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Abstract

This paper explains the location choices of multinational companies (MNCs) in a transition economy by traditional economic factors and institutional quality. Based on a thorough theoretical framework and a set of hypotheses, empirical data of an enterprise survey of 153 foreign firms in three regions of Ukraine is analyzed. The data contains information on location choice of MNCs, assessment of institutional quality, and embeddedness within the regional economy. The paper contributes to the literature on MNCs and location choices by introducing an analysis of a set of foreign direct investment (FDI) location choice determinants at the regional level within a transition economy perspective, which has not gained sufficient attention in existing research.

KEY-WORDS: Location determinants, FDI, multinational company, transition economy, enterprise survey

JEL: D23, F21, F23, R11

I. Introduction

The role of FDI for economic growth and development of states, regions and cities has been widely investigated recently (Bevan and Estrin, 2004; Dunning, 1993; Meyer and Nguyen, 2005). While the impact of multinational companies' activities on the economic development of the countries hosting their subsidiaries has been discussed quite comprehensively in the literature, the regional level and the factors behind the geographical distribution of FDI at the sub-national level have not gained sufficient attention (Cantwell and Iammarino, 2000).

Special attention has been paid to FDI flows to transition economies, which owe their economic and social transformation to a large extent to foreign firms, which introduce knowledge, technology and new opportunities into these emerging markets. Transition from socialism to capitalism and the integration of Central and Eastern European countries into the world economy proceeded through international trade and capital flows, which encouraged growth and innovation, and facilitated the restructuring of firms and sectors (Bevan and Estrin, 2004). Foreign-owned firms usually possess higher labour productivity, innovation potential, supplier and customer networks than incumbent firms when entering new markets. FDI flows from developed countries towards emerging economies becomes an important transmitter of economic resources and serves as a catalyst for development and attraction of further investments (Frenkel et al., 2004).

Foreign investors assess overseas locations within the paradigm of opportunities and obstacles. They are mainly interested to invest into the locations which offer advantages in terms of proximities, market growth, lower costs, strategic resources, and favourable institutional conditions in order to maximise their return on investment. Institutions contribute substantially to the location advantage, since the specific institutional setting at the location of a business activity is of great importance in large and decentralised emerging markets. Transition states have opened their economies for inflows of foreign capital since their socio-political transformation. But despite the spread of market institutions at the national level, the business environment at the regional and local level faces frequent changes of policies, institutional rules and attitudes, which reduce the enforceability and predictability of institutions for potential foreign investors.

The factors that attract MNCs towards certain markets and economies are unevenly distributed among countries and regions. While some regions are clearly benefitting from attractive initial conditions, which pull in foreign investments that further foster the transition process, regions which do not have such favourable conditions lag behind and perform relatively poor (Barrell and Pain, 1999). Thus, the regional variation in the institutional environment at different locations represents an important extension of the original reasoning about foreign firms choosing specific markets (Meyer and Nguyen, 2005). This is of an even bigger importance for countries which share a border with the European Union (EU) and are not yet the members of the EU, but part of the European Neighbourhood Policy (ENP). It is supposed that geographical distance to the EU border has an impact on the institutional quality and, thus, the investment decisions of MNCs. An advantageous position of regions closer to the border and capital regions is expected.

The range of specific host region determinants for the attraction of FDI is generally divided into two broad groups: traditional economic factors and institutional factors (Frenkel et al., 2004; Bevan et al., 2004; Kang and Jiang, 2012). Traditional economic factors are based on the systematic conceptualisation of FDI location choices by Dunning (1993) in his eclectic paradigm OLI, which stands for ownership, location and internalisation advantages. The importance of specific traditional location factors attracting FDI according to Dunning depends on the motives of the investor, namely natural

resource seeking, market seeking, efficiency seeking and strategic asset seeking. Based on these motives, the paper will describe a broad range of region specific economic factors, such as cost-related parameters, market-related factors, availability of local knowledge and technology, and agglomeration forces that all have a significant impact on the propensity of MNCs to invest abroad.

The relevance of the institutional perspective for location choices of MNCs has gained a much wider audience recently. It focuses explicitly on the embeddedness of firms into local institutional environments (Kostova and Zaheer, 1999). Foreign firms become highly dependent on the institutional factors at the chosen location for investment and have to adapt themselves (at least to a certain degree) to the local institutional framework in order to gain legitimacy and integration within the regional economic system. FDI from developed into developing countries depends even more on institutional parameters, since developed country MNCs are used to a business environment shaped by a set of rather complete market-based institutions in their home markets (Kang and Jiang, 2012). Nevertheless, these MNCs are often big players in their industry and have the power to shape institutional contexts in the host country due to their large size, superior capabilities and dominant position in global value chains. Thus, an interdependent perspective on institutional quality, location choices of MNC, and institutional change is needed.

The aim of the paper is to identify determinants of location choices of FDI in transition economies, based on empirical evidence of an enterprise survey of 153 foreign-owned firms, carried out in three regions in Ukraine within the project "SEARCH: Sharing knowledge assets: interregionally cohesive neighbourhoods" funded by the European Union within the Seventh Framework Programme for Research (FP7). The analysis of the results of the enterprise survey aims at answering the following research questions:

1. What are the motives of foreign investors coming to different regions of Ukraine?
2. What are the region specific factors that determine the location choices of foreign firms in Ukraine?
3. How does regional institutional quality in Ukraine impact the propensity of foreign firms to invest in certain regions in Ukraine?

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, covering in such a way also the management perspective of investors with regard to the value added of their managerial investment decision making. The results of the 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. The paper contributes to the provision of a thorough theoretical framework on location choices of MNCs by integrating institutional and proximity components within the empirical results on (1) traditional economic factors that attract FDI to certain localities within transition economies, specifically Ukraine and (2) institutional and proximity parameters of regions that attract or distract MNCs in order to determine the impact of the institutional environment and proximity advantages of certain regions on the propensity of foreign firms to invest in certain regional host markets.

The paper consists of the following parts: Chapter II describes internationalization of MNCs, explaining the focus of the paper on the FDIs towards transition economies and the reasoning behind a company's decision to internationalize; Chapter III presents the conceptual framework of the paper and discussion on the main determinants of the location

choices of MNCs; Chapter IV introduces the analytical framework of the paper with the main hypotheses of the empirical research; Chapter V covers data and methods; Chapter VI provides the results of empirical analysis of the dataset of the enterprise survey in Ukraine; Chapter VII follows with the discussion of the results; and Chapter VIII introduces the summary of the whole paper.

II. Internationalization of multinational companies

2.1 Foreign direct investments in transition economies

According to UNCTAD (2012) FDI inflows to transition economies, which include South-East Europe and the Commonwealth of Independent States (CIS), increased in 2011 by 25% up to $92 billion, whereas the increase of FDI flows towards developed and developing economies was about 21% and 11% respectively. Developing and transition economies continue to account for more than a half of the world's FDI inflows, comprising 45% and 6% of global FDI inflows respectively, although in terms of FDI inward stocks developing and transition economies are still lagging behind (UNCTAD, 2012). Indicators suggest that transition economies will continue with the same pace of growth rate of FDI inflows in the mid-term (Table 1).

