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MASTER'S THESIS

**THE ROLE OF FOREIGN INVESTMENT PROMOTION AGENCIES
AND THEIR IMPACT ON FOREIGN DIRECT INVESTMENT IN
SOUTHEAST EUROPE**

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INTRODUCTION

During the last 20 years, extensively more positive benefits of globalisation were produced in the global economies. Increased movement of people, goods, services and capital helped many developing countries achieve a sustained economic growth (Harding & Javorick, 2012). Numerous studies claimed that foreign direct investment (hereinafter: FDI) played a crucial role in the global economic growth. One of the key reasons for this was the movement of technologies and skills which directly influence productivity between developed and developing economies (Harding & Javorick, 2012). Foreign direct investment is an economic activity that has marked and increases over the last decades resulting in being an important and high on the agenda topic across the world. Often portrayed as a source of development and economic growth this has led to an ever-growing research about the determinants of FDI.

Through the past 20 years, researchers were increasingly focusing on identifying the level of influence of the quality of country's institutions on the inflow of FDI. The foundation for this research was based on the estimations that better quality and functioning of institutions, especially of investment promotion has a positive impact on both domestic investment, as well as FDI. Most researchers argued that the overall framework of investment institutions in both home and host economies have a significant influence on FDI. FDI promotion activities in Southeast Europe (hereinafter: SEE) countries are defined in their government FDI policies, which present a comprehensive and mandatory set of laws, institutions and activities. They present the key to define potential to attract FDI to developing economies.

According to my findings, the research of influence of Investment Promotion Agencies (hereinafter: IPA's) on FDI in transition economies, particularly South East Europe is rather limited. Literature on investment promotion and its influence on FDI is quite limited. The majority of the available literature defines investment promotion being an activity which is relatively cost effective way to attract FDI. This is especially relevant for developing countries (Harding & Javorcik 2011). When it comes to developed economies, the majority of the studies often produced unclear results. Studies conducted by Bobonis and Shatz (2007) and Charlton and Davis (2006) produce results which show increased inflows of FDI, especially in developed economies has a close link with investment promotion. Contrary, studies by Head, Ries and Swenson (1999) and Harding and Javorcik (2011) did not identify an important relation between investment promotion and FDI inflows in developed economies. This is a clear mix of results when it comes to developed economies. Harding and Javorcik (2012) claim that in addition to the mostly often evident benefits of FDI, as well as increasing importance and sympathies towards Investment Promotion Agencies (hereinafter: IPA's), the research and evidence about their effectiveness is rather limited and unknown, especially in South Eastern European economies. The overall lack of the available indicators and sources produces a gap in

defining the individual improvements for investment promotion. This is related to things such as activities of IPA's outside of their home country or targeting specific investors and sectors from a specific destination.

These specific improvement suggestions do not consider variations of quality of services provided by IPA's. There is a significant difference of individual IPA's and the services they provide to potential investors, such as information and benefits of investing in their home country. The work of IPA's has attracted the interest of researchers for the following particular reasons:

- FDI has become a focus of interests of governments since it proved to be amongst the key drivers of economic development, primarily in transitional countries.
- Governments are dedicating taxpayers money for the work of IPA's and need to take accountability for their work and prove their impact on FDI.
- Solid sources of inputs and measurability.

As for the last bullet-point above, some of the key sources in this general research for this topic is the World Bank's Foreign Investment Advisory Services and the Global Investment Promotion Best Practices which assess how much the quality of IPA work affect FDI. According to Harding and Javorick (2012), the differences between the quality of services that IPA's provide directly affect the levels of FDI inflow.

My attention through the proposed thesis is to identify the specific role of IPA's of SEE countries to attract FDI and measure their success by looking into their overall performance quality in terms of FDI attracted. Even though many factors contributing to the success of IPA's are hardly tangible, residing in their skills, history, experiences, personalities and insights of staff (Rugman & Verbeke, 2001).

The main research question of this study should provide an answer to the following:

Does the quality of investment promotion activities provided by IPA's of SEE countries positively contribute to FDI inflows?

The following hypothesis will be tested:

H1: The quality of investment promotion activities provided by IPA's of SEE countries Investment promotion agencies of SEE countries has positive and significant impact on FDI inflows.

By addressing a cross-institutional evaluation of IPA's of individual SEE countries, significant differences are arising as a result of the efforts to answer the before mentioned question. It is important to mention that empirical research conducted so far indicate that the work of IPA's positively contributes to attracting FDI to transitional economies.

However, according to my findings, none of the countries of Southeast Europe have been included in the empirical research.

The research of the relation between IPA's and its impact on attracting FDI in this masters thesis will be based on a sample of South-east European countries. The analysis will be based on an extended gravity model. During the research phase, section data provided by Vienna Institute for International Economics (hereinafter: WIIW) between countries receiving and providing FDI will be used. The dependant variable in this research represents annual level of bilateral FDI between host and providing country. Each observation will be designed as an average of bilateral data between SEE region countries as receiving countries of FDI and their biggest partners that invested in individual SEE countries between 2009 and 2011.

The independent variable of interest in this research will be the quality of FDI policy and services provided by IPA. This variable will be measured by a series of indicators about improvement progress in SEE countries, publicised in the Investment Reform Index (IRI) by OECD. Considering the fact that IRI adopted the comparative framework based on the experiences of OECD and that it includes both quantitative and qualitative data from different relevant sources, I believe that the before mentioned indicators present a clear picture of reforms for improvement of investment climate in SEE countries, including the quality of FDI policy and services provided by IPA, better than any other available indicators.

The use of these indicators brings additional value to this analyse. In addition to the independent variables related to IPA's, the econometric model will include variables used in gravity model, such as GDP of individual host and home countries, geographical distance and labour costs or wage levels.

This thesis has the following structure. First chapter will provide a topic-specific literature overview, followed by the definition and explanation of the concept of FDI in Section 1.1. Forms and types of FDI will be described in section 1.2. The flow and trends of FDI will be presented in section 1.3. and FDI policies in Section 1.4. Section 1.5. provides an insight into the role of institutions and why they are important for investment promotion, and section 1.6. will introduce investment promotion and the role of IPA's. Section 1.7. presents the conceptual framework of this research, which will cover the institutional theory and OLI paradigm under Section 1.8.

The second chapter provides an overview of investment promotion activities in South East Europe. The third chapter refers to the review of the empirical studies about the relationship of investment promotion agencies and FDI. The fourth chapter covers the results of the empirical analysis of the role of investment promotion agencies and their impact on FDI in South East Europe. This chapter is divided into two sections. Chapter 4 is

covering data sources and methodology of this investigation, including descriptions of dependent, independent and control variables and provides a theoretical foundation of the extended gravity model used in this thesis to examine the role of IPA's and their role on FDI in South East Europe. The last section explains the results of this research.

The chapter that covers the conclusion provides a summary of the results. This chapter also provides the contribution to this topic, highlighting the limitations to the investigation, as well as provides recommendations for further research.

1 LITERATURE REVIEW

Multinational companies (MNE's) base their decision on locating their existing or opening a new production facility or office in another country on several factors. Their decisions are actually based on a combination of economic, policy, infrastructure, and so called soft factor inputs. The number of countries around the world that compete heavily to attract foreign direct investment is increasing. The countries, regions, even cities and municipalities do not compete only with their first neighbours, but they compete with global competitors.

The prosperity and competitiveness of countries and regions such as Southeast Europe depends heavily on investment from abroad. The number of global MNE's has increased drastically since 1990's from 18.000 to more than 80.000 with operations more than 10 times spread through the world (UNCTAD, 2001). Furthermore, the FDI growth has overtaken the world exports and the world GDP since the 1980's (UNCTAD, 2012).

Governments as policy makers as well as theorists strongly believe that FDI produces a positive effect on economic development, especially due to flow of capital, job creation, transfers of technologies and know-how share on a global and international platform. According to Harding and Javorcik (2007), FDI contributes significantly to positive productivity of companies. This is especially visible in the supply chain industry.

1.1 Foreign Direct Investment (FDI)

According to UNCTAD World Investment Report (2007), FDI has been defined as an investment that includes a long-term relationship with a lasting interest and control by a resident entity in one economy in company which is resident in another country. In addition to the direct benefits for FDI host countries such as new employment and source of external finance and capital, FDI shows more and more importance related to national and regional competitiveness. According to International Monetary Fund (IMF) Balance of Payments Manual, FDI presents an investment made to acquire a lasting interest in an foreign economy.

According to Filipov and Guimon (2014), FDI is an important contributor for competitiveness on foreign markets. Jaruzelski and Dehoff (2008) claim that MNE's are progressively fragmenting across regions, not only the standard functions such as production or sales, but also lately growing innovative activities such as research and development (R&D). Effective intervention of governments is closely linked to the success of attracting quality FDI whose benefits for the domestic economy are positive (Rasiah, 2000).

Velde (2001) emphasises that pro-active and strategically oriented FDI policies and their implementations affect the dynamic pattern of an economies' competitive advantages. They are necessary in order to avoid the risk of a low skill and low income trap. A special-attention worth and recently introduced trend in FDI is the shifting of focus from quantity to quality of FDI.

Attracting high-quality FDI has been a trend in the recent years since 2008 onwards, particularly in the developed economies. This is closely related to the ever growing importance of innovation in business, equally within developed, but also developing economies. Innovation has in recent years been seen as the main driver of economic productivity, regional competitiveness and a sustainable and long term economic growth (Verspagen, 2005; Fagerberg, 1994).

1.2 Types and Forms of FDI

FDI usually appears in different forms and for different purposes. Generally, it is divided in literature under 3 key categories such as form, strategy and objectives (UNCTAD, 2005). There are three main types of FDI:

- Horizontal FDI, which presents a production activity of the company with no difference depending on the foreign or domestic location of the production (or activity in home and host country), primarily due to reasons of keeping the same company strength on corporate level on all markets where the company is active.
- Vertical FDI, presenting FDI dispersion within a multinational company based on cost-efficiency or access to less-costly resources on different geographical locations.
- Conglomerate FDI, where FDI is being implemented in order to produce products which are not being produced in other subsidiaries of the multinational company.

Companies that decide to invest in foreign markets have many options to conduct their activities and implement the FDI. These options mainly differentiate in the following forms of FDI:

- Greenfield investment, which presents a form of investment when a company builds an entirely new production facility in a foreign market.

- Brownfield investment, which presents the acquisition or renting of an existing production facility.
- Cross-border mergers, reflects an FDI activity of merging existing production facilities on different geographical areas, most often due to cost-saving or efficiency reasons.
- Joint ventures, are a widely-used and regular form of FDI, conducted between different multinational companies with a goal to respond to different market-specific requests, increase efficiency, acquire new knowledge, skills and information.

In this sense of FDI forms, cross-border mergers and acquisitions are spread mostly in practice. Evaluating further on cross-border mergers, they present a scenario when two or more companies registered in different markets engage in business relations by combining their assets and operations – merge or transfer their assets to a foreign market directly to a connected company by gaining ownership of it, which presents an acquisition. On the other hand, some authors like Kim (2009) state that greenfield investments are more favourable for FDI recipient countries than mergers and acquisitions.

Loewendahl (2001) states that most investment promotion agencies focus on attracting greenfield FDI. Countries around the world compete extensively to attract and receive greenfield FDI. This is particular due to the fact that greenfield FDI is believed and proved to contribute positively to a faster economic growth through injecting fresh capital into recipient country, create new jobs, and, equally important, transfer of know-how and new technologies.

A research by Harding and Javorcik (2011) shows that greenfield FDI contributes positively to the productivity of local companies as part of supply-chain industries in particular. According to Kokkinou and Psycharis (2005), the key benefits of any type and form of FDI include the following:

- Additional capital and other financial resources for the receiving country.
- Very useful transfer of know-how.
- Advanced workers skills and techniques (i.e. management, organisation, etc.).
- Positive impact on the productivity through introduction of new technologies.
- Directly or indirectly provide access for domestic companies to new export markets through supply-chain or customer management.

Particularly important is the fact that FDI is closely linked to a long-term perspective. This is particular due to the fact that short-term investments present a high turnover on securities. The particular long-term relationship reflects the continuous interest and control by a resident company in a foreign market (economy). If the financial asset is transferred from the parent company to a foreign-based company, it contributes to increase the production base of the host country.

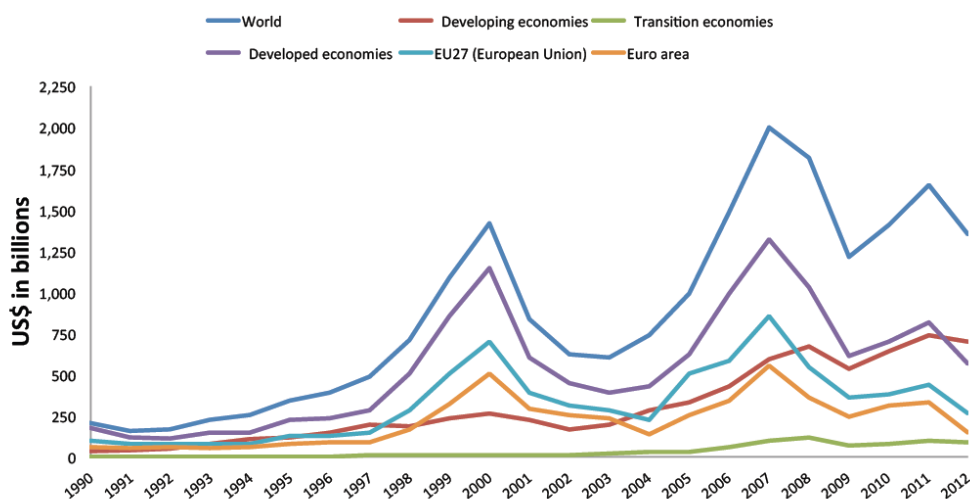
The literature that examined FDI primarily considers the institutional framework and its specific dimensions on the country level. Therefore, the FDI literature best explains what does particularly drive foreign investors to choose a particular country to invest in. Theoretical research results show that MNEs are primarily attracted by different factors exclusively linked to individual country characteristics (Bandelj, 2002).

1.3 Flow and Trends of FDI

According to UNCTAD (2012), due to the integration of international capital markets, global FDI flows have seen an incredible increase during the last two decades. In 1990, the global FDI inflow was at the level of USD 200 billion with an average increase of 23%. Interestingly, the global FDI inflow reached a level of USD 1.7 billion in 2015 (UNCTAD, 2016). This was impacted by different factors, such as increase of Greenfield investments in developing countries in particular. Exactly this was the case of SEE economies. FDI presents both a theoretical and practical phenomenon and occurs in the situation when residents of one country or region acquire assets of a firm in another country in order to establish production, distribution or other activities.

According to UNCTAD (2016), during the previous 13 years, the most significant changes when it comes to the origin of FDI were experienced in developing countries (primarily BRIC countries). The number of MNE's has constantly been growing in the developing countries, which led the developing countries to become active players in the global economy. Figure 1 indicates the global increase of FDI flows 1990-2012.

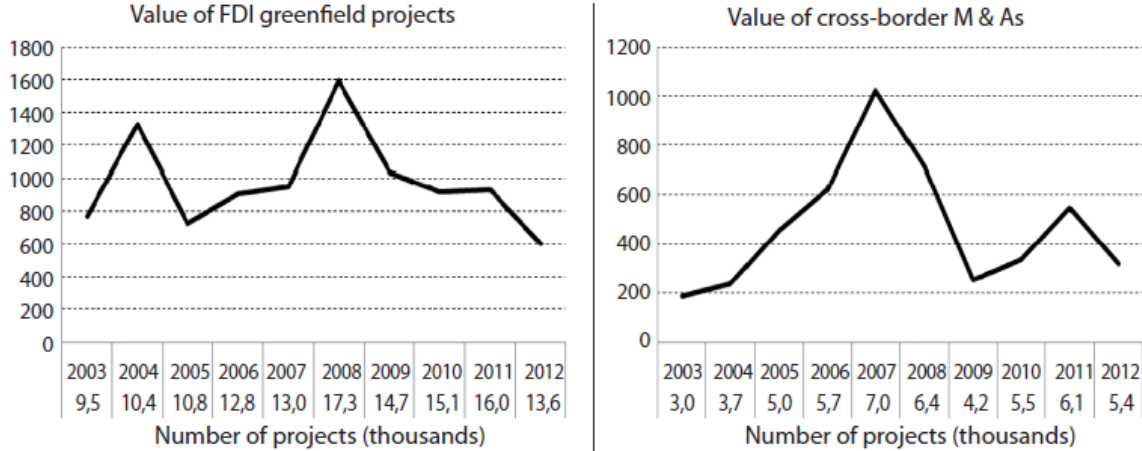
Figure 1. Global FDI Flows 1990-2012



Source: U. Steliulionyte, *How effective are investment promotion agencies in attracting more foreign direct investment? A case study of 27 EU countries*, 2014, p.5.

