Japan's foreign direct investment potential in Georgia

A thesis submitted in partial fulfillment of the requirements for obtaining the Master of Public Policy, International Program (MPP/IP) degree from the Graduate School of Public Policy at the University of Tokyo

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LIST OF ABBREVIATIONS AND ACRONYMS

BIT: Bilateral investment treaty

Brexit: Withdrawal of the United Kingdom from the European Union

CESEE: Central, Eastern and Southeastern Europe

CIS: Commonwealth of Independent States

COVID-19: Coronavirus disease

ESCAP/UNESCAP: UN Economic and Social Commission for Asia and the Pacific

FDI: Foreign Direct Investment

FTA: Free Trade Agreement

IB: International Business

IIA: International Investment Agreements

JBIC: Japan Bank for International Cooperation

JETRO: Japan External Trade Organization

JICA: Japan International Cooperation Agency

JSC: Joint Stock Company

LLC: Limited Liability Company

M&A: Mergers and Acquisitions

MNCs: Multi-National Corporation

MNE: Multi-national Enterprise

NEXI: Nippon Export and Investment Insurance

ODA: Official Development Assistance

OECD: Organization for Economic Cooperation and Development

R&D: Research and Development

SDGs: Sustainable Development Goals

UNCTAD: United Nations Conference on Trade and Development

V4: Visegrad Four countries (Czech Republic, Hungary, Poland, Slovakia)

WIR: World Investment Report

WTO: World Trade Organization

INTRODUCTION

The increasing importance of foreign direct investment (FDI) in the economic development path of countries has been prevalent in line with the globalization of capital flows. FDI is a particular form of investment, characterized by the establishment of a foreign-affiliated company overseas, under the management of the parent company. Compared with the other types of investments, FDI has the potential for knowledge transfer (Lesher & Miroudot, 2008). Overall benefits of FDI from the perspective of the FDI host country, where the investment occurs, encompass technology spillovers, human capital development, contribution to the integration into international trade networks, and contribution to the formation of the competitive business environment, leading to the fostering of economic growth (OECD, 2002).

The benefits of FDI are reciprocal since it contributes to the home country's economy in various aspects as well. From the perspective of home countries, where investor companies are based, effects include increased financial earnings through overseas profits, higher export earnings with more domestic output, foreign market access, stimulation of domestic investment, reverse spillovers by research and development (R&D) and acquisition of know-how with foreign pursuit, improved standards and practices, industrial upgrading and better competitiveness resulted from the efficient use of the labor force, productivity growth, mobilization of resources by the opportunity of acquiring natural resources overseas, improvement of tangible assets and products by the acquisition of capital goods and machinery while realizing a project overseas, to be utilized in home country factories and business, and finally, secondary and tertiary sequences, such as higher employment and wages, and economic growth, as other country effects (ESCAP, 2022). The latest vulnerabilities resulting from the COVID-19 pandemic and geo-political tensions have highlighted the challenges of relying on concentrated FDI destinations. This raises the question of whether countries that are still emerging as FDI destinations could serve as alternatives for investors.

Upon gaining independence after the collapse of the Soviet Union, Georgia established diplomatic relations with Japan in 1992, followed by the implementation of the full-scaled Official Development Assistance (ODA) projects from 1994 (Bibilashvili, 2020). Since then, bilateral relations between the two countries have been intensifying, however, the cooperation in investment still has not reached its full potential. Over the past decades, Georgia’s investment environment has significantly improved, which has deserved recognition from the international community for improvement of international rankings, related to doing business, corruption, and

governance. The COVID-19 pandemic had a significant impact on Georgia's economy. In 2020, inward FDI reached its lowest point of the past decade. However, from 2021, there are promising signs of recovery. In 2022, according to the preliminary statistics, total inward FDI surpassed post-pandemic levels and showed a 47.85% increase. 2022 marked a celebration of the establishment of 30 years of diplomatic relations and in 2021, two important agreements on elimination of double taxation (double taxation avoidance treaty) and bilateral investment treaty were signed. Furthermore, a significant project in the energy sector, involving the acquisition of a share in Georgian hydro-power plant, was successfully completed in 2019, just before the start of the Covid-19 pandemic. This transaction has had a positive contribution on the inward FDI from Japan in the following years of 2021 and 2022 (GEOSTAT, 2023). The recent patterns of change in global FDI flows, the encouraging signs of a strengthening relationship between Japan and Georgia, and yet untapped business collaboration between countries with the limited number of Japanese companies having a presence in the Georgian market motivated conducting the study on Japanese FDI potential in Georgia.

On top of the overall benefits of FDI to the host country, Japanese companies offer advanced expertise in various industries, with a greater potential for spillover effects. While there is ongoing discourse that top Japanese manufacturers are facing fierce competition globally, Japanese companies continue to display a commitment to innovation and development of new products, which is well reflected in the presence of Japan among the top three countries, with the highest number of international patent applications. According to the World Intellectual Property Organization (WIPO), in 2022, Japan was a top country with IP applications in the sub-sectors of electrical machinery, apparatus, and energy (WIPO, 2022).

Japan is recognized as a prominent contributor to global FDI. Since the expansion of Japan’s outward FDI in the 1980s, speed and magnitude have been fast-paced and Japan’s outward FDI could contribute to the growth in employment, exports, and output (Urata, 1993). At the same time, Japanese companies are well known for their careful approach and comprehensive approach to making strategic business decisions, such as overseas expansion and investments. The motivation behind the expansion of Japanese outward FDI has varied by the industry and region, but among overall reasons, notable was trade facilitation, securing and expansion of markets, creation of supply chains for the manufacturing sector by mobilizing energy, resources, and other inputs in FDI host countries, expansion of assets under ownership, or international distribution networks (Camarero et al., 2021).

To study the potential of Japanese FDI in Georgia, the author tried to analyze what are the current patterns of Japanese FDI in Georgia and understand the benefits and challenges for Japanese companies when considering Georgia for investments. The results suggest that the current form of Japanese FDI to Georgia is concentrated in market-seeking investments, either for covering a local market and/or neighboring countries. Key potential benefits of Georgia for Japanese investors are local market conditions with positive demographics and GDP growth patterns, availability of low-cost workforce, advantageous geographic location, low corruption level, and the presence of a bilateral investment treaty (BIT) between the countries. The potential weaknesses that might affect the attractiveness of Georgia, are potential concerns with political and macroeconomic stability levels, business measures, trade openness, cultural differences, and lack of well-established industrial production expertise, especially when it comes to the FDI realization in the manufacturing sector. Mentioned factors are important for not only Japanese investors but foreign investors overall, and most of these determinants are integral components of classic FDI theories. The determinants explain the behavior of MNCs in making decisions about overseas business expansion and investments, as explained in the review of the literature.

To conduct the research, the author utilized a qualitative method to collect multiple sources of data from news articles, documents, scholarly research, and historical data. For an in-depth understanding of Japanese FDI projects in Georgia, by using a case study approach, author analyzed several FDI projects from Japan. The author explored determinants of Japanese FDI by the previously conducted studies, with a focus on the European region. Based on the listed determinants, the author evaluated Georgia's performance against peer countries, which have more experience and better results in mobilizing FDI from Japan, such as the Czech Republic and Serbia. The comparative case study approach enabled the author to understand what potential benefits and challenges for Japanese investors in Georgia and explore gaps that the country needs to improve to facilitate more FDI from Japan.

Based on the findings of this research, the continuation of this study could be a sector-specific assessment of Japanese FDI potential in Georgia and other emerging topics, such as the impact of the presence of BIT between Georgia and Japan on the inward FDI from Japan, after several years pass since the enforcement of the agreement.

CHAPTER 1-BACKGROUND

1.1 THE RECENT TRENDS IN CROSS-BORDER INVESTMENTS

The rise of economic globalization led to the growth of cross-border investments over the past decades. The evolution of technology, communication, and better infrastructure made the exchange of goods, capital, people, and ideas easy across the globe. FDI has been contributing to the integration of countries into global value chains and trade networks. International expansion of production was largely promoted by the degree of economic development and the result of reforms implemented in host countries of FDI, internationalization of markets, and investment in human capital. Given the historical decline of FDI flows during crises, it is important to understand the consequences of current vulnerabilities on global FDI. This is particularly relevant within the context of the author's research on the potential for Japanese FDI in Georgia.

FDI has been a driver of the modernization of the economy of countries, however, cross-border investments have been vulnerable to crisis and economic downturns. To begin with, in the 90s, when corporations actively started expanding their footprint beyond national borders, FDI flows increased drastically. Between 1990 and 2000, the average growth of global FDI amounted to 15.3% per year. Later, global FDI inflows experienced a significant decline due to the global financial crisis, with annual growth rates falling from an average of 4.9% between 2000-2007 to 0.4% between 2008-2019 (UNCTAD, 2022).

The decline in FDI flows serves as evidence of the negative effects of crises on the global economy and on cross-border investments, consequently. International business (IB) literature suggests that from the macro level perspective, the major effect is that when FDI host countries experience low economic performance, foreign companies are discouraged from investing. In terms of micro-level perspective and firm-specific behavior, MNEs experience low demand and sales, with increasing costs. As a result, MNEs tend to either show escapist, defensive, or risky behavior to deal with the crisis, by reducing investments and halting production, terminating projects, and selling assets, or exiting host markets and/or relocating operations to the alternative country (Saleh, 2023, p. 11). Understanding the theoretical pattern, it becomes important to examine how current vulnerabilities impact global FDI flows.

In early 2020, the Covid-19 pandemic and consecutive global health crises affected the growth outlook of multinational companies and cross-border trade became a lesser priority. All major international financial institutions downgraded economic growth forecasts. The International Monetary Fund projected that the world’s economy would fall by 3% in 2020 and World Bank’s

projection was 5.2% decline. The global economic downturn across countries of all income levels had an immediate impact on trade and investment flows, leading to the appearance of signs of unwinding economic globalization. Countries started to prioritize the self-sufficiency of national economies, particularly for critical goods. Predictions from industry experts evolved around pausing overseas expansion activities, re-shoring or near-shoring overseas activities for lesser reliance on global supply chains. Talks about globalization have shifted towards increased regionalization in the medium term, especially in the context of China. Discussions evolved about moving production out of China or adopting strategies like China plus one (China+1) or China plus two (China+2). Businesses faced the choice of either relocating their production sites entirely from China or safeguarding their supply chains by having an additional country as a production location and Southeast Asian countries were often cited as the most viable alternative. Patterns of decoupling from China became visible starting in 2019 due to the US-China trade dispute. According to The Institute for Supply Management, companies that diversified sourcing during the US-China trade war appeared to be more resilient, but 95% of businesses surveyed have now seen their supply chains impacted as lead times more than double across the world (Forde, 2020).

Russia's invasion of Ukraine raised additional concerns regarding trade and investment. The effect of the latest disruptions is well-reflected in the numbers of FDI projects in the war-affected territory and the surrounding region, as well as on a global scale. According to UNCTAD's World Investment Report 2022, there were indications of a forthcoming recovery in global FDI flows, with a reported growth of 64%. A key reason for the rise was mostly caused by M&A transactions and the high levels of retained earnings of MNEs. However, subdued investment patterns by MNCs in new assets made the projected growth of FDI flows seem less sustainable. Investments in greenfield FDI projects accounted for just 11%, significantly below the pre-pandemic levels. Moreover, the number of investment policy measures adopted in 2021, amounting to 109, decreased by 28% compared to the previous year. Developed countries mostly introduced or reinforced their screening regimes for investment based on national security criteria, or extended the temporary regimes adopted during the pandemic to protect strategic companies from foreign takeovers, whereas developing countries continued the path to more liberalization and confirming the importance of FDI as a post-pandemic recovery strategy. Most of the incentives enforced by policymakers were based on tax incentives (UNCTAD, 2022).

FDI structure was significantly shifted in the region of Central, Eastern, and Southeastern Europe (CESEE). Russia experienced a withdrawal of foreign capital, and EU-CEE saw a decline in FDI

inflows. After the initial signs of recovery in the first quarter of 2022, in the second quarter, the EU-CEE region experienced a 21% decline in annual FDI. However, some countries in the region experienced high FDI inflows, mainly due to the energy transition and relocation of companies away from the war zone, such as the Czech Republic, Hungary, Lithuania, Poland, and Romania, as safer locations in the European Union zone (Pindyuk, 2023).

In addition to observing shifts in cross-border investment trends, it's crucial to grasp how investors' decisions have been shaped in practice. Produced since 1998, the FDI Confidence Index survey for 2022 by Kearney, a global management consulting firm, revealed that transparency of government regulations and lack of corruption are the most important factors for investors when making decisions in which country to make an investment. The annual survey has been examining investors' preferences grouped into two categories, such as market asset and infrastructure factors and governance and regulatory factors. Market asset and infrastructure factors cover technological and innovation capabilities, talent/skill level of the labor pool, domestic market size, availability of raw materials and other inputs, availability of financial capital in the domestic market, quality of digital infrastructure, cost of labor, quality of physical infrastructure domestic economic performance, research and development capabilities, and the availability of land/real estate. The second group with regards to governance and regulatory factors includes transparency of government regulations and lack of corruption, tax rates and ease of tax payments, use of moving capital into and out of the country, the strength of investor and property rights, the efficiency of legal and regulatory processes, general security environment, government incentives for investors, and countries participation in regional bilateral trade agreements.

