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**Working Paper**

## How Does Foreign Aid Affect the Relationship between IFRS Adoption and Foreign Direct Investment?

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AFRICAN GOVERNANCE AND DEVELOPMENT  
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A G D I Working Paper

WP/15/014

**How Does Foreign Aid Affect the Relationship between IFRS Adoption and  
Foreign Direct Investment?**

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**AGDI Working Paper**

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**How Does Foreign Aid Affect the Relationship between IFRS Adoption and Foreign Direct Investment?**

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**Abstract**

This paper constructs a theoretical model to explain the relationship between IFRS adoption, FDI and foreign aid. Using the SGMM estimation technique to check the issue of endogeneity and reverse causality, this relationship was examined on 92 countries for the period 2003-2012. Overall, IFRS adoption attracts more aid when conditioned on foreign aid; however, when disaggregating foreign aid, the effect of foreign aid on the nexus was contradictory, while multilateral aid flow was positive. This result remained consistent despite the battery of checks.

*Keywords:* Accounting Standards; Foreign Aid; Foreign Direct Investment; Globalisation; IFRS Adoption

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## 1. Introduction

Recounting empirical evidences suggest that IFRS adoption promotes the flow of foreign investment (see Gordon, Loeb and Zhu, 2012; Chen, Ding and Xu, 2014; Efobi, 2015). The underlining argument explaining this relationship is tied to the fact that a global set of financial reporting standard reduces information barriers that – hitherto – are caused by the discrepancies existing across national accounting standards and practices. However, in the context of IFRS adopting countries needing scarce external resources (like foreign aid) to sustain their development, we pose the following questions. First, will the demand for foreign aid diminish (or improve) the IFRS effect on FDI? Second, does this effect differ depending on the form of aid being considered? The answers to these questions has implication on whether IFRS adopting countries, whose focus is geared towards improving their attractiveness to foreign investment, should still rely on aid, and what form of aid should be most relevant. Also, answers to the questions will suggest those forms of aid that reinforces the IFRS adopting country's objective of improving foreign investment, and even provide empirical justification to support such claims. This study relates to the strand of literature that focuses on how macroeconomic variables interact with accounting structures, and its resultant effect on specific outcomes – like FDI (See Wysocki, 2011; Gordon, Loeb and Zhu, 2012; Chen, Ding and Xu, 2014; Efobi, 2015).

Foreign aid, which includes financial flows, technical assistance, and commodities that are designed to promote welfare and economic development, has remained an important source of foreign capital inflow, especially for developing countries. This is not without its criticisms, as fierce debate have been over the effectiveness of aid in the recipient country (for example Sachs, 2005; Easterly, 2006, 2008). An interesting and in-exhaustive strand of the debate on the effectiveness of foreign aid has been on whether its presence in a country has a complementary (or a substitutive) effect on foreign investment. Some studies are of the opinion that foreign aid are likely to have a complimentary impact on foreign investment as aid flows can be used to finance complimentary goods, such as infrastructure, human capital development (education), and government policies that enhance peace and stability (Selaya and Sunesen, 2012; Bandyopadhyay, Sandler and Younas, 2014). Also, foreign aid brings about a 'vanguard effect', implying that aid donors tend to place FDI in specific host countries; not downplaying the fact that these donors also have specific information about the aid recipient country and most times, make such information available to investors (Kimura and Todo, 2010; Annageldy, 2015). On the other hand, the substitutive effect from the

presence of foreign aid is traced to the fact that aid utilised for the development of physical capital competes directly with, or replaces investment that would have been undertaken by investors. More so, aid can instigate a rent-seeking behaviour among public officials and can hurt institutional structure of a country, creating a disincentive for the attraction of foreign investment (Alesina and Weder, 1999; Svensson, 2000; Knack, 2001; Economides, Kalyvitis, and Philippopoulos, 2008; Charron, 2011; Asongu, 2012, 2013, 2014).

Noting the controversy in the literature, pertaining to the effect of the presence of foreign aid on foreign investment, it raises a concern as to how (in) effective the adoption of IFRS can be in attracting foreign investment in the light of this form of capital. The underlining issue with foreign aid is that it forms an important aspect of foreign capital flow to countries (Banyopadhyay et al, 2015), and seldom will an IFRS adopting country not be confronted with the presence of this form of financial flow. This raises significant interest considering that countries' intention for the adoption of IFRS may likely be cut short/improved with their demand for foreign aid. This issue has not received attention in the International Accounting literature, and downplaying this issue will imply that we are "punching a brick wall" by solely expecting the adoption of IFRS to foster FDI. In this paper, therefore, we bring together two broad literatures by exploring both the IFRS-FDI, and the foreign aid-FDI in a single framework, where we allow for non-linearity in their relationships with FDI. Moreover, our empirical framework examines this non-linearity in the form of an interaction between IFRS adoption and foreign aid. This is important because it is reasonable that IFRS adoption built upon some form of resource inflow may affect (improve) the presence of foreign investment in the country. For example, considering the strand of literature that says foreign aid diminishes foreign investment, then it implies that if a country adopts IFRS and receives some form of foreign aid that are invested into physical capital, or creates rent-seeking behaviour, then the relative FDI outcome may not be visible. An implication of this will be to ensure that the IFRS adopting country receives only those forms of aid that will not diminish the incentives of foreign investors. This will require an empirical investigation for this to be ascertained.

Using a cross country data of 92 countries, over the period 2001-2012, for the IFRS adoption, FDI and foreign aid variable, and controlling for other FDI determinants identified by the literature, we obtain results of the following form: foreign aid in general improves the effect of IFRS adoption on FDI. When considering the components of aid, bilateral aid was found to have a diminishing effect on FDI of the IFRS adopting country. Multilateral aid, on the

other hand, was found to have a significant and positive effect on FDI, thereby complementing the adoption of IFRS. These results were robust to the inclusion of some heterogeneous factors as well as controlling for the periods of the global financial crisis. The results of this study are important for the following reasons: there has not been sufficient exploration as to the extent to which accounting standards evolve with other macro-economic factors – like foreign aid, to facilitate investment flow between countries. Our study provides a fresh evidence on this relationship by using a cross country data that covers about 92 countries for the period 2001-2012. Second, our investigation into the effect of the different forms of foreign aid on the IFRS-FDI nexus will provide clarity as to how the separate flows of aid (i.e. bilateral and multilateral) affect the nexus. Since empirical studies are between the complementary and substitutive effect of aid on FDI, we provide a clearer implications for the IFRS adopting country by considering the components of foreign aid. This will even support policy since distinction is provided pertaining to the effect of the different components of foreign aid on the nexus.

The remainder of this paper proceeds as follows: literature review on foreign aid, IFRS adoption and FDI, and the development of the main hypotheses are presented in section 2. The research method, inclusive of the conceptual and empirical model, variable definitions, estimation technique, and the characteristics of our sample are included in section 3. Section 4 presents the results from the baseline empirical analyses, as well as the robustness checks. The implications of our results, and conclusions are in section 5.

## **2. Review of Literature and Hypothesis Development**

### *IFRS Adoption and FDI*

Foreign Direct Investment (FDI) plays an important role on the overall economic situation of the host country. This includes its effect on employment (Jenkins, 2006; Javorcik, 2013); income equality (Dirk, 2003; Herzer and Nunnenkamp, 2011); market access (Fugazza and Trentini, 2014); technology and knowledge transfer (Blalock and Gertler, 2008; UNCTAD, 2010); fiscal revenue (Gropp and Kostial, 2001), and political, cultural and social issues (Dirk, 2006). As a result of the importance of this form of foreign capital, research interest are channelled towards understanding its determinant in order to aid countries' policy formulation to attract them. Among the important determinant of FDI is the prevailing institutional infrastructure in the country. This includes the legal structure, quality of governance and bureaucracy, control of corruption, and other forms of polity (Asiedu, 2006; Busse and Hefeker, 2007; Asiedu and Lien, 2011).

Interestingly, financial reporting structure is also seen as an important aspect of the institutional infrastructure of a country. A higher quality of accounting information increases the efficiency of capital allocation because of increased transparency and the reduction of information asymmetry between the parties involved in the transaction (Chen, Ding and Xu, 2014). Recounting evidences (e.g. Ball, 2006; Daske and Gebhardt, 2006; Barth et al, 2007) shows that the International Financial Reporting Standards (IFRS) presents a better quality of accounting information, especially with regards to the global investment flow, than national GAAP (Generally Accepted Accounting Principles). It is in this light that there has been a proliferation of accounting studies on the linkage between IFRS and FDI: thus, reaching the consensus that the adoption of IFRS has a positive impact on the inflow of FDI (Marquez-Ramos, 2011; Prochazka and Prochazkova, 2011; Amiram, 2012; Gordon, Loeb and Zhu, 2012; Chen, Ding and Xu, 2014; Efobi, 2015)

Chen, Ding and Xu (2014) identified atleast two channels that clearly explains why the adoption of IFRS results to an increment in the inflow of FDI into the adopting country. These channels are: the adoption of a common set of accounting standards – such as IFRS, removes certain barriers of non-comparability of financial information between countries, and reduces the information asymmetry between local and foreign investors. The second channel is that IFRS possesses certain features that are desirable for investors, compared to the national accounting standards. For instance, IFRS emphasises a more detailed explanations of accounting entries, which fosters transparency and will be relevant for investors in making informed decision about a particular investment.

It is important to state that consensus is reached on foreign investors depending on financial information to make decisions on what country to invest in. One of the earliest study to reach this conclusion is Gordon and Bovenberg (1996), who among other factors, magnified information asymmetry as the main driver of global capital immobility. Host country investors have informational advantage over foreign investors, and as a result derive rent from such advantage. Foreign investors are charged a premium on their investment because the necessary information like those pertaining to specific firms/industry, economic prospects and future government policies that may likely affect their investments, are tied to an economic value. As a result of this, transaction cost for involvement in foreign investment is high, which will likely hamper the volume of foreign investment flow. Chen, Ding and Xhu

(2014) even noted that the high cost (in terms of time and financial resources) of translating financial statement from local GAAP to a more understandable financial information, will discourage investment flow. As a result of this, investors will prefer to invest in countries with improved financial information framework in order to maximise their return on investment, by reducing the associated cost from ‘poor’ financial reporting structure.

