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THE IMPLICATIONS OF THE SHIFT TOWARDS SERVICES IN MULTINATIONALS' ACTIVITIES: EVIDENCE FROM THE GREEK CASE

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Abstract

Greece has been a traditional recipient of Foreign Direct Investment (FDI) since the early 1950s. The country constitutes an excellent example of how a small, open but peripheral economy, gradually changes according to the process of economic development. The paper's main target is dual: First to provide a comprehensive description of Greece's position in attracting FDI today and second to explain the location determinants of the structural change in Greek inward foreign investments from manufacturing to services. Whilst in the late eighties, inward investments mainly targeted the manufacturing sector, Greece nowadays attracts primarily FDI in services such as financial

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intermediation, real estate etc. Traditional factors attracting FDI seem to dominate the international investors' decisions as well as capital productivity and labour costs on the sectoral level, these are significant influences when investing in Greece. The paper concludes by offering interesting policy implications.

KEYWORDS: Foreign Direct Investment, Services, Greece, Multinational Enterprises

JEL Classification: F02, F21, F23

Introduction

In a world where Foreign Direct Investment (FDI) is one of the driving economic forces, its proportion in services is swiftly gaining significance (United Nations Conference on Trade and Development, 2004). Specific characteristics such as the inseparability between production and consumption of the product, the significant need for local adaptation as well as the important role of quality are features that make FDI in services unique in treatment (Boddewyn et al., 1986; Dunning, 1989). The role of services can also be characterised as crucial in the overall production process. Examples like the existence of infrastructure (Ramamurti and Doh, 2004) or financial services could be the backbone of the economy.

On the other hand, the non-tradable nature of services is revealed by their small share in world's exports. Their share in global trade is only 20% (IMF, 2003). As a response to this particular characteristic and to overcome trade-related barriers, many firms decide to cater the local market through FDI. World's inward stock of FDI in services has risen from 950 \$US billion to over 4 \$US trillion during the last decade, accounting nowadays for more than 60% of total inward stock. Many Multinational Enterprises (MNEs) decide to invest in marketing, trading and financial intermediation affiliates to support the operations of their global group. This is where this paper makes its first contribution. The paper's main focus is to provide an explanation of the impact of this shift towards services on FDI flows. The paper uses the case of Greece as a representative example for reasons discussed below.

Greece is a traditional recipient of FDI since the early 1950s. Chemicals, basic metals and the transportation sector attracted the majority of FDI flows during the after-war period, i.e. 1963-73. These heavy-Smithian types of industries helped extensively to the rejuvenation and the expansion of the country's industrial base. A gradual change of FDI structure, though, took place after Greece's accession to the EU in the early 1980s. Heckscher-Ohlin type of industries, i.e. textiles, food and drink and consumer electronics were the main recipients of FDI flows during the 1980s and 1990s. At the same time significant steps were taken by Greek governments to enhance the competitive advantages of the economy and put Greece in a rapid and stable development path, leading to convergence with the rest of EU core countries. Targeted EU policies and more precisely the Community Structural Funds as well as the Cohesion Funds further reinforced these efforts. The largest part of this assistance was directed towards improvement of infrastructure and only a smaller part to human capital, education and training (Paliginis, 2001).

Today, the country's policy aims at encouraging and attracting FDI. The majority of industries are open to foreign investors, with the most recent deregulation targeting the telecommunications sector and the gradual liberalisation of the energy industry. Ownership restrictions still apply only to television, merchant navy and mining. Capital inflows are allowed freely into the market and repatriation is also authorised and guaranteed. Incentives are offered to both foreign and domestic investors and since 1996 the Hellenic Centre for Investments (ELKE) functions as a one-stop shop for foreign investors.

Despite this situation, Greece during the last couple of years is struggling for FDI. There is a severe deterioration of Greece's position in attracting FDI (UNCTAD, 2003). Some authors argue that this deterioration is mainly due to the disability of the country to fully integrate in the EU and become a competitive partner. It is widely believed that the underlying reasons are the gradual increase in labour costs that took place after the early 1990's, the high levels of bureaucracy and mainly the absence of clear investment incentives (Dimelis, 2004).

This is where the paper makes its second contribution. The main issue this paper resolves is whether those are the true reasons for Greece's weakening as an attractive FDI location. The fall of inward FDI does not jeopardize the emergence of Greece as one of the largest investors in the Balkans as well as Central and Eastern European Countries (CEECs) (Demos et al., 2004; Stoian and Filippaios, 2008; Anastassopoulos et al. 2008). Greek firms making the most of their geographical proximity and capitalising on their cultural and commercial links with CEECs are heavily investing in those countries

(Iammarino and Pitelis, 2000). This reveals the dynamism and the vitality of Greek economy. As Bellak (2001) argues, the low net outward position of a country does not necessarily indicate an absence of competitive advantages. There is a restructuring in Greece's inward FDI stock with services gaining significance and manufacturing share going down. During the last decade, manufacturing share dropped by almost 20% whilst services emerged as the main sector attracting FDI with financial intermediation and real estate leading to this structural change.