As shown in the table 1, governance and regulatory factors are driving forces for choosing investment destinations (Kearney, 2022), whereas in 2019, the top decisive factors were included within governance and regulatory factors, as well as market asset and infrastructure factors. In terms of location preferences, 70% of investors prioritize developed markets as an investment destination for expanding their assets, and intensions to seek new opportunities were strongest for the Americas, amounting to 42%, followed by Asia Pacific, with 30% and Europe, with 21%. Based on a 2019 survey, investors were almost equally seeking opportunities in emerging markets, compared with developed and frontier markets preference of choice of 47% of survey participants (Kearney, 2019).

Recommendation for policy makers in adopting measures for recovery of both inward and outward FDI could be introduction of incentives, enhancing confidence of MNCs', liberalization, and adoption of FDI regimes and seeking for sustainable FDI (Saleh, 2023, p. 12).

2019	2020	2021	**2022**	Factor
4	3	5	**1**	Transparency of government regulations and lack of corruption
2	2	2	**2**	Technological and innovation capabilities
1	1	1	**3**	Tax rates and ease of tax payments
7	5	9	**4**	Ease of moving capital into and out of the country
5	13	6	**5**	Strength of investor and property rights
10	11	4	**6**	Efficiency of legal and regulatory processes
3	9	10	**7**	General security environment
8	12	7	**8**	Government incentives for investors
16	18	15	**9**	Talent/skill level of labor pool
11	8	13	**10**	Country's participation in regional bilateral trade agreements
14	6	11	**11**	Domestic market size
18	16	18	**12**	Availability of raw materials and other inputs
17	14	14	**13**	Availability of financial capital in domestic market
9	4	12	**14**	Quality of digital infrastructure
6	17	8	**15**	Cost of labor
15	15	16	**16**	Quality of physical infrastructure
12	10	17	**17**	Domestic economic performance
13	7	3	**18**	Research and development capabilities
19	19	19	**19**	Availability of land/real estate

Figure 1: Results of global investor survey, 2019-2022. Source: 2020 Kearney FDI Confidence Index, p. 7; 2022 Kearney FDI Confidence Index, p. 9.

From the perspective of investors, we can imply that factors connected with economic security and safeguarding overseas investment assets will be driving factors in shaping their decisions in the near and possibly, medium term.

1.2 CURRENT TRENDS OF JAPAN'S OUTWARD FDI

Uncertainties have been raising concerns of international investors and putting off projects, especially when it comes to greenfield investments. A good example is Japan, which has been among the largest sources of outward FDI over the last decade. It is interesting to observe the current patterns of Japan's outward FDI, within the context of this research on outward FDI potential.

In 2018, Japan became the world's biggest source of FDI for the first time in almost 30 years, confirming the significance of Japanese corporations in the world's trade and investment networks, but the decline of outward FDI from Japan was inevitable because of the Covid-19 pandemic (UNCTAD, 2019). According to the statistics from JETRO, sectoral distribution of Japan's outward FDI has been dominating in non-manufacturing sectors between 2017-2021. FDI in the manufacturing sector amounted to 34,4% out of the total flow, out of which, the top sub-sectors were: transportation equipment (20.1%), electric machinery (20.1%), chemicals and pharmaceuticals (16.24%), textile (12.77%). As for the outward FDI in non-manufacturing sectors, it amounted to 65.5% share and the sectoral distribution was the following: finance and insurance - 39%, wholesale and retail - 32.4%, communications - 10%, real estate - 5.2% (JETRO, 2022).

In 2020 global FDI decreased by 40%. However, in July 2020, Japanese investment projects made a significant contribution to global M&A deals. For example, corporation Seven & I Holdings announced a 21 billion USD M&A deal with American Marathon Petroleum's Speedway gas stations, which was not only the biggest M&A deal in Japan but one of the most significant in the world, amidst the pandemic crises. This indicated that rather than taking a "wait-and-see" approach, companies with big reserves in cash could continue making new deals (Yonemura, 2020).

Japan's outward FDI witnessed a significant decrease of 59% in 2020, compared with 2019. However, the following year, in 2021, there was a remarkable turnaround as FDI stock rebounded with a notable surge of 53%. According to the analytics of JETRO, Japan performed 476 outward greenfield investments and since 2003, the number has fallen below 500 for the first time. In 2021, for greenfield projects, the leading sectors were: automotive components, agricultural equipment, chemical products, and vehicles, whereas brownfield projects were topped by beverages manufacturing (project: Asahi Group Holdings, investment through Carlton & United Breweries in Australia), electronic/Electrical equipment (project: Hitachi, Ltd, investment through ABB Power Transmission and Distribution Division, in Switzerland), energy (project: Mitsubishi Corporation, Chubu Electric Power Co., Inc, Investment through Eneco, in Netherlands),

financial/insurance sector (project: Tokio Marine Holdings, Inc, investment through Privilege Underwriters, Inc, in USA), and pharmaceutical sector (project: Astellas Pharma Inc., investment through Audentes Therapeutics, Inc., in USA). In 2021, brownfield projects increased by 40%, compared to the previous year (JETRO, 2022).

The rebound of Japan's outward FDI after the pandemic was uneven, with a modest 2.6% growth. The top countries as a recipient of Japanese FDI between 2020-2022 were: the United States (65%), Singapore (12%), the United Kingdom (12%), and China (10%). In 2020, the government of Japan announced a special subsidy program for Japanese firms operating business in China, to motivate them to bring back production back to Japan or diversity in alternative countries. As of 2020, out of 33,000 China-registered firms with investment from Japan, only around 5% applied, which is a very small number of companies willing to reduce or withdraw their operations from China (Seguchi, 2021).

In 2021, the majority of Japan's outward FDI was still concentrated in China, amounting to 15.1%, whereas the share to other regions remained lower, for example, 7.6% in Europe and 7.4% in ASEAN, however, China's zero-covid-19 policies have arisen concerns among Japanese companies operating a business in China. Despite uncertainties, the decline in outward FDI to China was only 24% according to the preliminary outward FDI statistics in 2022. The rebound of outward FDI and its country-wide breakdown is a good example that so much interdependence has been built with concentrated locations, such as China, that it is not easy to decouple, however, since 2021 number of regional cooperations were initiated for supply chain resilience. Japan has been taking part in the latest cooperation frameworks initiated, for example, Japan, US, Australia, and India (QUAD) framework, addressing mapping out supply capabilities, identifying vulnerabilities, and security enhancement of semiconductors and critical components; Japan-US Commercial and Industrial Partnership (JUCIP), aiming to enhance cooperation in semiconductor manufacturing capacity; Japan-EU Digital Partnership, aiming to prevent supply chain disruptions and R&D of next-generation semiconductor technologies; Indo-Pacific Economic Framework (IPEF), uniting On May 23, the US, Australia, Japan, India, South Korea, New Zealand, and seven ASEAN countries on the occasion of the framework, aiming to strengthen semiconductor supply chain capabilities.

Recent developments indicate that preferences of Japanese investors have been evolving. According to the latest annual survey of manufacturing firms, which covers a period from July to September 2022, around 70% of companies expressed willingness to further expand overseas

operations and strengthen investments. Among promising countries for business expansion in the short run of the next three years, India surpassed China for the first time, and other attractive regions and countries were the USA and the ASEAN (Vietnam, Thailand, Indonesia, Malaysia, Philippines). European countries were downgraded in the list due to the geopolitical situation in the region, however, Germany remained a top choice for Japanese manufacturers. The survey revealed concerns related to China. On top of the prolonged lockdown measures, companies named rising labor costs and fierce competition in the local market. Additionally, factors such as "uncertainty over the operation of legislation" and "insufficient protection of intellectual property rights" raised from the China-US rivalry were among the issues companies mentioned, that might refrain them from reliance on China (JBIC, 2022).

In recent years, Japanese companies have increasingly demonstrated a strong interest to pursue the Sustainable Development Goals (SDGs) through overseas business projects. Surveys conducted by Toyo Keizai Inc. have revealed that 57% of 1614 Japanese companies were referring to or considering the realization of SDGs (Ikuta & Fujii, 2022). According to JETRO, several overseas collaborations were accomplished in 2021 with government institutions, academia, and private counterparts. Table 4 summarizes the characteristics of the projects related to the realization of SDGs.

War in Ukraine has posed challenges for Japanese companies. As per an investor survey conducted in April 2022, 40% of Japanese firms suspended business in Russia or announced such plans, immediately after the Russia's invasion of Ukraine (JETRO, 2022). However, further surveys conducted in 2022 indicated a low number of Japanese corporations withdrawing operations from Russia, as only 2.4% of the 168 Japanese companies decided to terminate operations in the country. As of February 2023, the number of listed companies that suspended operations in Russia stood at 27 (nippon.com, 2023). Even though the number is not high, the corporations included big Japanese MNCs, such as Toyota, and Nissan. As of March 2023, it was confirmed that due to the interruption in supplies of key materials and parts, Toyota decided to withdraw vehicle manufacturing operations from Russia (The Japan Times, 2023).

Another emerging trend in relations with the European region has been a rise of venture capital investments in Europe, Nordic & Baltic regions. According to the EU-Japan center for International Cooperation, Japanese venture capital investments were focused on technology startups and both in 2020 and 2021, on average 20 investments were pursued. Additionally,

Japanese corporations such as Digital Garage Inc., Toyota, and Itochu became shareholders in venture capital funds in New Nordics.

Japanese Company/Organization	Local company/Organization in overseas	Project content	SDG
Yokogawa Electric Corporation	Vergennes Waterworks District, Los Angeles, USA	Deployment of technology related to water quality improvement; Usage of emerging technology, such as AI for energy saving	SDG 3, SDG 6, SDG 8, SDG 11
Sucrecube Japan inc.	Senegal ministry of health; TUMIQUI Japan SASU	Deployment of technology for the ease of use of electricity and communication in rural areas of Senegal	SDG 1, SDG 2, SDG 3, SDG 4, SDG 5, SDG 7, SDG 8, SDG 9, SDG 12, SDG 17
ListenField (with the partnership of the University of Tokyo)	Indian Institute of Technology Hyderabad, Jayashankar Telangana State Agricultural University, International Institute of Information Technology Hyderabad	Development of agricultural support platform for genome-related research for accelerating reproductive processes of plants and current research project in progress about sustainable production of crops and climate change	SDG 1, SDG 2, SDG 3, SDG 11, SDG 15

Table 2: Examples of overseas collaboration by Japanese companies in 2021. Source: Reprinted from JETRO Trade and Investment Report, 2022 (p.48).

Ranking	Country
1	China
2	India
3	US

4	Vietnam
5	Thailand
6	Indonesia
7	Malaysia
8	Philippines
9	Mexico
10	Taiwan

Table 3: Promising Countries for Japanese companies. Source: JBIC (2022)

From the recent developments, following conclusions could be drown which are noticed in the latest patterns of Japanese outward FDI:

- Decoupling from China as well as withdrawal from Russian market is not significant, but there are some signs of seeking of diversifying destinations for overseas investments.
- Mergers and acquisitions are preferred over greenfield investments.
- Realization of SDGs in overseas business subsidiaries has an increasing importance.
- Investments in non-manufacturing sectors and breakthrough technologies are showing growth patterns.

1.3 GEORGIA'S INWARD FDI TRENDS

The research aims to study what is the potential of Japanese FDI to Georgia, in this matter, it is important to first understand the current state of inward FDI to Georgia and what are advantages the country offers for foreign investors.

Located on the crossroads of Europe and Asia, classified as an upper middle-income country, Georgia is a small country with a 3.7 million population and 5,023.27 USD of GDP per capita. Georgia has undergone a significant transformation to opening the economy and making a favorable investment environment for international investors. Currently, Georgia is a member of the United Nations, the Council of Europe, the World Trade Organization, the Organization of the Black Sea Economic Cooperation, the Organization for Security and Cooperation in Europe, the Community of Democratic Choice, the GUAM Organization for Democracy and Economic Development, and the Asian Development Bank (Invest in Georgia, n.d).

Georgia's progress over the past decade is positively assessed on the international scene. Progress has been expressed in the convergence of GNI per capita towards levels of the European Union, increasing from 3048 USD to 4608 USD between 2020-2021, elimination of poverty, and further opportunities for growth by initiating EU candidacy in 2022, which require sustained reforms in the country (World Bank, 2023).

Population	3,729,500
Area	69,700 km²
Income group	Upper middle-income
Workforce	5.4 million
Currency	Georgian Lari (Gel)
Time zone	GMT +1, daylight saving time GMT +2

Table 4: Key facts about Georgia. Sources: Invest in Georgia; Georgian National Statistics Office

Georgia's economy was heavily impacted by the Covid-19 pandemic. in 2020, FDI inflows dropped by 52.9% year-on-year and GDP fell by approximately 5.9%, compared to global decrease of 3%. In 2021, FDI, the economy has demonstrated a gradual recovery, GDP growth rate stood at 10.4% growth rate in 2021, with a 5% forecast for the coming years. The country's monetary policy relies on the inflation targeting policy and the inflation target has been maintained at a 3% target (National Bank of Georgia, n.d).

