Foreign Direct Investment in Developing and Transition Economies

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Abstract

Foreign Direct Investment (FDI) is an important trading phenomenon which takes place universally. FDI is one of the key drivers for world economic growth as it alleviates and promotes international business. In fact, the primary activities of multinational corporations make a significant contribution to the practice of FDI around the world. This paper initially discusses several benefits of both inward and outward FDI fluxes in developing and transition economies. Moreover, disclosure on potential risks from FDI inflows is presented. This research also mentions current scenarios and future prospects regarding FDI in the less industrialized regions based upon the annual World Investment Report. Lastly, alternative approaches for FDI recipients to appeal to more foreign investors will be suggested.

Foreign Direct Investment in Developing and Transition Economies

Introduction

In the context of national economies becoming more globally integrated and the appearance of industry 4.0, Foreign Direct Investment (FDI) plays an undeniably crucial role in fostering economic growth and ensuring prosperity. The increasing interdependence and interaction among countries have led to the expansion of FDI during the past decades. In fact, multinational companies constantly express their demand for external funding and expertise to magnify the trade of goods and services, not to mention access to newly-developed technology. In short, as an indicator of globalization, FDI is regarded as a key source of finance, management, and technological innovation.

Although both developed and developing countries express an emerging need for foreign investment, this paper will narrow its focus to the particular impacts of FDI on developing and transition economies. The International Monetary Fund (IMF) classifies transition economies as economies which move from “a centrally administered system to one based on market principles” (Nielsen, 2011, p. 17). This group includes the Russian Federation, Ukraine, Mongolia among others. On the other hand, developing countries are defined by IMF and the World Bank as countries with gross national income per capita of between $3,976 and $12,275 (Nielsen, 2011). This group consists of China, India, Brazil, Thailand and so on. Interchangeably, these nations can also be referred to as a combined group named emerging and developing countries. It is undeniable that developed countries such as the USA and Japan are considered appealing markets to all foreign investors. By contrast, countries that are still struggling with growing their economies at a constant rate will find it challenging to attract more FDI. Besides, defining the roles of multinational corporations in promoting FDI activities is essential to draw a big picture of global expansion strategies among companies worldwide. By searching further into the current scenarios and prospective trends in global FDI, possible solutions can be provided for these countries. Therefore, it is necessary to investigate which key factors foreign investors base their investing decisions on; thus enterprises and government in developing and transition economies can make proper incentive strategies accordingly.

A Conceptual Overview of Foreign Direct Investment

Foreign Direct Investment (FDI) is undoubtedly a global phenomenon with significant impact on economic growth. The study of FDI patterns in recent years has drawn attention of economists, not only in the developed countries yet also in the developing ones. Therefore, having a thorough understanding of this concept is necessary to an investigation of the world economy.

Definition

According to the Organization for Economic Co-operation and Development (OECD) (2008a), "Direct investment is a category of cross-border investment made by a resident in one economy with the objective of establishing a lasting interest in an enterprise that is resident in an economy other than that of the direct investor" (p. 17). FDI, therefore, considers at least two participants which are the foreign investor and the recipient of direct investment. Normally FDI is undertaken by venture capital firms or multinational enterprises.

FDI is separately distinguished from foreign portfolio investment to the extent that FDI permits ownership and control of the operations of firms overseas. In comparison, foreign portfolio investment refers to the acquisition of equity through purchase of stocks or bonds in another country. As a result, investors who make portfolio investments do not exercise control over the business entity. Essentially, FDI involves a more substantial, long-term commitment and interest in the invested countries' economy (OECD, 2008a).

FDI Flows

FDI flows of a single country are classified into inward flows and outward flows. Specifically, the inward flows accumulate all inflows of investment capital from foreign investors within a fiscal year. By contrast, the outward flows refer to the outflow amount of portfolio investment from a domestic economy to other countries. FDI can exist in the form of either cash, transfer of technologies, human capital, and the founding of multinational corporations.

A more in-depth approach to FDI classification is to denote FDI as either horizontal or vertical. Both horizontal and vertical FDI are illustrated via the operations of multinational corporations. A multinational enterprise is committed to horizontal FDI as it sells the company's products to local markets in many different countries. In contrast, vertical FDI occurs when the company leverages the production process by setting up manufacturing plants in other countries in order to exploit the comparative advantages of cheap labor (Beugelsdijk, Smeets, & Zwinkels, 2008).

Home Country and Host Country

It is essential to distinguish from the two terms *home country* and *host country*. On the one hand, *home country* is identified by OECD as the country in which the investors reside. In other words, such a country will make outward flows of investment to the others. On the other hand, *host country,* or the recipient of direct investment, is the country in which investors exercise their investing activities at different enterprises (OECD, 2008a). For instance, when Toyota, a Japanese company, operates its subsidiary called the GAC Toyota Motor Corporation in China, Japan is considered the home country for FDI while China is the host country.

The Importance of Free Trade Agreements

The practice of FDI always accompanies the implementation of free trade agreements (FTAs). FTAs are multilateral contracts launched among trade partners who engage in foreign investment activities. One of the main purposes of FTAs is to materially reduce or remove trade tensions such as import quotas and tariffs. Regarding vertical FDI, FTAs financially support multinational enterprises by dropping many investment-related costs. Examples of such avoidable costs are informational costs which incur as a result of location searching or local registration fees (Hikari, 2017). The prevailing presence of FTAs has alleviated FDI as it widely opens the borders between countries.

