GBRW CONSULTING

DFID Department for International Development

INVESTOR PERSPECTIVES ON EMERGING MARKET INVESTMENTS

STAGE 1 REPORT

February 25, 2013

Since 2002, GBRW has adopted a Corporate Social Responsibility policy which covers fairness to employees and associates; dealings with customers, suppliers and providers of finance; environmental protection issues; and contribution to the communities in which we operate

CONTENTS

FIGURES:

ACRONYMS

BRIC	Brazil, Russia, India and China
DFID	Department for International Development
EPZ	Export processing zone
FDI	Foreign Direct Investment
IB	International business
IFI	International financial institutions
IM	International (strategic) management
IMF	International Monetary Fund
IMD	International Institute for Management Development
IPE	International Political Economy
LDCs	Least developed countries
MNE	Multinational enterprise[1]
UNCTAD	United Nations Conference on Trade and Development

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[1] See "How do we define an MNE?" on page 7

1. EXECUTIVE SUMMARY

Terms of Reference

The study is based on a Discussion Document submitted to the Department of International Development (DFID) on December 17, 2012 by GBRW Limited (GBRW) and Investment Consulting Associates (ICA). This was supplemented by an Addendum dated January 8, 2013. These two documents set out the basis of the assignment and form the basis of the consultants' contract with DFID.

Selection of Focus Countries

Six Countries drawn from the list of the 21 countries which DFID classifies as Fragile and Conflict-Affected States (FCAS) were proposed as the Focus Countries for the study[2].

Country	Location	Population (million)	GDP (USD bn)	GDP per capita (USD)	GDP ranking
Bangladesh	South Asia	150.5	110.6	1,900	59
Myanmar	Southeast Asia	48.3	N/A	1,300	N/A
Nigeria	West Africa	162.5	235.9	2,600	42
Sierra Leone	West Africa	6.0	2.2	1,100	162
Uganda	East Africa	34.5	16.8	1,400	112
Yemen	Arabian Peninsula	24.8	33.8	2,300	87

The countries were selected to provide a representative sample based on the following criteria:

- Geographic range: Two countries are from West Africa, one from East Africa, one from the Arabian Peninsula, one from South Asia and one from Southeast Asia.
- Size: The list includes two of the three largest FCAS countries, Nigeria and Bangladesh (the other being Pakistan).
- Conflict-Affected status: Three of the countries present specific challenges: Sierra Leone (post-conflict); Yemen (actual conflict); Myanmar (post sanctions).
- Economic activity: The six countries represent a wide range of potential investment sectors for domestic and export sales.

It was also relevant that GBRW's directors and ICA's principals had worked on prior assignments in all six of the Focus Countries and that we have access to good local consulting resources in each of them.

Methodology

The study is divided into three stages:

- Stage 1, which is the subject of this report, includes an analysis of existing MNE investments in the Focus Countries, with the objective of producing a

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[2] Nigeria was substituted for Tajikistan following discussion of the original Discussion Document

matrix showing (1) types of MNE investor and (2) characteristics of investments made. This analysis is then used to help prepare a provisional list of MNEs to be interviewed in detail during the next stage of the assignment. In Stage 1 a literature review is provided, highlighting especially more recent findings that depart from the traditional literature on FDI and its determinants and drivers.

- In Stage 2, structured interviews will be conducted with approximately 25 MNEs from a range of parent countries and industries. The objectives of these interviews are to establish how the investment decision process operates in each MNE interviewed, what risk factors are considered and how each is evaluated. The MNE interviews will include discussion of the factors which drive positive investment decisions, as well as issues which are seen as strong or absolute impediments to investment. This approach also explores which risk factors are industry specific, which are more general and how MNEs in the various industries deal with them.
- Stage 3 involves an analysis of actual MNE investment in three of the Focus Countries, comparing actual investments made against the findings from the Stage 2 MNE interviews and the apparent attractiveness of their investment environments according to indicators such as the World Bank's Doing Business Indicators.

How do we define an MNE?

The fDi Markets data on which we have drawn (see below) lists ca. 540 corporate investors in the six Focus Countries, which we mapped against the Fortune Global 500 (F500) listing for 2012. 81 of these names (or 15%) appear in the F500 listing. In order to be able to consider as wide a range of interview candidates as possible, our view is that all the names listed in the fDi Markets data should be considered as potential interview candidates. We therefore use the term "MNE" to refer to this wider group of corporates.

We have agreed with DFID that the study would exclude financial or portfolio investors and investments in financial institutions and anticipated that it would also exclude State Owned Enterprises whose investment decisions are driven primarily by political rather than economic factors and large privately owned groups with non-transparent decision-making processes

Structure of Report

This Report is organised as follows:

Introduction

Section 2 sets out the background to, and objectives for, the study as a whole and the role of this report.

Literature review

Section 3 opens with a literature review, which discusses views on the relationships between risk and FDI in emerging and frontier markets,

One of the central elements of our approach is that suggested by the work of John Dunning[3], who argued that FDI is motivated by four drivers, either separately or in combination:

- Natural resource seeking, i.e. to gain access to specific natural resources available in the investee country;
- Market seeking, i.e. to supply goods or services in the investee country and/or nearby markets;
- Efficiency seeking, i.e. seeking plentiful supplies of cheap and well motivated unskilled or semi-skilled labour, or access to other competitively priced inputs (e.g. energy, land, port facilities etc.) or advantageous tax or regulatory regimes.
- Strategic asset seeking i.e. driven by the need of firms to acquire specific technological capabilities, and/or management or marketing expertise, to promote the long-term strategic objectives of the acquiring firm.

It is clear that much of the literature focuses on the causal relationship between FDI and risk, but does not address in detail how companies manage risk and how they deal with it in making their FDI decisions. Much of the literature takes a very macro economic perspective towards risk using econometric analyses, in which the firm is regarded as a black box.

This raises a number of questions for the current study:

- By taking a more investor level perspective, using a survey approach, will we be able to see different results and get a better understanding how firms assess or manage risks?
- Do firms operating in the primary, secondary and tertiary industry sectors view and manage risks differently?
- Which data do firms use in identifying and analysing risks in and between countries? Are the data sufficient?
- Can we explore the relationship between risk and FDI using other classifications of industries that go beyond primary, secondary and tertiary? For example the Dunning investment motivation criteria described above?
- Can we differentiate between the behaviour of Fortune Global 500 firms and smaller multinational businesses?
- Do firms from non-OECD countries (who are playing an increasingly important role in "South-South" investment) view and manage risk differently?

Review of available risk methodologies

The literature review is followed by a review of available risk methodologies (Section 4), which draws on the practical experience of ICA in working with MNEs on location selection.

This describes in five Phases the corporate decision-making process involved in the selection of a specific country for an FDI investment. It discusses the information available to, and used by, MNEs at different stages to produce a long list of potential

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[3] Dunning, J. (1993) "Multinational Enterprises and the Global Economy",

candidates for investment and the steps which then follow to evaluate short-listed candidates in greater detail.

It also discusses the disparity between the risk indicators which government officials tend to use and the ones which are most relevant to MNEs.

MNE investments in the Focus Countries

Sections 5 and 6 discuss our approach to data collection and our analysis of corporate investments in the Focus Countries.

Using data from the Financial Times fDi Markets database for FDI transactions, we identified ca. 540 corporates which had invested in the six Focus Countries over a 10 year period between 2003 and 2102. We analysed the names from the fDi Markets listing to identify "multiple investors" – i.e. those which have invested in more than one of the Focus Countries. The rationale for this approach was that we consider that we will learn more from "serial investors" rather than those who have just had a single experience in these countries.

This analysis generated 44 names across 22 sectors (out of the 39 sectors defined by fDi Markets). In order to broaden the base of potential interview candidates within individual sectors, we expanded our review by adding a further four countries – Pakistan, Uganda, Ethiopia and Nepal. This produced an extended long list of 112 corporate investors across 31 sectors, which are discussed in detail in Section 7

Interview candidates

Based on these data, we propose a methodology in Section 7 for determining which MNEs should be interviewed during Stage 2 and a long list of target candidates.

In order to cover the four investor categories described by Dunning, we propose to select companies from the top 10 sectors (by size of investment and jobs generated) identified from our analysis that we believe are representative of the four groups:

Dunning Category	*Representative Sectors*
Natural resource seeking	Coal, Oil and Natural Gas
Market seeking	Food & Tobacco plus Beverages
Efficiency seeking	Transportation plus Warehousing & Storage
Strategic asset seeking	Communications

Structured Questionnaire

In Section 8, we attach a format for the Questionnaire which we propose to use for structured interviews with the potential interview candidates. This will analyse the decision making processes in each company and explore the following hypotheses.

- Country risk and the extent to which it influences the FDI location outcome strongly relates to the MNE's motive to engage in FDI;
- Country risk plays a marginal role in natural resource seeking FDI, especially when MNEs are active in gaining access to scarce commodities such as oil, gas, copper, gold, etc.;

- Country risk in Strategic Asset Seeking FDI only plays a role when MNEs can choose several feasible (JV) partners in several different business locations;
- Country risk in Market Seeking FDI becomes a more prominent factor, especially when the MNE can relatively easy replicate their business format in the next most attractive consumer market;
- Country risk plays a significant role in Efficiency Seeking FDI where business activities are 'footloose' and MNEs can choose out of multiple locations with comparable attributes.
- The characteristics of the MNE (i.e. size, geography, sector, competitive landscape, etc.) also influence its location behaviour (i.e. risk seeking versus risk averse)

Other issues/Next steps

We conclude in Section 9 with discussion of a number of areas which are relevant to the programme of interviews planned for Stage 2.

2. INTRODUCTION

FDI in frontier and emerging markets

Attracting Foreign Direct Investment (FDI) to enhance competitiveness and to help achieve economic development goals is a fundamental objective of many governments around the world today. For many governments in emerging or frontier markets Foreign Direct Investment (FDI) is seen as a panacea, contributing to economic development by creating jobs, knowledge and capital transfer. On the other hand Multinational Enterprises (MNEs), who are the main actors in FDI projects, seek opportunities around the world to enhance their market share, exploit natural resources or make their production process more efficient.

The quality of a host country's business environment plays a key role in location decision-making by MNEs for their overseas investments[4]. However, a host country's business environment is a composite concept and consists of multiple factors some of which can potentially represent a risk for FDI.

Nevertheless, over the past decade many countries have experienced a growth in inward FDI levels, even countries with less attractive business environments. For instance many least developed countries (LDCs) and countries which are characterized by high risk levels have witnessed increased levels of FDI inflows over the past two decades. While FDI flows to these LDCs and high risk countries generally are small in absolute terms, they can nonetheless constitute a significant proportion of the overall capital formation in these countries. Indeed, and contrary to what is commonly thought, these countries offer considerable opportunities for additional investment (UNCTAD 2011).

FDI in these fragile states entails many risk factors that investors have to *analyse, manage and mitigate* in order to fully benefit from the potential these markets offer. The relative importance of each risk factor for FDI by the investing MNEs depends very much on the industry in which the MNE operates (e.g. for electronics, compared with services or primary industries), the business activity associated with the FDI project and the size of the MNE in terms of its global assets and turnover. In some cases, global corporations making substantial investments (e.g. in the oil and gas sector) can often re-*define* the level of risk by exerting pressure to improve the investment environment in a host country as part of the negotiation process for making an investment.

It is also important to understand that different risk factors are evaluated throughout the investment decision making process by firms. For instance, political risk factors may be considered to be more important and treated as "knock-out" criteria in the initial stages of an investment location decision-making process; in later stages operational risks evaluated across different locations might be a more important factor.

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[4] Even the home country business environment of a MNE can play a role in the outward expansion of MNE investments. For instance countries with stringent business environments or high labor costs and inflexible labor markets create more outward FDI projects by their MNEs.

This study attempts to answer the following questions:

- What motivates MNEs to invest in countries with disproportionally high risk levels?
- Why do many MNEs accept these high levels of risk in many of the frontier and emerging markets of the world?
- Do the factors considered by MNEs vary according to the sectors within which they operate; the motivating factors behind the FDI decision; the parent country's area of domicile; the nature of the investment; or other factors?
- How do MNEs price different risks in their investment models and how do they value the opportunity costs of risk?
- What techniques and approaches do MNEs use to manage and mitigate the different risks associated with FDI in frontier and emerging markets?

Approach of this study: a Boardroom perspective

Much of the literature and existing research has focused on political risks associated with FDI or investment in general However, this study takes a different and, we believe, unique approach, by focusing on MNE perspectives towards managing and mitigating the risks of FDI projects.

This study provides a categorization of risk factors associated with FDI based on the main distinction between (1) <u>operational risks</u>, i.e. those that are related to the specific operations of a firm in a market (for example, electricity supply, productivity levels and education levels, income levels, market potential) and (2) <u>institutional risks</u>, i.e. those risks that are related to the host country institutional environment within which the MNE must operate when it undertakes FDI (for example, strikes, traditional political risks like expropriation and nationalization, government bureaucracy, transparency, stability of rules and regulations, law and order).

In this study, we refine the framework and make a distinction between those operational and institutional risk factors that are external and those which are internal to the firm.

In Stage 2 of the study, we will explore the importance which MNEs attach to the various risk factors according to the industry in which the MNE operates and the business activity of the FDI project. We will also examine related issues, such as the size and country of domicile of the firm.

Objective of this study

Our objective is to generate a concise and accessible policy brief which can be used to guide DFID policy on interventions in its priority countries. This will include a summary of risk issues and mitigation approaches in a form which is accessible to a non-financial audience. The study will also focus on identifying actions which might realistically be taken by Governments (with support from donors and/or IFIs if appropriate) which could have a material impact on the country's ability to attract inward FDI.

3. LITERATURE REVIEW: ASSESSING THE FDI RISK NEXUS

This study looks at risks of firms that undertake foreign value added activities through FDI. It is important to note that firms sometimes undertake FDI to <u>reduce</u> risks, for instance by sales diversification. In these cases FDI is used as an instrument to minimize risks for the firm. This study does not look at those forms of risk, but rather explores risks associated with FDI in a host country and how firms deal with the presence of these "FDI risks".

In order to analyse the relationship between risk and FDI we have explored the most recent literature on this topic and summarized the main findings, approach and methodology in the table below:

Study	Purpose	Methodology	Sample and level of analysis	Conclusion
Busse and Hefeker, 2005	To determine indicators that matter most for MNEs and their FDI flows, mainly political risk indicators	• Cross-country • Longitudinal • Regressions	• 83 developing countries • 1984-2003 • 12 variables	Positive link government stability, law and order, quality of bureaucracy and FDI flows. Moreover, important determinants of FDI flows are investment profile, conflicts, ethnic tensions and democratic accountability
Noorbakhsh, et al. 2001	To assess the importance of human capital as resource that can attract FDI to developing countries	• Cross-country • Longitudinal • Regressions	• 36 developing countries • 1980-1994 • 10 variables	Positive, increasing link human capital and FDI flows
Asiedu, 2002	To examine why Sub-Saharan Africa has been rather unsuccessful in attracting FDI	• Cross-country • Regression	• 71 developing countries • 8 variables	Negative link being an African country and FDI flows; positive link trade openness, higher return on capital, infrastructure and FDI flows (though to a lesser extent for African countries)
Hayakawa et al. 2011	To identify political and financial risk factors that matter most for MNEs' FDI	• Cross-country • Longitudinal • Regression	• 93 countries • 1985-2007 • 20 variables	Socioeconomic conditions, investment profile and external conflict function as main political risk factors relating to FDI;
Walsh and Yu, 2010	To address two FDI characteristics: FDI per sector and FDI in emerging markets	• Cross-country • Longitudinal • Regression • Sectoral	• 27 advanced and EMC's • 1985-2008 • 12 variables • Primary, tertiary, secondary	No strong link between primary FDI and macro-economic stability, level of development or institutional quality; tertiary FDI appears to be much more strongly impacted by macro-economic stability than secondary FDI, whereas a weak currency has stronger links with secondary FDI than tertiary
Kaufmann et. al.,1999	To assess the relationship between governance and investment by providing a new governance data set	• Cross-country • Regression • Some indicators indirectly derived from polls and surveys	• 150 countries • 300 variables, aggregated to six overarching variables	A strong, positive relationship between good governance and better development outcomes
Wei, 2000	To study the effect of corruption on FDI	• Cross-country • Longitudinal • Regression • Some indicators indirectly derived from surveys	• 14 source countries to 45 host countries • 1990-1991 • 13 variables	Negative link corruption, tax rise and FDI flows

Study	Purpose	Methodology	Sample and level of analysis	Conclusion
Wheeler and Mody, 1992	To evaluate international investment location decisions in the context of incentive competition	• Cross-sectional • Regression	• Both countries and manufacturing MNE's • 10 variables	Agglomeration externalities (i.e. good infrastructure, specialized input suppliers and an expanding domestic market) have a positive link with FDI
Ali et al, 2010	To investigate the role of institutions in determining FDI	• Cross-country • Longitudinal • Sectoral • Regression	• 69 countries • 1981-2005 • Primary, secondary, tertiary • 7 variables	Positive link good institutions and FDI determinants, not for primary FDI but in particular for manufacturing and services
Anand & Kogut, 1997	To assess whether the sectoral distribution of these entries is explained by the relative technological capabilities of countries, market attractiveness and rivalry between firms	• Cross-country • Regression • Sectoral	• Firm entries from 3 countries • 10 variables • 4-digit level industries	Technological rivalry is one important factor among entries from the 3 big US FDI countries (Japan, UK and Germany), though clear differences exist between Japanese and European entries regarding industry and motives

In the literature the following indicators have been used to analyse risks and FDI:

Busse and Hefeker, 2005: one of the purposes is to examine a much wider range of indicators of political risk. Information for the variables has been taken from the International Country Risk Guide (ICRG), annually issued by the PRS Group. A total of 12 indicators, both assessing political risk and institutions, are used:

1) Government stability	4) Internal conflicts	7) Military in politics	10) Ethnic tensions
2) Socio-economic conditions	5) External conflicts	8) Religious tensions	11) Democratic accountability
3) Investment profile	6) Corruption	9) Law and order	12) Bureaucracy quality

Noorbakhsh et al, 2001: in evaluating the effect of human capital on attracting FDI, three variables, together representing human capital, are measured:

1) Secondary school enrolment rate
2) Accumulated years of secondary school in working age population
3) Accumulated years of secondary and tertiary education in working age population

Furthermore, some additional variables have been included, all are extracted/computed from the World Bank's World Development Indicators:

1) Change in FDI to GDP ratio	4) Credit to private sector	7) Relative efficiency wage in country from average efficiency wage	9) Product wage rate
2) Total trade to GDP ratio	5) Net energy imports	8) Efficiency wage in country (average wage per worker divided by productivity)	10) Growth rate of labour force
3) Growth rate of real GDP	6) Time trend		

Asiedu, 2002: the choice for the variables was limited due to data constrains as most developing countries do not possess a wide variety of data.

