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Determinants of Foreign Direct Investment: An analysis of Japanese Investment in Ireland using the Kano model

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Abstract

This paper presents findings from an analysis of the location-specific foreign direct investment (FDI) factors that attract Japanese multinational companies (MNCs) to Ireland. Data was collected from 11 Japanese MNCs and 2 support agencies using a structured Kano model in order to differentiate levels of satisfaction with, and relative importance of, 23 FDI attributes generated from the literature. Our findings reveal that Ireland's low corporate tax rate is the most important determinant for Japanese MNCs to invest in Ireland followed closely by the presence of a skilled workforce. While government's role in maintaining stability and the ability to access to large regional markets were found to be imperative, we learned that the nature of the domestic market was not important at all to Japanese investors. We also found that interconnected clusters of FDI factors are influential to Japanese investors when investing in Ireland thus providing a new lens to policymakers.

Keywords

Foreign direct investment (FDI), determinants, best practice, Kano model

1 Introduction

Foreign Direct Investment (FDI) is essentially an international investment where the investor gains significant influence in the management of an entity outside the investor's home country [Solomon 2011]. Empirical evidence shows that FDI has become an important force in the internationalisation of investment activities in both the global and Irish economies alike. For instance, the inflows of FDI globally were $1,114 billion in 2009 [UNCTAD 2010] while inflows into Ireland were $13.1 billion in 2011 [OECD 2012].

Given the economic importance of FDI for the Irish economy it is critical that the determinants for FDI are understood. However, much of the academic literature and empirical evidence on the determinants of FDI in Ireland has focused on large US firms [Gunnigle and McGuire 2001]. This may be explained by the prevalence of US firms in Ireland and the significance of their foreign investments. While US firms have rightly received attention from academics studying the determinants and impact of FDI in Ireland, there are potential benefits from having a more diversified investment profile including a lower exposure to economic and currency fluctuations in MNCs home countries. One region that has received little attention is Japan. Although the Japanese may have quite a different culture to the Irish, their focus on high-technology activity couples well with Ireland's recent focus on building a "Smart Economy" and developing the "Innovation Island". In light of this our research aims to analyse the determinants for FDI by Japanese MNCs in Ireland. The study presented here centres on the following question: What are the location-specific factors that influence the decision by Japanese MNCs to invest in Ireland?

2 Synthesis of the Literature

Although there is some consensus among scholars on the role of FDI in fostering economic growth there has however been limited consensus on FDI determinants [Eicher, et al. 2011]. While locational determinants of FDI are clearly driven by policy, economic and business facilitation factors the actual determinants depend greatly on the context and motives of the MNC. Dunning [1995] highlights that the factors of FDI are complex and there is no single explanation for all FDI determinants. Table 1 synthesises the broad categories, factors and associated literature relating to FDI best practice and determinants.

Category + Factor	**Reference**
Government Policy	
Proactive Role of Government	Rios-Morales and Brennan 2007, Lall 2002
Low Corporate Tax Rates	Eicher, et al. 2011
Low-Risk Political Environment	Blonigen 2005, Cieslik and Ryan 2004
High-Quality Government Institutions	Blonigen 2005, Kinoshita and Campos 2002
Industrial Policies for Knowledge Clusters	Dimitropoulou, et al. 2007, Morisset 2003
International Trade Agreements on FDI	Piteli 2010, Kinoshita and Campos 2002
Economic Activity	
Strong Macroeconomic Conditions	Eicher, et al. 2011, Piteli 2010, Razin, et al. 2008, Cieslik and Ryan 2004, Kinoshita and Campos 2002
Access to Local Capital within a Stable Banking System	UNCTAD 2010, Piteli 2010, Ozturk 2007
Low Levels of Corruption and Risk	Kolstad and Villanger 2004,Wei 2000,Wheeler and Mody 1992
Access to a Strong Export Market	Cieslik and Ryan 2004
Growing Domestic and Regional Markets	UNCTAD 2010, Groh and Wich 2009, Torrisi, et al. 2008, Cheng and Kwan 2000, Wheeler and Mody 1992
Competitive Labour Force Costs and Productivity	Groh and Wich 2009, Cheng and Kwan 2000, Barrell and Pain 1996
Access to High-skilled Labour	Dimitropoulou, et al. 2007, Gilmore, et al. 2003, Noorbakhsh, et al., 2001, Borensztein, et al., 1998
Clusters and Agglomeration Effects	Kinoshita and Campos 2002, Head, et al. 1995, Wheeler and Mody 1992
Low-Cost Operations and High Quality Infrastructure	Li and Clarke-Hill 2004, Cheng and Kwan 2000
Business Enablement	
Access to Progressive Investment Promotion Incentives	Groh and Wich 2009, Naudé and Krugell 2007, Baniak, et al. 2005, Li and Clarke-Hill 2004, Morisset 2003, Ramcharran 2000
Access to Local Amenities and High Quality of Life	Li and Clarke-Hill 2004, Gunnigle and McGuire 2001
Previous Investment or Knowledge of Ireland	Cieslik and Ryan 2004

