Nation Branding and How It Is Related to Foreign Direct Investment Inflows

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ABSTRACT

This study examines the existence of a correlation between the brand image of a country and its foreign direct investment (FDI) inflows. Furthermore, does the Brand Image of a country have a positive impact on its FDI inflows? To proceed to the object of the study, we use a panel model regression that applies to the ten best nation branding index countries¹ between 2008 and 2014. The result illustrates a strong positive correlation between nation branding and FDI inflow, indicating that nation branding plays a significant role in attracting business to the country. Moreover, countries that exhibit high nation branding have a tendency to have significant increases in FDI inflows.

Keywords: Nation Branding Index, Foreign Direct Investment, Trade Openness, Growth Real GDP, Political Stability, Control of Corruption, Panel Estimation

JEL Classifications: F3, M2, O19

1. INTRODUCTION

The world economy today is linked together in many different aspects. One of the important indications of this connectivity that directly focuses on the economy is the foreign direct investment (FDI). Based on the 2017 World Investment Report, the FDI is the most constant resource of external financing for developing countries. Furthermore, the report has indicated an accumulation of 1.8 trillion US dollars inflow for the total world in 2017¹. The importance and the value of the FDI over the world have inspired countries to market their economies to attract more attention from investors toward their economy. However, developing the public sector to make an economy more attractive for investment should be the first priority of local authorities (Kumar, 2003). It is also essential to develop business environments by investing in human capital and easing the comparative advantage of the economy in respect to competitive economies.

Over the years, the concept of marketing has been used at the micro level of the economy to develop brand identities for specific products and trademarks². In the same way, an image of a country has an impact on their FDI (Bah et al., 2015). Nation branding cultivates the external image of a country³. Nation branding is a sum of successful factors that a country has in respect to the rest

¹ World investment report 2017 published by United Nation Conference on Trade and Development (UNCTAD).
² Kaneva (2011).
³ Laroche et al. (2005).
of the world. These factors affect the private sector, trade, tourism, and diplomatic and cultural relations with other nations.

The nation branding index (NBI) is an index that measures the power and the quality of the country by combining six factors. Those six factors are governance, exports, people, tourism, investment, immigration, culture and heritage. The index has covered developed and developing countries. The NBI has become an important indicator for developed countries. Furthermore, European countries have established their nation brand to attract more tourists, as the UK had done in 1997 with its focus on “Cool Britannia.” Also, Germany developed the “Germany -- Land of Ideas” campaign in 2006 to attract more foreign students. France initiated the “Origine France Garantie” in 2015 to support French products. Furthermore, Italy launched the Extraordinary Commonplace at the 2015 World Economic Forum in Davos to give the world a wider image of the country as more than just stereotypical pizza makers. Switzerland created the organization Presence Switzerland (PS) in 2001, which has been integrated with Federal Department of Foreign Affairs. The strategy behind PS is to promote Switzerland’s vision and constructing a network with foreign decision makers. Also, in 2013, Sweden had designed a new brand identity that contains a flag, text and language to represent the three elements of its branding strategy. Australia has announced new branding that will be launched in near future, called “Clean and Green.” The “Cool Japan” campaign was created by Japanese government to promote its culture. This brand was created in 2002 to attract more tourists to have insight in Japan. Furthermore, Canada invested 32 million dollars in 2009 for initiative branding to put maple leaf brand in quality products. The United States is the top nation to develop nation branding over the years. In 2016, United States has dropped to 6th place. This drop in the USA's nation branding raises the question of what should be done to maintain US branding. The ability of a country to maintain their nation’s brand affects their relevancy and the ability to gain publicity.

Today, the competition among products in the global markets is tight and sensitive. Furthermore, companies are investing in their brands to sustain the level of their brand image. Companies have free reign over the development of their nation brand image. Thus, the NB is beneficial for the private and public sectors. Countries with developed national brands are alike in the structure of their economy, which raises the question of what differentiates the FDI among them. In this study, we are investigating whether a brand image of a country has a role in distinguishing one country from the another in terms of their FDI.