This paper explores this issue and reveals another explanation behind the Greek case. We provide evidence supporting that Greece is facing a restructuring process of its inward FDI stock from manufacturing sectors to services. This process is not isolated from the emergence of services as the most significant sector of FDI activity (UNCTAD, 2004). Then we put forward some policy implications stemming from the Greek case but being relevant as well as to other countries facing similar restructuring in their inward FDI position (Anastassopoulos et al, 2004). This is the paper's third and final contribution. The paper uses Greece as an example but the policy design implications can be generalised in other countries similar to Greece's characteristics, i.e. small, open but peripheral economies.

The paper is then structured as follows: Next section provides the theoretical formulation and a literature review. Section 3 discusses the structure of Inward FDI in the Greek economy. The fourth section provides the definitions of variables and associated underlying hypotheses. Results and their interpretation are presented in section 6. Finally, section 7 covers the policy implications and concludes the paper.

Theoretical Formulation and Literature Review

This paper uses a combination of Dunning's (1981) Investment Development Path (IDP) and the underlying eclectic paradigm (Ownership, Location, Internalisation framework (OLI)) to explain Greece's position. In a seminal paper published back in 1981, Dunning explains the International Investment Position of countries using "...a Dynamic or Development Approach". In that paper, each country's position in terms of net outward investment is associated with its level of economic development. The structure and composition of inward and outward investment in each stage are explained in terms of eclectic paradigm (Dunning, 1981). Later revisions of the IDP, by Dunning himself (1986) or Dunning and Narula (1996) did not alter the basic philosophy of the IDP.

IDP is based on the change of corporate, location and internalisation characteristics conveyed by eclectic paradigm. Dunning's (1977; 1988; 1993) eclectic paradigm, usually identified as Ownership-Location-Internalisation (OLI) paradigm, has emphasised that the return to FDI, and hence FDI itself, can be explained by the competitive-ownership advantages of firms (O), indicating who is going to produce abroad 'and for that matter, other forms of international activity' (Dunning, 1993:142), by location factors (L) 'influencing the where to produce' (Dunning, 1993:143) and by the internalisation factor (I) that 'addresses the question of why firms engage in FDI rather than license foreign firms to use their proprietary assets' (Dunning, 1993:145).

The first set includes the ownership or competitive advantages (O) of firms seeking to engage in FDI. Property rights, intangible assets, specialised management capabilities, organizational and marketing systems, innovatory capabilities are just a few examples of ownership advantages. The second set is related to specific location characteristics (L) of alternative countries or regions. Low input prices, productive and skilled labour force, well-developed infrastructures, investment attraction policies and country level innovatory competences, represent the major location attractive factors. The third set of factors has to do with the internalisation (I) advantages. Exploiting market failures is the main argument behind this I type of benefits. Lowering search and negotiation costs, controlling market imperfections and to compensate for the lack of future markets are a few internalisation incentive advantages.

A combination of these factors determines the position of a country's firms within the IDP framework and consequently the country's position. Dunning (2000) himself characterized the eclectic paradigm 'as an envelop for complementary theories of MNC activity'. An interesting extension of the eclectic framework is offered by Dunning (2001) himself. In response to the critique that the eclectic framework is static, he stresses its dynamic and evolutionary nature. The strategic response of the firms in terms of their external environment can change the configuration. The changes in the external environment range from alterations in the location factors of a specific region to amendments in the competitors' strategies. This led to a modification of the OLI framework presented by Guisinger (2001). He argues that the environment in which firms operate is characterised by two types of complexities. The first one is the environmental complexity, be it domestic or foreign. The second is the structural complexity and is related to the number of businesses, corporate functions and product lines that managers have to control. Madhok and Phene (2001) suggested a strategic management approach for the eclectic framework adopting a resource based view of the firm (Penrose, 1956 and 1959). Cantwell

and Narula (2001) on the other hand, followed a more global approach stressing the increasing dynamics among the three pillars of OLI due to globalisation forces. Indeed, OLI has been extended to accommodate several criticisms (Dunning, 2001; Cantwel and Narula, 2001; Estrella Tolentino, 2001) and this study joins this strand of research.

Subsequently, the five stages of development are related to Net Outward Investment of the country. In stage 1 there is no outward investment since the home based firms do not hold any ownership advantages. But there is no inward investment as well, since the country has insufficient specific location advantages. The end of the turbulences of the Second World War and the Civil War signalled the beginning of the reconstruction and economic development process¹ in Greece. The country easily slipped out of the first stage of IDP. The reconstruction of the economy accompanied by a rapidly growing market, made Greece an attractive location for the years following the War.

