), relative to manufacturers, investors in the services sector show a preference for relatively similar host markets, revealing that in services, in-depth knowledge of the host market is more valuable than in manufacturing. Indeed, taking Brazilian investors as a benchmark, the investment sensitivity to distance of services sector investors is close to 80 percent greater than for manufacturers. Within services, transport and warehousing services are the most sensitive to the effects of distance.

Controlling for the sectoral composition of investment, firms from India, and to a lower extent from Korea, are less sensitive to distance than those from South Africa or Brazil. Indeed, in one specification, the probability of investment in a specific destination is insensitive to distance (column (4) in table A.8) This result, that was apparent from the descriptive analysis presented before, may reveal a greater level of sophistication of Indian and Korean investors relative to their South African and Brazilian counterparts, which would make them better prepared to face market dissimilarity–related costs.

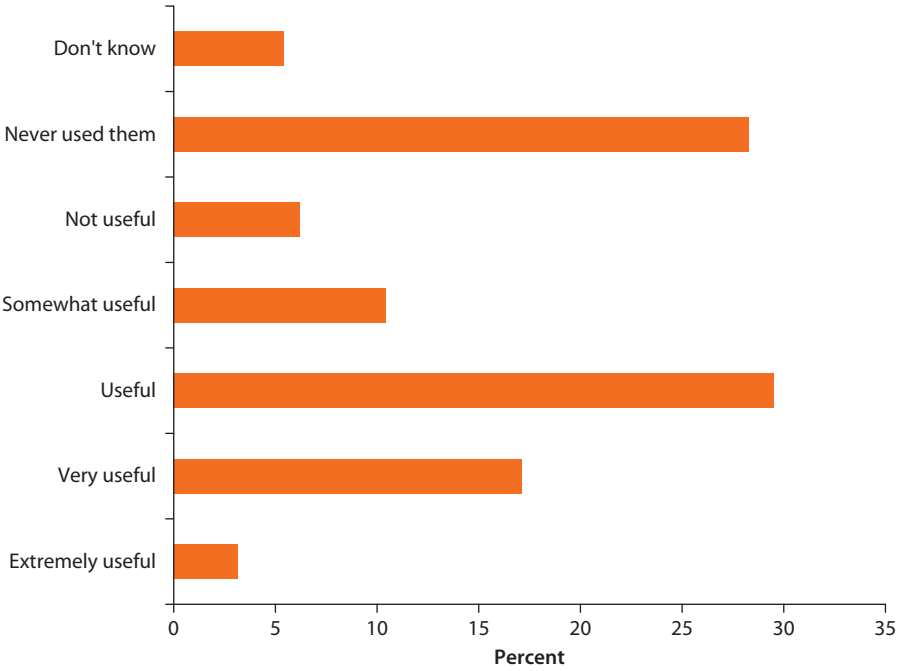
Bilateral investment treaties (BITs) facilitate cross-border investments. Most BITs contain commitments to protect investors of one country in the territory of the host country, ranging from assurances of fair, equitable, and nondiscriminatory treatment to undertakings to observe investment contracts and other investment-related obligations. These protections are accompanied by a powerful international arbitration mechanism that allows investors to bring claims directly against the host state, and which seem to increase the likelihood of investing in a statistically significant manner. This result is in line with previous literature on investments from both developed and developing countries, and reinforces the importance of these treaties in providing clear rules for both parties.[13]

More importantly, BITs reduce the cost of distance for investors. This is evident when the BIT dummy is interacted with distance, in the logit regression specification. By providing relatively more clear rules, BITs reduce to some extent the costs of investing in markets that are rather unfamiliar for investors.[14]

The Role of IPAs

Respondents were asked to identify the means through which they became aware of investment opportunities in those countries where they hold their largest investments. Of the 223 investors answering this question, 66 percent (145) reported learning about these investment opportunities from existing customers, suppliers, or investors. Almost 15 percent identified their parent company or headquarters as providing this information. Less than 2 percent of investors became aware of investment opportunities in the host country through direct contact with IPAs.

Figure 3.10 Investors' Evaluation of IPA Usefulness



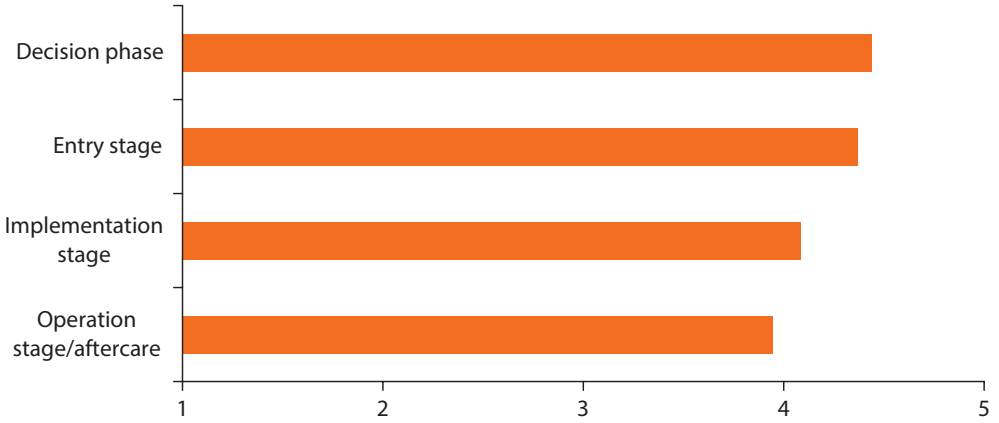
Source: World Bank based on Potential Investors Survey data.

Despite their limited role in promoting awareness of investment opportunities, IPAs appear to be a widely used and useful resource for investors. Almost 70 percent of firms with investments in developing countries reported having relied on the services provided by IPAs upon deciding to invest in a particular developing country. Only 16 companies (6 percent of respondents) thought IPAs were not useful.[15] By contrast, 30 percent found their services to be useful and almost 20 percent (52 firms) thought these were very or extremely useful (figure 3.10).

IPAs seem to be particularly useful for companies at an early stage in the decision to invest. When asked to rate the specific services provided by IPAs, investors reported higher satisfaction with IPA's provision of information on procedures and regulations of doing business as well as on corporate taxation and incentives. On average, as figure 3.11 shows, IPAs appear to be more helpful for investors during the decision phase (which obtained the highest average rating) and the entry stage (the second highest score). By contrast, IPA "aftercare" services such as providing information on finance sources and assistance in technological upgrading received the lowest average scores (see table 3.15).

There are significant differences across countries, both in usage and in reported levels of satisfaction. Indian and Korean firms are more likely to rely on IPAs in developing countries than their Brazilian and South African counterparts. Interestingly, Indian and Korean firms are also more sophisticated, in the sense of their investments being more geographically spread, as discussed above. Brazilian

Figure 3.11 Average Rating of Broad Category of IPA Services[a]



Source: World Bank based on Potential Investors Survey data.
a. Mean score of 5-point Likert scale (1=Not Useful, 2=Somewhat Useful, 3=Useful, 4=Very Useful, 5=Extremely Useful)

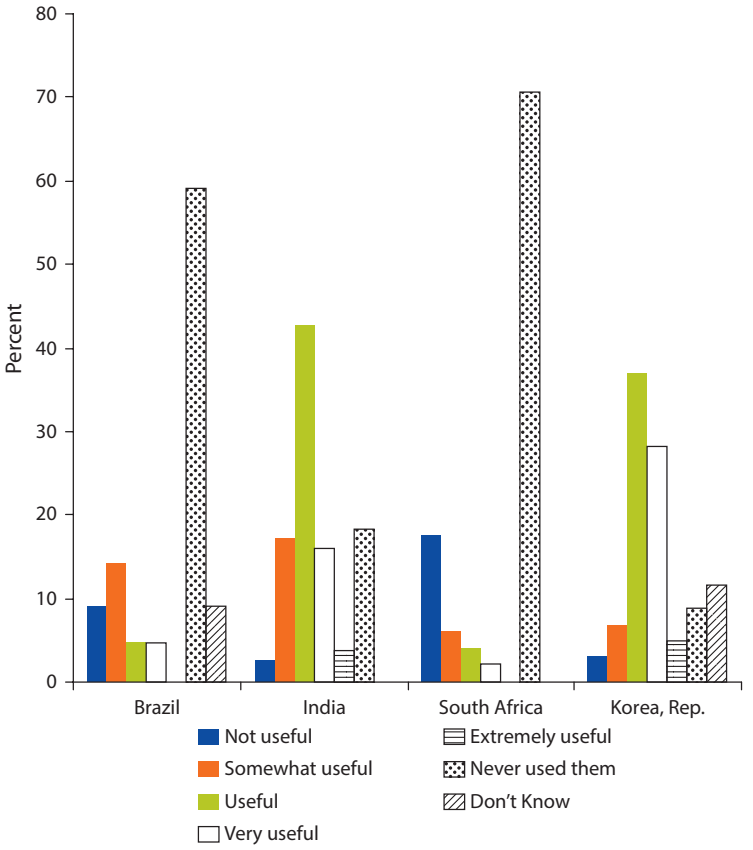
Table 3.15 Investors' Evaluation of Specific IPA Services

Description of service	*Score*[a]
Decision phase	
Information on markets	4.43
Information on availability of supporting infrastructure	4.42
Information on corporate taxation and incentives	4.63
Information on strategic partners and on relevant industry or sector	4.27
Entry stage	
Information on business procedures and regulations for doing business in destination country	4.71
Facilitating company registration, licensing (work permits, import/export permits, and so on)	4.47
Introduction to legal, accounting and other professional services	3.92
Soft landing services (for example, housing, schools, safety)	4.36
Implementation stage	
Finding suitable sites (land, office, factory)	3.9
Facilitating building construction	4.25
Access to utilities and infrastructure	4.18
Finding key staff	3.98
Operation stage/aftercare	
Complaint resolution (issues concerning tax, labor, customs, immigration, utilities)	3.84
Information on finance	3.58
Matchmaking (access to suppliers, buyers, finance)	4.23
Assistance in upgrading (information on technology sources, terms of technology transaction)	3.8
Access to utilities and infrastructure	4.26

Source: World Bank based on Potential Investors Survey data.
a. Mean score of 5-point Likert scale (1=Not Useful, 2=Somewhat Useful, 3=Useful, 4=Very Useful, 5=Extremely Useful)

and South African firms' investments show a sizable regional bias, which may reduce their needs for IPA services. A higher proportion of firms from India and Korea also rated the services provided by these agencies as useful or very useful. Indeed, the findings of regression analysis confirm that there are statistically significant differences in the perceived average level of usefulness of IPAs in the

