



Culture-specific Investment Attractiveness Index: An Original Composite Indicator

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Received: 25 May 2019

Accepted: 23 July 2019

DOI: <https://doi.org/10.32479/ijefi.8293>

ABSTRACT

This paper presents an original approach to the investment attractiveness of the countries. The author developed an index of investment attractiveness which takes into account indicators of cultural specificity. The specialty literature offers a variety approaches in which different factors that are considered determinants of foreign direct investment (FDI) are analyzed. However, even if cultural are frequently mentioned (and sometimes analyzed), they rarely represent an object of the research of FDI determinants. As for the indexes of investment attractiveness identified in the literature, the situation is even more difficult, and the cultural factors seem to be avoided. The elaboration of the culture-specific investment attractiveness index through the application of the principal component analysis technique proved to be efficient, the new construct being reliable. Further analysis of the connection between the index and the volume of FDI attracted confirm its suitability for explaining the localization of FDI in Europe.

Keywords: Investment Attractiveness Index, Foreign Direct Investment, Culture

JEL Classifications: C38, C43, F21, Z19

1. INTRODUCTION

Economic growth (the wealth of nations) has been the main object of the research in economic science since its beginnings. Economic research proved that factors such as natural resources, population density and military power do not represent universal determinants of economic growth; in turn, participation in exchange, specialization, efficient institutions, additional capital accumulation and technical progress appear to be the main forces that ensure sustainable economic growth (Heyne et al., 2011). However, the determinants of economic development are interdependent and must operate simultaneously. Consequently, even if specialization, free exchange and the efficiency of institutions are guaranteed, factors such as capital deficit and lack of access to technologies and know-how can lead to the economic underdevelopment of the country. In this context, foreign investment represents the means by which the transfer of capital, technology and know-how from rich countries to poor ones can

be achieved, ensuring rapid economic growth, though at a high cost (Heyne et al., 2011).

However, not any foreign investments provide a basis for economic growth like foreign direct investments (FDI) do. FDI is also driven by a multitude of factors, among which some of the above mentioned, given the link between FDI and economic development (apparently, bilateral): the country's economic growth is associated with the potential profitability of the investments, and determines the attraction of a larger volume of FDI.

The multitude of factors influencing the attraction of FDI in a particular country determines the researchers in the field to develop a universal index that includes as many significant factors as possible and explains the directioning of investment flows to specific countries or regions. Specialty literature offers a wide range of such indicators, of a different nature, developed or just applied in the context of FDI research: FDI confidence index (Kearney, 2005), FDI

attractiveness index (Pantelidis and Nikolopoulos, 2008), OECD FDI restrictiveness index (Kalinova et al., 2010), attractiveness index (Murat and Pirotti, 2010), FDI performance index (Lei et al., 2013) or FDI potential index (Lei et al., 2013; Maza and Villaverde, 2015). However, in this multitude of aggregate indicators the elements of cultural specificity are receiving too little attention (the author identified only cultural distance variable in the study of Murat and Pirotti [2010]). Being aware of the importance of cultural factor and of its impact on FDI localization, the author developed an index that takes culture into account, without diminishing the importance of other FDI determinants.

At the same time, the specialty literature provides us with numerous studies that highlight the importance of the cultural factor in the FDI process and the need for cross-cultural investigation in the context of the analysis of FDI (e.g., Vasil'chenko, 2009; Tang, 2012; Kuksa, 2014; Lopez-Duarte et al., 2015).

Being aware of the importance and impact of the cultural factor on FDI directioning, the author developed an index that takes into account the cultural factor, together with the other ones.

The index was developed on the basis of the factors identified by the literature review, with the aim that the score for this index, associated with the investment attractiveness, should explain the localization of FDI.

In order to achieve this aim, the author set up the following goals:

- Selection of the factors – elements of the index;
- Establishment of the reliability of potential index and of the possibility of its development;
- Compilation of the index and its calculation for European countries;
- Analysis of the results of calculations and division of the countries on categories of investment attractiveness;
- Investigation of the link between index values and actual FDI attraction.

The author's main contributions include involving of the indicators of cultural specificity in developing the index of investment attractiveness and developing of the index that can be considered a useful indicator for explaining the FDI localization in Europe.

