IMPACT OF THE WORLD BANK'S EASE OF DOING BUSINESS RANKINGS ON

COMPOSITIONS OF FDI INFLOWS: M&A AND GREENFIELD FDI

By

Kim, Anna

THESIS

Submitted to

KDI School of Public Policy and Management

in partial fulfillment of the requirements for the degree of

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ABSTRACT

IMPACT OF THE WORLD BANK'S EASE OF DOING BUSINESS RANKINGS ON COMPOSITIONS OF FDI INFLOWS: M&A AND GREENFIELD FDI

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Foreign direct investment (FDI) inflow plays a substantial role in the growth and development of every country. Accordingly, the question of what drives FDI inflows has been explored and answered in the literature, as has been the positive correlation between FDI inflows and regulation indicated by the World Bank's Ease of Doing Business Rankings (DBR). Relatively little studies has been conducted, however, on the effects of these rankings on the two FDI compositions of mergers and acquisitions (M&A) and greenfield FDI. This paper shows that improved DBR attracts significantly more FDI inflows, though the result becomes insignificant, albeit negative (as the DBR is measured in rankings, e.g. 1st is the highest rank.), when the sample narrows down to developing economies. Moreover, these findings suggest that greenfield FDI is more negatively impacted by regulations than M&A, though the effect is not significant. The analysis offered here has potentially important implications for governments regarding actions that can improve their DBR and generate the benefits associated with increased greenfield FDI, specifically increased capital and rising employment rates.

Keywords: FDI; World Bank's Ease of Doing Business Ranking; M&A; greenfield FDI; panel fixed effect estimation

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1. Introduction

In 2015, global foreign direct investment (FDI) flows increased by 38 percent, reaching 1.77 trillion dollars. These figures are the highest since the global economic and financial crisis of 2008 to 2009, and recovery in the amount of FDI flows was strong in 2015; cross-border mergers and acquisitions (M&A) were valued at 721 billion dollars. The previous year's funding level was only 432 billion dollars, and the huge increase was the principal factor behind the global rebound in 2015. The value of announced greenfield FDI remained at its highest value, 766 billion dollars (UNCTAD, 2016).

Figure 1 illustrates global investment trends from 2003 to 2014 based on the World Investment Report (WIR) statistics made available by the United Nations Conference on Trade and Development (UNCTAD). Data on FDI inflows and the cross-border M&A is used to plot the graph. This paper constructed the greenfield FDI data by deducting the value of M&A from the total amount of FDI inflows. It is to be noted that FDI inflow and M&A were at their highest levels right before the global financial crisis, in 2009; they then decreased in value during the crisis and afterward began a slow recovery. The value of greenfield FDI, however, was little affected by the financial crisis, continuing to increase until 2014. This trend can be explained by the fact that a high proportion of greenfield FDI goes to developing countries.

Then, in what proportions the aggregate FDI inflows can be divided into M&A and greenfield FDI? Figure 2 and 3 show the comparison of proportions of M&A and greenfield FDI by grouping countries into either developed and developing. As shown in figure 2 and 3, the red colored area from the origin represents the proportion of greenfield FDI out of the total FDI inflows (shown as the green colored area from the origin) whereas the blue colored area indicates the proportion of M&A. It is notable that the value of greenfield FDI is higher

than M&A during the period of 2003 to 2014 in developed and developing countries. However, the value of greenfield FDI and M&A is somewhat lower in developing economies than developed economies as expected. In addition, the proportion of greenfield FDI over M&A is significantly large in developing economies compared to developed, and it may be explained by the fact that relatively, there are few large corporations that have the capacity to merge in developing nations. Moreover, one considerable difference between the two graphs is that investment trends including FDI inflows, M&A, and greenfield FDI have changed according to the financial recession which caused a decrease in the amount of investment beginning in 2008. Whereas in developing economies, global financial trends have caused a slightly negative change in investment trends and it sustains the increasing flows.

Many studies have been conducted on the relationship between FDI inflows and economic growth, and even on the effect of FDI on poverty. Over time, FDI has become accepted as a positive aspect of economic development, with the result that political leaders and policy makers put a great deal of effort into attracting FDI to their countries. Since then, a great many professionals and academics have tried to identify the features and qualities that encourage firms to invest as a mode of FDI. We will explore in greater detail factors that drive FDI inflows in the literature review section below. UNCTAD's report defines FDI as an investment in one economy made by a resident of another economy with the prospect of "lasting interest," meaning a long-run relationship between the private investor and the foreign investment company. This being the case, the FDI data only counts instances in which a private investor possess at least 10% of the voting power in the investment enterprise; less than 10% ownership counts as a portfolio investment (United Nations, 2009). Much research has accordingly been conducted to answer the question of whether FDI inflows are impacted

by a country's regulations in the expectation of higher long-term returns.

More recently, many researchers have begun to use a new World Bank database called the Ease of Doing Business Rankings (DBR) to measure several local regulations regarding small and medium enterprises (SMEs). Since the data for this database has been collected since 2003, relatively few studies of FDI have had the opportunity to make use of it. Among these studies, the empirical results that estimate the impact of the DBR on FDI inflows have proved to be quite controversial. Further, little if any work has been done on the effects of the DBR on the two compositions of FDI, cross-border M&A and greenfield FDI.

The purpose of this study is to help fill this gap in the literature by investigating the relationship between FDI inflows and the regulatory environments of recipient countries, controlling for macro-financial characteristics. This paper thus aims to determine whether countries with less burdensome business regulations attract more FDI inflows and how the DBR differentially impacts cross-border M&A and greenfield FDI.

This paper uses a panel data set of 189 developed and developing countries for the period from 2004 to 2014 to demonstrate that, on average, the DBR does correlate negatively with FDI inflows. Thus, the regression result of greenfield FDI shows a pattern roughly equivalent with respect to aggregate FDI to the result with M&A.

The rationale behind the results can be explained in terms of the tendency of firms to make inroads into a foreign market in the mode of greenfield FDI when the regulatory environment is more conducive to starting and operating a local firm, as reflected in a high DBR (equal to low absolute number of rankings, e.g. 1st is the highest rank.). Greenfield FDI requires firms to develop foreign market with a new company, factory, and store, activities that incur higher risks than M&A. The social, economic, and political conditions of FDI-recipient economies therefore are significant in attracting more greenfield FDI than in M&A.