As of 2015, the World Trade Organization confirmed that “there are over 225 FTAs currently in force” (Reed, Lira, Lee, & Lee, 2016, p. 176). Moreover, developing countries and countries in transition economies have proactively participated in FTAs during the past few decades. As a result, these countries are more likely to attract foreign investors since they propose favorably low initial trade barriers on goods. A recent example of a FTA which encourages FDI flows is the signing of the African Continental Free Trade Area in 2018 (United Nations Conference on Trade and Development, 2018). The positive influence of this specific FTA is underpinned by Africa's efforts to open their domestic economies to more foreign investors.

The Roles of Multinational Corporations in FDI

There exists a crucial connection between Multinational Corporations (MNCs) and FDI in shaping the world economy. In fact, the contribution of MNCs has also been emerging in a globalization era when companies around the globe strive to enlarge their scale. MNCs' roles in FDI are, but not limited to serving as a physical channel for FDI flows among enterprises and promoting exports of the host countries.

Historical Establishment of MNCs Worldwide

MNCs refer to the business organizations whose operating activities take place in many different countries yet are managed by the headquarters located in the home country. The initial presence of modern MNCs can be traced back to the 19th century with the inception of the Dutch East India Trading Company which exported capital and technology to pre-industrial territories of Asia and Latin America (Dass & Jamal, 2018). Throughout this period the majority of MNCs originated from Europe and had their foreign subsidiaries in less developed or developing countries. Nevertheless, since then, MNCs have continued to grow dramatically. During the 20th century, U.S. and Japanese MNCs joined the fierce global competition along with the multinational enterprises in

Europe. Giant international corporations such as Toyota, Nike, Apple, and Coca-Cola, whose parent companies are in developed countries, tend to target their foreign affiliates in developing countries in Asia or Africa. Further, the participation of multinational firms from developing countries and transition economies such as China and Brazil has been significant for the past few decades. These enterprises seek to set up their branches in both developing and developed countries. In short, the global existence of MNCs has made certain impacts on developing countries from both financial and political perspectives.

The Majority of FDI Occurs Via Mergers and Acquisitions

Multinational enterprises account for a large portion of the world's production and administrate more than half of world trade (Kordos & Vojtovic, 2016). FDI actually flows through the operating, financing, and investing activities of these multinationals. Specifically, MNCs engage in FDI via direct investment in wholly-owned subsidiaries, joint ventures, or strategic alliances among mature foreign enterprises. For example, by owning a subsidiary beyond its boundaries, a MNC will send abroad "a package of capital, technology, managing talent and marketing skill to carryout production" (Dass & Jamal, 2018, p. 2). In comparison to greenfield FDI (the establishment of the MNC's own facility abroad), executing FDI via mergers and acquisitions (M&A) makes it feasible for the parent countries to better keep track of their assets overseas. Specifically, over 80% of the world FDI belongs to M&A activity based on a report in 2000 by the United Nations Conference on Trade and Development (as cited in Stepanok, 2015). Likewise, the value of M&A has dominated FDI as giant companies try to trade goods or services in several industries including textile, agriculture, and logistics across borders. According to a recent report by M&A Institute (as cited in Fosler & Logan, 2018), 3,800 deals on M&A worldwide were assessed with a total value of approximately $900 billion worth of FDI inflows during the first quarter of 2018. Moreover, global M&A activity is believed to be “robust over the past few years” (UNCTAD, 2008, p. 7).

Promotion of Exports

Apart from being a tangible bridge between FDI inflows and outflows, MNCs simultaneously facilitate exports in the home country. Multinational companies in the home countries will be oriented to enter export markets in addition to domestic sales. In other words, MNCs from transition and developing economies would be able to be involved in more exporting activities as the companies expand their operations abroad. Revenues from exports contribute remarkably to the economy of the home countries. Especially, in a study by Jetter (2017), average export concentration (AEC) index was used to evaluate the growth rate of national economies. Specifically, AEC index ranges from 0 to 1 and measures export diversification and its relationship with economic growth. AEC index also illustrates whether a certain country exports to competitive markets (AEC < 0.01), un-concentrated markets (AEC < 0.15), moderate concentrated markets (0.15< AEC <0.25), or highly concentrated markets (AEC > 0.25). The study revealed that developing countries with higher AEC such as Niger (0.33) and the Philippines (0.32) show higher growth rate in GDP of 8.8% and 7.6% respectively.

Many mature enterprises from developed nations build their plants in other developing countries or create a joint collaboration with foreign firms to benefit from lower costs of manufacturing. For instance, American Eagle Outfitters, a large U.S. retailer in the clothing industry, imports its merchandise from suppliers and vendors overseas. The company declares to source the majority of its merchandise through approximately 300 vendors, primarily from developing countries in Asia such as China (U.S Security and Exchange Commission, 2019) Accordingly, there has been a rapid expansion in China's agricultural exports in recent years. Another example is Nestle, a reputational multinational company that has assisted Brazil and Vietnam in trading coffee beans overseas.