The paper proceeds as follows. The second section provides an overview of the FDI determinants that were used as the elements of the composite index. The third section presents the methodology and data sources, the fourth section demonstrates the results of the analysis, while the fifth investigates the connection between the index and the attraction of FDI. The last section discusses the conclusions, the limitations and the directions for future research.

2. FDI DETERMINANTS

The starting point in the elaboration of the composite index is the analysis of specialty literature, presented in Tocar (2018) together with a classification of the determinants of FDI. Out of the multitude of factors, the author selected 20 indicators belonging to six main categories:

- Economic factors;
- Infrastructure;
- Technology;
- Institutional-political factors;
- Human factor;
- Cultural factors.

These factors were applied in numerous studies, confirming the impact on FDI. From the group of economic factors the author selected market size (growth domestic product [GDP] per capita - Mateev, 2008, Kersan-Skabic, 2013), Economy's degree of openness (represented by trade - Noorbakhsh et al., 2001; Kok and Ersoy, 2009; Kersan-Skabic, 2013), the level of economic freedom (Pearson et al., 2012) and Market competitiveness (Herfindahl-Hirschman Market Index (HH Index) - Bera and Gupta, 2009).

The impact of infrastructure (Kok and Ersoy, 2009; Khachoo and Khan, 2012; Du et al., 2012) was represented by the trade and transport infrastructure index, an element of the logistics performance index (World Bank).

The influence of technology (Kok and Ersoy, 2009; Sharma and Bandara, 2010) was represented by the high technology export variable, which demonstrated consistency in simultaneous equations modeling.

Six governance indicators were selected for the representation of institutional-political factors (Bhardwaj et al., 2007): Control of corruption, government effectiveness, political stability and absence of violence/terrorism, regulatory quality, rule of law and voice and accountability.

The elements of the index that belong to human factor included human capital (Noorbakhsh et al., 2001) and unemployment rate (Jimenez et al., 2011; Pearson et al., 2012). As a proxy for human capital, the author applied human capital index (World Development Indicators – World Bank).

The category of cultural factors was represented by the cultural dimensions developed by Geert Hofstede (Bhardwaj et al., 2007; Tang, 2012), because it is the only system of cultural factors available for a number of countries sufficient to ensure the significance of the developed index.

3. METHODOLOGY

3.1. Data

For data collection, online databases of international institutions (World Bank, World integrated trade solution [WITS], UNCTAD), the heritage foundation database (for economic freedom index values), and the online database of Hofstede's cultural dimensions (Hofstede insights) were used.

3.2. Method

The index was developed on the basis of composite indicators construction manual (OECD, 2008) by applying principal component analysis.

The reliability of the index was tested using the Cronbach's alpha coefficient of internal consistency. In order to evaluate the adequacy of sampling, the author applied the Kaiser-Meyer-Olkin (KMO) coefficient and the Bartlett's sphericity test.

Because of the lack of data for Serbia and of the impossibility of completing them, the initial number of countries was reduced, so that the sample analyzed included 31 European countries. The missing data for the republic of Moldova on trade in 2017 were imputed through the application of the trend extrapolation technique. The estimation of Hofstede dimensions for the republic of Moldova was made by applying the weighted average technique, taking into account the scores of Romania (due to ethnic, historical and cultural proximity), Russia (due to a common historical past, an important Russian community and Russian cultural and linguistic influence) and Ukraine (due to a common historical past, an important Ukrainian community and territorial and cultural proximity) with equal weights for each country.

Table 1: The value of Cronbach's alpha coefficient for the elements of the culture-specific investment attractiveness index

Cronbach's alpha	Cronbach's alpha based on standardized items	Number of items
0.823	0.823	20

Table 2: The values of Kaiser-Meyer-Olkin coefficient and Bartlett's sphericity test

Parameter	Value
Kaiser-Meyer-Olkin measure of sampling adequacy	0.781
Bartlett's test of sphericity	
Approx. Chi-square	688.118
df	190
Sig.	0.000