Major advantages which Georgia offers to foreign investors include transparent business environment, connectiveness to the region with free trade agreements, and affordable costs of operating a business, including low costs of labor and production inputs. According to World Bank's latest edition of "Ease of Doing Business" ranking, country stands 7th and according to OECD's FDI regulatory index, Georgia stands 8th in overall ranking and 1st among non-OECD member countries. The flexible tax environment of the country is well recognized. By having only 6 taxes which are flat, non-increasing, Georgia is ranked as the 3rd least tax burdened country in the world, with 9.9% Total Tax Rate (World Bank, OECD, 2020).

Georgia's market itself is limited to the 3.7 million population of the country, but with an extensive network of free trade agreements, Georgia has access to a 2.3 billion market. The country is a member of the World Trade Organization (WTO) since 2000 and has a Deep and Comprehensive Free Trade Agreement (DCFTA) with the European Union, China, Ukraine, Turkey, CIS

(Commonwealth of Independent States), and EFTA (Iceland, Liechtenstein, Norway, and Switzerland) countries, General Schemes of Preference (GSP) with the US, Canada, and Japan.

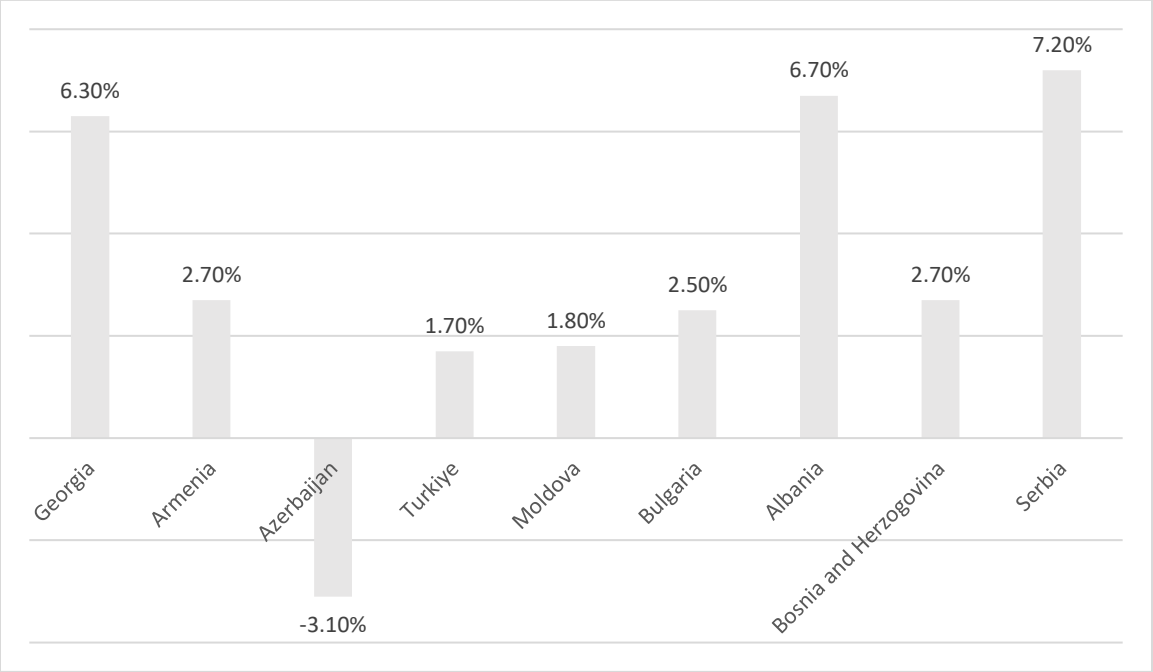

Figure 1: FDI to GDP ratio in upper-middle income countries of eastern Europe. Source: World Bank, 2021

Georgia offers relatively low costs for operating the country. The average monthly gross salary in 2021 was 420 USD, with the total workforce of 1.5 million people and 55% of them are 44 years old or younger. Due to the vast water resources, renewable energy and cost of electricity is affordable, approximately 8 cents per kWh (Invest in Georgia, n.d).

Agriculture, fishing	0.7%
Mining	3.6%
Manufacturing	9.8%
Energy sector	13.0%
Construction	8.8%
Hotels and restaurants	3.9%
Transports and communications	19.6%
Health and social work	1.9%
Real Estate	8.0%
Financial sector	17.9%
Other sectors	12.8%

Table 5: Georgia's inward FDI breakdown by sectors, 2011-2021. Source: Georgian National Statistics office (GEOSTAT)

Georgia's FDI composition over the past decade (2011-2021) has been concentrated on the sectors, such as transport and communication, financial sector, energy sector, real estate. These sectors typically have a strong connection with the local market, national infrastructure, and resources. In terms of the country-wide breakdown of Georgia's inward FDI, over the past 10 years, the top sources of cumulative FDI between 2011-2021 were dominated by UK, Azerbaijan, and Netherlands. Table 5 and Figure 2 show a sectoral and country-wise breakdown of inward FDI.

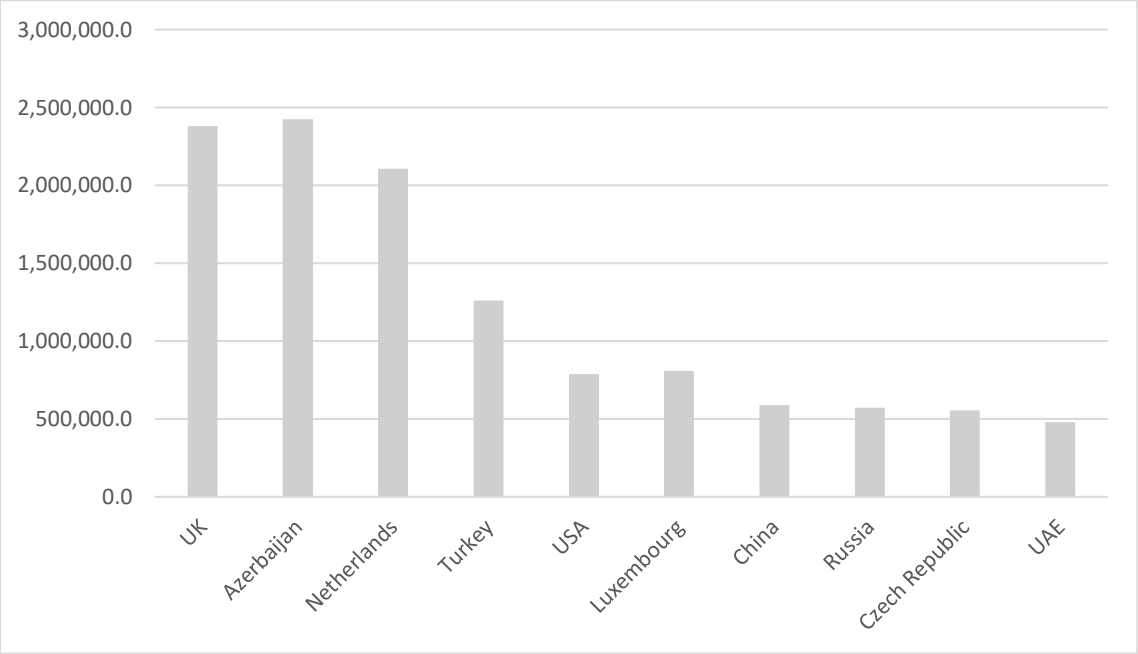

Figure 2: Georgia's inward FDI by countries (in USD thousands), 2011-2021. Source: Georgian National Statistics office (GEOSTAT).

Aiming to diversify FDI flows in more productive sectors, with spillovers on technology and domestic sector development, a new incentive mechanism was approved in 2020, by the government of Georgia, through the implementing state agency LEPL Enterprise Georgia (also referred to as Invest in Georgia). In the framework of the program, the foreign company can receive up to 15% cashback of the committed investment after fulfilling investment obligations by implementing an FDI project in eligible sectors, such as manufacturing of electrical and electronic engineering products, manufacturing of aircraft parts and components, manufacturing of vehicles and equipment, as well as their parts, export of business services/business process outsourcing (BPO), global business services (GBS), information and communications technology (ICT), developing warehouses and logistic centers, aircraft repair and maintenance services (Enterprise Georgia, 2020).

Another important policy initiative enforced after the outbreak of covid-19 pandemic was a law on the adoption of "International Company Status". Approved on February 10th, 2020, by the government of Georgia, the adoption of international company status aims to promote Information and communications technology (ICT) services exporters from Georgia can benefit from reduced rates of personal income and profit tax to 5% each. Regular tax rates for personal income are 20% and 15% for corporate income tax (Georgian Revenue Service, n.d).

Other general incentives which both domestic and foreign investors can benefit from are: 0% corporate income tax on retained/reinvested profit, as the profit tax applies only to distributed earnings. Otherwise, corporate income tax is 15%. Additionally, there are four free industrial zones (FIZs) in Georgia, which offer certain tax incentives. For example, if a company produces goods for export in FIZ, it is exempt from all taxes except Personal Income Tax (20%), which is paid from employees' salaries (Invest in Georgia, n.d).

With its geographic location, favorable business environment, relatively lower costs of business operations, and available policy incentives, Georgia could become an attractive option for international investors. The classic literature on FDI by Dunning and other authors suggests that efficiency-seeking investment becomes an interest for foreign investors once their motivation goes beyond local market focus or strategic asset-seeking (Dunning, 2008). While the presence of new incentives in Georgia might be an additional factor for enhancing the country's attractiveness to international investors, it is important to understand whether it aligns with the needs of investors, in the changing landscape of global investment flows.

1.4 An overview of Japan's FDI to Georgia

Georgia and Japan have been sharing diplomatic relations for the past 30 years. Georgia is a recipient of loan, grant aid, and technical cooperation assistance programs, which aim to address the challenges that Georgia is facing, including skills shortage, infrastructure, and environment. Japan's ODA assistance through JICA (Japan International Cooperation Agency) started in 1995 after Georgia gained independence and established a diplomatic relationship with Japan. Since then, JICA has been engaging in key sectors of the importance of Georgia's economic development path, such as energy, health, human resource development, economic infrastructure, and environment, through grants and loan projects (JICA, n.d). Japan-Georgia relations intensified after liberal democratic party leader, prime minister Hashimoto's "Eurasian Diplomacy" initiative. Before 1997, ODA assistance from Japan was insignificant, as Georgia was perceived as a country

with a fragile economy, lacking vision towards the future development of the economy and democracy. Japanese ODA to Georgia significantly increased between 2012-2014 and by that time, Japan was the second largest contributor in development assistance funding, after the USA (Bibilashvili, 2021).

Relations between Japan and Georgia in the scope of investment are still untapped. According to the publicly available data from the Georgian National Statistics Office of Georgia, between 1997 and 2022, the total outward FDI from Japan to Georgia amounted to around 516 million USD (GEOSTAT, 2022) which represents less than 1% of total Japanese outward FDI o eastern Europe region. The total outward FDI flow to the Eastern Europe region amounted to 72,699 million USD (JETRO, 2023).

To understand how Japanese investments are doing in Georgia, the author analyzed inward FDI statistics from Japan in the period of 2016-2022, shown in Figure 3. To obtain data about FDI statistics and the number of investor companies contributing to the yearly FDI inflow, the author requested information from the National Statistics Office of Georgia, as company-related information was not publicly available.

In 2022, Japan's FDI flow to Georgia made a promising recovery 2022, increasing to 68.6 million USD, which is ten times higher than 2020's inflow. In 2022, FDI from Japan reached a peak for the time of 2016-2022 and stood at a historical maximum of a wider period between 1997-2022, for which statistical data is recorded. The growth was largely attributed to the investment deal of TEPCO on the acquisition of a stake in a Georgian hydropower plant in 2020 and subsequent investment tranches continued in the following years.

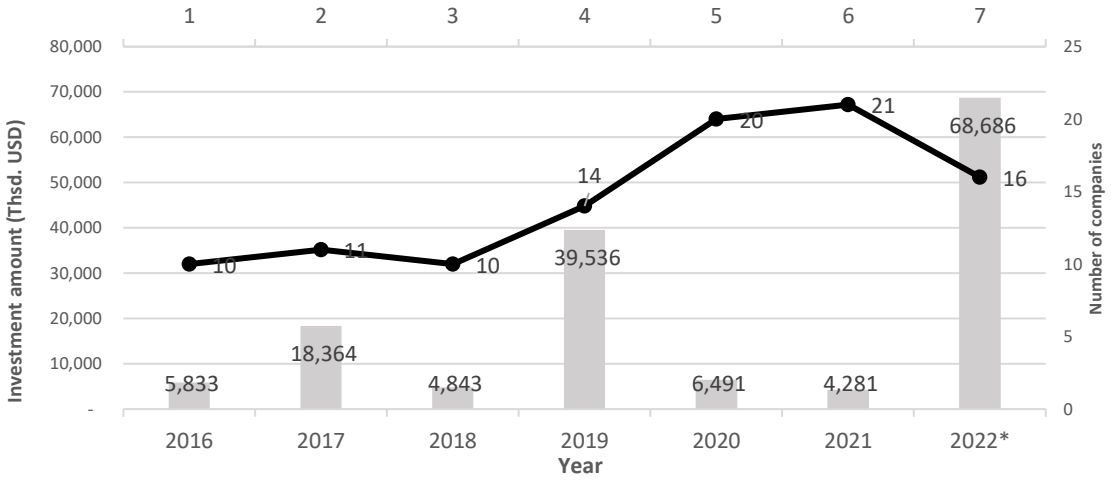

Figure 3: FDI from Japan to Georgia. Source: Georgian National Statistics Office

As of March 2023, there were 58 legal entities registered in Georgia with the involvement of Japanese capital. Out of 58 registered enterprises, the author excluded businesses with the registration status of individual entrepreneurs due to the scope of the study, as the definition of FDI implies that in overseas business activities, a sufficient level of investment and commitment to a foreign country by job creation and technology transfer may not be present in the activities of individual entrepreneurs or sole proprietors. As a result, 22 legal entities were filtered and registered with the involvement of most of the Japanese capital. Additionally, the author identified one entity that is not counted in Japanese FDI flow; however, it is a subsidiary Japanese company's European headquarters, affiliated with a Japan-based multinational corporation. To understand the activities of the companies with current active business status counted in Japanese FDI flow to Georgia, table 2 provides summary information.