Table 1: Synthesis of the literature relating to FDI determinants

3 Research Method

We designed a structured survey to empirically capture the salient location determinants for FDI in Ireland by Japanese MNCs. 23 specific measures were developed based on a synthesis of the most recent literature to ensure that data reflected the most up to date research findings. A Kano questionnaire was developed to help identify the relative interdependence and strata of determinants for FDI investment. Kano questionnaires have two questions for each determinant. The first question measures how a respondent feels using a Likert scale when a requirement is met (the functional question) and the second question measures how a respondent feels where the requirement is not met (the dysfunctional question). This approach challenges traditional customer satisfaction models that suggests that the better we perform on each service attribute the more satisfied the customers will be. Kano's model contends that performance on specific attributes is not equal in the eyes of the customers and that certain categories of attributes produces higher levels of satisfaction than others. Consequently the model determines six categories of quality attributes as shown in Table 2. This approach allows us to discern the relative importance of each of the determinants.

Kano Category (Alternative Names)	**Description**
Attractive (Delighter, value-add)	An Attractive (A) feature means that a feature of the country provides extra satisfaction when present but the country is still satisfactory when the feature is absent.
One-Dimensional (Performance, proportional)	A One-Dimensional (O) feature means that the more functional the feature within the country the more satisfied the investor and vice versa.
Must-Be (Basic, expected)	The Must-Be (M) feature indicates aspects where the investor is more dissatisfied when the country attribute is not there, but satisfaction never rises above neutral no matter how functional the attribute becomes. Extra effort spent improving such features would make little impact on satisfaction for the investor.
Indifferent (No difference)	An Indifferent (I) feature means that a feature of a country does not provide either satisfaction or dissatisfaction to the investor.
Reverse (Negative feature)	A Reverse (R) feature causes dissatisfaction. Such features should be eliminated.
Questionable (Quality control mechanism)	A Questionable (Q) feature means that scores signify that the question was phrased incorrectly, or that the person misunderstood the question

Table 2: Description of Kano categories Adapted from [Lai and Wu 2011], [Yang 2005], [Kano, et al. 1984], [Berger, et al. 1993]

Using these questionnaires and associated evaluation tables, the perceptions of respondents are grouped into the Kano categories [Kano, et al. 1984]. The classification of a feature is determined by: Kano category = maximum (A, O, M) if (A+O+M) > (I+Q+R) or maximum (I, Q, R) if (A+O+M) ≤ (I+Q+R) [Lai and Wu, 2011]. The customer satisfaction coefficient can also be determined: This states whether satisfaction can be increased by meeting an FDI requirement, or whether fulfilling the FDI requirement merely prevents the customer from being

dissatisfied [Berger, et al. 1993]. The customer satisfaction coefficient is measured using the following formulae.