Table 3: Variance explained by identified components

Component	Initial eigenvalues			Extraction sums of squared loadings			Rotation sums of squared loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	10.888	54.439	54.439	10.888	54.439	54.439	10.433	52.166	52.166
2	2.169	10.846	65.285	2.169	10.846	65.285	2.4	12.001	64.167
3	1.574	7.868	73.153	1.574	7.868	73.153	1.686	8.428	72.596
4	1.266	6.328	79.48	1.266	6.328	79.48	1.377	6.885	79.48
5	0.911	4.554	84.034						
6	0.691	3.455	87.49						
7	0.498	2.491	89.98						
8	0.473	2.363	92.344						
9	0.371	1.853	94.197						
10	0.279	1.397	95.594						
11	0.248	1.24	96.834						
12	0.182	0.91	97.744						
13	0.144	0.721	98.465						
14	0.117	0.586	99.051						
15	0.085	0.425	99.476						
16	0.039	0.197	99.673						
17	0.033	0.166	99.84						
18	0.016	0.081	99.921						
19	0.011	0.056	99.977						
20	0.005	0.023	100						

The information on all elements of the index and the data sources are presented in Appendix 1.

4. RESULTS

Since the index was to contain various elements with different units of measure, the variables were pre-standardized. The composition of the index was proved to have a high reliability, as evidenced by the value of the Cronbach's alpha internal consistency coefficient (Table 1).

In order to evaluate the adequacy of sampling, the author applied the KMO coefficient and the Bartlett's sphericity test. The value of the KMO coefficient should be $>0,6$ in order to proceed with factorial analysis (OECD, 2008). The results of the initial indicators' evaluation demonstrate a satisfactory level of the KMO coefficient, while the significance of the Bartlett's test suggests that there is a correlation between the elements of the index, and the principal component analysis is appropriate (Table 2).

Principal component analysis is applied in order to identify (from the multitude of quantitative indicators) the latent variables, i.e. the factors (components) that determine the variance of all elements (and, consequently, of the future index) and are not correlated with each other. The results of components identification are provided in Table 3.

For the selection of principal components the author applied the Kaiser criterion, therefore only components with eigenvalues >1 were retained. Following the analysis, 20 components were identified, although the first four components account for almost 80% of the variance of all indicators (79,48%); these are the factors that have eigenvalues >1 . The remaining 16 components cover only about 20% of the total variance of initial indicators.

In order to identify a clear pattern of factor loadings, the author proceeded to the rotation of factors (of the factorial axes) (OECD, 2008). Varimax was chosen as the rotation technique, since it minimizes the number of indicators with high loadings for the same factor. As a result, the author obtained the principal components' rotated loadings, which represent, simultaneously, the factors' weights in the future composite index.

The rotation of the factorial axes made it possible to identify the best view of components' loadings (which are, in fact, the correlations between the initial indicators and the selected principal components), explicitly presented in Table 4. These represent the basis for defining the identified factors.

The first factor has strong positive loadings with control of corruption (0,957), government effectiveness (0,952), rule of law (0,950), regulatory quality (0,921), voice and accountability (0,897), infrastructure (0,891), GDP per capita (0,871), human capital index (0,835), indulgence versus restraint (0,833), but also a strong negative correlation with power distance. Since the highest loadings are represented by the governance indicators, the first component can be defined by institutional-political factors.

The second component has strong positive loadings with the market concentration index (0,830) and Trade (0,777). Therefore, it can be defined in terms of economic factors.

The third factor is defined by the long-term orientation versus short-term orientation dimension, which has the highest loading (0,799), and the fourth – by the masculinity versus femininity dimension (with a loading of 0,872).

Finally, the author elaborated the calculation formula for the investment attractiveness index, by applying the approach according to which the weight of each principal component in the composite index is equal to the weight of the variance explained

by it in the total variance explained by the principal components (Davidescu et al., 2015). Therefore, the index was calculated according to the following formula:

$$I_{csia} = \frac{52,17}{79,48} PC1 + \frac{12,0}{79,48} PC2 + \frac{8,43}{79,48} PC3 + \frac{6,89}{79,48} PC4 \quad (1)$$

where: I_{csia} = Culture-specific investment attractiveness index;
 $PC1$ = Principal component 1;
 $PC2$ = Principal component 2;
 $PC3$ = Principal component 3;
 $PC4$ = Principal component 4.

