FOREIGN DIRECT INVESTMENT IN THE TOURISM SECTOR: PULL FACTORS

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ABSTRACT

Foreign Direct Investment (FDI) has become an increasingly important element for economic development. Specifically in the Tourism Industry, it is paramount to know which factors affect FDI inflows. The aim of this study is to analyze the main potential determinants in the process of attraction FDI in to the Tourism Sector. This article offers a comprehensive review of articles that were published, and concludes that the key determinants of FDI in the Tourism Sector are similar to the determinants of FDI in other sectors. The information obtained is a starting point for the implementation of strategies to attract foreign investment.

Key Words: Foreign Direct Investment; Tourism; Development; Determinants.

INTRODUCTION

The internalization of an economy that was once characterized by its foreign trade flows (imports and exports) and by the movement of people, nowadays results in an intensification of FDI movements. Globalization and neo-liberal policies, including liberalization and privatization, have generated a significant growth of FDI in recent years (Colantonio, 2005; Mohamed & Sidiropoulos, 2010).

Despite the increase of globalization in the Tourism industry, there is surprisingly little empirical research on the impact of FDI. Many studies about FDI exist, but only a few analyse the Tourism sector and its implications. According to (Dwyer & Forsyth, 1994), even though FDI plays an important role in the development of world Tourism, the analysis of its impacts has been neglected and has attracted less attention in the literature than what was expected.

More and more countries worldwide try to attract FDI to promote their growth. FDI is a means to finance new structures and equipment and allow a transfer of more advanced technology and forms of management, in addition to the multiplier effects it provides. It is crucial for countries to understand what drives companies to invest aboard, given that FDI contributes to their economical growth and development.

The aim of this study is to identify the factors considered to be determinant in the process of attracting FDI to the Tourism sector, from a comprehensive review of literature. Accordingly, the paper begins with a brief summary of international trade theories and their connection with FDI; followed by a theoretical framework of FDI identifying the positive and negative impacts and the determinant factors in the attraction process.

In the second part of the paper, the connection between FDI and the Tourism sector is analyzed, concluding that the factors considered determinant in FDI attraction are similar to Tourism and other sectors, but varying in their importance. Lastly, some strategies are suggested to attract FDI.

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LITERATURE REVIEW

The nature of international trade

Throughout the centuries, literature has witnessed a number of attempts to explain international trade. Successive research in this area has led to a group of theories proposed by various authors who have been crucial to understanding the internationalization phenomenon.

Adam Smith's theory of absolute advantage and David Ricardo's theory of comparative advantage are the two most noteworthy classical trade theories. Contributions from the neoclassical theories include Heckscher, Ohline and Samuelson with the factor proportions theory and Hymer and Kindlegerger with the industrial organization theory. These theories allow us to conclude that the existence of market imperfections help feed FDI.

The most important new theories of international trade include the product-life cycle theory (Vernon and Wells), Michael Porter's competitive advantage theory and the internationalization theory based on Coase's transaction cost theory and expanded on by Horst, McManus, Buckley & Casson and Rugman. Dunning's eclectic or OLI paradigm theory merges the existing theories explaining that in order for FDI to occur three sets of factors have to be combined (*Ownership advantages, Locational advantages* and *Internationalization advantages*).

With the Uppsala internationalization model, international trade studies crossed the boundaries of economic theory to also include the organizational behaviour theory. Psychic distance, environmental factors, cultural affinities and social ties are FDI determinants (Johanson & Wiedersheim-Paul). Schumpeter was the first to emphasize the importance of innovation, followed by the contributions of Simmonds & Smith, Bilkey & Tesar and Cavusgil that corroborated the internationalization model based on innovation. Mintzberg and Ahlstrand & Lampel's resource-based view theory focuses more on intrinsic aspects of company / organization. Johanson & Mattsson and Johanson & Vahlne identify the importance of network relationships in foreign markets (network theory). According to this theory, human capital as entrepreneurship is the driving force of the internationalization process. The current theory of international new ventures or born globals emerged with Oviatt & McDougall.

The previously mentioned theories provide some insight into the complexity of FDI flows; however, an integrated theory that combines these elements in an analytical manner has yet to be developed. Although these theories appear in an isolated manner, they should be understood as complementary and not dissociated or alternatives.

