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## **Determinants and home-country effects of FDI outflows**

Evidence from Latin American countries

Ramón Padilla Pérez  
Caroline Gomes Nogueira



UNITED NATIONS

E C L A C

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This document has been prepared by Ramón Padilla Pérez, Economic Affairs Officer at the International Trade and Industry Unit, and Caroline Gomes, Research Assistant at the International Trade and Industry Unit, ECLAC, as part of the activities of the programme of work at the International Trade and Industry Unit of ECLAC.

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## Abstract

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Foreign direct investment (FDI) by Latin American companies has increased sharply since the beginning of the 2000s. While most investment flows correspond to firms from large economies (i.e. Argentina, Brazil, Chile, Mexico and Colombia), small economies have also witnessed the increasing internationalisation of their domestic companies. This study has two main contributions. First, it examines the strategies followed by multinational enterprises (MNEs) from Latin America when they decide to invest in other countries, highlighting differences by sector and issuer-country size. To that end a new database, which comprises quantitative information on the main operations abroad of Latin American enterprises (both greenfield, and mergers and acquisitions) was constructed, based on fDi Markets and Thomson Reuters Datastream. Second, it investigates the home-country effects of outward foreign direct investment (OFDI) by conducting a case study of Costa Rica through a representative sample of firms investing abroad.

The econometric findings show that MNEs from both large and small Latin American economies have market seeking as an important strategy to invest abroad. Yet MNEs from large economies tend to invest in countries which already have strong commercial ties, that are well-endowed with natural resources and not necessarily in neighbouring countries, while those from Central America are more likely to invest in countries with lower wages following an efficiency-seeking strategy. As for the case study on the benefits on home countries, the main findings are: a) internationalisation is not only for large and mature firms as medium and small-sized firms are actively investing abroad; b) most firms have pursued a market-seeking strategy; c) the benefits for the firm and the home country are stronger in companies with a clear internationalisation strategy; d) there is a positive relationship between international trade and internationalisation, and e) investing abroad does not mean, in general, that such firms are closing down or reducing their operations at home.





## Introduction <sup>1</sup>

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Foreign direct investment (FDI) by Latin American companies has increased sharply since the beginning of the 2000s. A large number of Latin American firms have shown a strong internationalisation strategy through both the purchase of assets (mergers and acquisitions) and greenfield investments throughout Latin America and, increasingly, in other regions. While most investment flows correspond to firms from large economies (i.e. Argentina, Brazil, Chile, Mexico and Colombia), small economies have also witnessed the increasing internationalisation of their domestic companies.

The effects of FDI on the recipient or host country have been widely studied (e.g. Iammarino and McCann, 2013; Padilla-P rez and others, 2008; UNCTAD, 2006; Madani, 1999; Grossman and Helpman, 1991; Caves, 1974). The economic literature often distinguishes between quantitative economic benefits (e.g. productivity growth, gross capital formation, as well as increased employment, exports and production) and qualitative ones (e.g. technology transfer and training of local human resources). However, there are also potential negative effects on the host country, such as the displacement of local investment and profit repatriation (Moran, 2000).

Yet, very few empirical studies have attempted to examine the effects to the issuer or home country of the investment. In addition, the internationalisation of companies from small, developing economies has also been poorly analysed. Having a small domestic market, sometimes with a less favourable environment in terms of local production and technological capabilities is a challenge that requires different strategies compared to those seen in larger or more developed economies.

From a public policy perspective, it is helpful to have a better understanding of the internationalisation strategies adopted by Latin American companies, as well as the benefits obtained in the home country. On the one hand, the international expansion of companies contributes to structural change, since the transfer of activities and production processes to other countries offers opportunities

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<sup>1</sup> The authors are grateful to PROCOMER, in particular to Luis Carlos Vargas, Marta Esquivel, Noelia Garro and the entire Market Intelligence Unit team for their valuable support in organizing the interviews for the firm survey and providing additional supporting data. The authors would like to thank Jorge Mario Martínez Piva and Simona Iammarino for their very useful comments on earlier drafts of this document. They are also thankful to Samuel Garoni and Laure Duhamel for their valuable research assistance in reviewing the existing literature on home country effects of FDI outflows. Francisco Villarreal provided guidance for the econometric analysis, while Jesús López helped the authors with the sample selection methodology.

for technological upgrading in the home country, due to improvements in processes and products, as well as the transition to more technologically complex and higher value-added activities. On the other hand, if there is a positive net benefit for emitting economies, then there is room for public policy to encourage and support the internationalisation of domestic companies.

Within this context, the aim of this study is to examine the strategies followed by multinational enterprises (MNEs) from Latin America when they decide to invest in other countries, highlighting differences by sector and issuer country-size. This study also aims to investigate the home-country effects of outward foreign direct investment (OFDI).

A database which comprises quantitative information on the main operations abroad of Latin American enterprises (both greenfield, and mergers and acquisitions) was constructed, based on fDi Markets, a database maintained by the Financial Times, and data from Thomson Reuters Datastream. Statistical analysis was conducted, distinguishing between outward FDI from large and small Latin American economies. Particular attention is given to Central American economies,<sup>2</sup> as a case of small, developing countries in which outward FDI has increased rapidly in recent years. Among Central American economies, the internationalisation of Costa Rican firms stands out. In effect, Costa Rica has been the largest issuer of FDI among Central American countries. To analyse further the strategies followed by multinational firms from small, developing economies, as well as the effects for the home country, a questionnaire was designed and applied to a representative sample of Costa Rican multinational firms.

The remainder of the paper is organized as follows. Section I provides a conceptual framework of the determinants and home-country effects of FDI outflows. Section II provides a description of the recent performance of FDI inflows and outflows in Latin America. Section III describes the dataset compiled for this study and presents descriptive statistics and econometric results on the differences between large and small Latin American countries in terms of FDI outflow determinants. Section IV conducts an analysis of home-country effects of outward FDI, using a case study of Costa Rican multinational enterprises. Finally, Section V concludes and presents policy recommendations.

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<sup>2</sup> Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama.

# I. Conceptual framework

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## A. Determinants of international production and MNE activity

Foreign direct investment (FDI) can be defined as a cross-border investment involving medium and long-term relationships and control by a parent company (a multinational enterprise) over affiliate enterprises located overseas (IMF, 2009; OECD, 2008; UNCTAD, 2006). In turn, multinational enterprises (MNEs) are defined as incorporated or unincorporated firms which comprise parent companies and their foreign affiliates (UNCTAD, 2006). Parent companies are enterprises which control assets of other entities in at least one country other than its home country, usually by owning an equity stake of 10% or more of the shares or voting power. Foreign affiliates, which include subsidiaries, associates and branches, are enterprises controlled by investors residing outside the host economy.

From a traditional economic and neoclassical theoretical point of view, MNEs engage in foreign production to maximize profits or to further the interests of their stakeholders. An early and more elaborated attempt to explain the determinants of MNE activity is the product life-cycle theory developed by Raymond Vernon.<sup>3</sup> There have been more recent attempts to explain the determinants of MNE activities such as the internationalisation theory of MNEs and the macroeconomic theory of foreign direct investment (FDI). The internationalisation theory analyses the reasons why firms decide to engage in FDI rather than using the international markets of goods as an expansion mechanism,<sup>4</sup> while the macroeconomic approach focuses on explaining the macro-level determinants that affect the host country's FDI flows such as GDP, interest rates, exchange rates, productivity, trade openness, geographical proximity, differences in terms of availability of natural resources and labour force, and institutional framework.<sup>5</sup>

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<sup>3</sup> Vernon (1966), drawing upon some earlier work by Michael Posner (1961), developed an international trade and internationalisation of production model based on the stages of product life-cycle: entry, maturation and standardisation. In the first stage, when product innovation is taking place, the new good is produced and consumed near the sources of knowledge, inputs and services needed for innovating. In a second stage, the product is improved (maturation) and the innovative country starts exporting it to other countries. In the last stage, when the product has been standardized, low labour costs play a central role and internationalisation of production takes place when the manufacturing activities are moved to low-skilled, low-waged countries, which export the good to the innovative one.

<sup>4</sup> See, for instance, Buckley and Casson (2009) and Rugman (2009).

<sup>5</sup> For further details, please see Pitelli (2010); Lall (1997); Goldberg and Klein (1997); Nachum (1998), and Wilhelms (1998).

Even though international production by MNEs has increased significantly and taken on new patterns over the previous three decades, the eclectic Ownership-Location-Internalisation (OLI) paradigm of international production developed by John H. Dunning in the mid of the decade of 1970 is still the leading conceptual tool to study the determinants of FDI and MNE activities (Eden and Dai, 2010; Teece, 2014).<sup>6</sup> Dunning developed a broad analytical framework which combines different major economic, business and managerial theories, such as industrial organisation theory, internalisation theory and location theory to explain both the activities and changing patterns of MNEs abroad (Iammarino and McCann, 2013). It distinguishes three main drivers for FDI: ownership (O), location (L) and internalisation (I).

First, in order to compete in foreign markets, MNEs need competitive advantages arising from production technology, trademarks, marketing expertise, patents, or management and general organizational abilities; these are referred to as ownership-specific advantages (O) and include tangible resources, such as manpower, capital and natural resources as well as intangible ones or capabilities such as technology, information and entrepreneurial skills.

The second component of the OLI paradigm states that there must be location-specific factors (L) in a foreign country, such as market size, transportation costs, resources and market structure, as well as a favourable political, legal, institutional and cultural environment, which make it profitable to set up new investments abroad. In this setting, the more immobile the natural or created endowments, the more companies are likely to engage in foreign direct investments.

A third and last component of the paradigm seeks to explain the reason why firms choose to engage in FDI activities or internalize transactions (I), rather than exporting products or licensing production technologies. Hence, the greater the net benefits of internalizing cross-border product markets, the more likely a firm will prefer to engage in foreign production.

The eclectic paradigm has faced numerous challenges to its continued applicability in the light of new phenomena associated with the process of increasing global economic integration, trade liberalisation, emergence of new countries as important players in the world economy, and increasing significance of the knowledge-based economy. For instance, the advent of electronic commerce and the broadening access to some standardized technologies over recent years have reshaped intra-firm production and trade, increasing the number of licensing agreements and management contracts. By contrast, knowledge and trade-intensive industries such as pharmaceuticals, industrial electronics and management consultancy, observed a marked increase in merger and acquisition operations.<sup>7</sup>

Each component of the OLI paradigm has been questioned by some scholars.<sup>8</sup> These criticisms have led to the revision and extension of the OLI paradigm by Dunning himself (e.g. 2001, 2003, 2008, 2009). For instance, Dunning (2001) acknowledged that cross-border, non-equity alliance and strategic asset-augmenting FDI have become more important forms of international economic arrangements, requiring a reassessment of the paradigm. Therefore, he introduced dynamic components and concepts such as the investment development path (IDP), which asserts that as a country goes through various stages of development the configuration of the OLI paradigm undergoes changes. For instance, in the first stage of the development path, least developed countries face a negative net outward investment position since they are net FDI receivers and outward FDI is negligible or non-existent.

<sup>6</sup> Before Dunning, Behrman (1972) had already studied the strategies of MNEs.

<sup>7</sup> In order to take into account new global phenomena, for instance, Mathews (2006) developed an alternative analytical framework called linkage, leverage and learning (LLL). Mathews argues that through the establishment of joint ventures and other forms of collaboration in global value chains, MNEs from emerging countries are able to quickly access new resources that are not internalized by the company (e.g. capital, technology, skills and knowledge). Once this linkage is established, companies having entered international markets later in the process can leverage their global links for resources, particularly analysing its costs-benefits and learning about new sources of competitive advantage and how to operate internationally.

<sup>8</sup> The ownership-specific component has been questioned for a number of reasons, such as not addressing internalisation theory and market failures (Rugman, 2010), or new forms of international businesses (Cantwell and Narula, 2003), and not incorporating both strategic management and institutional theories (Bevan, Estrin and Meyer, 2004). By the same token, the internalisation-specific component has faced some criticism, since it does not address non-transaction related functions and has provided little guidance on how to create resources and capabilities (Teece, 2014; Cantwell, 2014). As for location, there is an increasing recognition that sub-national and region-specific advantages are crucial for attracting FDI, therefore recent analysis on firm location strategies emphasises the importance of local rather than national characteristics (Iammarino and McCann, 2013).

Dunning has also revised the theoretical framework in order to address the institutional theory, based substantially on the work of Douglas North, and examined how an institutional dimension could be incorporated into the three components of the OLI paradigm (Dunning and Lundan, 2008). Although some aspects of institutional analysis have been implicit in the existing theories of international business for a long time, it is important to explicitly separate the institutional effects from other influences on the activities and strategies of MNEs.

In summary, the emergence of new phenomena on MNE activity has added to, rather than subtracted from, the relevance of the OLI paradigm. Regardless of the different categorisations and successive extensions of the model, the eclectic OLI paradigm offers a satisfying conceptual structure for explaining the extent and pattern of international production. It combines both micro- and macroeconomic perspectives by accommodating different theoretical strands under a unifying umbrella (Iammarino and McCann, 2013). For the aim of this document, the extended OLI eclectic paradigm provides a robust conceptual framework and a comprehensive explanation of the extent and patterns of foreign production.

## B. Taxonomy and investment strategies of MNEs

Different taxonomies to study MNEs investment strategies have been developed. Narula (2001), for instance, presents a taxonomy of subsidiaries based on two main scales: the level of competence of the subsidiary and the scope of its activities.<sup>9</sup> Birkinshaw and Morrison (1995) propose a taxonomy based on the mandate of foreign subsidiaries.<sup>10</sup> The taxonomy developed by Dunning, based on the OLI paradigm offers a clear and comprehensive framework to study the determinants of FDI. This framework takes into account the industry and the nature of the value added activities performed, as well as the investor's objectives and strategies. Based on Dunning (2000), four main types of investment strategies are here identified. Yet, it must be acknowledged that although these four categories are quite clear at the conceptual level, at the empirical level it is not simple to disentangle them, since most companies follow more than one strategy at the same time (Iammarino and McCann, 2013).<sup>11</sup>

First, there are market seekers, which invest in a particular country or region to supply goods or services in the host and adjacent countries. The main reasons to set up an affiliate abroad are market size or prospects of market growth; the need to adapt products to local tastes or needs; following main suppliers and customers that have previously set up foreign producing facilities; and improved access to other markets giving the favoured entrance conditions of the host country. Second, there are natural-resource seekers, which are MNEs encouraged to invest abroad to gain access to particular and specific resources, such as mineral, raw materials and agricultural products.

A third type of MNEs are efficiency seekers, which are designed to reduce production costs, for instance, through having access to abundant supplies of low cost and unskilled labour. An additional motivation of the efficiency seekers is to rationalize the structure of established resources to gain from the common governance of geographically dispersed activities. The main benefits arise from economies of scale and scope, and risk diversification. Fourth, the strategic asset seekers are prompted by the need for acquiring technological capabilities, management or marketing expertise, and organisational skills.

<sup>9</sup> The author identifies three main kinds of subsidiaries: a) truncated miniature replicas (TMR), which are a duplication of the parent firm, but possibly not with the same scale of production and not all the value adding activities; b) rationalized affiliates whose operations are based on an efficiency seeking motivation, aimed at optimizing costs over multiple locations, and c) single-activity affiliates which are severely truncated and are generic in the sense that there are often numerous such affiliates in various locations and do not contribute anything unique to the assets of the MNE (Narula, 2001).

<sup>10</sup> First, the local implementer which is a subsidiary with limited geographic scope, typically a single country, and a severely constrained product or value-added scope. Second, the specialized contributor has considerable expertise in specific functions or activities, but its activities are tightly coordinated with the activities of other subsidiaries. Third, the world mandate has worldwide or regional responsibility for a product line or entire business, and typically has unconstrained product scope and broad value-added scope (Birkinshaw and Morrison, 1995).

<sup>11</sup> Some scholars have built complementary taxonomies based on Dunning's approach. For instance, Rasiah and others (2010) argue that in addition to market, labour and natural resource seeking strategies, three more drivers can be identified: a) value chain control seeking, i.e. locating different stages of the value chain in different countries to exploit cost and quality differentials; b) financial incentive seeking, to take advantage of both host and home governments incentives, and c) technology seeking, in order to access to technology and strategic assets.