### *Foreign Aid and FDI*

Since the main objective for the adoption of IFRS is to improve foreign investment flow, therefore, there is the need to understand how this fares in the presence of the demand for foreign aid. Importantly, conceptualising foreign aid will be the first task in understanding this linkage. The Development Assistance Committee (DAC) provides a standard definition: foreign aids are financial flows, technical assistance and commodities that are designed to promote economic development and welfare as their main objective and can be in the form of grants or subsidized loans – also referred to as concessional financing<sup>1</sup> (Radelet, 2006). Foreign aid can be in the form of Official Development Assistance (ODA), which include those forms of aid provided for development by donor governments to low and middle income countries; Official Assistance (OA) such as aids provided by governments to richer countries; and Private Voluntary Assistance (PVA), which includes those financial aid originating from sources other than donor governments. Clearly, the ODA has remained the largest source of development assistance compared to the others (OA and PVA).

The effectiveness of foreign aid in relation to foreign investment has remained a controversial issue. Some authors perceive foreign aid as having a complementary effect on foreign investment (Harms and Lutz, 2006; Selaya and Sunesen, 2012; Annageldy, 2015). This is tied to those forms of aid that are directed towards the development of complementary factor input like infrastructure and human capital development. The consequential effect of the presence of these forms of aid is that they raise marginal productivity of capital, and provides a location advantage to investors (Harms and Lutz, 2006). Therefore, the presence of this forms of aid will likely spur investment inflow. Some other authors believe that foreign aid provides a vanguard effect on foreign investment in the recipient country (Kimura and Todo, 2010). Aid donors provide access to foreign investment in the specific countries by either

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<sup>1</sup> According to the DAC, a financial flow is regarded as concessional financing when it does not carry market or near-market terms. For instance, a transfer of fund will not be regarded as aid if the interest rate is not – at least – 25 percent lower than the present value of a comparable loan at market interest rates.



directly placing these investors, or providing specific information about the respective country to foreign investors.

On the other hand, some authors believe that the presence of aid has a substitutive effect on FDI. There are two broad strands in support of this argument. The first portrays foreign aid as harmful to governance (e.g. Alesina and Weder, 1999; Svensson, 2000; Knack, 2001; Economides, Kalyvitis and Philippopoulos, 2008; Charron, 2011; Asongu, 2012, 2013, 2014). These evidences demonstrate that aid directly strengthens the existing corruption pattern through its tendency to create distortions in the public sector, foster rent seeking behaviour of public officers, and delay pressure for effective reforms. A prevalent explanation seems to be that foreign aid reduces the incentives of public officers to create and drive reforms due to their reliance on aid transfers, and it causes rent seeking behaviour by increasing the size of resources fought over by interest groups<sup>2</sup> (see Alesina and Weder, 2002; Svensson, 2000). In the light of this, to the extent that foreign aid diminishes the governance structure in a country by enhancing the prevalence of corruption, foreign investors will display less preference for countries of this nature.

The second group perceives some forms of aid as competing directly with foreign investment, and will likely result to a crowding-out effect. For instance, aids that are directed towards physical capital formation (like agriculture, manufacturing, and trade development) replaces the investment opportunities that foreign investors would have hitherto undertaken. The presence of these forms of aid will result to capital mobility and rate-of-return equalisation across countries, which will ‘upshoot’ the flight of other forms of capital (see Selaya and Sunesen, 2012). A related argument put forward by Arellano et al (2009) and Kimura and Todo (2010) accentuates that aid is likely to increase the supply of tradable and hence reduce the relative price of non-tradable. In the light of this, aid distorts the allocation of domestic resources and will most likely discourage FDI flow – especially those channelled towards tradable sectors.

### *Hypothesis Development*

Based on the fallout from the literature, in relation to the effect of IFRS adoption on FDI, and the complementary (or substitutive) effect of foreign aid on FDI, it is not certain that a

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<sup>2</sup> A case in point to support the fact that increase foreign aid breeds corruption is the case of an African country (identity withheld), where it was reported that about US\$ 500 billion development assistance was stolen (Ojeme and Ezinwa, 2006). Similar occurrences were recorded for other African countries (see Peron, 2001; Moyo, 2009).

country that adopts IFRS will have a resultant FDI effect in the presence of foreign aid flow. Our aim therefore is not to say something about the effectiveness of aid, but rather to analyse if countries that has adopted IFRS will be able to attract FDI despite the presence of foreign aid. We therefore propose the following hypothesis:

Hypothesis One:

*The effect of IFRS adoption on FDI will reduce if the country opens up to the receipt of foreign aid, ceteris paribus.*

The first hypothesis does not take into account the different types of foreign aid flow. Some authors perceive that the degree to which aid affects FDI depends on the type of aid being considered. In the same vein, the degree to which IFRS adoption affects FDI will depend on the type of foreign aid being received by the country. In the preceding discussions, it is important to pay attention to the fact that most of the conclusions reached were not clear about the types of aid that can either be complementary or substitutive to foreign investment. This is important as it will provide a clear explanation as to how IFRS adoption will fare in the light of these forms of aid. We pay attention to the submission of Charron (2011) that "... bilateral ODA is argued by many to be tied with the political agenda of the donor country and less focused on "good governance" reform in the recipient country for its own sake. Though of course not apolitical, multilateral ODA is seen as relatively more impartial, and the program to fight corruption and improve governance in the developing world ...". This suggest that to some extent, an IFRS adopting country that is confronted with the inflow of bilateral foreign aid may not be able to attract much of FDI, compared to those that experience an inflow of multilateral aid. Therefore, we present the second hypothesis for this study as:

Hypothesis Two:

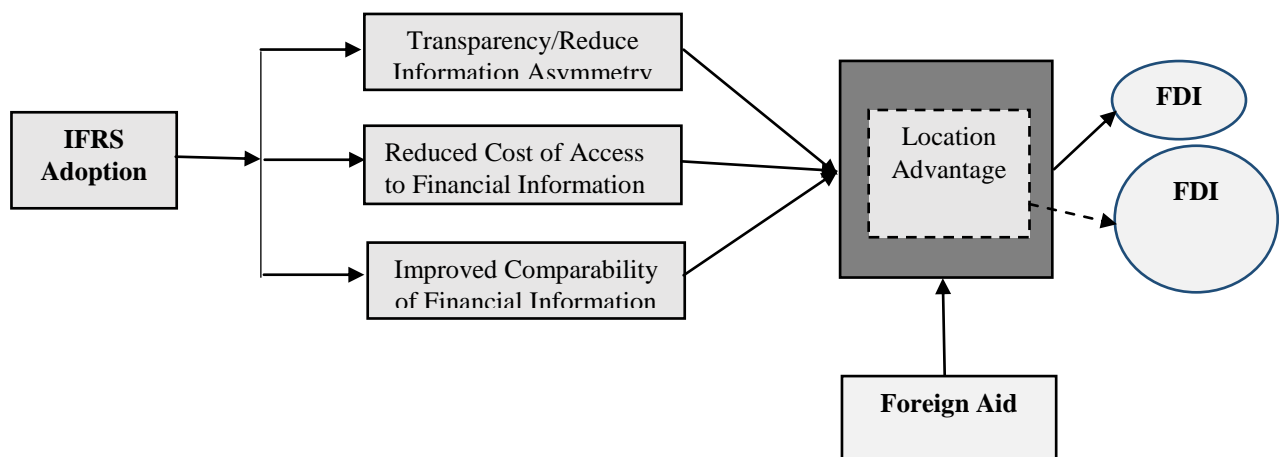
*An IFRS adopting country will attract more FDI when confronted with the inflow of multilateral foreign aid than its bilateral counterpart, ceteris paribus.*

### **3. Research Method**

We present the conceptual framework that displays the relationship that this study is trying to model. Figure 1 clearly illustrates that IFRS adoption is supposed to attract foreign investment by improving the location advantage of the adopting country in three respects: improve transparency/information asymmetry, reduce the cost of access to financial

information and improve comparability of financial information. However, the degree to which IFRS attracts FDI is dependent on the effect of foreign aid flow on the location. Put differently, the type of foreign aid flow into the host country will either contaminate (or improve) the location advantage already created by the adoption of IFRS. From the Figure, some aid flows have a negative impact on the host country, thereby causing a location disadvantage (see the darker section of the box tagged ‘location advantage’): the resultant effect is that the volume of FDI flow is reduced. On the other hand, the aid flow with a positive effect on the host country will have an incremental effect on FDI flow.

**Figure 1: Conceptual Framework on the Linkage between Foreign Aid, IFRS Adoption and FDI**



We set up the empirical model to test these presumptions. Borrowing from the empirical frameworks of Gordon, Loeb and Zhu(2012), and Chen, Ding and Xu (2014), such that:

$$FDI_{it} = \beta_0 + \beta_1 IFRS\_Adoption_{it} + \beta_2 covariates_{it} + \varepsilon_{it} \quad (1)$$

We included the (conditional) effect of foreign aid in the model, thereby transforming equation (1) to:

$$FDI_{it} = \beta_0 + \beta_1 IFRS\_Adoption_{it} + \beta_2 covariates_{it} + \beta_3 Foreign\_Aid_{it} + \phi Foreign\_Aid \times IFRS\_Adoption_{it} + \varepsilon_{it}$$

(11)

*Variable Definition*

FDI is the foreign investment flow in country ‘i’ at time ‘t’. Precaution was taken from the comment in Dong (2014), that FDI measures should be such that captures the case of reverse

investment (i.e. disinvestment). Based on this, a standard measure of FDI<sup>3</sup> was applied such that FDI is computed as the percentage of net FDI inflows to GDP ‘*FDI/GDP*’ (Bandyopadhyay, Sandler and Younas, 2014).