Foreign Direct Investment

IMF (2003) provides the most widely shared and accepted definition of FDI. It defines it as a category of international investment that reflects the objective of a resident in one economy (the direct investor) obtaining a lasting interest in a company resident in another economy (the direct investment company). The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment company, and a significant degree of influence by the investor on the management of the company. A direct investment relationship is established when the direct investor has acquired 10 percent or more of the ordinary shares or voting power of a company abroad. Direct investment comprises not only the initial transaction establishing the FDI relationship between the direct investor and the direct investment company but also all the subsequent capital transactions between them and among affiliated companies resident in different economies.

Therefore, FDI is the investment made by an entity in a foreign country that can take the form of Greenfield Investment or Mergers and Acquisitions (the level of ownership can be Sole-Venture or Joint-Venture)

The impacts of FDI

FDI plays an increasingly important role in the economy of diverse countries in the world. The advantages of FDI in a given economy, as well as the importance of developing actions to attract this type of investment, are widely debated and presented by various authors. The impacts of FDI comprise very attractive economical, governmental or social factors for any country.

Many authors are unanimous in stating that FDI is an important vehicle for technology transfers and management knowledge and skills, and represents an important role in promoting economic growth and development (Borensztein, Gregorio, & Lee, 1998; Mohamed & Sidiropoulos, 2010; Zhang, 2001). Some of these authors also indicate other advantages of FDI like creating employment, increasing wages, creating capital and profits, improving national productivity, stimulating local entrepreneurship and promoting competition and efficiency. FDI can also be a means to finance the acquisition of new structures and equipment, and result in spillovers to the local economy through the connections that are made with the local suppliers, competitors, benchmark and training. It integrates the domestic economy in international chains that may offer a reduction of input costs, promote economies of scale and increase exports.

A literature review shows that FDI also brings negative effects. According to (Adames, 2000), FDI reduces the productivity capacity of the host country and inhibits the appropriate technology flow consistent with domestic markets. Another negative effect is the increasing level of foreign investment and the continuous remittance of indigenous funds to developed countries destroying the availability of domestic capital reducing the opportunities for domestic investment. Similar negative impacts are presented by other authors (Figlio & Blonigen, 2000; Reddy & Zhao, 1990; Saggi, 1999).

According to (Amirahmadi & Wu, 1994), FDI sometimes tends to operate in enclave, in which a tendency exists of the Transnational Corporations (TNCs) to internalize production and distribution to reduce costs. Many times profits are not invested in the host countries and the TNCs have total control over some sectors, taking into consideration the many specific benefits of these companies (brand, superior technologies, and management skills, amongst others).

Determinant factors in the FDI attraction process

(Tsai, 1994) stated that empirical research about FDI determinants and their consequences have increased in recent years. These studies demonstrate that when a company decides to invest in another country, it takes into consideration the contextual analysis of the surrounding environment (common to all companies) and the transactional (specific to each sector). In addition to this analysis, it is necessary to analyse the company (human, financial and organizational resources).

A large number of authors agree that political and economical stability is essential for FDI to exist, and that the size of the host market has been considered to be one of the most important incentives for FDI. Many authors have identified throughout the years other determinant factors in the FDI attraction process. Research from (Amirahmadi & Wu, 1994; Chen & Hu, 2002; Ojala, 2008; Resmini, 2000) identify cultural, psychic and geographical proximities as factors to be considered. Writers like (Cheng & Kwan, 2000; Davidson, 1980; Konopaske, Werner, & Neupert, 2002) consider specific company characteristics as determinants. Factors such as company size, international experience, the existence of branches, economies of scale, preference of potential competitors, availability of skilled labour and new supplier networks are also important.

Several studies, including (Fatehi-Sedeh & Safizadeh, 1988; Tu & Schive, 1995), were concerned with explaining the socio-political determinants, as political stability or risk of the country, corruption and political freedom. Human capital as a FDI determinant is identified by authors such as (Michie, 2001; Noorbakhsh, Paloni, & Yousset, 2001), who identify the importance of educational level and workforce skill. Other studies (Moosa & Cardak, 2006; Resmini, 2000; Tsai, 1994) focus on macroeconomic factors (GDP, exchange rate policy, economy openness, exports, exchange rates, interest rates and inflation). Researchers like (Agarwal & Ramaswami, 1992; Biswas, 2002; Cheng & Kwan, 2000) name some microeconomic indicators that influence FDI (market size and growth, governmental policies, tariff and trade barriers).

