THE MOTIVES OF COMPANIES AS DETERMINANTS FOR ACCEPTING DIRECT FOREIGN INVESTMENTS

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Abstract

Foreign direct investments are a very important plane through which external phenomena and processes „penetrate" into the national economy. The notion of foreign direct investments significantly goes beyond the "narrow" definition of capital and it should be perceived and analyzed in a broader context. The dynamics of contemporary economic changes cause that different parts of the world are diverse in terms of economic and social development. Therefore, trying to eliminate the said differences, state authorities (local authorities) compete with each other, taking advantage of a possibly available group of factors (investment climate) in order to attract foreign investors.

Powering the Polish economy with foreign capital in the form of foreign investments is and will be one of the important factors of its further development. Therefore, we should call for creating more advantageous investment climate, encouraging foreign investors to allocate free capital here.

Key words: foreign direct investment, motives of companies, investment climate

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Introduction

Capital relocation on an international scale has become one of significant factors in development processes of contemporary world economy. It is, on the one hand, an effect of the process of economic globalisation ,while on the other hand, it remains its key accelerator.

For the countries, whose development capacities are limited by the scale of their own resources, supplying with the capital of transnational corporations in form of foreign direct investments may become the basic factor of growth and improvement of the competitiveness level of economies.

So is acquiring foreign direct investments from abroad perceived by majority of the Mid-Eastern European countries, which have implemented the landmark process of economic transition. The needs for restructuring and modernization of economies of those countries far outstrip their financial and technical capacities. With scant level of national savings and low accumulation capability of domestic companies, the supplying with the external capital has become one of the major conditions for the economic development.

The main aim of this article was highlighting the motives facilitating the inflow of foreign direct investments to the given country/region.

The factors accounting for the foreign investments

Theories of foreign direct investments that have been formulated for years, attempted to provide an answer to the question: what conditions should be present for foreign direct investments? Why are foreign investors able to compete with local companies? Why do they choose the particular country as a place of investment location? The attempts of the theoretical quest proliferated with various hypotheses.

With regard to the reasons for foreign direct investments, we can determine four groups of phenomena which in formulated hypotheses are regarded to be the factors accounting for the foreign investments. They are the following:[4]

1. Market failure,
2. Flawed market structures (monopolization),
3. Market imbalance,
4. Distortions imposed by the government.

[4] A. L. Calvert, *A Synthesis of Foreign Investment Theories and Theories of the Multinational Firm*, „Journal of International Business Studies",1981, no 1, p. 43-59.

The first two groups of factors present the approach represented in the efficiency and monopolistic trend. Localization factors, however, are gathered within two separate groups as market imbalance and distortions imposed by the government.

Market failure, is present in the occurrence of external effects and the existence of public goods. The expenses on research and development and other forms of acquiring knowledge are really high and due to flawed external knowledge market or its absence, it is difficult to make up for them with the proper income. The knowledge market is not ideal because of difficulties related to the assessment of the value of the company's knowledge and indicating its proper price. In many markets legal assurances protecting the company's knowledge (e.g. patents, royalties) are often insufficient and not followed up. The knowledge, however, is company specific and is a crucial factor of its competitive advantage. It encompasses the knowledge of technology, production, market, organization and management. [5] It leads to the exploitation of this production factor inside the company – to its internalization and accounts for using foreign direct investments for the expansion in the foreign markets as foreign direct investments let prevent or diminish knowledge infiltration by the competition. This way of thinking has produced modern theories aiming to explain the existence of Foreign direct investments. Among many of them, the theory of internalization requires the most attention.

At its basis lie the following assumptions: [6]

– companies maximize profit in the world of flawed markets,
– if markets for indirect products are flawed, there appears a stimulus to bypass all the creations of the internal markets; this in turn implies the incorporation to the common property and under common activity control, which were incorporated by markets,
– internalization of markets over the national borders produces transnational corporations.

Following this theory, the market is not the most effective form of execution of many transactions carried out by companies which is why in some cases it is more beneficial to execute internal transactions, within the same company, than external by means of the market.

The flawed market structure, the initial motivation of companies to invest abroad is the possibility of enjoying the benefits resulting from property

[5] E. Sitek, Determinanty bezpośrednich inwestycji zagranicznych przedsiębiorstw *[Determiners of Foreign Direct Investment by Companies],* Wydawnictwo Politechniki Częstochowskiej *[Częstochowa University of Technology Press],* Częstochowa 1997, p. 62.

