FACTORS DETERMINING DEVELOPMENT OF FOREIGN DIRECT INVESTMENT IN THE LIGHT OF LOCATIONS' THEORY

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Abstract

Nowadays, one should take into account the fact of extensive freedom of enterprises' location, investing directly within the whole integrating area. Undoubtedly, this resulted from the following: liberalization of capital flows as well as technical and technological developments which made it possible to disperse different stages of production. However, despite lack of investment barriers, a large number of less-developed regions are still being avoided by investors, which deepens the polarization in the interregional dimension of the whole integrating area.

This paper takes up issues related to the factors determining the development of companies with foreign capital contributions in the light of FDI theory of locations.

Key words: foreign direct investment, location's theory, FDI 's development factors in Poland

Introduction

The main goal to undertake economic activity by business entities in the form of foreign direct investment (FDI[4]) in neighboring countries is to ensure their development. The said goal can be achieved by attainment of partial

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[4] In the further part of her paper, the author shall use the acronym FID which stands for foreign direct investment.

goals which are related, among other things to: winning (keeping up, extending) markets, widely understood costs or purchasing motives. Investments realized to achieve market goals can be divided into offensive and defensive ones. The former ones focus on wining new or extending existent markets, the latter focus on keeping up the held position on that market. One should also bear in mind expectations of the receiving party (country, region, city), and consequently a number of investment incentives offered to investing business entities. Among the most remarkable expectations of the receiving party one should rank: transfer of new technologies, increase in labor efficiency, increase in export or elimination (reduction) of unemployment.

Nowadays, one should take into account the fact of extensive freedom of enterprises' location, investing directly within the whole integrating area. Undoubtedly, this resulted from the following: liberalization of capital flows as well as technical and technological developments which made it possible to disperse different stages of production. However, despite lack of investment barriers, a large number of less-developed regions are still being avoided by investors, which deepens the polarization in the interregional dimension of the whole integrating area.

This paper takes up issues related to factors determining the development of companies with foreign capital contributions in the light of FDI theory of locations.

1. Foreign direct investment theories. Location factors

The professional literature presents a large number of theoretical explanations of determinants affecting the capital flow between countries (see Table 1). Basing on existent FDI theories, we can argue that investors' decisions on foreign markets depend on proprietary advantages and benefits of their internalization, whereas as for geographical positioning, factors comprising the environment of an enterprise in a receiving country decide.[5] The most comprehensive presentation of the problem of a foreign expansion has been incorporated in the eclectic theory of international production[6] which includes a complex of the determinants of FDI. Three kinds of conditions have been listed here to be met simultaneously for foreign direct investment to appear.

[5] Latocha T., *Foreign Capital in Polish–Textile–Clothing Industry – As an attempt of Analysis based on the Foreign Direct Investment and Location Theories*, „Fibres & Textiles in Eastern Europe", no. 1(45)/2004, p.8-12.

[6] *The method is also referred to as OLI paradigm (ownership – location – internalization) by J.H Dunning*

