FDI Motivations and their Impacts in Former Soviet Republics

Shorena Kurdadze, Caucasus International University, Georgia

The European Business & Management Conference 2016
Official Conference Proceedings

Abstract
Foreign Direct Investments (FDI) in developed and developing countries have particular significance, because of the expected positive impacts they may have on receiving countries - growth enhancing effects caused by the new available resources such as capital, technology and skills that FDI are supposed to bring into the host countries. In particular, studies focused on developing countries point to the need of reaching a threshold level of absorptive capacity to grasp FDI benefits. Indeed, Multinational Enterprises own superior technological and managerial capabilities that may spill over affecting the production function of local firms[1]. The goal of this article is to analyze the growth impact of FDI taking into account different types of FDI and their suitability under different host-economy conditions in Former Soviet Republics (FSR) and Georgia. Eight years ago, a survey conducted about „The Motives and Impediments to FDI in the CIS“[2] in a group of four FSR countries (Ukraine, Moldova, Georgia and Kyrgyzstan) based on a survey of 120 enterprises. The same kind of survey conducted by author of this article in 2016 in Georgia based on survey of 45 enterprises (18 of them are from top 50 investors in last five years operating in Georgia). The results indicate that non-oil multi-national enterprises (MNEs) are predominantly oriented at serving local markets. Most MNEs in the FSR operate as 'isolated players', maintaining strong links to their parent companies, while minimally cooperating with local FSR firms. The surveyed firms secure the majority of supplies from international sources. For this reason, the possibility for spillovers arising from cooperation with foreign-owned firms in the FSR is rather low at this time.

Keywords: Investment Motivations in FSR

iafor
The International Academic Forum
www.iafor.org

[1] Sikharulidze D (2012). MOTIVATIONS FOR FOREIGN DIRECT INVESTMENT AND THEIR IMPACT ON GEORGIA'S ECONOMY. Economics and business 61-78
[2] Kudina, A., & Jakubiak, M. (2008). The Motives and Impediments to FDI in the CIS.

The present work is based on research (K.A; J.M; 2008) in the two countries Moldova and Ukraine attest (60 respondents) and the author's own research in 2016 in Georgia (45 respondents). The main objective was to define investment motives by asking interviewees to answer several questions: about the strategic role of the subsidiary established in the host FSR country, about their investment motives, and about the share of exported production. The 2008 year sample consisted of 30 foreign-owned companies in Ukraine, 30 foreign-owned firms in Moldova, 30 foreign-owned companies in Georgia, 29 in Kyrgyzstan and 1 in Kazakhstan. We use 2008 survey results of Ukraine and Moldova (60 firms) and own survey of Georgia (45 firms). We also compared the 2008 survey data to 2016 survey data of Georgia.

Investment Motivations

Investment motives are often classified either as market-seeking (when investing firm wants to supply products and services to a recipient country market) or as resource-seeking (intending to benefit from cost-efficient production in a recipient country) and/or as efficiency-seeking (looking for labour-productivity advantage or local specific creative assets).

Market seeking

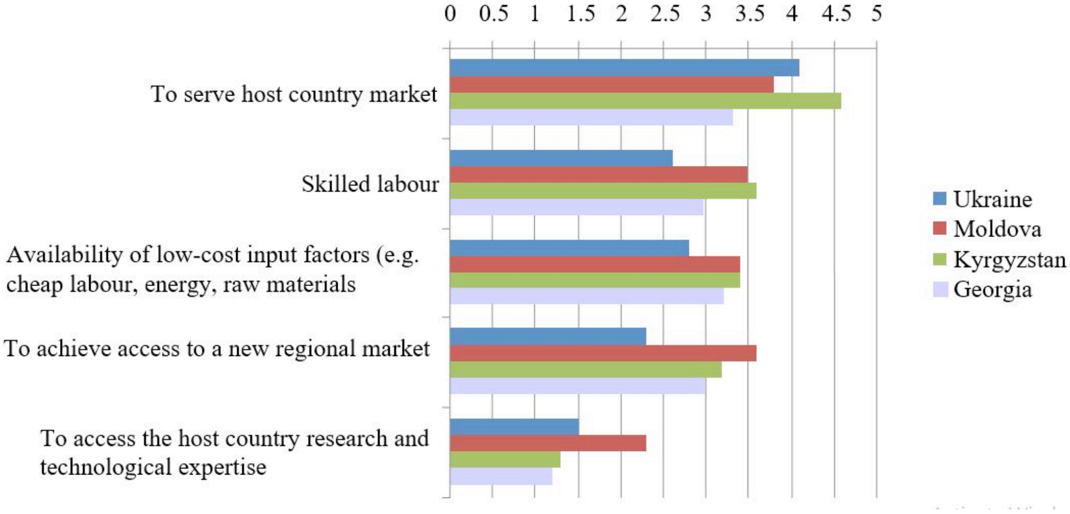
This motive is the dominant one in the sample. Most of the companies that participated in the survey held a substantial share of the recipient country's market. Companies that participated in the survey (2007-2008), had mastered a significant part of the recipient country's market[3]. The average domestic market share for Ukrainian firms was close to 30%, while Moldovan investors held leading positions with average market share of about 47%. Only in Georgia did foreign investors estimate that they possesed less than 20% of the local market share. This means that the majority of the surveyed firms not only managed to supply their host markets, but also secure dominant positions in these markets. The percentage of local production of final and intermediate goods that is exported was rather low at 17% and 30% on average, with the exception of Moldova[4]. About 70% of all production of final goods is earmarked for local markets. Some companies even mentioned that they faced a lot of problems when trying to export their products to other countries, particularly to Russia. The role of the CIS affiliates in the operations of their parent companies as suppliers of existing products to the host country market and to other CIS markets was found to be rather important (see Figure 3). The companies noted high levels of demand in the growing markets, which is very positive for the further expansion of their businesses.