Figure 3.12 Evaluation of IPA Usefulness by Country of Origin



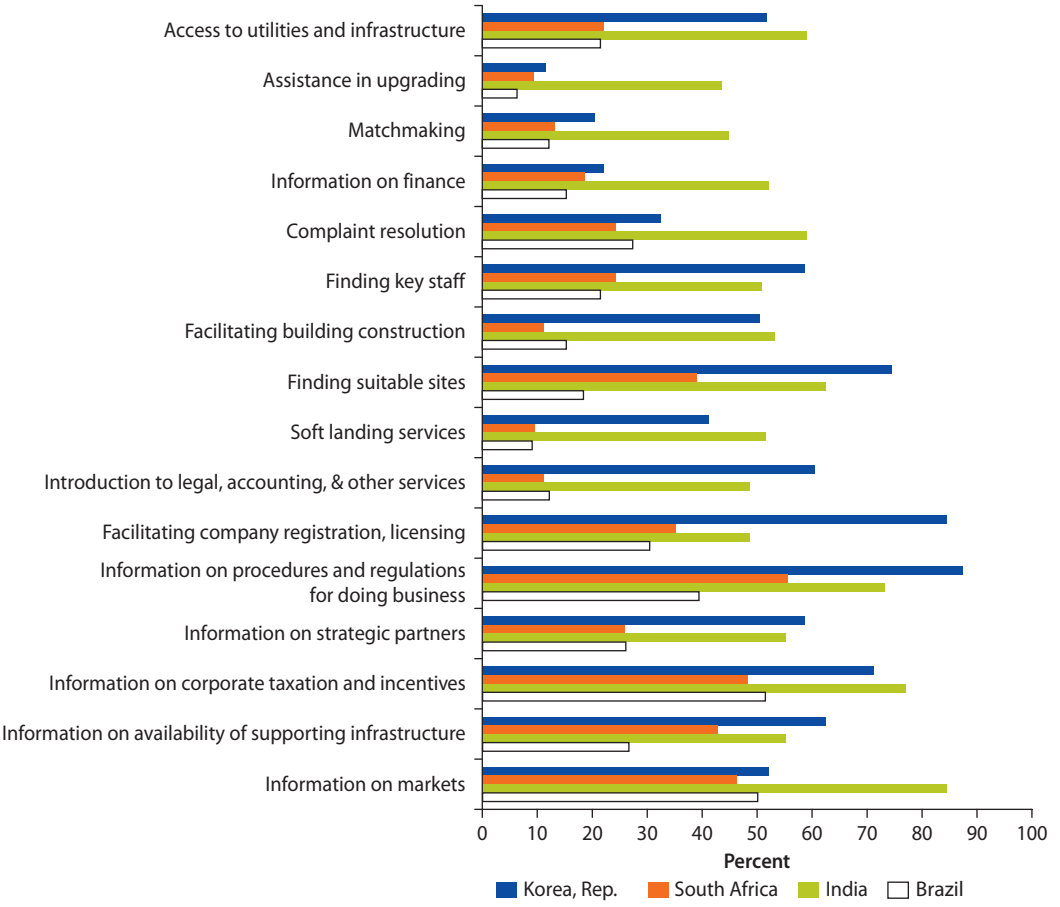
Source: World Bank based on Potential Investors Survey data.

four countries. Compared to India, only Korean companies tend to be more likely to give IPA services a higher rating. By contrast, both Brazilian and South African companies are less likely than Indian firms to find these services useful (figure 3.12).

There are also variations in the ways in which different countries perceive the range of services offered by IPAs. Figure 3.13 presents the percentage of respondents in each country ranking IPA services as "extremely useful." Korean and Indian companies in general rate most of these services more favorably than their Brazilian and South African counterparts. A higher proportion of Indian companies, however, report extreme satisfaction with IPAs' provision of information on markets and on corporate taxes and incentives. By contrast, Korean companies exhibit greater satisfaction with IPA support at the entry stage.

IPAs appear to be more important for smaller firms. Smaller firms report higher levels of satisfaction with the quality of their services. This result is invariant to two alternative definitions of size: median revenue and on number of employees.

Figure 3.13 Evaluation of Specific IPA Services by Country of Origin[a]



Source: World Bank based on Potential Investors Survey data.
a. Percentage of respondents in each country ranking IPA services as "extremely useful."

The median revenue of those firms that were not satisfied with the quality of the services provided by IPAs (US$ 632.5) is significantly higher than the median income of those that ranked the usefulness of their services favorably (table 3.16). Similarly, companies with a higher number of full-time employees seem less likely to find their services useful. For small firms, the cost of processing information about foreign markets per unit of output produced is higher than for large firms, so there is a greater value for them in obtaining IPA services. Interestingly, these results also suggest that IPAs provide useful services not only to large firms whose investments may be attributed to political priorities, but also to small TNCs.

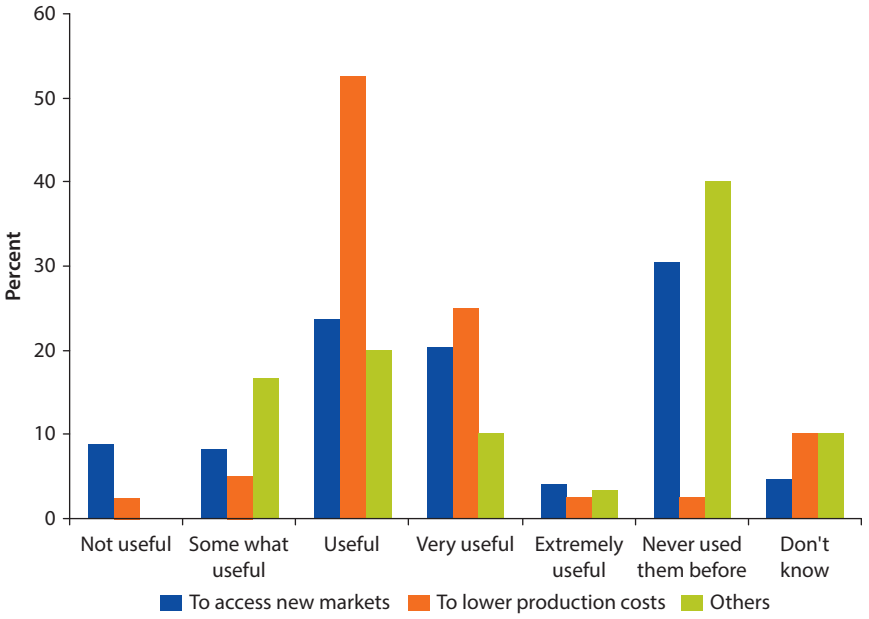
The relevance and usefulness of IPAs depend on the predominant motives guiding a firm's decision to invest. This is because there is a link between the motivations that firms have for investing abroad and how binding the different obstacles to investment are. IPAs have a role in helping to alleviate these

Table 3.16 IPA Evaluation and Firm Size

	Revenues (median) (2009 millions of USD)	*Full time employees (Mean)*	*Total number of employees (mean)*
Not useful	632.48	9,217.8	11,010.2
Somewhat useful	179.42	7,645.9	1,921.4
Useful	125.9	2,481.5	5,142.1
Very useful	106.5	1,610.2	504.2
Extremely useful	190.6	1,211.1	—
Never used them	263.5	8,674.3	7,424.3
Don't know	—	1,813.2	2,309.3

Source: World Bank based on Potential Investors Survey data.
Note: — = not available.

Figure 3.14 IPA Evaluation and Motives for Investment
Percent



Source: World Bank based on Potential Investors Survey data

constraints. Indeed, as figure 3.14 suggests, IPAs appear to be more useful for those firms whose decision to invest is motivated by lowering production costs and, to a lesser extent, for those seeking to access new markets.

Does the association between IPA evaluation and the size and motives of firms still hold when controlling for other factors? To answer this question and to gain a better understanding of the firm characteristics that may influence perceptions of usefulness of the services offered by IPAs, we conducted

multivariate regression analysis. We focus on two different outcomes or dependent variables: (1) the decision to use IPAs or not; and for IPA users (2) the perceived level of usefulness of these services. To examine the predictors of the likelihood that a company uses IPA services or not, we estimate a logistic regression model (box 3.4). To probe the determinants of IPA valuation, instead, we estimated an ordinary least squares (OLS) model using an ordinal scale of 1 to 5 measuring satisfaction with their services as the dependent variable. In both models, we use the various characteristics of investors, including size, sector of operation, ownership structure, trade dependence, and country of origin, as explanatory factors.

Determinants of IPA Use: Our results, presented in table A.10 in the appendix A, suggest that company size, measured in terms of labor force does not appear to have a statistically significant impact on the likelihood that a company will use IPAs. However, our results do show a negative effect of labor productivity on the use of IPAs, suggesting that the less productive firms are more likely to seek assistance from IPAs. We also find a positive and significant association between the company's degree of trade internationalization and IPA use. Controlling for other factors, companies that are publicly listed and those in the manufacturing sector are also more likely to use IPAs. By contrast, companies with investments in African countries are less likely to seek IPA assistance (See box 3.5 "Africa IPAs" for discussion of the role of IPAs in Africa). Finally, the results fail to uncover any specific "Korea" effect. When controlling for other factors, firms from Korea are *not* more prone to use IPAs than their counterparts from the other countries.

The results of our regression analysis also confirm the association between the motives of firms and their tendency to use IPA servies. In columns (1) and (2) of table A.12, we present estimated coefficients of a logistic model with the binary variable *UsedIPA* as the dependent variable and dummy variables for the different motivations that respondents were asked to rank in the survey. In Model (2), we control for other statistically significant factors (as per table A.10). Our findings suggest that companies that are motivated by the objective of lowering production costs are more likely to use IPAs.

Determinants of IPA Evaluation: All other things equal, smaller firms tend to find the services of IPAs in developing countries more useful. Thus, while size does not influence whether a company decides to use IPAs or not, it *does a*ffect reported levels of satisfaction by users (see table A.11). Labor productivity also has a significant and negative impact on the dependent variable, suggesting that the marginal benefit of interacting with IPAs decreases with the opportunity cost of firms' time. Firms with investments in Africa, in turn, also appear to find IPA services less useful. Although the dummy variable for Korean companies included in column 3 is statistically significant, its addition reduces the significance of firm size, suggesting colinearity issues between the two variables. Interestingly, characteristics such as involvement in international trade and sector of operation,

Box 3.4 The Role of IPAs

To further investigate whether there is an association between the characteristics of firms and the perceived usefulness of investment promotion agencies (IPAs), we conduct multivariate regression analysis. We examine the factors influencing two distinct outcome variables: (1) the decision of companies to use IPA services and (2) their perceptions of these agencies' usefulness.

In the first model, the dependent variable *Y* is whether a company *i* used the services of an IPA or not (*UsedIPA*). To estimate this probability, we use a logistic regression model, which relies on a logistic transformation and expresses the probability p that $Y = 1$ as a linear function of a series of predictors, including firm size, productivity, legal status, and so on.

$$log\ \frac{P}{1-P} = \beta_{0j} + \beta_{1j}\ X_i$$

We also estimated an OLS model using an ordinal scale of 1 to 5 measuring satisfaction with IPA services (*IPAEval*) as the dependent variable.

$$Y = \beta_{0j} + \beta_{1j}\ X_i$$

In both models, we include the same explanatory variables considered in the analysis of company's investment profile, namely:

Number of employees: as a proxy of company size, we include the average per week number of full-time employees that work there.

Labor productivity: this is measured as the value of the company's 2009 revenues in US dollars divided by number of full time employees working there.

Trade dependence: percentage of total sales that the company makes in foreign markets.

Domestic ownership: dummy variable that is equal to 1 if the company is domestically owned, that is, if its ownership by a foreign entity is <10 percent, and 0 otherwise.

Legal status (publicly listed): dummy variable, taking the value of 1 if the company's shares are widely held and managerial control is not exercised by an individual or family holding a major stakeholder in the company.

In addition, and based on examination of descriptive statistics and the bivariate analysis in section 2, which suggests a greater tendency by Korean firms to use and to give positive assessment to IPA services, we include a dummy variable (Korea) for companies from this country. Similarly, some specifications of the model contain a dummy variable for firms in the manufacturing sector.

Moreover, in some of the specifications, we explore whether there is an association between the motives underlying a firm's decision to invest abroad and its tendency to use and rate IPA services. To that end, we transform the variable Motives into a series of dummy indicators, that take the value of 1 if the firm selected a specific motivation (to access new markets, to lower production costs, to access natural resources/inputs, to join a specific partner and to export back to the home country) and 0 otherwise.

Box 3.5 IPAs in Africa

In an effort to increase inflows of FDI, African countries have created new institutions to promote and facilitate investment by helping potential investors to identify opportunities and to overcome obstacles in pursuing them. African investment promotion agencies (IPAs) face a number of challenging tasks, namely, bridging the capability and informational gaps at the domestic level, while enhancing perceptions and fostering Africa's credibility in international markets.

How effective have these institutions been in achieving these goals? Two interrelated findings suggest that there is still significant room for improvement. First, among all firms, those that invest in Africa are less likely to use IPA services. Second, from the subset of all firms that use IPA services, those that invest in Africa find IPA services less useful than firms that invest elsewhere.