The paper is organized as follows: Section 1 cites the motivation of this study and surveys the previous studies in the field. Section 2 discusses the methodology and the data. Section 3 summarizes the findings. Finally, Section 4 states the conclusion and the limitations of the study.

In the early studies of FDI’s effect over the economy, several studies revealed a negative effect (Moran, 1998), (Aitken and Harrison, 1999). Furthermore, (Leehey and Neary, 1997) found that FDI has a negative impact over companies in the host country. On the other hand, (Leehey and Neary, 2004) results show positive effects on the FDI in increasing the productivity of local companies that have been involved in R&D. In terms of the host country’s productivity, they condition the increase of productivity in the country with the high extent of knowledge spillover among the countries. Moreover, (Dimelis and Papaioannou, 2010) have studied the impact of FDI and Information and Communication Technology (ICT) on productivity growth. They find that the FDI has less impact in the growth than ICT. The FDI has a positive effect on developed countries and developing countries with insignificance in developing countries. However, (Vu and Noy, 2009) have studied the impact of sectorial FDI on economic growth. The results have varied from country to country and from sector to sector.

On the macro level, (Rodriguez and Rodrik, 1999) found insignificant correlation between degree of openness for the country and the level of the development. (Carkovic and Levine, 2002) have corrected their model for endogeneity and found that FDI dependently has an effect over economic growth. Furthermore, (Pelisescu and Rudulescu, 2009) conclude that FDI has indirect effect over the economy. The FDI indirectly influences productivity and competitiveness, as has been shown in the Romanian economy.

In the transition period, Melnyk (2014), (Melnyk et al., 2014) investigate the FDI’s impact on economic development in the post-communism period. They found out that there is a significant impact of FDI on economic growth in the hosted country. The developing countries are not favorable countries to receive FDI, but there are pretty much number of developing countries are receiving FDI (Mottaleb and Kalirajan, 2010). Furthermore, China, India, Nigeria and Sudan are receiving FDI in high percentage among developing countries. Thus, a question has been raised as to what factors make a country favorable to receive FDI compared to other countries with same level of income or resources.

In equilibrium framework, (Blonigen, 2005) has investigated the factors that affect the decision of the firms to become multinational enterprises. He concludes that taxes and exchange rate are the factors that mostly affect the decision of those firms. However, (Dunning, 1980) has used the OLI-framework that accommodates three factors. The three factors are ownership advantage, location advantages and international advantage. In focusing on the factors affecting the decision of MNEs we can conclude that those factors relying on the country’s advantages and quality.

US firms have invested in Canada based on geographical advantage that gave the firms the ability to distribute production lines easily (Shatz and Venable, 2000). Furthermore, language plays major factor for US firms to move forward in their investment toward UK and Ireland (Antonakakis and Tondl, 2010). Also, the level of current FDI in the country has a role in the decision for the MNE (Barry and Bradley, 1997). Moreover, (Benassy-Quere et al., 2007)
have found that institution labialization, tax system, transparency, absence of corruption, affective justice, sensible standards and property right insurance have priority in deciding to implement FDI over OECD in developing countries. Moreover, Lipsy (2000) has estimated the detriments of the FDI inflows annually to find that real GDP growth and real income per capita have a positive impact on attracting FDI inflow. Furthermore, country economy size and taxation have an impact in determining the FDI inflow. On the other hand, (Alam and Shah, 2013) dispute the association between FDI and infrastructure in the OECD. Recently, Papadopoulos et al., 2016 based their study on systematic and integrative review in the literature. They find that successful branding depends on know-how and hard work rather than image advertisement. On the other hand, (Dellis et al., 2017) investigate economic structure as determinant of FDI inflow. They find that there is a significant relationship between the quality of the host country and FDI inflow. However, Kokko (2006) has studied the impact of outward FDI in the invested countries. The result implies that characteristic of the investment could play a role for home country to benefit from its investment with small positive impact on its total export.

This study focuses on using an index to represent the country quality level. The use of that index is to clarify the effect of the country characteristics as sum rather than one variable that may find no result due to a lack of finding a direct relationship. The advantage of using such an index is to avoid misleading, that is emphasized in the literature like (Papadopoulos et al., 2016) and (Dellis et al., 2017).