During the second stage inward investments become commercially viable mainly for three reasons: it is the availability of cheap labour force that will primarily attract rationalised investments. Exploitation of natural resources emerges as the second key incentive and finally well-populated developing countries attract import-substituting investments. For the period 1955-1990 Greece can be classified as a stage 2 economy with FDI becoming “commercially viable as domestic markets increase and cost of servicing them fall” (Dunning, 1981). The FDI attraction to the Greek economy combines all the characteristics of stage 2 FDI, since on one hand it had an import-substituting character in several industries like communications and transport, but on the other hand, substantial investments were also made in order to exploit natural resources, especially in the Food and Beverages and the Textiles industries.

According to Mardas and Varsakelis (1996), this period can be broken into two distinct phases. During the first one, until the late seventies, MNEs invested in the local market in order to exploit their monopolistic or oligopolistic advantages, rather than take advantage of the comparative advantages of the local economy. During the second one, from the early eighties onwards, a decrease in FDI is perceived due to a high level of state intervention and an unstable economic environment. During that same period, i.e. from 1955 until 1990, outward FDI from Greece is negligible. Only during the late eighties, some outward FDI is recorded, especially regarding European Union countries. Stage 2 came to an end in the early nineties. The opening up of Central and

¹ The first attempt to open the economy to international investors was made with the Law 2687/53 for the attraction of foreign investors.

Eastern European Markets created new opportunities for Greek firms to use their accumulated experience and expertise and for subsidiaries of MNEs to upgrade their role as regional headquarters in the new markets.

The third stage of IDP, that follows, is the most interesting as well as the most dynamic one. Domestic firms upgrade their competitive capacity. Sectors that have strong comparative location advantages attract inward FDI, whilst the opposite holds for the outward FDI. Domestic firms having already promoted their potential invest abroad. This strategic change seems to be verified by a prior study of Pantelidis and Kyrkilis (1994) where they argue, "... it is possible for foreign subsidiaries to readjust their market strategies depending on time and in accordance with changing conditions...". At the same time, Greek economy stabilises fiscally and grows with higher rates than most European partners. The structure of inward investment gradually changes. Greece clearly becomes a stage 3 country (Duran and Ubeda, 2001). This structural change is directly related to the progression from one stage of IDP to another. In the fourth stage the country becomes a net outward investor. Finally, entering the last stage of development path the net outward FDI is around zero with inflows and outflows neutralising each other. Greece is far from being classified as either a stage four or five country.

In addition to the above described framework and in order to fully understand the behaviour of the main FDI actors, we should define the strategic motivations of MNEs. A typology is proposed, describing the basic motives of MNEs when investing in a country. Based on previous works of Dunning (1993) and Filippaios et al. (2004) we identify two main drives for FDI. Market servicing motives are capturing the need of MNEs to serve the local market through local production rather than through exports. In this case either the local market is large enough and thus makes the accomplishment of economies of scale feasible, or the product requires local adaptation or finally there are special characteristics of the product that make the catering of the market impossible through exports. This last case is closely related to services related to FDI.

The second motive is efficiency or resource seeking and in this case MNEs focus on the exploitation of local production factors. We can here make a clear distinction between FDI in manufacturing and in services. The former is primarily related to efficiency seeking motives whilst the later is closely related to market seeking (Birkinshaw and Hood, 1998; Akbar and McBride 2004). There is another characteristic of particular importance though that needs to be stressed out here. Resource seeking FDI is not a long-term strategy for MNEs due to increases in the factor of production costs as well as changes in the host country's characteristics (Akbar and McBride, 2004).

In this framework, the determinants of inward FDI in Greece are rarely examined in the international business literature. Until now, only a few attempts were made in the international literature with a seminal one from Petrochilos (1988). Almost all studies are either purely descriptive or do not go beyond the analysis of specific case studies. This is the first attempt to analyse inward Greek FDI using a coherent and comprehensive framework. Moreover, almost all previous studies have focused on the manufacturing sector of the Greek economy. One attempt that deviates is by Petrochilos (1995) focusing on foreign banks. For a long time, the lack and inconsistency of FDI data dissuaded scholars from examining the Greek case². Furthermore, this paper also complements studies that have taken into account the factor of the country of origin rather than firm specific advantages in assessing FDI (Grosse and Trevino, 1996; Deichmann, 2001).

Locational Determinants of Inward FDI in Greece

The main purpose of this section is to provide a preliminary investigation and understanding of the Greek case. Nowadays, inward investments in Greece are predominantly targeting services rather than manufacturing activities, whilst European Union is the dominant investor in Greece. It is worth mentioning that this contradicts what was happening until the late eighties when US dominated inward FDI in Greece. Greece gradually became a high cost location and since resource seeking FDI, as already discussed above, is not long-term orientated then we would expect FDI to fall. This is further reinforced from the fact that market servicing in manufacturing is either short-term, taking advantage of the local competition but changes as the country gradually evolves through the different stages of IDP. The only long-term motive for market servicing in manufacturing would be the prospect of an increase in demand.