This can be clearly observed in figure B3.5.1. Almost 60 percent of firms with investments in Africa never used IPA services—more than three times the proportion of firms investing outside of Africa that never used these agencies. In addition, the percentage of investors in Africa that gave IPA services the lowest possible rating (Not Useful) is three times higher (12 percent) than the percentage of firms that invested elsewhere (4 percent) and found IPA services unsatisfactory.

Rather than relying on IPAs, firms investing in Africa rely on domestic customers, suppliers, and existing foreign investors to obtain relevant market information and learn about investment opportunities. African IPAs were reportedly not very important in generating awareness of investment opportunities within the host countries (see figure B3.5.2). The percentage of investors that identified the local IPA as the key provider of initial information is very low (3 percent) (although slightly higher than the same proportion for investors outside of Africa). Domestic customers and suppliers, as well as existing foreign investors, were more influential in making potential investors aware of available opportunities. Indeed, the role of existing investors in attracting new firms appears to be more central than for firms that don't invest in Africa. Other relevant sources of awareness generation in the case of African countries included external advisors, private organizations, and United Nations Industrial Development Organization (UNIDO) Investment and Technology Promotion Offices (ITPOs).

The importance of these informal networks in providing relevant information that could facilitate investment decisions underscores the largely untapped value that IPAs could add in Africa. Although informal networks are useful, they do not fully substitute the role that IPAs should be playing.[a] Existing foreign investors and other firms in the market may have incentives not to reveal all information—likely a strategic asset for them—to prospective investors. Hence, the value of IPAs for developing close relationships with the existing FDI base by, for example, improving services in the implementation and operation stages. Services such as helping firms to gain access and to expand their infrastructure, providing information on additional sources of financing, and facilitating linkages with suppliers and buyers could indirectly contribute to attract new investors. Yet, as figure B3.5.3 shows, firms with investment in Africa gave some of the lowest average scores to these so-called "aftercare" services.

Our results are also consistent with recent comparative work by the International Finance Corporation (IFC) on national investment promotion intermediaries (IPIs) and their

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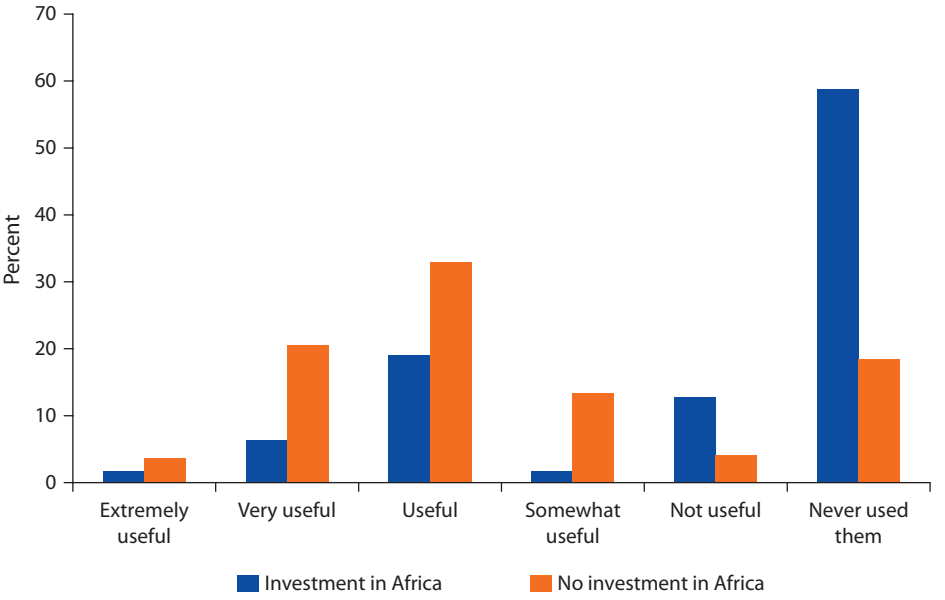
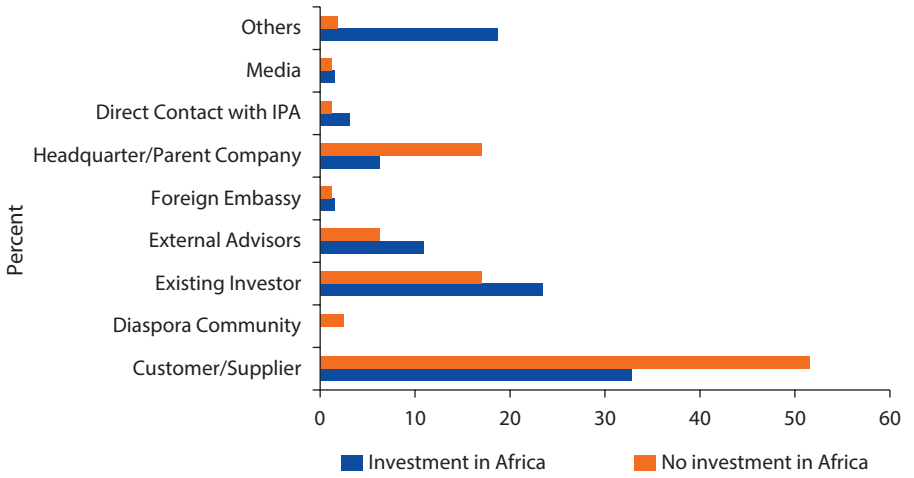
Box 3.5 IPAs in Africa *(continued)*

Figure B3.5.1 Evaluation of IPAs



Source: World Bank based on Potential Investors Survey data.

Figure B3.5.2 Main Source of Information on Investment Opportunities in Host Country[a]



Source: World Bank based on Potential Investors Survey data.
a. Percentage of respondents that identified each item as the main source of information.

performance. The Global Investment Promotion Benchmarking project, launched in 2006, has evaluated the capabilities and performance of over 210 IPIs worldwide. Specifically, this exercise assesses the performance of IPIs in two areas: responding to inquiries and providing online information to potential investors. As figure B3.5.4 indicates, as a group, the IPIs

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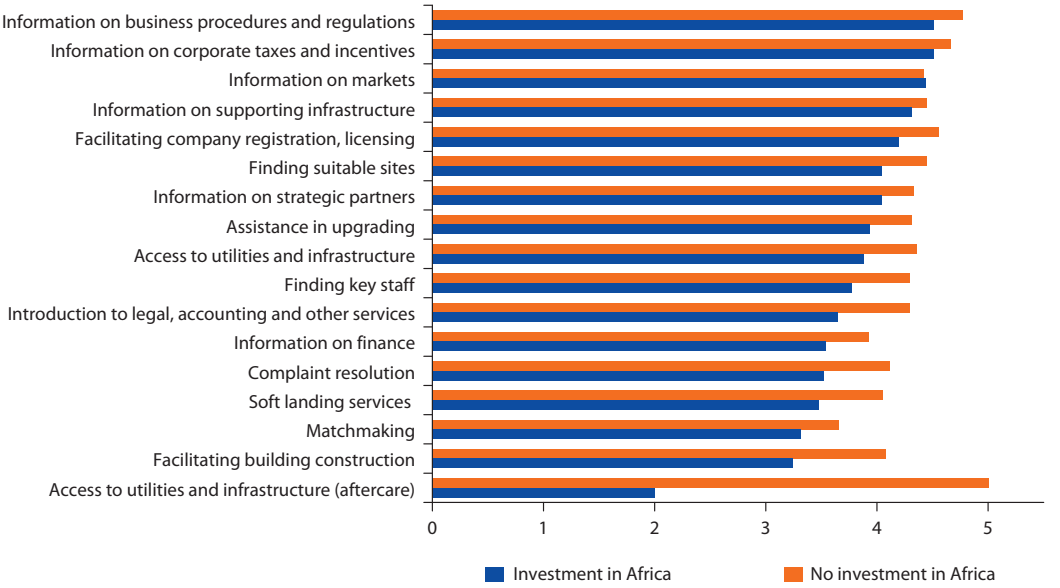
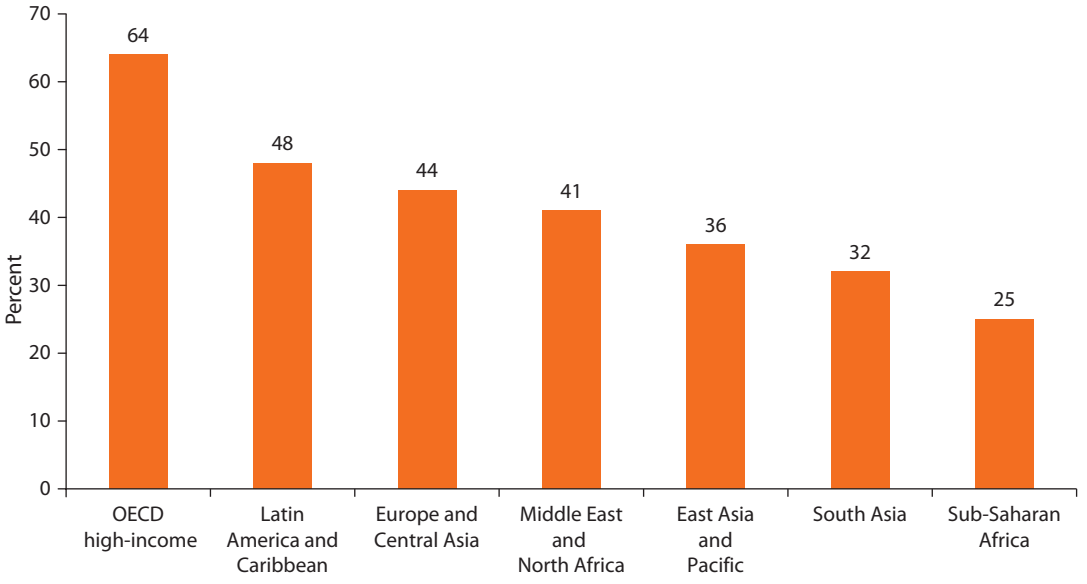
Box 3.5 IPAs in Africa *(continued)*

Figure B3.5.3 Evaluation of Specific IPA Services[a]



Source: World Bank based on Potential Investors Survey data.
a. Mean score of 5-point Likert scale (1=Not Useful, 2=Somewhat Useful, 3=Useful, 4=Very Useful, 5=Extremely Useful)

Figure B3.5.4 Global Investment Promotion Benchmarking for 2012, Regional Average



Source: World Bank Group.
Note: OECD = Organisation for Economic Co-operation and Development.

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Box 3.5 IPAs in Africa *(continued)*

of Sub-Saharan African countries performed substantially worse than the agencies of other regions, obtaining an average score of 25 percent.[b]

Yet, there are significant variations across countries within Africa. Indeed GIPB (2012) further distinguishes between the very weak performances of IPIs in West and Central African countries (20 percent) and the slightly stronger record of these agencies in the East and Southern African region (33 percent). In table B3.5.1, we list the IPAs and scores of the countries identified by investors in our sample as main investment destinations in Africa. We can observe that, while all of these host countries have IPAs, the performance of these agencies is generally weak, with very few exceptions. Botswana, for example, appears to be the outlier in this group, obtaining a "Good" score.

We also investigate what types of firms, among investors in Africa, predominantly use IPAs and find their services useful. We first estimate a logistic model to investigate the likelihood that firms with investment in Africa use the services of IPAs. We find that smaller firms in Africa are more likely to use IPAs. In addition, and consistent with the results obtained for the sample as a whole, our results indicate that publicly listed companies and those that are more dependent on international trade are more likely to use IPAs. Moreover, controlling for other factors, Indian firms that invest in Africa are more likely to rely on IPA assistance. By contrast, South African firms are less likely to demand the services of IPAs in other African host countries, as probably they have an informational advantage.

