THE IMPACT OF FOREIGN DIRECT INVESTMENT ON THE LOCAL CHILEAN INDUSTRY

A thesis submitted in fulfilment of the requirements for the Degree of Doctor of Philosophy at The University of Waikato by

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Abstract

For a relatively small country located far from most major markets, Chile has been remarkably successful at attracting inward Foreign Direct Investment (FDI). However, the nature and extent of the contribution of inward FDI to Chile is not well understood. Most research has focused on the direct effects of FDI on the economy or the foreign affiliate. That is, there is a lack of research that considers the impact of FDI on the development of local industry. Therefore, this thesis main research issue is: “How does inward FDI impact on local industry in Chile?” It focuses on the impact of FDI at the firm level by assessing the indirect and direct linkages that foreign affiliates form with local firms, through which they may influence the upgrading of local industry, as well as identifying factors that may influence linkage formation.

This thesis uses Scott-Kennel’s model of local industry upgrading as a guideline to address the main research issue. This model provides a micro-level explanation of the Investment Development Path (IDP), in turn, making it feasible to examine how the impact of FDI on local industry upgrading may occur. The model proposes a process of local asset augmentation (upgrading) that operationalizes the IDP by illustrating the mechanisms by which local firms may upgrade their resources and capabilities via linkages with foreign affiliates. However, Scott-Kennel’s model is based on the New Zealand context, which presents differences from the Chilean context. Hence, this thesis assesses the suitability of Scott-Kennel’s model in the context of a developing economy, Chile.

From a methodological perspective the value of this thesis originates from the various challenges encountered during data collection by using quantitative methods that triggered the reconsideration of the research context and research questions that ultimately led to adopt a qualitative methodology using multiple case studies. Case firms included in the study are significantly foreign-owned affiliates operating within the service sector in Chile.

This thesis provides evidence that FDI has a significant impact on the upgrading of local industry in the context of Chile, through direct effects over the affiliate, competitive effects, local sourcing, assistance linkages, corporate social responsibility linkages and collaborative agreements. The results also support Scott-Kennel’s findings that not all FDI is the same. Distinct groups of affiliates are distinguished according to their extent and quality of linkage formation. In so doing, it provides a starting point for identifying those affiliates that are more likely to be engaged in a variety of local linkages and those that are less likely to be so well integrated with the local industry.

A key contribution of this thesis relates to the role of government policy in the process of local industry upgrading via FDI in the context of developing countries. The evidence suggests that while FDI policy may be neutral government policy plays a major role through directive industry policy and the provision of an investment environment which is stable politically and economically. Overall, the findings in this thesis relating to foreign affiliates and their activities in Chile will provide policy makers with a better understanding of the nature and outcomes of interaction between foreign and local firms.
This journey would not have been completed without the guidance, encouragement, support, and assistance of a large number of people. I would like to thank all those who contributed, in many different ways to this thesis.

In the first place I would like to express my deepest gratitude to my chief supervisor, Associate Professor Michele Akoorie, for her supervision, advice and guidance throughout the research process and the production of this thesis. Her commitment as a chief supervisor went beyond my expectations by providing me with constant encouragement and support in various ways, especially during the birth of my daughters and the change of methodology. Above all and when most needed, she believed in my capacities and in this thesis. I am indebted to her more than she knows.

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Chapter 1  Introduction

1.1.0 Introduction

Foreign direct investment (FDI) is different from other private capital inflows – such as portfolio investment – since, in addition to equity-based ownership, direct foreign investment implies a direct or lasting interest in, and control of, an enterprise (Loungani & Razin, 2001). FDI typically comprises a bundle of assets, including capital, technology, human resources, and knowledge (Dunning, 1993) and the economies of scale and scope associated with multinational operations (Scott-Kennel, 2001). This bundle of resources has important implications for both the multinational enterprise (MNE) and the host economy. The possession of a unique set of resources constitutes an advantage for MNEs to overcome the challenges of operating in a foreign location and has implications for the extent and pattern of local development in a host country. For developing countries, like Chile, seeking to create location-advantages and extend existing assets, this bundle of resources cannot be overemphasized since it offers enormous potential for local spillages of firm-specific advantages.

Chile has recognised the potential positive impacts of FDI; in turn, it has adopted a positive attitude towards FDI since the military coup in 1973. Accordingly, Chile has attracted significant inflows of FDI. In the 1990s, Chile positioned itself as one of the most successful Latin American countries in attracting FDI. Historically, FDI has played an important role in Chile’s economic growth by expanding local production and linking the country to foreign markets and economic resources (Kline, 1992). As a result, FDI is seen as having a key role to play in national development strategies and is viewed as the force with which to exploit and sustain the competitiveness of local resources and capabilities (UNCTAD, 1999).

However, the nature and extent of the contribution of inward FDI to Chile is not well understood. Most research has focused on the macroeconomic impacts of FDI inflows and on the direct effects on the foreign-owned affiliate. These studies have provided evidence regarding the impact of FDI on productive capacity, export development, and foreign-affiliates’ productivity (Riveros & Vatter, 1994; Agosin, 1998; Ffrench-
Davis, 2003; CEPAL, 2000; Foreign Investment Committee, 2004; Alvarez, 2003; Thomsen, 1998; Paredes & Sanchez, 1996). While the evidence is mixed with regard to the impact of FDI on the economy at the macro level, it shows positive direct effects on the affiliates. As to the indirect effects of FDI in the Chilean industry, there are only two studies that have formally assessed the effects of FDI at the industry level (Alvarez, 2003; Alvarez & Gorg, 2005). Both studies used panel data in the manufacturing industry; one focused on the impact of FDI on local firm productivity, and the other focused on the competitive effects of FDI. While there are other publications regarding the indirect effects of FDI these are not based on objective, academic research (Benavente & Crespi, 1998; Riveros & Vatter, 1994).

As a result, research in Chile has not provided objective evidence on the operations of foreign-owned affiliates in Chile, and their wider effects on local industry. The implications of this lack of research for Chile are twofold. First, while the potential contributions of FDI are well recognized, understanding of the extent to which MNEs transfer and/or diffuse their firm-specific advantages to local firms presents a significant gap in the existing literature. Second, a lack of information on the activities of MNEs in Chile implies that Chile has almost no control over the resulting impacts of FDI; in turn, it is less likely to maximize the potential benefits that FDI holds for the Chilean economy through government policy.

Therefore, the aim of this thesis is to address the impact of FDI on Chilean industry. From this perspective, it builds on the findings of previous studies (refer to Chapter Three) by providing empirical evidence on the extent and nature of the impact of inward FDI on the development of local industry in Chile, specifically in the service sector.

This chapter outlines the purpose and structure of the thesis. First, it describes the background and origins of foreign investment in the Chilean context. Then it briefly reviews the conceptual framework of the study and the main research objectives. The methodology utilized for the study is then presented, followed by a brief discussion of the importance of the research. Finally, the structure of the thesis is presented.
1.2.0 Research Background

The earliest foreign investment in Chile was in 1822, four years after the declaration of its independence from Spain. Since then three main periods can be distinguished (Behrens, 1992), namely a period of British investment predominance (1822-1918); a period of United States’ investment predominance (1919-1973), and period of decree law 600 (DL 600) (1974-present). While each period presents distinct characteristics in terms of FDI inflows and economic structure, historically, FDI has played an important role in the development of many of Chile’s industries. For instance, during the period of British investment predominance FDI entered marketing and interoceanic transport followed by a flow of FDI into the railway business and mining sector. The British continued to dominate in this period through investment in a range of industries – such as the food industry, textiles, printing, and metals (Muñoz, 1977).

However, CEPAL (1954) estimated that the importance of FDI in the process of capital formation in Chile was higher in the period previous to the “Great Depression” (1930). From then on the percentage of FDI to gross capital formation decreased, stabilizing at about 21%, reflecting the implementation of the “import-substitution” strategy after 1930. Until the early 1950s FDI inflows were mainly directed to the mining sector (69%), and public services (18.1%). Changes in FDI regulations during the administration of President Carlos Ibáñez del Campo (1954-1958) resulted in a significant increase in manufacturing investments, although mining continued to be the main attraction for foreign firms.

In the late 1960s Chile’s economic landscape was substantially altered by a series of reforms, particularly the nationalization of large-scale copper mining and agrarian reform (ECLAC, 2000; Cardoso & Faletto, 1979, Behrens, 1992). Consequently, within a relatively short period of time the country suffered from a severe political and economic crisis and, as conditions for foreign capital were found to be discouraging, a sharp fall in FDI inflows resulted. The stock of FDI decreased towards the end of 1973 to US$500 million, one of the lowest in Latin America (Desormeaux, 1993).

Since 1973 (military coup in Chile – Bureaucratic Authoritarian (B-A) regime) the Chilean government has dramatically changed its attitude towards foreign investors,
in the context of widespread adoption of an economic liberalization doctrine. This change is reflected in the adoption of an outward looking economic policy based on the principles of neo-liberalism. The B-A regime implemented a range of measures for attracting FDI. In 1974, the government enacted a new Foreign Investment Statute, the Decree Law 600 (DL 600), which regulates the conditions of market entry, capitalization and remittances of foreign capital. This legal instrument was used to raise the profile of foreign investment, and it soon became one of the main sources of financing for a renewed development strategy based on an extensive opening-up of the economy (ECLAC, 2000; Bitar, Espinosa, Maulian, Vergara, & Vignolo, 1980). Since 1974, the vast majority of foreign investors have chosen to use this mechanism (DL 600). As a result of deregulation and liberalization since the late 1980s, FDI has contributed to the development of the banking sector, telecommunications and public services.

Previous research has suggested that the government plays a major role in economic development by providing a business environment that enables sound investment through government policies (UNCTAD, 2000; Narula & Dunning, 2000). While the Chilean government proclaims that it has taken a neo-liberal approach (laissez-faire approach to policy) towards development, there is debate regarding whether this is true in practice (Rodrik, 2004; Richards, 1997; Petras, Leiva & Veltmeyer, 1994). It is argued that the Chilean government has had an active role in the business affairs of the country by undertaking a policy-driven strategy for economic development. In other words, while at the macro level the Chilean government has embraced the fundamentals of the neo-liberal system at the micro level it has followed a neo-structuralism approach. This implies that the government has been attempting to direct the operations of private firms, both local and foreign, to foster economic development.

In light of the changes to the investment environment in Chile over the last three decades, there is a lack of research that considers the impact of FDI on the development of local industry, and on long-term economic development. Therefore, this thesis originates from a need to respond to increasing academic and public interest in foreign investment and its economic impacts.
1.3.0 Research Objectives and Theoretical Framework

The revision of FDI patterns and empirical studies in Chile, in Chapter Three, reveals that Chile has relied on FDI to develop many of its industries. Indeed, recently, the government has taken specific measures in an attempt to maximize the potential of FDI for the development of specific industries. In light of this evidence, the central research issue of this thesis is: How does inward FDI impact on local industry in Chile?

The impact of FDI on host economies can be broken down into direct effects and indirect effects. Direct effects relate to the macroeconomic impact of FDI on the local economy such as capital flows, employment creation, and technology transfers. In addition, direct effects relate to the effects over the foreign-owned affiliate as a result of the transfer of firm-specific resources from the MNE. Indirect effects take place via linkages between the foreign affiliate and local firms.

The unique characteristics of MNEs are crucial when analysing the impact of FDI on host countries. The transfer of a unique set of resources from the parent firm to the foreign affiliate may improve the latter’s performance relative to local firms, as well as presenting the potential for indirect effects. That is, FDI presents the potential for upgrading local firms’ capability. However, whether upgrading of local industry occurs does not only depends on the characteristics of the foreign affiliate, it also depends on the location-specific factors of the host economy. This point needs to be considered carefully when assessing the impact of FDI in the context of Chile since developing countries usually have a very different structure from the capital exporting ones. They have, for example, less developed local capacities, which may lead to different effects.

The theoretical framework of the thesis is based on the Investment Development Path (IDP) developed by Dunning (1981). The IDP acknowledges that, over time, inward FDI has the potential to assist local industry through upgrading, later leading to outward FDI activity by local firms. The Ownership, Location and Internalization paradigm (OLI) operationalises the IDP by suggesting that the extent to which FDI will impact on an economy depends on the nature of: the O-specific characteristics of the investor; the L-specific characteristics of the host country; and the extent to which
firms choose to internalize cross-border markets for intermediate products (Dunning, 1993).

The OLI paradigm is useful for addressing the issue of the impacts of FDI on host economies since it illustrates the relationship between the ownership, location, and internalization configuration of foreign and local firms and the progression of a country through the five stages of the IDP trajectory (Dunning & Narula, 1996). That is, the paradigm presents a means of operationalising a macro level concept (the IDP) based on a micro level phenomenon (the process of local industry upgrading). (Refer to Chapter Two for a detailed description.)

The paradigm suggests that progression through the IDP stages is prompted by the development of O-advantages in local firms and the diffusion of foreign O-advantages, particularly created assets (Scott-Kennel & Enderwick, 2005). In so doing, it suggests that FDI contributes to the development of O-specific assets of local firms, which then enable those firms to become outward investors themselves. This phenomenon suggests that FDI possesses an enormous potential for indirect effects through the diffusion of O-advantages to local firms. However, the realization of this potential depends on a specific country’s composition of FDI, location factors, and government policy (Scott-Kennel, 2001).

Dunning (1998) states that the contribution of FDI to the upgrading of local industry is strongly conditional on the following: the motives for the investment; the size; nationality and the degree of multinationality of the investing firms; the human and physical infrastructure and market structure of the host country; the form of entry by the foreign affiliate; the nature of the products; the characteristics of related firms; and the entrepreneurial ethos and strategies of both the investing companies and local firms in the host country. This suggests that the extent of indirect effects via indirect and direct linkages between foreign affiliates and local firms depends on a wide range of variables. These factors are either related to the foreign affiliate (FDI induced change) or the host country (non-FDI induced change).

Scott-Kennel’s (2001) model draws on the IDP and OLI paradigm (Refer to Chapter Four for a detailed description.). The model applies the framework of the IDP at the
micro level by proposing a typical process of local asset augmentation, as well as the contribution of inward FDI to industrial development as a continuum from enclave to full integration. In so doing, it refers to the interaction between the O-, and I-, advantages of the foreign affiliate, and the L-advantages of the host economy. The process includes four different stages. Each stage represents a step towards the upgrading of O-specific advantages of local firms and/or the foreign affiliate. The extent and rate of progression through these stages is determined by the specific OLI configuration of the foreign affiliate, and especially the L-specific advantages of the host country.

The model recognizes three main types of linkages between foreign affiliates and local firms according to their potential for local industry upgrading: low quality linkages (i.e., competitive effects); moderate quality linkages (i.e., forward and backward linkages); and high quality linkages (i.e., knowledge and collaborative agreements). Scott-Kennel (2001) proposes that the quality of linkages is positively related to the degree of linkage (DOL) of the affiliate in the local industry. In other words, she proposes that if the quality of linkages is higher, the affiliate is more integrated with the local economy and the DOL is higher. She further suggests that as the affiliate increases its local DOL, the potential for indirect effects increases, which, in turn, suggests that the DOL of the foreign affiliate in the host economy is what will determine whether the O-specific advantages of the MNE will diffuse through to local firms or not – eventually leading to local industry upgrading.

Hence, Scott-Kennel’s (2001) model of local industry upgrading proposes an evolving scenario of development in which each type of linkage, and DOL, is related to different OLI configurations. In other words, the model suggests that the contribution of inward FDI to a country’s economic development is positively related to the DOL at the firm level, which at the same time depends on the OLI configuration of the affiliates.

However, Scott-Kennel’s (2001) model is based on the New Zealand context, which may be different from the Chilean context. The model may not be appropriate in this context since there are other variables at play related to government policy and economic environment. Hence, the aim of this thesis is to assess how MNE activity
impacts on the development of local industry in the context of Chile while assessing Scott-Kennel’s (2001) model in a different context. In light of this objective, the first research question is:

- Is Scott-Kennel’s model applicable in the context of Chile?

The following step is to assess how FDI impacts the local Chilean industry. In order to do so, there are three main research questions related to the impact of FDI in Chile that this thesis brings forward:

- What impacts do parent MNEs have on the characteristics, activities, and competitiveness of its affiliate in Chile?
- In what ways do the activities of foreign affiliates in Chile contribute to the upgrading of local firms?
- Are there specific factors that are likely to bring about a greater degree of linkage with the local economy than others?

The thesis is concerned with the direct and indirect effects of FDI that arise from the O-advantages that are transferred to the foreign affiliate via the parent MNE once it has been established in Chile. In order to identify which O-specific advantages may be diffused to the Chilean industry, a detailed profile of the affiliate is presented. The profile indicates how affiliation with the parent firm may affect the affiliate operating in Chile. In light of this profile, the indirect effects of FDI over local industry are addressed by assessing the extent and type of linkages formed between the foreign-owned affiliates and local firms in Chile. Particularly, the thesis is concerned with investigating the ways in which the O-advantages, or other resources belonging to the affiliate, may diffuse to local firms via linkage formation. The thesis also analyses which firm-specific and location-specific factors may play a determining role on the extent of linkage formation by the affiliate.

