Research Article

Inward Foreign Direct Investment: A Case Study of Pakistan

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Abstract

The purpose of this study is to identify and analyze the methods for increasing the volume of Inward Foreign Direct Investment (FDI) in Pakistan. Two different approaches are investigated: firstly, identifying the main barriers to investing in Pakistan, and secondly, examining the key success factors (KSFs) of the top FDI recipients in the world. Both parametric and non-parametric statistical analyses are applied. The study findings provide guidance to the implementation of common KSFs for increasing inward FDI. The paper discusses cultural barriers in developing markets for investors' collective performance, the consequence and significance of cultural barriers in emerging markets, and the requirement for social adaptation for successfully attract inward FDI in developing counties. This paper identifies and proposes suggestions for resolving the internal problems of Pakistan's investment climate that act as impediments to increased FDI volume.

Keywords: *Foreign Direct Investment; Case Study; Key Success factor; Government; Company; Pakistan*

1. Introduction

The government of Pakistan has undertaken several steps to increase the volume of inward Foreign Direct Investment (FDI). Although Pakistan continues to attract a significant volume of FDI with regard to the size of its economy, various barriers prevent it from gaining sufficient FDI as compared to other developing countries (Arslan, 2010). FDI is vital for any country's prosperity as it grants the technology, managerial skills, information, tax revenues, financial capital, jobs and goods and services that add value to increasing a country's economic competitiveness. This is turn promotes sustainable economic growth, which translates into reduced poverty and a higher standard of living (Moran, 1998).

In 2004, global FDI rose slightly after three years of consistent decline and then rose by 29% to $ 897 billion in 2005. In 2004, around 36% of all global FDI went to developing countries. Developed countries had problems in attracting FDI because many investors were shifting their investments to low-cost economies in Asia and Eastern Europe. However, in 2005 developed countries saw a significant 38% increase of FDI inflows after the four-year slump. FDI inflows were comparably more resilient in 2008 (Briefs, 2009).

According to the World Investment Report in 2004, the United State (US), the United Kingdom (UK), Luxembourg, Australia and Belgium were the five leading developed countries in attracting FDI. China has the third highest FDI worldwide, and the highest in Asia. Germany, Switzerland and Netherlands are not included in the 20 top FDI recipient countries. This is quite surprising as they held top positions in previous years. FDI in Ireland decreased dramatically from $26 billion in 2003 to $9.1 billion in 2004 (Christiansen, Bertrand, & Goldstein, 2005).

In 2009, in all three kinds of economies, i.e., developed, developing and progression, experienced decreased FDI. After 6 years of continuous growth of FDI inflow to developing countries, FDI flow declined by 40% in 2009. In 2010, the FDI inflow recovered in developing countries rather than in developed countries. The decline was not so serious during the economic downturn in 2000-2003 as compared to the GFC of 2008-2009 (Cali, Massa, & te Velde, 2008).

FDI declined most severely in South Asian Countries from 2008 to 2009 (Samad, 2010). Bangladesh, India, Pakistan, Sri Lanka and Afghanistan received $700 million, $34.61 billion, $2.38 billion, $404 million and $185 million FDI in 2009, as compared to $1.86 billion, $40.14 billion, $5.43 billion, $752 million and $300 million in 2008, respectively. According to (Arslan, 2010), from 1977 to 1996 the foreign investment rose 25% in South Asian Countries.

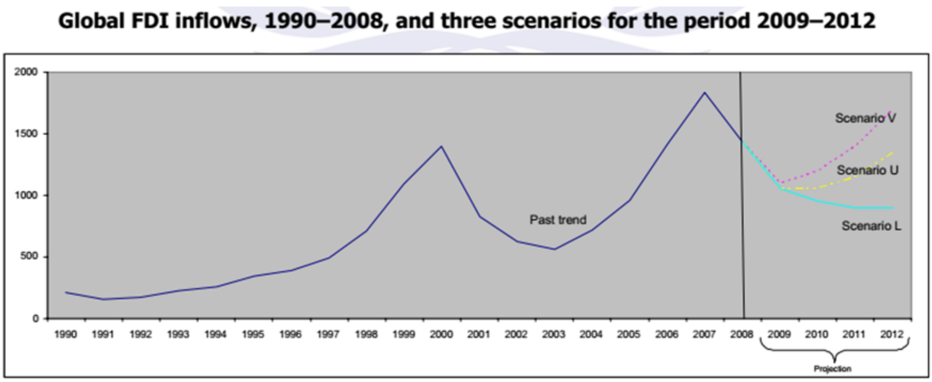
Pakistan recorded 2% economic growth in 2007 which was the worst in the last few decades. Pakistan faces many current problems like global crisis, the financial crisis, the energy crisis, poor security situation and flood effects. The top three countries providing FDI to Pakistan are the US, the UK and the United Arab Emirates (UAE), with 347.5, 119 and 121.8 million dollars respectively (Looney, 2012).

The research aim is to analysis the current situation of worldwide FDI and the role of Pakistan. The main research focus is to explore how Pakistan can increase its inward FDI. Two different approaches are investigated: firstly, identifying the main barriers to investing in Pakistan, and secondly, examining the key success factors (KSFs) of the top FDI recipients in the world: the USA, the UK, China and Ireland.

The rest of this article is organized as follows. Part two presents the literature review. Part three discusses the research methodology. Part four presents and analyzes the study findings. Part five presents the study discussions and recommendations. Finally, part six is the conclusion of the article.

2. Literature Review

FDI is one of the most influential topics of the international community (Daniels, 2004). In South Asia countries, there are three types of inward FDI: investment in natural resources, investment to serve the domestic market, and investment in export-oriented industries (Columbus, 2003). FDI has two different dimensions: expansionary FDI, in which the investors exploit distinct advantages through sales growth in the investing country and the host country, and defensive FDI, in which the investors seek to exploit cheap labor of the host country for reducing the cost of production (Moosa, 2002).



Source: UNCTAD, based on FDI/TNC database (www.unctad.org/fdi statistics) and UNCTAD's own estimates.
Note: The shapes of V, U and L scenarios are for illustrative purposes only and not based on any statistical methods.

Figure 1.

FDI increases the optimum distribution of global resources, expedites industrial restriction, stimulates the global technology transfer, promotes innovations in the economic systems and technology, fosters economic growth and increases integration of the global economy (Daniels, 2004). FDI also provides many benefits for individual economies. FDI brings financial capital, technology, managerial skills, jobs, tax revenue, information and goods and services that nurture the country's economy. This further, advances continued growth of economic, which leads to poverty reduction, better living standards and superior opportunities for public. FDI helps management, capital, technology, quality control, and highest penetration in external markets. FDI contributes to human resource training, transfer of skills and technology and management capacity between different enterprises (Daniels, 2004).

