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# Determination analysis of realization in foreign investment: A case in West Java

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**Abstract**

In 2024, West Java Province aims to boost foreign investment to 250 trillion rupiah, maintaining its leading position in investment realization. This research examines factors influencing foreign investment in West Java, including SMEs (*Usaha Mikro, Kecil, dan Menengah-UMKM*), expenditure per capita, flood, waste, productive land, and unemployment. Prior strategies focused on direct engagement with foreign investors but neglected other critical determinants. This study investigates key sectors and economic indicators to provide a comprehensive analysis. The data used in this paper is a balanced panel of 27 residences and cities in West Java with an annual period from 2018 to 2022. We choose REM as the best model using panel data tests, including Chow, Hausman, and BPLM. This paper found that SMES, expenditure, productive land, and unemployment significantly positively affect the predictor. On the other hand, how floods and waste are handled has an insignificant effect on the predictor.

Keywords: Foreign investment; SMEs; expenditure; waste; flood; unemployment

## 1. Introduction

In 2024, investment in West Java Province is targeted to increase to 250 trillion rupiah because of its position in the previous year, which reached first place in the realization of domestic and foreign investment. It is challenging for the West Java regional government to maintain its first position in investment realization. After all this time, the government's strategy to attract foreign investors has only been door-to-door by participating in various investment events abroad. However, various indicators influence investor decisions that the government often ignores. Several studies have shown that infrastructure, government rules, inequality, and small business, etc., could impact foreign investment (Fauzan *et al.*, 2023; Fkun *et al.*, 2023; Salim and Faoziyah, 2022; Septiani, 2018; Sherty Veronika and Mafruhat, 2022). Therefore, to maintain its achievement of investment position, the government must also pay attention to the factors and sectors where the investor is most likely interested.

West Java Province is recognized as one of the main investment destinations in Indonesia (Purnomo and Sofia, 2019). Understanding local governments' economic landscape and regional investment policies is crucial for potential investors (Purnomo and Sofia, 2019). For instance, by improving human resources development and quality of work life, the region's appeal can increase in the eyes of foreign investors (Fkun *et al.*, 2023; Lestari and Caroline, 2021). Furthering education and training to enhance the capability and skills of the people of West Java will assist in positioning the area as a good place for investors to operate by having a skilled labor force. The study by An and Yeh (2021) postulates that the positive impacts of FDI can be realized in nations with improved economic competence. Thus, the development of infrastructure, revisions of policies, and the sustainability of economic factors within West Java will create a favorable environment for foreign investors.

Further, Sreenu and Rao (2023) elaborated on infrastructure and FDI, pointing out that infrastructure plays a significant role in attracting FDI, where countries with good infrastructure will attract more FDI than other countries. This aligns with the view that upgrading the economic status and

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implementing infrastructural facilities forms the basis for establishing foreign investment in a country such as West Java, Indonesia. Enhancing infrastructure, including transportation networks and utilities, can create a conducive environment for businesses and investors.

In conclusion, to effectively realize investment in West Java, Indonesia, the government must prioritize sectors that attract foreign investment to increase realization foreign investment, including economic indicators, industry-specific opportunities, health infrastructure, energy management strategies, environmental sustainability, biodiversity, and agricultural potential. By thoroughly evaluating these factors, investors can make informed decisions and capitalize on the diverse investment opportunities offered in West Java. Therefore, this journal aims to explore the indicators of the various factors and sectors tested. It is hoped that the government can also focus on what investors need and develop the sectors, not only through door-to-door methods, to gain investment.

## 2. Literature review

A study about governance in Islamic banks is very limited. Most of them Realization foreign investment refers to the actual implementation and execution of foreign investment projects, not just planned or intended projects. It includes the entry of foreign direct investment (PMA) into a country or region, reflecting the establishment of subsidiaries or the acquisition of large stakes in foreign companies (Kastratović, 2023). FDI entails a long-term relationship and significant control by the foreign investor over the company in the host country. The primary goal of FDI is to acquire a lasting interest in the foreign country, often leading to the transfer of knowledge, technology, and management practices to the local economy (Javorcik, 2004; Wang, 2022).