Finally, the thesis follows Scott-Kennel’s (2001) proposition that the DOL of the affiliate with local industry will determine the extent and nature of its overall impact on upgrading. In so doing, it also addresses the issue of whether certain types of FDI are more likely to form linkages that result in such upgrading.
In sum, based on the theoretical framework and previous empirical studies in Chile, central to the thesis is the aim to show the degree to which the local firm may benefit from the diffusion or transfer of firm-specific advantages of a MNE operating locally via linkages.

1.4.0 Methodology

The research questions put forward in this thesis have never been assessed in the Chilean literature thus no data exist that may help answer them. As a result, it was necessary to collect primary data. To employ a quantitative approach seemed suitable since the research is based on Scott-Kennel’s (2001) study, which used postal surveys. Nevertheless, as explained in detail in Chapter Five, various challenges were encountered when using surveys in this study as a result of not giving sufficient consideration to the differences in context between New Zealand and Chile. From these events, the low response obtained by using online surveys, after three follow-ups, was the one that triggered the decision to change the methodology to collect data.

The purpose of the study remained unchanged despite the drastic change in methodology. The selection of a qualitative approach is based on the aim of this thesis, the challenges faced during the data collection stage, and the context for this study. Within qualitative methodologies, phenomenology was identified as the most suitable. Drawing on the principles of phenomenology, the case study method was selected as a strategy for data collection and the analysis process.

The sample frame defined for this study includes those firms that are significantly owned and controlled by foreign investor(s)¹ and operate within Chile in sectors that have received most foreign direct investment over the last three decades in Chile, namely mining; services; and electricity, gas, and water (under the classification of the Chilean Foreign Investment Committee). The cases included in this study belong to the services sector (including electricity and water). The database of foreign-owned firms operating in the mining, service, and electricity, gas, and water sectors in Chile is compiled to conduct this research. This end is achieved by using the database constructed for the quantitative approach in conjunction with a list of foreign firms.
operating in Chile (classified into sectors) provided by the Chilean Foreign Investment Committee.

The design and execution of the study has endeavoured to provide a better picture of the process of local industry upgrading through FDI. The validity and reliability of the study’s findings are reinforced by the inclusion of specific research design features to address such concerns. In addition, particular actions were taken for ensuring high ethical standards in accordance with the “University of Waikato’s Handbook of Ethical Conduct in Research, 2001”.

1.5.0 Relevance of the Research

Historically, FDI has provided the foundation for many of Chile’s industries, such as mining, banking and public services. Since the shift from an inward-looking to an outward-looking economy in the 1970s, foreign investment has increased considerably. Notwithstanding, most research in Chile has focused on the direct effects of FDI, hence there is a lack of understanding regarding indirect effects of FDI. It is for this reason that a more comprehensive study and analysis of FDI in Chile is critical for understanding its immediate and longer-term effects, and for providing potential direction for improvement in FDI policy in Chile.

From an academic perspective, the relevance of the thesis lies in the focus on the nature of indirect effects. Research has suggested that such effects may contribute just as much to the economic development of a host economy as do the direct effects of the investment. Despite this proposition, the assessment of indirect effects has not been as common as the measurement of direct effects. Consequently, there is a shortage of empirical evidence with which to examine the nature of such effects. This thesis addresses this gap by assessing the extent and nature of a broad range of indirect effects.

In addition, the thesis contributes to existing literature by assessing Scott-Kennel’s (2001) model of local industry upgrading in the context of a developing country. Portelli (2002) suggests that while the role of MNEs is seen as a means to actualise
the process of technology transfer and that FDI does represent the most efficient option to promote a process of industrial development, there are limitations of FDI as a driver to technology and industrial development. That is, FDI does not automatically lead to positive externalities in the host economy. Hence, the thesis builds on Scott-Kennel’s (2001) model by identifying L-advantages that may play a determining role on linkage formation that go beyond local firm capability, such as government policy.

1.6.0 Structure of the Thesis

The following chapter (Chapter Two) examines existing theories and empirical studies that focus on the impact of FDI on economic development. The evolution of theories of the MNE is reviewed in relation to impact assessment. The review begins by looking at alternative theoretical perspectives in Latin America in consideration of the context of the study. It then focuses on the discussion of the IDP and OLI paradigm since these theories constitute the basis for Scott-Kennel’s model of local industry upgrading, which is assessed in this thesis. The discussion shows how the eclectic paradigm (OLI) integrates streams of previous international business research. This research considers why the MNE should choose to, and is able to, operate beyond local markets and compete with local firms in their home markets. The resulting paradigm provides insight into the motivations and strategy of the MNE, which relate to its behaviour via the foreign affiliate. In support of the theoretical discussion, empirical evidence is also presented. These studies investigate the nature, extent and determinants of FDI and its economic impact.

Chapter Three provides the context for the study. It begins by presenting the existing investment mechanisms in Chile, followed by a revision of the historical importance of FDI in Chile. It then looks at the extent and pattern of FDI in Chile since 1974. These data provide a clear picture as to the role of FDI in the economy, and trends of inward and outward FDI stocks and flows. Using these data, Chile’s net outward investment position (NOI) by means of the IDP framework is illustrated. The chapter also discusses the determinants of Chile’s IDP trajectory. The determinants discussed include the L-advantages of Chile, economic systems and economic development strategy, and government policy.
The chapter then reviews existing empirical evidence on the impact of FDI in Chile. Most of these studies focus on the evaluation of the macroeconomic impacts of FDI or the effects on the foreign-owned affiliate. In so doing, the chapter clearly shows the limitations of existing research in Chile. It confirms the need to extend and develop certain areas, such as the impact of FDI through indirect effects that have not been adequately addressed by previous research.

Chapter Four presents Scott-Kennel’s (2001) model of local industry upgrading followed by an assessment of its applicability in the Chilean context. Then the model is reviewed in the context of developing countries. Finally, a number of questions and propositions are presented in order to assess in more detail how FDI impacts the local industry.

Chapter Five’s purpose is to describe the methodology of the study. It first presents the initial research approach (quantitative) and the challenges encountered during data collection. It then focuses on describing the qualitative methodology ultimately selected for the study. It includes the process by which phenomenology is selected as the most appropriate methodology while discussing the characteristics of alternative methodologies and the process of research method selection. It also provides the details of the specific case study design for fieldwork and analysis. The limitations of the methodology and methods are also presented.

The results of the empirical research are presented in Chapter Six in the form of individual case studies. Each case study is structured following the major concepts of the study, namely affiliate profile, linkage formation, determinants of linkage formation, and degree of linkage. The individual case studies are based on analysis that looks at the data gathered using interviews and additional information, in relation to the main research areas.

In order to obtain a wider level of understanding of the ways through which FDI impacts the local industry the findings presented in Chapter Six are synthesized using across-cases analysis in Chapter Seven. Across-cases analysis is possible since case firms share common characteristics while presenting interesting differences.
The discussion of the results is presented in *Chapter Eight*. It evaluates the findings presented in Chapters Six and Seven with regard to the research questions and propositions presented in Chapter Four. It presents the main findings of the study and highlights possible implications in the Chilean context.

The final chapter concludes the thesis by providing a summary of each chapter and the major findings and implications for Chilean industry. It revisits the gap in the literature by considering the implication of this study for FDI research in Chile, theory development, and policy. Finally, the thesis concludes by acknowledging the limitations of the study and areas for future research.

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1 In practice, this means those firms, which have 25 percent or more of their capital owned by foreign interest(s).
Chapter 2  Literature Review

2.1.0 Introduction

With the rapid expansion of multinational enterprises (MNEs) in the global economy, the effect of FDI on the host economy has been of great interest to both academics and governments, and remains a contentious issue (Liu & Wang, 2003). The debate over the impact of FDI has generated a vast literature. From a theoretical perspective, the literature can be divided into theories that argue in favour of MNEs, emphasizing the benefits that MNEs bring to host economies, and those that adopt a more critical approach, which underline the negative effects of MNEs’ activities. However, in practice, there is a continuum with many writers considering both benefits and costs (Jenkins, 1987).

In Latin America, three main approaches towards FDI have emerged, namely the developmentalism, economic nationalism, and dependency approaches (Jenkins, 1984). The developmentalism approach predominated in Latin America in the 1950s and the early 1960s. It emphasizes the positive effects of MNEs’ activities on host economies. On the other hand, the economic nationalism and dependency views, developed in the late 1960s, are both more critical of the MNEs emphasizing the negative effects of FDI. The different positions adopted towards MNEs have at their roots different implicit theoretical frameworks for the analysis of their impact.

Supporters of the positive effects of FDI on host countries (developmentalist view) base their arguments on neo-classical economic theory, which argues that MNEs efficiently distribute resources internationally. Capital flow models, the product cycle, and internalization theory are the most acknowledged neo-classical attempts to evaluate the effects of FDI in host tradable economies. The theory of international trade represents the earliest neo-classical attempt to evaluate the effects of foreign investment. It mainly focuses on explaining the way in which scarce resources are allocated between alternative uses, and to suggest ways and means of improving this allocation (Dunning, 2002). It deals with the impact of foreign investment on the host economy in terms of macroeconomic variables such as real wages, economies of
scale, and tax revenue. For an analysis of indirect effects, the traditional trade theory is not ideal since it does not sufficiently take into account the differences between foreign direct investment and other types of capital inflows (Blomstrom, 1989).

The view that FDI should be seen as an aspect of the economics of industrial structure rather than of international factor movements was initiated by Hymer (1960), and subsequently developed by Kindleberger (1969), Caves (1971), Vernon (1966), and Dunning (1981). The starting point of the industrial organisation approach is to explain why firms undertake investment abroad by recognizing the package nature of FDI and the existence of market imperfections. The package consists not only of capital, but also technology, brand names, trademarks, and management techniques. According to the industrial organisation approach, the distinctive characteristics of MNEs are pivotal when analysing the impact of FDI on host countries. This consideration is of importance, particularly, for developing economies, since such economies have a very different structure from the capital exporting ones. In many developing countries the local firms are relatively small, weak, and technologically backward. These countries also differ from the developed ones in such aspects as market size, degree of protection, and availability of skills. The entry of MNEs into developing countries, through foreign-owned affiliates, may therefore have effects, both positive and negative, which are substantially different from the effects to which entries into developed countries give rise (Blomstrom, 1989).

Subsequent developments of the industrial organisation approach are either related to the pro-MNE position of the developmentalist view – such as product cycle, internalization theory, and OLI paradigm – or the critical position of the dependency and economic nationalist views. The main difference between both groups is that whereas for neo-classical writers, particularly internalization theorist, market imperfections are exogenous, arising from government intervention or the nature of certain products such as technology, for dependency and nationalist writers, the MNEs are themselves major factors creating imperfect markets.

The position according to which MNEs play a positive role in the development process is shared by a large part of the academic world and basically by the most important international organizations. The eclectic theory of international production
(or OLI paradigm) and the concept of investment development path (IDP), developed by John Dunning (1981), are both examples of further developments of the industrial organisation approach. The underlying assumption of these theories is that direct investment by MNEs has the potential to restructure industries of the host economy and to upgrade its competitiveness (Mortimore, Vergara & Katz, 2001).

The proposition that there is a link between the foreign investor’s activities and the stage of development of the host economy (IDP concept) suggests that FDI plays a key role in the economic development of the host economy. It suggests that the introduction of a specific set of assets, or resources, via the affiliate may have an impact at the level of the firm, industry, or the economy. It is argued that the direct transfer of O-specific advantages from the MNE to the foreign-owned affiliate and the indirect diffusion of the foreign investor’s assets, or FDI spillovers, have the potential to strengthen the economic activities of local firms in the host country (Dunning, 1993).

The impact of FDI is normally thought of in terms of its static, direct contribution to host countries. Indeed, most research has sought to explain the changes to net levels of investment and economic development at the macrolevel. However, FDI may also have important wider dynamic impacts on the competitiveness of places by importing new knowledge and technologies and affecting production efficiency in local industry (Potter, Moore & Spires, 2002). The latter impacts have received much less attention in the literature. As a result, there is a lack of literature that considers the process of firm upgrading at the microlevel which occurs as a consequence of inward FDI (Scott-Kennel, 2001). Hence, the aim of the thesis is to assess how FDI may contribute to the upgrading of local firms in the context of a developing country, namely Chile.

This chapter will look at relevant theories and paradigms that explain the impact of MNE activity on economic development. By doing so, it establishes the theoretical foundation for the thesis. Since the thesis’s main objective is to assess how MNEs activity influences local industry upgrading in Chile, the chapter will first present a concise review of the alternative theoretical perspectives on MNEs in Latin America. The discussion of these alternative approaches will provide the basis for analysing
Chile’s historical reliance on FDI, in the next chapter. Then, the chapter will focus on reviewing the eclectic paradigm and the Investment Development Path (IDP). Both will be discussed in depth since they provide the theoretical foundation for the research model developed by Joanna Scott-Kennel (2001) (Refer to Chapter Four.), which in this thesis will be evaluated in the context of Chile. To complement the discussion, empirical studies will be referred to when considered appropriate. Specifically, recent research that assesses the impact of FDI on macroeconomic variables, the affiliate, and linkages between foreign and local firms will be reviewed. The review of empirical studies provides support for existing theory while throwing light on the limitations of existing research, in turn, suggesting certain avenues in need of further research.

2.2.0 Theoretical Perspectives on the Multinational Enterprise in Latin America

The impact of MNEs’ activity on development has been a major issue of debate. There exists a large theoretical and empirical literature about the impact of MNEs on growth in developing countries. In the 1960s and 1970s MNEs were often considered as responsible for perpetuating or even widening inequalities between developed and developing countries. In recent years a much more optimistic view on the role of MNEs has prevailed (See Caves (1996) for a summary of the debate about the role of MNEs in economic development.). This change reflects both important economic events and theoretical developments. On the one hand, the debt crisis¹, which started in 1982, left many developing countries with very limited access to foreign financial resources; this made FDI, which is essentially equity and not debt, an attractive form of foreign capital. On the other hand, the emergence of “endogenous growth” theories stressed the importance of human capital accumulation and technological externalities in the development process. In this respect, MNEs, which can rely on the most advanced production and organization methods, are seen as a natural and powerful vehicle of technology transfer to less developed economies (Marino, 2000).

This section now reviews the different positions that have been adopted towards MNEs in Latin America. There are three main approaches to the analysis of MNEs in
Latin American industry (Jenkins, 1984):

1. Developmentalism
2. Economic Nationalism
3. Dependency (Dependencia School)

2.2.1 Developmentalism

This approach argued that developing countries presented major obstacles to growth such as low level of savings and inadequate foreign exchange earnings, and considered industrialization as essential for breaking out of this vicious circle (Jenkins, 1984). The contribution of FDI was mainly thought of in terms of capital, technology, and management expertise.

Capital flow models regarded FDI as a capital flow which increased the stock of capital in the host country, increasing savings and foreign exchange availability (Buckley & Casson, 1985). There are three main assumptions underlying these models:

(i) foreign resources supplement local resources and that in their absence there would be no local production;
(ii) profits are not excessive since markets approximate the perfectly competitive model; hence, market imperfections are mainly the result of misconceived government policies; and
(iii) MNEs generate additional local resources or utilize previously unutilized resources.

The product cycle represents the change of focus of the neo-classical approach during the late 1960s away from the capital contribution of FDI towards technology transfer. It built on capital flow models by acknowledging the specific characteristics of MNEs and their operations, specifically:
(i) the “package” nature of FDI, which incorporated capital, technology, and management techniques;
(ii) the existence of a strong correlation between FDI and concentrated market structures; and
(iii) the need to integrate trade theory and the theory of foreign investment.

Although primarily concerned with explaining changing patterns of trade and investment, the theory provided some interesting implications for the analysis of the effects of FDI in developing countries. It predicts that these countries will enjoy a comparative advantage in mature, standardized products. In addition to supplying standardized technology to developing countries the product cycle theory emphasizes the importance of MNEs in providing access to overseas markets for developing economies’ exports.

The most recent development of the neo-classical approach is the “internalization theory” (Buckley & Casson, 1976). It has been the approach adopted by most pro-MNE writers. The central argument of this approach is that MNEs exist because of market imperfections. By internalizing their operations firms bypass imperfections in external markets. The eclectic paradigm, developed by Dunning (1981), builds on this theory by stating that MNEs are able to undertake international production and to compete against local firms in host markets because they possess ownership (O)-specific advantages. These O-specific advantages enable the MNE to overcome the inherent disadvantages of operating in a foreign environment (Chen & Chen, 1998b), such as unfamiliarity with distribution and marketing practices, an absence of supplier and purchaser networks, as well as the additional costs of having to relocate and establish production facilities in a foreign country.

In analyzing the gains to host countries these are not primarily related to the transfer of capital, as in the traditional neo-classical model, but to transfers of technology which would not otherwise take place because of external market imperfections (Casson, 1979). It has even been suggested that since market imperfections are more pervasive in developing countries than in developed countries, developing countries are in a position to benefit even more through MNEs’ operations which circumvent such imperfections (Hirsch, 1976).
2.2.2 Economic Nationalism

During the 1960s theoretical developments in the analysis of MNEs’ operations provided an economic basis for a new critical approach towards FDI, mostly acknowledged as the “industrial organization approach”. The seminal contribution to the development of this approach was made by Hymer (1960). He pointed out the link between industrial concentration and FDI. It was then emphasized that FDI should be seen as an aspect of the economics of industrial structure rather than of international factor movements. Specifically, central to this approach is the view that FDI should be seen as part of the strategy of large oligopolistic firms and not simply as a resource flow. Hymer (1960) identified two major motives leading MNEs to control subsidiaries in foreign locations:

(i) to make use of specific advantages which the MNE has over firms in host countries;
(ii) to remove competition between the firms concerned and to eliminate conflict.

