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Place, space, and foreign direct investment into peripheral cities

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ABSTRACT

Perspectives drawn from the economic geography literature are increasingly used to generate insights into locational issues in international business. In this paper, we seek to integrate these literatures further by investigating the locational determinants of foreign direct investment (FDI) into peripheral cities within an emerging economy. Peripheral cities in emerging economies are attracting a growing proportion of global FDI flows, but the international business literature lacks a framework for understanding subnational determinants of FDI, particularly into non-core locations. We draw on the core-periphery model to build and test theory on how spatial interdependencies between subnational locations impact on the distribution of FDI inflows into a large and heterogeneous country China. Our results show that whilst peripheral cities tend to have a negative effect on FDI, this effect is positively moderated by proximity to core cities. The results highlight the importance of considering interactions between place and space when investigating locational issues in international business.

1. Introduction

International business scholars have made concerted efforts to address the neglected role of location in the theory of the MNE (Dunning, 1988) by building on conceptions of location in the economic geography literature (e.g. Blanc-Brude, Cookson, Piesse, & Strange, 2014; Monaghan, Gunnigle, & Lavelle, 2013). One of the largest distinctions between the treatment of location in the international business and economic geography literature is the level of analysis at which firm behaviour and the locational determinants of foreign direct investment (FDI) are theorised and investigated (Beugelsdijk, McCann, & Mudambi, 2010). International business research has traditionally been conceptualised at a national level (i.e. considering between country differences). Economic geography, on the other hand, has traditionally investigated firm activity at a subnational level (i.e. considering within country differences). Beugelsdijk and Mudambi (2013) further point out that conceptions of location in economic geography are typically unpacked into place and space. Place encompasses location specific characteristics, whereas space refers to the relative spatial positioning of a particular place. In this study we draw on a further locational feature of the economic geography literature, the core-periphery pattern (Baldwin, Forslid, Martin, Ottaviano, & Robert-Nicoud, 2003; Krugman, 1991a, 1991b, 1998).

Krugman (1991a, 1991b) formalised a core-periphery model to explain how economic activities become concentrated in a small number of locations within countries. The model suggests that in order to generate scale economies whilst minimising transportation costs, firms tend to concentrate their activities in locations with high demand. Overtime, this results in the emergence of a core-periphery pattern, which in its simplest iteration results in a manufacturing core and an agricultural periphery. One of the most observable manifestations of the core-periphery pattern is the increased concentration of populations and economic activities in cities (Krugman, 1998). Cities play a significant role as economic hubs for domestic business activities, but recent research also shows that cities are key locations for MNEs (Blevins, Moschieri, Pinkham, & Ragazzino, 2016; Goerzen, Asmussen, & Nielsen, 2013). However, whilst cities can be regarded as core locations relative to agricultural locations, differences across cities can also be understood from a core-periphery perspective (Mans, 2014). For example, capital cities typically differ in character, size and economic power from other cities within the same country (Glaeser, Kolko, & Saiz, 2001). This is further accentuated for 'global cities' which offer global connectivity and an appreciation of foreignness and foreign firms (Blevins et al., 2016). The rapid pace of urbanisation is creating new opportunities for FDI within countries (McCann & Mudambi, 2005) and, as a consequence, small- and medium-sized cities that are not yet

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“global” are increasingly seen as important engines of national economic growth. Indeed, non-core urban locations or, “peripheral cities” (Mans, 2014), particularly those in emerging and developing economies, are attracting a growing proportion of global FDI flows (MGI, 2011). The key implication of these trends is that now, more than ever before, “*the periphery matters*” (Mans, 2014;).

We incorporate the place-space and core-periphery distinctions to build and test theory on the subnational locational determinants of FDI in an attempt to clarify the determinants of FDI into peripheral cities. While research at the sub-national level is growing, Nielsen, Asmussen, and Weatherall (2017) highlight that conflicting findings on the determinants are common. FDI plays a critical role in bringing desirable technology, capital, and employment to peripheral cities (Coe, Dicken, & Hess, 2008; Florida, Mellander, & Qianô, 2012; Tuan & Ng, 2003) but, it is not clear what determines FDI into these locations (McCann & Mudambi, 2005). Rapid economic growth, coupled with lower costs of production (relative to more established alternatives) are key location advantages for peripheral city locations (Mudambi & Santangelo, 2016; MGI, 2011). Despite this, existing research suggests that peripheral cities are “unfavourable” locations (Tsui-Auch & Möllering, 2009) that increase foreign investment uncertainty (Goerzen et al., 2013; He, 2006; Mariotti & Piscitello, 1995) and negatively affect firm performance (Hsu, Chen, & Caskey, 2017; Li & Sun, 2017). Indeed, peripheral cities generally attract less FDI than core cities within the same country (Qiu, 2005). Therefore, the trend toward increasing FDI in peripheral cities raises important and interesting questions concerning the determinants of FDI into seemingly unfavourable subnational locations. Furthermore, given the relative neglect of subnational locations in the international business literature (Beugelsdijk et al., 2010; Dunning, 2008; Nielsen et al., 2017), this is an important question for FDI theory more generally. Indeed, McCann and Mudambi (2005: 1862) note that “within individual countries, identifying the conditions under which MNEs will locate in large or small urban cities, in central or peripheral locations [...] is now regarded as essential.”