Advantages of FDI for Developing and Transition Economies as Host Countries

On the aggregate level, FDI plays an indispensable role in boosting the financial status of not only the home countries but also the host countries. Furthermore, "It is accepted all over the world that foreign direct investment (FDI) plays a positive role in the process of economic growth" (Iqbal, Masood, & Ramzan, 2013, p. 52). Apart from allowing foreign investors to outsource from potential markets in the home countries, FDI is beneficial to the developing countries receiving such portfolio investment. FDI promotes the direct transfer of financial capital and infrastructure, establishing more opportunities for the labor force and improving overall living standards.

The Acquisitions of Finance, Tangible and Intangible Resources

FDI guarantees an inflow of capital into the home countries to fund necessary projects. Inventories and other valuable assets are also transferred to the developing and transition economies once foreign investors decide to invest in these countries. Noorbakhsh, Paloni, and Youssef (2001) emphasized that "For developing countries, FDI became especially important as a source of funding in the wake of the debt crisis, given the significant reduction in the flows of official and other private capital" (p. 1593). As opposed to debt-related flows such as bank loans, FDI flows have remained one of the largest and least volatile of all external financial flows to developing economies (UNCTAD, 2018). Vacaflores, Mogab, and Kishan (2017) added that "FDI is perceived as an engine of growth by many policymakers because it can generate productivity spillovers in the host economy, increase the volume and efficiency of investment, [and] augment the stock of knowledge" (p. 206). Through FDI, the host country simultaneously creates a channel to transfer knowledge and technology among its branches in different countries.

Generating Employment Opportunities and Developing Human Capital

FDI has driven numerous multinational corporations, which results in more jobs being created and human capital being leveraged. Apart from sending some experts abroad, direct investors from the home country also hire local people to operate or supervise the branches located in the host country. In other words, FDI potentially generates employment in host countries through employment in MNCs' subsidiaries. Another noticeable benefit is that jobs within FDI enterprises are more likely to pay higher wages than jobs in indigenous firms. A survey on wages in Malaysia's biggest industries including food and beverages, chemicals, general machinery, and furniture states that salary paid by foreign multinationals are two-fifths more than that paid by local firms (Ramstetter, 2014). Furthermore, the FDI investors may be willing to provide more training compared to local firms to make sure that the companies being invested in perform well and generate profits. In short, capital financing from foreign companies helps to provide employment opportunities and promotes utilization of basic labor skills for the host countries.

Enhancement of Economic Productivity with Incremental Income

FDI flows in to several industrial segments of the host countries and promotes economic growth. The power that FDI has on developing and transition economies is evident. As MNCs make domestic entry, they generate chains of new local suppliers as well as open new markets. Moreover, MNCs encourage exports in the host countries, which boosts indigenous production activities. Additionally, the presence of a vast number of foreign enterprises will either directly or indirectly encourage domestic competition in the market. Being one of the most important economic processes arising from globalization, FDI has led to the rapid expansion of a number of industries across borders. Furthermore, “FDI generally occurs in tandem with greater international trade integration, which may reflect increasing vertical integration as well as the establishment of transnational distribution networks” (OECD, 2002, p. 11). Hence, higher productivity and more efficient resource allocation can be achieved. In short, proponents of FDI believe that FDI plays a crucial role in modernizing a national economy.

Improvement of Overall Living Standards

Due to the constant inflows of capital investment, country gross domestic product (GDP), as well as per capita income would raise considerably, which ultimately improves standards of living. Alfaro (2014) claimed that “FDI can increase national welfare if multinational enterprises pay higher wages than domestic firms do” (p. 13). Inward FDI will trigger the enhancement of infrastructure such as transportation and other services. The quality of governance may also witness constructive progress as a result of FDI. Moreover, as MNCs from more developed countries enter developing and transition economies, citizens in the host country will have more selection of high quality products. Especially, if MNCs are committed to Corporate Social Responsibility (CSR), there is no doubt that local community will gain noteworthy benefits. Corporate entities prioritize CSR as it reflects how their activities influence social changes. Several MNCs have demonstrated consistent commitment to CSR, thus proactively contributing a positive impact on the environment, stakeholders, customers, and employees (Fontaine, 2013).

Benefits of FDI for Developing and Transition Economies as Home Countries

It is a common assumption that FDI normally flows from a capital-rich to capital-scarce countries. However, FDI outflows may give a noticeable boost to industrial growth of the developing and transition economies as these make direct investment in more industrialized countries. This reverse flow of FDI has become more prevalent in the last few decades, and has exclusively contributed to economic growth. According to Bano and Tabadda (2015), FDI initiating from the developing parts of the world such as East, Southeast, and South Asia has experienced an upsurge since 1980. A few potential advantages that developing countries receive as home countries may include the expansion of sale and production to foreign markets, outsourcing to a skillful and highly qualified workforce or access to technological innovation (Knoerich, 2017).

Expansion of Market Channels to Overseas

Corporations today have a tendency of practicing FDI as an effective international market entry strategy. Horizontal FDI provides MNCs with opportunities to reach potential markets abroad which may bring about more profits compared to the local ones. In other words, FDI diversifies MNCs' approach to a larger number of prospective consumers all over the world. Consequently, under sufficient management, MNCs would witness an increase in total revenues generated from foreign subsidiaries. Moreover, once domestic markets gradually turn saturated, it is necessary that a company look to distribute its products to new markets overseas. There is also a likelihood that MNCs from developing and transition economies will invest in developed countries, thus they can offer the high quality products to populations with moderate or higher income. Huawei, one of China's most prominent MNCs, achieved sales of approximately $75 billion in 2016 as it operated in over 170 countries (Murmann, Huang, & Wu, 2018). In addition, Huawei is popular among many developed countries such as Germany, Italy, Poland, and Spain.