The first motive has been widely accepted in the literature on MNEs – referred to as O-specific advantages by Dunning (1981) – but it is only the industrial organization approach that has continued Hymer’s emphasis on FDI as a means of restraining competition (Jenkins, 1987). It mainly focuses on the market power of MNEs, which is seen as deriving from a number of oligopolistic advantages possessed by MNEs particularly access to capital, control of technology, marketing through advertising and product differentiation, and privileged access to raw materials.

By recognizing the market power of MNEs the economic nationalist view stresses a number of consequences arising from MNEs’ activity in developing countries (Jenkins, 1984). First, it is observed that MNEs have tended to invest in oligopolistic markets in host developing countries and that they tend to contribute to increased concentration. Second, the oligopolistic nature of MNEs enables them to earn monopoly rents in host countries. However, the existence of transfer prices allows them to disguise profit remission from a host country by overpricing imported inputs
or underpricing exports. A third area of concern has been the abuse of market power by using restrictive business practices. It is argued that MNEs impose restrictive clauses on subsidiaries and licensees through technology contracts – such as tying inputs of raw materials, machinery, etc. – the technology supplier, or restricting exports in order to divide world markets. Fourth, it is argued that MNEs use their market power to create demand for their products rather than responding to consumer preferences expressed through the market. Finally, even though it recognizes the package nature of FDI as the neo-classical view does, the economic nationalist view concludes that some components of the “package” tend to displace rather than supplement local resources in the host economy. For instance, FDI inflows are perceived to displace local capital, leading to concern over the denationalization of local industry.

2.2.3 Dependency or Dependencia School

In Latin America, during the late 1960s, the question of FDI in manufacturing was one of the major issues which led to the dependency critique of Economic Commission for Latin America (ECLA) developmentalism in Latin America (Jenkins, 1984). It sees MNEs as a major mechanism blocking development in developing countries and as an important obstacle to socialist transformation.

The dependency approach criticized the developmentalist assumptions about FDI’s contributions in terms of additional foreign exchange, additional savings, and better technology, and management techniques. It notices three main mechanisms that link FDI to underdevelopment (Jenkins, 1987):

(i) Drain of surplus – FDI is viewed as a vast “suction-pump” for obtaining resources from the periphery (dependent developing countries). Foreign capital, far from supplementing local savings, appropriates a significant proportion of such savings to finance its own expansion. Moreover, far from being a transitory event, reliance on foreign capital tends to continually reproduce itself, as more new investment is needed in order to
meet the increasing requirements of profit, dividend, royalty and technical assistance payments.

(ii) Creation of oligopolistic structures – the extension of MNEs’ operations to developing countries has also led to the extension of the oligopolistic (or monopolistic) structures of advanced capitalism to these areas. Monopolistic firms, with high profit rates, will tend to repatriate profits, intensifying the drain of surplus and limiting the rate of capital accumulation within the host economies.

(iii) Emergence of a dependent bourgeoisie – MNEs are likely to expand by displacing or acquiring local competitors or moving into new areas of activity. This way, denationalization (foreign control over the economy) increases and the spheres available to local capital are reduced. As a result, FDI reduces the local bourgeoisie in developing countries to the subordinate status of a “dependent bourgeoisie”, which is consequently incapable of playing its historical role in promoting capitalist development.

While the drain of surplus, the creation of monopolistic structures, and the emergence of a dependent bourgeoisie were the three main mechanisms by which FDI was linked to underdevelopment in developing countries, there are other consequences identified by dependency writers. It is argued that FDI concentrates on the production of luxury products for a small elite instead of supplying basic goods for the mass of the population. Also, MNEs are not integrated in the local industry since they tend to generate links primarily with the parent firm or other affiliates and only to a very limited extent with local suppliers. Moreover, MNEs tend to use their political influence in order that public expenditure is allocated to support their investment through the provision of infrastructure (Jenkins, 1987; Cardoso & Faletto, 1979).

In sum, the economic nationalist and the dependency view are similar as both differ from the developmentalist view by assuming that:

(i) MNEs possess resources that tend to displace rather than supplement local efforts;
(ii) MNEs are major factors creating imperfect markets; hence, market imperfections are not exogenous to MNEs;

(iii) MNEs’ specific advantages are seen as a source of market power, which leads to negative consequences in the host economy, rather than enabling MNEs to overcome the inherent disadvantages of operating in a foreign location; and

(iv) The extension of MNEs’ activities in host economies is a result of their market power rather than their inherently greater efficiency compared to local firms.

As to this point, dependency’s arguments against MNEs are similar to those presented by the economic nationalism approach; however, they differ in terms of their political conclusions. While economic nationalism writers emphasize the need for the State to actively intervene in bargaining with MNEs in order to ensure that greater shares of MNEs’ profits accrue to the host economy, dependency supporters adopt a more extreme position by emphasizing the need to break out of the capitalist system in order to transcend underdevelopment. This is, only through a socialist revolution can the situation of developing economies be fundamentally altered (Jenkins, 1987).

Some of the more recent dependency writings on MNEs in Latin America (See Cardoso & Faletto, 1979 for a discussion of dependency and development in Latin America.) have moved away from the totally negative evaluation of earlier critics of FDI. The “drain of surplus” argument has been replaced by a new emphasis on the classical Marxist view of the contradictory nature of capitalist development and the internationalization of capital in particular (Jenkins, 1984). It has been argued that dependence and development are not contradictions in terms. Cardoso and Faletto (1979) specify that a real process of dependent capitalist development does exist in Latin America, referred to as “associated-dependent development”. However, they emphasize that by the notion of “development” they do not refer to the achievement of a more egalitarian or more just society. Hence, they argue this form of development produces as it evolves, in a cyclical way, wealth and poverty, accumulation and shortage of capital, employment for some and unemployment for others. In so doing, they criticize previous dependency arguments as well as developmentalism views.
Specifically, they criticize those who expect permanent stagnation in underdeveloped dependent countries as well as those who expect capitalistic development of developing economies to solve problems such as level of poverty, full employment, better income distribution, and better standards of living. Development, in this context, means the progress of productive forces, mainly through the import of technology, capital accumulation, penetration of local economies by foreign firms, increasing numbers of wage-earning groups, and intensification of social division of labour.

While recognizing that FDI may have negative effects on host dependent economies (developing countries), neo-dependency writers acknowledge that FDI may at the same time help promote development. Nonetheless, whereas FDI can immediately fill some “gaps” such as investment, production, and employment, other “gaps” inextricably linked to industrial upgrading such as skills, capability and technology development take time to emerge or possibly never take place (Portelli, 2002). Narula and Dunning (2000) further notice that benefits of inward FDI are more likely to emerge from that kind of FDI which is likely to generate positive spillovers and that this kind of FDI tends to elude developing countries.

For instance, FDI in services can help improve the competitiveness of host economies by providing capital, technology, and managerial knowledge, enhance skills and restructure inefficient enterprises (UNCTAD, 2004; Aharoni, 2000). In a world with fewer investment and trade restrictions, shrinking economic distance and more mobile resources, only activities that are competitive survive and grow (UNCTAD, 2004; Li, 1994). Thus, competitive production has become essential for development in order to achieve and sustain growth, structural change, desired patterns of income distribution, education, health, environmental protection and, ultimately, development. Countries need firms that are efficient and productive enough to compete in open markets. In ensuring a competitive production sector, services play a vital role, for three main reasons (UNCTAD, 2004). First, services are the largest productive sector in most economies, and their competitive production is critical to the welfare of a society as a whole. The growth and efficiency of services promote competitiveness in the broad sense of the term. Second, many services are crucial inputs into products that compete in domestic and international markets. Third, advances in information and
communication technologies (ICTs) facilitate trade in services as they make it unnecessary for providers and users to be close to one another. As a result, IT-enabled services are now increasingly globalizing in the same way as manufacturers have been for several decades (Grosse, 2000).

Many studies have sought to assess the impacts of FDI on economic development. The majority of these studies have focused on the impacts at an aggregate level, or on macroeconomic effects. The macroeconomic effects refer to the impacts of FDI on aspects of local economies, including international trade, employment, productivity, the balance of payments, technology transfer, and overall welfare (Hejazi & Pauly, 2003).

The position according to which MNEs play a positive role in the development process is shared by a large part of the academic world and basically by the most important international organizations. Indeed, many developing countries have designed policies in order to attract foreign investment from developed countries. But interestingly, as noted by de Mello (1999) in his survey about FDI and growth in developing countries, whether FDI can be considered to be a catalyst for output growth, capital accumulation, and technological progress is a less controversial hypothesis in theory than in practice (For a brief review of empirical studies refer to Table 2.1.).

It has been argued that foreign capital can finance investment and stimulate economic growth, thus helping to increase the standard of living (Wysokinska, 1998; Hejazi & Pauly, 2003; Calvo, Leiderman & Reinhart, 1996; Honglin, 2001). However, the available empirical literature shows that the impact of FDI on economic growth is far from conclusive (Refer to Table 2.1.). The role of FDI seems to be country-based, and can be positive, negative or insignificant, depending on the economic, institutional and technological conditions in the host country.

In terms of employment, it is important to consider the counterfactual position of employment creation by the foreign affiliate. For instance, when the technology gap between the home and the host country is wide, capital intensive foreign investment may involve less employment than more labour-intensive local investment. The overall impact on employment is negative if this foreign investment crowds out local
investment. On the other hand, foreign investment can still be thought of as making a contribution to employment if local investment would not have occurred in the absence of inward FDI. In the scenario where a local firm is acquired when experiencing difficulties, subsequent downsizing by the new foreign owners may reduce local employment significantly. However, the counterfactual scenario may have involved a greater loss of employment through the closure of the firm (Scott-Kennel, 2001).

In the case of FDI in services, employment creation is unlikely to be very considerable. Although tradable services display higher labour content than do manufacturers, the small average size of investing firms, their need for skilled labour and preference for entry by acquisition, all militates against sizeable direct employment creation (Enderwick, 1989; Miozzo & Grimshaw, 2008). In addition, if services MNEs prefer to use expatriate managers or professionals, they may be regarded as holding back local skills development (UNCTAD, 2004). On the other hand, the greater availability and better quality of producer and intermediate services as a result of FDI can stimulate production in downstream industries and add to employment in those industries (UNCTAD, 2004).

It is often claimed that MNEs have advantages due to the possession of proprietary technology. It has been argued that MNEs have been a major channel for access to advanced technologies by host economies; hence, playing a central role in the technological progress of these countries (Wu, 1999; Thomsen, 1998; Barrel & Pain, 1997). The link between technology and economic growth is widely acknowledged. However, empirical evidence has provided mixed results (Refer to Table 2.1.).

These mixed results can be partly explained by the condition proposed by Borensztein, De Gregorio, and Lee (1998). They conclude that a condition that needs to be met by host economies in order to benefit from FDI is that they need to have a minimum stock of human capital. That is, the ability of a country to benefit from transferred technology is dependent on the level of skills, education and experience of the workforce. This need is most evident in the services sector where services MNEs require a ready pool of highly educated labour since technology transfer involves the transfer of skills rather than disembodied information (Enderwick, 1989; UNCTAD,
In addition, Grewlich (1978) indicates that, in terms of technology, FDI may lead to ‘truncated’ firms (foreign affiliates) in which many important activities are performed abroad by the parent or other affiliate firms. The reliance on external sources could indeed mean lesser development of the host economies’ capacities and perhaps even a stultification of these capacities.

The alternative approaches towards FDI in Latin America have put forward several arguments either in favour of or against FDI. In so doing, they provide alternative explanations of why FDI may have a positive or negative impact on the host economy. The limitation of empirical studies assessing the impact of inward FDI from a macroeconomic perspective is that, while they provide evidence either supporting or rejecting the hypothesis that FDI is positively related to economic development, they do not provide evidence that helps to understand why FDI may exert negative and/or positive effects on the host economy.

The aim of the thesis is to assess how FDI may contribute to the upgrading of local firms in Chile. In so doing, its focus of analysis is at the microlevel. Hence, it is necessary to understand first why FDI may have positive and/or negative effects on the host economy from a microlevel perspective. In order to do so, the following sections will focus on the discussion of relevant theories and paradigms that explain the impact of FDI on host economies, and which assume that FDI has the potential to upgrade the host country’s local industry. Figure 2.1 shows the classification model that will guide the discussion of the themes reviewed in the following sections. It is a generic model that illustrates a schema for analysing the role of the MNE in the host country. The schema shows the interaction between the foreign MNE and the host country.

The schema suggests that both the MNE and the host country possess competitive advantages. These advantages, in conjunction with the firm’s strategy, the host country’s economic systems and government policy, will determine the way in which the MNE’s affiliate organises its resources and capabilities (organisational routes) in the host market. Government policy and the economic systems employed in that
Table 2.1  
**Macroeconomic effects of FDI on host economies: Empirical literature review**

| Economic growth | In Bornschier, Chase-Dunn and Rubinson (1978) and Dutt (1997) growth rates are negatively related to foreign capital stocks while in Dutt (1996), Blomstrom (1992), and Ram & Zhang (2002) growth rates are positively related to FDI. Li and Liu (2005) find that there is a strong complementary relationship between FDI and economic growth in both developed and developing countries while Hein (1992) finds no significant relationship. The coefficient of FDI is significantly positive or not significant in Balasubramanyam, Salisu & Sapsford. (1996), while in other papers such influence is positive or negative according to the level of development of the recipient country (as in Borensztein, De Gregorio & Lee, 1998, and de Mello, 1999).

Encarnation and Wells (1986) find that import substitution policies can lead to significant numbers of foreign investment projects which might be economically harmful to the host country. Several studies have shown that inflows of FDI are positively related to market openness in terms of trade (Balasubramanyam & Salisu, 1991; Kravis & Lipsey, 1982; Jackson & Markowski, 1995; Basu, Chakraborty, & Reagle, 2003; Marino, 2000; Honglin, 2001).

While some studies have found that foreign capital adds to the stock of domestic capital available for investment (Hejazi & Pauly, 2003; Borensztein et al., 1998), they conclude that the effect is dependent on the size of that investment and whether it adds to, or substitutes for, local investment activity.

Large capital inflows can have less desirable macroeconomic effects, including rapid monetary expansion, inflationary pressures, real exchange rate appreciation and widening current account deficits (Calvo, Leiderman & Reinhart, 1996; Hooley, Cox, Shipley & Fahy, 1996). |
| Employment | Empirical evidence exists supporting the hypothesis that inward FDI increases the level of employment in the host economy (Nunnenkamp, Alatorre-Bremont, Waldkirch, 2007); however Driffield and Taylor’s (2000) study suggests that the contribution of MNEs to the host economy in terms of employment depends on a number of factors. First, the entry mode directly influences whether foreign investment increases the level of employment or not. For example, Greenfield investments are likely to add more to the level of employment than acquisitions of existing firms. Second, the type of investment has a direct influence on the level of employment. For instance, investment in primary industries may use low-skilled labour, while service or manufacturing related activities typically rely more on local sources of un/skilled labour.

In addition to impacts on the level of employment, MNEs may also contribute to the quality of employment and the development of human resources in the affiliate (Honglin, 2001; Hooley, Cox, Shipley & Fahy, 1996). Driffield and Taylor (2000) find that in the UK foreign firms are significantly more skill intensive than local firms, and conclude that FDI improves the skills base of the economy, if significant training occurs as a result of an increased demand for skilled workers. |
| Technology | Several studies have found a positive relationship between FDI and the level of productivity of firms (Barrel & Pain (1997) in Germany and the UK; Caves (1974) in Australia; Globerman (1979) in Canada; Blomstrom (1986) in Mexico; Blomstrom & Wolff (1994) in Mexico). That is, local firms are more efficient in those sectors where MNEs are present. However, other studies have reported that there is an inverse relationship between FDI and industrial productivity in host countries (Haddad & Harrison, 1993; Aitken & Harrison, 1999). Accordingly, Dunning (1998) indicates that most R&D activity is still undertaken in the home rather than the host countries, especially where those countries are developing. |
Figure 2.1 Schema for Analysing the Role of MNEs in Host Country Industry

Source: Scott-Kennel 2001, p. 18

Organizational Routes
I-specific advantages, including L-specific advantages of hierarchies compared to markets or inter-firm cooperation

Firm Strategy

Economic Systems

Government Policies

Transactional Relationships
(Linkages)

Competitive Advantages of Firms
O-specific advantages

Competitive Advantages of Countries
L-specific advantages

Impact on Upgrading of Industry

MNE/Affiliate Welfare
- Level, pattern & location of MNE activity
- Organizational structures, managerial strategies, control
- Resources and capabilities transferred to affiliate
- Opportunities for upgrading via MNE affiliation

Host Country Welfare
- Capital, balance of payments
- Employment, human capabilities
- Technology
- Upgrading of market structure and productivity:
  - Competition, demonstration effects
  - Access to international markets, resources
    - Demand & supply
country besides influencing the choice of operational mode taken by the MNE’s affiliate, also determine the location (L)-specific advantages of the host country.