On top of the secondary data and information requested from the National Statistics Office of Georgia, the author cross-checked the sector in which companies are active, in the online database of the registry of economic activities in Georgia. Information about the specific economic activity of 6 registered Limited Liability Companies, with the majority of the Japanese capital, was not available in either public internet sources or non-public information collected by the author.

Sector	Number of companies
Energy	1
Hotels, restaurants, real estate	5
Information technology related services	2
Services related to construction, design, and engineering	2
Trade of vehicles	2
Trade of other goods	3
Other sectors*	6

Table 6: Sectoral breakdown of activities of Japanese companies in Georgia. National Statistics Office of Georgia; Registry of economic activities in Georgia, an online database (2023)

CHAPTER 2 - LITERATURE REVIEW

2.1 THEORIES ON FDI

To gain insights into the evolution of thoughts and perspectives with regards to FDI, this chapter reviews common FDI models and theories, which have been prevalent over the past five decades:

Production Cycle Theory of Vernon - introduced in 1966, theory explains certain types of FDI committed by mainly US-based companies in Western Europe, in the manufacturing sector. Vernon's idea relied on the fact that after World War II, products made by American firms were in demand in overseas countries, since they had a competitive advantage with better technology, over the competitors. US-based transnational companies could create local products for domestic consumption and export the surplus overseas. Because of the reason that European companies started imitating US-made products, US-based transnational corporations were forced to open manufacturing facilities in Europe (Denisia, 2010). The theory highlights the importance of innovation, growth, maturity, and decline phases in a production cycle, from which we can imply that the choice of locating production in certain FDI host geography depends on the development stage of the product.

The Theory of Exchange Rates on Imperfect Capital Markets - this theory, which was prevalent in the 1980s, analyzes the influence of foreign exchange risk from the perspective of international trade. Studies by Itagaki in 1981 and Cushman in 1985 concluded that the increase in the real exchange rate boosted FDI, realized in US dollars, whereas appreciation in foreign currency led to the reduction of FDI in the context of the USA. The theory has certain critics in terms of lack of explanation of FDI flows between countries simultaneously, with different currencies (Denisia, 2010). However, the exchange rate has been a widely used variable in later studies and a number of scholars have tested the impact of exchange rate on FDI.

The Internalization Theory – developed by Buckley and Casson in 1976 and later by Hennart (1982) and Casson (1983), the theory relies on the fact that transnational companies are organizing their internal activities for developing specific activities, which are supposed to be exploited at a later stage. Other scholars, such as Dunning paid significant importance to this theory but argue that it only partially explains FDI. In 1976, Hymer concluded that FDI will take place only in the case when relative costs of overseas operations outweigh firm-specific advantages. The author paid attention to the obstacles that foreign firms encounter, for example, higher information costs compared with local firms, currency risk, or factors such as different treatment by governments, which leads to the conclusion that overseas investments possess adjustment costs for transnational

corporations. In 1982, Hennart upgraded the understanding of the theory by the inclusion of concepts of vertical and horizontal integration (Denisia, 2010, p. 54). This has sparked the attention of many scholars recently who try to explain FDI in the context of global value chain fragmentation and regionalization trends (Paul & Feliciano-Cestero, 2021).

Eclectic paradigm - also known as the OLI model, is one of the widely used frameworks which explain the behavior of MNEs in the context of outward FDO. It covers three tiers, such as Ownership (O), Location (L), and Internalization (I). Four types of investor motives, explained in the upcoming chapter such as resource seeking, strategic asset seeking, efficiency-seeking, and market seeking, can be understood within this framework. Going back to the tiers of the eclectic paradigm, they can be explained as follows: Ownership (O) - suggests that firms invest abroad to exploit their ownership advantages, such as unique technology, managerial expertise, and brand recognition, that allow them to compete effectively in overseas market. Location (L) - pillar is built on the idea that MNCs firms invest overseas to seize location-specific advantages of the FDI host country, in terms of access to natural resources, competitive costs of labor, favorable policies such as taxation, and all attractiveness factors which are decisive for realizing investment in particular FDI host country (Lopes, 2010). And finally, the internalization (I) aspect of the OLI paradigm suggests that by investing overseas, firms can minimize transaction costs.

Published in 2001, in his original paper "The Eclectic (OLI) Paradigm of International Production: Past, Present and Future", Dunning explains how he extended the pillars of the OLI paradigm with Internalization (I) theory. Firms may choose to organize their certain production activities within their home country, and they have a choice of locations outside their borders. In the process of deciding whether to generate and/or exploit their specific advantages internally or to acquire and/or sell them in open markets, it is needed to understand why MNCs decide investment overseas through FDI. The popularity of utilizing the OLI framework in contemporary research on FDI is that it has created a good ground for developing enhanced frameworks. Additionally, it allows one to link a phenomenon of international business with other theories, such as transaction cost economics, resource-based view, and some interrelated disciplines, such as economic geography (Paul et al., 2021).

Another interesting framework, which was introduced in the 2000s is the CAGE distance framework, by Ghemawat in 2001. It applies to the context of both developed and emerging countries and provides an opportunity to understand the internationalization process of MNCs (Paul et al, 2001). Ghemawat's rationale for the creation of the framework was based on Walmart's

expansion case. The dimensions of the CAGE model unite the distance or difference between the home country of the MNC and the potential overseas expansion destination in four categories, such as cultural, administrative, geographic, and economic. The first pillar, cultural distance is selected for the reason that culture, as a concept itself, in terms of shared values and social norms, shapes the behavior of individuals and organizations. Cultural distance refers to the differences in religious beliefs, race/ethnicity, social norms and values, and language. Administrative distance unites the historical and political associations between MNCs and potential overseas expansion destinations, in terms of existence/absence of colonial links, free trade agreements, and economic and political exchanges. The geographic distance dimension covers not only the geographic distance between countries but other important factors, such as the country's size, distances to borders within the country, time zones, and access to water resources/ocean (p.2). Table 7 summarizes the framework applicable to the country context. As we can see, motivations for investing overseas under OLI's framework focused more on internationalization and ownership advantages, rather than location advantages, which, remained under-researched in the literature related to International Business (Cruz et al, 2020). Noteworthy, L as a location-related factor, under the OLI framework, is something that policymakers can influence, to drive FDI flows.

UNCTAD's World Investment Report (WIR) model - issued in 1998, provided a framework of location-specific determinants of FDI, which addressed policy factors driving FDI to host countries. It is important to highlight that determinants change over time and the model applies to specific countries, at a specific time when using the framework for evaluating location-specific determinants of FDI host country (Mattila, 2004). The host country determinants under the WIR model in Figure 1 provide a more comprehensive breakdown and we could say that it is extended of the OLI model of Dunning, however, economic determinants listing down factors which are decisive for the four types of FDI (market seeking, resource, and asset seeking, efficiency seeking), are more useful for towards the case of specific industry and a company, for a micro-level analysis, whereas policy and business facilitation determinants are the ones which policy makers have more influence to improve. Table 8 provides a summary.

UNESCAP (2017) suggests categorizing determinants from three perspectives, such as: the home country for FDI (where the investor is based), the FDI host country (where the investment is made), and the investor companies (from a corporate decision-making angle). From the perspective of home country, determinants are evolving around economic conditions of policies, such as market size, rate of return, industrialization level, growth prospects, human capital, physical infrastructure,

major macroeconomic fundamentals, such as physical infrastructure, labor costs, human resource availability, and proactive policy in terms for outward FDI realization for the corporations based in the home country. From the perspective of the home country, important economic policies and conditions are listed such as private ownership promotion, the efficiency of the financial market, trade policy and integration in trade agreements, FDI policy, country risk perception, legal framework, and bureaucracy level. From the perspective of MNCs/TNCs, risk perception and location decisions (UNESCAP, 2017).

	Cultural distance	Administrative distance	Geographic distance	Economic distance
Country pairs (bilateral)	Different languages; Different ethnicities; Different religions; Lack of trust; Different norms and values	Lack of colonial ties; Lack of shared regional trading group; No common currency; political hostility	Physical distance; Lack of land border; Differences in time zones; Different climate /disease environment	Gap between rich and poor; Differences in terms of cost or quality of natural resources, financial resources, human resources, infrastructure and information knowledge
Countries (unilateral)	Insularity; Traditionalism	Nonmarket or closed economy (bias between home country and foreign country); Lack of membership in international organizations; Quality of institutions (weak institutions), corruption	Landlockedness; Lack of internal navigation ability; Geographic remoteness; Weak transportation and communication links	Size of economy; Low per capita income

Table 7: CAGE framework on the country level. Reprinted from Ricart et al. (2003, p. 9), based on Ghemawat (2001)

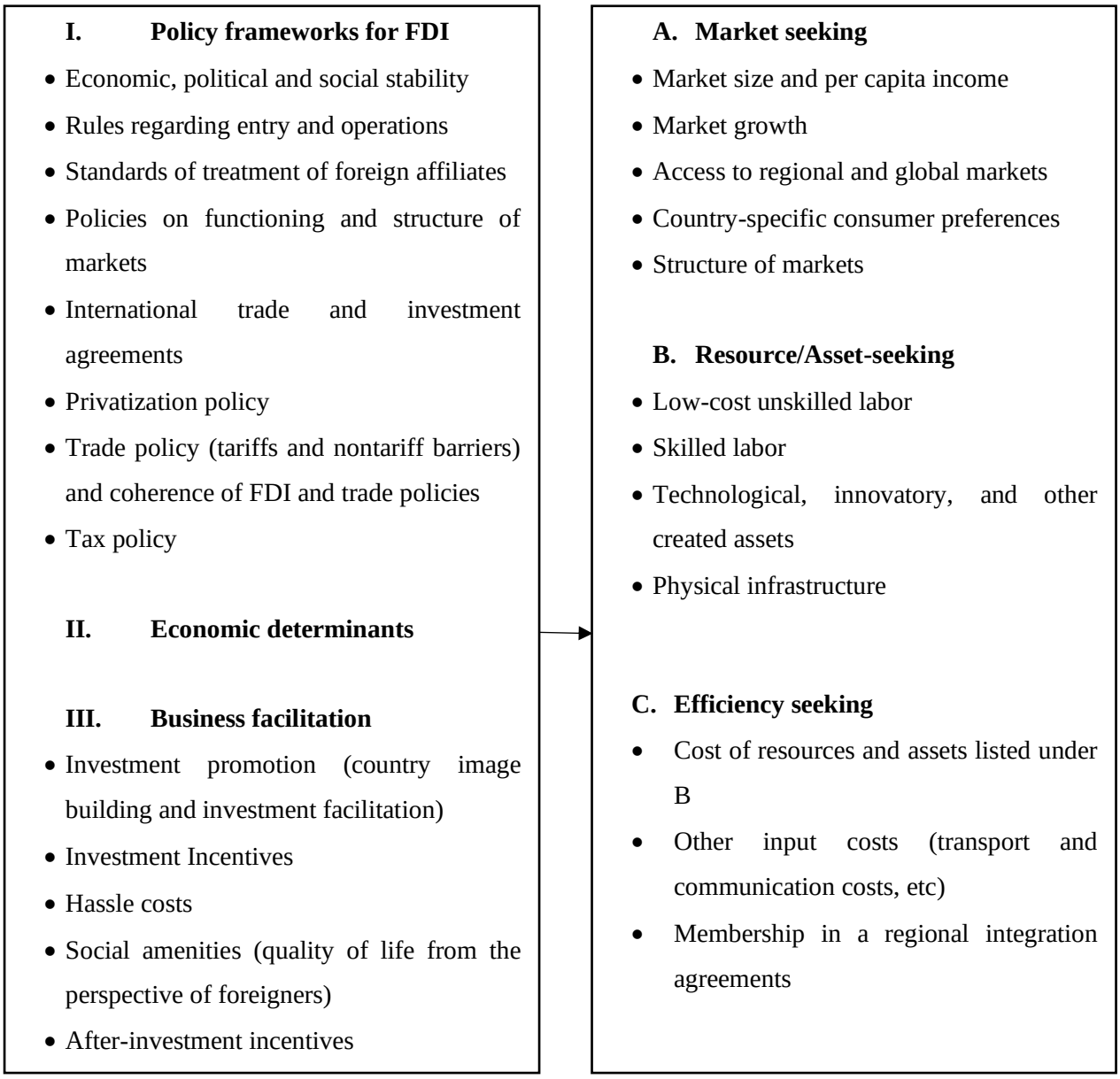

Table 8: Host country determinants of FDI, WIR model. Reprinted from Mattila, 2004. P. 14

As evident from the discussion, determinants of FDI can vary based on different theoretical models, however, they share commonalities and in contemporary studies about FDI with determinants observed, are derived from the classic theories.