- Extent of satisfaction: (A+O) / (A+O+M+I)
- Extent of dissatisfaction: (O+M) / (A+O+M+I) * (-1)

FDI determinants can be prioritised using the rule provided by Berger, et al. [1993]: Must-be > One-dimensional > Attractive > Indifferent. However, in some cases, it can be unclear as to which feature to prioritise and in these cases, the '*self-stated-importance*' scores provided by respondents are used to determine the priority. In order to increase precision we used Berger's approach to specify a point in a two-dimensional coordinate system [Berger, et al. 1993]. Our analysis is based on 23 pairs of questions (Q = 23) where j = 1, ..., Q, and N respondents (N = 11) where i = 1, ..., N. Our research also used a self-stated importance questionnaire across the 23 areas (W = 23) in parallel with the Kano questionnaire. Thus, there are three scores for each potential FDI requirement being investigated: Functional, Dysfunctional, and Importance. These three scores are coded as follows:

- Functional: Y_{ij}= -2 (Dislike), -1 (Live with), O (Neutral), 2 (Must-be), 4 (Like)
- Dysfunctional: X_{ij} = -2 (Like), -1 (Must be), O (Neutral), 2 (Live with), 4 (Dislike)
- Importance: W_{ij} = 1 (Unimportant), 2 (of Little Importance), 3 (Moderately Important), 4 (Important), 5 (Very Important).

The values for X and Y take on the values -2, -1, 0, 2 and 4 only. The logic for the asymmetrical scale (beginning from -2, rather than -4) is that Must-Be and One-dimensional are stronger responses than Reverse or Questionable. Therefore, the scaling should give less weight to the less strong responses to diminish their influence on the average.

All 23 Japanese MNCs in Ireland were included in the sample frame to allow us to generalise findings within the Irish context. 11 of these companies participated in the study (cf. Table 3). In addition representatives of the Irish Development Authority (IDA) and the Japanese business forum in Ireland were also included to help obtain further insight into foreign investment by Japanese firms in Ireland.

No	**Company Name**	**Industry Sector**
1	Astellas Ireland Co., Ltd.	Pharmaceuticals
2	Carten Controls Limited	Hardware ICT
3	Daiwa Europe Fund Managers Ireland Ltd	Financial Services
4	Fujitsu Ireland Ltd	ICT
5	Neriki Europe Ltd	Industrial Products and Services
6	Orix Ireland Ltd	Financial Services
7	Rexxam Electronics Irl. Ltd	Hardware ICT
8	Sojitz Aircraft Corporation	Financial Services
9	Sumitomo Mitsui Finance Dublin Limited	Financial Services
10	THK Manufacturing of Ireland Ltd.	Industrial Products and Services
11	Mitsubishi Motors	Motor Vehicles

No	Company Name	Industry Sector
1	IDA Ireland	Semi-state Body
2	Telegael Ltd	Information/Media Group

Table 3: List of participating organisations

4 Analysis of Findings

92% of the respondents worked in senior management positions primarily in financial (31%) manufacturing (23%) and ICT (23%) organisations. The average tenure of key informants is 14 years. Thus, the respondents were well equipped to answer research questions regarding perceptions of managers in Japanese MNCs. Table 4 presents the consolidated survey responses from 23 measures of FDI determinants.

Topics	Kano Category	Dysfunctional (X)	Functional (Y)	Importance (W)
Policy Determinants				
The Irish government plays a proactive role in Foreign Direct Investment (FDI)	Must Be	3.4	2.8	4.2
Low-risk political environment with infrequent occurrences of social disorder	One Dimensional	3.8	3.1	4.2
High-quality government Institutions promoting high standards for investment	Must Be	2.9	2.5	4.0
High quality industrial policies leading to many specialised knowledge clusters	Attractive	2.2	2.5	4.5
International trade agreements on Foreign Direct Investment (FDI) promoting openness to trade	Must Be	3.4	2.5	4.2
Low corporate tax rates	One Dimensional	3.2	3.2	4.4
Economic Determinants				
Macroeconomic conditions are positive (e.g. strong growth, low inflation and favourable exchange rates	One Dimensional	3.2	3.4	3.8
Access to local capital markets within a stable banking system	Must Be	3.1	2.3	4.1

