

Chapter 13

Four Fundamental Factors for Increasing the Host Country Attractiveness of Foreign Direct Investment: An Empirical Study of India



Hwy-Chang Moon and Wenyan Yin

Abstract Protectionist policies and recent coronavirus outbreak have made it more difficult for host countries to attract Foreign Direct Investment (FDI) and require governments to enhance their country's attractiveness for adapting to this changing environment. In this respect, this study introduces four fundamental factors that improve the inflow of FDI by comparing them with conventional elements that are commonly considered as being positive for such inflows. Unlike traditional factors that particularly stress what resources the host countries must possess in order to attract FDI, the fundamental factors suggested by this study emphasize more the *how* aspects, the effective way to utilize and mobilize a country's available resources. Furthermore, in order to understand better the importance of these factors, it uses India as an illustrative example. The Modi government introduced its "Make in India" policy to enhance its manufacturing sector by attracting FDI, yet such inflows to the manufacturing industries have remained very low. Thus, India requires more systemic measures for improving its business environment. By comparing its FDI attractiveness based on the four factors against nine other Asian economies, this study identifies strengths and weaknesses of India. It then suggests a series of strategic guidelines for enhancing India's FDI attractiveness.

Keywords Foreign direct investment (FDI) · Host country · Attractiveness · India · Make in India

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K. B. Misra (ed.), *Handbook of Advanced Performability Engineering*,
https://doi.org/10.1007/978-3-030-55732-4_13

13.1 Changes in Global Investment Environment and Challenges for Host Countries

The Trump administration's "America First" policies have strengthened the intensity of protectionism and reshoring in the USA. Such measures have had a major impact on the global investment environment, as the USA has long been one of the largest sources for outward Foreign Direct Investment (FDI). The main objective behind this policy is to impose high import duties on Multinational Corporations (MNCs) as a way to induce a transition from the long espoused "export strategy to the USA" to an "FDI strategy in the USA." At the same time, the Trump administration introduced a series of policies to improve the US investment environment by relaxing regulations and improving the efficiency of the government's operations. In fact, not only more US companies operating overseas but also foreign MNCs have invested in the USA in response to this policy approach (Economist [1], Moon and Yin [2]; Wall Street Journal [3]).

The recent United Nations Conference on Trade and Development (UNCTAD) report [4] has acknowledged that US tax reform contributed to the reduction of its outward FDI flows while global FDI inflows have witnessed a decline in both 2018 and 2019. However, MNCs do not just respond to government policies, rather they would make the decision to invest based on whether the host country has sufficient investment attractiveness or not. It may then seem like that the Trump administration pressured many of these MNCs, but a careful analysis of their true motivations will show that their decisions are based more on the fact that the USA enjoys strong investment attractiveness and offers many business opportunities (A.T. Kearney [5]; Moon and Yin [2]).

Global FDI inflows remain flat, with a 1% decline from US\$1.41 trillion in 2018 to US\$1.39 trillion in 2019 (UNCTAD [4]). FDI flows to developed countries decreased by a further 6% to an estimated US\$643 billion, a historically low level, and FDI flows to developing countries remained unchanged compared to the previous year. The weaker macroeconomic performance and uncertain investment policies for firms such as the ongoing USA–China trade tensions were the main reasons behind the global downturn of FDI flows. Furthermore, with the current outbreak and spread of the coronavirus, global FDI flows may shrink by 5–15% and may hit the lowest levels since the Global Financial Crisis of 2008 (UNCTAD [6]). Therefore, it can be expected that competition in the future among countries will become more intense toward attracting FDI.

In order to sustain FDI inflows, the most important policy objective for governments is to enhance investment attractiveness. The locational determinants of FDI flows have long been investigated by previous studies and the conventional view has often emphasized the importance of production costs, labor skills, technical and managerial knowhow, infrastructure adequacy, and institutional quality (Du et al. [7]; Singh [8]). Although these factors do influence the FDI attractiveness of host countries, they may not be always applicable or doable for all countries which are at different development stages. Moreover, some factors often require a long period

of time in order for a country to enhance their competitiveness to a level that would satisfy global investors. In this respect, this study¹ seeks to introduce four fundamental determinants that affect FDI attractiveness. Unlike preceding studies that mostly emphasize “what” factors of locational advantages, the four factors stress “how” aspects and well explain why countries endowed with similar resources show better performance in attracting FDI. Therefore, the four factors are particularly useful in providing strategic directions for developing countries to effectively mobilize and integrate the available resources to improve FDI attractiveness.

The rest of this study is organized as follows. It begins by presenting the four fundamental determinants that affect FDI attractiveness of host countries. We then take the case of India. We examine first the status of its FDI inflows and assess the effectiveness of the “Make in India” policy in particular adopted in 2014 to revitalize its manufacturing competitiveness. To better understand the relative strengths and weaknesses of India compared with its Asian counterparts, we then conduct a comparative analysis of nine other Asian economies by comparing the four key determinants. Based on the above investigation and analysis, this study provides a series of policy implications and strategic directions for Indian policymakers by applying the global value chain (GVC) approach, which encompasses not only trade but also various international means including investment and non-equity mode (NEM).