PMA is widely recognized as a crucial factor in international economic integration and is considered a catalyst for economic growth, particularly in developing countries. PMA can enhance productivity in domestic firms through knowledge spillovers and technology transfer from multinational corporations to local industries. Countries often compete to attract PMA with the expectation that the expertise and resources brought in by foreign investors will benefit domestic industries and contribute to economic development (Sokang, 2018).

### *Relationship between foreign investment and waste management*

Managing waste is critical in creating an environment that will encourage investment by foreign entities. Waste management also impacts space structure and business climate apart from embodying a location's sustainability standards (Sanjeevi and Shahabudeen, 2015). Research by Wulansari and Adhariani (2023) also shows that corporate waste disclosure and risk-taking signify the extent of the company's transparency and accountability on waste management, which may affect foreign ownership and investment judgements.

Sun *et al.* (2020) state that the proper development of waste management and transportation systems is critical for the best execution of residential waste treatment and management initiatives in rural settings. Scholars have taken note of this research work, and it may have implications for investments. These studies show how important waste management is for choosing a successful and attractive business climate for foreign investments by significantly affecting the 'realization' and decision-making about possible investments. Taking all these references together, one is in a position to understand how critical waste management is in determining investment decisions. This synthesis demonstrates how decision making for waste management investment is a complex process and that there is a need for an effective plan to attract investors to the sector.

### *Relationship between foreign investment and SMEs*

It is noted that attention is paid to such a topic as the relationships between SMEs and FDI. Many studies on this relationship have produced useful data. Idehen and Iguisi (2020), while defining FDI and FPI, have found that they are inversely related to the growth of SMEs in Nigeria. Similarly, Faridi *et al.* (2021) have also found negative effects between FPI and SMEs in the growth rate in Pakistan. This study therefore gives a conflicting and sometimes negative implication of FDI on MSMEs. It is necessary to note that there is not always a negative relationship between SMEs and FDI. This means that FDI can act as a complementary source of funds to finance SMEs' investment, and where the right policy framework is provided, FDI can play a very important role in SMEs' development (Tülüce and Doğan, 2014). Moreover, Abanis *et al.* (2022) established a moderately positive

relationship between capital structure, investment decisions, and the financial performance of SMEs in Uganda, which indicates the possibilities of certain kinds of investment for SMEs.

***Relationship between foreign investment and disaster flood***

Foreign investment realization and decisions are a function of natural disasters, albeit rather complex. Some studies have examined this relationship and focused on how disasters could affect decisions concerning foreign investments in various ways. Oh, and Oetzel (2011) studied how MNCs manage great catastrophes and found that both country risk and disasters can attract fresh foreign investment. This demonstrates that extreme catastrophes can affect foreign investment realization and can even cause an increase in investment in response to their consequences.

Nonetheless, Doytch (2020) notes a dearth of literature on the relationship between natural disasters and FDI, suggesting there needs to be more understanding about the extent of disasters' effect on investment decisions. Similarly, Ramos *et al.* (2021) ask the question as to whether FDI in a certain nation can be influenced by damages that result from natural disasters. Based on the preceding findings, there is a need to do more research and undertake further analysis of the relationship between FDI and natural disasters. Neise *et al.* (2022) also point out that most existing works have omitted natural disasters as a business risk and thus failed to consider the impact of disasters on FDI. This, on the same note, underlines the importance of integrating catastrophe risk while making financial decisions.

Thus, the research findings generally show that natural disasters might influence the realizations and decisions relating to foreign investments. Also, some works suggest that disasters can create new FDI generated through a fresh investment round. However, more research is necessary to understand the extent and specific ways disasters affect decisions about FDI fully.

***Relationship between foreign investment and unemployment***

The research identified that employment chances in Pakistan are influenced negatively by FDI, Pakistan's GDP, and the inflation rate indicated by the CPI (Arslan and Zaman, 2014). Numerous works explain the complex connection between foreign investment and the level of unemployment. Numerous studies have been done on factors that relate to foreign investment and the aspect of unemployment. On the other hand, Alalawneh and Nessa (2020) found out that the level of FDI does not influence the unemployment rate. Thus, there is a complex relationship between FDI and unemployment. In all of these studies, the necessity of unemployment for foreign investment is indicated by varying variables influencing the link.