During the last couple of decades, Greece attracted a large volume of infrastructure related investments. The industry risk in those investments is higher than in manufacturing but the liberalisation of the Greek market created incentives for MNEs to enter (Trevino and Mixon Jr., 2004). During this stage the institutional framework in the host country is very important. According to Mudambi and Navarra (2002:636), institutions are important determinants of FDI because they ‘represent the major immobile factors in a globalised market... Legal, political and administrative systems tend to be internationally immobile framework whose costs determine the international attractiveness of a

² The adoption from Bank of Greece of the New Balance of Payment System since 1996, gives us the opportunity to inspect the locational determinants of inward FDI in Greece from 1996-2001, for different sectors and a range of investing countries.

location. Institutions affect the capacity of firms to interact and therefore affect the relative transaction and co-ordination cost of production and innovation’.

For potential investors the incentives and restrictions created by institutions ‘shift the playing field favouring some deals and opportunities while discouraging others. They force the investing firms to think strategically about how to avoid the limits imposed by domestic laws as well as how to reap the benefits that the law and particular circumstances are capable of providing’ (Spar, 2001). This is only partially confirmed though by Pournarakis and Varsakelis (2004). They found that institutions alone do not contribute substantially to explaining the cross-country variation of FDI-inflows. Instead, they argued that FDI decisions require simultaneous improvements in markets, internationalisation and institutions. The main problem for MNEs was competition from Greek natural monopolists (Ramamurti and Doh, 2004). FDI inflows in the Greek economy surpassed the outflows towards other countries until 1998. Actually before the 1987, Balance of Payments data show zero or negligible amounts of FDI outflows from Greece. Table 1 outlines the Greek FDI situation. The table presents indicative data back in the early seventies, the eighties and then from 1995 onwards as this is the key period under examination in this paper.

Table 1. FDI Inflows, Outflows and Inward, Outward Position in Greek Economy (millions of dollars)

YEAR	FDI inflows	FDI outflows	FDI inward stock	FDI outward stock
1970	50
1980	672	..	4524	2923
1990	1005	11	5667	2948
1995	1053	42	10957	3004
1996	1058	-25	12015	2978
1997	984	156	12999	3134
1998	85	262	13084	3396
1999	571	539	15890	3935
2000	1089	2102	12499	5861
2001	1589	607	12006	6371
2002	50	655	12056	7026

Source: UNCTAD, 2004

After the mid 1990s FDI outflows grew and FDI inflows fell rapidly. The increase in 2000 and 2001 with respect to the inward FDI flows is primarily credited to the extensive liberalisation of the financial and telecommunications sectors. Both sectors immediately attracted the attention of large MNEs. Recent data show that although FDI outflows are still high, inflows remain at low levels raising concerns about the competitiveness of the Greek economy. The implementation of the new Balance of Payments collection system, based on the conceptual framework of the Fifth Edition of the IMF Balance of Payment Manual, on behalf of the Bank of Greece, gave us the opportunity to collect data on FDI segregated for international investors and sector of activity. Available data range from 1996 until 2001. There is a substantial lag between data collection and actual publication dates, thus, this is the only consistent period. Tables 2 and 3 give a brief description of inward FDI position of international investors in Greece by means of home country and sector of activity for 1996 and 2001³.

Table 2. FDI flows by home country

COUNTRY	TOTAL 1996	TOTAL 2001
BELGIUM	3.0%	0.8%
GERMANY	13.0%	8.4%
SPAIN	1.0%	0.2%
FRANCE	12.0%	9.6%
IRELAND	1.0%	0.9%
ITALY	6.0%	2.5%
LUXEMBURG	15.0%	24.8%
HOLLAND	19.0%	19.4%
UNITED KINGDOM	9.0%	3.4%
DENMARK	0.0%	0.1%
SWEDEN	1.0%	0.2%
EU TOTAL	80.0%	70.3%
OTHER EUROPEAN COUNTRIES	8.0%	16.4%
ASIA COUNTRIES	2.0%	0.5%
AFRICAN COUNTRIES	1.0%	0.9%
AUSTRALIA	0.0%	0.1%
USA	5.0%	6.6%
OTHER AMERICAN COUNTRIES	4.0%	5.2%
REST TOTAL	20.0%	29.7%

Source: ELKE, 2004

³ The full tables with the distribution by sector and country of origin can be obtained from the author upon request.

Table 3.FDI Flows by sector of economic activity

FIELD OF ECONOMIC ACTIVITY	% BY FIELD OF ECONOMIC ACTIVITY 1996	% BY FIELD OF ECONOMIC ACTIVITY 2001
AGRICULTURE	0.1%	0.0%
MINING	2.4%	3.3%
MANUFACTURING	59.9%	39.0%
ELECTRICAL ENERGY	0.0%	0.1%
CONSTRUCTION	1.3%	1.5%
COMMERCE	19.0%	8.6%
HOTELS	4.2%	3.7%
TRANSPORTATION & COMMUNICATION	8.3%	19.7%
FINANCIAL SERVICES	3.4%	10.6%
REAL ESTATE	0.0%	1.7%
OTHER	1.3%	11.9%
TOTAL	100.0%	100.0%