The underlying suggestion of the schema is that MNEs have the potential to impact on the upgrading of the host economy industry. However, the extent of the impact is dependent on the choice of organisational route. In other words, the degree to which the MNE’s affiliate chooses to use the market and/or inter-firm cooperative strategies for organising its resources, instead of fully internalising its advantages (internalization (I)-advantages), will influence the extent to which the resources and capabilities of the MNE may diffuse to local firms. Hence, the choice of organisational route is central to understanding the occurrence of transactional relationships (or linkages) formed between foreign affiliates and local firms (Scott-Kennel, 2001).

In summary, the impact of MNEs on the host economy’s local industry will depend on the extent and nature of linkages between the MNE and its foreign affiliate that involve the transfer of resources, and of linkages between the foreign affiliate and local firms, and whether the resources remain internalized within the MNE (and the affiliate) or diffuse to local firms. The extent to which these linkages occur is expected to be a function of the interaction between the strategy and ownership (O)-specific advantages of the MNE, and the policies and location (L)-specific advantages of the host country (Scott-Kennel, 2001).

2.3.0 The Eclectic Paradigm (OLI) and the Investment Development Path (IDP)

Two theories have emerged from further developments of the industrial organisation approach, which provide the theoretical foundation for this research, namely the concept of investment development path (IDP) and the eclectic theory of international production (or OLI paradigm). The IDP concept was first proposed by Dunning in the early eighties (1981). Since then it has been refined and extended several times (Dunning, 1986; Dunning & Narula, 1994, 1996, 2002). Several other authors have made contributions to the development of this concept, including Lall (1996), and
The IDP is an application of the OLI paradigm, which has been widely used as a framework for looking at the relationship between FDI and economic development. The OLI paradigm has become the seminal work in the study of FDI. It is the most widely used conceptual foundation for work in this area. The OLI paradigm suggests that a country’s IDP trajectory is determined by three sets of factors, namely the MNE’s ownership-specific advantages (O), the location-specific advantages of both home and host countries (L), and its propensity to internalize (I) markets for these O-advantages in a foreign location. Hence, it is useful for addressing the issue of the impacts of FDI in the Chilean context since it shows the relationship between the ownership, location, and internalization (OLI) configuration of the foreign and local firms and the progression of a country through the stages of the IDP trajectory (Dunning & Narula, 1996).

Numerous empirical studies have been undertaken to test the validity of the IDP model. These are either multi-country studies using cross-section analysis or longitudinal studies that focus on the IDP trajectory of one country (Gorynia, Nowak, & Wolniak, 2008). Nevertheless, Dunning and Narula (1996) argue that a cross-sectional analysis across countries has severe limitations as the IDP is essentially a dynamic concept, and every IDP is idiosyncratic and country-specific. Hence, the IDP can be best analysed on a country-by-country basis. Several of the longitudinal studies that focus on the IDP trajectory of one country are contained in the book edited by Dunning and Narula (1996), including Clegg (1996) examining the UK’s IDP; Graham (1996) focusing on the fifth stage of the US IDP; Akoorie (1996) investigating the sectoral patterns of inward and outward FDI in New Zealand; Calderon, Mortimore, and Peres (1996) analysing the impact of FDI on the production structure of the Mexican economy; Van Hoesel (1996) examining Taiwan’s FDI and its impact on the country’s industrialisation; Kumar (1996) investigating India’s inward and outward FDI during this country’s distinct development stages; and Zhang and Van Den Bulcke (1996) analysing China’s IDP.

China’s development path, Bonaglia and Goldstein (2006) analysing Egypt’s IDP, and Gorynia, Nowak, and Wolniak (2008) exploring changes in industry composition of FDI inflows to and outflows from Poland using the IDP as a conceptual framework.

### 2.3.1 The Investment Development Path and L-specific Advantages

The IDP concept proposes that a country’s net outward investment (NOI) position is systematically related to its level of economic development, relative to the rest of the world. In so doing, its analysis of the effects of FDI on host economies is at the macrolevel. However, its fundamental idea is strongly grounded at the microlevel (Scott-Kennel & Enderwick, 2005). It presumes that the direct transfer of O-specific advantages from the MNE to the foreign-owned affiliate and the indirect diffusion of the foreign investor’s assets, or FDI spillovers, have the potential to strengthen the economic activities of local firms in the host country (Dunning, 1993). In other words, it presumes that FDI prompts local industry upgrading.

The IDP suggests that countries might undergo five main stages of development. Some general characteristics of these stages are highlighted in Table 2.2. Generally speaking, in the earlier stages the country’s infrastructure and technological capabilities are poorly developed, hence, inadequate to support inward FDI. However, such investment will grow as the economy develops. Countries in stage two have achieved the necessary threshold level of technological capacity; in turn, considerable amounts of inward FDI are attracted, though local firms’ capabilities are not sufficiently developed to undertake outward investment. Stage three countries are in the process of converging on the technological frontier. Market seeking and efficiency seeking FDI is mostly attracted as L-advantages become increasingly created asset-based. At this stage, both inward and outward FDI increase. Stage four and five countries are wealth-driven economies, and their development strategies are created asset-based. What differentiates stage four and five countries is their NOI position, positive and fluctuating around zero respectively.

The stage in which the country might be is determined by its propensity to be outward and/or inward direct investor, which is identified by its NOI position. Under the rubric
of the OLI paradigm, the stage of development a country is in is influenced by the extent and nature of O-specific advantages of both local firms and foreign affiliates; the L-specific advantages of the host country; and the extent to which local and foreign firms choose to use their O-specific advantages jointly with the local resources and capabilities of home or host countries via the market or within the firm ((I)-specific advantages) (Dunning, 1993; Narula, 1996).

Narula (1996) states that the structure of the host economy influences FDI activity while FDI activity influences the economic development of the host economy. In other words, changes in the OLI configuration of the host economy, relative to other countries, lead to changes in the NOI position of the host country and its stage of economic development. Indeed, it is revealed by the extant literature that different configurations of O, L and I-advantages play a crucial role in advancing a host economy through the different stages of the IDP. In stages 1 and 2, L-advantages – such as facilitative government policy and infrastructure – are important for attracting FDI. Further progression through the IDP stages is prompted by the development of O-advantages in local firms and the diffusion of foreign O-advantages, particularly created assets (Scott-Kennel & Enderwick, 2005).

Figure 2.2 suggests that changes in the OLI configuration are FDI and non-FDI induced. Specifically, it illustrates how inward FDI and autonomous (non-FDI induced) changes may impact on the host country. These catalysts for change, hence, prompt the change from earlier to later stages of economic development. For example, a firm’s O-advantages in time t+1 may be dependent on the locational profile of its assets on time t, while a country’s L-advantages in time t+1 may be influenced by its ability to attract foreign O-advantages in time t (Narula, 1996).

The exact nature of the changes depends on the motive of the investment, the role of the foreign affiliate within the structure of the MNE (or MNE’s strategy) (Narula & Portelli, 2004), and the OLI configuration of the firms (Scott-Kennel, 2001). These issues are dependent on the available L-specific conditions in the host economy (non-FDI induced change). Indeed, the host country’s location advantages play an important role in determining the level of embeddedness7 of the subsidiary (Benito, Grøgaard, & Narula, 2003), and this is the primary determinant of the quality of the
FDI, and its subsequent impact on local industry.

Scott-Kennel (2001) emphasizes that the level of embeddedness of the foreign affiliate in the host economy is what will determine whether the O-specific advantages of the MNE will diffuse through to local firms or not – eventually leading to local industry upgrading. Dunning (1998) states that the contribution of FDI to the upgrading and increased productivity of the host country’s resources and firms is strongly conditional on the motives for the investment; the size, nationality and the degree of multinationality of the investing firms; the human and physical infrastructure and market structure of the host country, the form of entry by the foreign affiliate; the nature of the products; the characteristics of related firms, and the entrepreneurial ethos and strategies of both the investing companies and local firms in the host country. Hence, this statement suggests that the extent of linkages between foreign affiliates and local firms depends on a wide range of variables. The factors that have been acknowledged in the extant literature as influencing the formation of linkages between foreign and local firms are either related to the foreign affiliate (FDI induced change) or the host country (non-FDI induced change).

2.3.1.1 FDI Induced Change: The Foreign Affiliate

Empirical studies have identified a range of foreign affiliate’s features that are found to influence linkage formation in local industry. Among them, motive for investment and the role of the affiliate (MNE’s strategy) have been acknowledged to play a key role (Scott-Kennel, 2001).

Role of the affiliate or MNE’s strategy - While the MNE directly influences the economy by transferring its O-specific advantages to the affiliate, the combination of O-specific advantages and the strategy of the MNE also have important implications at the level of the industry. MNEs may influence the productivity and growth of local firms, and they may change the nature and evolution of concentration. They may alter financing, marketing, and technological and managerial practices in the industries that they enter (Blomstrom, 1989). However, whether these advantages diffuse through to local firms or not may depend on the strategic response of the MNE.
<table>
<thead>
<tr>
<th>Table 2.2</th>
<th>IDP: Stages of development</th>
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<tbody>
<tr>
<td><strong>Stage 1</strong></td>
<td><strong>Stage 2</strong></td>
</tr>
<tr>
<td>NOI Position</td>
<td>Little or no inward FDI. No outward FDI. <strong>NOI</strong>: negative</td>
</tr>
<tr>
<td>Economic Structure</td>
<td>Primary Sector</td>
</tr>
<tr>
<td><strong>Industrial upgrading and local conditions</strong></td>
<td>Factor-driven development</td>
</tr>
<tr>
<td></td>
<td>L-advantages limited to natural resource endowments: local infrastructure and O-advantages of local firms are not sufficient to support FDI</td>
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<td></td>
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<tr>
<td><strong>Motives for FDI</strong></td>
<td>Resource-seeking investment</td>
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<td></td>
<td>Growing presence of market-seeking FDI</td>
</tr>
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*Source: Narula & Dunning (2000); Scott-Kennel & Enderwick (2005)*
Figure 2.2 Some Dynamics of the Stages of Growth Using the Eclectic Paradigm

Source: Dunning 1993, p. 278

Stage $t_1$

**FDI induced change** (including changes in strategy of MNEs)

$O_{t_1}$

$O_{t_1}$ $O_{t_n}$

$O_{t_2}$ $O_{t_n}$

Economies of common governance;
Increasing opportunities to earn economic rent

$L_{t_1}$

$L_{t_1}$ $L_{t_n}$

Upgrading/downgrading of local capabilities;
More efficient resource allocation and usage

$I_{t_1}$

$O_{t_2}$ $O_{t_n}$

Non-FDI induced change (including policy changes of governments)

$O_{t_2}$ $O_{t_1}$

Improved efficiency of, or discriminatory financial support in favour of, domestic firms

$L_{t_2}$ $L_{t_n}$

Increased or reduced tax incentives; performance requirements imposed on foreign investors

Stage $t_n$
Hirschman (1970) introduced the concept of “exit” and “voice” to explain the responses of firms and States to threats to their economic autonomy. Under the rubric of hierarchical capitalism (discussed later in this chapter), firms mostly react to market failure by adopting “exit” rather than “voice” type strategies. A firm chooses to ‘exit’ where the response is to replace the market through hierarchical internalization, for instance, when the firm chooses to use intra-firm sources of inputs. Alternatively, a firm adopts a “voice” strategy where the response is to work with the market, for example, working with existing suppliers or purchasers to reduce or eliminate market failure (Dunning, 1995). This kind of strategy has the potential to have a very positive effect on local development.

In general three strategic responses can be distinguished (Scott-Kennel, 2001). First, when the MNE bounds its affiliate to source inputs within the MNE, in turn, the affiliate uses very few locally produced inputs. In this case the extent to local sourcing and opportunities for spillovers will be limited, hence, very few advantages can be expected to be passed on to local firms. Second, as a strategic response, the affiliate is forced to import when the technological capability of the host country is not sufficient to produce competitive and reliable input. A third strategic response may be that the affiliate recognises the potential for local sourcing (in the longer term) and works with local firms. The affiliate’s willingness to commit to local suppliers, sub-contractors and the like, to bring them up to speed, to improve supply capability and to enforce high standards, may be the most effective means of local upgrading.

UNCTAD (1994) states that empirical evidence suggests that foreign affiliates that follow simple-integration, rather than complex-integration strategies, are less likely to establish linkages in the local industry since they tend to rely on imported inputs and create few local supply linkages. For instance, Buckley (2004) notes that although many of the foreign software firms that entered the Irish software industry in the 1990s are involved in higher end development activities, these have failed to develop any significant linkages with local firms mainly because high level research and development activities generally take place in the home country with lower level production operations taking place in Ireland. This instance illustrates the case of information- and knowledge-intensive industries which generate considerable knowledge that is better protected and more profitable when applied within the
organisations (Enderwick, 1989; Fernández, 2001; Kundu, Kumar & Peters, 2008).

MNEs pursue different strategies, which are usually closely related to their motive of investment in the host country. For instance, in the past, MNEs operating in relatively closed local markets often developed substantial supplier linkages, not only because quality requirements were less rigid and economies of scale less relevant, but also because host countries often imposed local-content requirements. By comparison, investors seeking resources or focused on export-oriented industries created relatively few linkages, but these linkages with local suppliers were more competitive and sustainable (UNCTAD, 2000). However, agreements within the WTO framework, such as TRIPs, TRIMs and SCM, have limited the potential for developing countries to use traditional policy instruments (Narula, 2002) that encourage MNEs to adopt strategies that lead to a greater level of embeddedness in the host economy.

However, it is not always the case that firms choose to either “exit” or “voice” the market in order to reduce market failure. On this respect, the literature fails to consider that a firm may adopt either of these strategies even in the absence of market failure. Moreover, market failure could also be remedied by attracting new firms (such as other MNE affiliates) to the local market as suppliers, rather than working with existing firms. This oversight has considerable implications for local development, and has received very little attention in the empirical literature (Scott-Kennel, 2001).

In sum, the nature of the MNE’s and affiliate’s strategy toward local involvement and the internalization of its advantages it is expected to impact on the extent and nature of local upgrading.

**Motive for investment** - Dunning and Narula (1996) classifies the purposes of FDI into resource-based, market-seeking, efficiency-seeking, and strategic asset-seeking. These can be broadly divided into two types. The first three motives are primarily asset-exploiting in nature, which means that the MNE’s primary objective is to generate profits through the use of its existing O-specific advantages. The last motive refers to the case where the MNE aims to add to its existing assets (Narula & Dunning, 2000).
Each type of investment is associated with a certain set of O-, L-, and I-specific advantages and activities. Hence, it is expected that the OLI configuration associated with each type of investment affects the extent to which the MNE’s affiliate will link with the local industry (Scott-Kennel, 2001). Table 2.3 shows four key motives for investment identified by the extant literature and consolidated in Dunning (1993). It presents the expected positive and negative impacts on a local economy as a consequence of this OLI configuration. Scott-Kennel (2001) built on this summary by suggesting the degree of linkage that is typically associated with each motive and OLI configuration.

Resource-seeking FDI refers to investment that seeks natural resources or cheap labour in the host country. This type of investment tends to require few local inputs. For instance, foreign affiliates in manufacturing tend to be more embedded in the local industry than resource-based FDI in terms of local sourcing (Mortimore et al., 2001). However, foreign affiliates in primary industries may get involved in local industry through forward linkages.

Williams (1997) states that resource and market-seeking investments are likely to concentrate on low value-added activities and rely on parent firm know-how since both are driven by the need to access low-cost resources and new markets. However, forward linkages may be formed when foreign affiliates perceive that more benefits arise when local firms are made responsible for marketing and distribution activities. Also, backward linkages will occur if the affiliate incorporates manufacturing with market-seeking investment.

Market-seeking FDI, in terms of foreign affiliates engaged in the production of products for the local market, relies on local sourcing because such production tends to require local inputs (Kiyota, Matsuura, Urata, & Wei, 2005; Barkley & McNamara, 1994), in turn; strong linkages with local firms are likely to be formed. In the case of service MNEs, they tend to go overseas in search of new markets and to follow existing clients who have moved overseas (Grosse, 2000; UNCTAD, 2004; Fernández, 2001; Kundu, Kumar, & Peters, 2008; Kundu & Merchant, 2008; Li, 1994) thus services FDI usually focuses on serving the local market (Enderwick, 1989). This type of FDI has the potential to get involved in the host economy through
forward linkages. Services are generally intangible and depend to some extent on the interaction between the buyer and the seller for their provision (Fernández, 2001), thus they involve some kind of assistance to the client firm (Grosse, 2000). In contrast, foreign affiliates involved in export-oriented activities seeking to service foreign markets tend to form few linkages with local firms (Mortimore et al., 2001).

Efficiency-seeking FDI refers to investment that seeks to increase productive efficiency through globalized operations, including exploiting economies of scale, economies of scope, or simply international division of labour which implies that foreign affiliates are likely to establish linkages with local firms in order to acquire cost-effective quality inputs (Mortimore et al., 2001).

Strategic asset-seeking FDI is a catch-all term referring to investment that links with foreign strategic assets. That is, foreign affiliates engage in collaborative agreements with local firms when the latter possess firm-specific assets that complement the O-specific resources of the affiliate. This kind of FDI results in high-quality linkages (Chen & Chen, 1998a). Nonetheless, if the foreign affiliate chooses to acquire the firm possessing complementary assets, this move results in full internalization of local O-specific advantages, in turn; the impact is on the new firm rather than on the industry (Scott-Kennel, 2001).

Other factors - Besides the MNE’s strategy and motive for investment, the extant empirical literature suggests a range of variables that may also help to explain the level of embeddedness of the foreign affiliate in the local industry – which eventually leads to changes in the OLI configuration.