Chart 1. FDI theories

THEORY	AUTHOR	CONTENTS
Theory of profitabilty	Mill,Marshall	The capital flows from a country of a low profitability to a country characterized by the scarcity of the capital, and therefore its higher profitability; assuming lack of limitations, cross-border flows should lead to evening out the price of a utility (rate %) between countries.
Theory of relative shifts of capital costs and workforce	K. Koijima	He mentions FDI: **1)** being motivated by the wish to use comparative advantages of the receiving country – less developed: FDI flows from an expensive workforce country to low-cost ones, which makes the costs of workforce and capital use even out between countries, and therefore change comparative advantages of particular countries as well as 2) FDI realized to make use of a monopolist advantage of an investor who makes investment in the sectors in which his home country has a comparative advantage over the foreign one
Theories of shaping investment postion of countries	Dunning, Geldner, Chenery.	They seek dependencies between the size of a market, level of the country's development measured by GDP per capita, and a net FDI flow; Dunning argues that the higher GDP, the larger the number of net FDI per capita (net FDI = the sum of FDI flowing from a given country decreased by the sum of FDI undertaken in a given country) – higher--developed countries are larger net investors.
Theory of currency areas	Aliber	FDI flow from strong-currency countries to weaker-currency countries which are stable in the long term; companies from strong-currency countries allocate capital in a weaker-currency country, where thanks to exchange gains it capitalized at a higher % rate, simultaneously, they have an advantage over local companies, as they can offer a better price for assets.
Theory of oligopolistic reaction (principle follow the leader)	Knickerbocker	In oligopolistic market conditions, companies undertake investment within the framework of a defensive strategy, following major competitors in order not to lose an export market or deterioration of their competitive position on the home market.
Theory of proprietary advantage of an enterprise	Hymer	FDI shall be undertaken by companies which have at their disposal a certain proprietary advantage (e.g. in the form of more sophisticated technologies, better marketing, better financial opportunities) over local businesses. The advantage must be as much remarkable as to outweigh or at least neutralize the starting position of local businesses which do not have to, among other things, incur costs related to collecting information about the new market.
Theory of appropriation	Magee	FDI as a form of international expansion is undertaken particularly by innovative companies, having at their disposal an advantage in the form of products with a large

		content of high technologies, as manufacturing products for a foreign market through their foreign branch offices, it is easier for foreign investors to retain higher revenues related to the advantage than if they distributed the product through market mechanism.
Theory of internalization of internal transactions	Coase, Wiliamson, Buckly, Casson	FDI is undertaken by international corporations in order to "avoid" the market, i.e., carrying out transactions inside the same enterprise (intra-firm trade) at the prices compliant with the company's global strategy, most often lower than the market ones – FDI is undertaken in order to lower transactional costs by introduction of transactions into a specific "internal market"
Product life cycle theory of (theory of (Technological gap theory	Vernon, Posner	FDI results from 1) uneven spread of technological know--how in the world and its limited flow, which causes that one can distinguish innovative countries and imitating countries between which FDI takes place and 2) the product's transition through phases of innovation, maturity and standardization. Companies from innovative countries are source of modern products – innovations. Each innovation goes through the phases: 1. Birth, production targeted at the innovator's domestic market, II. Maturity, stabilization of demand ensues and the demand on foreign markets goes up, and simultaneously other highly developed countries undertake production of a good, which may jeopardize the innovator's export, as well as through phase III of standardization in which the reversal of the trade flow takes place and the product is exported from the imitator's market to the innovator's one.

Source: own study on the basis of J. Witkowska, A. Stępniak " Theories of international economic exchange". 1990; T. Kalinowski " Joint ventures as a modern form of international economic cooperation", UMK, Toruń 1993.

1. The Company must have certain specific proprietary advantages, making its position more advantageous against competitors in a given country:

Among features making an enterprise's position more advantageous on should rank:

- size and position of an enterprise, diversification of a product or manufacturing processes, division of work and specialization, monopolist position, better provision with resources and their use,
- trademarks and technologies legally protected,
- modern production management, marketing and organization system, sizeable research and development capability, qualified workforce, experience and professional practice,
- exclusive or privileged access to resources (workforce, financial resources, natural resources, information, etc.),

– having privileged position or exclusiveness in access to markets,
– state protectionism.

2. Advantages of activity internalisation:
   – lower costs of market transactions' service,
   – avoiding costs of market transactions' service,
   – reduction in the risk related to demand on the domestic market,
   – increasing the possibility of proper price policy management,
   – possibility of controlling the quality of products by the salesman,
   – avoiding or making use of state regulations,
   – possibility of controlling supplies' source and active influence on sales terms and conditions of resources as well as controlling markets,
   – possibility of application of competitiveness strategy.
3. Location advantages:
   – spatial arrangement of manufacturing factors, production and markets
   – prices, quality and production efficiency factors,
   – transportation and communication costs,
   – extent and character of the state intervention,
   – favourable climate for FDI,
   – technical and social infrastructure condition in the capital allocation country,
   – advantages of scale in the field of research and development, production, marketing and market[7].

The flexible paradigm shows that foreign direct investment is a function of three variables governing their undertaking: characteristics of a given enterprise (its advantage), advantages resulting from internalization of economic activity as well as location advantages.