Table B3.5.1 Performance of IPAs in Selected African Countries

Country	*IPA*	*Score*
Botswana	Botswana Export Development and Investment Authority	Good
Tanzania	Tanzania Investment Centre	Average
Ghana	Ghana Investment Promotion Centre	Average
Malawi	Malawi Investment Promotion Agency	Average
Kenya	Kenya Investment Authority	Average
Lesotho	Lesotho National Development Corporation	Average
Nigeria	Nigeria Investment Promotion Commission	Weak
Ethiopia	Ethiopian Investment Agency	Weak
Egypt, Arab Rep.	General Authority for Investment and Free Zones	Weak
Swaziland	Swaziland Investment Promotion Authority	Weak
Mozambique	Centro de Promoção de Investimentos	Weak
Namibia	Namibia Investment Centre	Weak
Zimbabwe	Zimbabwe Investment Authority	Weak
Angola	Agência Nacional para o Investimento Privado	Weak
Zambia	Zambia Development Agency	Very Weak
Cameroon	Cellule de Gestion du Codes des Investissements	Very Weak

Source: World Bank Group.
Note: IPA = investment promotion agencies.

box continues next page

Box 3.5 IPAs in Africa *(continued)*

We then look at the predictors of IPA evaluation, using instead an OLS model and an ordinal scale of 1 to 5 to measure satisfaction with IPA services *(IPAEval)* as the dependent variable. We find that a firm's trade dependence and productivity levels are positively associated with the score it gives to IPAs. (See table A.13). In addition, our results indicate that, all else equal, South African firms investing in Africa rate IPA services more negatively than investors from the three other countries.

In sum, our data reveals that in Africa, less firms use IPAs and that those that do find their services less useful. Instead, investors in Africa tend to rely more heavily on business counterparts and informal networks for information and other services that IPAs fail to provide adequately. These results highlight the benefits of improving the institutional quality of IPAs and other public entities promoting investment, which can act as more reliable and consistent providers of information.

a. The crucial role of existing investors and other firms operating in the domestic market in providing information and influencing the decisions of potential investors is consistent with the findings of previous surveys of investors in Africa (for example, UNIDO 2002, 2005, 2011).
b. GIPB scores are presented in the form of an index, with 100 percent the highest possible score. Each of the two identified dimensions, websites and handling of investor inquiries, accounts for 50 percent of the overall performance score. Online information and inquiry responses are categorized as follows: very weak (0–20 percent); weak (21–40 percent); average (41–60 percent); good (61–80 percent); and best practice (81–100 percent).

which were found to be associated with the decision to use IPAs, do not appear to have a statistically significant effect on the IPA usefulness score. The results in columns (3) and (4) of table A.12, moreover, indicate that there are no statistically significant association between the main motivation of investors and their rating of IPA services.

The Role of International Economic Agreements

Do international treaties influence investment decisions into developing countries? Can governments boost the attractiveness of their country to foreign investors by signing on to international trade and investment agreements? The survey and subsequent analysis by Kenyon and Margalit (2012) shed light on these questions.[16]

Respondents were first asked whether they had knowledge of the international trade and investment agreements signed by the country in which their largest investment is located. The majority of respondents (74 percent) were unaware of any regional or bilateral trade agreements to which the host country is a signatory. Of the 229 investors that answered this question, only 60 respondents (26 percent) had knowledge of participation in international trade agreements by their largest host country. Interestingly, this awareness varied across countries. Almost 60 percent of South African investors and 56 percent of Brazilian respondents claimed to be aware of the trade agreements signed by their largest host country. By contrast, only 30 percent of Indian and less than 6

percent of Korean respondents claimed to know whether their main investment destination had a trade agreement.

More than half (51 percent) of those with knowledge of trade agreements signed by the host country said the latter actually had influence on their companies' business operations. When asked about the specific benefits derived from these agreements, 30 percent mentioned the expansion of the size of the export market and 23 percent said they contributed to a reduction in the costs of trade. Access to raw materials (16 percent) and improved access to finance (13 percent) were also identified as important potential benefits of trade agreements by the host country. Notably, no respondents selected the option of the trade agreement including a chapter on investment and investor protection as the main benefit. Almost 70 percent of respondents said there were no potential disadvantages from membership in trade agreements.

A smaller proportion (43 percent) of investors were aware of the host country's record in terms of BITs. Ninety percent of those who claimed to be aware of the BITs signed by their host country were from Korea. To the follow-up question of whether these treaties influenced their companies' business operations, only 16 respondents (30 percent) gave an affirmative answer, citing, among other potential benefits, greater safety and clarity in the investment process.

These results suggest that while the host country's participation in international trade and investment treaties is not the most prominent factor influencing the choice of an investment location by TNCs from emerging markets, it is taken into account by a sizable share of foreign investors. To shed further light on the ways in which membership in international economic agreements may influence the attractiveness of a host country in the eyes of foreign investors, the survey included an experimental question, in which executives were asked to assess and rate four hypothetical investment scenarios from the perspective of their own firm (Kenyon and Margalit 2012). By randomly assigning respondents to receive different information about the investment conditions, such as whether or not the potential host country participated in international trade and investment treaties, it is possible to evaluate the causal impact of these agreements on potential investors' perceptions and assessments of the investment climate.

More specifically, firm executives were presented with four vignettes containing the description of "Country X," which included a set of details about the hypothetical investment destination (such as population size, rate of growth and degree of political stability) that were held constant across all respondents. However, all respondents were randomly assigned to receive one of four different treatments, which varied in respect to the economic policy actions the government of the country has taken. While all four treatments included a government that is openly supportive of free market economic policies, in only two of the scenarios the country was a member of international trade and investment treaties. In addition, two of the treatments referred to specific pro-market policies

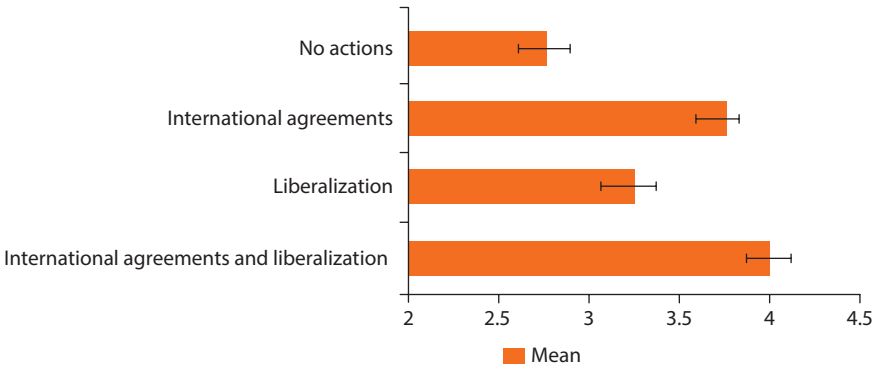
that the government had introduced. In sum, executives were presented with four potential investment scenarios differing as follows:

1. The country signed on to international treaties
2. The country implemented pro-market reforms
3. The country signed on to international treaties and implemented pro-market reforms
4. The country has done neither.

Respondents were then asked to rate the business climate with a five-point scale: very bad (1), bad (2), indifferent (3), good (4), and very good (5). Kenyon and Margalit (2012) examine the causal effect of the government's decision to join international trade and investment agreements on the attractiveness of the country to potential foreign investors using a test of means of these ratings of the investment climate. Their results show that, indeed, the combination of signing onto international treaties and implementing pro-market reforms leads to the most favorable assessment of the investment climate (3.95) (see figure 3.15). Moreover, membership in international agreements is associated with a higher rating (3.71) than only implementing liberal economic policies (3.28).[17]

In sum, the findings suggest that membership in international economic agreements does indeed increase the perceived attractiveness of a developing country in the eyes of potential investors. The comparison of means test, however, provides no information as to the specific mechanisms through which trade and investment agreements boost the attractiveness of host countries. Thus, Kenyon and Margalit (2012) test empirically for the presence of possible mechanism that may account for this effect, including the role of international treaties as signaling mechanisms, their use as commitment devices constraining predatory behavior by host governments, and their market-enhancing and cost-reducing effects.

Figure 3.15 Perceived Attractiveness of Investment Climate



Source: Kenyon and Margalit (2012).

Their analysis finds strong support for the market-enhancing effects of international agreements. In other words, firms appear to prefer investing in countries that are members to trade and investment agreements because these treaties allow firms to benefit from lower barriers of access to other countries' markets and to export back to the home country. Indeed, firms that described their main motivation for investment abroad as either "to export back to the home country" or "to benefit from a trade agreement" rated scenarios in which countries signed onto international agreements more positively than other firms. This large and positive association between trade motives and rating of investment climates holds when controlling for sector of operation, home country and size of the firm.

In contrast, this study found little empirical evidence in support of the other three possible mechanisms. The authors demonstrate that those firms that are most concerned with the quality of the legal framework and the transparency of business regulations in the host country do not assign a greater premium to those countries that participate in international economic agreements than other firms that have different concerns. Their analysis also fails to find any evidence suggesting that firms with less mobile investments, which one would expect to be more concerned about political risk, assign a higher rating to host countries that are members of an international economic institution. Thus, international treaties seem to have a limited impact in reducing developing countries' time-inconsistency and credible commitment problems.

Similarly, Kenyon and Margalit (2012) find no evidence that participating in international agreements contributes to increase investor confidence by signaling that the country has a market-friendly orientation. Indeed, respondents gave the hypothetical country that signed international economic agreements a more favorable rating than they assigned to the two hypothetical scenarios in which the government of the country made pro-market statements and implemented liberal reforms. This suggests that signing onto a treaty has an independent effect that goes beyond signaling a market-friendly orientation and policies. Finally, the study found little empirical support for the cost-efficiency mechanism. Contrary to what one would expect to observe if this mechanism was at play, firms whose motives for investing abroad is efficiency of production do not rate a country that participates in an international treaty more favorably than firms who are less concerned about enhancing production efficiency.

Notes

1. Within these broad sectors, investors come from a wide range of different industries. Moreover, sectoral composition of FDI outflows varies across countries. Among Korean firms, the most popular products are automobile parts and components, clothing and footwear, and IT and electronics (including components). Indian investors are concentrated in software development, clothing production, and pharmaceuticals. By

contrast, a greater proportion of South African and Brazilian investors specialize in foodstuffs, agribusiness, finance, and other services.

2. We obtain the same results when running a logistic model using the dependent variable 'Invested in a developing country' (which is 1 if the firm invested in any developing country and 0 otherwise). See column 3 table A.1 in the appendix A for results. When examining the decision to invest in a developed country only, however, we find that only trade internationalization and the publicly listed dummy are statistically significant. Sector of operation does not appear to influence the likelihood of emerging-market TNCs investing in a developed country (column 4, table A.1).
3. From the questionnaire: "By serious consideration we mean that the company has spent a nontrivial amount of time and resources researching the investment opportunity."
4. The distribution of respondents across countries, however, is more balanced than in the previous question on main investment destination (27 from Brazil, 34 from India, 45 from South Africa, and 33 from Korea).
5. This indicator is constructed by the OECD and is based on the OECD-WTO Trade in Value Added database.
6. The MAOTRI captures the trade policy distortions imposed by the trading partners of each country on its export bundle. It measures the uniform tariff equivalent of the partner country tariff and nontariff barriers (NTB) that would generate the same level of export value for the country in a given year. Tariffs can be based on the Most Favored Nation (MFN) tariffs, which apply to all trading partners, or the applied tariffs, which takes into account bilateral trade preferences.
7. Of course, the sectoral composition plays a role in the relative sizes of the MAOTRI. For example, the higher level of protection faced by Korea's exports reflects in part the sectoral composition of its exports, which are relatively concentrated in automobiles and other products facing higher tariffs in world markets.
8. However, when considering the top three most important factors selected by respondents, we find that a greater proportion of investors (63.1 percent) than noninvestors (49.1 percent) selected political risk.
9. See, for example, KPMG (2013).
10. Unfortunately, the cross-sectional nature of our data prevents us from strictly testing Gammeltoft's claim on the *increase* in the global reach of emerging-market multinationals.
11. Note that a count of zero investment from country i in country j in sector s masks two different scenarios: (i) no investment from i is conducted in j in sector s, or (ii) firms from i that invest in j in sector s have not answered the question or have not been sampled. The underlying process that determines whether a zero corresponds to (i) or to (ii) is unknown and hence not modeled here.
12. An alternative was to use a zero-truncated Poisson, but given that the data showed overwhelming evidence of overdispersion, the Negative Binomial model is preferred.
13. See for example, Wagle (2011).