13.2 Four Determinants of FDI Attractiveness²

Dunning [9] classified the motivations for MNCs into four categories: resource-seeking, market-seeking, efficiency-seeking, and strategic-asset-seeking FDI. Hence, in order to attract FDI from firms with these four factors, the host country should have advantages of abundant natural resources, large market, cheap labor, or superior technology embedded in a specific field. However, these factors are featured as either inherited advantages or are difficult to emulate for all countries, particularly developing economies.

Moreover, with respect to manufacturing industries, previous studies have found that cheap labor is often an important factor in influencing FDI inflows. However, this stands in contrast to the fact that MNCs’ automation rate for the production process is increasing while the proportion of labor costs in total production costs is decreasing. For example, the Taiwanese company Foxconn, which makes half of the world’s iPhones, plans to fully automate 30% of its production by 2020, and it has already reduced more than 400,000 jobs by using tens of thousands of robots from

¹This study was extended and further developed from Moon and Yin’s [44] study titled “Chap. 1: Strategic Direction for Promoting FDI in India,” which is a part of report entitled, *Policy Recommendation for the Development of Invest India*, prepared by KOTRA, Korea.

²The four factors in this part are correlated with the four elements in Moon’s [36] Korea’s economic development strategy which include agility, benchmarking, convergence, and dedication.

2012 to 2016 (South China Morning Post [10]). Therefore, low labor costs are no longer a critical factor in attracting FDI to the manufacturing sector.

Accordingly, other aspects are required to assess the overall investment attractiveness in a more comprehensive and systematic manner. In the section below, we present four more fundamental and doable factors for host countries to attract FDI, by comparing with the four general factors that are commonly believed to enhance a country's FDI attractiveness.

13.2.1 Cheap Labor Versus Productive Labor

Theoretically, low-cost labor is considered as an important determinant for MNCs to invest abroad in developing countries (Dunning [9]). Thus, they should possess a comparative advantage with labor, particularly with low wages, in order to attract FDI from developed countries. Yet, while developing countries have a comparative advantage of low-cost labor compared with advanced countries, there is no significant difference in wages among developing countries. In this case, given the cheap labor among developing countries, labor productivity becomes a more important determinant for attracting FDI. Empirically, Campos and Kinoshita's [11] study found that there were no significant effects with labor cost on FDI inflows. They argued that labor cost should be adjusted for labor productivity, and low wage rates alone are not a good indicator of labor cost advantages. Other studies (Redding and Venables [12], Ma [13]) found that although MNCs prefer low-cost labor countries, they will not simply move to less developed regions of a certain country, but rather they will tend to seek the regions with a qualified labor force. Our study defined productivity as an indicator for addressing both aspects of speed and precision; yet preceding studies were mostly focused on the speed aspect only.

This logic explains well why Apple and Samsung Electronics selected China and Vietnam, respectively, as the locations for the production and assembly of their smartphones. Although the wages of China and Vietnam are lower than those of some emerging economies such as the "Four Asian Tigers," they are higher than those of other developing countries such as Cambodia, Indonesia, and the Philippines (Moon and Yin [2], Yin [14]). Samsung's smartphone factory is located near Hanoi, the capital of Vietnam, while Apple's smartphone factory is located in Guangdong province. Both are the most expensive regions in the two countries (Yin [14, 15]). Therefore, low wages alone do not adequately explain why Vietnam and China were selected as the manufacturing base for these two large smartphone producers. Instead, the productivity of Chinese and Vietnamese workers is much higher than that of neighboring countries. In Vietnam, the labor cost of unskilled workers is only one-sixth of that for their counterparts in South Korea (Korea, hereafter), but there is no significant difference in labor productivity between Vietnam and Korea (Moon and Parc [16]). On the other hand, Chinese production plants are much bigger and more efficient than their counterparts in the USA, and thus have a high degree of agility to respond quickly to requirements in a changing international environment.

13.2.2 Better Environment Versus Adapting to the Global Standard

Government policies toward attracting FDI appear to emphasize what they have achieved over a certain period. For example, the Modi government in India has set its goal of becoming one of the top 50 places in the world for World Bank's ease of doing business index and has been working to create a good business environment. In order to enhance its attractiveness for foreign investment, India is seeking to improve the business environment by reducing corruption and improving its general infrastructure and has already achieved significant improvement in these fields. In 2020, India was ranked 63 among the list of 190 countries in the ease of doing business index, and this is a significant improvement from its 2014 ranking of 142. This would suggest that the macroenvironment has improved since the Modi government took office in 2014. Furthermore, out of the 12 macroeconomic indicators selected by the *Wall Street Journal* in 2016, India demonstrated a stronger performance across eight indicators when compared with the previous government (Wall Street Journal [17]).

