A review of the determinants of FDI in developing countries and their comparison with Saudi Arabia

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Abstract

The aim of this review was to gain insights into the factors affecting FDI inflow in other developing countries and compare it with Saudi Arabia. A two layered approach as followed to search for the relevant literature. First, the relevant literature about Saudi Arabia was searched, and second, the relevant literature about other developing countries was searched. A total of 7 studies were reviewed to address the aims of the research. The most important drivers of FDI in Saudi Arabia were found to be the cost factors, market factors, infrastructure and technological factors, political and legal factors, and social and cultural factors. Also, the size of the source country, the distance of the source country from Saudi Arabia, and high per capita income of the source country are also important determinants of the FDI inflow in Saudi Arabia. The main determinants of FDI in developing countries were found to be communication between countries, higher return on investment, better infrastructure, openness to trade, GDP, inflation rate, scientific research, favourable FDI policy, internal market growth, decrease in interest rate, wages and quality of labour. A comparison of the determinants of FDI in Saudi Arabia and other developing countries indicates that the factors peculiar to Saudi Arabia are the political and legal factors and cultural factors. This may be because of the fact that Saudi Arabia is an Islamic country and the Islamic culture and way of life is reflected in all aspects of doing business in Saudi. The comparison also found that Saudi can learn from other foreign countries to increase FDI inflow. This can be done by improving communication between countries, making sure countries investing get higher return on investment, better infrastructure, openness to trade, encouraging scientific research, having better FDI policy, encouraging internal market growth, by decreasing in interest rate, and improving wages and quality of labour. The findings from this review are expected to inform the policy makers and other relevant authorities of the Saudi economy.

Keywords: Saudi Arabia, FDI, Determinants, Developing Countries, Comparison

Introduction

According to the website Study.com, "Foreign direct investment (FDI) is an investment in a business by an investor from another country for which the foreign investor has control over the company purchased. The Organization of Economic Cooperation and Development (OECD) defines control as owning 10% or more of the business. Businesses that make foreign direct investments are often called multinational corporations (MNCs) or multinational enterprises (MNEs). An MNE may make a direct investment by creating a new foreign enterprise, which is called a greenfield investment, or by the acquisition of a foreign firm, either called an acquisition or brownfield investment."

FDI is important for most countries as it pormotes local jobs and simulates the economy. Saudi Arabia is a Middle Eastern country with a population of over 32 million and Arabic is the official language (OPEC, 2017). According to OPEC (2017), “Saudi Arabia possesses around 18 per cent of the world's proven petroleum reserves and ranks as the largest exporter of petroleum. The oil and gas sector accounts for about 50 per cent of gross domestic product, and about 70 per cent of export earnings." Oil and gas are a limited resource and the Saudi government has made efforts to develop other industries and diversify into other sectors. One of the ways to promote economic growth is to encourage FDI inflow in the country. By studying the determinants of FDI in other developing countries, Saudi Arabia can make more informed strategies to encourage FDI into the country. Therefore, the aim of this review is to gain insights into the factors affecting FDI inflow in other developing countries and compare it with Saudi Arabia. The findings from this review are expected to inform the policy makers and other relevant authorities of the Saudi economy.

Methodology

The Google Scholar literature database was utilized in this review. A two layered approach as followed to search for the relevant literature. First, the relevant literature about Saudi Arabia was searched, and second, the relevant literature about other developing countries was searched. The relevant literature about Saudi Arabia was searched using the keywords, "Saudi Arabia", "FDI", and "Determinants", and the comparable literature about other developing countries was searched using the keywords, "Developing Country", "FDI", and "Determinants". The findings from the review are summarized in the subsequent section. A total of 7 studies were reviewed to address the aims of the research.

Review

A review of the relevant Saudi Arabian literature was done first.

Binsaeed (2009) studied the factors affecting FDI in the petrochemicals industry in the Saudi Arabian context. A review found that the most important drivers of FDI were the cost factors, market factors, infrastructure and technological factors, political and legal factors, and social and cultural factors.

Roberts and Almahmood (2009) researched the characteristics of the source country from which the FDI comes in the Saudi context. The authors compiled and analyzed data relating to the source countries that had invested into Saudi. The results of the analysis indicated that the size of the source country, the distance of the source country from Saudi Arabia, and high per capita income of the source country were the important determinants of the FDI inflow in Saudi Arabia.

A review of the relevant studies from other developing countries was done next.

Kok and Acikgoz Ersoy (2009) researched the determinants of FDI in developing countries using an analysis of secondary data. The study found that the most important determinant of FDI was communication between countries. Also, the interaction of FDI with some FDI determinants have a strong positive effect on economic progress in developing countries, whereas the interaction of FDI with the total debt service/GDP and inflation have a negative impact.

Asiedu. (2002) studied the determinants of FDI in the African context. The study found that the determinants of FDI are different in Africa. Specifically, a higher return on investment and better infrastructure have a positive impact on FDI to non-Sub-Sahara African countries (SSA) countries, but have no significant impact on FDI to SSA. The study also found that openness to trade promotes FDI to SSA and non-SSA countries; however, the marginal benefit from increased openness is less for SSA.

Singhania and Gupta (2011) researched into the determinants of foreign direct investment in India. The authors analysed macroeconomic variables using time series regression analysis. The study found that out of all the macroeconomic variables used, only GDP, inflation rate and scientific research are significant and that FDI Policy changes have had a significant impact on FDI inflows into India.

Felisoni de Angelo et al. (2010) studied the determinants of FDI in Brazil. The authors analyzed empirical data and found that the internal market growth represented by aggregate consumer sales was a significant determinant of FDI in Brazil. Also, increase in interest rate on consumer financing was negatively related to FDI flows during the captioned period.

Seetanah and Rojid (2011) studied the determinants of FDI in Mauritius. The study found that the most instrumental factors affecting FDI in Mauritius appear to be trade openness, wages and the quality of labour. Also, size of the market was found to have a relatively lesser impact on FDI.

Conclusions

The aim of this review was to gain insights into the factors affecting FDI inflow in other developing countries and compare it with Saudi Arabia.

The most important drivers of FDI in Saudi Arabia are the cost factors, market factors, infrastructure and technological factors, political and legal factors, and social and cultural factors. Also, the size of the source country, the distance of the source country from Saudi Arabia, and high per capita income of the source country are also important determinants of the FDI inflow in Saudi Arabia.

The main determinants of FDI in developing countries were found to be communication between countries, higher return on investment, better infrastructure, openness to trade, GDP, inflation rate, scientific research, favourable FDI policy, internal market growth, decrease in interest rate, wages and quality of labour.

A comparison of the determinants of FDI in Saudi Arabia and other developing countries indicates that the factors peculiar to Saudi Arabia are the political and legal factors and cultural factors. This may be because of the fact that Saudi Arabia is an Islamic country and the Islamic culture and way of life is reflected in all aspects of doing business in Saudi.

The comparison also found that Saudi can learn from other foreign countries to increase FDI inflow. This can be done by improving communication between countries, making sure countries investing get higher return on investment, better infrastructure, openness to trade, encouraging scientific research, having better FDI policy, encouraging internal market growth, by decreasing in interest rate, and improving wages and quality of labour.

The findings from this review are expected to inform the policy makers and other relevant authorities of the Saudi economy.

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