## C. Empirical evidence on the determinants of MNE Investments

This section presents a review of empirical studies on the determinants of firms with increasing involvement in international markets. Several authors have used innovative approaches to examine not only the determinants of FDI in emerging markets, but also further decisions taken by MNEs once they have set up an affiliate in host countries.

Piteli (2010) analysed the determinants of FDI inflows in developed OECD, European, and non-European countries. Results showed the critical role of high total factor productivity for attracting FDI to developed countries. Other studies conducted in Europe found that the growth potential of markets and the purchasing power of consumers are important determinants of FDI inflows (Meyer, 1996; Pye, 1998; Mold, 2003).

Some scholars have analysed the determinants of FDI inflows to low and lower middle income countries in Asia, Africa and Latin America. For instance, Mottaleb and Kalijaran (2010) suggest that large domestic markets and a high growth potential are important in determining FDI inflows to the developing countries. Ranjan and Agrawal (2011) analysed the determinants of FDI inflows in Brazil, Russia Federation, India and China, finding that market size, trade openness, labour cost, infrastructure facilities and macroeconomic stability and growth prospects are potential determinants of FDI inflow in BRIC countries. The determinants of FDI inflows in Latin America have been widely studied, following a regional (e.g. Ferraz and others, 2011; ECLAC, 2012) or country-level approach (Martínez-Piva and Hernández, 2012; Dussel, 2007; Kosacoff and Porta, 1997). Further studies in developing countries also found that potential market size, the degree of export orientation, human resources, an enabling environment through the provision of infrastructural facilities, and macroeconomic stability are important determinants of FDI flows both in the short and long run (Oladipo, 2010; Chan and others, 2014).

Another group of studies illustrates that factor costs are an important determinant of FDI inflows. Lankes and Venables (1997) and Pye (1998) argue that financial efficiency, production costs, transportation costs and labour cost advantages are important factors in determining FDI inflow of export-oriented companies.

Research has also been done regarding the motives for FDI in R&D, since there has been an increasing trend to transfer R&D activities to emerging countries. MNEs' motives for investing in R&D sites overseas are twofold: first, to adapt existing products and services to local needs and regulations, for instance when MNEs establish manufacturing facilities abroad and assign technologically complex processes and products to them, they need to establish R&D sites in close proximity to the factories; second, they need to augment their knowledge base – certain countries or regions may be particularly advantageous locations for R&D facilities due to the presence of other R&D organisations such as research universities, skilled researchers, public-funded research institutes and innovative competitor firms. Additional factors which may turn a country attractive for FDI in R&D are created by the presence of industries producing crucial inputs for innovative activity, such as laboratory equipment for manufacturing firms, maintenance firms, and specialised laboratory testing services, which are called home-based-augmenting R&D (Cantwell, 1989, 1992; Kuemmerle, 1999; Narula, 2001; Cantwell and Molero, 2003; Cantwell and Mudambi, 2001 and 2005; Cantwell and Piscitello, 2013).

In terms of determinants of FDI from developing countries, the empirical analysis is scant and mostly focused on Asia (especially China). Gammeltoft and Kokko (2013) have analysed the trends of investment outflows from emerging economies and found that OFDI from developing countries has experienced a rapid increase in recent years. Evidence of the Chinese case shows that Chinese outward FDI is attracted to large markets, high inflation, high openness to trade, poor institutions, cultural proximity and large natural resources.<sup>12</sup>

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<sup>12</sup> For instance see Buckley and others (2007), Cheng and Ma (2008), Zhang and Daly (2011), Amighini and others (2013), and Kolstad and Wiig (2012).

In various editions of its flagship publication *Foreign Direct Investment in Latin America and the Caribbean*, ECLAC has analysed the internationalisation strategies of Latin American multinational enterprises (e.g. ECLAC, 2006 and 2014), distinguishing between sectors and issuing countries. For instance, in the 2005 edition several country-level case studies were conducted in the largest Latin American issuers (i.e. Argentina, Brazil, Chile and Mexico) (ECLAC, 2006). It concluded that the most common strategy followed by Brazilian MNEs has been to invest abroad as an insurance against country risk while firms from Chile and Mexico were motivated by increasing competition in their domestic markets as a result of economic reforms. Along with Brazil, Argentina's MNEs were the first to internationalise; however, they were bought eventually by foreign companies.

A recent study released by the World Bank analyses the characteristics, motivations, strategies, and needs of emerging-market investors using data from a survey of investors and potential investors in four emerging economies: Brazil, India, the Republic of Korea, and South Africa. The main findings reveal that accessing markets is the main motivation to invest abroad and there is a clear regional concentration with emerging-market firms facing binding costs in order to invest in distant and unfamiliar markets. Also, investors are significantly more dependent on international trade, which reveals a complementary nature of international trade and FDI for emerging economies (Gómez-Mera and others, 2015).

## D. Home country effects of FDI outflows

The previous sections examined the existing literature on the determinants of FDI and the strategies followed by multinational enterprises when they decide to invest in other countries, elaborating a conceptual framework to address the first aim of this research. This section, in turn, elaborates the conceptual framework to address the second objective of this document which is to study the home-country effects of OFDI. As said, the OLI paradigm is a comprehensive framework to study the strategies of MNEs, but it says rather little on the impact of FDI on home countries. Therefore, a conceptual framework is here developed based on a thorough review of the existing literature and the experience of the authors studying FDI and MNEs. Potential effects can be classified into two: quantitative (e.g. employment, productivity and sources of financing) and qualitative (e.g. technology transfer and human resources formation). In addition, there is a set of horizontal factors affecting the intensity and characteristics of the potential effects arising from OFDI (see table 1).

**Table 1**  
**Overview of different effects on home countries that may arise from OFDI and factors that influence these outcomes**

1. Quantitative effects	<ul style="list-style-type: none"> <li>- Number of jobs</li> <li>- Quality of employment</li> <li>- Balance of payments (international trade of goods and services)</li> <li>- Sources of financing</li> <li>- Royalties</li> <li>- Revenues of home-country operations</li> <li>- Home-country tax payments</li> <li>- Increased productivity</li> <li>- Economies of scale</li> </ul>
2. Qualitative effects	<ul style="list-style-type: none"> <li>- Technology transfer</li> <li>- Human capital formation</li> <li>- Product and process innovations</li> <li>- Production and technological capabilities</li> </ul>
Horizontal factors	
<ul style="list-style-type: none"> <li>- FDI-strategy and industry</li> <li>- Linkages with home economies</li> <li>- Organisations and institutions</li> </ul>	

Source: Own elaboration.



## 1. Quantitative effects

Diverse studies have focused on productivity gains in home economies stemming from outward FDI. Most quantitative studies on productivity effects have used data samples from either the firm or sector level on the outward FDI of firms in any given year. Using this data in combination with different production functions the authors were then able to quantitatively assess, through different econometric exercises, the extent to which OFDI affected productivity gains in different home countries. These studies were conducted in different industries, following business-, industry- or country-level approaches, mainly in European and Asian countries (e.g. Vahter and Masso, 2006; Hsu and others, 2011; Athukorala and Chand, 2000). Some authors have found different levels of productivity gains, while others conclude that there is no increase in productivity at all. For instance, Bernard and others (2009) argue that in the US, the plants of US MNEs show labour productivity 16.6% higher than large domestic firms and 44.6% higher than small US firms.

There is a commonly held belief that OFDI automatically leads to job destruction in the home country. When MNEs transfer their operations to other countries, they may leave workers in the home economy bereft of their jobs. Yet, although the economic literature is not conclusive, most empirical evidence suggests a small and marginally positive effect of OFDI on employment in home countries (UNCTAD, 2006). Most studies focus on the impact on developed countries. For instance Federico and Minerva (2008) found a positive relation between OFDI and the number of employees in Italy, compared with companies that did not conduct any such an investment abroad. Similarly, Lee and others (2015) found that Japanese MNEs increased employment at home as a result of foreign investment associated with enhanced production efficiency and better global market access, which in turn generate greater demand for their final outputs. In contrast, Moran (2011) argues that US MNEs increased their total employment (domestic and foreign) between 2000 and 2007, but with a slight decline in home-country employment. When looking at developing countries, Liu and Lu (2011) discovered a similar positive correlation in China between home-country employment and OFDI. Similarly, in South Korea there was only a short-run, slightly negative effect on employment for companies that invested in less developed countries and no significant effect for companies investing in more advanced economies, which indicates that it is important to differentiate between the destination country of OFDI to properly assess the effects on employment in the home country (Debaere and others, 2010).

OFDI also may have effects on home economies in terms of quality of employment. For instance, a study of US and Swedish firms found that when production is transferred to developing countries by MNEs, labour intensive activities are reduced in the home economy (Blomström and others, 1997). Borga and Lipsey (2009) show that US parent firms are more capital-intensive than their foreign subsidiaries, and therefore the high-value added activities tend to stay in the home country. By the same token, studies of Japanese and US firms show that higher OFDI led to more high-skilled employment at home associated with supervision responsibilities (Lipsey and others, 2000; Slaughter, 2000). Furthermore, Elia and others (2009) distinguished between OFDI to developed and developing countries: If a MNE invests in a developing country, its demand for high-skilled labour force at home increases while investment in developed countries demand less skilled labour at home.

Improvement of balance of payments arising out of OFDI-related export growth represents another potential positive effect on home countries. A study conducted by Lee (2002) concludes that OFDI and exports are not mutually exclusive, i.e. although a firm internationalizes its production, it does not mean that its global exports decrease. Several authors find an association between an increase in exports and outward FDI in studies from different countries (Bajo-Rubio and Montero-Muñoz, 2001; Chow, 2011; Chen and others, 2012b; Pfaffermayr, 1996). This effect takes place because despite shifting parts of production abroad, the company is able to expand its business and ultimately create greater economies of scale. This in turn leads to an overall increase in exports, which outweighs possible losses occurring from production moving abroad.

Kim and Rang (1997), on the other hand, show that OFDI in South Korea and Japan has neither had a positive nor negative impact on exports, showing that country specific differences influence export levels too. Lim and Moon (2001) highlight that outward FDI had a higher effect on home country

exports if the subsidiaries were located in less developed countries than in developed countries. Furthermore, findings are more pronounced if the subsidiaries are relatively new and if the industry is in a declining stage in the firm's home country. A far larger number of academic studies have found a direct correlation between exports and outward FDI, however, as in the case of productivity, the countries used for the analysis have been predominantly developed or recently developed Asian economies, while there are only a few studies on Latin America.

Another important issue of OFDI is whether it crowds in or out domestic investment. The answer lies in how the investment abroad is financed. If it is financed through cross-border capital flows, and if raising this capital crowds out home-country investment, then outward FDI would adversely affect domestic capital formation. Otherwise, if the company has sufficient financing possibilities there are only very few adverse impacts (Lee, 2002).

A further strain of research looks at the new sources of financing that outward FDI creates for the investing company. A major concern in relation to outward FDI in developing countries is capital flight whereby domestic firms make acquisitions abroad to safe-guard their money outside their home market for fear of macroeconomic or political instability. Evidence suggests that MNEs from developing countries use financing methods abroad to a significantly higher extent than their peers from developed countries, since macroeconomic and political instability tend to be higher in developing countries (UNCTAD, 2006). In the same vein, Tavares (2005) argues that Cemex's acquisition of RMC in the UK gave it access to hard currency, while Votorantim chose to expand to the United States and Canada in order to have access to capital at more competitive conditions than in its home country.

Tavares (2005) sees financial risk diversification as another important reason for companies to conduct outward FDI. This finding was derived from interviews with 50 translatinas. Risk diversification has been especially important to companies that want to hedge themselves against exchange rate risks to which Latin America economies have not always been immune in the past.

Home country public finances can also be influenced by domestic companies that invest abroad if the government decides to acquire a stake in the company or take over the company altogether. In nationalized oil companies it may quite often be the case that the corporation invests abroad and with its investment decision impacts the financial household of the entire country (UNCTAD, 2006).

OFDI may have also an impact of home-country tax revenues, since increasing output and employment in internationalised firms may lead to higher fiscal contributions. Yet, empirical studies show that multinationals are predisposed to be in countries with low taxation of foreign-source of income when making location decisions for new subsidiaries or parent firms (Barrios and others, 2012). Therefore, stringent tax regimes tend to have a negative impact on the home country with MNEs transferring their profits toward countries with less stringent tax regimes. As a consequence, countries may become the victim of tax revenue shortfalls and suffer revenue losses (OECD, 2013; Voget, 2011; Altshuler and Grubert, 2003). Another potential effect of FDI on home economies arises from capital and profits repatriation. Evidence of the effects of dividend taxes on the profits repatriated from foreign subsidiaries show that companies will adapt their repatriation policy depending on the dividend tax rate (Desai and others, 2001; Bellak and others, 2010).

A last quantitative effect to be considered is the impact of FDI on home economies stemming from stock exchange presence overseas (cross-listing). In this setting, some companies choose to be listed in two different stock markets pursuing segmentation and diversification gains, reducing the systematic risk for the home country, achieving more visibility in financial markets and financial press, and decreasing transaction costs for investors overseas (Litch, 2002). Moreover, cross-listing can also

generate compliance costs and transparency obligations which can be high, in particular for small companies.<sup>13</sup>

## 2. Qualitative effects

The research on the qualitative effects that OFDI may have on home economies, such as knowledge transfer and human resources formation, has grown recently but it is still a relatively new branch of study. Chen and others (2012a) found evidence supporting reverse spillover effects that occur when emerging market MNEs have subsidiaries in markets richer in technological resources. It is essential to study how emerging market firms gain the absorptive capacity to internalize the newly gained knowledge stemming from their operations abroad and spread it to the rest of the economy. More studies have found improvements in technological capabilities in home economies as a result of OFDI in both developing and developed countries (Driffield and others, 2014; Al Azzawi, 2012; Zhao and Ordó ez de Pablos, 2010; Driffield and Love, 2003; Lee, 2002).

Some studies examine firm-level enhanced competitiveness and focus on human capital transformation and technology transfer. Most research is presented in form of case studies of different firms that have conducted OFDI. Jeenanunta and others (2013) looked at three major Thai companies that invested in developed countries between 2008 and 2010, and concluded that substantial training of Thai employees in the newly acquired affiliates, personnel exchange and joint projects were common mechanisms of knowledge transfer. This, in turn, resulted in more sophisticated products and better trained employees. Mani (2013) analysed the Indian car manufacturer Tata in a case study where the company established a joint venture with the Korean firm Daewoo. The author found three main ways of knowledge transfer that occurred thanks to its investments abroad: R&D joint product development and technology transfer through licensing and the exchange of employees for training purposes. Another paper addressing a case in Indonesia also discovered positive knowledge spillover effects from OFDI in the local company (Aminullah, and others, 2013). In summary, MNE s production and technological capabilities may be strengthened as a result of investing abroad.

Not all scholars, however, agree that knowledge is automatically transferred to the investing company. Lissoni (2001) is more critical when it comes to the questions of tacit and codified knowledge. He concludes that knowledge circulates within a few smaller epistemic communities and that even local messages were highly codified. His research was conducted in small Italian mechanical firm clusters. While this is just one example of a very specific industry, it is important to further study how tacit knowledge can be disseminated and how codified knowledge is transmitted between parent company and subsidiary.

Other qualitative domestic effects are related to technology transfer from the investing company to home-country suppliers or other organisations such as universities or research centres, through a wide array of linkages. When a MNE invests abroad, it may acquire new technological knowledge, which may be transferred to the rest of the home economy through a wide array of domestic linkages.

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<sup>13</sup> Examples of Latin American MNEs listed at the New York Stock Exchange (NYSE) show that firms tend to benefit of a better notoriety with a better exposure to the world s largest pool of capital and liquidity, increase liquidity by giving them access to a much larger, more diversified, and more global shareholder base. This point is very important in particular for small firms, stock exchange allows them to detain capital and invest in innovation, capital expenditure or pay off existing debt. In particular, Brazilian companies such as Bradesco, Braskem, BRF, Gafisa and Gerdau, are the most present in the New York Stock Exchange; with a market capitalisation representing 72% of the Latin American total. Copa Airlines and Banco Latinoamericano de Comercio Exterior, both from Panama, are the only two Central American MNEs listed at the NYSE.