Country-by-country data was rescaled according to the percentile rank in order to obtain a clearer and a more demonstrative dataset. Therefore, the Index score for each country is placed on a scale from 0 (the minimum score, corresponding to the lowest investment attractiveness) to 100 (the maximum score, corresponding to the highest investment attractiveness). A score of 50 represents an average value of the index.

Figure 1 reflects the results of the calculations of investment attractiveness index for European countries in 2017.

In order to increase the demonstration capacity of the index values, the author arranged the European countries in order of the score increase and grouped them into five categories (Figure 2), including countries with a very low, low, medium, high and a very high index score.

The category of countries with a very low value of the index (0-20) includes post-socialist, Orthodox states, located in Eastern Europe: Ukraine, Moldova, Russia, Romania, Bulgaria and Greece (the latter one is the only country in this group without a communist past).

Table 4: Rotated component matrix

Variable	Component			
	1	2	3	4
Zscor: GDP per capita	0.871	0.088	-0.099	-0.126
Zscor: Trade, % of GDP	-0.047	0.777	0.182	0.199
Zscor: Index of economic freedom	0.717	0.426	0.339	-0.232
Zscor: Market concentration index HH	0.127	0.83	-0.35	0.165
Zscor: Trade and transport infrastructure	0.891	-0.2	0.084	0.256
Zscor: High technology exports	0.517	0.137	0.468	-0.156
Zscor: Control of corruption	0.957	0.102	-0.005	-0.174
Zscor: Government effectiveness	0.952	0.083	-0.001	-0.082
Zscor: Political stability and absence of violence/terrorism	0.688	0.512	-0.156	0.009
Zscor: Regulatory quality	0.921	0.227	0.167	-0.121
Zscor: Rule of law	0.95	0.168	-0.002	-0.113
Zscor: Voice and accountability	0.897	0.134	-0.105	-0.007
Zscor: Human capital index	0.835	-0.018	-0.014	0.108
Zscor: Unemployment rate	-0.136	-0.62	-0.325	0.338
Zscor: Masculinity versus femininity	-0.047	0.189	0.159	0.872
Zscor: Uncertainty avoidance	-0.703	-0.209	-0.232	0.34
Zscor: Power distance	-0.849	-0.088	-0.035	0.157
Zscor: Individualism versus collectivism	0.732	0.078	0.478	0.076
Zscor: Long-term orientation versus short-term orientation	-0.255	-0.012	0.799	0.235
Zscor: Indulgence versus restraint	0.833	-0.068	-0.251	0.004

GDP: Growth domestic product

Figure 1: The values of the culture-specific investment attractiveness index for European countries in 2017