The variable *IFRS\_Adoption* was measured as a dummy ‘1’ if a country has adopted IFRS and ‘0’ otherwise, following consensus in accounting literature (see Gordon, Loeb and Zhu, 2012). The concept ‘adopt’ implies that the country’s security and exchange commission or any other financial reporting regulatory institution has declared the country as legally adopting IFRS. More so, in cases like Kazakhstan, where financial institutions were required to adopt IFRS from January 2003 and publicly listed companies from January 1, 2005, we chose 2005 as the IFRS adoption year because it presents a fairer representation of the financial reporting structure of the country. This is because financial institutions is only a spectrum of the entire publicly listed companies, and it may not be representative of the national transition to IFRS.

The third important variable is foreign aid (*Foreign\_Aid*), measured using the net official development assistance and official aid received to GDP constant 2005 US\$<sup>4</sup>. The disaggregated data on bilateral (*Bilateral\_Aid*) and multilateral aid flow (*Multilateral\_Aid*) was measured using bilateral net financial flows and multilateral net financial flows to GDP in constant 2005 US\$, respectively. These measures were favoured by Charron (2011), Asongu (2012), Das and Dutta (2012).

### *Covariates*

Standard financial economic literature (e.g. Asiedu, 2006; Busse and Hofeker, 2007; Asiedu and Lien, 2011; Anyanwu, 2012; Bandyopadhyay, Sandler and Younas, 2014; Efobi et al, 2014) was carefully considered in selecting the covariates. The covariates were classified into

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<sup>3</sup> According to the 2013 definition of UNCTAD, FDI includes associates and subsidiaries and consist of the net sales of shares and loans (including non-cash acquisitions made against equipment, manufacturing rights, etc.) to the parent company plus the parent firm’s share of the affiliate’s reinvested earnings plus total net intra-company loans (short and long term provided by the parent company. For branches, FDI flows consist of the increase in reinvested earnings plus the net increase in funds received from the foreign direct investor. FDI flows with a negative sign (reverse flows) indicate that at least one of the components in the above definition is negative and not offset by positive amounts of the remaining components (see definition in <http://unctad.org/en/Pages/DIAE/FDI-Flows.aspx>).

<sup>4</sup> This indicator consists of those forms of disbursements of funds that are made on concessional terms (net of repayments of principal) and grants by members of DAC, multilateral institutions and non-DAC member; this is with the aim of promoting economic development and welfare in countries and territories of recipients. It includes loans with a grant element of at least 25 percent and those forms of aid flows from official donors to countries and territories in the DAC list of recipients

market, structural and governance structure variables. The indicators of market structure include GDP growth rate (*GDP\_Growth*) and the population of the country (*Market\_structure*). These two measures reflect the macroeconomic condition of the country, which affects the return on investment in the host country.

The structural covariate include infrastructure – measured using the number of telephones per 10 persons in a country (*Infrastructure*), and openness of the economy (*Openness*) measured as the ratio of exports plus imports to GDP. These two measures affect the volume of FDI flow in terms of the available structure in the host country for inducing FDI (see Busse and Hofeker, 2007; Asiedu and Lien, 2011).

The last group of covariates – governance structure – was measured using indicators of the prevalence of democracy in the country (*Democracy*) and corruption (*Corruption*). Democratic institutions and the extent of corruption control creates proper accountability and responsiveness of the government to the needs of other economic agents (individuals and firms). This attracts FDI to a particular location (see Busse and Hofeker, 2007; Asiedu and Lien, 2011). Democracy is measured as the average of political right and civil liberty, originally scaled as 1 (better democratic institution) to 7 (poor democratic institution). In this study, this was rescaled as 7 (better) and 1 (worst). The corruption variable was scaled as -2.5 (low corruption control) to +2.5 (high corruption control).

#### *Robustness Checks: Controlling for the Unobserved Heterogeneity*

For robustness and further check of the validity of the results of this study, some unobserved country heterogeneous peculiarity are accounted for. In this study, four important characteristics were identified based on arguments in contemporary FDI study. They include political globalisation (*Pol\_Globalisation*), internal civil conflict (*Civil\_Conflict*), natural resource endowment (*Endowment*) and the period of global financial crisis. *Pol\_Globalisation* reflects the extent of political integration of a country with the rest of the world. It is an index that is weighted based on the number of embassies the country host, the number of international organisation that the country belongs to, the number of peacekeeping missions participated by the country and the number of international treaties the country has rectified. A higher index imply that the country is more politically opened, which is an attraction to foreign investments (Bandyopadhyay, Sandler and Younas, 2014).

The internal civil conflict concerns itself with the acts of civil violence, civil war, ethnic violence and ethnic war. These items were included in a single index, where higher index reflects increased civil unrest and it has a negative consequence on the volume of FDI flow to the country (see Asiedu, 2006; Asiedu and Lien, 2011). The natural resource endowment of the country is measured as the share of fuel and minerals in total merchandise exports. The intuition for including this peculiarity is premixed on the fact that natural resource is a potent factor in attracting foreign investors to a country (see Asiedu and Lien, 2011).

The last unobserved heterogeneous peculiarity that will be studied is controlling for the period of the global financial crisis. The cyclical shocks experienced during this period has an effect on the behaviour of global capital flow: such as the reduction of the volume of FDI flow and other forms of foreign capital like aid. Therefore, this occurrences reverberates the need to control for this period in a stochastic model that involves volatile phenomenon like FDI and foreign aid (see Aryeetey, 2009; Fosu, 2010; Cobbinah and Okpalaobieri, 2012; Evenett and Aggarwal, 2012; Osabuohien, Efobi and Beecroft, 2014). Hence, the years 2008 - 2010<sup>i</sup> was coded as 1 (i.e. financial crisis period) and 0 otherwise.

#### *Sample and Data Source*

To test the validity of our empirical model, data was gathered for 92 countries for the period 2003-2012 (see appendix A1 and A2 for list of sampled countries and relevant summary statistics). The period was chosen because 2003 was the year that the first standard was released after the formation of the International Accounting Standards Board (IASB) in 2001. The criteria for the sample selection was based on data availability, spanning a period of – at least – five consecutive years.

The data for the FDI, foreign aid (both multilateral and bilateral), and macroeconomic, structural and natural resource variable were sourced from the World Bank's World Development Indicators-WDI. The IFRS adoption variable was sourced from the IFRS website ([www.ifrs.org](http://www.ifrs.org)), Deloitte IASPlus ([www.iasplus.com](http://www.iasplus.com)) and World Bank Group Report on Standards and Codes ([www.worldbank.org/ifa/rosc](http://www.worldbank.org/ifa/rosc)); while the governance structure data was from the Freedom House – freedom in the world data – on political rights and civil liberty around the world. The data on political globalisation was from the KOF index of globalisation (<http://globalization.kof.ethz.ch/>). The data for internal civil conflict was gotten from the global report database on societal conflict.

### *Method of Analysis*

A linear dynamic panel-data (DPD) model was estimated to capture the dynamic component of the estimations of this study. The dynamic component is based on the fact that investors incur considerable sunk cost at the start of their investment in a host country and as a result of this, the current value of investment will be explained by its lagged value (see Busse and Hofeker, 2007; Asiedu and Lien, 2011; Bandyopadhyay, Sandler and Younas, 2014). Some other studies (e.g. Mijiyawa, 2010) also see the need to account for the lagged value of investment because of the agglomeration effect that comes with foreign investment. In essence, current investment in a location will inform future investments.

The dynamic component of the estimation of this study renders the standard estimators inconsistent. Blundell and Bond (1998) proposed an efficient estimator called the system GMM (SGMM), which takes the first difference of the data and also uses the lagged values of the endogenous<sup>5</sup> variables as instruments. More so, it uses additional moment conditions to ensure the efficiency of the instruments used in the analysis. The SGMM estimation has the singular weakness of the likelihood of its estimates using too many instruments: this is also called the problem of instrument ‘proliferation’. Therefore, in order to increase the credibility of the results, the Sargan and the autocorrelation tests were reported.

The underlining assumption for the SGMM technique is that there is no autocorrelation in the idiosyncratic errors. This can only be verified by the Sargan and AR (2) test. For the AR (2) and Sargan test, the p-values were reported and the significance of these test reveals that the result is susceptible to a type 1 error – producing significant result despite there is no underlining association between the respective variables (see Roodman, 2007; Asiedu and Lien, 2011). It is advisable that the number of instruments for each SGMM estimations should be reported in order to compare the number of instruments as against the cross section (in this case, the number of countries included in the analysis).

## **4. Estimation Result and Discussions**

The issue of multicollinearity was first tested using the pairwise correlation analysis (see Table A3 in the appendix). There was no case of multicollinearity since the bivariate

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<sup>5</sup> Endogeneity problem is expected since the model will likely contain unobserved panel-level effects that are correlated with the lagged dependent variable.

relationships amongst the explanatory variables were not in any way suggestive of high association. The implication of this is that precaution will not be taken in including the covariates into the stochastic model.

The regression result for the variables *FDI/GDP*, *IFRS\_Adoption*, *Foreign\_Aid* and the interaction term (*IFRS\_Adoption* × *Foreign\_Aid*), and the covariates are reported in Table 4.1. Considering the behaviour of the variable *IFRS\_Adoption*, it follows the expected sign of a significant positive effect in all the columns. Recent studies like Chen, Ding and Xu (2014), and Gordon, Loeb and Zhu (2012) had empirical justifications to support this finding. Noting this, what follows next, however, is to observe the consistency of this variable at the introduction of different covariates into the model. The behaviour of the *IFRS\_Adoption* was still consistently improving the inflow of FDI to the adopting country. The behaviour of this variable justifies the ‘commodious’ theoretical claim in accounting literature that the adoption of IFRS creates important changes in the informational environment that will lead to the improvement of corporate transparency: consequently, the barriers to FDI inflows are relieved as a result of the lowering of transaction costs and information asymmetry. Considering the preliminary checks – like the *AR (2)*, *Sargan* and instrument ratio – presented in the lower segment of the Table, we are confident that this result does not suffer from any form of misspecification and spuriousness, nor is it caused by instrument proliferation that blurs the estimates of SGMM.