2. DATA AND METHODOLOGY

The data set consists of annual observations for the period between 2009 and 2014 for the 10 best NBI countries. Due to data limitation, the data covers the United States, Canada, Germany, United Kingdom, France, Japan, Italy, Australia, Switzerland and Sweden. The data has been obtained directly from Simon Anholt.

The rest of the required data set for the selected countries has been obtained from the World Bank database, except for the FDI. The FDI data has been obtained from the United Nations Conference on Trade and Development (UNCTAD) database. We are using inflow FDI in US dollars in log form. Furthermore, Trade Openness, Inflation, GDP, Corruption and Political Stability are transformed to log form. The control variables have been chosen based on literature review supporting their importance to the strength of the model.

In this study, The FDI inflow is chosen to be the dependent variable for the panel regression model, while NBI scores are chosen to be the independent variable.

The panel regression analysis will be used to process the estimation of this study. The linear regression equation will be expressed as follows:

\[ Y_t = \beta_1 X_t + \alpha_t + \epsilon_t \]

\( Y_t \) is the dependent variable, which is the FDI inflows of the 10 best NBI countries.

\[ \ln\text{FDI}_t = \alpha + \beta_1(NBI)_t + \beta_2(\text{Trade Openness})_t + \beta_3(\text{Inflation})_t + \beta_4(\text{Growth of real GDP})_t + \beta_5(\text{Corruption})_t + \beta_6(\text{Political Stability})_t + \epsilon_t \]

Where:

- \( NBI_t \) is the nation brand index score at the level of country \( i \) at year \( t \).
- \( \text{Trade Openness}_t \) is percentage of trade from GDP which is the sum of exports and imports of goods and services measured as a share of gross domestic product at the level of country \( i \) at year \( t \).
- \( \text{Inflation}_t \) is the inflation as measured by the consumer price index, which reflects the annual percentage change in the cost to the average consumer of acquiring a basket of goods and services that may be fixed or changed at specified intervals at the level of country \( i \) at year \( t \).
- \( \text{Growth of real GDP}_t \) is annual percentage growth rate of GDP at market prices based on constant local currency at the level of country \( i \) at year \( t \).
- \( \text{Corruption}_t \) is corruption, which captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests. Estimate gives the country’s score on the aggregate indicator, in units of a standard normal distribution, i.e., ranging from approximately −2.5-2.5 at the level of country \( i \) at year \( t \).
- \( \text{Political Stability}_t \) is political stability and absence of violence and terrorism, which measures perceptions of the likelihood of political instability and politically-motivated violence, including terrorism. Estimate gives the country’s score on the aggregate indicator, in units of a standard normal distribution, i.e., ranging from approximately −2.5-2.5 at the level of country \( i \) at year \( t \).

2.1. Data Description

2.1.1. The nation brand index

The score of the index is based on an interview focusing on six dimensions. The dimensions are mainly culture, governance, people, exports, tourism, investment and immigration. The index ranks countries based on cumulating scores from the seven categories. In 2014, the United States ranked first with total score of 68.92 points. Furthermore, Germany ranked second with a total score of 67.64 points. UK accumulated 66.95 points in third place, followed by France with 66.40 points in fourth place. Canada placed fifth with total of 65.73 points and Japan in the sixth place with slight difference from Canada with 65.49 points. Switzerland, Australia and Sweden placed eighth, ninth and tenth in the sequence with 64.53, 64.52 and 63.69. On the other hand, Figure 1 describes the NBI for the ten countries in this study. We can emphasize that most of the countries experienced a downturn after 2011, and that it could be due to the political turmoil around the world during this period.
2.1.2. The FDI

We can conclude there is a decrease in the level of the FDI in USA and UK as in Figure 2. These two countries are major countries in attracting FDI. Furthermore, the rest of the countries that are covered in this study are facing the same pattern at a slight rate. This drop in FDI for those top ten countries in FDI can be attributed to the financial crisis of 2008. On the other hand, most of the ten countries express a stumpy evolution with stable level after the downswing even for those not reaching their levels of FDI prior the crisis. However, we can observe a further decline mainly for the USA, Switzerland, United Kingdom, France and Germany since 2011. On the other hand, Canada and Australia have a stable evolution in the same period.