This outcome is supported by the assessment of investment motives. The interviewees were asked to grade reasons for initiating business activity in the CIS by ranking each of the options on a scale of 1 (unimportant) to 5 (very important). Most companies mentioned the ability 'to serve the host country market' as the most important motive in all four economies (see Figure 1). On the top of this, companies in Moldova and Kyrgyzstan mentioned the ability to avoid import duties while supplying the domestic

[3] Kudina, A., & Jakubiak, M. (2008). The Motives and Impediments to FDI in the CIS. 18-21; 28-35
[4] Where the majority of both intermediate and final goods are exported.

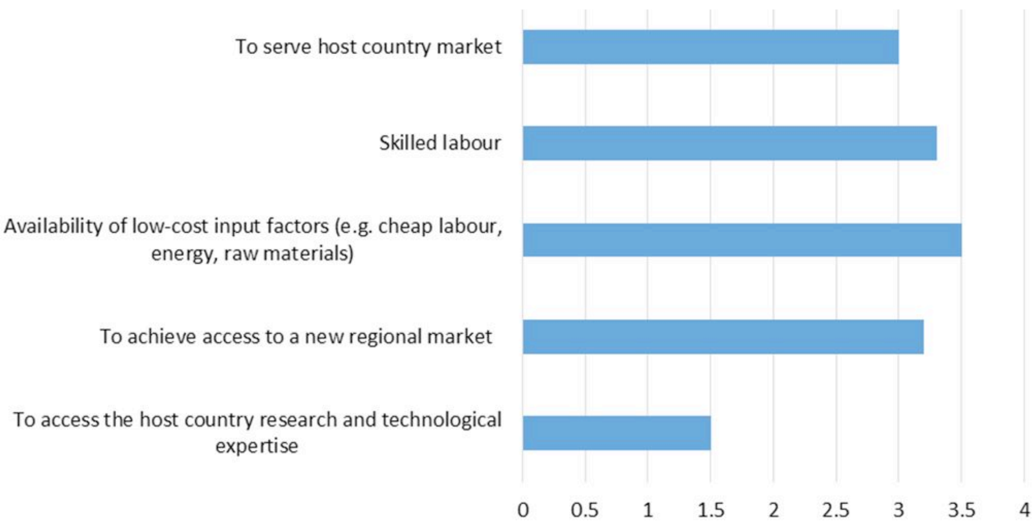
market as another reason to invest. The same result was in Georgia, author's survey in 2016 (figure 2).

Figure 1. Reasons to invest in the CIS



Source: Kudina, A., & Jakubiak, M. (2008). The Motives and Impediments to FDI in the CIS.
Note: higher number indicates that a given reason is more important. Numbers are simple averages.

Figure 2. Reasons to invest in Georgia



Source: Authors research in 2016
Note: higher number indicates that a given reason is more important. Numbers are simple averages.

Resource-seeking

The second and third most important investment motives varied across the countries, although they were predominantly concentrated on the use of low-cost factors of production and skilled labour. In Ukraine and in Georgia, the second most important motive was the availability of low-cost input factors, i.e. cheap labour, energy and raw materials. This is explained by the availability of rich natural resources along with cheap labour force and by the close proximity to the EU in the case of Ukraine. In the case of Georgia it is probably explained by high investments in pipeline transportation. Interestingly, the second most important motive for investing in Moldova was the ability to access the new regional market (Central and Eastern European)[5], which can be attributed to the country's proximity to the 'new' EU states. This motive can be also attributed to the willingness to exploit Moldovan labour and other resources (graded as the third most important motive). The possibility to access regional markets was also found to be an important factor for investors in Georgia (meaning access to whole Southern Caucasus).