#### **INSERT TABLE 4.1 HERE**

The effect of the aid flow on FDI was consistently positive and significant across the columns of Table 4.1: this is irrespective of the combinations of the other explanatory variables. This behaviour supports the effectiveness of aid for an improvement in the attractiveness of FDI. However, this result should be treated with caution and not taken as sacrosanct. This is based on the argument by Charron (2011) that in observing the behaviour of aid, and its effect on other economic outcomes, it will be more factual to focus on the type of donor been observed. It is important to note that the aggregate aid data is a combination of both bilateral and multilateral aid flow. The effect of these two groups are divergently explaining the economic outcome of the FDI recipient country. This will be taken up subsequently.

Note that most of the covariates follow theoretical expectations. For example, in most of the column of Table 4.1, the per capita GDP (measure of income), measure of infrastructure, openness of the economy, democracy and corruption, had a positive and significant influence



on the volume of FDI flow to the sampled countries. This result supports the consensus that income, the market structure (in terms of the population), openness of the economy, support for democracy and reduction in corruption, improves the flow of FDI.

The interaction term between foreign aid and IFRS adoption was considered. The partial effect is such that  $(\partial FDI / \partial Foreign\_aid = \beta + \varphi \times IFRS\_Adoption)$  where  $\beta$  and  $\varphi$  are the parameters of interest. The results from Table 4.1 shows that the coefficient of the interaction terms are consistently positive and significant at the 1 percent level. This does not support the first hypothesis that the presence of foreign aid ameliorates the impact of IFRS adoption on FDI. Instead, the empirical result supports an increasing effect of the impact of IFRS on FDI, when the country receives foreign aid. Notably, the coefficient of the interaction term '*Foreign\_Aid* × *IFRS\_Adoption*' - in almost the entire column of Table 4.1 - was higher than the direct effect of the individual variables (i.e. *IFRS\_Adoption* and *Foreign\_Aid*). This shows that on the average, the sampled countries will attract more FDI when they have adopted IFRS and have access to more inflow of foreign aid.

There are theoretical arguments to support this finding. Some stance (e.g. Tavares, 2003; Okada and Samreth, 2012) justifies foreign aid as having a reducing effect on poor governance structure like corruption, while others (see Kosack and Tobin, 2006; Selaya and Sunesen, 2012) presume that aid has a catalysing effect on the development of complementary inputs as it supports the recipient governments' finance. Since these two components (better governance and complementary inputs like infrastructure) are critical for the presence of FDI, then the magnitude of the coefficient of the interaction term in Table 4.1 is justifiable. However, the implicit presumption that foreign aid complements IFRS adoption in increasing the flow of FDI will only be properly situated when the components of foreign aid flow – in terms of the type of donor – are examined.

Talking about the components of foreign aid, Table 4.2 presents the effect of the inclusion of the variable "*Multilateral\_Aid*". In the entire columns, the explanatory variables (i.e. *IFRS\_Adoption* and *Multilateral\_Aid*) followed expected sign and the level of significance were verified. This is similar to their behaviour in Table 4.1. The signs and levels of significance of the covariates in Table 4.2 are also similar to that of Table 4.1. The preliminary checks, presented in the lower segment of the Table confirms that these outlook were efficient and not informed by autocorrelation in the error term (i.e. *AR 2* test was above

0.05), neither were they borne out of invalid instruments that were included in the analysis (i.e. *Sargan Test* was above 0.05 and instrument ratio was above 1).

#### **INSERT TABLE 4.2 HERE**

The interaction term between multilateral aid and IFRS adoption (i.e. *Multilateral\_Aid*×*IFRS\_Adoption*) was included in the model in the ‘B’ columns(including 7A-C) of Table 4.2. The aim is to see the partial effect of IFRS on FDI, when the volume of multilateral aid flow is considered. From the Table, the interaction term was positive and significant in all the columns. This variable displayed a consistent behaviour and just like the total foreign aid, the partial effect of IFRS adoption on FDI drastically increased when conditioned on multilateral aid flow. This supports the second hypothesis that an IFRS adopting country with multilateral aid will have a better inflow of FDI. In essence, this form of aid has a complementary effect on the IFRS-FDI nexus. More so, the effect is even higher when compared with the direct impact of IFRS adoption on FDI.

In comparison, the bilateral aid effect on the IFRS-FDI nexus was presented in Table 4.3, where the interactive term *Bilateral\_Aid* × *IFRS\_Adoption* is presented, among the other variables. Focusing on the interactive term, this variable presents a negative relationship with the flow of FDI. This is apart from the consistent negative relationship that *Bilateral\_Aid* displayed in relation to FDI flow. Convincingly, it can be said that the flow of bilateral aid into an IFRS adopting country negatively affects the IFRS-FDI nexus. Just like the interaction terms containing *Total\_Aid*×*IFRS\_Adoption*, and *Multilateral\_Aid*×*IFRS\_Adoption*, the coefficient for *Bilateral\_Aid* × *IFRS\_Adoption* shows a high magnitude of effect in all the columns of Table 4.3. As usual, this coefficient does not suffer from any influence from instrument proliferation (i.e. AR 2, Sargan test were > 0.05 and the instrument ratio was > 1), nor is the result spurious.

#### **INSERT TABLE 4.3 HERE**

Bringing the research questions (i.e. the extent to which the volume of foreign aid flow into the IFRS adopting country affect FDI, and the differing effect of the type of aid flow in terms of bilateral or multilateral aid flow on FDI) into context, the result from the estimations suggest that foreign aid tends to increase the effect of IFRS adoption on FDI, but not mainly through the bilateral aid channel, but through the multilateral aid flow. The estimates clearly supports that multilateral aid flow compliments IFRS adoption to attract FDI. The bilateral aid flow has more of a substitutive effect: it negates the IFRS effect on FDI.

This relationship is tied to the argument that some forms of foreign aid – especially bilateral aid – improves poor governance because, sometimes, the aid that flows from donor countries are driven by nationalistic agenda and not on strengthening the governance structure of the recipient country for effective management of such aids (Charron, 2011). These forms of aid are most times not focused on the reform agenda of recipient countries and it ends up increasing rent-seeking behaviour of public officials. Perhaps, donors tie less accountability to the fund given to the beneficiary country as long as the donor's interest in the country is protected. In essence, these forms of aid fuel corrupt beurocrats. This is unlike multilateral agencies who takes interest in the structural reform of the countries and pursue effective governance structure of the aid recipient country. For instance, in the expositions of Easterly and Pfutze (2008), more multilateral agencies (with the exception of few) are selective in the volume of aid flow to countries, depending on the governance structure that is prevalent in such recipient country. This supports the argument of Dollar and Levine (2004) and Charron (2011) that multilateral aid donors are more biased towards recipients sustainable policy than bilateral donor.

Another important argument to support the findings from this study is that most multilateral aid flow are tied towards the development of complimentary factor input like infrastructural development, human capital and policy reform (See Easterly, 2007; Kremer and Miguel, 2007). This widespread interest by multilateral donors will support the improvement of the location advantage that the IFRS adoption has earlier created, which will impact on the overall FDI inflow to the country. Bilateral organisations cannot be disassociated with being tied to specific conditions or sectors. As it is well known, bilateral aid donor often indulged in “tied aid”, which can exacerbate wasteful government consumption (Ehrenfeld, 2004). Some of the aid flows from these donors are conditioned to influence the recipient countries to use a certain percentage for goods/materials that stem from the donor country: this increases the market power of the donor country's firm and are mostly ineffective in setting market oriented policy for the recipient country (Easterly, 2007; Easterly and Pfutze, 2008; Whittle and Kuraishi, 2008). Furthermore, the donors give these aids to foster their interest in a particular sector in the country, which may directly compete with other foreign investors and affect their overall inflow into the country. This creates a destabilisation in the achievement of the objective for the adoption of IFRS.

We can therefore conclude that, despite the adoption of IFRS, the extent to which the recipient country is able to attract FDI depends on the type of aid that the country receives. Multilateral

aid flow will be more beneficial to the IFRS adopting country than bilateral aid flow, *ceteris paribus*. For multilateral aid, the recipient country will at least make minimal reform when receiving multilateral aid, or they end up facing the consequences of a poor reputation that will likely affect their access to future aid flow. Also, some of these reforms will affect the improvement of complementary inputs like the development of hard and soft infrastructure. These are necessities that, if present, the IFRS adopting country will be able to attract more FDI. This explanation also applies to the indicator of total aid flow (i.e. the variable *Foreign\_Aid*) because this variable is mostly explained by multilateral aid (see Figure A1 and A2); therefore it is convincing to base the behaviour of *Foreign\_Aid* on the influence of multilateral aid flow. Put differently, the presence of multilateral aid data in the total aid offsets the adverse effect of bilateral aid. This informs the reason for the positive effect of the interaction term of total aid and IFRS adoption on FDI.

#### ***Robustness Check: Controlling for the Unobserved Heterogeneity***

As earlier mentioned, four estimations were carried out as checks: they include the introduction of *Pol\_Globalisation*, *Civil\_Conflict*, *Endowment* and the periods of financial crisis, in the mainstream stochastic model. In considering the behaviour of the main variables, the preliminary checks were conducted and these include the assurance that the estimates reported were not susceptible to a type 1 error. The *AR (2)*, *Sargan* test, and the instrument ratio in Table 4.4 reveals that the estimates do not suffer from instrument proliferation, neither are the internal instruments having a second order autocorrelation with the error term.