From the point of view of the above-mentioned arguments, it is important to identify location factors which make up an investment climate. It is comprised of economic factors (market, resources of production utilities and their acquisition costs, legal factors (business law), social factors (inhabitants' style of living, regional culture, command of foreign languages) as well as political ones (political stability and respective investment risk in a given country)[8]. The location of enterprises in a region is determined first

[7] Luc S., *Zagraniczne inwestycje bezpośrednie a przekształcenia strukturalne w przemyśle polskim*, SGH, Warszawa 2000,p. 17-18.

[8] Stępniak A., *Integracja regionalna i transfer kapitału. Inwestycje bezpośrednie w aspekcie klimatu inwestycyjnego w UE,* wyd. UG, Gdańsk 1996, p. 83-84.

and foremost by its qualitative location factors; local authorities related to business environment (financial, insurance, informative, training, consulting, promotional),[9] modern global transport and communication infrastructure, possibility of keeping up the just-in-time regime, and even the landscape beauty.[10]. In the 1990's, so-called soft location factors began to be appreciated more; these were the ones which are not directly related to a company's activity and are difficult to be quantified.[11] The said soft factors complete hard factors which affect a company directly and are easily measurable. The division of location factors has been presented in table 2.

The specialist literature mentions six external location factors, playing the most important role when choosing the location for the future place of economic activity, making use, among other things, of advanced technologies. These are the following:[12]

- workforce (human resources),
- universities and research and development institutions,
- landscape beauty – living conditions,
- transportation infrastructure,
- services and political climate for economic activity,
- conurbation advantages .

Table 2. Division of FDI location factors

CATEGORY	HARD FACTORS	SOFT FACTORS
Labour market	– supply of qualified workforce, – level of remuneration,	– quality of administration, – job and career opportunities, – educational opportunities, – distance from workplace
Infrastructure	– supply of grounds and offices, – communication links, – intra-regional communication situation,	– image of industrial districts, – quality and decision-makers' imagination of grounds and buildings – communication and supply facilities within the workplace,, – communication links,
Costs	– prices of grounds, – local charges and taxes,	– regional differences in wages.

[9] Olesiński Z., Predygier A., *Wpływ działalności inwestycji otoczenia biznesu na kształtowanie konkurencyjności regionu* w: Socjologia gospodarki. Rynek, instytucje, zarządzanie, red. K.Konecki, P.Tober, Łódź 2002, p. 415-425.

[10] Gorzelak G., *Transformacja systemowa a restrukturyzacja regionalna*, UW, Warszawa 1995, p. 64.

[11] Gorzelak G., *Polskie regiony w procesie integracji europejskiej*, „Studia Regionalne i Lokalne", nr 2-3/2002, p. 85.

[12] Benko G., *Geografia technopolii,* PWN, Warszawa 1993, p. 78.

	– local subsidies and allowances,, – regional outlay on environment protection, – electricity and water supply, remunerations and wages.	
Locations	– access to crucial economic centres and markets	– geographic location, – geopolitical location, – availability of other attractive regions.
Environment Quality	– air cleanliness, – outlays on water, waste disposal	– climate, weather – cleanliness of air, – quality of water.
Economic climate	n/a	– social climate, – quality of administration which supports economy, – political climate.
Opinions	n/a	– image, historical and cultural importance.
Culture	n/a	– cultural sponsorship, – cultural and leisure offer,
Quality of life	n/a	– existence of parks – attractiveness of Old Town and vicinity

Source: own research on the basis of: W. Dziemainowicz, B. Jałowiecki, Municipial policy and foreign investment in the Polish metropolises, Warszawa 2004, p. 23.

The factors mentioned above indicate that the role of the strongest links of the spatial layout: of big cities – academic life, research centers, but also financial institutions offices and other specialist services. Only few areas located far from such centers can keep up with them. These are spatial layouts which offer especially favorable conditions to conduct economic activity; they have good communication links, offer decent living and working standards, and they have become centers of innovation simultaneously. Cyclical research of location factors of foreign capital allocation in Poland has enabled us to draw up a list of factors which play a crucial *role*[13]. These are: favorable location and communication links between cities, large market in the region, large supply and inexpensive workforce, a possibility of acquisition of free production premises, new markets' opportunities, and Polish partner's bonds with the region, a foreign partner's ties with the region.