Exploitation of Labor Skills and Expertise

In addition, outflows of FDI to developed countries help the firms in developing and transition economies to benefit from a competent workforce with a high level of education and managerial capability. In fact, MNCs usually express a priority to recruit local people instead of hiring expatriate employees to guarantee the employment rate of their home country. Nevertheless, it has been challenging for MNCs from developing countries since they are constantly confronted with a shortage of qualified candidates.

Based on a study by the European Development and Finance Institutions (2016), 38% of the companies in emerging economies struggle with filling their job vacancies since residents of the developing countries are limited to agricultural work or basic entry-level skills. In addition, the supply of talented human capital in any country is apparently finite, making it one of the scarcest resources. An annual survey conducted in 2011 by Manpower Groups revealed that “45% of Asia-Pacific employers had difficulty filling job vacancies due to a lack of available talent” (as cited in PricewaterhouseCoopers, 2012, p. 2). Globalization and rapid technological innovation require MNCs to flexibly adapt to the fast-changing and increasingly competitive economy. Without appropriate experience, skills and knowledge, MNCs would face difficulties in infrastructure growth. FDI therefore offers managers in developing countries the chance to benefit from superior foreign experts.

Access to Advanced Technology

Indeed, there are certain monetary restrictions that limit the developing countries from acquiring the latest technologies. The existence of FDI and multinational enterprises have alleviated those constraints. Along with the efforts to maximize the competence and skill of workers, MNCs regard FDI as an exposure to innovative processing technologies. Although information technology has evolved over the past five decades, it has never ceased to have an important effect on redefining business operations and supply chain management. Economists, likewise, are not skeptical about the positive impact of technology. In particular, certain industries such as automotive, aviation, and household appliances manufacturing display a radical demand for advanced computerization or auto mobilization. Globalization also motivates the integration of technology in order to ameliorate productivity and strengthen connection among corporations around the world. Technology is among the most important resources, which leverages “free movement of goods, information, and people across national boundaries” (Berisha-Shaqiri, 2015, p. 73). In short, specialized engineering and applied sciences allow any MNCs to achieve comparative advantages over their competitors.

Unfortunately, the advancement of technology in developing and transition economies still undergoes several constraints. By contrast, corporations in the developed countries, being equipped with sufficient research and development expertise as well as sophisticated machines, are rapidly taking technology forward. Therefore, many technological companies from Southeast or Northeast Asia have diversified their locations into developed countries to consolidate the electronic and semiconductor economies. Once again, Huawei is an MNC that makes huge investments in research and development (R&D). Specifically, the company spends approximately $15 billion annually on R&D (Jiang, 2018) and places its R&D centers in over eight European countries to integrate global talent for continuous innovation. On the other hand, if the developing and transition economies refuse to incorporate technology into running the businesses, they would undoubtedly succumb to economic stagnation which might later result in nationwide poverty. Hence, FDI plays an exceptional role in infusing advanced technology from developed host countries into the less-developed home countries.

Latent Risks of FDI on Developing Countries as FDI Recipients

Nevertheless, the pros of FDI are also accompanied by certain cons, which should be taken under consideration by the governments and the enterprises that are involved in such capital investment practices. In other words, latent drawbacks do exist if host countries fail to handle FDI with proper policies. From an economic perspective, the risks that FDI can impose on the countries which receive them may range from partial loss of taxes and revenues, dependence on foreign instead of domestic investment, and emergence of foreign monopolies that do harm to domestic entrepreneurship.

Unfavorable Shift of Revenues from the Host to the Home Countries

One of the most apparent disadvantages of FDI is that a significant portion of proceeds generated by multinational corporations will inevitably move from the host countries to the home countries. Accordingly, it poses challenges for the host country government to collect corporate taxes from these corporations. For instance, as an attempt to incentivize foreign investors, a host country usually offers tax policies such as tax holidays that favor them. As a result, loss in revenue due to loss in tax income may incur. In addition, although foreign investors benefit from the exploitation of the local raw materials and labor force, not all of the profits will remain in the host countries. In other words, the GDP of the host country would improve to a certain extent; however, a significant amount of incremental income will be returned to the shareholders residing in the home country. According to research on 1,500 MNCs operating in India, the MNCs which link to tax havens tend to practice more profit-shifting strategies to lower tax jurisdictions (Jansky & Prats, 2015).

Hindrance to Domestic Investment

Local economies may turn out to be dependent on major foreign investors, which hinders domestic investment as well as technology research and development. In reality, the supply of funds from FDI inflows can benefit local firms to enhance liquidity indicators since FDI somehow releases financial constraints. Nevertheless, domestic companies would accordingly seek FDI for additional funds instead of financing their projects through borrowings from national investing banks. Ahmed, Ghani, Mohamad, and Derus (2015) conducted an empirical study on Uganda, a developing African country, to figure out the negative impacts that FDI may have on domestic economy. The research concluded that FDI presents a “persistent crowding-out effect in both the Agriculture and Construction sectors, implying that foreign investment effectively displaces domestic investment in these two sectors” (p. 426). Therefore, it poses a need for the government to protect domestic investors by establishing proper policies.