Efficiency-seeking

Access to a country's research and technological expertise was found to be the least important reason to invest in the FSR (see Figure 1 and Figure 2), which suggests that investors do not yet seek efficiency in the FSR. This was confirmed by the answer that the exploitation of the cost-effective production in the FSR for the purpose of exporting products to the EU was not important for the strategy of the parent companies. Moreover, the surveyed firms export rather small volumes of intermediate goods (17% of the production of firms producing intermediate goods is exported, on average), which means that they are weakly integrated into vertical production chains.[6] The survey results indicated that market-seeking is the predominant motive for investing in the four analyzed countries. The second most important motive is for seeking resources.

Finally, based on the survey results we can say that investors in FSR are focused market, another important motive is resource seeking and efficiency-oriented FDI is weakest motivation.

Conclusion

In this paper, we explored the problems which foreign investors encounter in FSR's. Furthermore, we analyzed how different investors' profiles (market-, resource- and efficiency-seeking) affected the problems they are encountering in their countries of operation, and the particularities of their modes of operation. Analysis showed that market-seeking was a dominant motive for investors in our sample. The companies hold substantial shares of recipient country markets, and only export a small portion of their products. The growing FSR markets produce high demand, which foreign investors aim to capture in expanding their business to this region. This motivation is

---

[5] Collins, S., Rodrick, D. (1991), Eastern Europe and the Soviet Union in the World Economy. Institute for International Economics, Washington, D.C., 1991. - K.A and J.M

[6] With the exception of the Moldovan companies. Foreign subsidiaries producing intermediate goods in Moldova export over 50% of their production. Kudina A, Jakubiak M (2008)

similar to the motivation foreign investors in the Central Europe countries had in the early 1990s.

It had the most positive effect on investment performance, followed by skilled labour- and cheap input orientations. Hence, serving the local market was the most beneficial strategy for investors. The second and third most important investment motives varied across the countries, though they were predominantly focused on the use of low-cost factors of production (including natural resources) and skilled labour.

Econometric analysis in survey made by Kudina A. Jakubiak M. showed that the ambiguity of the legal system and problems in establishing clear property rights were the biggest concerns for investors seeking cheap factors of production in the FSR, whereas the uncertainty of the economic environment was most harmful for investors seeking skilled labour. The latter problem was also the most significant for investors who are trying to tap in into local R&D. Thus improving macroeconomic stability should be of primary importance to governments that wish to attract skilled labour- and R&D-seeking FDI, which are the two types of investors that bring the greatest benefits to the development of the host country.

It should be noted that the following impediments so that they do not override the potential profits from using cheap CIS labour: the political instability in Georgia, and the extensive bureaucracy, corruption and uncertainties connected to domestic legislation in Moldova and Ukraine.

The results suggest rather pessimistic implications for the influence of technological spillovers on the productivity of domestic firms. In studies examining CEE data, it was apparent that the highest productivity-increasing gain for local firms took place when foreign-owned and technologically superior firms bought local supplies, taught suppliers and made them acquire new technologies. Only in this case do positive technological spillovers take place. However, in the case of our sample, it seemed that potential spillovers from FDI are rather limited to certain firms and/or sectors of economic activity.

Based on 2009-2015 statistical data of top 50 investors in Georgia, Investment were entering annually, mainly to the existing companies. This situation improved in 2015. According to the survey results of 18 companies (from top 50 investors in Georgia in last 5 years), the investment environment has been improved compared to the mentioned post-Soviet countries in terms of ease of business registration and bureaucratic processes.

Finally it can be said that the post-Soviet countries, politicians and economists have to work to improve the political and economic environment, which provides a positive outlook for foreign investors to invest in this countries. Efficiency-seeking FDI is crucial for the country's attraction and it include an investment in Research & Development, but with the high level of corruption, investing in post-Soviet countries is becoming quite unattractive.

Acknowledgement

This project was implemented by support of Rustaveli National Science Foundation (Grant_#RNSF/DO387/2-230-14)

References

Sikharulidze D (2012). MOTIVATIONS FOR FOREIGN DIRECT INVESTMENT AND THEIR IMPACT ON GEORGIA'S ECONOMY. Economics and business 61-78.
UNCTAD reports 2008-2016
www.geostat.ge

Kudina, A., & Jakubiak, M. (2008). The Motives and Impediments to FDI in the CIS.
Dunning, J.H. (1993), Multinational enterprises and the global economy. Workingham: Addison-Wesley.

Altomonte, C. and E. Pennings (2006). Searching for Horizontal Spillovers Through Incremental Foreign Direct Investment. Tinbergen Institute Discussion Paper 05-101.

Globerman, S., Shapiro, D. and Tang, Y. (2004), *Governance and Foreign Direct Investment in Emerging and Transition European Countries.* Working Paper – Western Washington University (2004)

Collins, S., Rodrick, D. (1991), Eastern Europe and the Soviet Union in the World Economy. Institute for International Economics, Washington, D.C., 1991.

Contactemail:Sh.kurdadze@yahoo.com