In addition to this, there is empirical support from Njoroge (2021) study that has revealed that GDP growth per capita has a strong and positive relationship with FDI per capita. Moreover, Ismail and Houssein (2020) indicated a negative relationship between GDP per capita and foreign aid, thus emphasizing that it is crucial to distinguish between various types of FCI. Alley (2015) also spoke of the coexistence of foreign direct investment per capita and gross domestic product per capita in Sub-Saharan African economies, further discussed as requiring further research.

***Relationship between foreign investment and expenditure per capita***

Expenditure within the household has been used in different studies to predict FDI, and therefore, the variable is relevant to this study. In a study by Musakwa *et al.* (2021) ), it was concluded that FDI can lower poverty in the short run and long run, especially if poverty is measured using household consumption expenditure. Arefin *et al.* (2021) noted that economic factors such as Gross Domestic Product, Fixed Telephone Subscribers, Inflation Rate, and Education Spending affect FDI. Li and Liu (2005) pointed out that the interaction between FDI and economic growth has become more and more endogenous. They stated the need for deeper studying of how changes in household expenditure affect FDI processes.

***Relationship between foreign investment and productive agriculture land***

According to Arezki *et al.* (2015), the study focused on identifying the determinant of foreign land acquisition for large-scale agriculture. The findings showed that foreign investors were likely attracted to countries with large agricultural tracts. In addition, Asiedu (2006) found that factors like natural resources and markets like arable land enhance FDI. Besides, Jiang and Chen (2020) also highlighted the importance of agricultural land in investment by stating that the higher agricultural

returns and relatively cheaper land have led to an increase in foreign agricultural investment in developing countries.

Besides, it presents how the latter has been on the rise in allowing the sale or transfer of large amounts of agricultural land for foreign investment, making a point that agricultural land is a critical component in investment (Robertson and Pinstrup-Andersen, 2010). In addition, it states the significance of agriculture for economic growth and development in this context, pointing to the role of foreign direct investments in agriculture (Stojadinovic-Jovanovic and Dasic, 2015). In summary, the above literature purports that productive agricultural land is a potential factor affecting the global investment strategy, especially in large-scale agriculture and utilization of natural resources.

## 3 Method

### *Data*

We use a balanced panel of 27 West Javan cities and homes annually from 2018 to 2022. Panel data analysis has several important benefits that make it a useful tool in many different types of study. One important advantage is that individual effects allow one to control for unobservable heterogeneity, which cannot be done with cross-sectional analysis (Morgado and Pindado, 2003). Compared to cross-sectional data, panel data provides more sample flexibility and degrees of freedom, enhancing the ability to infer model parameters more accurately and represent the complexity of human behavior (Mousavian *et al.*, 2023). Additionally, panel data enables studying dynamic relationships and modeling differences or heterogeneity between subjects, leading to a deeper understanding of the data (King'wara, 2020).

Furthermore, the variables we used in this model are the realization of foreign investment (Realisasi PMA), flood by total evidence, tourism area, productive agriculture land, expenditure per capita, unemployment, poor road conditions, waste handled, and small and medium enterprises (SMEs).

Table 1. Variables description

| Category | Variables | Description | Symbol | Measurement |
|---|---|---|---|---|
| Dependent variable | Realization of Foreign Investment (PMA) | Logaritma data of realization of foreign investment | l_forinv | Rupiah |
| Independent Variable | Flood | Data on the number of flood events | flood | event |
| | Small Micro and Medium Enteprise (SMEs) | Data on the number of SMEs unit | SMEs | unit |
| | Waste handled | Data on the number of wastes handled per day | waste | Ton |
| | Unemployment | Data on the number of people unemploy | unemp | people |
| | Household Expenditure | Expenditure per capita | exp | Thousand rupiah |
| | Productive land | Area of productive land for rice cultivation | padi_h | hectare |

