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Risks and Foreign Direct Investment Inflows: Evidence from Yemen

(Risiko dan Pelaburan Langsung Asing: Bukti dari Yaman)

Hamdan Amer Ali Al-Jaifi
Nur Adiana Hiau Abdullah
Angappan Regupathi
(School of Economics, Finance and Banking, Universiti Utara Malaysia)

ABSTRACT

This study aims to find the relationship between the political, exchange rate and inflation risk factors with the yearly foreign direct investment (YFDI) in Yemen, over the period between 1990 to 2010. Secondary data results showed that political risk and exchange rate risk have an inverse relationship with YFDI, while inflation risk has a significant positive relationship. Further analysis on a survey collected from 62 multinational enterprises (MNEs) operating in Yemen showed an insignificant relationship between the perceived political, exchange rate and inflation risk factors and corporate foreign direct investment (CFDI). The conflicting results possibly imply that the MNEs' subsequent capital investments may not be affected by the perceived political, exchange rate and inflation risks that would nonetheless have been considered during the initial business plan. It is likely that MNEs that were already operating in Yemen may have developed capabilities in terms of knowledge, bargaining and lobbying skills. Therefore, perceived risks are no longer seem to influence their investment decisions.

Keywords: Foreign direct investment; political risk; exchange rate risk; inflation risk; multinational enterprises

ABSTRAK

Kajian ini bertujuan mengenal pasti hubungan di antara faktor-faktor risiko politik, tukaran asing, dan inflasi dengan pelaburan langsung asing tahunan (YFDI) di Yaman sepanjang tempoh 1990 hingga 2010. Dapatan data sekunder menunjukkan bahawa risiko politik dan risiko tukaran asing mempunyai hubungan songsang dengan YFDI, manakala risiko inflasi mempunyai hubungan positif yang signifikan. Analisis selanjutnya terhadap data soal selidik yang dikutip daripada 62 syarikat multinasional (MNEs) yang beroperasi di Yaman, menunjukkan hubungan tidak signifikan antara faktor tanggapan risiko politik, tukaran asing dan inflasi dengan pelaburan langsung asing korporat (CFDI). Keputusan yang bertentangan ini memberi implikasi bahawa pelaburan modal syarikat multinasional yang berikutnya mungkin tidak dipengaruhi oleh faktor-faktor tanggapan risiko politik, tukaran asing dan inflasi, walaupun faktor-faktor ini seharusnya telah diambil kira pada peringkat awal rancangan perniagaan. Ada kemungkinan juga bahawa syarikat multinasional yang telah beroperasi di Yaman telah membangunkan keupayaan dari segi pengetahuan, tawar-menawar dan kemahiran melobi. Oleh itu, tanggapan risiko tidak lagi mempengaruhi keputusan pelaburan mereka.

Kata kunci: Pelaburan langsung asing; risiko politik; risiko tukaran asing; risiko inflasi; syarikat multinasional

INTRODUCTION

Globalization has brought the integration of the financial and economic systems to most countries. It has raised the opportunities for success, but also had increased risks inherent with globalization. Foreign direct investment (FDI) is closely linked to globalization and the world economy (Anyanwu 2012). According to United Nations Conference on Trade and Development (UNCTAD), the FDI expansion around the world has been driven by the multinational enterprises (MNEs), which are the dominant players in the global economy. These MNEs do not make investment decisions autonomously as their decisions rely on the economic and political environment of the host countries. MNEs are risk-sensitive when they commit to undertake an investment.

All countries strive to seek more FDI inflows because of the expected beneficial effects on income generation from the capital inflows, technology advancement, management expertise, and market know-how (Gökmen & Temiz 2014). A group of studies showed that a combination of political and economic variables works best in explaining FDI decisions (Asiedu 2002; Musonera 2008; Schneider & Frey 1985; Solomon & Ruiz 2012). Countries that have high political risk such as having a history of expropriating FDI, weak institutions, endemic corruption and autocratic governments tend to receive relatively lower FDI flows (Moosa 2002). As for exchange rate, it was found that when host country's currency appreciates, FDI inflows increase as investors see it as a good sign for the host economy and expect high returns. Others used inflation rate as an indicator of macroeconomic instability (Bouoiyour 2007; Solomon & Ruiz 2012; Zaman, Hashim & Awan 2006). A high inflation rate could be a sign of internal economic instability and a country's inability to keep a stable monetary policy.

In the FDI literature, the impact of political and macroeconomic uncertainties is far from settled for