Along the value of FDI, the number of individual FDI projects marked an increasing tendency. This leads me to conclude that FDI projects are being decentralised. The trends of outward FDI from developing economies had a tendency to increase and that countries looking to attract FDI should also focus their efforts to those markets. In fact, recent years marked more FDI being absorbed in the developing economies than in the developed ones. Picture 2 shows the global value of FDI projects and the trends from 2002-2013, in terms of greenfield and cross-border merger projects. It is obvious from Picture 2 that the peak of number of global FDI projects was reached together with the overall value just before the global economic downturn in 2007.

Figure 2. Global Trend of FDI Projects (2003-2012)



Source: UNCTAD, *World Investment Report 2013; Global Value Chains: Investment and Trade for Development*, 2013.

The reason for including the overview of global FDI trends is primarily to show general trends and to conclude later in thesis that the global trends do not transmit directly to SEE countries. Interestingly to note is the fact that it happened for the first time in history by 2012, developing countries were attracting more FDI than developed ones (Miskinis and Byrka, 2014).

However, the key destination for FDI projects in terms of number of individual FDI projects remained to be developed economies, in particular western countries, fore fronted by Western Europe. It is also useful to mention the trends including FDI impact on creating jobs in key European FDI destinations. Table 1 demonstrates the trends in Europe’s FDI, including interesting data on the impact of creation of jobs. Unfortunately, the FDI data according to sectors is not available for SEE countries which are subject of my research. The table below shows a clear domination by FDI in services compared to manufacturing of goods, by sales and marketing dominating the FDI sector with up to 50%. However, this does not present a disconnection with the manufacturing of goods. This exactly leads to the conclusion that sales and marketing services representing a commercial present in foreign markets are a key for FDI projects in manufacturing of goods.

On the other hand, manufacturing creates more than half of the jobs created by FDI activity. Contrary to this conclusion and despite the fact that there is no such data available for SEE countries, UNCTAD (2016) suggests that majority of FDI went to the manufacturing sector, rather than services.

Table 1. Key activities by FDI and creation of jobs in key European FDI destinations

Activities	Number of FDI projects	% change from 2010 to 2011	FDI job creation	% change from 2011 to 2012
Sales and marketing	1,899	-2	17,519	-11
Manufacturing	1,018	5	89,117	-12
R&D	290	23	12,523	64
Logistics	284	20	19,481	48
Business support services	278	37	20,927	10
Headquarters activity	155	-8	6,514	-26
Education and training	31	-14	262	-68
Total	3,955	+5	166,343	-2

Source: Ernst & Young, *Growth, actually: Ernst & Young's 2012 European Attractiveness Survey*, 2012

When it comes to South East Europe, the domestic and foreign investments have consistently exceeded the EU average as a percentage of GDP since 2007 (UNCTAD, 2016). In recent years, this gap narrowed significantly, primarily due to the economic crisis. The following Table 2 gives an overview of FDI destinations in South East European countries in terms of cumulative value of FDI.

Table 2. FDI Income net according to destination countries in SEE (2012- 2013)

Country	Value of FDI (in mEUR)
Albania	115
Bosnia and Herzegovina	276
Bulgaria	1,816
Croatia	673
Macedonia	236
Montenegro	479
Romania	2,138
Serbia	286
Kosovo	73

Source: Vienna Institute for International Economics, *FDI Report for Central, East and Southeast Europe*, 2014.

Although the levels of FDI stagnated in SEE during the recent years, as percentage of GDP, FDI has been rising in most of the SEE economies and exceeded the EU average again (UNCTAD, 2016). Table 12 in Appendix shows the individual flow of FDI among

selected countries in SEE which were subject of research for this thesis. It is noticeable that the trends of FDI flow vary depending on the year and host and home country.

However, a general trend is visible of specific home countries targeting more or less same and similar regional markets. Many factors could be associated with these, such as traditional market links, history and culture, stability, institutional support, advantages of some markets towards others in terms of infrastructure, labour, legislation, etc. This is commented in more detail as part of the conclusion chapter.

1.4 FDI Policies

Investment policies refer to a government's foreign and domestic investment framework, while investment promotion denotes activities designed to attract investment to an economy or region (UNCTAD, 2016). FDI promotion activities in SEE countries are defined in their government FDI policies, which present a comprehensive and mandatory set of laws, institutions and activities. They present the key to define potential to attract FDI to developing economies. UNCTAD (2013) identified three different stages of investment promotion policy development. The first presents the country's liberalisation in terms of regulatory frameworks in order to allow FDI inflows. The second stage presents the establishment of IPA's, and the third stage focuses on investment promotion sector targeting. Furthermore, latest research suggests the formation of a fourth stage – targeting sustainable FDI. The quality of investment policy determines heavily investment promotion and facilitation (OECD, 2010).

According to OECD Investment Reform Index (2010), successful FDI policies usually include national treatment, admittance of personnel, transfers, FDI incentives, performance requirements, land ownership, intellectual property rights, expropriation, international investment agreements and international arbitration. Institutions play a very important role in attracting FDI. According to Dunning (2004), institutions primarily evolve by responding to market-related imperfections. Hence the considering of institutions as mechanisms that influence efficiency in relation to economic transactions. When it comes to FDI, institutions and organisations are crucial in implementing a country's FDI policy. According to Gordon and Bovenberg (2006), the reasons why countries get involved with investment promotion is to cut the transactions costs towards potential investors. This includes presentation of market and sector-related information about the country they represent, assist potential investor to overcome administrative procedures and complex legal requirements, as well as providing incentives. Companies' endeavour to promote their product and make it best visible to potential customers is very closely associated with government's efforts to represent their country in the best possible light by promoting investment in order to attract foreign capital which proved to have a positive impact on economic development (Moran, Graham, Blomstrom, 2005).

Global competition for FDI has been marking a constant increase (Harding and Javorcik, 2007a). Economies that were traditionally back held and closed now open up for new challenges to attract FDI. At the same time, developed economies intensify their activities related to attracting FDI. As already mentioned in the introduction to this paper, traditional FDI promotion policies used to focus exclusively on quantity of FDI, which is about to measure how much investment has been generated. They were only about to maximise the amount of inward investment.

Two key factors for measuring FDI according to this approach were accumulation of capital and generation of employment. Economists from the neoclassical era looked at FDI as benefits related exclusively to a stable source of financing from abroad, which had a positive reflection at the country's balance of payments.

According to Williamson (2005), FDI policy prescriptions under the Washington Consensus, focused on deregulation, liberalization of capital flows and privatization of state-owned enterprises. This model is still being used in numerous developing economies. However, it is very common that these countries by using this model face macroeconomic constraints and increased levels of unemployment. This approach has become questionable even in the developed countries, especially with the start of the global economic crisis in 2007.

On the other hand, recognising other heterogeneous approaches to attract FDI led to the aim of targeting the most relevant and quality FDI that meet the individual countries' specific development objectives (Enderwick, 2005). Same author states that the approach to attract not only quantity, but primarily quality FDI is based on the policy to attract higher value-adding operations by overseas companies such as R&D activities, business process outsourcing, headquarter functions, technology focused and high-growth sectors like information and communication technologies, life sciences and biotech, precise engineering, etc.

The final and very comprehensive and most difficult aspect of the FDI quality approach is the focus on the sustainability of FDI, in particular related to environmental protection and efficient and long term use of a country's natural resources. Combining the traditional quantitative and qualitative approach to attract FDI policy produces an interesting 2x2 matrix, stating out four different scenarios that countries can expect. This is shown in Table 3.

Table 3. The FDI Policy Matrix

	Quantitative approach	Qualitative approach
FDI attraction	Increase of FDI inflows as a response to short term shortage of capital (balance of payments) and or jobs (unemployment). Reliance on foreign investment in the process of transition, restructuring and industrialisation.	Attraction of FDI, which can result in technological upgrading and knowledge sharing and pullovers. Selective targeting of specific business functions and industrial sectors. Greater attention to sustainability.
Subsidiary development	Growth (but not evolution) of existing subsidiaries, i.e. quantitative extension of existing operations, creation of new jobs and reinvestment. The objective is to increase capital flows and enhance the role of foreign subsidiaries in manufacturing, employment and exports.	Upward evolution or functional upgrading of existing subsidiaries to better contribute to national development objectives. The objective is the higher integration of subsidiaries both within the national innovation system and within global innovation networks.

Source: J. Guimon and S. Filippov, *Competing for High-quality FDI: Management Challenges for Investment Promotion Agencies*, 2014, p.29.

To measure the effectiveness of either the qualitative or quantitative policy approach, several factors can be taken into consideration. Some, but not all, of the factors, that help evaluate FDI policy, are presented in Table 4.

Table 4. Selected Indicators to Evaluate FDI Policy

	Quantitative approach	Qualitative approach
FDI attraction	<ul style="list-style-type: none"> - Inward FDI flows (% of GFCG) - Number of new FDI projects - Number of new jobs created 	<ul style="list-style-type: none"> - Number of new FDI projects in R&D, BPO, headquarters, ICT, biotech, etc. - Number of new jobs created for skilled workforce, researchers, PhD holders, etc.
Subsidiary development	<ul style="list-style-type: none"> - Inward FDI stock (% of GDP) - Number of subsidiaries - Assets of subsidiaries - Employment of subsidiaries - (Domestic) sales of subsidiaries, added value of subsidiaries, profits of subsidiaries 	<ul style="list-style-type: none"> - R&D expenditures of subsidiaries - Employment of skilled workforce - Industry-university R&D collaborations - Patent applications by subsidiaries - Linkages and contributions of subsidiaries to domestic clusters - Exports of subsidiaries

Source: J. Guimon and S. Filippov, *Competing for High-quality FDI: Management Challenges for Investment Promotion Agencies*, 2014, p.30.

The above scenarios and examples are a try to illustrate the several approaches to investment promotion under different FDI policies. Head (2010) states that it is crucial challenge to develop and adjust useful performance indicators given the dynamic nature and complexity of evolving issues in the FDI process.

Summing up, IPA's should build their activities around the different scenarios by selecting the one which is most relevant for their market. In general, all FDI policy scenarios are related to each other in one or another way. This means that the key challenge for IPA's is

to diversify their efforts by taking into account the different scenarios. It can clearly be concluded that the FDI policies aimed at quality are quite different than those focusing on quantity. The former are more diverse and definitely include many more factors and scenarios than the latter.

1.5 The role of institutions and why they are important for investment promotion

Institutions and their role within the economy played a key role as part of previous and current academic and theoretic discussions as well as policy development. It is considered that institutions itself strongly influence the development in general, but, more importantly, the quality of institutions is a pre-condition for a successful development (Silajdzic and Mehic, 2013). Dunning (2004) divided institutions in two parts or exhibits:

- Push and pull parts that externally influence the activities related to company behaviour.
- Variables linked to the institutions, usually controlled by the host country.

The push and pull parts that externally influence the activities related to company behaviour are outside of the scope of reach of a country's policy and organisations, as well as outside of internal country factors mentioned before. The variables related to institutions which are being controlled by the host country are equally important in the process of setting a positive framework and business surrounding for an increased inflow of FDI. In fact, these variables are very much linked to the policy work of host countries. Hence their tight relation to promotion incentives and the work of IPA's.

Silajdzic and Mehic (2013) have attempted to develop a conceptual framework and at the same moment demonstrated the mechanism underpinning the institutional effect on multinational companies including positive externalities assumed to impact and minimise the transition of coordination costs of the multinational companies. Dunning (2004) sees institutions as country-specific advantages affecting the location of inbound FDI. This shows the clear and constantly increasing importance of the role of institutions for the general productivity of both developed and developing economies, as well as for attracting inward FDI.

According to the classification by Dunning (2004), the institutionally related determinants are spread among three empirical groups of variables, each influencing inbound FDI. They also indicate economic determinants influenced by the motives of multinational enterprise activity, as well as its mode of entry. The same paper states that institutional determinants are an umbrella which is closely linked to the efficiency of other determinants. Those determinants that are being controlled by host countries have a strong background and

relation to policy framework that is closely related to the modalities, which both help and monitor institutional infrastructure.

On the other hand, the business facilitating variables, meaning low levels of administration and solid supporting services tend to have a higher dependency on the quality of institutions. Institutional development has been the subject of a growing number of literatures. Importance of development of institutions in comprehensive difference through the FDI inflows is growing internationally (Globerman, 2001; Mudambi, 2005; Estrin and Bevan 2004). It is currently considered that institutions are very important determinants of FDI in terms of contributing the factors for decision making, such as location advantage. Majority of the determinants linked to the market very much relate to the structures and enforcement for incentives for investments and implementation of procedures. Promotion schemes, as mentioned in Table 5 below, presents an equally important part of institutions. In practical terms, these present primarily the work of IPA's. They indicate a combination of host country determinants, different types of FDI motives and the principal economic determinants in host countries. As it can be seen in Table 5, the host country determinants play a major important role and include different aspects of policy framework, economic determinants-business facilitation reflecting different types of motives, which drive FDI in certain host countries, such as search for new markets, resources, production efficiency or assets. This is all reflected through principal economic determinants in host countries, such as shown in the third column in Table 5 on the next page. Bringing all of this together in relation with FDI, institutional importance became highly relevant for most countries, both in the developed and developing economies. Competition for FDI has become a universal phenomenon (Harding & Javorcik, 2007). This explains the variety of host country determinants, including institutional differences.

Mudambi (2005) considers that institutions are representing an important "immobile structure in a globalised market". They believe that these features reflect the overall performance of individual economies. In a world of expressed competition among countries fighting to increase their share among the global FDI, institutions should play a more important role as well as increase their influence on multinational companies and their location pattern (Dunning, 2008). Despite of reasonable expectations that institutional influence includes both directly and indirectly costs and operations of multinational companies in host countries equally as they affect the capacity of multinational enterprises to fully exploit their own skills and competences, the theory provides evidence for this (Ali, 2010). The evidence for cross-country analysis shows positive influence of institutions in attracting FDI in the works by Addison and Heshmati (2003). The inconclusive evidence or easily said lack of evidence for institutional influence on attracting FDI is shown in the studies by Bevan and Estrin (2004).

North (1991), defines institutions as the rule of the game in a society that structures and constraints human interactions. Furthermore, North (1991) believes that acknowledged

importance of institutions reflects the fact that institutions affect economic agents', including multinational companies, transaction and production costs. They also constitute a country specific location advantage during their evolvement in relation with their historical, political and cultural setting of the society.

Table 5. Key host country determinants of FDI

Host country determinants	Type of FDI motives	Principal economic determinants in host countries
<p>Policy framework for FDI:</p> <ul style="list-style-type: none"> - Economic, political and social stability - Rules regarding entry and operations - Standards of treatment of foreign affiliates - Policies on functioning and structure of markets (especially competition and M&A policies) - Bilateral international agreements on FDI - Privatisation and price reform policies - Trade policy (tariffs and non-tariff barriers) and stable exchange rates - Taxation policy (including tax credits) - Industrial/regional policies <p>Economic determinants</p> <p>Business Facilitation</p> <ul style="list-style-type: none"> - Encouragement of entrepreneurship - Investment incentives and promotion schemes - Form and quality of legal property system - Protection of intellectual property rights - Social amenities (bilingual schools, housing, quality of life, etc.) - Pre- and post-investment services (e.g. one stop shop services) - Good institutional infrastructure and support, e.g. banking, legal, accountancy, services - Social capital - Region-based cluster and network enhancement - Legislation/policies designed to reduce corruption, corporate malfeasance, etc. 	<ul style="list-style-type: none"> - Market seeking - Resource seeking - Efficiency seeking - Asset seeking 	<ul style="list-style-type: none"> - Market size and per capita income - Market growth - Access to regional and global markets - Country specific consumer preferences - Structure of markets - Psychic/institutional distance <hr/> <ul style="list-style-type: none"> - Land and building costs - Cost and quality of raw materials - Low cost unskilled labour - Availability, quality and cost of skilled labour <hr/> <ul style="list-style-type: none"> - Cost of resources and capabilities adjusted for productivity labour inputs - Other input costs, e.g. transport and communication costs to, from and within host economy - Membership of a regional integration agreement conducive to promoting a more cost-effective inter-country division of labour - Quality of market enabling institutions/enforcement mechanisms <hr/> <ul style="list-style-type: none"> - Quality of technological, managerial, relational and other created assets - Physical infrastructure (ports, roads, power, telecommunications) - Contents of macro-innovatory, entrepreneurial and competitive enhancing, educational institutions - Mindsets, institutions and policies towards economic growth/development

Source: J. Dunning, *Institutional reform, FDI and European transition economies*, 2004, p. 5.

