

ABSTRACT

Foreign Direct Investment (FDI) has a positive impact on economic growth through increased revenue and productivity. However, developing countries generally have a relatively higher level of shadow economy compared to developed countries. The existence of the shadow economy can increase investment costs and uncertainty, potentially acting as a barrier to FDI inflows. Furthermore, the impact of these barriers is believed to be greater for FDI in the form of greenfield investments than for cross-border mergers and acquisitions (M&A).

This study aims to analyze the relationship and the strength of the shadow economy's influence on FDI by distinguishing FDI based on its respective types, namely greenfield investment and cross-border M&A. This study was conducted by analyzing the relationship patterns and the influence of the shadow economy on each type of FDI—greenfield investment and cross-border M&A—separately across 22 developing countries from 2003 to 2017. The data used were panel data analyzed using the Random Effects Model.

The results of this study indicate that the shadow economy has a significant negative impact on both greenfield investment and cross-border M&A. A higher level of the shadow economy hinders the inflow of greenfield investment more strongly than it does the inflow of cross-border M&A in developing countries.

Keywords: Shadow economy, FDI, Greenfield investment, Cross-border M&A