#### **INSERT TABLE 4.4 HERE**

From Table 4.4, the inclusion of '*Pol\_Globalisation*' follow expected sign and significant values in most of the columns where it appeared, except for column 1B that contains bilateral aid. The relative behaviour of this variable suggest that foreign investment will prefer to locate operations in countries that grant more political freedom. However, the presence of bilateral aid does not substantiate this conclusion. This supports the conclusion of Bandyopadhyay, Sandler and Younas (2014). The variable '*Internal\_Conflict*' maintained a consistent negative and significant effect on the volume of FDI flow. This suggest that foreign investments will repatriate from countries that experiences rising internal conflict. The variable '*Endowment*' maintains a consistent positive and significant sign across the columns (column 3A-B), suggesting that foreign investors will be attracted to countries with natural resources, due to their extractive motive (see Asiedu, 2006; Asiedu and Lien, 2011).

As expected, the financial crisis dummy was negatively influencing the volume of foreign investment flow. However, this depends on the model and the period of financial crisis being examined.

Considering the variables of interest '*IFRS\_Adoption*' and foreign aid, their behaviour across the columns of Table 4.4 confirms that they are robust. The *IFRS\_Adoption* variable maintained a positive and significant outlook across the columns; foreign aid – i.e. '*Foreign\_Aid*' and '*Multilateral\_Aid*', were consistently positive and significant across the columns. The '*Bilateral\_Aid*' variable was consistently negative and significant across the columns. This was not in any way different from its behaviour in the earlier Table 4.3. In essence, the inclusion of these unobserved heterogeneous factors does not in any way inform nor influence the behaviour of our main variables.

In the same spirit, the interaction terms – all coined '*interaction*'<sup>6</sup>, containing the multiplicative between the components of foreign aid and IFRS adoption – maintained similar signs as earlier presented in Tables 4.1, 4.2 and 4.3. The significance of the interaction terms vary depending on the *heterogeneous* factor being considered. For instance, when the variable '*Internal\_Conflict*' was included in the model, only the interaction term between aggregate foreign aid and IFRS adoption was positive. The other interaction terms, though maintained a consistent sign with earlier Tables, their levels of significance were not verified. Similarly, the interaction term between bilateral aid and IFRS adoption (see columns 3C, 4C, 5C and 6C) – though negative – was not significant. Overtly, it can be concluded that the signs – behaviour – of the variables of interest is not informed by the inclusion of the heterogeneous factors. However, for bilateral aid and its interaction term with IFRS, the significance is somewhat inconsistent when considering some of these heterogeneous factors.

### ***Further Robustness Check***

In this section, further robustness checks was considered on the data. The econometric model was re-estimated using the sample that excludes transition countries, Highly Indebted Poor Countries (HIPCs) and highly corrupt countries (HCCs) [categorisation are presented in Table A2]. The transition countries were excluded from the sample based on the argument of Marquez-Ramos (2011) that the effect of the adoption of IFRS on FDI are higher in transition economies. Relating this to this study, the argument suggest that it is likely that the

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<sup>6</sup>The multiplicative '*Foreign\_Aid × IFRS\_Adoption*', '*Multilateral\_Aid × IFRS\_Adoption*' and '*Bilateral\_Aid × IFRS\_Adoption*' were respectively presented in columns A, B and C of Table 4.4.

consistency of the IFRS adoption variable and the interaction terms might likely be distorted if these countries are excluded from the sample. The exclusion of the HIPC countries from the sample is based on the argument that HIPC countries are likely going to have poor economic structure as a result of inefficient economic management and planning. This may likely deter FDI flow:therefore including countries in this category (as sample) may likely blur the behaviour of the main explanatory variables in the econometric model. Finally, HCCs countries were excluded because of the ‘depressing’ institutional frameworks prevalent in them (see Easterly, 2008). The inclusion of these countries - in the original sample - may likely produce an outlier effect in such a way that foreign aid in the stochastic may not reflect its exact behaviour.

From Table 4.5, the variables *IFRS\_Adoption*, *Foreign\_Aid*, *Multilateral\_Aid*, *Bilateral\_Aid* and the interaction terms did not behave differently. This imply that despite the presence (or removal) of *TC*, *HIPC* and *HCC* is not in any way informing the behaviour of the variables of interest. This suggest that the explanations earlier given suffices and is not biased due to the inclusion of these categories of countries in the sample.

#### **INSERT TABLE 4.5 HERE**

#### **Concluding Remark**

This study investigates the impact of foreign aid on the IFRS adoption-FDI nexus in 92 countries for the period 2003-2012. The SGMM estimation technique was applied to estimate the econometric model, while considering other forms of robustness to check the consistency of the estimates. This study also disaggregated the foreign aid variable into multilateral and bilateral aid. For the sampled countries, an increase in foreign aid improves the effect of IFRS adoption on FDI. However, when considering the disaggregated foreign aid variable, the multilateral aid improves the effect of IFRS adoption on FDI, while the bilateral foreign aid diminishes this effect. These results are robust to the inclusion of some country’s unobserved heterogeneous factors and as well as the exclusion of transition countries, highly indebted poor countries and highly corrupt countries.

A more nuanced explanation given for the reasons for the divergent effect between bilateral and multilateral aid include: most times, the multilateral donor are interested in the reforms and policies of the recipient countries and this therefore ties this form of aid to institutional

improvements and better governance structure that promotes the inflow of foreign investors. In the light of this, multilateral aid will complement the adoption of IFRS in improving the inflow of FDI. On the other hand, bilateral aid may not be so conscious of the institutional structure, atleast as long as the investment of the donor country is protected. The effect of this is that, in general, this form of foreign aid may not lead to sustainable institutional development that promotes FDI flow.

As a further inquiry, it will be important to examine the effect of foreign aid on IFRS-FDI nexus by considering the sectors to which aid are directed. The data that was used in this study only considered aggregate aid flow, multilateral and bilateral aid flow. While we present an interesting finding that can spur debate, further enquiries can be channelled towards observing the effect of aid flow to different sectors like infrastructure, education, humanitarian, agriculture and industry, and its effect on the IFRS-FDI nexus.

**Table 4.1: The Effect of IFRS Adoption, Foreign Aid and the Interaction Term on FDI**

	1A	1B	2A	2B	3A	3B	4A	4B	5A	5B	6A	6B	7A	7B	7C
IFRS_Adoption	0.32* (0.00)	0.37* (0.00)	0.33* (0.00)	0.32* (0.01)	0.38* (0.00)	0.24 (0.16)	0.55* (0.00)	0.03 (0.84)	0.97* (0.00)	0.29** (0.04)	0.91* (0.00)	0.21*** (0.08)	0.59* (0.00)	---	---
Foreign_Aid	5.28* (0.00)	1.75*** (0.08)	5.29* (0.00)	2.10*** (0.06)	1.11 (0.26)	2.70 (0.15)	8.45* (0.00)	6.46* (0.00)	5.08* (0.00)	1.50*** (0.10)	5.07* (0.00)	0.87 (0.38)	---	2.40* (0.00)	---
GDP_Growth	0.22* (0.00)	0.22* (0.00)	0.21* (0.00)	0.22* (0.00)	0.29* (0.00)	0.30* (0.00)	---	---	---	---	---	---	0.22* (0.00)	0.22* (0.00)	0.22* (0.00)
Market_Structure	-0.49* (0.00)	-0.50* (0.00)	-0.50* (0.00)	-0.51* (0.00)	-0.88* (0.00)	-0.90* (0.00)	---	---	---	---	---	---	-0.51* (0.00)	-0.50* (0.00)	-0.51* (0.00)
Infrastructure	-0.01 (0.55)	0.01 (0.55)	---	---	---	---	0.00 (0.73)	0.01 (0.39)	---	---	---	---	0.01 (0.28)	0.00 (0.78)	0.00 (0.76)
Openness	0.04* (0.00)	0.04* (0.00)	0.03* (0.00)	0.04* (0.00)	---	---	0.05* (0.00)	0.05* (0.00)	---	---	---	---	0.04* (0.00)	0.04* (0.00)	0.04* (0.00)
Democracy	0.17* (0.00)	0.13* (0.01)	0.17* (0.00)	0.15* (0.00)	---	---	---	---	0.10* (0.00)	0.04 (0.17)	---	---	0.16* (0.00)	0.13* (0.01)	0.16* (0.00)
Corruption	0.06 (0.55)	0.01 (0.91)	---	---	---	---	---	---	0.65* (0.00)	0.74* (0.00)	---	---	0.06 (0.47)	0.03 (0.75)	0.10 (0.28)
Foreign_Aid × IFRS_Adoption	---	12.80* (0.00)	---	11.39* (0.00)	---	12.04* (0.00)	---	9.92* (0.00)	---	13.58* (0.00)	---	13.84* (0.00)	15.02* (0.00)	10.19* (0.00)	11.53* (0.00)
FDI (-1)	0.04* (0.00)	0.04* (0.00)	0.04* (0.00)	0.04* (0.00)	0.06* (0.00)	0.06* (0.00)	0.03* (0.00)	0.03* (0.00)	0.06* (0.00)	0.06* (0.00)	0.05* (0.00)	0.05* (0.00)	0.04* (0.00)	0.05* (0.00)	0.05* (0.00)
Constant	7.39* (0.00)	7.84* (0.00)	7.68* (0.00)	7.90* (0.00)	17.44* (0.00)	17.99* (0.00)	0.12 (0.44)	0.16 (0.39)	3.98* (0.00)	4.57* (0.00)	4.01* (0.00)	4.33* (0.00)	7.81* (0.00)	7.72* (0.00)	7.74* (0.00)
AR(2)	0.46	0.50	0.47	0.51	0.41	17.99	0.39	0.40	0.35	0.38	0.29	0.31	0.57	0.48	0.55
Sargan	0.36	0.32	0.43	0.35	0.19	0.11	0.36	0.37	0.34	0.23	0.24	0.20	0.31	0.33	0.31
Cross section (n)	77	77	77	77	85	85	85	85	77	77	85	85	77	77	77
Instrument (i)	74	75	72	73	70	71	70	71	70	71	68	69	74	74	73
Instrument Ratio (n/i)	1.041	1.027	1.069	1.055	1.214	1.197	1.214	1.197	1.100	1.085	1.250	1.232	1.041	1.041	1.055