Douglas and North (1990) take the concept of institutions as the formal conventions that are also usually associated with legislation and procedures, wider known as standards. North (1990) acknowledges the importance of institutions, which is based on perception that institutions affect economic agents such as multinational corporations, affiliated with transaction and production costs. This forms a location advantage, specific for any individual country, related to political, historical, economic and other country-specific differences. As the number of countries world-wide form a growing competition when it comes to competition to attract FDI, institutions are expected to play a growingly important role (Dunning, 1998).

Summing up, the general literature related to institutional aspect and its relations to FDI is quite divided when it comes to conclusions. For example, according to Silajdzic and Mehic (2013), there is a significant number of differences related to the empirical literature such as conceptual measurement issues and issues with methodological data that have contributed to the inconsistency and lack of evidence that go in favour of institutions. Bevan and Estrin (2004) says that conceptual and measurement issues are in most cases related to the lack of clear and mutual understanding on which institutions matter and why.

1.6 Investment promotion and the role of Investment Promotion Agencies

Summing up all the benefits of FDI, one of the key questions, both from perspective of policy makers, but also theory, is how to attract and convince investors to choose the host market for FDI. Hence, investment promotion is more and more considered as a cost-effective way to attract and increase inflow of FDI. Competition for the growing global FDI stock is very tough and individual countries have been adopting more liberal FDI policies. This is especially considered to be the case in developing countries because information necessary to make decisions on investments is often not readily available and the bureaucratic procedures not always clear to investors. Hence the liberal approach to FDI.

It is important to mention that empirical research conducted so far indicate that the work of IPA's positively contributes to attracting FDI to transitional economies. However, according to my findings, none of the countries of Southeast Europe have been included in the empirical research. Therefore, the purpose of this research is to deepen the knowledge and fulfil the literature gap related to the role of IPA's and their impact on attracting FDI to SEE economies.

The key benefit and purpose of investment promotion is reduction of transaction costs that foreign investors run across. It is all about provision of useful information such as key strengths of the market, infrastructure and locations, key benefits and sector opportunities, clarifying local laws and regulations. One of the key elements of the investment promotion

activity is to help investors to overcome a various types of bureaucratic procedures and ease the way of landing their investments in targeted host countries.

According to Wells and Wint (2000), investment promotion is furthermore defined as activity that governments implement to attract inflow of FDI by conducting the following additional activities:

- branding of the host country,
- participation in seminars,
- trade fairs,
- literature promotion,
- direct marketing activities,
- sector-targeted efforts,
- facilitating relations with potential investors,
- match making with local partners,
- preparation of project summary documents,
- identifying potential and realistic projects in host country.

The same paper states that a crucial activity of investment promotion also presents the care of existing investors through follow-up activities in order to help maintain their projects operational, sustainable and profitable. Wells and Wint (2000) exclude the grants of incentives and direct negotiations with foreign investors. However, some governments provide mandate to their bodies to conduct such activities.

According to Javorcik and Harding (2007), investment promotion activities are usually divided into the following areas:

- national image building,
- investment generation,
- services for investors,
- policy advocacy.

Activities related to building up an image of a potential investment destination present the building perception of a country/market being an attractive location for FDI. Promotion through media and building up a country image certainly generate significant interest by tourists. However, the investment by MNE's requires a more structured and targeted approach, which involves much higher costs. So, the creation of a sensible and meaningful strategic approach to investment promotion for a region like southeast Europe or any other region, certainly presents a necessary and highly complex task.

Identifying and targeting potential investors with a potential to express interest in establishing presence in a country, develop concise strategies and contacts to interact into

dialogue presents investment generation activities. Servicing investors presents assistance provided to potential investors in the form of identifying and analysing sector opportunities, providing assistance in overcoming administrative procedures, such as assistance in obtaining relevant permits, business registration and maintaining activities.

Public advocacy is aimed to improve the investment climate and identify the inputs and views from the private sector. As a relatively new activity or service, investment promotion agencies (IPA's) as part of government bodies or private sector-contractors existed since early 1980's. More than 160 national and sub-national level IPA's existed in 2010 (OECD, 2010).

The overall purpose of IPA's is to grow the international visibility of a country or region by conducting traditionally marketing campaigns, but lately more and more facilitate the investment process by providing tailored services to MNEs or other private, public or institutional investors before, during and after the investment process (Guimon and Filipov, 2010). Wells and Wint (2000) state that usual activities of IPA's include the following:

- building country's image,
- generate investment,
- develop relationship between foreign investors and home-country suppliers,
- facilitate investments and disseminate information.

The experience shown by investment promotion stakeholders reflects the fact that the most effective way to conduct investment promotion activities and attract FDI is through so called targeting activities. Targeting directly means to focus on selected priority sectors, instead of trying to attract investors from all sectors. This is because some sectors might not be relevant and realistic for the host market. Agencies without a target approach tend to promote their markets as good place to do business, whereas the targeted approach usually emphasises the positive sides of why a market is good to do business in a specific sector.

The IPA's usually attend all types of business events, fairs, etc., while at the same time choosing sector-specific events to narrow down the potential to meet and transmit information to the most relevant potential investors by providing focused messages tailored for a narrowed audience. This approach is expected to be more efficient than a general approach to foreign investment promotion activities. IPA's are usually funded by governments (UNCTAD, 2007). However, there are certainly other minor sources of funding IPA's such as private sector fees, external aid, etc. Investment promotion activities can affect the decision process of a potential foreign investor in different ways. For example, if a company has decided to conduct a FDI into a certain market based on own needs and different reasons, they would usually initiate the process by drawing up a list of potential investment destinations with the help of a specialised in-house department or an external specialised consultant.

Depending on the size and international presence of the company, the list can include from 10 to 30 or more potential investment destinations. They are usually selected on the following basis:

- most popular global or regional investment destinations,
- markets located close to already existing facilities or operations,
- emerging destinations for FDI (i.e. developing economies, etc.).

The IPA's might be especially active in the emerging destinations in order to attract the attention of potential investors to consider the markets they promote. Furthermore, the potential foreign investor or its contractor-consultant will probably consider those markets whose advertisements they have seen in media or at business events and whose IPA's have approached them directly. Following on this, the decision making process is continuing by narrowing the list of potential markets before visiting the countries. The accessibility to information plays a crucial decision making role. Here comes the importance of work of IPA's on providing updated and accurate statistical information which is easily accessible on their websites, but also their readiness to provide tailor-made responses to their potential investors as their customers. In addition, customising a relation to potential investor increases the chances for the host market to be shortlisted or selected for a particular FDI project.

The investment decisions are usually being fine-tuned after a market visit and identification of potential sites, stakeholders and always very much-needed local partners. Investors very often consider if any local incentives for foreign investors is available. All these information can be supplied by IPA's. This really shows the important role these agencies play in the process of investment promotion and investment implementation. They do not quit the relations once the investor has decided to invest in their market, but need to strengthen their relation with the investor and work closely together on any other assistance within their mandate by serving as a intermediary between the investor and local government institutions and other stakeholders. All these explanations of the FDI selection process highlight the importance of investment promotion and the work of IPA's.

When it comes to SEE, this will be presented in the chapter 2, but it is important to mention here that all SEE economies have publicly funded IPA's which have the task to attract and facilitate entry of foreign investors (OECD, 2010). The IPA's of SEE countries goal does not differ from global trends, which is primarily to facilitate commercial linkages between FDI and domestic potentials and companies.

The detailed scrutiny of SEE IPA's involving structural and performance variables results in significant differences in different areas of their organizational structure such as functioning and their performance. This has a significant impact on the quantity and quality of FDI inflow into their home countries. Trnik (2007) says that today's proactive

SEE government efforts to attract FDI have gradually evolved from restrictive policies that were uncertainly about advantages of FDI. While very little from this restrictive government functions has left, institutionalized approach to FDI is carried out by IPA's as for this purpose created government agencies with delegated authority from initiating strategies and action plans all the way to implementation of government activities related to attracting FDI.

1.7 Conceptual framework of investigation

Harding and Javorick (2012) note that increase of movement of people, products, services and capital positively influenced many developing countries to achieve long term economic development. Many research papers conclude that FDI has become a leading driver force of economic growth worldwide, particularly by supporting the transfer of technologies and knowledge from developed to developing countries (Hoekman and Javorick, 2007). FDI's importance as a driving force behind economic growth has become a hot research topic in recent years, in particular, researchers were dealing with the determinants of FDI. The literature around this topic has elevated significantly during the past ten years and is now a important topic when it comes to globalization in general.

The main outlines in the literature concerning the determinants of FDI are often focused on the classic determinants comprised of country characteristics and natural resources of that specific country. The emerging consensus is based on the widely quoted taxonomy by Dunning (2008) and his earlier work on the eclectic (OLI) paradigm. Dunning divided the FDI motives into four main types:

- resource seeking,
- market seeking,
- efficiency seeking,
- strategic asset/knowledge seeking.

Dunning's work has motivated a bulk of empirical literature on developing and transition countries to pinpoint the main factors which hosts countries have to provide to secure FDI inflows, for example inflation, exchange rate effects, taxes, tariffs, trade openness and financial liberalization, the size of the manufacturing sector and etc (for recent work see Wernick, Haar and Singh, 2009 and Bevan and Estrin, 2004). In addition to the role of classical determinants identified above, a number of recent studies have attempted to identify the role of structural reforms as key determinants in attracting FDI inflows in host countries (Morisset, 2003, Asiedu and Freeman, 2009). This part of studies deals with the impact of business environment and trading and financial liberalization.

It was Wels and Wint (2000) who first noticed that governments eager to attract FDI have to undertake specific type of marketing called investment promotion. According to Trink

(2007), investment promotion is a range of different activities, many of which resemble marketing, used by governments in order to attract FDI. According to Murphy (1999), policies and promotion should be seen as two sides of a coin which are explicitly linked and promotion is nothing more than the implementation of a key part of governments' FDI policies. While Bobonis and Shatz (2007) and Charlton and Davis (2006) provide evidence suggesting that investment promotion is associated with higher FDI inflows into developed countries, Head, Ries and Swenson (1999) and Harding and Javorcik (2011) do not find any significant effect of investment promotion efforts in developed countries. Moving forward from theoretical framework around policies, the theoretical framework related to institutions is also closely linked, but at the same time limited to research, despite being at the centre of academic and policy discussions (Silajdzic and Mehic, 2013). Same paper also states that there is a growing number of theoretical focusing on institutional development in comprehending differences in patterns of FDI inflows across countries. A growing number of authors is dealing with this question of relation between institutions and FDI as, which is being explained in the following section.

1.8 The OLI paradigm

Why do companies want to go abroad is well explained by one of the international most widely known theory – Dunning's adaptation of the eclectic paradigm or widely known as the OLI framework. This approach is related to studying FDI. It was created by John Harry Dunning. He was a British economist and is widely recognised as the father of the field of international business. Since the late ninety seventies when the Ownership, Location and Internalisation (hereinafter: OLI) paradigm was developed, it has proved to be a very useful way of thinking about Multinational Enterprises (MNE's) and has inspired a great deal in applied work in economics and international business. The paradigm does not present a usual formal scientific theory backed up by scientific data by itself. It presents more a relevant and useful framework which categorises almost all of the recent analytical and empirical research on FDI. For quite long, Dunning's eclectic paradigm has been the most influential framework for empirical investigation of determinants of foreign direct investment. The OLI paradigm presents theoretical framework which enables the investigation of the significance of factors that influence the early and initial processes for expansion of MNE's through relocating their production processes overseas as well as the subsequent growth of their activities (Dunning and Robson, 1987; Tolentino, 2001). This framework facilitates the comparison between different theories by establishing the common ground between various approaches and by clarifying the specific questions theorists have posed, in addition to the different levels of analysis (Cantwell & Narula, 2001). The abbreviation "OLI" presents the following:

- O - ownership.
- L - location.
- I - internalisation.

They present three advantage sources that influence companies' decisions to internationalise and become a multinational. This also presents the assumption that the returns of FDI, presenting the main reason for the FDI, can be explained these three factors. The advantages of ownership present who exactly (which company or organisation) is engaging in production overseas and what activity this international engagement does this include (Dunning, 1993). Dunning (2004) incorporated majority of the institutional assets into the eclectic paradigm, which resulted in an overview of institutions, enforcement/empowerment mechanisms and institutional dysfunctions. This is shown in Table 6 below. Majority of the studies dealing with the impact of institutions on the location decision of multinational companies focus on the institutional dimension affiliated with political situation, rule of law, corruption, efficiency related to contract enforcement, protection of property rights, risks of nationalisation and expropriation. There is a limited, almost non-existent focus on the role of IPA's on FDI.

Table 6. Institutional assets in the eclectic paradigm

<i>Institutions</i>	O	L	I
	<i>Corporate governance</i>	<i>Social capital</i>	<i>Organizational/relational</i>
Formal	<ul style="list-style-type: none"> - External legislation - Discipline of economic markets - Corporate goals 	<ul style="list-style-type: none"> - Laws/regulations - Discipline of political markets - Rules-based incentives/standards 	<ul style="list-style-type: none"> - Contracts (e.g. inter-firm) - Contracts (e.g. intra-firm)
Informal	<ul style="list-style-type: none"> - Codes/norms/conventions - Country/corporate cultures - Moral ecology/mindsets (particularly of decision takers) - Pressures from competitors and special interest groups 	<ul style="list-style-type: none"> - Inherited social customs, traditions - Foreign organisations as institutions reshapers - Motivating institutions (e.g. re innovation, entrepreneurship), competitiveness - Attitudes toward change and uncertainty 	<ul style="list-style-type: none"> - Covenants, codes, trust-based relations (both inter and intra firm) - Institution-building through networks/clusters of firms - Extent/form of institutional/cultural distance
Enforcement/ Empowerment Mechanisms			
Formal	<ul style="list-style-type: none"> - Sanctions/penalties (both external & internal to firms) - Stakeholder action (consumers, investors, labour unions, civil society) 	<ul style="list-style-type: none"> - Sanctions, penalties, policies - Quality of public organizations(e.g. re protection of property rights, rule setting, legal system) - Collective learning (in shaping and implementing institutions) 	<ul style="list-style-type: none"> - Penalties for breaking contracts - Strikes, lock-outs, high labour turnover - Education/training

table continues

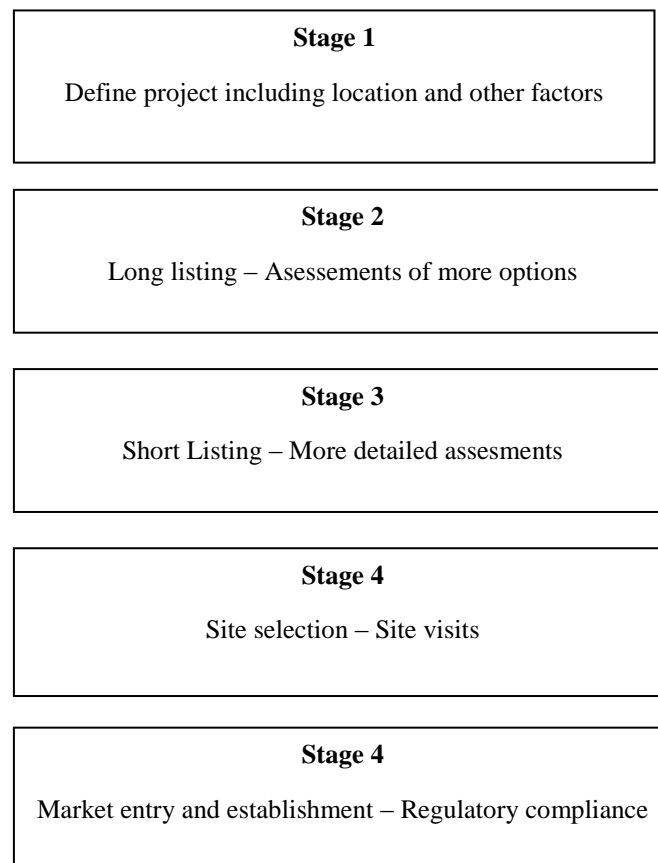
continued

<p>Informal</p>	<ul style="list-style-type: none"> - Moral suasion - Loss or gain of status/ recognition - Retaliatory options - Build up/decline of relational assets (e.g. trust, reciprocity, etc.) - Blackballing 	<ul style="list-style-type: none"> - Belief systems - Tradition (e.g. pride/shame) - Demonstrations, active participation in policy making organisations (Bottom-up influence) - Societal guidance/moral suasion (Top-down influence on institutions, organisations and individuals) - Social safety change 	<ul style="list-style-type: none"> - No repeat transactions - Guilt, shape - External economies arising from networks/alliances, e.g. learning benefits - Blackballing
<p>Institutional dysfunction</p>	<ul style="list-style-type: none"> - Dishonest accounting practices, fraud and other corporate malfeasance - Lack of transparency - Inadequate institutional framework 	<ul style="list-style-type: none"> - Crime, corruption, flaws in justice system, breakdown in communities/personal relations - Inability to cope with technological or institutional change 	<ul style="list-style-type: none"> - Lack of good intra or inter-corporate relations - Failure of alliances, codes, lack of transparency /honesty, etc.