Source: ELKE, 2004

The FDI composition for 1996 and 2001 is quite different, indicating a structural change in inward FDI which possibly reflects the undergoing structural changes in the Greek economy. The major investor in Greece for both periods, i.e. 1996 and 2001 is the European Union. In the second period though, the share of EU FDI has fallen from 81% to 70.3%. The leading investor for 1996, coming from E.U. is the Netherlands, holding 19% of total FDI stock in Greek economy⁴, Germany and France holding 13% and 12% in that order. USA holds only 5% of Greek inward FDI stock for 1996. The data with respect to the country of origin of the FDI do not change significantly for 2001. Luxembourg is the leading investor with 24.8% and the Netherlands follows with 19.5%. Significantly lower are the shares for Germany and France, with 8.4% and 9.6% respectively. This leads to an overall smaller share of EU for 2001. On the other hand US increase their importance by 1.6% rising to 6.6%. The most significant change, however, is that of the Other European Countries, which double their share, from 8% in 1996 to 16.4% in 2001.

There is also a substantial redistribution in respect to the sectoral allocation of FDI. This redistribution is ascribed, as already mentioned, to the liberalisation of the financial and telecommunications sectors. The inward FDI stock in the manufacturing sector falls significantly from almost 60% to 39%. Similar is the

⁴ The second investor, in terms of relative importance, is Luxembourg with almost 15%. A point that needs further clarification is that FDI coming from Luxembourg are mostly investments from offshore companies located there.

trend for the commercial sector with a diminishing share from 20% to only 8.6%. On the other hand, Transportation and Communications sector almost doubled its share, rising from 8.32% to 19.7% revealing the effect of the liberalisation of telecommunications market. Furthermore, other sectors like Financial Services and Real Estate emerge attracting substantial investments. The period 1996-2001 indicates a change of FDI targets in the Greek economy, from the manufacturing sector to primarily high value activities such as financial services, transportations and communications. Identifying the determinants of inward FDI stock in this transition period is the principal aim of the next sections of this paper.

Variable Description and hypotheses

Investigating the location determinants that drive FDI activity is a key issue for international business⁵. Two types of analysis are usually used. The first one focuses on a single country, using macroeconomic or sectoral specific independent variables throughout time. The second type sees FDI activity in a multi-country context (Dunning, 1993, p.148).

This study falls in the first category, focusing on Greek inward FDI among different sectors. To investigate the location determinants, we combined macroeconomic and sectoral data. Macroeconomic variables and data on inward FDI were collected from the Annual Report of the National Statistics Service of Greece and the Balance of Payments Statistics collected from the Bank of Greece. Specific data sector were compiled using the STAN database for Industrial Analysis⁶ that contains data to analyse industrial performance. It is based on activity tables of member countries' annual National Accounts and uses data from other sources, such as industrial surveys/censuses, to estimate missing details. STAN is maintained by the Economic Analysis and Statistics Division of OECD Directorate for Science, Technology and Industry.

The variable under investigation is the sectoral FDI position, as measured by the total FDI stock, of selected investors⁷. The time period of the sample expands from 1996 to 2001. As already mentioned, due to the significant time lag between data collection and the respective publication date this is the only

⁵ Extensive literature reviews for this issue can be found in Dunning (1993) or Caves (1996).

⁶ The version of STAN used in this paper, is based on the International Standard Industrial Classification for all Economic Activities, Revision 3 (ISIC Rev. 3) and covers all activities including services.

⁷ Data from 15 countries were used. These were: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and United States. For these countries we were able to find consistent sectoral data necessary for the econometric exercise.

period with consistent data for a thorough investigation. The independent variables used, as well as, the underlying hypotheses are illustrated below:

The total size of the economy is measured by the Gross Domestic Product (GDP). Market size is probably the most commonly used variable in explaining the location determinants of FDI attraction. Various studies use GDP as a factor that attracts FDI, thus hypothesising a stable and statistically significant positive sign (Papanastassiou and Pearce, 1990; Head et al., 1995; Brainard, 1997; Petrochilos, 1988). The size of the market is an important factor determining FDI decisions in services as well. Many studies, focusing on services specifically use similar measures to ours (Moshirian and Pham, 1999). In this study the GDP also acts as a normalisation variable for the dependent variable and enables us to capture possible spillovers between complementary sectors.

On the other hand, variables measuring the openness of the economy to the international environment do not always have a clear relationship with FDI. In this paper we define OPEN as the ratio of total trade over GDP. A positive relationship would suggest that FDI is directed primarily to sectors with high export propensity (Caves et al., 1980; Saunders, 1982; Li and Guisinger, 1992), whilst a negative relationship implies that FDI and trade are used as substitutes in catering the local market (Filippaios et al., 2004).

To account for the relative size of each sector (SIZE) we use employment, measured as the actual number of headcounts engaged in production. A positive relation is expected with FDI, since this variable functions as a proxy for industry's market size.