1) Return on investment in host country: inversely related to real GDP per capita
2) Infrastructure development: telephones per 1,000 population
3) Openness of the host country: import plus export as ratio to GDP
4) Political risk: number of assassinations and revolutions
5) Other explanatory variables: ratio of liquid liabilities to GDP, ratio of government consumption to GDP, inflation rate and growth rate of GDP

Hayakawa et al, 2011: variables are grouped into two categories: political risk components and financial risk components, both measured via ICRG data.

Political risk variables

1) Government stability	4) Internal conflicts	7) Military in politics	10) Ethnic tensions
2) Socio-economic conditions	5) External conflicts	8) Religious tensions	11) Democratic accountability
3) Investment profile	6) Corruption	9) Law and order	12) Bureaucracy quality

Financial risk variables:

1) Foreign debt as a % of GDP	4) Net international liquidity	7) Budget balance as % of GDP
2) Foreign debt service as a % of exports	5) Exchange rate stability	8) Current account as % of GDP
3) Current account as a % of exports	6) Annual inflation rate	

Walsh and Yu, 2010: a distinction is made between macro-economic and qualitative, institution variables.

Macro-economic variables

1) Openness	3) average inflation	5) real GDP growth
2) multilateral real exchange rate	4) stock of FDI	6) GDP per capita

Qualitative, institutional variables:

1) labour market flexibility	3) judicial independence	5) financial depth
2) infrastructure quality	4) legal system efficiency	6) school enrolment at primary, secondary and primary

Kaufman et al, 1999: selected governance indicators are grouped into six clusters, corresponding to six basic aspects of governance, which in combination form aggregated governance indicators. These six clusters of governance indicators include:

1) Voice and accountability: the process by which government is selected and replaced
2) Political instability and violence: perceptions of the likelihood that the government in power
3) Government effectiveness: perceptions of the quality of public service provision, bureaucracy and commitment
4) Regulatory burden: incidence of market-unfriendly policies
5) Rule of law: the extent to which agents have confidence in and abide by the rules of society
6) Graft: perceptions of corruption

Wei, 2000: a wide range of variables and sources, including:

1) Corruption (Business International, later EIU): the degree to which business transactions involve corruption or questionable payments
2) Corruption (Transparency International): average of ten survey results on corruption over a number of years
3) GDP per head (IMF)
4) Population (IMF)
5) Restrictions on cross-border ventures (World Competitive Report)
6) Restrictions on foreign investors' ability to exert corporate controls (World Competitive Report)
7) Restrictions on their eligibility to bid for public sector contracts (World Competitive Report)
8) Restrictions on their ability to access host country's domestic capital markets (World Competitive Report)
9) Linguistic ties: in case a source and host country share a common language
10) Illiteracy ratio (World Bank Development Report): share of the population over the age of fifteen who cannot read and write in their everyday life
11) School enrolment (World Bank Report)
12) Statutory marginal tax (PWC)
13) Tax payments to the host countries by the foreign subsidiaries of American firms (PWC)

Wheeler and Mody, 1992: this paper attempts to broaden the scope of the existing empirical work on multinational investment by specifying a capital expenditure function which incorporates measures of agglomeration benefit as well as risk and classical location factors. Indicators are derived from the US Department of Commerce Publication and Business International (later EIU).

1) Labour cost	4) Infrastructure quality	7) Relationship with the West	10) Openness (based upon 9 variables)
2) Level of corporate taxation	5) Degree of industrialization	8) Relationships with neighbours	
3) Market size	6) Level of foreign direct investment	9) Risk (based upon 13 variables)	

Ali et al, 2010: property right security, constructed from the PRS Group's ICRG, is the most essential variable, which combined two sub components, the Investment Profile index and the Law and Order index, which measure institutional quality directly related to property rights. Moreover, controlling variables are included, such as the GDP per capita, ratio of merchandised trade to GDP (openness), number of telephone lines per 1,000 inhabitants (physical infrastructure) and policy-related variables (tariff rate, inflation rate and top marginal corporate income tax rate).

Anand and Kogut, 1997: the question posed is whether the sectoral distribution of foreign entries into the US at 4 digit level, is explained by the relative technological capabilities of countries, market attractiveness and rivalry between firms.

1) Technological capabilities and rivalry: R&D expenditure data from the OECD for the investing countries

2) Market attractiveness of the host country: concentration rates and advertising measures at the 4-digit level, dollar value of shipments, degree of import penetration

External risks and FDI

A large body of literature examining determinants of FDI begins with a partial equilibrium firm-level framework to inform empirical analysis. These studies typically examine how exogenous macroeconomic factors affect the firm's FDI decisions, with the primary focus on exchange rate movements, taxes, tariffs and lower capital costs. This is interesting, as while most countries compete vigorously for FDI inflows, the distribution of the inflows is far from uniform.

According to Hayakawa, Kimura and Lee (2011), the level of country risk is closely related to the level of business risks. It seems intuitively plausible to believe that a sound institutional environment (i.e. efficient bureaucracy, low corruption, secure property rights, etc.) should attract more FDI. Likewise higher business risk due to high country risk of the host countries would discourage FDI by MNEs. Undeniably, the quality of institutions influences FDI activity. First, poor legal protection of assets increases the chance of expropriation of a firm's assets making investment less likely. Poor quality of institutions necessary for well-functioning markets, and/or corruption, increase the cost of doing business and thus should also diminish FDI activity. And finally, to the extent that poor institutions lead to poor infrastructure (i.e. public goods), expected profitability falls as does FDI into a market.

However, as highlighted in the introduction of this literature review, there is an ongoing debate as to what extent external risks impact FDI. Asiedu (2002), Noorbakhsh, et al (2001) and Wheeler and Mody (1992) conclude that neither political risk nor expropriation risk and corruption have any significant impact on FDI. Hines (1995) provides an interesting "natural experiment" approach by examining the impact of the 1977 U.S. Foreign Corrupt Practices Act which stipulated penalties for U.S. multinational firms found to be bribing foreign officials. His estimates find a negative impact on U.S. FDI in the period following this Act (Blonigen 2005). This implies that the Act has had an impact of firms moving away from countries that entail risks of prosecution. Other papers find that institutional voids (political risks) have a negative impact on FDI flows. For instance, with a sample of 22 developing countries, Gastanaga et al (1998) find that lower corruption and nationalization risk levels and better contract enforcement are associated with greater FDI flows. Wei (2000) also finds that corruption significantly impedes FDI inflows.

Busse and Hefeker (2007) find that government stability, internal and external conflicts, corruption, ethnic tensions, law and order and quality of bureaucracy are highly significant FDI determinants. Ali et al (2010) also find that institutions are a robust predictor of FDI and that property rights security is the most important aspect of institutions in determining FDI flows. Specifically they find that institutions have a significant impact on FDI in manufacturing and services but that institutional quality does not impact FDI in the primary and extractive sectors.

As emphasized in the introduction the existing literature and research has largely focused on the relationship between political risk (expropriation, military and religious tensions, political and government stability, corruption, law and order, ethnic tensions, democracy) and FDI, in particular throughout the 1970s to 1990s. The evidence of the precise impact of political risk remains mixed (Blonigen 2005),

but in general there is a negative relationship between FDI flows and political risk (Busse and Hefeker, 2005).

However, there are many authors who conclude that neither political risk nor expropriation risk and levels of democracy have any significant impact on inward FDI into a country, in particular in the extractive industries (Noorbakhsh, et al. 2001; Asiedu, 2002). More recently others have emphasized that financial risk matters most for investment decision-making by MNEs (Hayakawa et al. 2011). Yet others have stated that the role of institutions and their quality are a predictor of FDI (Busse and Hefeker, 2005; Li, et al 2010; Walsh and Yu, 2010), but emphasized that while institutions have a significant impact on FDI in manufacturing and in services, the quality of political institutions and good governance matter less for FDI in the primary sector (Kaufmann et. al.,1999). In general much of the contemporary research focuses on the role of institutions or the quality of (political) institutions.

Only a limited number of researchers have adopted a firm level perspective towards FDI and risks. An exception is Ghoshal (1987), who classified risks in various ways. Ghoshal distinguished between four types of risk associated with FDI and MNE activity:

- *Macro-economic risks:* these are risks that are beyond the ability of an individual firm to influence. Examples are: natural disasters as well as shifts in market forces (like changes in commodity prices);
- *Policy risks:* these are risks that arise out of the uncertainty about the future (political) actions of host country governments;
- *Competitive risks:* these risks stem from uncertainties about competitors' market behaviour;
- *Resource risks:* these arise from uncertainties surrounding the acquisition of raw materials or intermediate products.

The disadvantage of the above approach is that it only highlights risks that are mainly related to the policy environment in which the firm operates.

In summary, the role of political risk in relation to FDI has been explored extensively using a wide variety of indicators as listed at the start of this Section. However, political risk matters less for FDI in the extractive industry than in other industries. Although the evidence of the latter remains limited, financial risks and the role (and quality) of institutions have become more important in recent research over the past years.

Missing links and research agenda

During the literature review we have found a number of missing links that will be explored in this study and are the building blocks of this research project. These are as follows:

- Much of the literature focuses on the causal relationship between FDI and risk, but does not say much about how companies manage risk and how they deal with it in making their FDI decisions.
- Much of the literature takes a very macro economic perspective towards risk, using econometric analyses, in which the firm is regarded as a black box. By

taking a more investor level perspective, using a survey approach, would we be able to see different results and get a better understanding of how firms perceive and manage risks?

- Can we explore the relationship between risk and FDI using other more relevant categorisations of industries that go beyond primary, secondary and tertiary?
- Do firms operating in other industries than the primary industry manage risk differently?
- Can we differentiate between the Fortune Global 500 firms and smaller firms in how they manage risk?
- Do firms from non-OECD countries manage risk differently?
- Is there a relationship between risk and the driver or motive of FDI?
- Which data do firms use in identifying and analysing risks in and between countries? Are these data sufficient?
- What is the approach or methodology that firms adopt when analysing risks across countries?

A firm level perspective towards FDI and risk

In order to better understand the firm-level perspective towards risks in emerging and frontier markets it is necessary to explore the literature that focuses on the motives of firms undertaking FDI , and how those manage their foreign operations and manage the risks that are associated with this process. In other words, why do firms undertake FDI, and what is the interaction between their motives and the business environment in which FDI projects take place? .

Firms have a variety of strategies at their disposal to operate internationally. It is important to understand that the most influential mechanism to operate internationally is FDI and hence entails most risks. Firms can license, or export, or set up sales agent structures in foreign markets. FDI is a strategy that involves a strong commitment to a foreign market and obviously entails higher risks than arm's length modes of international expansion. The figure overleaf shows this evolution:

Figure 1 Modes of Internationalization

Source: Investment Consulting Associates (2011)

Licensing and franchising are among the most frequently adopted internationalization modes for leveraging business concepts, especially if the company is reluctant to invest directly in foreign countries. Licensing requires relatively little time, resources, or knowledge of the foreign market, and the licensee or franchisee is taking the majority of the economic risks. It looks a straightforward way of internationalizing in the short run, but experience shows that it requires significant coordination efforts, to avoid often-seen escalations. The reliance on the licensee is high and there is a risk that the licensor or franchisor creates its own competitor.

As a second level in the spectrum of internationalization modes, exports via a local agent or distributor could contribute to a potential cost advantage through economies of scale, and efficient use of resources. Setting up a new export line requires relatively small financial resources, and no physical presence is needed in the destination market. The risks are associated with transportation and shipment, payment mechanisms and contractual agreements, as well as disruptive trade barriers.

When export sales take off the company may consider moving to the next level of involvement; a common way to deal with the increasing complexities of a growing export business is to set up a dedicated sales and marketing representative office. In this case the local office will take care of the administrative side and further promote the product or service offering in the foreign market. This requires investment in staff, accommodation and equipment. Risks relate to increasing overhead, but local disruptive matters can be controlled more easily.

If volumes justify it significant (supply chain) savings can be realized when value added activities such as packaging and assembly are relocated to the foreign market. Companies tend to start with 'simple' activities to learn how to do business and set up an organization in their foreign markets. Starting small helps keep learning costs, ramp-up difficulties and initial low productivity at manageable levels. By this stage the complexity is increasing and the local mandate is growing.

Finally, at the top end of the spectrum, a Foreign Direct Investment either through an acquisition or greenfield investment can be used to strengthen the foreign market position. This is a strategic company decision, requiring substantial investments and a dedicated involvement. The advantages are full ownership and control, a strong signal to customers and other stakeholders, circumvention of duties and other barriers, and possible incentive benefits. An acquisition shortens the time cycle and the company can benefit from existing sales channels and organizational capabilities. But cultural risks and difficulties in managing change can lead to frustrated processes and hidden costs.

Dunning and FDI motivating drivers

Given the above difficulties in FDI strategies why do firm undertake FDI? Based on Behrman (1972), Dunning (1993) argued that FDI is *motivated* by four drivers, either separately or in combination[5]. The categorisation set out below will be used in this study as we believe it captures all the motives to undertake FDI

- (Natural) resource seeking (supply oriented);
- Market seeking (import or export substituting);
- Efficiency seeking (rationalized investment);
- Strategic asset seeking (supply oriented).

(Natural) resource seeking MNEs typically invest abroad to acquire specific resources at a lower cost than would be obtained in the MNE's home market (if available at all). Resource seeking MNEs are often primary producers who want to secure physical supply of resources. Most of FDI during the early 1990s was driven by US and European MNEs seeking to secure sources of supply of minerals and primary products. Up to the second World War three fifths of the accumulated foreign direct capital stock was of this kind, while by the mid 1980s resource-seeking FDI had declined to about one third of worldwide MNE activity (Dunning, 1993).

The bulk of FDI is still **market oriented** to supply goods or services in the investing market or (adjacent) third markets. In most cases these markets were previously served through exports from the domestic market (Dunning, 1993). There are four different reasons for market-seeking FDI:

- Firstly, firms may have to follow main suppliers or customers that have set up businesses overseas.
- Secondly, MNEs may favour a strategy of "thinking global and acting local", implying that products have to be adapted to local tastes.
- Thirdly, it may be cheaper to serve a foreign market or adjacent market locally than supplying it from a distance. This last rationale is especially country- and

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[5] The explanation of the four motives of international production draws heavily upon Dunning (1993, p. 56-62).

industry- specific. Some third markets cannot be served through exports from the domestic market, due to local content requirements, tariff barriers or import-substituting trade regimes. Not investing in the foreign market would harm the competitive position of the firm.

- The fourth and increasingly important reason for market led FDI is "that an MNE may consider it necessary, as part of its global production and marketing strategy, to have a physical presence in the leading markets served by its competitors" (Dunning, 1993: 58-59). This type of strategic market seeking FDI is largely driven by a defensive rationale.

The key motivation of **efficiency seeking** investments is to rationalize the structure of established resource-based or market-seeking investments (Dunning, 1993). Efficiency-seeking FDI takes place among MNEs seeking plentiful supplies of cheap and well motivated unskilled or semi-skilled labour (manufacturing and service MNEs from countries with high wage costs). This type of FDI is often located in more advanced industrializing countries, emerging markets, such as the BRICs, Mexico, South Korea and Taiwan (often in the form of export processing zones –EPZs), but also to a lesser extent in European countries such as Spain and Portugal.

More recently, efficiency-seeking FDI has largely taken place among experienced and large MNEs. In order for efficiency FDI to take place, markets must be well developed and open for FDI. This is why efficiency seeking flourishes in regionally integrated markets. There are two kinds of efficiency seeking FDI:

- The first is designed to take advantage of differences in the availability and cost of traditional factor endowments in different countries and locations, explaining the intra-firm division of labour.
- The second type of efficiency seeking FDI takes place in countries with similar location conditions and income levels. Traditional factor endowments play a less important role "while 'created' competencies and capabilities, the availability and quality of supporting industries, the characteristics of the local competition, the nature of consumer demand and the macro- and micro-policies of governments play a more important role" (Dunning, 1993: 60).

The fourth motive, **asset-seeking FDI**, relates to FDI aimed at acquiring assets of foreign firms to promote the long-term strategic objectives of the acquiring firm, sustaining and advancing the firm's international competitiveness. It is driven by the need of firms to acquire specific technological capabilities, management or marketing expertise. More recently this form of FDI is typified by the search for talent and highly-skilled workforces as a reason for FDI by MNEs. This type of strategic asset FDI makes use of local competence levels that are very often *created* by local or national governments.

These four motivations have been used by many scholars to explain FDI, and are often primarily related to the interaction between the host country environment and the MNE (UNCTAD, 1998). The traditional view in such research is that MNEs are attracted by raw materials and cheap labour in specific countries or regions. "*An emerging argument is that country advantages may also be understood as generating trajectories which pull foreign direct investment (FDI)*" (Anand and Kogut, 1997: 485). In most research, characteristics of the host countries provide the most important explanatory variable driving the internationalization process. FDI of all types is motivated specifically by considerations directly related to the

employment of skilled or unskilled labour. Among these are efficiency seeking investments, where labour costs and a skilled educated workforce play a major role.

For market-seeking FDI, on the other hand, the availability and cost of labour or skilled human resources is not the main consideration in the choice of location, although it is likely to be one of several secondary factors that determine the investment location decision." (UNCTAD, 1999: 259). Besides, the buying power of the population – and thus the size of the market - is often related to the number of people working in relatively high-wage sectors.

In the early 1990s many large MNEs pursued multiple objectives when conducting FDI projects (Dunning, 1993: 56). It is not always easy to separate the four motives for FDI. In particular statistical data on efficiency and strategic asset related FDI are missing (Dunning, 1993). However, it is likely that these forms of FDI account for an increasing share of the international activity of MNEs, particularly within major markets (*ibid.*).

Dunning also stresses that the motives for foreign production may change as MNEs become established and experienced foreign investors. "Initially, most enterprises invest outside their home countries to acquire natural resources or gain (or retain) access to markets. As they increase their degree of internationalization, however, they may use their overseas activities as a means by which they can improve their global market position by raising their efficiency or acquiring new sources of competitive advantage" (Dunning, 1993: 57). The location decisions of MNEs have undergone profound changes in the 1990s (cf. Dunning, 1998). The knowledge-based factor of production in the form of skilled labour now predominates, whereas low-wage labour as a location factor prevailed in the 1970s. Locational advantages arise out of a highly skilled, educated and well-trained labour force, providing the competitive edge for many industries.