2.2. Data Analysis and Modeling

2.2.1. Descriptive statistics

From Table 1, variables used in the model have shown different standard deviation except for the trade openness ratio.
Furthermore, the nation brand index ranges between 63.44 and 70.17. This high score range is due to the selection of the best ten for the period we select. The trade openness shows a big difference from 24.76% to 132.49% with a mean of 62.44%. In addition, the standard deviation for the trade openness is 26.53, due to the classification of selected countries in the study such as advanced economies. The Inflation rate fluctuated between −1.35% and 4.48% with a mean of 1.57%. This deviation in the range due to economic crisis in 2008, affecting the future expectation of inflation. The expecting inflation is an indicator for individual and firm decision.

The real GDP growth varies from −5.62% to 5.99% with a mean of 0.83%. Furthermore, this is explained by the financial and economic crisis of 2008 and by the presence of Italy in the dataset that has a negative ratio for all the period. The normal range for corruption is approximately −2.5–2.5, according to the World Bank. In the sample, the range is between −0.11 and 2.32 with a mean of 1.6 and a moderate standard of deviation of 0.6. This is mainly explained again by the negative score of Italy over the whole period. The Political stability is ranging between −0.106 and 1.399 with a mean of 0.8145.

The Hausman specification test will be used to incorporate the best fit of the estimation to the model. However, Hausman test is the guide to choose the appropriate panel data model and distinguish whether to use the fixed effects method or random effects model. Table 2 has Ramsey test for linearity test the relationship between dependent and independent variables. The linearity Hypothesis is $H_0$: The model has no omitted variables.

According to the results of the test, the p-value is greater than $\alpha = 5\%$, thus we fail to accept the null hypothesis. Therefore, the relationship between the FDI and the predictors is linear.

On the other hand, we proceed with the multicollinearity test to ensure that the estimate coefficient is not intermittently in response to small changes in the model or the data. Thereby, variance inflation factor (VIF) will be used for the multicollinearity test.

\[
VIF = \frac{1}{1 - R^2}
\]

If the tolerance is <0.20 or 0.10 or VIF is 5 or 10 and above indicates a multicollinearity problem.

From Table 3, we can emphasize the VIF test. The result shows that all variables have a VIF of <5. This result indicates that the multicollinearity is not in existing for the variables in the estimation. Furthermore, the estimate of one variable’s impact on FDI while controlling for the others will be more precise.

### 2.3. Homoscedasticity Test
Another assumption of regression is to check for homoscedasticity. Homoscedasticity suggests that the random disturbance in the relationship between the independent variables and the dependent variable is the same across all values of the independent variables. The method that will be used for homoscedasticity is the White test, which establishes whether the residual variance of a variable in a regression model is constant.

Table 4 state the P-values, the P-value is very small and <5%. Since $P < 5\%$, we fail to reject the null hypothesis and consequently to accept the alternative hypothesis that means the variance is not homogeneous.

### 2.4. Fixed versus Random Effect Regression
Table 5 states the regression of the fixed and random effect models which are highly significant with a $P < 1\%$ and the adjusted $R^2$ of 59% and 39% respectively. The Hausman specification test was undertaken to assess the most appropriate model for the data set.

### 2.5. Hausman Test
$H_0$: Difference in coefficients is not systematic

Table 6 states the Hausman test results with P-value insignificant. Therefore, we fail to reject $H_0$ because the result has no significant difference on the coefficients. Thus, the random effect model will be proceeded for this study.

### 2.6. Normality Test
According to the Shapiro-Wilk W test for normal data, we fail to reject the null hypothesis because the $P = 0.27$ as in Table 7 and the P-value is based on the assumption that the distribution is normal. As a result of that, residuals are normally distributed.

### 2.7. Independence Test
Pesaran’s test of cross-sectional independence coefficient is 3.687 and the $P = 0.0002$. Since the $P < 5\%$, we fail to reject $H_0$. There is cross-sectional independence. Thus, there is dependence.

