

A QUANTITATIVE ASSESSMENT OF THE MAIN DETERMINANTS, AT THE REGIONAL LEVEL, OF THE FOREIGN DIRECT INVESTMENT IN ROMANIA

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Abstract: Several variables have been identified in the literature as important determinants of the foreign direct investments in a specific region. Identifying these characteristics (characteristics emphasized at regional level) that determined the foreign companies to invest in Romania is extremely important in the current economic situation. Shaping the profile of the foreign investor in Romania, based on the main factors taken into consideration by companies when building their investment strategies, is the main goal of this paper (the approach used is based on a quantitative analysis).

1. INTRODUCTION

As the specialist have already proven there is a vast range of different motives that lay behind the investment decisions of firms in foreign countries. It is argued that "...there are substantial differences in economic performance across regions in virtually every nation. This suggests that many of the essential determinants of economic performance are to be found at the regional level" (Porter, 2003, p.550). According to this logic the foreign firms should conduct a thorough environmental scan, at national and regional level as a first stage of a developing strategies process when deciding to invest in a foreign country.

After the communism collapsed, all the countries of Central and Eastern Europe have been forging strategies to attract foreign capital as a way of achieving sustainable economic growth (Martin and Velázquez, 2000). Foreign direct investment by multinational corporations are considered to play an important role in the transformation of former centrally planned economies into vibrant market systems, since it provides an inflow of capital, management skills and jobs, alongside increasing exports and transfer of technology. It is also perceived as one of the conditions paving the way for improving the competitiveness of the economy and enhancing the provision of goods and services for the domestic market.

There are significant differences when talking about economic performance across development regions in every nation. Therefore we can believe that many of the main determinants of the economic performance are to be found at the regional level (Porter, 2003, p.550). Romania was no different and the development had a differentiated rhythm in the component regions, fact that brought strong discrepancies between them. The factors that conducted the development of the capital city and its outskirts (surrounding areas) are easy to identify when noticing that the labor resource (educated labor force, main universities in Romania) the economic capital and the decisional factors (at political level) are concentrated in this area. On the other hand the factors that led to different development levels in all other regions of the country are not as obvious. Therefore the main goal of this study is to identify and quantify the most important determinants (related to each region's potential) which influenced the managerial decision of laying the investment in a certain region. Assuming that foreign companies that invested in Romania located their investment based on a clear strategy we will try to provide in this paper a national framework and a regional one where the main strengths and the main

weaknesses of the seven regions of our country will be described (the Bucharest-Ilfov region was not included in our research). To be more precise, our main focus will be on the process of environmental scan, when the important characteristics of each region were identified, quantified and comparatively analyzed (between the 41 counties of Romania or between the 8 regions of NUTS-II) by firms.

We also believe that identifying the main foreign direct investments determinants is crucial in the current economic situation, when the foreign investments are considered to be one of the most important levers that can restore the balance in the Romanian economy and further drive a sustainable economic growth. Therefore by identifying these factors the authorities can construct the profile of the foreign investor that is suitable for each region. Thereby we suggest that only by identifying the strengths and weaknesses in attracting investors for each region in particular, disadvantaged communities can be helped and a balance regarding the economic development at regional level can be restored. In these circumstances, the paper will proceed by presenting a literature review on the main FDI determinants, a description of the methodology used in the study and also the main results of the conducted survey.

2. LITERATURE REVIEW AND GENERAL FRAMEWORK:

2.1. MAIN FDI-s DETERMINANTS

Several variables (constructed at the regional level) have been identified in the literature as important determinants of FDI. According to Chakrabarti (2003), an expansion in the market size of a location leads to an increase in the amount of direct investment in that location through an increased demand. Foreign investors are likely to be attracted by large markets allowing them to internalize profits from sales within the host countries. According to Woodward (1992) foreign companies prefer states with strong markets and low unionization rates. The effect of specific market and regional growth characteristics are also taken into consideration in the spatial analysis of FDI in the United States, by Bagchi-sen and Wheeler's study. Population is a measure of the market size and it indicates the economic dynamics of a location and states market growth potential (Bagchi-sen and Wheeler, 1989). The other important determinant of FDI which defines local market size is GDP.