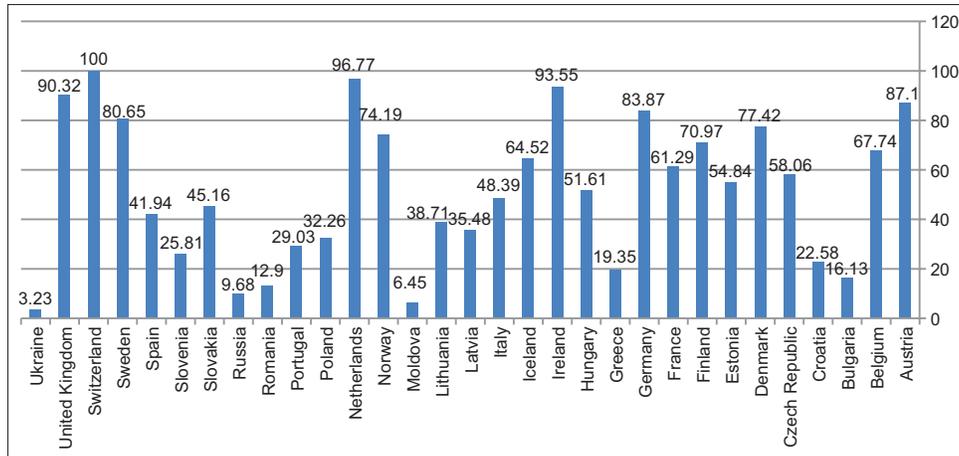
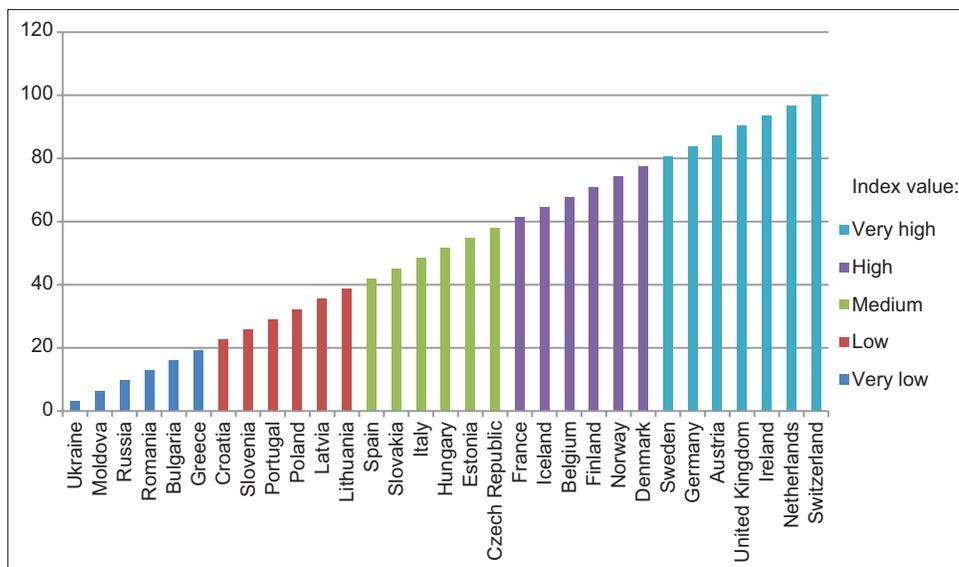


Figure 2: The categories of European countries according to the value of culture-specific investment attractiveness index



The second category, comprising the countries with low index values (20-40), mainly incorporates post-socialist Catholic countries (Croatia, Slovenia, Poland, Lithuania), but also Portugal (a catholic country without a communist past) and Latvia (a post-socialist country with a mixed population in terms of religion).

In the category of countries with average investment attractiveness (index values are in the range of 40-60) the author encountered both highly-secularized post-socialist countries (Slovakia, Hungary, Estonia, Czech republic) and Catholic countries from Southern Europe (Spain and Italy).

Countries with a high Index value (60-80) mainly include protestant countries from Northern Europe (Iceland, Finland, Norway, Denmark), as well as the traditionally Catholic (though strongly secularized) francophone countries from Western Europe (France and Belgium).

The highest values of the cultural-specific investment attractiveness index are characteristic for the traditionally protestant, highly-secularized countries (Sweden and Great Britain), for traditionally protestant countries where the

protestant confession lost its dominating status throughout the 20th century (Germany, the Netherlands, Switzerland) and for Catholic countries with a strong protestant influence throughout history (Austria and Ireland). The highest value of the index was attributed to Switzerland, followed by the Netherlands and Ireland.

5. CULTURE-SPECIFIC INVESTMENT ATTRACTIVENESS INDEX AND FDI

In order to demonstrate the reliability of the developed index regarding its relation with the volume of the attracted foreign investments, the author conducted an analysis of the correlation between the index and several indicators representing different expressions of FDI intensity (Table 5), extracted from the UNCTAD statistics.

The correlation analysis demonstrated a significant link between the index developed and most of the indicators selected to represent FDI, though the correlation with the FDI stock per capita proved to be the strongest.

