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Oualid Abidi
American University of the Middle East
College of Business Administration

Vladimir Dženopoljac
American University of the Middle East
College of Business Administration

Stevo Janošević
University of Kragujevac
Faculty of Economics
Department for Management and
Business Economics

A REFLECTIVE ANALYSIS OF FIRM-LEVEL DETERMINANTS OF BINARY INVESTMENTS BETWEEN MENA COUNTRIES

Teoretski prikaz mikro-faktora binarnog investicionog odlučivanja u zemljama MENA regiona

Abstract

This explorative study advocates firm characteristics as potential drivers of Foreign Direct Investment (FDI) within the Middle East and North Africa (MENA) region. Research propositions stipulate the role of firm-specific variables in explaining the regional expansion of MENA companies through FDI. MENA companies in different sectors have increasingly invested in other countries in the region over the last years and this does not seem to be restricted to isolated cases. These regional investors are not dissuaded by the challenging economic and institutional conditions in MENA economies. Therefore, there is a need to understand what could possibly lead companies in MENA countries to invest in other markets in their region despite their unattractiveness for the outside investors. A set of eight propositions has been established to account for the potential role of firm-level variables in explaining this decision. Variables pertain to firm size, ownership advantages, productivity, networking capabilities, international experience, affiliation with homeland authorities, and leverage.

Keywords: *FDI, MENA, firm-level variables*

Sažetak

Ova eksplorativna studija nastoji da identifikuje potencijalne pokretače stranih direktnih investicija (SDI) u okviru regiona Bliskog istoka i Severne Afrike (Middle East and North Africa, MENA). Istraživačka pitanja nastoje da ukažu na ulogu i značaj mikro faktora konkurentnosti koji opredeljuju ekspanziju kompanija iz MENA regiona posredstvom SDI. Kompanije iz MENA regiona, koje pripadaju različitim industrijskim granama, sve više investiraju u druge zemlje ovog regiona tokom poslednjih godina, pri čemu se ne radi o izolovanim slučajevima, već o pravilu. Pomenute investitore iz ovog regiona od SDI ne odvraćaju ni izazovi ekonomske i institucionalne prirode pojedinih MENA zemalja. Stoga je jako bitno razumeti faktore koji motivišu strane investitore da investiraju u tržišta ovog regiona, uprkos njihovoj relativno slaboj atraktivnosti. Set od osam istraživačkih pretpostavki predstavljenih u radu osvetljavaju značaj i ulogu različitih mikro faktora kod donošenja ovakvih investicionih odluka. Identifikovane varijable obuhvataju veličinu preduzeća, prednosti vlasništva, produktivnost, sposobnost povezivanja sa poslovnim partnerima, međunarodno iskustvo, afilijacija sa lokalnim vlastima i nivo finansijskog leveridža.

Ključne reči: *SDI, MENA, mikro faktori*

Introduction

FDI was one of the most dominant channels of internationalization in the 1960's. This movement was intensified in the late 1990's due to free trade and higher capital mobility between nations [5]. In this context, developing economies became interesting destinations for FDI since they joined the World Trade Organization. The improvement of transportation and communication systems around the world also reinforced their attractiveness for investors. In addition, the privatization of numerous state-owned enterprises created a surge of FDI in those nations [6].

FDI could be defined as "a movement of capital (and other resources) from a parent corporation in the home country that creates a substantial equity interest in a host country corporation, called a subsidiary" [24, p. 220]. FDI can be classified into four categories: merger and acquisition, joint venture, new plant and others, e.g. plant expansion, increase in equity stakes [33].

A number of Arab countries offered significant incentives to encourage inward FDI. For instance, Algeria allowed foreign ownership in hydrocarbons sector through joint ventures with the national company. Libya enabled foreign investors to hold minority ownership positions in specific sectors [29]. Despite ascending competitiveness of different countries in the region, particularly Gulf States, MENA countries have poor performance in attracting FDI if compared with other developing countries such as East European or Southeast Asian countries [20]. The share of MENA economies in the world's total FDI amount remains relatively low if the region's contribution to world economy is taken into account [25].