The share of equity of the foreign affiliates held by the parent firm – or level of autonomy of the foreign affiliate – is expected to have a negative impact on local sourcing. Foreign affiliates under tight control of the parent firm tend to rely heavily on the parent firm for procurement of inputs, output sales, personnel, and other factors. Indeed, the parent firm has an incentive to increase supply or sales of inputs to its subsidiaries in order to maintain its business at home (Kiyota, Matsuura, Urata, & Wei, 2005). That is, the evidence suggests that higher levels of autonomy allowed to the affiliate are related to higher local involvement (Williams, 1997). In addition,
greater specialisation of the foreign affiliate into higher value-added activities implies lower levels of autonomy, in turn, fewer local linkages are formed (Ivarsson, 1999).

The mode of entry also influences the extent of linkages. Greenfield investments typically involves an increase in local linkage formation while acquisitions of local firms may involve a decrease in existing linkages as the foreign affiliate may source from parent and related affiliate firms offshore (Barkley & McNamara, 1994). However, a recent study of Japanese foreign affiliates provided evidence showing that firms started through the acquisition of an existing firm tend to buy more locally than Greenfield plants do since a local purchasing network is already established (Kiyota et al., 2005; Barkley & McNamara, 1994).

Kiyota et al. (2005) found that the experience of the affiliate, in terms of length of operation in the host market, has positive effects on local sourcing in the affiliates in East and Southeast Asian countries, especially China, but not for the affiliates in developed countries. However, Barkley and McNamara (1994) did find evidence of a positive relationship between the age of operation and propensity to source locally in the US. Hence, so far the available evidence suggests that linkages tend to increase over time as the foreign affiliate becomes more integrated with the local economy.

Many empirical studies support the idea that industry sector plays a strong determining role in the extent of linkage formation. For example, foreign firms in the high technology sectors such as automobile and computer industries were found to establish only weak linkages to the local economy (Barkley & Mcnamara, 1994; Mortimore et al., 2001). Consistently, Kiyota et al. (2005) found that the extent of backward linkages established by foreign affiliates was different between industries when controlling for other factors. Foreign affiliates that operate technologies that use intermediate goods more intensively will generate stronger linkages (Rodriguez-Clare, 1996). This finding implies that stronger linkages are likely to be found in those industries where intermediate goods are used more intensively.
<table>
<thead>
<tr>
<th>Type of FDI</th>
<th>O</th>
<th>L</th>
<th>I</th>
<th>Expected Impacts</th>
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<tbody>
<tr>
<td></td>
<td>Resource-seeking</td>
<td></td>
<td></td>
<td>Positive: introduction of O-advantages, employment, increased market access for exports, increase in output through utilization of natural resources, improvements to infrastructure, exports</td>
</tr>
<tr>
<td></td>
<td>Capital, technology, access to markets, complementary assets, size, negotiating strengths</td>
<td>Natural resources, transport &amp; communication infrastructure, incentives</td>
<td>Stability of supply, prices &amp; market control</td>
<td>Negative: high capital intensity control over resources, market concentration</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>Degree of linkage</strong>: low to moderate</td>
</tr>
<tr>
<td></td>
<td>Market-seeking</td>
<td></td>
<td></td>
<td>Positive: introduction and possible transfer or diffusion of O-advantages through local sourcing, R&amp;D (product modification), import reduction, employment, g&amp;s availability and cost improvements</td>
</tr>
<tr>
<td></td>
<td>Capital, technology, information, management &amp; organisational skills, surplus R&amp;D &amp; other capacity, EoS, brand loyalty</td>
<td>Material and labour costs, market size or characteristics, government policy (regulations, imports, incentives)</td>
<td>Reduce transaction or information costs, buyer ignorance or uncertainty, protection of property rights</td>
<td>Negative: market concentration and competition</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>Degree of linkage</strong>: moderate</td>
</tr>
<tr>
<td></td>
<td>Efficiency-seeking</td>
<td></td>
<td></td>
<td>Positive: As above, plus market access for exports, increased output/efficiency due to scale/scope economies</td>
</tr>
<tr>
<td>a)products</td>
<td>As above, plus access to markets, economies of scope, geographical diversification, sourcing of inputs</td>
<td>a) Economies of product specialization and concentration</td>
<td>a) As for second category plus gains from economies of common governance</td>
<td>Negative: Specialisation of affiliate may reduce opportunities for O-advantage transfer/diffusion</td>
</tr>
<tr>
<td>b)processes</td>
<td></td>
<td>b) Low labour costs, incentives</td>
<td>b) Economies of vertical integration and horizontal diversification</td>
<td><strong>Degree of linkage</strong>: low to moderate</td>
</tr>
<tr>
<td></td>
<td>Strategic asset-seeking</td>
<td></td>
<td></td>
<td>Positive: As above, plus opportunities for transfer of O-advantages through collaboration</td>
</tr>
<tr>
<td></td>
<td>Any of the first three that offer opportunities for synergy with existing assets</td>
<td>Any of the above that offer technology, markets or assets in which the firm is deficient</td>
<td>Economies of common governance, competitive or strategic advantage, risk reduction</td>
<td>Negative: Hollowing out of local capacity</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>Degree of linkage</strong>: moderate to high</td>
</tr>
</tbody>
</table>

Studies on the role of country of origin as a determinant for linkage formation provide mixed evidence. For instance, Rodriguez-Clare (1996) found that linkage formation in Mexico was higher when the cost of communication between the parent firm and the affiliate was higher, since this factor provides a stronger incentive to source locally. That is, foreign affiliates are likely to generate more local linkages when they come from regions that are farther away and more different in terms of their cultural, social and legal structures. Accordingly, Banga (2003) found that US affiliates have larger spillover effects in India than Japanese affiliates do since the former are more integrated into the local industry than the latter. However, Barkley and McNamara (1994) found no significant influence on local linkages.

2.3.1.2 Non-FDI Induced Changes: L-specific Advantages of the Host Country

Under the rubric of the eclectic paradigm, location-specific advantages are assets which are specific to a certain location or country and are available to all firms. Hence, L-specific advantages refer to the competitive advantages of countries, rather than firms. In other words, the MNE is attracted to a specific location because it perceives that it can better exploit its O-specific advantages there due to that location’s specific set of advantages.

It is important to make explicit that the L-advantages of the home country also influence the MNE’s activities, by contributing to the development of its O-advantages. Porter (1990) suggests that a firm’s propensity to undertake FDI depends on firm-specific advantages that are the result of home country competencies.

The explanation of the location of MNE’s value-adding activities is provided by the theory of international resource allocation based on the spatial distribution of factor endowments. The study of the “where” of production originated, hence, in classical or neo-classical trade theories (Dunning, 1993). Location was thought to play a primary role in determining which countries would be involved in trade and FDI, and where they would invest. Some authors, such as Kojima (1982; 1990), have taken a macroeconomic perspective and are concerned about why countries engage in FDI. In so doing, they tend to focus on location-specific variables and why firms of a particular nationality may have different propensities to engage in trade and
production than others.

Perhaps the most significant work in the area was that of Vernon (1966; 1974), who proposed that the choice of location of foreign production by large North American MNEs followed the rise and decline stages of the product life cycle. Drawing upon some earlier work by Posner (1961), Vernon (1966) argued that the O-advantages of US firms were determined by the structure and pattern of US factor endowments and markets. The product life cycle (PLC) theory was significant in that it was the first dynamic interpretation of the determinants of, and relationship between, international trade and foreign production. In so doing, he identified how L-advantages played a critical role in determining the location of production. The product cycle theory describes how at each stage of the product’s life cycle different countries were able to offer the required L-advantages. Subsequently, in his Mark II international product life cycle (IPLC) Vernon (1974) concluded that the parent company of the MNE was no longer the sole source of O-advantages – subsidiaries could also develop O-advantages and they could then internalize these O-advantages to other subsidiaries or the parent firm.

It is argued that, in developing countries, although the role of FDI is seen as a means to actualise the process of technology transfer and that FDI does represent the most efficient option to promote a process of industrial development (Narula & Dunning, 2000), there are obvious limitations of FDI as a driver to industrial development. FDI does not automatically lead to positive externalities in the host economy. For instance, MNEs may prefer to use technologies that are suited to their particular needs, and the purposes for which they have made the investment (Lall & Streeten, 1977). MNEs tailor their investment decisions to the existing market needs, and the relative quality of L-specific advantages. Hence, the extent of FDI being a driver of industrial upgrading depends on the quality of L-specific advantages and how these advantages are developed over time. In an optimal scenario, location advantages in developing countries should be transformed from generic to more “created” asset types (Narula & Dunning, 2000).

The point is that the process of developing location advantages, primarily through improved capabilities of local firms, determines the application of more sophisticated
O-specific advantages of the MNE (reviewed later in this chapter), which are tenable to industrial and technological development. Hence, it is essentially non-FDI changes in a host country (L-specific advantages) that determine FDI-induced changes key to industrial upgrading (Portelli, 2002).

In broad terms, L-specific advantages include natural resources (land, primary resources), material and labour costs (e.g., low labour costs), size of local market, and created assets (skilled labour). The wider cultural, legal, political and institutional environments also shape the L-advantages of a country. For example, the level of economic development of a country in terms of infrastructure and sophistication will influence the type and level of investment that is attracted. For instance, shifts in economic structure resulting from change in demand and supply conditions due to economic growth and development have greatly increased the importance of services in national economies and expanded the size of markets for services. Considering that the nature of services require service firms to establish service facilities in host economies, the expansion of national services markets world-wide, therefore, represents a major improvement in L-advantages stimulating FDI in services (Mallampally & Zimny, 2000).

This conclusion suggests that L-specific variables play a key role in linkage formation. Government policies, capability of local firms and the technology gap between foreign and local firms have been significantly acknowledged in the existing literature. In order to illustrate this set of non-FDI influences, it is helpful to use the ESP paradigm which classifies countries according to their economic environment (E), economic systems (S), and government policies (P) (Dunning, 1993; Koopman & Montias, 1971).

**Economic Environment (E)** - This includes the country’s resources and capabilities (human resources, natural resources), as well as the ability of local firms to use these to compete locally and in foreign markets (stage of economic development). A certain economic environment results in a certain level and structure of output (primary, industrial services, specializations). Hence, the components of (E) can be likened to L-specific advantages, and determine the ability of the host country to absorb and utilize the assets that accompany inward FDI.
The technology gap hypothesis stipulates that spillovers increase with the difference in technology levels between local and foreign firms in the industry. However, the empirical evidence does not support the traditional linear technological gap hypothesis. For instance, some studies have found that FDI has a greater impact on reducing the productivity gap between foreign and local firms in the case of a low initial gap (Haddad & Harrison, 1993 in Morocco; Kokko, 1994 in Mexico; Kokko, Tansini, & Zejan, 1996 in Uruguay).

Recent theoretical work emphasises local firms’ capability as a critical factor determining whether the O-advantages of MNEs diffuse through to local firms or not. A broad consensus suggests that local firms need a certain level of local human capital to be able to benefit from knowledge transfer by MNEs (Lall, 1996; Borensztein et al., 1998). From this standpoint, developed countries are expected to have a higher level of human capital and hence to benefit more from FDI than developing countries. This position seems to be confirmed by Xu (2000) whose main finding is that technology transfer provided by US MNEs contributes to the productivity growth in developed, but not in developing, countries. As most developing countries do not meet the threshold requirement, they may find it difficult to benefit from inward FDI.

Kokko et al., (1996) specify that the more local firms invest in learning, the more knowledge they are able to absorb. Recent empirical studies suggest that absorptive capacity is crucial for local firms to benefit from FDI. For example, Liu, Siler, Wang, and Wei (2000) find for the UK that foreign presence in a sector positively affects the labour productivity of local firms, but is positively moderated by the local firms’ intangible assets. In India, Kathuria (2000) finds that spillovers depend to a large extent on the investment by local firms in learning and R&D.

The concepts of technology gap and absorptive capacity have been connected in recent empirical research that suggests that opportunities for knowledge acquisition increase with the technology gap, but recipients’ ability to use it declines. Potential knowledge diffusion (or spillovers) increases with the technology available in the FDI firm, which increases with the technology gap. However, realised spillovers decline as firms fall too far behind to be able to absorb the technology (Blomstrom & Sjoholm,
1999). Hence, diffusion of knowledge from foreign to local firms may be related to the technology gap in an inverse-U-shaped function (Liu et al., 2000).

Buckley and Casson (1985) state that the lack of expertise on the part of the host country – local firms – will raise the costs of technology transfer and increase the benefits of internalization, in turn, influencing negatively the formation of linkages between foreign affiliates and local firms. For instance, technology and unavailability of supply have been referred to as key factors prohibiting greater localised supply, especially for the case of specialist supply items (Brown, 1998; Barkley & McNamara, 1994). In addition, Batra and Tan (2002) indicate that there are some factors that constrain the use of local firms as suppliers. They provide evidence showing that poor Just-in-Time (JIT) practices, lack of quality control, and low levels of skills are the principal impediments to using local suppliers. In addition, reflecting their more advanced technological needs, foreign firms were also more likely to cite low technology levels in local firms as a serious impediment.

Consistently, there is evidence suggesting that linkages increase as local capability improves. (See review in Dunning, 1993). It suggests that whether foreign affiliates establish linkages or not depends on the ability of local firms to respond to the demands of the foreign affiliate effectively.

Also related to the host country’s local capacity is the argument that the quality of institutions is likely to be an important determinant of FDI activity, particularly for developing countries (Bloningen, 2005). Poor quality of institutions increases the cost of doing business and, thus, may diminish FDI activity. Olofsdotter (1998) considers the absorptive capability of FDI receiving countries and finds that positive effects of FDI are stronger in those with a higher level of institutional capability. Wei’s papers (2000a; 2000b) show that a variety of corruption indices are strongly and negatively correlated with FDI; however, other studies found no supporting evidence (Wheeler and, 1992).

**Economic systems (S)** - refer to the macroorganisational mechanism within which the allocation of the country’s resources and capabilities is decided. The economic system of a country will determine its propensity to engage in international trade, and
whether its resources and capabilities are allocated by the government, or by market mechanisms or a combination of the two.

Bhagwati (1978) suggests that the volume and efficacy of inward FDI will vary according to whether a country is following the export promoting (EP) or the import substituting (IS) strategy. Similarly, Ozawa (1992) distinguishes two types of trade and investment regimes: an outward-looking, export-oriented (OL-EO) type, and inward-looking, import substituting (IL-IS) type. He goes further by indicating that it is frequently found that countries combine features of both regimes (strategies) to produce a hybrid regime. However, a certain regime could still be identified as either more strongly or weakly characterized by one approach.

The essential feature of the OL-EO strategy being its neutrality, the OL-EO trade regime does not provide artificial and transitory incentives to FDI. In contrast, the IL-IS regime is entirely policy driven. The IL-IS strategy aims to protect the home market and attract home based investment to serve the market. Balasubramanyam et al. (1996) found that – in the context of developing countries – while FDI is a driving force in the growth process in OL-EO countries it exerts no significant influence on growth in IL-IS countries. This finding implies that the impact of FDI varies across countries and that trade policy can affect the role of FDI in economic growth.

The extant empirical evidence has been supportive to Bhagwati’s original proposition. It has found that openness to trade is positively correlated with FDI (Singh & Jun, 1995; Basu et al., 2003; Marino, 2000). In other words, the more open the industry is to foreign markets and keen international competition, the greater the productivity of those firms which survive. Furthermore, openness of an industry to international markets appears to be associated with access to a larger pool of knowledge for domestically-owned firms; access to new technologies, in turn, promotes local technology transfer and spillovers (Chuang & Lin, 1999 for Taiwan).

**Government Policies (P)** - A country’s economic system may change drastically when government policies are changed which suggests that government policy is perhaps the most significant component of the ESP configuration in terms of its impact on, and arising from, FDI (Scott-Kennel, 2001).
Government policies (P) refer to the strategic objectives of governments and the macro (fiscal, monetary, and exchange rate policies) or micro (industry, trade, investment and competition policies) measures taken by them to implement and advance these objectives, within the system and environment of which they are part. These policies directly influence the activities of MNEs in the host economy (Dunning, 1993) as well as the economic environment of the host country. For instance, through various government policies, governments may affect important factors such as the availability, type and quality of skilled labour (education and training policies); the level and pattern of innovation (patent and trade mark legislation); their own research and development programme; growth, size and diversification of firms (competition policies); and, through a whole host of macroeconomic policies, the industrial climate in which firms operate. In short, whether L-specific advantages manifest in an economy or not largely depend on government policy (Scott-Kennel, 2001). Hence, government policies play a vital facilitative (or inhibiting) role in the developmental trajectory of an economy. For instance, in the case of service MNEs, these are attracted by the existence of a vigorous goods sector, a ready pool of highly educated labour, accommodative industrial policy encouraging collaboration between service users and suppliers and an atmosphere conducive to academic/industrial collaboration (Enderwick, 1989).

Trade and competition policy has been recognized as having a determining role on the extent to which affiliates are willing to form linkages. A general agreement is that the more competitive and outward-oriented an economy is, the more linkages it encourages (UNCTAD, 1999). Research on the factors influencing linkage levels in Singapore suggests that proactive government policies play a leading role in shaping this process (Brown, 1998). This finding confirms earlier empirical research which suggests that a main determinant of linkage formation is host government policy (Lall, 1980).