Table 1. World FDI inflows, billions of dollars

Region	FDI inflows			%			FDI inward stock	%	FDI inflows projections	
	2009	***2010***	***2011***	***2009***	***2010***	***2011***	***2011***	***2011***	***2013***	***2014***
Developed economies	606,2	618,6	747,9	50,6%	47,3%	49,1%	13055,9	63,8%	810-940	840-1020
Developing economies	519,2	616,7	684,4	43,3%	47,1%	44,9%	6625,0	32,4%	720-855	755-930
Transition economies	72,4	73,8	92,2	6,0%	5,6%	6,0%	757,3	3,7%	100-130	110-150
World	1197,8	1309,0	1524,4	100%	100%	100%	20438,2	100%	1630-1925	1700-2110

Source: UNCTAD (2012)

Executives of the major MNCs have rated the economies of developing and transition states among top 10 destinations of their FDIs until 2014 according to the World Investment Prospects Survey 2012-2014. In 2011 Ukraine together with Russian Federation and Kazakhstan belonged to the group of the highest FDI inflows, namely the group of above 5 billion of dollars investments (UNCTAD, 2012). Thus in Table 2 we can observe, that Russia and Ukraine hosted together more than 90% of greenfield investments in 2011, which contributed to the overall two thirds of greenfield investments being hosted by developing and transition economies.

Table 2. FDI flows and stock in CIS in 2011, millions of dollars

Region	FDI inflows, millions of dollars	As % of CIS	FDI stock, millions of dollars	As % of CIS	Value of greenfield FDI projects	As % of CIS
CIS	84539	100%	672253	100%	17485	100%
Armenia	525	1%	5046	1%	83	0%
Azerbaijan	1465	2%	9113	1%	435	2%
Belarus	3986	5%	12987	2%	127	1%
Kazakhstan	12910	15%	93624	14%	383	2%
Kyrgyzstan	694	1%	1274	0%	-	-
Moldova, Republic of	274	0%	3163	0%	0	0%
Russian Federation	52878	63%	457474	68%	15503	89%
Tajikistan	11	0%	993	0%	-	-
Turkmenistan	3186	4%	16627	2%	-	-
Ukraine	7207	9%	65192	10%	954	5%
Uzbekistan	1403	2%	6761	1%	-	-

Source: UNCTAD (2012)

The reasons of such a significant rise of transition economies on the global FDI arena originate from the past. Since 1990s Central and Eastern European countries have undergone profound transformations of their economic and social systems in a pursuit of change from planned socialist economic systems towards market economies. Substantial economic liberalization, which underpinned these transformations, resulted in the appearance of transition markets as popular destinations for FDIs from abroad (Majocchi and Strange, 2007). The range of factors, that attract foreign investments, is very broad considering the fact that all Central and Eastern European markets move away from their communist legacy and have established themselves as new untapped markets with a big potential of consumer demand, plenty of resources, low cost production locations and strategically important access to new knowledge and labour. On the other hand, transformation from the Soviet past towards a new capitalist system included certain transition of regional economic systems, which had been shaped by the socialist industrialization in the Soviet times. This meant a distribution of industries without an efficient market-based economic rationale behind it. During the transition period, their regional industrial structures lost their right to exist and became locations without a competitive future if industrial development was still based on the paradigm of planned development rather than economic efficiency. Thus, after the collapse of the Soviet Union and consequently of the socialist industrialization system all regions were left with socialist legacy which included a certain social platform, i.e. socialist mentality, and economic prerequisites originating in industrialised economic systems with a respective infrastructure.

The extent to which regions have managed the post-socialist transformation has an impact on the FDI inflows to these locations. Since foreign investors strive to minimize their costs in order to marginally benefit from their investments, they aim at getting embedded into the regional economic systems of the host country. For such an embeddedness to take place foreign investors try to avoid regions with strong socialist industrialisation heritage due to the difficulty of

integration into the different cognitive, social, organisational and institutional environment. Therefore, path-dependency of the economic system influences location choices and the intensity of local embeddedness of foreign firms, particularly in the case of post-Soviet transition states.

2.2 Imperatives of a "multinationality" of firms

The location choice of an MNC is of a strategic importance, because the factors which attract foreign firms to certain locations determine the firm's competitiveness in the long run. International strategies of transnational companies are centred on tapping selective knowledge and strategic location-bound resources in order to improve the comparative advantage of an internationalizing firm over the non-internationalizing (Porter, 1994). Internalisation theory developed by Buckley and Casson (1976) and extended by Hennart (1982) states that transnational companies strive to act in such a way so that to develop their internal specific advantages, which they can then exploit while internationalizing. Hymer (1976) contributes to the internalisation theory with the line of thinking that any firm decides to invest abroad only when the benefit of exploiting firm-specific advantages outweigh the relative costs entering foreign markets. Internalisation theory was also very much supported by Dunning (1980, 1988) with his eclectic paradigm. The OLI paradigm deals with three theories of FDI, where:

- "O" stands for **ownership advantages**. Ownership advantages refer to the firm-specific assets, both tangible and intangible, that firm possesses, specifically with regard to the property competences, which enable a company to marginally outreach its competitors in terms of profitability. Any firms have a certain set of internal advantages, over which it has monopolistic rights that allow using those advantages for the clear benefit of the firm. These advantages can be divided into three groups (Denisia, 2010):
  - *monopoly advantages* – privileged access to a market through having property rights on certain patents, trademarks and limited resources;
  - *technology advantages* – knowledge important for enforcement of innovation and upgrading activities;
  - *economies of large size* – economies of scale, scope, learning.
- "L" stands for **location advantages**. Location advantages are all those factors a specific location owns, that attract foreign companies to the hosting location. Advantages of a certain country or even region can be divided into economic advantages, institutional advantages and social advantages. All these location-specific parameters enable an MNC to become more profitable with either lower costs involved or better access to specific knowledge, which becomes a strategic asset on the way to outperforming competitors.
- "I" stands for **internalisation advantages**. Internalisation advantages refer to those advantages which are brought to the firm by owning production within a specific location rather than by licensing or joint-venture agreements. When the benefits of producing the products by itself are higher for the firm than costs of not doing so, then the firm might choose entering a new market through the FDI entry mode.

The strategic importance of factors for choosing a particular location when investing abroad depends on the motivation to relocate a value-added activity. Dunning (1993, 2000) identifies four main motivations for FDI, namely, market seeking, resource seeking, efficiency seeking and strategic asset seeking. *Resource seeking* investors strive for the availability of cheap natural resources, labour, physical infrastructure. Natural resources play a very important role in the decision of an

MNC to enter the market, because they are often an important prerequisite for making use of the market and the strategic assets this market can offer. Historically, foreign investors were attracted by natural resources such as minerals, raw materials and agricultural products. Central and Eastern European countries are well known for the abundance of natural resources as one of the most important determinants of FDIs. Availability of oil and gas, land and sea are voted to be top-ranked by foreign investors coming to Russia, Azerbaijan, Kazakhstan and Ukraine (Kudina and Jakubiak, 2008). Therefore, the growth of FDI flows to countries of the CIS in 2011 is determined by natural resource seeking FDIs, mostly greenfield investments in mining, quarrying and petroleum (UNCTAD, 2012).

Market seeking investors are attracted by the host country's market size, its income per capita, market growth and consumer demand in order to benefit from the economies of scope and scale. Within market seeking strategies, proximity plays a very important role, because MNCs are encouraged to invest in those locations, where potential suppliers and customers are already present. Moreover, MNCs are very much bounded by localisation economies, which results in a tendency to invest, where other firms from their home countries and/or the same sector of economic activity have already established their presence. The market seeking motive has also been acknowledged as a very important determinant for FDI locations in post-Soviet states. After the transformation these countries have undergone in 1990s, their markets have been established as emerging platforms for new untapped opportunities (Ledyaeva, 2009). Nowadays the vast majority of FDI inflows attracted by the CIS countries are determined by continuously strong growth of local consumer markets (UNCTAD, 2012).

Efficiency seeking investors aim at reaching more efficient division of labour or specialization of assets (Dunning, 2000). Reduction of entry barriers and transport costs usually enable the efficiency seeking FDIs to grow. This makes them sequential to the first two types of foreign investment motivations. Foreign investors when entering new markets because of the natural resources abundance or new market opportunities strive to organize their business activities at a host location in such a way so that to benefit from the optimization of labour division. Therefore, in this paper we will not focus in detail on this motivation of FDI, treating it as the one related to the first and second types of foreign investment motivations.

