



## **POLICY NOTE OF THE WORKING PAPER 2/05**

### **Location choices of multinational companies in transition economies: A literature review**

**January 2013**

#### **OBJECTIVE OF RESEARCH**

This working paper aims at explaining the location choices of multinational companies (MNCs) in a transition economy by institutional quality, proximity, and traditional economic factors. The conceptual framework of the paper deals not only with place specific characteristics of the receiving country, but takes a broader look at the motives of foreign firms to invest in local capabilities in the host region. The paper contributes to the literature on MNCs and location choices by introducing an analysis of institutional determinants at the regional level within a transition economy perspective which has not gained sufficient attention in existing research. Based on a thorough theoretical framework and a set of hypotheses, the paper serves as an important pre-requisite for the further empirical research of the enterprise survey carried out in Ukraine. The data of the survey contains information on location choice of MNCs, assessment of institutional quality, and embeddedness within the regional economy. The results of an enterprise survey will also uncover the link between initial aims of MNCs and their

strategic orientation in the host region. This approach will provide a comprehensive picture of patterns of location decisions for FDI in transition economies and more specifically in Ukraine.

## SCIENTIFIC METHODS

The paper is devoted to the literature review identifying what are the main determinants of the location choices of MNCs in transition economies. Thus, having determined that the main motivations of foreign investors in transition economies are resource seeking and market seeking, the main factors impacting the decision of a foreign firm to invest in transition economies are cheap natural resources, labour, physical infrastructure, market size and availability of market niches, customer demand and low competition. Moreover, institutional quality and the local business culture play a very important role, especially in the transition economies. Both formal and informal institutions of a certain locality, which is hosting the investment of an MNC, moderate the transaction costs in the hosting markets and determine the access to the local networks, which are essential for the MNC to successfully embed within the new environment.

Based on the literature review a set of hypotheses have been formulated on the location choices of MNC in transition economies, taking the case of Ukraine where an enterprise survey of 153 foreign-owned firms in three regions of Ukraine: the capital region Kyiv, close to the EU border region Lviv and far from the EU border region Kharkiv. The criteria of selection of the regions were based on the FDI-inflows in these regions and geographical position towards the EU border. According to the data of the State Statistical Committee of Ukraine Lviv region is the first in terms of FDI-inflows in the Western part of Ukraine and Kharkiv region the is the first in terms of FDI-inflows in the Eastern part of Ukrainewas carried out.

The empirical data of the survey is represented by a set of standardized questionnaire data. The questionnaire was developed based on closed Likert-scale questions divided into 6 thematic blocks. One separate block was devoted specifically to the location choices and location patterns of FDI and one to institutions and business environment, covering the questions on the different factors playing determinant role in the investment decisions of foreign investors, MNC's incentives, aims and strategic orientations at the regions they have previously invested in, government providing any financial or administrative help towards foreign-owned firms in different regions of Ukraine and the overall quality of institutional environment of the latter.

The survey companies were selected randomly from the manufacturing sector. Our focus was only on manufacturing firms, since according to UNCTAD (2012) manufacturing sector hosted 60% of all the greenfield FDI projects in 2011 in transition economies as destinations compared to 32% and 8% in services and primary sectors respectively. Moreover, in the World Investment Prospects Survey 2012-2014 57% of respondent MNCs were classified as operating in the manufacturing sector, 36% in the services sector and 7% in the primary sector. According to State Committee of Statistics in Ukraine FDI inflows in services sector in 2011 were significantly high, although around 49% of FDI in services sector were forwarded into financial subsector with other subsectors being very insignificantly represented. In manufacturing sector FDI inflows were equally distributed within a range of subsectors. The criteria of selection of the subsectors within the manufacturing sector for choosing survey firms were determined by the strong presence of companies with FDI in these subsectors.

The sampling frame was based on the State Committee of Statistics in Ukraine firms directory and firms accounts of the Ukraine State Agency of Investment and National Projects Management. Overall 863 foreign firms from the food and machinery & equipment sector have been contacted by phone. 150

companies were successfully interviewed by the students face-to-face and 3 companies have filled out the questionnaires themselves and were contacted by phone afterwards to ensure the correctness of the given answers. There is no significant difference between the regional distributions of response rates, with the average response rate of around 17%.

## **POLICY VALUE-ADDED**

The empirical research of the enterprise survey of foreign firms in Ukraine will enable analysis and verification of our research hypotheses providing an important insight about FDI flows in transition economies. The results of the survey will uncover region specific characteristics of the location choices of FDI with regard to traditional economic factors and institutional parameter. Such an approach will provide a comprehensive holistic picture of the regional determinants attracting MNCs to the ENP countries.