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Further, when the sample narrows down to 24 developing economies categorized as low income by the World Bank, the positive correlation between increased rankings and FDI inflows is not robust.

This paper is structured as follows. Part 2 reviews the literature on the determinants of FDI, FDI and growth, and of DBR and FDI. Section 3 provides the economic specification and the data employed in the analysis. Section 4 presents and discusses the results. Section 5 offers conclusions and insights.

2. Literature Review

2.1. Growth and FDI

The neoclassical growth model is based on the idea that technological progress and population growth are the only exogenous factors that generate economic growth. The effects of FDI thus can only translate into economic growth in cases where FDI itself affects technology in a positive and permanent way. According to a relatively recent endogenous growth model, however, FDI can influence growth endogenously by generating increasing rates of returns in production through externalities or spillover effects (Makki & Somwaru, 2004).

Many researchers have attempted to prove the causal link between FDI and growth. Chowdhury and Mavrotas (2006) have used the Toda-Yamamoto causality test to determine whether GDP causes FDI, or vice versa, in three developing countries that are major FDI recipients, namely Chile, Malaysia, and Thailand. They report that, Malaysia and Thailand show bi-directional causality with respect to GDP and FDI whereas in Chile, GDP causes FDI. In another study, Hansen and Rand (2006) analyzed the Granger causal correlation between FDI and GDP in a sample of 31 developing countries over a period of 31 years, and their empirical results suggest that FDI has a lasting effect on GDP, while GDP has no long-

term effect on the FDI-to-GDP ratio. It thus appears that FDI causes economic growth through transfers of knowledge and new technology. There is debate regarding exactly how FDI affects GDP, but it is undeniable that FDI is a significant part of improving economic performance. Based on this notion, scholars have begun to conduct studies on investigate the causes of FDI inflows that translate into economic development.

2.2. Determinants of FDI

Most scholars acknowledge the importance of FDI, and those who study the topic tend to focus their research on the motivations for FDI inflows. In other words, the aim is to identify the features of FDI-recipient economies that are more successful in drawing FDI inflows. This paper surveys the relevant literature and explains why certain factors have been used as control variables.

As mentioned above, one of most influential determinants of FDI is the domestic market size of FDI-recipient countries. Most studies include GDP and such variants as GDP growth and GDP per capita as variables in their regression models, and the results have been remarkably consistent in showing a positive and significantly robust correlation between GDP and FDI. Artige and Nicolini (2005) suggest that GDP per capita acting as proxy for the market size is the most significant FDI decision element supported by the horizontal model. Chakrabarti (2001) asserts that FDI begins to rise and expand further once the market size reaches a certain critical point. In this paper, GDP per capita is used as one of the control variables to capture the effect of the home country's domestic market size. This variable, however, determined through dividing by the population, only measures the influence of the purchasing power of domestic households in the market. The present study therefore also includes the total populations to control fully the impact of the domestic market size.

Trade openness is instrumented as the sum of imports and exports as a percentage of

GDP. This method is standard in the FDI literature, but the analysis outcomes are somewhat controversial. Chakrabarti (2001) discovers that this variable correlates relatively strongly with FDI inflow. Ang (2007) also asserts that trade openness impacts positively to FDI inflows: "Specifically, a one percentage point increase in trade openness would generate about a 1.094–1.323 percentage point increase in FDI inflows according to our model." Some research, however, is inconsistent with these arguments. Kolatad and Villanger (2008), for example, demonstrate that FDI in the service sector is impervious to the trade openness of the FDI recipient countries. In an effort to resolve the issue, this paper also examines the strength of the relationship between trade openness and FDI inflows and how trade openness affects FDI inflows either negatively or positively.

The inflation rate, which indicates the overall change in prices in an economy and thus represents a country's macroeconomic stability, is calculated as the annual growth rate of the GDP implicit deflator. Demirhan and Masca (2008) assert that FDI inflow correlates significantly and negatively with inflation, arguing specifically that having low inflation tends to attract more FDI inflows to developing economies. Consistent with this view is the work of Kok and Ersoy (2009), whose investigation of the effect of FDI inflows on macroeconomic performance proves that inflation has a negative impact. Ezeoha and Cattaneo (2012), however, find empirically that higher inflation rates do attract more FDI inflows. This contradiction is another that the present study seeks to resolve.

More recently, some researchers have added to the equation institutional variables representing the political stability of FDI-recipient countries. Thus Globerman and Shapiro (2002) state that "Our results suggest that weakening environmental protection regimes are more likely to discourage than encourage FDI." Chan and Gemayel (2004) assert that stability in terms of investment risk is a crucial feature for attracting FDI, particularly in the

Middle East and North Africa, since firms naturally desire the most accurate estimates possible of their rates of return. The study by Demirhan and Masca (2008) just mentioned, however, shows that political risk simply has not been an influential factor, or at least a statistically significant one, in attracting FDI. In other words, when a host country promise high returns to firms, they may fail to take into account the political risk there. In this study, the impact of political stability on FDI inflows is examined using the database of Worldwide Governance Indicators (WGI), which was sourced from the World Bank.

Multinational enterprises (MNEs) tend to invest in a country where there are sufficient numbers of skilled labors to absorb the process of technical knowledge transfer. Wage levels are an important driving force, but skilled employment is also essential for the transfer of knowledge and management techniques. Noorbakhsh, Paloni, and Youssef (2001) use different proxies for labor skill to demonstrate its effect, employing an econometric approach. Their method is first to run several regression models with secondary school enrollment as a variable, and then to replace this variable with such stock measures of human capital as the cumulative years of secondary and tertiary education in the working age population. Presented as significant and positive coefficients, these results elucidate an important point of human capital in FDI inflows. Blomstrom and Kokko (2003) similarly argue that the level of human capital in FDI recipient economy determines both the amount of FDI inflows and the capability of local firms to reap potential spillover benefits. In keeping with these findings, this paper uses the percentage gross rate of secondary school enrollment data to control for the effect of this variable on FDI inflows.

2.3. Regulation (DBR), FDI and Growth

The Doing Business ranking (DBR) is a quantitative indicator of the business regulations of the world's approximately 189 countries that is based on a survey conducted by

entrepreneurs who are active in each. The available data is from 2004 to 2015. The Doing Business index is comprised of 11 areas of regulations related to daily business life, 10 of which are utilized in computing the ease of doing business rankings, namely starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency (www.doingbusiness.org).