### *Analysis method*

Two methodological approaches are used in this study. By first examining the correlations between each independent variable and each dependent variable, we apply descriptive analysis. The link between independent and dependent variables is then used for our inference analysis. This is explained by the model in Equation 1:

$$l\_forinv_{it} = waste_{it}B_1 + smes_{it}B_2 + flood_{it}B_3 + unemp_{it}B_4 + exp_{it}B_5 + \text{padi\_h}_{it}B_6 + e_{it} \ldots (1)$$

Panel data have at least three basic models for their estimation. There are three types of models: Fixed Effect Model (FEM), Random Effect Model (REM), and Common Effect Model (also known as Pooled Least Square Model or Pooled Regression) (Septina, 2022). As a framework for panel data

analysis, the Common Effect Model is foundational in panel data regression (Wijaya, 2022). More complicated approaches are provided by the Fixed Effect Model and Random Effect Model, which allow researchers to take time-invariant unobserved heterogeneity and individual-specific effects into account (Septina, 2022). These models are essential for panel data analysis as they allow researchers to explore the correlations between variables while considering individual and temporal effects. This helps researchers thoroughly grasp the data dynamics (Septina, 2022).

After doing descriptive analysis, we choose the most suitable model for the data. Commonly, there are three-panel data tests: Chow, Hausmann, and Breusch-Pagan Lagrange Multiplier test. When deciding between PLS and FEM, the Chow test was utilized. When deciding between the FEM and REM models, we applied the Hausmann test. When comparing the REM and PLS models, the Breush-Pagan LM was used to make the comparison. The GLS approach can be used to estimate directly if REM is the best model for the data. However, the variance-covariance structure must be filled in if either PLS or REM is the most suitable model. Simple OLS estimation is adequate if the LM test does not indicate a problem. Otherwise, the estimate approach known as generalized least square (GLS) is used to evaluate the cross-sectional correlation.

The type of least squares used in regression analysis depends on the nature of the data and the assumptions being made, including the Ordinary Least Squares (OLS) and the Generalized Least Squares (GLS). OLS is a frequently used method that is described as simple, effective, and, in some cases, efficient (Wang *et al.*, 2016). This is usually used when there is no autocorrelation issue, heteroscedasticity, or multicollinearity in the data. OLS is the most efficient method of estimating the regression coefficients when the error term is normally distributed and follows the linear model. However, when there is heteroscedasticity, or the errors are autocorrelated, then GLS is used since OLS will depart from the assumptions it makes. When errors are heteroscedastic or auto-correlated, GLS will provide more efficient estimates than OLS because it considers the error variance pattern (Kempf-Leonard, 2004). In the case of panel data analysis and when dealing with complex data structures that require acknowledgment of error correlation, GLS is useful. Therefore, when the conditions for OLS cannot hold, GLS is preferable, while OLS is preferred if the data conforms to the standard assumptions of conventional linear regression.

## 4 Results and discussion

### *Descriptive analysis*

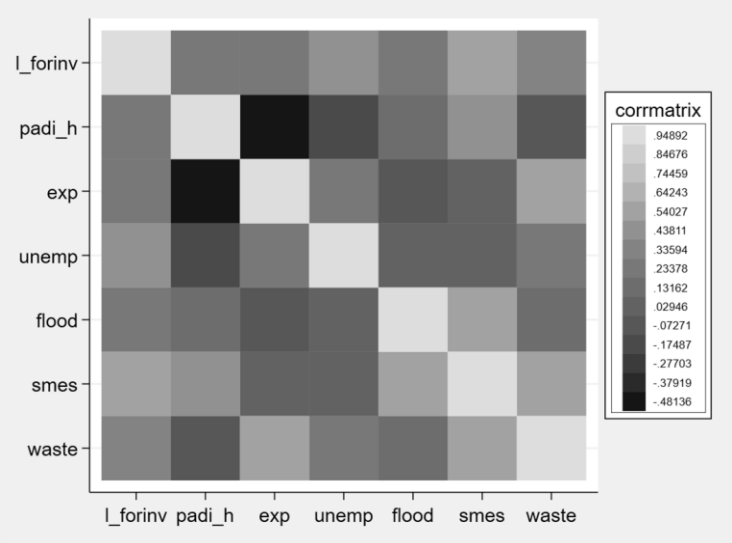


Figure 1. Heatplot correlation matrix

We can see in Figure 1. that the correlation between the dependent variable (l_forinv) and the independent variables illustrates a strong correlation. The highest correlation is in the SMEs (MSME) variable. This indicates that foreign investment realization strongly correlates with MSMEs in West

Java. All independent variables tested positively correlate with foreign investment realization compared to other variables tested as dependent variables.