Low levels of corruption and risk when investing in FDI	One Dimensional	3.8	3.2	4.5
Access to a strong export market with an economy driven by exports	One Dimensional	2.8	2.6	3.9
A growing Irish Domestic Market	One Dimensional	2.5	2.3	3.6
Access to a large and growing regional market (e.g. EU)	One Dimensional	3.2	3.2	4.2
High labour productivity (Rate of output per employee and high utilisation days)	One Dimensional	3.4	3.7	4.5
Access to high-skilled Labour (i.e. strong knowledge, research and innovation base)	One Dimensional	3.8	3.5	4.5
Access to low-cost labour (e.g. low wages)	Attractive	1.9	2.0	3.6
Low-cost business operating environment (e.g. low-cost transport, communications, energy)	One Dimensional	3.2	3.1	4.2
Access to high-quality physical infrastructure (ports, roads, power, logistics, telecomms)	One Dimensional	3.7	2.9	4.3
Business Enablement Determinants				
Access to well-developed investment promotion incentives	Must Be	2.9	2.5	3.8
Access to a mature legal system (Independent judiciary, strong Intellectual property laws and enforcement of contracts)	Must Be	3.8	2.7	4.5
Access to a favourable, business-friendly environment (e.g. reduced bureaucracy and ‘red tape’)	One Dimensional	3.5	3.0	4.2
Access to local amenities and social services providing increased quality of life	One Dimensional	3.2	3.2	4.0
Access to a well-educated workforce within a well-developed educational sector	One Dimensional	3.5	3.1	4.5

Your company has previous presence and/or previous investment in Ireland	Indifferent	2.0	1.7	3.5

Table 4: Analysis of Findings

Figure 1 shows a plot of the X-Y position in terms of functional (Y) (when a determinant is present) and dysfunctional (X) (when a determinant is not present) scores with the size of the individual bubble representing its importance score (W). To define and understand the most important FDI factors for Japanese firms investing in Ireland, we determine constellations of FDI importance. This helps to understand the relationship between FDI determinants for Japanese MNCs investing in Ireland. We propose four constellations of FDI importance. The size of each point on the map represents the average importance score. Taking the most significant determinants and linking them to related high-importance factors provides the following constellations.