Behavioural theories explaining the FDI decision making process of firms

Although, a very old publication Aharoni's (1966) behavioural approach towards internationalization and FDI examined the management decision process underlying firms' international investments process, using a sample of 38 US MNEs. What drove managers and what was their role in the foreign investment decision process? What factors were consistently important in the decision to internationalize or expand existing foreign activities? As Aharoni argued, the initial decision of a domestic firm to go abroad is not due to a single reason but the result of a chain of events (Aharoni, 1966). "*A foreign investment decision process is a very complicated social process, involving an intricate structure of attitudes and opinions, social relationships both in and outside the firm, and the way such attitudes, opinions and social relations are changing. It contains various elements of individual and organisational behaviour, influenced by the past and the perception of the future as well as by the present.*" (Aharoni, 1966: 13). Rational economic reasoning is important, but Aharoni also argued that a large share of foreign investment decisions were frequently made out of coincidence, hazard, or chance encounters.

Furthermore, Aharoni pointed out that each single foreign investment decision created intangible sunk costs in the form of amount of time, resources and effort committed prior to the foreign investment decision. The decision process underlying a subsequent foreign investment by an established MNE is different from the first foreign activities of a uni-national firm and as such should be treated differently

(Aharoni, 1966). Even when MNEs increase their international operations, and FDI becomes increasingly sequential in nature, each foreign investment or expansion decision is taken very carefully.

Other theories explain FDI from the perspective of herd behaviour and stress that it is not just locational variables that determine the spatial distribution and organization of FDI, but also the strategic responses to these variables and to the anticipated behaviour of competitors. Authors in this field emphasize the competitive interaction among internationalizing MNEs, explained through "oligopolistic reaction" (Knickerbocker, 1973) and the "exchange of threats" (Graham, 1975 and 1978 and 1990; Flowers, 1976), resulting in "follow the leader" and "bandwagon" patterns in FDI within oligopolistic industries.

The figure below shows some typical quotes and slogans on why firms undertake FDI.

Figure 2: Reasons for undertaking FDI
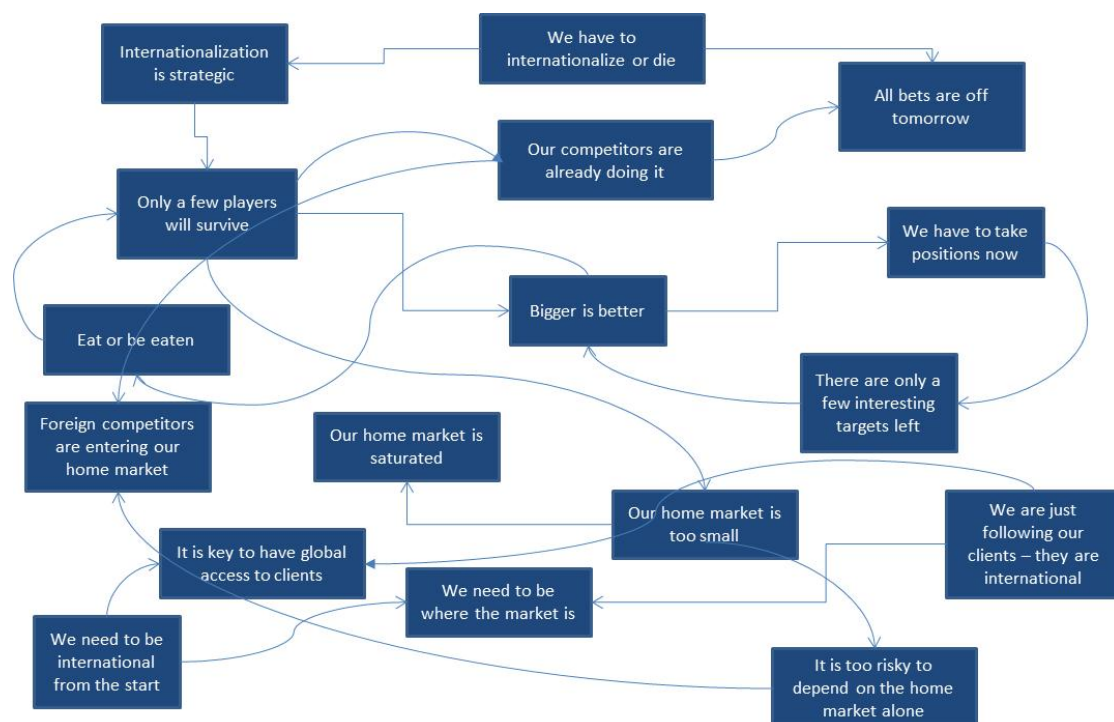
Source: From Local Champions to Global Masters 2001 by Paul Verdin and Nick van Heck

A framework for analysing FDI and risks

A synopsis and overview of all factors which are mentioned in the relevant literature on risk, FDI and multinational corporations is provided in Figure 3. The categorization in figure 3 is modified slightly by the authors to accommodate more recent developments in MNE international expansion through FDI. The categorization departs from the main distinction between operational risks (i.e. those that are related to the operations of a firm in a specific market) and institutional risks (i.e. those risks that are related to the institutional host country environment in which the MNE must operate when it undertakes FDI). It refines the framework and make a distinction between those operational and institutional risk factors that are external and internal to the firm. The importance which MNEs attach to the various

risk factors is likely to vary according to the industry in which the MNE operates and the business activity of the FDI project, as well as the size of the firm (i.e. Fortune Global 500 vs. mid-sized firm). So far research has been biased towards large firms in the extractive industry while limited research has focused on firms operating in more manufacturing driven industries and smaller firms.

Figure 3: External and Operational Risks Assessment

Category	Operational Factors	Institutional Factors
Internal to the MNE	Population and Income • Size and sectoral distribution • Economic Growth and per capita income • Population Growth and control • Income distribution Workforce and employment • Size and composition • Sectoral and geographic distribution • Productivity • Migration and urban employment Sectoral analysis • Agriculture and self-sufficiency • Industrial growth and distribution • Size and growth of the public sector • National priorities and strategic sector Economic Geography • Natural resources • Economic Diversification • Topography and infrastructure Government and social services • Sources and structure of government revenues • Sectoral and geographic pattern of expenditures • Size and growth of the budget deficit • Rigidities in spending programs • Regional dependency on central revenue sources Cost indicators • Price indices • Labour costs and wages • Utilities and Real Estate • Interest rates, money supply, etc. • Tax indicators	Composition of population • Ethno-linguistic, religious, tribal or class heterogeneity • Relative shares in economic and political power • Immigration and outmigration Culture • Underlying cultural values and beliefs • Religious and moral values • Sense of alienation with foreign or modern influences Government and Institutions • Constitutional principles and conflicts • Resilience of national institutions • Role and strength of the army, church, parties, press, educational establishment, etc. Opposition • Strength, sources of support, effectiveness Power • Key leaders' background and attitudes • Main beneficiaries of the status quo • Role and power of the internal security apparatus General indicators • Level and frequency of strikes • Riots and terrorist acts • Number of treatment of political prisoners • Extent of official corruption
External to the MNE	Foreign Trade and invisibles • Current account balance and composition • Income and price elasticity of exports and imports • Price stability of key imports and exports • Evolution of the terms of trade • Geographic composition of trade External debt and servicing • Outstanding foreign debt • Terms and maturity profile • Debt servicing to income and exports Foreign Investment • Size and relative importance • Sectoral distribution • Geographic and regional distribution Overall balance of payment • Trends in the capital account • Reserve position • Capital flight General indicators • Exchange rates • Changes in international borrowing terms	Alignments • International treaties • Position of international issues, UN voting record, EU accession • Double taxation treaties • Regional Integration Agreements Financial support • Financial aid, food and military assistance • Preferential economic and trade linkages Regional ties • Border disputes • External military threat or guerrilla activities • Nearby revolution, political refugees Attitude towards foreign capital and investment • National investment codes • Polls of local attitudes towards foreign investors • Court proceedings in disputes General indicators • Record of human rights • Formal exiled opposition groups • Terrorist act in third countries • Diplomatic or commercial conflict with home country

Source: De la Torre and Neckar 1988, and modified by Investment Consulting Associates (2013)

4. REVIEW OF AVAILABLE RISK METHODOLOGIES

In the previous section we have discussed *why* MNEs engage in FDI. In this section, we will draw attention to *how* MNEs engage in FDI and what techniques they use to mitigate business risks as much as possible while making their foreign investments.

The growth of many emerging markets over the last decades can be largely attributed to FDI by European, Japanese, and US based MNEs. In line with this view, Thomas Friedman's book "The World is Flat" (2007) has become an international bestseller among CFOs, business leaders and policy makers. Friedman argues that today's globalization is characterized by a greater number of 'participants' (i.e. localities and individuals) that are participating in the global economy and that it is driven by greater (inter)connectedness in which the level playing field has 'flattened'. Friedman describes himself playing golf at a golf course in Bangalore India. From the tee he was instructed to aim the golf ball at either the Microsoft or IBM building. He added that the tee markers were from Epson, and one of the caddies was wearing a hat from 3M. Outside, some traffic signs were sponsored by Texas Instruments, and the Pizza Hut billboard showed a steaming pizza, under the headline "Gigabites of Taste!". Friedman argues that these entrepreneurs and CEOs were responding to the flattening of the world in which there is one level playing field. Each was figuring out a strategy for his or her company to thrive or at least survive in this new environment (Friedman 2007).

However, many multinational corporations and their senior management do not experience this 'flattening' process. In addition, Friedman's example summarises "Western MNEs" investing in developing economies. However, global investment trends have structurally changed; for example, MNEs from Pakistan are heavily investing in Ethiopia, while Kenyan MNEs are seeking investment opportunities in Bangladesh. This "South-South" investment has gained recognition, as its importance grows day by day. Anecdotal evidence suggests that the managements of these emerging-market MNEs have mastered the skills of improvising in rapidly-changing economies and can exploit these skills in other markets with similar speeds of development, ways of doing business and needs for adaptability.

One policy that almost all developing and developed countries have in common is their membership of at least one preferential trade and investment agreement (PTIA), based on International Investment Agreements (IIAs), with the majority of them being members of several such treaties. The proliferation of IIAs suggests that these agreements are considered a useful element of FDI policymaking worldwide. IIAs have expanded both geographically and with regard to the number of participating countries. International investment rulemaking, in particular regional and bilateral, is becoming a widespread phenomenon covering all regions.

The impact of IIAs on FDI has been measured in a series of econometric and other studies, published between 1998 and 2008. While these studies often arrive at different conclusions, and their findings are subject to important qualifications, several concur that IIAs do influence a company's decision where to invest. Several studies also concur that this impact is generally stronger (in terms of increased FDI inflows) in the case of free trade agreements, regional integration agreements or economic cooperation agreements than in the case of Bilateral Investment Treaties (BITs).

The term "Nearshoring" of business activities is used to explain this spatial pattern of regional FDI. One of the best examples is the Mexican industrial hinterland region just across the Mexico-United States border. This region, part of the NAFTA agreement, has successfully attracted tens of thousands of mainly US MNEs, looking for cheaper production locations, yet in close proximity to their home market.

Completely opposite to Friedman's liberal and hyper-globalization ideas is the point of view of Pankaj Ghemawat, Professor at Harvard and global strategist. He argues that the world is not flat at all; it is in fact full of barriers, regional trade-blocs and economic obstacles. In his publications Redefining Global Strategy (2007) and World 3.0 (2011) he summarizes examples of perfectly managed companies failing to become profitable in foreign markets due to external influences and unforeseen enterprise risks. These different perspectives are summarised in the matrix below:

	Open / Liberal	Restrictive / Protectionist
Globalization	One Level Playing Field *"The World is Flat"*	Emerging Economies *"South – South" Investment*
Regionalization	Regional Trade and Investment Agreements *"Nearshoring"*	Trade Barriers and Regional Preferences *"World 3.0"*

Source: Investment Consulting Associates (ICA)

Within this context and taking into account a corporate perspective, we examine in the next sections how MNEs undertake FDI and location decisions, based on different sources of information. We will take a closer look into different country risk benchmark and cost modelling techniques to show how MNEs in different sectors and business activities can (theoretically) manage and mitigate risks in FDI decisions.

Country due diligence

As noted in the literature review, there is no broad consensus on the impact of external country risk factors on FDI; the nuance that Ali et al (2010) presented to differentiate by sector and activity shows that country risks can be 'overruled' by more important business motives to engage in FDI.

This implies that Natural Resource Seeking FDI, especially that related to extraction of raw materials, is in most cases unaffected or marginally influenced by country risk, while other more *footloose* types of investment such as labour intensive manufacturing (Efficiency Seeking) are much more affected. In other words, the location decision of MNEs active in the oil, gas, mining and extraction industry, is primarily driven by the availability of raw material supplies. In contrast, the management of a garment production facility is constantly pioneering cheap labour markets to relocate or expand their current production capacities.

The location of FDI through a strategic merger or acquisition (i.e. Asset Seeking FDI) is in the first instance determined by the number of alternative partners available. In monopolistic or oligopolistic markets these alternatives are rather limited and therefore take precedence over the location and risk assessment. More hybrid forms of partner selection in relation to location analysis becomes available where there are several feasible partner candidates available in different countries.

Finally, MNEs engaging in Market Seeking FDI typically concentrate on the availability of large scale consumer markets, ideally in close geographical and cultural proximity to their home market. This type of FDI implies a successful replication of the home country sales and marketing efforts in the foreign marketplace and normally entails several different location options.

In an ideal world, and in cases where MNEs can choose one out of several different location scenarios, they develop a holistic and phased location decision approach. This approach allows them to rationalize location strategies and to mitigate business risks. An example is provided in Figure 4 below.

Figure 4: MNEs' approach to FDI location decisions
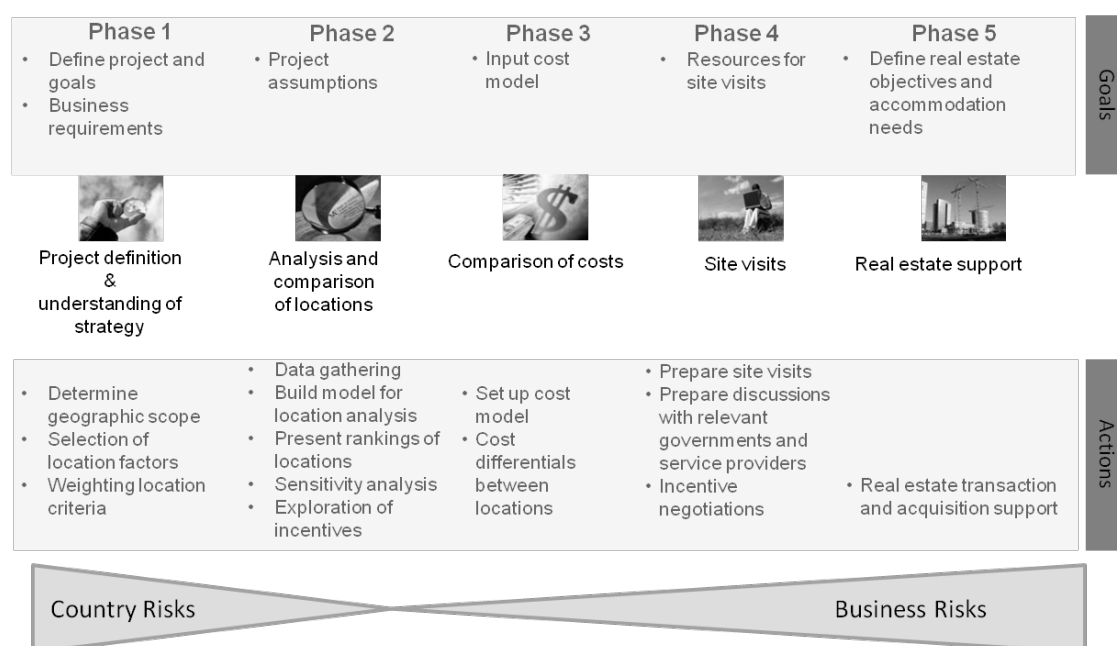
Source: Investment Consulting Associates – ICA

A corporate site selection process depends on a wide range of external country-related as well as business-related factors, making it a complex decision-making task. It is our experience that these external country risk factors are considered important only in the first two phases; soon after a selection of possible locations is made, the focus shifts (almost) exclusively to internal business-related drivers.

It is common for decision makers to use their subjective judgment and gut feelings based on their experience in selecting (or rejecting) the most appropriate location for investment. The reason is that data for site selection originate from varied sources and are not organized in a format that decision makers can readily use to derive any meaningful information. Moreover, data availability for emerging economies is generally poor, contradictory or simply non-existent. An absence of country data often results in rejection of a specific country even before a long list of potential locations is drafted. This underlines the importance for emerging economies of providing comparative statistics to investors.

The following sections describe the typical stages in an MNE's location decision-making process. The stages are based on those typical for a market-seeking or

efficiency-seeking investment, and may differ somewhat for a natural resource seeking investment.

Phase I – Project definition & understanding strategy

In many cases FDI projects are discussed at Board level as a strategic corporate decision. During these initial boardroom sessions, the purpose is to secure and facilitate effective project management, a successful initiation of the project and a description and configuration of the proposed FDI project. Typical questions asked at this stage include:

- What are the critical business drivers (i.e. cost reduction, service and or supply chain optimization) that should be translated into a location strategy?
- Are there any knock-out criteria which rule out locations beforehand?
- Is the purpose to enter a new market or to produce for the home market?
- Where are the key raw material suppliers located and what human resources are required?

The objective of the initiation phase is to have a full understanding of the proposed investment project, work processes, (intermediate and final) products, and supply chains, which can then be translated into a geographical scope and capability requirements. At this stage the firm would create a "long list" of countries that might meet the corporate requirements.

Typically in this phase firms create a multi-disciplinary project management team. This helps ensure that different parts of the organization, such as human resources, legal, fiscal and operational, are communicating with each other to avoid a location decision biased in favour of any one perspective.

Phase II – Risk Assessment and Country Benchmark Analysis

In the second phase, a risk assessment and country benchmark analysis results in an evaluation of the expected risk, cost and return levels. The technique, at this stage, is to incorporate a combination of external country risk factors as well as internal business drivers. Figure 3 above summarized the different external and internal risks that are being categorized. A comprehensive list of location factors used as proxies to quantify the different risk categories is then benchmarked and transformed into a country competitiveness ranking.

This analysis would typically consider the following (non-exhaustive) criteria, clustered into operational and institutional aggregates, internal as well as external to the firm:

Internal to the firm – Operational Factors

- Preferred regions and non-preferred regions in each country from a utility cost, availability, and reliability viewpoint;
- Site-specific information such as location of high voltage power, areas promoted by Government agencies, level of local expertise, etc.;
- Availability and costs of production-level workforce;
- Sales tax/duties/tariffs (i.e. indirect tax matters) relating to the importation and exportation of relevant products;

- Tax regimes in each jurisdiction, along with availability of tax and non-tax incentives.