### 3. Horizontal factors

Three horizontal factors which directly impact the effects of outward FDI for the home economy are identified below.

#### a) FDI-strategy and industry

The first horizontal factor has to do with the strategy that the firm pursues when investing abroad. As mentioned above, there is a wide array of studies on the strategies of MNEs, and the most disseminated is the one developed by Dunning (2000), already mentioned in section B above, which identifies four main types of MNEs according to their motivations to set up a foreign affiliate: natural-resource seekers, market-seekers, efficiency-seekers and strategic-asset seekers. If a MNE invests abroad in search of advanced technological knowledge, it is more likely to acquire new knowledge through its international activities and transfer it to its home country than if it pursues an efficiency-seeking strategy.

MNEs also differ in their willingness to transfer technology and the mechanisms to do it, according to their corporate strategy. This strategy has a strong impact on the type of links built with local organisations and consequently on technological learning. For instance, the literature recognizes that technology transfer strategies differ according to whether firms from the United States and Europe or Asia are being considered. Empirical analyses show that Asian firms, in comparison with European and United States firms, in general have a less internationalised R&D activities structure (Padilla-P rez, 2008; Molero and Heijs, 2002; Reger, 2001, 2002; Meyer-Krahmer and Reger, 1999).

The dynamics of technical change differ greatly across industries in terms of characteristics, the sources of new knowledge, the actors involved, the boundaries of the process, and the organisation of innovative activities. Keith Pavitt's (1984) seminal paper classified firms according to sources of new knowledge and technology and the appropriability mechanisms. Pavitt proposed four types of sectoral patterns for innovative activities: supplier dominated (e.g. textiles, services); scale-intensive (e.g. steel, automotive); specialised suppliers (e.g. machinery and equipment producers); and science-based sectors (e.g. electronics, pharmaceuticals). Other empirical studies on innovation-related sectoral differences include Robson and others (1988), PACE (1996) and Cohen and others (2002). These industry-specific dynamics affect the impact of OFDI on the home economy: Innovative and more technologically-open industries are expected to have larger technology-related effects.

#### b) Local linkages

The linkages built by the MNE in the host economy, but also in its home economy, represent the second horizontal factor. If the MNE operates as an enclave in the host economy, which is to say with few or no interactions with domestic firms and other organisations (universities, research centres and industry associations, among others), the room for learning is limited (Padilla-P rez, 2008). If the MNE, by contrast, develops strong economic and technological-knowledge links with domestic organisations, there is much more space for acquiring new knowledge that may be transferred to home-economy organisations in a second stage. The same occurs in the home country: the stronger the linkages with the rest of the home economy, the greater the potential to transfer new knowledge acquired abroad to local organisations and individuals. Therefore, the embeddedness of MNE in both home and host economies is crucial to define the type and intensity of effects arising from investing abroad.

When MNEs engage in activities with other home-country firms and organisations, they may disseminate knowledge acquired thanks to their investments abroad (Padilla-P rez, 2008; de Propriis and Driffield, 2006; Zander, 1999; Blomström and Kokko, 1998). The type and intensity of these linkages is crucial for the diffusion of knowledge between companies that are expanding abroad and home-country firms and organisations (Iammarino and McCann, 2013). The ease with which technology transfer occurs depends on several factors, such as technological proximity (i.e. how far apart the home and host countries' technological knowledge level is) and competition (the more competition from abroad the greater the chances that local companies feel pressured to adapt to new market conditions and absorb new knowledge and technology) (Blomström and Kokko, 2003).

### c) Organisation and institutions

A third factor influencing the effects of outward FDI on home economies is associated with local organisations and institutions. Institutions govern societal transactions in the areas of politics, economics and society and can be broadly classified into formal and informal. Culture, for instance, can be viewed as part of informal institutions, rules and norms of a specific society that are passed on from generation to generation, but that are also constantly changing and evolving. The legal system of a country, in contrast, is an example of a formal institution. Organisations are embedded in this institutional framework, and influenced by it. There is constant interaction between the institutions of a country and the organisations that are situated in it (Peng and others, 2008).

As hinted above, knowledge transfer may occur if the connections are made between organisations and the MNE. The institutional framework has a significant impact on those interactions. Collaboration between MNEs, education organisations and the government can also lead to knowledge-transfer into the wider economy (Padilla-P rez, 2008). And robust institutions and organisations, including public policies, may foster stronger linkages.

The so-called investment-development path (IDP) developed by John Dunning in the eighties sheds light on the development stage of a country and its institutions, on the one hand, and MNEs investment patterns, on the other. Dunning (1986) stresses five different stages of development a country finds itself in and each stage is characterized by a different pattern of investment flows. While in early development stages no outward FDI occurs and only limited inward flows take place, inward flows become more pronounced as the economy develops. With increased knowledge and development, companies of developing countries see the need to go abroad and acquire resources and market access, which they are no longer able to attain at home until OFDI flows start to overtake inward FDI. This process is dependent on the development stage of the country and the advancement of its institutions. More recently, Iammarino and McCann (2015) argued that it is more relevant to analyse subnational regions than countries, since within developing countries it is common to find more advanced regions whose private enterprises have developed capabilities to invest abroad.

Stoian (2013) argues that there are several factors playing a significant role in determining whether a country undertakes investment abroad, all of them embedded in the institutional environment: large and small scale privatisation, enterprise restructuring, price liberalisation, trade and foreign exchange, competition policy, banking reform and interest rate liberalisation, securities markets and non-bank financial institutions. Several authors have analysed the institutional environment of firms that conduct OFDI with particular interest in the Chinese case (Liu and others, 2005; Tolentino 2010; Luo and others, 2010), as well as in Russia and post-communist states in Eastern Europe (Stoian, 2013; Kalotay 2008; Andreff, 2003). They have found a correlation between government actions and outward FDI.

The government may foster networks to improve knowledge flows between different organisations, including MNEs, thus enhancing the positive effects that MNEs have on home economies. Some examples are supporting academic research linked to MNEs activities and needs, fostering knowledge exchange through internships and personnel exchange programs and promoting knowledge-based backward and forward linkages between MNEs and local firms.

Lastly, while the bulk of the literature highlights positive and neutral effects of OFDI, some authors also mention certain potentially negative effects on the home economy. For instance, capital outflows may harm the domestic economy if they are used for purposes of capital flight, and to crowd out domestic producers through increased knowledge and competences on the part of the company conducting the investment abroad and subsequent monopolistic tendencies. Another negative effect may be the creation of industrial structures that are dependent on affiliates from abroad (UNCTAD, 2006; Lee, 2002; Kokko and Blomström, 2003). Also, taxation and profit repatriation strategies may have a negative impact on home economies if companies are less prone to reinvest in their home country and increasingly employ tax avoidance schemes in order to pay less tax at home (Devereux and Maffini, 2007).

## II. Recent performance of foreign direct investment in Latin America

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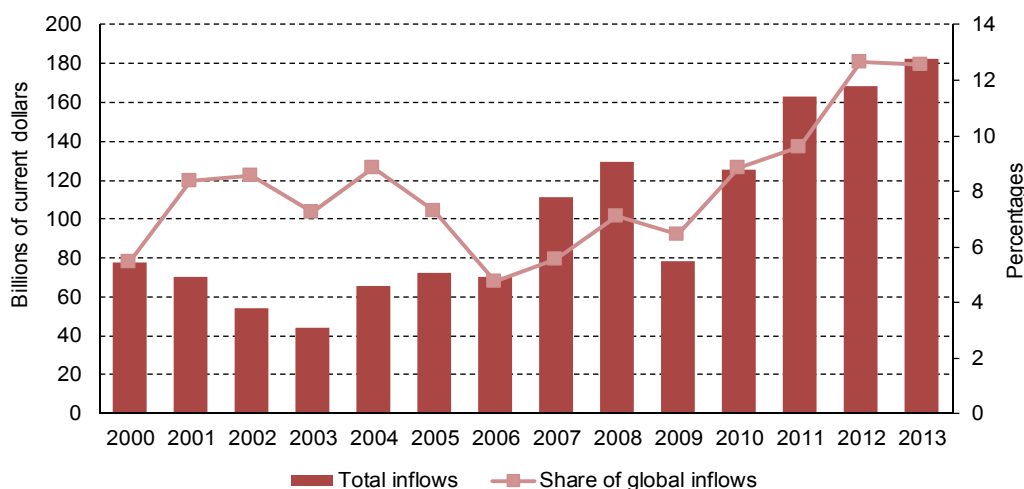
As an introduction, a brief description of the evolution of FDI inflows in Latin America in the last three decades is presented. During the eighties, when FDI flows were scant, Latin American countries opened up their economies and removed restrictions on FDI through bilateral and multilateral agreements, as well as unilaterally, following a wave of liberalisation policies. Between 1985 and 1990, total annual FDI inflows to Latin America amounted to 7.2 billion of dollars, on average (see figure 1).

In the nineties, openness to foreign investment was deepened with the privatisation of public companies, which often were bought by foreign investors. In addition, in the northern subregion of Latin America, FDI inflows reached productive sectors that made use of preferential export-oriented tax schemes mainly for manufacturing industries, such as free-trade zones and maquiladoras, while in the southern subregion of Latin America foreign investment was focused on supplying local markets and extraction of natural resources. Between 1990 and 2000, total annual FDI inflows amounted to 40.3 billion of dollars, on average. The share of Latin America in global FDI inflows peaked at 13.2% in 1997, as seen in the figure 1.

Over the past decade, FDI inflows in Latin America increased sharply: between 2000 and 2010, total annual FDI inflows increased to 81.7 billion of dollars, on average. The two main factors contributing to the increase of FDI were the economic growth of the region and high international demand for commodities. Three qualitative changes followed the growth of these FDI inflows: the greater weight of FDI within the services sector; a structural change within the manufacturing sector leading to a shift from production of durable goods for the domestic market to production for exports, and the renewed importance of the natural resources sector.

Between 2010 and 2013, total annual FDI inflows jumped to 160 billion of dollars on average. Foreign MNEs continued to seek investment opportunities in the markets of Latin America, even with the presence of adverse factors after the 2009 crisis. GDP growth in the region slowed and export prices of commodities decreased, however, private consumption, which is a key factor for market-seeking FDI, continued to grow (ECLAC, 2014). Latin America's share of total global FDI inflows rose from 5% in mid-eighties to 12.7% in 2013.

**Figure 1**  
**Latin America: FDI inflows and LA share of global FDI inflows, 2000-2013**



Source: Own elaboration, based on data from UNCTAD.

## Analysis of FDI outflows in Latin America

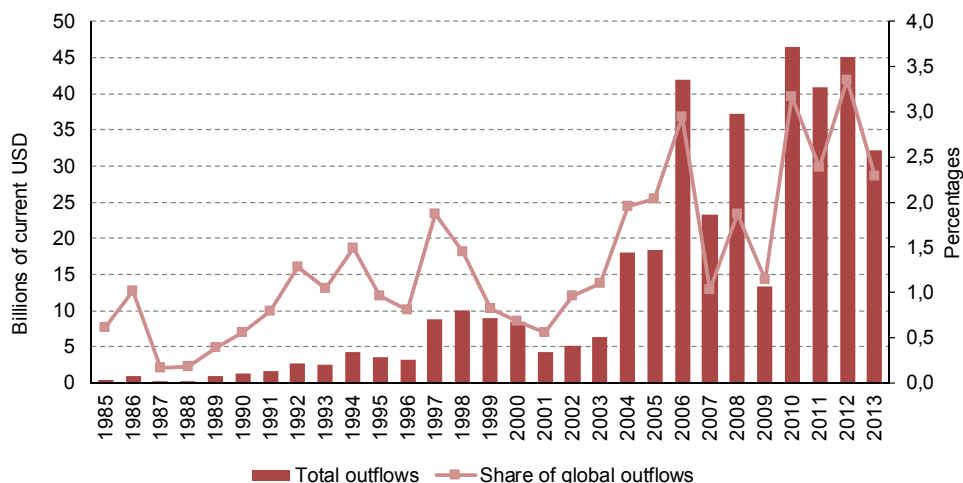
Trends in outward FDI from emerging and developing economies can be split into three different waves starting in the decade from 1960 until recent years (Rasiah and others, 2010). From the sixties to the mid-eighties, a first wave of FDI outflows originated in Latin America towards other neighbouring developing countries with similar demand structures, driven mainly by market- and efficiency-seeking determinants such as the need to establish trade supporting networks and to access protected markets and natural resources. By this time, a large part of these multinational corporations were state-owned, especially in natural resources, and entered new markets through minority ownership and greenfield investments.

From the late eighties to the mid-nineties, a second wave originated in the so-called Asian tigers (i.e. Republic of Korea, the Chinese Province of Taiwan, Hong Kong Special Administrative Region of the People's Republic of China and the Republic of Singapore) towards other fast-growing and newly-industrialized economies, driven by strategic-asset seeking, and also to less developed economies with low-cost labour forces. With a total annual FDI outflow of only 1.3 billion on average, Latin America was not a leading actor during this period.

A third wave of outward FDI emerged in the late 1990s with more geographically diverse countries of origin, modes of ownership, sectoral composition, and destinations. From this period on, Latin America emerged as one of the leading issuers of outward investment among emerging economies, with finance and business services becoming a leading sector in outward FDI. Between 1999 and 2009, total annual FDI outflows by multinational Latin American companies increased to 16.8 billion of dollars, on average. More recently, between 2010 and 2013, total annual FDI outflows jumped to 41.2 billion of dollars, on average. As a result, Latin America's share of total global FDI outflows increased from around 0.8% by the late from the nineties to 2.3% in 2013 (see figure 2).

Developing countries remain the main destination of FDI outflows from emerging economies, yet investments in developed countries have increased in recent years. In addition, though these investments are originated in a few large emerging economies, there has been a significant increase in investments from small developing countries. This increasing volume of outward investments from emerging and developing economies has been driven by a variety of factors such as the increase in wealth, reforms in trade and investment policies and increased regional integration, as well as the improvement of firm-specific advantages (Rasiah and others, 2010).

**Figure 2**  
**Latin America: FDI outflows and share of global FDI outflows, 1985-2013**

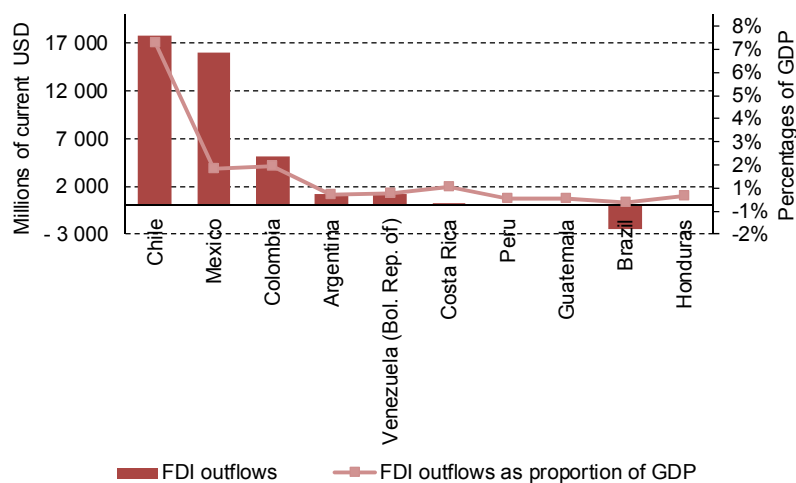


Source: Own elaboration, based on data from UNCTAD.

Figure 3 shows a three-year average of total FDI outflows and FDI outflows as a proportion of GDP for the ten largest issuer countries in the region. In 2011-2013, Chile, Mexico and Colombia were the largest issuer countries of total FDI outflows in Latin America in absolute terms. Analysing FDI outflows as a percentage of GDP, Chile and Colombia show the highest ratio in the region. Central America is represented by Costa Rica and Guatemala among the ten largest issuer countries in the region.