In general, multinational managers often compare foreign countries where they can better exploit local resources and complement their asset portfolios as well as enhance their overall competitiveness (Moon [18]). While it is necessary to regularly improve the business environment and build upon past performances, it is more important to adapt to the international standard in terms of institutional regulations and industrial and living infrastructure. Such a factor can influence the MNCs' overall operational costs directly or indirectly. Notably, in an era where the value chains of firms have become more global and finely sliced up, host countries will be less likely to take on their entire value chain. Instead they will only host part of their value activities which reveal how they must adapt to a changing business environment and follow global best practices in order to ensure smooth and effective linkages among the value activities of MNCs dispersed among different regions of the world. Therefore, it is important for the host country to regularly compare strengths and weaknesses against their rivals, and secure higher investment competitiveness. Moreover, in addition to benchmarking the global best practices in terms of FDI attractiveness, the host country can further improve its attractiveness and outperform its rivals by adding plus alpha to better serve the investment needs of MNCs.

13.2.3 Entire Country Versus Industry Cluster

The mainstream literature of International Business has mainly adopted the entire country as the geographic unit of analysis for locational selection of FDI flows (Qian et al. [19]). However, when an MNC invests in a particular country, it tends to be in a specific area rather than the entire country, so regional competitiveness has become a more influential factor for MNCs when selecting the destination for their overseas investment. Some studies (Alcácer and Chung [20, 21]; Mudambi et al. [22]) have

found that the analysis at the county and city level appeared to provide more solid evidence in respect of locational choices for FDI, particularly among high-technology firms. Moreover, from the perspective of enhancing the firms' competitiveness, they have long relied on localized resources and competences for new ideas and technologies which are often generated from interaction and communication among professionals within local communities (Moon [23]; Porter [24]). Therefore, firms within the cluster possess the advantage of accessing and exploiting local resources and are more likely to pursue innovation and competence enhancement strategies than those outside the cluster (Li and Bathelt [25]). In addition, given the context of GVCs, firms prefer regional clusters that have linkages with other clusters around the world. This is due to the fact that firms can benefit from mobilizing and exploiting knowledge and resources located in different regions on a global scope (Alcácer and Chung [20]; Moon and Jung [26]; Yin [8]). Furthermore, from the "doability" aspect of a nation's government, it is more effective to develop competitiveness in a specific region because the larger the country, the more difficult it is to achieve balanced regional development. Therefore, it is more efficient for the government to develop specific clusters that can attract foreign investors by providing good facilities and infrastructure. The cluster dimension of this study emphasizes three aspects, industrial infrastructure, living infrastructure, and international linkages, whereas preceding studies have mostly focused on industrial infrastructure.

The importance of clusters can be seen by examining the geographical distribution of Korea's investment in Vietnam where it is the leading investor. Korean companies invested heavily in clusters in northern Vietnam, near Hanoi, and in clusters in southern Vietnam, near Ho Chi Minh City. Among the northern regions, Bac Ninh Province has attracted the most FDI from Korea, which is the result of the investment by Samsung Electronics and its suppliers in Yen Phong and Que Vo industrial clusters. The second largest area for receiving Korean FDI is Hanoi, followed by Dong Nai, Thai Nguyen, Ho Chi Minh City, Haiphong, and Vung Tau (ASEAN Secretariat and UNCTAD [27]). Six out of the seven top regions for Korean FDI are categorized as Focal Economic Zones, which consist of a number of coastal provinces and major cities in Vietnam. By June 2016, Vietnam has established a total of 324 industrial clusters and 16 special economic zones, which accounted for about 50% of the cumulative FDI to Vietnam (HKTDC [28]). In particular, more than 75% of these were clustered in the Focal Economic Zone.

13.2.4 Education Versus Desire for a Better Life

Labor force can be generally divided into two categories: unskilled and skilled workers. Relatively high-skilled labor is needed to attract investment and such labor force is created by a high level of education. However, developing countries usually have more comparative advantage in low-skilled labor when attracting investment. For low-skilled workers in developing countries, a high level of education will help improve their productivity, but it means that there is a chance that they will be

less likely to engage in long-term repetitive tasks such as assembly line production. Furthermore, they might also be sensitive to issues surrounding human rights and social welfare. In fact, many companies are increasing salaries due to repeated union strikes in their factories.

In this respect, when MNCs invest in developing countries, they will usually prefer hardworking, highly motivated workers who can meet the production standards that are required even if their level of education is low. For example, workers in Apple's Chinese assembly plant can work 6 days a week, 12 h a day. In addition, China has the flexibility to mobilize a large number of workers within a short period of time (Moon [29]). Thus, as soon as the parts and components arrive at the Foxconn assembly plant at midnight, 8,000 workers can be quickly assembled from the company's dorms and will begin work after a 30-min break (New York Times [30]). In other words, Chinese workers have a high sense of motivation and can always be put to work in a rapid way.

