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Developed economy investment promotion agencies and emerging market foreign direct investment: The case of Chinese FDI in Canada

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ABSTRACT

In light of the perceived benefits derived from inward FDI, many developed economies have systematically established investment promotion agencies (IPAs) to attract foreign investment. While IPAs in the past have been created by a wide variety of countries and regions, their target economies have overwhelmingly been in developed markets. The rise of emerging market MNEs is significantly changing this picture. We analyse the impact of IPAs on attracting emerging market FDI to developed economies by looking at the example of Chinese FDI into Canada. We find strong statistical evidence that the presence of Canadian provincial-level IPAs located in China increases the likelihood of Chinese firms locating in that Canadian province. Focusing on the role of IPAs in lowering liabilities of foreignness, we explore how differences in host and home country contexts may explain our findings.

1. Introduction

Attracting foreign direct investment (FDI) has become an increasingly important objective for developed economies. This is because inward FDI may have numerous benefits for host economies, including such things as access to capital, productivity spill-overs, innovation spill-overs and employment creation (Bobonis & Shatz, 2007). The benefits of FDI for developed economies, therefore, constitute a potentially significant source of economic growth. Alfaro, Chanda, Kalemli-Ozean (2006) for instance, found, 'increases in the share of FDI or the relative productivity of the foreign firm leads to higher additional growth in financially developed economies' (p. 1).

In light of the perceived benefits derived from generating FDI, many developed economies have systematically implemented policies which target foreign MNEs. Chief amongst these policies is the establishment of investment promotion agencies (IPAs) (Head & Ries, 2010). The establishment of IPAs to generate FDI is not, however, a new phenomenon. These policy initiatives have been actively pursued by both developed and emerging economies for well over 30 years (Morisset, 2003). While the sources of IPAs have traditionally been heterogeneous across global economies, target economies have overwhelmingly been developed economies, such as North America and Europe. Historically, focusing on generating FDI from developed economies made economic sense, as the vast majority of FDI flows came from developed country MNEs.

The rise of emerging market (EM) MNEs has fundamentally altered this one-way stream of FDI from developed economies to the rest of the world (Sauvant, Maschek, & McAllister, 2010). FDI from emerging markets now makes up an increasingly large share of global FDI flows. As of 2013, for example, EM firms constituted around 38% of all outward FDI flows globally (UNCTAD, 2014). China, for example, now invests heavily outside its borders to ensure such things as natural resource security (Zweig & Bi, 2005). The increasing importance of emerging markets as a source of FDI has not gone unnoticed and policy-makers in both developed and developing economies have looked to attract their share of these investments. Today, for example, the majority of IPAs representing the Canadian province of British Columbia are located in *emerging markets*, not developed markets. In fact, British Columbia has more offices in China than in any other target economy. The emergence of EM firms as important sources of FDI has created an aggregated focal shift in IPA policy strategy in some cases, and a simple expansion of the scope of IPAs to target developing economies in other cases.

Why might IPAs be a useful policy-tool? IPAs may lower the transaction cost of investing in a particular location through the dissemination of information and services that may not otherwise be readily accessible to foreign firms. IPAs may be effective in

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lowering a foreign firm's entry costs, particularly with regards to the liability of foreignness (LOF) in the host economy. LOF deals primarily with the fact that, 'multinational enterprises (MNEs) doing business abroad face costs (Hymer, 1976; Kindleberger, 1969) arising from the unfamiliarity of the environment, from cultural, political, and economic differences, and from the need for coordination across geographic distances' (Zaheer, 1995, p. 341). It is argued LOF presents barriers to entry for foreign firms and that the psychic distances (i.e. environmental, cultural, political, and economic differences) between two developed economies (such as Canada and Germany) are less than those between developed and developing economies (such as Canada and China) (Ronen & Shenkar, 2013). In this light, it is interesting to consider whether IPAs are now becoming more important facilitators of FDI flows, given the potentially greater psychic distances encountered in attracting investment flows from emerging to developed markets. It is perhaps not a coincidence that many IPAs have been established with the aim of targeting psychically distant emerging market firms, those with high levels of LOF. This expansion in scope, however, represents new challenges for developed economy IPAs, as they must look to effectively mitigate LOF and entice EM MNEs to undertake FDI in markets with which they are not familiar.