Domestic Entrepreneurship Being Stifled

Host countries must be cautious when allowing foreign incorporation of wholly-owned companies since it would possibly lower the comparative advantage of domestic enterprises (Loungani & Razin, 2001). The presence of more MNCs from other countries may conflict with the national firms. There seems to be a trend that the financial giants of the world are trying to monopolize by taking over lucrative sectors through the means of FDI, which forces local businesses to reluctantly cut their product price. Loungani and Razin (2001) explicitly explained:

> FDI is not only a transfer of ownership from domestic to foreign residents but also a mechanism that makes it possible for foreign investors to exercise management and control over host country firms—that is, it is a corporate governance mechanism. The transfer of control may not always benefit the host country because of the circumstances under which it occurs, problems of adverse selection, or excessive leverage. (p. 2)

For instance, when companies that are initially founded in the 4.0 industry such as Uber or Lyft start to grow their scope to developing countries, traditional taxi drivers are forced to lose their current jobs. In Vietnam, Vinasun and Mailinh are among the most famous brands in the taxi industry. Nevertheless, these "local taxi companies are fac[ed] with the new competitors which are Uber, Grab and Easy Taxi" (Mai & Ngo, 2016, p. 228). According to research conducted by Mai and Ngo (2016), the statistics indicate that the mean value of customer loyalty and customer satisfaction regarding local taxi brands is 3.5, which is "neutral or not satisfied much" (p. 232). Whereas, the foreign companies offer cheaper prices, provide more comfort, and thus gain a significant amount of market share in comparison with local taxi companies (Mai & Ngo, 2016). While creating more employment opportunities for drivers who can adapt to technology quickly, Uber simultaneously takes away jobs of local drivers. Under specific situations, FDI seems to edge out local manufacturing firms. Despite driving beneficial competitions, FDI, to a certain extent, conversely threatens the performance of domestic corporations.

Considerations by Developing Countries from the Home Country Standpoint

FDI, similar to any types of investment, requires astute research and accurate assessment of possible situations. Putting efforts into examining the targeted host countries evidently lead to success for many MNCs. Trung Nguyen, a Vietnamese trademark coffee brand, has extensively expanded to Japan, Singapore, Canada, and France with more than 400 franchises. The success of this company has come from the firm's counterintuitive strategy to "match new markets that are geographically, culturally, and economically distinct from the firm's home base" (Larimer, 2003, p. 2). To the contrary, there are cases of MNCs that enter the home countries without conducting initial research. For instance, WeChat is a social ecosystem headquartered in Shanghai, China with a billion of users. Nevertheless, the company failed in trying to expand into Western countries such as the U.S. market (Evans, 2018). The reason is that people in the host country did not show favor in this communication service, and most users found it inconvenient to switch from their current social media like Facebook and Whatsapp to a new one (Montag, Becker, & Gan, 2018). In addition, having an ability to evaluate influential factors will prepare investors from developing and transition economies for future outward FDI. Prudent awareness of political, financial and legal factors will permit the home countries to formulate alternatives or take early actions against unfavorable circumstances.

Political Factor as a Determinant of FDI Distribution

As FDI certainly involves dealing with different governments, there is a likelihood that politics will be a considered element to foreign investors. Choosing a country to allocate FDI cannot be a random selection. Instead, the home country's decision must be based on the political atmosphere of the host country. Actually, politics can adversely influence business operation from both social and economic perspectives. It could also be the case that political risks would increase uncertainty in the economic environment (Khan & Akbar, 2013). For example, the process of global expansion entails meticulous attempts to scrutinize the external threats such as political unrest, terrorism, electoral issues, corruption, or social media regulation in the host countries. Schneider and Frey (1985) claim that a country where such threats exist "is more of a risk and therefore less attractive to invest in than a country offering political stability and a guarantee of property rights" (p. 161). In other words, investors have to make sure that the FDI is directed to low-risk countries. A host country presenting higher risk in politics may fail to sustain incentives for the home country to invest.

Financial Analysis of the Invested Countries

Another fundamental element that captures foreign investors' concerns are measurable financial variables of the host countries. Such quantifiable numbers would provide investors with proper information about the current financial position of the nations into which they are about to make outward FDI. Without acknowledging the economic factors of one country, the home countries may find it difficult to maximize total return on investment. Some suggested aspects to look for in a host country are exchange rate stability, interest rate, and health of the banking systems.

Exchange rate stability. First of all, issues associated with currency are prevalent in MNCs' daily operating activities. As goods and serviced are exchanged across the borders to customers living in several continents and regions, the method of payment for each transaction will differ accordingly. For instance, an MNC from China functioning in Japan will have to process with both yuan and yen. Similarly, a multinational enterprise whose nationality is Indian will receive sales in both rupee and U.S. dollars if it expands the markets to America. However, currency exchange rates have been encountering major fluctuation on a frequent basis. In general, being unable to predict or timely react to such change will make it difficult for the home country to maintain its earnings quality from FDI. Common solutions to exchange rate volatility are forward contracts and futures contracts. Both contracts are formal agreements which specify "a price today for future delivery" (Jordan, Miller, & Dolvin, 2018, p. 461) between a buyer and a seller. In terms of currency, futures and forwards set the spot rate at which a specific currency exchange can be executed. The economic task accomplished by future and forward contracts help investors to hedge against inflation.