The role and significance of particular location factors for an international corporation is conditional upon the structure of its added value chain

[13] Błuszkowski J, Garlicki J., *Opinia inwestorów zagranicznych o społecznych i ekonomicznych warunkach działalności w Polsce*, Indicator, Warszawa 2000,p. 45.

in geographical terms.[14] The same location factors of regions shall bear different importance for manufacturing, service or distribution companies, and yet different for those dealing with research and development work or marketing. Furthermore, so called greenfield investment shall be dependent on economic, political and social condition of the receiving party, but with already existing investments, e.g., (joint ventures) they shall be less important, however also assessed in the context of the whole venture.

The other problems are large companies' strategies which are visible in the form of mergers, acquisitions as well as alliances, whose investments are always related to a company's cost-cutting or removal of competitors, and their flow is directly determined by location factors of regions. One can conclude that foreign investors being driven by location advantages strengthen these location factors which they are attracted by.[15]

2. FDI 's development factors in Poland, subject to assessment by foreign investors.

Assessment of countries at the angle of their attractiveness as a place of direct investment allocation is the matter widely discussed in numerous papers and reports. In most of them in the last few years, Poland has been viewed as one of the most attractive countries for investors in the world, being in each case the most interesting country among new EU members.

For the purposes of this paper, the research results of the following institutions which deal with the discussed issues have been presented: The Polish Information and Foreign Investment Agency (PAIiIZ), Ernst & Young, United Nations' Conference on Trade and Development (UNCTAD) as well as a reputable global strategic consultancy company A. T. Kearney.

The market survey on foreign investors' opinions about social, political and economical conditions of economic activity was carried out in December 2005, ordered by The Polish Information and Foreign Investment Agency. The method of individual interviews with owners and foreign capital companies' managers was applied. 700 foreign-capital companies were subjected to the survey, whose contribution is more than 10% of share capital or initial capital, and employment – at least 10 people.

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[14] Sitek E., *Inwestycje bezpośrednie przedsiębiorstwa na rynku zagranicznym*, Częstochowa 2000, p. 18.

[15] Latocha T., *Bezpośrednie inwestycje zagraniczne w UE w świetle teorii rozwoju regionalnego i teorii lokalizacji*, Studia Europejskie, 2/2005, p. 52.

More than 1/3 of foreign investors determined 3 crucial factors of undertaking economic activity in Poland. These are the following: size of the Polish market, cheap labor as well as prospects of Poland's economic growth. The decision on the location of an investment is always closely connected to availability of human resources in a region. First and foremost, foreign investors have always paid attention to labor costs (86,3% of the surveyed considered this factor as important, out of that 48,2 % considered it as very important). Employees' qualifications are also considered essential by investors (84,8 % and 49, 0% respectively).[16]

The results indicate several other factors which would comprise the source of incentives necessary for a foreigner investor to undertake economic activity in Poland. These have been among other things, access to other markets (37%), well-developed industrial infrastructure (35,1%), lower prices of components (34,8 %), little competition from local businesses (34%) or living conditions (21,1%). The ranking of factors indicated by surveyed companies have been presented in table 3.

Table 3. Factors determining undertaking economic activity by foreign investors depending on the country of origin

Position in the rank	Factors	Significance of factors			
		Germany N=239	Great Britain N=58	France N=55	USA N=42
1	Size of the Polish market	53,1	65,5	50,9	57,1
2	Labour costs	59,0	46,6	45,5	47,6
3	Economic growth prospects	48,1	51,7	50,9	40,5
4	Workforce qualfication	50,6	51,7	47,3	47,6
5	Workforce supply	48,5	48,3	56,4	47,6