Internal to the firm – Institutional Factors

- Historic and projected socio-economic and political stability;
- Infrastructure related information such as concentration of local suppliers, level of financial resources, level of telecommunications and utilities available in the country, fresh water supply, freight services, Government bureaucracy, etc.

External to the firm – Operational Factors

- Foreign Trade, External debt and servicing;
- Foreign Investment;
- Overall balance of payments and Exchange rates.

External to the firm – Institutional Factors

- International agreements and treaties;
- Financial support and attitude towards foreign financial capital and investments;
- Regional ties, political freedom, human rights and (nearby) political and diplomatic conflicts.

There are a number of public and proprietary information providers such as the World Bank, World Economic Forum, IMF, IMD, International Country Risk Guide, and Economist Intelligence Unit that have developed country risk-rating systems to enable MNE clients to compare and contrast the investment risk climate in countries around the world. These can be use to generate a high level assessment of the quality of conditions and level of stability encountered by investors, under which the political, economic, legal, tax, operational, and security environments are separately rated for each country.

The Country Risk analysis process

There are various approaches to assessing country environments and their risks. Therefore, it is essential for both public and corporate decision makers to understand the techniques and measurements generally applied to evaluate country risks.

The term "country risk" relates to the likelihood that changes in foreign business environments occur and affect the profitability and riskiness of FDI (McGowan and Moeller, 2011). This potential effect works in a twofold manner. On the one hand, the effect may generate additional FDI flows as improving ratings stimulate MNEs to invest in subsidiaries in particular countries. Conversely, as observed in current times of economic turmoil, downgrading country ratings may result in a withdrawal of both current and future FDI flows since MNEs fear endangerment of their profits and increasing project costs. As a consequence, country risk has a significant impact on a country's FDI flows (Madura, 2007).

Much research has attempted to categorise the main sources of country risks. Dzidrov and Dzidrov (2010) point to six overlapping categories, reflecting the interrelationship between the categories:

1. *Transfer risk*: risks arising from a foreign government deciding to restrict capital movement, resulting in difficulties for MNEs seeking to repatriate profits;

2. *Exchange rate risk*: a sharp devaluation of a foreign currency may lead to reductions of profits and dividends when measured in the parent company's reporting currency;

3. *Location risk*: risks that are attributable to negative spill-overs of regional conflicts and trading disputes;

4. *Sovereign risk*: problems may arise when in times of economic and/or political upheaval governments default on their obligations under external loan agreements;

5. *Economic risk*: changes in economic structures may potentially disturb expected returns of investments and can arise from change in economic policies and a nation's competitive advantage, which makes economic risk strongly intertwined with political risk;

6. *Political risk*: risks that occur when politics and the "rules of the game" affect the capital flows of MNEs, such as bureaucracy, corruption, too many or too few restrictions, and frequently changing policies.

Both public and private organisations are involved in estimating country risks, and providing businesses, governments and institutions with country risk advice. For example:

- Credit rating agencies such as S&P's and Moody's could be classified as service providers mainly concentrating on "sovereign risks";
- The International Country Risk Guide (ICRG) looks mainly at political threats, so falls into the category of providing "political risk" ratings.

However, as most country risk assessment institutions focus on several main causes of risk, it is in many cases not possible to classify them into under a single heading. For instance, ICRG also incorporates financial and economic sources of risks.

Bhalla (1983) developed a risk assessment technique by combining both ratings of financial and political risks in an integrated matrix: the Foreign Investment Risk Matrix or FIRM (Madura, 2007). Bhalla's objective was to categorise countries based upon political and economic risk factors, which could be used as a fundamental analysis tool by investment decision makers. He did this by evaluating political stability and economic potential through measuring three and five variables, respectively.

- ***Political stability*** was measured through government stability, frequency and intensity of policy changes and the public attitude towards politics and institutions.

- ***Economic potential*** was measured through GNP per capita, infrastructure, distribution of GNP, economic growth potential and demographic circumstances.

Through these variables, Bhalla constructed a four by four matrix, which plotted political and economic risk on the axes at four levels: acceptable risk, moderate risk, major risk and unacceptable risk. This FIRM thus positions countries within one of the 16 categories, based on their political and economic risks (Dzidrov and Dzidrov, 2010).

Madura (2000) adapted Bhalla's FIRM (McGowan and Moeller, 2011), resulting in a continuous and variable framework rather than the 16 categories, where potential investment risks may be acceptable, unacceptable or uncertain, the last requiring further analysis for potential investment. Figure 5 shows an illustration of an investment risk case where the UK is the most acceptable investment country, Russia is unacceptable and Brazil and Poland are uncertain regions requiring further examination.

Figure 5: Visualisation of a FIRM for an imaginary investment risk case (Madura)
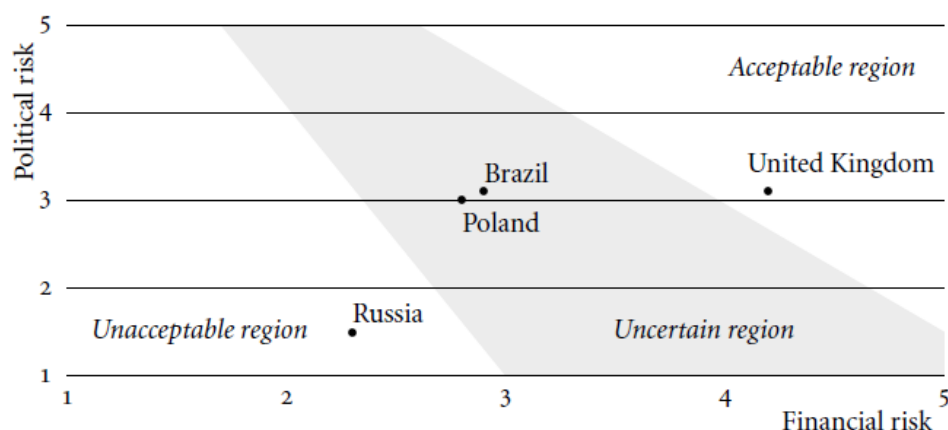
Source: McGowan and Moeller, 2011

Bhalla's FIRM can be considered as one of the first and basic quantitative approaches for assessing and rating country risks. In fact, this quantitative approach evolved into the most commonly applied technique by which governments and investment agencies now measure and benchmark country risks. Quantitative approaches rely mainly on statistical data, coefficients and numbers, transforming these into ratings and scorings which are ultimately distilled to assess country risk with a single grade.

Country Risk information providers

The table overleaf lists the principal public and private country risk service providers. More specific details of these evaluations are included in Appendix 2.

Name	# Countries	Indicators or sector	Purpose
Risk Monitors			
WEF: Global Competitiveness Report	144	111	Investment Climate
WB/IFC: Doing Business In Reports	185	28	Investment Climate
Freedom House: Freedom in the World	195	27	Investment Climate
PRS: ICRG	140	22	Risk Survey
Moody's	113	3**	Sovereign Risk Rating
S&P's	128	10	Sovereign Risk Rating
IHS Global Insight – Sector Intelligence	*	9	Sector Analysis
Datamonitor – Sector Intelligence	*	7	Sector Analysis
IMD: World Competitiveness Yearbook	59	329	Business Climate
EIU: Country Intelligence Reports	60	171	Business Climate

* Available country reports depends on specific sector
** Moody's uses three main categories (Social interaction, Social and political dynamics, and Economic Fundamentals) however, the number of sub-categories is not known

The only service provider in this list strictly evaluating investment risks is PRS's International Country Risk Guide. It emphasises three sources of risk, being political, economic and financial. This is mainly consistent with the previously described model in which political and economic/financial factors are the main sources of country risk.

Nevertheless, the other service providers present relevant country risk assessments albeit through indirect sources. For example, the World Economic Forum's Global Competitive Index assesses the competitiveness of nations. It does not directly focus on country risks but logically implies that if a country is competitive, investment risks are lower and thus investment potentials increase. The same reasoning applies to the IMD's World Competitive Yearbook, the World Bank's Doing Business report, Freedom House's Freedom in the World, the credit rating agencies and the Economist Intelligence Unit.

While most of these country risk assessment service providers serve a similar purpose, information dissemination to a wider public, the information is used for different purposes:

- Government officials use the information to address shortcomings in their investment climate and to promote FDI, if their rankings and scores allow;
- Corporate investors use the information to support a business case for FDI and to mitigate enterprise risk that affects the *bottom line*.

Phase III – 'Pricing' of different risk levels

In this third phase, general business climate and risk indicators play a limited role. For the shortlist of locations that are still in competition for the FDI project, MNEs will draft a detailed business case. Operational factors such as raw material supplies, duties, packaging, transportation, salaries, depreciation expenses, etc. will now determine which locations are considered more favourable from a financial business case perspective.

Only a few global data providers are able to service the private sector by providing regional or even local operational cost data. Additional data collection from other (local) sources will always be necessary to verify and validate facts and figures, down to municipality level.

Hence the FDI location decision process, and the financial assessment of investments considers a far broader range of factors than just general investment climate risk scores. The difference between a risk neutral and a cost competitive location can be highlighted by using a variant of a cost-benefit analysis, represented by a 'Benefits' score and a 'Costs' score. A low country risk rating, combined with other factors, such as sophisticated infrastructure, a large and skilled labour force, and macro-economic stability, would result in a high 'Benefits' score. On the costs side, relatively low labour costs, affordable real estate and low utility costs, supply chain costs and taxation costs are inversely related to the 'Costs' score of a country (i.e. lower cost levels result in a higher cost score). Figure 6 below shows how potential FDI locations can be plotted graphically based on their Cost and Benefits scores.

Figure 6: Location Cost-Benefit Analysis
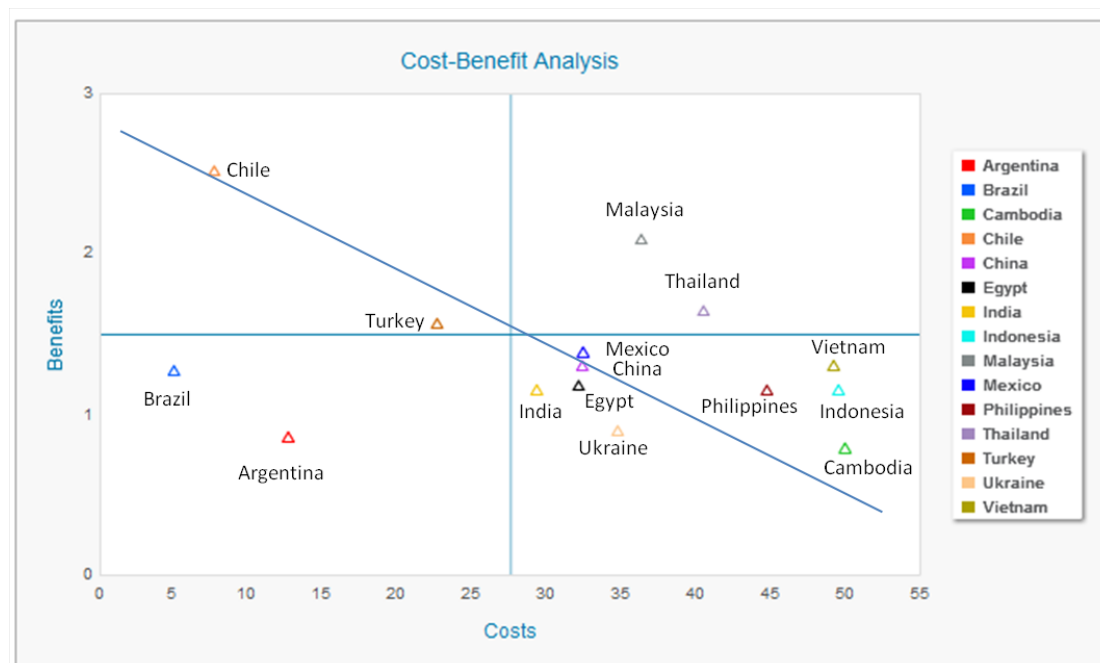
Source: Investment Consulting Associates – ICA & LocationSelector.com

For example, an MNE showing risk-avoiding behaviour might accept higher cost levels (a low 'Costs' score) if this was combined with a very high 'Benefits' score (i.e. a location in the upper left quadrant). Ideally countries would be situated in the upper right quadrant indicating an optimal combination of benefits (low risks) and attractive costs levels. This is a common and proven methodology for narrowing down the list of possible countries for an investment.

At this point all locations that are still being considered have different, but acceptable risk levels. A financial due diligence such as presented in Figure 7 requires an in-depth assessment of the annual operating costs, as well as the required capital expenditure. MNEs also integrate the different fiscal implications that are applicable in the shortlisted jurisdictions, along with the impact of possible incentive packages which may reduce capital expenditure and/or operating costs.

When actually evaluating and incorporating different risk levels in this financial due diligence, MNEs take into account the measureable operational factors internal to the firm to determine bottom-line effects. In order to monitor the possible outcomes, MNEs design a variety of scenarios, considering different elements and their influence on internal operational factors and rates of return. At this stage, institutional factors and external operation factors are generally not taken into consideration.

The result is a comparative overview of the *capital investment*, *net present value*, the *internal rate of return*, *total operating expense* and a potential *net income* per location.

Figure 7: Example of a location cost model

Total Expenses (Incl. Taxes)	22,711,348	22,620,606	22,618,447	22,923,229	22,927,648	22,445,482
Net Present Value	2,933	2,920	2,920	2,964	2,965	2,895
Rank	3	4	5	2	1	6
Internal Rate of Return	19.4%	19.4%	19.4%	19.5%	19.5%	19.3%
Rank	3	4	5	2	1	6
Total Operating Expense	22,711	22,621	22,618	22,923	22,928	22,445
Rank	4	3	2	5	6	1
Total Net Income	853	849	849	861	861	843
Rank	3	4	5	2	1	6

Source: Investment Consulting Associates - ICA

The role of forecasting and scenario planning is particularly important, because the construction of large scale manufacturing projects can take up to two years. In addition, MNEs need time to create a local organization, hire employees and ramp up production processes. Before a large scale operation achieves full production capacity this could take up to three to four years. Essential for a solid business case is to understand in what direction critical cost drivers such as labour, raw materials and transportation costs are moving. MNEs work with various scenarios in the business case to understand and mitigate operational business risks under different circumstances.

Phase IV – Site visits and due diligence

Based on a statistical and financial assessment, MNEs create a shortlist of potential locations to visit. Validation of these facts and figures and a local due diligence are critical requirements in every location decision, but especially in emerging markets. Comprehensive site visit(s) are necessary to understand the local business

environment, and should include visits with local government, other foreign investors and local service providers. In most cases more than one site visit is required in order to obtain a fair understanding of the local business opportunities.

During and immediately after the site visits, MNEs explore and prepare for a comparative feasibility study for the different sites that are available. Increasingly, attention shifts towards the implementation of the FDI project and one important aspect in this regard is the initiation of the incentive negotiations with the regional or national Government. Other important questions that are addressed are the investor licensing process and the required procedures that need to be completed in the entry stage. In our experience countries with transparent processes, genuinely offering one-stop-shop services have a clear advantage over countries in which this process is much more difficult.

Phase V –Real Estate Strategy and final site selection

Finally, in Phase V the real estate and land requirements are highlighted and compared to the different site options. Especially in large FDI projects, the facility and land acquisition process is in many cases subject to negotiations as well.

Phase VI – Implementation (entry stage)

Nearly every developing country desires FDI. Allowing FDI without conditions, however, exposes the country to the potential abuses of MNEs and an inequitable distribution of benefits. At the entry stage, a host country's administrative agency screens the FDI proposal based on the proposal's general suitability to the host's development objectives and the level or likelihood of its expected benefits (Sornarajah).

The host may restrict entry only to those investments that satisfy certain government objectives or may provide investors with incentives when locating in a particular region of the country, engaging in a particular high-priority sector, or undertaking a particular type of direct investment, such as a joint venture with local partners.

The range of operational restrictions, also known as performance requirements, is broad and the choice of restriction imposed depends upon the particular objectives of the host country. Common operational restrictions include:

- minimum local content restrictions, export performance requirements;
- limitations on imports, foreign exchange and remittance restrictions;
- minimum local equity restrictions;
- technology transfer requirements;
- local employment requirements;
- personnel entry restrictions, and;
- product licensing requirements.

The use of these performance requirements is intended to control potential abuses by MNEs and to maximise the potential contribution of the MNE's investment to the development goals of the host country. In this game of give and take, MNEs obviously favour liberal investment procedures, however, they are not reluctant to adhere to certain operational requirements if they are communicated in a transparent manner.

Countries with transparent investment laws and sophisticated institutions, communicate and explain these operational requirements at a very early stage, allowing MNEs to incorporate them in their risk and financial evaluations (see phase 2 and 3). However, in many cases, and especially in countries with developing institutions, new, additional or altered operational restrictions may be imposed on the direct investment at the final stage before allowing entry.

As a consequence, MNEs need to allow for appropriate financial and human resource contingencies to cope with these unforeseen risks. Two examples illustrate the detrimental effect on a country's investment climate, culminating in huge additional capital investment or significant losses due to production delays:

- Tata Motors announced in 2006 that the Nano would be manufactured in Singur, West Bengal. Very soon, local farmers began protesting against the acquisition of their land that the new factory entailed. Tata first decided to delay the Nano launch but later decided to abandon the production site (under construction) and re-build the car plant in a different state instead.
- Very recently, Rio Tinto (and Oyu Tolgoi LLC), rejected a request from the Government of Mongolia to renegotiate the Oyu Tolgoi Investment Agreement, imposing an increase in the royalty taxes. This has led to speculation that the mining operations will be suspended or even terminated.

Conclusions

Whether stimulated through a global level playing field or restricted through regional barriers, FDI is one of the instruments that MNEs have at their disposal to enter new markets, produce more effectively, source key raw materials or seek for strategic partnerships. By definition, MNEs engaging in FDI are willing to accept a certain level of risk and uncertainty. The relation between risk, uncertainty, and the location of FDI has been an intense topic of debate.

In the literature review, we found that the bulk of the research on risk and FDI concentrated on the relationship between external country risks and the levels or direction of FDI. The MNE was considered a black box and these external forces were driving the FDI location decision. Gradually, more emphasis was placed on the role of sectors and business activities of MNEs and their impact on the location of FDI. Walsh and Yu, and also Ali et al, argued that country risk and FDI levels differ per type of sector (i.e. the primary, secondary and tertiary sector). Dunning and Aharoni's primary study object was the MNE, instead of the external environment, and they defined different motives and ways of behaviour to explain why MNEs engage in high-risk FDI projects. It is fair to say that the firm level perspective has gained popularity in the international business literature.