The World Bank Group (2014) issues a Doing Business report every two years, at which time it introduces important improvements to its indicators that have resulted from economic analysis of integrated regions as well as specific countries. A new conceptual framework can be constructed by tracking these improvements, and the efficiency of regulation can be enhanced as well. Even though Doing Business indicators are based on domestic small and medium-sized enterprises (SMEs), many policy makers acknowledge their explanatory power regarding increased FDI inflows. Cross-country correlations have already proved that economies with higher DBR do attract more FDI inflows irrespective of other contributing determinants, such as the domestic market size. This empirical result suggests that countries that provide better business environments for domestic SMEs tend to offer the same positive environments for foreign companies too. Figure 2 shows graphically the relationship between the positive performance of DBR and increased FDI inflows per capita, and demonstrates that countries that are adjacent to the frontier had higher FDI inflows per capita in 2011.

Though the DBR was developed only fairly recently, several studies have already been conducted using the DBR dataset. A few scholars have chosen the DBR as a proxy for business regulatory environment and have conducted studies on the effects of regulation on economic performance in general. Djankov, McLiesh, and Ramalho (2006) demonstrate that

countries with better regulations experience more fast-paced growth. The effect of improved regulations is substantial. In their OLS regressions, which include dummies for each quartile of the business regulation index, moving to the best quartile from the worst generates a 2.3 percent rise in average yearly growth. Messaoud and Teheni (2014) have also examined the relationship between business regulations and economic performance using the Doing Business index, in this case in 162 countries over the period from 2007 through 2011. Their regression results make clear that most regulation indices among the ten sub-indicators of the DB correlate positively with the average growth rate, with the exception of the "Trading Across Borders" and "Dealing with Construction Permits" indices.

In addition to exploring the effects of regulations on general economic growth, some researchers have attempted to find a parallel path to growth. This work has focused on FDI that correlates with the growth and regulatory setting of economies. Jayasuriya (2011) demonstrates that DBRs can significantly increase FDI inflows, in this case by approximately 300 million USD; the phenomenon may be attributable to the DBR having "a strong signaling-effect" on foreign investors. Busse and Groizard (2008) stress that regulation can have a beneficial effect on FDI, leading to economic development in FDI recipient countries. Thus, governments need to tackle the institutional environment and regulatory framework to enjoy the potential positive effects of FDI inflows.

Piwonski (2010) demonstrates that there is a strong correlation between DB indicators and FDI inflows, a finding that confirms the direct linkage of inflows to government action. Some governments have already tried to increase their DBRs by eliminating unnecessary red tape in order to increase investment in domestic firms. Corcoran and Gillanders (2015), using a pure cross-sectional approach, also find that a better business regulatory environment induces more FDI inflows on the average. More specifically, they

also report that most of this positive influence comes from "Trading Across Borders," whereas other sub-indicators of the DBR have little or no impact on FDI inflows. Namely, open trade countries tend to draw more inward FDI, and its profits therefore go to their domestic markets.

Morris and Aziz (2011) have conducted regional studies focused on countries in Sub-Saharan Africa and Asia. They report that overall DBR and FDI inflows do not correlate strongly in any database of emerging Asian countries from 2000 to 2005. Two factors of the DBR, however, "Registering Property" and "Trading across Borders," did correlate positively with FDI inflows in Asian and Sub-Saharan Africa countries over the six-year period from 2000-2005. This finding can be illustrated by the fact that MNEs tend to invest in the vast market economies, such as India and China. In the same way, in Africa, Nigeria, Sudan, and the Democratic Republic of Congo are the largest recipients of FDI despite having low rankings.

The Doing Business Rankings can be a useful tool, not only for the objective measurement of regulations, but also for measuring numeric variation over time. By examining improvements in the rankings for each economy during a certain period, researchers can use the delta value as a proxy for regulatory reform. Thus Eifert (2009) investigates the effect of regulatory reform on investment rates and economic growth using a five-year panel data of the DBR through Arellano-Bond dynamic panel estimators. He finds that regulatory reforms influence economic performance positively, especially in such relatively well-managed poor countries as China and India. However, according to the paper by Jayasuriya (2011), there is weak evidence or correlation to imply that the large improvement in rankings gauged by "Reform" (a dummy variable for economies with a rise of greater than nine ranks in the rankings) attracts more FDI inflows.

Despite the fact that DB reports' prescriptive power has generated considerable controversy, many governments use DB studies to guide their reform efforts. A paper by Hanusch (2012) accordingly aims to provide some suggestions for the proper way to use DB studies to leverage the potential of various countries. First, he suggests that governments should seek to create reforms of their investment climates that are "feasible," meaning that the benefits should outweigh the financial and political costs. Second, if "visibility" (in terms of the overall impact of the DBR) is the goal, governments should undertake reforms that can be expected to realize the greatest advances in the overall DBR; if, in contrast, the goal is "impact" (in terms of the actual economic effects of DB-related reforms), governments need to target two specific DB sub-indicators, "Getting Credit" and "Enforcing Contracts."

2.4. Greenfield FDI, M&A and Regulation

Greenfield FDI establishes new entities setting up new offices, buildings, and factories, in the course of which capital is used for the purchase of fixed assets, materials, and goods and services, in turn increasing local employment. By contrast, cross-border M&A includes merging or taking over the capital, assets, and liabilities of currently existing enterprises in foreign countries.

Only a few studies have distinguished aggregate FDI into the two different compositions of greenfield FDI and M&A, each with its own separate effects and features. One example is a paper by Wang and Wong (2009) that finds, based on a sample of 84 countries, that the growth effect of greenfield FDI is significantly robust and positive, in contrast, that of acquisition FDI is negative. M&A can also be beneficial, but only when host countries have adequate human capital. Nanda (2009) uses a different method to examine the impact of the two separate modes of FDI on economic development, but reaches substantially the same conclusions: greenfield investment shows a significant positive influence on

economic performance, and M&A do not. Calderón, Loayza, and Serven (2004), however, argue the opposite, that the acquisition of existing assets (M&A) has a stronger impact on growth than investment in new assets (greenfield FDI).