Figure 3: Groups of European countries according to their score for the culture-specific investment attractiveness index in 2017

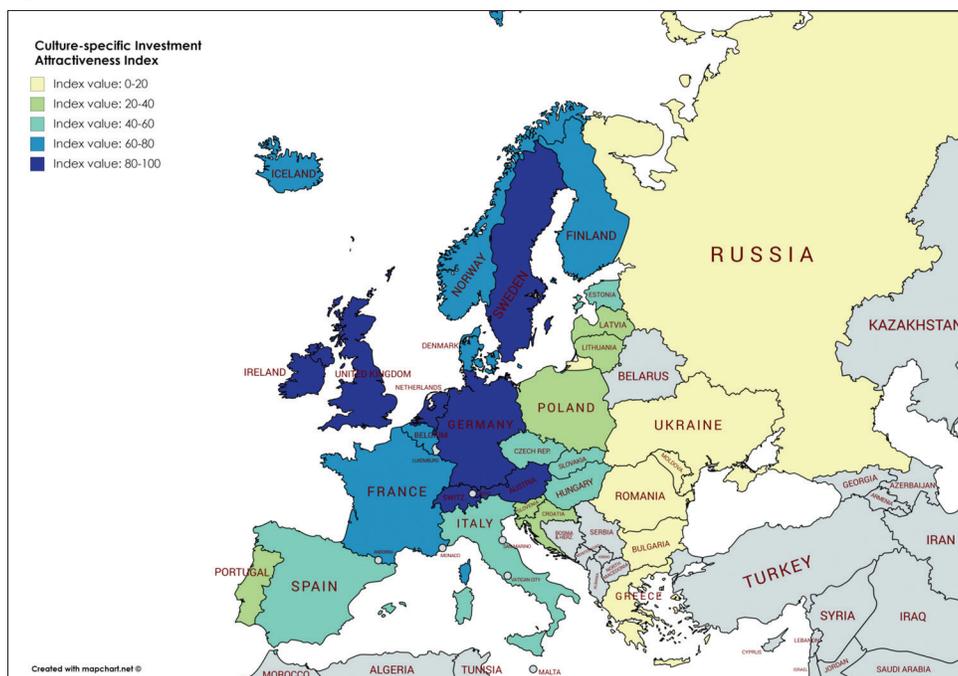


Table 5: Pearson correlations for the relationships between culture-specific investment-attractiveness index and FDI intensity indicators

Parameter	Correlation	FDI stock per capita	FDI stock, % of GDP	FDI inflows, % of GDP	FDI intensity	FDI inflows per capita	FDI inflows, mln USD
Pearson correlation	Investment attractiveness index	0.605**	0.438*	0.191	0.387*	0.481**	0.449*
Significance		0.000	0.014	0.302	0.031	0.006	0.011

** - P<0.01; * - P<0.05, FDI: Foreign direct investment

Table 6: Pearson correlations for the relationships between culture-specific investment-attractiveness index and FDI stock per capita after the elimination of the outliers

Parameter	Correlation	FDI stock per capita
Pearson correlation	Investment attractiveness index	0.810**
Significance		0.000

** - P<0.01; * - P<0.05, FDI: Foreign direct investment

However, the value of the Pearson coefficient was not very high (0,605), which was the reason for a detailed analysis of the FDI per capita indicator. The descriptive statistics and normality testing (by Kolmogorov-Smirnov and Shapiro-Wilk tests) identified problems with skewness and kurtosis, as well as non-compliance with the assumption of the distribution normality due to aberrant values. These problems were solved by the elimination of aberrant values.

After eliminating the outliers, the Pearson coefficient value demonstrates a strong significant correlation between the investment attractiveness index and the FDI stock per capita (Table 6). This result confirms the existence of a significant connection of the developed index with the actual attraction of FDI into the economy and demonstrates its reliability and applicability.

In order to illustrate this connection, the author developed two informative maps in which European countries are grouped according to the degree of cultural-specific investment attractiveness with cultural specifics (Figure 3) or the FDI attracted per capita stock (Figure 4) in 2017.

From these figures, it can be noticed that both the lowest index values and the lowest volumes of FDI were identified for Eastern

European countries: Russia, Ukraine, Moldova, Romania and Greece. A slightly better situation in both cases is demonstrated by Latvia, Lithuania, Poland, Croatia and Slovenia. High or very high values of both the investment attractiveness index and the FDI volume were identified for Iceland, Norway, Sweden, Finland, Denmark, Great Britain, Ireland, Belgium, the Netherlands, Austria and Switzerland. Therefore, the author noticed that the distribution of countries according to the value of the investment attractiveness index overlaps, to a large extent, with their distribution according to the volume of FDI stock per capita.