Vietnam has a high degree of flexibility in terms of working conditions and long-working hours. In terms of the number of working days per year, Vietnam has 302 days, while Korea has 249 days; and it also has longer working days (Vietnam: 2,416 h, Korea: 1,992 h) (Moon and Parc [16]). Of course, in developed countries, such conditions could be criticized for exploiting human rights or poor-working conditions, but in developing countries, such diligence and high motivation can be regarded as a great competitive factor for catching up with developed countries. This advantage influences the decision of MNCs for overseas investment among developing countries with similar labor costs.

Table 13.1 summarizes the comparative analysis examined above between the general understanding of location determinants of FDI and the four fundamental factors. The conventional factors that are commonly regarded as critical in attracting FDI are necessary but not sufficient for improving the attractiveness of the host country. Moreover, preceding studies have emphasized part of the four fundamental factors, but not all of them in a single framework in a comprehensive and systematic way. This study redefines or extends the concept of each of the four factors for their influences in attracting FDI toward the host country as shown in Table 13.1.

Table 13.1 Key factors affecting the attractiveness of FDI

General understanding	Fundamental factors
Cheap labor	Productive labor (Agility: speed and precision)
Better environment	Better than competitors (Benchmarking: learning and plus alpha)
Entire country	Industry cluster (Convergence: related industries, living environment, and international linkages)
Education	Desire for a better life (Dedication: diligence and motivation)

13.3 An Empirical Study of India's FDI Attractiveness

13.3.1 The Performance of India's FDI Inflows and Promotion Policy

India is the eighth largest recipient of FDI. In 2019, it attracted US\$49 billion of FDI inflows, which is a 16% increase from the previous year (UNCTAD [6]). As Fig. 13.1 shows, FDI inflows to India declined amid the global economic downturn of 2008, but they have been steadily increasing since 2012. Today they have even surpassed the pre-Global Financial Crisis level, demonstrating an increasing trend over the last decade. Moreover, India was ranked 16 in A.T. Kearney's FDI Confidence Index Top 25 for 2019 that judges which countries are likely to attract the most investment over the next three years (A.T. Kearney [5]). This should be attributed to its rapid economic growth, the government's relaxation of FDI regulations, and a proactive FDI incentive policy. The top five investors in India are Singapore, Mauritius, Netherlands, USA, and Japan (in order) which altogether accounted for 77% of India's FDI inflows for fiscal year 2018–2019 (see Table 13.5), which reveals much about how India is highly dependent on the investment of just a few countries. In terms of sectoral distribution, as of the fiscal year 2018/2019, the service³ industry received the highest FDI inflows, accounting for 20.6% of the country's total amount. This is followed by computer software and hardware (14.4%) and trade (10.0%) (see Table 13.6). FDI inflows to India are still concentrated on the service sectors, and FDI inflows to other manufacturing sectors, such as automobiles, chemicals, and pharmaceuticals, are still relatively low.

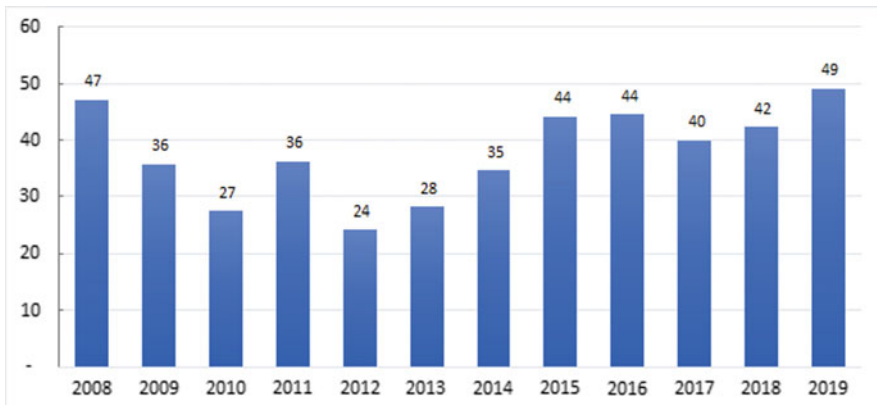


Fig. 13.1 The trend of India's FDI inflows, 2009–2019 (US\$ billion). *Source* UNCTAD FDI Statistics, <https://unctadstat.unctad.org/EN/>; UNCTAD (2020)

³Services sector includes Financial, Banking, Insurance, NonFinancial/Business, Outsourcing, R&D, Courier, and Tech.