The World Investment Report (WIR) 2000 gives voice to some of the concerns regarding foreign acquisitions, remarking that "FDI entry through the takeover of domestic firms is less beneficial, if not positively harmful, for economic development than entry by setting up new facilities." Not only do cross-border M&A fail to develop productive capacity, but they also merely transfer ownership from domestic to foreign companies. This relocation of ownership is often followed by employment adjustment of domestic company and elimination of some production or functional activities, such as research and development (CNUCED, 2000). Nanda (2009) also points out the benefits and concerns regarding both modes of FDI: "Greenfield investment not only creates additional capacity on its own, it also stimulates further investment through forward and backward linkages" (compared to acquisition FDI using pre-existing linkages). For their part, transnational corporations prefer to develop their overseas markets through the M&A mode than through greenfield FDI because less risk is involved in using the resources of exiting firms. Moreover, M&A do not create gestation lag; they can earn profits from the first day of business.

It is now clear that greenfield FDI brings greater benefits to developing countries than M&A or privatization. Paradoxically, however, most developing countries implement economic policies that encourage FDI through M&A rather than greenfield FDI. The paradox is explained by the fact that greenfield FDI requires extensive legal and administrative clearance from local government agencies before a firm even opens its doors (Nanda, 2009). Reducing red tape through such measures as decreasing the steps, and therefore the length of time, necessary to start a business could therefore create conditions more favorable to

greenfield FDI. This is not to say that local governments should abolish all regulations regarding foreign corporations that are pursuing greenfield FDI in order to enter the domestic market. The point is that the government agencies that administrate these regulatory measurements need to accelerate their processes. In fact, one of the reasons that China enjoys a higher rate of growth than India is the greater rapidity with which it approves FDI projects (Nanda, 2004).

From the perspective of the government of an FDI-recipient country, greenfield FDI is preferable because it generates more benefits by opening up the domestic market, in particular increases in capital and the employment rate. For MNEs, they prefer to employ greenfield FDI to enter foreign markets where there are business-friendly environments without any unnecessary administrative regulations. For them, the World Bank's DBR serves as one of the signals that a country is reducing red tape with regard to its own domestic firms. Thus, by appreciating the fact that business regulations impact greenfield FDI relatively more than M&A, an FDI-recipient country can use the DBR as an indicator of willingness to carry out administrative reform in order to encourage much greener greenfield FDI.

3. Research Model

3.1. Hypotheses

This paper aims to estimate the explanatory power of the World Bank's DBR, which currently includes 189 countries for the period from 2004 to 2014. Using the DBR as a quantitative proxy for the efficiency of local governments with respect to business regulations, the amount of FDI inflow into each country will be compared with the DBR of the same year. The two modes of FDI, greenfield FDI and M&A, will also be compared with the rankings. The following three hypotheses will be tested.

The first null hypothesis is that each economy's DBR will have a positive and

significant correlation with an increase in FDI inflows. The alternative hypothesis is that moving up in the rankings will attract FDI inflows. It should be observed that a lower DBR number (equal to high rank, e.g. 1st is the highest rank.) indicates that the business regulatory environment is relatively more conducive to starting and operating a firm, which results a negative correlation between the FDI inflows and the DBR. Going deeper, this paper will divide the aggregate FDI inflows into M&A and greenfield FDI. Thus, the second null hypothesis is that the DBR is a significant determinant of M&A, whereas the alternative hypothesis is that M&A is not significantly impacted by the rankings. The last null hypothesis is that the DBR is neither a negative nor a significant determinant of greenfield FDI; the alternative hypothesis is that greenfield FDI is negatively and significantly influenced by the DBR. In what follows, the data will first be examined for correlation, and then a panel fixed effects model will be performed in order to provide statistical results. Conclusions will be drawn from the fit of the line, and the variability of the data will be addressed in an effort to make clear the limitations of the paper.

3.2. Data and Methodology

Before discussing the methodology of the paper, it will be useful first to review the data used in the econometric model. Table 1 shows the list of dependent and independent variables. FDI inflows, M&A, and greenfield FDI are the dependent variables. Data on FDI inflows have been extracted from UNCTAD's WIR for various years. Data on M&A have also been taken from the UNCTAD database accessible through its website; data on greenfield FDI, however, is not available. Thus, following the method used by Nanda (2009), data on greenfield FDI have been calculated by subtracting the value of M&A from the total FDI inflows.

A key independent variable is the World Bank's DBR, which measures several

important dimensions of the business regulatory environment in which local firms operate. The focus of this paper is on how countries' overall Doing Business rankings change over time; however, economies are ranked based on scores in ten different categories, each of which consists of equally weighted sub-indicators. The following 11 areas of business regulation are measured: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, resolving insolvency, and labor market regulation. The rankings of economies regarding the labor market regulation indicators are not, however, incorporated in the aggregate DBR.

Table 2 shows how the DBR is measured in the various areas. The Doing Business index is based on domestic laws and regulations as well as administrative requirements. The DBR is composed through a number of rounds of interviews with professionals in both the private and public sectors and through questionnaires, conference calls, written correspondence, and visits by a regional team. The Doing Business team first develops questionnaires for each topic and gathers the completed forms of survey questions from private sector practitioners and government officials. The team then evaluates the related laws and regulations along with the information from the surveys. After the data have been reviewed and the report written up, the final report is published (Doing Business, 2016).

Doing Business data covers the full scope of factors, policies, and institutions that impact the quality of a country's business regulation or economic potential, including market size, macroeconomic stability, and level of corruption, each topic being relevant to a diverse features of the business regulatory environment. These data thus shed the light on the importance of government actions in the day-to-day running of local SMEs. The motivation for making the data accessible is to encourage governments to design regulatory

environments in which new entrants with compelling ideas are able to start businesses and established firms can invest and expand (Doing Business, 2016). This paper will use the Doing Business data as a proxy for a government's regulatory actions and will compare this data with the dependent variables of aggregate FDI inflows, M&A and greenfield FDI.

In order to monitor the robustness of the results, several additional determinants of FDI inflows have been added in the model. The control variables are selected based on an extensive review of the previous literature regarding the potential determinants of FDI explained above. GDP per capita and trade openness are used as macroeconomic variables, and inflation rate is included as a financial stability variable. The population variable controls fully the impact of domestic market size, and the governance indicator is meant to measure the quality of government in terms of respecting its citizens and formulating sound policies. The labor skill variable represents the availability of skilled workers in the foreign market measured as the percentage of secondary school enrollment. All control variables are sourced from the World Bank.