Another major determinant of FDI is the existence of agglomeration economies. Agglomeration economies are important to attract foreign direct investment. Agglomeration economies refer to the positive externalities and economies of scale associated with spatial concentration activities and co-location of related production facilities (Chadwick, 1989; Krugman, 1991; Smith and Florida, 1994). There is systematic evidence suggesting that multinational companies are attracted to clusters of economic activities in their own and in closely related industries and activities (Glickman and Woodward, 1988; Wheeler and Mody, 1992; Head and Ries, 1996; Devereux and Griffith, 1998; Guimaraes et. al., 2003; Driffield and Munday, 2000). The total number of industrial enterprises in a county is expected to significantly attract FDI since the existence of industrial clusters signals a set of favorable condition for foreign investors such as the presence of local suppliers, specialized labor and infrastructure (He, 2002). According to Coughlin, Terza and Arromdee (1991), the density of manufacturing activity was one of the important factors in location decisions of foreign firm in the US during 1981-1983. The other variable related to agglomeration economies is population density.

Infrastructure is another key factor that determines FDI. There is a positive relationship between infrastructure and inward FDI. Empirical studies support for the

importance of infrastructure in FDI location decisions is provided by Wei and et al. (1999), Mariotti and Pischitello (1995), Broadman and Sun (1997) and He (2002). A location with good infrastructure is more attractive than the others (Wei and others, 1999; He, 2002).

Cantwell (1989) states that knowledge-seeking investments vary across locations because they depend on location specific factors, such as the number of scientists and educated people in the area, previously established innovations, R&D intensity, the education system, and good linkages between educational institutions and firms. As a result, companies may supplement their existing technologies by expanding internationally to access new knowledge. This expansion may suggest two types of knowledge-seeking behavior between firms originating from leading versus lagging technical centers (Cantwell and Janne, 1999). Companies from lagging technical locations need to catch up and locate their research centers abroad in order to improve their existing technology. However, while firms from leading locations do not need to catch up, they may also locate their research centers abroad to source more diverse knowledge, since "... the acquisition of new skills, and the generation of new technological capacity, partially embodied in new plant and equipment, must be a goal of every firm" (Cantwell, 1989, p.8). Florida (1997) finds that accessing new indigenous technology is more important than customizing existing technology for new markets.

Having these variables identified as main determinants of FDI we believe that they were also included in the situational analyses performed by companies who have decided to invest in Romania and they will also be included in the future by other companies when planning their strategies of investing in Romania.

2.2. TERRITORIAL ORGANIZATION OF ROMANIA (NUTS II)

After 1990, Romania shifted its spatial policy from a central-based policy to a regional-based policy, in compliance with EU-standards. According to four criteria (number of inhabitants, surface, cultural identity and functional-spatial relations) Romania was divided 1998 into eight Development Regions. These eight regions serve as NUTS-II units and they are used by the authorities as a framework for the development policies while the counties serve as NUTS-III units. The eight units used further in our study are as follows: North-East, South-East, South, South-West, West, North-West, Center and Bucharest - Ilfov.

3. METHODOLOGY USED IN THE STUDY AND MAIN RESULTS

3.1. RESEARCH GOAL AND RESEARCH DESIGN

The main goal of this study is to identify the main determinants of the direct foreign investments in Romania at regional level for the seven regions excluding the Bucharest-Ilfov development region. Basically, the study is constructed so, that it will provide a list of the main strengths and weaknesses of all seven Romanian regions, that would influence a foreign investor to choose the proper location for a future investment when developing his strategy. As mentioned before, our study can be seen also as a guide for local authorities in their attempt of attracting foreign direct investments.

In order to identify these factors and to quantify their importance our study was constructed using a statistical survey. Administrative data were collected from the Romanian authorities for all direct foreign investments in Romania (in the seven regions). For a clear identification of the targeted population we used five criteria: (1) firms that have more than 100 employees; (2) companies that were established between 1990 and 2009;

(3) companies that were still operating in 2009; (4) more than 50% of the original investment should be foreign; (5) companies should be activating in the manufacturing industry. Because the volume of the population was quite small (a total number of 669 firms) an exhaustive research was decided to be the correct approach. Further, a survey involving an eight questions questionnaire was conducted over the telephone. The survey was conducted among middle and top managers of the companies which fulfilled our designated criteria. Data obtained from our questionnaires were analyzed using the SPSS statistical software and a descriptive image of the main FDI-s was constructed for each region.