FDI is a tool through which a host country's academia, resources and capabilities can be improved. (Moran, 1998) explained that FDI is the most important source of external finance for many countries. FDI helps to develop a host country's economy through domestic sources of capital, transferring and developing technology, expertise, higher management, creates jobs and promotes exports (Columbus, 2003). A low level of productivity affects the economy like a vicious circle such as a low level of productivity in turn, leads to wages of low level, which further decreases savings, investment, productivity levels. To increase the economy productivity of poor and small countries, FDI can supply effective management, entrepreneurs, marketing and technology (Moran, 1998). Therefore, every developed and developing country is seeking FDI.

FDI has some disadvantages such as stronger economies may target the poorest and the smallest economies either to weaken them or acquire the domestic market in order to exploit the skilled labor of the host country at low cost. Mostly FDI ignores the law of the host country, and disturbs the local culture, custom and behavior. Pollution, health and safety problems are created. To invest in the host country industries, FDI drains capital from the host country. Using higher technology and higher management function reduces the cost of unskilled laborers (Columbus, 2003).

FDI has grown faster than world production, capital formation and trade, due to the following two factors. First, the advanced technology of multinational enterprises (MNEs), and second, to increase the profit and share of local firms (Elmawazini, Saadi, & Ngouhouo, 2005). The potential of FDI affects the host country's growth. It is argued that the physical inflow of capital and technology create a link between FDI inflow and the host country's economy growth (Johnson, 2006). The inflow of physical capital increases the economic growth of the host country but the growth in the host country's technology plays a greater role than capital (Balasubramanyam, Salisu, & Sapsford, 1996). FDI inflow country's increases the growth rate of developing economies but not developed economies. Export promoting strategy, but not import promoting strategy, increases economic growth (Mah, 2010). FDI increases the growth rate where a higher level of institutional capabilities such as property rights, protection, strong judiciary and bureaucratic efficiency and high human capital. FDI inflow can increase the economic growth of the host country, but a trade regime and macroeconomic stability are necessary (Zhang, 2001). The growth of the host country's economy requires a strong relationship between knowledge and technology.

Technology is a special kind of knowledge which is distinguished from other kinds of knowledge. Knowledge capital and technology are very important for MNEs as they provide a link between FDI and economic growth (dulescu Magdalena & Maria).

With a semi-industrialized economy, in term of purchasing power Pakistan is the 27th largest economy in the world. Its history has been developed by periods of political instability, rule of military, and wars with India the country on the border. The country faces continuously illiteracy, poverty, and corruption problems (Osmani, 2009). The country of Pakistan is underdeveloped that has faced continuously problems of security, internal political issues, and lowest degrees of foreign investment. However, between 2001 and 2007, 10% decreased in poverty and GDP growth in the industrial and service sectors was 5-8%, but in 2008 and 2009 the growth rate slowed down and unemployment rose. In 2007, 2008 and 2009 inflation increased from 7.7%, 20.3% and 14.2% respectively. Since 2007, the currency of Pakistani has depreciated. Pakistan's current account and foreign exchange stabilized due to remittances from Pakistani workers. Pakistan has the problems of increasing investment in healthcare, education, and energy, and lowering dependence on foreign donors. The country GDP in purchasing power parity in US dollars was $432.9 billion in 2009, $415 billion in 2008 and $400.6 billion in 2007, GDP at the official exchange rate was $162 billion in 2009. The real growth rate in 2009 was 4.6%, 3.6% in 2008 and 1.6% in 2007. GDP per capita in US dollars was $2,400 in 2009, $2,300 in 2008 and $2,300 in 2007, as seen in the figure below (Silver, 2013).

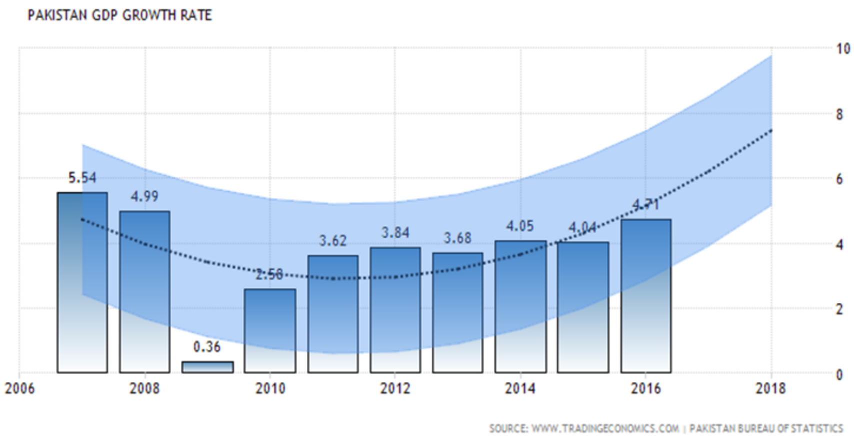


Figure 2.

The big industries in Pakistan are textiles, food processing, pharmaceuticals, construction materials, paper products, fertilizer and shrimp, in which the growth rate was -1.9% and oil production, was 59,140 bb/day and consumption 373,000 bbl/day in 2009. In 2008 natural gas production and consumption were 37.5 billion. In 2008 and 2009 exports were and US$21.21 & US$18.33 billion, respectively. Pakistan exports rice, leather goods, chemicals, manufactures, sports goods, carpets, rugs and textiles (yarn, cotton cloth, bed linen, and garments). Pakistan's export partners in 2009 were the US, UAE, Afghanistan, the UK and China 15.87%, 12.35%, 8.48%, 4.7%, and 4.44% respectively. In 2009 and 2008, Pakistan imports were US$28.53 billion & US$38.22 billion respectively, and the import commodities were petroleum, plastics, machinery, transportation equipments, edible oils, tea, paper and paperboard, steel and iron. In 2009 Pakistan's import partners were China, Saudi Arabia, UAE, US, Kuwait, Malaysia and India, 15.35%, 10.54%, 9.8%, 4.81%, 4.73%, 4.43% and 4.02% respectively (Manes, 2009). Pakistan's FDI fell by 44.7% in 2009-2010, compared with 2008. FDI in Pakistan was 3.52 billion in 2005-2006. In 2008 and 2009, FDI fell due to a decline in economic growth and attacks from terrorists.

As terrorist attacks increased, in 2009-2010, investment continued to slump to $1.72 billion. The top investors in Pakistan were the US, the Netherlands, Britain, UAE, Switzerland, Singapore and Cayman Islands, with $490m, $269.2m; $214m; $182m; $126m; $93.5m and $69.2m respectively (Arslan, 2010).