Several authors have attributed this inconsistency to the inadequacy of institutional and regulatory systems. Despite financial deregulation in those countries, legal systems still give upper hand to local governments over foreign investors [31]. As such, governmental policies seem to be responsible for the lower rate of investment in MENA countries. The lack of structural reforms toward more openness and credit supply severely reduced private investment. Economic instability also contributed to limiting the prospects of private investments in the MENA region, in particular the fluctuation of gross domestic product (GDP) inflation and interest rates [4].

MENA countries are expected to facilitate business venturing, safeguard contract enforcement [20], and undertake profound institutional reforms in order to create more competitive and safer business environments. As such, MENA economies would be more effective players in the global arena [6].

As research suggests that local investors in the MENA region are less responsive to the aforementioned impediments [29], this study attempts to depict their profile. Propositions will be made to grasp the characteristics of local FDI suppliers within the MENA region. The resulting framework can shed some light on the firm-level factors that encourage those investors despite the institutional and economic situation in other MENA markets. Firm characteristics, such as state ownership and networking capabilities, could potentially provide a more thorough understanding of the specificity of MENA countries as FDI destinations. As a matter of fact, FDI in the MENA region has received less attention from academics contrary to other emerging economies [25].

The paper is organized as follows. Related work is presented in the first section. Research propositions are defined in the next section. Implications for future research and contributions are discussed in the last section.

Literature review

The delimitation of the MENA region varies depending on the study. The World Bank [10] states that the MENA region includes 21 countries: Algeria, Bahrain, Djibouti, Egypt, the Islamic Republic of Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Libya, Malta, Morocco, Oman, Qatar, Saudi Arabia, Syrian Arab Republic, Tunisia, the United Arab Emirates, Palestine, and the Republic of Yemen. However, the data for Palestine is not available, so the presentation of data about foreign direct investments (FDI) will include 20 listed countries from the MENA region. Authors tailor their samples depending on the topic and their research aims. For example, Elmawazini et al. [10] studied ten countries from the MENA region. Rugmans and Ebbers included 16 MENA countries in the list. Salem and Baum [28] studied FDI determinants in the commercial real estate sector relative to eight MENA countries. Therefore, the main purpose of this paper is to shed light, from theoretical perspective, on the microfactors that might determine the FDI inflow into the MENA region countries. Literature fails to offer any deeper insight into this issue. It rather shows the macroeconomic determinants of FDI.

Drivers of FDI in MENA countries

Macroeconomic and institutional factors were largely debated in literature as FDI determinants of inward FDI in MENA economies. Macroeconomic factors pertain to the scope of local economy, government spending [20], balance of payments [32], level of GDP per capita [13], [25], and GDP [4]. Literature shows conflicting results in regard to the effect of natural endowments: positive [20] or negative [25], [35]. Negative influence might be the result of foreign ownership restrictions that countries possessing natural resources usually opt for [25]. The quality of institutional environment was suggested as a major FDI inflow determinant in MENA countries. This is assessed through the degree of transparency, control exerted over money exchange, tax appraisal, expropriation risk and profit repatriation [20]. Openness to trade and freedom to conduct business were also demonstrated as influential FDI determinants in MENA countries. These variables concern the adequacy of regulatory systems and the easiness of venture creation, operating and closing [32]. While country risk had negative effects on FDI inflows into Arab countries [21], political stability, on the contrary, plays a significant role in attracting FDI in commercial real estate sector in Gulf Cooperation Council (GCC) economies [28].Other factors have been discussed in literature as potential determinants of FDI inflows in the region: percentage of enrolment in tertiary education, research and development expenditures, technological infrastructure and labor costs. Domestic investment is deterrent to FDI inflows in Arab countries [21].

Effects of FDI in MENA countries

FDI have several implications in developing economies, such as gains in productivity and efficiency, technology transfer, development of exports and managerial expertise [20]. Technology transfers were conducive to cultural, economic and technological changes in developing countries.

