

## INVESTMENT PROMOTION AGENCIES ARE EFFECTIVE IN ATTRACTING FOREIGN DIRECT INVESTMENTS

It is commonly acknowledged that foreign direct investment (FDI) plays an important role in worldwide economic development. By acknowledging the benefits of foreign investments, governments in many transition countries are devoting significant effort to attract FDI flows into their economies.

There are many different methods used to attract FDI, including use of targeted financial incentives (tax concessions, cash grants and specific subsidies), improving domestic infrastructure and local skills to meet the demands and expectations of foreign investors, improving the general business climate of a country by decreasing administrative barriers, and promotional programs [1].

Investment promotion by governments today is an important tool for improving the investment environment and for attracting FDI to their countries. At the same time, however, there is increasing competition for FDI investments among both developing and transition countries. As a result, a trend has developed for many countries to form investment promotion agencies on national and increasingly, on a sub-national level. Few IPAs existed 20 years ago, while today there are more than 160 national IPAs and more than 250 sub-national agencies worldwide [2]. The sub-national IPAs represent regions of the country. Recent research shows that economies in transition are succeeding in attracting more FDI when they have agencies that assist potential and current foreign investors, and these agencies increasingly follow the IPA model [3].

Promotional efforts to attract FDI often become the focal point of competition among developed and developing countries. This competition often extends to the sub-national level, with different regional authorities pursuing their own strategies and devising their own strategies or incentives to attract new investments.

Despite the competition, countries around the world have moved to a common approach for IPA promotional techniques and similar structures. Recent research assesses the impact and trends related to both promotional techniques and structural approaches.

### Investment Promotion Agencies: A Historical Review

It was only fifteen years ago when the Foreign Investment Advisory Service (FIAS) published a paper entitled "Marketing a Country: Promotion as a Tool for Attracting Foreign Direct Investment," which offered what has become the standard approach for the structure

and function of agencies that promote foreign direct investment [4]. The original paper focused on strategies for developing countries.

The original work hypothesized that countries needed to adopt an industrial marketing approach to market the country to foreign investors, just as major industrial organizations market their products to large customers. Wells and Wint described a model for IPAs that recognized the close parallels between industrial buying and the investment decisions. They also noted that the promotional techniques that are most effective in attracting FDI are similar to the techniques that are most effective in selling industrial products to corporations [4].

The initial approach for country marketing focused on three basic investment promotion techniques: image building, investment generation and investor services. Wells and Wint contended that "the weight assigned to these techniques, or the strategy of an agency, should reflect the task that the particular country faces in marketing itself to investors. For example, a country that has recently changed its policies toward foreign direct investment could benefit from an emphasis on image building, since it might need to convey new information to potential investors who would otherwise be unaware of the changes."

In 2001, Authors Wells and Wint revised their analysis and report to include strategies for transition countries. They described the evolution of IPAs as experience validated the impact of basic promotional strategies and demonstrated how countries added new promotional techniques.

Wells reported that a fourth promotional technique has evolved in many countries [4]. The fourth technique involves active work by IPAs to improve the investment climate in their countries, and in 2001 UNCTAD found this technique embraced by about 80% of IPAs [5].

### Main Functions of an Investment Promotion Agency

Today, IPAs around the world focus on: providing information to potential investors, creating an attractive image for the country as a place to invest, providing services to prospective investors, and working to improve the overall investment climate. Promotion in this context does not include any effort by a country to provide incentives to foreign investors, screening of foreign investment or negotiation with investors [4].

FIAS describes the basic promotional functions as follows [2]:

1. *Image building* creates the perception of a country as an attractive site for international investment. Activities commonly associated with image building include focused advertising, public relations and events. For example:

- Advertising in general financial media
- Advertising in industry- or sector-specific media.
- Cultivating journalists to seek favorable news stories.
- Participating in investment exhibitions.
- Conducting general investment missions from source country to host country, or from host country to source country.
- Conducting general information seminars on investment opportunities.

*Investor facilitation and investor services* refer to the range of services provided in a host country that can assist a current or potential investor in analyzing investment decisions, establishing a business, and maintaining it in good standing. Activities in this area include information provision, “one-stop shop” service aimed at expediting approval process, and assistance in obtaining sites, utilities, and so on. For example:

- Engaging in direct mail or telemarketing campaigns.
- Conducting industry- or sector-specific investment missions from source country to host country or vice versa.
- Conducting industry- or sector-specific information seminars.
- Engaging in firm-specific research followed by sales presentations.

*Investment generation* entails targeting specific sectors and companies with a view to creating investment leads. Activities include identification of potential sectors and investors, direct mailing, telephone campaigns, investor forums and seminars, and individual presentations to targeted investors. Investment generation activities can be done both at home and overseas. For example:

- Providing investment counseling services.
- Expediting the processing of applications and permits.
- Providing post-investment services.

*Policy advocacy* consists of the activities through which the agency supports initiatives to improve the quality of the investment climate and identifies the views of the private sector on that matter. Activities include surveys of the private sector, participation in task forces, policy and legal proposals, and lobbying. For example:

- Participating in policy task forces.
- Developing lobbying activities.
- Drafting laws or policy recommendations.
- Reporting investor’s perceptions.

