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A Stakeholder View of Foreign Direct Investments and Regional Development

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We introduce a stakeholder view to analyze the impacts of foreign direct investments (FDI) on regional development. We propose a scheme to measure the impact over time and apply our view to Dunning's four types of FDI. The stakeholder view enables us to understand which stakeholders benefit more and which less in different types of FDI. We argue that efficiency-seeking FDI has the highest potential for regional development, followed by resource-seeking FDI and market-seeking FDI. Furthermore, FDI requires investments in the short term, and benefits will occur in the long term, so its success depends on adopting a holistic long-term orientation.

Foreign direct investment (FDI) has been growing at a fast rate starting the 1990s despite some level of slowing down recently due to political tensions and the Covid-19 pandemic. Especially in developing countries and in Central Eastern Europe inward FDI has gained great importance. The governments have been offering incentives with the aim to attract FDI so that domestic firms can benefit from advanced technologies and managerial know-how brought in by FDI.

The European Union (EU) aims for the sustainable growth of competitive and innovative regions. It allows member states to subsidize investments in line with the Lisbon strategy (Commission of the European Communities, 2005; European Council, 2000). However, the EU's parallel concern is to create similar conditions of competition in all member states (Commission of the European Communities, 2007) and to create barriers to overspending by member states and race for foreign investments. Such a race might be unsustainable and even damaging for the member states and the EU.

Location theory, of New Economic Geography, concentrates on linkages, network embeddedness, and integration of newcomer companies while explaining agglomeration and industry concentration (e.g., Krugman, 1991; Porter, 1998). Scholars argue that FDI and its spillover effects stimulate growth in regions (Gugler & Brunner, 2007; Iammarino, 2018; Markusen & Venables, 1999).

The impact of FDI in host countries is a key research question in international business (IB) research (e.g., Buckley & Ghauri, 2004; Buckley & Lessard, 2005; Driffield & Love, 2007; Dunning, 1998; Dunning & Lundan, 2008; Santangelo, 2018; Sass et al., 2018; Spencer, 2008). The focus of both IB and economic geography (EG) research is on the build-up of backward (supplier) linkages as the key

for a less developed region to gain from the FDI and take-off. However, research findings have been inconclusive (Görg & Strobl, 2001; Spencer, 2008).

The aim of this research is to clarify the pros and cons of FDI in a more synthesized way by stakeholders. For that reason, we suggest focusing on the costs and benefits of the FDI on all stakeholders in the host region over time and based on that, we propose a broad framework for measuring the impacts of the FDI. This differentiated stakeholder framework allows us to see which stakeholders have benefited more from the FDI and which ones less. With this framework, we aim to provide a complementary perspective to the extensive, however inconclusive contributions of IB and EG research.

The paper is structured in the following manner. First, we review related IB and EG literature about the impacts of FDI in host regions. After that, we present our arguments for making use of the stakeholder perspective and develop our framework. Finally, we discuss the applicability of our framework and make suggestions for further research.

Impacts of FDI in Host Regions

International Business Perspective

IB research on foreign production extensively addresses problems of strategic behavior, knowledge management, and location (e.g., Buckley, 2002; Buckley & Lessard, 2005; Kogut & Zander, 1993; Spencer, 2008). They often emphasize that FDIs may be necessary to overcome hurdles from being regionally peripheral (Driffield & Love, 2007; Dunning, 1998; Hunya, 2001; Kalotay, 2004; Kojima, 2000; Meyer & Gelbuda, 2005; Ozawa, 2001). In his eclectic paradigm, Dunning (1998) identified the motives behind multinational enterprises (MNEs) engaging in FDI: seeking resources, markets, efficiency, and strategic assets.

Resource-seeking FDI involves a large initial investment in the region, transferring capital, technology, and know-how. There are few linkages to the local product and labor markets (Nunnenkamp & Spatz 2004). The aim of this type of FDI is to secure the supply in the value chain (Eckert & Rossmessl, 2005). The oil and gas industry is a good example, where MNEs invest in oil and gas-rich regions. In this type of FDI, the macro-economic benefits for the host region can be easily endangered by corrupt local elites (e.g., Bjurling, 2006; Gunton, 2003).

Market-seeking FDI is a response to eliminate the costs of serving a foreign market from a distance, and it benefits the local customers by increasing the variety of products and services and enhancing the level of competition (Nunnenkamp & Spatz, 2004). However, crowding out local competitors may be a danger, especially when the MNE commands superior market power, and this type of FDI does not necessarily generate export revenues for the host region (Villar et al., 2020).