Table 1: Foreign direct investment, net inflows (% of GDP) [34]

Country Name	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Algeria	1.26	0.60	0.51	2.03	1.88	0.94	1.03	1.12	1.57	1.25	1.54	2.00	1.43	1.29	0.72	0.81	0.70	-0.24	1.03
Bahrain	2.90	6.85	4.01	0.90	2.25	4.67	6.58	6.57	15.75	8.08	6.98	1.12	0.61	2.71	2.90	3.04	2.87	-2.56	0.88
Djibouti	0.62	0.60	0.60	0.59	0.58	2.29	5.79	3.13	14.08	23.04	22.79	9.23	3.23	6.38	8.13	19.66	9.63	7.18	..
Egypt, Arab Rep.	1.27	1.17	1.24	0.52	0.74	0.29	1.59	5.99	9.34	8.87	5.83	3.55	2.92	-0.20	1.00	1.45	1.57	2.07	2.44
Iran, Islamic Rep.	0.02	0.03	0.18	0.32	2.74	1.87	1.60	1.28	0.87	0.58	0.49	0.72	0.75	0.73	0.78	0.65	0.48	0.53	0.80
Iraq	..	..	..	..	..	..	0.82	1.03	0.59	1.09	1.41	1.43	1.01	1.12	1.56	2.19	2.04	1.85	0.09
Israel	1.50	3.54	6.08	1.36	1.31	2.62	2.18	3.38	9.35	4.92	4.76	2.22	2.99	3.31	3.50	4.05	1.96	3.79	3.75
Jordan	3.92	1.94	10.79	3.05	2.49	5.36	8.21	15.76	23.54	15.32	12.87	10.13	6.39	5.15	5.01	5.79	6.08	4.27	3.98
Kuwait	0.23	0.24	0.04	-0.32	0.01	-0.14	0.04	0.29	0.12	0.10	0.00	1.05	1.13	2.12	1.65	0.82	0.30	0.25	0.26
Lebanon	..	..	5.76	8.24	6.98	14.24	9.06	12.32	12.27	13.74	14.83	13.54	11.14	7.83	7.09	5.78	6.08	4.76	5.26
Libya	-0.47	-0.36	0.37	-0.39	0.71	0.54	1.08	2.19	3.76	6.94	4.72	2.18	2.39	..	..	..	..	..	..
Malta	7.22	20.77	17.26	9.62	-10.6	16.7	123.1	341.1	370.3	451.7	165.3	16.93	105.8	82.08	36.12	5.03	1.37	28.68	22.17
Oman	0.72	0.26	0.42	0.03	0.54	0.12	0.45	4.95	4.29	7.92	4.85	3.07	2.12	2.40	1.78	2.04	1.59	-3.11	2.54
Qatar	3.39	0.91	1.42	1.68	3.22	2.66	3.78	5.61	5.75	5.90	3.28	8.31	3.73	0.56	0.21	-0.42	0.50	0.65	0.51
Saudi Arabia	2.92	-0.48	-0.99	0.01	-0.32	-0.27	-0.13	3.69	4.86	5.85	7.59	8.50	5.53	2.43	1.66	1.19	1.06	1.25	1.15
Syrian Arab Republic	0.54	1.66	1.40	0.52	0.53	0.73	1.10	1.73	1.98	3.07	..	..	..	..	..	..	..	..	..
Tunisia	2.98	1.52	3.50	2.05	3.41	1.97	1.90	2.21	9.42	3.89	5.80	3.51	3.03	0.94	3.45	2.29	2.15	2.25	1.65
United Arab Emirates	0.34	-1.17	-0.49	1.15	0.09	3.42	6.77	6.03	5.77	5.50	1.60	0.45	3.03	2.04	2.36	2.43	2.68	2.46	2.58
Yemen, Rep.	-3.47	-4.03	0.07	1.57	1.07	-0.76	1.03	-1.80	5.87	4.24	5.78	0.51	0.61	-1.58	-0.04	-0.33	-0.54	-0.04	-2.05
Middle East & North Africa	**1.29**	**0.71**	**1.30**	**0.87**	**1.02**	**1.82**	**2.59**	**4.79**	**6.10**	**5.97**	**4.33**	**3.51**	**3.18**	**1.96**	**1.77**	**1.68**	**1.50**	**1.64**	**1.77**

As such, multinationals helped in reducing the digital gap worldwide [6]. Table 1 presents FDI inflows as percentage of GDP in MENA economies, from 1998 to 2016 [34].