In order to follow the evolution of the investment attractiveness index and to identify the main trends, the author calculated index values for European countries in 2007 (10 years before the reference year [2017] and also a moment of prosperity on the eve of global economic crisis (Figure 5)).

Figure 4: Groups of European countries according to the value of foreign direct investment stock per capita in 2017

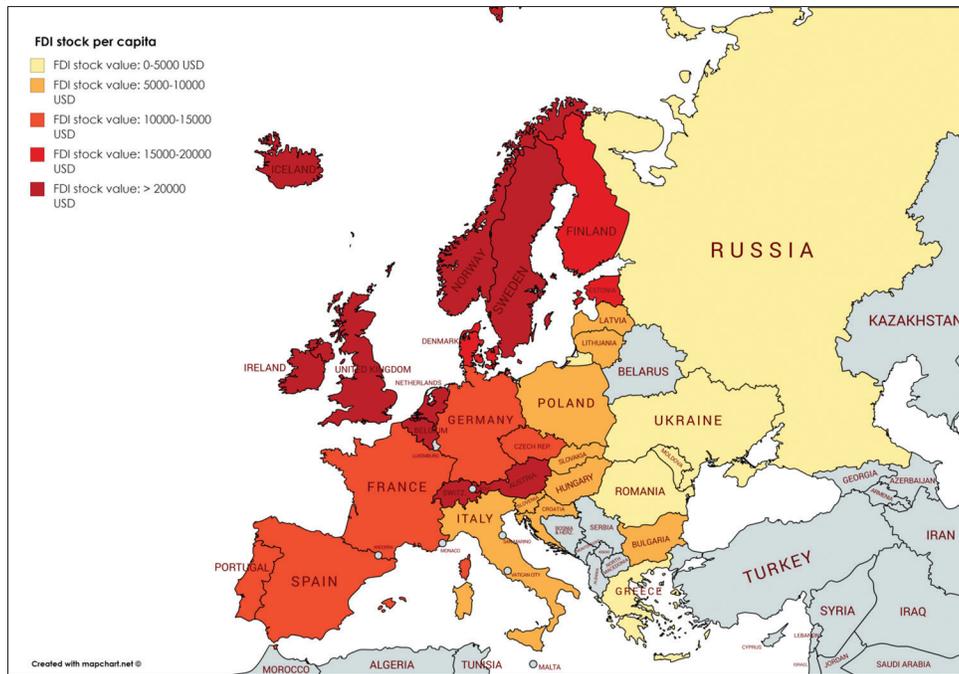
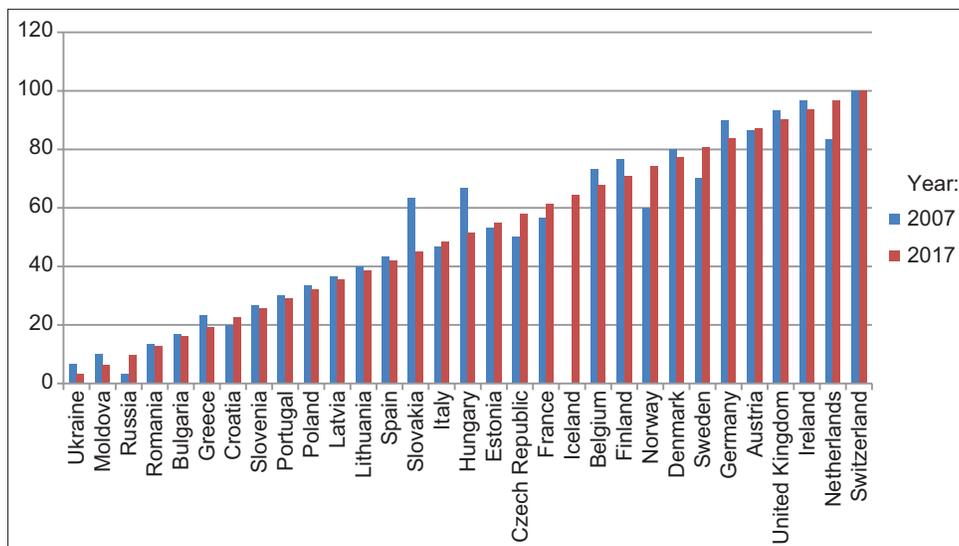