***Results analysis***

Table 2. Test results to choose the best model

| Test | Chow | BPLM | Hausman |
|---|---|---|---|
| P value | 0.000 | 0.000 | 0.1819 |
| Choose Model | FEM | REM | REM |

As a result of Table 2, out of all the available models, the REM stands out as the most preferable model. The other models include FEM and PLS after conducting tests and analyzing p-values. From the data analysis, it can be concluded that REM has optimal results when comparing the data set's variability. The statistical tests applied to the results show that they are statistically significant for REM, which has a higher explanatory power and a better model fit in comparison with the other models. Therefore, the p-values depict that even within the groups and between groups, REM is efficient in understanding variations, which substantiates the effectiveness of REM in the modeling approach of the given research scenario. This selection of REM as the preferred model stems from its ability to capture the many folds of the data to improve the credibility and validity of the study.

Table 3. Random effect regression output

| Variables | Coefficient | P>value (0.10) |
|---|---|---|
| C | 14.56263 | 0.000 |
| SMEs | 0.0000117 | 0.004*** |
| flood | -0.0141615 | 0.440 |
| unemp | 0.1821365 | 0.065* |
| exp | 0.0005726 | 0.025** |
| waste | -0.0000763 | 0.863 |
| padi_h | 0.0000154 | 0.082* |
| Prob>chi2 | | 0.000 |
| Wald chi2 | | 32.22 |

***1% confidence level, **5% confidence level, *10% confidence level

The overall model in Tabel 3. is significant, as indicated by the Prob > chi2 value of 0.000, suggesting that at least one of the independent variables is significantly related to the dependent variable. The Wald chi2 statistic of 32.22 further confirms the model's strength in explaining the variation in the dependent variable. The constant (C) has a coefficient of 14.56263 with a p-value of 0.000, indicating that when all independent variables are zero, the dependent variable has a value of 14.56263, which is highly significant at the 1% level. The variable 'SMEs' has a positive coefficient of 0.0000117, important at the 1% level (p-value 0.004), indicating that for each unit increase in 'SMEs' (possibly related to small and medium enterprises), the dependent variable increases by 0.0000117 units.

The variable 'flood' has a coefficient of -0.0141615, suggesting a negative impact on the dependent variable; however, this effect is not statistically significant (p-value 0.440). On the other hand, 'unemp' (unemployment rate) has a positive coefficient of 0.1821365, significant at the 10% level (p-value 0.065). Indicating that each unit increase in 'unemp' is associated with an increase of 0.1821365 units in the dependent variable.

The variable 'exp' (expenditure per capita) shows a positive and significant impact on the dependent variable, with a coefficient of 0.0005726 and a p-value of 0.025, significant at the 5% level. Conversely, 'waste' has a negative coefficient of -0.0000763, but this effect is insignificant (p-value 0.863). Finally, 'padi_h' (productive land) has a positive coefficient of 0.0000154, significant at the 10% level (p-value 0.082), suggesting that an increase in 'padi_h' is associated with an increase in the dependent variable.

In conclusion, the regression results indicate that 'SMEs', 'unemp', 'exp', and 'padi_h' are significant predictors of the dependent variable, each positively influencing it to varying extents. 'Flood' and 'waste' do not show significant effects, implying that variations in these factors do not substantially impact the dependent variable within this model. The overall significance of the model underscores its robustness in capturing the relationships between the independent and dependent variables.

***Discussion***

The result reveals that waste was handled, and the flood did not significantly negatively affect the realization of foreign investment in West Java. This may indicate a complexity in the relationship between the realization of foreign investment (PMA) and waste handled and flood. This complexity indicates that independent variables (waste and flood) could significantly decrease the realization of foreign investment (PMA).