Despite the information related to the importance of FDI determinants presented, it is obvious that these are not all relevant at the same time. The research also clearly states that the relevance of each determinant depends on the origin and host countries, the characteristics of the companies and the type of FDI that is being analysed.

Foreign Direct Investment in the Tourism sector

Although FDI is a way in which countries may expand Tourism, the dynamics and implications of FDI in this sector have not been studied much. (P. Buckley & Geyikdagi, 1996) pointed out that FDI in Tourism has received little attention due in large part to the difficulties in obtaining information and data. Tourism for (UNCTAD, 2007) is not a singular activity, it is an agglomeration of many separated and related activities that include transportation, accommodation, food and beverage services, entertainment, culture, conventions, trade fairs, sports and recreation.

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Based on the available data, FDI in Tourism continues to be low, compared to other FDI levels in other economic activities (Dwyer & Forsyth, 1994; Peric & Radic, 2010; UNCTAD, 2007). This is due to the fact that Tourism is made up of a number of diverse and interrelated activities, which do not always make it possible to distinguish the foreign from the domestic investors. Moreover, the frequent use of management contracts or franchising operations make it difficult to collect data and causes this gap between official FDI data and the activities of the companies.

Positive and negative impacts of FDI

The impacts of FDI in Tourism may vary according to the characteristics of the countries, the historical context and the characteristics of the companies. Several authors analyse the positive impacts (Bull, 1990; P. Forsyth & Dwyer, 1992; Purcell & Nicholas, 2001). FDI complements domestic investment, promoting trade, knowledge transfer, skills, technology and advanced management. It creates jobs, trains employers and helps place destinations on the tourism map. Foreign brands improve the image of locations, and at the same time bring stability and trust (UNCTAD, 2007, 2008). FDI provides access to global marketing and to global distribution networks (Barrowclough, 2007). According to (Peric & Radic, 2010), FDI contributes to the improvement of infra-structures in the host country, such as airports, motorways and hotels.

A number of authors also identify the negative effects (Clancy, 1999; Freitag, 1994; Oppermann, 1993; Thompson, O'Hare, & Evans, 1995). (Copeland, 1991) argues that when there is too much FDI, it may result in an excessive trust and a high risk to the host community. Furthermore, (Brohman, 1996) believes that although FDI stimulates the expansion of Tourism, many developing countries face enormous challenges to overcome poverty and inequality, many times due to economic domination on behalf of the TNCs, given rise to unequal socio-economic relationships.

Determinant factors in FDI attraction in the Tourism sector

(Barrowclough, 2007) claimed that FDI in Tourism focuses mainly on accommodation. (Dunning & Mcqueen, 1981), relying on the Eclectic Theory, were the first to make a profound attempt to explain the forms of TNC involvement in the international hotel industry. This study indicates three reasons for internationalization in the accommodation sub sector: Ownership advantages, Location advantages and Internalization advantages. The aim of subsequent studies was to identify determinant factors to attract FDI to the Tourism sector. Political, economic and social stability of the host country is seen as an attraction factor by (Dunlop, 2003; Dunning & Kundu, 1995; Dunning & Mcqueen, 1981; Endo, 2006; Go, Pyo, Uysal, & Mihalik, 1990; Hong, Jones, & Song, 1999; Te Velde & Nair, 2006; Zhao & Olsen, 1997).

Another determinant relates to the specific characteristics of the company (Ownership Issues), measures according to the size of the company, ability to obtain economies of scale, international experiences, strategic development of the brand and level of technological advances of the company (P. Buckley & Geyikdagi, 1996; Dunning & Kundu, 1995; Dunning & McQueen, 1982; Endo, 2006; Johnson & Vanetti, 2005; Kantarci, 2007; Rodríguez, 2002). For most of these authors the specific advantages of location are also very attractive (the size, growth, state and development of the tourism market; tourist facilities; Government policies towards FDI; the number and type of attractions; cheap labour and natural and cultural resources). In the opinion of (Go, et al., 1990; Zhao & Olsen, 1997), similarities in language and culture between the country of origin and the host country tend to facilitate the FDI process. Geographical, cultural and historical proximity may also influence the process (Endo, 2006; Rodríguez, 2002; UNCTAD, 2007).