The importance of government policy is highlighted in the development of the service sector. Three or four decades ago, governments of both developed and developing countries strictly controlled the extent and form of foreign involvement in major services such as telecommunications, banking, and advertising, as well as education,
health and public utilities. Once the liberalization of FDI policies began around the mid-1980s and gathered momentum during the 1990s, services FDI surged (UNCTAD, 2004; Mallampally & Zimny, 2000; Kundu & Merchant, 2008). For instance, substantial liberalization of policies with respect to FDI has taken place in Latin America, partly as a result of privatization programme, which has enabled impressive increases in FDI in services (UNCTAD, 2004; Mallampally & Zimny, 2000).

Through specific policies government may directly influence on the extent of local linkage formation. However, several types of policy instruments used by developing countries to encourage MNEs to transfer skills and technology are either illegal – such as local content regulations 12– or are time-restricted 13 (Narula & Dunning, 2000). The issue of local content regulation has been one of the most contentious policy issues between developed and developing countries. Developing countries keen on developing their own supporting industries argue for the need for local content requirements, while developed countries interested in securing a freer investment environment argue in favour of removing such restriction. Local content regulations have been found to influence the formation of backward linkages negatively. Hence, the application of local content requirement does not seem suitable for developing countries (Belderbos, Capannelli, & Fukao, 2001).

In markets where legal methods of protection, such as intellectual property rights, are effective, the strategic need for innovating firms to internalize operations would appear less compelling than in markets where legal protection is weak (Teece, 1986). This situation suggests that appropriate intellectual property rights may reassure MNEs wanting to form linkages with local firms while the reverse may happen if legal protection is weak.

Ultimately government policy indirectly influences the potential of linkage formation by playing a key role in shaping the L-specific advantages of the host economy. Specifically, through industry and education policy, the government influences the degree of local firm capability (Scott-Kennel, 2001).

Government intervention is a country-specific variable which affects both the
generation of ownership advantages and the economic ties between investing firms and host countries (Dunning, 2002). Such involvement may be direct, through government ownership or participation of industries, or indirect, by the creation of an industrial environment and strategy in which industry and government work closely with each other.

For instance, over the last couple of decades, whether voluntarily or through World Bank-sanctioned SAPs, the focus of Latin American countries has shifted away from endorsing local industrial development towards policies endorsing economic efficiency and the role of the market (Narula, 2002). Perhaps the greatest change has been the reduction in State ownership and the subsequent privatisation of assets. While the change in policy orientation and the successive privatisation of State-owned firms have reduced the interventionist role of governments, their role as market facilitator and provider of complementary created asset-based L-specific advantages has become more significant (Dunning, 1995). Hence, it is not that the role of governments needs to be minimised, as in most Latin American economies, but that it needs to be sensibly and selectively applied (Narula, 2002).

Industrial policy that targets selected industries for growth by means of intensive investment in created assets – such as education and technological capacity – can and does accelerate the movement of countries through the IDP (Narula & Dunning, 2000). Attracting specialized FDI to a particular sector can alter the sequence of industrial upgrading because specialized FDI may help to improve the created assets associated with a sector. Moreover, created assets in one sector may have significant knowledge flow externalities in another which, in turn, may represent significant input to another sector.

In East Asia, government has played a key role in providing economic stability, which has much to do with political stability. In other words, it has not necessarily been strong regulation that has limited the development of local industry but the lack of consistent regulation (Narula, 2002). That is, in most developing countries, a coordination failure exists between the progress registered in outward looking policies and the stagnant, underdeveloped local capability systems (Portelli, 2002). Therefore, whereas developing countries have registered some success in attracting much needed
FDI flows to their economies (as a result registering some success in their outward-looking economic strategies), it is increasingly evident that the host socioeconomic systems are still characterised by weak absorptive capacities. The extent of these local capacities is to a certain extent reflected in the generic L-advantages that developing countries possess, particularly with regard to the low quality of human capital and the weak absorptive capacity and capabilities of local firms.

In sum therefore, the L-advantages of a country – and in turn, its ESP configuration – are shaped by government forces, and determine both the nature and impact of inward investment, and the degree to which local firms are able to upgrade their own competencies and undertake outward investment (Scott-Kennel, 2001).

2.3.2 Internalization- and Ownership-specific Advantages

2.3.2.1 O-specific Advantages

According to the OLI paradigm, ownership-specific (O) advantages explain “why” foreign MNEs undertake international production and are able to compete against local firms in host markets. O-specific advantages refer to those firm-specific advantages that are exclusively owned by the MNE. O-specific advantages can be classified into two types (Dunning, 1993):

(i) **Asset advantages (Oa).** These are O-advantages that arise from the possession of particular intangible assets. Property right and intangible asset advantages allow MNEs to enjoy efficiency advantages via the exploitation of firm-wide resources over many markets. These O-advantages add to the stock of productive resources available in the host country, and utilisation of these resources adds to economic output and development.

(ii) **Advantages of common governance (Ot).** These are O-advantages arising from the ability of the firm to coordinate multiple and geographically dispersed value-added activities in order to achieve efficiency and lower transaction-costs.
The existence of both types of O-advantage is a result of two types of market failure. The first is that firms are different in terms of the resources they have and in terms of their right to exploit them exclusively (property rights). The second market failure relates to the fact that those resources might be more efficiently organised via external market transactions (common governance) (Scott-Kennel, 2001). Table 2.4 provides a list of Oa advantages and Ot advantages.

The role of O-advantages for encouraging firms to engage in multinational operations is evident for service firms. Service MNEs’ O-advantages are mainly knowledge-based. These are proprietary assets of the firm that are embodied in such things as the human capital of the employees, patents, and otherwise exclusive technical knowledge, copyrights or trademarks, or even more intangible assets such as management know-how or the reputation of the firm (Markusen, 1989; Fernández, 2001; Rugman & Verbeke, 2008). These knowledge-based assets are more likely to give rise to FDI than are physical-capital assets since knowledge-based assets can be transferred easily across space at low cost. In addition, knowledge often has a “jointness” or “public-goods” characteristic in that it can be supplied to additional production facilities at very low cost (Markusen, 1989, p.35).

With regard to the transfer of O-advantages empirical evidence suggests that FDI has immediate impacts in the host economy due to the transfer of O-specific advantages from the parent firm (MNE) to the foreign affiliate – or firm that becomes part of a MNE. There are direct effects over the affiliate since along with capital, contributions of knowledge and technology also occurs. In this sense the impact of FDI is linked to the O-specific advantages of the investing MNE. The transfer of the MNE assets to the foreign affiliate provides the latter with the potential to overcome any inherent disadvantages of its home country location. Hence, through accepting inward FDI, firms potentially gain access to resources, such as technology, knowledge and management skills, that their local competitors cannot duplicate in the short run, enabling them to attain or maintain positions of local dominance (Hooley et al., 1996).

For a locally owned firm that is acquired by a MNE, the impact of additional capital injection, changes to both the quantity and quality of employment, and the transfer of technology can be very beneficial to the firm’s subsequent performance and competitiveness (Cantwell, 1991). Empirical evidence exists that supports this
perspective. Several studies have compared the capabilities of foreign affiliates and local firms (Hu & Jefferson, 2002; Alvarez, 2003; Kathuria, 2002; Child, Faulkner, & Pitkethly, 2000; Hooley et al., 1996; Girma, Greenaway, & Wakelin, 2001). Overall these studies indicate that on average, foreign affiliates are more productive than local firms. Also, it is found that foreign affiliates are more export-oriented than local firms, and present a more intense use of a skilled workforce.

<table>
<thead>
<tr>
<th>Asset advantages (Oa), property rights and/or intangible asset advantages:</th>
<th>Product innovations, production management, organisational and marketing systems, innovatory capacity, organization of work, non-codifiable knowledge (‘bank’ of human capital experience), marketing, finance, know-how, ability to reduce costs of intra and/or inter-firm transactions.</th>
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<tr>
<td>Advantages of common governance (Ot), that is, of organizing Oa with complementary assets:</td>
<td>(i) Those that branch plants of established enterprises may enjoy over new firms. Those resulting mainly from size, product diversity and learning experiences of enterprise (e.g. economies of scope and specialization). Exclusive or favoured access to inputs. Ability of parent company to conclude productive and cooperative inter-firm relationships. Exclusive or favoured access to product markets. Access to resources of parent company at marginal cost. Synergistic economies.</td>
</tr>
<tr>
<td></td>
<td>(ii) Which specifically arise because of multinationality. Multinationality enhances operational flexibility by offering wider opportunities for arbitraging, production shifting and global sourcing of inputs. More favoured access to and/or better knowledge about international markets. Ability to take advantage of geographic differences in factor endowments, government intervention, markets, etc. ability to diversify or reduce risks. Ability to learn from societal differences in organisational and managerial processes.</td>
</tr>
</tbody>
</table>

**Source: Dunning (1993), pg. 81**

The affiliate may benefit from the parent firm in terms of improvement of the quality of human resources through introducing training and new skills (Biegelbauer, Griebler, & Leuthold, 2001). Moreover, the foreign affiliate may draw on the R&D output, technical know-how and expertise of the parent firm. Core innovation can be adapted to suit local conditions and then used to gain competitive advantage (Dunning, 1998). However, MNEs have also been known to reduce local R&D activities, or relocate them offshore following the acquisition of a local firm (Costa & Robles, 2002). In the case of service MNEs, each of their foreign affiliates ‘free rides’ on the R&D and other knowledge capital created by the MNE or other affiliates. This idea is in contrast to the argument that a host nation may lose when foreign MNEs producing locally do their R&D at home (Markusen, 1989).
Not all of the effects on the foreign affiliate from the intra-firm transfer of resources will occur in the short-run. For instance, the beneficial impacts arising from the intra-firm transfer of resources such as innovative managerial and work practices, favoured access to inputs, information, established markets, and distribution networks, as well as the advantages of common governance and economies of scale and scope (Scott-Kennel, 2001), will occur in the medium to long term.

FDI, through the control and influence it affords the foreign acquiring management, will stimulate the adoption of managerial practices consistent with those of the parent firm. For instance, research has found differences between firms with and without foreign participation in terms of market orientation, marketing objectives and marketing strategy, export orientation and financial performance (Child et al., 2000; Hooley et al., 1996). In so doing, MNEs can provide a new source of management skill and expertise to an economy via the foreign affiliate. Child et al. (2000) in their study of acquisitions of 201 UK firms by US, Japanese, French, and German investors, found that managerial practices were changed more in firms acquired by foreign investors rather than by local investors.

As the foreign affiliate is involved in the international network of the parent firm, it benefits through the use of established marketing and distribution networks. These networks facilitate intra-firm trade as well as inter-firm trade. They result in broader market coverage and favoured access to inputs for the affiliate, which otherwise would not be available for the firm (Biegelbauer et al., 2001). The affiliate also benefits from firm-specific knowledge and experience of how to operate in international markets.

In sum, the set of resources transferred from the parent firm to the affiliate are likely to be used by the latter as a source of competitive advantage since these resources are not available to local firms. These resources will also affect the nature of the indirect effects on local industry. That is, it is presumed that the foreign affiliate does not influence local industry in the same way as local firms do.

The local presence of the foreign affiliate may lead to indirect effects in the local industry. *Indirect effects* relate to further impacts that come about through changes in the strategy, practices, and competitive advantage of local firms as a result of the local
presence of foreign investors (Potter et al., 2002; Hu & Jefferson, 2002). Indirect effects are expected to take longer to occur since much of the O-specific advantages embedded in foreign investors are not easy to copy or diffuse to the local industry, but instead require a deep process of demonstration and communication between the foreign-owned affiliate and local firms for transfer to be successful (Potter et al., 2002). Exposure of local firms to the O-specific advantages of foreign affiliates may lead to knowledge transfers either through indirect demonstration effects or through direct collaboration, or linkages (reviewed later in this chapter).

The interaction with MNEs may benefit or harm local firms, creating what is known as positive and negative spillovers. Spillovers arise from nonmarket transactions when resources, notably knowledge, are spread without a contractual relationship, so-called externalities (Meyer, 2004).

Local firms may benefit from FDI through personnel turnover, demonstration and agglomeration effects, and knowledge spillovers (Kokko et al., 1996; Girma et al., 2001; Hubert & Pain, 2001; Kathuria, 2002). However, the presence of FDI in a certain industry may exert adverse effects on local firms in that industry. This situation can occur through fierce competition crowding out local activities in product, financial, or factor markets (UNCTAD, 1999). By enjoying better technologies and lower production costs, foreign affiliates may cut into the market share of local firms. In a short-run imperfectly competitive market structure, the productivity of local firms may be reduced when sales fall, so that fixed costs are spread over fewer units. Nonetheless, in the long run, the increased competition induced by the increased presence of FDI in local industries may force inefficient local firms to exit and surviving firms to improve their performance, leading to the potential improvement of social welfare (Hu et al., 2002; Potter et al., 2002).

A large body of empirical literature has analysed the way FDI influences local firms. The main theoretical foundations of these studies are knowledge spillovers on the basis of demonstration effects and the movement of labour. Agglomeration of firms in related industries can encourage local upgrading through demonstration effects. Demonstration effects work through the direct contact between local firms and a foreign affiliate operating at different levels of technology. After observing
technological and organisational innovations adapted to local conditions, local firms may recognize their feasibility, and thus strive to emulate them. Prior to such an encounter, local firms have limited information as to the costs and benefits of new methods (technology), and as a result may perceive the risk of investment as too high. However, the successful performance of the foreign affiliate in the local industry acts as a guarantee of the viability of adopting new methods. As local firms come into contact with existing users, information about technological innovations and new practices is diffused, in turn, the uncertainty is reduced, and emulation activity increases (Blomstrom & Kokko, 2002).

Another channel of spillovers is the movement of employees. Through training of local employees MNEs build local human capital; however, these highly skilled individuals may move to local firms or start their own business. In addition, upgrading of employees skills within MNEs may not only result from formal training, but also, from exposure to modern organisation forms and international quality standards. If these employees move to local firms, they can take some of this tacit knowledge with them, in turn, improving productivity throughout the economy.

A number of studies have sought to measure the aggregate effect of foreign presence on the performance of local firms in the same industry. These empirical tests face the obstacle that spillovers are difficult to measure directly. Indeed, at the aggregate level, it is difficult to determine if changes in productivity levels have come about as a result of indirect or direct linkages between firms (Scott-Kennel, 2001). Thus, many studies proxy spillovers by the observed improvements in productivity among the firms that came in contact with FDI – so-called productivity spillovers. In so doing, these studies are limited to measuring the existence of effects rather than the extent and nature of linkages. (For a brief review, see Table 2.5.)

2.3.2.2 Internalization-specific Advantages

Internalization theory concentrates on viewing transactional market imperfections, with these market imperfections being impediments to the simple interactions of supply and demand to set a market price. The focus of interest is in the firm’s choice to directly own the foreign assets rather than to use some other means of acquiring the rents from the foreign production units. This is explained as a function of the relative
costs and efficiency of transferring assets or coordinating production through internal hierarchies compared with external markets. Hence, the thrust of the concept of internalization is that the actions of firms can replace the market or alternatively can augment it (Buckley & Casson, 1985).

According to Buckley and Casson (1976), to consider O-advantages as a separate explaining factor of international production is “double counting” if internalisation is to be considered dynamically because the act of internalising a market is done to increase profits and it represents a strategic move. In other words, it is not the possession of a unique asset as such which provides the firm with its advantage. Instead, it is the process of internalising that asset as opposed to selling it to a foreign producer which gives the MNE its unique advantage. At the core of this standpoint is the assumption that the economies of internalisation provide the basic logic for the formation of the firm, and remain of strategic importance throughout its life (Buckley & Casson, 2009).

The eclectic paradigm is different from the internalisation theory in the sense that the O-advantages of MNEs are treated as endogenous rather than exogenous variables, apart from those advantages which arise from the act of cross-border internalisation. Internalisation theory states that O-specific advantages are the outcome of structural market imperfections and exist prior to the foreign investment being made; in turn, these advantages are exogenous. By contrast, the eclectic paradigm recognises that O-advantages of MNEs are the outcome of past decisions which, at the time they were taken, were endogenous to the firm. In so doing, it explains that it is not only the firm’s assets (Oa) that give it a competitive edge, but also its ability to realise the benefits from integrating these advantages with other resources to achieve economies of scale and lower transaction costs across international markets (Dunning, 1995). In other words, if the firm perceives that it will benefit more from adding value to its O-specific advantages itself, rather than transferring the right to their use to other firms, then this constitutes an internalization (I) advantage. Hence, internalisation theory explains “how” the MNE is able to organise cross-border activities, in turn, completing the tripartite explanation of international production.

Internalisation advantages are concerned with protecting the firm against, or
exploiting, market failure. Theory suggests where market failure exists or external transaction costs are high, the MNE will choose to internalise its advantages (Hennart, 1989). Market failures can be classified into structural and transactional failures. Structural imperfections are said to arise where there are barriers to competition and economic rents are earned. Structural market failure, therefore, is concerned with the capture of what Hymer referred to as “monopoly” rents (1960) through existing, or created barriers to entry toward other firms. In other words, the more a foreign firm possesses O-advantages over local firms in a potential recipient country, the more imperfect the market is for the transfer of these intangible assets, and hence the more likely that firms will choose to deploy them in the host country via FDI (Dunning, 1986).