Despite India's high potential for FDI attractiveness, the actual investment environment is not as attractive relative to its competitors. According to the World Bank's ease of doing business index 2020, the investment environment is considered to be still relatively poor, ranking 63 out of 190 countries, and in some other categories (starting a business, 136; registering property, 154; enforcing contracts, 163) it shows substantial weaknesses. Therefore, in order to attract more FDI, the government should adopt new measures such as deregulation and simplification of procedures. Furthermore, as mentioned above, India's FDI inflows are dependent upon only a few investors, so it is necessary to further increase the range of the total FDI inflows. In the cumulative period of 2000–2019, the share of investment among these top five countries is 69%, and this trend is intensifying.

While FDI inflows in India have been centered on the competitive industries such as services and Information Technology (IT), for a more sustainable future it will be necessary to expand its range to other sectors. Investment in the service and IT sectors accounted for 18 and 10% of the cumulative total for the period 2000–2019, respectively, and the portion of investment for the service sectors has been surging in recent years. The concentration of FDI inflows among a few industries is still high as they are predominantly led by large MNCs rich in capital. At the same time, small businesses are dissuaded due to the country's poor infrastructure. This contrasts with Vietnam, where FDI inflows among both large and small firms have surged recently. For example, an increasing number of Korean SMEs as well as large conglomerates have both invested in Vietnam and are also located in or near the same cluster (ASEAN Secretariat and UNCTAD [27]).

In his inaugural speech in 2016, Modi emphasized the need to attract more FDI through “minimum government, maximum governance,” which would be achieved by implementing a series of reforms. He also stressed the importance of revitalizing the economy through improving the business environment. The role of FDI for enhancing economic growth was evident in his desire to increase the range of FDI inflows. Such a policy intends to supplement the lack of capital and technology in India by attracting more investment.

The Modi government seeks to foster India as a global manufacturing center through the “Make in India” campaign launched in 2014. The goal is to increase the share of manufacturing for its total GDP from the current 15 to 25% by 2022. By the fiscal year 2018–2019, while India's service sector has maintained more than 50%, the share of its manufacturing sector has remained at 15%. This is lower than its Asian competitors, such as China (30%), Korea (30%), and Indonesia (24%) (KOTRA [31]).

A key means toward achieving the “Make in India” goal is to attract FDI. To this end, the Indian government introduced a series of policies including (1) creating a favorable environment for businesses such as simplification of complex regulations; (2) building new social infrastructures such as industrial clusters and smart cities; and (3) nurturing 25 key industries including IT, aviation, and renewable energy. In this respect, it will inevitably compete with China and Vietnam in Asia, which already enjoys a high level of competitiveness as bases for global manufacturing.

Despite this approach, recent statistics have indicated that the “Make in India” policy has not achieved the desired results in improving the level of manufacturing. As shown in Fig. 13.2 and Table 13.2, since the government has promoted the “Make in India” policy in 2014, FDI flows have gone more to the service sector than to the manufacturing industry. As of the fiscal year 2018–2019, FDI inflows to four major services (services, telecommunications, computer software, and hardware and trade) accounted for more than 50% of the total FDI inflows to India. By contrast, the portion of the three major manufacturing industries (automotive, chemical, and pharmaceutical) was a bit more than 10%. In addition, as shown in Table 13.2, the ratio of FDI inflows to major service sectors has increased significantly from 40 to 51.2% over the past three years, but the ratio of FDI inflows to manufacturing has in fact decreased from 16.1 to 11%.

Although some manufacturing sectors (e.g., mobile phone production) appeared to be doing well, the key stated outcomes were unlikely to happen by the target year of 2022 (The Hindu Business Line [32]). Recently, The Department-Related Parliamentary Standing Committee on Commerce of India also acknowledged that the FDI inflows in manufacturing is declining, and the low inflow of FDI in the manufacturing sectors fails to achieve the original purpose of Make-in-India scheme (Business Standard [33]). It recommended the government to take further efforts to increase the share of manufacturing sectors in the total FDI inflows.

In order to offer a new approach for India to enhance its FDI attractiveness, we will first examine its relative position in terms of the four fundamental determinants of locational attractiveness of FDI inflows. For this, we have selected nine other Asian economies for comparison from which we can investigate the relative strengths and weaknesses of FDI attractiveness.