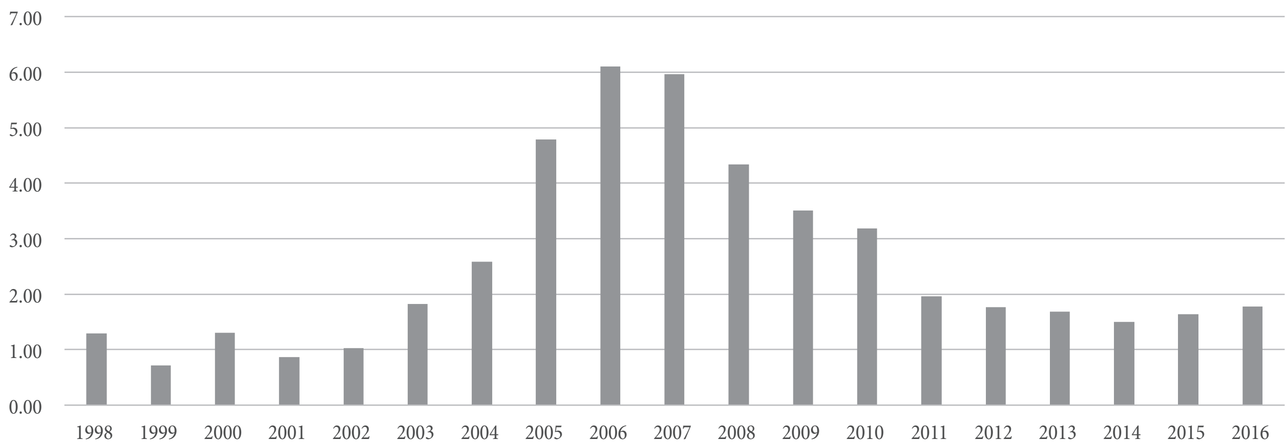
As it can be observed from Table 1 and Figure 1, the growth of FDI began in 2003, after MENA economies left their regression path, which they followed during the 1990's. On the other hand, as it was pointed out earlier, FDI inflow followed the pattern of GDP and GDP growth in particular (Figures 2 and 3).

As regards MENA economies in particular, the results are mitigated. On the one hand, FDI inflows increase merchandise and manufacturing exports in those countries [1]. For example, in the same sense, the role of subsidiaries established by multinationals from developed countries in Tunisia can evolve to embrace the accumulation of new competencies. Some subsidiaries build bigger capacity that allows them to fulfill broader mission in the region [27]. On the other hand, several studies argue in favor of limited FDI effects in the MENA region. Despite their positive role in supporting local employment, FDI inflows did not contribute to economic growth in Saudi Arabia [3]. Nonetheless, FDI has a strong impact on long term economic prosperity in GCC countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates) [31]. FDI inflows into MENA economies have no impact on gains of labor productivity. This might be due to the limited technological capabilities and human skills in those countries. In addition, a significant amount of FDI inflows in MENA countries targets non-manufacturing sectors, expected to be less relevant for technology transfers [10].

MENA economic integration and its effects on investment interflows

The signing of various trade agreements within the MENA region, such as the GCC and the Arab Maghreb union (Algeria, Libya, Mauritania, Morocco, and Tunisia), was supposed to prelude intensified cooperation and greater economic integration. Integration prospects were motivated by economies of scale and reduction of industrial duplication between MENA countries. Integration was a response to mounting fears of globalization and its effects on national sovereignty and growth opportunities in the international marketplace [5]. Although countries of the MENA region share common traits related to history, language, business practices and governance systems, they remain significantly different in terms of economic structure and energy endowments [25]. Only Egypt, Jordan, Morocco and Tunisia have competition laws. Dispute resolution is still not effective in several MENA countries [26]. Other factors obstructing economic integration between Arab states were stressed, i.e. government intervention and lack of coordination [12]. Romagnoli & Mengoni [26]

Figure 1: Middle East & North Africa, foreign direct investment, net inflows (% of GDP)[1]



1 Foreign direct investment are the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. This series shows net inflows (new investment inflows less disinvestment) in the reporting economy from foreign investors, and is divided by GDP.

discussed the missing "deep integration" between MENA countries, which takes into account the interdependencies of financial markets and the standardization of institutions and procedures.