2.2 TYPES OF FDI

FDI can take different forms or types. Hereby, this chapter explains the concept of FDI.

FDI is a cross-border investment, when an investment commitment is made by a resident of one country to establish an enterprise in another economy, with lasting interest and a significant degree of influence in the management of the direct investment enterprise, considering that investor holds at least 10% of the voting power in enterprise. Enterprises categorized under direct investment could be entities with at least 50% of the voting power of investors, or associates with 10-50% voting rights (OECD, 2008). FDI contributes to higher economic growth, which is the most potent tool for alleviating poverty in developing countries such as technology transfer, human capital development, and contribution to the host country's economy by contribution to corporate tax revenues while generating a profit (Loungani & Razin, 2001).

Measurement of FDI can be in the form of flow and stock. Flow measures current transactions, which take place in a certain time period, such as yearly basis, whereas stocks are revalued cumulations of flows that took place in the past (Wacker, 2013, p. 5). Most of the secondary data used for this study is expressed in flows. Flows show the movement of the investment in a specific country, for a particular time and possess the flexibility to showcase changes in FDI trends.

There is a myriad of research conducted that tries to investigate the impact of FDI on the development indicators of countries. Researchers have been arguing whether FDI is beneficial or detrimental to a country's development. Theory suggests that along with the benefits, the so-called "crowding out" of domestic investment could be a negative side of FDI, whereas other groups of scholars imply that the net benefit of FDI is positive, even if crowding out effect takes place (OECD, 2002). Although the aim of this research is not to investigate whether FDI is good or bad for Georgia, the author assumes that FDI, particularly from Japan, is beneficial for the country. Table 8 provides a summary of the potential benefits and costs of FDI, in general.

Having discussed the definition of FDI, it is important to understand what the forms of investment are. Protsenko (2003) concludes two key reasons for firms seeking international operations, such as serving foreign markets and lowering costs, therefore, these motivations lead to the differentiation of two types of FDI in terms of horizontal and vertical. Horizontal FDI stands for the creation of the same type of products targeted for foreign markets and due to the high costs of export and trade barriers, companies have the motivation of setting up a business overseas to serve FDI host countries, as a market. In contrast, vertical FDI serves the separation of production processes and fragmentation of value chains and places specific processes in countries abroad.

Potential benefits	**Costs**
Capital inflows, financing for development	Repatriation of earnings - effect on the balance of payment depends on the trade effect of FDI and to what extent the repatriation of earnings happened. FDI has the potential to generate tax income, however, benefit could be reduced by the costs of generous tax incentives
Employment generation	Foreign companies can crowd out domestic enterprises. The net effect of FDI on employment depends on the sector, and host country's policies about employment practices
Skills generation	Foreign companies might hire the best talents in the host country
Technology transfer	Transfer has its cost. FDI host countries are not always able to absorb cutting-edge technologies from overseas and poor intellectual property rights slow down the process
Competition	Crowding out of local enterprises-entry of foreign market players might bring some changes in domestic market
Market access	In the case of the membership of FDI host countries in specific trade agreements, the preferential regime might be negatively affected by restrictive rules of origin
Linkage with domestic firms	Crowding out of domestic firms-despite the potential for local SMEs to be integrated in global value chain, by the presence of overseas MNCs, issues related to standardization and compliance might be an obstacle for local SMEs. As a result, MNCs might attract suppliers from their countries with richer experience, which might lead to competition with SMEs in FDI host country
Introduction of superior standards and development of local communities	Potential social and environmental costs, for example, displacement of local communities, unfavorable labor practices and poor working conditions for locals, pollution of environment

Table 8: Potential benefits and costs of FDI for the host country. Reprinted from Foreign Direct Investment Handbook 2022/2023, UNESCAP. p. 56

Vertical FDI itself is distinguished between backward and forward linkages. When multinational corporations acquire ownership of earlier stages of production, it is backward vertical integration, whereas later stages of value generation lead to forward integration (Kaspar, 2022). Moreover, backward and forward linkages are the source of the creation of spillovers for FDI host countries due to the inclusion of domestic firms in the value creation (Lesher & Miroudot, 2008).

Another important classification of the types of FDI is derived from the OLI paradigm, developed by Dunning, and explained in the previous chapter. According to the model, key layers for FDI determinants are the utilization of advantages of ownership, location, and internalization. Ownership advantage is a competitive advantage as a follow-up of FDI when companies create unique resources against competitors and FDI is a source of achieving this type of advantage (Dunning, 2001). Location advantages are factors that make FDI host countries attractive for operating a business and lastly, internalization advantage is acquired by companies when expanding to foreign markets, in terms of gaining knowledge of the culture of overseas countries, business practices, and other local elements (Think Insights, 2023).

The four types of FDI motivations are market-seeking, resource-seeking, efficiency-seeking, and strategic asset-seeking. Market-seeking FDI is motivated by the desire to access new markets while resource-seeking FDI is motivated by the desire to access natural resources or other inputs. Efficiency-seeking FDI is motivated by the desire to reduce costs or increase efficiency, while strategic asset-seeking FDI is motivated by the desire to acquire strategic assets such as technology or brands (Walsh & Yu, 2010). In other words, natural resource-seeking investment is based on investors' motivation to access natural resources in the FDI host country. Market-seeking investment-in this case, the FDI host country can potentially serve as a product market for an investment company or serves as a gateway to the regional market. In the strategic asset-seeking investment case, investors' motivation is the acquisition of strategic assets, such as infrastructure, distribution networks, and so force. Efficiency-seeking investment enables investors to seize opportunities in terms of efficient business operations through cost savings, or access to a talent pool, which contributes to competitiveness (Fruman, 2016).

Developing countries have been competing in attracting efficiency-seeking investments from foreign companies, which can generate jobs that pay above-average salaries, transfer knowledge and technology, and boost the economy. The promotion of investments with efficiency-seeking motivation has become very important for countries, which are seeking further diversification of economic sectors. The importance of FDI is well recognized, however, as literature suggests, not

all types the FDI bring expected benefits for developing countries. Attracting efficiency-seeking FDI to countries needs more comprehensive efforts. Major benefits include job creation with greater productivity and value, better opportunities for expertise and technology transfer, resulted by upgrade of economy (Fruman, 2016).

In terms of the entry mode, FDI may take the form of greenfield investment or brownfield investment. While the realization of greenfield investment, a multinational company builds venture from a scratch, the investor has a high degree of control of the assets of the company in the FDI host country. By setting up a start-up company, opportunities are created for the local workforce and the company adapts to the institutional environment of the FDI host country (Ha et al., 2021).

Contrary to the concept of greenfield investment, brownfield investment can be defined as an acquisition undertaken by a foreign company for establishing a local operation in an FDI host country. An investor uses existing business as a base, however, completely replaces most of the existing resources and capabilities (Meyer & Estrin, 2021). In other words, the entity either invests in existing facilities and infrastructure by completion of a merger and acquisition (M&A) transaction, or leases existing facilities in a foreign country to launch business activities (ResearchFDI, 2022).

The choice of entry more depends on the business strategy and preferences of the individual investor. Countries with rule-based governance environment are more likely to attract M&As as due diligence on the investment is more reliable, while countries with relation-based governance environment are more likely to attract greenfield investments as they allow full control and therefore better protection of the investments with first-hand information, thus reducing the risks of information asymmetry and property rights violations by other stakeholders and higher assurance that “you get what you buy” (Alon et al., 2020).

Knowing the definition of FDI in terms of its types, motivating factors of investors, and entry modes is crucial for understanding the strategies employed by MNCs, with regards to the decisions of realization of overseas investments. These insights contribute to the comprehension of the factors driving inward FDI flows in a country, as well as the potential benefits and policy decisions associated with FDI promotion. To analyze FDI cases in the host country according to the criteria outlined in Table 9, this approach will be applied to the case of FDI projects from Japan in Georgia, which will be further discussed in the upcoming chapter.

What is the type of investment? (Vertical vs Horizontal)
What is the motivation of an investor? (Market seeking, Strategic asset seeking, Resource Seeking, or Efficiency seeking)
What is an entry mode? (Greenfield or Brownfield/M&A transaction?)

Table 9: Criteria to analyze FDI project (compiled by author)

2.3 FACTORS INFLUENCING JAPANESE OUTWARD FDI.

Due to the limited presence of Japanese companies in Georgia and hereby, a significantly small number of scholarly research about Japanese FDI cases in Georgia, the author could not discover previously conducted studies aiming to determine the motivations of Japanese investors for investing in Georgia. To bridge this gap, the author analyzed the characteristics of Japanese FDI cases in Georgia, to be discussed in the upcoming chapter, and conducted a literature review to identify the primary determining factors for Japanese companies committing to FDI, with a focus on the European region. The idea behind this process was to list location-specific determinants, which would enable the author to develop a framework for assessing Georgia's competitiveness for Japanese FDI at a later stage.

In the beginning, the author identified studies that touch upon perspectives for economic cooperation and in the area of investment between Japan and Georgia. As previously mentioned, limited scholarly works about this topic could be explained by the rare cases of Japanese investments to Georgia, and hereby, the lack of interest of researchers to study potential determinants which could drive investments from Japan to Georgia.

Marbot (2020) conducted a study about cooperation between Japanese and European companies in third markets (outside the European Union), due to its importance for EU-Japan connectivity. The study touches upon the interest of Japanese corporations with the mega project of the Baku-Tbilisi-Ceyhan (BTC) crude oil pipeline from Azerbaijan, which goes through Georgia, to Turkey. Being operational since 2006, it is one of the longest pipelines with a length of 1,768km. British Petroleum (BP) a main shareholder of Baku-Tbilisi-Ceyhan Pipeline Company (BTC Co), two Japanese corporations, Itochu, which is a general trading firm, and INPEX Co, which is a holding company with subsidiaries operating in the oil and gas exploration area, are reported to have a

minority interest in the project of 3.4% in case of Itochu, and 2.5%, in case of Inpex, also confirmed in the press release of European Commission on 13 July 2006. The project has been having geopolitical importance, as it was quoted in the media. The study provides general recommendations on enhancing EU-Japan business collaborations in third countries, with a focus on the local environment and demand, and following ethics and compliance standards of the business partners.

The research conducted by Papava & Charaia (2022) addressed cooperation prospects between Georgia and Japan. According to the descriptive analysis of statistics of FDI from Japan to Georgia, flows have been fluctuating and, before 2021, in some years, achieving even 3% of total Georgia's inward FDI flow. The authors highlighted the sectoral focus of Japanese FDI, such as energy, transport, and communication, and brings forward the example of TEPCO, as the latest significant investment project in the energy sector in Georgia. The study does not include an analysis of the potential benefits and limitations of Japanese FDI to Georgia, however, the author notes the importance of the existence of the recently signed bilateral agreement on "Liberalization, stimulation, and protection of investments" between Japan and Georgia in January 2021. Another important agreement signed in 2021 which is expected to stimulate FDI, is the convention for the elimination of double taxation between countries. Additionally, state incentives are available to promote attraction of FDI from Japan and foreign countries, overall.

As it is shown in the previous reviews, there is a limited information about specific motivations behind the interest of Japanese companies towards realization of FDI in Georgia. For this reason, the author reviewed previously conducted studies aiming to explore the general motivational factors guiding Japanese FDI, with a particular focus on research related to the European region.

Chiappini (2014) conducted an empirical study to examine the relationship between governance indicators and Japanese outward FDI in the context of the manufacturing sector based on the data of 30 countries. General results showed that host market size, exchange rate, macroeconomic stability, natural resource endowments, and policy-related variables, such as societal rules, control of corruption, the effectiveness of government, political stability, and private sector policies navigate Japanese outward FDI. Moreover, in terms of the relevance to the different country groups, the author identified market size, trade openness, and political and macroeconomic stability as key driving forces of Japanese FDI in developing countries.

Later research by Chiappini and Viaud (2020) identified key determinants of Japanese outward FDI in the manufacturing sector. By analyzing data from 30 countries between 2005-2017, authors

found that determinants depend on development levels of host country characteristics. Whereas Japanese FDI in developed economies is driven by factors, such as differences in per capita GDP, taxation, the bilateral real exchange rate of the yen, regional trade agreements, exports, and distance in the perception of corruption, in developing economies it is determined by market size, taxation, and trade openness. Moreover, the authors imply that non-technological industries, which rely on the labor force, are more likely to choose foreign countries for operations.

Camarero et al. (2021) analyzed determinants of Japanese outward FDI during 1996-2017, based on the examining data of 27 host countries. Authors identified that for East Asian and emerging countries Japanese FDI is more concentrated towards vertical FDI strategies, whereas for EU countries horizontal FDI strategies are prevalent. In terms of specific FDI determinants, among 48 indicators grouped in broad categories, authors conclude that Japanese outward FDI is motivated by factors related to GDP and population, labor endowment, trade, investment, institutions, macroeconomic factors, communications infrastructure, and business freedom measures.