Table 3 illustrates the fundamental features of the data and shows simple summaries of the sample and the measures, including the number of observations, mean, standard deviation, maximum, and minimum. The number of observations varies with the amount of data for each variable. A strongly balanced panel dataset is, however, used in the model, meaning that each cross-sectional unit is observed for the same time periods. The amounts of money were logged to correct the measurement and follow normality, and percentage point data was divided by 100 in order to match measurement with other variables.

With the purpose of testing the three null hypotheses mentioned above, the equation is constructed in the following form:

$$Y_{it} = \beta_1 X_{it} + \theta Z_{it} + a_{it} + u_{it}$$

- Y_{it} is the independent variable (IV): FDI inflows, greenfield FDI, and $M\&A$, where $i = country$ and $t = year$.

- X_{it} represents one key (IV), in this case, DBR.

- β_1 is the coefficent for the key IV: DBR.

- Z_{it} represents all of the control independent variables: GDP per capita, population, trade openness, inflation, Governance, and labor skill.

- θ is the coefficent for the control IVs

- $a_{it}(i = 1 \dots n)$ is the unknown intercept for each entity $(individual - specific\ effect)$

- u_{it} is the error term

Much of the literature on the FDI determinants has used the fixed effects panel data estimation. Using this estimation allows controlling for such unobservable and unmeasurable variables as national factors (e.g.,, policies, legal systems, and international agreements), which are captured by a_{it}, the unobserved individual heterogeneity in the model. The main benefit of choosing the panel fixed effects model is to solve common bias resulting from omitted variables. For instance, even if one omitted variable, such as the legal system, is correlated with both the dependent variable and one or more included independent variables, the fixed effects method controls for unobserved heterogeneity, in this case, a legal system that is constant with time. However, in order for this to be true, the omitted variables must have time-invariant values with time-invariant effects. Lastly, robust standard errors are used to eliminate possible bias from multicollinearity and heteroscedasticity in all models. There

are some limitations regarding the data and the model, which will be explained in next section.

3.3. Limitations

The Doing Business methodology is designed to replicate certain aspects of business regulations, and it has its merits and limitations that need to be stated when using its data set. Two positive aspects of this methodology are that the data is cost-effective and that it can be comparable across economies (Doing Business, 2016). On the other hand, the data is subnational, meaning that it is based on a survey conducted in the country's largest business city, for instance Shanghai in China, for which reason it may not representative of regulations across the country (Data Notes, 2012).

Second, the data was originally gathered under four sub-indicators in 145 economies starting from 2003, and six more sub-indicators and forty-four additional countries have since been included. Thus, countries with the same scores on subheadings may have different aggregate rankings owing to the added number of economies. Further, the data only focus on countries' relative improvements in each year, and do not in every case reflect absolute changes or reforms. In other words, all 189 countries could improve at the same time over a decade, but the rankings always range from 1 to 189 in which their relative rankings would still remain the same.

Third, the data assumes that a business has an access to all information on every requirement and does not squander any time finishing necessary procedures. In the real world, businesses can miss relevant information and can choose not to follow burdensome procedures. When this happens, it may take longer to start a firm, and as a result the data can differ from what the local entrepreneurs report in the World Bank's survey. Lastly, the data is only gathered from an exclusive type of business, typically a limited liability company, and

therefore does not reflect the voices of sole proprietors (Data Notes, 2012). These limitations to constructing the DBR objectively may give rise to measurement errors.

There is also a methodological limitation that needs to be addressed. Although the fixed effect estimation is free from bias caused by the time-constant country effect, it may suffer from an endogeneity problem, specifically reverse causality. For instance, the amount of FDI inflows can change the regulatory environment of a country that receives FDI. From the government's perspective, this increase can motivate deregulatory policies and administrative business processes to encourage further FDI inflows, creating a positive feedback loop. It would be, however, tricky to assess the sole impact of regulation on FDI inflows. Also, country-specific, time-variant factors can be correlated with independent variables, and this kind of omitted variable bias cannot be solved using the panel fixed effect estimation. For example, an omitted variable such as the tax rate on corporate income can be correlated with FDI inflows, M&A, and greenfield FDI, thereby leading to bias.

4. Results

Table 4 presents four models undertaken in different ways. For the first and second models, the independent variable is logged FDI; the first model does not include any control variables, whereas the second is run with all of the control variables. The first model does not show any significant correlation between FDI inflows and the DBR. However, when all the control variables, including logged GDP per capita, logged population, trade openness divided by 100, inflation rate divided by 100, governance, and labor skill divided by 100, are embodied in the second model, the DBR is a robustly significant determinant of FDI inflows at the 5% significance level, and the coefficient shows that moving up one rank in the DBR leads to a 0.457 percentage rise in the amount of FDI inflows. Again, it must be kept in mind that a drop in the rankings (equal to the increase in the absolute number of the ranking)

corresponds to more burdensome regulations on domestic firms, which should mean a negative relationship between rankings and FDI inflows; namely, a country that is ranked higher on the DBR can expect greater FDI.

In Models 3 and 4, the dependent variables are logged M&A and greenfield FDI. In neither model is the DBR significantly related with M&A and greenfield investment. However, greenfield FDI is negatively impacted by the DBR, which means that an improvement of one ranking (i.e., a decrease in the absolute number of the ranking) results in a 0.358 percentage rise in greenfield investment inflows. By contrast, the value of M&A has a positive relationship with the DBR. Namely, the value of greenfield FDI can be increased by a foreign government's moves to build a more business-friendly market, whereas the value of M&A cannot be increased by such measures.

When the results are compared, those of Models 2 and 4 have the same pattern and structure, with the beta coefficient and its sign of DBR indicating negatively and percentages of 0.457 and 0.358, respectively, whereas the coefficient of M&A is positive and a percentage of 0.0656. Moreover, the beta coefficients for the control variables are also to a certain degree equivalent. Specifically, among the control variables, logged GDP per capita shows positive and robustly significant relationships with both FDI inflows and greenfield FDI at the 1% significance level, while it has a negative correlation with M&A. In addition, FDI inflows and greenfield FDI are significantly and positively impacted by logged population, whereas M&A is not. Likewise, signs and beta values are quite similar for Models 2 and 4, for instance positive signs for the trade openness variable as opposed to the negative sign in Model 3. It is therefore suggestive that the DBR is more likely to be significantly correlated with the value of greenfield FDI than M&A in cases where more accurately collected data was available.

