International Business Review 21 (2012) 618–630

Contents lists available at ScienceDirect

International Business Review

journal homepage: www.elsevier.com/locate/ibusrev

A quantitative approach to guiding the promotional efforts of IPAs in emerging markets

Gordon Sirr [a,*], John Garvey [a], Liam Gallagher [b]

[a] Department of Accounting and Finance, University of Limerick, Limerick, Ireland
[b] Business School, Dublin City University, Dublin, Ireland

ARTICLE INFO

Article history:
Received 8 December 2010
Received in revised form 19 May 2011
Accepted 18 July 2011

Keywords:
Daily realised volatility
High-frequency data
Investment promotion agencies
Large multinational companies
Nationalisation

ABSTRACT

Investment promotion agencies (IPAs) engage in a range of promotional activities with the aim of improving foreign direct investment (FDI) inflows. However, at any particular time, they tend to concentrate their efforts towards image building or investment generation. The decision of where to focus promotional efforts depends on investors' perceptions of the IPA's location. In contrast to current methods, this paper employs an innovative quantitative finance approach that allows IPAs to speedily measure risk perceptions using real-time data. Using this approach, the paper focuses on determining whether or not the risk of nationalisation is a concern for large multinational companies in the natural resource sector. Our empirical results demonstrate that such companies are not concerned about nationalisation risk. The findings have implications for guiding the promotional efforts of IPAs, both in countries where nationalisation is a risk and in countries where changes in the political environment have reduced the risk of nationalisation.

1. Introduction

In emerging markets, FDI is considered an essential component of economic development. Countries around the world compete intensely to attract foreign investors and IPAs carry out various activities with the aim of improving FDI inflows. While IPAs engage in a range of promotional activities, evidence suggests they tend to focus their promotional efforts at any particular time towards image building or investment generation. Image building activities are conducted to build an image of a location as an attractive site for investment. Once an appropriate image of the investment climate is formed in the minds of prospective investors, IPAs tend to shift their promotional efforts towards investment generation activities (Wells & Wint, 2000). Thus, the focus of promotional efforts depends on investors' perceptions of the IPA's location.

For IPAs in emerging markets, determining investors' perceptions is a challenging task due to the presence of political risks that are generally not as prominent in developed markets. Moreover, a company's susceptibility to political risk can change over time due to changes in FDI policies of host governments (Oetzel, 2005). In this paper, we focus on changes in political risk that arise due to the intensification of populism in a host country. In such circumstances, there is a greater risk that changes in policy will adversely affect foreign investors as governments tend to give in to social and political pressures to redistribute wealth to the populace. A nationalistic ideology often underlies the populist fervour; therefore, host governments have a greater incentive to expropriate or nationalise foreign investments in order to meet the demands of the electorate. In Bolivia, such populist sentiment led to the nationalisation of the oil and gas sector. This paper uses financial market data to measure investors' perceptions around events that heightened the risk of nationalisation.

* Corresponding author.
E-mail address: gordon.sirr@ul.ie (G. Sirr).

0969-5931/$ – see front matter © 2011 Elsevier Ltd. All rights reserved.
doi:10.1016/j.ibusrev.2011.07.006

Specifically, we are concerned about the risk of nationalisation for large multinational companies in the natural resource sector. Attracting such companies is an important aspect of investment promotion as they are more capable of successfully entering and conducting business in foreign markets. In contrast to smaller companies, they have various competitive advantages in FDI, such as the ability to get financing more easily (Horst, 1972), more rapidly reach the limits of foreign markets (UNCTC, 1992) and make larger investments (Tan & Vertinsky, 1996). However, large companies are also more prone to attracting the attention of host country authorities (Henisz, 2000). Moreover, large natural resource companies have a greater capacity to exploit a host country and are therefore more susceptible to the risks of expropriation and nationalisation (Stosberg, 2005; Vaghefi, Paulson, & Tomlinson, 1991). In order to guide the promotional efforts of IPAs, this paper focuses on determining whether or not the risk of nationalisation is a concern for large multinational companies in the natural resource sector. The research has implications for IPA activity, both in countries where nationalisation is a risk and in countries where changes in the political environment have reduced the risk of nationalisation.