Brazil had been traditionally the largest issuer; however its flows declined in recent years since Brazilian MNEs are investing less abroad. This could be mainly a result of the financing strategy of Brazilian MNEs, which refer loans from overseas subsidiaries to their parent companies in order to avoid the higher interest rates prevailing in Brazil. Other possible influence factors are the uncertainties generated by the international economic crisis, leading Brazilian companies to concentrate in the domestic market bringing their investments back to their headquarters instead of reinvesting abroad. In addition, the political and economic instability of key partner countries such as Argentina and Venezuela (Bolivarian Republic of) also contributed to the slowdown in outward investments.

**Figure 3**  
**Latin America (10 largest issuer countries): FDI outflows and FDI outflows as proportion of GDP – three-year average, 2011-2013**

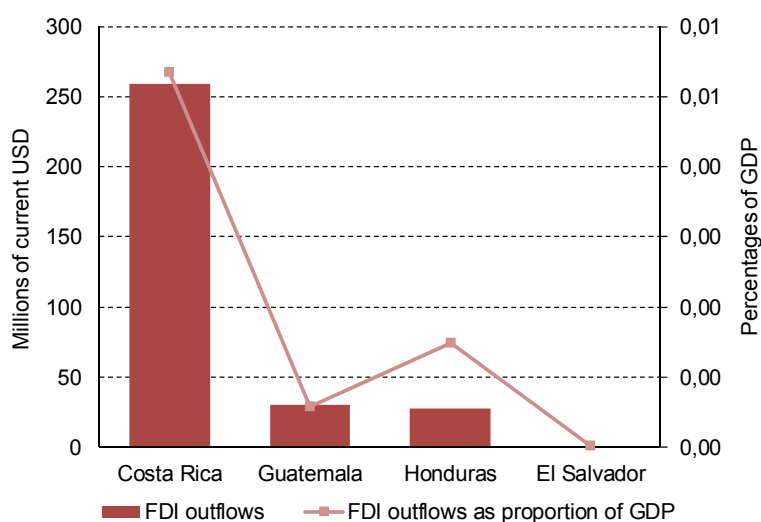


Source: Own elaboration, based on official figures and estimates.



In Central America, Costa Rica is by far the largest issuer of investments, reaching approximately 259 million of dollars a year on average between 2011 and 2013. Data of FDI outflows were not available for Nicaragua and Panama. FDI outflows from El Salvador represent a very small amount with null values in 2011 and 2012 and only 3 million of dollars in 2013, according to official estimates.

**Figure 4**  
**Central America: FDI outflows and FDI outflows as proportion of GDP – three-year average, 2011-2013**



Source: Own elaboration, based on official figures and estimates. Data of FDI outflows were not available for Nicaragua and Panama.

According to the Financial Times Global 500, which establishes a ranking of the top global companies, 13 Latin American multinational enterprises are among the 500 largest worldwide. They are focused on natural resources, financial services, retail and telecommunications. These include MNEs exclusively from the two largest economies in the region Brazil and Mexico: Ambev, Petrobras, Itau Unibanco, Vale, Bradesco, Am rica Móvil, Femsa, Banco do Brasil, Cielo, Grupo Mexico, Itausa, Telef Brasil and Banco do Brasil Seguridade.

Among the 25 largest Latin American MNEs, according to a ranking published by America Economía magazine of the 100 largest Latin American MNEs, eight companies are from Chile, seven from Mexico, five from Brazil, two from Argentina, and one from Peru. Oil and gas, energy, steel and metallurgy, air transportation and telecommunications are among the dominant sectors of Latin American MNEs. Four Central American companies stand out among the 500 largest companies in the region: RECOPE and Group ICE from Costa Rica, Autoridad del Canal de Panama and Copa Airlines from Panama (America Economía, 2014).

In addition, according to the ranking of the 500 largest companies in Latin America published by Am rica Economía (2014), the largest Central American MNEs, all of them with investments abroad, are: RECOPE, Grupo ICE, Banco BAC San Jos , Dos Pinos, Cafe Britt, and Florida Ice & Farm Co from Costa Rica; Pollo Campero, Cementos Progreso, and Cervecería Centroamericana from Guatemala; Autoridad del canal de Panama, Copa Airlines and Banco General from Panama; Grupo Financiero Ficohsa, ALCON, Cervecería Hondure a and Grupo Terra Honduras from Honduras; Grupo Poma and Almacenes Sim n from El Salvador; and Grupo Pellas from Nicaragua (Am rica Economía, 2014).

### III. Regression analysis

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This section undertakes statistical and econometric analysis, which aims to identify the strategies followed by multinational corporations in Latin America, and how these may vary between sectors and issuer country size.

#### A. Database construction

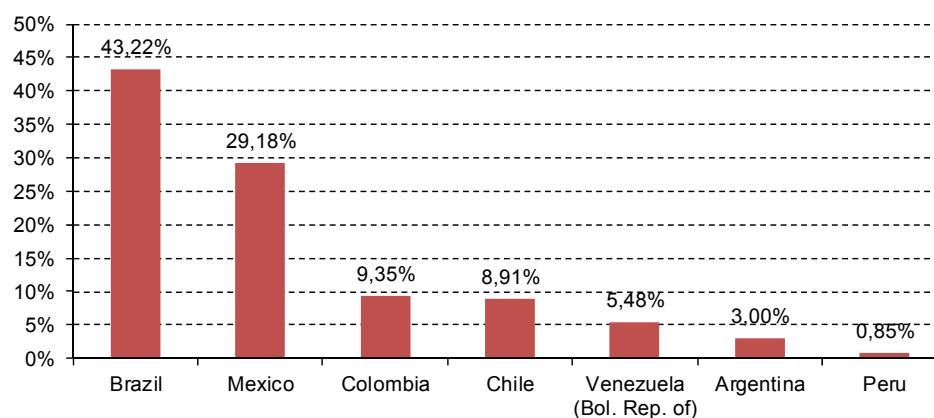
Based on information from the fDi Markets database maintained by the Financial Times, which monitors cross border greenfield investments covering all sectors and countries worldwide, and data from Thomson Reuters Datastream on cross border merger and acquisition (M&A) operations, a comprehensive database on FDI projects was created for the period 2003 to 2013. The database comprises the six countries of Central America and the seven largest economies in Latin America (Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela (Bolivarian Republic of)), which are the main FDI issuers with 89% of all greenfield and M&A operations in the region.

Data from both sources were combined by analysing metadata and merging variables with similar definitions. Variables collected from the fDi Markets database were the following: effective date of transaction, deal value, deal type, target name, target nation, target region, target macro industry, target number of employees, acquiror ultimate parent name, acquiror ultimate parent nation and acquiror ultimate parent region. Variables collected from Thomson Reuters Datastream were the following: project date, capital investment, project type, investing company, destination country, region, industry sector, jobs created, parent company, source country and source region.

Brazil and Mexico have a very significant participation in the total amount of investments in the region, according to the projects identified in the database (see figure 5). The former accounts for 43.2% of total OFD (both greenfield and M&A), and the latter for 29.2%. In line with the data presented in the previous section, Argentina, Colombia, Chile and Venezuela (Bolivarian Republic of) are among the six largest issuers in the region in terms of the total amount of projects (deal value).

**Figure 5**  
**Large Latin American economies: FDI outflows in relative terms**  
**(share of the regional total), average 2003-2013**

(In percentages)

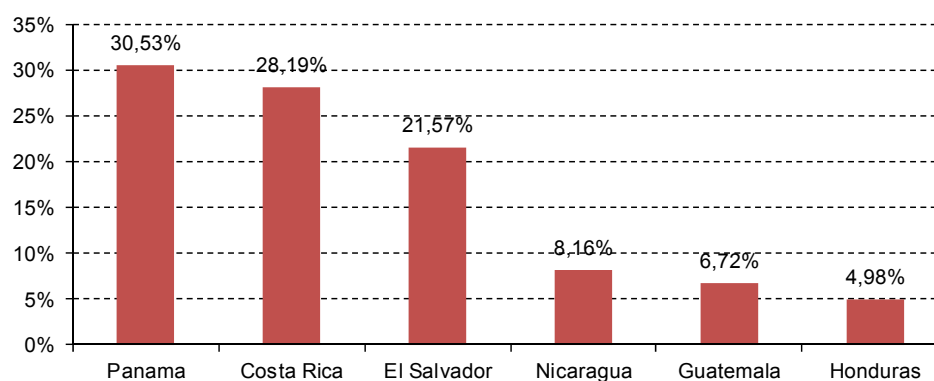


Source: Own elaboration, based on data from fDi Markets and Thomson Reuters Datastream.

In Central America, Panama and Costa Rica have a similar share of the total amount of investments in the region (around 30%). The interesting fact here is that Panama has the greatest number of projects in the region with 128 out of 283, followed by Costa Rica, Guatemala and El Salvador with 49, 45 and 31 projects, respectively. This leads to the conclusion that despite a much higher number of projects, the deal value of projects originating in Panama is quite low compared to those of its neighbours. In this setting, Costa Rica and El Salvador have fewer projects than their Panamanian neighbour but deal values are significantly higher. Honduras and Nicaragua conducted a small number of OFDI projects between 2003 and 2013 (18 and 12 projects, respectively).

**Figure 6**  
**Central America: FDI outflows in relative terms (share of the**  
**regional total), average period, 2003 to 2013**

(In percentages)

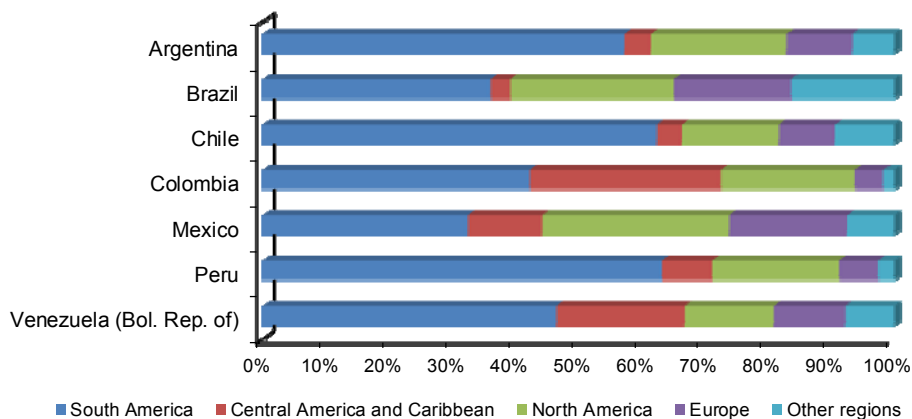


Source: Own elaboration, based on data from fDi Markets and Thomson Reuters Datastream.

As for the geographical destination of projects, figure 7 shows that investments are highly concentrated in neighbouring countries. OFDI from large Latin American economies is clearly oriented to other countries within their subregion with exception of Brazil and Mexico, which have explored

other markets such as North America, Europe and Asia. There is a reduced presence of Latin American MNEs in other regions such as Asia and Africa.

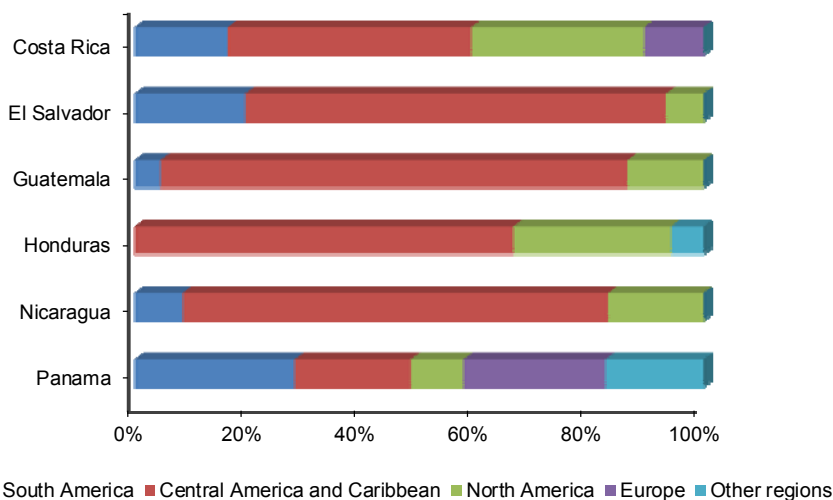
**Figure 7**  
**Large Latin American economies: Main destination regions, 2003-2013**  
*(In percentages)*



Source: Own elaboration, based on data from fDi Markets and Thomson Reuters Datastream.

In Central America, investments are even more concentrated in neighbouring countries (see figure 8), with the exception of Costa Rica and Panama, which are the two countries with the greatest diversification of investment destinations.

**Figure 8**  
**Central America: Main destination regions, 2003-2013**  
*(In percentages)*



Source: Own elaboration, based on data from fDi Markets and Thomson Reuters Datastream.

Lastly, individual projects were checked in order to identify outliers and any atypical transaction. In this setting, as mentioned in the previous section, it has been determined that projects from Panama during the 2003-2013 period do not fully represent capital originating from Panamanian companies, since the country is a well-known host of multinational enterprises which establish their headquarters in the country for fiscal and financial purposes. For instance, Panama reports diverse projects from holding companies that control assets overseas. The main purpose of those holding companies located in Panama is to own shares of other companies for the purpose of forming a corporate group and benefitting from preferential investment schemes offered by the Panamanian law. For consistency reasons, it was decided to leave OFDI from Panama out of the sample for further quantitative exercises. In addition, it is important to highlight that a number of countries generally follow financial strategies to attract FDI<sup>14</sup> that may be channelled through these countries, but the final destination of the investment is unknown. Traditional FDI determinants may not be applicable to these observations and their inclusion could thus contaminate the results. Therefore, these observations were also excluded from the econometric analysis.

## B. Descriptive statistics

Table 2 presents descriptive statistics on FDI projects by sector and transaction type for the two samples of Latin American countries (the largest economies and Central America), which were obtained using the database described above. The main results show that greenfield represents the main type of operation for both samples of countries. In terms of sectors, large Latin American economies concentrate their overseas investments in manufacturing, most as M&A operations. In contrast, Central American MNEs focus their operations in the services sector, most as greenfield operations.

The table below also shows the average deal value and average number of employees by sector, as well as the type of operation for both samples of countries. As expected, the average deal value for operations originating in large Latin American economies is higher (117.2 million of dollars), with a greater deal value on primary sector operations in which the largest companies of the region are concentrated. As for Central America, the highest average deal value is concentrated in the natural resources sector, mainly due to a single project with a very high value. As for the average number of employees, in both country samples the manufacturing sector is the one which employs more labour force within its operations.

**Table 2**  
**Descriptive statistics on FDI projects by sector and transaction type, 2003-2013**

	Large Latin American countries				Central American countries			
	Total number of FDI projects		Average deal value (Millions of dollars)	Average number of employees	Total number of FDI projects		Average deal value (Millions of dollars)	Average number of employees
	<i>Greenfield</i>	<i>M&amp;A</i>			<i>Greenfield</i>	<i>M&amp;A</i>		
Natural resources	238	138	190.8	218.0	2	2	221.0	N.A.
Manufacture	629	764	149.7	889.0	20	15	9.0	267.9
Services	808	446	61.6	433.8	76	27	30.4	78.7
Total	1 675	1 348	117.2	583.9	98	44	30.9	116.9

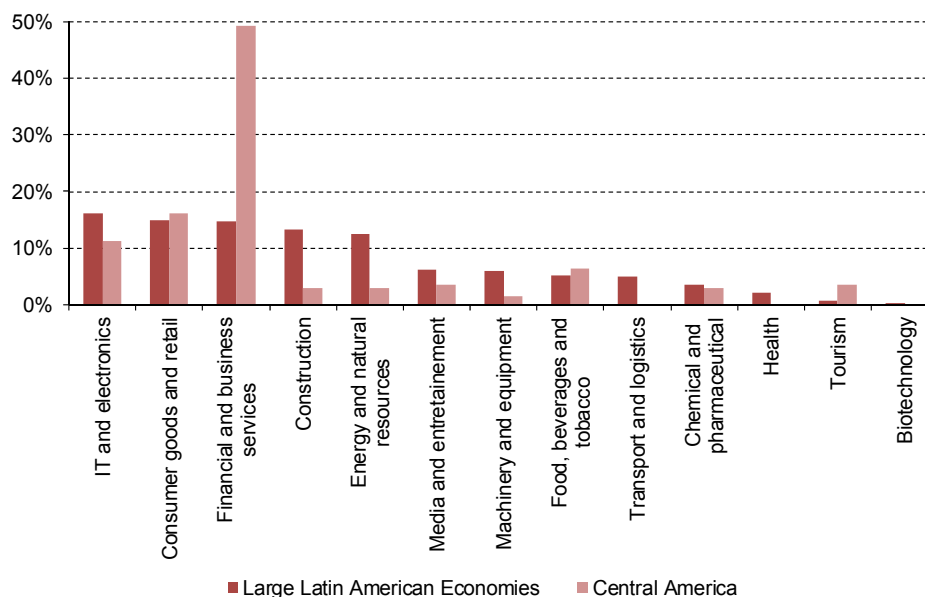
Source: Own elaboration, based on data from fDi Markets and Thomson Reuters Datastream. For consistency reasons, Panama was left out of the sample.