14. The BIT dummy and its interaction were not included in the last specification (both for the Logit and Negative Binomial models) because the likelihood function did not converge.
15. However, when asked to expand on the reasons why IPAs were not useful, many of the respondents revealed they had not really used them.
16. The findings discussed in this section are from Kenyon and Margalit (2012).
17. The results from the experimental questions should be interpreted with caution. There is recent neuroscience evidence that shows that experiments are subject to hypothetical bias—that is, when agents face a hypothetical choice, they may opt differently than when they face a real choice. The difference lies, according to the research, on different computation methods for costs and benefits when comparing hypothetical with real situations, rather than with different valuation systems (Kang et al. 2011). We thank Leonardo Iacovone for pointing us to this line of research.

CHAPTER 4

Conclusions

The Potential Investors Survey seeks to shed light on the characteristics, motivations, and strategies of investors from four emerging economies: Brazil, India, South Africa, and the Republic of Korea. While most existing surveys of foreign investors focus exclusively on companies that are engaged in foreign investment, our sample includes both actual and potential investors. The data from the survey thus allows us to draw conclusions about what differentiates investors from firms that considered investing but decided not to and from those that never considered investing abroad. It also provides information on the different characteristics, motivations, and needs of investors across countries.

In this final chapter, we first summarize the main empirical findings of the survey and then discuss their implications for scholarly and policy debates on outward foreign direct investment from emerging markets and on the role of investment promotion agencies in developing countries.

Main Findings

Investors Versus Noninvestors

Investors differ significantly from noninvestors in size, level of internationalization, ownership structure, and legal status. Compared to noninvestors, companies that invest in developing countries are larger in terms of the size of their work force and derive a greater proportion of their revenues from international trade. In addition, firms that are publicly listed and owned by domestic capital are also more likely to be investors than noninvestors.

Our finding that size and trade internationalization increase the likelihood that firms invest abroad is consistent with the expectations and conclusions of the literature on emerging-market transnational companies (TNCs). The recent surge in outward foreign direct investment (OFDI) from emerging economies has been explained as a response to the competitiveness pressures of economic globalization, as these countries became more open to international trade and

investment flows. Exposed to competition from abroad, firms from developing countries increased their competitiveness and developed firm-specific advantages, becoming outward investors and active participants in global value chains. We expected the larger and more internationalized firms to be more competitive and hence to start investing abroad sooner than their smaller, inward-oriented counterparts. But, in addition, OFDI can be a substitute for trade in markets where firms confront high barriers to entry. This trade barrier-jumping rationale of OFDI involves not only trade policy-related barriers, such as tariff and nontariff measures, but also adverse geographical conditions and poor infrastructure that hinder trade. This is particularly relevant in the case of African countries.

Sectoral Composition

The literature on emerging-market TNCs has emphasized an important change in the sectoral composition of the latest wave of OFDI from the developing world. While TNCs from developed and developing countries in previous decades tended to concentrate on the primary and secondary sectors, OFDI from emerging-market firms since the 2000s has been preponderantly in services. In particular, according to recent studies, finance and business services account for the higher share of OFDI from emerging countries. The data from the Potential Investor Survey is insufficient to test these contentions empirically. The sample contains firms in only five sectors, selected for their economic importance. However, the findings from our sample suggest that among surveyed firms, those in the manufacturing sector are more likely to be investors or to consider investing than those in the services sector.

Destinations

Recent work on emerging-market TNCs suggests that the latter have become increasingly globalized, spreading their geographical reach beyond their region. The data from the Potential Investor Survey, however, does not unambiguously support these claims. Our findings show that companies invest more in countries in their own regions. This considerable regional bias suggests that firms still face substantial costs of investing in distant and/or dissimilar markets. Among the four countries considered, our findings indicate that firms from India, and to a lesser extent those from Korea, are more globalized in their investments than companies from Brazil and South Africa. This points to significant differences in levels of sophistication and knowledge of international markets across companies from the four countries.

Yet, the observed regional bias in outward FDI flows from emerging markets may have positive implications for both investors and host markets. Evidence from previous work on FDI spillovers suggests that regional investors are more likely to integrate with local supply chains and tend to have smaller technology gaps with local firms. Indeed, the regional bias in location is likely to be related to the regional bias in "interaction." As investors find it easier to interact with

supply chains and labor markets that are more familiar to them, the overall transaction costs of cross-border investments fall, which leads to a regional bias in location decisions. Thus, the presence of regional investors may result in more significant spillovers than the presence of investors from outside the region.[1]

Motives and Main Location Factors

The main motivation for investment for firms in our sample is to gain access to new markets. Lowering production costs is the second most important motive for companies to invest in a developing country. Indeed, investors identified market and business opportunities, and in particular, the presence of key clients and competitors, as the main factors influencing the choice of an investment location. Only 5 percent of investors claimed to invest abroad with the goal of acquiring natural resources and inputs. These results are consistent with findings from previous studies, which have concluded that while TNCs from emerging markets may be increasingly driven by asset augmenting strategies, the majority of firms from developing countries continue to be mainly market and efficiency seeking.

While accessing new markets is the top motivation for firms from the four countries, Korean companies are much more focused on the cost and availability of inputs than their Brazilian, South African, and Indian counterparts. In fact, more than 35 percent of Korean companies claimed that lowering production costs was the main motivation for investing abroad. The stronger emphasis placed by Korean firms on gaining access to inputs and enhancing efficiency is best explained in reference to their greater integration into global value chains, when compared with firms from the three other countries.

Political Risk

Absence of market and business opportunities is the principal impediment to investment for firms in our sample. Our findings furthermore suggest that emerging-market firms are moderately concerned about political risk, transparency, and political stability. Indeed, the data from the survey shows that, overall, investors give *less* importance than noninvestors and considered investors to the effects of political risk and other noneconomic aspects of the business environment. A greater proportion of firms that do not invest abroad selected political risk as the most important factor influencing the decision not to invest. While our data is inconclusive, the differences may be interpreted as suggesting that political risk is a binding constraint that deters many firms from investing in developing countries.

Interestingly, our findings show that investors are more concerned with political stability and transparency than corruption, fair elections, and security in the host country. These findings suggest that firms from emerging markets are not deterred by irregular or corrupt practices, the low quality of democracy, and insecurity, as long as these issues are predictable and can be anticipated.

Market Size Versus Cultural and Geographical Barriers

Apart from worrying about political risk, firms also face a trade-off between investing in an attractive, large and dynamic market, and investing in a familiar market, where geographic and cultural barriers may be lower. Our results suggest that, indeed, firms tend to invest more in countries that are relatively more similar to them: that share a language and a colonial history, or that are contiguous. In addition, physical distance between markets reduces the probability of investing in a given market, while transaction costs associated with different languages, lack of a common colonial history, or not sharing borders are, jointly, significant determinants both of the probability of investing, and of the number of investments in a given market, suggesting that these transaction costs matter in the investment decision.

Moreover, and in line with the literature, we find that firms in the services sectors are more sensitive to transaction costs associated with geographical and cultural differences. Our findings suggest that relative to manufacturers, investors in services show a preference for relatively similar host markets, revealing that in services, in-depth knowledge of the host market is more valuable than in manufacturing.

In addition, our statistical analysis reveals that bilateral investment treaties (BITs), which generally contain commitments to protect investors of one country in the territory of the host country and provide arbitration mechanisms, facilitate cross-border investments. Specifically, by providing relatively more clear rules, BITs reduce to some extent the costs of investing in markets that are rather unfamiliar for investors.

International Trade Agreements

Like BITs, international trade agreements also increase the perceived attractiveness of a host developing country in the eyes of potential investors. The results from the survey suggest that while the host country's participation in international trade and investment treaties may not be the *most* prominent factor influencing the choice of an investment location by TNCs from emerging markets, it is taken into account by a sizable share of foreign investors. More than half of investors with knowledge of the trade agreements in which host countries participated said the latter influenced their companies' investment decisions. In particular, investors pointed to the opportunities that such agreements provide for accessing new markets and for reducing the costs of trade.

We also investigate the mechanisms through which international trade agreements contribute to attract foreign direct investment. The empirical analysis confirms the centrality of the market-enhancing effects of international agreements. In other words, firms appear to prefer investing in countries that are members of trade and investment agreements because these treaties allow them to benefit from lower barriers of access to other countries' markets and to export back to the home country. In contrast, there is little evidence to indicate that alternative effects of trade agreements, such as their role as signaling mechanisms,

or as commitment devices constraining predatory behavior by host governments, are relevant for investors from emerging markets.

IPAs

According to investors in our sample, investment promotion agencies (IPAs) in host countries play a marginal role in promoting awareness of investment opportunities there. Instead, investors rely more heavily on existing investors, suppliers, and customers to find out about potential opportunities for investment in developing countries. Nevertheless, IPAs are a widely used and useful resource for firms once they have made the decision to invest in a particular host market.

IPAs seem to be particularly useful for companies at an early stage in the decision to invest. When asked to rate the specific services provided by IPAs, investors reported higher satisfaction with IPAs' provision of information on procedures and regulations of doing business as well as on corporate taxation and incentives. By contrast, IPA "aftercare" services such as providing information on finance sources and assistance in technological upgrading, received the lower average scores.

Our findings indicate that, all other things equal, smaller firms find the services of IPAs in developing countries more useful. Firms that have lower levels of labor productivity are also more likely to find IPA services useful. Interestingly, characteristics such as involvement in international trade and sector of operation, which were found to be associated with the decision to use IPAs, do not have a statistically significant effect on the IPA usefulness score.

We also find that demand for IPA assistance also depends on the sector of operation and on the predominant motives guiding a firm's decision to invest. Firms in the manufacturing sector, whose investments tend to be less mobile, are more likely to demand the services of IPAs and to find these useful. Similarly, investors that are motivated by the goal of lowering production costs are more likely to rely on IPA assistance.

FDI and IPAs in Africa

The last half-decade has witnessed an expansion of foreign investment by large emerging economies in Africa. However, only a small proportion (10 percent) of firms in our sample have invested in an African country. These firms are predominantly of South African and Indian origin. They have invested in various countries in the African continent, primarily in Namibia, Nigeria, Botswana, and Zimbabwe. Their main motivation for investing there is to access regional and domestic markets. Compared to firms that do not invest in Africa, these companies are significantly less concerned about the effects of political risk in host countries. Indeed, our results suggest that political instability, poor security conditions, lack of transparency, and institutional weaknesses deter potential investors from entering the African market. Efforts by African countries to attract foreign investment from large emerging economies, should therefore also address strengthening domestic institutions and improving other noneconomic aspects of the business climate.

In an effort to increase inflows of foreign direct investment, African countries have created new institutions to promote and facilitate investment. Our results suggest, however, that African IPAs have not been very effective in helping potential investors to identify opportunities and to overcome obstacles in pursuing them. The findings from the survey show that among all firms, those that invest in Africa are less likely to use IPA services. Moreover from the subset of all firms that use IPA services, those that invest in Africa find IPA services less useful than firms that invest elsewhere.

Implications

The findings of the study have implications for academic and policy debates on OFDI from emerging economies and on the role of investment climate characteristics on firms' investment decisions.

First, our findings contribute to discussions in the academic literature on TNCs from emerging economies and the extent to which they differ from earlier TNCs from developed and developing countries. Several scholars have stressed the qualitative differences in the sectoral composition, geographical scope, and motivations for OFDI from emerging markets in the 2000s and in previous decades. In particular, much of the work on emerging-market TNCs views the latter as increasingly driven by asset augmenting strategies. Whereas the traditional developed-country companies generally invested abroad to gain access to resources, inputs, and markets, developing-country TNCs have incentives to access "created" assets such as brands, distribution networks, and managerial skills, in foreign countries through mergers and acquisitions (M&As) or other types of asset augmenting FDI.