**Note:** The market structure variable, which represents the population of the country, was presented in its logged form. The values in parenthesis are the probability values: their values were at 1% ‘\*’, 5% ‘\*\*\*’ or 10% ‘\*\*\*’ levels of significance



**Table 4.2: The Effect of IFRS Adoption, Multilateral Foreign Aid and the Interaction Term on FDI**

	1A	1B	2A	2B	3A	3B	4A	4B	5A	5B	6A	6B	7A	7B	7C
IFRS_Adoption	0.44* (0.00)	0.22*** (0.07)	0.48* (0.00)	0.27** (0.05)	0.64* (0.00)	0.16 (0.26)	0.51* (0.00)	0.28*** (0.06)	1.10* (0.00)	0.79* (0.00)	1.14* (0.00)	0.83* (0.00)	0.00* (0.00)	---	---
Multilateral_Aid	30.04* (0.00)	23.14* (0.00)	28.43* (0.00)	22.82* (0.00)	11.46* (0.01)	4.03 (0.50)	45.32* (0.00)	39.86* (0.00)	28.75* (0.00)	18.50* (0.00)	34.63* (0.00)	24.27* (0.00)	---	19.76* (0.00)	---
GDP_Growth	0.21* (0.00)	0.22* (0.00)	0.21* (0.00)	0.22* (0.00)	0.29* (0.00)	0.29* (0.00)	---	---	---	---	---	---	0.22* (0.00)	0.22* (0.00)	0.22* (0.00)
Market_Structure	-0.44* (0.00)	-0.45* (0.00)	-0.44* (0.00)	-0.44* (0.00)	-0.93* (0.00)	-0.93* (0.00)	---	---	---	---	---	---	-0.48* (0.00)	-0.46* (0.00)	-0.48* (0.00)
Infrastructure	0.01 (0.38)	0.01 (0.41)	---	---	---	---	0.01 (0.18)	0.01 (0.18)	---	---	---	---	0.00 (0.91)	0.00 (0.57)	-0.00 (0.78)
Openness	0.04* (0.00)	0.04* (0.00)	0.04* (0.00)	0.04* (0.00)	---	---	0.05* (0.00)	0.05* (0.00)	---	---	---	---	0.04* (0.00)	0.04* (0.00)	0.04* (0.00)
Democracy	0.27* (0.00)	0.25* (0.00)	0.27* (0.00)	0.26* (0.00)	---	---	---	---	0.18* (0.00)	0.15* (0.00)	---	---	0.25* (0.00)	0.27* (0.00)	0.25* (0.00)
Corruption	0.23** (0.02)	0.18*** (0.07)	---	---	---	---	---	---	0.69* (0.00)	0.71* (0.00)	---	---	0.06 (0.53)	0.17*** (0.09)	0.06 (0.53)
Multilateral_Aid × IFRS_Adoption	---	20.27* (0.00)	---	19.94* (0.00)	---	46.24* (0.00)	---	22.60 (0.11)	---	31.52* (0.00)	---	29.71* (0.00)	39.62* (0.00)	28.07* (0.00)	40.78* (0.00)
FDI (-1)	0.03* (0.00)	0.03* (0.00)	0.03* (0.00)	0.03* (0.00)	0.05* (0.00)	0.05* (0.00)	0.02* (0.00)	0.03* (0.00)	0.05* (0.00)	0.05* (0.00)	0.04* (0.00)	0.04* (0.00)	0.04* (0.00)	0.03* (0.00)	0.03* (0.00)
Constant	5.49* (0.00)	5.74* (0.00)	5.61* (0.00)	5.71* (0.00)	18.28* (0.00)	18.42* (0.00)	-0.21 (0.16)	-0.12 (0.48)	3.64* (0.00)	3.92* (0.00)	3.90* (0.00)	4.00* (0.00)	6.77* (0.00)	5.91* (0.00)	6.79* (0.00)
AR(2)	0.65	0.66	0.67	0.69	0.67	0.68	0.45	0.47	0.49	0.50	0.38	0.40	0.75	0.69	0.75
Sargan	0.37	0.38	0.41	0.37	0.15	0.14	0.44	0.46	0.36	0.33	0.24	0.24	0.39	0.35	0.39
Cross section (n)	77	77	77	77	85	85	85	85	77	77	85	85	77	77	77
Instrument (i)	74	75	72	73	70	71	70	71	70	71	68	69	74	74	73
Instrument Ratio (n/i)	1.04	1.03	1.07	1.06	1.21	1.20	1.21	1.20	1.10	1.09	1.25	1.23	1.04	1.04	1.06

**Note:** The market structure variable, which represents the population of the country, was in its logged form. The values in parenthesis are the probability values: they are presented at 1% ‘\*’, 5% ‘\*\*’ or 10% ‘\*\*\*’ levels of significance

**Table 4.3: The Effect of IFRS Adoption, Bilateral Foreign Aid and the Interaction Term on FDI**

	1A	1B	2A	2B	3A	3B	4A	4B	5A	5B	6A	6B	7A	7B	7C
IFRS_Adoption	0.44*	0.40*	0.41*	0.39*	0.29*	0.52*	0.52*	0.49*	1.06*	0.96*	1.06*	0.97*	0.41*	---	---
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	---	---
Bilateral_Aid	-10.19*	-11.93*	-9.18*	-11.24*	-4.62	-10.76*	-0.48	-4.08	8.98**	-1.14	-18.03*	-7.22	---	-12.33*	---
	(0.00)	(0.00)	(0.00)	(0.00)	(0.22)	(0.00)	(0.89)	(0.34)	(0.03)	(0.78)	(0.00)	(0.11)	---	(0.00)	---
GDP_Growth	0.22*	0.22*	0.23*	0.23*	0.29*	0.29*	---	---	---	---	---	---	0.22*	0.22*	0.22*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	---	---	---	---	---	---	(0.00)	(0.00)	(0.00)
Market_Structure	-0.51*	-0.51*	-0.51*	-0.51*	-0.95*	-0.96*	---	---	---	---	---	---	-0.50*	-0.52*	-0.51*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	---	---	---	---	---	---	(0.00)	(0.00)	(0.00)
Infrastructure	0.01	0.01	---	---	---	---	-0.00	-0.01	---	---	---	---	-0.01	-0.01	-0.01
	(0.13)	(0.11)	---	---	---	---	(0.64)	(0.59)	---	---	---	---	(0.30)	(0.16)	(0.36)
Openness	0.04*	0.04*	0.04*	0.04*	---	---	0.05*	0.05*	---	---	---	---	0.04*	0.04*	0.04*
	(0.00)	(0.00)	(0.00)	(0.00)	---	---	(0.00)	(0.00)	---	---	---	---	(0.00)	(0.00)	(0.00)
Democracy	0.26*	0.27*	0.23*	0.24*	---	---	---	---	0.17*	0.15*	---	---	0.28*	0.30*	0.31*
	(0.00)	(0.00)	(0.00)	(0.00)	---	---	---	---	(0.00)	(0.00)	---	---	(0.00)	(0.00)	(0.00)
Corruption	0.07	0.06	---	---	---	---	---	---	0.73*	0.88*	---	---	0.12	0.05	0.11
	(0.44)	(0.51)	---	---	---	---	---	---	(0.00)	(0.00)	---	---	(0.18)	(0.62)	(0.20)
Bilateral_Aid × IFRS_Adoption		-9.57		-10.78*		-30.35*		-18.55		-45.15*		-46.80*	-1.26	-13.72	-3.35
		(0.39)		(0.31)		(0.00)		(0.13)		(0.00)		(0.00)	(0.89)	(0.14)	(0.66)
FDI (-1)	0.04*	0.04*	0.04*	0.04*	0.06*	0.06*	0.04*	0.03*	0.06*	0.06*	0.04*	0.04*	0.04*	0.04*	0.04*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Constant	7.16*	7.10*	7.45*	7.40*	18.78*	18.91*	0.44*	0.45*	4.07*	4.22*	4.30*	4.27*	6.94*	7.26*	7.09*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
AR(2)	0.80	0.83	0.82	0.84	0.717	0.74	0.57	0.57	0.57	0.61	0.45	0.86	0.79	0.86	0.83
Sargan	0.32	0.31	0.31	0.31	0.152	0.16	0.44	0.44	0.33	0.37	0.27	0.30	0.37	0.30	0.36
Cross section (n)	77	77	77	77	85	85	85	85	77	77	85	77	77	77	77
Instrument (i)	74	75	72	73	70	71	70	71	70	71	68	74	74	74	73
Instrument Ratio (n/i)	1.04	1.03	1.069	1.055	1.214	1.197	1.214	1.197	1.100	1.085	1.250	1.041	1.041	1.041	1.055

**Note:** The market structure variable, which represents the population of the country, was presented in its logged form. The values in parenthesis are the probability values: they are presented at 1% ‘\*’, 5% ‘\*\*’ or 10% ‘\*\*\*’ levels of significance

**Table 4.4: Robustness Checks (Including Political Globalisation, Internal Civil Conflict, Resource Endowment and Financial Crisis Dummy)**

