How to Attract Multinational Corporations?

Translation of the article in "*Delovoy Express*" Business Weekly №03 (757), February 8, 2008

Economy and Values Research Center (EV) presented its research on "Attracting Multinational Corporations to Armenia" at the end of last year. The research aimed to answer the question on whether Armenia has the potential to attract foreign direct investment from high-tech and medium high-tech multinational corporations involved in the Electronic & Electrical, Software & Computer, Pharmaceutical & Biotech, and IT Hardware sectors.

For the purpose of the research, EV analyzed Foreign Direct Investment (FDI) global trends and strategies of 20 multinational corporations (MNCs): Siemens, IBM, Microsoft, Phillips, Pfizer, etc. The EV researchers studied the motivational factors of the companies in order to find out what attracts them to particular countries, and what elements of the global value chain were targeted in different countries, for example, Operations, Manufacturing (including Assembly & Test), Sales & Marketing, Research and Development (R&D), Financial Services and Business Consulting.

Hungary and Israel were highlighted as success cases. What has happened in Hungary? After the collapse of the Soviet Block, Hungary attracted a large flow of FDI. But quite soon afterwards, labor started to become more and more expensive. As a result, most MNCs closed or moved their production units to Asia. However, at the same time, MNCs shifted higher-value processing and R&D businesses from Western Europe to Hungary. Israel and Hungary managed to create attractive conditions for R&D. Ten out of the 20 above-mentioned MNCs have set up R&D centers and production units in Hungary. Israel is considered a global R&D power house. What's the secret?

A high-skilled labor force, government programs, and university-private sector collaboration proved to be decisive factors. In 2005, the gross tertiary enrolment ratio in Armenia was 28%; in Hungary and Israel this figure was 65% and 59% respectively. It follows that we lag significantly behind with this indicator (let alone the quality of the education), and companies who are planning to invest in Armenia may face the problem of a shortage of skilled workers. This problem, in turn, will bring about an increase in labor costs. The science and engineering enrollment ratio is also important. Here Armenia seriously falls behind other countries. While in Israel this ratio is 30% and in Hungary about 19%, in Armenia it is only 6.5%. The governments of Hungary and Israel provide significant investment incentives (R&D tax incentives and various programs directed at boosting innovative activities of the companies).

What type of investment can we not count on? First of all, FDI in mass production because of our small market size, as well as our geopolitical and transportation problems. This means that Armenia cannot emerge as a regional hub for the mass production of this or that product. Companies involved in the extraction of natural resources, such as mining and quarrying were privatized and further investment in this sector will increase operational efficiency. Possibilities of attracting investment in the telecommunications sector are limited and mainly connected with the entrance of a third mobile operator. The situation is the same with physical infrastructure, which too is largely foreign-owned. This means that only the high tech industry can be counted upon.

The analysis of the structure and dynamics of FDI distribution in 1998-2006 will help to understand the current situation. 20.4% of investment went to telecommunications, followed by mining and infrastructure, food/beverages/tobacco, wholesale and distributive trade, air transportation activities, precision equipment, and IT and R&D. Interestingly, in 2003-2006, FDI was mainly driven by re-investments, i.e. reinvested profit.

What is being done in the sphere of Innovation? In 2005, the law on State Support of Innovation Activities was adopted. In 2007, the state budget was supposed to allocate USD 600,000. But for the most part, most of this investment went to science and the scientists that are absolutely not connected to the private sector, not aware of the needs of the companies, and develop something that, in fact, no one needs.

In general, a good indicator of the efficiency of R&D capacity of any country is the number of registered patents registered in the U.S. In Israel, in 2005, there were 137 patents per 1 million people. In Armenia, the figure was 0.3 in 2005. That means that only one invention was patented and registered in the U.S. Later in 2006, two patents were registered in the U.S. However, it would be unfair not to mention that in Kazakhstan where large amounts are spent on R&D the indicator of registered patents is only 0.1 per 1 million people. In addition, before the collapse of the Soviet Union, 25,000 scientists and engineers were working in Armenia. Currently, according to official data, only 6700 are working and they are mainly involved in international research projects. This means that investors may have problems in attracting current specialists.

Now let us look at the problem from the financial side. Do the investors enjoy privileges in Armenia? In Israel and Hungary the government provides grants for training university graduates, i.e. these countries provide grants to employers for training. Additionally, governments provide R&D tax incentives and grants. We have none of these.

To sum up, we may say that the main obstacles in attracting MNCs to Armenia are; the lack of skilled labor force, knowledge, industrial zones and techno-parks. Hungary, in its time, created industrial zones where transnational corporations had all the necessary conditions to develop, including tax incentives. In 1998, tuition fees were eliminated in this country, i.e. the government was doing providing investment in education. Can this be applied to Armenia? Can our country subsidize all the higher educational institutions? "No", says Anna Makaryan, EV Research Associate. "But I think that that students in some departments need to be provided with tuition waivers for subjects that are particularly demanded or will be demanded in the near future."

The research concludes that Armenia needs to provide tax incentives and state grants, and strengthen cooperation between the private sector and academia. The government should provide R&D grants to initiate cooperation between academia and private enterprises (up to 66% of the approved R&D budget is granted in the case of Israel). It is necessary to create industrial zones, techno-parks, education centers for equipping scientists and engineers, university excellence centers for students, and an innovation fund to fund new ideas from new companies. Such companies will also be attractive for foreign corporations. And, of course, it is necessary to improve the quality of public schools by creating modern science labs (chemistry, physics, etc). All the above mentioned activities are internationally adopted practice. In the case of Armenia, it is also necessary to actively involve the Diaspora, especially those representatives of the Diaspora that hold managerial positions in high tech companies.

There is another, not less interesting lever for attracting investments; the huge Iranian market, where investment from the West is limited. In other words, taking into consideration the good relationship with this country, Armenia might consider becoming a regional platform for Western corporations to produce and export products to that market.

Karen Arzumanyan