



PRESS RELEASE OF THE WORKING PAPER 2/14

Location choices of multinational companies in Ukraine

September 2013

OBJECTIVE

The objective of the working paper is to identify determinants of location choices of foreign direct investments (FDIs) in transition economies, based on empirical evidence of an enterprise survey of 153 foreign-owned firms, carried out in three regions in Ukraine as one of the transition economies of the European Neighborhood Policy (ENP) states. The goal of the analysis of the location choices of FDIs is to provide ENP countries, which are still transition economies, with a theoretical and empirical perspective on the possible ways to grow economic potential through provision of attractive host economies for the incoming multinational companies (MNCs), since the role of FDI for economic growth and development of states, regions and cities has been widely investigated recently. This press release will give an overview of the most important conclusions and results of the working paper.

MAIN RESULTS

In the working paper special attention is paid to the acknowledgement of the importance of FDI inflows into a transition economy. The paper identifies determinants of location choices of FDIs in Ukraine as one of the post-Soviet transformational states, based on empirical evidence of an enterprise survey of 153 subsidiaries of MNCs, carried out in three regions in Ukraine, the capital region Kyiv and two bordering regions Lviv, close to the EU border Western region, and Kharkiv, close to the CIS border Eastern region. The paper contributes to the provision of a thorough theoretical discussion on location choices of FDIs based on the revised OLI paradigm with an integrated institutional component and provides a conceptual framework with (inter)national and motivation-specific sub-national level determinants of the location choice decisions of foreign investors. The empirical results of the multinomial regression analysis cover the assessment of the traditional economic factors that attract FDI to

certain localities within transition economies, specifically Ukraine and institutional quality parameters of the target regions that attract MNCs to the host regional markets.

The results of the empirical analysis show that market seeking investors will most probably invest in the capital region Kyiv, rather than in the bordering regions Lviv and Kharkiv. Large market potential, better access to resources and higher institutional quality of the capital will attract greenfield investors. Close to the EU border Lviv region except for having an absolute advantage of being proximate to the EU border, pulls in investors due to its human capital concentration. These findings go in line with an assumption of the less post-Soviet legitimacy of the Western region Lviv, whereas in close to the CIS border region Kharkiv the old industrial infrastructure as the remains of the planned economy is still present. This leads to the attraction of the foreign investments originating from CIS to serve the local market with pre-established customer-supplier networks. Overall better institutional quality of the capital results in the attraction to the latter of FDI firms assessing institutional environment at the current location as of good quality. This supports the argumentation of the importance of the institutional environment as a pull factor for FDI inflows, but also indicates an uneven government support of regional economic systems, leading to a disproportional regional development.

An important policy implication we could introduce based on the above stated empirical results are the following. Firstly, there is a need of development of strategic region specific assets as the location advantages of the target regions. Such strategic assets are human capital, concentrated knowledge pools, highly skilled labour and technology oriented infrastructures. This could potentially lead to the attraction of more strategic asset seeking investors, which would increase the competitiveness of certain regions, on the one hand, and provide an alternative to the market seeking motivation of the majority of MNCs, since the potential of the market is a limited asset by itself. Secondly, there is a need to encourage investing firms to serve the local market rather than use the regional economic systems as solemnly resource bases. This could be possibly achieved by the targeted development of local infrastructures, especially in Lviv region, where the tendency of incoming investors is to re-import manufactured goods abroad. By the targeted development of local infrastructures we mean the government support of local SMEs in building customer-supplier networks and clusters of sector-specific firms. Thirdly, there is a need to introduce equal government support in terms of overall regional institutional quality and preferential government treatment to both the capital and bordering regions. This will lead to introduction of FDI friendly local institutional frameworks, which will positively affect FDI inflows, since institutional quality does have an important impact on the inward foreign investments. This could be achieved by the means of region specific FDI incentives, such as creation of business incubators and stimulation of inter-firm cooperation between domestic and foreign firms.