Strategic asset seeking investors are motivated by an opportunity to rationalize the structure of the market seeking investment so that the foreign firm benefits to the most from the way its activities are geographically spread (Kudina and Jakubiak, 2008). The main purpose of these investors is to gain from different local-specific factor endowments, culture, institutional environment, specific knowledge and technologies available at the host markets. Firms go abroad when they already have certain unique capability they want to develop further. Therefore, MNCs expand in order to gain access to those capabilities, which are essential for the development of their own competencies, but are not available at their home markets (Cantwell, 1989).

The OLI paradigm stresses out one important aspect any firm considers before its internationalization. This is referred to a transnational company's decision to enter a foreign location based on the maximised economic efficiency, i.e. the trade-off between the costs, involved in setting the production at a different location abroad, and the costs of exporting the products from the home to a hosting country. This reasoning is approved by the gravity approach (Bevan and Estrin, 2004). The gravity theory states that the decision of an MNC to go abroad is determined by the relative market sizes of the home and host countries and their distance from each other. Distance is then viewed as a measure of the transaction

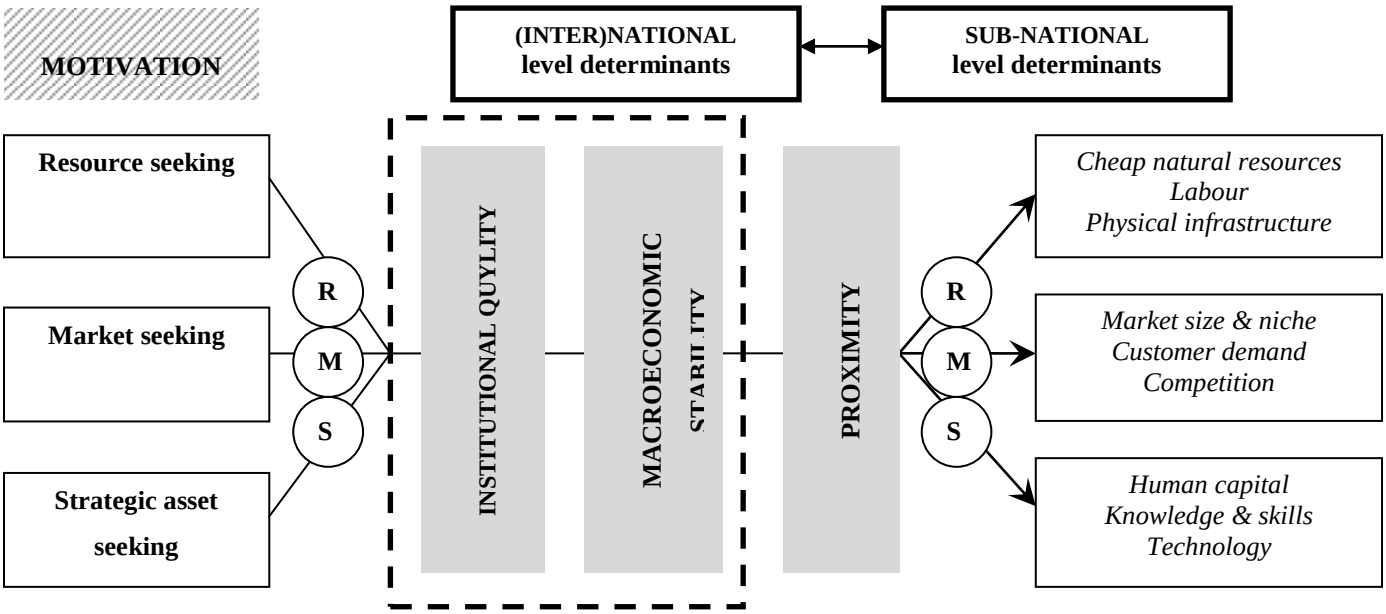
costs involved when going abroad. Thus, the costs of adjustment to the local market in terms of language, culture and logistics among many others are supposed to rise when the distance increases. The gravity model introduces an important parameter, such as proximity, as one of the factors that have a strong impact on the firm's decision to invest in a specific market. We will further discuss proximity in detail within our conceptual framework.

In 2008 Dunning has revised the OLI paradigm, adding institutions as an important component within the whole framework. Combining the macro level of institutions as the controlling mechanism of the behaviour of economic agents, and the micro level of institutions impacting managerial decision making, institutions affect all three elements of the eclectic paradigm (Dunning and Lundan, 2008). The authors state that the most objective link between institutions and the OLI paradigm exists with regard to location advantages. This is where institutions as formal and informal rules of the game together with the enforcement mechanisms introduce certain laws, regulations, rules of the civil society that form certain location-specific institutional environment. The internalisation advantages are institutionalised at the micro level, because when a firm is taking a decision about ownership of certain physical assets in the hosting country, it automatically deals with the relational advantages of such an ownership, i.e. contracts trust-based relations and institution building through networks of firms (Dunning and Lundan, 2008). The least institutionally connected are ownership advantages. As the authors put it, since ownership advantages are exceptionally internal and firm-specific, informal institutions in a form of a certain "corporate culture" are easily influenced by external norms and values of the local environment, in which the firm is embedded.

III. Conceptual framework

The analysis of the location choices of MNCs in transition economies, specifically in Ukraine, is threefold: analysis of the aim of foreign investors towards the region specific hosting market, basically investor's motivation, identification of the (inter)national level determinants and analysis of the sub-national level determinants of the location choice of the foreign investment (Figure 1).

Figure 1. Conceptual framework



Source: provided by author

If MNCs decide to internationalize, they base their location decisions on their preliminary motivation. Since our conceptual framework targets Ukraine as a post-Soviet, Eastern European Neighbourhood policy state, we focus on resource seeking, market seeking and strategic asset seeking, as the most dominant motivations in this region, omitting in such a way efficiency seeking (Ledyaeva, 2009). Depending on the incentives of going abroad, investors search for precisely those local factors, available at the host location, which will satisfy their initial aim of investment. Therefore, these factors differ with regard to the motivation of internationalization. We call these local region-specific factors sub-national level determinants, while institutional quality, macroeconomic stability are the (inter)national level determinants. However, proximity stands in between of the (inter)national and sub-national level determinants, since while it is important for the firms assessing the distance between the home and the host countries, it is also an important factor according to the theory of Marshallian or agglomeration externalities. Thus, on the sub-national level the location choice of a certain region by an investor will depend on the concentration of knowledge spillovers and technology exchange, generated by the proximity to the firms from the same sector or origin (Rodriguez-Clare, 2007). While the sub-national level determinants gain relative importance with respect to the motivation an investor has towards entering the hosting economy, (inter)national level determinants are assessed by all investors regardless of their motivation. Therefore, institutional quality and macroeconomic stability together with proximity aspects play the role of the first filter since they decide whether a host location is considered by an MNC on the first hand. If a multinational is not attracted by these factors, it may not enter the market, because firstly, these are the factors which MNCs face first when entering the market, and secondly, the attractiveness of other location determining factors is positively related to institutional quality and macroeconomic parameters of a certain region. If the firm passes through the first filter, then it focuses on the sub-national level determinants corresponding to its preliminary motivation of going abroad. Thus, the second filter represents the motivation-specific determinants. And again if a company is not attracted by these, i.e. these factors do

not satisfy its initial motivation, the hosting location with these factors stops being interesting for this company. The sub-national level determinants are also affecting the managerial perspective of an investing firm. This means that targeting certain factors at a certain location describes the management strategy of the firm. When a multinational is looking for cheap natural resources, for example, its strategy will probably be using the current location as a resource base with the further re-import of the produced goods to the home country. On the other hand, when a firm is looking for specific knowledge pool, it will invest into the development of the social and human capital of the current region and will focus on serving of the local market. There is also a feedback loop between the two levels of location choices determinants. For example, if the market size or growth is very attractive as in the case of China and to an increasing degree in Russia, MNCs might be willing to invest in these locations even if the institutional environment is still hostile. In the following part of this chapter we will discuss precisely both (inter)national and sub-national determinants for MNC's investment location decisions.