Source: J. Dunning, *Towards a new paradigm of development: implications for the determinants of international business*, 2006, p. 215.

The location factor indicates where the production will be taking place. The internalisation indicator deals with the question why do companies decide to transfer production overseas, rather than engage foreign companies to produce for them (Dunning, 1993). The general OLI framework provides a platform to explain the aspect of added value for companies to benefit from international activities. By considering one of the most important questions related to relocating of production, companies need to go through five different stages of location decision making as shown in Figure 3.

Figure 3. Process how investors select a FDI location



Source: J. Dunning, *Towards a new paradigm of development: implications for the determinants of international business*, 2006, p. 215.

In order to be able to compete in overseas territories, companies need to own specific ownership advantages. They are usually called competitive or monopolistic advantages (Dunning, 2004). In an extended context, compared what has been mentioned above, the ownership advantages are dealing with the reasons why some companies conduct overseas activities and operate in overseas markets, and others do not the same, and suggest that MNE's have specific advantages that make it possible to reduce operational costs in a foreign economy. These are the costs which are not subject for domestic producers (Dunning, 1988). These costs can also depend on the specific origin of the company (Dunning, 1988). The location advantages focus on where an MNE chooses to locate and what are the main reasons for doing this.

And lastly, internalisation advantages influence how a firm chooses to operate in a foreign country, assuring the savings in transactions, hold up and monitoring costs of a fully-owned subsidiary compared to the advantages of other options for market entry, such as exports, licensing or joint venture. A key feature of this approach is its focus on the incentives facing individual companies. This now presents a standard in mainstream international trade theory, but was not all so in the 1970's when FDI was typically seen through a Heckscher-Ohlin lens as an international movement of physical capital in search of higher returns (Mundell, 1957).

1.8.1 Ownership

Ownership advantages are key to explaining the existence of MNE's. A key idea is that companies present collections of assets and that candidate MNE's possess higher than average levels of assets having a of internal public goods. These assets can be applied to production at different locations in the world without reducing their effectiveness. Examples include managerial structures, product development, marketing skills and patents all of which are included in the term "headquarter services" Helpman (1984).

As clearly being a multi-dimensional factor, it is very common to use this in terms of a single index of company productivity. The most sophisticated topics similar to this is found in recent work on heterogeneous companies by Helpman, Melitz and Yeaple (2004). This approach combines the simplest version of the horizontal motive for FDI with the assumption that companies differ in their productivities.

In latest research results, Dunning (2008) also added institutionally related aspects to the specific ownership advantages, such as the structures of incentives. Similar incentives, when looked through a specific national company or MNE influence the ways that resources are deployed or accessed. The ownership advantages may affect many aspects of managerial structures and decision-making, as well as the influence of stakeholders (Dunning, 2008).

This thesis also names some of the most important ingredients related to ownership advantages through technological and organizational factors, contributing to the process of adding value to MNE's, reflected through institutional changes:

- developing corporate social responsibility,
- development of intellectual property rights,
- patent laws,
- impact of globalisation on the institutional advantages of national assets,
- accelerated innovation processes,
- increased pressure on corruption,
- importance of environment friendly practices.

Companies need to count on extra costs to help them determine their productivity levels. At the moment of determining the productivity levels, companies decide on changing and adjusting the levels of production. Companies that classify as low productivity performers, tend to supply only the domestic market. Companies in the range of a medium productivity usually engage in exporting their products. Finally, the companies with maximum levels of productivity go one step further and invest in foreign markets by becoming FDI investors. Dunning claims that these statements are backed by the evidence. In addition to this, the

OLI model is also based on the belief that industries with higher company heterogeneity produce a bigger number of companies which are involved into FDI.

However, the OLI paradigm and the ownership advantage does not explore why company productiveness differ in the first place. Prior investment in research and development (both process and product) and in marketing presumably account for the disproportionately greater productivity of most companies including MNE's. Ownership assets can also have a negative aspect. This can usually be associated with host governments and their negatively contributing factors, such as good or poor protection of patents, transparency of legislation, financial regulation with negative impact, health & safety standards, etc.

Doz, Santos and Williamson (2001) conclude that MNE's with a widely spread geographical presence can easier fight the negative aspects of ownership disadvantages that companies limited to restricted geographical and political areas. In addition, Birkinshaw, Hood and Jonsson (1998) encourage ownership subsidiarity and creative value-adding activities to increase the ownership advantages of MNE's.

1.8.2 Location

Since different theories have tried to generalise the advantages of ownership or merge them with other reasons for companies moving abroad, more reasons for MNE's to move overseas has been investigated. One of the main problems that has attracted quite lots of attention is the distinction between horizontal and vertical FDI. Engaging in horizontal FDI presents situation when a company locates a plant abroad in order to improve its market access to foreign customers. This FDI means that a copy of the home-country based production is the same as the one opened in a foreign location.

Contrary, the vertical FDI is not producing for the foreign market. The realistic reason behind vertical FDI is to make use of the low production costs in the foreign location. The practice shows that majority of these companies remain their headquarter in the home country and the company specific or ownership advantages can be seen as generating a flow of headquarter services to the home country plant, there is a sense in which all FDI is vertical. It is hence very important to distinguish between market access motives and motives to lower the cost for FDI.

Brainard (1997) explained the horizontal motive by naming it "proximity-concentration trade-off". Foreign investment in production reduces the general trade costs and produces the advantage for investing abroad. On the other side, the production is being de-centralised from the home country. In general, the FDI is usually encouraged by exports on one side and discouraged by de-centralising production.

The vertical motive for FDI implies a very different view of individual determinants and implications of FDI. Here, the focus is on how a company can serve its home market, either by producing at home or by vertically disintegrating and moving its production facilities to a more cost favourable foreign location. In order to decide whether or not to engage in FDI, companies need to choose between centralising of production and cost-efficiency which comes with producing abroad.. The offshoring depends negatively on the host country wage and positively on the source country wage.

The vertical motive for FDI gives significant importance to comparative costs of production. In addition, the gain is decreasing in the source country trade costs, implying that the trade liberalization will encourage FDI. Until recently, empirical studies of FDI tended to favour the horizontal rather than the vertical motive. Majority of case studies have shown that tariff jumping was important in many historical episodes. In addition, majority of FDI is being spread between high-income countries with approximately similar wage costs (although much of this is likely to be neither vertical nor horizontal FDI, but rather cross-border mergers and acquisitions). Many formal econometric studies by Brainard (1997) and Markusen (2002) have shown that the horizontal motive provides a good explanation for FDI. On the other side, there is no clear evidence that distance plays an important role for FDI, as the horizontal model implies. Empirical work by Yeaple (2003) based on data at the level of individual companies suggest that both motives are important, primarily due to the fact that if the alternative market can be complementary in terms of size, the return on engagement in FDI is shown with the sum increase of overall costs and outsourcing overseas.

More broadly, with many countries there are additional reasons pro FDI and the horizontal and vertical motives are likely to interact in complicated ways. Even for vertically integrated companies, proximity and concentration are not in conflict where serving a group of foreign countries is concerned. The reduction of trade costs between European countries in the 1990's encouraged US and Asian companies serving European markets to focus their production in European plants and by that engage in a so-called export platform FDI.

Similarly, Yeaple (2003) has shown that the vertical and horizontal motives may reinforce each other if a parent company wishes to both serve foreign markets in similar high-income countries and to avail of lower production costs in low-income countries. In general, the pattern of location of foreign production plants is likely to reflect the complex integration strategies of firms facing both horizontal and vertical motives for foreign direct investment.

1.8.3 Internalization

Internalisation is the third pillar of Dunning's taxonomy and is quite often seen as the most important one. Ethier (1986) claims that internalisation presents the backbone of the taxonomy. Macroeconomists tend to explain the reasons behind activities carried out by some companies one side and long transactions on the other side. This is not a topic that only FDI-related economists deal with. Ronald Coase (1939) was a pioneer arguer that optimal scale of the company or the optimal degree of internalization reflects a balance between the transaction costs of using the market and the organisational costs of running a company. Information economists have in recent years tried to endogenise these two cost sources with highlighting the inability of agents to write complete contracts.

Ethier (1986) was among the first ones who conducted this approach. This model suggests that companies should conduct research prior to engaging in production. The research results should result in integration either through a vertically organised company (mostly spread among MNE's) or handed over to downstream users. The pre-condition for this is that the end user must agree to conduct the research before the results have been announced.

Another approach which is not similar to the before-mentioned one was introduced by Antras and Helpman (2004). In addition to the property rights approach by Grossman-Hart-Moore, the issue of bargaining between a company owner and potential supplier or employee, ex post efficiency is bigger when ownership rights are allocated to the party that is contributing more to the final output.

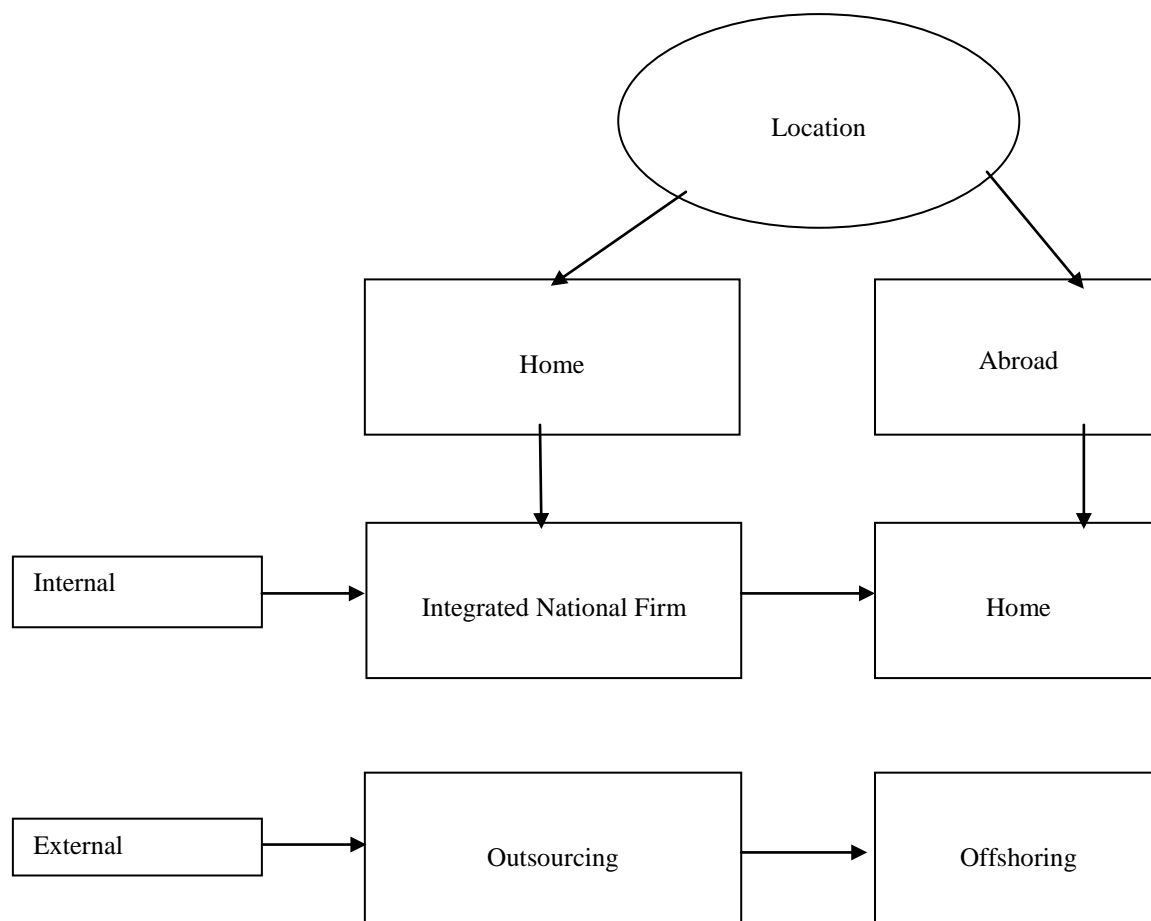
Embedded in a model of product differentiation and trade, this implies that more efficient companies and companies for which headquarter services are more important should exhibit internalization where the owner enters contractual arrangement with the supplier who becomes an employee. Companies with less efficiency should exhibit the arms-lengths trade which means that the supplier remains a separate legal entity. Furthermore, the model assumes that producers of finalised products are located only in one country – the North of a two-country North-South model.

These procedures are assumed to have a two-fold choice: one is that they have to choose between vertical integration, which solves the hold-up problem but at the cost of reducing incentives to the provider of the input and an arms-length relationship. Otherwise, these companies would not be able to dislocate their production process in any country and compensating the higher wages in the North with lower uncertainty in terms of protection of contracts in the South.

All of the potential outcomes are shown in Figure 4. This means that heterogeneous companies are choosing between the different modes based on the relation of their

productivity, share of headquarter services in the value of output and on the differences in costs between domestic and foreign locations.

Figure 4. Taxonomy of Location-internalization Modes



Source: J. Dunning, *International Journal of the Economics of Business, World Economy: The OLI Framework*, 2001, p. 8.

The OLI framework and majority of research works dealing with FDI have been focusing on the greenfield aspect of FDI for a long time, until recently. Greenfield is a model when a parent company constructs a new plant in a host country. In reality, here the bulk of FDI, particularly between the developed countries present the form of cross-border mergers and acquisitions in which the parent company acquires a controlling interest in an existing host country company. Estimates by UNCTAD suggest that mergers and acquisitions accounted for over 80% of global FDI during the 2000's. The distinction is very important since research suggests that the determinants and implications of cross-border mergers and acquisitions are quite different than those of greenfield FDI. Domestic mergers and acquisitions were extensively studied by finance and industrial organisation scholars suggesting two principal motives in their literature. Different synergic motives are visible in any market where a company that has been the subject to acquisition owns assets that

are complementary to those owned by the one who acquired it. On the other hand, the strategic motive arises in oligopolistic markets.

Oligopolistic means a market where the number of competitors is small. The strategic motive comes since a company benefits by acquiring or merging with competitor and with this step increasing its own position in the market. The synergies for companies that went through an acquisition or merging process can be caused by different sources. These can include reduction of costs caused by transfer of technologies, dismissal of surplus employees, as well as decisions and changes related to prices of products and change in marketing costs.

When it comes to the open economy, particularly important are synergies between “O” and “L” of the OLI paradigm as advantages of different companies such as advantages of productivity, extended new networks on one, and domestic experience and knowledge in the company that has been targeted for acquisition. A similar model was developed by Yeaple (2003). This model is related to international markets for assets which enables companies to look for and match with relevant and similar partners. The prediction of this model suggest that relevant matching is a result of acquisition of more efficient companies than those who acquired them.

Furthermore, this model presents an interesting remark. Usually, the very efficient companies are not often involved in cross border mergers and acquisitions, but rather engage in greenfield FDI. This result is usually consistent with the evidence these investments produce. If the synergies are implemented in practice, those mergers that are driven by synergies could potentially raise the global welfare. On the other hand, those mergers driven by strategic considerations could potentially reduce the global welfare because of the increasing of their consideration in general. According to Neary (2007), this kind of merging institutions is usually incomplete for two key reasons: the common lack of synergies and the general expansion of more efficient acquiring companies. Summing up all three elements, it can be concluded that Dunning’s eclectic paradigm (OLI) presents a holistic, but at the same time a context specific framework which deals with analysing the FDI determinants.

Despite being the mostly used framework for analysing the determinants for FDI, the OLI paradigm also has its limitations, which were even recognised by Dunning himself. This is in particular related to the facts that eclectic OLI paradigm is not addressing some of the key issues directly. It is linked mainly to the issues that dominated the thinking of many economists about FDI, things such as the distinction between the horizontal and vertical motives for locating manufacturing facilities abroad. It also does not deal with the increasingly important distinction between greenfield investments and mergers and acquisitions models of participating in FDI.