MNE investments create jobs, bring in capital and provide for skill transfer, and all over the world governments are actively seeking to attract such investments. They communicate to each other, yet they seem to use a different vocabulary. Institutions such as industry associations have the ability to play honest broker and to try to synchronize the expectations on both sides. These institutions are also an important source for MNEs to use in gathering primary data on any kind of operational restriction they need to be aware of prior to making an FDI decision.

In terms of risk ratings, there seem to be differences between the preferred sources of governments and those of MNEs. MNEs are primarily interested in those risk monitors that address operational cost factors in combination with relevant location factors (i.e. internal to the firm). Furthermore, they are willing to invest in databases providing very detailed firm level information. Country level risk reports are considered interesting in the exploratory phase, but soon become ineffective as data sources, since they lack the necessary in-depth analysis for building a strong business case. Figure 8 provides an integrated framework based on the literature review and this section on risk methodologies.

Figure 8 Integrated framework based on literature review and risk methodologies
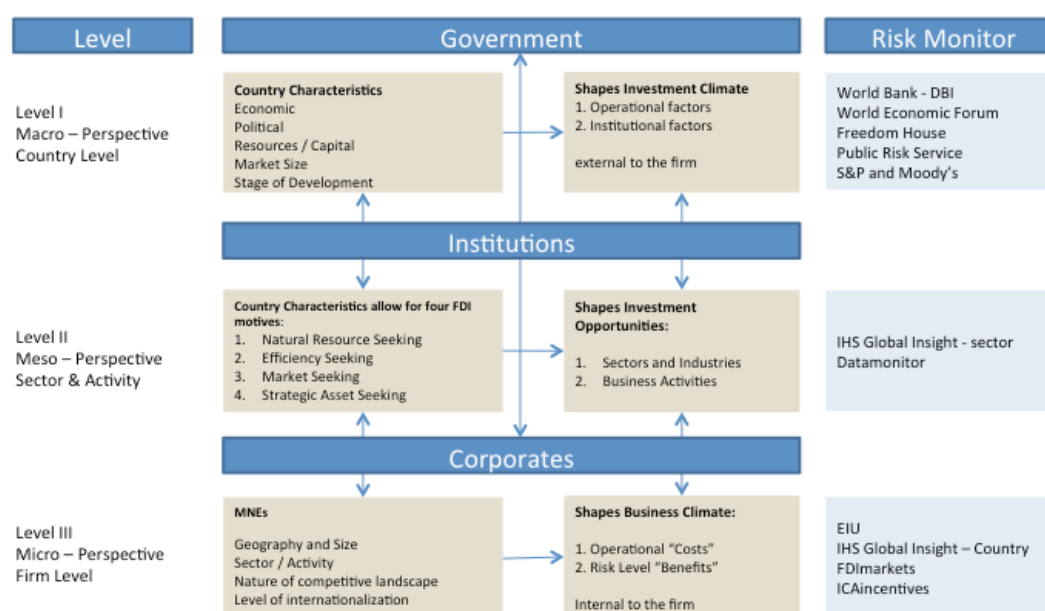
We believe that this study can make a significant contribution to an understanding of the risk factors that MNEs consider, and how they use that risk information, in coming to FDI location decisions. The intention of this study has been, from the outset, to focus at the level of the firm. Based on the above review of existing research into FDI and risk, and in particular of firm-level practices, we believe that the next stages of this study should focus specifically on:

- Clarifying differences in approaches to risk between different categories of MNEs, based primarily on the Dunning classification, but at the same time noting differences that may be attributable to other factors, such as size of firm, and source country.
- Exploring in more detail with our sample of MNEs:

  o Their processes for assessing potential investments in emerging markets, especially in FACS;
  o The risk factors that are considered , and how they are used at each stage of the decision process;
  o How, if at all, risk is priced into their business case models.

5. DATA ON MNE INVESTMENTS IN FOCUS COUNTRIES

Collection of data

Given the nature of the Focus Countries, there was a degree of uncertainty over the quality, timeliness and reliability of the data on MNE investments which we would be able to obtain, even with support from experienced local consultants.

Our Discussion Document envisaged that we would use local consultants (with a budget of 3 consultant days per country) to conduct a desktop analysis of existing MNE investments in the Focus Countries. In fact, we subsequently discovered that we could purchase data from the Financial Times fDi Markets database for all six countries. This information is based on public announcements, is forward-looking in nature and is recorded under the following headings, giving a very high degree of granularity:

- Project Date
- Investing Company
- Parent Company
- Source Country
- Source State
- Source City
- Destination Country
- Destination State
- Admin Region
- Destination City
- Industry Sector
- Sub-Sector
- Cluster
- Industry Activity
- Capital Investment Estimated
- Jobs Created Estimated
- Project Type

The results for the six Focus Countries were 759 investment projects identified for the period January 2003 to November 2012, broken down as follows:

Focus Country	# of investment projects
Bangladesh	151
Myanmar	80
Nigeria	333
Sierra Leone	21
Uganda	132
Yemen	42
Total	**759**

The total value of Capital Investments announced was $169 bn and total jobs announced as created were 184,000.

Basis of fDi Markets data collection

fDi Markets have described the basis on which data is collected:

The FDI analysis traces greenfield investment projects as well as expansion projects. Joint ventures are only included where they lead to a new physical (Greenfield) operation. It does not include mergers and acquisitions (M&A) or other equity-based or non-equity investments. The Sectors recorded in fDi Markets are aligned with SIC codes (which in turn can be aligned to NACE or NAICS codes). There is no minimum size for a project to be included. However, every project has to create new direct jobs and capital investment.

Data on FDI projects is collected real time by a team of analysts. The quality control of the data is rigorous through a team of experts. All project data are updated on a monthly basis and revised based on new intelligence being received.

- *We include only those FDI projects that generate economic value (i.e. new jobs, invested capital expenditure in land, facilities, machinery, etc.)*
- *FDI project data consist of the following types of projects:*
  - *Greenfield Investment (a new operation)*
  - *Brownfield Investment (expansions or re-investment in existing foreign affiliates or sites)*
  - *New forms of Investment (joint ventures, strategic alliances, licensing and other partnership agreements), only when they lead to a new physical (Greenfield or Brownfield) operation*

The data presented include FDI projects that have either been announced or initiated by a company. The data on capital investment and job creation are based on actual figures or estimates of the corporate investment. As companies can raise capital locally, phase their investment over a period of time, and can channel their investment through different countries for tax efficiency, the data used in this report are different than the official UNCTAD macro-economic data on FDI flows (Balance of Payment – BOP statistics).

Comparison of fDi Markets data with UNCTAD Global FDI Database

A comparison of the fDi Markets data with the UNCTAD Global FDI Database for the same six Focus Countries highlights the fact that the fDi Markets figures are significantly higher, as can be seen by the following comparison for Uganda:

Inward FDI flows (USD mn)	2007	2008	2009	2010	2011	Total
UNCTAD	792	729	842	544	792	3,699
fDi	518	4,133	1,317	2,570	1,417	9,955
fDi/UNCTAD %	65%	567%	156%	472%	179%	269%

As stated above, the fDi Markets data are based on projects rather than investments (so may include investment by local partners as well as foreign investors); are forward looking rather than historic (so will "front end" figures for flows which might run over more than a single year); are often based on company announcements (so will involve an element of hype or spin in some cases); and may simply involve human error in capturing or entering data[6]. Where values for capital investment or jobs created are not provided by the investor, fDi use their own estimates, which may also introduce an element of uncertainty.

It follows from this that not all projects will have gone ahead on the basis announced or at all, or may not involve exactly the stated levels of capital investment or job creation. In addition, our review of some investments raises questions as to whether they would constitute FDI as normally understood or whether, for example, they are related to specific commercial contracts.

Nevertheless, it is important to bear in mind that the purpose of collecting data on MNE investments in the Focus Countries is to enable us to identify those MNEs which are candidates for the Stage 2 interviews – it is not to produce a definitive analysis of FDI, or a detailed examination of the differences between the two sets of data collected using different assumptions and methods.

While we treat the fDi Markets data with some caution, our view is therefore that the project data presented almost certainly provide the best available indication of the investments which multinational companies are making in their overseas operations. Since they also reflect announcements or other information made publicly available on investment projects for which risk assessments can be assumed to have taken place, they form a good starting point for our identification of suitable candidates for interviews.

Validation of fDi Markets data

As a further step to validate the fDi Markets data, we have used our local consultants in Myanmar, Yemen, Uganda and Sierra Leone to comment on the listings of investment projects generated and to identify established MNEs which were not captured in the project listing above.

Our consultant in Bangladesh advised that data could only be collected on a Ministry by Ministry basis and would require prior notification and approval plus a letter of introduction/authorisation from DFID. We foresaw similar problems for Nigeria, and decided that the fDi Markets data on the 330 investments in that country (44% of the total projects listed) should be a reliable source to identify potentially active investors.

In drawing up our long list of potential candidates (see Section 7 below), we have deleted some projects which did not proceed or were not recognised and added some names identified by the local consultants.

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[6] for example, fDi Markets show an investment of $15 bn in Nigeria in 2008 by Western Goldfields, a Canadian company. This is the single largest investment listed, yet the company's website suggests that it is a Nigerian company and makes no reference to an investment project of anything like this size.

6. ANALYSIS OF EXISTING MNE INVESTMENTS IN THE FOCUS COUNTRIES

NB: While financial institutions are excluded from the scope of our study, we have retained data on the financial sector in a number of the following graphs for comparison purposes.

Distribution by country

Unsurprisingly, Nigeria and Bangladesh, as the two largest countries by population and GDP, attracted the largest numbers of investment projects:

Figure 9: Number of investments by country
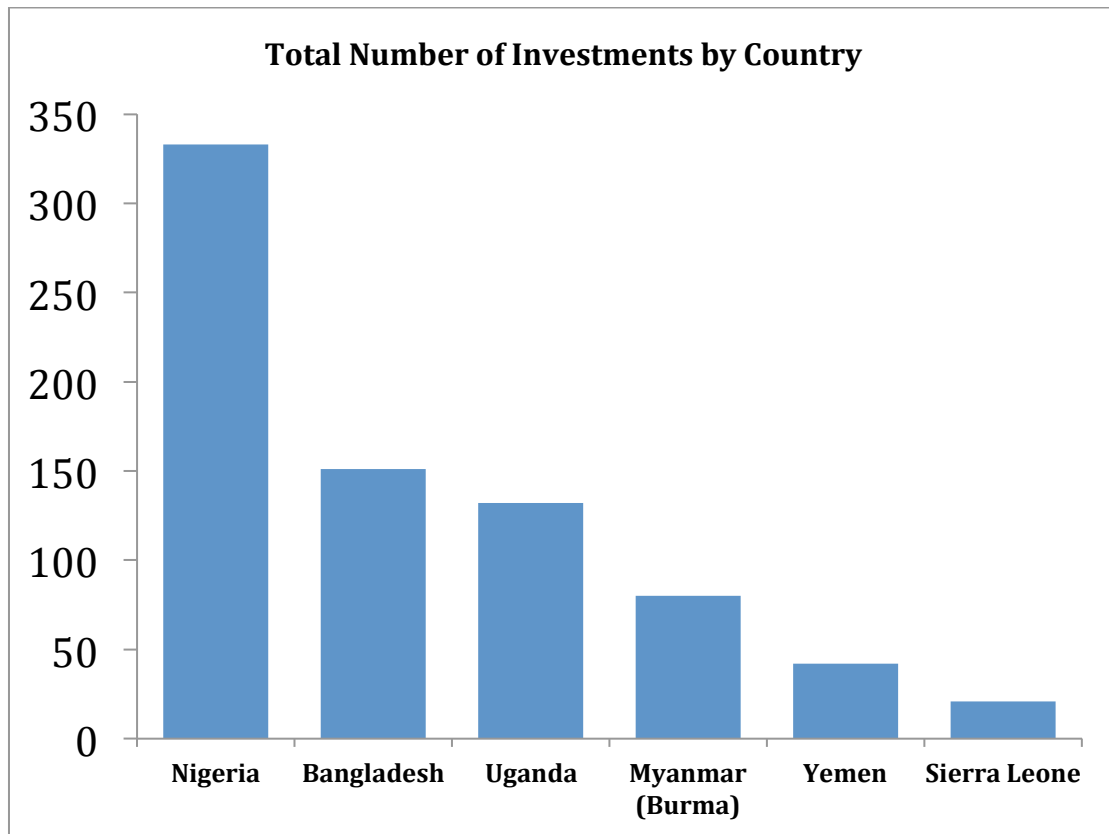
FT FDI Database: 2003 - 2012

Sectoral distribution

The fDi Markets are categorised under 39 sectors, which can be mapped to Standard Industrial Classification (SIC) categories if necessary[7].

The analysis of investment projects by sector below illustrates very strongly the weighting of extractive industries, which fall under the "Coal, Oil and Natural Gas" classification. This weighting has implications for the choice of MNEs for interview, which we discuss in Section 7.

Figure 10: Percentage Capital Investment by Sector
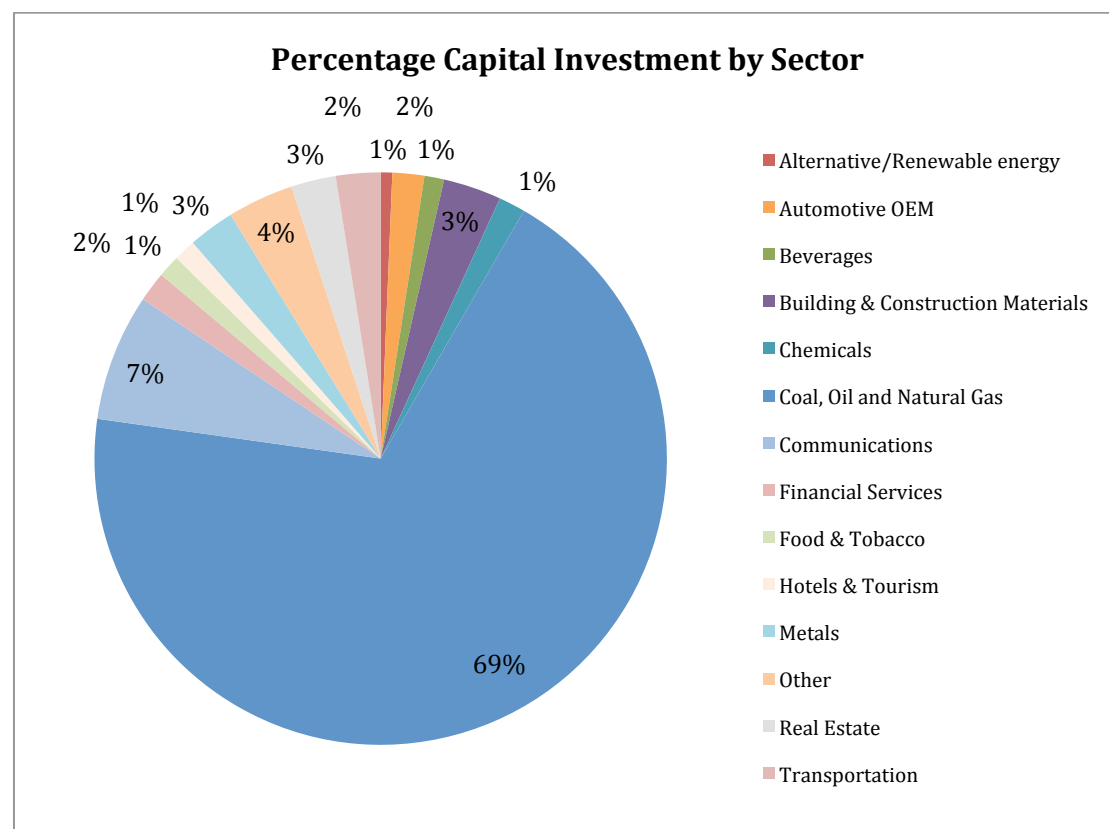
FT FDI Database: 2003 - 2012

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[7] SIC codes were established in the US in 1937 and are used by government agencies and financial institutions to classify industry areas. The SIC system is also used by agencies in other countries, including the UK.

Job creation

A comparison of capital investment against job creation highlights the very high level of jobs created in the "Other" category – ca. 50,000 or 27% of the total – against a capital investment of $6 bn, or only 4% of the total.

Figure 11: Capital Investment and Jobs Created by Sector
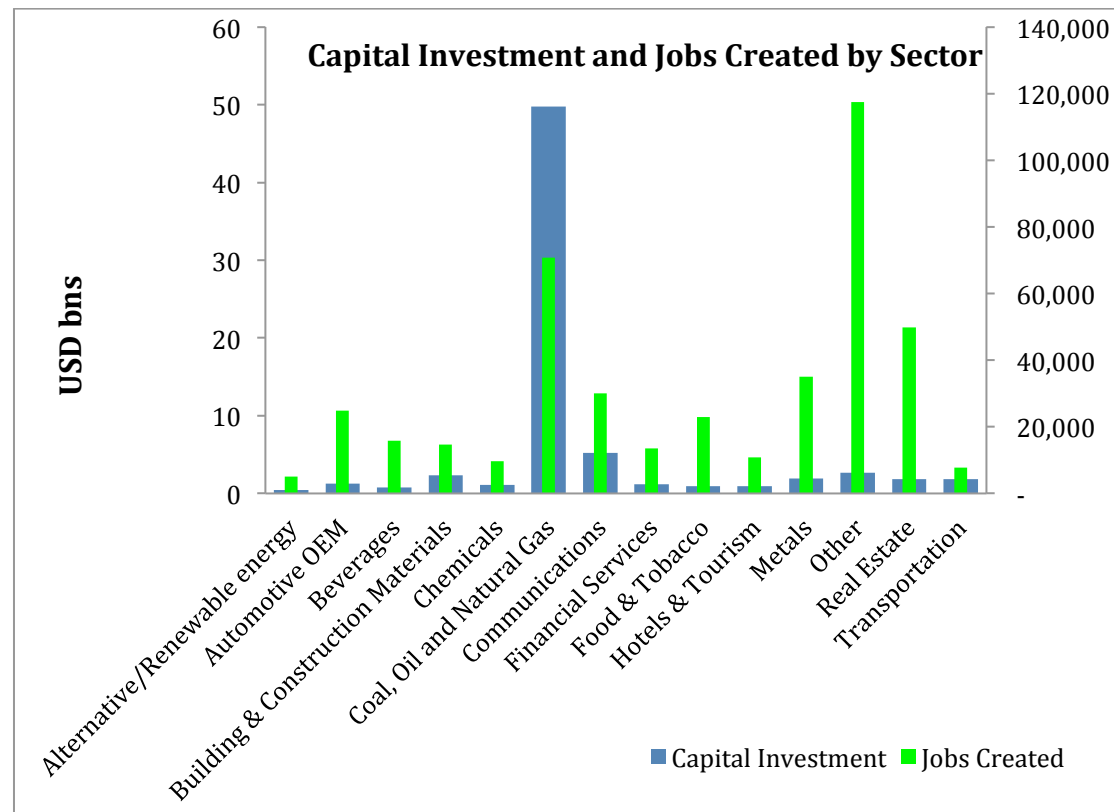
FT FDI Database: 2003 - 2012

A more detailed analysis of the "Other" sector shows, unsurprisingly, that Textiles form the largest single element (21,200 jobs), followed by Non-Automotive Transport OEM (5,000) and Consumer Electronics (2,500).