The ability of MNEs to raise capital, favours their presence to capital-intensive sectors. The results of Clegg (1987) strongly support this argument. For this reason we also included in our specification the CAPPDOD variable, constructed as Gross Fixed Capital Formation over the Value Added of the sector⁸. Gross Fixed Capital consists of acquisitions, fewer disposals, of new tangible assets, i.e. machinery and equipment, transport equipment, livestock, constructions and new intangible products, i.e. mineral exploration and computer software to be used for more than a year. It does not include acquisitions of land, mineral deposits, timber tract and government outlays for

⁸ An alternative specification with production instead of value added was also used (CAPPDOD2). Production represents the value of goods and services produced in a year, irrespectively of their final use, i.e. sold or stocked. Furthermore, production includes intermediate inputs, like energy, materials and services required producing the final output. Any output of these intermediate goods consumed within the same sector is also recorded as output. The impact of such intra-sector flows depends on the coverage of the sector. The results are available upon request from the author.

military purposes. In addition, value added for a particular industry mirrors its contribution to national GDP. It is not directly measured but calculated as the difference between production and intermediate inputs. Value added comprises labour costs, consumption of fixed capital, indirect taxes less subsidies and net operating surplus as well as mixed income.

Labour cost is another variable commonly used in the empirical literature dealing with the location determinants of FDI. A negative relationship is hypothesised and confirmed in studies like the ones by Cullem (1988), Pain (1993) and Hatzius (2000). Their results hold for developing countries as well (Ridel, 1975). Finally, Moore (2001) proves that the cost of labour is more significant in labour-intensive industries. In the case of services the labour cost gains special significance as recent literature argues that services and especially the banking sector is a human capital intensive industry (Moshirian and Pham, 1999). In our analysis, we use wages and salaries over labour productivity (ULC) to capture this relation⁹. Wages and salaries of employees paid by producers is the major component of value added and labour productivity and is measured as the ratio of constant price value added to number of employees engaged. Although hours worked would be preferable as a measure of labour input, at the present time consistent hours worked data are not available for all OECD countries, at the industry level. It represents the amount of output per unit of input, output being defined as value added.

A variable measuring the profitability of each sector is also applied in our analysis. COMP is defined as operating surplus and mixed income over value added¹⁰. Operational Surplus and Mixed Income measure the surplus or deficit accruing from production before taking account of any interest, rent or similar changes payable on financial or tangible non-produced assets borrowed or rented by the enterprise as well as interest, rent or similar receipts receivable on assets owned by the enterprise. It also includes wages of the self-employed. The sign of this variable is ambiguous. The profitability of an industrial sector is an indication for potential success of new investments. Increased competition from local firms that have superior knowledge of the market and its conditions might, however, deteriorate international investments.

Finally, to capture the special relations in terms of culture, legal framework and geographic proximity of Greece with the rest of its European partners we

⁹ Total labour compensation was also used in the place of wages and salaries (ULC2). Total labour compensation includes supplements such as contributions to social security, private pensions, health insurance, life insurance and similar schemes. The results are available upon request from the author.

¹⁰ Like in the case of CAPPROD we used also operating surplus and mixed income over production (COMP2). The results are available upon request from the author.

included in our model three dummies, i.e. EUDUMMY and EUDUMMYC, EUDUMMYP interchangeably, expecting a positive relation. Greece is part of the integrated European environment and thus EU investors will have superior advantages over the rest of international investors. Business culture, moreover, can be a significant factor affecting international business (Hofstede, 1980; Benito and Gripsrud, 1992). Another aspect closely related to FDI and MNEs in services is their “regionalisation” (Rugman, 2003). According to “regionalism” most MNEs in service sectors operate primarily in their home triad, i.e. Europe, North America and Asia.

Based on our theoretical conceptualisation and the above discussion we concluded in the following estimable equation:

$$FDIP_{i,t} = GDP_t^+ + OPEN_t^{+or-} + SIZE_{i,t}^+ + CAPPROD_{i,t}^+ + COMP_{i,t}^{+or-} + ULC_{i,t}^- + \varepsilon_{i,t}$$

Where $i=1, \dots, N$ is the industrial sector, $t=1996-2001$ measures the time period and $\varepsilon_{i,t}$ represents the error term. Table 4 gives a brief description of the variables used in the analysis.

Table 4. Variables Description and Sources

Name of Variable ¹¹	Description	Source
GDP	Gross Domestic Product of Greece	National Statistics Service of Greece
OPEN	Exports plus Imports over GDP	National Statistics Service of Greece
SIZE	Employment of sector	STAN OECD Database
CAPPROD	Gross Fixed Capital formation of Sector over Value Added of Sector	STAN OECD Database and author's calculations
ULC	Wages and Salaries of Sector over Labour Productivity of Sector	STAN OECD Database and author's calculations
COMP	Operating Surplus and Mixed Income of Sector over Value Added of Sector	STAN OECD Database and author's calculations
EUDUMMY	European Union origin of the investor	Author's Calculations
EUDUMMYC	European Union Core origin of the investor	Author's Calculations
EUDUMMYP	European Union Periphery origin of the investor	Author's Calculations

Results and interpretation

Our next step is to test the location determinants of inward Greek FDI. We used the two variables referring to total economy, GDP and OPEN, and four

¹¹Production, value added, labour costs and employment, data for 1999-2001 are provisional.

variables defined in sectoral level, SIZE, CAPPROD, ULC and COMP¹² in a unified framework. The method of estimation is Least Square Dummy Variables (LSDV) allowing for individual sectoral effects, which in all estimations proved to be significant¹³. Furthermore, we included in our model specification a range of EU dummies capturing the country of origin of the international investor, with emphasis on the core and peripheral countries. Table 5 reports the results for the location determinants of Greek inward sectoral foreign investments.