Moreover, (Arslan, 2010) explained the most attractive sector for investment was oil and gas with $604.7m. Other top industries receiving significant FDI were telecommunications, finance, transportation, paper and pulp, construction, chemicals and others with $309.8m, $133m, $104.2m, $80.5m, $86.3m, $79.1m and $375m respectively. The responsibility of lower level of FDI is due to bad governance and government policies. It was also stated that worsening security problem and law and order situation was responsible for low level of FDI. "FDI cannot be encouraged in a worsening law-and-order situation"

H1: *The disadvantages of Pakistan investment climate restrict the increased volume of FDI to Pakistan.*

FDI targets the newly industrialized economies like Hong Kong, China, Korea, Singapore, and

Taipei, China in Asia. Recently FDI is moving to China, India, and Vietnam. This changing direction of FDI flows suggests a positive interlink between Asia and Pacific region of confidence building, FDI inflows and economic growth. FDI inflow in the power sector in Pakistan is very low. Across the world, Pakistan contributed 0.2% FDI, which is less than 1% of emerging and Asian countries FDI and in South Asian countries 18% FDI in 1997. Instead of liberalization and the government looking for inward FDI, Pakistan has failed to attract FDI(Arslan, 2010).

Government policies were focused on encouraging the private sectors in the 1960s, and the public sectors in the1970s. The government of Pakistan made market-oriented policies and declared the private sectors the engine of the economy growth in the 1980s and 1990s. Meanwhile, the government of Pakistan made a great offer to foreign investors (Arslan, 2010).

In the 1990s, the government of Pakistan decided that the rules and regulation for FDI will be the same as for the local investors, and except for a few industries the need to gain governmental approval for foreign investors was removed. The investors were allowed to purchase any equity in the industries which already existed. Before, a No Objection Certificate (NOC) for all investors was required from the provisional government for the project location, while now only NOC is required from the foreign investors in those areas which are on a negative list of the provincial government. The investors were not allowed to negotiate terms and conditions with the government for transferring technology and other requirements in the past, while in present they can discuss every issue without any hesitation. Nowadays, foreign currency is freely exchanged, and foreigners and local investors, both residents and nonresident Pakistanis, can bring in, possess and take out foreign currency and open accounts. The concession was given by the government between 1990 and 1995 for those who established businesses in remote rural areas of special custom duty and sales tax.

2.1 Factors Influencing the Flow of FDI into Pakistan

Pakistan encouraged foreign investor particularly after the 1991/92 liberalization program by the government. It encouraged the investors through 100% foreign ownership of capital, operating companies without register with the local stock exchanges, no limits on sending money overseas, and allowing investment withdrawal at any time. Besides these encouragements, Pakistan is a highly populated country with 180 million people which offers marketing potential for consumers and durable goods. In addition, Pakistan has a favorable geographical location but still has failed to attract inward FDI like other developing countries such as example Hong Kong, China, Malaysia and Thailand. The most visible factors preventing foreign investors from investing in Pakistan are political instability, law and order, economic weaknesses, poor government economic policies, government bureaucracy, unfavorable local business environment, big gap between policies and their implantation, very poor infrastructure, unsympathetic attitude toward foreign investors, culture and social barriers and lack of technically trained and educated laborers (Khan, 1999).

Table 1. SWOT analysis of Pakistani business climate (author's own study)

Strengths	**Weaknesses**
Domestic market growth potential Market size Availability of natural resources Educated, skilled, motivated workforce	Corruption Bureaucracy Regulatory obstacles to business Lack of Government policy, transparency Weak corporate governance Security problems Weak FDI promotion
Opportunities	**Threats**
Economic growth Macroeconomic stability Low cost advantage Good relation with Islamic Countries	Political instability Poor image Over dependence on natural resource Macroeconomic instability No progress on legislation, regulation and terrorism

2.2 Key factors of Success for top recipients in attracting FDI

This section identifies the KSFs for top worldwide recipients in attracting FDI, the USA, the UK, China and Ireland, in order to develop an objective view of the key factors that determine countries' investment success. The fundamental common key factors that are valued by most investors and are crucially important for any country in order to attract investment will be identified. The experiences of top FDI recipients are analyzed to determine the reasons of their success. Then the factors that are common for FDI success across these countries are identified. These common factors will be an important basis for FDI attraction in any country. On the basis of these findings, recommendations will be made for the KSFs that Pakistan should develop in order to increase the volume of its inward FDI.

This choice of countries is based on a very simple principle: picking the recipients of FDI. The USA and the UK are two developed countries that traditionally attract the highest FDI. China has been the biggest recipient of inward FDI for a numbers of years. Ireland used to attract an incredibly high volume of FDI in terms of the size of its economy. Primarily, the focus is on identifying the important common factors that are valued by investors and are crucially relevant for any country in order to attract investment. These countries are examined one by one.

2.2.1 Ireland

Ireland is analyzed as a top FDI recipient despite no longer being at the top. The research will discuss how Ireland got the top position for inward FDI. Ireland received large FDI for a few years and became the "Celtic Tiger" with a growth record that matched East Asia's economic growth of 80% in real terms over decade of x to y (Peet, 2004).

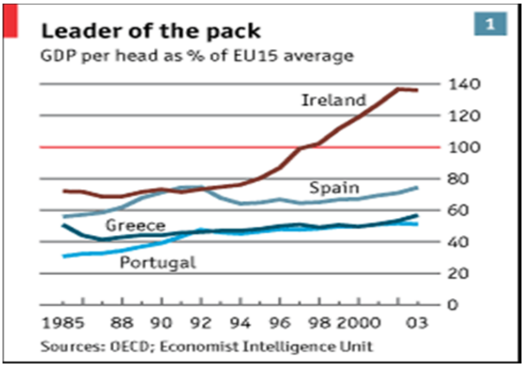


Figure 3. Source: (Peet, 2004)

Ireland and its FDI is a unique case which was the subject of many different analyses and studies. Some new research members of the EU and transition economies still try to copy "the Irish Model success" in attracting FDI. However, it is hardly possible to follow as every country is unique in the sense of its political, economic, social and technological processes. Thus, only some factors, rather than the entire model, can be applied in every country or industry with regards to the particular conditions and circumstances. The factors that Ireland has implemented and developed to promote itself and to attract FDI might be a useful example of how Pakistan can increase its low volume of FDI.

Low tax and generous investment incentives: One of the main drives for foreign investors to bring their capital to Ireland is the low tax environment. Across the world, Ireland provides the most valuable corporate tax environments. A 12.5% tax rate on corporate trading income has applied since 2003 (which is far below the EU average of 30%).

Availability of young, educated and productive labor: The quality and availability of the Irish workforce was one of the country's greatest competitive advantages in attracting inward FDI during the beginning of its fast development (Peet, 2004). Ireland has a very unique, young and well educated employees. The population of Ireland is the youngest in Europe with over 40% below the 25 years age. In addition, the quality of Ireland's education is exceptionally high, which everyone receives. In Ireland 6 out of every 10 third level students and their major are in science, engineering or business studies. The Irish government recognizes and it is trying to sustain it by further investing in education. The government has a strategy to increase the highest level research talent from Ireland and abroad and will double the number of PhDs by 2013 ("young, talented workforce," 2011).

Table 2. ("young, talented workforce," 2011).