From the entire targeted population less than half of the questioned managers answered our questionnaire; more precisely we had a total number of 235 valid responses. The fact that only 235 units decided to fill the questionnaire transformed our exhaustive research in a sampling survey and therefore we will handle our results with great caution further. Based on them we will construct the profile of the investor for each region without conducting a statistical inference.

The response rate for each region is as follows: 51 respondents and a 33.1% response rate for the development region Center, 32 respondents and a 31.1% response rate for development region South, 17 respondents and a 31.5% response rate for the development region South East, 43 respondents and a 29.7% response rate for the development region West, 28 respondents and a 45.9% response rate for the development region North East, 46 respondents and a 42.6% response rate for the development region North West and finally 18 respondents and a 40.0% response rate for the development region South West (The overall aggregate response rate is 35.1%). Thereby it is obvious that we have two distinct classes: class no.1 containing the first four regions characterized by a low response rate and class no.2 consisting in the last three regions characterized by a high response rate. Using these two clusters the obtained results (from our sample) might be extended at the level of the entire targeted population because the selection mechanism can be considered as being similar to randomization.(Analyzing the selection mechanism is not the topic of this study and it will no longer be discussed).

3.2. ANALYSIS AND MAIN RESULTS

In this section, we will construct the general framework by describing the obtained results at national level and then we will further present each region comparatively with this general framework. The questionnaire consists of eight questions: seven simple questions and a complex one with 18 sub-questions clustered in four groups.

The main part of our analysis will focus on the sixth question (the complex question): "Which were the reasons that made you decide invest in this region?" The four main classes mentioned before are as follows: (1) Infrastructure, (2) Labor force, (3) Concentration factors and (4) Other factors. The answer to all eighteen questions, included in the four clusters, is a scale with five values: 1 – This factor was not taken in consideration, 2 – Very little importance, 3 – Little importance, 4 – Important, 5 – Very Important. Further in our analysis we have modified the scale for each question by building a dichotomous variable because the low volume of our two samples and also in order to respect our proposed approach based on strengths and weaknesses.

The first class of factors "Infrastructure" includes five topics as follows: (1) transportation costs, (2) quality of the roads, (3) the existences of the airports nearby, (4) the existence of viable land for the investment and (5) favorable conditions for distribution of the products. Transportation costs were considered as being important and very

important by over 38% of all investors. Also the existence of viable land for the investment was considered by almost 50% of the interviewed managers as being a crucial reason in the location choosing strategy. Concerning for the authorities might be the fact that almost 90% of the respondents consider the quality of the roads as being very poor in Romania and also almost 76% of them do not consider the existence of airports nearby as being a factor that might require attention when locating an investment. However the existence of favorable conditions for distribution is considered as being important or very important by over 42% of the investors. When going further with our analysis, the situation at regional level shows some important discrepancies regarding the Romanian infrastructure.

Infrastructure					
Region	F1	F2	F3	F4	F5
Important and Very important					
Center	32,00%	14,00%	20,40%	50,00%	40,80%
N-E	28,30%	7,10%	14,30%	57,20%	14,30%
N-W	43,40%	6,50%	28,10%	47,80%	52,10%
South	34,40%	6,20%	18,80%	46,90%	31,30%
S-E	32,30%	5,90%	11,80%	29,40%	69,60%
S-W	37,50%	5,90%	17,70%	29,40%	27,80%
West	41,80%	21,00%	41,90%	62,80%	54,70%
General	38,40%	10,80%	24,20%	49,40%	42,20%

Figure 1. Level of importance for each factor from the first class at regional level;

Companies who assign the transportation costs a greater importance are more incline to choose North-West or West. This fact shows that those firms are interested in the European Highway system and therefore they locate in Romania near the Hungarian border. On the contrary companies that do not consider those costs as being so important are more inclined to locate their facilities in South, South-East or North-East (these regions are not connected with the European Highway system which stops in Hungary). As mentioned before the quality of the Romanian roads is a problem for the large majority of the investors. What is noteworthy here is that a significant larger percentage of the respondents from the region west consider the quality of the roads as being important. Also respondents located in the West consider the existence of an airport as a significant factor in the decision making process. North-East and South-East respondents consider the existence of an airport nearby as an advantage in a significant lower percentage. Those who give a greater importance to the existence of viable land decided to invest in West region or in North-East region. Favorable conditions for distribution are of significant higher importance for investors who decided to locate their facilities in the following regions: West, South-East and North-West.