Propositions about firm-level drivers of FDI exchanged within the MENA region

Location-bound macroeconomic and institutional variables seem to play a less determinant role in explaining investments exchanged between MENA countries. Trade agreements were interpreted as potential FDI drivers as they were insufficiently defined and planned. Therefore, local investors might be supported by their own attributes. A set of firm-level factors could justify the decision of local investors from the MENA region to expand their operations in their region. Due to the inexistence of a comprehensive framework, research propositions are argued based on the mainstream literature results regarding firm-level determinants of inward FDI in developing countries.

Horizontal FDI – market-seeking investment – appear to be the dominant type of inward FDI in developing

Figure 2: Middle East & North Africa, GDP (current, US$[2])

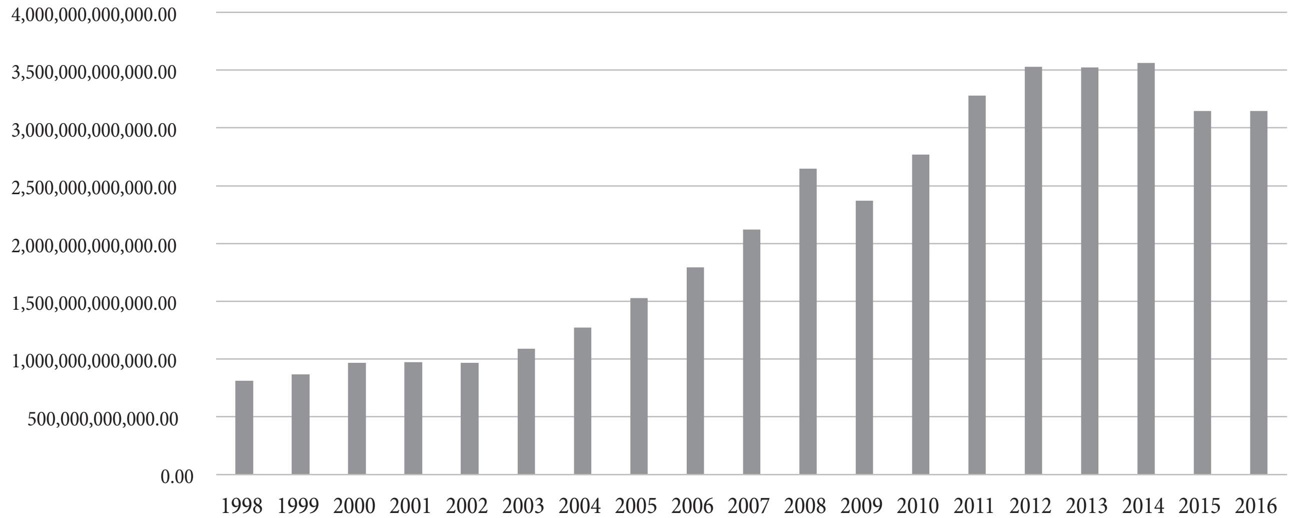
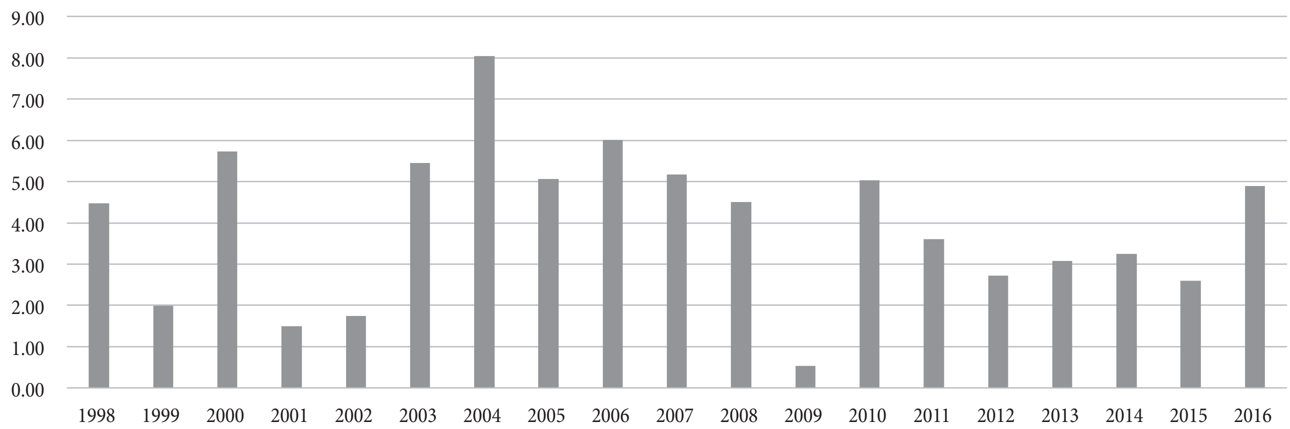