The Ireland Educational System meets the requirements of a developed economy	
Country	Score
Ireland	6.620
France	6.380
USA	5.660
UK	5.560
Spain	3.900

Ireland has powerful work culture and keenness for "getting things done". This is replicated in the rate of turnover of employee which is well below the average of European (Gopinath & Chen, 2003). It means that owners enjoy greater obligation from their employees, have greater proportions of properly experienced workers and acquire low annual cost of training ("young, talented workforce," 2011)

Table 3. Flexibility and adaptability of workforce when faced with new challenges ("young, talented workforce," 2011)

Name of Country	**Score**
Ireland	7.380
USA	7.100
Netherlands	6.880
UK	6.110
Czech Republic	5.640
Germany	5.450
Japan	5.450
Portugal	5.140
Spain	4.800
France	4.330
Hungary	3.890

Moreover, the above table shows that Ireland has the highest score in quality of flexibility and adoptability, which is the country greatest advantage in attracting foreign investors. Therefore, the educational system quality of Ireland, the flexibility and availability of its young personnel, the lower rate and higher labor productivities have afforded a real competitive advantage for business in Ireland. All these factors resulted in Ireland attracting a high number of international companies in the country ("young, talented workforce," 2011).

Strong Government Support of foreign investors: The Irish Industrial Development Agency (IDA) is also an agency of Irish government that ensures that companies from overseas expanding or establishing their operations in Ireland obtain the best assistance, cooperation and advice. Ireland provides such investors a well competitive offer of supports of investment. Worldwide, IDA Ireland offers its services dedicated teams of every industry specialists in 14 offices (Enterprise Ireland, 2009). IDA Ireland coordinated all the services and supports needed to ensure that the startup or expansion of the foreign companies proceeds without trouble. For this purpose, and in order to anticipate and meet its client needs, efficient experience and professional “one stop shop” has been established. Both Enterprise Ireland’ and IDA’s promotion and data sharing activities have helped Irish companies to establish relations with foreign investors and contributed to promote Ireland overseas. Moreover, these agencies supplied Ireland’s policy makers with valuable data in order to shape the environment in accordance with the requirements of the foreign investors and consequently, to improve the country’s overall investment climate. Thus, the example of Ireland indicates that government authorities in order to increase FDI should do the best job they can in informing and communicating with foreign investors in order to increase the volume of its inward FDI ("young, talented workforce," 2011).

Developed Infrastructure: In Europe Ireland has one of the most competitive and advanced telecommunication infrastructure. The sophisticated system of telecommunications of Ireland enables firms to achieve economies by centralizing their Europe management in Ireland, design, link and advance scientist, engineers, and other R&D personnel worldwide for real-time development activities and conferencing, provide customer support and marketing by telephone around Europe from a sole call center. Furthermore, the market of telecommunications is fully de-regulated and presently over 20 corporations compete on the foundation of significance added services. Other factors that have attracted foreign investors include political and economic stability, the English language (as an international language), the stability of euro currency, and culture (close and understandable for European investors).

This analysis of KSFs in Ireland has indicated a kind of investment paradox. Ireland has some significant competitive advantages that are valued be foreign investors but at the same time Ireland is far from being perfect. As the analysis shows, nearly every advantage has its downside that, theoretically, can put off foreign investors. However, they have not. It means that a few really strong advantages in investment climate are enough to compete successfully on the international stage for foreign capital. Moreover, these advantageous factors are quite strong so investors tend to ignore other existing disadvantages. Thus, Pakistan can learn from the case of Ireland that is enough to concentrate and develop a few weighty advantages and reduce obvious risks in order to succeed.

2.2.2 United Kingdom (UK)

In the analysis of KSFs in attracting FDI, the UK cannot be ignored. It has been competing very aggressively on the international market for foreign capital and has been one of the top FDI recipients in the investment report and reviews. The UK is considered one of the most superior inward investments place in Europe. Almost 40% of US and Asian investment into the EU goes to the UK. Moreover, in 2005 the UK managed to attract massive capital inflows of $219 billion that represents the highest figure ever recorded for a European country. Thus, the evidence of the UK could probably be useful in solving the problem of poor volume of FDI in Pakistan (from Developing, 2006).

Long term economics, political stability: Stability, in general, is quite a common indicator of a favorable investment climate in many developed countries. For this reason, it should not be identify as a crucially important factor in attracting FDI in any country. However, the author feels that an exception should be made regarding the UK. These factors make this country particularly attractive for foreign investors. The economy of UK is one of the strongest in Europe. Interest rates, Inflation and unemployment remain very low (Driffield, 2004) even some rose seen in the inflation of the UK in the figure below.

The currency of the UK is very strong and in generally the country’s economic performance is very good. Moreover, the government is improving education, transport and health services, which affects the overall image of the country. The economic survey of the EU forecasted that “countries e.g. the UK are expected to attract low level of FDI in the near future and could even practice some disinvestment, especially in export-oriented manufacturing sectors like industry of automotive, if they stay outside the Euro location” the UK is considered to be something in the political aspect as well (Dodson, 2006).

A highly skilled, flexible, English speaking workforce*:* As the UK cannot match the low labor costs of India and China competitors, it puts all its emphasis on developing and increasing its skilled and motivated workforce committed to developing high value added products and services.

This is the niche where the UK is competing for FDI high value-added investment.

The UK has 29.6 million and adaptable skilled personal and education with high standards, focus on training and vocational education. Across Europe, regulations of labour market in the UK including hours of working are characterized to be among the most flexible. Furthermore, the UK has a strong technology and science base with world top class disciplines of design, research & development. Majority UK scientific institutes and universities are participating in joint research projects with business. The workforce in the UK is English speaking. The fact of conducting business in English simple for every investor as it is the most common language in the world and it usually does not create barriers in communications (Driffield, 2004).

High quality Corporate Governance: The quality of corporate governance in the UK is considered by the investors as very high. Corporate governance in the UK was the highest among 23 nations in the survey (2005) by International Government Rating Agencies. The fact of high quality governance is promoted very well by the government agencies and it plays a significant role in attracting FDI.

Advanced Telecommunication Infrastructure: The telecommunication infrastructure has been one of the major drivers in attracting FDI into the UK. Telecommunication has played the same role and performance in the UK as was mentioned for Ireland.

2.2.3 China

As repeated surveys and actual FDI inflows bear out, China remains the top destination for foreign investors. Here is an analysis of KSFs that made China a top FDI destination.

Inexpensive Labor Force: Inexpensive labor force is one of the strongest competitive advantages of China. In 2004, the average monthly salary was 30- 97 US$, depends on the sector and location (Palmade & Anayiotas, 2004). The availability of professional and low cost labor is one of the main factors to attract FDI into China.

Rapidly growing economy and huge potential market: Mostly investors are agreeing that cheap labor as the main reason to invest in China. The rapidly growing economy in terms of production and consumption has attracted the foreign investors. According to (DeLong, 2003) “over the past three decades the growth of economy has averaged 9.5% and expected to continue at the same speed ahead. Per capita income is growing rapidly and steadily and people consumption is growing as well and that creates a new market”. Thus, the investors are looking for the internal China markets and not export. Another factor that attracts the investors is significant tax exemption and deduction.