[6] P. J. Buckley, M. Casson, *The Future of Multinational Enterprise*, MacMillan Press, London 1976, p. 33.

advantages, otherwise referred to as advantages related to non-classic production factors (technology, organization and management, marketing). The full use of these advantages is impossible without starting the activity abroad in form of direct investments. These advantages are the following:

- *technological advantages* – enabling the initiation of manufacturing of new products, products of better features, etc.
- *financial advantages* resulting from the possibility of using own capital resources and easier access to the sources of external financial supply,
- *advantages in the scope of management skills,* the opportunities of using solutions applied in parent companies,
- *marketing advantages,* resulting from the high value of know-how in the market sphere,
- *advantages connected with the opportunity of using cheaper production factors,* better IT network, broader support of managerial decisions.[7]

The administration of the above legally protected technical solutions, specific production experience and the knowledge and qualifications of employees (know-how) allows for manufacturing cheaper goods or superior to those offered by the local competition, and the access to the parent company resources (financial, technological, personnel, etc.) does not require additional investments. The knowledge and skills collected within the company has the property that it is not diminished by multiple using, and final cost of using technical solutions, primarily developed in the parent company is slight. [8]

The market imbalance, the common property of all the hypotheses, seeking the reasons for foreign direct investments in the market imbalance is the conclusion of the fading and short-term nature of foreign direct investments. In this approach, they are the power leading to the state of balance the markets where it has been upset. The activity of this power ceases when the balance is regained, i.e. when the rates of return between the countries equalize. The conditions of imbalance, which provide stimuli for investing abroad – following the above hypotheses are:

- differences in the average rate of return,
- differences in costs of labour,
- technology markets imbalance,

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[7] W. Karaszewski, *Przedsiębiorstwa z udziałem kapitału zagranicznego w Polsce w latach 1990-1999 (miejsce w gospodarce kraju, czynniki i perspektywy rozwojowe*) *[Companies with the Foreign Shareholding in Poland in the Years 1990-1999* (position in the national economy, development factors and prospects*],* Mikołaj Kopernik University Press 2001, p. 29.

[8] A. Calvet, *A Synthesis…*, op. cit, p. 49.

– overvaluation of the currency.

Distortions imposed by the government, the characteristic feature of the second group of hypotheses seeking the reasons for foreign direct investments is highlighting the role of governments of home and host countries in the provision of stimuli for investing abroad. Those distortions are any changes of conditions in which companies operate stemming from the economic policy of a government. In this group of hypotheses the main reasons for foreign direct investments are:

– tariff and non-tariff barriers to trade,
– taxes,
– pricing and profit regulations,
– antimonopoly laws,
– and any changes to institutional conditions in which companies operate.

Yet it seems that none of the existing theories explain in a comprehensive way the causes of the foreign expansion of companies. This problem is shown in most detail in ***the eclectic theory of international production*** **also called *OLI paradigm (ownership, location, internalization).*** [9]

Its author has integrated the theories of monopolistic benefits, internalization and production location. The name of the theory alludes to eclectics in order to explain that the intention was combination into one whole of various theories describing the functioning of direct foreign investments which can be inconsistent. J. H. Dunning has underscored three kinds of conditions, which should be simultaneously met for foreign direct investments to appear.[10] They are:

1. resulting from the ownership advantage of the investing company,
2. resulting from activity internalizations,
3. determining the geographic location of business activity.

It should be noted that all the theories pertinent to foreign direct investments, including J.H, Dunning's eclectic theory are criticized as they do not provide a full account of the phenomenon and so far there is not a single comprehensive theory accepted by all the researchers in the field.

As the matter of foreign direct investments is perceived differently, in international economic literature there are functioning numerous theories in which their authors have attempted to set out the most prominent factors determining this phenomenon. Thirty theories have been considered in which researchers try to pinpoint the motives which are followed by companies carrying out foreign direct investments.

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[9] The author of the eclectic paradigm is J.H. Dunning.

[10] E. Sitek, op. cit., p. 66.