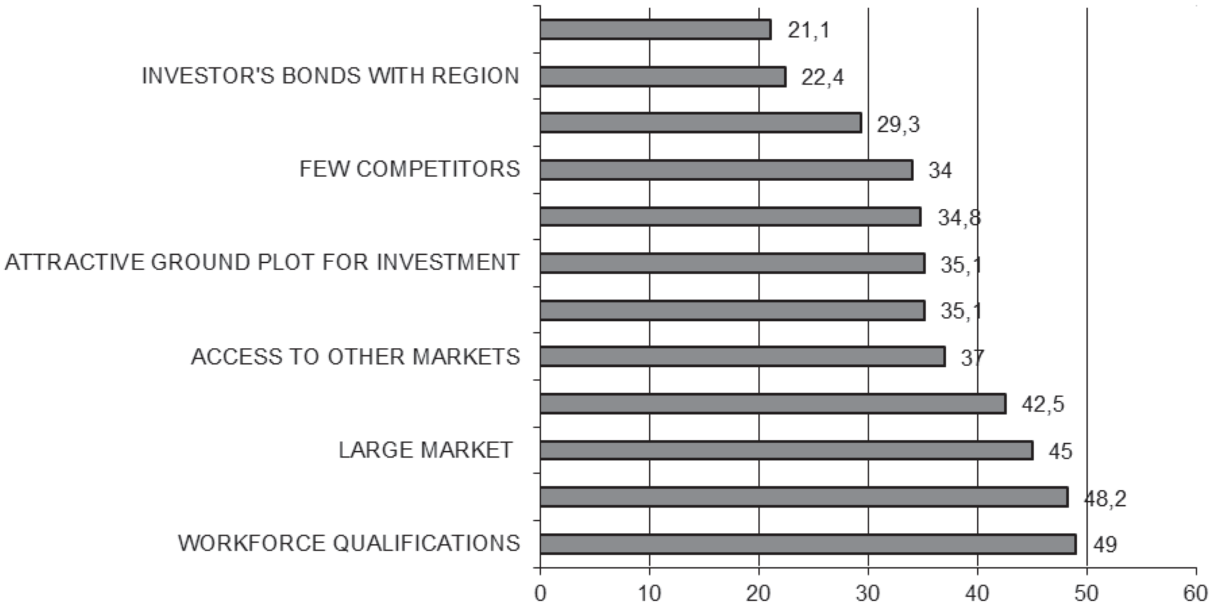
Source: own research on the basis of CBM INDICATOR 2012.

Ernst&Young carried out a survey in February and March 2012 on a random sample of 513 managers of companies in the world, coming mainly from Europe, North America as well as Asia. The aim of the survey was to examine current trends in FDI. When asked about regions in the world in which to allocate their investment projects, the managing directors indicated that the most attractive region of the world is Western Europe, (indication of 68 %). The second most attractive region was Eastern and Central

[16] Latocha T., *Foreign Capital in Polish–Textile–Clothing Industry – As an attempt of Analysis based on the Foreign Direct Investment and Location Theories*, „Fibres & Textiles in Eastern Europe", no. 1(45)/2004, p. 3.

Europe which gained (indication of 57% points). It is worth noting that companies from Western Europe indicated Eastern and Central Europe as the most attractive region. This area is also the most attractive for the sector of consumer goods.

Chart 1. Ranking list of factors determining the location of investment in a given region of Poland (in %)



Source: own research on the basis of survey by INDICATOR for PAIiIZ

In order to obtain even more detailed data, Ernst& Young analyzed its information on investment preferences by particular countries. Poland took the fifth position and was indicated by 15 % of the surveyed, being also evaluated as the most attractive country of Eastern and Central Europe. Simultaneously, Ernst & Young performed an analysis of directions of planned investments, taking into account the following:

- existing investment and announced decisions,
- plans of moving manufacturing activity,
- perceiving Europe's attractiveness in the last three years [17]

More than a half of the companies surveyed are planning investments in Europe. With the division into countries, Poland held the third position. Investment plans as to the country were expressed by 8% companies. Among high-tech companies, Poland was first on the list. Countries preferred by decision-makers as a place for investment according to Ernst&Young, *Europe: the opportunity of diversity,* have been shown in table 4 below.