Mainly caused by its approach as a general framework, OLI paradigm in itself has a quite limited capacity for explaining the more specific types and options for foreign production or the behaviour of individual MNE's (Dunning, 2008). However, the OLI eclectic paradigm provides very useful platform for organising the knowledge around one of the most important topics in every economy – FDI.

2 INVESTMENT PROMOTION ACTIVITIES IN SOUTH EAST EUROPE

Promoting a country's economy with a goal to draw attention of foreign investors is one of the most important roles of the governments. This is especially important for developing economies, which all of the countries in SEE belong to. OECD (2010) suggests that it is essential for any economy wishing to draw investors to promote itself as an attractive investment destination. As indicated earlier in this thesis under the chapter dealing with investment promotion and its relation to FDI, all SEE economies have investment promotion facilities, including IPA's, in place. FDI plays a crucial role of the investment flow in SEE. In most of the countries, more than 50% of annual investment flow comes from foreign investors. Hence the clear importance of the need for efficient work of IPA's in attracting quality FDI to the economies of SEE.

OECD (2015) presents the key source of information for investment promotion activities in SEE. As mentioned in the introduction chapter, there is a serious gap in literature and source of information when it comes to SEE and investment promotion activities. Hence the importance of work of OECD and their publications giving a regular snapshot of investment promotion activities in SEE countries. OECD (2015) conducted this very useful assessment of investment promotion activities in SEE based on the following key investment promotion indicators:

- investment promotion and facilitation strategy,
- work of investment promotion agencies,
- FDI Incentives,
- FDI-SME links,
- one stop shop services for foreign investors,
- targeting of foreign investors,
- availability of Client Relationship Management Systems (CRM),
- aftercare services provided to foreign investors.

The most important indicator for this research is the role of investment promotion agencies. Table 7 indicates the scores for selected SEE countries. The scores are provided from 1-5, where 1 is being the lowest and 5 the highest score.

Table 7. Investment Promotion and Facilitation Sub-Dimension: Indicator scores

	Albania	Bosnia	Kosovo	Macedonia	Montenegro	Serbia
Investment promotion and facilitation strategy	2.0	2.0	2.0	3.0	2.0	2.0
Investment promotion agencies	3.0	2.5	2.0	3.0	3.0	3.0
FDI Incentives	1.0	3.0	1.0	3.0	3.0	3.0
FDI-SME links	3.0	0.0	1.0	1.0	1.5	2.0
One stop shop services for investors	1.5	1.0	1.0	1.0	0.5	2.0
Investor targeting	3.0	1.5	2.0	3.0	1.0	3.0
Client relationship management	2.0	1.5	1.0	2.0	1.0	2.0
Aftercare services	1.0	2.5	2.5	2.5	1.0	3.0

Source: OECD. *OECD assessment conducted in SEE economies in 2015*, OECD Competitiveness in South East Europe, 2016, p. 33.

As the results of this assessment indicate, all SEE countries have established investment promotion activities and are involved in different investment promotion activities. All SEE countries operate a comprehensive framework of investment promotion activities. However, not all countries have brought it on a satisfactory level. In terms of the highest scores, most of the SEE countries have achieved best results in producing investment promotion and facilitation strategies and setting up IPA's that operate on a satisfactory level. The results also suggest that there is still space in terms of development of additional and more advanced investment promotion and facilitation services.

OECD (2015) suggests that the main pre-condition for establishing successful investment promotion and facilitation processes is establishing a comprehensive investment promotion infrastructure. This should include an effective investment promotion strategy followed by sufficiently funded and staffed IPA's. IPA's should present a single point of contact for investors.

IPA's should provide one-stop shop services related to administrative procedures defined by local legislation and help investors to overcome this processes as smooth as possible. Especially these procedures are more complicated in SEE economies and investment promotion services provided by IPA's are more needed to easier overcome those. As mentioned, the SEE countries scored best in defining and designing effective investment promotion strategies. This indicator measures the level of involvement of governments in developing and implementing investment promotion and facilitation strategies.

Most of the SEE countries have effective investment promotion strategies, which include clearly defined objectives, tools and mechanisms, points of action and defines precisely responsibilities. This presents a basis for establishing effective IPA's. The indicator measures IPA's performance as a government body that is responsible for the implementation of the investment promotion strategy. According to this research, a global practice of success of a single IPA rather than more government bodies implementing different aspects of the investment promotion strategy is also replicated in SEE economies. OECD (2015) suggests that a well staffed and well funded IPA presents a backbone of successful implementation of investment promotion and facilitation strategies.

The one stop shop indicator is closely related to the effectiveness score of SEE IPA's. It is important to highlight that IPA's are not a single point for processing all necessary requests and procedures that are required by local legislation, but to navigate investors and shorten the process in terms of easier understanding and communication between all government bodies involved (courts, utility agencies, local administrations, etc.).

This indicator measures exactly this process related to how quick and clear investors are being provided access to all necessary information and contacts to be issued the necessary permissions required to start their business. The reason for explaining these indicators separately is its close link with the performance of IPA's.

Countries across SEE have all developed and adopted investment promotion and facilitation strategies, as well as established reasonably well functioning IPA's. However, in order to prove the efficiency and advance their operations, additional investment promotion and facilitation infrastructure is yet to be established (OECD, 2016).

After SEE countries have all set up investment promotion and facilitation infrastructure including fully operational IPA's, they should focus more on process of targeting and attracting investors. Some of the SEE countries like Serbia for example, have already demonstrated active investor facilitation activities, such as selection and interaction with potential investors of specific profiles or from targeted sectors, completed promotional activities by organising specific events where targeted projects were offered, helped identify and overcome administration processes and eventually tried linked investors with local supply chains. However, SEE countries still need to work on introducing customer relationship management systems and follow-up activities or aftercare services. CRM services should link both investment opportunities with targeted investors.

Looking ahead, based on the current situation as indicated by the OECD (2016) assessment, all SEE investment promotion agencies should consider updating and developing more some of their policy aspects by strengthening the implementation of their investment promotion strategies. This is clearly the case for Bosnia and Herzegovina and Kosovo, who already have quality strategies, but lack behind when it comes to their

implementation. In addition to these two countries, FYR Macedonia is strengthening its focus on reducing administrative points of contact and transferring more responsibility for this to their IPA's by strengthening the capacities of their IPA's, such as increasing their annual budgets.

Further developing aftercare services provided by SEE countries' IPA's would also bring additional benefit to local economies by linking foreign investors with domestic supply chains. This is an area where all SEE countries have a need for strong development. In addition to this, OECD (2016) also recommend to build up on the limited existence of customer management systems in order to ease their IPA's communication and targeting of investors.

Having said all this and considering the results of this master's thesis explained in chapter 4, it is still very difficult to define the level of impact that the work of IPA's of SEE countries has on the inflow of FDI into these economies. This master's thesis complies with the results of the OECD (2016) research results in the conclusion that only investment promotion and facilitation strategies are measurable in terms of affecting the flow of FDI and all other indicators are yet to be further developed and implemented. Once this process is completed, there is a high probability that more indicators can produce a clearer effect and can be subject to influence to FDI.

3 REVIEW OF EMPIRICAL STUDIES ABOUT THE RELATIONSHIP OF INVESTMENT PROMOTION AGENCIES AND FDI

Empirical literature on FDI is mainly focused on analysing traditional determinants of FDI. In principle, there is a lack of research of institutions. There only a couple of papers available with a focus on the impact of IPA's on FDI. These studies are presented in Table 8. in this chapter. Accordig to Silajdzic and Mehic (2013), the role of institutions in general economic terms has not been a subject of examination for a long period of time and outside of the centre of academic and policy discussion.

Majority of the resarch conducted and related to investment promotion and IPA's is reletaed one or the other way exclusively to the following rather practical than theoretical sources: World Bank's Foreign Investment Advisory Service (FIAS), World Bank Multilateral Investment Guarantee Agency (MIGA), Global Investment Promotion Best Practices and perhaps as the most relevant United Nations Conference on Trade and Development (UNCTAD). However, these sources provide a significant academic value trough their specific institutional policy focused approach. On the theoretical side and despite the fact that investemnt promotion as an activity has gained a much more active role in the national policies, the exact impact of investment promotion has not been extensively analysed by economic theorists.

The overview of the most valuable theoretical studies on the effectiveness of IPA's is shown in Table 8 below. According to Dunning (2004), the institutions are expected to play a more important role and increasingly influence multinational companies by setting positive local patterns in a world of increased competition between countries for a higher share of FDI. Same paper states that key feature of institutions and the institutional infrastructure of which they are part is that they are location bound extra market instruments designed to facilitate economic activity (including inbound FDI), by reducing the transaction costs of such activity. Such transaction institutions are well known to international business scholars.

They present the so called hassle costs of doing business as well as the uncertainties from possible opportunism, moral hazards and incompleteness in commercial dealings. Further on, the same paper states that the purpose of an effective and market facilitating institutional infrastructure is to reduce these costs which, among others, include inadequate property rights, the absence of property regulated banking system, widespread corruption, imperfect or underdeveloped financial markets as well as weak incentive structures. All these factors contribute positively to the competitiveness of companies.

One of the first studies that dealt with investment promotion effectiveness was done by Wells and Wint (1990). This study presents a clear structure and individual functions of IPA's. In addition, this study also was the first one to emphasize significant influence of IPA's work on FDI levels. For long time it was the only study that evaluated the aspects of marketing a country. The negative side of this study is that it lacked to measure the level of promotion. According to Wells and Wint (1990), investment promotion was divided into four individual areas:

- national image building,
- investment generation,
- investor facilitation,
- advocacy of policy

The first – national image building is being considered as a marketing campaign being implemented on a national level with a pretty clear aim of the IPA to voice the message of the country as an attractive location for multinational investment. Moving on down this process, the investment generation focuses on a specific sector, company or targeted market with an aim to create a trigger and investment lead. Once the investor or more potential investors have been identified, investor facilitation activities are supposed to assist the investors on the more technical side, such as identifying locations and assistance with regulatory requirements. On top of that, the activities related to policy advocacy are focusing on transmitting successful messages to other potential investors, but also facilitate communication with host governments regarding identified issues as well as suggesting to policy makers to adopt best practices and make improvements to existing investment policies.

A part of this study conducted by Morisset and Andrews-Johnson showed that the outcomes were related to the capacity of investment promotion which explains cross country flows in FDI inflow using more recent data. Furthermore, significant influence of the structure of IPA's was recorded. Wrapping up this study, it clearly shows the evidence of IPA's focusing primarily on the image building and activities related to investment generation. The same study also indicates that, statistically seen, investment promotion activity has a positive impact on attracting FDI. A very similar research approach has been conducted by Morisset and Andrews-Johnson (2004). The main difference was that this study on effectiveness of IPA's was conducted based on a much better data and evidence. The main conclusions from this study suggest that activities related to policy advocacy make the most impact on attracting FDI.

The second most important activity according to this study present image building and investor facilitation services on their third place. The authors did not manage to identify a strong effect of investment generation on FDI. On the other hand, investment generation has a strong budgetary stake in most of the budgets of IPA's. As concluded by Harding and Javorcik (2011) and Loewendahl (2001), sector targeting as the third generation of investment policy, has the biggest impact on attracting FDI. It showed clear evidence of targeted investor tailored services are much more effective than general investment promotion campaigns, without a particular target. The empirical study by Charlton and Davis (2007) confirms the theoretical implications from the previous studies claiming that the FDI inflow increased by 41% in a specifically targeted sector and that those sectors which were specifically targeted by IPA's marked more than double inflow of FDI compared to other non-targeted sectors.

All the before mentioned theoretical research conclusions go in favour of targeted investment promotion activities and successful attracting of FDI within the targeted sectors, as well as in favour of efficient use of investment promotion resources. Furthermore, a relatively new study by Harding and Javorcik (2013) focuses for the first time on the quality of services provided by IPA's.

Until this study, several measures have been undertaken in majority of IPA's to increase the quality of the services they provide. In order to measure the quality, the authors used data related to the quality of IPA's websites and inquiry handling to support this empirical research. As like the previous studies, the conclusion of this one also confirms that the quality of services provided by IPA's are very much related with increased quantity of inflows of FDI. In practical terms, the conclusion of this study means that successful investment promotion activities require a high degree of professionalism along top quality services along a well maintained, up-to date and user friendly website containing specific information, particularly what the investors require during the selection process. On a different method, the study by Head, Ries and Swenson (1999) has a different approach in investigating the effectiveness of IPA's. This study places a decentralised presence of IPA

offices and interestingly concludes that investment promotion can generate FDI even in case of lack of availability of investor-relevant information.

Results of most other studies conclude that investment promotion is the most efficient for countries that have an attractive business environment. This clearly states the forefront importance of business environment compared to investment promotion activities. On the other hand, IPA's still play an important role in the whole process, especially when it comes to provision of supporting services to investors. Harding and Javorick (2011) still claim that investment promotion has a positive effect on quicker flow of information. They also state that investment promotion is working well only in developing countries, where it helps in overcoming the bureaucratic procedures which present obstacles for investors.

Moving forward with the theoretical research, Sung-Hoon Lim (2008) has conducted the research on influence of the establishment on the FDI inflows. His study investigated the role of IPA's as a mediating unit between the host country business environment and FDI. He concludes that IPA's mediation bases on its position as influencer of multinational companies by influencing their decision and covering negative aspects such as lack of information. Morisset and Andrews-Johnson (2004) claim that the primarily significant role is still played by the host-country investment climate and not by IPA's, even in case when IPA's conduct brilliant performance. They claim that IPA's only act as facilitators, without the power to influence and implement regulations or policies that are of key importance to the potential investor. In practical terms, this means that IPA's act as a bridge between the business environment and inflows of FDI.

The second group of literature present studies by different international organisations. The World Bank's Foreign Investment Advisory Services (FIAS) and the Global Investment Promotion Best Practices assess how much the quality of IPA work affect FDI. FIAS is publishing different innovative studies related to this subject on a regular basis. Perhaps UNCTAD's studies are most relevant and important for this topic. This studies are quite similar to FIAS. They are based on global surveys of IPA's. They are used in particular for general evaluation of trends and IPA performances with a special focus on examples of best practices in investment promotion.

The annual survey which is a part of UNCTAD's regular surveys, The World of Investment Promotion at a Glance, is a global summary of IPA's organizational structure and tools. Many useful information regarding IPA's best practices in investment promotion can be found in The Survey of Best Practices in Investment Promotion, also part of UNCTAD. This paper has a similar aim which is to identify the best practices as a pre-condition to develop effective policies and practices for investment promotion. Rodrik (2002) produced studies for The Multilateral Investment Guarantee Agency (MIGA), which is also part of the World Bank Group. These documents are as other World Bank documents policy focused with a goal to improve the capacity of IPA's worldwide with a special focus on developing

countries. These studies present IPA's performance evaluation that assess the quality of IPA's based on investor enquiry examples for world-wide agencies for investment promotion.

They also compare individual performances of IPA's. The main advantage and message of these studies is that good quality information provided by IPA's to potential investors can very much influence their decisions to locate their investments in a certain market. It is based on a strong industry evidence. The negative aspect of these studies is their general or large level focus of research, very often limiting the information on results from surveys of participating investment promotion agencies worldwide. The results usually provide a general picture of investment promotion worldwide very often lacking to provide information about individual agencies as well as regional analysis and comparisons.

The research on IPA's and investment promotion in general in SEE is almost non-existent. I was not able to find any specific research document that focused on SEE. Many authors claim that there is still many directions that needs to be further investigated because the area of investment promotion contains numerous empirical gaps. Morriset (2004) stated that individual case studies and regional comparisons are one of the best ways to overcome the lack of information on empirical gaps within investment promotion literature. With this in mind, the global IPA literature covers global trends and useful guidelines on how to improve IPA's.