Yet, our empirical findings suggest that the new TNCs from emerging markets do not differ significantly from investors from developed and developing countries in previous waves of FDI expansion. In terms of motives for investment, the data from the survey suggests that much of the OFDI from emerging economies is market and efficiency seeking. While the new wave of OFDI from emerging markets has allegedly concentrated in the tertiary sector, in our sample, we find a significantly stronger tendency by manufacturing firms to invest abroad. Finally, while the literature highlights the increasingly global geographical reach of the new TNCs from emerging countries, our survey reveals a strong regional bias, particularly in services. Overall, therefore, a critical message that emerges from this study is that foreign investors from emerging economies have very similar needs and priorities as traditional TNCs from developed countries.

However, the similarities should not be overstated. The acceleration of economic globalization in the last few decades has certainly modified the environment in which international firms operate. The new TNCs from emerging markets, unlike their predecessors, are active participants in the process of globalization, being integrated in global value chains. While still mainly focused on their regions, firms from India and Korea are increasingly targeting destinations outside their immediate region.

The results from the survey also have implications for debates on the effects of political risk and weak governance on investment and economic growth. The findings indicate that while investors from emerging economies are moderately concerned with the effects of political risk and institutional factors, such concerns are not as important as market and business opportunities in determining the location of investment. However, we also find that compared to noninvestors and to potential investors, those firms that do invest in developing countries assign lower importance to noneconomic (political and cultural) factors. These results may be suggesting that political risk deters some of the firms considering investment from actually doing so. The difference between investors and noninvestors is even starker when restricting our analysis to the African continent. These results are inconsistent with claims that firms from developing countries enjoy an "adversity advantage" relative to competitors from advanced economies.

When focusing exclusively on investors, we find that variables such as corruption, fair and regular elections, and fears of expropriation are particularly irrelevant for companies when selecting an investment location. Investors appear to value stability and transparency significantly more, suggesting they are capable of coping with the effects of poor governance as long as they can anticipate them and, perhaps, plan around them.

Finally, our findings have implications for debates on the role of international trade and investment agreements on foreign investment flows. We find that both preferential trading agreements and BITS have a positive effect on investors' choices. In contrast to recent studies that see international trade agreements as crucial commitment and signaling mechanisms, our evidence shows that these trade deals are primarily valued for the market opportunities they create. BITs, in turn, by providing clear rules and arbitration procedures, appear to reduce uncertainty and information asymmetries, therefore partially offsetting the costs of geographical and cultural barriers to investment.

In addition, the study's findings have a number of policy implications for governments that seek to attract FDI from emerging economies. They suggest that there are several aspects of the business environment that governments can influence through policy choices and interventions.

First, we find that that investors are particularly interested in accessing markets through which they can take advantage of the opportunities of an increasingly globalized economy. By maintaining market-friendly, liberal trade and investment policies, the governments of developing countries can offer greater opportunities to investors. In particular, governments can enhance their attractiveness in the eyes of foreign investors by participating in international trade and investment agreements and providing information on the opportunities that these create.

Second, our empirical findings raise a number of important insights for IPAs and other national institutions involved in the design of policies aimed at attracting inflows of foreign investment. The survey points to room for improvement in several areas of these agencies' operations. In particular, it sheds light on the limited role that IPAs in host countries typically play in raising awareness about

investment opportunities there. Currently, firms appear to rely to a greater extent on existing customers and other business counterparts and informal networks in the host country. Although informal networks are useful, they do not fully substitute the role that IPAs should be playing. Existing foreign investors and other firms in the market may have incentives not to reveal all information—likely a strategic asset for them—to prospective investors. There is therefore much to be gained from IPAs adopting a more proactive role in raisign awareness on investment opportunities in the host economy not only in neighboring countries but also in more distant regions.

At the same time, given the importance of existing investors in attracting new firms, there is much to be gained from IPAs developing close relationships with the existing FDI base by, for example, improving services in the implementation and operation stages. Services such as helping firms to gain access and to expand their infrastructure, providing information on additional sources of financing, and facilitating linkages with suppliers and buyers could indirectly contribute to enhance the country's reputation and hence to attract new investors.

Finally, our analysis shows that smaller and less productive firms tend to demand and value the assistance provided by IPAs to a greater extent. There may thus be grounds for IPAs to focus and target their scarce resources on the specific needs of these companies of limited size.

Note

1. See, for example, Farole and Winkler (2014).

Appendix A

Table A.1 Predictors of Investment Profile (Multinomial Logit and Logit Regressions)

	Investors	*Considered investors*	*Investors Developing country*	*Investors Developed country only*
Variables	*Multinomial logit*	*Multinomial logit*	*Logit*	*Logit*
South Africa	1.561***	0.341	1.632***	–1.849**
	(0.37)	(0.477)	(0.387)	(0.808)
Korea, Rep.	0.237	–0.820**	0.107	–2.538***
	(0.256)	(0.396)	(0.266)	(0.476)
Brazil	–0.107	0.111	–0.0931	–0.882
	(0.405)	(0.446)	(0.416)	(0.621)
Manufacturing	0.925***	–0.108	0.903***	–0.254
	(0.259)	(0.342)	(0.266)	(0.499)
Finance	–0.225	0.209	–0.176	0.0683
	(0.406)	(0.416)	(0.416)	(0.698)
Number of employees	0.0496***	0.0132	0.0532***	0.00102
	(0.0164)	(0.026)	(0.0185)	(0.0143)
Labor productivity	–3.68E-10	–1.53E-10	–3.92E-10	–3.42E-06
	(1.29E-09)	(6.80E-10)	(1.28E-09)	(9.43E-06)
Trade dependence	0.0231***	0.00743	0.0245***	0.0180***
	(0.00338)	(0.00564)	(0.00358)	(0.00548)
Ownership (domestic)	0.500*	0.57	0.600**	0.267
	(0.297)	(0.378)	(0.303)	(0.522)
Legal status (publicly listed)	0.979***	–0.178	0.928***	1.201**
	(0.329)	(0.356)	(0.34)	(0.597)
Constant	–3.536***	–1.816***	–3.363***	–3.014***
	(0.549)	(0.643)	(0.563)	(0.938)
Observations	579	579	579	579

Source: World Bank based on the Potential Investors Survey.
Note: Standard errors in parentheses; * $p<0.10$, ** $p<0.05$, *** $p<0.01$.

Table A.2 Predictors of Investment Profile by Country of Origin (Multinomial Logit Regressions)

Considered	*Brazil*	*Korea, Rep.*	*South Africa*	*India*
Manufacturing	0.623	–0.937	–1.263	13.7
	(0.645)	(0.666)	(0.844)	(1.148)
Finance	0.792	0.289	–0.423	13.92
	(0.747)	(0.822)	(0.918)	(1,148)
Number of employees	–0.00478	0.145	0.722**	–0.022
	(0.033)	(0.177)	(0.3)	(0.0599)
Trade dependence (low)	0.372	1.387*	0.245	0.519
	(0.646)	(0.734)	(0.839)	(0.776)
Trade dependence (moderate)	1.342	0.254	–0.0256	0.601
	(0.862)	(0.905)	(1.124)	(0.714)
Trade dependence (high)	0.18	1.141	0.768	0.381
	(1.216)	(0.825)	(1.248)	(0.897)
Legal status (publicly listed)	0.515	13.93	–0.429	–1.445**
	(0.555)	(2,199)	(0.751)	(0.723)
Ownership (domestic)	0.138	–0.0358	0.82	14.37
	(0.566)	(0.82)	(0.775)	(822.4)
Constant	–2.372***	–16.51	–1.666	–28.35
	(0.71)	(2,199)	(1.131)	(1.412)
Investors				
Manufacturing	0.585	1.472***	–0.62	–1.031
	(0.858)	(0.42)	(0.78)	(0.797)
Finance	–0.0246	1.43	0.5	–2.015*
	(1.214)	(0.936)	(0.867)	(1.155)
Number of employees	0.0511**	0.255*	0.814***	0.00803
	(0.0224)	(0.138)	(0.295)	(0.0244)
Trade dependence (low)	1.768**	1.971***	1.861**	1.682***
	(0.866)	(0.746)	(0.834)	(0.624)
Trade dependence (medium)	3.141***	3.114***	1.579	1.563***
	(1.018)	(0.744)	(1.028)	(0.568)
Trade dependence (high)	–0.0767	4.136***	2.163*	1.600**
	(1.985)	(0.742)	(1.263)	(0.653)
Legal status (publicly listed)	0.689	13.42	1.216**	–1.001*
	(0.716)	(856.8)	(0.608)	(0.593)
Ownership (domestic)	–0.139	1.253*	0.666	0.405
	(0.703)	(0.658)	(0.666)	(0.61)
Constant	–3.764***	–18.92	–3.385***	–0.0162
	(1.00)	(856.8)	(1.201)	(1.058)
Observations	120	262	95	149

Source: World Bank based on the Potential Investors Survey.
Note: Standard errors in parentheses; *p<0.10, **p<0.05, ***p<0.01.

Table A.3 Participation in Global Value Chains (2009)

Percent

	Forward participation				*Backward participation*			
Industry	*Korea, Rep.*	*Brazil*	*India*	*South Africa*	*Korea, Rep.*	*Brazil*	*India*	*South Africa*
Agriculture	0.0513	4.0942	1.2958	0.0811	0.0233	0.779	0.0891	0.65822
Mining and quarrying	0.1187	3.6587	1.9039	7.8096	0.0021	0.8763	0.2276	3.8545
Food products and beverages	0.0264	0.9426	0.0891	0.0501	0.3203	1.1316	0.3408	0.56197
Textiles, leather, and footwear	0.6429	0.5055	0.5691	0.0601	0.9587	0.1775	1.3250	0.1502
Wood, paper, paper products, printing, and publishing	0.4432	1.1075	0.1654	0.34099	0.1675	0.3091	0.1294	0.5386
Chemicals and nonmetallic mineral products	2.9504	2.5190	1.9494	0.4352	9.2854	1.7449	2.557	2.0425
Basic metals and fabricated metal products	1.9648	3.3347	0.9976	2.5756	3.3525	1.1279	1.1031	3.8493
Machinery and equipment	0.7057	0.3755	0.3187	0	2.0511	0.3849	0.5455	0
Electrical and optical equipment	6.7770	0.3487	0.8860	0.1600	13.6392	0.5210	2.1071	0.2857
Transport equipment	1.2464	0.3189	0.1958	0.1072	6.6540	1.1931	0.8702	2.5328
Manufacturing	0.2452	0.0549	0.7559	0.0731	0.1558	0.0456	7.6197	0.4396
Electricity, gas and water supply	0.5813	0.5699	0.3297	0.31405	0.0058	0.0011	0.0003	0.0396
Construction	0.0497	0.1218	0.2283	0.1042	0.0275	0.022	0	0.0114
Wholesale and retail trade; hotels and restaurants	2.1336	3.4396	2.3880	1.1085	0.6672	0.2014	0.8261	0.6449
Transport and storage; post and telecommunications	2.1736	2.3374	1.7619	1.9732	2.9263	0.2781	0.953	0.7106
Financial intermediation	0.7801	0.7533	1.1856	0.7924	0.0838	0.0193	0.12034	0.0502
Business services	3.2382	1.9561	4.6914	0.8745	0.2876	0.1380	2.8191	0.0471
Other services	0.2579	0.7356	0.6361	0.4727	0.0335	0.0771	0.2889	0.072

Source: OECD Statistics.