3.1 Agglomeration effects and proximity

Economic geographers have for a long time acknowledged that firms in the same industries are drawn to the same location in order to benefit from geographical proximity, which results in positive "agglomeration effects" (Boschma, 2005; Bathelt et al., 2004; Cooke, 2001). Firms' clustering within certain regions causes the formation of pecuniary and technological externalities, which explain the industry localization (Head et al., 1995). The reason for this is that localization of companies provides a pool of workers with common skills range, a certain knowledge base, which enables the firms exchange knowledge and technology, benefiting in such a way from technological spillovers. Therefore, firms tend to choose those locations, where there is a substantial representation of firms from the same industry in order to benefit from the factor endowment.

Agglomeration economies have been widely recognized as one of the major motives for FDI flows (Krugman, 1991; Cantwell and Iammarino, 2000). Positive externalities of agglomeration effects, which are reached by co-location of FDI, are crucial for the productivity of a firm. Agglomeration economies are associated with the localization economies, or industrial clustering, and urbanization economies. Localization economies arise when a range of firms from the same sector co-locate within one locality. A number of empirical studies have proved the positive impact of location- and industry-bound agglomeration benefits on the extent of intensification of FDI inflows towards certain locations (Head et al., 1995; Majocchi and Presutti, 2009). Marshallian agglomeration externalities based on the specialization paradigm support stated above in the following three ways. Firstly, firms tend to co-locate, which causes agglomeration externalities to emerge, because this allows them to develop specialized labour available at a specific location. Secondly, in such a way firms provide a non-tradable input, which is industry-bound, because they develop common technologies and infrastructure, which leads to economies of scale. Thirdly, sharing ideas and exchange of experience result in intensification of cooperation between economic actors. This leads to the enforcement of agglomeration benefits that become a clear determinant for further FDIs to the location (Bunnell and Coe, 2001). The urbanization economies provide the benefits for companies to be located within one urban location. Larger cities with a certain level of developed infrastructure potentially offer more benefits than smaller cities. Among such advantages urbanization economies offer,

the most prominent are proximity to the market, suppliers and customers, labour pool, knowledge and technologies, transport and communication infrastructure.

Boschma (2005) described such type of proximity as cognitive, which has a strong impact on the decision of companies to co-locate. Thus, he defines cognitive proximity as the closeness to the firms from the common knowledge base in order to make the knowledge transfer easier and less costly. Therefore, we would also assume that FDIs in transition economies will focus on the regions with a wide presence of the firms of the same industry. When an MNC decides on the location of its subsidiary, it assesses the importance of this location for the further learning and innovation. For this purpose, which drives the development and growth of any business, the availability of common knowledge, social context, organizational networks, common institutional environment and close geographical distance between the other firms of the industry are all of a tremendous importance. Localized learning introduced by Malmberg and Maskell (2006) also clearly states the value of a spatial proximity to different factors important for firms to learn and in such a way develop their competitive advantages. We assume that highly industrialized regions of post-Soviet states will attract those firms that will benefit from already existing infrastructure and intra-sectoral firms' networks of customers and suppliers. With respect to geographical proximity, it refers to physical distance between economic actors (Boschma, 2005). The less this distance is, the better can firms benefit from knowledge externalities. Therefore, we assume that proximity to the EU and thus to the firms from the home country will have a positive impact on the FDI inflows into those regions of post-Soviet states, that are close to the EU border. In this case these regions will benefit from the less socialist industrialization heritage and will attract foreign firms by the opportunities of social fit and easier embeddedness process into the regional economic system.

3.2 Institutional quality

Institutional differences at different locations stand out to be an important factor in the decision making with regard to internationalizing not only to the new countries, but even to the new regions within those countries. Thus, just as institutions at the national level attract the inflows of FDIs to the countries, institutions at the sub-national level attract investment to the regions (Meyer and Nguyen, 2005). Settling within certain regions, firms get embedded into the regional economic systems. The success of their business operations in these regions depends on the factor endowments of the specific regions. Institutions are one of the major factors that determine the way a firm will integrate itself into the local economic system. Under institutional quality we mean the degree to which institutions create firm-friendly favourable conditions, which are coherent over time with high predictability of changes aimed at facilitation of doing business within certain geographic areas. 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. North (1990) states, that institutional environment establishes formal an informal rules of the game, which reduce uncertainty and transaction costs. In such a way impacting the business strategies of local domestic firms, there is a specific institutional mi-lieu created, which plays the role of a filter for foreign firms striving to invest into the new market. Bevan et al. (2004, p. 45) support the ideas stated above with "legal, political and administrative systems tend to be internationally immobile framework whose costs determine international attractiveness of the location".

When a firm decides whether or not to enter a certain market its main objective is to gain market legitimacy. Establishment and maintenance of legitimacy in the new local-specific environment is very important within the foreign expansion of any MNC. Kostova and Zaheer (1999, p. 64) define organizational legitimacy of an MNC as "the acceptance of the organization by its environment, which is vital for its organizational survival and success". The authors identify three factors that frame organizational legitimacy: the environment's institutional parameters, the organization's characteristics and the process of legitimacy that impacts how the environment views the organization. The organizational legitimacy is analysed in such a way through the processes of overcoming entry barriers by a foreign firm in the hosting economy and by adapting to the existing cultural environment. The entry barriers a market has towards incoming flows of capital and goods are created by institutional environments, which frame the activities of these markets. Therefore, an entry barrier is one of the first elements of an institutional framework the MNC faces when entering the market. Again coming back to the transaction costs theory and internalisation theory, when the costs of overcoming the entry barriers of the new market for a foreign firm outweigh the potential profit the firm can make in this new market within the development of its competitive advantage, the firm will not internationalize to this specific market. MNCs try to identify in which locations the institutional constraints are less repressive (Kang and Jiang, 2012). In such a scenario, institutional elements of a certain economy become the bottleneck of the firm's decision of whether to invest or not in this economy. Cultural adaptation of an MNC in the market although being an important factor in successful embeddedness of a firm within the local economic system, is not a sufficient condition for the organizational legitimacy to take place (Kostova and Zaheer, 1999). The reason to this lies in the fact that organizational legitimacy of a foreign firm is socially constructed, which means that there should be a definite fit between the formal institutional component and the way the foreign firm is integrated within the latter and an informal institutional environment, which makes the organization being ingenuously accepted by the local market. Thus, MNCs in the hosting markets face three pillars of institutional environments, namely the regulatory, the cognitive and the normative (Scott, 1995). When taking decision on entering a new market, a firm assesses not only the regulatory pillar of institutions, i.e. local laws and regulations, but also the cognitive pillar of cognitive structures of society and the social pillar of societal values this society embraces (Kostova and Zaheer, 1999). Such a multi-pillar assessment of the hosting institutional environment is an important key in the decision of a firm to invest in a certain market. Within the regulative pillar of institutions it has been empirically proved that stable economic policy, security of property rights, less ownership restriction and bureaucracy have a positive impact on the propensity of foreign firms to invest in these locations. With respect to the cognitive pillar, foreign firms before taking the decision of whether to invest into a certain location or not assess the routines of the domestic firms in the markets, which form a specific local cognitive structure. This is needed to percept the behavioural pattern of the future suppliers and customers the foreign firm will cooperate with. At this point trade relations are being framed by the local institutional environment and the latter influences the whole expansion strategy of an MNC. Within the normative pillar of institutions cultural distance between the foreign firm and the domestic firm in terms of pre-established informal rules and norms, local business culture, gives a hint for the foreign firms on the level of difficulty of embeddedness into the local economic system.