Efficiency-seeking FDI aims to reduce input costs (e.g., labor costs) in manufacturing industries by taking advantage of the factor endowments of the host region. This type of FDI may bring in more compatible technology and know-how and offer spillover benefits to local suppliers and competitors (Nunnenkamp & Spatz, 2004). Production from efficiency-seeking FDI is usually oriented to world markets, so it is expected to generate export revenues for the host region (Villar et al., 2020).

Strategic asset-seeking FDI usually involves the acquisition of assets in host region companies to improve the competitiveness of the MNE (Dunning, 1998). This has been a preferred motive for MNEs from emerging markets, which lack strategic assets (Gao et al., 2019). The successful harmonization of backward and forward linkages plays a vital role in the success of this type of FDI (Buckley et al., 2012).

This classification is not always easy to make in practice since MNEs often have multiple motives. Motives can also change over time. As a result, different stakeholders of the host region may be affected differently by a certain FDI at different points in time (Nunnenkamp & Spatz, 2004).

FDI may create technological externalities (Blomström & Kokko, 1998; Buckley et al., 2007). IB research acknowledges this and focuses on two types of effects on the host region's productivity development: direct effects on the recipient firm's productivity, and indirect effects on the productivity of other local firms through spillovers from the MNE. There are four types of spillover effects, namely the demonstration-imitation effect, the competition effect, the foreign linkage effect, and the training effect (Blomström & Kokko, 1998). The host region's capacity to absorb and benefit from FDI, however, depends on the technology gap between the superior technology brought in by the investment and the technology in the recipient region (Kokko et al., 1996; Sjöholm, 1999). Transferring to a less developed region requires trained local workers. If there is a large technology gap, there may be no absorptive capacity (Guimón et al., 2018). Thus, the better the endowment of human capital, the more local firms benefit from the technology transfers, but there may not be spillover effects in cases in which the MNE takes the best workers, and there is no turnover of the workers from the MNE to local firms (Nunnenkamp & Spatz, 2004).

Economic Geography Perspective

Economic geography studies economic activity from a location perspective in terms of concentrations of enterprises and people (Krugman, 1991). The forces behind the concentration of economic activity are market size, dense labor market, and linkages (Krugman & Venables, 1995; Venables, 1996). Backward linkages are created when the initial investment creates demand for local suppliers (Pavlinek, 2018). Following this, local suppliers may improve their productivity and quality so that other MNEs and local end producers enter the host region, which creates forward linkages. As a result, cumulative causation or a virtuous circle with new backward and forward linkages may come into play (Markusen & Venables, 1999). Change in demand due to backward linkages may increase profit, attracting new companies to the market. Since prices of goods supplied eventually decrease, more products can be sold, and that feeds back to the original industry. Furthermore, clustering also triggers beneficial externalities such as innovations via information spillover (Sölvell et al., 2003). The ability to innovate depends on the stock of research and development (R&D), experience-based know-how, specialized labor force, and infrastructure in the host region (Ghebrihiwet, 2019; Porter, 1990).

In terms of these factors, there may be significant differences among locations, and industrial concentration may not always be explained by the evolution of industrial linkages (Crescenzi et al., 2014). Concentration may also be the consequence of technology change, economic policy change, and gravitation towards international trade and collaboration. Sectors that use intermediate goods in production intensively and have a high level of economies of scale are more likely to exhibit agglomeration and specialization (Tohmo et al., 2006). Krugman and Venables (1995) argued that there can be some flexibility in location decisions at the beginning, but, with the advance of the agglomeration process and the unfolding of backward and forward linkages in the cluster, the level of flexibility diminishes.

Economic geographers also study how FDI affects local firms. Similar to what is argued in IB research, openness to trade is considered a prerequisite since MNEs increasingly pursue complex integration strategies (Theyel et al., 2018). Unrestricted import of intermediate goods is required, and the transfer of modern technology and know-how may depend on the institutional development of the host region (Ghebrihiwet, 2019; Sadler, 1999). According to Markusen and Venables (1999), these create two types of effects on the industry. One effect is *competition* in product and factor markets. This may reduce the profitability of local firms within the same industry but at the same time may benefit other sectors. For example, price reduction and forward linkages may benefit customers, and that may increase demands for other local outputs. This strengthens supply industries, and that may create forward linkages in the

cluster. The second effect is the *linkage* effect to supplier industries, which reduces input costs. In assessing these effects, Markusen and Venables (1999) introduced three sources of costs and benefits. First, FDI creates technological externalities for the local economy as knowledge spillovers and demonstration effects. Second, FDI interacts with fixed distortions in the local economy, such as the local tax system. Third, FDI may change the supply and demand in imperfectly competitive industries. In sum, FDI can be a catalyst for the development of the host region which is expedited by foreign capital, entrepreneurial activity, and technology, as presented for example with the flying geese pattern in South-East Asia (Kojima, 2000; Ozawa 2001).