Up to now, the relationship between political events and financial market performance has been the subject of numerous studies. Much literature in political science, such as that of Gemmill (1992), has examined stock market responses to uncertain political events by mainly focusing on market movements in relation to elections. Lin and Wang (2007) point out that further empirical research has explored the impact of a variety of political uncertainties that may be related to capital markets, such as strikes, boycotts, terrorist acts, macroeconomic management, monetary policy, legislation, and social and political evolution. In comparison to previous literature, the distinguishable feature of this paper is that it focuses on the market's perception of the risk of nationalisation in a populist political environment by applying an innovative quantitative finance approach for measuring the market's reaction to specific events. High-frequency data (HFD) for companies on the London Stock Exchange (LSE) that were affected by the nationalisation of oil and gas resources in Bolivia are used to accurately measure volatility changes around events that preceded and paved the way for the nationalisation. It is possible to exploit these financial market data for the purpose of measuring the political risk perceptions of IPA clients as equity investors have the same concerns as IPA clients in relation to risks that may adversely affect the future profitability of the company. Moreover, it is not just short-term risks that concern investors as numerous studies demonstrate that they generally undertake investments over a long-term horizon (Investment Company Institute and the Securities Industry Association, 2005; Ipsos MORI, 2002).

At present, investors' perceptions are measured using qualitative methods and IPAs are advised to refer to publicly available reports on their location and investment climate (MIGA, 2010). Surveys of business conducted by political risk insurance (PRI) providers are also used to measure perceptions of political risks. These methods only provide a measurement of risk perceptions at a point in time; thus, they become outdated with developments in the political environment. Furthermore, they are limited as to the information they provide about specific companies' perceptions of risk. The innovative approach that is utilised in this paper allows for the timely identification of changing risk perceptions and has the potential to guide the promotional efforts of IPAs. It provides a means for IPAs to quantitatively measure risk perceptions and base their promotional efforts on more up-to-date and relevant information. It allows IPAs to immediately identify the extent of investor concern and enables them to speedily determine whether image building or investment generation activities should be conducted to attract FDI. Moreover, it provides IPAs with a method to assess the risk perceptions of specific companies. In this context, our approach can guide the promotional efforts of IPAs in attracting targeted investment.

2. Literature review

2.1. Attracting FDI through IPA activities

Foreign investment is considered by many policymakers and international financial institutions to be an essential part of economic development, especially in developing countries. Policymakers believe that FDI can contribute to faster economic growth by increasing capital and advancing technology in such countries. Empirical evidence also suggests that FDI may lead to positive productivity spillovers to local firms. Due to these various benefits, countries around the world compete intensely for FDI.

For many years, developing countries have lagged behind developed countries in attracting foreign investors. For instance, UNCTAD (2007) reveals that developing countries only received 38.6 percent of total global FDI inflows in 2005. Moreover, a significant proportion of the FDI inflows to developing countries are concentrated in a few countries, whereas the majority of developing countries seemingly fail to attract FDI. According to UNCTAD (2007), China, Columbia, Egypt and Indonesia received almost 31 percent of total FDI inflows to developing countries in 2007, whereas some developing countries, such as Bolivia, faced the problem of negative FDI inflow. Taking into consideration both the benefits of FDI and the failure of developing countries in attracting foreign investors, an important issue for policymakers in developing countries is how to attract FDI (Harding & Javorcik, 2007).

In recent decades, the promotion of investment has become recognised as an essential component of attracting inward investment, especially in emerging markets. As a result, there has been a rapid growth in the number of IPAs throughout the world. Since its establishment in 1995, the World Association of Investment Promotion Agencies (WAIPA) has recorded an increasing number of members from a wide range of locations worldwide. For instance, the number of registered IPAs increased from 112 in 2002 to 191 in 2006 (Zanatta, Costa, & Filippov, 2006). These agencies strive to promote investment