Factors Affecting Foreign Direct Investment Location in the Petrochemicals Industry, the case of Saudi Arabia

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BBS Doctoral Symposium 23rd & 24th March 2009
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Abstract

Foreign Direct Investment (FDI) is an important source of capital and economic growth in developing countries. It provides a package of new technologies, management techniques, finance and market access for the production of goods and services. However, attracting FDI is a major challenge for host countries as it faces the challenge of identifying the major factors that motivate and affect the FDI location decision. After reviewing the literature we identify the most important major location factors for FDI, which are the cost factors, market factors, infrastructure and technological factors, political and legal factors, and social and cultural factors. However, the previous studies lack the focus on the complexity of the relative important of the location factors to a specific industry and specific country. Therefore, this study will fill the previous studies gaps by studying the relative important of location factors to the Petrochemicals FDI located in Saudi Arabia.

Literature review

There has been a considerable literature on the determents of location factors for Multinational Corporations (MNCs) when they choose their foreign market location, but very little on the relative important of the location factors for FDI in specific country and industry.

It is widely believed that the trend towards globalize production and marketing has major implications for developing countries' attractiveness to FDI. The boom of FDI flows to
developing countries since the early 1990s indicates that multinational enterprises have increasingly considered these host countries to be profitable investment locations. At the same time, various experts argue that the determinants of and motivations for FDI in developing countries have changed in the process of globalization. As a consequence, it would no longer be sufficient to offer promising markets in order to induce FDI inflows. Policymakers would face rather complex challenges in striving for location attractiveness to FDI (Kokko 2002).

Reportedly, FDI are increasingly pursuing complex integration strategies, i.e., MNCs "increasingly seek locations where they can combine their own mobile assets most efficiently with the immobile resources they need to produce goods and services for the markets they want to serve" (UNCTAD 1998). This is expected to have two related consequences regarding the determinants of FDI. The Host countries are evaluated by FDI on the basis of a broader set of Policies than before. The number of policies constituting a favorable Investment climate increases, in particular with regard to the creation of Location-specific assets sought by FDI. The relative importance of FDI location determinants have changed. Even though Traditional determinants and the types of FDI associated with them have not disappeared with globalization, their importance is said to be on the decline. More specifically, "one of the most important traditional FDI determinants, the size of national markets, has decreased in importance. At the same time, cost differences between locations, the quality of infrastructure, the ease of doing business and the availability of skills have become more important" (UNCTAD 1996: 97).

Likewise, Dunning (1999) argues that the motives for, and the determinants of FDI have changed. According to Dunning, FDI in developing countries has shifted from market-seeking and resource-seeking FDI to more (vertical) efficiency-seeking FDI. It would have important policy implications if globalization had changed the rules of the game in competing for FDI. The
policy challenge may become fairly complex; host country governments would have "to provide and publicize a unique set of immobile assets, pertinent to the types of economic activity they wish to attract and retain, vis-à-vis those offered by other countries" Dunning (1999). Arguably, policymakers can no longer rely on the previous empirical literature stressing the overriding role of some clearly defined factors shaping the distribution of FDI.

Until recently, there was a strong consensus in the literature that MNCs invest in specific locations mainly because of strong economic fundamentals in the host countries for example, large market size, stable macro economic environment etc. (Dunning 1993, Globerman and Shapiro 1999; Shapiro and Globerman 2001). However, with the growing integration of the world markets and increased competition amongst the host countries to attract FDI, the host country’s economic fundamentals may not be sufficient for inward FDI. Therefore it now becomes important to study afresh what determines inflow of FDI. In this regard, there is a need to focus on the role played by host government policies and investment agreements in attracting Inward FDI.

Research’s Questions and Hypothesis

This research attempts to answer the following main question:

\[ Q: \text{What are relative important of FDI location factors in the Saudi Petrochemicals Industry} \]

The main question is broken into sub-questions to clarify the purpose of the research as follow:

\[ Q1: \text{What are the relative important of cost factors on FDI location decision in the Saudi Petrochemicals Industry?} \]
Q2: What are relative important of Market factors on FDI location decision in the Saudi Petrochemicals Industry?

Q3: What are relative important of infrastructure and technological factors on FDI location decision in the Saudi Petrochemicals Industry?