Figure 12: Breakdown of "Other" Sector
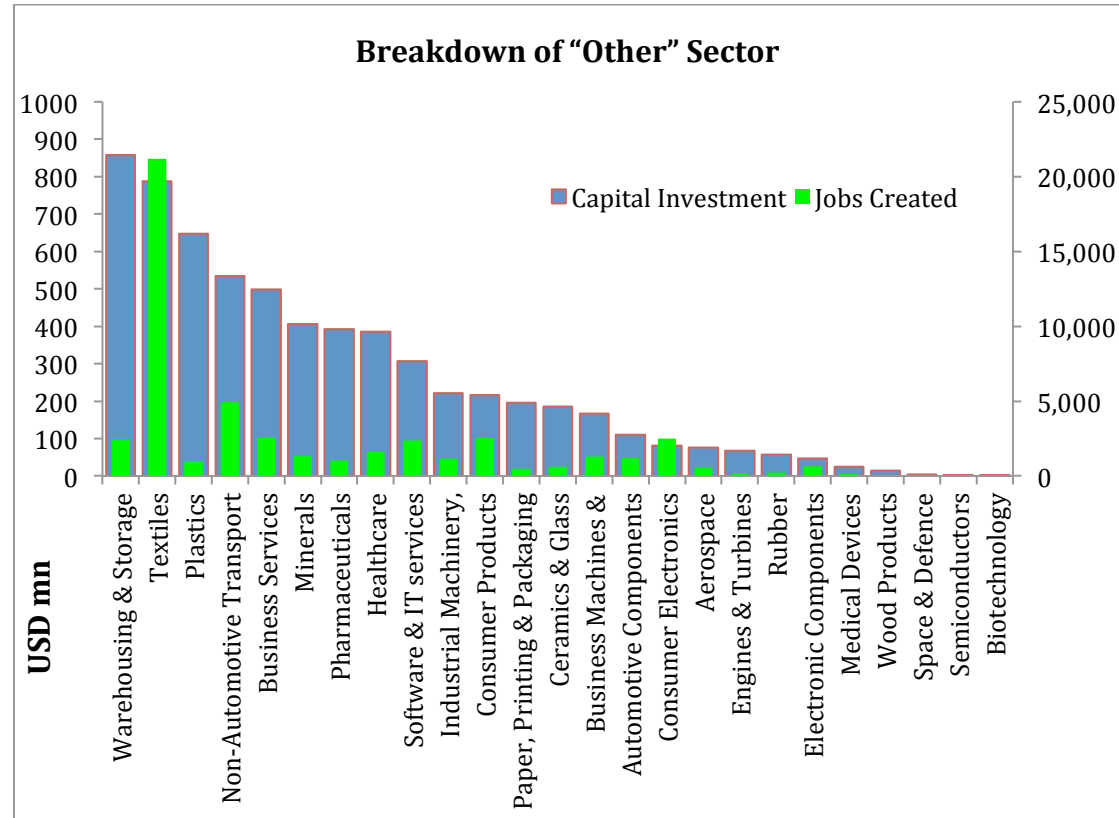
FT FDI Database: 2003 - 2012

Comparisons Pre- and Post- Global Financial Crisis

We have also examined patterns of projects announced for the first half of the 10 year period covered by the fDi Markets data, i.e. 2003 to 2007, or prior to the Global Financial Crisis, and 2008 to 2012[8]. The pattern for the second period is distorted by the Western Goldfields transaction referred to in an earlier footnote (highlighted in gold below), but even excluding this it can be seen that announcements of both capital investments and jobs created were materially higher in the second period than the first (by 33% and 39% respectively).

The increasingly prominent role of China can also be seen reflected in the second period Capital Investment figures.

Figure 13: Capital Investment/Jobs Created by Source Country – Two Periods
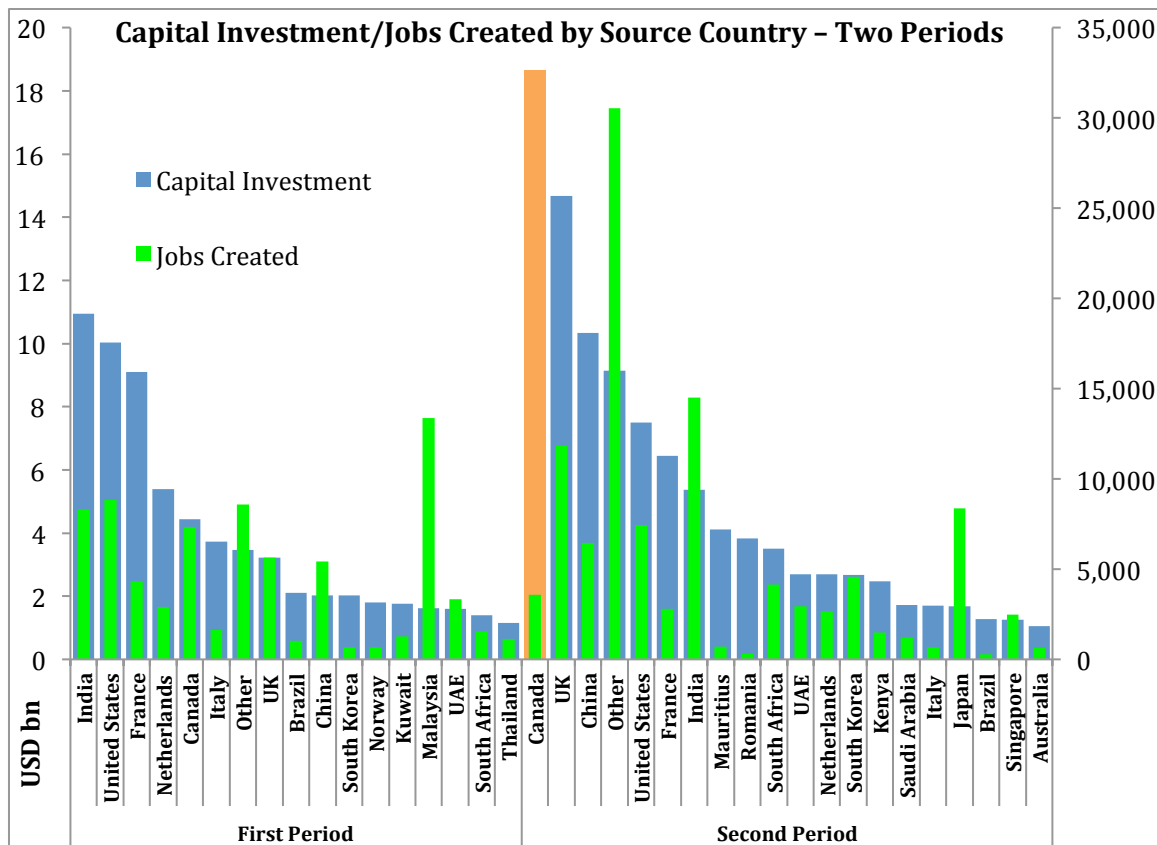
FT FDI Database: 2003 - 2012

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[8] Specified for countries with total capital investment > USD 1bn, else grouped into "Other"

Top MNEs by Capital Investment and Jobs created

A listing of all MNEs which have announced aggregate projects in excess of $1 bn over the 10 year period shows an overwhelming presence of companies in the extractive sector, plus a small number of mobile telecoms companies.

Figure 14: Top Firms by Capital Investment and Number of Investments
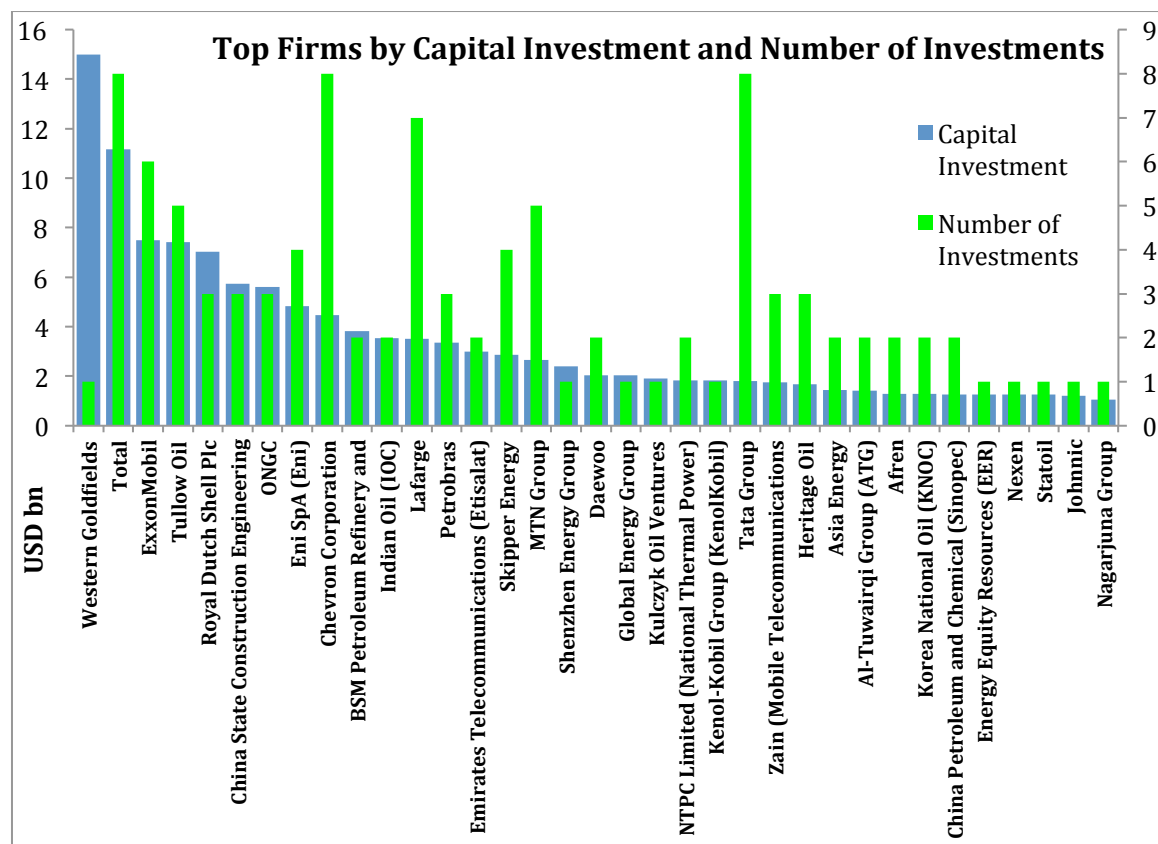
FT FDI Database: 2003 - 2012

The following slide shows very significant divergences between jobs created, which may relate to the nature of the investments and/or may reflect the basis on which the announcement was made (for example, whether it relates to the investee company only or to other jobs in the supply chain).

Figure 15: Capital Investment and Jobs Created – Firms Above USD 1bn
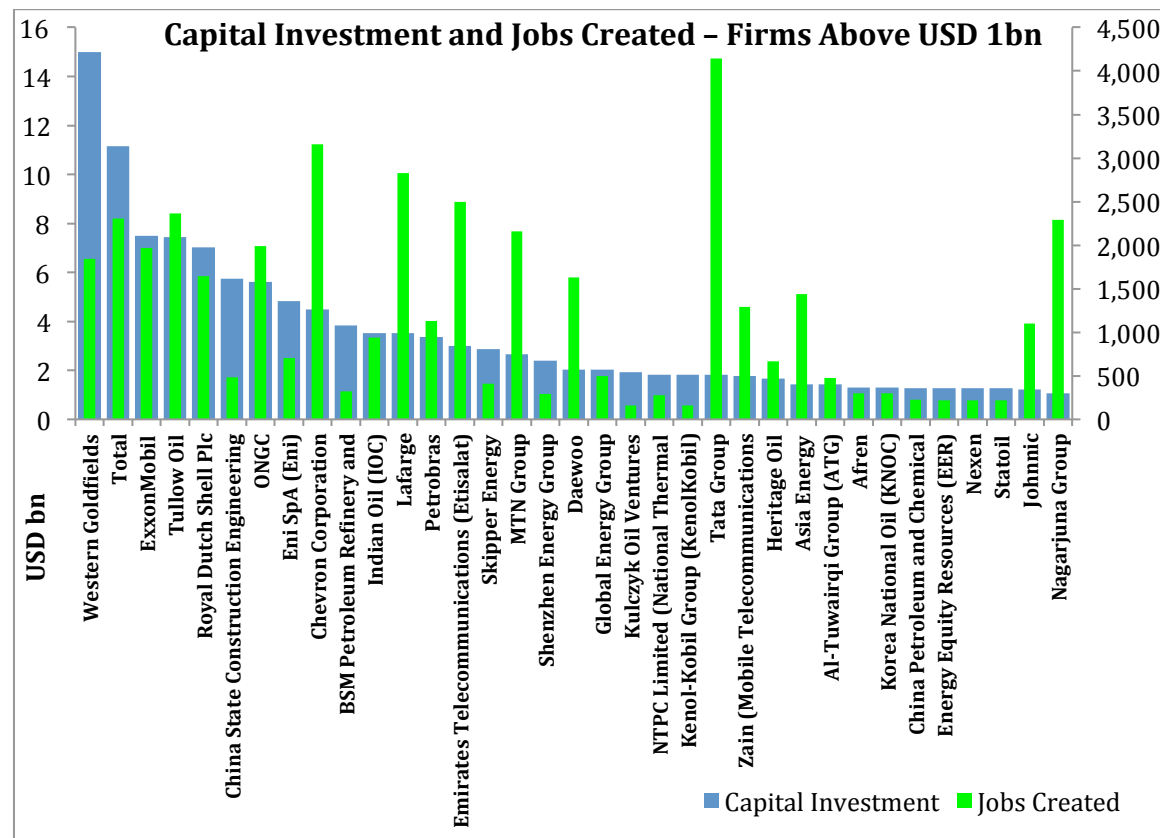
FT FDI Database: 2003 - 2012

7. METHODOLOGY FOR DETERMINING WHICH MNES SHOULD BE INTERVIEWED DURING STAGE 2

How do we define an MNE?

In our initial discussions with DFID, we agreed that:

DFID is interested in understanding the factors which MNEs evaluate when considering investments in emerging market countries and in identifying those elements which can be addressed by national governments to increase the volume of sound long term investment.

The definition of a "sound" long term investment includes a high level of transparency, a rational business case, a commitment to meeting environmental guidelines, compliance with relevant industry codes of conduct and an absence of corruption. These criteria will therefore influence the choice of MNEs to be surveyed.

We also agreed that the study would exclude financial or portfolio investors and investments in financial institutions. We anticipated that it would also exclude State Owned Enterprises whose investment decisions are driven primarily by political rather than economic factors, as well as large privately owned groups with non-transparent decision-making processes (for example, oligarch controlled groups).

The fDi Markets data list ca. 540 corporate investors, which we have mapped against the Fortune Global 500 (F500) listing for 2012[9]. 81 of these names (or 15%) appear in the F500 listing, although, unsurprisingly, these 81 companies account for a higher share of reported investments, both by number (23%) and by value (34%). Since many of the F500 companies are in extractive industries, restricting our focus to the largest multinationals would lead to a high sector concentration.

Our view is that all the names listed in the fDi Markets data should be considered as potential interview candidates. We therefore use the term "MNE" to refer to this group of corporates.

Approach to selection of companies for interviews

In our approach to selection of potential candidates for interview, we have borne in mind the limitation imposed by the small sample size of 25 companies.

We also have to consider a number of practical issues, specifically:

- To ensure that the selected companies are in locations where we can interview them cost-effectively;
- To accept that not all the shortlisted names will be prepared to meet with us; and
- To plan for the fact that we may decide to reject a number of the shortlisted names when we research them during the interview preparation phase.

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[9] This is not 100% reliable, since investor company naming conventions may differ between the fDi database and the Fortune 500 list; additionally, some investments may have been made through subsidiaries of the ultimate or intermediate holding company

We used the fDi Markets data to identify "multiple investors", i.e. those which have invested in more than one of the Focus Countries. The rationale for this approach was that we consider that we will learn more from "serial investors" rather than those who have just had a single experience in these countries. Our initial analysis of "multiple investors" from the fDi Markets database (i.e. those which have invested in more than one of the Focus Countries) produced a long list of 44 names across 22 sectors out of the 39 used by fDi Markets.

In order to broaden the base and to generate a larger number of potential candidates within individual sectors, we expanded our review by adding a further four countries – Ethiopia, Nepal, Pakistan and Uganda. This produced an extended long list of 112 companies, which are shown in Appendix 3. The long list covers 31 of the 39 sectors defined in the fDi database as shown in the table below (shaded cells):

Sector
Aerospace
Alternative/Renewable energy
Automotive Components
Automotive OEM
Beverages
Biotechnology
Building & Construction Materials
Business Machines & Equipment
Business Services
Ceramics & Glass
Chemicals
Coal, Oil & Gas
Communications
Consumer Electronics
Consumer Products
Electronic Components
Financial Services
Food & Tobacco
Healthcare
Engines & Turbines
Industrial Machinery, Equipment & Tools
Leisure & Entertainment
Medical Devices
Metals
Minerals
Non-Automotive Transport OEM
Paper, Printing & Packaging
Pharmaceuticals
Plastics
Real Estate
Rubber
Semiconductors
Software & IT services
Space & Defence
Textiles
Hotels & Tourism
Transportation
Warehousing & Storage
Wood Products

A number of the unrepresented sectors, for example Aerospace, Biotechnology, Semiconductors and Space & Defence, would not be expected to be strongly relevant given the local conditions prevailing in FCAS. In addition, Financial Services have been excluded under our Terms of Reference.