The legal framework of the transition economies has drastically changed after the collapse of the Soviet Union. The institutional transition of regions in post-Soviet countries hinders rather than supports economic growth since the

institutional legacy of the past still prevails in many areas of the economy (Tridico, 2011; Nagy, 2002). Post-Soviet governments did not manage to effectively change their institutional environments and the fit between formal and informal institutions is still lacking due to the existence of the old communist heritage. Therefore, Western businesses entering Eastern and Central European markets face higher transaction costs, because they have to adjust to the normative and regulatory pillar of institutional environments with a lower quality than in their home market, to the cognitive pillar of post-Soviet legacy, and post-communist informal mind-set. Nevertheless, MNCs do choose emerging markets of transition states as their primary investment locations, although their region specific locations differ according to their readiness to deal with the path-dependent institutions. According to Bevan et al. (2004), the reason for this is that firms try to find ways to benefit from certain peculiarities of institutions in post-socialist states in two ways. Firstly, the change of ownership in the post-Soviet states enabled privatization of many formerly state-owned firms. This leads to the development of a private sector and firms tend to be attracted by private firms to do business with these new players due to their higher profitability, urge for new business opportunities, and market friendly corporate cultures. Moreover, privatization allows for acquisitions of formerly state-owned firms or monopolies by MNCs, which became one of the major modes of entry for foreign firms. Secondly, institutional transition implies the establishment of a new financial infrastructure, which at its infancy stage offers low costs for its financial services. This becomes an important attractive factor for foreign firms to enter a certain new market and make use of complementary local finance. In addition, foreign banks and other financial services providers were attracted to these new markets.

3.3 Resources, markets, and strategic assets

International investment flows are determined by “push” and “pull” factors of a certain locality. Thus, “push” factors are those determinants that influence the outflow of the capital from the home region, whereas “pull” factors are the ones that attract foreign capital into the host region. In this paper we will specifically focus on the “pull” factors that have an impact on the decisions of foreign companies to invest in the host region. According to Dunning (1988) FDI is attracted by regions, where it is possible to combine the ownership advantages with the location specific advantages of the host regions by internalization. Foreign companies entering Eastern and Central European states search for inputs they could integrate into their global operations (Majocchi and Strange, 2007).

Resource seeking investors according to Kang and Jiang (2012) try to get control over natural resources as one of the major motivations of FDI activities. Among the resources the host location can offer the most important are supposed to be the natural resources of a country or a region, per capita income, labour market conditions, infrastructure (Barrell and Pain, 1999). The natural resources or raw materials play an important role for the delivery and processing operations of firms. Proximity to the suppliers of specific raw materials is also a prominent issue in choosing locations for foreign investments.

Resmini (2000) suggests that the majority of FDI towards Eastern and Central European countries is determined by the aim of serving the local market. Foreign firms, while co-locating within certain markets, strive to capitalize on the effect of market enlargement and the effect of competition setting. The market enlargement effect refers to the satisfaction of the local demand and the establishment of a new customer base as the primary aim of foreign firms. The competition setting effect is related to the fact that MNCs are trying to outrun their competitors in taking the lead of untapped niches with

their products in the new markets. At this point such market specific aspects as income level, size of population, market facilities, consumer characteristics and future growth potential is taken into account by foreign investors when entering new markets. Bevan and Estrin (2004) empirically proved the positive relationship between market size and FDI inflows.

Strategic asset seeking investors are looking for advanced technologies, immobile strategic assets, such as patents, brands, distribution networks and local knowledge (Buckley et al., 2007). These investors choose those locations for their FDI, where they can only develop their competitiveness level with the help of certain assets, available only at a specific location. Availability of such strategic assets usually results in the formation of certain asset-specific infrastructure around the latter. This leads to the appearance of clusters of firms, customer-supplier networks, embedded in certain regional economic systems by the means of using the same strategic assets, which act as a specific glue connecting business actors around.

IV. Analytical framework

The assessment of the location choices of MNCs in Ukraine is based on the results of the enterprise survey of 153 foreign-owned firms in Ukraine. The survey focused, among other issues, on location choices and location patterns of FDIs in Ukraine. The firms were asked to rate the importance of different factors, which played a role in their investment decision; to choose the initial aims of investment with respect to serving the local market or just using the market as the resource base for manufacturing facilities with further re-import to their home countries. Moreover, the survey covered questions on institutional environment. The results allow linking the institutional quality at a certain location to the location choice of MNCs in this region.

In order to answer the research questions introduced at the beginning of the paper, the following three hypotheses are formulated:

H1. *MNCs investing in the Capital region of Ukraine are motivated by market seeking and aim at serving the local market, whilst the decision of foreign firms to invest in the Eastern and Western regions of Ukraine is determined by resource seeking aiming at re-import of the manufactured goods to their home countries.*

The Western region on Ukraine leads in terms agricultural production and is rich in land resources, whereas the Eastern region still has a strong legacy of socialist industrialization and therefore, possesses a certain physical infrastructure with all the resources needed for such an infrastructure to work. The capital region in Ukraine is the region with the highest purchasing power and concentrated pool of suppliers and customers within a range of market niches. Therefore, we assume that the market will be the main incentive for foreign firms to invest in the Capital region, whilst the existing resources will attract foreign investors to invest in the Western and Eastern regions.

Having assumed that FDIs to the Capital region are driven by the interest of foreign investors in the market and in the bordering regions these are the resources which play an important role, we further hypothesise, that those FDIs driven by the market potential will focus on serving the needs of the local market in order to benefit from it. On the other hand, those investments attracted by abundance of resources will presumably aim at using the current location as a resource base for manufacturing purposes and the outputs of the production cycle will be exported.

H2. *Proximity to the EU and the weaker socialist industrialization heritage of the Western region attract FDI to this region, whereas availability of good infrastructure and proximity to other firms from the same sectors (as the remains of the socialist industrialization) are the dominant factors for MNCs to invest in the Eastern region.*

The Western region of Ukraine is the EU bordering region and the Eastern region of Ukraine borders Russia. Historically, the Eastern region has been under the influence of communist regime much longer than the Western region. Therefore, we assume that the legacy of communist past is weaker in the West and stronger in the East. Thus, we presume that proximity advantages to the EU border combined with a perspective of easier embeddedness into the less post-communist social context will attract FDI inflows to the Western region of Ukraine. Historically determined strong legacy of socialist industrialization in the Eastern part of the country results in such an important advantage as still existing good infrastructure with a pool of suppliers and customers related to this infrastructure. Therefore, we hypothesise, that proximity to other firms from the same sectors as well as availability of the physical infrastructure will to a larger extent influence the location of MNCS in the East of Ukraine.

According to the stated above with regard to the socialist industrialization heritage we assume that the Western part of Ukraine is more open in a cognitive sense to new ideas and innovation, since the roots of Soviet regime are not so strong in the West as they are in the East. Thus, the openness of the firms in the EU bordering region to the new coming FDIs will be higher in comparison to the locked in the post-Soviet regime East, where the social context is much more framed by the remains of the communist past.