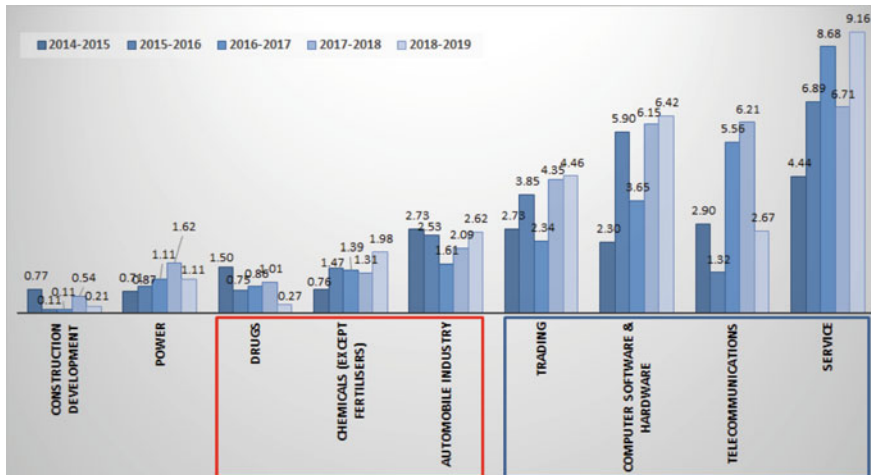


Fig. 13.2 Sectors attracting highest FDI inflows (US\$ million). *Source* DIPP FDI Statistics, Development of Industry Policy & Promotion of India, <https://dipp.gov.in/publications/fdi-statistics>

Table 13.2 Percentage of FDI in core services and manufacturing sectors

	2014/4–2015/3	2015/4–2016/3	2016/4–2017/3	2017/4–2018/3	2018/4–2019/3
4 non-manufacturing sectors	40.0%	44.9%	46.5%	52.2%	51.2%
3 core manufacturing sectors	16.1%	11.9%	8.9%	9.8%	11.0%

Source: DJPP FDI Statistics, Development of Industry Policy & Promotion of India, <https://dipp.gov.in/publications/fdi-statistics>

Table 13.3 Criteria for measurement

Factors	Criteria	Source	Data type
Labor productivity	1.1 Workforce productivity	IMD	Survey
	1.2 Ease of doing business	World Bank	Survey
Best practice adaptability	2.1 Adaptability of government policy	IMD	Survey
	2.2 Firm-level technology absorption	WEF	Survey
Cluster competitiveness	3.1 State of cluster development	WEF	Survey
	3.2 Value chain breadth	WEF	Survey
Goal orientation	4.1 Working hours	IMD	Hard
	4.2 Worker motivation	IPS	Survey

13.3.2 An Empirical Study: Comparative Analysis Between India and Asian Countries

This section highlights the need to quantify the major factors that influence FDI attractiveness as described above by comparing India's competitiveness with nine other economies in Asia. This will be helpful toward understanding India's current position in terms of FDI attractiveness in a more rigorous and systematic manner. The criteria for measuring the four factors were selected from the National Competitiveness Report (e.g., IMD, WEF, and IPS), and statistics published by international organizations (e.g., World Bank) (see Table 13.3). In addition to India, the countries for evaluation include four first-tier Asian newly industrialized economies (NIEs) which are Korea, Taiwan, Hong Kong, and Singapore, and four second-tier NIEs which are Indonesia, Malaysia, the Philippines, and Thailand. China is also included, bringing the total to 10 countries for this comparative analysis.

Among the eight criteria, the reasons for selecting two indicators related to best practice adaptability are as follows. Criterion 2.1 is an indicator that measures the adaptability of the government's policies to changes in the external environment. A higher level of adaptability implies that the government has a strong intention to compete with its rivals. On the other hand, Criterion 2.2 measures the level of firms' acceptance of the latest technology that helps understand its standing relative to its rivals.

Since each individual data contain different units, we had to first standardize them.⁴ The indices of the four factors were obtained by calculating the average of the two criteria that belong to them. We then determined the overall FDI attractiveness by calculating the average of the four factors. Based upon this approach, the higher the composite competitiveness index is, the higher the FDI attractiveness. By applying this methodology of measurement and quantification, the results for the investment attractiveness of the 10 economies are summarized in Table 13.4.

⁴The years of data for the eight criteria were 2016 or 2017.

Table 13.4 Results: competitiveness ranking

Country	Overall ranking	Productive labor	Best practice adaptability	Cluster competitiveness	Goal orientation
Singapore	1	2	1	3	2
Hong Kong	2	1	3	1	4
Taiwan	3	3	5	2	1
Malaysia	4	4	2	4	10
China	5	7	6	7	3
Korea	6	5	7	5	8
Thailand	7	6	4	9	5
Indonesia	8	10	8	6	9
India	9	9	10	8	7
Philippines	10	8	9	10	6

The 10 economies in this study are pursuing different strategies toward attracting FDI in the manufacturing sector. Singapore and Hong Kong, which are ranked first and second, respectively, play a role as global or regional hubs. They seek to attract regional or global headquarters of MNCs by engaging in the manufacturing sector. On the other hand, in Taiwan there are a large number of internationally competitive SMEs, and most of them supply high value-added parts and components to global companies. Therefore, Taiwan seeks to attract investment through its connection with the GVC of MNCs. China and the four second-tier NIEs mainly attract FDI for low value-added activities such as assembly.

Korea has a number of internationally competitive global companies. Most of these usually transfer their low value-added production activities to developing countries in order to utilize cheap labor, while concentrating on high value-added activities in Korea. Therefore, the appropriate strategy for Korea would be to attract FDI in high value-added activities, such as R&D centers, rather than low value-added activities. This shows that policies for attracting FDI should be related to the characteristics of GVC in host economies.