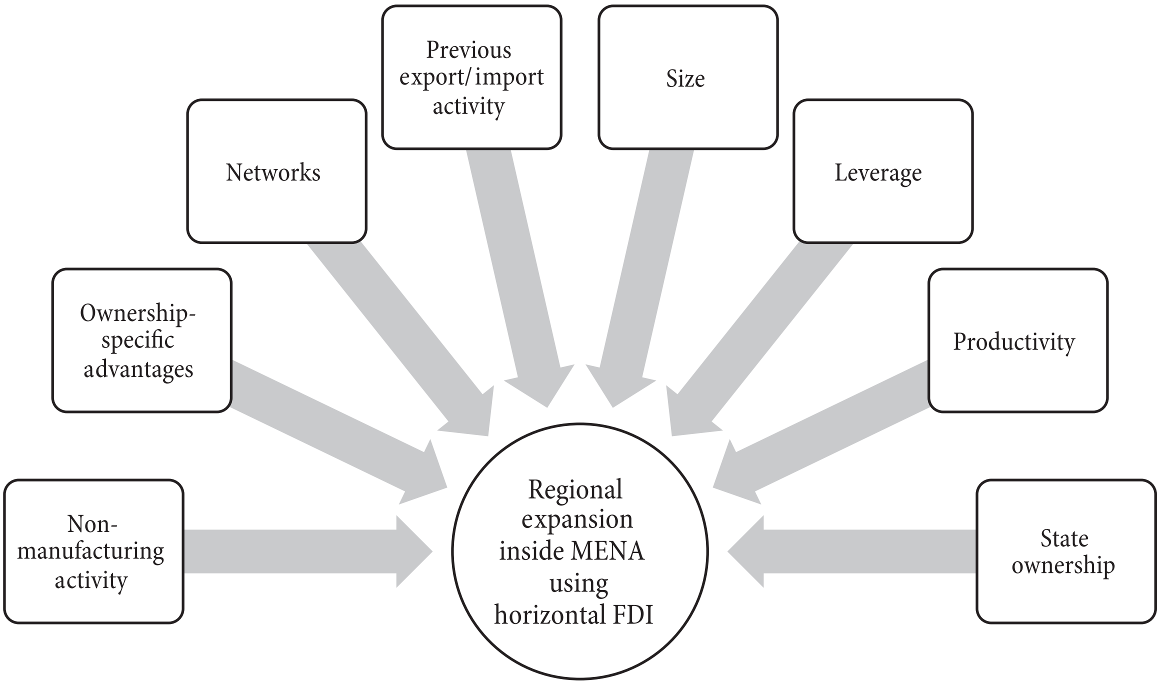
Figure 3: Middle East & North Africa (GDP growth, annual[3])



2 GDP at purchaser's prices is the sum of gross value added by all resident producers in the economy plus any product taxes and minus any subsidies not included in the value of the products. It is calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources. Data are presented in U.S. dollars. Figures for GDP presented in dollars are converted from domestic currencies using official exchange rates for each year. For a few countries where the official exchange rate does not reflect the rate effectively applied to actual foreign exchange transactions, an alternative conversion factor is used.

3 Annual percentage growth rate of GDP at market prices based on constant local currency. Aggregates are based on constant 2010 U.S. dollars. GDP is the sum of gross value added by all resident producers in the economy plus any product taxes and minus any subsidies not included in the value of the products. It is calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources.