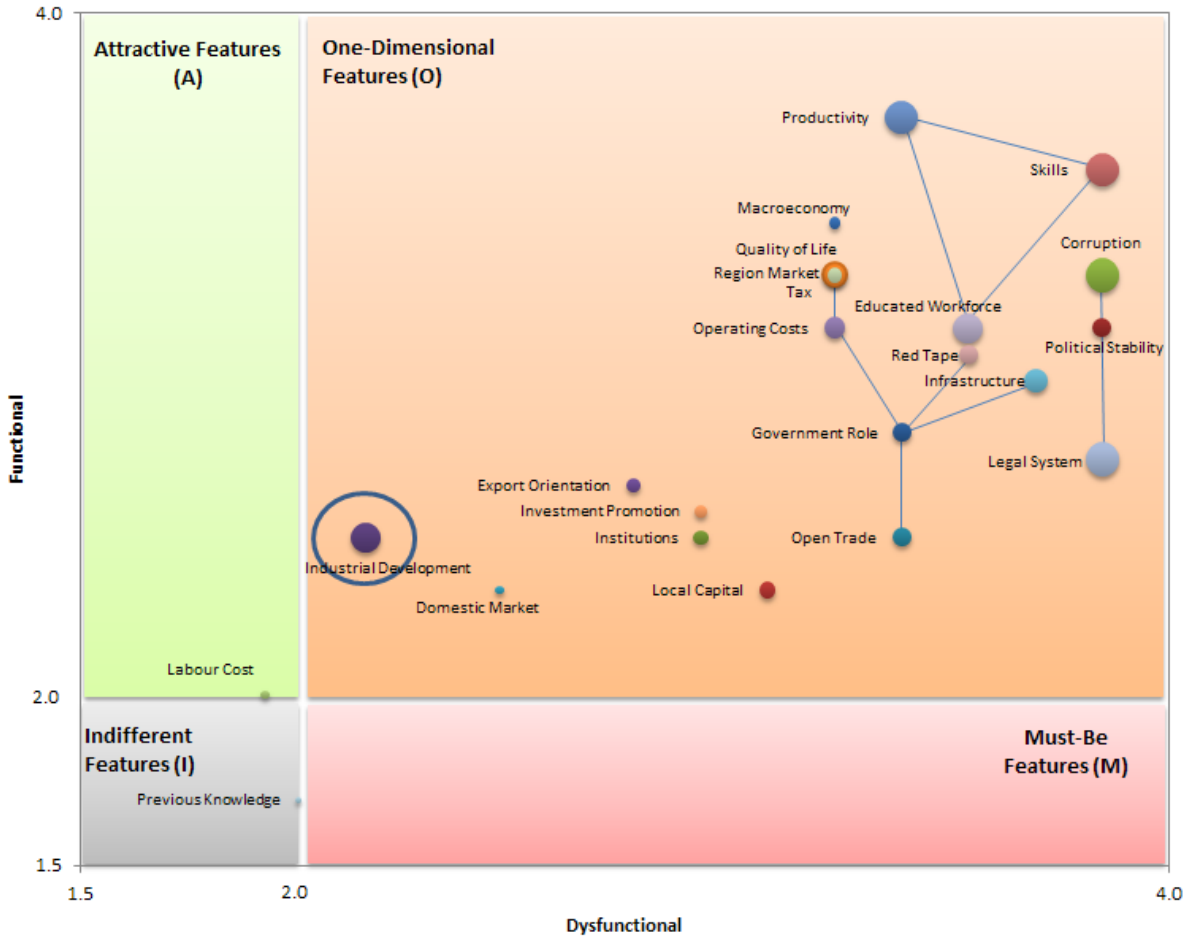

Figure 1: Constellations of importance

4.1 The Quality People Triangle

Japanese firms attach significant importance to productivity, skills and an educated workforce. Increases in all these factors are seen as highly satisfying and conversely a reduction in these factors results in significant dissatisfaction. The results suggest that every effort must be made to develop the Irish workforce, as increases in these features will increase attractiveness for

Japanese investors. That is, a focus on business-aligned education that delivers necessary skills and improves productivity is both satisfying and important to Japanese investors.

4.2 The Risk Spire

Foreign investment from Japan is risk averse and the presence of a well-functioning legal system and low levels of corruption is essential. While improvements in these factors will not result in as much satisfaction as the quality people triangle, any decline in these factors will lead to a greater overall dissatisfaction with Ireland as an investment location.

4.3 The Government Web

The role of Government is linked to a number of factors that respondents highlighted as relatively important. Quality infrastructure, openness to trade, access to regional markets and low levels of bureaucracy are linked to government policy and impact on doing business. Further linkages to operating costs and taxation reflect the importance of profitability for Japanese MNCs. Although each determinant has a lower importance than the previous constellations, on aggregate government role is a crucial determinant of FDI attraction.

4.4 The Industrial Development Circle

The development of high quality industrial policies leading to many specialised knowledge clusters is ranked with high importance. Improvements in this factor will lead to moderate satisfaction while deterioration will lead to moderate dissatisfaction. This circle seems incongruous but this may highlight that industrial development is a more attractive feature and highly valued by Japanese MNCs. This may also be linked to the Japanese perspective of appreciating the 'long term' as industrial development is focused on a long term perspective.

4.5 Top Five FDI Determinants

We asked respondents to rank the top five most important determinants from a predefined list of 23. The opportunity to add additional determinants was provided but no respondent added any. The percentage of importance scores for each FDI determinant was calculated for each rank from 1 to 5. Using the aggregate totals, the top five FDI determinants from the survey are shown in Figure 2 below. Ireland's low corporate tax rate is seen as the most important element by Japanese MNCs for investment in Ireland followed closely by the skilled workforce. The government's role in maintaining stability and access to large regional markets is also of paramount importance. Interestingly, the domestic Irish market received no importance scores from any respondent and this may reflect the export nature of Japanese MNCs in Ireland.