Existing research shows that FDI at a subnational level is spatially dependent (Blanc-Brude et al., 2014). In other words, the volume of FDI received by a location is dependent on its proximity to other locations. However, it remains unclear how these ‘space’ effects interact with location specific ‘place’ effects. We offer an important extension to existing theory on the locational determinants of FDI by building and testing theory on how ‘place’ effects in peripheral locations interact with geographic distance, or ‘space’, effects in determining the pattern and determinants of FDI within countries. Our study attempts to apply theory to operationalise geographic and core-periphery distances between cities, particularly with respect to the consideration of FDI into peripheral city locations. Our central contention is that distances between core and peripheral locations play an important role in affecting FDI into the periphery. Specifically, we suggest that cities that are geographically remote are less attractive to foreign investors all else remaining equal.

Whilst the focus of this research is on FDI into peripheral locations, our study offers important contributions to understanding the locational determinants of FDI more generally. We affirm existing research that demonstrates the importance of considering both place and space when investigating the determinants of FDI (Blanc-Brude et al., 2014). However, our core contribution is in showing how space and core-periphery dynamics interact to affect the location choices of foreign investors. In doing so we offer a framework for investigating the subnational locational determinants of FDI. We find that geographic proximity to other cities generally impacts positively on FDI, but this is conditioned on the type of city. Specifically, our results suggest that geographic proximity to other cities generally has no significant impact on FDI into peripheral cities. Instead, we find support for the role of core-periphery space as a determinant of FDI into peripheral cities. We find a positive and statistically significant effect for core-periphery space on FDI into peripheral cities at both regional and national levels.

Overall these results suggest that MNEs consider investing in a peripheral city only if and when this city enjoys geographical proximity to a core city.

We follow other subnational studies and have selected China as our empirical context (Nielsen et al., 2017). China is a good testbed for analyzing subnational investment strategies because it is currently pursuing aggressive urbanisation policies (Lin, 2014) and attracting FDI to lagging regions and cities is an integral component of China’s economic planning (Fetscherin, Voss, & Gugler, 2011; Qiu, 2005) which over the years has tried to stimulate investments in particular geographical regions. We differentiate between national core, regional core, and peripheral cities in China using the Chinese government’s administrative hierarchy (He, 2006). Our results clearly show the importance of core-periphery proximity for attracting FDI into peripheral cities. Beyond its theoretical implications, this finding has significant implications for the effectiveness of regional catch-up policies in China (e.g., ‘Go West’), Europe (e.g., European Regional Development), and elsewhere.

2. Theory and hypotheses development

2.1. Subnational locations and foreign direct investment

The FDI location decision is regarded as one of the most important strategic decisions in international business (Aharoni, 1966; Buckley & Casson, 1976; Dunning, 2008). Consequently, there is a large body of literature on the locational determinants of FDI (for reviews see Blonigen, 2005; Kim & Aguilera, 2016; Nielsen et al., 2017). The core thrust behind much of this literature is that FDI is attracted to those locations that are endowed with “location advantages”, such as well-developed markets, industrial density and valuable resources (Dunning, 1988; Verbeke, 2009). However, the IB literature has traditionally focused on FDI location choice at the host country (or national) level (Buckley, Devinney, & Louviere, 2007; Enright, 2009; Galan et al., 2007; Jiang, Holburn, & Beamish, 2016; Magnani, Zucchella, & Floriani, 2018; Rasciute & Downward, 2017). Yeung (2009) regarded this “methodological nationalism” as a key limitation to the advancement of scholarship on the MNE. Indeed, a subnational level of analysis offers a significantly closer approximation of the realities of spatial decision-making within MNEs (Beugelsdijk & Mudambi, 2013; Iammarino & McCann, 2013) and, therefore, arguably represents a better basis for theorising.

A significant body of literature on the relationship between MNEs and locations has treated the concepts of location and country as interchangeable, without discussion of contextual nuances and differentiating factors within and across locations (Beugelsdijk et al., 2010). Indeed, a key aspect of Porter’s (1990, 1994, 1998) influential work on the contingencies between firm strategy and location is the notion that the relevant economic area for a firm is much more localised, and smaller, than the nation (Porter, 1994). The key issue here is that when location choice is analysed at the level of the country, subnational diversity and contextual nuances of the specific locality are aggregated and lost (Chan, Makino, & Isobe, 2010). This is a significant oversight, especially in the context of widely heterogeneous countries such as the large emerging markets (Meyer & Nguyen, 2005; Tan & Meyer, 2011) and developed economies that exhibit a distinctive economic concentration in a city or region (Dimitratos, Liouka, & Young, 2009; Mudambi & Santangelo, 2016). In essence, between country location choice studies implicitly assume that locational features conditioned at the level of the country are reflected homogeneously across all subnational regions. However, not only is this an unrealistic assumption for any country but city states (Chan et al., 2010; Mataloni, 2011), it also offers only a stylised and highly unspecific account of the spatial decision making of MNEs in practice (Sethi, Judge, & Sun, 2011). For example, a particular business function is not located at a country level; rather, it is geographically positioned *within* a country and within

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