H3. *The higher the institutional quality of the region, the more attractive this region is towards incoming FDIs. Therefore, the superior institutional quality of the Capital region has a positive impact on the propensity of foreign firms to invest in the region, resulting in institutions playing an important determining role in the investment decisions of foreign firms in Kyiv region.*

Considering high regional differences with respect to institutional quality in Ukraine, we assume that the capital region benefits from access to better government support, which presumably leads to better institutional quality in the region. Since we have established in our previous discussion that institutional quality of a location is an important factor in determining location choices of MNCs, we assume that in the region with high institutional quality it plays an important role in attracting MNCs.

V. Data and methods

The enterprise survey in Ukraine lasted for four months, having been launched in April, 2012 and finished in July, 2012. Overall 153 subsidiaries of MNEs from the food and machinery & equipment sectors were surveyed in different three regions of Ukraine: the capital region Kyiv, close to the EU border region Lviv (the Western region) and far from the EU border region Kharkiv (the Eastern region). 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 Ukraine (Table 3).

Table 3. FDI distribution by regions of Ukraine

Regions of Ukraine	FDI increase, reduction per year, $ million		FDI cumulatively starting from the beginning of investment on October 1, 2011, $ million	FDI per person cumulatively starting from the beginning of investment, $	
	2009	2010		2009	2010
Western region					
Volyn region	63,2	11,7	246,6	321,6	332,8
Zakarpatya region	7,3	-1,1	340,1	293,0	291,7
Ivano-Frankivsk region	134,7	-92,5	622,2	460,8	393,9
Lviv region	240,6	75,2	1 363,9	473,2	503,7
Chernivtsi region	1,7	0,5	63,4	68,6	69,1
Capital region					
Kyiv (city)	2 387,9	2 634,1	24 016,8	7 031,9	7 946,2
Kyiv region	178,1	77,5	1 702,8	887,4	935,3
Eastern region					
Donetsk region	107,8	424,7	2 292,2	366,1	464,6
Lugansk region	243,3	-6,3	747,3	275,0	274,7
Sumy region	85,5	114,1	348,3	207,1	307,0
Kharkiv region	472,8	622,7	2 776,7	754,6	985,0

Source: Provided by author, based on the State Statistical Committee of Ukraine

The criteria of selection of the sectors of the survey firms were determined by the strong presence of companies with FDI in these sectors (Table 4). The survey companies were selected randomly from the manufacturing firms. Our focus on manufacturing firms was threefold. Firstly, in order to analyse the embeddedness of MNEs and domestic SMEs into the regional institutional and economic systems of a host transition economy we needed to identify the business processes, which involved exchange of knowledge, such as innovation activities, organizational upgrading and customers-supplier interactions, which are all related to the production processes. Secondly, while developing the survey we were interested in the linkage between institutional quality as the prerequisite of MNEs to invest in Ukraine and their further propensity of technological upgrading within collaboration with domestic SMEs, which constitutes a manufacturing cycle. And thirdly, we aimed at investigation of the real input of foreign investors into the comparative advantage of such a post-communist state as Ukraine, where hard industry based on production activities is of a strategic importance.

Table 4. FDI inflows in the targeted regions in 2010, by sectors, millions of USD

Regions	Food, beverages and tobacco	Pharmaceutical and chemical products	Machinery and equipment	Basic metals and fabricated metal products	Pulp and paper products	Manufacture of textiles and wearing apparel, leather and related products	Wood and wood products, furniture
Kyiv region	481,1	75,2	699,4	67,6	112,8	148,8	23,1
Lviv region	64,3	38,2	107,6	34,5	41,9	35,9	58,3
Kharkiv region	146,5	54,3	286,4	87,9	57,4	28,6	24,5

Source: Provided by author, based on the State Statistical Committee of Ukraine

The sampling frame was based on the firms' directory and accounts of the State Agency of Investment and National Projects Management of Ukraine. Overall 863 subsidiaries of MNEs from the food and machinery & equipment sector have been contacted by phone. 140 companies were successfully interviewed face-to-face and 13 companies have filled out the questionnaires themselves and were contacted by phone afterwards to ensure the correctness of the given answers. The distribution between surveyed and contacted MNEs in the sampled three regions is provided in Table 5. We can clearly observe that there is no significant difference between the regional distribution of response rates.

Table 5. Response rate in different regions

	Lviv region	Kiev region	Kharkiv region	Total
Survey **food** foreign firms	23	28	9	60
Survey **machinery & equipment** foreign firms	27	25	41	93
Total surveyed firms	**50**	**53**	**50**	**153**
Total contacted firms	**280**	**298**	**285**	**863**
Total response rate	***17,9%***	***17,8%***	***17,6%***	***17,7%***

Source: Provided by author

The empirical data of the enterprise survey is represented by a set of a standardized questionnaire data with closed likert scale questions. The questionnaire consisted of 6 thematic blocks. One separate block was devoted to the location choices and location patterns of FDIs, asking the survey firms to rate on the scale from unimportant to very important such factors, as lower costs, market demand, human capital and knowledge, infrastructure, preferential policies and subsidies, proximity to customers and suppliers, proximity to other foreign firms from the same country and sector as well as to the EU border. The firms were also asked to indicate their initial aim of investment, i.e. whether they aimed at re-importing the produced goods from Ukraine to their home countries, using in such a way the Ukrainian market solemnly as a resource base, or the initial goal of investment was selling the products in the Ukrainian market only in such a way serving the latter. The survey also focused on the investigation of institutional environment, covering among others the questions of the assessment of the quality from very good to very bad of such aspects of an institutional framework at the current location as enforceability of legislation and regulation policies, physical and intellectual property rights protection, reliability of oral contracts and agreements as well as central and regional government support.

We carried out the descriptive analysis of the distribution of firms assessing the determinant factors of their location choice decision as very important, important and unimportant factors (Table 1, Annex). Crosstabs descriptive analysis covered the assessments of the factors playing a role in the investor's location choice decision with regard to the differences between three regions, namely differences between the capital region Kyiv, the Western close to the EU border region Lviv and the Eastern far from the EU border region Kharkiv.

We ran the multinomial logit regression model with the regional dummy as our dependent variable estimating the probability of a foreign firm to enter Kyiv region, Lviv region or Kharkiv region. The results of the multinomial regression are presented in Table 8. After multicollinearity check we have chosen the following variables as our control dummies: ownership type, the home country of the investor, sector, location choice determinant factors, initial aim of the investment and institutional quality composite indicator.

The ownership dummy includes brownfield and greenfield investors. By brownfield FDI we mean those subsidiaries of MNEs, which entered the Ukrainian market and acquired an existing production site for future business operations. Greenfield FDI group encompasses those subsidiaries, which built new production sites in Ukraine. The choice of the home country of the investor as one of the independent variables aimed at investigation whether the proximity parameter, especially closeness to the EU border in case of the Western Lviv and to the CIS border in case of the Eastern Kharkiv, does play a role in the investment decision of MNCs towards different regions of Ukraine with regard to where these MNCs originate from, namely from EU-15, EU-new member states, the CIS or rest of the world. Introduction of a sector dummy, covering two survey sectors, i.e. food sector and machinery and equipment sector, within the independent variables of the model was intended for checking whether the MNC's choice of a specific region actually depends on a certain industry present in this region. In the Soviet times the Eastern region Kharkiv was known as an industrial engine of the country, whereas the Western Lviv was an agricultural centre. Therefore, regional path-dependent infrastructure might play a role in the attractiveness of different regions towards FDI. In order to determine which factors do attract MNCs to different regions of Ukraine we introduced lower costs, market demand, human capital, infrastructure, preferential policies and subsidies, proximity to customers/suppliers, proximity to other firms from the same sector and proximity to the EU border within the independent variables of the model as dummy variables with two groups of firms, one group assessing the factors as important and another one as unimportant. In such a way we did not include only one factor covered in the survey among the determinant factors of FDI location choice decisions, namely proximity to other firms from the same country of origin, due to high correlation of the latter with proximity to other firms from the same sector and proximity to the EU border. Controlling for the initial aim of the investment allows us to observe an impact of the firm's orientation towards re-import or serving the local market on its regional location choice. And the institutional quality composite indicator dummy was included in order to analyze the relationship between the good quality of institutional environment of the region and the location choice of this region as the recipient of foreign investment. We have built the composite indicator of institutional quality on the basis of equal weighting with 25% weight devoted to each of the four institutional aspects covered in the enterprise survey, provided that physical property rights protection and intellectual property rights protection were treated as one property rights protection indicator and central government support and regional government support were combined into one government support indicator. Thus, we came up with equal weights of enforceability of legislation, property rights protection, reliability of oral contracts and agreements and government support. Since the questions on the above parameters were likert scale from 1 (very bad) to 5 (very good), the institutional quality composite indicator was recoded into a dummy with the value 1, i.e. good and very good quality of the institutional environment with the threshold of 3,5 and above on the likert scale, and 0 – average, bad and very bad quality of the parameter of institutional environment with the threshold of less than 3,5 on the likert scale.