There may be a worst-case scenario, too. It is the case of a dependent region, organized around the production of the MNE (Hanson, 2001). In such cases, the government is in a weak bargaining position, and often the macro-economic benefits are endangered by corrupt local elites (Nunnenkamp & Spatz, 2004). In such a case, the host region will lack backward and forward linkages. Furthermore, the foreign dominance of production may hinder the development of entrepreneurial activity in the region that would diversify the economy, an important factor for a region to take off (Menzel & Fornahl, 2010). The low variety of companies and technologies may be a reason for negative development in regions (Sölvell et al., 2003). Economic development in positive cases occurs with the diversification of the economy around export-oriented activities.

A Stakeholder View of FDI and Regional Development

After reviewing relevant literature in IB and EG research, one may still call for a more synthesized way to understand development in the host region resulting from FDI. This is because one can neither see the influences of an FDI on different groups in the host region (other than suppliers) nor measure systematically the benefits earned and the costs incurred by the host region over time.

Our suggestion is to focus on the input-compensation relationships between the investing MNE and the stakeholders of the host region. In doing so, first, we need to define who are the host-country stakeholders. In a broad sense, stakeholders of a firm are those organizations or individuals who can affect or be affected by the achievement of the firm's goals (Freeman, 1984). In a narrow sense, they are individuals or organizations who depend on the firm to realize their goals, and whom the firm needs to execute its operations (Rhenman, 1964). Clarkson (1995) distinguishes primary stakeholders from secondary stakeholders. Primary stakeholders are those actors defined by the narrow-sense definition, including shareholders, employees, suppliers, distributors, creditors, customers, and the government. Primary stakeholders have an interdependent relationship

with the firm in that they make inputs to the firm and receive compensation in return (Ahlstedt & Jahnukainen, 1971). Inputs from the selected groups of primary stakeholders are capital (shareholders), labor (employees), raw materials and intermediate products (suppliers), distribution services (distributors), loans (creditors), money for products (customers), and infrastructure (government). The corresponding compensations for these primary stakeholders are dividends (shareholders), wages (employees), revenues (suppliers, distributors, and creditors), products (customers), and taxes (government). Secondary stakeholders do not possess a tight and continuous interdependency with the firm as the primary stakeholders do. They may be local competitors, media, and local society. We argue that regional development occurs through creating benefits for the host region's stakeholders (See Figure 1).

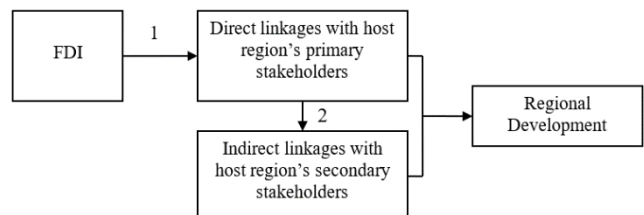


Figure 1. A stakeholder view of FDI and regional development

Our framework assumes that the core FDI creates direct linkages, i.e., input-compensation relationships, between the MNE and its primary stakeholders in the region (See Arrow 1 in Figure 1). These direct linkages may trigger indirect linkages with secondary stakeholders in the host region (See Arrow 2 in Figure 1). For example, increasing activity in the region may stimulate the attention of the media or affect the strategies of local competitors. Regional development will be realized when the total benefits to the host region's stakeholders exceed the related costs. What are the costs and benefits for each of these groups of stakeholders? How could we measure them separately and come up with an overall measure of regional development? How does this framework apply in the context of the FDI typology by Dunning (1998)? We tackle these issues next.

Costs and Benefits for Stakeholders

In answering the first question, we need to address the benefits and costs for each group of stakeholders in the host region separately (See Table 1).

Table 1. Costs and benefits of the FDI to host region

stakeholders

Primary stakeholders		
Stakeholder	Costs	Benefits
Local shareholders	Cash outflow for new investment	Dividends earned
Local employees		Additional employment
Local suppliers	Cash outflow for new investment	Additional cash inflow from operations
Local distributors	Cash outflow for new investment	Additional cash inflow from operations
Local creditors		Additional cash inflow from operations
Local customers		Lower prices
Host government	Investment incentives for FDI, cash outflow for additional investment for infrastructure, loss of tax revenues from imports	Additional tax revenues
Secondary stakeholders		
Stakeholder	Costs	Benefits
Local competitors	Loss of cash inflow from operations	
Local media		Additional cash inflow from operations
Local society		Charity work, donations

To achieve that, we benefit from financial tools. Costs are defined here as all kinds of quantifiable increases in cash outflows (or decreases in cash inflows) in time by stakeholders due to the FDI. Vice versa, benefits are all kinds of quantifiable increases in cash inflows (or decreases in cash outflows).