Investment climate

Among Polish authors we may also find trials of finding the determinants of location of foreign direct investments. According to M. Gelder the location factors should be divided into: costs of production, with a detailed reflection of costs of labour, marketing factors, such as market size, its dynamics, stage of development and competition intensity, trade barriers – tariff and non-tariff barriers to trade and state policy treated as the aggregation of facilitating conditions, in which we include the stability of the political system, social relations, as well as the character and degree of economic development.[11] J. Rymarczyk, however, creates four groups of factors, following the theory of location. In the first group he lists institutional and political factors, making investment climate in the given country. To the second group, he includes cost factors, covering the access to production factors and their price. Market factors are the third group of determinants, deciding about undertaking foreign investments in the given country. The fourth group encompasses trade barriers. [12] Another division available in the relevant literature has been offered by K. Przybylska, who has split the factors deciding about the attractiveness of the foreign market for foreign investments into two major groups:[13]

1. determinants stemming from the motives of undertaking of foreign direct investments.
2. determinants stemming from the investment climate of the host country.

E. Oziewicz, however, has separated ten major motives of investing abroad, which she divided into three categories:[14]

1. **"cost" motives,** such as exploring dependable, cheap sources of raw materials, seeking cheap labour, deposit safety, which is diversification of the investment portfolio, safeguarding against the drop of currency exchange rates,
2. **"profit" motives:** exploring new sale markets, desire to omit barriers to trade, diversification of the level of development, being the cause

[11] M. Geldner, *Przyczynek do teorii zagranicznych inwestycji bezpośrednich*, „Monografie i opracowania" *[The Contribution to the Theory of Foreign Direct Investments, Monographies and Case Studies]*, SGPIS, Warszawa, 1986, no. 193, p. 76.

[12] J. Rymarczyk, *Internacjonalizacja przedsiębiorstwa[Internalization of a Company]*, PWE, Warszawa 1996, p. 40-42.

[13] K. Przybylska, *Determinanty bezpośrednich inwestycji zagranicznych w teorii ekonomii [Determinants of Foreign Direct Investments in the Theory of Economics]*, WAE in Cracow, "Scientific Journal" no. 144, Cracow 2001, p. 100.

[14] E. Oziewicz, *Zagraniczne inwestycje bezpośrednie w rozwoju gospodarczym Azji Południowo-Wschodniej (ASEAN)[Foreign Direct Investments in the Economic Development of South-East Asia]*, Wydawnictwo UG *[Gdańsk University Press],*Gdańsk 1998, p. 56.

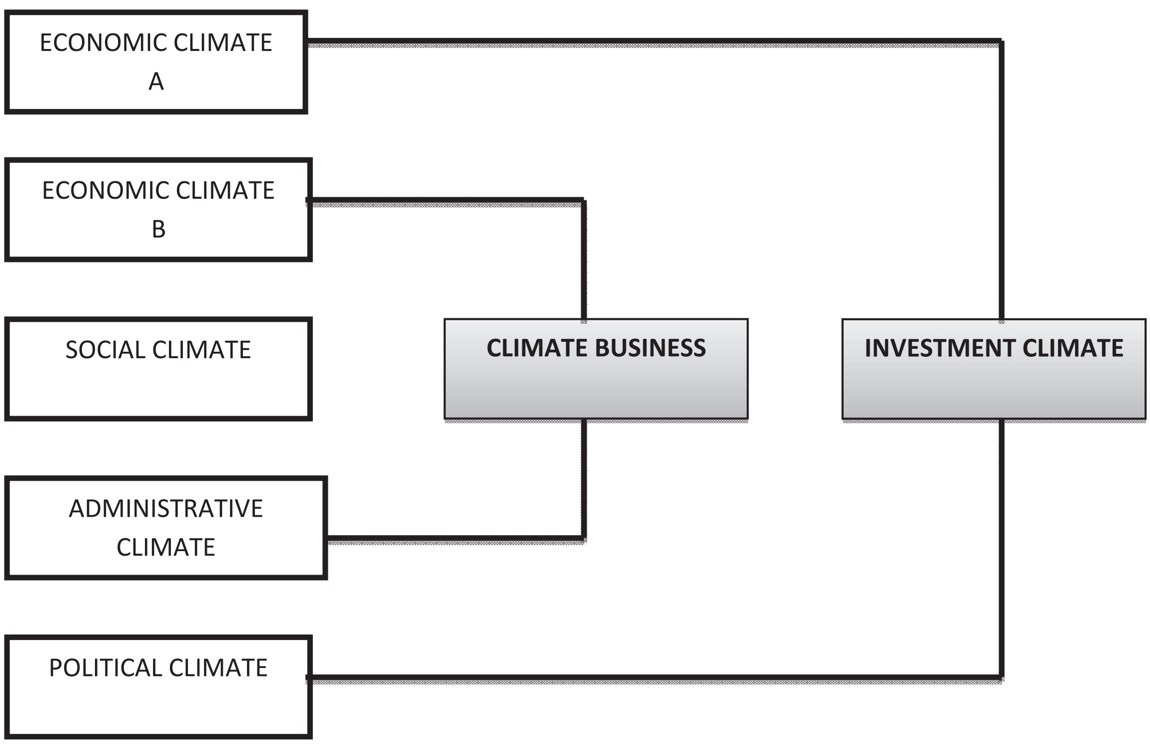
of differences in the profit rate levels, rise of the profit rate and profit mass,

3. **“mixed” motives:** the process of concentration and centralization, a control over a foreign company.