Table A.4 Predictors of the Likelihood That Firms See Political Variables as an Important Location Factor

	Political risk (Top 1)	*Political stability (Top 3)*	*Transparency (Top 3)*	*Corruption (Top 3)*	*Security (Top 3)*	*Bureaucracy (Top 3)*	*Macro stability (Top 3)*
Variables	*Logit*	*Logit*	*Logit*	*Logit*	*Logit*	*Logit*	*Logit*
Invested in Developing Countries (DC)	–0.585*	0.414*	0.624***	–0.721	–0.995***	0.585	–0.00791
	(0.32)	(0.223)	(0.233)	(0.595)	(0.368)	(0.442)	(0.351)
Invested in Advanced Countries (AC)	–0.451	0.488	0.0312	–0.213	–1.017	–0.763	1.414**
	(0.683)	(0.429)	(0.449)	(1.165)	(0.621)	(0.855)	(0.715)
Manufacturing	0.824**	0.628**	0.262	0.541	–0.14	–0.0538	–0.00709
	(0.363)	(0.245)	(0.258)	(0.628)	(0.385)	(0.547)	(0.328)
Finance	1.641***	0.735**	1.535***	0.526	–0.345	0.734	0.671*
	(0.438)	(0.324)	(0.333)	(0.741)	(0.553)	(0.744)	(0.37)
South Africa	0.668	0.526	–0.868**	2.415***	–0.427	–2.581**	2.954***
	(0.534)	(0.346)	(0.373)	(0.897)	(0.512)	(1.093)	(0.833)
Korea, Rep.	1.115***	0.805***	0.0349	0.103	–1.413***	–1.659***	2.950***
	(0.426)	(0.277)	(0.259)	(0.906)	(0.385)	(0.46)	(0.81)
Brazil	0.949*	0.574	–0.958**	1.498	–1.958**	–1.196	2.370***
	(0.538)	(0.369)	(0.425)	(0.981)	(0.809)	(0.804)	(0.862)
Legal status (publicly listed)	0.0197	–0.316	0.650*	1.015	1.255**	0.78	–0.211
	(0.438)	(0.296)	(0.345)	(0.639)	(0.557)	(0.689)	(0.423)
Number of employees	0.00669	0.00455	–0.00483	–0.0587	0.00108	–0.0353	0.00612
	(0.0102)	(0.00873)	(0.01)	(0.0822)	(0.023)	(0.0451)	(0.0119)
Trade dependence	0.00878*	0.00236	–0.00522	0.00249	0.00778	0.0136**	–0.0242***
	(0.00483)	(0.00356)	(0.00384)	(0.00979)	(0.00528)	(0.00657)	(0.00774)
Constant	–3.514***	–1.874***	–1.680***	–5.219***	–2.171***	–3.056***	–4.127***
	(0.61)	(0.395)	(0.428)	(1.13)	(0.685)	(0.873)	(0.89)
Observations	556	558	558	558	558	558	558

Source: World Bank based on the Potential Investors Survey.
Note: Standard errors in parentheses; *p<0.10, **p<0.05, ***p<0.01.

Table A.5 Predictors of Investment Profile (Multinomial Logit)

Variables	*Considered*	*Investors*	*Considered*	*Investors*	*Considered*	*Investors*	*Considered*	*Investors*	*Considered*	*Investors*
Manufacturing	−0.0331	0.942***	−0.0151	0.970***	−0.0131	1.002***	−0.0766	0.931***	−0.015	1.000***
	(0.35)	(0.258)	(0.349)	(0.257)	(0.349)	(0.256)	(0.352)	(0.258)	(0.35)	(0.256)
Finance	0.183	0.143	0.32	0.134	0.257	0.307	0.199	0.235	0.262	0.284
	(0.428)	(0.38)	(0.433)	(0.381)	(0.425)	(0.375)	(0.427)	(0.377)	(0.424)	(0.375)
South Africa	0.191	0.715**	0.0396	0.717**	0.0869	0.638*	0.0504	0.547	0.108	0.691**
	(0.432)	(0.336)	(0.431)	(0.336)	(0.431)	(0.334)	(0.428)	(0.333)	(0.43)	(0.336)
Korea, Rep.	−1.273***	−0.0973	−1.294***	−0.129	−1.302***	−0.117	−1.387***	−0.19	−1.299***	−0.0452
	(0.41)	(0.265)	(0.41)	(0.265)	(0.409)	(0.264)	(0.413)	(0.268)	(0.413)	(0.269)
Brazil	0.437	−0.353	0.293	−0.366	0.353	−0.491	0.295	−0.539	0.36	−0.426
	(0.427)	(0.406)	(0.425)	(0.405)	(0.421)	(0.403)	(0.424)	(0.403)	(0.423)	(0.405)
Number of employees	0.0134	0.0735***	0.0123	0.0711***	0.0128	0.0719***	0.0111	0.0717***	0.0125	0.0736***
	(0.0328)	(0.0246)	(0.0323)	(0.0243)	(0.0326)	(0.0244)	(0.0328)	(0.0245)	(0.0327)	(0.0244)
Trade dependence	0.00943	0.0237***	0.00861	0.0243***	0.00954	0.0236***	0.00905	0.0233***	0.00943	0.0232***
	(0.00585)	(0.00367)	(0.00585)	(0.00368)	(0.00583)	(0.00364)	(0.00587)	(0.00365)	(0.00585)	(0.00365)
Political risk (Top 3)	0.33	0.567***								
	(0.29)	(0.21)								
Transparency (Top 3)			−0.379	0.554**						
			(0.357)	(0.224)						
Corruption (Top 3)					0.232	−0.563				
					(0.632)	(0.6)				
Political stability (Top 3)							0.609**	0.438**		
							(0.303)	(0.22)		
Bureaucracy (Top 3)									−0.00232	0.731*
									(0.692)	(0.442)
Constant	−1.454***	−1.970***	−1.143***	−1.840***	−1.269***	−1.649***	−1.339***	−1.683***	−1.262***	−1.750***
	(0.466)	(0.361)	(0.44)	(0.347)	(0.429)	(0.335)	(0.433)	(0.337)	(0.434)	(0.342)
Observations	558	558	558	558	558	558	558	558	558	558

Source: World Bank based on the Potential Investors Survey.
Note: Standard errors in parentheses; *p<0.10, **p<0.05, ***p<0.01.

Table A.6 Predictors of the Likelihood That Firms See Political Variables as an Important Location Factor

	Political risk (Top 3)	*Political stability (Top 3)*	*Transparency (Top 3)*	*Security (Top 3)*
Variables	*Logit*	*Logit*	*Logit*	*Logit*
Invested in DC	0.831***	0.640***	0.680***	–0.554
(outside Africa)	(0.227)	(0.229)	(0.233)	(0.382)
Invested in Africa	–0.161	–0.0401	–0.0944	–1.676**
	(0.324)	(0.362)	(0.386)	(0.692)
Invested in AC	0.388	0.529	–0.148	–0.842
	(0.395)	(0.415)	(0.435)	(0.604)
Manufacturing	0.28	0.586**	0.162	–0.223
	(0.22)	(0.247)	(0.26)	(0.389)
Finance	1.219***	0.636**	1.517***	–0.596
	(0.314)	(0.323)	(0.332)	(0.551)
South Africa	–0.403	0.701*	–0.601	–0.2
	(0.335)	(0.364)	(0.395)	(0.549)
Korea, Rep.	–0.241	0.736***	–0.157	–1.430***
	(0.258)	(0.277)	(0.262)	(0.382)
Brazil	–0.726**	0.528	–1.007**	–2.065**
	(0.346)	(0.37)	(0.429)	(0.816)
Legal status	0.283	–0.271	0.785**	1.342**
(publicly listed)	(0.28)	(0.299)	(0.351)	(0.579)
Number of employees	0.00441	0.00652	–0.00351	0.00541
	(0.00989)	(0.00891)	(0.0102)	(0.0229)
Constant	–0.303	–1.829***	–1.735***	–2.064***
	(0.361)	(0.393)	(0.427)	(0.685)
Observations	558	558	558	558

Source: World Bank based on the Potential Investors Survey.
Note: Standard errors in parentheses; *p<0.10, **p<0.05, ***p<0.01.

Table A.7 Predictors of Investment in Africa

	Invested in Africa	*Invested in Africa*	
Variables	*Logit*	*Marginal effects*	*Invested outside Africa*
Manufacturing	–0.0573	–0.0034863	1.297***
	(0.461)		(0.302)
Finance	–0.91	0.0553473	0.693
	(0.563)		(0.476)
South Africa	2.636***	0.4316686***	–1.914**
	(0.504)		(0.775)
Korea, Rep.	–2.578***	–0.0984082***	0.767***
	(0.658)		(0.261)
Brazil	–1.029	–0.0638029	–0.076
	(0.771)		(0.42)
Number of employees	0.0471***	0.0028689 ***	0.0170*
	(0.014)		(0.0095)
Trade dependence	0.0161***	0.0009823***	0.0205***
	(0.00596)		(0.0034)
Legal status (publicly listed)	1.442***	0.0877234***	0.233
	(0.451)		(0.403)
Ownership (domestic)	0.196	0.0119471	0.359
	(0.445)		(0.342)
Productivity	–1.03E-07	–6.27E-09	
	(1.39E-07)		
Constant	–4.041***		–3.519***
	(0.86)		(0.622)
Observations	579	579	628

Source: World Bank based on the Potential Investors Survey.
Note: Standard errors in parentheses; *p<0.10, **p<0.05, ***p<0.01

Table A.8 Logit Regression (First Stage), Dependent Variable: Investment from *i* into *j* in Sector s=0 If No, 1 Otherwise, with Country-of-Origin and Sector-Specific Sensitivities to Distance

Variables	*Logit*	*Logit*	*Logit*	*Logit*	*Logit*	*Logit*
GDP PC of destination	1.98e-05**	2.15e-05**	2.47e-05***	2.57e-05***	–4.10E-06	1.63E-05
	(2.46)	(2.548)	(2.783)	(2.867)	(–0.337)	(1.616)
Population of destination	1.85e-09***	2.12e-09***	2.76e-09***	2.54e-09***	8.71E-10	1.82e-09***
	(4.281)	(4.67)	(5.487)	(4.931)	(1.26)	(2.757)
Distance capital to capital	–0.00027***	–0.00028***	–0.00039***	–0.00031***	–0.00025**	–0.00048***
	(–7.018)	(–7.135)	(–3.488)	(–2.901)	(–2.151)	(–2.911)
India		0.273	–1.121	–1.019	–0.666	–0.404
		(0.672)	(–1.241)	(–1.202)	(–0.722)	(–0.482)
Korea, Rep.		0.443	–0.291	–0.197	–0.753	–0.738
		(1.031)	(–0.281)	(–0.201)	(–0.679)	(–0.747)
South Africa		0.382	1.454*	1.016	0.131	0.163
		(0.978)	(1.786)	(1.311)	(0.143)	(0.181)
Distance capital to capital * India			0.000234*	0.000222*	0.000115	0.000197
			(1.715)	(1.741)	(0.857)	(1.543)
Distance capital to capital * Korea, Rep.			7.39E-05	5.72E-05	4.24E-05	0.000233*
			(0.489)	(0.397)	(0.274)	(1.72)
Distance capital to capital * South Africa			–0.000268*	–0.0002	–9.87E-05	–9.86E-06
			(–1.892)	(–1.474)	(–0.699)	(–0.0710)
Contiguity					0.27	0.101
					(0.487)	(0.186)
Common official language					1.234***	0.692**
					(3.395)	(2.145)
Colony					0.143	1.327*
					(0.178)	(1.656)
BITS	0.880***	0.862***	–0.0277	–0.115	0.331	
	(3.326)	(3.081)	(–0.0442)	(–0.193)	–0.493	
BITS * Distance Capital to Capital			0.000192**	0.000207**	0.000231**	
			(2.207)	(2.434)	(2.485)	
Manufacturing						1.092
						(1.477)
Trade						1.187
						(1.311)
Transportation and warehousing						–1.389
						(–1.166)

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Table A.8 Logit Regression (First Stage), Dependent Variable: Investment from *i* into *j* in Sector s=0 If No, 1 Otherwise, with Country-of-origin and Sector-Specific Sensitivities to Distance *(continued)*

Variables	*Logit*	*Logit*	*Logit*	*Logit*	*Logit*	*Logit*
Distance capital to capital*manufacturing						0.000179
						(1.47)
Distance capital to capital*trade						–0.00022
						(–1.245)
Distance capital to capital*transportation and warehousing						6.92E-05
						(0.358)
Average exports (2007–09)					1.43e-07***	9.18e-08***
					(4.481)	(3.331)
Services		–2.034***	–2.107***	–0.41	–1.073**	
		(–8.582)	(–8.654)	(–0.843)	(–2.037)	
Distance capital to capital*services				–0.00033***	–0.00023***	
				(–3.631)	(–2.590)	
GDP PC of origin	5.82E-06					
	(0.312)					
Population of origin	0					
	(–0.0136)					
Constant	–2.150***	–1.160***	–0.554	–1.052	–1.457*	–2.337**
	(–5.348)	(–2.855)	(–0.784)	(–1.524)	(–1.814)	(–2.275)

Source: World Bank based on the Potential Investors Survey.
Note: Z-stats in parentheses, *p<0.10, **p<0.05, ***p<0.01.
BITS = Bilateral investment treaties; GDP PC = gross domestic product per capita.