Local shareholders: The FDI can be undertaken by the foreign MNE as a wholly-owned subsidiary or a joint-venture (JV) with local shareholders. We can talk about costs and benefits for local shareholders only in the case of JV. In that case, the costs for local shareholders would be the capital they invest in the JV, and the benefits would be the dividends they earn during the lifetime of the JV.

Local employees: The FDI is most likely to create new job opportunities in the host region. It is difficult to imagine costs for employees who start to work in the new plant. Direct benefits could simply be measured by the additional wages created from the FDI, i.e., the total payroll of the affiliate in the host region. There could also be indirect benefits of the FDI to increasing employment in the region. These could be achieved through additional employment for all stakeholders in the region due to increased activity and entry of other foreign stakeholders into the region. Both direct and indirect benefits should be considered in the calculations.

Local suppliers: Local suppliers benefit from the FDI by earning new contractual revenues, i.e., increased cash flow from operations. In earning the additional cash flow from operations, local suppliers may also need to make initial investments, e.g., new machinery or a new plant, to satisfy the needs of the FDI. This necessitates an initial cash outflow for investments, which is considered in this research to be the cost for local suppliers. Local suppliers can also benefit indirectly from the entries of the investing MNE’s competitors in the region.

Local distributors: The costs and benefits for local distributors are like those for local suppliers. Initial additional cash outflow for new investments is considered a

cost and earned additional cash flow from operations is considered a benefit. Local distributors can also benefit indirectly from the entries of the investing MNE’s competitors in the region.

Local creditors: Local creditors benefit from the FDI since all investments need additional financing. The more this financing is realized through local creditors, the higher the benefits for them. Accompanying investments in the region bring indirect benefits to local creditors.

Local customers: Local customers also benefit if the FDI results in a decrease in the prices of products. Such price decrease could result from cheaper production in the host region or the elimination of import duties. In the latter case, the benefit to customers would be a cost to the host government.

Host government: The host government may be faced with high costs in the beginning. It may need to give tax incentives for the FDI to attract it to the region, or it may need to invest in new infrastructure. Benefits for the host government will be realized later through increasing tax revenues when the investing MNE and all stakeholders earn profits resulting from the FDI.

Secondary stakeholders: The measurement of costs and benefits is more difficult in the case of secondary primary stakeholders since they lack the input-compensation relationship. Local competitors can lose market share, resulting in costs in terms of loss of operational cash flow. Local media can benefit from increased economic activity, but this benefit would probably be limited. With increasing prosperity, local society could benefit from donations and charity work undertaken by all stakeholders in the region.

Measuring the Net Benefit for Stakeholders

We should note that the costs and benefits incur at different times for all stakeholders. Therefore, we should take a longitudinal approach and consider the time value of cash flows in our measurements. We do this by using the financial concept of *net present value* (NPV) in measuring the net benefits of the FDI. This concept discounts all future cash flows (CF) by a certain annual discount rate, r.

$$NPV = CF (Year 0) + CF (Year 1)/(1+r) + CF (Year 2)/(1+r)^2 + CF (Year 3)/(1+r)^3 + + CF (Year n)/(1+r)^n$$

Figure 2. The net present value calculation for stakeholders

Based on this formula we define the net benefit of the FDI for a particular stakeholder to be the net present value of all the benefits minus costs during the lifetime of the FDI. We also define the net benefit of the FDI as the sum of the net benefits for all local stakeholders.

Applying the Framework to the Typology of Dunning

(1998)

In *resource-seeking* FDI, the MNE makes a capital investment in the region for the infrastructure to extract the resources, e.g., oil and gas. This investment can also be in the form of acquiring existing infrastructure and upgrading them. In the case of a green-field investment, the MNE is likely to utilize local construction companies as suppliers. Linkages with suppliers will be limited to maintenance and running of daily operations (e.g., the supply of food and stationery). There will also be a need for transportation suppliers when exporting the resources, creating forward linkages. The government will benefit the most from this type of FDI in terms of taxation operating the resource fields as well as corporate taxes and revenues from the export of the resources. The MNE will utilize mostly local employees in production, and that will also contribute to the local society. There may be local shareholders if host country regulation demands so, but the control of the operations will be with the MNE. The need for distributors in the region will be limited to that portion of the resource that will be consumed locally. There may also be a limited need for local creditors if the MNE receives funding from international sources. Nevertheless, multiple stakeholders will benefit from this type of FDI.