The academic literature on IPAs is limited. Several studies have analysed IPAs, in particular looking at the impact of IPAs on the generation of inward FDI to the region where the IPA is located (Bobonis & Shatz, 2007; Coughlin & Segev, 2000a; Head, Ries, & Swenson, 1999; Lim, 2008; Morisset, 2003; Wilkinson & Brouthers, 2000; Woodward, 1992). However, many of these studies are now dated. Moreover, as far as we are aware, the impact of IPAs on the investment behaviour of EM FDI has not been studied. This is a potentially interesting question, not only for policy related reasons (i.e. how do we formulate policies to attract EM MNEs?), but also because there are some interesting conceptual issues to explore. It is widely conjectured that EM MNEs may actually be different to developed market MNEs (Cuervo-Cazurra, 2012; Hennart, 2012; Narula, 2012; Ramamurti, 2012). While this question is far from resolved, if such things as EM domestic market institutions (i.e. home country-specific advantages) lead to idiosyncratic investment behaviours in EM MNEs (via, for example, their impact on firm-specific advantages), it is far from clear that the findings of the aforementioned IPA studies will apply to EM MNEs. There may also be EM MNE specific factors which influence the success or failure of IPAs. For example, a recently developed strand of literature suggests EM MNEs particularly seek strategic assets in developed markets (Luo & Tung, 2007; Mathews, 2006). If this is correct, perhaps developed market IPAs need to adjust their strategies accordingly. Such questions regarding the role of IPAs remain under-researched. By exploring IPAs of developed market origin working in emerging markets we may also be able to shed further light on the salient features of EM MNEs and the related conceptual discussions.

The primary question this study asks is, therefore, whether developed economy IPAs aid in the generation of FDI from EMs. We model FDI from a specific developing economy (China) to a specific developed market (Canada) using data from 2003 to 2013. More specifically, we evaluate Chinese FDI into Canadian provinces to explore how provincial-level IPAs impact the location decision of Chinese MNEs. Our empirical modelling draws primarily from constructs developed in mainstream International Business literature, including LOF and psychic distance, which predicts the propensity to invest in a location, ceteris paribus, may decrease with increased levels of psychic distance (Lim, 2008). Interestingly, we find that the presence of IPAs significantly increases the propensity for a Chinese firm to locate in a given province, giving some credence to the idea that IPAs may be an effective means of attracting EM MNE FDI to developed markets.

This paper proceeds as follows. First, we provide a literature review from which we develop our hypotheses. The data and methodology are then described, followed by the discussion of results, policy implications and conclusions.

2. Literature review and hypothesis development

2.1. Investment promotion agencies and FDI generation

IPAs are often governmental organizations, funded by regional or national government agencies, to promote inward investment. The impact of IPAs in generating FDI has been studied for over 25 years. The seminal work of Wells and Wint (1990) was amongst the first to question the effectiveness of IPAs in generating inward FDI. They determined IPAs offer benefits to countries in much the same way marketing campaigns benefit for-profit organizations. In an updated version of this work, Wells and Wint (2001) define IPAs rather broadly, as 'activities that disseminate information about, or attempt to create an image of the investment site and provide investment services for the prospective investors' (p. 4) (we also adopt this definition). They go on to identify four main functions of the IPA: image building, investor facilitation, investment generation and policy advocacy.

The task of image building is to create the perception of a given market as an attractive location for FDI at the national or sub-national level (Lim, 2008). An example of this would be Ontario, Canada's IPA branding its province as the financial centre of Canada. Ontario's IPAs, for example, prominently showcase the majority of banks in Canada being headquartered in Ontario, as well as having the largest stock market in Canada and a large number of finance professionals. Through branding itself as the premier Canadian location for financial investment, it hopes to gain the majority of foreign investment in this niche area.

Advising on, and sometimes expediting, approval processes, facilitating the purchase or lease of physical sites, setting up utilities accounts and the like all encompass the facilitator role IPAs play. According to Morisset (2003), '*Investor facilitation* and *investor services* refer to the range of services provided in a host country that can assist an investor in analysing investment decisions, establishing a business, and maintaining it in good standing' (p. 7). Canadian IPAs, for example, attempt to make applying for and obtaining business licenses a transparent process at both the provincial and national level. IPAs also provide highly specific services to help navigate complex rules, regulations and expectations of, for example, natural resource extraction FDI. More specifically, IPAs may give examples from past investments on how 'net socio-economic benefit' to the host country was derived. This will generally help investing organizations assess the potential value of the intended investment, as well as increase the chances of the investment being approved.

IPAs play an important on-the-ground role in nurturing positive relationships between target firms and their respective governmental counterparts. A further refinement to investment facilitation is, therefore, the role IPAs take in match-making and logistical support of high-level government-to-government relationships. Positive ambassadorial-level diplomatic ties have, for example, been found to facilitate increased levels of trade (Ciuriak, 2014). Regarding Chinese outward FDI, Zhang, Jiang, and Zhou (2014) recently found 'bilateral senior visits improve the awareness of, or foster the positive sentiment toward, the investing country, creating a more friendly investment environment for foreign companies to overcome the liabilities of foreignness' (p. 219). In many cases, IPAs act as an important facilitator of provincial trade missions headed by provincial premiers. British Columbia's Premier, Christy Clark, for example, led a trade mission to China in November 2013 with intentions to 'advance liquefied natural gas