On the other hand, all the 10 economies have established domestic clusters and international linkages with neighboring countries, by utilizing the comparative advantage of relevant countries. For example, Singapore, Johor in Malaysia, and Riau in Indonesia have cooperated to develop a transnational growth triangle known as SIJORI and have successfully promoted regional economic cooperation for attracting FDI. In effectively transferring Singapore's existing labor-intensive industries to neighboring countries, it has not only contributed to the advancement of its industrial structure, but Malaysia and Indonesia were also able to achieve economic growth by attracting a large amount of capital and technology know-how. Meanwhile Hong Kong, Korea, and Taiwan were seeking to promote economic development through regional linkages that have been supported by FDI with their bigger neighbor—China.

India is ranked ninth overall and is thus less competitive when compared with other Asian countries. As Fig. 13.3 shows, India is weaker than China across all four

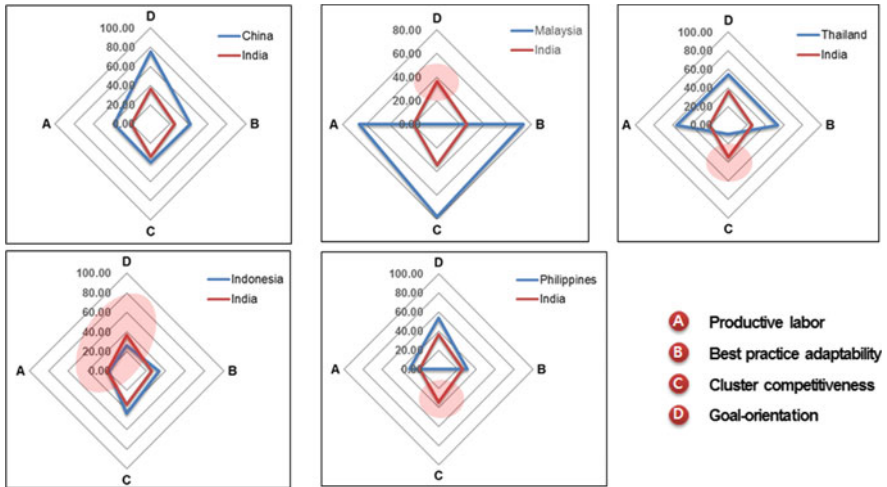


Fig. 13.3 Comparison of the structure of FDI attractiveness

factors. However, compared with Malaysia, Thailand, Indonesia, and the Philippines, it shows competitive advantage in part for these four factors. Specifically, India has a competitive edge for the factor of “goal-orientation” compared to Malaysia and Indonesia, and has a competitive advantage in terms of “cluster competitiveness” compared to Thailand and the Philippines. Therefore, India has a relative superiority in cluster competitiveness and goal orientation compared to the second NIEs, but it is inferior in the other two factors—labor productivity and best practice adaptability.

Here we can see that India’s rigid labor market hinders the improvement of its labor productivity. On top of this, the lack of skilled labor due to a high turnover rate, frequent demand for increases in wages, and limited motivations are problems that limit the improvement of labor productivity in India. Much of this is due to the fact there has been no significant change in the labor market system since the economic reforms in 1991. Political difficulties continue to block the amendment of the country’s labor laws that could enhance flexibility in the market [40].

Under the GVC context, comprehensive competitiveness consisting of all parties involved in these activities becomes more important than a single firm’s competitiveness. India has cheaper labor costs compared with China and some developing countries, but its logistics costs are particularly high. In general, India is responsible for MNCs’ assembly in the GVC, or producing low value-added intermediate goods and exporting them to other countries. Therefore, logistics costs arising from linkages with other countries are important because India accounts for only a part of MNCs’ entire value chain activities. But the drawback in this case is that India’s logistics costs are four to five times higher than international standards (Economist [34]). In addition, the traffic control and management system in India are lagging, which causes a high rate of traffic accidents and consequently increases the cost of doing business in India (Millennium Post [35]).

To address environmental and energy issues as well as the infrastructure, the Indian government announced in 2014 that it planned to create one hundred smart cities across the country by 2022. A solid infrastructure is crucial in attracting FDI, but the more fundamental solution is to reduce unnecessary regulations. According to Moon [36], leading MNCs are more sensitive to excessive regulations than government incentives. This is not only because regulation increases the cost of doing business but it also has a significant negative impact on its current competitive advantage in the host country. Therefore, if local governments sufficiently ensure the basic business activities by reducing regulations, MNCs will be able to make the most of their ownership advantages through investment. Furthermore, they will more likely work with local governments and participate in building infrastructure and improving other economic factors.