[17] *www.ey.con[14.11.2014]*

Table 4: The opportunity of diversity

COUNTRY	Number of responses in %
China	37
USA	30
Germany	19
Great Britain	16
Poland	15
Czech Republic	11
Indies	11
France	8
Russia	8
Hungary	7

Source: Own report drawn up on the basis of E&Y.

The results of the survey suggest that Poland is perceived as one of the most attractive countries in terms of investment, which provides opportunities of stable inflow if investment in the future. However, the difference between the proportion of investors who chose Poland as a preferred country for investment (15%), and those who plan to locate concrete investment projects (8%), indicates that Poland's image as a country of possible investment is better than actual conditions offered to investors. The surveys carried out again regarding Poland's perception as a place good for foreign investment by E&Y in 2012 gave results highlighting the following factors – Poland's advantages: low labor costs, employees' qualifications, and geographical location of our country, size of the market and availability of public assistance. According to E&Y, a great benefit is young and well-qualified employees. More than 48% of the whole population is below 35 years of age. Furthermore, 24% of Poles speak English, and 18% German. Poland's geographical location may also favor cooperation with, e.g. the USA. Other factors attracting investors are the following: Poland's membership in EU, 38- million market as well as good economic situation, economic growth of 6.1 % in 2011 as well as stable inflation (2.5% in March 2012). According to E&Y, inflow of foreign investment would be higher if Poland had more distinctive investment marketing and more effective publicity among investors of the whole world markets. [18]

Next survey of investors' opinions with respect to factors comprising investment climate of a given country has been presented by the United

[18] Polska atrakcyjna dla inwestorów bo tania i dobrze położona, Gazeta Wyborcza z dnia 23.04.2012.

Nations Conference on Trade and Development (UNCTAD). It carried out a survey of expected trends in attracting FDI among 87 experts in terms of location of FDI: consultants, advisers and analysts taking part in the decision-making process of international corporations. The survey took place in the period from January to February 2004. The majority of experts viewed FDI prospects with optimism. Poland is on the list of the most frequently mentioned countries with positive prospects of FDI inflow, due to, among other things, European Union membership benefits[19]. Among Central and East European countries, on the ranking list of the most attractive countries in terms of FDI inflow, beside Poland only the Czech Republic appeared. (table 5).

Table 5. The most attractive countires in terms of FDI inflow – Global ranking

COUNTRY	Place in ranking
China	1
Indies	2
USA	3
Thailand	4
Poland	5
The Czech Republic	6
Mexico	7
Malaysia	8
Great Britain	9
Singapore	10

Source: own research on the basis of UNCTAD-DITE, Global Investments Prospects Assessment (GIPA) 2011.

UNCTAD's report indicates attractiveness of countries, perceived by people who deal with consultancy in terms of FDI's location. These are the people whose opinions may to a large extent translate into actual companies' actions. Poland is viewed positive, being in the fifth place in the world on the list of the most attractive FDI investment. However, the Czech Republic is viewed similarly; hence the necessity arises to increase Poland's competitiveness through investment climate improvement.

[19] *UNCTAD-DITE, Global Investments Prospects Assessment (GIPA) 2012.*

Conclusions

Actual positioning of Poland gives it a good chance to acquire FDI, however it does not guarantee its inflow. Therefore, actions aiming at improving investment climate in Poland are necessary. The necessity of such actions has been highlighted in the World Bank and OECD's report, pointing at unfavourable regulations and macroeconomic tendencies. In the debate, an argument often appears that it is necessary to stimulate the inflow of FDI characterized by the high level of added value, and thus investment related to branches of high innovation and extensive degree of know-how contribution. Therefore, one should back increasing human resources' qualifications, commercialization of research results, popularization of modern technologies, etc. R&D centres appearing in Poland more and more may indicate success in this respect. However, less well-off countries "do not let the grass grow under their feet". The potential in the form of more and more qualified workforce as well as more innovative businesses in the already mention countries such as: Bulgaria, Romania, and first and foremost China and Indies make us think that also in the case of R&D centers as well as branches manufacturing relatively technologically advanced products, dislocation to the detriment of Poland may occur.

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