Figure 5: The values of the culture-specific investment attractiveness index for European countries in 2007 and 2017



For Iceland, the value of the Index in 2007 was not calculated due to the lack of data

The evolution of the values of investment attractiveness index demonstrates both positive and negative trends. The largest decreases in the index values can be observed in the cases of Slovakia and Hungary. Considerable negative trends were also registered in the cases of Ireland, Great Britain, Germany, Denmark, Finland, Belgium, Greece, Moldova and Ukraine.

On the other hand, the strongest positive trends were identified in the cases of the Netherlands, Sweden, Norway, France, the Czech republic and Russia. Index values are relatively stable over time for the other countries. It should also be noticed that the distribution of the countries according to their investment attractiveness remained relatively stable over time (with a few exceptions).

6. CONCLUSIONS

The culture-specific investment attractiveness index is based on the specialty literature analysis, including 20 indicators that belong to six categories of FDI determinants: economic factors, technology, infrastructure, institutional-political factors, human factor and cultural factors. The analysis of the reliability and sampling adequacy demonstrated the representativeness of the selected set of indicators and the opportunity to develop a composite index.

By applying principal component analysis the author identified four principal components, which were defined as follows (after the analysis of rotated loadings): institutional-political factors,

economic factors, long-term orientation versus short-term orientation and masculinity versus femininity.

The elaboration of the culture-specific investment attractiveness index was accompanied by the subsequent grouping of countries into five categories according to their score:

1. Countries with a very low index value: Ukraine, Moldova, Russia, Romania, Bulgaria and Greece.
2. Countries with a low value of the index: Croatia, Slovenia, Portugal, Poland, Latvia and Lithuania.
3. Countries with an average index value: Spain, Slovakia, Italy, Hungary, Estonia and Czech Republic.
4. Countries with a high index value: France, Iceland, Belgium, Finland, Norway and Denmark.
5. Countries with a very high value of the index: Sweden, Germany, Austria, Great Britain, Ireland, the Netherlands and Switzerland.

The countries' distribution demonstrates a strong cultural footprint, mainly related to the dominant confession (currently or in the past).

The correlation analysis identified a strong and highly significant connection between the culture-specific investment attractiveness index and the FDI stock per capita, which proved to be the most effective indicator of the transformation of investment attractiveness into investment stock.

6.1. Limitations and Directions for Future Research

The most important limitation is represented by the fact that the selection of representative variables from numerous FDI determinants identified in the literature was made by the author (in this sense, the choice was also influenced by the availability of longitudinal and cross-sectional data).

In future research, the calculation of the culture-specific investment attractiveness index can be expanded globally so that a comprehensible map of investment attractiveness could be developed. Also, the number of representative FDI factors included in the index might be increased.

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APPENDIX

Appendix 1: The elements of the culture-specific investment attractiveness index

No.	Variable	Description	Source of data
1	GDPpc	GDP per capita	World bank
2	Trade	Trade, % of GDP	World bank
3	EconFreedom	Index of economic freedom	The heritage foundation
4	HH	Market concentration index HH	WITS
5	Infrastructure	Trade and transport infrastructure	World bank
6	Tehnology	High technology exports	World bank
7	Controlcorruption	Control of corruption	World bank
8	Governeffect	Government effectiveness	World bank
9	Politstability	Political stability and absence of violence/terrorism	World bank
10	Regulquality	Regulatory quality	World bank
11	Ruleoflaw	Rule of law	World bank
12	Voiceaccount	Voice and accountability	World bank
13	Unemployment	Unemployment rate %	World bank
14	Humancap	Human capital index	World bank
15	PDI	Power distance	Hofstede insights
16	IDV	Individualism versus collectivism	Hofstede insights
17	MAS	Masculinity versus femininity	Hofstede insights
18	UAI	Uncertainty avoidance	Hofstede insights
19	LTO	Long-term orientation versus short-term orientation	Hofstede insights
20	IND	Indulgence versus restraint	Hofstede insights