Urata and Kawai (2000) examined FDI location determinants of Japanese small and medium enterprises as they have been actively investing in Asia since the 1980s. By that time, according to the surveys of METI, the main motivation for SMEs was leveraging local labor capabilities of FDI host countries to tackle the beginning of massive labor shortages in Japan, followed by sales motivation in FDI host countries, export possibilities to Japan and third countries and lastly, favorable industrial policies in FDI host countries. A study conducted by authors revealed that important determinants for Japanese SMEs in committing FDI overseas are supply-side factors, such as abundant low-wage labor, good infrastructure, and governance in the FDI host country, and demand-side factors, such as local market capabilities.

The recent research of Urata and Baek (2023) examined whether the International Investment Agreements (IIAs) determine the investment decision of Japanese companies. The authors conducted an empirical study on 12435 FDI cases by 3838 Japanese companies in 92 countries between 2000-2019, in manufacturing and non-manufacturing sectors. The authors found out that the presence of IIAs and comprehensive ones in particular, such as bilateral investment treaties (BITs) increase the likelihood of attracting FDI from Japan. The presence of such agreements can provide firms with the credibility of a business-friendly environment, with clearly defined regulations in FDI host countries, and FDI host countries can attract more FDI with the presence of IIAs.

Ikemoto (2006) revealed key motivations of Japanese Investors for investing in Central and Eastern Europe, such as AC-8 countries (Poland, Czech Republic, Hungary, Slovakia, Slovenia, Estonia, Latvia, and Lithuania). The group consists of eight countries for which the European Membership acceding process was finalized in 2004. By that time, Japanese FDI was mostly concentrated in the manufacturing sector. The author identified key attractiveness of CEE countries for Japanese investors for the future FDI upon joining European Union, as such: industry expertise-tradition in manufacturing, skilled workforce, qualified production managers; Advantageous geographic location to cover EU market, developed infrastructure, lower labor costs compared to already EU member western countries. Moreover, the author highlights the individual behavior of Japanese companies, which, at first started operations in Western Europe and expanded in the CEE region afterward.

Štrach & Everett (2006) highlighted factors why Japanese companies have been choosing Eastern Europe and the Czech Republic in particular, as an FDI destination. Theories summarized by the authors suggest that Japanese FDI patterns are distinguished by a high density of related industrial activities, skilled workforce, minimum power of labor unions and Czech reality matched expectations of Japanese companies (p.27). Additionally, the author emphasizes the importance of the "bandwagon effect" identified by earlier scholars, that Japanese firms follow the experience of locating investments in a particular region and this applies to the Czech Republic. To summarize, key factors why Japanese companies tend to select the country for investment are skilled labor, low-cost labor, political stability, supply-chain linkages, and cultural similarity factors.

Szunomár (2021) summarized the key motives of investments of Japanese companies in Visegrad 4 countries (V4). The transition of V4 member countries, Czech Republic, Hungary, Poland, and Slovakia, from centrally planned to a market economy, could foster mobilizing FDI in their development pathway. Even though inward FDI was at first dominated by Western European companies, after the transition, FDI from Asia, especially from Japan, has been growing even before the fall of "The Iron Curtain" and accelerated after the accession of countries to the European Union and onwards (p. 54). In terms of the current situation, the author notes that even the COVID-19 pandemic and consecutive economic crisis did not slow down the intentions of Japanese companies' growth, by widening available supplier capacities, Japanese companies continued expanding and introducing new technologies. The composition of Japanese investments in the region varies country by country, with an average 40-50% share in the manufacturing sector. The most important factor that motivates Japanese companies to select this region for investment

projects is the availability of skilled labor in terms of quality rather than low wage levels since neighboring eastern European countries offer more competitive labor costs. Another important factor presence of Japanese companies in those markets which gives a good signal to other investors in terms of credibility. Moreover, due to Brexit, V4 countries have the potential to mobilize more FDI, with relocation potential of business especially in the automotive industry. Another important consideration listed by the authors is the market-seeking motive with the possibility of accessing wider regions of the EU and non-EU member countries, such as CIS, EFTA, and the Mediterranean (p. 60).

Considering the findings from previously conducted studies, key determinants of Japanese FDI are in line with theoretical facets of FDI determinants discussed in the previous chapter, especially relevant to the WIR model by UNCTAD, which itself relies on Dunning's OLI framework. Table 10 summarizes the determinants, which, in the later stage of the research, was utilized to for evaluating competitiveness of Georgia for Japanese FDI.

Determinant	Author (s)
Local market size and capabilities	Chiappini (2014); Chiappini and Viaud (2020); Urata and Kawai (2000)
Exchange rates	Chiappini (2014)
Trade openness	Chiappini (2014); Chiappini and Viaud (2020)
Political and macroeconomic stability	Chiappini (2014); Camarero et al (2021); Strach & Everett (2006)
Labor endowment, skilled labor availability, wage levels.	Camarero et al (2021); Strach & Everett (2006); Urata and Kawai (2000); Ikemoto (2006)
Communications infrastructure	Camarero et al (2021)
Business freedom measures	Camarero et al (2021)
Presence of IIAs	Urata and Baek (2023)
Advantageous geographic location for regional coverage	Ikemoto (2005); Szunomár (2021)
Cultural similarities with Japan	Štrach & Everett (2006)
Industrial tradition, supply chain linkages	Štrach & Everett (2006)

Table 10: Motivational factors of Japanese outward FDI, compiled by author

CHAPTER 3-METHODOLOGY

3.1 RESEARCH PROCEDURE

This section will explain the research methodology utilized to study the potential of Japanese FDI in Georgia. This section covers research questions, methodology and design, collection of information, and data. Questions this research addresses are the following: What are the current characteristics of Japanese FDI in Georgia? What are the benefits and challenges Japanese companies might face when considering FDI in Georgia?

In the early stage of the research, it is essential to understand the current situation and existing potential. The timeliness and relevance of the study can be demonstrated by providing an overview of the existing patterns of global and Japanese outward FDI trends, which can potentially influence decisions of investors.

This research utilized a qualitative method to collect multiple sources of information from news articles, documents, scholarly research, and historical data. The research relies on both descriptive and case-study research designs. To answer the research questions, the author conducted an analysis of current FDI cases from Japan to Georgia, which can be an indication of what kind of FDI projects could be a target for Japanese investors in the future, based on the insights from past success stories. For analysis, the author deployed a case study approach. This qualitative case study is an approach that aims to explore a phenomenon within its context. It allows the exploration of issues with a variety of facets, for a better understanding of the phenomenon. The case study approach is useful when a study aims to answer “why” and “how” (Baxter & Jack, 2010).

Additionally, the author conducted a literature review for building a conceptual assessment framework. With this, the author was able to identify the determinants of Japanese FDI in European countries and based on them, assessed Georgia's competitiveness, by using secondary data and information sources in the form of descriptive statistics and rankings, created by international organizations. In this process, the author relied on a comparative case study approach by comparing Georgia’s performance with peer countries, such as the Czech Republic and Serbia to draw conclusions about which parts Georgia needs to improve its attractiveness for Japanese investors and derive some policy recommendations. With the relevance of the research aiming to explore the "why" and "how" questions surrounding a particular subject or topic, comparative case studies involve the analysis and synthesis of the similarities, differences, and patterns across two or more cases that share a common focus or goal (Goodrick, 2014).

For collecting descriptive data, the author relied on public and non-public information from governmental organizations, such as the National Statistics Office of Georgia, and publicly available databases of international organizations, such as World Bank Open Data.

3.2 VALIDITY ISSUES AND LIMITATIONS

While this research provides valuable insights into the potential of Japanese FDI in Georgia and offers recommendations, the author acknowledges certain limitations. First, while analyzing cases of Japanese investments in Georgia, the author could collect only three cases, which might be an incomplete representation of all companies currently operating in Georgia with Japanese investments. Due to the limited publicity of the companies, and lack of information in the open sources, such as news articles and previously conducted scholarly studies, and difficulties in reaching out to companies to collect non-public information, the analysis might lack practical, micro-level insights of why the companies were motivated to select Georgia. To partially solve this issue, the author analyzed FDI cases in the context of theoretical concepts to understand what forms current FDI projects from Japan take.

To answer the research question, on what could be potential benefits and limitations to Japanese companies' future investments in Georgia and to draw respective implications, the author analyzed the competitiveness of Georgia based on the common determinants, that have been driving Japanese FDI overall, and in European countries. Due to the absence of universal indicators for assessing location-specific indicators, the results might be biased. To overcome this issue, the author best tried to utilize worldwide recognized indices and rankings, aiming to evaluate the performance of countries in various aspects, such as economic environment, quality of talent pool, business freedom measures, and so forth.

Finally, due to the absence of a similar type of research, and the uniqueness of Georgia with relatively low cases of Japanese FDI, the author was unable to rely on one specific research to replicate the procedure and furtherly upgrade, depending on the needs of the study. In this matter, the author needed to develop her understanding of how to best use qualitative methods for studying the potential of Japanese FDI in Georgia.

CHAPTER 4-FINDINGS AND DISCUSSION

4.1 CASES OF JAPANESE COMPANIES IN GEORGIA

For the study, the author analyzed cases of Japanese FDI projects in Georgia. While the identified 22 active companies present a small sample for drawing a comprehensive picture of Japanese FDI patterns in Georgia, and case study covers 3 companies, the author tried to reveal specific factors, such as the form of investment, entry mode, and motivation. This information provides valuable insights into patterns that might emerge in the short and medium run, as Japan and Georgia will continue intensifying business linkages and economic cooperation.

Toyota Caucasus LLC: As a subsidiary of Toyota, Toyota Caucasus LLC has been responsible for the business development of the Toyota and Lexus brands in six countries of the Caucasus and Central Asia. Toyota has been a bestselling car brand in Georgia for years and within the regional coverage, Georgia and Azerbaijan have been key target markets of the company for car sales (Financial Channel, 2015). Since the establishment of an office in Georgia in 2006, Toyota Caucasus LLC has realized more than 10 million USD in investment and annually, it trades around 10 million vehicles to the region (Papava & Charaia, 2022). According to publicly available information sources, in 2021, Toyota Caucasus LLC reported growth numbers, such as a 25.5% increase in profits 2021 (Georgian Business Consulting, 2021).

We can imply that this particular investment case is characterized by a market-seeking motive of leading Japanese MNC, which seized opportunities of Georgia to introduce its own products to the local market and moreover, to establish it as a hub for sales and business development operations of the wider region. In line with post-pandemic recovery, passenger car imports in Georgia recovered fast in 2021 and 2022, achieving 73.1% year-to-year growth, amounting to 1.6 billion USD. Out of the total import of 149 000 passenger cars, local consumption experienced 16.2% yearly growth and exports showed a 25.1% yearly rise (Galt & Taggart, 2023).

TEPCO-JSC Dariali Energy: In April 2020, TEPCO Renewable Energy announced the decision on the acquisition of a 31.4% share in Georgian Hydro Power Plant (via legal entity JSC Dariali Energy). Being the first carbon-neutral project in Georgia and among all projects worldwide being financed by EBRD (European Bank for Reconstruction and Development), Dariali HPP was selected as a hydropower plant serving to contribute to the energy independence of Georgia (TEPCO, 2020). Before making an investment decision, TEPCO conducted a comprehensive study about Georgia and finalized its investment decision in 2020. The total cost of the project is estimated at USD 123 million (Papava & Charaia, 2020).

Georgia's latest electricity sector outlook shows positive trends for both rising consumption and export. In 2022, export revenues from electricity amounted to 84.3 million USD which is almost a 153.7% increase, and with the positive trade balance, amounting to 43.2 million USD. The surge in export was mainly caused due to the electricity prices in neighboring Turkey. Domestic consumption of electricity in 2022 showed a positive trend of 3.3% growth, out of which 68.3% was concentrated in Hydro Power Plants (Galt & Taggart, 2022). Therefore, it can be concluded that electricity generation through hydropower plants is a lucrative investment opportunity for both domestic market and export purposes.

Konica Minolta Business Solutions Georgia: Established in 2019, Konica Minolta Business Solutions Georgia is a part of Konica Minolta Business Solutions Czech, which itself is a subsidiary of Konica Minolta Business Solutions Europe GmbH headquartered in Germany, and a wholly owned subsidiary of Konica Minolta Inc., Tokyo, Japan. It should be noted that due to the affiliation with regional headquarter, capital investment committed in Georgia was not counted in the share of the total Japanese FDI flow for the year 2019. Upon establishing a representation, the company's focus in Georgia was announced to be toward service business development. According to the company, the Caucasus market (Georgia, Azerbaijan, and Armenia) have been a market for a long time, and before establishing an office in Georgia, the company's hardware and solutions were supplied through indirect distribution channels and successful attempt of market penetration via dealers led to the decision of opening an office in Caucasus region. Tbilisi, the capital of Georgia was selected to establish an office to serve three countries, responsible for business growth and provision of Konika Minolta solutions. The services and solutions provided include solutions for industrial, production, and office printing, and software for the improvement of document workflows (Konika Minolta, 2019). This particular investment case shows the attractiveness of the local market for business development, as well as serving as a hub for neighboring countries in the Caucasus region.