Criteria for selection of interviewees

In selecting companies for interview, our primary criterion has been to identify clusters of companies in sectors corresponding to Dunning's four primary motivations which drive FDI decisions, as discussed in Section 3 above:

- *Natural resource seeking*, i.e. to gain access to specific natural resources available in the investee country;
- *Market seeking*, i.e. to supply goods or services in the investee country and/or nearby markets;
- *Efficiency seeking*, i.e. seeking plentiful supplies of cheap and well motivated unskilled or semi-skilled labour, or access to other competitively priced inputs (e.g. energy, land, port facilities etc.) or advantageous tax or regulatory regimes;
- *Strategic asset seeking* i.e. driven by the need of firms to acquire specific technological capabilities and/or management or marketing expertise, to promote the long-term strategic objectives of the acquiring firm.

In practice, these objectives may overlap in many cases.

We have discussed whether to select individual companies (regardless of sector) whose investments correspond to each of the four groupings above to form clusters for interview. However, the fDi Markets data do not provide sufficient detail to classify the objectives of each investment (and many companies have made multiple investments, classified under various industry activities).

In addition, we were concerned to identify homogenous groups of FDI investors whose approaches could be compared and contrasted. For this reason, we have tried to identify industry sectors whose characteristics would be expected to correspond broadly to the Dunning motivations.

Major industry sectors

The two tables overleaf show the top 10 sectors by job creation and capital invested, as well as the numbers of potential interviewees on the long list:

Table: Top 10 sectors by jobs created

Sector	Jobs created	# of candidates
Coal, Oil and Natural Gas	14,761	16
Communications	12,384	23
Automotive OEM	*6,261*	*2*
Food & Tobacco	5,542	7
Transportation	4,793	6
Beverages	4,725	4
Building & Construction Materials	4,686	3
Metals	4,549	3
Warehousing & Storage	3,876	4
Chemicals	3,702	2

Table: Top 10 sectors by capital invested

Sector	Capital invested $ mn	# of candidates
Coal, Oil and Natural Gas	$58,420	16
Communications	$11,069	23
Transportation	$2,188	6
Chemicals	$2,028	2
Alternative/Renewable energy	*$1,677*	*5*
Metals	$1,659	3
Building & Construction Materials	$1,540	3
Beverages	$1,423	4
Warehousing & Storage	$1,081	4
Food & Tobacco	$1,073	7

It can be seen that there is considerable overlap (apart from the two sectors highlighted in italics) between the two groups. There is also a strong correlation between investment and job creation in the two groups[10].

In order to cover the four categories described by Dunning, we propose to focus our attention on selected sectors from the above top 10 sectors shown above, which are likely to be strongly correlated with the four Dunning categories.

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[10] This contrasts with a number of the tables shown in Section 6; the reasons for the difference is that the former include a number of investors in a single country (for example, in the textile sector in Bangladesh) which do not qualify as multiple investors and so are not included in the data above

We propose that those representative sectors should be as follows:

Dunning Category	Representative Sectors
Natural resource seeking	Coal, Oil and Natural Gas
Market seeking	Food & Tobacco plus Beverages
Efficiency seeking	Transportation plus Warehousing & Storage
Strategic asset seeking	Communications

We have had some discussion over whether the Transportation and Warehousing & Storage investments illustrate Efficiency seeking or Market seeking behaviour. Since the USP of corporates in this sector is to offer high quality and cost-effective movement or storage of goods, it could be argued that their market is in fact other companies seeking efficient services. In addition, much of the demand for investment in Focus Countries may be driven by clients in OECD countries who are either exporting to importing to the locations of the investments.

This area does require further analysis as part of our preparation for Stage 2 and it may be that we will define these sectors as a further example of Market seeking behaviour.

Interview candidates

These sectors generate the following candidates for interview. Those which fall within the Northeast America/Continental Europe/Hong Kong and Singapore locations assumed in our Discussion Document appear as normal text; those which we believe can be added within the project budget appear in green; and those which cannot be accommodated within the project budget are in red.

The list includes five Gulf-based names. We believe that the project budget will cover meetings with these, provided that we are able to arrange a minority of other interviews using Videoconferencing, Skype or telephone (see below).

Natural resource seeking

Company	Location	OECD?
Al Ghurair Group	UAE	N
Al-Tuwairqi Group (ATG)	Saudi Arabia	N
Cairn Energy	UK	Y
Cemex	Mexico	N
Chevron Corporation[11]	United States	Y
China Petroleum and Chemical (Sinopec)	China	N
Eni SpA (Eni)	Italy	Y
ExxonMobil[12]	United States	Y

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[11] California
[12] Texas

Company	Location	OECD?
Korea National Oil (KNOC)	South Korea	Y
Nexen	Canada	Y
NTPC Limited (National Thermal Power)	India	N
ONGC	India	N
Petrobras	Brazil	N
Petronas	Malaysia	N
RTZ	UK	Y
Total	France	Y
Tullow Oil	UK	Y

Market seeking

Company	Location	OECD?
British American Tobacco (BAT)	UK	Y
Charoen Pokphand Group	Thailand	N
Coca-Cola[13]	United States	Y
Diageo	UK	Y
Dominion Group[14]	United States	Y
DuPont	United States	Y
Heineken	Netherlands	Y
Nestle	Switzerland	Y
SABMiller	UK	Y
Starbucks[15]	United States	Y
Sterling Paper Group of Companies	Philippines	N
Unilever	UK	Y

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[13] Atlanta
[14] Oklahoma
[15] Seattle

Strategic asset seeking

Company	Location	OECD?
Altech Group	South Africa	N
Avanti Communications	UK	Y
Aviat Networks (Harris Stratex Networks)[16]	United States	Y
Bharti Group	India	N
China Central Television (CCTV)	China	N
Emirates Telecommunications (Etisalat)	UAE	N
Ericsson	Sweden	Y
France Telecom	France	Y
Huawei Technologies	China	N
IHS Plc	Nigeria	N
Mobiserve	Egypt	N
MTN Group	South Africa	N
NEC	Japan	Y
Nippon Telegraph & Telephone (NTT)	Japan	Y
Nokia	Finland	Y
Nokia Siemens Networks	Finland	Y
Nortel Networks	Canada	Y
Qualcomm	United States	Y
Seacom	Mauritius	N
Siemens	Germany	Y
Warid Telecom	Pakistan	N
Zain (Mobile Telecommunications Company) (MTC)	Bahrain	N
ZTE	China	N

Efficiency seeking

Company	Location	OECD?
Al-Futtaim Group	UAE	N
AP Moller - Maersk	Denmark	Y
Deutsche Post	Germany	Y
DP World	UAE	N
Mercator Transport	Canada	Y
Neptune Orient Lines (NOL)	Singapore	N

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[16] California

Company	Location	OECD?
SEKO Worldwide[17]	United States	Y
The Kuok Group	Malaysia	N
TNT (TPG)	Netherlands	Y
TNT Express	Netherlands	Y

This produces a total of 62 companies, of which 26 are considered not possible to interview, leaving 36 companies on our interview list.

Our original Discussion Document envisaged face to face interviews with all the selected candidate MNEs. This is still our very strong preference; however, the geographic distribution of the European and US names may mean that we need to use Videoconferencing, Skype or telephone for some discussions in a minority of cases. This would also enable us to add some North American names which are located away from the Northeast.

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[17] Illinois

8. FORMAT FOR PROPOSED QUESTIONNAIRE

We attach as Appendix 4 a copy of the draft Questionnaire which we propose to use for the structured interviews with MNEs.

The Questionnaire will be accompanied by an interviewer's guide which provides detailed instructions on the organisation and conduct of the interview so as to assure consistency of approach by different interviewers, as well as useful tips on obtaining the maximum information from the interview process.

Once potential interviewees have been identified, we expect to send them a detailed outline of the areas to be covered and the way in which they will be approached, so as to maximise the benefit from the time available.

Prior to the interview, the interviewer will be expected to have obtained the most recent Annual Report and to have prepared a bullet point analysis of the interviewee company, including details of key financials; performance; organisation and corporate structure; and investments in emerging markets other than the Focus Countries.

Our target time for the interview is two hours, although in some cases this may be too long for the interviewee. The discussion will focus both on the company's general policies for investments in emerging markets and fragile states and on the specific issue surrounding the investment(s) listed in the fDi Markets data. Both the Business Commentary and the Notes sections of the company's Annual Report are often a valuable supplementary source of information on these areas.

9. OTHER ISSUES/NEXT STEPS

An earlier version of this report was discussed with DFID at meetings held on Thursday 7 February. This report incorporates the feedback from DFID during those meetings and subsequently.

We now await further feedback from DFID on the following issues:

- Agreement to the list of target candidates set out in Section 7.
- The revised Questionnaire for structured interviews.
- The form and content of our proposed letter of introduction to MNEs (draft provided on 21 February).

On the assumption that these issues are agreed, we look forward to DFID's confirmation that we can start work on Stage 2 of the assignment.

GBRW Limited　　　　　　　　　　**Investment Consulting Associates (ICA)**

25 February 2013

APPENDICES:

1. Literature list

Literature List

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Figure 2:

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Figure 3:

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2. Country risk assessment service providers

Public country risk service providers

WEF	Global Competitiveness Index (GCI), 2012-2013		
Goal(s) and target group	Assessment of the competitiveness landscape providing insight into the drivers of their productivity and prosperity to inform strategies and constructive discussions among policy-makers, business leaders, academic research and civil society		
No. of countries	144		
Source(s)	• Institutions • Infrastructure • Macroeconomic environment • Health and primary education	• Higher education and training • Goods market efficiency • Labour market efficiency • Financial market development	• Technological readiness • Market size • Business sophistication • Innovation
Indicators	*Institutions* • Public institutions • Private institutions *Infrastructure* • Transport infrastructure • Electricity and telephony *Macroeconomic environment* • Macroeconomic environment *Health and primary education* • Health • Primary education	*Higher education and training* • Quantity of education • Quality of education • On-the-job training *Goods market efficiency* • Competition • Quality of demand *Labour market efficiency* • Flexibility • Efficient use of talent *Financial market development* • Efficiency • Trustworthiness	*Technological readiness* • Technological adaption ICT use *Market size* • Domestic market size • Foreign market size *Business sophistication* • Business sophistication *Innovation* • R&D innovation
	NB these indicators do represent the "12 pillars" of competitiveness sources but some of them are measured within subcategories (e.g. public institutions: property right, corruption, etc)		

Methodology: The "12 pillars" are all measured through the mentioned indicators and weighted according to the development stage of countries. That is, although all "12 pillars" indicate sources of competitiveness, the relative importance of each one depends on a country's particular stage of development. Thus, the pillars are organized along three sub-indexes (factor driven, efficiency driven, innovation driven economies) measured by the GDP per head and share of exports of mineral goods in total exports

IMD	World Competitiveness Yearbook (WCY), 2013		
Goal(s) and target group	To rank and analyse the ability of nations to create and maintain an environment in which enterprises can compete, which functions as benchmark for decision-makers and the business community		
No. of countries	59		
Source(s)	• Economic performance • Government efficiency • Business efficiency • Infrastructure		
Indicators	*Economic performance (78 indicators)* • Domestic economy • International trade • International investment • Employment • Prices *Government efficiency (70 indicators)* • Public finance	• Fiscal policy • Institutional framework • Business legislation • Societal framework *Business efficiency (67 indicators)* • Productivity • Labour market • Finance	• Management practices • Attitudes and values *Infrastructure (114 indicators)* • Basic infrastructure • Technological infrastructure • Scientific infrastructure • Health and environment • Education

Methodology: Each sub-factor, independently of how many indicators are used to capture this sub-factor, represents a weight of 5%. Simply aggregating the results of the 20 sub-factors and their indicators, results in the overall country ranking.

WB/IFC	Doing Business, 2013		
Goal(s) and target group	To measure business regulations for domestic firms to inspire policy makers and researchers		
No. of countries	185		
Source(s)	A dynamic business environment—with firms making investments, creating jobs and increasing productivity—which pays attention not only to macroeconomic factors but also to the quality of laws, regulations and institutional arrangements that shape daily economic life.		
Indicators	• Starting a business • Dealing with construction permits • Getting electricity • Registering property	• Getting credit • Protecting investors • Paying taxes • Trading across borders	• Enforcing contracts • Resolving insolvency • Employing workers

Methodology: Data are gathered via questionnaires and interviews to verify. A simple averaging method is used for weighting indicators equally and ranking countries according to their scores.

FH	Freedom in the World, 2013	
Goal(s) and target group	To rate and report freedom worldwide, which is used by policymakers, leading scholars, the media, and international organizations	
No. of countries	195	
Source(s)	• Political rights • Civil liberties	
Indicators	*Political rights* • Electoral process • Political pluralism and participation • Functioning of government	*Civil liberties* • Freedom of expression and belief • Associational and organizational rights • Rule of law • Personal autonomy and individual rights

Methodology: The survey includes numerical ratings as well as analytical reports. Ten questions are asked regarding political rights, fifteen regarding civil liberties, all assigned with an equally weighted, numerical rating. Adding up the two sub-scores results in freedom rating.

Public country risk service providers

PRS	International Country Risk Guide (IRCG), 2013		
Goal(s) and target group	In-depth and exhaustively researched analysis of the potential risks to international business operations		
No. of countries	140		
Source(s)	• Political • Economic • Financial		
Indicators	*Political* • Socioeconomic Conditions • Investment profile • Internal conflict • External conflict • Corruption • Military in politics • Religious tensions	• Law and order • Ethnic tensions • Democratic accountability • Bureaucracy quality *Economic* • GDP per head • GDP growth • Annual inflation rate	*Financial* • Budget balance as a % of GDP • Current account as a % of GDP • Foreign debt as a % of GDP • Foreign debt service as a % of exports • Current Account as a % of exports • Net international liquidity as months of import cover • Exchange rate stability

Methodology: Each source consists of several components (i.e. indicators) which are assigned a numerical value (risk point) according to a predetermined weighted scale for each country. By means of a formula, the total composite risk rating can be calculated.

S&P	Country credit rating, 2013	
Goal(s) and target group	Over the years credit ratings have achieved wide investor acceptance as convenient tools for differentiating credit quality. Sovereign credit ratings reflect Standard & Poor's Ratings Services' opinions on the future ability and willingness of sovereign governments to service their debt obligations to the nonofficial sector in full and on time.	
No. of countries	128	
Source(s)	• Economic • Political • External	• Fiscal • Monetary
Indicators	*Political* • Institutional effectiveness • Political risks *Economic* • Economic structure • Growth prospects *External* • External liquidity • International investment position	*Fiscal* • Fiscal performance • Flexibility *Monetary* • Debt burden • Monetary flexibility

Methodology: Each of the five sources are indicated with a numerical score, based on qualitative and quantitative considerations, after which the scores are aggregated into two profiles; political and economic (political and economic scores) and flexibility and performance (external, fiscal and monetary scores), which together account for the indicative rating level.

Moody's	Country credit rating, 2013
Goal(s) and target group	To provide investors with a simple system of gradation by which future relative creditworthiness of securities may be gauged
No. of countries	113
Source(s)	Social interaction Social and political dynamics Economic fundamentals
Indicators	N/A

Methodology: Judgment of a group of credit risk professionals to weigh and calculate various risk indicators and their impacts upon business forecasts.

EIU	Country risk service, 2012	
Goal(s) and target group	To provide accurate and impartial forecasts and analysis which empower our clients to act with confidence when making strategic decisions	
No. of countries	120	
Source(s)	• Sovereign • Currency • Banking	• Political • Economic • Overall
Indicators	• Politics/institutions • Economic policy • Economic structure	• Macroeconomic • Financing and liquidity

Methodology: Expert's answers to a series of 77 predetermined qualitative and quantitative questions.

3. Long list of "multiple investor" MNEs

Multiple investors
Data for companies investing in six destination countries plus four additional (Kenya, Ethiopia, Pakistan, Nepal) between January 2003 and November 2012.

	Original long list
	Additional names added

	#	Project Date	Investing Company	Parent Company	Source Country	Industry Sector	OECD
1	71	Jun 2012	3M	3M	United States	Consumer Products	Y
2	189	Apr 2011	Ad Dynamo	Ad Dynamo	South Africa	Business Services	N
3	82	Dec 2011	Al Ghurair Group	Al Ghurair Group	UAE	Coal, Oil and Natural Gas	N
4	570	Aug 2006	Al Futtaim Technologies	Al-Futtaim Group	UAE	Transportation	N
5	273	Oct 2009	Al-Shaymaa	Al-Shaymaa	UAE	Consumer Electronics	N
6	595	Jan 2004	Al-Tuwairqi Group	Al-Tuwairqi Group	Saudi Arabia	Metals	N
7	491	Apr 2008	Al-Tuwairqi Group (ATG)	Al-Tuwairqi Group (ATG)	Saudi Arabia	Coal, Oil and Natural Gas	N
8	119	Feb 2012	Altech Group	Altech Group	South Africa	Communications	N
9	496	Mar 2008	APM Terminals	AP Moller - Maersk	Denmark	Warehousing & Storage	Y
10	42	Sep 2012	Apollo Hospitals Group	Apollo Hospitals Group	India	Healthcare	N
11	331	Oct 2009	AstraZeneca	AstraZeneca	UK	Pharmaceuticals	Y
12	368	Apr 2009	Atlas Copco	Atlas Copco	Sweden	Industrial Machinery, Equipment & Tools	Y
13	12	Nov 2012	Avanti Communications	Avanti Communications	UK	Communications	Y
14	356	Jun 2009	Aviat Networks (Harris Stratex Networks)	Aviat Networks (Harris Stratex Networks)	United States	Communications	Y
15	65	Jul 2012	BASF	BASF	Germany	Chemicals	Y
16	256	Jul 2010	Bharti Airtel	Bharti Group	India	Communications	N
17	719	Jul 2003	British American Tobacco (BAT)	British American Tobacco (BAT)	UK	Food & Tobacco	Y
18	561	Sep 2006	CA Technologies (Computer Associates International)	CA Technologies (Computer Associates International)	United States	Software & IT services	Y
19	567	Aug 2004	Cairn Energy	Cairn Energy	UK	Coal, Oil and Natural Gas	Y
20	113	Mar 2012	Cemex	Cemex	Mexico	Coal, Oil and Natural Gas	N
21	505	Jan 2008	Charoen Pokphand Group	Charoen Pokphand Group	Thailand	Food & Tobacco	N
22	378	Mar 2009	Chevron Corporation	Chevron Corporation	United States	Coal, Oil and Natural Gas	Y
23	72	Jan 2012	China Central Television (CCTV)	China Central Television (CCTV)	China	Communications	N

Multiple investors

Data for companies investing in six destination countries plus four additional (Kenya, Ethiopia, Pakistan, Nepal) between January 2003 and November 2012.