### 3. EMPIRICAL RESULTS
The Table 8 shows the relationship between FDI and NBI using a generalized least square regression.
The result shows that a significant effect of the Nation Brand Index over the FDI inflows of a country as in Table 8. Furthermore, the NBI is significant at 1% with positive impact on FDI. An increase in NBI by 1% will lead to an increase 0.25% in the FDI. This result expresses that country with increase in brand appeal and brand power will attract more foreign investments. Also, this result is consistent with the results of (Kalamova and Konrad, 2010). However, the trade openness is a positively significant factor over FDI with 0.004%. A trade openness increase by 1% will lead to a 0.004% increase in the FDI. This is can explain how trade openness affects domestic activities that strengthen the local economy to attract more investors (Keho, 2017).

The real GDP growth has a significant positive effect on FDI inflow at a level of 1%. A 1% increase in real GDP growth will lead to a 0.026% increase in the FDI inflow. This result has an interesting outcome relative to the studies in the field. Most of the studies have shown a positive direct impact on the economic growth of the country. In the other hand, this study shows that there is a bi-directional positive effect between economic growth and FDI. Furthermore, this can explain how more FDI inflow will boost the economy and this will have an indication to investors to invest in this economy.

Table 2: Ramsey RESET test
<table>
<thead>
<tr>
<th>Variable</th>
<th>Observations</th>
<th>F</th>
<th>Prob&gt;F</th>
</tr>
</thead>
<tbody>
<tr>
<td>r</td>
<td>70</td>
<td>2.47</td>
<td>0.0704</td>
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</table>

Table 3: Multicollinearity test

<table>
<thead>
<tr>
<th>Equation (1)</th>
<th>Coefficient</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>NBI</td>
<td>0.2534435***</td>
<td>0.000</td>
</tr>
<tr>
<td>Trade openness</td>
<td>0.004077***</td>
<td>0.000</td>
</tr>
<tr>
<td>Political stability</td>
<td>0.9163287***</td>
<td>0.000</td>
</tr>
<tr>
<td>Corruption</td>
<td>0.3249305***</td>
<td>0.002</td>
</tr>
<tr>
<td>Real GDP growth</td>
<td>0.0259112***</td>
<td>0.000</td>
</tr>
<tr>
<td>Inflation</td>
<td>0.0396194***</td>
<td>0.000</td>
</tr>
<tr>
<td>Constant</td>
<td>−3.519245</td>
<td>0.000</td>
</tr>
<tr>
<td>Wald Chi-square</td>
<td>552.08</td>
<td>0.000</td>
</tr>
<tr>
<td>Number of observations</td>
<td>70</td>
<td></td>
</tr>
<tr>
<td>Number of groups</td>
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</tr>
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</table>

**Coefficient significant at the level of 1%**

Table 4: Homoscedasticity test

<table>
<thead>
<tr>
<th>White’s test for H; Homoscedasticity</th>
<th>Chi-square</th>
<th>Prob&gt;Chi-square</th>
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<tbody>
<tr>
<td>r</td>
<td>70</td>
<td>57.65</td>
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</table>

Table 5: Fixed versus random effect regression

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<tr>
<th>Variable</th>
<th>Fixed effect model</th>
<th>Random effect model</th>
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</thead>
<tbody>
<tr>
<td>NBI</td>
<td>0.0259528</td>
<td>0.0373819</td>
</tr>
<tr>
<td>Trade openness</td>
<td>0.0102952</td>
<td>0.0063764</td>
</tr>
<tr>
<td>Real GDP growth</td>
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<td>0.016928</td>
</tr>
<tr>
<td>Inflation</td>
<td>−0.0874276</td>
<td>−0.0771933</td>
</tr>
<tr>
<td>Political stability</td>
<td>0.4860285</td>
<td>0.36656</td>
</tr>
<tr>
<td>Control of corruption</td>
<td>−0.1289509</td>
<td>−0.1658753</td>
</tr>
<tr>
<td>Adjusted-R²</td>
<td>0.59</td>
<td>0.39</td>
</tr>
<tr>
<td>Number of observations</td>
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<td>Number of groups</td>
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<td>10</td>
</tr>
<tr>
<td>P-value</td>
<td>0.000</td>
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**Coefficient significant at the level of 1%**

