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Host country marketing culture and foreign direct investment

Ilkay Yilmaz^{a*}, Mehmet Nasih Tag^b, Ceren Ozkan^b, Suleyman Degirmen^a^a*Department of Economics, Mersin University, Mersin 33342, Turkey*^b*Department of Business Administration, Mersin University, Mersin 33342, Turkey*

Abstract

This paper attempts to analyze the impact of host country competitive environment on the level of FDI that the host country receives. Specifically, we consider two features of the competitive environment: buyers' sophistication and firms' degree of customer orientation. Using a large set of panel data and controlling for economic causes along with sources of risk, we find that FDI stocks in a country decreases with the degree of buyer sophistication and increases with the degree of customer orientation of firms. These results suggest that target country competitive environment is an important factor that determines where FDI goes.

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1. Introduction

The aim of this paper is to investigate the importance of marketing in the determination of foreign direct investment (FDI). According to Word Bank [1], total FDI net inflows in the world was about 1.7 trillion dollars in 2011. The highest FDI receiving countries are China and the US, which received 280 and 257.5 trillion dollars of FDI in 2011 respectively. It is not surprising that one of the fastest growing economies of the world since the late 1970s, China, and the biggest economy in the world, the US, are on the top of the list. The size and the growth of the host country economy are certainly among the important determinants of FDI as many studies confirmed. The literature on FDI determinants counts various factors, other than the growth and the size of the host country economy, such as the growth and the size of the source country economy, the distance between the source and the

* Corresponding author. Tel.: +903243610001 (Ext. 5305); fax: +903243610056.

E-mail address: ilkay_y1240@yahoo.com

host countries, host country endowments of natural resources, the cultural proximity between both countries, institutional factors, political and economic risks of both countries, trade between both countries, etc. as possible determinants of FDI. To our knowledge specific marketing variables have never been investigated as possible determinants of FDI. In this study we analyze the effect of two marketing variables, namely degree of customer orientation and buyer sophistication, on FDI stocks.

The total FDI net inflows in the world has been steadily increasing throughout the 1990s since 1991, but it decreased in the periods between 2000 and 2003 and between 2007 and 2009. It went down from 1319 billion dollars in 2000 to 573 billion dollars in 2003, and then it sharply increased and reached to 2472 in 2007. It decreased two consecutive years after 2007 and became 1163 billion dollars in 2009 and then started to increase again, reaching to 1724 billion dollars in 2011 [1]. The volatility of FDI inflows in 2000s might be attributed to early 2000s recessions and the financial crisis of 2007-2008. Assuming that globalization will continue to increase capital mobility as well as the likelihood of global crises, we might expect both the increase of further FDI in the world and its higher volatility in the near future. This makes it further interesting and valuable to make use of the latest available data on FDI to test the current validity of traditional determinants and search for new explanatory variables as possible determinants of FDI.

Our analysis focuses on the effects of marketing variables of degree of customer orientation and buyer sophistication on the level of FDI in the country. The variable of degree of customer orientation measures the way companies treat their customers. A high value of this variable indicates that companies are highly responsive to customers and customer retention whereas a low value indicates that companies generally treat their customers badly. The other marketing variable, buyer sophistication, measures how customers make purchasing decisions. A high value of this variable indicates that customers' purchasing decisions are based on a sophisticated analysis of performance attributes whereas a low value indicates that customers' purchasing decisions are based solely on the lowest price. It is fairly reasonable to expect multinational enterprises (MNEs) to take into account these attitudes of incumbent companies and customers in the host country when they decide whether to invest in that country.

The paper is organized as follows. In the next section we present a literature review, which might help us to emphasize the economic and institutional factors whose effectiveness in the determination of FDI has been supported by earlier research. The third section illustrates the model specification and the estimation procedure. It also describes the data used. In the fourth section, results are presented and interpreted.

2. Literature Review

FDI theory suggests numerous factors that potentially impact FDI in a country. In addition there is evidence that many of these determinants are highly contextual. That is, what host country factor attracts FDI depends on the motives for FDI, industry specific characteristics, and the function being performed by the MNE subsidiary [2]. Host country determinants include a broad spectrum of government policies, business facilitation practices, and economic factors.

A quick review of some literature on FDI determinants might help us to see which factors as determinants of FDI have been supported by earlier empirical studies. Bevan and Estrin [3] aims to analyze empirically the determinants of inward FDI to the Central and Eastern European Countries by focusing on proximity, concentration advantages and factor costs. They use panel data on bilateral FDI flows from individual source to host countries between 1994 and 2000. Their explanatory variables are GDPs of both source and host countries, the distance between the two countries, trade variable (host country imports from EU as a percentage of the country's GDP), unit labor costs in the host country, interest rate differential between the source and the host countries, risk variable which captures institutional development and economic and political risk, and an announcement dummy variable which indicates whether the host country has EU prospect. Random effect estimates indicate that gravity factors, GDPs and the distance between the countries, as well as unit labor costs are significant determinants of FDI. The empirical results also show that EU announcements about potential accession have significant and positive effects on FDI flows to transition economies.

Busse and Hefeker [4] examine the impact of political risk and institutions on FDI inflows into 83 developing countries from 1984 to 2003. The results of their panel data analysis indicate that government stability, internal and external conflicts, law and order, ethnic tensions, bureaucratic quality and, to a lesser degree, corruption and

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