Table 8. Overview of previous studies of IPA activities

Author	Main topic of research	Sample data and country	Methodology	Results
Wells and Wint(1990 and 2000)	The focus here was to identify the specific techniques used in investment promotion and to define how to use them in a most effective way to attract FDI. Further on, the study tried to identify the best organisational structure for IPA's and to measure the effectiveness of their activities through specific models.	As a ground for the research, 50 individual case studies were taken from both developing and developed economies. The oldest one was from 1985 stretching until 1998.	Two methodological approaches were based on two individual processes: statistical analysis related to listing of countries by business facilities with active promotion in the USA as a dummy and interviews.	A positive connection between IPA's activities and FDI was identified.
Head, Ries and Swenson (1999)	This study focused mainly on the statistics and its significance of IPA's activities of individual countries.	The samples were based on 760 Japanese manufacturing establishments in the USA during 1980-1992.	Regression analysis by using a dummy for the investment promotion office based in Japan.	The research was focused on Japan and no significance was identified of IPA's work. However, a positive effect was identified.
Loewenda	Case studies focused on	Information available	The research is based on	The case-study

continued

<p>(2001)</p>	<p>strategy, organisation, lead generating activities, investor facilitation and investment services.</p>		<p>case studies. Empirical test have not been conducted.</p>	<p>results suggest that the following activities provide the best results: combine integrated marketing activities of marketing image and targeting of specific potential investors together with post-investment care activities and development of specific services.</p>
<p>Morriset and Andrews-Johnson (2004)</p>	<p>How do investment promotion activities explain different levels of FDI in different countries. How important is the overall country business environment for FDI and its relation to investment promotion activities. The variations of investment promotion activities in different functions or individual activities.</p>	<p>58 cases from 2001</p>	<p>In general, the analysis was based the approach where it was assumed that governments strive to bring the levels of FDI to a maximum, by minimising resources for promotion at the same time. The following proxies for investment promotion were used: IPA budget, IPA staff, public agency dummy, number pf private representatives in the IPA board, prime minister/president dummy.</p>	<p>The results prove that investment promotion activities are able to influence potential investors and this to some extend explains the FDI difference in different countries. When it comes to functions of investment promotions, this paper identified that the most effective function is attributed to the policy advocacy on first place and image building and investor service as second and third. Investment generation activities have not proved to have significant influence in FDI increase. Importance of IPA's and their activities does not play an important role according to this study. Only some aspects of IPA's activities such as</p>

continued

				reporting and support from private sector are contributed to increased inflows of FDI.
Charlton and Davis (2007)	This study focused on the question if IPA's activities really contribute to the increase of FDI or their work only supports the FDI that would happen anyways.	19 OECD countries in the period from 1999-2001	Panel data difference – in difference matching score estimator.	This study confirms that IPA's activities have a positive effect on the increase of FDI leading to a significant increase in targeted industry sector of up to nearly 50%.
Babonis and Shatz (2007)	Does merging and acquisitions including clustering in the USA lead to increase of FDI. In addition, this paper investigated whether fiscal policies and incentives for foreign investors contributes to the increase of FDI flow.	Levels of FDI across USA from 1977 – 1996.	Arellano-Bond dynamic panel data generalised method of moments (GMM) estimator, OLS and FE regressions.	When it comes to developed countries, the results indicate a positive impact and relation to IPA's activities. The FDI was increased by almost 1% on a annual basis in geographic regions where IPA's operate.
Lim (2007)	In what ways can IPA's contribute and influence FDI.	Cross section analysis of 68 countries where the Korea Trade Investment Promotion Agency operates their offices. It is 22 offices in Europe, 15 in Middle East and Africa, 2 North America, 12 in Central and South America in 1999.	Structural equation analysis with estimations of a maximum likelihood regarding IPA as a mediator between the host county's FDI environment and FDI inflows. The proxies used for investment promotion included the following: IPA age, overseas staff intensity (ratio of overseas staff compared with locally engaged staff) and number of IPA staff.	The overall results of the empirical analysis suggest a positive relation of IPA's activities with regards to FDI inflows.
Lederman (2010)	Research around the impact of export promotion agencies on exports and which models of institutions have the largest impact.	103 developed and developing economies in 2002.	OLS and Heckman regression analysis.	The results of the empirical analysis show a positive impact of export promotion agencies on exports. The key

continued

				strength and benefit of export promotion agencies lies in the area of overcoming trade barriers and information flow, particularly about export opportunities.
Harding and Javorcik (2011)	Research to respond to the question if targeted investment promotion activities increase the number of FDI compared to non-targeted activities for the same period.	124 countries from 1990 – 2004 of FDI from the USA.	Regression analysis with difference – in – difference approach and country year-fixed effect, country-sector fixed effect and sector-year fixed effect.	The study concluded that targeted IPA activities produce even double the amount of FDI than general or non-targeted activities. A very important conclusion of this study suggests that investment promotion activities work better in developing economies than in developed ones. It also suggests that investment promotion is more important for countries with less transparency, increased corruption, with less regulated business procedures (i.e. establishing of business, construction permit administration, etc.)
Symelite (2012)	The impact of investment promotion activities in the Baltic States.	Lithuania, Latvia and Estonia.	The following three multiple criteria methods were used: Simple Additive Whitening (SAW), Algorithm of TOPSIS, CDM-23 method. A set of 25 criteria describing FDI were investigated.	Even the different models of investment promotion used in the three different countries proved a positive impact on FDI. The reason Estonia has the highest level of FDI lies primarily in the fact that Estonia

continued

				implemented the full package of investment promotion activities, including image building, investment generating and investment services compared to the other two Baltic countries which are still on the image building stage of investment promotion development.
Filippov (2012)	Overall examination and analysis of investment promotion activities of EU 27 IPA's and other non-EU European countries, with a particular emphasis on FDI from BRIC countries.	27 EU member states including 3 federal regions from Belgium and 9 non-EU European countries (Albania, Bosnia and Herzegovina, Croatia, Iceland, Macedonia, Montenegro, Norway, Serbia and Switzerland in June 2012.	Case study analysis with a particular focus on investigating if IPA's have websites in BRIC languages as well as representational offices in those countries.	The results of the analysis indicate that 39 IPA's from European countries benefitted significantly due to focusing their investment promotion activities in BRIC countries. This supports the decision made by the IPA's to focus on BRIC countries when targeting their investment promotion activities. On the other hand, the results were negative for some countries, meaning that there was no FDI value transformed from investment promotion activities. This was the case for small number of countries.
Djokoto (2012)	Does increased and more quality investment promotion activities cause an increase of FDI at the same time.	FDI inflows to Ghana from 1970-2008.	Co-integration among investment promotion and FDI into Ghana was established by using auto regressive distributed lag	The regression analysis based on aggregated data provides a positive response suggesting

continued

			(ARDL) models in the presence of a mix of 1 (0) and 1 (1) variables.	a relevant significance between investment promotion activities, its quality on one side, as well as FDI inflow into countries with high quality investment promotion services.
Harding and Javorcik (2013)	Do better quality of IPI services result in higher inflows of FDI?	156 countries during 2000-2010.	The analysis was based on aggregated data: regression analysis controlling for a set characteristics of the host country, robustness checks by controlling business climate the effectiveness of the government. Analysis based on sector level: regression analysis with difference-in-difference approach and the normalised IPI quality score, country and industry fixed effects.	The findings suggest that a positive and statistically significant relationship between IPI quality and inflows exists. Increased volume of FDI is attracted by countries IPI with higher quality of handling investors' enquiries and better quality of their websites. One-unit increase in the GIBP score was associated with a 1.5% increase in FDI inflows.

Although the importance of IPA's within national policies has gained momentum during the last 20 years, the research on the effects that the work of IPA's produce has been quite limited. By analysing the results of the literature review related to the work of IPA's and their impact on FDI, it can be concluded that the results in general have no consensus and show mixed results. It is important to conclude that studies whose subjects are dealing with developed economies usually identify a negative effect of IPA's on attracting FDI, while studies that focus on developing economies produced positive effects. The negativities or lack of the studies listed above are related primarily to the fact that the empirical tests of the literature was based on crude proxies of IPA's, in most cases measuring the institutional aspect of IPA's, rather than measuring the IPA's performance.

In addition, the negative aspects of the existing literature include an overall focus on direct factors affecting FDI, rather than investigating indirect factors. However, the majority of the literature showed significant results in terms of a positive effect that the work of IPA's produce on the FDI. In terms of SEE countries, there is a clear lack of research focusing on the work of IPA's and their role in attracting FDI. Therefore, the goal of this research is to fill this gap.

4 EMPIRICAL ANALYSIS: THE ROLE OF FOREIGN INVESTMENT PROMOTION AGENCIES AND THEIR IMPACT ON FOREIGN DIRECT INVESTMENT IN SOUTHEAST EUROPE

4.1 Data and Methodology

The empirical analysis of the relation between IPA's activities on attracting FDI in this master thesis is based on a sample of South-east European countries. Each observation point in our dataset reveals FDI flows between home country i (EU-15) and host country j (Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Montenegro, Romania and Serbia) in the period from 2009 to 2011. Denoting the year by t , the source country by i and the host country by j , we estimate the following specification:

$$FDI_{ij} = GDP_i + GDP_j + Distance_{ij} + IPA_j + Wage_j + Inflation_j + e_{ij} \quad (1)$$

where:

FDI_{ij} denotes log FDI stock between home and host countries;

GDP_j denotes log of gross domestic product of home country i ;

GDP_i denotes log of gross domestic product of host country j ;

$Distance_{ij}$ denotes log distance between capital cities of host and home countries;

$Wage_i$ denotes log unit labour cost of the host country i ;

$Inflation_i$ denotes log inflation rate of the host country i ;

IPA_i the quality of investment promotion activities provided by IPA of host country i ;

e_{ij} denotes error term.

The dependant variable in this research represents annual level of bilateral FDI between host and home country. FDI flows vary significantly among transition economies. Given the nature of the data, and following Di Mauro (2000) and Christie (2003), we opt for using the FDI stock levels, rather than FDI inflows. Looking at the stock level has the advantage of stripping out the business cycle and any other 'time anomalies'. In addition, Christie (2003) suggests that indicating the FDI stock levels instead of inflows justify the link to the functional form of the gravity equation because FDI inflows can be nil or even negative, which is something that the gravity equation cannot account for. On the other side, stocks at least can never be negative. The source for FDI as a dependant variable has been extracted from the Database on FDI published by The Vienna Institute for International Economic Studies (WIIW).

Each observation has been designed as an average of bilateral data between SEE region countries as receiving countries of FDI and EU 15 countries (Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and United Kingdom) that invested in individual countries of South-east

Europe (Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Montenegro, Romania and Serbia) between 2009 and 2011.

The independent variable of interest in this research is the quality of investment promotion activities provided by IPA. Measuring this variable was based on a series of indicators about investment promotion and facilitation in SEE countries, published in the Investment Reform Index (hereinafter: IRI) by OECD. According to IRI (2010) investment promotion and facilitation (hereinafter: IPF) covers issues bearing on the IPF strategy, the institution implementing the strategy, and the monitoring and evaluation mechanisms in place to gauge progress. The IPF sub dimension also assesses specific investment promotion services and activities to attract and retain foreign investment. These activities include, among others, the development of linkages between foreign investors and local enterprises, implementing client relationship management processes and one-stop shop assistance for foreign investors in their pre-establishment phases.

The major advantage of IRI is that it combines different sources of data, such as OECD Investment Compact and compares it with other sources such as World Bank, European Commission, etc. This clearly provides a visible picture of priorities of policies and institutional investments for governments.

Investment promotion and facilitation activity includes mainly the investment promotion strategy and the institutions that are tasked to implement the strategy. Exactly this brings Investment Promotion agencies at the forefront of the strategy. This phase also includes close and regular monitoring and evaluation mechanisms that are supposed to secure progress.

Considering the fact that IRI adopted the comparative framework based on the experiences of OECD and that it includes both quantitative and qualitative data from different relevant sources, we believe that the before mentioned indicators present a clear picture of reforms for improvement of investment climate in SEE countries, including the quality of FDI policy and services provided by IPA's, better than any other available indicators. The use of these indicators adds additional value to this analysis. A detailed description of each variable related to the quality of investment promotion activities provided by IPA used in this analysis is given in Table 9.

Table 9. Description of the quality of investment promotion activities provided by IPA variables

Variable	Description
Strategy	The strategy indicator considers whether a strategy has been ratified by government, identification of specific sectors to be promoted to foreign investors, an organisational structure (e.g. responsibilities of senior management and implementing units in the IPA), planning mechanisms relevant to human and financial resource needs (e.g. budget estimates) and the presence of a timetable for review.
Implementing agency	This indicator considers whether: the IPA has the backing of senior government officials; its internal organisation is developed; staff are drawn from both the public and private sectors and speak multiple languages; the annual budget is based on a carefully defined programme of work and covers all overhead and human resource costs; the IPA has an internal planning mechanism which consists of a calendar of events, statistical tracking database and internal rules of procedure; and a system exists for monitoring and evaluating results of activities.
Monitoring and evaluation	Monitoring and evaluation mechanisms can be used to track an IPA's performance and determine whether its objectives are being met and at what cost. The criteria used in this indicator include whether: annual reports are prepared by the IPA, activities undertaken by the IPA are assessed, the performance is benchmarked against other IPAs and the annual report is publicly released.
SME-FDI linkages	This indicator considers whether: the IPA has a defined linkage strategy (e.g. have specific sectors been prioritised and are there potential foreign and local participants), a basic operating structure exists (i.e. is there a unit within the IPA that implements the linkage programme), a monitoring mechanism exists to track the linkage programme's progress and whether the linkage programme has been expanded to other sectors.
One-stop shop	This indicator assesses to what extent foreign investors can rely on an IPA's OSS services. An IPA which can provide on-site approval for licenses, permits and other registration steps will receive a higher score than an IPA which only collects the necessary documents and forwards them to the appropriate bodies within the government.
Client relationship management (CRM)	This indicator considers whether: the IPA has a system in place to track foreign investors' corporate information and all exchanges of communication between the IPA and the foreign investor, noting specific preferences in location; there is timely follow-up of investor inquiries; the CRM database is structured, regularly updated, user-friendly and easily accessible; and the IPA uses information gathered from its CRM system to tailor promotional material to investors.
Policy advocacy	The indicator considers whether: a specific unit exists within the IPA to undertake policy advocacy activities, regular consultations are held with foreign investors, annual assessments of the impact of FDI are undertaken and the unit has a specific role in the development of investment policy.
Aftercare services	This indicator considers the type of aftercare services an IPA provides to foreign investors, such as administrative support (e.g. assistance with obtaining licenses and permits) or operational support (e.g. finding local suppliers). The indicator also considers whether the IPA provides investors with guaranteed response times to inquiries.

Source: OECD. *Monitoring Policies and Institutions for Direct Investment in South-East Europe*, OECD Investment Reform Index 2012, 2012.

Further, we incorporate a set of control variables in our model. We include information on gross domestic product of home and host country (GDP_i and GDP_j), distance (DIS), labour cost (LC) and inflation rate (INF), which proved to be significant in a number of previous empirical studies (Grossman and Helpman, 1991; Bevan and Estrin, 2004; Kinoshita and Campos, 2004; Silajadzic and Mehic, 2012, etc). The home country market size is approximated by the home country GDP. According to Resmini (2000), most empirical studies dealing with FDI, particularly with countries in transition suggest that there is a positive relation between home country GDP and FDI.

Our model also includes the GDP of the host country. The host country GDP presents the proxy for the size of the host country market. This also presents the size for the potential market for the investor (home country), although, FDI does not always target the host market only. This is particularly the case in SEE economies, where a regional presence is usually preferred due to small market size of individual markets. Resmini (2000) states that bigger markets usually present bigger opportunities for new products or services. Further, our model also includes the geographical distance between the FDI home and host countries. The geographical distance represents the distance between the FDI home and host countries' capital cities in kilometres. This data was sourced from the World Distance Calculator database. The distance serves as a proxy for all means of transport, operational costs, infrastructure, cultural factors, costs related to communication, transaction costs, etc. (Limao and Venable, 2001). The labour cost is another control variable used in this research. According to Neuhaus (2005), the prevailing factors for attracting FDI besides the market size and dynamics and access to the FDI host market definitely include the costs and quality of the inputs (labour). As mentioned before in this study, companies can engage in FDI because of primarily lower production costs in the FDI host country including costs of energy, raw materials, but particularly because of labour costs. With this in mind, labour costs have special importance in industries with high labour intensity. However, majority of results in research studies such as the one by Silajadzic and Mehic (2012) point out that labour costs do not have special significance on the decision for the location of FDI. According to the same study, the proxy variables for labour costs are neither consistently statistically significant in FDI models, nor consistently negatively related to FDI. There are also other authors that have found a negative a non-significant relation of labour costs on FDI, such as Clausing and Dorobantu (2005) and Johnson (2006). In our analysis unit labour cost is measured as an average gross monthly wages. The source for this variable is extracted from UN ILO database.

The last control variable used in this model is the inflation rate. Inflation rate is often used as a proxy for prudent fiscal policy and macroeconomic stability. In addition, this variable is often related to economic reforms and their successful implementation in transition economies and presents an important indicator to foreign investors about the health of the host economy, but also indicate the risk for the investment. A low inflation usually indicates that the host government has a committed approach to economic reforms. It is

then assumed that countries with lower inflation rate will attract more FDI (Kinoshita & Campos, 2002). The source for this variable has been extracted from the World Bank database. Table 10 and Table 11 present the descriptive statistics of variables and the correlation matrix among variables, respectively.