Table A.9 Negative Binomial Regression (Second Stage), Dependent Variable: Count of Cross-Border Investments from *i* into *j* in Sector s, with Country-of-Origin and Sector-Specific Sensitivities to Distance

Variables	*Negative binomial*	*Negative binomial*	*Negative binomial*	*Negative binomial*	*Negative binomial*	*Negative binomial*
GDP PC of destination	4.54e-05**	4.73e-05**	4.99e-05**	5.03e-05**	3.90e-05**	3.72e-05**
	(2.19)	(2.232)	(2.101)	(2.107)	(2.124)	(2.325)
Population of destination	9.73E-10	7.91E-10	8.62E-10	8.36E-10	2.98E-09	2.15E-09
	(1.115)	(0.982)	(1.069)	(1.018)	(1.609)	(1.383)
Distance capital to capital	–0.00011	–0.000149**	–0.00036	–0.00036	–0.0007	–0.0001
	(–1.630)	(–2.151)	(–1.242)	(–1.231)	(–1.318)	(–0.204)
India		1.163	–2.085	–2.07	–7.400*	–3.659
		–1.28	(–0.993)	(–0.995)	(–1.719)	(–1.305)
Korea, Rep.		3.031***	1.362	1.322	–4.289	0.0172
		(2.75)	(0.574)	(0.564)	(–0.937)	–0.00616
South Africa		1.489	1.443	1.245	–5.822	–2.706
		(1.498)	(0.804)	(0.639)	(–1.518)	(–1.011)
Distance capital to capital*India			0.00044	0.000438	0.000802	0.000502
			(1.36)	(1.362)	(1.522)	(1.253)
Distance capital to capital*Korea, Rep.			0.000121	0.000126	0.000683	0.000298
			(0.32)	(0.339)	(1.163)	(0.726)
Distance capital to capital*South Africa			–0.00017	–0.00014	0.000403	0.000155
			(–0.486)	(–0.390)	–0.857	–0.415
Contiguity					–1.848	–0.718
					(–0.890)	(–0.423)
Common official language					2.654*	1.221**
					(1.784)	(2.171)
Colony					–0.0819	0.932
					(–0.0622)	(1.252)
BITS	–0.239	–0.638	0.0466	0.101	2.614	
	(–0.401)	(–0.960)	(0.0245)	(0.0537)	(1.177)	
BITS*distance capital to capital			9.59E-05	8.75E-05	–0.00014	
			(0.391)	(0.361)	(–0.833)	
Manufacturing						3.702***
						(2.906)
Trade						1.364
						(0.701)

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Table A.9 Negative Binomial Regression (Second Stage), Dependent Variable: Count of Cross-Border Investments from *i* into *j* in Sector s, with Country-of-Origin and Sector-Specific Sensitivities to Distance *(continued)*

Variables	*Negative binomial*	*Negative binomial*	*Negative binomial*	*Negative binomial*	*Negative binomial*	*Negative binomial*
Transportation and warehousing						3.784**
						(2.287)
Distance capital to capital*manufacturing						–0.00035
						(–1.560)
Distance capital to capital*trade						–0.00043
						(–0.838)
Distance capital to capital*transportation and warehousing						–0.00243***
						(–9.024)
Average exports (2007–09)					–3.50E-08	–2.39E-08
					(–1.150)	(–0.915)
Services		–1.657**	–1.903***	–1.635	–2.704***	
		(–2.497)	(–2.742)	(–1.208)	(–3.000)	
Distance capital to capital*services				–5.79E-05	9.21E-05	
				(–0.224)	(0.494)	
GDP PC of origin	0.000133***					
	(2.853)					
Population of origin	1.21E-09					
	(1.529)					
Constant	–15.52	–10.29	–1.465	–1.462	3.433	–1.836
	(–0.499)	(–0.0756)	(–0.392)	(–0.404)	–1.024	(–0.588)
Observations	2,592	2,592	2,592	2,592	2,568	2,568

Source: World Bank based on the Potential Investors Survey.
Note: Z-stats in parentheses, *p<0.10, **p<0.05, ***p<0.01.
BITS = Bilateral investment treaties; GDP PC= gross domestic product per capita.

Table A.10 Predictors of IPA Use

	Used IPA	*Used IPA*	*Used IPA*	*Used IPA*
Variables	*Logit*	*Logit*	*Logit*	*Marginal effects*
Number of employees	–0.00402	–0.00485	–0.00563	–0.00086
	(0.00919)	(0.00946)	(0.00959)	
Productivity	–5.90e-09*	–5.38e-09*	–5.38e-09*	–8.23e-10*
	(3.05E-09)	(3.14E-09)	(3.14E-09)	
Trade dependence	0.0115*	0.0150**	0.0153**	0.0023442**
	(0.00675)	(0.00643)	(0.00643)	
Manufacturing	0.877**	0.873**	0.985**	0.1506408**
	(0.38)	(0.39)	(0.451)	
Invested in Africa	–1.667***	–1.661***	–1.643***	–0.2511174***
	(0.402)	(0.386)	(0.388)	
Legal status (publicly listed)	0.980**	1.016**	1.021**	0.156121**
	(0.454)	(0.436)	(0.436)	
Ownership (domestic)		0.503	0.496	0.075803
		(0.516)	(0.517)	
Finance			0.31	0.04736
			(0.628)	
Korea, Rep.	0.436			
	(0.51)			
Constant	–0.391	–0.893	–1.016	
	(0.436)	(0.646)	(0.696)	
Observations	221	209	209	209

Source: World Bank based on the Potential Investors Survey
Note: Standard errors in parentheses; *p<0.10, **p<0.05, ***p<0.01. IPA = investment promotion agencies; OLS = ordinary least squares.

Table A.11 Predictors of IPA Evaluation

	IPA evaluation	*IPA evaluation*
Variables	*OLS*	*Elasticities*
Number of employees	–0.0125*	–0.01451
	(0.00654)	
Productivity	–5.69e-09**	–0.00525
	(2.63E-09)	
Trade dependence	0.00288	0.04039
	(0.00252)	
Manufacturing	0.282	0.07734
	(0.259)	
Finance	0.421	0.00971
	(0.407)	
Invested in Africa	–0.432*	–0.02089
	(0.236)	
Legal status (publicly listed)	0.523**	0.15299
	(0.24)	
Ownership (domestic)	0.476	0.14583
	(0.303)	
Constant	1.839***	
	(0.397)	
Observations	145	145
R^2	0.19	

Source: World Bank based on the Potential Investors Survey.
Note: Standard errors in parentheses; *p<0.10, **p<0.05, ***p<0.01. IPA = investment promotion agencies; OLS = ordinary least squares.

Table A.12 Effects of Firms' Motives on IPA Use and Evaluation

	Used IPA	*Used IPA*	*Used IPA*	*IPA evaluation*	*IPA evaluation*
	Logit	*Logit*	*Marginal effects*	*OLS*	*OLS*
To access new markets	1.086	1.411	0.237	0.697	0.1
	(0.785)	(0.94)		(0.598)	(0.608)
To lower production costs	3.843***	2.659*	0.381*	0.895	0.0239
	(1.27)	(1.372)		(0.614)	(0.632)
To access natural resources/inputs	0.624	0.554	0.101	0.81	0.223
	(0.962)	(1.192)		(0.704)	(0.739)
To join a specific partner	0.981	1.437	0.241	0.167	–0.0329
	(1.443)	(1.571)		(0.932)	(0.922)
To export back to the home country	0.981	1.83	0.293	0.667	0.688
	(1.155)	(1.585)		(0.78)	(0.807)
Number of employees					–0.0126*
					(0.00638)
Labor productivity		–6.51e-09**	–8.70e-10**		–7.64e-09**
		(3.29E-09)			(3.12E-09)
Trade dependence		0.0170**	0.0023**		0.000996
		(0.00742)			(0.00279)
Invested in Africa		–1.998***	–0.267***		–0.693***
		(0.416)			(0.233)
Legal status (publicly listed)		0.866	0.116		0.495*
		(0.542)			(0.289)
Constant	–0.288	–0.845		2.333***	2.641***
	(0.764)	(1.083)		(0.589)	(0.698)
Observations	209	188	188	151	138
R^2				0.022	0.165

Source: World Bank based on the Potential Investors Survey.
Note: Standard errors in parentheses; *p<0.10, **p<0.05, ***p<0.01. IPA = investment promotion agencies; OLS = ordinary least squares.

Table A.13 IPAs in Africa

	Used IPA	*Used IPA*	*Used IPA*	*Used IPA*	*Used IPA*	*IPA evaluation*	*IPA evaluation*	*IPA evaluation*	*IPA evaluation*
Variables	*Logit*	*Logit*	*Logit*	*Logit*	*Marginal effects*	*OLS*	*OLS*	*OLS*	*Elasticities*
Number of employees	−0.0416*	−0.0444*	−0.0329	−0.0430*	-0.0055	0.0211	0.0423	0.0235	0.0446
	(0.0241)	(0.0231)	(0.0254)	(0.0249)		(0.0328)	(0.03)	(0.0313)	
Labor productivity	−9.54E-08	−1.73E-07	−1.43E-07	−9.01E-08	−2.38E-08	4.11e-06**	4.02e-06**	4.03e-06**	0.063**
	(1.22E-06)	(1.26E-06)	(1.26E-06)	(1.22E-06)		(1.55E-06)	(1.35E-06)	(1.48E-06)	
Trade dependence	0.0292**	0.0189	0.0228*	0.0309**	0.0038**	0.0220**	0.00608	0.0171	0.329**
	(0.0131)	(0.0141)	(0.0137)	(0.0145)		(0.01)	(0.0111)	(0.0101)	
Manufacturing	0.157	−0.921	-0.92	0.155	−0.153	0.609	−0.00825	0.0988	0.1522
	(0.669)	(1.021)	(0.907)	(0.668)		(0.534)	(0.535)	(0.606)	
Legal status (publicly listed)	1.761*	1.775*	1.724	1.842*	0.287*	1.229	0.346	1.06	0.449
	(1.029)	(1.004)	(1.075)	(1.079)		(0.875)	(0.851)	(0.841)	
Ownership (domestic)	−0.231	−0.766	−0.793	−0.179	−0.1321	0.566	0.113	0.456	0.163
	(0.75)	(0.866)	(0.89)	(0.775)		(0.57)	(0.533)	(0.548)	
South Africa		−1.824*					−1.703**		
		(1.1)					(0.731)		
India			2.152**		0.3587**			0.935	
			(1.013)					(0.603)	
Korea, Rep.				−0.447					
				(1.44)					
Constant	−2.312*	0.0242	−1.802	−2.434*		−0.499	2.137	−0.27	
	(1.309)	(1.864)	(1.395)	(1.389)		(1.11)	(1.488)	(1.068)	
Observations	54	54	54	54	54	21	21	21	21
R^2						0.472	0.627	0.554	

Source: World Bank based on the Potential Investors Survey.
Note: *p<0.10, **p<0.05, ***p<0.01. IPA = investment promotion agencies; OLS = ordinary least squares.

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