In addition, figure 9 depicts the share of FDI projects by sector, for both large Latin American economies and those of Central America between 2003-2013. High technology, IT, electronics and

<sup>14</sup> Countries such as Antigua, Aruba, Barbados, Bahamas, Belize, Bermuda, Cayman Islands, Cyprus, Dominica, Grenada, Guernsey, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, and Caicos Islands.

telecommunication is the main target sector of operations originating from large economies of Latin America, with 16.1% of all operations, followed by basic consumer goods and retail (14.9%), and business and financial services (14.8%). In Central America, business and financial services is by far the main target sector (49.3% of all projects), followed by basic consumer goods and retail (16.2%) and high technology, IT, electronics and telecommunication (11.3%).

**Figure 9**  
**Share of FDI projects by sector, 2003-2013**  
(In percentages)



Source: Own elaboration, based on data from fDi Markets and Thomson Reuters Datastream. For consistency reasons, Panama was left out of the sample.

## C. Hypotheses

Based on the conceptual framework presented in the previous section, a set of dependent and explanatory variables were selected in order to investigate the strategies followed by multinational enterprises (MNEs) from Latin America when they decide to invest in other countries, highlighting differences by sector and issuer country size.

Dunning's seminal taxonomy was the cornerstone to build the model specification. In addition, control variables were added following more recent empirical studies (see chapter I). The explanatory variables of the model were selected based on the four main types of motives for MNE activity abroad: market access, lower production costs and increased efficiency, access to natural resources and strategic asset seeking. For further details on data sources and definitions, please see Annex A.<sup>15</sup>

In order to investigate the market-seeking strategy, GDP is used as a measure of the absolute market size of the host country. In line with the literature, a positive relationship between the amount of OFDI and market size is expected. Following Amighini and others (2013), the model specification also includes Latin American exports to host countries in order to capture the intensity of trade relations and identify whether FDI are substitutes for exports (i.e. to leap trade barriers) or follow exports as a better strategy to serve their customers and increase customer loyalty (Buckley and others, 2007).

<sup>15</sup> In the first stage of the econometric analysis, other independent variables were included. For instance, for strategic-asset seeking, the number of patent applications and R&D expenditure were initially introduced in the model. However, due to data availability and high correlation with other independent variables, only those which produced the most consistent and stable econometric results were kept for the final estimation.

The distance between the home- and host-countries most populated cities is included as a proxy for trade costs. In this setting, some authors suggest that firms are more likely to engage in FDI in more distant markets since the greater the distance, the higher the transport costs (Barba Navaretti and Venables, 2004), while the gravity model predicts a negative relationship since costs of investing increase with distance (Kolstad and Wiig, 2012).

In terms of efficiency seeking, little evidence is found on developing countries, especially in the literature on China. Therefore, lower production costs and increased efficiency do not seem to be important motivations for MNEs in developing countries. This is quite natural and expected since developing countries in general are very competitive in terms of lower wages. In any case, a variable of host country average monthly wage is included in order to verify whether Latin American MNEs invest in other countries seeking lower production costs. Expected sign might vary across sectors.

As for natural resource seeking, empirical evidence shows that outward FDI is motivated by the necessity to meet the demand for natural resources, which is particularly true for investments toward other developing countries (Buckley and others, 2007; Cheung and Qian, 2008; Kolstad and Wiig, 2012). Following the approach from Amighini and others (2013), the model specification includes two proxies for natural resources: the share of fuels and the share of ores and metals in total merchandise exports by the host economy.

In relation to strategic asset seeking, the number of years of schooling is included in the model as a proxy for the level of human resources, which is expected to have a positive sign since human resources have a positive impact on the location choice of firms seeking to upgrade capabilities.

Based on Bloningen (2005), a number of control variables, which were significant in previous empirical studies, were also included in the model in order to capture different dimensions of economic and political stability. First, inflation is included as an indicator of macroeconomic stability, which negatively affects profit expectations and reduces FDI attraction. However, according to Buckley and others (2007) the results for inflation can be ambiguous since MNEs from economically unstable countries tend to be more tolerant to high inflation. Second, in order to capture political instabilities in host countries, a measure of World Governance Indicators (WGI) on political stability is included, which is usually positively associated with FDI attraction but, similar to the case of inflation mentioned above, investors from developing countries are more tolerant of weaker institutions.

Additionally, following the approach from Amighini and others (2013), the model specification includes the number of telephone mainlines as a proxy for infrastructure and communication availability in the host country. A positive sign is expected since good infrastructure facilitates investment.

Assuming that investment decisions are taken in a period prior to the actual transaction, all explanatory variables were incorporated in the dataset with a lag. In this setting, investment operations which occurred between 2003 and 2005 have explanatory variables with an average for the 2000-2002 period; for those occurred between 2006 and 2008, explanatory variables have an average for the 2003-2005 period; investments taking place between 2009 and 2011 have explanatory variables with an average for the 2006-2008 period; and for those occurred between 2012 and 2013, explanatory variables have an average for the 2009-2011 period. For the complete list of variables with their detailed definitions and sources, please see Annex A.

Table 3 presents the mean for each variable potentially associated with the four main types of motives for MNE activity abroad, dividing the sample into two groups: destination countries of investment from large Latin American economies and from Central American economies. As shown below, there are differences in the means between the two groups of countries for all variables, which are statistically significant at the 1% level, except for GDP and wages (statistically different at the 5% level), and political stability and inflation (not significant).<sup>16</sup> MNEs from large Latin American economies direct their investments, on average, to larger, more developed (in terms of human resources),

<sup>16</sup> The first step was to test for normality. Since none of the variables follow a normal distribution, all variables in absolute terms were transformed into natural logarithms. Therefore, nonparametric tests of differences in means were run.

wealthier and natural-resource richer host economies, whereas MNEs from Central America orient their investments to geographically closer markets.

**Table 3**  
**Mean comparison of explanatory variables, 2000-2011**

	Indicator	Destination countries for Central American investment	Destination countries for investment from large LA economies
<i>Market-seeking</i>	Exports (millions of dollars) <sup>a</sup>	0.63	14.5
	GDP (billions of dollars) <sup>b</sup>	1 950	2770
	Distance between most populated cities <sup>a</sup>	1 705.5	5 792.7
<i>Natural resource-seeking</i>	Share of fuel on total exports <sup>a</sup>	7.5	13.4
	Share of ores and metals on total exports <sup>a</sup>	4.4	10.1
<i>Efficiency-seeking</i>	Host-country average monthly wage <sup>b</sup>	1 456.6	1 772.7
<i>Specialized resource-seeking</i>	Human capital (years of schooling) <sup>a</sup>	8.3	9.4
	Political stability	-0.16	-0.13
<i>Additional control variables</i>	Inflation	5.7	4.9
	Infrastructure (telephone mainlines per 1,000 people) <sup>a</sup>	23.0	29.9

Source: Own elaboration, based on data from various sources. Please consult Annex A for further details.

Note: <sup>a</sup>, <sup>b</sup> indicate that the difference in means is statistically significant at the 1% and 5% confidence level, respectively. For consistency reasons, Panama was left out of the sample.

## D. Baseline specification

The baseline estimation covers outward FDI projects of 13 Latin American countries over the 2003-2013 period. The empirical strategy consists of estimating two probit models, which measure the partial effect of each explanatory variable on the response probability function, represented by a binary formulation of the dependent variable assuming the following values:

### *Estimation 1*

1 if Latin American MNEs have invested in sector  $k$  in host-country  $j$  and 0 otherwise. The baseline specification can be generalized as follows (Equation 1):

$$\Pr (FDI_{jk} = 1 | X_j, \beta, \alpha_j) = \alpha_j + \beta X_j + \varepsilon_{jk} \quad (1)$$

where  $X$  is the vector of explanatory factors,  $\beta$  the vector of the coefficients associated with  $X$ ,  $\alpha$  is the vector of the host-country  $j$  specific unobservable effects and  $\varepsilon$  is the error term.

### *Estimation 2*

1 if Latin American MNEs are from large Latin American home-countries  $i$  and 0 otherwise. The baseline specification can be generalized as follows (Equation 2):

$$\Pr (SIZE_i = 1 | X_j, \beta, \alpha_j) = \alpha_j + \beta X_j + \varepsilon_{i,j} \quad (2)$$

where  $X$  is the vector of explanatory factors,  $\beta$  the vector of the coefficients associated with  $X$ ,  $\alpha$  is the vector of the host-country  $j$  specific unobservable effects and  $\varepsilon$  is the error term.

Additional dummy variables were included to control for the home country  $s$  size and the investment type.



It is worth stressing that the volatility of annual FDI flows may make it difficult to detect significant determinants of FDI; hence, the number of deals is a more appropriate unit of analysis than the deal value (investment amount) when investigating the location strategies of multinationals and their investment motivations because the choice of a specific country and the motivation of the investment might be largely independent of the amount of capital invested. Also, binary response models reduce the risk of measurement error.

The final specification of the model can be written as follows (equations 3 and 4):

$$\Pr(FDI_{jk} = 1 | X_j, \beta, \alpha_j) = \alpha_j + \beta_1 lGDP_j + \beta_2 lX_{ij} + \beta_3 lDIST_{ij} + \beta_4 FUEL_j + \beta_5 ORMET_j + \beta_6 lWAGE_j + \beta_7 HUMCAP_j + \beta_8 POLSTAB_j + \beta_9 INFL_j + \beta_{10} INFRA_j + \varepsilon_{j,k} \quad (3)$$

$$\Pr(SIZE_i = 1 | X_i, \beta, \alpha_i) = \alpha_j + \beta_1 lGDP_j + \beta_2 lX_{ij} + \beta_3 lDIST_{ij} + \beta_4 FUEL_j + \beta_5 ORMET_j + \beta_6 lWAGE_j + \beta_7 HUMCAP_j + \beta_8 POLSTAB_j + \beta_9 INFL_j + \beta_{10} INFRA_j + \varepsilon_{i,j} \quad (4)$$

## E. Econometric results

The empirical findings are presented in two tables, one estimating the response probability function by sector and another estimating the response probability function by country size. Table 4 below summarizes the results for the host-country determinants of Latin American outward FDI disaggregated by sector: manufacturing (regression 1), services (regression 2) and natural resources (regression 3).

Regression 1 shows results for the host-country determinants of Latin American outward FDI in the manufacturing sector, which is positively associated with exports, indicating that FDI is a complement of international trade, with investment flows going to countries to which the region already exports. Results for the manufacturing sector also suggest that firms are more likely to invest in FDI in more distant markets since distance is positive and statistically significant. Hence, in order to enter more distant markets in the manufacturing sector, Latin American MNEs tend to carry it out through direct investment.

Empirical evidence also indicates that efficiency-seeking strategies are important for MNEs investing in the manufacturing sector, since wages are negative and statistically significant. This result is similar to empirical evidence from developed countries, with results pointing out that manufacturing FDI usually seeks for lower production costs. Also, the additional control variables for political stability and infrastructure are significant and positively associated with OFDI, indicating that Latin American MNEs in the manufacturing sector look for good infrastructure and politically stable host-countries. The dummy variable for investment type also shows that there is a greater propensity to conduct investments through mergers and acquisitions (M&A) rather than through greenfield. Therefore, the manufacturing sector in Latin America prefers to invest in existing production capabilities rather than developing new facilities.

Regression 2 shows results for the host-country determinants of Latin American outward FDI in the services sector. Unlike the manufacturing sector, Latin America FDI in services is negatively associated with exports, indicating that FDI is a substitute for exports and aims to leap trade barriers (especially because services are in general not tradable). In contrast to manufacturing, OFDI in services is more likely to take place in closer markets, since the costs of investing in distant and culturally dissimilar markets is higher.

Regression 2 also shows evidence that specialized-resource strategies seem to be important for MNEs investing in the services sector, since higher wages are often associated with skilled work. Also, the additional control variables for political stability and infrastructure are significant and negatively associated with OFDI, indicating that Latin American MNEs in the services sector do not see poor infrastructure and lack of political stability as a deterrent to invest in a host-country. More specifically, the lack of a good infrastructure services sector may indicate that these countries are potential markets for companies in the telecommunications sector, for example. Lastly, the dummy variable for investment type also shows that there is a greater propensity to conduct investments through greenfield rather than

through mergers and acquisitions (M&A) in this sector. In contrast with manufacturing, service MNEs tend to enter new countries through new investments.

Regression 3 shows results for the natural resources sector. As expected, the natural resources-seeking strategy is confirmed since MNEs in this sector tend to invest in countries well-endowed in ores and metals. Results also indicate that the dummy for home-country size is significant and positively associated with OFDI in the natural resources sector, indicating a greater propensity for MNEs from large Latin American economies to conduct larger investments in this sector. The dummy variable for investment type also shows that there is a greater propensity to conduct investments through greenfield rather than through mergers and acquisitions (M&A) in this sector.

**Table 4**  
**Probit regression on OFDI determinants by sector**  
**for the period 2003-2013**

	Dependent variable Pr ( $OFDI_{i,j} = 1$ )		
	Manufacture	Services	Natural resources
	(1)	(2)	(3)
GDP	-0.020 (0.61)	0.047 (1.41)	-0.032 (0.69)
Exports	0.108 <sup>a</sup> (3.77)	-0.115 <sup>a</sup> (4.02)	-0.002 (0.05)
Distance	0.093 <sup>c</sup> (1.65)	-0.153 <sup>a</sup> (2.69)	0.123 (1.58)
Fuel	0.003 (0.98)	-0.006 <sup>c</sup> (1.95)	0.005 (1.43)
Ores and Metals	0.000 (0.05)	-0.005 (1.44)	0.008 <sup>c</sup> (1.91)
Wages	-0.131 <sup>c</sup> (1.83)	0.208 <sup>a</sup> (2.87)	-0.125 (1.32)
Human capital	-0.426 (1.48)	0.262 (0.91)	0.275 (0.70)
Political stability	0.187 <sup>a</sup> (3.04)	-0.136 <sup>b</sup> (2.19)	-0.118 (1.53)
Inflation	0.003 (0.40)	-0.003 (0.50)	0.002 (0.23)
Infrastructure	0.010 <sup>b</sup> (2.16)	-0.014 <sup>a</sup> (3.23)	0.009 (1.48)
Dummy home-country size	0.122 (0.68)	-0.261 (1.47)	0.601 <sup>c</sup> (1.83)
Dummy investment type	0.524 <sup>a</sup> (8.99)	-0.424 <sup>a</sup> (7.23)	-0.217 <sup>a</sup> (2.79)
Constant	-0.731 (1.09)	0.486 (0.72)	-2.074 <sup>b</sup> (2.09)
Observations	2 042	2 042	2 042

Source: Own elaboration.

Standard errors are shown in parentheses.

<sup>a</sup>, <sup>b</sup>, <sup>c</sup> indicate significance at the 1%, 5% and 10% confidence level, respectively. For consistency reasons, Panama was left out of the sample.