Figure 4: Firm-level factors affecting local investors' decision to invest in other MENA markets



nations, e.g. Chinese privately owned enterprises [14], Malaysian firms [36], and Turkish manufacturing firms [18]. As a matter of fact, economic structure and industrial similarity of MENA countries do not support vertical FDI inflows, which are usually motivated by cost savings and denotes the relocation of specific activities in the value chain [22]. Hence, local investors in the MENA region would be operating in non-manufacturing sectors. They are expected to be mainly service companies that do not rely on any industrial or research activities.

Proposition 1: local investors in MENA economies operate in non-manufacturing sectors and apply horizontal FDI.

Possession of distinctive capabilities is a major determinant of FDI [8], [9]. The resource-based view of the firm posits that a firm will internationalize its operations if it possesses valuable specific advantages. Internationalization would allow the exploitation of homeland-specific advantages in foreign markets [15]. The development of specific advantages enables firms to outperform local competitors in host locations [2]. Ownership-specific advantages represent the most powerful determinants of outward FDI [24]. Location-specific advantages are seen as hygiene factors of international expansion. Four ownership-specific advantages encourage outward FDI intensity, namely technological development, marketing and advertising capabilities, managerial and organizational knowledge, and access to funding. Ownership-specific advantages mostly comprise intangible assets and have distinctive features, i.e. transferability from parent to subsidiary and adaptability to host country environment at low costs. Although those findings have been demonstrated for manufacturing industries, non-manufacturing firms have the potential to create ownership-specific advantages in different areas, such as services, management of information systems and human resources [23].

Proposition 2: local investors in MENA economies possess ownership-specific advantages, especially in marketing and management.

A significant share of FDI is made through alliances in pursuit of profitable synergies overseas [9]. The definition of ownership-specific advantages should be reassessed to account for firm's capability of identifying and integrating valuable knowledge assets worldwide. Information spillovers exchanged between partners facilitate FDI. For instance, foreign investors in India target areas that attracted similar investments from abroad [22]. Furthermore, Chinese firms with international bonds tend to be more active investors in the international marketplace [35]. The decision of Japanese firms to invest abroad is explained by the information spillovers gained from co-located exporters/investors [30]. Hence, evidence suggests that firm's connections with exporters or investors whose operations were relocated to MENA countries could be a potential driver for FDI decision in those locations.

Proposition 3: local investors in MENA economies are active in networking with other firms that exported/invested into the target MENA market.

International involvement of firms was depicted in literature as gradual. This was explained as a strategy used by firms to overcome barriers related to information asymmetry in new markets [17]. The Uppsala evolutionary model states that knowledge gathered in local markets precedes internationalization. Knowledge accumulation in foreign markets through export in the first stage lowers risk and facilitates commitment of more resources locally. Therefore, previous export activity is likely to encourage firms to increase their involvement in MENA markets achieved through FDI. Although stage models were challenged by the emergence of born-global firms that internationalize upon or soon after their inception, this theory might remain applicable for large firms expanding to the MENA region. Access to knowledge assets may not be sufficient for firms to overcome barriers to entry into those markets. The inclination of French firms to engage in outward FDI is supported by the knowledge gained from previous exporting activity [11]. Regardless of location-bound factors, previous exporting activity into one market stimulates FDI decision in the next year.

Proposition 4: local investors in MENA economies undertake exporting/importing activity into target market prior to FDI decision.

Other firm-level factors are likely to explain FDI decision in MENA economies, such as firm size, leverage and productivity. Firm size has a positive effect on Japanese horizontal FDI outflows. Larger firms may more easily afford scale-independent costs of investment [30]. Similarly, Indian companies operating in pharmaceutical and metals and metal products industries are more likely to invest abroad as their volume of sales increases [19]. Therefore, firm's size might represent an important advantage that could offset investment impediments pertaining to information asymmetry in developing nations. Larger firms usually benefit from significant support from the local government as they represent major employers and capital suppliers.

Proposition 5: local investors in MENA economies are large firms.