2.2.4 The United States of America

The factors which attract the investors into the US is its large domestic market potential and proximity to customers, educated and skilled workforce, great promotion and strong governmental support of foreign investors, developed infrastructure and logistics.

These are the KSFs in attracting FDI of a number of leading countries in the world. This was essential in order to develop an objective view of the key factors that determine countries' investment success. Primarily it was tried to identify those important common factors that are valued by investors and are crucially relevant for any country in order to attract investment. The factors listed below are the basic factors that are important for the investment attraction.

Skilled or inexpensive labor force (or productivity)
Developed infrastructure
Government support of foreign investors
Generous investment incentives (tax or non tax)
Market potentials or market growth

Now knowing what factors a country should have in order to attract investment successfully, the author can make recommendations to Pakistan for increasing the volume of its inward FDI. The *research focus will be on proving the two hypotheses*.

***H2:** The adoption and development of KSFs for top worldwide recipients in attracting FDI in Pakistan (best practices) will create new investment opportunities for foreign capital.*

3. Research Methodology

The anticipated research work is exploratory in nature using both secondary data and primary data, undertakes a thorough review of basic and up-to-date literature available and tries to explain the factors affecting the inward FDI in Pakistan. The secondary data related to the issue have been taken from already existing literature, published documents, books, thesis, journals, web and newspapers.

While the primary data collected through emailed questionnaires from those respondents who conduct business in Pakistan and belong to another country or from those Pakistanis who are working for a foreign country operating business in Pakistan. The researchers believe that nobody can identify the increase volume of inward FDI to Pakistan better than foreign investors. They are currently conducting business there and they see what problems Pakistan should solve and what factors of success should be developed in order to attract FDI for positive effects of the economy.

Thus, the researcher emailed 80 questionnaires during the 8-week survey period to companies of different origin that undertake business in Pakistan. At the end of the survey period, 35 companies responded with completed questionnaires, a return rate of 43.75%. Here, the researcher connects the theoretical knowledge gained though continuous research of secondary sources of information (related to the topic) to the results of the primary research. Such connection of the theory and practice provides the researcher with a greater vision of the entire topic and facilitates a definite answer to the core question of this paper "How can Pakistan increase the volume of its inward FDI?" In presenting the study results, the main characteristics of the population are introduced and then the hypotheses and comparison of FDI in Pakistan with other countries are tested. For this purpose, the researcher used both non-parametric and parametric statistics.

4. Findings

By asking the respondents about the origin of their companies, the USA, the UK and Japan emerged currently as big investors in Pakistan. There are huge potentials for the other countries like China, Germany and Netherlands to invest in Pakistan.

Table 4, Companies' origin

		Frequency	Percent	Valid%	Cumulative %
Valid	USA	15	42.9	42.9	42.9
	Germany	1	2.9	2.9	45.7
	UK	5	14.3	14.3	60.0
	Japan	2	5.7	5.7	65.7
	Netherlands	1	2.9	2.9	68.6
	Malaysia	1	2.9	2.9	71.4
	Austria	1	2.9	2.9	74.3
	Australia	1	2.9	2.9	77.1
	UAE	2	5.7	5.7	82.9
	Korea	1	2.9	2.9	85.7
	China	1	2.9	2.9	88.6
	Norway	1	2.9	2.9	91.4
	Egypt	1	2.9	2.9	94.3
	Bermuda	1	2.9	2.9	97.1
	France	1	2.9	2.9	100.0
	Total	35	100.0	100.0	

The above table shows that the highest percentage of the participating companies in the survey is the USA (42.9%), followed by the UK (14.3%), Japan and UAE (5.7%). All of the remaining responses were from companies representing a single country. This distribution among the countries is purely random and the return was based on the initiative of the companies to participate in survey questionnaire.

Numbers of respondents is 35. Mean is 4.5, Median is 3, and Mode is 1. While Standard

Deviation is 4.421, variance is 19.55 Range is 14. Minimum and Maximum are 1 and 15.

Most companies' respondents that participated in the survey started their job with the company in 2003 (34.3%), followed by 2004 (20.0%). The rest of the company's participants started their jobs between 1999 and 2008. According to some comments of the questionnaire participants, 2003 was a lucky time for starting a job with the companies. Because there was a complete change in the attitude of the investing companies and their stake holders. According to another participant, after 9/11 the investors mostly entered the Pakistani market in 2003. These investors had been interested to enter the Pakistani market but waiting for the right time which the participants thought was 2003 and 2004 after the easing to some extent of the Afghan war. The period of 2001 was full of unfavorable economic and political events. Due to the Afghan war, the government was in the hands of dictator, terrorism and security problems and general economic instability, and crises. According to another participant, investors came to Pakistan when the situation improved significantly, in terms of investment risk and they spread their businesses. Thus, this tendency that gives a hope to Pakistan for an increase in the volume of inward FDI in the future as the analysis shows continuous improvement of different aspects of the investment climate in Pakistan especially security problems which were improved to some extent in 2010. Therefore, this question is indirectly related with hypothesis one. The disadvantages of Pakistan investment climate restrict the increased volume of FDI to Pakistan.

Transportation and communication are the most profitable businesses in Pakistan. This shows that Pakistan has a huge population, a big market size, good strategic location and infrastructure facilities and that these are the most attractive factors that bring other companies to Pakistan. Our second hypothesis is directly related to this question and if these advantages are shown and the KSFs are advertised to the outside world, Pakistan will be the best place for investment. The data for this question are given below.

Table 5. Key business function of the companies

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Provide Consumers Products	9	25.7	25.7	25.7
	Restaurants Services	2	5.7	5.7	31.4
	Health Services	3	8.6	8.6	40.0
	Transportation & Communication services	13	37.1	37.1	77.1
	Exports & imports Services	2	5.7	5.7	82.9
	Materials and Mining Services	5	14.3	14.3	97.1
	Other please specify	1	2.9	2.9	100.0
	Total	35	100.0	100.0	

Foreign investors are currently involved in a variety of business operations in the Pakistani market. However, according to the respondents of this research, the key business functions of most of the companies are transportation and communication services (37.1%) and providing consumer products (25.7%). Restaurants and export and import services, health services and materials and mining companies are all engaged in the Pakistani market.

Most motivating factors in Pakistan: Cost is the most important factor among all others factors. This is the greatest advantage of Pakistan that the cost of production is very low from raw materials to taxes. This question links directly with second hypothesis. So by adopting and developing these KSFs, Pakistan can become the most favorable place for investors.

Table 6. Most motivating factors in Pakistan

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Size of domestic markets	7	20.00	20.00	20.00
	low cost of Labors, taxes and raw materials	18	51.40	51.40	71.40
	Strategic location	10	28.60	28.60	100.00
	Total	35	100.00	100.00	

Most foreign investors (21.4%) are interested in Pakistan because of the low cost of labor, low level of taxes and low cost and easy availability of raw materials. The second and third important factors are strategic location (28.6%) and size of domestic market (20%).