In all cases GDP is positive and significant indicating that the size of the economy is an attractive factor for foreign investors. Similar is the result in Petrochilos (1988), where GDP lagged on period is positive and a significant factor for attracting FDI in Greece for the period 1995-1978. On the other hand, the negative and significant sign for OPEN indicates that international investors do not use Greece as an export platform for neighbouring markets. When it comes to sectoral variables, SIZE is negatively signed, contrary to theory, but is always insignificant¹⁴. Capital productivity is always positive and significant, which means that investors judge the potential success of their investment by the productivity of the already established capital. When it comes to labour costs, normalised by productivity, international investors are discouraged by high costs. This result is common in the international business literature (Barrell and Pain, 1996, 1999 a, b; Cushman, 1987; Cullem, 1988; Wheeler and Mody, 1992; Veugelers, 1991). A point worth making here is that wages and salaries over productivity are more significant than total labour compensation over productivity¹⁵ when measuring efficiency seeking motives. Finally, the competition measure used is always negative, which means that international investors are putting a damper on things when a sector is highly competitive. The EUDUMMY is positive and significant, an expected result considering EU countries are at the most the largest investors. When we break, however, the dummy to EU Core and Periphery countries, this remains positive and significant for Core countries but turns negative, although insignificant, for the Periphery.

¹² The use of different definitions, as discussed in the previous section, for CAPPROD, ULC and COMP did not alter in any way the results. The results are available upon request from the author.

¹³ The use of time effects in the estimation did not alter the results and time effects were proved to be insignificant in all equations.

¹⁴ Other measures of size were also used as Production, Value Added or shares of these variables in total economy but none gained significance. We also tested the model excluding the GDP but the results remained the same. The results are available upon request from the author.

¹⁵ The results are not included in the paper but are available upon request from the author.

Table 5. Location Determinants of Inward Greek FDI
Fixed- effects estimation with robust standard errors
Dependent Variable: Sectoral FDI Stock

	EQ 1	EQ 2	EQ33
GDP	0.0167*** (3.25)	0.0167*** (3.26)	0.0167*** (3.29)
OPEN	-0.1274*** (-2.87)	-0.1274*** (-2.88)	-0.1274*** (-2.90)
SIZE	-0.0086 (-0.23)	-0.0086 (-0.23)	-0.0086 (-0.23)
CAPPROD	0.2117* (1.86)	0.2117* (1.86)	0.2117* (1.87)
ULC	-0.5012** (-2.02)	-0.5012** (-2.02)	-0.5012** (-2.04)
COMP	-0.1284 (-0.88)	-0.1284 (-0.88)	-0.1284 (-0.89)
EUDUMMY		81.3429*** (2.88)	
EUDUMMYC			110.1422*** (3.42)
EUDUMMYP			-14.6547 (-0.56)
Cons	2746.2980** (2.41)	2675.8010** (2.37)	2675.8010** (2.39)
F-stat of model	3.20***	2.96***	2.68***
R-square	0.188	0.193	20.65
F-stat of FE[♦]	10.17***	10.20***	10.35***
Obs	480	480	480
Mean VIF[♦]	2.64	2.53	2.56

t-statistics are in parentheses

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$

The final step of our investigation on the location determinants of Greek inward FDI was to break our sample into services and manufacturing sectors¹⁶. The results are presented in table 6.

[♦] Tests the joint significance of the industry effects.

[♦] A VIF value less than 20 is not expected to create any problems to the results due to multicollinearity

¹⁶ We used as Services: Commerce, Hotels, Financial Intermediation, Leasing and Real Estate.

Table 6. Location Determinants of Inward Greek FDI
Fixed-effects estimation with robust standard errors
Dependent Variable: Sectoral FDI Stock