Table 10. Descriptive Statistics

Variable	Observations	Mean	Stand. Deviation	Min	Max
FDI average	97	1070.1	2022.74	0.13	11264
GDPi	138	6888.15	2954.16	4215.56	14069.50
GDPj	138	41766.16	21922.81	4215.56	105909.60
Distance	138	1351.01	688.22	153.50	2974.50
IP	138	3.14	0.45	2.50	3.80
Wages	138	401.17	120.96	291	710.70
Inflation	138	3.60	2.33	1.56	8.43
Strategy	138	3.70	0.80	2	5
Implementing agency	138	4.44	0.58	3.50	5
Monitoring and evaluation	138	2.75	0.43	2	3
SME-FDI linkages	138	1.87	0.32	1	2
One-stop shop	137	3.27	0.67	2	4
Client relationship management (CRM)	138	3.19	0.79	2	4
Policy advocacy	138	3.39	0.84	2	5
Aftercare services	138	2.29	1.19	1	4

It is interesting to note here that descriptive statistics indicate that some of the indicators move between values 1 and 2, or 2 and 3 while other indicators move between value 1 and 4, or 2 and 5. This leads to a conclusion that in individual dimensions of the quality, a huge difference exist in the activities that are related to the work of IPA’s (Strategy, Aftercare services, SME-FDI linkages), while in some dimensions individual countries have achieved similar results (Monitoring and evaluation and One-stop-shop). Related to this, a small variation in data between countries or a small standard deviation can produce an effect on insignificant results of the regression analysis. According to Table 11, it can be concluded that a high correlation between individual quality investment indicator exists, which is also expected considering the fact that individual dimensions of improvement of work of IPA’s tend to go together. This is why we incorporate the quality of investment promotion activities variables singly in equation (1). In addition, a high correlation amongst variables labour cost and gross domestic product of host country exist, so the estimation of model (1) will be performed both with and without the mentioned variable.

Table 11. Correlation matrix

Variable	FDI average	GDPi	GDPj	Distance	Wage	Inflation	IP	Strategy	Inst Supp	Monitoring	One stop	Client Relation	Policy	Aftercare	SME
FDI average	1.0000														
GDPi	0.4036	1.0000													
GDPj	0.3059	0.1069	1.0000												
Distance	0.0869	0.0461	0.6872	1.0000											
Wage	0.1816	0.8197	0.071	-0.0369	1.0000										
Inflation	0.2317	0.0303	-0.39	0.0036	-0.2511	1.0000									
IP	0.1196	0.416	-0.0696	-0.0829	0.2053	0.4188	1.0000								
Strategy	0.0544	-0.46	-0.0221	0.05	-0.6550	0.1484	0.0778	1.0000							
Implementing agency	0.1852	0.2129	-0.0355	-0.0582	0.0377	0.1725	0.7389	0.0337	1.0000						
Monitoring and evaluation	0.24	0.5931	0.022	0.0265	0.2810	0.2751	0.8263	0.1472	0.4372	1.0000					
SME-FDI linkages	-0.0514	0.3488	-0.0311	0.0326	-0.0554	0.2851	0.5417	-0.1371	0.2866	0.6556	1.0000				
One-stop shop	0.0875	0.3665	-0.0678	-0.1143	0.4211	0.1794	0.8463	-0.051	0.7028	0.6668	0.1559	1.0000			
Client relationship management (CRM)	0.2424	0.4167	-0.008	0.031	0.0249	0.4936	0.7197	0.4262	0.2284	0.8673	0.5685	0.4087	1.0000		
Policy advocacy	0.1299	0.5839	-0.0253	-0.1033	0.6606	0.0421	0.7775	-0.3323	0.681	0.6021	0.1733	0.9375	0.2841	1.0000	
Aftercare services	-0.1711	0.236	-0.1058	-0.1628	0.2775	0.352	0.53	-0.5858	0.3881	0.1422	0.4071	0.3968	0.0639	0.5087	1.0000

4.2 Results

We estimate regression equations based on specifications (1) using the Ordinary Least Squares (OLS) method of estimation. The results of the regression analysis are shown in Table 12. The printout of the OLS regression estimation is available in Appendix 1.

Table 12. Regression results

	Model 1	Model 2	Model 3	Model 4
GDPi	4.62*** 4.50	2.78*** 5.55	2.41*** 4.51	2.43*** 5.82
GDPj	1.52*** 4.62	1.41*** 4.54	1.42*** 4.21	1.45*** 4.95
Distance	-1.48*** -3.94	-1.29*** -3.86	-1.27*** -3.19	-1.48*** -4.63
Wage	-4.44*** -3.37			
Inflation	0.12* 2.21	0.19* 2.97	0.23* 4.27	0.33* 5.21
Strategy		0.74*** 3.44		
Aftercare services			-3.95* -1.68	
SME-FDI linkages				-0.65*** -4.99
Number of observations	97	97	97	97
R ²	0.42	0.42	0.37	0.49
F test stat	8.80	13.46	8.95	17.49
Prob > F	0.00	0.00	0.00	0.00
Skewness/ Kurtosis tests for normality	0.05	0.05	0.02	0.00
Prob > chi 2				
Breusch-Pagan/Cook-Weisberg test for heteroskedasticity				
Prob > chi 2	0,00	0.10	0,02	0.15
Ramsey RESET test for correct functional form				
Prob > F	0,27	0.15	0,68	0.09

Notes: Dependent variable: bilateral FDI stock between home and host country; t statistics are given in brackets; *Significance level=0.10; **Significance level=0.05; ***Significance level=0.01.

We first estimated baseline specification without including the variables related to the quality of investment promotion activities. Hereinafter the interpretation of variables' coefficients refers to on average, *ceteris paribus* conclusions. All variables have the expected sign and are significant at the 5% or 1% level. The results indicate that both home and host country size of the market proxied by GDP levels significantly determine FDI flows across SEE countries. The results also indicate that labour costs adversely affect FDI flows. The coefficient on labour cost is negative and significant at 1% level. Besides, the inflation rate is suggested to positively influence FDI flows. This variable is significant only at 10% level. Although unexpected higher inflation rates, in the SEE context, are associated with better growth performances. The VIF statistics for the estimated model shows that multicollinearity (i.e. $1/VIF = 0.2$) exists between the variables labour cost and gross domestic product of host country. So the results with the respect to labour cost variable may be treated with caution. On that account this variable was excluded from the estimation in the models that follow.

The diagnostic test Breusch-Pagan/Cook-Weisberg test for heteroscedasticity showed the presence heteroscedasticity. In case of presence of heteroscedasticity, OLS estimates are inefficient. In line with this, the usual tests of significance are generally inappropriate and their use can often lead to incorrect inferences. Given this we opted for modified OLS estimator that is VCE (robust) estimator. This estimator obtains consistent (i.e. asymptotically unbiased) results. The remaining diagnostic tests suggest that we can proceed with the interpretation of the results; the assumptions of normality and correct functional form cannot be rejected at conventional levels of significance.

Models 2, 3 and 4, in addition to variables integrated in baseline specification, included individual variables that are related to the quality of investment promotion activities. Table 12 shows the results of the three models. Here we note that the table includes only investment promotion variables found to exhibit significant influences on FDI inflows. All control variables have the significant influences on FDI flows (GDP home and host countries, Distance and Inflation). It should also be noted that changes in the magnitude of the coefficients for these variables for three models estimates are negligible which indicates the stability of the estimated model (see models 2, 3 and 4). In the model 2, the Strategy variable has an expected positive and significant impact on the inflow of FDI. However, in model 3, the Aftercare services variable has a significant impact, but at the same time an unexpected negative sign. A possible explanation for this result can be found in the result of the diagnostic test Skewness/Kurtosis test for normality. This diagnostic test suggests that we cannot proceed with the interpretation of the results; the assumptions of normality can be rejected at conventional levels of significance of 5%. A similar explanation can be used for the results in model 4. The SME-FDI linkages variable has an unexpected negative sign and is statistically significant at 1% level. The diagnostic test for normality and functional form can be rejected at conventional levels and the results cannot be interpreted. Finally, it is interesting to note that out of all indicators used as proxy variables quality of investment promotion activities, only those variables whose data varied between the countries were found to exhibit significant influence (e. g. limited variability in the data). For all other variables where data showed fluctuations ranging between the values 1 and 2 or 2 and 3 on the scale of 1 to 5, we obtained insignificant results, as we initially assumed.

CONCLUSION

The goal of this master's thesis was to analyse the impact of the quality of investment promotion activities provided by IPA's on the inflow of foreign direct investment in SEE countries. This thesis also attempted to fill in the gap in the geographical subject of research and contribute to the existing literature related to work of IPA's in the SEE countries that is their impact on FDI. The following research question was investigated: *Does the quality of investment promotion activities provided by IPA's of SEE countries positively contribute to FDI inflows?*

The research was based on bilateral data for the host SEE countries and home EU-15 country data. For the variable of interest, different indicators, published by OECD, relating to the quality of investment promotion activities provided by IPA's were used. In addition to the mentioned variables, control variables such as GDP host and home countries, distance, labour cost, and inflation were used.

The results of the baseline gravity model show that the variables of GDP host country, distance, labour costs and inflation have significant impact on FDI in the countries of the SEE region. The research results suggest that, as expected, bigger markets attract more FDI because of the economies of scale. This leads to the conclusion that the foreign direct investments in SEE countries are market oriented.

As like in previous studies about the determinants of FDI, the gravity variable Distance is significant, which highlights efficiency as a motive in decision making about the choice of location form multinational enterprise activities. With this regard, the investment strategies of MNE's also include a relative importance of transport costs, communication costs, costs of stay of own personell outside the domestic enviroment, etc. However, from the aspect of implication for attracting FDI, the market size and distance have the least potential for implementing activities which would attract FDI to these countries. The importance of distance as an FDI determinant can be used by choosing a relevant geographic focus on those countries that will promote potential benefits of investment into individual countries of the SEE region.

The results of this empirical research confirmed also the argument that high labour cost have a negative influence on FDI. With regards to this, the choice of FDI location is also oriented by the search for cost efficiency.

Many studies related to the role of IPA's in attracting FDI have been published. However, none of them were specifically related SEE economies and even fewer dealt with measuring the impact of IPA's specific activities on attracting FDI. But is this really the case with SEE economies? This study aimed to provide an answer to this question. However, the results of the research could not provide a fully trustful answer.

The main reason for this is that the variables related to the quality of investment promotion activities provided by IPA's have no variability between countries and perhaps cannot accurately depict the differences in the character and the scope of IPA activities. Therefore, reliable conclusion about the causal relationship between the quality of investment promotion activities and FDI in this thesis is based on the obtained significant impact of the Strategy variable. For all other proxy variables, the results need to be interpreted carefully. Using the indicators for IPA's activities published by the OECD, present the main limitation of this research. With this in mind, the presented results by using indicators published by OECD should be supplemented by other analysis which would use other available indicators as the proxy variable for IPA's activities, which have higher variability between the countries in focus.

As a crucial part of the conclusion of this thesis, it is important to explain the strategy indicator and its importance for attracting FDI. This research also supports the proposition made by OECD (2010) that investment promotion strategy is a fundamental part of the institutional activity of the investment promotion and facilitation of all SEE countries. The conclusions and policy of this master thesis are similar to those made by OECD (2010 and 2016). On the level of individual countries, the results pretty much go in line with the following recommendations. For example, Serbia has developed one of the most upfront IP strategies and its IPA, the Serbian Investment and Export Promotion Agency (SIEPA) is effectively implementing the strategy. Albania and FYR Macedonia have also made substantial progress towards establishing a comprehensive strategy framework, which resulted in significant increase of FDI. As result of these strategies, both countries have well-funded and functioning IPA's, the Albanian Investment Development Agency AIDA and Invest in Macedonia. However, both countries still struggle to fully implement their strategies, especially when it comes to support in administrative processes to foreign investors (i.e. one stop shops, etc.).

The recommendations to improve this service should have a positive impact on FDI. On the other side, Bosnia and Herzegovina, Kosovo, and Montenegro have all adopted their IP strategies, but these countries are still on their way to develop a full investment promotion facilitation structure. In Kosovo, the services for foreign investors need to be centralised and supplemented by a complete range of services.

The Investment Promotion Agency of Bosnia and Herzegovina (FIPA) and the Kosovo Investment and Enterprise Support Agency (KIESA) are still not in the process of implementing the full set of services and measures which have been defined by their countries' investment promotion strategies. The positive announcements were made by the governments of these countries that they will allocate additional resources to fully implement these strategies. Particular focus needs to be put on one stop shop activities in these countries. Finally, as a recommendation for future research, we would suggest using of other indicators related to the activities of IPA's in econometric framework, as well as analysis of IPA's role in FDI promotion relying on qualitative research methods.

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APPENDIXES

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APPENDIX A: List of abbreviations

FDI - Foreign direct investment

SEE - Southeast Europe

IPA - Investment Promotion Agencies

MNE - Multinational companies

UNCTAD - The United Nations Conference on Trade and Development

R&D - Research and Development

IMF - International Monetary Fund

BRIC - Refers to the countries of Brazil, Russia, India and China

GDP - Gross Domestic Product

EU - European Union

OLI - Ownership advantages; Location advantages; Internalization advantages

FIAS - Foreign Investment Advisory Service

MIGA - World Bank Multilateral Investment Guarantee Agency

SME - Small Medium Enterprise

AIDA - Albanian Investment Development Agency

FIPA - The Investment Promotion Agency of Bosnia and Herzegovina

KIESA - Kosovo Investment and Enterprise Support Agency

APPENDIX B: FDI flow in South East Europe

Table 13. FDI Flow in South East Europe

Host	Home	FDI 2011	FDI 2012	FDI 2013	FDI average
Albania	Austria	220.5	353.7	443.6	339.3
Albania	France	26.2	39.9	51	39
Albania	Germany	74.5	83.8	83.6	80.6
Albania	Greece	559.9	601.1	507.5	556.2
Albania	Italy	347.9	386.8	427.4	387.4
Albania	Netherlands	207.3	222.7	253.1	227.7
Albania	Spain	0.1	0.1	0.2	0.1
Albania	United Kingdom	-5.3	-2.4	0.4	-2.4
Bosnia and Herzegovina	Austria	1016.2	970.9	1299.3	1095.5
Bosnia and Herzegovina	Germany	259.1	278.9	287.3	275.1
Bosnia and Herzegovina	Italy	110.8	118.2	123.6	117.5
Bosnia and Herzegovina	Netherlands	147.2	156.7	161.3	155.1
Bulgaria	Austria	5529.5	5822.9	5526.4	5626.3
Bulgaria	Belgium	427.7	432.7	537.9	466.1
Bulgaria	Denmark	254.5	258.1	269.6	260.7
Bulgaria	France	767.2	848.4	966.1	860.6
Bulgaria	Germany	1986	1842	1756.1	1861.4
Bulgaria	Greece	2873.8	2857.6	2759.7	2830.4
Bulgaria	Ireland	775.8	738.1	685.8	733.2
Bulgaria	Italy	621.1	724	780.8	708.6
Bulgaria	Luxembourg	951.3	1284	1363.7	1199.7
Bulgaria	Netherlands	7326.2	7230.6	7138.1	7231.6
Bulgaria	Spain	880.1	877.2	941.8	899.7
Bulgaria	United Kingdom	2665.2	2334.9	2183.7	2394.6
Croatia	Austria	7767.4	7542	8259.3	7856.2
Croatia	Belgium	207.2	316.6	220.2	248
Croatia	Denmark	165.9	150.4	126.9	147.7
Croatia	France	1265.1	661.5	761.4	896
Croatia	Germany	3300.1	3040.6	2717.5	3019.4
Croatia	Ireland	137.5	126.8	119.8	128
Croatia	Italy	611.2	683.8	638.6	644.5
Croatia	Luxembourg	1545.3	1389.9	1461.2	1465.5
Croatia	Netherlands	3621.5	2551.6	1941.7	2704.9
Croatia	Spain	90.5	81.1	90.1	87.2
Croatia	Sweden	456.4	352.7	381.6	396.9
Croatia	United Kingdom	934.4	789.5	762.8	828.9
Macedonia	Austria	362.6	371.7	416.8	383.7
Macedonia	Belgium	1.2	1.2	1.9	1.4
Macedonia	France	26.1	129.5	131.5	95.7
Macedonia	Germany	62	71.4	86.8	73.4
Macedonia	Greece	380.3	431.2	442.9	418.1
Macedonia	Italy	55.8	58.5	65.2	59.8
Macedonia	Luxembourg	62	16.1	15.4	31.2
Macedonia	Netherlands	523.6	550.4	740.4	604.8
Macedonia	Sweden	3.6	5.2	23.4	10.7