Transactional market failure occurs when the market is unable to organise transactions in an optimal way (Dunning, 1993). The transactional imperfections that he acknowledges are those that occur where the transaction of a particular good or service yields costs and benefits external to those of the transaction, but are not reflected in the terms agreed to by the transacting parties. This eventuality may be due to either imperfect information or uncertainty arising from say, political risk, unreliability of supply, potential dissipation of proprietary knowledge via arm’s length transactions, or due to difficulties in valuing the asset or transaction or achieving economies of scale (Magee, 1977).

In sum, the reasons for replacing the external market functions with internally coordinated hierarchies are to:

- Avoid or reduce transaction or negotiating costs.
- Avoid lack of knowledge or inefficiency causing inappropriate pricing of products.
- Gain advantage over competitors by controlling supply of inputs, product or production strategy and access to markets.
- Exploit/protect oneself against consequences of government intervention (transfer pricing).
- Protect property rights.
• Make better use of capacity and gain advantages of size.

FDI means that firms with O-advantages prefer internal expansion abroad rather than licensing or entering into other arrangements with local firms (UNCTAD, 2004). This point is particularly evident in the service sector where it is important to safeguard proprietary knowledge (e.g., banking and financial services, most information-intensive and professional services), to ensure product quality (e.g., advertising, consulting, some consumer services), to minimize transaction costs associated with opportunism, to protect property rights, to avoid search and negotiation costs, to tap synergies from geographical diversification (financial services), and to obtain inputs or develop new markets (trading firms) (Dunning, 1993). On the other hand, for some service industries, non-equity links or minority joint-ventures are preferred. In these cases, quality control, performance commitments and the minimization of transaction costs can be embodied in management contract or franchising agreements (e.g., hotels, restaurants, car rentals) (UNCTAD, 2004). Hence, the balance between the forces making for internalization and externalization varies among industries and firms. However, many of the O-advantages of service firms are based on proprietary knowledge on which profits may be maximized through internalization. (For a discussion of the O-advantages and I-advantages of service MNEs refer to Aharoni and Nachum (2000) and Enderwick (1989)).

Internalisation theory may be considered a general theory in so far as it is able to predict the situations in which firms choose to internalize foreign markets. However, in many respects, as suggested by Buckley (1990), it is better described as a paradigm than a theory, in as much as the kinds of market failure that determine one form of foreign added value activity may be quite different from that of another. Moreover, Buckley and Casson (1985) have acknowledged the need to integrate location-specific variables with internalisation variables (which are not independent of each other) to present a holistic theory of the MNE activity. In addition, one of the major limitations of internalisation theory and the OLI paradigm is the lack of consideration of the organisation of transactions beyond pure hierarchical or pure market forms. The internalization concept may be moderated to include the emerging collaborative or “quasi-internalised” forms of transaction and inter-firm relationships (Scott-Kennel,
2.4.0 Quasi-Internalisation and Transactional Relationships

The OLI paradigm refers to the organisational routes taken by the firm (as illustrated in Figure 2.1), in turn, suggesting that firms have a choice when organising their value-activities. For instance, it could be expected that when the net benefits of externalising transactions via the market outweigh the net benefits of internalising these transactions within the firm, the firm will choose to use the market. However, it is only when it is recognized that firms have other choices besides fully internalising (hierarchical capitalism) or fully externalising their transactions (via market), that the concept of quasi-internalisation comes into the picture (Scott-Kennel, 2001). This concept is of crucial importance for the thesis since it brings into account the role of linkages (transactional relationships) when attempting to explain how the activities of MNEs may contribute to the upgrading of local firms.

The concept of quasi-internalisation implies that the reconfiguration of firms’ boundaries involves not only the externalisation of independent, or standard competencies, but also the quasi-internalisation of complementary competencies (Palpacuer, 2000). In so doing, it diverges from traditional transaction-cost hierarchical capitalism and full-internalisation under FDI, toward alliance capitalism and quasi-internalisation (Dunning, 1995).

Traditional industrial organisation theory correctly asserts that MNEs benefit from internalising transactions within the firm hierarchy, across national borders. Nonetheless, the fast changing competitive environment of the last couple of decades has challenged firms' competitive positions through the emergence of new technologies, products, markets and competitors. As a result, flexibility and adaptability have become key management concepts to develop a sustainable competitive advantage, and successful firms apply them in new organisational strategies that call into question many conventional tenets on organisations and their management. These strategies involve a decentralised and responsive work organisation, based on cooperative relations not only within the firm but also in its
relations with customers, suppliers, and competitors (Palpacuer, 2000). In other words, in order to remain competitive, firms may become more flexible and responsive through specialisation and streamlining of their operations (Dunning, 1995), outsourcing and undertaking collaborative agreements that augment, as well as exploit, existing and complementary assets (Buckley & Casson, 1998; Teece, 1992), and lowering the costs of R&D and technology (Dunning, 1995).

The disinternalisation of noncore activities is frequently replaced, not by arm’s length market transactions, but by controlled inter-firm cooperative arrangements. There is considerable discouragement for firms who contract out non-core activities to other firms to do this via arm’s length transactions. Instead, they need to maintain influence over the price, quality, design and innovation processes associated with products included in their value chain. This scenario frequently requires inter-firm cooperative agreements, or on-going interaction and support of suppliers and subcontractors.

Inter-firm cooperation is not a new phenomenon. What is new is its relative significance as an organisational form (Scott-Kennel, 2001). Until the late 1970s scholars still considered that collaborative production and transactional arrangements between firms were alternative modes of organizing economic activity to hierarchies or markets, rather than as part of an organisational system of firms, in which inter-firm and intra-firm transactions complemented each other (Dunning, 1995). At present, there are several emerging areas of theory that suggest clearly there are opportunities for some activities to be contracted out via market transactions, even as a complement to FDI rather than a substitute. These theories (See Table 2.6 for a brief review.) recognise that firms are pursuing flexibility through alternate organisational forms that blur the distinction between markets and hierarchies (Ghoshal & Bartlett, 1990).

In terms of the OLI paradigm, these theories suggest that host countries have the potential to benefit from FDI, not only at the level of the affiliate or through local sourcing, but via linkage formation with local firms that encourages quasi-internalization of O-advantages (Scott-Kennel, 2001).
Table 2.5  
Impact of FDI on local industry through indirect linkages (spillovers): Empirical evidence

<table>
<thead>
<tr>
<th>Type of impact</th>
<th>Studies</th>
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<tr>
<td><strong>Productivity level of local firms (Cross-sectional data)</strong></td>
<td>Studies have found a positive relationship between the presence of MNEs and higher productivity levels in local firms or industry (Caves, 1974; Blomstrom, 1989; Blomstrom &amp; Wolff, 1994; Globerman, 1979; Kokko, 1994). However, this methodology does not capture the often long lags between MNE entry and its impact on local firms. Moreover, the cross-sectional association between foreign presence and industry productivity may be a result of MNEs entering industries with higher productivity, rather than of productivity being raised by FDI. Indeed, Dunning (1993) suggests that MNEs operate in technology-intensive industries, such that reverse causality is highly plausible.</td>
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<td><strong>Productivity level of local firms (panel data)</strong></td>
<td>Gorg and Strobl (2001) show that studies using cross-sectional data obtain more positive estimates of the spillover coefficients than do panel data studies. Results for panel data research in developing countries are not conclusive as to whether foreign presence has negative or positive effects on local firms. Aitken and Harrison (1999), using panel data of Venezuelan plants conclude that the impact of FDI on the productivity of firms is positive; however, a higher participation of FDI reduces the productivity of local firms. In India, Kathuria (2002) found that the productive efficiency of Indian industry improved, but the increase in efficiency was greater for foreign affiliates. In addition, they found that in the non scientific subgroup, the entry of foreign firms had a negative effect on the efficiency of local firms. Haddad and Harrison (1993, in Morocco, found no evidence supporting the existence of spillovers in the industries studied. Kugler (2001) also found insignificant effects on Colombia. For transition economies, the evidence is also not conclusive. Liu (2002) in China found positive effects, while other studies found negative effects in Bulgaria, Romania (Konings, 2001) and the Czech Republic (Djankov &amp; Hoekman, 2000). Hence, the overall evidence does not support the proposition of positive intra industry productivity spillovers, with the possible exception of special circumstances such as the transition from central planning to a market economy (Meyer, 2004).</td>
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<td><strong>Export behaviour of local firms</strong></td>
<td>Empirical evidence suggests that the presence of foreign firms has a positive influence on the exporting activities of local firms (Aitken, Hanson, &amp; Harrison, 1997; Pain &amp; Wakelin, 1998). Aitken, Hanson, and Harrison (1997) conclude that foreign affiliates are a natural conduit for information about foreign markets and technology, and a natural channel through which local firms can distribute their products. To the extent that foreign firms directly or indirectly provide information and distribution services, their activities upgrade export prospects of local firms.</td>
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Table 2.6
Quasi-internalisation theories: A summary

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<tr>
<th>The organisational capability (OC) view</th>
<th>The organisational capability (OC) view</th>
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<td>• Firms compete on the basis of value rather than on the basis of cost.</td>
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<td>• Firms engage in network activities and embrace collaborative agreements when they perceive that the external firm possesses the ability to provide more than would be possible via sole reliance on internal markets within the MNE (Madhok, 1996).</td>
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<td>• Example: In order to be able to speed up the process of entering a new (foreign) market MNEs will choose to form alliances with local firms to draw on their knowledge of the local market (Dunning, 1995).</td>
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<th>Agglomerative economies/Clustering</th>
<th>Agglomerative economies/Clustering</th>
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<tr>
<td>• Marshall (1920) was one of the first economists to consider the concept of agglomerative economies. He noticed that spatial clustering or agglomeration of firms with related interests may yield agglomerative economies.</td>
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<td>• Within this agglomeration of related industries, firms which possess complementary resources (such as technology) are able to collaborate in order to develop their dynamic capabilities (Porter, 1990). This collaboration, in turn, leads to competitive upgrading in the region or economy (Scott-Kennel, 2001).</td>
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<th>Networks</th>
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<td>• The concept emerged from Gerlach’s (1992) analysis of Japanese networks (keiretsu).</td>
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<td>• It refers to multiple firms that are linked through cooperative, although not uncompetitive, arrangements.</td>
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<td>• Networks are formed to facilitate the transfer of intangible resources (knowledge and innovation) between firms in order to assist the common strategic outputs of the group.</td>
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<td>• Networking enables the firm to be flexible while the network of interlinked firms maintains strategic cohesion.</td>
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<td>• The hierarchy of organisation passes beyond the boundaries of the firm to incorporate suppliers, alliance and joint venture partners.</td>
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<tr>
<td>• The firm becomes a controller of a network of interrelated activities both within and outside the firm. In terms of internalization theory, these higher-order linkages with the local economy effectively open internal markets which were previously closed within the firm (Buckley &amp; Casson, 1998).</td>
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<th>Strategic linkage theory</th>
<th>Strategic linkage theory</th>
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<td>• It emphasizes the possibility that FDI is driven by the quest for new O-advantages rather than by the possession of such advantages (Lall, 1996).</td>
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<td>• This is mostly true for firms owning less developed resources such as MNEs from developing countries and small firms. In other words, it explains the foreign investment decision as an attempt by follower firms lacking in certain capabilities to link with existing host-country competencies in certain industries (Chen &amp; Chen, 1998a).</td>
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Empirical studies suggest that foreign investors impact the industry by influencing the practices of local suppliers and/or customers through direct linkages. Direct linkages involve a purposeful inter-firm relationship. They can be classified into forward and backward linkages. Direct linkages also include non equity collaborative agreements between firms, which can be distinguished as developmental and collaborative linkages (Scott-Kennel, 2001). (See Table 2.7 for a summary of empirical studies on direct linkages.)

Forward linkages refer to the interaction between foreign investors and local customers, for example, supplying local firms with a product that requires further processing (Barrow & Hall, 1995). This occurs when the foreign affiliate passes raw materials, intermediate or final products or services, to another firm for further processing, packaging, marketing or distribution, or use by industrial customers, or for additional value-added such as after-sales services. The extent of forward linkages by the foreign affiliate depends on the product itself, the L-specific advantages of the host economy, and the extent of local experience on the part of the affiliate (Scott-Kennel, 2001).

Evidence suggests that forward linkages are typically not as common as backward linkages. For instance, Batra and Tan (2002) in their study of inter-firm linkages in Malaysia found that the reported rates of forward linkages were low relative to backward linkages. There are several reasons why they are not as common. For instance, MNEs may prefer to add value to their products by themselves because they perceive that the costs of establishing forward linkages outweigh the benefits of doing so. Moreover, when the foreign affiliate engages in the production of output intended for offshore markets, which are usually more sophisticated than the home market, then few linkages are created (Scott-Kennel, 2001).

Although those kinds of forward linkages have been referred to in the literature, empirical research on these linkages or on the extent of these linkages is scarce (Dunning, 1993). Forward linkages have received less attention in the literature mainly because empirical research has focused on manufacturing industries where backward linkages are more prevalent (Sun, 1998).
Table 2.7  
Direct Linkages: Empirical evidence

<table>
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<tr>
<th>Type of Linkage</th>
<th>Reasons for type of linkage</th>
<th>Effects on local firms</th>
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| **Forward Linkages**| Foreign firms may choose to rely on forward linkages because (Scott-Kennel, 2001):  
• A firm chooses to focus on core activities and subcontracts noncore activities to other firms.  
• In the initial stages of investment through forward linkages a foreign firm learns from the locally experienced and knowledgeable firm.  
• MNEs may need to offer guidance about use and servicing to marketing outlets when their reputation is at stake.  
• Evidence is mixed as to whether the presence of foreign affiliates promotes downstream development in processing industries (Dunning, 1993).  
• Forward linkages may result in the local customers’ upgrading of innovatory capacity. For example, local customers may receive support in the form of training in sales techniques and supply of sales equipment (Potter et al., 2002; Meyer, 2004).  
• While forward linkages in terms of the foreign affiliate supplying productive inputs to local firms are not usually expected, forward linkages in terms of foreign affiliates buying services from local firms are more probable. A number of studies have shown a high reliance by foreign affiliates on local service providers (Collis, Noon & Berkeley, 1994; Fuentes, Alegria, Brannon, James, & Lucker, 1993). However, they do not clarify whether these services constitute inputs or further downstream processing (Scott-Kennel, 2001). Hence, they identify the effects of vertical linkages rather than either backward or forward linkages. |
| **Backward Linkages**| UNCTAD (2000) distinguishes four main motives why MNEs source locally:  
• Local supplier is able to produce better or cheaper inputs than the MNE.  
• Supplier has access to cheaper basic factors such as lower labour costs.  
• Occasional subcontracting for the purpose of increasing production in the case of demand peaks is used.  
• Subcontracting when local supplier is able to respond to fluctuations in demand by way of functional flexibility can be used.  
• Empirical work is most often concerned with the extent or quantity of local sourcing by the affiliate (Scott-Kennel, 2001). Available evidence suggests that most foreign firms have some local linkages (McIntyre, Narula & Trevino, 1996). Some studies find that in developed economies (Barkley & McNamara, 1994; Barrow & Pain, 1995) the extent of linkages with local firms is limited. Moreover, linkages are even more limited in countries where local capabilities are few or export-processing zones create foreign enclaves (Fuentes et al., 1993).  
• Backward linkages may result in strong impacts on product development activities, production organization and technologies, quality assurance systems, cost control, and delivery and distribution methods (Barkley & McNamara, 1994; Barrow & Hall, 1995). For example, recent studies have found higher productivity in supplier industries to industries with high foreign presence (Kugler (2001) for Colombia, Aitken & Harrison (1999) for Venezuela, & Smarzynska (2002) for Lithuania).  
• Backward linkages can create spillovers through several mechanisms (Lall, 1978; Smarzynska, 2002): (i) Foreign affiliates may improve the productivity of local firms by providing support in the form of technical assistance and training of employees, |
and assistance in purchasing of raw materials. (ii) They may set higher requirements regarding product quality and services aspects of the supply relationships. (iii) FDI may increase demand for intermediate goods, and thus allow local suppliers to realise scale economies (Meyer, 2004).

- Batra and Tan (2002) find in Malaysia that the most important types of assistance focus on improving the quality and timely delivery of parts and components – through help with quality control, JIT, technology improvement and worker training.

| Developmental Linkages | Backward and forward linkages can be distinguished in terms of their quality into either developmental or dependent linkages (Turok, 1993):
|---|---|
| Versus | • In the *developmental scenario*, the affiliate chooses to decentralize decision-making in order to be more flexible; in turn, the affiliate establishes close, long-term relationships with other firms.
| Dependent Linkages | • In the *dependent scenario*, the affiliate achieves flexibility by establishing price-cutting and short-term, convenient relationships with local firms.

- Local firms benefit from quality linkages with foreign affiliates in terms of improvements to systems and technology such as manufacturing methods, and machinery design (Dunning, 1998; Barrow & Hall, 1995).
- Evidence gathered by Potter, Moore and Spires (2002) in their study of the wider effects of FDI to the UK suggests that buyer-supplier linkages have an effect on stimulating the technological capacity of firms outside of the few well-documented cases in technology districts. The strong impacts were most concentrated on product development activities, production organization and technologies, quality assurance systems, cost control, and delivery and distributions methods.
- Barrow and Hall (1995), in the UK, and Turok (1993) in Scotland, conclude that evidence of value-added, technology based, linkages between firms is not significant. That is, the evidence indicates that many of the links with local suppliers correspond more closely to the dependent scenario than the developmental scenario.

| Collaborative Linkages | • Mowery and Rosenberg (1989): Access to research results at lower cost, and to minimize duplication of research activities of competitor firm.
|---|---|
| | • To get access to complementary assets such as technology, information and resources (Chesnais, 1988; Dunning, 1995).
| | • Competitive or collusive activities, exclusionary market or manufacturing rights, and specialisation of core activities (Scott-Kennel, 2001).