Every company that invests in another country thinks strategically and they want 100% results. While the result is above 70%, this is not good enough. They plan for 15 to 20 years in advance and thus negotiate regularly with the government. Corrupt bureaucracy, security problem and poor government climate prove our first hypothesis that these disadvantages restrain the volume of inward FDI to Pakistan. The result should be above 95%. Most foreign investors' responded that their companies are succeeding in the Pakistani market place: 71.4% of the respondents replied that they have been successful in achieving their goals over the past years while the remaining 28.6% were neutral. This distribution of the answers gives hope for a successful future.

Asking the respondents about the expanding the business operation is also an important question. Expanding the business operations means that companies are quite happy operating in the host country which will directly increase FDI: 77.1% answered positively to this question, which was not in line with the researcher's expectation. The result is positive but it should be above 90%. Moreover, 22.9% of companies don't want to expand their operations, because the Pakistani climate restricts inward FDI, which is shown in the first hypothesis. Complete data for this question are given below.

Table 7. Companies planning for the future

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Expanding	27	77.10	77.10	77.10
	The same level	8	22.90	22.90	100.00
	Total	35	100.00	100.00	

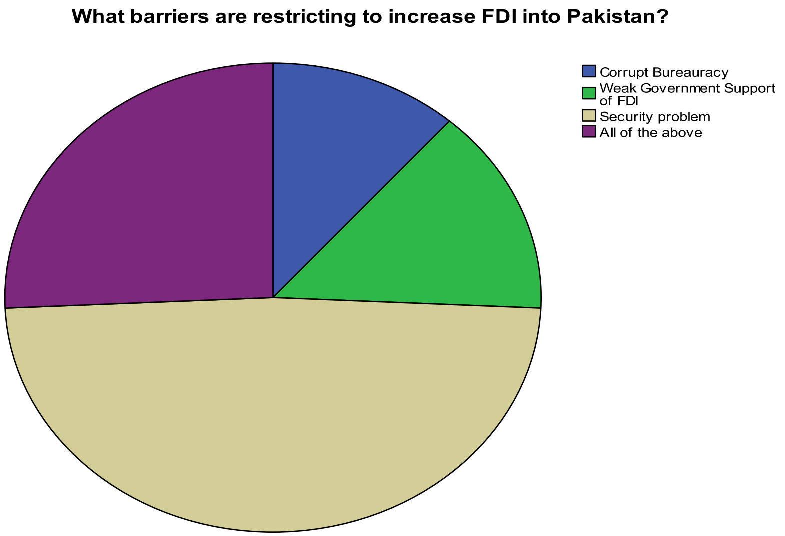


Figure 4. Barriers to investing in Pakistan

This question is directly linked with first hypothesis. In attracting FDI every single factor should be noted and importance should be given to every factor that causes barriers and helps FDI. By asking the respondent about the barriers to FDI, the respondents agreed that security problem and corrupt bureaucracy are the main barriers to FDI. More data are presented below.

Table 8. Barriers restricting increased FDI into Pakistan

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Corrupt Bureaucracy	4	11.4	11.4	11.4
	Weak Government Support of FDI	5	14.3	14.3	25.7
	Security problem	17	48.6	48.6	74.3
	All of the above	9	25.7	25.7	100.0
	Total	35	100.0	100.0	

Most companies have more than one obstacle in conducting business in Pakistan: 48.6% of respondents named security as the top barrier they face in conducting business in Pakistan, followed by corrupt bureaucracy (11.4%), weak supports of government of FDI (14.3), and all the above mentioned problems (25.7%) were the most cited problems that investors face in conducting business in Pakistan. This outcome of the primary research supports the recommendations made in the literature review. Inadequate and inconsistence legislation and inefficient judicial system have been cited as the main barriers to conducting business in Pakistan which come under the topic of weak supports of the government of FDI.

The labor market in Pakistan is the most important factor. A big pool of high skill and lower cost is available any time. There is no doubt about the labor efficiency of Pakistani labor. Above 93% agree with this. This question is related to our second hypothesis that labor is one of the KSFs and most companies that are investing in Pakistan are coming for this low cost labor. Data are presented below.

Table 9. Problems regarding the labor market

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Neither Agree Nor Disagree	3	8.60	8.60	8.60
	Disagree	32	91.40	91.40	100.00
	Total	35	100.00	100.00	

The table shows that investors disagree that they have any problems regarding labor: 91.4% said that they are satisfied with the laborers in Pakistan, which proves the point from the literature review that Pakistan has high quality, professional and flexible labor which attracts foreign investors to Pakistan. Therefore, this question has a direct linkage with the second hypothesis in which labor is one of the KSFs for top worldwide recipients in attracting FDI.

The investing climate is actually the environment in which the firms operate, including policies and regulatory environment in which the government plays an important role. Currently, the economic climate is tough but every firm and company is optimist about the future of Pakistan. More than 77% agree that it will improve in the near future. This question is linked with question number seven and hypothesis No 1. Most of them agreed that if the barriers are removed then the investing climate will improve very quickly. More data are given below.

Table 10. The investment climate and opportunities in Pakistan

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Improve	27	77.10	77.10	77.10
	Remain the same	8	22.90	22.90	100.00
	Total	35	100.00	100.00	

Companies participating in the survey questionnaire (77.1%) believed that the climate of investment and opportunities in Pakistan will improve in the future whereas 22.1% anticipate that it will remain the same. The questionnaire participants did not comment on the choices of their answers in this question, so it is difficult to judge what made them think the investment climate would improve or will remain the same. Based on the literature review and primary research that investment climate will improve if Pakistan eliminates the barriers.

For conducting business in Pakistan, this question is very important and has a direct linkage with hypothesis 2. The KSFs like easy availability of labor, low cost of inputs and taxes are positive in Pakistan. Therefore, to operate business in Pakistan is easier than in other developing countries. Data are given below.

Table 11. Conducting business in Pakistan

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Easier in Pakistan	25	71.4	71.4	71.4
	The Same in Pakistan	10	28.6	28.6	100.0
	Total	35	100.0	100.0	

According to the result of the primary research, Pakistan is considered by foreign investors (71.4) to be an easier place for conducting business. The remaining 28.6% said that conducting business in Pakistan is the same as conducting business in other developing countries.

As compared to other developing countries in South Asia like China and India, the result shows that Pakistan is a higher risk area due to internal problems. In the last few years, the political and economic climates are becoming more unstable and there is more investment risk and companies hesitate to invest. However, companies that have been operating during the last two decades are very optimistic about this and they think that the investment climate will be favorable very soon. Data are given below.

Table 12. Comparison of the investment risks in Pakistan with other developing countries

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Higher Risk in Pakistan	28	80.0	80.0	80.0
	The Same Risk in Pakistan	7	20.0	20.0	100.0
	Total	35	100.0	100.0	

In terms of investment risks, Pakistan performed worse (80%) than most of the global developing countries in the region. The author thinks that internal problems which were mentioned in question seven created higher risk in Pakistan than in other developing countries.