In *market-seeking* FDI, the investment of the MNE can be limited to a sales office in the host region. In that case, there will be little employment limited to mainly sales and marketing activities, and the primary beneficiaries will be local distributors and local customers. In addition, local media will earn advertisement revenues, while the host government will enjoy tax revenues. If the sales subsidiary will be a joint venture with a local company, local shareholders will also benefit. In case the MNE decides to establish a manufacturing FDI to meet local demand, benefits will extend to local suppliers and local employees as well.

In *efficiency-seeking* FDI, we assume the acquisition or establishment of manufacturing operations in the host region. The manufacturing plant is of a larger scale compared to resource-seeking or market-seeking FDI, targeting both local demand and exports. Automotive manufacturing in Eastern Europe, targeting mainly demand in Western Europe is a good example of this type. There will be both backward and forward linkages in this type of FDI, benefiting mainly local employees, local suppliers, host government, and local society.

Finally, in *strategic asset-seeking* FDI, there is a change of ownership from local shareholders to the MNE. As such, it does not necessarily mean additional investments and the accompanying creation of new jobs in the region. On the contrary, there is a risk that the MNE initiates a restructuring project to reduce costs or even to move operations out of the region. This leaves the region vulnerable to costs on local employees, local suppliers, host government, and local society.

In the light of the above discussion, we believe that the efficiency-seeking FDI has the highest potential to contribute to regional development, followed by resource-seeking FDI and market-seeking FDI. In the case of strategic asset-seeking FDI, we are more likely to consider potential costs than benefits.

Discussion

The stakeholder perspective offers an accurate way of understanding the impacts of FDI on the host region. It may be subject to two difficulties in implementation. First, it may not be easy to measure benefits and costs, especially the indirect ones. Second, such an analysis can only be made once the lifetime of the FDI is over. For ongoing FDI or for FDI which has not been undertaken yet, we would need to predict future benefits and costs. A third limitation of our framework arises from the fact that not all benefits or costs are easily quantifiable. How could we quantify the costs of pollution caused by the FDI on the local society? Or how could we quantify benefits from knowledge spillover? As a result, our framework is limited to quantifiable costs and benefits only.

Despite these limitations, the developed framework offers valuable insights for decision-making. An important insight is that costs are usually upfront, and benefits are realized after stakeholders start to make profits from their investments. This insight makes us realize that FDI can lead to regional development only in the long run. Failure at early stages not only hinders regional development but also incurs high losses to all stakeholders in the region. Therefore, all stakeholders, and primarily the host government, should pay utmost attention to the FDI's long-term success. This can be achieved by long-term orientation and the adoption of systems thinking by stakeholders. Opportunistic behaviors by any of the stakeholders during the early stages of the FDI can harm regional development and thus should be avoided.

A second insight is that benefits and costs are different for all stakeholders. It seems at first sight that benefits should outweigh costs for all stakeholders except for local competitors, but this may not be the case. Power relationships between the investing MNE and each group of local stakeholders may play a role in determining which of the stakeholders will benefit more from the FDI. We need empirical research to find out more about differences in benefits to different stakeholder groups and the causes behind these differences. This research provides an initial framework for conducting such empirical research. Such an understanding may be important for policymakers for influencing the distribution of wealth in the host region. Taking a longitudinal approach, we may also better understand how dependent the host region can become on the FDI and how the bargaining power of the host government can change over time.

A third insight is that benefits are likely to be higher for

primary stakeholders than secondary ones. Indeed, most of the benefits are realized by primary stakeholders, and then some of them are redistributed to secondary stakeholders. This is an important insight because we cannot speak of regional development if the benefits are restricted to a certain group of stakeholders. How could the benefits be distributed to a larger group in the region? Our research raises awareness of this issue, but further longitudinal research is needed to come up with answers. As we take the time dimension seriously, we may follow the emergence of new entrepreneurial classes in the region. We can analyze whether that is just a supplier to the MNE, or it is also capable of undertaking independent businesses that would diversify the structure of the economy in the region. From the regional perspective, we may consider how varied firms and technologies become in the region because of the FDI.

Finally, our proposition for a more detailed cost-benefit analysis of host-region stakeholders is not an alternative to IB or EG research on FDI. Rather, it offers a complementary perspective for measuring the impacts of the FDI separately for various groups of stakeholders. Combining insights from all three perspectives and conducting longitudinal research can produce valuable knowledge for a better understanding of the impacts of the FDI on host regions, the behaviors of different stakeholder groups during both the planning and the implementation stages of the FDI, and ultimately the possibilities for the region to develop.

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