	Services	Manufacturing
GDP	0.0533** (2.45)	0.0195*** (3.24)
OPEN	-0.4441* (-1.84)	-0.1343*** (-3.11)
SIZE	-0.0959 (-0.60)	0.0122 (0.25)
CAPPROD	0.1165** (2.35)	0.9792 (0.61)
ULC	-1.3166* (-1.77)	-0.5527** (-1.98)
COMP	-0.5649* (-1.89)	-0.1060 (-0.6)
Cons	1054.32 (1.41)	2668.68*** (2.66)
F-stat of model	3.23***	3.17***
R-square	0.228	0.189
F-stat of FE[♦]	2.74***	5.17***
Obs	165	360
Mean VIF[♦]	7.59	2.87

t-statistics are in parentheses

*** p < 0.01, ** p < 0.05, * p < 0.10

Results are slightly different from the aggregate picture. The two macroeconomic variables keep their signs and statistical significance, but OPEN is less significant for the Services equation. The CAPPROD is significant only in Services equation but keep in both cases its positive sign. ULC, on the contrary, is more significant to Manufacturing equation, though it keeps its negative sign. Finally the most impressive result comes from the COMP variable. It becomes significant in Services, suggesting that international investors are discouraged from investing into Greek sectors where the local firms are competitive, established and profitable. This is further reinforced if we take into account that Services include financial services, Hotels and Real estate, sectors where a good knowledge of the local market is a prerequisite for success. If market seeking is the main motivation for investing

[♦] Tests the joint significance of the industry effects.

[♦] A VIF value less than 20 is not expected to create any problems to the results due to multicollinearity

in financial sector or services, in general, the negative effect of competitiveness is easily explained.

The clearest example of this behaviour is the Greek Banking Sector. During the second half of the 1990s the degree of concentration rose due to a wave of mergers and acquisitions. Nowadays, in the Greek banking sector 39 firms are operating, the majority of them being foreign¹⁷. Alternatively, one can argue that it is domestic banks which maintain a strong position in the market, having a better knowledge of the local clientele. Despite the fact that Greek market is still rich in opportunities, as the outstanding credit is still low compared to the EU average, and local competitors are quite small in capitalisation, there is no clear indication that large multinational financial institutions are or will enter the Greek market¹⁸.

Policy implications and conclusions

The main purpose of this study was to provide evidence on Greece's position in the international investment framework. The rapid growth of the Greek economy conducted by the stable and FDI-promoting legal framework, transformed Greece from a stage 2 to a stage 3 country in terms of IDP positioning. This process took place mainly during the late nineties. This development caused a structural change in Greece's inward FDI. From inward investment targeting mainly the manufacturing sector in the late eighties, Greece nowadays attracts primarily FDI in services such as financial intermediation, real estate etc.

Our second aim was to examine the location determinants of inward FDI in Greece as the country entered the third stage of IDP. This would synthesise the puzzle of the Greek economy and its position in the international economy. Furthermore, the study investigated different sectors exerting a pull on FDI since inward FDI are not homogeneous. Traditional factors attracting FDI seem to dominate the sample, as both the size of the economy, as well as its openness, are significant. On the other hand capital productivity and labour costs on the sectoral level are also influencing the decision of international investors to invest in Greece. The picture is slightly different though, when we split our sample to FDI aiming at services and production. For the former a measure of the competitiveness of the already established companies acts as a barrier to investors. Financial intermediation, real estate and hotels are sectors

¹⁷ From 39 firms, only 17 are domestic and 22 are foreign.

¹⁸ The outstanding credit is only 22% of Gross Domestic Product, compared to 47% for EU average and the capitalisation of the five largest banks in Greece put together corresponds only to a medium sized European Bank.

that include as a precondition the good knowledge of the local market in order to be competitive and viable. It looks like Greek firms have this competitive advantage and thus, this might be a good explanation for the decrease of FDI in Greek economy these last years. On the other hand investment in production is mainly determined by labour costs and capital productivity.

Finally the paper offers possible policy and managerial implications for countries at the same stage as Greece as well as companies considering investing in those countries. Liberalisation of the market and the establishment of local forward and backward linkages to gain knowledge and experience are the main conclusions for policy makers and managers respectively. Attracting FDI in services is of significant importance for the local economy. This kind of FDI fosters the creation of both forward and backward linkages with local customers and suppliers respectively and thus helping to the transformation of the local economy (Keren and Ofer, 2002).

The removal of existing barriers to FDI in services is a tough challenge for national policy makers. The usual barriers are restrictions to market entry, restrictions to ownership and control of foreign affiliates and in some cases operational restrictions, focusing on constraining the scope of operations. According to Brown and Stern (2001) the liberalisation of services can create significant welfare effects for the host country as well as enhance the realisation of economies of scale.

Conversely, though, one has to bear in mind that due to the specific nature of FDI in services, reflecting the complexity of different technologies used, different needs and scopes, this makes the design of successful FDI attraction policies a very difficult challenge for both national and international policy makers.

The primary goal for national as well as regional policies should be first to attract the right type of FDI for the country or the region and then extract benefits from it. Further liberalisation will increase competition among local and multinational firms and will give the opportunity to MNEs to use their ownership advantages in a deregulated framework thus contributing towards lowering the costs of production (Brown and Stern, 2001).

Another possible way of attracting FDI is actively promote them in service-related sectors where resource seeking motives dominate. In the case of Greece, the tourism sector, hotels etc., would be an excellent example.

To conclude, we should stress the important role of infrastructure and skill development as a prerequisite for FDI attraction. The policy mix, though,

should be different from country to country in accordance with the country's specific needs.

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