	1A	1B	1C	2A	2B	2C	3A	3B	3C	4A	4B	4C	5A	5B	5C	6A	6B	6C
IFRS_Adoption	0.40*	0.36***	0.14	0.27*	0.47*	0.51*	0.21*	0.61*	0.89*	0.40*	0.22***	0.34*	0.37*	0.22***	0.35*	-0.32*	0.22***	0.41*
	(0.00)	(0.07)	(0.42)	(0.00)	(0.00)	(0.00)	(0.06)	(0.00)	(0.00)	(0.00)	(0.07)	(0.00)	(0.01)	(0.07)	(0.00)	(0.00)	(0.08)	(0.01)
Foreign Aid	1.95*	26.49*	-20.80*	3.02*	0.63*	-5.89*	6.30*	25.85*	-8.69***	2.13**	22.81*	-11.96*	0.22*	22.81*	-13.72*	1.67***	23.48*	-11.84*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.09)	(0.05)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.09)	(0.00)	(0.00)
GDP_Growth	0.23*	0.20*	0.22*	0.24*	0.23*	0.24*	0.28*	0.28*	0.29*	0.22*	0.22*	0.22*	0.22*	19.14*	0.22*	0.22*	0.22*	0.22*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.01)	(0.00)	(0.00)	(0.00)	(0.00)
Market Structure	-0.55*	-0.57*	-0.58*	-0.31*	-0.27*	-0.36*	-0.57*	-0.53*	-0.57*	-0.49*	-0.45*	-0.50*	-0.50*	-0.45*	-0.51*	-0.50*	-0.44*	-0.50*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Infrastructure	0.01	0.00	0.01	0.01*	0.00	-0.02*	0.03*	0.03*	0.02*	0.00	0.00	0.01***	0.01	0.00	0.01	0.00	0.01	0.01
	(0.47)	(0.87)	(0.15)	(0.00)	(0.49)	(0.00)	(0.00)	(0.00)	(0.00)	(0.80)	(0.52)	(0.07)	(0.53)	(0.52)	(0.13)	(0.60)	(0.41)	(0.12)
Openness	0.04*	0.04*	0.04*	0.04*	0.05*	0.05*	0.02*	0.03*	0.03*	0.04*	0.04*	0.04*	0.04*	0.04*	0.04*	0.04*	0.04*	0.04*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Democracy	0.09**	0.17**	0.22*	0.19*	0.31*	0.35*	0.12*	0.26*	0.25*	0.13*	0.27*	0.28*	0.12*	0.27*	0.28*	0.11**	0.25*	0.27*
	(0.03)	(0.02)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.01)	(0.00)	(0.00)	(0.01)	(0.00)	(0.00)	(0.02)	(0.00)	(0.00)
Corruption	-0.01	0.08	0.22	0.53*	0.76*	0.65*	0.17	0.14***	0.16***	0.05	0.19**	0.07	-0.02	0.19**	0.05	0.01	0.19**	0.07
	(0.94)	(0.59)	(0.19)	(0.00)	(0.00)	(0.00)	(0.14)	(0.10)	(0.09)	(0.55)	(0.04)	(0.48)	(0.85)	(0.04)	(0.64)	(0.92)	(0.05)	(0.45)
Political_Globalisation	0.01***	0.01**	-0.00															
	(0.08)	(0.05)	(0.64)															
Internal_Conflict				-0.06*	-0.08*	-0.08*												
				(0.00)	(0.00)	(0.00)												
Endowment							0.03*	0.03*	0.03*									
							(0.00)	(0.00)	(0.00)									
Financial_Crisis_2008										-0.37*	-0.22**	-0.10						
										(0.00)	(0.05)	(0.39)						
Financial_Crisis_2009													0.18	-0.22***	-0.15			
													(0.22)	(0.05)	(0.35)			
Financial_Crisis_2010																-0.31***	-0.11	-0.09
																(0.05)	(0.50)	(0.61)
Interaction	12.54*	26.75*	-26.30**	10.78*	1.96	-9.51	9.20*	22.46*	-0.91	12.21*	19.14*	-14.27	12.12*	19.14*	-13.24	12.51*	22.12*	-11.08
	(0.00)	(0.02)	(0.05)	(0.00)	(0.76)	(0.39)	(0.00)	(0.00)	(0.90)	(0.00)	(0.01)	(0.17)	(0.00)	(0.01)	(0.26)	(0.00)	(0.00)	(0.33)
FDI (-1)	0.04*	0.02*	0.04*	0.02*	0.02*	0.03*	0.07*	0.07*	0.07*	0.04*	0.03*	0.04*	0.04*	0.03*	0.04*	0.04*	0.03*	0.04*
	(0.00)	(0.01)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)

Constant	8.33*	0.02*	0.02*	3.66*	1.44*	3.27*	8.79*	6.81*	8.07*	7.77*	5.69*	7.00*	7.83*	5.69*	7.13*	8.02*	5.49*	6.91*
	(0.00)	(0.25)	(0.28)	(0.00)	(0.03)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
AR(2)	0.48	0.63	0.86	0.77	0.87	1.00	0.99	0.22	0.17	0.51	0.68	0.85	0.50	0.68	0.84	0.49	0.65	0.81
Sargan	0.32	0.50	0.41	0.33	0.38	0.23	0.37	0.55	0.48	0.31	0.36	0.29	0.33	0.36	0.30	0.33	0.38	0.32
Cross section (n)	77	77	77	77	77	77	77	77	77	77	77	77	77	77	77	77	77	77
Instrument (i)	76	66	66	76	76	76	76	75	76	76	76	76	76	76	76	76	76	76
Instrument Ratio (n/i)	1.01	1.17	1.17	1.01	1.01	1.01	1.01	1.03	1.01	1.01	1.01	1.01	1.01	1.01	1.01	1.01	1.01	1.01

**Note:** The market structure variable, which represents the population of the country, was presented in its logged form. The values in parenthesis are the probability values: they are presented at 1% ‘\*’, 5% ‘\*\*’ or 10% ‘\*\*\*’ levels of significance. The columns ‘A’ are for the models that include total aid in the estimation technique. Columns B and C are for the estimation models that includes multilateral aid and the bilateral component of aid, respectively. The ‘Foreign Aid’ variable included in the Table represents the three categories of aid. The coefficient of the total aid variable ‘*Foreign\_Aid*’ are in columns A, while that of multilateral and bilateral aid are in columns B and C, respectively. The interaction variable contains the multiplicative between total foreign, multilateral and bilateral aid, and IFRS adoption. The coefficients of *Foreign\_Aid* × *IFRS\_Adoption* are in column A, while that of *Multilateral\_Aid* × *IFRS\_Adoption* and *Bilateral\_Aid* × *IFRS\_Adoption* are in the B and C columns respectively.

**Table 4.4: Robustness Checks *Cont’d***

**Table 4.5: Further Robustness Checks**

	Excluding Transition Countries			Excluding Heavily Indebted Poor Countries			Excluding Highly Corrupt Countries		
	1	2	3	4	5	6	7	8	9
IFRS_Adoption	0.633* (0.000)	0.073 (0.633)	0.461*(0.003)	0.426* (0.000)	0.153*** (0.051)	0.649* (0.000)	0.293*** (0.084)	0.686* (0.000)	0.848*(0.000)
Foreign_Aid	6.881* (0.000)	---	---	0.867 (0.680)	---	---	0.124 (0.950)	---	---
Multilateral_Aid	---	24.479* (0.000)	---	---	23.419** (0.035)	---	---	6.655** (0.020)	---
Bilateral_Aid	---	---	-22.348* (0.001)	---	---	-7.865* (0.005)	---	---	-6.086 (0.156)
GDP_Growth	0.109* (0.000)	0.118* (0.000)	0.116* (0.000)	0.202* (0.000)	0.196* (0.000)	0.191* (0.000)	0.307* (0.000)	0.279* (0.000)	0.286* (0.000)
Market Structure	-0.427* (0.000)	-0.448* (0.000)	-0.547* (0.000)	-0.500* (0.000)	-0.495* (0.000)	-0.532* (0.000)	-0.651* (0.000)	-0.532* (0.000)	0.548*(0.000)
Infrastructure	0.030* (0.008)	-0.004 (0.723)	0.033* (0.008)	0.047* (0.000)	0.038* (0.000)	0.040* (0.000)	0.027* (0.004)	0.044* (0.000)	0.031*(0.000)
Openness	0.030* (0.000)	0.027* (0.000)	0.022* (0.000)	0.028* (0.000)	0.033* (0.000)	0.031* (0.000)	0.020* (0.000)	0.036* (0.000)	0.035*(0.000)
Democracy	0.175* (0.000)	0.105** (0.034)	-0.015 (0.745)	0.052 (0.142)	0.071 (0.133)	0.066*** (0.100)	0.154* (0.001)	0.324* (0.000)	0.290*(0.000)
Corruption	1.293* (0.000)	1.101* (0.000)	1.210* (0.000)	0.596* (0.000)	0.709* (0.000)	0.706* (0.000)	0.313* (0.007)	0.510* (0.000)	0.353***(0.013)
Foreign_Aid × IFRS_Adoption	16.698* (0.000)	---	---	26.465* (0.000)	---	---	7.304** (0.029)	---	---
Multilateral_Aid × IFRS_Adoption	---	38.696* (0.000)	---	---	83.963* (0.000)	---	---	13.464** (0.040)	---
Bilateral_Aid × IFRS_Adoption	---	---	-21.628 (0.146)	---	---	-1.236 (0.829)	---	---	-3.737*** (0.058)
FDI (-1)	-0.012 (0.386)	0.002 (0.908)	-0.015 (0.251)	0.047* (0.000)	0.105* (0.000)	0.104* (0.000)	0.050* (0.000)	0.047* (0.000)	0.049* (0.000)
Constant	8.624* (0.000)	9.056* (0.000)	11.150* (0.000)	8.300* (0.000)	8.413* (0.000)	9.098* (0.000)	10.535* (0.000)	6.354* (0.000)	7.177*(0.000)
AR(2)	0.220	0.494	0.502	0.881	0.323	0.369	0.880	0.173	0.169
Sargan	0.364	0.397	0.527	0.304	0.296	0.306	0.932	0.491	0.598
Cross Section (n)	72	72	72	66	66	66	67	67	67
Instrument (i)	64	64	64	64	64	64	64	64	64
Instrument Ratio (n/i)	1.125	1.125	1.125	1.031	1.031	1.031	1.047	1.047	1.047

**Note:** The market structure variable, which represents the population of the country, was presented in its logged form. The values in parenthesis are the probability values: they are presented at 1% ‘\*’, 5% ‘\*\*’ or 10% ‘\*\*\*’ levels of significance.