Most companies working in Pakistan are multinational. In comparing the average rate of return with other developing countries, therefore, this question is directly linked with hypothesis 2. If the average rate of return is higher it means that the country has adapted the KSFs of top FDI recipients or vice versa. More data have been given below:

Table 13. Return on investment

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Higher ROI in Pakistan	17	48.60	48.60	48.60
	Same ROI in Pakistan	18	51.40	51.40	100.00
	Total	35	100.00	100.00	

With regard to the average return on investment (ROI), Pakistan received about an average rate of response: 51.4% said that Pakistan has the same ROI while the remaining 48.6% responded to higher ROI than other developing countries. The authors believed that inexpensive labor and raw materials, low level of taxes, and size of domestic market lead to higher ROI, while lack of infrastructures, weak government support of FDI and lack of other KSFs lead to lower ROI or the same ROI. Therefore, ROI is linked to hypothesis 2.

The result obtained from the primary research that most of the laborers are male proves the culture of Pakistan that women mostly work at home. Therefore, this question is directly linked to hypothesis one.

Table 14. Gender

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Male	29	82.9	82.9	82.9
	Female	6	17.1	17.1	100.0
	Total	35	100.0	100.0	

According to the result obtained from the primary research, the majority (82.9%) is male laborers while the rest (17.1%) are female. The researchers strongly believe that the main reason for unequal distribution between males and females in the field of labor is the culture of Pakistan.

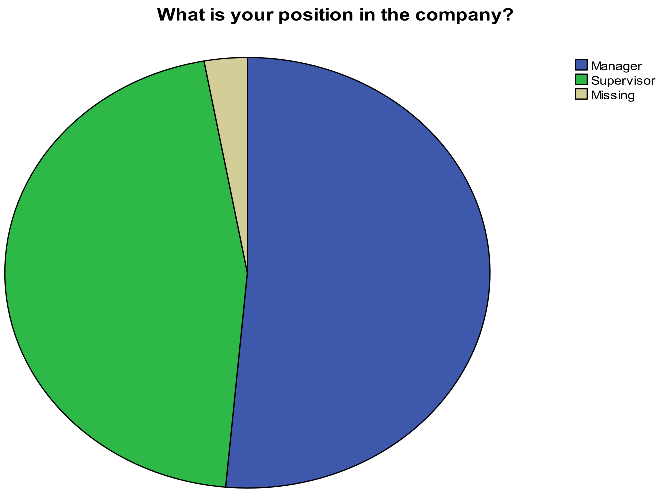


Figure 6. Position in the company

With regards to this question, the researcher wanted to know from whom the responses came because lower rank workers have less knowledge than higher rank. It is considered that higher rank persons must be more experienced and qualified than lower rank persons. The data for this question are below.

Table 15. Position in the company

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Manager	18	51.40	52.90	52.90
	Supervisor	16	45.70	47.10	100.00
	Total	34	97.10	100.00	
Missing	System	1	2.90		
Total		35	100.00		

Nearly half of the respondents are managers (51.4%) and 45.7% are supervisors. One respondent (2.9%) did not disclose his position. The result shows that most respondents had higher job responsibility. It means that they must have the experience and knowledge that the researchers asked in the questionnaire. Therefore, it is believed that the primary research should be accurate and to the point for this time period.

Summary and conclusion of the main findings of the primary research: The results of the Survey Questionnaire demonstrate that Pakistan is a favorable location for foreign capital. The vast majority of foreign investors (questionnaire participants) are succeeding in Pakistan in terms of their businesses. So, most investors are planning to expand their operations and investment in Pakistan in the near future.

The result also shows that Pakistan has high investment potential. The country satisfies the main strategic determination of FDI. First, Pakistan has a big potential market with a large population of consumption and income per capita. Secondly the availability of natural and human resources and the low cost advantages of input labor and taxes. All of these points were tested in the primary research and received the highest percentage of votes.

However, in term of barriers, Pakistan faces the following major obstacles to attracting FDI: security problems, corruption, bureaucracy, no governmental support for FDI etc. Half of the respondents (50%) replied that Pakistan has a higher ROI than other developing countries. Finally, the majority of the respondents were male and supervisors or managers of the company.

5. Discussion and Final Recommendations

The recommendations in the following section are written based on the findings in the literature review and the primary research undertaken for the purpose of the study.

In accordance with the study findings, there are several areas that need to be addressed in order to increase the volume of FDI to Pakistan. The recommendations are designed for the attention of the government, Board of Investment (BOI) and foreign companies and suggest the active involvement of these groups. The involvement of the government and policy makers is of crucial important in order to gain an overall improvement of investment climate of the country with the aim of investment risk reduction and development of investment opportunities. Recommendations should also be considered and promoted by the Federal Investment Promotion Agency- “Trade and Investment Agency of Pakistan”. Some of the recommendations should be considered by the regional promotional agency as they provide some advice on how the efficiency of BOI can be increased and how obstacles that foreign investors face in Pakistan can be overcome. The following section should be used as a guide for what are generally recommended actions; for detailed recommendation additional research should be undertaken.

Pakistan can increase the volume of inward FDI by solving its internal problems of investment climate and developing some key factors that are crucial for success (based on the analysis of the top FDI recipients).

Active promotion of Pakistan as a great investment location and strong support of foreign investors: Pakistan needs to become more competitive and proficient in attracting FDI and in understanding and meeting investors’ expectations. It should learn to promote itself as a great investment location. Moreover, foreign investors must see that Pakistan is interested in their capital and that it demonstrates direction towards the improvement of its investment climate and values every single investment as a special one, through offering great support and help throughout the process of investing and operating. This goal is achievable if efforts are made on different levels.

An investment promotion strategy that outlines the government’s commitment and approach to attracting FDI should be developed. Such a strategy should outline the main direction of the promotion activities, including what actions the government will take to improve the business environment, details on how to coordinate the investment promotion strategy and how facilitation is going to be achieved at both federal and provincial levels.

The BOI should become an active leader of promotional activities within the country and worldwide investors. BOI is the main source of contact at the federal level in Pakistan and it is going to be the first point of contact for any potential investor in the case of interest in the country as an investment destination. It is the first source where investors will get an impression of the country’s profile, get information about investment opportunities and Pakistani partners and find out what investors are already conducting businesses in Pakistan. Such information should be freely available for investors and delivered in a professional manner. Thus BOI should provide a wide range of high quality services for investors.

Firstly, it should establish some kind of information analytical network capable of providing information on different provinces and the investment potential in Pakistan. Secondly, it should have an up-to-date web site available in different languages to facilitate easy access to desirable information. Thirdly, it should undertake proactive marketing such as the organization of focused seminars, conferences and exhibitions, publishing articles in national and international press regarding Pakistan and its investment opportunities. These are very general but important activities for creating public awareness. Lastly, the agency could develop cooperation with international financial organizations. Pakistan should also learn from the experience of IDA and Enterprise in Ireland and should take similar steps to attract FDI. Pakistan should give equal importance to all four provinces, along with FATA, Kashmir and Gilgit Bulkistan, while they are nowadays focused on a few areas of bigger cities in Pakistan. Thus, BOI should provide full information about all regions so that investors can find the region where they can get competitive advantages.