Volatility in exchange rate does not always lead to negative consequences. Under certain circumstances, appreciation in the host country's currency relative to the value of the home country's currency can appear to be both beneficial and disadvantageous. On the one hand, vertical FDI may result in losses in profit since the host country's minimum labor wage and production costs will surge. In this case, the home country should refrain from constructing manufacturing plants overseas. On the other hand, this specific exchange rate movement will have positive implications on horizontal FDI. For instance, when a company from a developing country such as Vietnam successfully expands its market to Europe as the Euro is growing in value compared to the Vietnam dong, the company would generate more revenues. Therefore, when appreciation in currency of the host country is observed, the home country ought to perform horizontal FDI. In short, the investment strategies of MNCs evidently indicate an interdependence on exchange rate stability and instability in the host countries.

Interest rate. The behavior of interest rates in the host countries is also a component that draws the attention of foreign investors. For several centuries, interest rates have been a useful measure to help investors make key decisions. From the macroeconomic point of view, interest rates may materially affect the purchasing power of consumers in a country. For example, as the government imposes reductions on interest rates, people are able to borrow more, and thus able to spend more on goods and services. In other words, income and level of spending of a country's citizens are reflected in changes in interest rates. According to a recent study of FDI in the ASEAN 5 economy, the authors disclosed that "investors will look for low cost funding sources or lower rates" (Siddiqui & Aumeboonsuke, 2014, p. 60). Thus, it is crucial that MNCs from developing and transition economies analyze interest rates as a benchmark guide for choosing the host countries. Obviously, investors are less willing to invest in a country where the purchasing power of local residents is low. As a step in the FDI decision-making process, the home country may need to carry out several research studies into the prospective overseas markets to collect data about interest rates adjusted for inflation.

Infrastructure and Availability of Natural Resources

Lastly, the conditions of infrastructure and natural resources in the host countries should be discussed as well. Roads, airports, or harbors are expected by foreign investors to be in good conditions. Especially in terms of transportation, home countries are inclined towards host countries that create convenience for logistics since goods are transferred on a continual basis. In contrast, a country that is unable to improve infrastructure will fail to help the home country with facilitating shipping and reducing costs. Hence, the FDI inflows to countries under weak and vulnerable economies remain fragile over years.

Moreover, the availability of natural resources is also a crucial determinant of FDI flows. It is undeniable that the biggest economic issue nowadays is the scarcity of essential resources. According to Kalaitzi, Matopoulos, Bourlakis, and Tate (2017), global domestic material consumption had climbed by 94% to 67.8 billion tons since 1980. In recent decades, the demand for natural materials has continued to increase, which leads to potential depletion and shortage of those resources. Subsequently, one of the key drivers for FDI outflow is the shortage in natural resources of the home countries. Therefore, countries that demonstrate abundance in unexploited natural resource will attract more FDI. Investing in the host countries with sufficient natural resources, importantly, calls for the home countries’ obligation to wisely utilize and responsibly preserve these properties.

Trade Policy or Investment Restrictions

International business substantially relates to trade barriers such as government restrictions on imports and exports, which directly affect FDI decisions. Upon making direct investment into any country, the home country should be fully informed about trade policies enforced by the host countries to prevent inadvertent violations. Tariffs and quotas are the most common examples of strains confronted by MNCs worldwide in trading across boundaries. Whether released regulations are favorable to investment or not, multinational enterprises must completely comply with them to ensure legal trade.

An ongoing foreign trade issue that currently captures attention of the transition economies is the Trade War between China and the U.S. Beginning in 2018, the Trade War is predicted to have prominent impacts on FDI flows to and from developing countries. Although both countries have developed a mutual economic relationship over the past several decades, there seem to exist bilateral disputes between the two. Specifically, President Trump has made an official announcement to levy "45% punitive tariffs on imports from China" (Li, He, & Lin, 2018, p. 1557). All the sanctions imposed by the Trade War have restricted both MNCs from the U.S. and China. Many of the transnational enterprises from the U.S., which set up plants in China, will struggle with shifting to alternative suppliers. At the same time, simulation results suggest that China's economic indicators, including welfare, GDP, and manufacturing employment will be hurt (Li et al., 2018). As mentioned, the new trade policy between the U.S. and China creates an enormous challenge for both countries. In particular, it would be of high importance that any MNCs from China, which are considering expanding their markets or manufacturing process to the U.S., cautiously weigh the pros and cons when finalizing their decisions.

Current Scenarios and Prospective Trends

FDI is not distributed evenly across countries, and "[t]he vast majority of FDI is between wealthy nations despite the availability of cheaper labor in developing economies" (Buchanan, Le, & Rishi, 2012, p. 81). Conclusively, it is obvious that FDI barely flows downstream into the poorer and slower growing nations. Nevertheless, dynamic economies among the developing countries, namely China or India, still attract large inflows of FDI. In the near future, research has predicted that there is an evident upward trend of net FDI inflows and outflows in developing countries despite the recent economic downturn (UNCTAD, 2018).

Current Patterns of FDI Inflows in Developing Countries

Recent studies show that the FDI net inflows to emerging and developing countries have been slightly fluctuating in the past few years, yet still maintaining at a relatively high level (UNCTAD, 2018). Actually, developing and transition economies have been appealing to foreign investors for decades due to their immense market and consumption. Despite showing certain falling trends, the current scenario of FDI inflows appears to be optimistic within these countries in general.