#### **Structural Approaches for an Investment Promotion Agency**

Countries creating IPAs have two basic options, a government-controlled agency or a private-sector agency,

tasked to carry out the non-traditional government activity of investment promotion. Wells and Wint [4] observe that governments may not be able to acquire the skills needed if the investment promotion activity is to be managed effectively. Alternatively, governments may choose to delegate the investment promotion activity to the private sector where it would function independently, or autonomously. The risk with the latter alternative is that the private sector may not be able to effectively manage the tasks that require government management, such as helping businesses with applications or permits or other government requirements.

Wells and Wint report that many countries pursue a quasi-governmental or semi-autonomous structure to bring together the skills and capabilities required to manage the key functions of the IPA. Such quasi-governmental agencies report to the government but are not part of government and do not carry many of the burdens government agencies must carry. Additionally, the quasi-governmental agencies have greater success acquiring the skills and management expertise needed to manage the promotional effort, and management controls enable the quasi-governmental agencies to function under government oversight. Finally, quasi-governmental agencies do not have the problems a private agency would face with no direct access to governments to expedite investment servicing. The quasi-governmental agencies usually have boards or directors and advisory groups that bring together government and private-sector participants, while the agency functions with day-to-day autonomy in carrying out the designated functions. The Bleyzer Foundation reports that among the 14 national IPAs operating in the CEE and CIS regions, seven are either autonomous or semi-autonomous governmental agencies [3].

#### **Research on Effectiveness of Investment Promotion Agencies**

FIAS authors Wells and Wint conducted research in the late 1990s as they were revising their earlier work on “Marketing a Country;” including basic research on the effectiveness of IPAs. They found that the investment promotional activities tended to be most successful in attracting foreign investment when the investment is focused on export-oriented investment, whether for export to world markets or regional markets [4]. Their research showed less success when IPAs focused on seeking firms to invest to serve domestic markets. Firms that are seeking sites to serve export markets can choose from a variety of countries. Their research indicates that investment promotion activities probably influenced their investment decisions.

Later research conducted by the Foreign Investment Advisory Services (FIAS) of the World Bank provided compelling evidence of the overall effectiveness of IPAs. [2] Authors Jacques Morisset and Kelly Andrews-Johnson surveyed 75 IPAs around the world in 2002, gathering data on the 2001 results for those countries.

Morisset and Andrews-Johnson found that the effectiveness of IPAs was greater when the IPA was under a supervisory board with representatives of the private sector, and when the IPA had a direct reporting relationship to a country's president or its prime minister. In their report, it is suggested that, in a transition economy, an IPA that has a self-governing or semi-independent structure can be more effective because it can help to strengthen the government's commitment to market reforms and affirm the agency's credibility and visibility in the business community.

Research from Morisset and Andrews-Johnson at FIAS and from UNCTAD [5] suggests that the effectiveness of investment promotion activities depends on the functions the IPA performs, as well as the organization, status, budget and personnel of an IPA. The FIAS research on «The Effectiveness of Promotion Agencies at Attracting Foreign Direct Investment» found that 35% of all IPA activities involve image building, 33% to investment servicing, 22% to investment generation, and only 10% to policy advocacy. The recent UNCTAD study reports that 80% of IPAs are involved in policy advocacy services. The FIAS research report notes that policy advocacy appears to be the most effective activity to attract FDI, followed by image building and investor service; further, it notes that investment generation is not associated with higher FDI flows, despite the fact that it tends to take the greatest share of most IPA budgets.

The various research on effectiveness calls attention to the importance of management and personnel. UNCTAD has done a number of studies on IPA personnel and the correlation of their quality and performance to the success of the IPA. Similar studies have gathered data on the role and contributions of advisory boards, particularly those composed of representatives from both private and public sector. The involvement of private sector representatives contributes to transparency, of course, but also appears to help the IPA better understand how decisions are made in the private sector [3].

The FIAS report on the effectiveness of IPAs identifies a special advantage of a structure that brings together public and private sector representatives. The report suggests that policy advocacy may be the IPA function most closely associated with FDI flows when the IPA has both public and private sector participation. The IPAs are in a strategic position to carry out policy advocacy because the IPA is the interface between the public and the private sectors. IPAs build a relationship with private firms that can help IPAs identify the real problems that investors in the country encounter, rather than identifying such matters from a distance [2].

As IPAs grow worldwide, various special training programs have been developed to prepare public and private sector individuals for work within the IPA structure. UNCTAD conducts programs on investment promotion for diplomats from developing and transition countries, which can prepare them to support IPA image

building activities. The World Association of Investment Promotion Agencies [6] conducts training programs and regional meetings for IPA personnel. A World Bank unit also supports IPAs through the Multilateral Investment Guarantee Agency (MIGA), which provides a toolkit of international best practices in investment promotion, designed to help national and local investment entities attract and retain foreign direct investment [7].