Table 5 shows the results for the probit regression, which aims to identify differences in outward FDI between large and small economies of Latin America. Results for exports, distance, endowments of natural resources and political stability were positive and statistically significant, indicating that those are variables important to the investment decisions of MNEs from large Latin American countries, while results for GDP and wages were negative and statistically significant, illustrating that those are variables important to the investment decisions of MNEs from Central American countries. Both groups of countries have market seeking as an important strategy to invest abroad. MNEs from large Latin

American economies tend to invest in countries with which they already have strong commercial ties, that are well-endowed in natural resources and not necessarily in neighbouring countries. In contrast, MNEs from Central America are more likely to invest in countries with lower wages following an efficiency-seeking strategy.

**Table 5**  
**Probit regression on OFDI determinants by**  
**country size for the period 2003-2013**

	Dependent variable Pr ( $SIZE_t = 1$ )
	(4)
GDP	-1.290 <sup>a</sup> (7.44)
Exports	1.389 <sup>a</sup> (9.17)
Distance	3.006 <sup>a</sup> (9.78)
Fuel	0.073 <sup>a</sup> (4.78)
Ores and Metals	0.000 (0.01)
Wages	-0.717 <sup>a</sup> (3.25)
Human capital	0.449 (0.53)
Political stability	1.305 <sup>a</sup> (4.58)
Inflation	-0.014 (0.34)
Infrastructure	-0.005 (0.34)
Dummy investment type	0.062 (0.28)
Constant	-2.401 (1.15)
Observations	2 042

Source: Own elaboration.

Standard errors are shown in parentheses.

<sup>a</sup>, <sup>b</sup> and <sup>c</sup> indicate significance at the 1%, 5% and 10% confidence level, respectively. For consistency reasons, Panama was left out of the sample.

Table 6 summarises the results of the econometric analysis, distinguishing between sectors and large and small Latin American countries.

**Table 6**  
**Summary of econometric results**

Independent variable	Manufacture	Services	Natural resources
FDI by sector	<p><b>Main significant variables:</b> Exports, distance, wages, political stability, infrastructure and dummy for the investment type.</p> <p><b>Main investment strategy:</b> Market-seeking and efficiency-seeking.</p>	<p><b>Main significant variables:</b> Exports, distance, share of fuel in total exports, wages, political stability, infrastructure and dummy for the investment type.</p> <p><b>Main investment strategy:</b> Market-seeking and specialized resource-seeking.</p>	<p><b>Main significant variables:</b> Share of ores and metals in total exports, dummy for country size and dummy for investment type.</p> <p><b>Main investment strategy:</b> Natural resource-seeking.</p>
	Large Latin American countries	Central America	
FDI by home-country size	<p><b>Main significant variables:</b> Exports, distance, share of fuels in total exports and political stability.</p> <p><b>Main investment strategy:</b> Market-seeking and natural resources-seeking.</p>	<p><b>Main significant variables:</b> GDP and wages</p> <p><b>Main investment strategy:</b> Market-seeking and efficiency-seeking.</p>	

Source: Own elaboration.



## IV. Home-country effects of FDI outflows: The case of Costa Rican MNEs

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### A. FDI outflows in Costa Rica: Recent trends

As mentioned, Costa Rica is the largest issuer of FDI outflows in Central America. As a case study, this section presents the results of a survey conducted in the first quarter of 2015 among Costa Rican transnational enterprises. As a brief introduction to Costa Rica, it has a total land area of 51,100 square kilometres and in 2014 had 4.7 million inhabitants. It is considered by the United Nations Development Programme (UNDP) as a high-human development country (UNDP, 2014), with a GDP per capita of dollars 10,184 (current dollars),<sup>17</sup> one of the highest in Latin America. Between 2000 and 2013, the Costa Rican economy expanded at annual average rate of 4.4%. In 2013, manufacturing represented 21.1% of GDP, while services accounted for 58.5%. Exports of services have grown rapidly recently, increasing their participation in total exports from 33.6% in 2000 to 50.8% in 2013.<sup>18</sup>

A survey conducted by the Costa Rican Trade Promotion Agency (PROCOMER) in 2013 identified 96 domestic firms with FDI in at least one foreign country and headquarters located in Costa Rica. According to this report (Soto and Ivarez, 2013), until 2013 Costa Rican firms had invested 1.52 billion of dollars abroad in 256 different investment projects. They have operations in 21 different countries which, in addition to Central America, include the United States, Spain, Ecuador and Peru. Furthermore, these investments generate over 14,800 direct jobs abroad in over ten different sectors.

The United States received the largest share of OFDI from Costa Rica totalling 434.2 million of dollars in 2013, of which 388 million of dollars correspond to a single M&A operation: the acquisition of the North American Brewery (NAB) by Florida Ice and Farm Company S.A. (FIFCO). OFDI to Panama and Nicaragua totalled 256.7 million of dollars and 210.4 million of dollars in investments, respectively. Panama, Nicaragua and Guatemala are the main destinations in terms of number of projects.

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<sup>17</sup> World Bank (2015).

<sup>18</sup> ECLAC (2015).

Most OFDI from Costa Rica is concentrated in the services sector. In Panama, which as mentioned is the main destination (by number of projects), most of these investments were conducted in the trade sector, followed by construction, infrastructure and logistics services. In general, OFDI is highly concentrated in these three activities, with a moderate share of other sectors such as agriculture, livestock and fisheries, information technology and other manufacturing industries.

## B. Methodology

### 1. Sample selection

The sample size was determined using a simple random sampling (equation 5) which creates a subset of a statistical population and each member of the subset has an equal probability of being chosen. The confidence level of the sample is 90%, with an absolute error of 16% and a P parameter equal to 0.5. A sample of 31 companies provides a very high representativeness and reliability of results, being one third of the total population.

$$n = \frac{Z_{\alpha/2}^2 P(1-P)}{\delta^2} \quad (5)$$

Where:

n = sample size

$Z_{\alpha/2}^2$  = standard normal distribution squared

P = maximum variance ratio parameter (assuming normality in the estimator and that we are not studying a very rare feature in the population).

$\delta^2$  = maximum squared error

The departing point was the study conducted by PROCOMER mentioned above. Thus, 31 firms were randomly selected from the list of 96 firms. In addition, a first criterion for sample selection was established in order to take into account the size of operation: all firms which represent 2% or more of total Costa Rican OFDI operations were included. A second criterion was to include firms from all sectors (see table 7).

**Table 7**  
**Sample selection**

Sector	Companies	Sample by sector
Agri-food	8	6
Construction and infrastructure	12	3
Manufacturing	9	6
Retail and services	67	16
<i>N</i>	96	31

Source: Own elaboration, based on the survey of companies.

### 2. Questionnaire

A questionnaire of 34 questions was created in order to collect micro-level data on both strategies followed by Costa Rican MNEs and effects to the home country that may arise from investing abroad. The questionnaire is divided into five sections: company background, internationalisation strategy, quantitative effects, qualitative effects and horizontal factors and public policy (see Annex B).

The first section aims to collect data on company background such as industrial sector, location, ownership type, total number of employees in the home country and overseas, share of domestic capital, main products and main destination countries, taking into account the weight of the sales from subsidiaries in total company sales.

Firms also listed the countries in which they have established subsidiaries, the year of establishment, the share of each subsidiary in terms of total FDI, type of operation (greenfield, M&A or both) and the main activities in the country (i.e. if the subsidiary concentrates its activities in sales, marketing or production). The second section aims to collect data on the company's internationalisation strategy, asking about the main reason for investing abroad, if the strategy changed over time, if it varies according to the destination and if the company has plans to invest in other markets.

The third section examines the quantitative effects as a result of the internationalisation strategy in terms of the number of employees in the home country, modification in quality of employment (i.e. transition from low-skilled towards high-skilled labour), international trade (both imports and exports), access to foreign sources of financing, repatriation of profits, new sources of tax income, increase in production scale and whether the internationalisation has strengthened the firm's competitiveness in terms of market share, production costs or product characteristics.

The fourth section investigates the qualitative effects resulting from outward FDI in terms of access to new sources of technological knowledge, improvement of capabilities in the home country, knowledge spread in the home economy through linkages with other firms (suppliers or customers), universities and research centres, and improvement of products and services.

The fifth and last section collects information on horizontal factors and public policy related to the internationalisation strategy. It aims to investigate if the subsidiaries have built economic and knowledge-related linkages with firms and other organisations (universities and research centres) in the host economies, if public policies or other factors in host countries have hindered or fostered the interaction with domestic firms and organisations, whether the firm received public support in order to increase operations overseas and if interviewees believe government should provide support for OFDI.

The questionnaire targeted general managers, CFOs and owners of Costa Rican companies, which have invested abroad. It was initially sent by email when first contact with the company was made and subsequently endorsed through a face-to-face interview (77% of all interviews) or by phone in order to validate the responses and collect additional information. The interviews were conducted between February and March 2015.

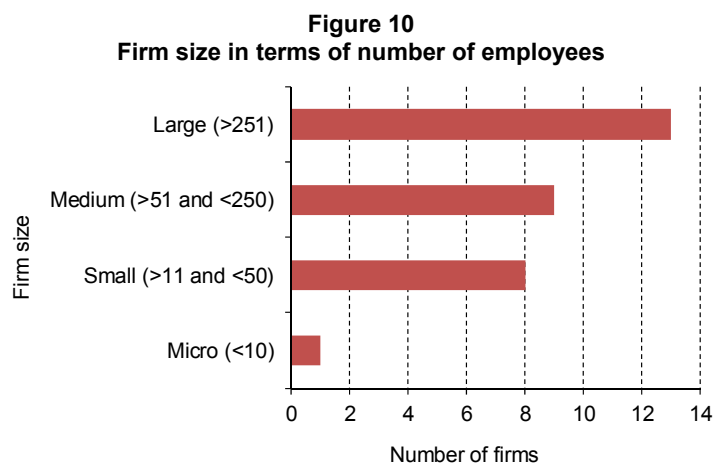
### **3. Sample description**

This section summarizes the main characteristics of survey respondents. As mentioned, the sample was designed to reflect the share of the four main sectors in Costa Rican foreign investments. According to table 9, retail and services is the lead sector in investments overseas. The main activities identified within this sector are IT services (e.g. software, e-learning, Internet content), logistical services and retail trade. The agri-food industry is the second most important sector in terms of the number of operations abroad, with activities ranging from the production of fruits and vegetables to processed beverages and food, followed by other manufactures and construction.

In terms of ownership structure, nine out of ten respondents have declared that the firm is 100% domestic, with only a few companies reporting foreign capital participation in their investments. In these firms, foreign capital participation is less than 50%, and foreign investors are from El Salvador, the United States and Mexico.

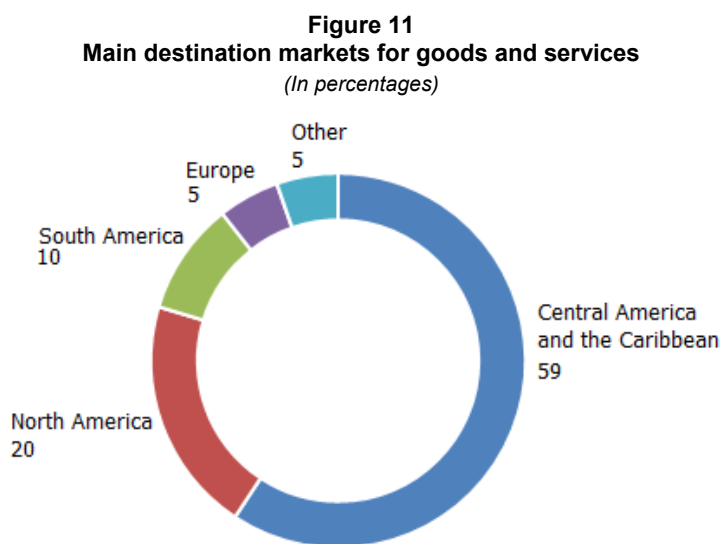
Figure 10 below shows the distribution of the sample according to firm size in terms of total number of employees in 2014 (in Costa Rica and abroad). Seventeen firms (55% of the sample) are small and medium-sized enterprises (SMEs), with the number of employees ranging between 11 and 250, followed by large companies with over 251 employees (13 firms or 42%) and one micro enterprise (3%).





Source: Own elaboration, based on the survey of companies.

On average, 50.6% of sales of goods and services from interviewed firms were oriented to the domestic market in 2014, while 18.2% corresponded to exports from the headquarters and 31.2% to foreign sales through subsidiaries. As for market destination, there was a clear regional concentration with 59.3% of total exports from interviewed firms destined for Central America and the Caribbean, 20.4% to North America, 9.7% to South America, and only 5.3% to Europe and 5.3 to other regions (see figure 11). Within Central America, Panama is the lead destination (15.0%), followed by Nicaragua (11.5%). In North America, the United States is the lead destination (10.6%), followed by Mexico (6.2%).



Source: Own elaboration, based on the survey of companies.

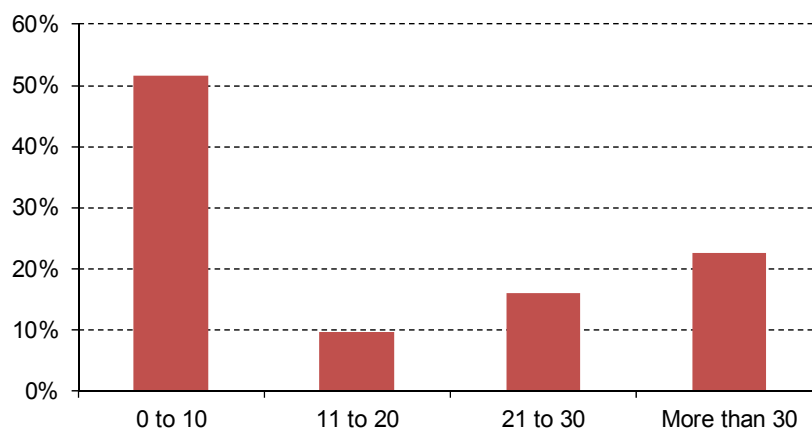
## C. Internationalisation strategy

The firms included in the sample reported 95 operations abroad in 2014, an average of three foreign operations per firm. These correspond to foreign investments that took place in any year before 2015 and were still operating in early 2015. Yet, there are significant differences among firms: 17 interviewed firms (55% of the sample) reported only one foreign operation, while only six firms (19%) had more than five foreign operations each. Nineteen firms (61.3% of the sample) had invested only in other

Central American countries; ten firms (32.3%) had operations in other Latin American countries outside Central America, and seven firms (22.6%) had invested outside Latin America.<sup>19</sup> As for the activities conducted in the subsidiaries, firms in the services sector usually performed the same activities abroad as in their headquarters. In contrast, those in manufacturing commonly carried out different activities in their subsidiaries, such as sales and customer service.

Although the first investment abroad by interviewed firms took place in the decade from 1950, internationalisation is a relatively recent process in Costa Rica: five conducted their first investment abroad in the nineties, 16 in the decade from 2000 and nine in the last five years. The internationalisation process has been relatively fast for most of them with 16 firms (51.6% of the sample) investing abroad for the first time within the first ten years after their establishment; three firms (9.7%) between 11 and 20 years, five firms (16.1%) between 21 and 30 years, and seven firms (22.6%) more than 30 years (see figure 12).

**Figure 12**  
**Number of years between establishment**  
**and initial investment**  
*(In percentages)*



Source: Own elaboration, based on the survey of companies.

Costa Rican firms have internationalised mainly through greenfield (21 firms or 67.7% of the sample), while only three did it through M&A (9.7%) and seven firms (22.6%) through both types of operations. In terms of destination, of the 21 firms which have internationalised mainly through greenfield, 16 firms (76.2%) stated that their investments are all located within Central America.

As for the motivation for investing abroad, 29 interviewed firms had invested in order to access new markets (market seeking), since Costa Rica is a small country and the rest of Central America is a natural market in which to expand their operations. It is important to mention that 16 firms declared more than one motivation for investing abroad. For some firms, mainly those operating in the services sector (logistics and IT services), investing abroad is a real necessity to be competitive. For instance, firms providing logistics services to international enterprises must have a regional presence, since Central American countries are commonly seen as one large market. Therefore, international enterprises frequently look for one regional provider instead of looking for different smaller providers for each country. Similarly, medium and large-sized firms easily reach a large share of the domestic market, and investing abroad is the only strategy that is left to expand their businesses. Furthermore, specialised services and goods require in-site customer service, demanding the establishment of a subsidiary near the main clients.