The World Investment Report 2017 (UNCTAD, 2017) reveals that FDI inflows to developing countries have shown significant recovery from the 10% drop in 2016 to reach $646 billion. The report also adds that "FDI flows to transition economies almost doubled, to $68 billion [from 2013 to 2015], following two years of steep decline, reflecting large privatization deals and increased investment in mining exploration activities" (p. 11). In particular, China and India, have been accepting a significant amount of FDI from developed countries. Statistically, Noorbakhsh et al. (2001) claimed that "China has been the largest developing country recipient of FDI since 1992" (p. 1594). Regarding India, Duggal (2017) indicated that "The total foreign direct investment of $6 [b]illion in 2005 to the inflow of $ 60 [b]illion in 2017 is a long journey of 13 years and represents an increase of 9.92 times" (p. 9). Buchanan et al. (2012) clearly stated that "One of the FDI success phenomena of the past decade has been the BRIC (Brazil, Russia, India and China) economies" (p. 82).

Last year, according to United Nations Conference on Trade and Development (UNCTAD), inward FDI to the developing countries continued to remain stable at around $671 million (UNCTAD, 2018). In addition, the same report revealed that there was unfortunately a dramatic decline in FDI inflows to transition economies by 27% due to "geopolitical uncertainties and sluggish investment in natural resources" (p. 11). However, in general, the stream of FDI into developing countries still demonstrates a sustainable interest of foreign investors to the less industrialized economies.

Current Patterns of FDI Outflows in Developing Countries

It is crucial to restate that today, FDI outflows from developing and transition economies towards more industrialized countries have been substantial and significant. There has been a steady increase in the number of multinational enterprises based in developing countries over the years. In particular, rapidly-industrializing countries such as India, China, and Mexico have introduced numerous influential multinationals, namely Tata Group, Huawei, Lenovo or CEMEX. The products and services of these corporations are not limited to information technology, food and beverage, communications, consulting. Furthermore, statistics on the primary activities of the above mentioned MNCs are quite impressive on a macroeconomic basis. For example, the Tata Group, which is based in India, possesses total assets of more than $100 billion and operates in over 100 countries (Bano & Tabbada, 2015).

According to the annual report released by UNCTAD Investment and Enterprise Division, during the fiscal year 2017, “FDI outflows from economies in transition recovered by 59%, to $40 billion, after being dragged down by the recession in 2014-2016” (UNCTAD, 2018, p. 6). Moreover, within the next reporting period, FDI outflows from developing countries in Latin America and Africa have risen by 86% and 8% (UNCTAD, 2018). Despite the unfavorable economic factors, FDI outflows in these countries still prove to maintain at a relatively high level. Especially, China has been ranked #3 among the top 20 home economies with $125 billion in FDI outflow during 2017, which proves how dynamic MNCs’ activities are in this country.

Outlook on Future FDI Inflows and Outflows

Optimistically, historical data and analysis of current economic conditions suggest that FDI inflows to developing and transition countries will continue to rise steadily in the upcoming years. Projections on inward FDI seem to illustrate marginal increase. Overall, on a global scale, “in real terms, cross-border capital flows have been increasing at a rate of about 6% a year since 1980, faster than those of the world's GDP and trade”, of which “developing economies as a group are expected to gain about 10 percent” (Buchanan et al., 2012, p. 81). In detail, if developing and transition economies are able to escalate the value of cross-border M&A and leverage international production, there is likelihood that FDI inflows will experience improvement. As developing and transitions countries are constantly working on numerous feasible policies to attract extra foreign investors by gradually shifting to free market economy, there is no doubt that such economies will grow to receive the biggest portion of global FDI.

FDI outflows from developing and transition economies illustrate a potential downward trend as a consequence of the U.S. – China Trade War. The impact of this political phenomenon may cause a decline in investment from Chinese MNCs. While China accounts for an enormous portion of outward FDI from the less developed parts of the world, such decline will lead to an overall decrease in outflows from developing Asia. However, Asia is forecasted to continue attracting relatively higher-skill manufacturing from developed regions. “The World in 2050” report by PricewaterhouseCoopers (2015) projects that in the next 20 years, Western companies will keep looking for emerging economies such as Vietnam, Bangladesh, the Philippines, and Indonesia to invest in. The steady growth in FDI recently may serve as a strong launching pad for future acceleration in world trade and improvement in MNCs activities.

Practical Strategies to Appeal to FDI

Foreign investors tend to consider several key concerns to minimize the risks and maximize their wealth. For example, currency exchange and tax rate, trade policy, political situation, local skills in the home countries or product life cycle are some possible determinants that should be considered. Since investors always want the highest return for the lowest risks, so they must carefully evaluate the various influential elements. Developing countries and countries in transition economies should adopt “proactive approach[s] for attracting more FDI” such as liberalizing economic policies, lowing labor costs, and providing favorable investment incentives (Iqbal et al., 2013, p.

58). In order to attract more FDI inflows, the home countries ought to advocate free trade, allowing proper adjustments to interest and exchange rates, creating incentives for MNCs to enter, as well as having thorough compromises with the partner countries.