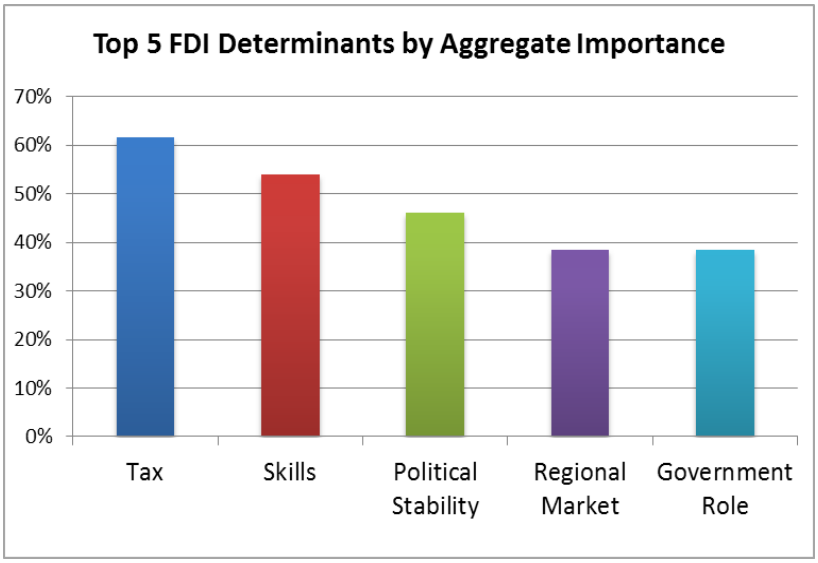

Figure 2: Top five FDI determinants

5 Discussion

5.1 Policy Determinants

The role of policy determinants in attracting investment is clear from the results. Table 4 shows that Japanese MNCs regard the proactive role of Government in attracting FDI as a basic expectation, along with high-quality institutional standards. This finding is in line with expectations as Rios-Morales and Brennan [2007] argue that governments require a holistic approach to reduce barriers to foreign investors and provide incentives alongside more long-term development goals. There is anecdotal evidence to suggest that government restrictions on foreign ownership are strongly resented by Japanese investors and enforced export rules are a major disincentive. The respondents to this survey appear to agree and regard openness to trade as a necessary determinant for foreign investment.

Previous research has failed to reach consensus on the impact of political instability and risk on foreign investment. Studies by Blonigen [2005] and Cieslik and Ryan [2004] found that political risk is a deterrent to FDI. In this study, political stability is perceived as a one-dimensional feature of FDI by the respondents meaning there is a direct correlation between level of political stability and the MNCs positive perception of the country. Thus, this study agrees with the work of the aforementioned authors. It contrasts however with the findings of Wheeler and Mody [1992] who found that although geo-political risk was significant, domestic socio-political risk is assigned little importance. The contrast in results may reflect the difficulty in measuring perceived risk and the differing proxy indicators used to determine risk levels.

The final aspect of political determinants of FDI is the industrial standards. This refers to the promotion of high quality industrial policies, which drive specialised knowledge clusters in Ireland. This study shows that industrial development is seen as an attractive feature of FDI. This means that it may not be an initial consideration for foreign investors from Japanese MNCs but any improvements in industrial development will be seen as very attractive. This finding concurs with a study by Dimitropoulou et al. [2007] who argued that the quality of government policy on industrial development aimed at creating areas of regional specialisation is crucial, as these regions are positively associated with FDI. However, this study fails to determine the reason why industrial development is seen as an attractive feature of FDI and thus it is not possible to confirm whether it is a real contributory factor for Japanese investors.

5.2 Economic Determinants

The decision to invest in Ireland by Japanese MNCs is highly dependent on economic factors. The results from the survey on the economic determinants of FDI highlight that the economic climate in Ireland is perceived to affect the foreign investment decision in different ways.

Our study found that access to local capital within a stable banking system is essential for Japanese investors and must be provided. A report by UNCTAD [2008] highlighted that for western countries including the EU-15, a stable banking system is crucial for investment. Other studies also point out that a functioning banking system that enables local businesses to interact with MNCs is vital for investment purposes [UNCTAD 2011], [Piteli 2010]. Based on Berger et al. [1993] interpretation, Must-Be features are the most important and therefore, this study agrees with the prior research.