Macedonia	United Kingdom	76.7	102.5	48.1	75.8
Montenegro	Austria		121.3	90.9	103.6
Montenegro	Denmark		82.5	115.8	95.9
Montenegro	France		30.8	36.5	35.5
Montenegro	Germany		23.9	28.2	26.1
Montenegro	Greece		85.3	82.9	83.4
Montenegro	Ireland		32.7	36.5	35.2
Montenegro	Italy		423.3	440.4	432.3
Montenegro	Luxembourg		6.2	5.8	18.3
Montenegro	Netherlands		127.7	122.6	136.2
Montenegro	United Kingdom		133	129.7	131.4
Romania	Austria	9037	9346	9667	9350
Romania	Belgium	1115	864	1116	1031.7
Romania	Denmark	111	384	241	245.3
Romania	France	4259	4384	5042	4561.7
Romania	Germany	6718	6398	6272	6462.7
Romania	Greece	3281	3016	2934	3077
Romania	Ireland	137	146	193	158.7
Romania	Italy	2528	2808	3341	2892.3
Romania	Luxembourg	638	989	1274	967
Romania	Netherlands	10907	10903	11982	11264
Romania	Spain	841	1064	958	954.3
Romania	Sweden	146	312	402	286.7
Romania	United Kingdom	482	627	719	609.3
Serbia	Austria	2377.4	2533.5	2588.9	2499.9
Serbia	Belgium	67.2	73.5	75.1	71.9
Serbia	France	368.9	480.7	494.1	447.9
Serbia	Germany	1197.2	1273.5	1318.3	1263
Serbia	Greece	1309.5	1319.8	1025.5	1218.3
Serbia	Italy	759.6	890.4	972.1	874
Serbia	Luxembourg	349.2	1162	1227.4	912.9
Serbia	Netherlands	1242.3	1484.3	1487.1	1404.6
Serbia	Spain	47	97.4	112.5	85.6
Serbia	United Kingdom	314.4	344.3	383.8	347.5

Source: Vienna Institute for International Economics, *FDI Report for Central, East and Southeast Europe*, 2014

APPENDIX C: Results of OLS Regression Estimation and Diagnostic Tests

summarize FDIaverage GDPiav GDPjav Distance IP Wageav Infav Strategy Instsup Monitoring
Onestop ClientRel Policyadvoc Aftercare FDISME

Variable	Obs	Mean	Std. Dev.	Min	Max
FDIaverage	97	1070.1	2022.748	.1333333	11264
GDPiav	138	6888.151	2954.166	4215.567	14069.5
GDPjav	138	41766.16	21922.81	4215.567	105909.6
Distance	138	1351.012	688.2247	153.5	2974.5
IP	138	3.142754	.4463784	2.5	3.8
Wageav	138	401.1758	120.969	291	710.7
Infav	138	3.602174	2.333974	1.566667	8.433333
Strategy	138	3.706522	.8053839	2	5
Instsup	138	4.449275	.589723	3.5	5
Monitoring	138	2.753623	.4324703	2	3
Onestop	138	1.876812	.3298506	1	2
ClientRel	137	3.277372	.672243	2	4
Policyadvoc	138	3.199275	.7935411	2	4
Aftercare	138	3.391304	.849515	2	5
FDISME	138	2.297101	1.198597	1	4

. pwcorr FDIaverage ln GDPiav ln GDPjav ln Distance ln Wageav ln Infav IP Strategy Instsup
Monitoring Onestop ClientRel Policyadvoc Aftercare FDISME

	FDIave~n	GDPiavl~n	GDPjavln	Distan~n	Wageavl~n	Infav	IP
FDIaverageln	1.0000						
GDPiavl~n	0.4036	1.0000					
GDPjavln	0.3059	0.1069	1.0000				
Distanceln	0.0869	0.0461	0.6872	1.0000			
Wageavl~n	0.1816	0.8197	0.0710	-0.0369	1.0000		
Infav	0.2317	0.0303	-0.0390	0.0036	-0.2511	1.0000	
IP	0.1196	0.4160	-0.0696	-0.0829	0.2053	0.4188	1.0000
Strategy	0.0544	-0.4600	-0.0221	0.0500	-0.6550	0.1484	0.0778
Instsup	0.1852	0.2129	-0.0355	-0.0582	0.0377	0.1725	0.7389
Monitoring	0.2400	0.5931	0.0022	0.0265	0.2810	0.2751	0.8263
Onestop	-0.0514	0.3488	-0.0311	0.0326	-0.0554	0.2851	0.5417
ClientRel	0.0875	0.3665	-0.0678	-0.1143	0.4211	0.1794	0.8463
Policyadvoc	0.2424	0.4167	-0.0080	0.0310	0.0249	0.4936	0.7197
Aftercare	0.1299	0.5839	-0.0253	-0.1033	0.6606	0.0421	0.7775
FDISME	-0.1711	0.2360	-0.1058	-0.1628	0.2775	0.3520	0.5300

	Strategy	Instsup	Monito~g	Onestop	Client~l	Policy~c	Afterc~e
Strategy	1.0000						
Instsup	0.0337	1.0000					
Monitoring	0.1472	0.4372	1.0000				
Onestop	-0.1371	0.2866	0.6556	1.0000			
ClientRel	-0.0510	0.7028	0.6668	0.1559	1.0000		
Policyadvoc	0.4262	0.2284	0.8673	0.5685	0.4087	1.0000	
Aftercare	-0.3323	0.6810	0.6021	0.1733	0.9375	0.2841	1.0000
FDISME	-0.5858	0.3881	0.1422	0.4071	0.3968	0.0639	0.5087
FDISME	1.0000						

regress FDIaverageln GDPiavl~n GDPjavln Distanceln Wageavl~n Infav

Source	SS	df	MS	Number of obs =	97
Model	151.941984	5	30.3883968	F(5, 91) =	13.51
Residual	204.656519	91	2.24897273	Prob > F =	0.0000
				R-squared =	0.4261
				Adj R-squared =	0.3946
Total	356.598503	96	3.71456774	Root MSE =	1.4997

FDIaverageln	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
GDPiavl	4.62894	.9006985	5.14	0.000	2.839813	6.418067
GDPjavln	1.523553	.3133279	4.86	0.000	.9011653	2.14594
Distanceln	-1.484173	.3459183	-4.29	0.000	-2.171297	-.7970487
Wageavl	-4.444688	1.28267	-3.47	0.001	-6.992555	-1.89682
Infav	.1237771	.0720172	1.72	0.089	-.0192763	.2668304
_cons	-14.85199	3.999066	-3.71	0.000	-22.79564	-6.908335

. predict res, residuals
(41 missing values generated)

. sktest res

Skewness/Kurtosis tests for Normality

Variable	Obs	Pr(Skewness)	Pr(Kurtosis)	adj chi2(2)	joint Prob>chi2
res	97	0.0560	0.0233	7.88	0.0194

. estat hettest

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity

Ho: Constant variance
Variables: fitted values of FDIaverageln

chi2(1) = 9.44
Prob > chi2 = 0.0021

. estat ovtest

Ramsey RESET test using powers of the fitted values of FDIaverageln

Ho: model has no omitted variables
F(3, 88) = 1.31
Prob > F = 0.2770

. estat vif

Variable	VIF	1/VIF
Wageavl	4.95	0.202170
GDPiavl	4.71	0.212334
Distanceln	2.80	0.357665
GDPjavln	2.69	0.371496
Infav	1.26	0.794731
Mean VIF	3.28	

. regress FDIaverageln GDPiavl GDPjavln Distanceln Wageavl Infav, vce(hc3)

Linear regression

Number of obs = 97

F(5, 91) = 8.80
 Prob > F = 0.0000
 R-squared = 0.4261
 Root MSE = 1.4997

```
-----+-----
```

	Robust HC3					
FDIaverageln	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
GDPiavl	4.62894	1.027965	4.50	0.000	2.587014	6.670866
GDPjavln	1.523553	.3299939	4.62	0.000	.8680603	2.179045
Distanceln	-1.484173	.3762726	-3.94	0.000	-2.231592	-.7367537
Wageavl	-4.444688	1.320529	-3.37	0.001	-7.067757	-1.821618
Infav	.1237771	.0559722	2.21	0.030	.0125951	.234959
_cons	-14.85199	3.939353	-3.77	0.000	-22.67703	-7.026947

```
-----+-----
```

regress FDIaverageln GDPiavl GDPjavln Distanceln Infav Strategy

Source	SS	df	MS	Number of obs = 97	
Model	151.626122	5	30.3252245	F(5, 91) = 13.46	
Residual	204.97238	91	2.25244374	Prob > F = 0.0000	
Total	356.598503	96	3.71456774	R-squared = 0.4252	

Adj R-squared = 0.3936
 Root MSE = 1.5008

```
-----+-----
```

FDIaverageln	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
GDPiavl	2.78248	.5015213	5.55	0.000	1.78627	3.778691
GDPjavln	1.414893	.3113912	4.54	0.000	.796353	2.033434
Distanceln	-1.29877	.3361254	-3.86	0.000	-1.966441	-.6310978
Infav	.1950496	.065758	2.97	0.004	.0644295	.3256697
Strategy	.7419546	.2155465	3.44	0.001	.313798	1.170111
_cons	-28.25371	4.816812	-5.87	0.000	-37.82172	-18.68571

```
-----+-----
```

. predict res, residuals
 (41 missing values generated)

. sktest res

Skewness/Kurtosis tests for Normality

Variable	Obs	Pr(Skewness)	Pr(Kurtosis)	adj chi2(2)	joint Prob>chi2
res	97	0.0569	0.2574	4.89	0.0865

. estat hettest

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity

Ho: Constant variance

Variables: fitted values of FDIaverageln

chi2(1) = 2.68
 Prob > chi2 = 0.1019

. estat ovtest

Ramsey RESET test using powers of the fitted values of FDIaverageln

Ho: model has no omitted variables

F(3, 88) = 1.78
 Prob > F = 0.1561

. estat vif

Variable	VIF	1/VIF
GDPjavln	2.65	0.376712
Distanceln	2.64	0.379394
GDPiavl	1.46	0.685914
Strategy	1.43	0.699801
Infav	1.05	0.954698
Mean VIF	1.84	

. regress FDIaverageln GDPiavl GDPjavln Distanceln Infav Aftercare

Source	SS	df	MS	Number of obs =	97
Model	132.162528	5	26.4325055	F(5, 91) =	10.72
Residual	224.435975	91	2.46632939	Prob > F =	0.0000
Total	356.598503	96	3.71456774	R-squared =	0.3706
				Adj R-squared =	0.3360
				Root MSE =	1.5705

FDIaverageln	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
GDPiavl	2.415693	.5456431	4.43	0.000	1.33184	3.499546
GDPjavln	1.429123	.3264212	4.38	0.000	.7807269	2.077518
Distanceln	-1.273751	.3548204	-3.59	0.001	-1.978558	-.5689434
Infav	.2356953	.0678709	3.47	0.001	.1008781	.3705124
Aftercare	-.3954024	.231017	-1.71	0.090	-.8542892	.0634845
_cons	-21.37973	4.41212	-4.85	0.000	-30.14386	-12.61559

. estat hettest

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity

Ho: Constant variance
 Variables: fitted values of FDIaverageln

chi2(1) = 4.77
 Prob > chi2 = 0.0289

. estat ovtest

Ramsey RESET test using powers of the fitted values of FDIaverageln

Ho: model has no omitted variables

F(3, 88) = 0.49
 Prob > F = 0.6882

. estat vif

Variable	VIF	1/VIF
Distanceln	2.68	0.372798
GDPjavln	2.66	0.375372
GDPiavl	1.58	0.634494

```

Aftercare |      1.52    0.659020
  Infav   |      1.02    0.981280
-----+-----
Mean VIF |      1.89

```

```

. drop res
. regress FDIaverageln GDPiavl n GDPjavln Distanceln Infav Aftercare

```

```

Source |      SS      df      MS                Number of obs =      97
-----+-----                F( 5,      91) =     10.72
Model  |  132.162528    5  26.4325055          Prob > F      =  0.0000
Residual |  224.435975   91  2.46632939          R-squared     =  0.3706
-----+-----                Adj R-squared  =  0.3360
Total  |  356.598503   96  3.71456774          Root MSE     =  1.5705

```

```

-----+-----
FDIaverageln |      Coef.   Std. Err.      t    P>|t|     [95% Conf. Interval]
-----+-----
GDPiavl n |  2.415693   .5456431     4.43  0.000     1.33184    3.499546
GDPjavln |  1.429123   .3264212     4.38  0.000     .7807269    2.077518
Distanceln | -1.273751   .3548204    -3.59  0.001    -1.978558   -.5689434
  Infav   |  .2356953   .0678709     3.47  0.001     .1008781    .3705124
Aftercare | -.3954024   .231017     -1.71  0.090    -.8542892    .0634845
  _cons  | -21.37973   4.41212     -4.85  0.000    -30.14386   -12.61559
-----+-----

```

```

. predict res, residuals
(41 missing values generated)

```

```

. sktest res

```

Skewness/Kurtosis tests for Normality

```

----- joint -----
Variable |  Obs  Pr(Skewness)  Pr(Kurtosis)  adj chi2(2)  Prob>chi2
-----+-----
res     |   97    0.0211      0.0289      8.84        0.0120

```

```

regress FDIaverageln GDPiavl n GDPjavln Distanceln Infav Aftercare, vce(hc3)

```

```

Linear regression                Number of obs =      97
                                F( 5,      91) =     8.95
                                Prob > F      =  0.0000
                                R-squared     =  0.3706
                                Root MSE     =  1.5705

```

```
-----+-----
```

		Robust HC3				[95% Conf. Interval]	
FDIaverageln	Coef.	Std. Err.	t	P> t			
GDPiavl	2.415693	.5350827	4.51	0.000	1.352817	3.478569	
GDPjavln	1.429123	.3393482	4.21	0.000	.7550489	2.103196	
Distanceln	-1.273751	.3989483	-3.19	0.002	-2.066212	-.4812888	
Infav	.2356953	.0552407	4.27	0.000	.1259665	.345424	
Aftercare	-.3954024	.2351119	-1.68	0.096	-.8624232	.0716185	
_cons	-21.37973	4.437744	-4.82	0.000	-30.19476	-12.5647	

```
-----+-----
```

```
regress FDIaverageln GDPiavl GDPjavln Distanceln Infav FDISME
```

```
-----+-----
```

Source	SS	df	MS	Number of obs = 97		
Model	174.74947	5	34.949894	F(5, 91) =	17.49	
Residual	181.849032	91	1.99834102	Prob > F =	0.0000	
Total	356.598503	96	3.71456774	R-squared =	0.4900	
				Adj R-squared =	0.4620	
				Root MSE =	1.4136	

```
-----+-----
```

```
-----+-----
```

FDIaverageln	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
GDPiavl	2.433782	.417897	5.82	0.000	1.603681	3.263884
GDPjavln	1.451281	.2934698	4.95	0.000	.8683397	2.034223
Distanceln	-1.486065	.3209467	-4.63	0.000	-2.123586	-.8485434
Infav	.3356715	.0644595	5.21	0.000	.2076305	.4637124
FDISME	-.6559477	.1313823	-4.99	0.000	-.9169226	-.3949728
_cons	-20.52852	3.670529	-5.59	0.000	-27.81957	-13.23746

```
-----+-----
```

```
. predict res, residuals
(41 missing values generated)
```

```
. sktest res
```

Skewness/Kurtosis tests for Normality

```
-----+-----
```

Variable	Obs	Pr(Skewness)	Pr(Kurtosis)	adj chi2(2)	Prob>chi2	joint
res	97	0.0087	0.1505	8.00	0.0183	

```
-----+-----
```

```
. estat hettest
```

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity

Ho: Constant variance
 Variables: fitted values of FDIaverageln

chi2(1) = 2.04
 Prob > chi2 = 0.1536

```
. estat ovtest
```

Ramsey RESET test using powers of the fitted values of FDIaverageln

Ho: model has no omitted variables
 F(3, 88) = 2.18
 Prob > F = 0.0961

```
. estat vif
```

Variable	VIF	1/VIF
Distanceln	2.71	0.369184
GDPjavln	2.66	0.376279
FDISME	1.23	0.814808
GDPiavl	1.14	0.876446
Infav	1.13	0.881463
Mean VIF	1.77	