Based on the summarized cases of Japanese FDI projects in Georgia, we can imply that Japanese companies see the market potential in Georgia (market-seeking motivation), and they are expanding in the sectors where they are already active (projects are likely to classify within the horizontal FDI, there are no visible signs of vertical FDI with backward or forward linkages), and choosing entry modes such as greenfield entry, or M&A. Cases show that careful planning has been made to enter the country, which indicates to the long-term motives of Japanese companies

to stay and prosper in the Georgian market. Moreover, sectors in which investment projects took place, show promising growth patterns.

Name of the company	Entry mode	Motivation	FDI classification
Toyota	Greenfield	Market seeking	Horizontal
Tepco	M&A	Market seeking	Horizontal
Konica Minolta	Greenfield	Market seeking	Horizontal

Table 11: Japanese investments realized in Georgia (summarized by author)

4.2 Assessment of Georgia's competitiveness for Japanese FDI

This part begins with an overview of peer countries that the author selected for the comparative case study and continues with the assessment of Georgia's competitiveness for Japanese FDI.

4.2.1 Overview of peer countries, for comparative case study

Two countries selected for comparison, such as Czech Republic and Serbia, as they have been successful in attracting FDI in general, and particularly from Japanese companies. An important consideration for selection was the inclusion of countries in the same geographic region, but within different income groups. This selection allows the author to conduct a benchmarking exercise to identify potential gaps that could pose obstacles for Japanese companies while considering investment in Georgia and show the advantages that Georgia offers in comparison to peer countries.

Czech Republic: Located in central Europe, The Czech Republic is a medium-sized, open economy with over 74.4% of the country's GDP relying on exports, dominated by industries such as automotive and engineering. By creating a favorable environment for FDI, a country has been able to attract and retain a significant number of investments since the 1990s (US Department of State, 2021).

Czech Republic's success story in the facilitation of attracting FDI from overseas is well recognized. The most highly valued characteristics in choosing the country for business by foreign investors are an educated workforce, good connectivity, superior infrastructure, and high quality of life, in terms of safety, culture, environment, healthcare, and education (Czech Invest, n.d).

The Czech Republic has a designated agency Czech Invest, which facilitates both inward and outward investment. The country has been known for its liberal FDI policies, however, lately, the

Population	10.5 million
Area	78,870 km²
Income group	High income
Workforce	5.4 million
Currency	Czech crown (CZK)
Time zone	GMT +1, daylight saving time GMT +2

Table 12: Key facts about Czech Republic. Sources: Czech Invest; World Bank

country has introduced a foreign investments screening Act that took effect in May 2021 and completed its first full year in operation in 2022. It aimed to establish a screening procedure and application requirements for investors from non-EU countries. In line with the requirements from the European Commission, special attention has been paid to investors and projects with the involvement of capital from Russia and Belarus (White & Case, 2023).

The Czech Republic offers investment incentives to foreign companies, which are country wide, or/and applicable to the regions where investment takes place. The forms of incentives given to investors are in the form of tax relief or subsidies. Sectors eligible for incentives are technology centers, business support services centers, the manufacturing industry, and in particular, the manufacturing of strategic products (Czech Invest, n.d).

Business ties between the Czech Republic and Japan in the field of investments date back to the 1960s, when representatives of Japan first inspected the country for new opportunities. The first case of investment is related to Mitsui & Co, which established a representative office in Prague for conducting activities related to hotel business in 1968. In 1993, JETRO established an office in Prague for facilitating the entrance of Japanese investments to the Czech Republic. At the beginning of the 2000s, FDI inflow from Japan was increasing by 300 million USD per year, and by 2001, Japanese companies employed around 18 000 local workforce (Štrach & Everett, 2006). After the Czech Republic's accession to the European Union, the boom of Japanese companies continued, mainly in the automotive industry. 58 Japanese companies have invested in the Czech Republic as of 2004, more than half of them were in the Automotive sector, with total investment stock of 1.77 billion USD and 9000 individuals employed. Due to the influence of Toyota's investment in the Czech Republic and strengthening supply chain networks by building plants in

neighboring countries, Toyota's supplied automotive components manufacturers strengthened their investment ties with the Czech Republic due to the increasing number of units of cars produced (Ikemoto, 2006). Currently, there are 245 Japanese have invested approximately 5.1 billion USD invested in the Czech Republic, in both manufacturing and non-manufacturing sectors, which has created 46,970 job opportunities in the country (Japanese Chamber of Commerce and Industry, n.d).

Serbia: Having the largest economy and relatively diversified sectors in the western Balkans, Serbia is an attractive hub due to its strategic location. Additionally, Serbia offers natural resource endowments, such as copper, which attracts the attention of foreign companies. Serbia's main growing sector is automotive manufacturing, with a developing cluster of sector players, and the country's efforts to attract FDI in R&D lead to economic diversification and enhancement of competitive capabilities (Vasa & Angeloska, 2020).

Population	6.834 million
Area	88,500 km²
Income group	Upper middle income
Workforce	3,26 million
Currency	Serbian Dinar
Time zone	GMT +2

Table 13: Key facts about Serbia. Source: World Bank

According to the Development Agency of Serbia, Serbia has attracted over 54 billion USD worth of FDI, since 2007. "IBM Global Location Trends 2020" has been recognized Serbia as a leading country which creates most FDI jobs per million inhabitants. Major advantages of Serbia as an investment destination include abundance of qualified workforce with good technical skills, competitive business operating costs, optimal geographic location, preferential trade agreements with strategic countries and regions, providing a duty-free access to 1.3 billion population as a market, financial and fiscal incentives for foreign investors, and 15 free industrial zones with preferential export-import regime and other benefits such as ready use infrastructure for business operations (Development Agency of Serbia, n.d). Currently, Japanese investors from diverse sectors are presented in Serbia, including MNCs, Nidec Corporation, Panasonic, Toyo Tires, Yazaki. As of October 2022, Japanese investments in Serbia reached 200 million euros, from

which around half was invested in previous two years (Chamber of Commerce and Industry of Serbia, 2022).

Japan and Serbia have been sharing friendship, contacts and cooperation since the late 19th and early 20th centuries, starting with the exchange of letters between King Milan Obrenović and Emperor Meiji in 1882 (Ministry of foreign affairs of the republic of Serbia, 2022). Bilateral relations in the area of business have been strengthening between the two countries over the past decades. It is important to note that JICA has been supporting the country under the ODA by with technical cooperation, and from 2011, through ODA loans to support market-oriented economic reform, Health/Education sectors and environmental protection (JICA, n.d).

4.2.2 ASSESSMENT AND FINDINGS

In this section, the author compares Georgia's performance in selected determinants with that of Serbia and the Czech Republic.

Local market size and capabilities: To assess local market capabilities, the author relies on indicators, such as real GDP growth, urban population, life expectancy (Camarero et al, 2021), and general population size. The measurement relies on the data retrieved from the World Bank's statistics, from an open data platform. Compared with the selected benchmarking countries, such as the Czech Republic and Serbia, Georgia's dynamics are optimistic.

Over the past 10 years (2011-2021), the average real GDP growth in Georgia amounted to 4.2%. The highest indicator over the past decade was shown in 2021, because of a post-pandemic recovery of economic activities. In the case of the Czech Republic, the average GDP growth rate is 1.9%, and for Serbia, 2.3%. A higher real GDP growth indicator is a good sign, indicating that the economy is expanding, employment is growing, and the living conditions of citizens are improving (IMF, 2014). In terms of urban population percentage to the overall population, for Georgia, it is 60%, and for the Czech Republic and Serbia, it is 74% and 57%. As for the life expectancy at birth, for Georgia, it is 72%, and for the Czech Republic and Serbia respectively, 77% and 73%. And finally, the overall population size of Georgia is 3.7 million inhabitants, which is lower than the Czech Republic and Serbia (10.5 million and 6.8% million), however, other indicators are following similar patterns, indicating the potential of the local market of Georgia.

Exchange rates: Chiappini (2014) identified exchange rates as one of the important determinants of Japan's outward FDI and emphasized the fact that when investors buy assets in a foreign market

in the FDI host country, payment is made in the local, foreign currency of the host country, whereas profits of MNC are dominated in the home currency, and appreciation of home country's currency has a positive impact on the realization of overseas investments (p.5). According to Google Analytics, the Japanese yen depreciated against Georgian Lari by 15.43%, against Serbian Dinar by 14.68%, and against Czech Koruna by 21.27% over the past 5 years (as of June 6, 2023). Considering the fact that the Japanese Yen has been depreciating against foreign currencies over the past years, the effect on FDI a complex topic of discussion and requires comprehensive analysis. However, the comparison shows that the level of Yen's performance against the Georgian Lari should not be a significant decisive factor for Japanese companies in refraining from making an investment in Georgia, as exchange rate fluctuations follow the similar patterns when compared to peer countries.

Trade openness: For exploring the level of trade openness of the three countries, the author used the measurement of the trade openness index, from the database of the UNCTAD (2021), where Georgia's index was evaluated as 40.34, and in the case of the Czech Republic and Serbia, 61.17 and 38.90, respectively. The index measures the significance of international trade of goods, related to the domestic economic output of countries. In this matter, Georgia is behind the Czech Republic, due to a long history of export-oriented manufacturing and a diversified export base.

Political and macroeconomic stability: In this part, the author examined Worldwide Governance Indicators from the World Bank's data set for the year of 2021. In the first pillar of control of corruption, Georgia's percentile ranking was 75.5, whereas, for the Czech Republic and Serbia, the results were 72.6 and 36.1. In the pillar of government effectiveness, Georgia was behind the Czech Republic by having 72.1 as a percentile rank, whereas the results of the Czech Republic and Serbia were 82.2 and 55.8. In the third pillar of political stability and absence of violence/terrorism, Georgia (31.6) falls behind both the Czech Republic (83.0) and Serbia (43.4). In terms of regulatory quality, Georgia's result was 82.7, whereas the Czech Republic performed better with a result of 87.5 and Serbia had 53.4 as a percentile rank. In terms of the Rule of Law, Georgia's performance was 56.7, whereas the Czech Republic showed 84.1 as a percentile rank and Serbia, respectively, 51.0. In the pillar of voice and accountability, Georgia's result was 47.3, whereas the Czech Republic and Serbia showed 81.2 and 47.3 percentile ranks. As results show, in most of the pillars, except for the control of corruption, Georgia lags behind the Czech Republic.

For the measurement of the macroeconomic stability level, the author made a comparison based on the following indicators: unemployment rate, inflation level measured by the annual growth

rate of the GDP deflator, and monetary freedom index (Camarero et al, 2021). The sources of the first two indices were the World Bank's estimations, and for monetary freedom index, it is a combined measure of price stability, with the assessment of price controls (The Heritage Foundation, 2023). Table 14 summarizes the results. Results show that Georgia's macroeconomic stability indicators are weaker, compared with both Serbia and Czech Republic.

	Georgia	Czech Republic	Serbia
Unemployment rate (2022)	11.3%	2.4%	9.5%
Inflation level (2021)	10.3%	3.3%	5.9%
Monetary freedom index, 2022	72.0	78.0	78.6

Table 14: Macroeconomic stability indicators, 2021-2022. Sources: World Bank; The Heritage Foundation

Labor endowment, skilled labor availability, wage levels: In this part, the author used three different indicators for comparison. For labor endowment, the author relied on the measurements related to the quality of the labor force. To begin with the total labor force, for Georgia, is estimated to be 1,853 million. The Czech Republic's total labor force was estimated to be 5,307.54 million and Serbia's labor force stood at 3,265 million (World Bank, 2022). To understand how the total labor force is contributing to the economy, the labor participation rate for Georgia stood at 63.4% (2020), whereas for the Czech Republic and Serbia, it amounted to 57.3% (2021) and 59.8% (2021). Since the statistics related to the labor force are also linked to the population size of countries, which are different, for better comparability, the author looked at labor productivity. ILOSTAT's measurement of GDP per hour worked amounted to $17.33 (2021), whereas for the Czech Republic, was $40.82 and $17.38 for Serbia. Additionally, the author reviewed the Human Development Index by ILOSTAT, which is a composite index summarizing key areas of human capital, in terms of life quality in terms of longevity and health, education quality, and standard of living. In the index, Georgia's assessment is 0.8, and for the Czech Republic and Serbia, it is 0.84 and 0.8. The higher index shows the better condition of human capital development level.

The abundance of low-wage workers has become an important consideration not only for Japanese MNCs, but foreign investors overall. Even though for high value-added industries, the availability of a skilled workforce has a higher importance, it is important to understand wage levels in Georgia and how is it comparable with selected countries. The average monthly salary for Skilled Production Operatives is the lowest in the case of Georgia, amounting to 437 USD, whereas, for

the Czech Republic and Serbia, it is 605 USD and 1454 USD (Invest in Georgia, 2021). As we can see, there might be some concerns in terms of the abundance of highly skilled workforce in Georgia, whereas cost-wise, salary levels are the lowest.

Communications infrastructure: In this part, the author relied on the measurement of Georgia's performance against selected countries by examining indices related to communications infrastructure, as used in Camarero's research (2021). These include evaluations of fixed telephone subscriptions in the host country per 100 people, mobile cellular subscriptions in the host country per 100 people, and individuals using the Internet in the host country per 100 people.