In the light of the above motives of starting up an activity by foreign investors outside the home country, it is also worth mentioning about the *investment climate.* It is an overall range of activities of the host country and the home country, encouraging potential investors to implement a direct investment. The investment climate has been analysed by many theorists and described by many experts. The most logical and detailed analysis has been presented by L. C. Nehrt.[15] He divided the investment climate into the following elements:

– economic climate A,
– economic climate B,
– social climate,
– administrative climate,
– political climate (Fig.1.).

Figure 1. **Investment climateaccording to Nehrt**



Source: own elaboration based on the L. C. Nehrt, *The Political Climate for Private Foreign Investment,* New York, Boston, Washington, 1970, s. 3.

[15] L. C. Nehrt, *The Political Climate for Private Foreign Investment*, New York, Boston, Washington, 1970, p.3.

Economic climate A defines the present and anticipated situation in the country potentially importing the capital. It determines only making up of a decision to invest capital.

Economic climate B characterizes the state of the infrastructure of the country and long-term changes, as well as influences the efficiency of attracting capital to the importing country.

Social climate is a situation present in the labour market, as well as all socio-economic conditioning determining work quality and safety. Labour factor mobility is also of a key importance.

Administrative climate understood as a range influence of governmental factors on economic life, which features the following elements:

– the status of a foreign company, range of activity,
– the procedure of setting up of a company, legal form of the enterprise,
– laws governing the profit transfer, finance and accountancy, taxes,
– management.

Finally, **political climate** is composed of:

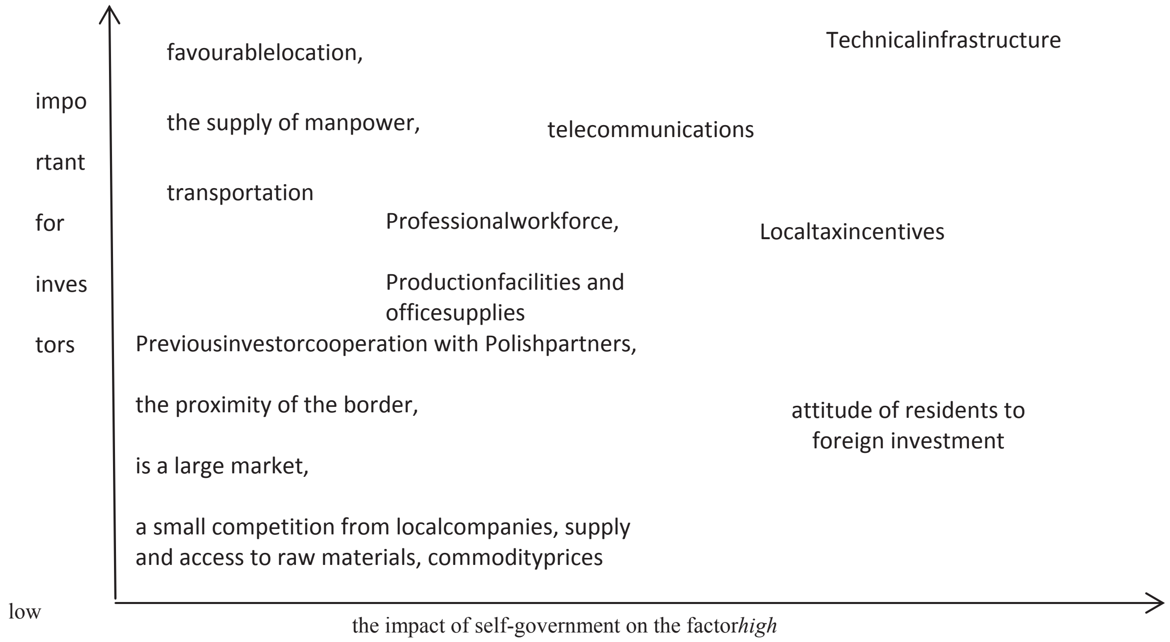
– political views of governing parties and government officials,
– vested interest and goals of the governing groups,
– agreements of mutual security of investments between countries,
– the importance of the private sector in economy, possibility of nationalization of companies, incentives granted to foreign investors.[16]

All the above-mentioned components of the investment climate are undoubtedly the factors being considered by foreign investors both at the moment of designing and implementing of investment, and in the process of business activity. The most beneficial situation for the investing companies is definitely when market, cost determinants or their combination is accompanied by the favorable investment climate.