The results of the control variables are consistent with previous studies. Thus strongest determinant of FDI is logged GDP per capita, where a p-value is less than the 1% significance level. Most studies present empirical results that have a significant and positive association between FDI inflows and the market size of recipient countries. Further, logged population and trade openness are also positively and significantly associated with FDI inflows, as expected.

Table 5 indicates the regression results when narrowing down to developing economies in isolation. From the aggregate data including all 189 economies, this paper only extracts countries categorized as low income by the World Bank, and it constructs a new panel dataset for conducting the panel fixed effects estimation. When looking at Model 2 supplemented with the control variables, it is noteworthy that a favorable relationship exists between improvements in the rankings and FDI inflows, though the correlation is not robust. The coefficients are also smaller than is the case when all economies are included in the analysis (i.e., the results from Table 4, Model 2). None of the control variables, apart from logged GDP per capita, is significantly correlated with FDI inflows.

There are a number of ways to explain the lack of a significant relationship between the rankings and FDI inflows for developing nations. The work of Jayasuriya (2011) suggests one possibility, namely that the DBR may reflect only the formal time and costs once a firm is in complete compliance with the regulations in a foreign country, though this scenario may not be indicative of actual business experiences. In addition, Hallward-Driemeier and Pritchett (2011) point out a discrepancy between policy and its implementation, observing that "policy implementation often deviates from the stated policy, in firm (or individual) specific ways," such as bribes, gifts, and unexpected clandestine meetings with the government officials. This does not of course mean that the government of a developing

country should focus on ensuring full compliance with its regulation and forego trying to improve its standing on the DBR. Also, it should again be noted that the results of this paper are based on the averaged values of 24 developing economies and therefore cannot be generalized to developed countries.

5. Conclusion

Using panel data from approximately 189 developed and developing economies for the period from 2004 to 2014, this paper is the first to show empirically that, for the average economy, improvement in the Doing Business Rankings increases FDI inflows. In keeping with the results of previous literature, improvements in other determinants of FDI are indeed found to correlate with greater inflows of FDI. It may be the case, however, that a higher DB ranking has a strong signaling effect on foreign investors, encouraging an inflow of foreign capital.

Second, this paper demonstrates that an improvement in the DBR is more likely to encourage multinational enterprises to enter foreign markets through the mode of greenfield FDI rather than M&A. Thus, foreign corporations tend to invest in countries in which government agencies streamline the regulatory process. Recipient governments prefer greenfield FDI over M&A owing to its ability to create additional capacity through increasing capital and the employment rate. The deregulation of administrative procedures favored by entrepreneurs can therefore be a win-win strategy for both foreign firms and domestic governments, which in return can reap the benefits of inflowing greenfield FDI.

This paper does have some limitations in terms of data and statistical analysis, specifically measurement errors and an endogeneity problem caused by the omitted variable bias and reverse causality. Within these limitations, the aim is to suggest various perspectives on the effects of regulation on FDI, especially on the two FDI compositions of M&A and

greenfield FDI. Governments can thus use the findings presented here to encourage foreign investment by improving their Doing Business rankings according to the type of FDI that they wish to encourage to their domestic markets.

Given the heterogeneity of the 189 sampled economies, it would be useful to determine how the Doing Business rankings impact FDI inflows into countries across geographical regions. Further research might therefore investigate whether foreign investors are more likely to invest in emerging Asian economies given similar improvements in their DBR rankings as opposed to investment in Europe or the Americas. A similarly fruitful line of analysis could focus on how improvements in DBR rankings relate to FDI inflows in the various industrial sectors, primary, manufacturing, and service. As more data become available, researchers and policy makers should be able to answer such questions, and thereby provide policy makers and firms with insights regarding the significance of the DBR.

6. Appendix

**Figure 1. Global FDI inflows, M&A, and greenfield FDI, 2003-2014
(in millions of dollars)**
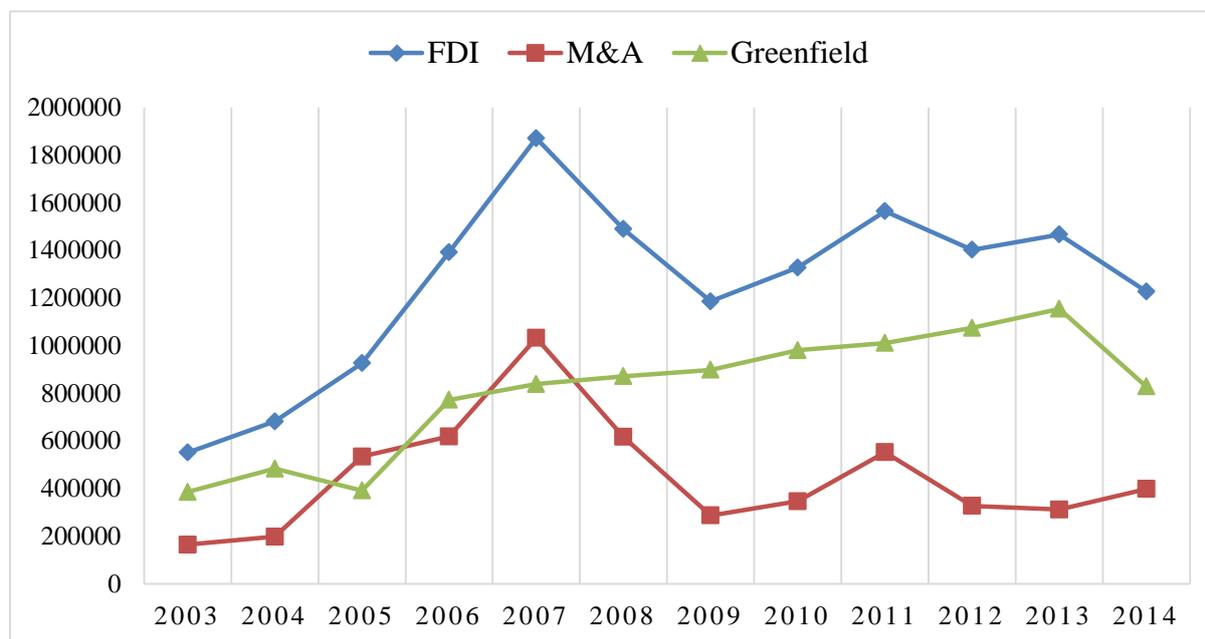
Source: UNCTADstat database