<sup>19</sup> The sum is not 100% since some firms have operations both in Latin America (outside Central America) and outside Latin America.

An efficiency-seeking strategy was pursued by seven firms, mainly through investments in neighbouring countries. Companies in the manufacturing sector, especially those that produce labour-intensive and low value-added goods, often seek to reduce their labour and logistic costs by transferring their production units to countries with lower wages, such as Nicaragua and Honduras.

Three firms had invested abroad following a strategic-asset seeking strategy and all can be found within the information technology (IT) sector. When expanding their businesses, these companies face a lack of skilled labour within the country; hence they are encouraged to establish subsidiaries, mainly outside the Central American subregion, in countries such as Peru and Ecuador in order to have more access to trained and experienced programmers and IT experts.

Lastly, natural-resource seeking strategies were pursued by only two firms. Companies from the agri-food sector are often encouraged to invest abroad in order to gain access to larger and cheaper cropping areas, allowing an increase and improvement in their production scale. In addition, four firms pursued a different strategy not included in the four main types originally identified by Dunning (2000). It is mainly the case of firms seizing business opportunities arising from having assets (such as a building), business partners or relatives in another country, but it does not respond to a clear and long-term internationalisation strategy.

#### Box 1

##### The case of Central American MNEs and their motivations to invest abroad

Although the majority of outward FDI issued in Latin America originated in a few large emerging economies, there has been a significant increase in the participation of investments originating in Central American countries.

Almost all Central American companies invest abroad with a strategy of seeking new markets within the region. Since Central American countries represent relatively small markets when each country is considered individually, many companies that originated in this region invest outside their country in search of a regional presence in order to access a much larger potential market. Florida Ice and Farm Company S.A. (FIFCO) is an example of a Central American MNEs investing abroad in order to expand its market coverage. FIFCO is a Costa Rican company operating in diversified business areas that range from food and beverages to real estate. The company is present in all neighbouring countries in Central America with a 12% share of the market for juices, drinks and refreshments (third place behind *Cervecería Centroamericana* and Coca-Cola). With a strategy of seeking new markets, the company announced in October 2012 that its subsidiary *Cervecería Costa Rica* (CCR) acquired the largest independent brewer in the United States, North American Breweries (NAB) and its subsidiaries. The firm has since doubled its size in terms of sales volume.

In terms of natural resource seeking strategies, Central American companies from the agri-food sector are often encouraged to invest abroad in order to gain access to larger and cheaper cropping areas as well as improving on their production scale. TicoFrut is an example of Central American company headquartered in Costa Rica which had invested in another country looking for natural resources. The company, which is the largest producer of oranges in Central America, has acquired land in the Rio San Juan department for growing oranges.

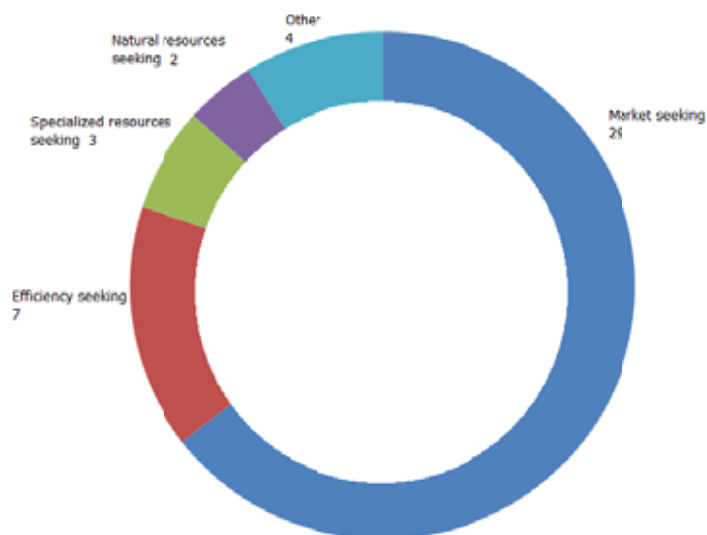
A third group of Central American MNEs have a more focused motivation in seeking production efficiency. In particular, companies in the manufacturing sector, especially those that manufacture labour-intensive and low value-added products, often seek to reduce their labour and logistic costs by transferring their production units to other countries. Yanber is an example of a Costa Rican company which has decided to invest in Nicaragua, setting up a production plant in the country in an effort to reduce production costs.

A fourth and last group of MNEs are the strategic asset seekers, which are represented within the Central American region by companies from the information technology (IT) sector. When expanding their businesses these companies face a lack of skilled labour within the region, so they are encouraged to establish subsidiaries in countries such as Peru and Ecuador in order to have more access to trained and experienced programmers and IT experts.

Source: Own elaboration based on public information.

**Figure 13**  
**Motivation for investing abroad**

(Number of firms)



Source: Own elaboration, based on the survey of companies.

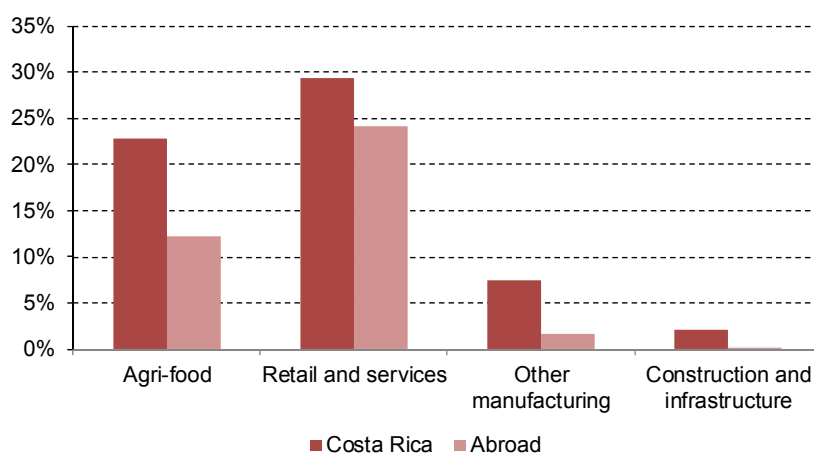
Among respondents, nine firms (29% of the sample) declared that they had to withdraw from at least one country in which they had previously invested, a decision that can be associated with an insufficient analysis of investment potential and strategy before going abroad. Another reason for market withdrawal was a heavy reliance in one large client; hence, once the commercial relationship with this client was discontinued, they could not sustain their operations in the host-country.

Market seeking strategies are concentrated in neighbouring countries (all Central American countries, but mainly Nicaragua and Panama), whereas efficiency seeking is more focused on countries with lower labour costs (e.g. Honduras and Nicaragua). Specialised-resource seeking takes place mainly outside the region (e.g. Colombia, Ecuador and Peru), since Costa Rica is commonly acknowledged to have a more developed education system compared to neighbouring countries, and natural-resource seeking takes place in neighbouring countries (Nicaragua).

In 2014, interviewed firms employed 8,599 workers outside Costa Rica, in contrast with 13,832 in the domestic market. Out of those generated abroad, 73.7% corresponded to jobs in other Central American countries. Assets abroad represented 23.3% of total assets in 2014. Figure 14 shows the percentage of employment generated in Costa Rica and abroad by sector; the sector with the highest share of employment both within and outside Costa Rica was retail and services.

Finally, 24 interviewed firms (77.4% of the sample) declared they have plans to invest in other markets in addition to those where they had operations already. Countries outside the Central American region are future targets of Costa Rican transnational firms (e.g. Colombia, Mexico and Peru), but interviewees argued that they are more challenging markets given their size and sharper competition. Some others stated that they were currently considering moving some of their operations towards countries with lower production costs.

**Figure 14**  
**Domestic and foreign employment generated by interviewed firms, by sector**  
*(Percentage of total domestic and foreign employment generated)*



Source: Own elaboration, based on the survey of companies.

## D. Quantitative effects of OFDI in Costa Rica

As a result of their internationalisation, 12 firms (38.7% of the sample) reported an increase in the number of employees based in Costa Rica, while it remained constant in 13 firms (41.9%). In the former, employment increased due to larger overall output; in the latter, interviewees argued that operations in the domestic and foreign markets were independent. Only in six firms (19.4%), did employment in Costa Rica decrease as a result of internationalisation, mainly due to increased efficiency and relocation of activities overseas. Although interviewees were not able to estimate with numbers this variation, a net positive effect can be inferred from firm size: in seven large firms the number of employees in Costa Rica increased, in five it remained constant and only in one was it reduced. Among small- and medium-sized interviewed firms, five reported they increased their number of employees, seven did not modify their headcount and five reduced it.

As for the quality of employment in Costa Rica, investing abroad resulted in better employment for 12 firms (38.7% of the sample), with no changes for the remaining 19 firms (61.3%). None of the respondents stated that investing abroad undermined the quality of domestic employment. The reasons cited for better employment at home were hiring and promoting more qualified employees at the headquarters to manage international operations, knowledge-intensive jobs tend to stay in Costa Rica, recruiting new personnel for new complex activities such as logistics, and the additional qualifications needed to supply demanding markets such as the United States and Europe.

Investing abroad resulted in more international trade for 21 firms (67.7% of the sample), since it allowed them to access new markets and to increase their exports. As mentioned, 31.2% of sales of goods and services were done through subsidiaries. Presence in foreign markets has had also a positive impact on reputation and reliability, giving them better access to foreign clients. The remaining ten firms (32.3% of the sample) declared that internationalisation did not have any impact on international trade. Interviewees were not able to estimate with numbers the variation of international trade.

Yet, PROCOMER has data on firm-level exports for the 1998-2014 period, which is available for 61 out of the total 96 Costa Rican MNEs. The analysis was extended to the whole population by crossing this information on firm-level exports before and after the first investment abroad in order to verify the

impact of the internationalisation strategy over exports.<sup>20</sup> The results show that 26 firms started their exports at the same time or shortly after they made their first investment (in the same year). In turn, 31 firms increased their average exports after investing abroad, whereas only four had decreased their sales abroad (see table 8).

**Table 8**  
**Impact on exports before and after investing abroad**

	Number of firms	Exports before investing abroad (average in dollars)	Exports after investing abroad (average in dollars)
Started to export after first investment	26	0	111 350
Exports increased	31	990 200	3 293 200
Exports decreased	4	1 125 900	253 400
Total	61	577 060	1 737 680

Source: Own elaboration, based on data provided by PROCOMER.

The internationalisation provided better sources of financing only to 12 firms (38.7% of the sample), in the form of access to loans with lower interest rates, improved credit scores as a result of larger and more international operations, and even access to foreign stock markets. The bulk of the sample (19 firms or 61.3%) declared that investing abroad did not provide them with better access to financing since most of them did not seek foreign financial resources or had preferred to invest abroad making use of their own capital.

Profit repatriation was a common practice among 13 interviewed firms (36.1%); 18 firms said they reinvested their profits abroad (55.6%), and three firms reported they had yet to generate any profits abroad (8.3%).<sup>21</sup> The reasons cited for reinvesting profits abroad were mainly that the operations were still in their initial stages and demanded more investments, or headquarters and subsidiaries having an independent financial management. The repatriation of profits to Costa Rica has brought effects to the company headquarters through the acquisition of machinery, equipment and software, building infrastructure, or simply increasing its working capital.

Most firms claimed to have achieved economies of scale as a result of their internationalisation (21 firms or 67.7% of the sample). This has had a positive impact in terms of lowered production costs, increased output and sales, and new business opportunities (mainly overseas). In summary, 25 firms (80.6% of the sample) reported that investing abroad improved their competitiveness, through new market knowledge, improved capabilities, more clients, lower costs, better products and services, increased purchasing power with suppliers, better customer service, risk diversification, and better reputation among stakeholders. Table 9 summarises the quantitative effects from investing abroad.

<sup>20</sup> Data on exports by retail and service firms is not always available since sales are carried out directly by subsidiaries or because data on trade in services is not recorded by official figures.

<sup>21</sup> The number of responses for this question amounts to 36, since five firms claimed to adopt both strategies: profit repatriation and reinvestment of profits abroad.

**Table 9**  
**Summary of quantitative effects**  
*(Number and percentage of firms)*

Effects	Positive	No effect	Negative
Number of employees	12 (38.7)	13 (41.9)	6 (19.4)
Quality of employment	12 (38.7)	19 (61.3)	0 (0)
Trade	21 (67.7)	10 (32.3)	0 (0)
Sources of financing	12 (38.7)	19 (61.3)	0 (0)
Profits repatriation <sup>a</sup>	13 (36.1)	18 (63.9)	...
Economies of scale	21 (67.7)	10 (32.3)	...
Competitiveness	25 (80.6)	6 (19.4)	...

Source: Own elaboration, based on the survey of companies.

<sup>a</sup> Positive effect corresponds to profit repatriation and no effect represents the sum of reinvestments in host countries and no profits generated in host countries.

## E. Qualitative effects of OFDI in Costa Rica

The first potential qualitative effect of investing abroad is linked to accessing new sources of knowledge. In effect, 13 firms (41.9% of the sample) acquired new technological and market knowledge as a result of their internationalisation: regional and local business practices, logistics expertise, product and process technologies, customer needs and marketing. For those firms which claimed that no new knowledge has been transferred, the main reason was that they considered Costa Rica as a more technologically-advanced country in comparison to neighbouring countries, therefore knowledge flows take the opposite direction (from Costa Rica to host countries).

By the same token, 16 firms (51.6% of the sample) reported positive effects on their personnel qualifications due to internationalisation associated with new skills and knowledge acquired through operations in new countries. For investments in neighbouring countries, this new knowledge was mostly related to consumer and marketing expertise, since, as mentioned, respondents in general considered Costa Rica as a more technologically advanced country. As for investments in more developed countries, the interaction with customers and suppliers has developed also more advanced technical skills.

When asked about the diffusion of new knowledge to the rest of Costa Rica through linkages with other firms (suppliers or customers), universities, research centres and industry associations, only nine firms gave a positive answer (29% of the sample). Other Costa Rican MNEs do have linkages with such organisations; however, these are mostly for business purposes.

Most firms interviewed (25 or 80.6% of the sample) claimed that investing abroad has had positive effects in terms of better products and services. The main reasons they cited were that competition abroad tends to be fiercer, especially in larger countries; foreign customers are more demanding; new knowledge acquired overseas is incorporated into existing products and services; increasing production (learning-by-doing); investment in new equipment and machinery to supply new and larger markets; certifications, as well as new product and packaging requirements in order to sell in more stringent and sophisticated markets; and new product innovation due to closer interaction with foreign clients.

Table 10 presents a summary of the qualitative effects from investing abroad, according to Costa Rica firms interviewed.

**Table 10**  
**Summary of qualitative effects**  
*(Number and percentage of firms)*

Effects	Yes	No
New sources of knowledge	13 (41.9)	18 (58.1)
New skills and knowledge of home-country personnel	16 (51.6)	15 (48.4)
Knowledge diffusion to the rest of the home country	9 (29.0)	22 (71.0)
Improved products and services	25 (80.6)	6 (19.4)

Source: Own elaboration, based on the survey of companies.

As a closing question, interviewees were asked to mention the main benefit from internationalising their operations. The main answers are summarised in table 11.

**Table 11**  
**Main benefits from investing abroad**  
*(Number and percentage of firms)*

Benefits	Number (Percentage)
Access to larger markets	53.6
Market diversification	14.3
Access to financial resources	3.6
New business opportunities	10.7
Economies of scale	10.7
Improved competitiveness	3.6
Learning	3.6

Source: Own elaboration, based on the survey of companies.

## F. Horizontal factors

The last section of the questionnaire inquired about horizontal factors which could be hindering or fostering the impact of OFDI in Costa Rica. Twelve firms (38.7% of the sample) claimed to interact with local organisations beyond commercial relationships with other companies (customers and suppliers). These interactions have benefited Costa Rican firms mainly through personnel training, knowledge of local regulations, development of local products and product customisation and knowledge of local markets. This result shows that in general the linkages of Costa Rican transnational firms with host-country organisation are still limited, which may limit the effects in both home and host countries.