With the summary of the review of theories from angle of the factors determining initiation of foreign direct investments discussed, we can note that in their decisions, entrepreneurs are guided by both external factors, appropriate for the given company, and external ones, comprising characteristic features for the domestic market and the foreign market (Fig. 2).

[16] A. Stępniak, *Integracja regionalna i transfer kapitału. Inwestycje bezpośrednie w aspekcie klimatu inwestycyjnego w Unii Europejskiej [Regional Integration and Transfer of Capital. Direct Investments within the Investment Climate in the European Union]*. Wydawnictwo Uniwersytetu Gdańskiego *[Gdańsk University Press]*, Gdańsk 1996, p. 83-84.

Figure 2. **Locational factors for FDI**



Source: own elaboration based on the data of PAIiIZ

Interesting information regarding the motives of undertaking foreign investments by entrepreneurs from EU member states is provided by surveys carried out by Stawicka[17] in the years 2005 and 2012. The survey was addressed to randomly selected companies operating in the territory of the European Union and having in its initial capital foreign shareholding, and the questions it contained regarded indicating by the entrepreneurs the stimuli, which influenced the execution of foreign direct investments in the given EU country, The synthetic conclusions of those surveys have been presented in the tabular summaries below.

[17] M. K. Stawicka, *Czynniki warunkujące wybór miejsca lokowania bezpośrednich inwestycji zagranicznych w UE – stadium komparastyczne lat 2005 i 2012[The Factors Conditioning the Choice of Place for the Location of Foreign Direct Investments in the EU – a Comparative Study of the years 2005 and 2012*] – http://zif.wzr.pl/pim/2013_1_2_23.pdf (as on 17.02.2014).

Tab. 1. **Internal and External stimuli which lead him to takeforeign investment in EU countries**

	Motives	***The importance of the stimulus***				***The importance of the stimulus***			
		Very important	***Important***	***Irrelevant***	***Unimportant***	***Very important***	***Important***	***Irrelevant***	***Unimportant***
		2005				***2012***			
Internalfactors	*The search for newmarkets*	***X***				***X***			
	Minimize the cost of production		***X***			***X***			
	Having advantages		***X***						***X***
	Profit maximisation	***X***					***X***		
	The effect of imitation		***X***					***X***	
	Gaining New experiences, skills, knowledge		***X***				***X***		
	The companystrategy				***X***				***X***
	To reduce the risk of				***X***		***X***		
	Access to unique materials			***X***				***X***	
	Lowcost for investment		***X***				***X***		
	Bypassing trade barriers			***X***				***X***	
	Economies of scale			***X***				***X***	
		2005				***2012***			

External factors	*The country's membership to the EU*			X			X		
	The country's membership of the Euro area			X			X		
	Offering Lower prices of manufacturing factors	X				X			
	Incentives/investment incentives	X					X		
	Large market	X				X			
	Political and economicstability			X		X			
	Increasedcompetition in the domestic market				X				X
	Adverseconditions for the sale of export products and licensing to companies				X				X
	Investment climate of the host country		X				X		
	The geographicallocation of the		X				X		
	Good infrastructure			X			X		
	The proximity of the existingoutlets		X					X	
	Protection of ownership of assets				X				X

Source: owne laboration based on: M.K. Stawicka, op. cit.

Conclusions

The above results of the surveys regarding the importance of motives, which the entrepreneurs were guided by while undertaking foreign investments in the EU countries, show that in vast majority foreign companies follow the will to *get a new sales market* for their products and *maximize their profit.* Furthermore, a key factor for the investors is a large and ready market, cheap production factors as well as investment incentives and reliefs. The majority of stimuli indicated as crucial in the survey of 2005 was again pointed at by respondents in 2012. It should noted that the external factor , known as *economic and political stability of the host country,* was in the first survey found as unimportant and in the second survey as vital. Undoubtedly such shift in importance of this stimulus was caused by the presence of the economic countries in many EU countries and the increased risk connected with operating in their territory.

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