Improvement of the business environment (simplify the process of investing and operating from the legislative point of view): Improve the business environment laws, regulations and procedures to ensure that Pakistan is not put at competitive disadvantages with respect to other countries. The business environment in Pakistan might be improved by simplifying the procedures of certification, licensing and customs clearance as the majority of foreign investors come across them on a regular basis. (Basically cut down the red tape). The authority should become more open to dialogue with business and facilitate the process of processing the documents, for example the customs authority could move away from demanding that companies meet absurd requirements, especially the submission of various documents. Certificate authorities could simplify and shorten the process of certificate application. At the same time, the authorities cannot really be blamed as they are just following legal documents. Thus, the legislation concerning those areas should be revised and rewritten with the idea of making the business environment better.

Government support and development of education: The Pakistani government should increase investment in education. Transferring free education to a commercial one will not help the country to keep its competitive advantage of a well-educated workforce. So, if Pakistan wants to sustain this advantage it should make education affordable for every student. The proper funding and high quality of education lead to comparatively low pay rates that will be crucial in the process of attracting FDI. The lesson of the top FDI recipients also shows that all of them make the further development of the educated workforce a key factor in their national priority. Pakistan should pay attention to this tendency and get its priorities right if it wants to compete successfully for FDI in the future.

Communication: The English language is a factor that is usually considered by foreign investors in choosing the location of their capital (English as an international language facilitates communication with foreign companies), the Pakistani government should make the development of English speaking skills, in both private and government schools, on priority bases. Basically, the educational establishments at different levels should emphasize the language skills of the people in the country in order to facilitate the foreign investment.

Corruption elimination: The issues of corruption have been discussed in the literature review in detail. This problem was also identified as the highest barrier to investing in Pakistan in the primary research. Therefore, strong policy is needed to eliminate corruption. The Pakistani government should eliminate corruption if the government is serious about increasing the volume of inbound FDI to the country. It should undertake real anticorruption actions such as fines, prosecutions and job dismissals. At this stage many anticorruption legal acts and orders have been introduced but they do not appear to have been used. So, it is the right time to exercise them and the starting point should be government officials and politicians. Corruption should be eliminated in the roots of the ruling source of the country; so society will not refer to country's heads when it is accused of being corrupt. Society cannot be expected to follow anti-corruption laws if the government itself is a greater example of it. The way of dealing with this problem could be the establishment of a separate independent body that is represented by independent inspectors. They could keep watch on government officials and investigate cases of alleged corruption. It is very important to set this up independently as the police and special investigation agencies are well known for cases of corruption themselves.

The government also should change the attitude of their public toward corruption. The government could try to form a new way of thinking for the future generation by integrating a special course regarding corruption issues as a part of high school programs. Children could be taught what corruption is, why it is bad for society, who suffers from it and how they can deal with it. Thus, the problem of corruption cannot be completely solved now but there is a hope that the situation will be improved in the future as a result of a diverse approach towards solving it today.

Foreign companies should also contribute toward solving the problem of corruption. The majority of foreign investors said that they had been forced to give bribes at some stage. The recommendation to them is to refuse giving any type of bribes in the future. If all of them resist the pressure of corrupted officials, report any case of corruption and make it a public issue the government officials will think before accepting bribes. Today potential foreign investors should accept the fact that they will come across corruption and decide if they want to deal with this actively or accept this and include it as an extra business cost in their feasibility studies.

Fair enforcement of regulation and laws: Today Pakistan is constantly being accused of unfair and selective application of the laws for domestic and international companies operating there by the news media and foreign investors. For example, some companies get away with abusing the rights of shareholders hiding profits from the taxman and grey imports, when others are being prosecuted. Some companies have to comply with the ridiculous amount of regulations during custom clearance when others get away this. Many such examples are highlighting in the press on a regular basis and this has to be stopped. The government should take this situation under control and enforce clear laws consistently and fairly to any company conducting business.

Funding of the infrastructure development: The lesson which was learnt from the top FDI recipients indicates that developed infrastructure is one of the main KSFs in attracting FDI. The infrastructure environment is quite favorable in general in Pakistan compared with that in Europe but it is still good enough to be a true factor of success in attracting FDI in Pakistan. Thus, if Pakistan wants infrastructure to become and remain a key factor, it needs to invest in it now. A strategy of continuous, graduate infrastructure improvement should be set up by the government. Pakistan should keep annual budgets for the infrastructure. In addition to the infrastructure, facilities should be equally divided throughout Pakistan so they will compete fairly for FDI.

Development of high quality Corporate Governance: Today corporate governance in Pakistan is described as unfavorable and has many problems. Pakistan should learn from the UK what high quality corporate governance actually means and adopt some of its principles as it is considered by foreign investors to be a high standard.

The government should make changes in the areas of corporate governance like financial disclosure, internal controls etc.

Adoption of emergent approach towards strategy if increasing inward FDI in Pakistan: Pakistani government should not set up long-term objectives and strategies of FDI improvement based on today's findings. In the modern world, the environment is so dynamic so it is difficult to predict what risks and opportunities will emerge in the near future. Thus, on the basis of the findings of its paper the researchers can say what steps Pakistan need to implement today and maybe in another couple of years in order to compete for FDI effectively. The recommendation for the future will be to monitor the situation regarding global FDI continuously, to spot new tendencies (e.g. new industries that investors want to invest in best policies in attracting FDI) and react to them by shaping the country's environment for FDI according to the most current investment needs. The proposed approach is as an emergent approach to the strategy that will enable Pakistan to respond to an evolving reality rapidly.

6. Conclusion

This work has attempted to answer questions related to "how Pakistan can increase the volume of its inward FDI?" It has analyzed the global FDI trends and directions, examined FDI shifts and identified the main providers and recipients of foreign capital. Such analyses are essential in order to identify the place and role of Pakistan in FDI distribution. Two major areas have been developed to answer the research question: identification and resolving of the internal problems of the Pakistan investment climate as impediments for increased the volume of FDI, and identification and analysis of key factors of success of the top FDI recipients. Recommendations have been made for how Pakistan can overcome the problems of corruption, government bureaucracy, unfair application of laws and regulations, poor quality of corporate governance and the lack of promotional activities of Pakistan as an investment destination. On the basis of a detail analysis of the KSFs of top FDI recipients (Ireland, the UK, China and the USA) the basic KSFs have been explained as skilled labor force, developed infrastructure, government support for foreign investors, and corporate governance. All the recommendations for the enhancement of inward FDI in Pakistan need to be concentrated on by the government of Pakistan. Other similar developing countries could also apply these KSFs for attracting investors.

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