The second class of factors "Labor force" includes 4 topics as follows: (1) the existence of available labor force, (2) the low cost of the labor force, (3) the existence of qualified labor force, (4) the high level of education of the population.

Labor force				
Region	F1	F2	F3	F4
Important and Very important				
Center	84,00%	82,00%	78,00%	45,80%
N-E	85,70%	82,10%	75,00%	14,80%
N-W	95,70%	82,60%	60,80%	15,90%
South	87,50%	80,70%	65,60%	37,50%
S-E	100,00%	94,10%	64,70%	35,30%
S-W	88,90%	83,30%	66,70%	23,50%
West	83,80%	76,80%	86,10%	44,20%
General	88,50%	82,00%	72,20%	32,40%

Figure 2. Level of importance for each factor from the second class at regional level;

Important to emphasize is that the first three topics were considered a major factor in the process of strategic planning (important or extremely important) by over two thirds of the companies from our sample. The most important is the existence of available work force, followed by low cost of this workforce and by the existence of qualified workforce. The high level of education is not as important due to the fact that most of the companies bring their specialists requiring local work force for the lower levels of the company. However in the regions West and Center the importance of this factor is significantly higher probably because of the main urban areas (Cluj, Arad, Timisoara). South East is the region where the existence of cheap labor force was considered an important advantage by almost all of the respondents. Also noteworthy is the fact that investors who located their investments in the West region or in the Center region considered the existence of qualified labor force an important characteristic in a significant higher percentage than the rest. Concluding this class of factors we can assert that aspects concerning the existence of labor force at reasonable costs are one of the main advantages of our country.

The third class of factors "Clustering factors" was divided into three main topics: (1) The existence of suppliers in the region, (2) The existence of other companies with the same activity field in the region and (3) The existence of other foreign companies in the region. The importance of these three factors in the opinion of our respondents, at regional levels will be displayed in Figure.3.

Clustering Components			
Region	F1	F2	F3
Important and Very important			
Center	35,30%	28,00%	40,00%
N-E	28,60%	32,20%	21,40%
N-W	39,10%	41,30%	26,10%
South	18,80%	21,90%	12,50%
S-E	41,10%	35,30%	35,30%
S-W	33,30%	18,80%	17,70%
West	32,60%	25,60%	21,00%
General	32,70%	29,70%	25,80%

Figure 3. Level of importance for each factor from the third class at regional level;

As we can see from the figures these factors are considered as being important by little over a quarter of the responding managers. The most important is the existence of

suppliers and the regions where it is significantly more important than the average are the North-West and South-East ones. Less important is for those companies which located their investment in the South region. The existence of other foreign companies in the region is regarded with significant greater attention by companies who chose the Center region or the South-East one. This factor is considered as being important by a significantly lower percentage of the respondents from the South region and by those from the South-West. The existence of other companies with related fields of activity is regarded as being important by a significant larger percentage of the investors who decided to invest in North-West and South-East.

The last class, called "Other factors" consists of six unrelated topics as follows: (1) tax incentives for investors, (2) the existence of universities or research centers in the region, (3) low rent levels or low land acquisition price, (4) availability of raw materials at low costs in the area, (5) the existence of a market for their products and (6) operating costs of the company. In the Figure 4 results obtained for these five topics will be listed.