Table 15 shows the summary of the results. As we can see, Georgia's broadband internet penetration is slightly behind the Czech Republic. Georgia also has lower fixed telephone subscriptions, compared with the selected countries.

	Georgia	Czech Republic	Serbia
Fixed telephone subscriptions of the host country per 100 people	9	12	37
Mobile cellular subscriptions of the host country per 100 people	148	126	124
Individuals using the internet in the host country per 100 people (fixed broadband subscriptions)	26.86	37.57	26.19

Table 15: Indices related to communications infrastructure (2021). Source: World Bank

Business freedom measures: To assess this dimension, the author referred to Heritage Foundation's (2023) business freedom index, which is integrated into the Index of Economic Freedom. The Business freedom index measures the efficiency of the government regulation of business. The higher the index it is, the better the performance. In this pillar, Georgia is slightly behind peer countries, with a score of 69.8. The evaluations for the Czech Republic and Romania are 76.9 and 74.3, respectively. However, Georgia's overall ranking is above the average score across all countries assessed by this ranking (59.9).

The Presence of International Investment Agreements (IIAs): The presence of international investment agreements has been argued to be important in the attraction and facilitation of FDI. Even though IIAs cannot guarantee an increase in FDI mobilization, developing countries can potentially benefit by enhancing their attractiveness, especially if it is combined with well-

structured FDI policies (UNCTAD, 2019). In the context of Japan, the importance of IIAs as a determinant for Japanese outward FDI was discussed in the number of researches.

Entered into force on July 23, 2021, Japan and Georgia signed "Agreement between Japan and Georgia for the Liberalization, Promotion and Protection of Investment". The agreement defines rules related to liberalization, promotion and protection of investment between Japan and Georgia, which is expected to strengthen bilateral investment flows between two countries (MOFA of Japan, 2021). Investment policy hub of UNCTAD classifies the treaty as a Bilateral Investment Treaty (BIT), as a form of IIA.

The Czech Republic and Japan do not have signed a separate investment agreement. Since the Czech Republic is a member of the EU, protection of investment and business exchanges is ensured through the agreement between the European Union, and Japan for an Economic Partnership, which includes provisions for investment (UNCTAD Investment Policy Hub, n.d). In case of Serbia, there is no existing IIA present with Japan.

Advantageous geographic location for regional coverage: Access to the wider region is important for FDI host countries, especially when the local market size is not large. The entrance of Japanese companies to European countries, due to the attractiveness of their favorable geographic location for regional access was shown in the studies of Ikemoto (2005), and Szunomar (2021). Even though geographic location is beyond the reach of policy interventions, the availability of tools that can potentially promote enhanced regional integration through bilateral and multilateral agreements, raise the attractiveness of the FDI host country.

Georgia is situated between Europe and Asia, having access to major markets in both regions. Its location on the shore of the Black Sea provides access to important shipping routes. According to the International Energy Agency (IIA), Georgia is an important route for bridging east and west for the transit of energy resources, such as the trade of electricity, oil, and natural gas (IIA, 2020). Georgia does not have a land border with EU countries; however, it is connected through the black sea to Romania and Bulgaria. Several Japanese companies have already selected Georgia as an investment destination to leverage the country's geographic location to South Caucasus and CIS countries, to be discussed in the next part of this chapter. Importantly, Georgia has a number of important trade agreements which enable companies to have duty-free access to the markets of the European Union, CIS, China, and EFTA, which in total creates a 2.3 billion population market (Invest in Georgia, n.d).

The Czech Republic is in the heart of European Union member countries and is a gateway to eastern and western Europe additionally, positions itself as a potential relocation country for companies, affected by Brexit. Most of the EU member countries are on an average 2-hour flight away from the Czech Republic, enabling foreign companies to use the country not only for local market coverage but accessing wider regions.

Serbia offers an advantageous geographic location as a gateway to Europe, and coverage of EU, southeastern Europe, or Middle Eastern customers. Like Georgia, Serbia is not a member of the EU, yet has a number of bilateral trade agreements enabling duty-free exports to the market of more than 1.3 billion population (Development Agency of Serbia, n.d).

Among the three countries, Czech Republic's attractiveness is the most evident, due to its geographic location in the heart of the EU, which ensures coverage of strategic markets. Both Georgia and Serbia are positioning themselves as a gateway to regional markets and attempting integration with regional and global trade networks with bilateral agreements, whereas Georgia has secured a relatively high number of bilateral trade agreements.

Cultural similarities: Discussed in the previous chapter of the literature review, cultural distance is an important part of the CAGE framework. However, assessment of the cultural similarity/distance is a challenge because of the existence of no objective criteria, which makes it difficult to compare and generalize results. Since all three countries are in the European region, cultural differences with Japan are inevitable, in terms of all dimensions, such as different languages, ethnicities, religions, and norms. Among all three countries, the Japanese community is the smallest in Georgia. According to MOFA of Japan, as of October 2021, the number of Japanese nationals residing in Georgia was 135. As for Serbia, the number is reported to be 159, according to the update for 2017, and in the Czech Republic, 2,564 Japanese nationals were residing, as of October 2021.

Industrial tradition, supply chain linkages: Unlike the Czech Republic and Serbia, Georgia does not have well-developed industry clusters in the sectors of interest of Japanese companies, such as high-technology manufacturing. When analyzing cases of Japanese FDI to Georgia, there were no examples of vertical FDI, resulted by the fragmentation of production. The research project recently conducted by UNIDO aiming to reveal key production clusters in Georgia showed that there is a certain concentration of enterprises in the regions of Georgia, in the sectors of primary production, such as manufacturing of beverages (including mineral waters), construction materials out of wood or plastic, cutting, shaping and finishing of stone, dairy products manufacturing and fish farming (UNIDO, 2019). In terms of the development of the high-value-added sectors, despite

the fact that there is no significant market player concentration, there is a limited presence of automotive manufacturing, in the form of government-owned and autonomous R&D centers. For example, located in Western Georgia, an auto-mechanical plant in Kutaisi City produces spare parts for agricultural products, and another production facility of Elmaval-Mshenebeli, assembles electric locomotives (Invest in Georgia, n.d). Additionally, Georgia has established itself as a hub for the re-export of automobiles in neighboring countries.

Czech Republic's diverse industries include high-technology manufacturing sectors, such as pharmaceutical products and preparations, computer, electronic and optical products, spacecraft, and related machinery manufacturing. Medium-high technology manufacturing covers the production of chemicals and chemical products, followed by medium-high technology manufacturing, such as chemical products, electrical equipment, medical equipment, motor vehicles and their parts, and other sub-sectors (OECD, 2020, p. 42).

Like the Czech Republic, Serbia has a success story of the diversified manufacturing sector, which has been contributing to the country's economy and attracting significant FDI. Major well-developed industries are automotive, food, beverage and agriculture, electronics, construction, and machinery sub-sectors. The country's specialization in industrial production and proximity to the EU market geographically, coupled with relatively low wage costs have led to the position Serbia as an attractive destination in southeastern Europe for FDI (OECD, 2021, P. 4).

CONCLUSION

Investment policies in Georgia demonstrate an open-door approach to investors despite the country of origin. For this research, the author focused on Japanese FDI. Based on the needs of foreign investors, the framework for assessing a country's competitiveness might vary within different sectors. Notwithstanding, the study provides meaningful insights into the current state of Japanese FDI in Georgia and the potential for further growth.

By analyzing the latest trends with global FDI in the introductory part, we learned that there are some signs of locating FDI projects in diversified geographic locations. The latest patterns of Japanese FDI show that outward FDI from Japan in the services sector is growing, and there is a rising interest from investors in realizing SDGs and seeking high-technology investments overseas. From the analysis of inward FDI flows of Georgia, we learned that Georgia has a significant progress in facilitating FDI and improvement of the investment climate of the country. Importance

of the diversifying of economic sectors and mobilization of the FDI from overseas, the government has recently launched a number of policy incentives, which aim to promote the facilitation of FDI in high-value-added sectors, with the motive of efficiency-seeking investment.

By analyzing a limited sample of Japanese corporations' presence in Georgia, the current focus is the realization of the projects with the coverage of the local market, and in certain cases, neighboring countries, as a customer base. It can be inferred that from the theoretical perspective, the primary incentive for Japanese investors in Georgia is the market-seeking motive, which, in the long run, is a good sign as a foundation to attract efficiency-seeking investors in more high-value sectors. As mentioned in the previous paragraph, the eagerness to boost the entry of investors with an efficiency-seeking motive is well reflected in the FDI promotion strategy of Georgia.

Analysis of the potential benefits and obstacles for Japanese FDI projects in Georgia revealed that the country's local market attractiveness measures, in terms of competitive labor costs, advantageous geographic location, low corruption level, and the presence of a bilateral investment treaty (BIT) with Japan, enhances Georgia's competitiveness. On the other hand, potential concerns relate to the quality of the workforce, the necessity for improving certain political and macroeconomic stability indicators, measures of business freedom, the challenge of bridging the gap of cultural differences, as well as the absence of industrial production and supply chain linkages. Those factors fall in the category of the determinants under the policy framework for FDI, as well as economic and business promotion, as referred to the WIR model by UNCTAD, which has the widest coverage of a diverse set of determinants.

To improve the competitiveness of Georgia as a location of choice for Japanese companies, the country needs to continue its work towards the improvement of political and macroeconomic stability indicators, and actively pursue necessary reforms aligned with its application for the European Union membership, submitted in 2022. Achieving these goals may require a systematic approach and drawing policy implications is the subject of comprehensive analysis, which is beyond the focus of this study. Additionally, some of the factors affecting political stability indicators are external. For instance, geopolitical instability in the region, Russia’s invasion of Ukraine, and Georgia’s occupied territories by Russia contribute to an elevated country risk for investors. However, tools, such as political risk insurance guarantees, offered by multilateral development banks, such as MIGA (The World Bank Group), could be utilized to mitigate the risks. Additionally, a memorandum between Japan’s NEXI and the Georgian side was signed in

2019, hereby, NEXI has been providing export insurance to domestic companies to export products to Georgia, to support strengthening bilateral business relations between countries (NEXI, 2019).

Another important aspect that needs to be improved is the skills of the workforce since we are in an environment where the quality of talent matters more than wage competitiveness, and global talent shortages have reached a critical level. Peer countries discussed in this study have a longstanding tradition of providing technical education. Serbia is a good illustration, where technical education at an early schooling age is prevalent and since 2017, the law on dual education was adopted and private sector companies involved in the program reached 900 within 2020/2021 (Development Agency of Serbia, n.d). Important steps and initiatives have been enforced in Georgia as well, to tackle the challenges with the qualification of the local workforce. For example, in 2020, a 70 million USD loan was approved by the Asian Development Bank to improve the vocational education system (VET) for strengthening the capacity of the workforce in industries and fields, with evolving market needs (ADB, 2020). Moreover, the FDI grant incentive package enables investors to request reimbursement for costs, related to the training of workforce during the implementation of FDI projects in Georgia (Invest in Georgia, n.d.). In terms of the other aspects, such as the cultural similarities between Japan and Georgia, both countries should continue their efforts to strengthen ties in business and cultural exchanges.

Strengthening industrial expertise and clusters in industries, other than primary production is essential for Georgia for diversifying the economy and attracting FDI with more substantial spillover effects in terms of knowledge and technology transfer. In this regard, it is interesting to examine examples from peer countries. Serbia's success story in attracting FDI is well supported by the strengthening capabilities of local suppliers, due to the complex process of the manufacturing and assembly of the products such as automobiles, and electronics. A strong local supplier base in the country has been a key factor attracting MNCs from overseas (Development Agency of Serbia, n.d). The Czech Republic has established a significant network of suppliers, considering the high need for in-house sourcing of MNCs for making a final product. In this matter, a state agency Czech Invest has developed a database of 3600 suppliers in manufacturing and ICT, in 10 sub-sectors across automotive, aerospace, engineering, and ICT. Investors can access a special market screen service, tailored to the needs of each company and it should be noted that the Japanese companies were in the top three countries, from which investors required such a service (Czech Invest, n.d.)

Other recommendations, which have emerged after learning current trends of global FDI and Japanese outward FDI, could include inclusion of sustainability metrics in the offerings to the investors due to the rising interest of Japanese investors in realizing SDGs in overseas projects. Global initiatives, such as OECD's FDI qualities initiative set goals for the improvement of the impact of the investment with a focus on the four areas, such as productivity and innovation, employment, job quality and skills, gender equality, and low carbon transition (OECD, 2022, p.4). The inclusion of sustainability impact measurement metrics in the projects and sectoral value propositions of Georgia might be appealing to Japanese investors.

The prospects of expanding the research on the potential of Japanese FDI in Georgia could be a sector-specific assessment of Georgia's attractiveness, in both manufacturing and non-manufacturing sectors, by surveying Japanese companies that have not yet made any investments in Georgia. It will be also valuable to develop discussions on how the presence of certain attractiveness components, for example, signing BIT between Georgia and Japan impacted the boosting of FDI, after a few years of the agreement being in force and conduct an empirical study on whether the signing of the BIT could rise volume of FDI inflow from Japan.

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