## Appendix

**Table A1: List of Sampled Countries**

Albania (TC)	Comoros (HIPC, HCC)	Guinea Bissau(HIPC, HCC)	Mauritania (HIPC)	Sri Lanka
Algeria	Congo, Dem. Rep.(HIPC, HCC)	Guyana (HIPC)	Mauritius	Swaziland
Angola (HCC)	Congo, Rep. (HIPC, HCC)	Haiti (HIPC, HCC)	Mexico	Tajikistan(TC, HCC)
Argentina	Costa Rica	Honduras (HIPC, HCC)	Moldova (TC)	Tanzania (HIPC)
Armenia (TC)	Cote D'Ivoire (HIPC)	Hungary (TC)	Mongolia (TC)	Thailand
Azerbaijan (TC)	Djibouti	India	Morocco	Tunisia
Belarus (TC)	Dominican Republic	Indonesia	Mozambique (HIPC)	Turkey
Belize	Ecuador	Jamaica	Nepal (HCC)	Uganda (HIPC, HCC)
Benin (HIPC)	Egypt	Jamaica	Nicaragua (HIPC, HCC)	Ukraine (TC, HCC)
Bhutan	El-Salvador	Jordan	Nigeria (HCC)	United Kingdom
Bolivia (HIPC)	Eritrea (HCC)	Kazakhstan (TC, HCC)	Pakistan (HCC)	United States
Bosnia (TC)	Ethiopia (HIPC)	Kenya (HCC)	Panama	Uruguay
Botswana	Fiji	Kyrgyz Republic(TC, HCC)	Paraguay (HCC)	Venezuela (HCC)
Brazil	Gabon	Laos (TC, HCC)	Peru	Vietnam (TC)
Bulgaria (TC)	Gambia (HIPC, HCC)	Lesotho	Philippines	Zambia (HIPC)
Burkina Faso (HIPC)	Georgia (TC)	Macedonia (TC)	Senegal (HIPC)	Zimbabwe
Cambodia(TC, HCC)	Ghana (HIPC)	Madagascar (HIPC, HCC)	Serbia (TC)	
Cameroon(HIPC, HCC)	Grenada	Malawi	Seychelles	
China (TC)	Guatemala	Malaysia	Sierra Leone (HIPC)	
Colombia	Guinea (HIPC, HCC)	Mali (HIPC)	South Africa	

**Table A2: Descriptive Statistics**

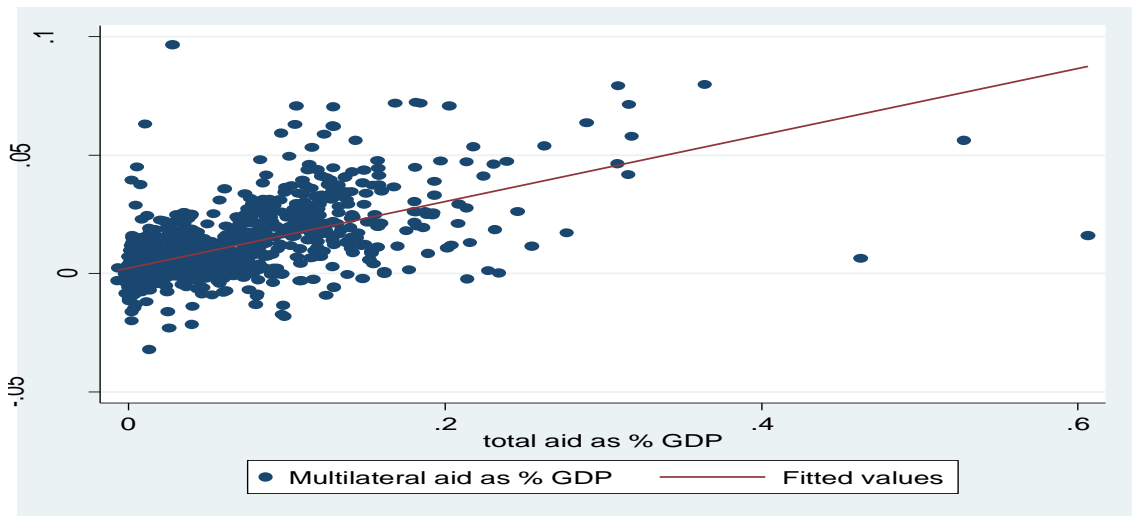
Variable	Identifier/Indicator	Mean	Std. Dev
<b>Explained Variables</b>			
Foreign Direct Investment	FDI/GDP	4.8661	5.8801
<b>Explanatory Variables</b>			
IFRS Adoption	IFRS_Adoption	0.5106	0.5002
Foreign Aid Total	Foreign_Aid/Foreign aid as % of GDP	0.0777	0.0922
Multilateral Aid Flow	Multilateral_Aid/ Multilateral aid as % of GDP	0.0104	0.0966
Bilateral Aid Flow	Bilateral_Aid/ Bilateral aid as % of GDP	0.0162	0.0698
<b>Market Structure</b>			
GDP Growth Rate	GDP_Growth/ GDP annual growth rate	4.7633	4.3267
Market Structure	Market_Structure/ Population	52,000,000	182,000,000
<b>Structural Covariate</b>			
Infrastructure	Infrastructure/ Telephones per 10 persons in a country	10.1770	10.0846
Openness of the Economy	Openness/Total trade as a % of GDP	84.6331	36.3754
<b>Governance Structure Covariate</b>			
Democratic Institution	Democracy (Mean of Political Right and Civil Liberty)	4.1563	1.5102
Corruption Control	Corruption (Control of corruption)	-0.5105	0.5009
<b>Other Variables</b>			
Political Globalisation	Pol_Globalisation	65.7468	17.8524
Internal Civil Conflict	Civil_Conflict/total civil unrest in a country.	2.3228	3.6495
Natural Resource Endowment	Endowment/ the share of fuel and mineral in total merchandise export	12.5189	13.6944

**Table A3: Pairwise Correlation**

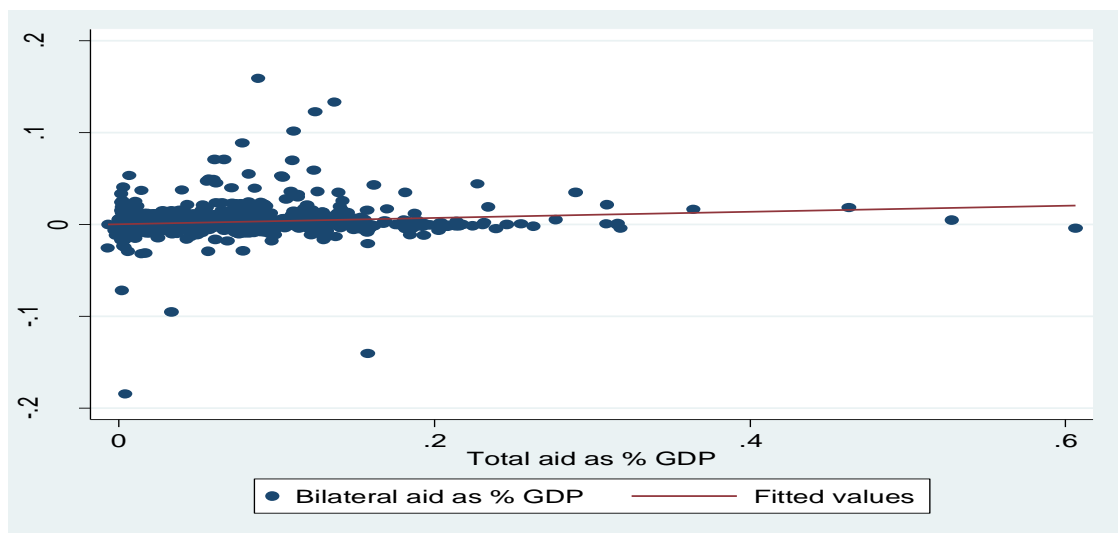
	FDI/GD P	IFRS_Adoptio n	Foreign_Ai d	Multilateral_Ai d	Bilateral_Ai d	GDP_Growt h	<u>Market Structur</u> <u>e</u>	Infrastructur e	Opennes s	Democrac y	Corruptio n
FDI/GDP	1.000										
IFRS_Adoption	0.109	1.000									
Foreign_Aid	0.037	-0.127	1.000								
Multilateral_Aid	0.038	0.090	0.306	1.000							
Bilateral_Aid	0.028	0.052	0.350	0.536	1.000						
GDP_Growth	0.173	-0.097	0.004	0.007	-0.013	1.000					
Market_Structure	-0.240	-0.104	-0.254	-0.222	-0.240	0.156	1.000				
Infrastructure	0.118	0.272	-0.435	-0.008	-0.044	-0.063	-0.092	1.000			
Openness	0.341	0.156	-0.136	-0.042	-0.055	0.042	-0.378	0.227	1.000		
Democracy	0.070	0.222	-0.184	-0.032	-0.017	-0.048	-0.221	0.390	0.183	1.000	
Corruption	0.094	0.248	-0.083	0.065	0.092	-0.071	0.167	0.323	0.010	0.485	1.000

Note: The market structure variable, which represents the population of the country, was presented in its logged form.

**Figure A1: Scatter Plot of Multilateral Aid and Total Aid**



**Figure A2: Scatter Plot of Bilateral Aid and Total Aid**





## References

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<sup>ii</sup>These years are important in identifying the period of the global financial crisis. This is due to the fact that the financial crisis was initially triggered by the bursting of the United States housing bubble in 2007, and afterwards, the financial crisis in Europe erupted in September 2008 and lasted up until 2010 (see Das and Dutta, 2012). These years witnessed a higher proportion of financial and economic recession in most donor countries