VI. Results

The descriptive analysis of the results in Table 6 shows that lower costs, market demand, human capital and local knowledge base are the most important factors assessed as such by 54,2%, 60,1% and 37,3% of surveyed firms respectively. With regard to such factor as infrastructure there is an equal amount of firms that assess it as important and not important factor for their location choice decision, namely 37,9% of firms.

Table 6. Distribution of firms assessing factors playing a role in investment decision

Factors	Very Important		Important		Unimportant	
	n	%	n	%	n	%
Lower costs	83	*54,2%*	45	*29,4%*	25	*16,3%*
Market demand	92	*60,1%*	34	*22,2%*	27	*17,6%*
Human capital / knowledge	57	*37,3%*	56	*36,6%*	40	*26,1%*
Infrastructure	37	*24,2%*	58	*37,9%*	58	*37,9%*
Preferential policies / subsidies	16	*10,5%*	40	*26,1%*	97	*63,4%*
Proximity to customers / suppliers	34	*22,2%*	46	*30,1%*	73	*47,7%*
Proximity to other foreign firms from the same country	26	*17,0%*	44	*28,8%*	83	*54,2%*
Proximity to other foreign firms from the same sector	25	*16,3%*	37	*24,2%*	91	*59,5%*
Proximity to the EU	36	*23,5%*	33	*21,6%*	84	*54,9%*

Source: provided by author

Preferential policies and subsidies together with the proximity to other foreign firms from the same sector seem to be the least determining factors in the FDI location choice, since there are 63,4% and 59,5% of foreign firms respectively, which evaluate these factors as unimportant for their decision to locate their subsidiary in the current region. The rest group of factors, such as proximity to customers and suppliers, to other foreign firms from the same country of origin as well as to the EU seem not play a determining role in the decision of foreign firms to enter certain regions of Ukraine due to the larger percent of interviewed firms assessing the latter as unimportant rather than important factors for their investment location decision (Table 6).

Although the crosstabs descriptive analysis in Table 1 (Annex) shows, that regional differences in terms of assessment of lower costs, market demand, human capital and knowledge are not significant, but still we can observe that in Kyiv region more than 60% of firms assess lower costs and market demand as very important factors for their investment location decision in the capital, while in the Western bordering region Lviv the amount of firms evaluating these factors as unimportant equals more than 20%, which is even higher that that of the Eastern region Kharkiv, where this figure is around 15% in terms of relative unimportance of the above factors for the foreign firms' location decision in the East of Ukraine. With regard to human capital the regional differences are also not significant, but the majority of survey firms assess human capital and knowledge as an important determining factor in Lviv region, whereas in the capital Kyiv region this figure is the lowest and equals only 30% of firms. Infrastructure together with preferential policies and subsidies and

proximity to other foreign firms from the same sector are assessed significantly different by the interviewed foreign firms in the three survey regions. Thus, infrastructure is very important for 32% of MNCs investing in Lviv region, while for those in Kharkiv region this figure equals only 24% and the lowest amount of firms assess infrastructure as a very important factor for the investment location choice decision in Kyiv region. The capital comes up to lead though in preferential policies and subsidies, as 17% of firms assess this parameter as very important when investing in Kyiv in comparison to only around 7% of firms in Lviv and Kharkiv regions. Nevertheless, the majority of firms assess preferential government treatment as not a defining factor in the location choice. Lviv region significantly outstrips the capital and the Eastern Kharkiv region with regard to such parameter as proximity to other foreign firms from the same sector with 34% of surveyed firms assessing this factor as very important for their decision to invest in Lviv region compared to only 10% and 5,7% of firms in Kahrkiv and Kyiv respectively. The same tendency concerns such factors as proximity to other foreign firms from the same country of origin and proximity to the EU, meaning that in Lviv region the amount of firms assessing these two factors as very important for their location choice decision is significantly higher than in Kyiv and Kharkiv regions. Thus, 30% of foreign firms in Lviv assess proximity to other foreign firms from the same home country as very important parameter in their decision to invest in Lviv, whereas in Kyiv and Kharkiv regions this is only around 13% and 8% of firms respectively. Proximity to the EU border is assessed as very important by the largest amount of firms, namely more than 55%, regarding all other factors playing a role in the investment decision in Lviv.

With regard to the initial aim of investment in the Table 7 we can observe that the majority of firms in all three survey regions choose serving the local market over re-importing of the manufactured products as an initial aim of their investment.

Table 7. Distribution of firms with regard to the initial aim of investment

Regions	Re-import	Serve the Ukrainian market	Sig.
Kyiv region	44,2%	55,8%	n.s.
Lviv region	44,0%	56,0%	
Kharkiv region	32,0%	68,0%	

Source: provided by author

The multinomial logit regression in Table 8 presents the assessment of the impact of the selected independent variables on the probabilities of MNCs to invest in different three survey regions, comparing the bordering Lviv and Kharkiv regions to the capital Kyiv region and the Western region to the Eastern region. Thus, the model shows that greenfield FDI firms are more likely to invest in Kyiv region rather than in Lviv region in comparison to brownfield FDI firms. For those foreign firms, for which market demand and preferential policies and subsidies play determining role in their investment location choice decision, the probability of entering the capital rather than bordering Lviv is higher. However, foreign firms are more likely to choose Lviv for the location of their FDIs if they are looking for human capital and proximity to the EU border. With regard to Kharkiv region in comparison to the capital, brownfield MNCs originating from the CIS region are more likely to invest in Kharkiv rather than in the capital in comparison to greenfield FDI firms coming from the EU and the rest of the world. Moreover, firms from machinery and equipment sector in comparison to those from food and beverages sector are also more likely to choose Kharkiv rather than the capital for location of their investments. Foreign firms assessing market demand as n important factor for their location choice decision are more likely to invest Kyiv

region rather than Kharkiv. Those firms aiming at serving the local market, on the other hand, more probably will enter Kharkiv rather than the capital. Nevertheless, Kyiv region rather than Kharkiv is more likely to attract foreign investors assessing local institutional quality as good. Concerning the comparison of two bordering regions, namely the Eastern Kharkiv region versus the Western Lviv region, foreign firms from the EU-15 as well as from the EU-new member states are highly likely to choose Lviv rather than Kharkiv locating their investments. The same holds true for the MNCs for which proximity to the EU border is of a determining importance in their location choice decision. At the same time, MNCs with initial aim of serving the local Ukrainian market rather than re-import of the produced goods from Ukraine to their home countries are more likely to choose Kharkiv region over Lviv region when going abroad with their investments. With regard to the role of local institutional quality, FDIs are more likely to choose Lviv over Kharkiv for locating their investments when assessing local institutional quality as good.