**Figure 2. FDI inflows by component,
by developed economy, 2003-2014**
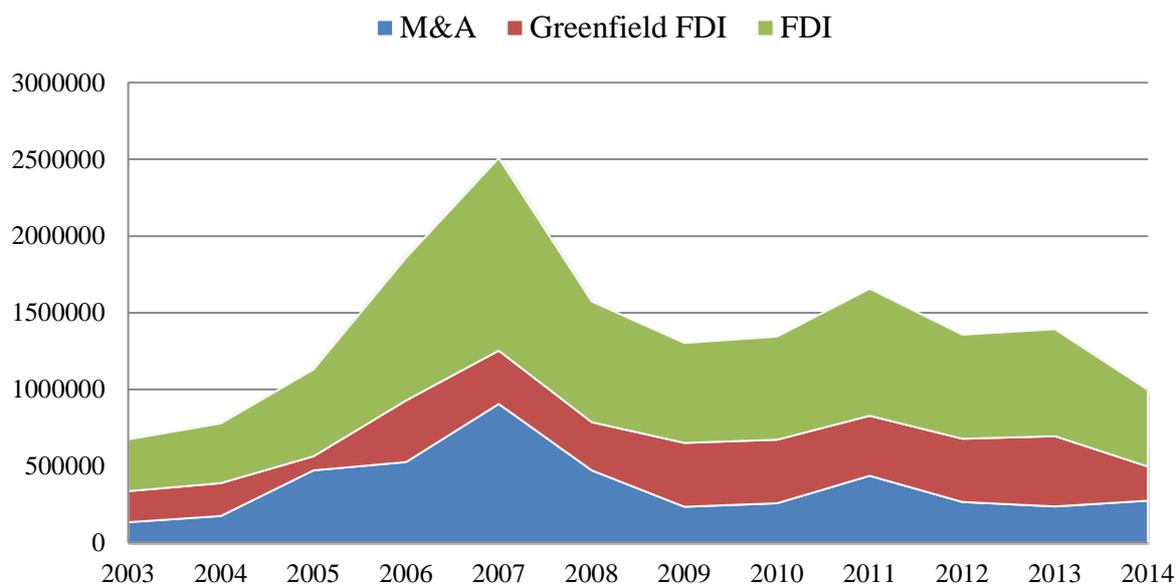
Source: UNCTADstat database

Figure 3. FDI inflows by component, by developing economy, 2003-2014

■ M&A   ■ Greenfield FDI   ■ FDI

Source: UNCTADstat database

Figure 4. Better overall regulation correlates with greater FDI inflows per capita

Distance to frontier, 2011
(percentage points)

FDI inflows per capita, 2011 (US$)

Note: The distance to frontier measure is normalized to range between 0 and 100, with 100 representing the best performance (the frontier). Sample includes 157 economies with positive 2011 FDI inflows per capita of $1,500 or less. This includes all economies covered by *Doing Business 2012* for which data are available, excluding outliers with negative inflows or inflows greater than $1,500 per capita. Dropping these outliers does not significantly affect the trend line.

Source: Doing Business database; United Nations Conference on Trade and Development, UNCTADstat database.

*Figure 4.*Better overall regulation correlates with greater FDI inflows per capita. Reprinted from "Doing Business 2013," by the World Bank, 2013, *Doing Business Report*, 48. Copyright (2013) by the World Bank.

Table 1. Description of variables

| Variables	Description	Sources
FDI	US $s at current prices and current exchange rates in millions	UNCTAD STAT
M&As	Sales of companies in the host economy to foreign TNCs (-) Sales of foreign affiliates in the host economy	UNCTAD cross-border M&A database
Greenfield FDI	Calculated by the difference between FDI inflows and M&A inflows	Author
Doing Business Rankings	Ranked from 1 to 189 (1= most business-friendly regulations)	World Bank's Doing Business
GDP per capita	Gross domestic product divided by midyear population in current U.S. dollars	World Bank's World Development Indicators
Population	Total number	
Trade openness	The sum of exports and imports of goods and services (% of GDP)	
Inflation rate	The annual growth rate of the GDP implicit deflator (annual %)	
Governance indicator	A simple average of the component indicators ranging from approximately -2.5 to 2.5	World Bank's Governance Indicator
Labor Skill	School enrollment, secondary (% gross)	World Bank's World Development Indicators

Source: Author

Table 2. What Doing Business measures

What Doing Business measures – 11 areas of business regulation	
Indicator set	What is measured
Starting a business	Procedures, time, cost and paid-in minimum capital to start a limited liability company
Dealing with construction permits	Procedures, time and cost to complete all formalities to build a warehouse and the quality control and safety mechanisms in the construction permitting system
Getting electricity	Procedures, time and cost to get connected to the electrical grid, the reliability of the electricity supply and the cost of electricity consumption
Registering property	Procedures, time and cost to transfer a property and the quality of the land administration system
Getting credit	Movable collateral laws and credit information systems
Protecting minority investors	Minority shareholders' rights in related-party transactions and in corporate governance
Paying taxes	Payments, time and total tax rate for a firm to comply with all tax regulations
Trading across borders	Time and cost to export the product of comparative advantage and import auto parts
Enforcing contracts	Time and cost to resolve a commercial dispute and the quality of judicial processes
Resolving insolvency	Time, cost, outcome and recovery rate for a commercial insolvency and the strength of the legal framework for insolvency
Labor market regulation	Flexibility in employment regulation and aspects of job quality

Note. Reprinted from "About Doing Business 2016," by the World Bank, 2016, *Doing Business Report*, 20. Copyright (2016) by the World Bank.