13.3.3 Implications for India's FDI Policies

The following presents strategic directions for attracting FDI across the four aspects. The first one is agility. The Modi government has been deregulating various industries over the past three years but there are still many other regulations that hinder investment by MNCs. In particular, labor-related regulations have a negative impact on labor market flexibility and productivity. This highlights the need to improve not only labor productivity but also create a more competitive labor force.

The second one is competitor comparison. Since 1990, India has been steadily pursuing a series of reforms and opening to attract FDI. Notably, the Modi government has implemented more active policies to speed up this process, yet India's FDI attractiveness still lags behind those of its Asian competitors, particularly China. In order to address this issue, systematic developmental strategies are needed by benchmarking specific national and industrial policies in accordance with India's current development stage. In addition, India has a competitive edge in industries such as software, automobiles, aerospace, but it still requires a good foundation for attracting FDI by securing its competitiveness in many other fields.

The third one is upgrade of related industries and living environment. The development of a living environment (software: education, medical, cultural, and entertainment facilities) as well as the industrial infrastructure (hardware: development of physical infrastructure and related industries) are important in developing international-linkage clusters. In order to attract high value-added activities among MNCs, it is important to draw in personnel with world-class skills by being able to provide high-level living and cultural facilities. India has to further consider the international linkage of its industrial clusters with other clusters around the world, thereby facilitating interlinkages of value chain activities spreading around the world.

The fourth one is clear and viable goal setting. As many of India's policies still have high political tendencies, it is important to establish consistent policies with a focus on economic development. As India is a federal state, the power has been decentralized across local governments which usually have various regulations and divergent

policies for attracting FDI. Therefore, it is important to have close coordination and cooperation toward achieving intended economic goals, implementing relevant policies, and establishing efficient institutions. The federal government should provide common economic goals and establish institutions that are able to adjust the conflicts and enhance regional cooperation. At the same time, the policies should be formulated and implemented in a way to lower regional transaction costs and increase the overall efficiency through the establishment of regional-linkage clusters.

13.4 Conclusion

With the US protectionist measures, attracting FDI from MNCs is becoming more difficult for other countries. And with the outbreak of the coronavirus and its impact on the global economy, the international investment environment has been very difficult. This has heightened the competition among countries around the world to attract FDI. In order to respond effectively to this challenging environment, this paper introduced four fundamental factors that influence the creation of an attractive environment for FDI. They are productive labor with both speed and precision, best practice adaptability, cluster development, and goal-orientation with diligence and strong motivation. In contrast with general factors such as cheap labor or educated labor force that are commonly believed to influence the FDI inflows, these four factors of this study assume that without superior inherited or created advantages in the resources themselves, countries that are able to mobilize their available resources in an efficient manner will be able to enhance their position compared to their rivals.

For a clearer understanding on the importance of these factors, we take India as an illustrative example. Despite its great potential in attracting FDI, India's current status of investment attractiveness is relatively weak when compared with China in particular. In order to enhance its overall attractiveness toward foreign investors, this study conducted an empirical analysis by comparing India's competitive position against the nine Asian economies. Despite India's relative advantage in some factors such as cluster development and goal orientation, its overall competitiveness in attracting FDI is still not high.

For India to attract FDI effectively in the manufacturing sector, it should improve the competitiveness of the four fundamental determinants suggested in this study. In addition to promoting the "Make in India" policy, India should be linked to the GVC activities of MNCs to improve the productivity and competitiveness of its firms. Furthermore, India should maximize values created in India by broadening the tool of globalization, from trade to FDI and then to more comprehensive value creation mode via GVC. In the end, the scope of competition and cooperation of clusters in India should be extended to globally linked ones.

Table 13.5 Top 10 investors for India's FDI inflows, April 2018–March 2019 (million US\$, %)

Country	FDI inflows	Country	FDI inflows
Singapore	16,228 (36.6)	UK	1,351 (3.0)
Mauritius	8,084 (18.2)	UAE	898 (2.0)
Netherlands	3,870 (8.7)	Germany	886 (2.0)
US	3,139 (7.1)	France	France (0.9)
Japan	2,965 (6.7)	Cyprus	296 (0.7)

Source FDI Statistics, Development of Industry Policy & Promotion of India, <https://dipp.gov.in/publications/fdi-statistics>

Table 13.6 India's FDI inflows by industry, April 2018–March 2019 (million US\$, %)

Industry	FDI inflows	Industry	FDI inflows
Service	9,158 (20.6)	Construction	2,258 (5.1)
Computer software & hardware	6,415 (14.5)	Chemicals (other than fertilizers)	1,981 (4.5)
Trade	4,462 (10.1)	Power	1,106 (2.5)
Telecommunications	2,668 (6.0)	Drugs and pharmaceuticals	266 (0.6)
Automobile industry	2,623 (5.9)	Construction development	213 (0.5)

Source FDI Statistics, Development of Industry Policy & Promotion of India, <https://dipp.gov.in/publications/fdi-statistics>

Appendix

See Tables 13.5 and 13.6.

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