Table 8. Multinomial logit regression model

	Lviv region *(Kyiv region is a reference category)*	Kharkiv region *(Kyiv region is a reference category)*	Kharkiv region *(Lviv region is a reference category)*
Ownership dummies (Brownfield FDI as a reference category)			
Greenfield FDI	-1,688***	-2,317***	-,629
Investor origin dummy (CIS as a reference category)			
EU-15	,804	-1,441*	-2,245***
EU-new member states	,753	-2,632***	-3,385***
Rest of the world	-1,054	-1,660**	-,606
Sector dummy (Machinery & equipment sector as a reference category)			
Food & beverages sector	-,538	-1,132*	-,594
Determinants of location choices dummies			
Lower costs	-,615	-,174	,441
Market demand	-1,665*	-1,521*	,144
Human capital	1,263*	,402	-,861
Infrastructure	-,340	-,047	,294
Preferential policies/subsidies	-1,845***	-,711	1,134
Proximity to customers/suppliers	,111	-,440	-,550
Proximity to other firms from the same sector	,274	,782	,507
Proximity to the EU border	1,437**	-,625	-2,061**
Initial aim dummy (Export from Ukraine as a reference category)			
Serve the local Ukrainian market	,102	1,609***	1,507**
Institutional quality dummy	-,935	-2,139***	-1,204*
Model fit			
Sig			*,000*
Cox and Snell Pseudo R-Square			*,579*
Nagelkerke Pseudo R-Square			*,651*
McFadden Pseudo R-Square			*,393*
N			*149*

Source: provided by author
Note: *Significant at the 0.10 level; **Significant at the 0.05 level; ***Significant at the 0.01 level

VII. Discussion

The results of the descriptive analysis and the multinomial logit regression show, that market seeking and strategic asset seeking motivations of FDI dominate in Ukraine. Analysis did not show significant presence of resource seeking investors in the survey regions. In the capital Kyiv region foreign firms are seeking for market's potential and broader demand. This could be explained by the fact that the capital region always serves as the commercial hub of the state, where the concentration of social capital is higher. This is especially relevant for the post-Soviet Eastern states with highly disproportional regional development, with the capital regions outstripping bordering regions in economic and social growth. Intensive market growth with a big variety of untapped market potential in a form of new business opportunities of the capital regions of transformation states serves as an attractive factor for foreign investments. The results of the regression analysis with regard to the higher probability of greenfield investments in Kyiv region compared to brownfield FDIs in the bordering regions lead us to the line of thinking that the capital does attract new foreign firms by its untapped market potential, opportunities for the development of new operational facilities and better access to the needed resources, business information and government. However, the results of our analysis also show that market demand being an important location choice factor for the capital region does not lead to human capital and local knowledge base also being the pull factor for FDI inflows. Thus, Lviv region attracts more foreign firms by its human capital together with the proximity to the EU border. This could be explained by the fact that firms coming from the EU to Lviv region tend to create their own clusters of firms, clusters-specific knowledge pools and networks, which help to decrease certain transaction costs and therefore support the subsidiary's embeddedness process within the new regional economic system. This is where agglomeration economies or Marshallian externalities are introduced. Lviv region being less affected by the Soviet communist regime due to not being the target region for industrialisation purposes during the Soviet times is at a more advantageous position in terms of being more open to new market trends and cross-border knowledge spillovers being close to the EU border. This leads to formation of a concentrated labour force pool with certain range of skills supported by the networks of the firms from the same sector.

Foreign firms in Kharkiv turn out to be much more local market oriented compared to the ones in Kyiv region and in Lviv. Although, as discussed above, investors in the capital region are predominantly market seekers, when it comes to whether to use the locality solemnly as a manufacturing base with further export focus or aim at serving the local market needs, it is not only the market potential, which decides for choosing any of these strategies. In case of the Eastern, close to the CIS border, region with a big share of FDIs originating from post-Soviet states, the old system of the planned economy still exists as the remains of the communist regime. Higher probability of firms from the machinery and equipment sector rather than food and beverages sector to invest in Kharkiv rather than Lviv supports our previous assumption, that since the Eastern part of Ukraine was historically serving as the engine of the Soviet "industrial machine", the old infrastructure with the existing networks of sector-specific suppliers and customers, makes Kharkiv region a good platform with a large market potential to be served.

Therefore, as long as we can confirm in our first hypothesis, that the capital region investors are market seekers, we cannot confirm that they are aiming at serving the local market, because this is the bordering region Kharkiv where this aim is more obvious. Concerning our second hypothesis, it can be accepted with regard to the importance of the EU border in attracting foreign investors to the Western region Lviv and the availability of old infrastructure in the Kharkiv region as the remains of the Soviet

times in explaining the initial aim of the local investors. Although in the case of Kharkiv region we can only assume that the fact of firms from the machinery and equipment sector being more likely to invest there in comparison to the firms from food and beverages sector could serve as a possible explanation of the existence of the old infrastructure in Kharkiv, since our regression results with regard to infrastructure control as well as proximity to other firms from the same sector control are not significant. Therefore, we cannot accept the second hypothesis fully either. Our third hypothesis on the role of institutional quality of the region affecting foreign firms deciding to locate their investments in this region is accepted. Both descriptive and multinomial regression results show, that the capital region attracts firms, which assess the quality of local institutional environment as good and for which preferential treatment of the government is important when making decision on location choice of their investments. The capital region in the majority of states is the target one for the government to create a business friendly institutional environment in order to attract entrepreneurs to the main commercial and industrial hub of the state.

VIII. Summary

In the 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.

Important policy implications 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.

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ANNEX
Table 1
Assessment of the **importance of the factors playing role in investment decision**
(share of firms) *by region*

	Very Important	Important	Unimportant	Sig.
Lower costs *(n=153)*				
Kyiv region	62,3%	24,5%	13,2%	n.s.
Lviv region	44,0%	34,0%	22,0%	
Kharkiv region	56,0%	30,0%	14,0%	
Market demand *(n=153)*				
Kyiv region	67,9%	24,5%	7,5%	n.s.
Lviv region	54,0%	18,0%	28,0%	
Kharkiv region	58,0%	24,0%	18,0%	
Human capital / knowledge *(n=153)*				
Kyiv region	30,2%	45,3%	24,5%	n.s.
Lviv region	42,0%	36,0%	22,0%	
Kharkiv region	40,0%	28,0%	32,0%	
Infrastructure *(n=153)*				
Kyiv region	17,0%	58,5%	24,5%	***
Lviv region	32,0%	24,0%	44,0%	
Kharkiv region	24,0%	30,0%	46,0%	
Preferential policies / subsidies *(n=153)*				
Kyiv region	17,0%	39,6%	43,4%	***
Lviv region	8,0%	14,0%	78,0%	
Kharkiv region	6,0%	24,0%	70,0%	
Proximity to customers / suppliers *(n=153)*				
Kyiv region	28,3%	28,3%	43,4%	n.s.
Lviv region	24,0%	34,0%	42,0%	
Kharkiv region	14,0%	28,0%	58,0%	
Proximity to other foreign firms from the same country *(n=153)*				
Kyiv region	13,2%	35,8%	50,9%	**
Lviv region	30,0%	26,0%	44,0%	
Kharkiv region	8,0%	24,0%	68,0%	
Proximity to other foreign firms from the same sector *(n=153)*				
Kyiv region	5,7%	39,6%	54,7%	***
Lviv region	34,0%	14,0%	52,0%	
Kharkiv region	10,0%	18,0%	72,0%	
Proximity to the EU *(n=153)*				
Kyiv region	7,5%	41,5%	50,9%	***

Lviv region	56,0%	12,0%	32,0%	
Kharkiv region	8,0%	10,0%	82,0%	

Source: provided by author