Other regressors have significant implications for predicted variables at different confidence levels. SMES has a significant positive relationship with the realization of foreign investment, meaning that every increase in one SMES unit will increase the realization of foreign investment by 0.000117%. This result reveals that foreign investors have a high interest in MSMEs in West Java, indicating that MSMEs can potentially increase foreign investment realization.

This result also proves that expenditure per capita has a significant positive relationship to predictors. This means that a one thousand rupiah increase in expenditure per capita makes the realization of foreign investment higher by 0,06%. This specifies how foreign investors always monitor economic welfare in a region. Expenditure per capita is well known to emphasize welfare (Salam *et al.*, 2019). Meanwhile, the productive land area has a significantly positive relationship to the predictor. A larger productive land area could indicate more inexpensive land (Ambalam, 2013; Li, 2015). Thus, this factor contributes significantly to gaining more foreign investors.

Something unique discovered in this paper is that unemployment has a significant positive relationship with predictor variables. This means that everyone unemployed could increase the realization of foreign investment (PMA) by 18%. This finding indicates a uni-directional relationship between the unemployment rate and foreign direct investment, potentially due to the availability of cheap labor in countries with high unemployment rates (Ndugbu *et al.*, 2019).

According to the result above, this paper would recommend that the government be able to improve regional quality to attract more investors. This is because there are several disparities in the realization of foreign investment in each district and city in West Java. In fact, districts and cities with large areas of productive land, indicating low land prices, have realized less foreign investment than other regions with more advanced infrastructure.

Furthermore, this research is trying to effectively address the challenge of unemployment positively impacting the realization of foreign investment (PMA) while striving to increase PMA inflows without worsening unemployment rates; various strategies can be recommended based on research findings. The study by Tegep *et al.* (2019), recommended that government policies aimed at attracting PMA should be complemented by initiatives to enhance the skills of local labor forces. Governments can lessen the impact of unemployment by ensuring that the workforce is prepared to benefit from FDI inflows by funding education and training programs that match the demands of the industries targeted for FDI.

Additionally, Alalawneh and Nessa (2020) proposed that reforming government policies to attract FDI and create conditions for a positive impact in the long term is crucial. This could involve implementing targeted policies that incentivize FDI in labor-intensive sectors with high absorptive capacity for employment, as highlighted by (Mkombe *et al.*, 2021). Such policies would ensure that FDI inflows lead to job creation and contribute to reducing unemployment rates.

## 5. Conclusion

This research examines the antecedents affecting the achievement of FDI in West Java, considering several factors such as SMEs, waste management and flood occurrences, unemployment, expenditure of households, and productive agricultural land. The most important shows that SMEs, household spending, and productive agricultural land are the key drivers of new investment. This confirms the researchers' hypothesis that these areas are priorities for foreign investors. Unexpectedly, the coefficient of high unemployment is also positively related to foreign investment, which means that

foreign investors may be attracted to areas with an abundant supply of workers because of their cheap labor. On the other hand, this study reveals no significant effect between the variables of waste management and flood events and the realization of foreign investment. This implies that a different form of interaction of these variables with the investment decisions may have an indirect impact or under conditions not captured in this research study.

Based on the study, some policy recommendations can be deduced for the West Java government. If the government wants to attract more FDI, it should concentrate on developing better infrastructure, mainly in the regional areas, developing SMEs, and investing in human capital. This includes enhancing education and training to ensure that the labor order meets the demands of the FDI-targeted industries' needs. Tackling unemployment through such programs can help in the development of the region, hence attracting investment and, at the same time, reducing the effects brought about by a high unemployment rate. Moreover, based on the study, it is necessary to focus on the issue of unequal investment realization throughout the districts and cities in West Java. Areas with extensive areas that meet the factors of production but have low investment rates should be targeted to improve their status with foreign investors.

However, this paper still has some limitations. While significant relationships were identified between variables such as SMEs, household expenditure, and foreign investment realization, the study primarily establishes correlations rather than causation, and there is a possibility of reverse causality where foreign investment might also influence these variables. Future research should expand the scope by considering additional factors such as political stability, cultural dynamics, and technological infrastructure, which could provide a more comprehensive understanding of the determinants of foreign investment. By addressing these broader aspects, policymakers can develop more nuanced strategies to attract and sustain foreign investment in West Java.

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