Other Factors						
Region	F1	F2	F3	F4	F5	F6
Important and Very important						
Center	31,90%	33,40%	52,10%	22,00%	36,00%	56,20%
N-E	25,00%	14,20%	39,30%	35,70%	14,20%	53,50%
N-W	21,70%	13,00%	52,20%	21,70%	21,70%	86,90%
South	22,60%	6,50%	67,80%	16,70%	35,50%	71,00%
S-E	23,60%	11,80%	35,30%	35,30%	23,50%	70,60%
S-W	35,30%	22,20%	64,70%	29,40%	23,50%	75,00%
West	16,30%	14,60%	44,20%	25,60%	18,70%	74,40%
General	24,40%	17,50%	50,80%	25,10%	25,40%	69,90%

Figure 4. Level of importance for each factor from the fourth class at regional level;

The low level for rents or the low land acquisition price and the general operating costs are considered as important determinants of the future investment by over 50% of the respondents. The operating costs of the future investment are an important factor for a significant larger percent (than the average percent) of the respondents for North-West region and are important for a significantly lower percent in Center and North-East. The investors who considered low rent levels or low land acquisition price as being important were more inclined to invest in South and South-West. (They considered the factor as being important in a significantly higher percent than the aggregate). Tax incentives, the availability of raw materials and the existence of a market for the company's products (almost 85% of the respondents declare they send more than 50% of their production to export) are considered as important determinants for the made investment by about a quarter of the respondents. A significantly larger percent of the respondents from the Center region and from the South-West region considered the tax incentives offered by authorities as being important when deciding to locate their investment. This factor was of importance for a significantly lower percentage of respondents from the West region. Firms who consider the existence of raw materials as being an important determinant for the future investment are more inclined to invest in North-East and in South-East. The existence of a potential market for their products is regarded as an important factor by a significantly larger percentage of the investors located in the Center region and South region. The existence of universities and research centers is the least important factor and is taken into consideration when deciding the location of a future investment by only little

over 17% of the respondents. It was considered important by a significantly larger percentage of the managers of the companies located in the region Center (Cluj is an important educational center) and by a significantly lower percentage of the respondents from South region.

Noteworthy for our research is that only around 22% of the respondents considered Bucharest-Ilfov region as an alternative when they decided the location of their new investment. Significantly larger percentages of the respondents from the region South and South-East considered Bucharest as an alternative (geographically neighbor areas) and significantly lower percentages from West, North-East and North-East. Also important to note is that over 68% of the investors preferred a green field investment. Those more inclined for a brown field investment located their facility, in a significantly larger percentage, in North-East or South-East.

Summing up the results displayed in this section we will list further the main strengths of each region when trying to attract a foreign direct investment. Companies who choose Center are more inclined to consider of relevant importance: the quality of roads, the high level of populations' education, the existence of other foreign companies, the tax incentives and the existence of universities and research centers in the area. Those located in the North-East regard the following aspects with an increased attention: the existence of viable land, the existence of other companies working in the same field and the availability of cheap raw materials. Companies that regard the following aspects as being possible determinants of a future investment are more inclined to invest in the North-West region: favorable distribution conditions, the existence of available work force, the existence of available raw materials, the existence of other companies working in related fields and the overall operating costs. Firms that chose South region to develop their activity were more inclined to consider in their investment strategy the next topics: the low rent level or low land acquisition price and the availability of a potential market for their products. South-East region is preferred by firms, who look with special attention on favorable conditions for distribution, available work force in the area, the cost of the labor force, all clustering factors and low rent levels or low land acquisition price. Companies that regard the: tax incentives, low rent levels or low land acquisition price and overall operating costs as being possible determinants of a future investment are more inclined to invest in the South-West region. Companies who choose West region are more inclined to consider of relevant importance: the infrastructure factors, the qualified labor force availability, the overall operating costs and the low cost of the available work force.

4. CONCLUSION

Through the present research we provided a quantitative view of the importance of some regional factors that were taken into consideration by foreign companies when they decided to invest in Romania. Our findings may be considered also a description of some strengths and weaknesses of the Romanian development regions when talking about attracting foreign direct investments. Although our findings are promising, further study is needed in order to clearly identify which are the most important factors, that foreign investors include in their managerial strategy, used to locate a future investment in Romania. Noteworthy is also the fact that extrapolation of the results should be done carefully due to the fact that the sample was not generated through a totally random mechanism.

Finally, in order to develop a more general framework consisting in a clear and complete description of the main regional factors that influence the foreign direct investments in Romania other surveys based on firms from other fields of activity need to

be conducted. Besides we suggest that further research, based on some of the present study findings, should focus on developing a quantitative predictive model (using a logistic regression) that would be able to predict where a FDI would be located based on some criteria specified in the managerial strategy of a company.

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