Q4: What are relative important of political and legal factors on FDI location decision in the Saudi Petrochemicals Industry?

Q5: What are relative important of social and cultural factors on FDI location decision in the Saudi Petrochemicals Industry?

The purpose of the research is to explore what are the relative important of FDI location factors in the Saudi Petrochemicals Industry.

According to this, the following hypothesis will be tested:

H1: Cost factors will play a major role on FDI location decision in the Saudi Petrochemicals Industry.

H2: Market factors will play a major role on FDI location decision in the Saudi Petrochemicals Industry.

H3: Infrastructure and technological factors will play a major role on FDI location decision in the Saudi Petrochemicals Industry.

H4: Political and legal factors will play a major role on FDI location decision in the Saudi Petrochemicals Industry.

H5: Social and cultural factors will play a major role on FDI location decision in the Saudi Petrochemicals Industry.
Objectives

There is a startling gap between current thinking on, allegedly, globalization induced changes in international competition for FDI and the lack of recent empirical evidence on shifts in the relative importance of traditional and nontraditional determinants of FDI in developing countries. The main objective of this research is to narrow this gap by making use of comprehensive survey data to identify the relative of important of FDI location Factors in the Saudi Petrochemicals industry. Therefore, we seek in this research to empirically examine the factors that influence foreign investors to engage in the Petrochemicals FDI in Saudi Arabia and what are the relative important of these factors on FDI location decision.

The study derives its importance from its coverage of an area in which there are relatively few studies in developing countries, in general, and Saudi Arabia, in particular, such countries have great need of this kind of study. As far as, the researcher is aware, this study is the first of its kind in Saudi Arabia and therefore it is hoped that this study will provide some useful insights, policy implications and recommendations for the country and international business community.

Research Methodology

We will use survey to test the hypothesis and will be sending to companies engage in FDI in the Saudi Petrochemicals Industry to determine their location factors priorities. The data for this research will be gathered using a questionnaire, from Petrochemicals FDI operating in Saudi Arabia. Saudi Investment Authority (SAGIA) records all foreign equity ventures operating in Saudi Arabia. SAGIA will provides the name, address and information about the Petrochemicals FDI operating in Saudi Arabia and represents the overall population of FDI, total paid-in capital,
proportion of foreign equity share holding, location of the investment, country of origin and entry date.

The names and contact address of chief executive officers (CEOs) and General Managers of each foreign partner will be compiled from SAGIA, the questionnaires will be hand over to the respective identified companies. We anticipate around 60% will be responded and participated in the survey. To analysis the data, Statistic Package for Social Science (SPSS) will be used. We have an official agreement for a full cooperation from SAGIA to provide us with all the information and logistic support we will need during the research study.

After reviewing the related literature on FDI location factors and studying the Saudi Petrochemicals industry we have chose the following five major location factors and sub-factors:

The main FDI location factors and sup-factors:

1. **Cost factors**

   *F1: Labour costs*

   *F2: Transpiration/ logistic cost*

   *F3: Low cost of raw materials*

   *F4: Return on investment*

2. **Market factors**

   *F5: Large size of host markets*

   *F6: Demand in host country*

   *F7: Level of competition in host market*

   *F8: Economic stability*

3. **Infrastructure and technological factors**
F9: Level of infrastructure
F10: High industrial concentration (Clustering)
F11: Availability of well qualify of work force
F12: Access to reliable and corporative suppliers

4. Political and legal factors
F13: Political stability
F14: International trade agreements
F15: Tax reduction in host country
F16: Benign environmental legislation towards FDI

5. Social & Cultural factors
F17: Cultural distance
F18: Attitude of the local community toward the firm

Limitations of the Research

The research has limited geographical focus, as it will focus only on FDI located in Saudi Arabia. Therefore, it is likely that the findings will not apply similarly to other countries. Another limitation is that the survey samples may not represent every sector of FDI in Saudi Arabia. Therefore, the findings may not apply to other sectors and of FDI in Saudi Arabia.
References:


Dunning, J.H. (1999), A Rose By Any Other Name? FDI Theory in Retrospect and Prospect, Mimeo, University of Reading and Rutgers University.