The one-dimensional or performance FDI features are all viewed to be contributory factors for FDI investment. The FDI features with the highest category response include skills (62%), productivity (54%), regional market (62%), corruption (54%) and macroeconomic conditions (54%). Foreign MNCs in Ireland employ higher proportions of skilled labour than industry on average and this correlates with the results of this survey. Japanese MNCs perceive the skilled workforce as a crucial economic determinant of FDI in Ireland and this agrees with the work of Borensztein, et al. [1998] and Noorbakhsh, et al. [2001] who found that access to high skilled labour is a significant determinant of a nation's location advantage and is important in attracting FDI.

Closely related is the productivity of workers and Ireland has traditionally been viewed favourably for its labour quality and productivity [Gunnigle and McGuire 2001]. In addition, Gilmore, et al. [2003] found that the availability of a skilled workforce was significantly more important in FDI decisions than low-cost labour. Our study concurs with this finding as productivity has a high one-dimensional score (i.e. the more the better) and labour cost is viewed as a lower priority attractive feature. Moreover, the results suggest that high labour costs are accepted by Japanese MNCs investing in Ireland but reductions in those costs would be very attractive for further FDI. Thus, this echoes the study by Gunnigle and McGuire [2001] that labour cost is not seen as a critical factor in MNC investment in Ireland.

5.3 Business Facilitation Determinants

The business environment within a host country has significant influence on investment decisions. Managers in Japanese MNCs perceive a well-developed investment promotion framework and a robust legal system as an expected requirement for investment. Morisset [2003] argues that promotion agencies with aggressive FDI campaigns positively influence FDI decisions, particularly where the country has a good overall investment climate. Similarly, the World Bank finds that promotion only succeeds when the country is attractive to investors. This is interesting as Must-Be features will not increase investor satisfaction with further improvements but increase dissatisfaction if absent. Thus, investment promotion is a must-have but not sufficient for investment and our survey agrees with the earlier research.

FDI features that can deliver satisfaction for foreign investors are one-dimensional FDI features of improvements in workforce education (54%), improvements to quality of life (46%) and streamlining of red tape (54%). There is a consensus that countries that invest in improving quality of life attract more FDI [Peterson, et al. 1999]. This study on Japanese MNCs appears to agree with the work of Gunnigle and McGuire [2001] on US MNCs investing in Ireland, locating in Dublin for quality of life reasons.

The importance of low levels of bureaucracy and red tape are also highlighted in the results. These findings concur with research conducted by Kinoshita and Campos [2002] who found that the degree of red tape and corruption was an important factor in investment. For Japanese MNCs, improving the bureaucracy of doing business will result in increased satisfaction.

Lastly, the prior knowledge of Ireland and the previous investment or presence in the country is perceived as indifferent. This is the lowest Kano category and suggests that Japanese MNCs attach little significance to this FDI factor. This result is in stark contrast to findings by Cieslik and Ryan [2004] who found that previous presence in the host country increased investment by Japanese MNCs in Europe. The reason for such a contrast is uncertain; however it may be the importance of such prior information is not seen as relevant until an investment is in progress and during the survey the need for such knowledge is not perceived as a major concern.

6 Conclusions

This study argues that the key factors for investment by Japanese MNCs are more complex than a simple ranking would suggest. We found that a new lens is required to differentiate and understand investors' perceptions of performance of FDI determinants. The method adopted in this study helps establish a prioritised constellation of groups comprising features that satisfy Japanese investors. Thus, Ireland's policymakers and industrial development agencies should now understand the nuances of investors' perceptions and be better positioned to create optimal industrial development activities.

Failing to meet minimum expectations on any must-be feature will critically harm a country's investment profile, lead to suppressed financial outcomes, and increased investor churn. Thus, avoiding poor performance perceptions on any must-be features must become a top priority for Ireland's national policymakers and promotion agencies alike. Investing in attractive and one-dimensional aspects of Ireland's locational attributes provides greater value for money than developing must-be attributes, which are already at a satisfactory level. Thus, once the must-be features are satisfactory, more funds should be invested in one-dimensional and then attractive features. This approach will delight investors, create points-of-difference from competitors and heighten investor preference for Ireland as an investment destination.

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