#### **Investment Promotion and Ukraine**

An Investment Council was established in Ukraine in 2004, and a May 2005 report [8] indicates that President Victor Yushchenko was named Head of the Council. That 2005 report also identified original Council membership to include 10 Ukrainian Government officials, as well as 14 private-sector representatives, including such leaders as the Head of Microsoft, the Delegate of the German economy in Ukraine, the Head of Kraft Foods of Ukraine, and other important business individuals. Various proposals have been offered on how to organize and staff the appropriate investment promotion agency for Ukraine, including establishment of related working groups with both public and private sector participants. Based on the original Council approach, one might assume that Ukraine is following the quasi-governmental approach with both public- and private sector involvement. As noted above, FIAS research shows that political visibility and participation of the private sector are two characteristics that are associated with IPA success in attracting FDI [2].

IPA observers point to important trends that may be relevant for Ukraine and for those in the country working to attract FDI. As reported above, IPAs commonly focus on four functional areas. In practice, however, investment promotion can cover many services, ranging from the provision of market information to the undertaking of feasibility studies and environmental impact assessments. UNCTAD studies confirm that different IPAs emphasize different aspects. Agencies in OECD countries and other developing countries apply the most focused approach to investment promotion with investor targeting and after-care as prime functions. However, UNCTAD reports that IPAs in economies in transition tend to take up more tasks, [5] which presumably would include policy advocacy and image building.

Investment promotion is increasingly sophisticated. UNCTAD research of IPAs shows that investment promotion is increasingly seen to be client-oriented, with IPAs reporting that personal contacts with investors are preferable to non-personal methods of promotion. IPAs report a considerable share of promotional budgets is devoted to arranging meetings with foreign companies, attending conferences and trade fairs, as well as undertaking missions abroad [5].

Research also indicates that the Internet is widely seen as a critical tool in investment promotion. Websites play a function as display windows on what countries and regions have to offer and provide agencies with the

opportunity to advertise their services. There are great differences in the use of the Internet. In developed countries, the World Wide Web serves as a prominent research and marketing tool for IPAs. UNCTAD notes that the information technology infrastructure also has an impact on investment decision, and well-functioning IT and telecommunications may become a necessary requirement to attract certain kinds of investment. Considering these issues, the use of IT will continue to be important for most IPAs in the coming years. It may be worth noting here that in December 2005 the Ukrainian Foreign Investments Promotion Agency does not yet have a website, although the Ukrainian Foreign IPA is listed as a member of the World Association of Investment Promotion Agencies [6]. The Kyiv Post reported in December 2005 that the Ukrainian government has issued a request for proposals from public relations agencies to work with the government on image building. It is not clear from the news reports, but perhaps that work might support the investment promotional activities related to image building.

Sub-national investment promotion is developing in certain areas. Transnational corporations often are attracted to specific locations or clusters of economic activity. Where sub-national agencies exist, a new challenge will arise. UNCTAD calls attention to "the need to coordinate policies across various administrative levels within a country. Without coordination, there could be competition among regions within a country that may lead to "fiscal wars" and result in waste as far as the welfare of the country as a whole is concerned. It also increases the risk that promotion agencies, if they are unable to coordinate with other policy-making bodies in the country, will be unable to deliver on promises to investors. The challenge is of particular importance in large countries" [5].

A final trend of possible interest for Ukraine is the development of regional cooperation among IPAs. UNCTAD notes that some countries come together to promote their region to foreign investors, and UNCTAD cites the Baltic Sea Region and the Association of Southeast Asian Nations. It is unclear the extent to which such cooperation among potential competitors actually can have an impact on the ability of individual countries to attract FDI.

Looking ahead, Ukraine has important opportunities to attract foreign direct investment. It has established under the President an Investment Council with significant participation from leading private-sector representatives from around the world. The Ukraine Foreign Investment Promotion Agency is established and, as press reports suggest, it appears work is moving forward on image building for the country. The country has strong sub-national organizations that can lead on regional investment promotion. International organizations exist to provide a broad variety of support and assistance to Ukraine's national or sub-national IPAs. Research by leading organizations provides important information on what makes IPAs in transition economies successful in attracting foreign direct investment, calling special attention to the importance of involvement of private-sector representatives and the need

for coordination between national and sub-national IPAs. In summary, a direction is set and Ukraine can benefit from the experience and learnings of IPAs around the world to achieve even greater success in attracting foreign direct investment for Ukraine.

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#### **Хаджинов И. В. К вопросу об эффективности инвестиционных агентств в привлечении прямых иностранных инвестиций**

В статье рассматривается роль национальных инвестиционных агентств в привлечении прямых иностранных инвестиций.

*Ключевые слова:* эффективность, инвестиции, агентства, предприятие, экономика.

#### **Хаджинов І. В. До питання про ефективність інвестиційних агентств у залученні прямих іноземних інвестицій**

У статті розглядається роль національних інвестиційних агентств у залученні прямих іноземних інвестицій.

*Ключові слова:* ефективність, інвестиції, агентства, підприємство, економіка.

#### **Khadzhyrov I. Investment promotion agencies are effective in attracting foreign direct investments**

In article the role of national investment agencies in attraction of direct foreign investments is considered.

*Key words:* efficiency, investments, agencies, enterprise, economy.

Received by the editors: 09.11.2010  
and final form in 01.12.2010