Table 3. Statistical description of data

Variable	Obs	Mean	Std	Max	Min
Log(FDI)	1900	6.747075	2.407545	-3.454788	12.63254
Log(M&As)	1079	5.573255	3.062956	-4.60517	12.30982
Log(Greenfield)	1604	6.999946	2.00831	.0813053	12.06227
DBR	1916	88.24791	50.51728	1	175
Log(GDP/cap)	2033	8.382264	1.541387	4.782983	11.66706
Log(Pop)	2068	15.60237	2.048113	9.89369	21.03389
Open/100	1931	9.630031	5.575706	.01	19.28
Inflation/100	2022	.0645245	.0840656	-.2954719	1.038228
Governance	2073	-.0490044	.8878416	-1.928332	1.985394
Labor skill/100	1360	.7904315	.2784491	.0916514	1.655813

Source: Author

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Table 4. Impact of DBR on FDI inflows/M&A/greenfield FDI

(Robust standard errors in parentheses, *** p<0.01, ** p<0.05, * p<0.1)

VARIABLES	Log(FDI)		Log(M&A)	Log(Greenfield)
	(1)	(2)	(3)	(4)
	Model 1	Model 2	Model 3	Model 4
Doing Business Ranking	-0.00360	-0.00457*	0.000656	-0.00358
	(0.00231)	(0.00246)	(0.00672)	(0.00258)
Log(GDP/cap)		0.626***	-1.186**	0.879***
		(0.229)	(0.575)	(0.247)
Log(Population, total)		3.067*	3.223	3.092**
		(1.635)	(3.521)	(1.554)
Trade Openness/100		0.740**	-0.282	0.447
		(0.354)	(0.872)	(0.399)
Inflation/100		0.450	0.801	0.189
		(0.458)	(1.199)	(0.391)
Governance		0.672*	1.180	0.233
		(0.370)	(1.307)	(0.428)
Labor Skill/100		-0.694	-0.160	-0.888
		(0.651)	(1.456)	(0.778)
Constant	7.184***	-46.92*	-36.59	-49.99**
	(0.204)	(24.710)	(55.540)	(23.990)
Observations	1,455	890	571	772
R-squared	0.003	0.095	0.014	0.102
Number of Countries	169	147	119	130

Table 5. Influence of DBR on FDI inflows/M&A/greenfield FDI to developing countries
(Robust standard errors in parentheses, *** p<0.01, ** p<0.05, * p<0.1)

	Log(FDI)		Log(M&A)	Log(Greenfield)
	(1)	(2)	(3)	(4)
VARIABLES	Model 1	Model 2	Model 3	Model 4
Doing Business Ranking	-0.0101**	-0.00136	-0.0177	0.00477
	(0.00423)	(0.00550)	(0.0194)	(0.00276)
Log(GDP/cap)		1.613**	-5.986	1.483**
		(0.766)	(3.724)	(0.623)
Log(Population, total)		4.544	4.627	1.546
		(3.287)	(18.11)	(2.350)
Trade Openness/100		-0.232	-0.143	-0.159
		(0.141)	(0.944)	(0.215)
Inflation/100		1.333	-4.733	-0.598
		(1.331)	(13.51)	(1.091)
Governance		-0.389	-3.746	0.0881
		(0.812)	(2.858)	(0.739)
Labor Skill/100		-0.869	4.532	5.931
		(6.524)	(28.22)	(3.931)
Constant	6.474***	-80.17	-40.49	-31.66
	(0.609)	(51.86)	(306.3)	(40.46)
Observations	249	127	36	104
R-squared	0.021	0.344	0.259	0.494
Number of Countries	28	24	13	18

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Table 6. Selected countries

Selected Countries			
Afghanistan	Ecuador	Libya	Senegal
Albania	Egypt, Arab Rep.	Lithuania	Serbia
Algeria	El Salvador	Luxembourg	Seychelles
Angola	Equatorial Guinea	Macedonia, FYR	Sierra Leone
Antigua and Barbuda	Eritrea	Madagascar	Singapore
Argentina	Estonia	Malawi	Slovak Republic
Armenia	Ethiopia	Malaysia	Slovenia
Australia	Fiji	Maldives	Solomon Islands
Austria	Finland	Mali	South Africa
Azerbaijan	France	Malta	South Sudan
Bahamas, The	Gabon	Marshall Islands	Spain
Bahrain	Gambia, The	Mauritania	Sri Lanka
Bangladesh	Georgia	Mauritius	St. Kitts and Nevis
Barbados	Germany	Mexico	St. Lucia
Belarus	Ghana	Micronesia, Fed. Sts.	St. Vincent and the Grenadines
Belgium	Greece	Moldova	Sudan
Belize	Grenada	Mongolia	Suriname
Benin	Guatemala	Montenegro	Swaziland
Bhutan	Guinea	Morocco	Sweden
Bolivia	Guinea-Bissau	Mozambique	Switzerland
Bosnia and Herzegovina	Guyana	Myanmar	Syrian Arab Republic
Botswana	Haiti	Namibia	Taiwan, China
Brazil	Honduras	Nepal	Tajikistan
Brunei Darussalam	Hong Kong SAR, China	Netherlands	Tanzania
Bulgaria	Hungary	New Zealand	Thailand
Burkina Faso	Iceland	Nicaragua	Timor-Leste
Burundi	India	Niger	Togo
Cabo Verde	Indonesia	Nigeria	Tonga
Cambodia	Iran, Islamic Rep.	Norway	Trinidad and Tobago
Cameroon	Iraq	Oman	Tunisia
Canada	Ireland	Pakistan	Turkey
Central African Republic	Israel	Palau	Uganda
Chad	Italy	Panama	Ukraine
Chile	Jamaica	Papua New Guinea	United Arab Emirates

China	Japan	Paraguay	United Kingdom
Colombia	Jordan	Peru	United States
Comoros	Kazakhstan	Philippines	Uruguay
Congo, Dem. Rep.	Kenya	Poland	Uzbekistan
Congo, Rep.	Kiribati	Portugal	Vanuatu
Costa Rica	Korea, Rep.	Puerto Rico (U.S.)	Venezuela, RB
Côte d'Ivoire	Kosovo	Qatar	Vietnam
Croatia	Kuwait	Romania	West Bank and Gaza
Cyprus	Kyrgyz Republic	Russian Federation	Yemen, Rep.
Czech Republic	Lao PDR	Rwanda	Zambia
Denmark	Latvia	Samoa	Zimbabwe
Djibouti	Lebanon	San Marino	
Dominica	Lesotho	São Tomé and Príncipe	
Dominican Republic	Liberia	Saudi Arabia	

Source: Author

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