	Original long list
	Additional names added

	#	Project Date	Investing Company	Parent Company	Source Country	Industry Sector	OECD
24	745	Apr 2003	China Petroleum and Chemical (Sinopec)	China Petroleum and Chemical (Sinopec)	China	Coal, Oil and Natural Gas	N
25	396	Dec 2007	Cisco Systems	Cisco Systems	United States	Software & IT services	Y
26	122	Jan 2012	Coca-Cola	Coca-Cola	United States	Beverages	Y
27	2	Nov 2012	Simat Group	ConvergeNet	South Africa	Business Services	N
28	606	Jan 2006	Cotecna	Cotecna	Switzerland	Business Services	Y
29	515	Nov 2007	Africa Consumer Care Limited (AFCC)	Dabur India	India	Consumer Products	N
30	150	Sep 2011	Dangote Cement	Dangote Group	Nigeria	Building & Construction Materials	N
31	143	Nov 2011	DHL	Deutsche Post	Germany	Warehousing & Storage	Y
32	201	Feb 2011	Guinness Nigeria	Diageo	UK	Beverages	Y
33	164	Aug 2011	Dominion Farms	Dominion Group	United States	Food & Tobacco	Y
34	454	Jul 2008	DP World	DP World	UAE	Warehousing & Storage	N
35	70	Jun 2012	DuPont	DuPont	United States	Food & Tobacco	Y
36	61	Jul 2012	Educor	Educor	South Africa	Business Services	N
37	346	Jul 2009	Elsewedy Electric (Elsewedy Cables)	Elsewedy Electric (Elsewedy Cables)	Egypt	Industrial Machinery, Equipment & Tools	N
38	247	Aug 2010	Emami Limited	EMAMI	India	Consumer Products	N
39	486	Feb 2006	Emirates Telecommunications (Etisalat)	Emirates Telecommunications (Etisalat)	UAE	Communications	N
40	713	Sep 2003	Energem Resources	Energem Resources	Canada	Metals	Y
41	313	Dec 2009	Eni SpA (Eni)	Eni SpA (Eni)	Italy	Coal, Oil and Natural Gas	Y
42	84	May 2012	Ericsson	Ericsson	Sweden	Communications	Y
43	299	Feb 2010	ExxonMobil	ExxonMobil	United States	Coal, Oil and Natural Gas	Y
44	373	Mar 2009	Orange	France Telecom	France	Communications	Y
45	115	Feb 2012	General Electric (GE)	General Electric (GE)	United States	Engines & Turbines	Y
46	39	Sep 2012	Grohe	Grohe	Germany	Consumer Products	Y
47	222	Oct 2010	Healthcare Global Enterprises (HCG)	Healthcare Global Enterprises (HCG)	India	Healthcare	N

Multiple investors

Data for companies investing in six destination countries plus four additional (Kenya, Ethiopia, Pakistan, Nepal) between January 2003 and November 2012.

Original long list
Additional names added

	#	Project Date	Investing Company	Parent Company	Source Country	Industry Sector	OECD
48	702	Oct 2003	Nigerian Breweries	Heineken	Netherlands	Beverages	Y
49	163	Sep 2011	Hewlett-Packard (HP)	Hewlett-Packard (HP)	United States	Software & IT services	Y
50	123	Jul 2011	Hidesign	Hidesign	India	Textiles	N
51	92	May 2012	Hon Chuan (Taiwan Hon Chuan Enterprise)	Hon Chuan (Taiwan Hon Chuan Enterprise)	Taiwan	Plastics	N
52	37	Sep 2012	Honda Motor	Honda	Japan	Non-Automotive Transport OEM	Y
53	74	Jun 2012	Huawei Technologies	Huawei Technologies	China	Communications	N
54	322	Nov 2009	IBM	IBM	United States	Software & IT services	Y
55	146	Oct 2011	IHS Plc	IHS Plc	Nigeria	Communications	N
56	317	Nov 2009	InterContinental Hotels Group (IHG)	InterContinental Hotels Group (IHG)	UK	Hotels & Tourism	Y
57	591	Apr 2006	Ivanhoe Mines	Ivanhoe Mines	Canada	Metals	Y
58	632	Aug 2005	Korea National Oil (KNOC)	Korea National Oil (KNOC)	South Korea	Coal, Oil and Natural Gas	Y
59	18	Oct 2012	KPMG	KPMG	Netherlands	Business Services	Y
60	148	Sep 2011	L'Oreal	L'Oreal	France	Consumer Products	Y
61	177	Jun 2011	Lafarge/WAPCO	Lafarge	France	Building & Construction Materials	Y
62	506	Jan 2008	Malaysian Helicopter Services (MHS)	Malaysian Helicopter Services (MHS)	Malaysia	Aerospace	N
63	286	Apr 2010	Mercator Transport	Mercator Transport	Canada	Transportation	Y
64	302	Feb 2010	Microsoft Nigeria	Microsoft	United States	Software & IT services	Y
65	46	Aug 2012	Mitsubishi Corporation	Mitsubishi Corporation	Japan	Business Services	Y
66	697	Jan 2004	Mobiserve	Mobiserve	Egypt	Communications	N
67	173	Jun 2011	MTN Uganda	MTN Group	South Africa	Communications	N
68	124	Jan 2012	NEC Africa	NEC	Japan	Communications	Y
69	261	Jun 2010	APL Logistics (APLL)	Neptune Orient Lines (NOL)	Singapore	Warehousing & Storage	N
70	579	Jun 2006	Neptune Software	Neptune Software	UK	Software & IT services	Y
71	202	Feb 2011	Nestle	Nestle	Switzerland	Food & Tobacco	Y
72	250	Aug 2010	Nexen	Nexen	Canada	Coal, Oil and Natural Gas	Y
73	21	Oct 2012	NTT Communications (Thailand)	Nippon Telegraph & Telephone (NTT)	Japan	Communications	Y
74	267	Jun 2010	Nokia	Nokia	Finland	Communications	Y
75	152	Sep 2011	Nokia Siemens Networks	Nokia Siemens Networks	Finland	Communications	Y
76	418	Nov 2008	Nortel Networks	Nortel Networks	Canada	Communications	Y
77	127	Jan 2012	NTPC Limited (National Thermal Power)	NTPC Limited (National Thermal Power)	India	Coal, Oil and Natural Gas	N
78	125	Jul 2011	Optimum Media Group (OMD)	Omnicom Group	United States	Business Services	Y

Multiple investors

Data for companies investing in six destination countries plus four additional (Kenya, Ethiopia, Pakistan, Nepal) between January 2003 and November 2012.

	Original long list
	Additional names added

	#	Project Date	Investing Company	Parent Company	Source Country	Industry Sector	OECD
79	532	Sep 2007	ONGC	ONGC	India	Coal, Oil and Natural Gas	N
80	32	Oct 2012	Oracle	Oracle	United States	Software & IT services	Y
81	654	Feb 2005	United Cement Company of Nigeria (UNICEM)	Orascom Group	Egypt	Building & Construction Materials	N
82	459	Jul 2008	Petrobras	Petrobras	Brazil	Coal, Oil and Natural Gas	N
83	499	Nov 2005	Petronas	Petronas	Malaysia	Coal, Oil and Natural Gas	N
84	572	Jul 2006	POSCO Engineering & Construction	Pohang Iron & Steel (POSCO)	South Korea	Real Estate	N
85	330	Oct 2009	Procter & Gamble (P&G)	Procter & Gamble (P&G)	United States	Consumer Products	Y
86	239	Sep 2010	QCOM Wireless Technologies	Qualcomm	United States	Communications	Y
87	192	Mar 2011	Regus	Regus	Luxembourg	Real Estate	Y
88	142	Nov 2011	NILE Breweries (NBL)	SABMiller	UK	Beverages	Y
89	20	Oct 2012	Samsung Electronics West Africa	Samsung	South Korea	Consumer Electronics	Y
90	341	Aug 2009	Seacom	Seacom	Mauritius	Communications	N
91	8	Nov 2012	SEKO Worldwide	SEKO Worldwide	United States	Transportation	Y
92	670	Oct 2004	Siemens	Siemens	Germany	Communications	Y
93	250	Nov 2009	Starbucks	Starbucks	United States	Food & Tobacco	Y
94	114	Mar 2012	SL Agritech	Sterling Paper Group of Companies	Philippines	Food & Tobacco	N
95	22	Oct 2012	Suzuki Motor	Suzuki Motor	Japan	Automotive OEM	Y
96	273	May 2010	Tata Motors	Tata Group	India	Automotive OEM	N
97	456	Jul 2008	Tetra Pak	Tetra Laval	Switzerland	Paper, Printing & Packaging	Y
98	721	Jul 2003	Texchem Resources	Texchem Resources	Malaysia	Chemicals	N
99	50	Aug 2012	Kerry Logistics	The Kuok Group	Malaysia	Transportation	N
100	240	Mar 2010	TNT Express	TNT (TPG)	Netherlands	Transportation	Y
101	85	May 2012	TNT Express	TNT Express	Netherlands	Transportation	Y
102	477	May 2008	Toshiba	Toshiba	Japan	Business Machines & Equipment	Y
103	413	Nov 2008	Total E&P Nigeria	Total	France	Coal, Oil and Natural Gas	Y
104	342	Aug 2009	Toyota Uganda	Toyota Motor	Japan	Automotive Components	Y
105	208	Jan 2011	Tullow Oil	Tullow Oil	UK	Coal, Oil and Natural Gas	Y
106	544	Feb 2007	VIA Technologies	VIA Technologies	Taiwan	Semiconductors	N
107	272	May 2010	Warid Telecom	Warid Telecom	Pakistan	Communications	N
108	492	Apr 2008	Wartsila (Waertsilae)(Wartsila)	Wartsila (Waertsilae)(Wartsila)	Finland	Engines & Turbines	Y
109	109	Mar 2012	Millward Brown	WPP	Ireland	Business Services	Y

Multiple investors

Data for companies investing in six destination countries plus four additional (Kenya, Ethiopia, Pakistan, Nepal) between January 2003 and November 2012.

Original long list			
Additional names added			

	#	Project Date	Investing Company	Parent Company	Source Country	Industry Sector	OECD
110	246	Sep 2010	YKK	YKK	Japan	Consumer Products	Y
111	350	Jul 2009	Zain Nigeria (Celtel Nigeria)	Zain (Mobile Telecommunications Company) (MTC)	Bahrain	Communications	N
112	665	Nov 2004	ZTE	ZTE	China	Communications	N

4. Proposed Questionnaire for Structured Interviews

GBRW
CONSULTING

INVESTMENT
CONSULTING ASSOCIATES

INVESTOR PERSPECTIVES ON EMERGING MARKETS

SEMI-STRUCTURED INTERVIEW GUIDE

LONDON   WASHINGTON DC   SINGAPORE

GLOBAL EXPERIENCE, PRACTICAL EXPERTISE

1. APPROACH TO FDI (GENERAL)

INTRODUCTORY QUESTIONS

1.1 Why would your company invest in a new country?

1.2 Can you describe your company's approach to evaluating and approving an investment in a new country?

1.3 Which parts of the company are involved in this process?

1.4 Are there any countries which you would not/have decided not to invest in because they are considered too risky?

1.5 If yes, are you able to discuss what risk issues were involved?

1.6 Are there any business risks associated with foreign expansion/investment which would be considered as totally unacceptable (knock out factors)? If so, what are they?

RESPONSE CHECKLIST 1.1/1.2

☐ MARKET SEEKING ☐ EXTRACTION

☐ EFFICIENCY SEEKING ☐ STRATEGIC ASSETS

☐ REGIONAL HUB ☐ OTHER

RESPONSE CHECKLIST 1.3

☐ FUNCTIONS ☐ GEOGRAPHIC VARIATION

☐ CENTRALISATION ☐ VARIATIONS IN APPROACH

NOTES

2. COUNTRY PERSPECTIVES (GENERAL)

SAMPLE QUESTIONS

2.1 How does the investment approval process differentiate between mature established markets and emerging markets?

2.2 Please describe the data sources that are most useful when it comes to making a decision.

2.3 Please describe any factors which are most likely to prevent a positive investment decision.

NOTES

RESPONSE CHECKLIST 2.1

☐ STRICTER BUSINESS CASE   ☐ GREATER FX RISK

☐ HIGHER HURDLE RATE   ☐ OTHER

RESPONSE CHECKLIST 2.2

WEF: Global Competitiveness Report
EIU: Country Intelligence Reports
Moody's/S&P/Fitch
PRS: IRCG
WB/IFC: Doing Business In Reports
IHS Global Insight – Sector Intelligence
Datamonitor – Sector Intelligence
IMD: World Competitiveness Yearbook
Freedom House: Freedom in the World
Transparency International

2. COUNTRY PERSPECTIVES (GENERAL)

SAMPLE QUESTIONS

2.4 How does your company approach analyzing different candidate countries for a potential investment?

2.5 Please describe your company's approach to assessing the balance between risk and return for candidate countries.

2.3 Do you use external consultants to assist in any of the above? If so, in what areas?

NOTES

RESPONSE CHECKLIST 2.4

☐ FOREIGN INVESTMENT RISK MATRIX (FIRM)

☐ OTHER (DETAILS)

3. SPECIFIC FCAS INVESTMENTS (SPECIFIC COUNTRY)

SAMPLE QUESTIONS

3.1 Can we talk about your investment(s) in [specific FCAS country]? Can you talk me through the investment decision process?

3.2 Which were the main risks you encountered in this country? Were you able to address them (and if so, how)?

3.3 Could you please describe the key features of the qualitative and/ or quantitative models used by your company when considering the investment(s)?

3.4 Would this process be different if this was a follow-on investment in the same country as opposed to a new investment?

3.5 Can we discuss other investments which your company has made in FCAS?

NOTES

RESPONSE CHECKLIST 3.3

☐ MINIMUM INVESTMENT SIZE

☐ RETURN ON INVESTMENT APPROACH

☐ HURDLE RATES

☐ RISK PREMIUM FOR SPECIFIC COUNTRIES

RESPONSE CHECKLIST 3.5

☐ SIMILARITIES

☐ DIFFERENCES

4. BUSINESS ENVIRONMENT (SPECIFIC COUNTRY)

SAMPLE QUESTIONS

4.1 Describe the features of the business environment which were most relevant when it comes to making an investment decision.

4.2 Describe the approaches you take when it comes to assessing the business environment

NOTES

RESPONSE CHECKLIST 4.1

☐ POSITIVES

☐ NEGATIVES

RESPONSE CHECKLIST 4.2

☐ COURT SYSTEM   ☐ POLICY MAKING

☐ POLIITICAL STABILITY   ☐ TRANSPORT INFRASTRUCTURE

☐ TAXATION   ☐ TRADE POLICY

☐ EMPLOYMENT POLICY   ☐ CORRUPTION

☐ RELIABLE ENERGY

5. SOCIAL AND DEMOGRAPHIC FACTORS (SPECIFIC COUNTRY)

SAMPLE QUESTIONS

5.1 Describe the demographic and social features which were most relevant when it came to assessing a country for investment purposes.

RESPONSE CHECKLIST 5.1

☐ LARGE AND/ OR GROWING POPULATION

☐ WORKFORCE SKILLS AND EDUCATION

☐ LIFESTYLE AND COST OF LIVING FACTORS

☐ THREAT OF CRIME AND/ OR TERRORISM

☐ POLITICAL STABILITY

☐ CULTURAL INTEGRATION

☐ LABOUR STABILITY

NOTES

6. GEOGRAPHIC FACTORS (SPECIFIC COUNTRY)

SAMPLE QUESTIONS

6.1 How did the geographic location of the country impact the investment decision?

6.2 In what ways did the natural resources of the country impact the investment by your company?

6.3 Is exposure to the risk of natural disasters (earthquake/ typhoon/flooding) an important risk issue?

RESPONSE CHECKLIST 6.1

☐ INTERNATIONAL TRANSPORT AND CONNECTIONS

☐ PROXIMITY TO SUPPLIERS/ CONSUMERS

NOTES

7. ECONOMIC AND POLICY ENVIRONMENT (SPECIFIC COUNTRY)

SAMPLE QUESTIONS

7.1 Describe the features of the economic and policy environment which were most relevant when it came to making the investment decision.

RESPONSE CHECKLIST 7.1

☐ ROBUST AND DISCIPLINED FISCAL REGIME

☐ FREE TRADE POLICY/ TRADE BLOC INTEGRATION

☐ CONVERTIBLE AND FAIR FLOATING CURRENCY

☐ FREE MOVEMENT OF CAPITAL

☐ PREDICTABLE AND COMPETENT MONETARY POLICY

NOTES

8. INVESTMENT INCENTIVES (SPECIFIC COUNTRY)

SAMPLE QUESTIONS

8.1 How significant were any of the following investment incentives in evaluating the business case?

8.2 Has the foreign government supported you in this investment decision (or implementation)?

8.3 Has the foreign government played a role in limiting the any of the major risks associated with the investment? If so, how?

RESPONSE CHECKLIST 8.1

☐ EXPORT FREE ZONES

☐ SPECIAL ECONOMIC ZONES

☐ CLUSTER DEVELOPMENT PROJECTS

☐ TAX INCENTIVES

☐ VALUE CHAIN DEVELOPMENT PROJECTS

☐ OTHER TAX BENEFITS

☐ LAND AND UTILITY SUBSIDIES

☐ REBATES

☐ OTHER PRIVATE SECTOR DEVELOPMENT PROJECTS

☐ OTHER

NOTES

9. POLITICAL RISK INSURANCE (SPECIFIC COUNTRY)

9.1 Did you consider insuring against any of the following factors when investing in [specific FCAS country]?

9.2 Would you use private sector insurers or an IFI source such as MGA? Why?

RESPONSE CHECKLIST 9.1

☐ **CURRENCY TRANSFER RESTRICTIONS**

☐ **EXPROPRIATION**

☐ **WAR & CIVIL DISOBEDIENCE**

☐ **BREACH OF CONTRACT**

☐ **NON-HONOURING OF SOVEREIGN FINANCIAL OBLIGATIONS**

NOTES

10. CONCLUSION (GENERAL)

SAMPLE QUESTIONS

10.1 What tangible actions could be taken by Governments of "difficult" countries which would have the biggest positive impact on the investment case?

10.2 What tangible actions could be taken by IFIs or donors which would have the biggest positive impact on the investment case?

10.3 Do you think your competitors use different criteria when deciding to make investments in emerging markets?

10.4 Can we come back to you to clarify any of the points we have discussed?

NOTES

RESPONSE CHECKLIST 10.1 AND 10.2

Do any of these issues apply specifically to the investment in [specific FCAS country]?