Constraints limiting firm's access to financial resources reduce the prospects of foreign investments by Japanese firms. Credit constraints affect their ability to cover the costs of information collection and networking in foreign markets [30]. In the same sense, the financial situation of the funding bank has a positive influence on the decision of Japanese firms to invest in the United States. Any decrease in the credit rating of the investor's main bank makes investment decision a less attractive entry mode [33].

Proposition 6: local investors in MENA economies enjoy sufficient credit supply.

Hyun & Hur [16] demonstrated that South Korean firms achieving high productivity rates are more likely to invest in countries characterized by tougher conditions of exploitation. Similar results were obtained for Japanese firms. Although minor, productivity has a positive impact on their FDI decision [30].

Proposition 7: local investors in MENA economies are characterized by high productivity rates.

The last firm dimension deemed relevant in explaining regional expansion through investment in MENA markets deals with ownership structure. Several studies have stressed state ownership, or state affiliation, as a determinant of investor's ability to moderate investment impediments in risky business environments. Malaysian companies linked with their government are prominent investors in foreign markets, especially in energy sector and financial services [36]. State ownership attenuates Chinese multinationals' concern for expropriation risks overseas. Strong home-host political relations reduce Chinese firms' exposure to expropriation risks. This positive moderating effect is higher for state-owned enterprises. These firms are less averse to expropriation risks in host countries highly dependent on exporting to the Chinese market [7].

Proposition 8: local investors in MENA economies are owned by or affiliated with the State.

Conclusion

This study proposes unveiling of firm-specific variables that could explain regional expansion through FDI inside the MENA region. In this regard, eight propositions were suggested to account for those characteristics, including type of activity, ownership-specific advantages, networking, previous export/import activity, size, leverage, productivity and ownership structure. Firms with those features are probably more capable of adapting to the business environment in other MENA countries. Variables, such as state ownership and size for instance, can allow those firms to influence the business environment in those countries. Cultural and political ties between different countries in the MENA region explain why local investors are less sensitive to barriers to investments. Local governments may use FDI as a strategy to capitalize on their political and economic power in the region. In this sense, specific organizations would be able to take advantage of those conditions, as well as the common cultural and linguistic heritage between MENA nations, to conduct profitable business. Though it lacks practical evidence, this work paves the way for future empirical studies that could test those propositions in different sectors. Moreover, scholars can study the repercussions of FDI decision on the performance of regional investors in the MENA region. As a matter of fact, no study explored to what extent local firms achieve positive results when they invest in other MENA markets.

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Oualid Abidi

is Associate Professor and Chair of Human Resource Management Department at the College of Business Administration, American University of the Middle East, Kuwait. He earned his PhD in Administrative Sciences at the Université Laval in 2011, Canada. Prior to that, in 2005 he acquired a Master's degree in Project Management at the Université du Québec à Trois-Rivières, Canada. He obtained his Bachelor's degree in Finance in 2002 from the Institut Supérieur de Gestion de Tunis, Tunisia. He has published papers in the field of international business, particularly foreign direct investment and international expansion of small and medium-sized firms. His research interests also include learner-centered teaching, diversity management and entrepreneurship.

Vladimir Dženopoljac

is Assistant Professor and Director of the MBA program at the College of Business Administration, American University of the Middle East, Kuwait. He teaches the following undergraduate courses: Strategic Management, Business Organization and Management and Introduction to Leadership. Prior to being appointed MBA Director, he was teaching MBA Strategic Management and was in charge of the supervision of the New Ventures Final Graduation Project for MBA students. Until now, he has published a significant number of papers in his field of professional expertise. His current areas of professional interest are intellectual capital management and strategic financial management.

Stevo Janošević

is Professor at the Faculty of Economics, University of Kragujevac. He teaches the following courses: Strategic Management (undergraduate studies), Business Strategy and Intellectual Capital Management (master's studies), and Change Management and Competitive Advantage (doctoral studies). Until now, he has authored and co-authored several books, such as Strategic Planning of Research and Development, Innovations and Technological Strategy of a Firm, Strategic Management, Total Quality Management, and Management and Strategy. He led and participated in over 60 studies for the needs of Serbian companies. He is also Chair of the Board of Directors at "Metalac-Proleter". His current areas of professional interest are change management and competitive advantage, enterprise restructuring, strategic financial management, and measurement and management of intellectual capital.