For Snyman & Saayman, 2009) there is a correlation between the countries that invest more and the origin of tourists that visit South Africa more, (P. Buckley & Geyikdagi, 1996) also reach the same conclusion in their study about Turkey. The same is true in China, according to (Tang, Selvanathan, & Selvanathan, 2007). Some authors refer to specific aspects that make the Tourism sector of a country more attractive, such as the existence of General Agreement on Trade in Services (GATS). (Dunlop, 2003; Lee, Fayed, & Fletcher, 2002; Te Velde & Nair, 2006) report that the existence of GATS agreements is just one of many factors that encourage a foreign investor to enter the market and that a positive relationship between GATS and FDI exists. (Jarvis & Kallas, 2008) also believe that being part of the European Union is also a FDI attractive factor.

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(Steiner, 2010) concludes that FDI in Tourism is influenced by Regulatory Framework, performance and liquidity of a national economy. On the other hand, bureaucracy, tax burdens, exchange rates and inflation rates may deter FDI (Go, et al., 1990; Te Velde & Nair, 2006; Zhao & Olsen, 1997).

The literature review shows that the decision to invest abroad is conditioned to external and internal factors. The external factors are related to characteristics of the countries, while the internal factors are related to the characteristics of the companies. FDI in Tourism is also conditioned to the extent of the tourism demand to a specific destination, as well as its specific activities related to Tourism (nature, culture …). The size of the economy and the growth rates are also important reasons for choosing the location and this may be indirectly affected by governmental policies and FDI incentives.

CONCLUSIONS

We conclude that the most significant determinants for FDI in goods, also seem to be the most important for FDI in services; however, the importance differs. Some of the most important FDI determinants in services are government policies, liberalization of the FDI regime, rates, financial incentives, home country business presence / local customer base, competitive advantages and cultural, historical and geographical proximity. While for FDI in goods the most important determinants are market size, trade barriers and differentiated production costs.

The size of the company seems to be a similar determinant for FDI in goods and services. As for Tourism, the existence of natural and cultural resources and the availability and quality of infra structures have an extraordinary importance.

The results presented here indicate that FDI causes direct effects, such as employment creation, capital generation, and increased tax revenues, amongst others. It also causes indirect effects, like the long term impact on the efficiency of domestic companies (technology/ productivity spillovers). Consequently, it is extremely important that countries clearly identify which determinants are more important to attract FDI to the Tourism sector, so that these receive more attention on behalf of the government entities and companies.

According to (Sheng & Tsui, 2010) policy-makers should carefully conduct FDI policies, evaluating the impacts in a wide socio-political framework. The incentive policies encourage investments not only from the locals, but also from foreign investors (P. J. Buckley & Papadopoulos, 1988; Sadi & Henderson, 2001). (Subbarao, 2008) indicates the rationalization of rates as an aspect to be considered for FDI attractiveness. (Peter Forsyth & Larry, 2003) believe that the tax system discourages foreign investors to invest in Tourism. In a study by (Mohamed & Sidiropoulos, 2010), it is suggested that to attract FDI flows, policy-makers should remove trade barriers, develop their financial system, reducce the level of corruption, improve political environment and build appropriate institutions. In the (UNCTAD, 2007) report, the measures to promote FDI in Tourism include government support in trade fairs, maintaining sites that promote the country as a destination for investment and promotional organization events.

In addition to these measures, countries should use financial and tax incentives, as well as attractive rates to attract FDI. Reducing the use of complex procedures (bureaucracy) and defining clear FDI policies in Tourism are an important part of the process. Local authorities can also help indirectly to promote FDI by providing basic infra structures free of cost to the investor.

The information obtained is a starting point for the implementation of strategies to attract FDI. However as a conceptual paper, this study is limited to literature and prior empirical research.

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