Table 6: Hausman test

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<td>Corruption</td>
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<td>−0.1658753</td>
</tr>
<tr>
<td>Chi-square</td>
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<td>0.9864</td>
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</table>

Table 7: Normality hypothesis test

<table>
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<th>Observations</th>
<th>Z</th>
<th>Prob&gt;Z</th>
</tr>
</thead>
<tbody>
<tr>
<td>r</td>
<td>70</td>
<td>0.606</td>
<td>0.27229</td>
</tr>
</tbody>
</table>

Table 8: FDI and NBI regression

<table>
<thead>
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<th>Equation (1)</th>
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Inflation is positively significantly to FDI inflows. Furthermore, a 1% increase in the inflation ratio will lead the FDI inflows to increase by 0.039%. This result is interesting regarding the results to found by most of the studies in developing countries. However, developed countries have an inflation targeting policy that will control the fluctuations of the inflation rate within a boundary that has upper and lower limit. The increase in the inflation is refuting an increase in the local demand for income increases for the local employees. The increase in the demand will attract more foreign investors to invest in the country to benefit from an increase in higher return in their investment. Furthermore, the adoption of Inflation Targeting policy gives the financial market transparency and predictable framework to plan investment decisions. Also, this policy will inherently raise transparency and predictability in order to lower policy uncertainty regarding risk. Also, the investment decisions will be more visible when the uncertainty in the long-run is lower. This finding is consistent with (Mason and Vracheva, 2017) findings, where they find that inflation targeting has positive effect on FDI inflow.

Political stability has a positive significant impact on the FDI inflows with 1% level. The political stability increases of 1% will lead FDI inflow to increase by 0.9%. This result indicates that political stability helps in providing investors with the necessary stable, attractive, and less risky investment environment. Thus, the investment will become less costly for them to invest in countries with the most highly stable political systems.

The corruption is positively significant at 1% level. The corruption is an index with rating scale. The highest the scale of the country is less corrupted that means an increase in the score of the country indicates less corruption in the country. The increase in the corruption scale by 1% will lead to a 0.32% increase in the FDI inflow. The corruption by its mean has adverse effects on economic performance. Furthermore, the increase in the corruption will have an additional cost that reduces potential profitability and reduces transparency in the business environment. Therefore, foreign investors would tend to avoid investing in countries with low corruption score in the index.

4. CONCLUSION

This study investigates the relationship between the nation brand of a country and its FDI inflows. Starting from the idea that FDI inflows cannot be completely characterized through NBI, we only use controls variables. The controls variables are trade openness, inflation, real GDP growth, political stability and corruption. The data that has been used covers the period between 2008 and 2014 for 10 countries. The countries covered in this study are the top ten developed nations, precisely: The United States, Canada, Germany, United Kingdom, France, Japan, Italy, Australia, Switzerland and Sweden. We use the Simon Anholt index to characterize the branding for the countries.

Our result is parallel to international insights about the importance of this new marketing phenomenon of nation brand. A strong nation brand offers a vital competitive advantage in this international field. However, it emerged as a concept in the last decade and there are not enough studies which confirm its importance. The aim of this study is to confirm whether or not a Nation Brand has its significant role in attracting business. The result has confirmed significant increase in the FDI inflows for the countries that have strong nation branding. Furthermore, the result expresses that countries which have implemented a whole strategy to promote their brand image, such as South Korea, could benefit from that implementation. Hereafter, governments must take seriously appropriate measures in order to ensure that nation brand is strategically managed and perceived by other nations. The nation branding will improve its identity and image to attain a positive international reputation.

This study is limited to its data by using top ten NBI mostly characterized by developed countries. The main reason that we use top ten NBI is due to the impact of FDI inflow over the economy in a developed country has a different outcome than in the developing country. However, using real macro data to reflect the country branding image would be more efficient and reliable to confirm the result, as well have comparison among them.

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