Proper Adjustments of Economic Policies

One practical strategy to implement by developing and transition economies is to make suitable modifications to the laws of trading. As previously discussed, trade barriers are frequent restrictions to FDI inflows. Tariffs, quotas, and other economic policies partially determine how FDI is distributed geographically. There is the possibility that foreign investors hesitate if the FDI-relevant policy enforced by the home countries is tremendously strict. Therefore, developing countries need to shift to a more FDI-friendly environment as they wish to encourage FDI inflows. A stable trade and investment climate will ensure MNCs to smooth out their decision making processes. Otherwise, the home countries may be incapable of approving FDI strategies or even deter FDI from developing and transition economies.

Suggestive Devaluation of Exchange Rate

There exists a direct correlation between FDI and exchange rate fluctuation. The government can devalue the country's currency, so investors can make the most of their fund. This policy particularly benefits horizontal FDI inflows. Currency depreciation, from a macroeconomic perspective, provides host countries with local advantages. A reasonable reduction in currency value in the host country against the home country will cut down on foreign production cost. In terms of corporations, cost-oriented MNCs are most likely to take advantage of currency devaluation. Lily, Kogid, Mulok, Sang, and

Asid (2014) asserted that a depreciation in Asian currencies against the U.S. dollar in the machinery sector actually turned these countries into the production site for exports, thus increasing FDI inflows. During August 2015, China's central bank intentionally lowered the reference rate of the renminbi, thus depreciating the currency against the dollar, the pound, the euro and the yen. This adjustment of the renminbi was an immediate response to the fall in exports by more than 8% annually (Jackson, 2015). This move has effectively recovered the price competitiveness of China exports and assisted several exporting industries nationwide. Nevertheless, currency depreciation can also do harm to vertical FDI as it reduces the revenues gained by foreign investors. In order to balance between the entries of cost-oriented and market-oriented MNCs, it is vital that developing and transition economies properly concentrate on the movement of exchange rate.

Tax Exemption or Lower Corporate Tax Rate

Taxation is another instrument used by host countries' governments to support direct investment abroad. As tax policies are among important factors that foreign investors examine in decisions on where to target outward FDI, policy makers should consider modifying tax rules. Corporate income tax expense negatively affects the bottom line of any MNCs. Therefore, multinational enterprises tend to avoid their income from being treated within a high tax bracket. Logically, FDI flows will react inversely with changes in tax rates. On average, "FDI decreases by 3.7% following a 1 percentage point increase in the tax rate on FDI" (OECD, 2008b, p. 2). Tax exemption or reduction on corporate tax rate for foreign companies, as a result, lowers the tax burden for investors.

In addition, the impact of tax rate on FDI inflows also depends on the economic growth of the host country. For developed countries, cutting down on corporate tax may not always generate a positive effect on FDI. The reason behind this is that when a MNC chooses developed countries as the destination for expansion, they focus more on the acquisition of advanced technology and the expertise of the labor force. In contrast, what usually makes developing and transition economics appealing to foreign investors is the cheaper costs of construction, labor employment, and transportation. This explains why FDI deters companies from developing nations that are unable to offer less expensive trade-associated costs. Tax cuts may offset the tax revenue that the host countries are supposed to receive and creates pressures for the governments to reduce personal income tax rates (OECD, 2008b). While reductions in tax on FDI seem to be expensive as it forgoes overall revenue, this policy remains a promisingly effective approach to attract inward FDI.

Appropriate Negotiation of Bilateral Agreements

Similar to FTAs, bilateral agreements play an important role in ensuring constant inward and outward flows of FDI. Each country involved in FDI ought to reach a mutual contract that considers all parties' interests. In other words, a bilateral agreement confers trading status between the two nations to minimize conflicts in trade standards among countries. Accordingly, certain sanctions enforced by the governments of the developing countries may regulate FDI inflows. Although negotiations between governments are sophisticated and challenging, developing countries should be flexible in identifying the interests of foreign investors to make appropriate compromise. Essentially, "policies that are often negotiated bilateral agreements, including trade agreements, bilateral investment treaties, customs unions and service agreements" may contribute to fulfilling the FDI flows among countries (Blonigen & Piger, 2014, p. 810). Having the power to negotiate would deliver fair benefits to both countries when trading goods and services abroad.

Conclusion

FDI certainly plays an indispensable part in consolidating and boosting international flows of trade to and from developing and transition economies. FDI alleviates international business and significantly contributes to world economic growth. In particular, countries in the less industrialized regions benefit from FDI as providers and recipients. Through FDI activities, a multinational network that promotes sustainable collaboration among different countries will be established. Furthermore, FDI positively influences developing and transition economies by bringing about long-lasting, reciprocal interests and other economical as well as social benefits to all involved nations. Nevertheless, potential risks of inward FDI should be taken under consideration by the government and MNCs in order to minimize or eliminate latent consequences.

Although FDI is definitely not a new concept, its substantial importance will still be a concern. Inward and outward FDI to and from developing and transition economies indicated constant yet marginal recovery and improvement in the past few years. In many decades to come, economists anticipate such upward trends to keep occurring within the world economy. When developing countries look for potential markets overseas, they must discuss the influential determinants before determining which countries to invest in.

Lastly, it is necessary for the developing countries to work on economic or political strategies to incentivize the addition of foreign investors. The suggested approaches to attract more FDI may have both advantages and disadvantages, and thus, host countries are required to examine thoroughly the alternatives in making such decisions.

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