Most respondents (15 or 48.4% of the sample) declared that public policies of host countries have not played any role in their decision to establish a subsidiary. In contrast, 12 firms (38.7%) and four firms (12.9%), reported that their investments abroad have been promoted or undermined, respectively, by host-country public policies. Among the former, firms mentioned tax incentives, better access to financing, infrastructure (e.g. industrial parks), and simplification of administrative processes. In addition, support from local industry associations, geographical and cultural proximity, and trade and investment agreements have also encouraged such investments. In contrast, companies were discouraged by complex tax systems, non-tariff barriers, corruption, political conflicts, red tape and insecurity. Although it is beyond the scope of this document, it is important to acknowledge that other emerging economies such as South Korea, Singapore and Malaysia are already adopting active policies to promote outward FDI (see Box 2).



**Box 2****Outward foreign direct investment policies: The experience across countries**

Outward FDI promotion is emerging as a policy priority. There has been a growing recognition that outward FDI can also bring benefits for growth and productivity. Therefore, governments have started adopting different promotional approaches in order to take advantage of these potential benefits. Active promotion of outward FDI involves a series of policy instruments and agencies which may vary across countries. While the active promotion of OFDI is a new type of investment policy in developing countries, in many developed countries it is already widely adopted since domestic firms have reached a certain level of development and often wish to take a step further toward internationalisation (UNCTAD, 2006).

The most important policy instruments in this field include: trade promotion organizations (TPOs), investment promotion agencies (IPAs), and export credit and insurance agencies. Few countries have designated agencies exclusively supporting outward FDI, but as exports and FDI represent alternative ways of serving a foreign market, many countries have added outward FDI promotion to the tasks of their trade promotion organizations (Kuyminska-Haberla, 2012).

While the nature of support offered for outward FDI differs, market information and match-making are the services most commonly provided by TPOs. In some countries, IPAs responsible for inward FDI promotion have also been given a mandate to encourage outward FDI. Examples include the Economic Development Board in Singapore, the Foreign Investment Agency of Vietnam, the Malaysian Industrial Development Authority and the Korean Trade-Investment Promotion Agency (KOTRA), which has established the Overseas Investment Information System, providing a complete range of information about investing overseas. In all cases, there is a clear separation of the departments dealing with specific tasks of inward and outward investment promotion (Kuyminska-Haberla, 2012).

Besides disseminating information about investment prospects, among the most popular instruments used by governments are also: trade missions, databases including information from business partners and investing intentions of home investors, and special incentives such as tax exemptions, preferential loans and export credits, which are used to reduce the cost of investing abroad.

Source: Own elaboration.

Lastly, 26 firms (83.9% of the sample) considered that the Costa Rican government should support firm internationalisation initiatives, mainly through legal assistance, market intelligence, and credit facilitation; fiscal incentives and trade agreements came in second place.

Table 12 classifies the sample in three types of firm according to their internationalisation strategy. First, 13 firms (41.9% of the sample) can be classified as large firms with a clear, long-term strategy. They usually have an aggressive internationalisation, which goes beyond the region, and reap large quantitative and qualitative benefits from their overseas operations. Large firms not only tend to be more internationalised than small firms, but also have a clear and more profitable strategy. Second, ten firms (32.3% of the sample) are SMEs with a clear internationalisation strategy. Their investment abroad is quite recent and mostly takes place within the region (Latin America). The benefits are mainly quantitative (exports, employment, economies of scale), although some qualitative benefits can be observed. Third, 8 firms (25.8% of the sample) are micro and SMEs with an unclear internationalisation strategy. They have on average one subsidiary, mostly within the subregion (Central America), and take advantage of situational investment opportunities. The benefits from investing abroad are limited.

**Table 12**  
**Firm typology by type of internationalisation strategy**

Size	Number of firms in the sample	Number of employees (in Costa Rica and overseas)	Average number of subsidiaries	Strategy	Benefits
Large enterprises	13 (41.9%)	Over 251	4	Clear, long-term strategy. Investment outside the region and more aggressive internationalisation.	Large quantitative and qualitative benefits.
Medium-sized and small enterprises with clear strategy	10 (32.3%)	From 11 to 250	3	Clear, long-term strategy. They are still in the first phase of the internationalisation process. Most investment is concentrated within the region.	Moderate benefits, and mostly quantitative.
Micro, small and medium-sized enterprises with unclear strategy	8 (25.8%)	From one to 250	1	Invest in other countries (Central America) due to some specific opportunity (i.e. important client or local partner).	Limited benefits. Often need to withdraw from foreign markets because investment abroad was miscalculated.

Source: Own elaboration, based on the survey of companies.



## V. Conclusions and policy recommendations

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In the past fifteen years, there has been a significant increase of outward FDI flows from Latin American countries, as well as from other developing countries. A large number of firms, from both small and large economies, have shown a strong internationalisation strategy through both the purchase of assets (mergers and acquisitions) and greenfield investments. Yet, little research has been undertaken to study outward FDI from developing countries and there is scant evidence on the determinants and home-country effects of investing overseas. This document has two aims: a) to examine the strategies followed by multinational enterprises (MNEs) from Latin America when they decide to invest in other countries, distinguishing between emitter country size and sector, and b) to investigate the home-country effects of OFDI.

As for the strategies, based on information from the fDi Markets database maintained by the Financial Times, which monitors cross border greenfield investments covering all sectors and countries worldwide, and data from Thomson Reuters Datastream on cross border merger and acquisition (M&A) operations, a comprehensive database on FDI projects was created for the period 2003 to 2013. The database comprises the six countries of Central America and the seven largest economies in Latin America (Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela (Bolivarian Republic of)).

With respect to investments by sector, Latin American MNEs in manufacturing and services follow mainly a market-seeking strategy, associated with the search for new growth opportunities (room for expansion in the domestic markets has been depleted) and increasing international competitiveness (clients demand a regional or international supply of goods and services). OFDI from Latin American companies takes place mainly within the region (other Latin American countries), although large firms are increasingly investing in other regions. In addition to market seeking, manufacturing firms also invest abroad in the search of efficiency, that is, lower production costs. In contrast, service sector firms seek specialized resources, such as qualified human resources. The natural resources sector, as expected, looks for destinations well-endowed in natural resources.

As for emitter country size, MNEs from both large Latin American and Central American countries pursue mainly a market seeking strategy. In addition, whereas natural-resource seeking is more relevant for MNEs from large Latin American countries, efficiency seeking is more important for Central American firms.

Regarding home-country effects of OFDI, a representative survey of Costa Rican firms with investment abroad was conducted. As mentioned, Costa Rica stands out as the small country in Latin America with largest OFDI flows. A sample of 31 firms was selected, taking into account size and sector. The main findings are:

- a) Internationalization is not only for large and mature firms. Small-sized firms may derive large benefits from investing overseas.
- b) Most firms have pursued a market-seeking strategy (29 out of 31 firms), although 16 firms reported an additional strategy (e.g. efficiency or natural-resources seeking). Costa Rica is a small country and the rest of Central America is a natural market to expand their operations. For some firms, mainly those operating in the services sector (logistics and IT services), investing abroad is a real necessity to be competitive.
- c) According to their internationalisation strategy three types of firms were identified: 13 large firms (41.9% of the sample) with a clear, long-term strategy; ten SMEs (32.3% of the sample) for whom investment abroad is quite recent and mostly takes place within the region (Latin America), and eight micro and SMEs (25.8% of the sample) with an unclear internationalisation strategy. The benefits for the firm and the home country (Costa Rica) are much larger in the first group of firms.
- d) As for the quantitative effects, there is a positive relationship between international trade and internationalisation. Investing abroad has opened access to foreign markets (firms which were not exporting before their internationalisation) and increased international trade for those which were already exporting.
- e) In terms of employment, the number of employees based in Costa Rica increased in 38.7% of interviewed firms (12 firms, most of them large) as a result of their internationalisation and decreased in only 19.4% of interviewed firms (six mainly medium and small-sized firms). Since market seeking is their main strategy, investing abroad does not mean, in general, that Costa Rican firms are closing down or reducing their operations at home.
- f) The main qualitative benefits are improved products and services, and new skills and knowledge for home-country personnel.

These findings highlight that there is a role for public policy, since firm internationalisation has positive effects on home countries. OFDI contributes to structural change in home economies through better jobs, stronger technological capabilities and increasing productivity. Investing abroad also facilitates access to international markets. Furthermore, the more developed the internationalisation strategy the higher the benefits for the home country. Therefore, public policies to support internationalisation should differentiate the specific needs of large, medium and small enterprises. Large and medium firms have clear and long-term strategies with easier access to market information when compared to small businesses, as shown by the survey results. Public support should also differentiate between sectors and regions, since, as mentioned, investment strategies vary.

According to the results of the survey, three main areas of policy intervention are identified: a) facilitation of market intelligence, including information on new business opportunities and host-country administrative and legal processes; b) improved access to formal sources of financing to support internationalisation strategies, and c) the fostering of interaction between MNEs and the rest of the local economy (firms, universities, research centres and industry associations) to increase the dissemination of new technological knowledge and best practices.

Investment promotion agencies (IPA) could have an important role in coordinating these efforts. Research results mentioned above show that, rather than relying on IPAs, firms investing abroad usually depend on customers and suppliers in order to access market intelligence often due to the firms lack of information on the role of agencies and how they can support companies. In this setting, IPAs could act to raise awareness of their role as investment promoters and in bridging the informational gap on host economies that exists for many potential investors. For instance, IPAs could create a Guide to invest

abroad , providing information on procedures and regulations for doing business as well as on corporate taxation and incentives in the host countries with the advice tailored for specific countries, regions and sectors. The support provided by IPAs should be coordinated with other industrial policies such as investment attraction and export promotion.

This investigation opens future avenues of research. First, further studies could examine the role of specific host-country policy instruments in attracting FDI from small, developing economies, such as free trade zones and other preferential tax schemes. Second, the effect OFDI from state-owned enterprises on home-economies has barely been studied and could have different features compared to private enterprises, since some of those investments may not be necessarily profit driven. Third, the case for public policies to foster firm internationalisation should be further investigated.

In terms of the theoretical literature, the empirical analysis presented in this paper shows that the internationalisation of firms from small developing economies does not respond necessarily to classic theories such as the product life cycle (Raymond Vernon) and the investment development path (John Dunning). On the one hand, firms from such countries are frequently far removed from the technological frontier. Their investments overseas pursue mostly a market access strategy and it is not the result of technology maturation and efficiency seeking strategies. On the other, firms from small low income countries, such as Honduras and Nicaragua, find it profitable to invest abroad, therefore outward FDI flows take place even if the country has yet to achieve a certain development level.



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## **Annexes**

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## Annex A

**TABLE A.1**  
**DEFINITION OF VARIABLES AND DATA SOURCES**

Variable	Definition	Source
GDP	Log of host country GDP (in constant dollars)	World Bank, World Development Indicators
Exports	Log of total exports from investing to recipient countries	BACI dataset (CEPII)
Distance	Log of distance between issuer and host country; based on bilateral distance between most populated cities	CEPII Gravity Dataset
Fuel	Share of fuel on total exports	World Bank, World Development Indicators
Ores and Metal	Share of ores and metals on total exports	World Bank, World Development Indicators
Wages	Log of host country average monthly wage (in dollars)	LABORSTA, International Labour Organisation (ILO) and OECD statistics
Human capital	Log of years of schooling for Population aged 15 and over	Barro-Lee Educational Attainment Dataset
Political stability	Perception of political stability. Estimate of governance performance which ranges from approximately -2.5 (weak) to 2.5 (strong)	World Governance Indicators
Inflation	Inflation, per cent, consumer price index	World Bank, World Development Indicators
Infrastructure	Telephone mainlines per 1,000 people	World Bank, World Development Indicators

Source: Own elaboration.



## Annex B

### Questionnaire for a representative sample of Costa Rican MNEs

#### I. Company background

1. Company name	
2. Industrial sector	
3. Location/city	

4. Ownership. Is the parent company established in Costa Rica?

<input type="checkbox"/> Yes <input type="checkbox"/> No
What is the share of domestic capital?
<input type="checkbox"/> 100% domestic capital
<input type="checkbox"/> Joint venture with foreign capital
Percentage of domestic capital _____

5. What are your company's three main products?

	In 2014	Three years ago (2011)
a.		
b.		
c.		

6. Destination of sales in the last year (2014)

a. Local market	%
b. Overseas	Through exports % Through subsidiaries %
Main destination countries	

7. Please list the countries in which the firm has established subsidiaries

Country	Year of establishment	Share of total FDI	Main activities in the country (i.e. sales, marketing, production, etc.).

8. Type of operation. Through what type of operation did your company enter new markets?

- |   |
|---|
| <input type="checkbox"/> Greenfield investment    |
| <input type="checkbox"/> Mergers and acquisitions |
| <input type="checkbox"/> Both                     |

9. Since the beginning of its internationalisation, has the company withdrawn from any market? If so, which countries and why?

- |  |
|--|
| <input type="checkbox"/> Yes <input type="checkbox"/> No |
|--|

Countries and reason for leaving the market:
--

10. Total number of employees (average full-time equivalents for the last three years)

	Home country	Overseas (total)	Overseas by country				
			Country 1	Country 2	Country 3	Country 4	Country 5
2012							
2013							
2014							

11. Please indicate the percentage of assets concentrated in subsidiaries and the revenues originated in them

	Assets	Revenues
2012		
2013		
2014		

## II. Internationalisation strategy

12. What is the main reason for investing abroad? Why would you recommend investing abroad?

Market seeking	<input type="checkbox"/>
Efficiency seeking	<input type="checkbox"/>
Specialized-resource seeking	<input type="checkbox"/>
Natural resources seeking	<input type="checkbox"/>
Other	<input type="checkbox"/>

13. Has this strategy changed over time? Why and how?

14. Does this strategy vary according to the destination (host country characteristics)? Please explain

15. In terms of future plans, has the company targeted markets or future projects which are currently being analysed? If so, which countries?

### III. Quantitative effects

16. Has the number of employees in the home country (headquarters) increased or decreased as a result of outward FDI?

	Growth rate (three years after internationalisation)
Increased	
Decreased	
Same amount as before internationalisation	

17. Has the quality of employment been modified as a result of outward FDI? (i.e. transition from low-skilled towards high-skilled labour). Please explain.

18. Has the amount of international trade (imports and exports) changed as a result of internationalisation? If positive, what was the growth rate three years after the internationalisation?

19. Has outward FDI given new or better access to foreign sources of financing? Please explain.

20. Are profits repatriated or remain overseas? Please explain the reasons for such a choice. If yes, has the repatriation of profits stemming from operations abroad had a positive effect on the home economy (investment, salaries, profits for stakeholders, etc.)?

21. Do the operations abroad provide new sources of tax income to the home-country government?

22. Has the outward FDI allowed for or provided incentives to increase production scale? What have been the results in terms of productivity and revenues?

23. Has internationalisation strengthened the firm's competitiveness? (i.e. market share, production costs, product characteristics, etc.)

## IV. Qualitative effects

24. Has outward FDI provided access to new sources of technological knowledge? Please explain.

25. Has outward FDI helped develop new capabilities in home-country personnel? Please explain.

26. Has the new knowledge been spread to the rest of the home economy through linkages with other firms (suppliers or customers), universities and research centres?

27. Have the firm's main products or services improved as a result of internationalisation? Please explain.

28. Would you recommend other companies invest abroad? Why?

## V. Horizontal factors and public policy

29. Have the subsidiaries built economic and knowledge-related linkages with firms and other organisations (universities and research centres) in the host economies? If positive, what benefits has the parent company derived?

30. Have public policies in host countries hindered or fostered interaction with domestic firms and organisations?

31. Have you found any other factor in host economies that may hinder or foster linkages with local firms and organisations?

32. Has your firm received public support to increase operations overseas? If yes, what kind of support has the company benefited from?

33. Should the government provide support for OFDI?

34. What kind of support would be most appropriate?

- Grants
- Loan programs
- Tax breaks
- Insurance and guarantees
- Legal assistance
- Bilateral or multilateral investment agreements

## Respondent's details

Respondent s name	
Respondent s position in the firm	
Phone number	
Fax number	
E-mail address	



UNITED NATIONS

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