- Studies of technology diffusion via industry networks are restricted to industrialised countries (Hakansson & Johanson, 1993). However, they provide useful insights for assessing the role of foreign firms in local clustering. For instance, it is hypothesised that competitive industry clusters attract firms which often engage in collaborative linkages to access L-specific resources embodied in local industry (Scott-Kennel, 2001).
- Evidence provided by Ivarsson (1999) on her study of Sweden’s internationally competitive industry clusters supports the hypothesis. She finds that foreign firms in the competitive clusters engaged in significantly more collaborative linkages than firms in non competitive clusters. However, results also showed that foreign firms still rely significantly on parent and sister affiliates overseas as sources of technological competence.
Backward linkages occur when the foreign affiliate purchases inputs from local firms (Barrow & Pain, 1995), or subcontracts part of the production process or service function out to other firms, increasing demand for local goods and services (Scott-Kennel, 2001). These linkages traditionally have been considered one of the principal conduits for spillovers from foreign affiliates to local firms (Hirschman, 1958).

Barrow and Hall (1995) conceptualise the extent of local sourcing linkages with a continuum that places at one end the affiliate that has no linkages and operates in an enclave environment, and at the other end, the locally integrated firm. In terms of the OLI paradigm it would be anticipated that the number of local linkages formed by MNEs would be fewer than those of uninational firms since the paradigm expects that the MNE would internalise most of its O-specific advantages (Scott-Kennel, 2001). The findings of Barkley and McNamara (1994) in the United States and Gorg and Ruane (1997) in Ireland support this declaration. They found that local firms had the highest levels of local sourcing of all the firms. However, a study by Batra and Tan (2002) in Malaysia found that foreign firms are more likely to source locally than are local firms.

A major limitation of most of the studies in this area is that they fail to make a distinction between the three sources of local inputs (Scott-Kennel, 2001). Typically the foreign affiliate has to determine whether to import intermediate products or produce them or buy them locally (Dunning, 1993). Are the local purchases made from other foreign firms? Are the intra-firm purchases made from branches or divisions of the same firm operating in the same country? Are the local purchases made from local firms in the host country? Such a distinction would reveal the extent to which affiliates were operating in foreign enclaves. An enclave exists when the foreign affiliate either buys from foreign firms in the host market or from branches or divisions of the same firm, rather than from local firms (Hirschman, 1958). As a result, the foreign affiliate is unlikely to establish linkages with local firms.

Another major limitation of the local sourcing literature as a whole is its suggestion that the impact of direct linkages is limited to increased demand for, or supply of, locally produced goods and services. This limitation is especially true of studies that use aggregate level data. The generation of such economic activity is insufficient, in
itself, to generate the virtuous cycle of local upgrading. In reality, direct linkages can be far more complex than simple demand/supply market transactions. For instance, they may involve on-going relationships between firms, and the provision and supply of goods and services customized to the purchaser’s requirements (Scott-Kennel, 2001).

Most of the extant empirical evidence suggests that the extent of local sourcing linkages formed by foreign affiliates is lower than that of local firms. However, rather than the quantity of linkages formed by the foreign-owned affiliate, it is the quality of the linkages that is more critical for the upgrading of local firms (Barrow & Hall, 1995).

So, in addition to assessing the quantity of linkages, or absolute value of local purchases, according to Scott-Kennel (2001) research should also evaluate:

- The extent to which resources of the MNE influence the types of local linkage formed;
- The extent to which these resources are internalised; and
- The extent to which diffusion or transfer of these resources to local firms occurs.

Barrow and Hall (1995) indicate that an examination of the extent, or quantity, of linkages allows judgment-making about whether the company is integrated into the local economy or constitutes an enclave of development. However, Turok (1993) suggests that the quality and dynamic nature of linkages are more critical considerations for the upgrading of local capabilities, or local O-specific advantages. Quality of linkages refers to how much upgrading of local capabilities occurs over time, the extent of deepening of local linkages, and the extent to which affiliates are integrated into the local economy (UNCTAD, 1999). He distinguishes between linkages that contribute to upgrading, or developmental linkages, and linkages that just increase demand, or dependent linkages.

In sum, the existence of forward and backward linkages does not guarantee local
upgrading. The critical issue is the quality of those linkages. That is, whether the relationships formed between the foreign affiliate and local firms contribute to the productivity and competitiveness of the latter through on-going assistance.

Beyond backward and forward linkages recent literature has suggested the existence of collaborative linkages. Turning to the cooperative forms of economic activity, they have expanded rapidly in the last few decades (Hejazi & Safarian, 1999). They encompass a wide range of organisational forms, such as strategic alliances, technology sharing or development agreements, and managerial contracts (Scott-Kennel, 2001) as well as licensing, joint ventures, and franchising (Duysters & Hagedoorn, 1996). These inter-firm agreements typically involve a reciprocal transfer or development of non equity resources, competences, or services.

The role of technology in economic development has received much attention in the literature. The theory of technological competence suggests that variations in innovative capability are a result of the nature of technology and the way in which it develops. The basic proposition is that technology always consists of two elements, namely the codifiable and the non codifiable. The first element involves codifiable knowledge such as information, which by nature is tradable. The second element is tacit, and involves the non codifiable elements of the skills, routines and operational practices that accumulate from learning processes. The dual nature of technology explains how it is possible for firms to share and jointly develop competences with other firms while maintaining their competitive advantages within the firm (Cantwell, 1991; Mowery & Rosenberg, 1989). This idea implies that the diffusion or transfer of technology involves codifiable knowledge, which is tradable, rather than tacit knowledge, which constitutes the core advantages of the foreign firm.

Few studies have explicitly investigated the role of collaborative linkages between foreign and local firms in the development of local industry. Perez (1997) further indicates that the developmental potential of bidirectional transfer of competences through collaborative agreements has been understated in the literature. The foreign affiliate is likely to become part of a network of firms in order to increase its O-specific advantages while R&D alliances may strengthen the competitiveness of participating firms (Dunning, 1998). Dunning (1995) states that this approach is
equivalent to a voice strategy, which overcomes the inflexibility and risks of hierarchical internalisation.

There are several constraints in the study of collaborative linkages. First, as in studies of backward and forward linkages, most studies of collaborative linkages do not differentiate between affiliate-affiliate and affiliate-local firm agreements. This differentiation is relevant when considering, for instance, the existence of ‘clusters of excellence’ in specific countries. That is, differences in L-specific advantages may influence these competences rather than the diffusion of technology from foreign affiliates. In industries where the technological tradition of local firms is well established, these firms are generally able to react promptly to foreign threats, to assimilate foreign technologies and to mobilize resources to compete with foreign firms in their own home markets, which suggest that L-specific differences are influencing these competences. Second, the extent of collaborative agreements is difficult to quantify due to the limited recording of non-equity, collaborative, organizational forms (Scott-Kennel, 2001).

2.5.0 Conclusion

In theory, the presence of MNEs in host economies is perceived to be either negative – economic nationalism and dependency – or positive – developmentalism. However, the position that the impact of FDI on economic development is positive has prevailed in the extant literature. Theory suggests that the introduction of a bundle of resources via the affiliate may have an impact at the level of the firm, industry and the economy. Inward FDI and appropriate government policy are expected to upgrade the capability of local firms. However, overall, the evidence is not conclusive as to whether inward FDI affects the host economy positively or negatively.

The IDP concept suggests that the NOI position of a country is systematically related to its level of economic development, relative to the rest of the world. It suggests that countries might undergo five main stages of development. The stage in which the country might be is determined by its propensity to be outward and/or inward direct investors. Advancement through the five stages is triggered by improvements to the investment environment, accompanied by appropriate inward FDI that promotes
The change from earlier to later stages of economic development is dependent on a number of factors, either FDI- or non-FDI induced. These factors will determine whether the O-specific advantages of the MNE will diffuse through to local firms or not – eventually leading to local industry upgrading. In other words, the extant literature has acknowledged a range of factors influencing the formation of linkages between foreign and local firms, which are either related to the foreign affiliate – such as an MNE’s strategy and motive for investment – or the host country – such as economic environment, economic system, and government policy. The latter set of factors is referred to as L-specific advantages by the OLI paradigm, and has been regarded as crucial for attracting, and benefiting from, FDI (Portelli, 2002).

The eclectic paradigm of international production operationalises the IDP, suggesting that the extent to which FDI will impact on an economy is a function of the nature of the O-specific advantages of the investor, the L-specific characteristics of the host country, and the degree to which firms choose to internalise cross-border markets for intermediate products (I-specific advantages). The paradigm is able to address the issue of the impacts of MNE activity in a country-specific context, as it illustrates the linkage between the ownership, locational and internalisation configuration of the foreign firm, and, at the macrolevel, the progression of a country through the five stages of the IDP trajectory.

At the level of the foreign affiliate, the impact of FDI is linked to the O-specific advantages of the investing MNE. These include the O-assets of the MNE and the advantages of common governance of the MNE’s activities over many markets. Corporate strategy and the motivation behind the investment will also influence changes to performance at the level of the foreign affiliate. Empirical evidence indicates that on average foreign affiliates are more productive than local firms, in turn, suggesting that the set of resources transferred from the parent firm to the affiliate is likely to be used by the latter as a source of competitive advantage since these resources are not available to local firms. These resources will also affect the nature of the indirect effects on local industry. That is, it is presumed that the foreign affiliate does not influence local industry in the same way as local firms do.
The combination of O-specific advantages and the strategy of the MNE have important implications at the level of the industry. Exposure of local firms to the O-specific advantages of foreign affiliates may lead to knowledge transfers either through indirect demonstration effects, or spillovers, or through direct collaboration, or linkages. MNEs may influence the productivity and growth of local firms; they may change the nature and evolution of concentration; they may alter financing, marketing, and technological and managerial practices in the industries that they enter (Blomstrom, 1989).

Hence, the extent of diffusion is situation-specific and generalizations from one context to another are difficult. Overall, the extent of such diffusion will depend on both the type and use of O-advantages of the foreign and local firms, as well as the L-specific resources and capabilities of the host or home country (Dunning, 1993). The subsequent impact will also be determined by government policies towards FDI, the type of investment undertaken, the specific industry involved, and the capabilities of the MNE versus those of local firms. The ability of the country to benefit from the O-advantages of the foreign firms is highly dependent on its stage of development and the subsequent levels of technological capability, market demand, and other L-specific factors.

Both theory and empirical studies present limitations for understanding the process of local industry upgrading. While the IDP and the eclectic paradigm are of great value for assessing the impact of FDI on local industry both present some limitations that restrict their usefulness as frameworks for studying the impact of FDI in terms of economic development through the process of upgrading of local firms. The IDP concept makes a difficult transition from the analysis of economic development of countries at a macrolevel to the upgrading of competitiveness of firms at a microlevel. As a consequence, the IDP fails to explain the process by which local firms upgrade their O-advantages, via interaction with inward investment and L-advantages, and ultimately become outward investors themselves.

The eclectic paradigm to some extent overcomes the limitedness of the IDP by taking a microeconomic perspective. However, it does not adequately capture alternate, non equity forms of organising transactions. In this sense, the eclectic paradigm is useful
as a broad framework for the analysis of MNE impact on local industry, despite the focus of the paradigm on the foreign firm, but it needs to be moderated by other theories and paradigms that suggest alternatives to full-internalisation. Emerging research in the area of cooperative forms of organising transactions suggests that there are growing incentives for foreign affiliates to employ flexible strategies with other firms, and, subsequently, increased opportunities for spillovers from their activity.

Most of the limitations of existing empirical evidence arise from studies assessing the indirect effects of FDI in terms of spillovers. For instance, the evidence provided by these studies is at the aggregate level which implies that while providing evidence as to the effects of foreign presence on local industry, they do not provide specific evidence as to the role of FDI-related factors in the process of change. In addition, measurement of effects at the aggregate level also implies the inability to establish if changes in local industry occur as a result of direct or indirect linkages. Thus, many studies proxy spillovers by the observed improvements in productivity among the firms that came in contact with FDI. In so doing, these studies are limited to providing evidence of the capacity of FDI to be associated with performance and structural change. As a result, the actual process of change at the level of the local firm is less well understood (Scott-Kennel, 2001).

Empirical studies assessing direct linkages have mostly focused on backward linkages and on the extent of linkages rather than the quality of linkages. In so doing, scant evidence exists regarding forward and collaborative linkages. As a result, research underestimates the impact of foreign presence in local industry when considering the sudden surge in “strategic partnering” occurring internationally (Teece, 1986).

Most of the studies assume that linkages generate positive effects on local industry. Indeed, negative indirect effects are commonly attributed to competitive effects, or acquisition of local firms. In so doing, most of the studies fail to consider the potential for ‘hollowing out’ or the decline of local industry as a result of a strong foreign presence or collaborative linkages (Perez, 1997). In addition, it is important to recognize the potential for a bidirectional transfer of resources, which may be beneficial or damaging to either of the participating firms (Scott-Kennel, 2001).
In conclusion, the IDP explains what happens when MNE activity impacts on the economic development of an economy. The eclectic paradigm explains why it happens, given the antecedents and outcomes of the investment. The gap in the literature is that there is no conceptual framework that helps explain how it happens. Moreover, the limitations of the extant research imply that there is no conclusive answer as to the net impact of FDI on the host economy and there is no comprehensive answer in terms of what needs to be considered to maximise the potential benefits of inward FDI for the host economy (Dunning, 1993). The extent and quality of linkages depend on a number of factors, which are either related to the foreign firm or the host country. Hence, in order to better understand the process by which countries progress through the stages of the IDP, it is necessary to understand the nature and extent of the impact of MNEs’ activities on local industry. It is suggested that the operationalisation of the IDP and the eclectic paradigm may be facilitated by a better understanding of how and why the process occurs (Scott-Kennel, 2001).

The following chapter considers the L-specific factors of the host country in the context of a developing country. Specifically, it reviews the extant literature on the extent and pattern of FDI in Chile. Regarding the limitations of the extant literature, these are addressed in Chapter Four by reviewing Scott-Kennel’s research model for examining the process of local industry upgrading by operationalising the OLI paradigm.

\[1\] Many developing countries regarded the import substitution strategy as the means to becoming an industrialized economy. The industrialization process was mainly financed through international debt. At the beginning of the 1980s, though developing countries were able to offer manufactured products, there was not sufficient demand from developed countries to sustain the production. As a result, developing countries were unable to pay back their loans leading to the debt crisis.
Cheap, reliable and modern infrastructures, as well as financial, technical and other services are the backbone of a competitive economy. With the rising importance of the information- and knowledge-based economy, the share of services in most activities is growing, which accentuates the need for the efficient provision of key services (UNCTAD, 2004).


Technology includes both hard forms, such as machinery or products, and soft forms, such as knowledge, managerial innovation and processes (Scott-Kennel, 2001).

NOI equals the stock of outward FDI less the stock of inward FDI.

Where economic development is measured by Gross Domestic Product (GDP) per capita.

Extent and nature of linkages formed between the foreign affiliate and local firms.

World Trade Organization

Since most services are both intangible and non-storable and, hence, not transportable over distances, they are not tradable at arm’s length across borders. Thus, product delivery of these services to foreign markets is impossible without the establishment of service facilities in those markets (Mallampally & Zimny, 2000).

Absorptive capacity is defined by Zahra and George (2002) as “a set of organisational routines and processes by which firms acquire, assimilate, transform, and exploit knowledge to produce a dynamic organisational capability” (p.186).

Possession of intangible assets has been referred to as a proxy for absorptive capacity (Meyer, 2004).

Under the Trade Related Investment Measures (TRIMs) agreement.

i.e. certain kinds of subsidies under the Subsidies and Countervailing Measures (SCM) agreements, implementation of the Trade Related Intellectual Property (TRIPs) agreement.

Structural Adjustment Programs.

Political stability implies long term continuance of economic policy.
Chapter 3  FDI in Chile

3.1.0 Introduction

Chile, as well as other developing countries, has achieved widespread recognition for its strong track record in attracting FDI. Chile has been the ninth largest recipient of FDI inflows among non-OECD member countries and was the twenty-eighth worldwide in the 1990s (Thomsen, 1998). Historically, FDI has provided the foundation for many of Chile’s industries, such as mining, banking, and public services. Since the shift from an inward-looking to an outward-looking economy in the 1970s, foreign investment has increased considerably. It is for this reason that a more comprehensive study and analysis of FDI in Chile is critical for understanding its immediate and longer-term effects, and for providing potential direction for improvement in FDI policy in Chile.

This chapter presents the position of FDI in Chile. It draws on the extant literature and official statistics to show the historical and current importance of FDI, as well as the extent and pattern of investment over time. The following sections focus on the analysis of the NOI position of Chile by examining the ESP paradigm in the Chilean context. The main objective of this analysis is to identify Chile’s location-specific advantages, as well as the policy environment that has shaped these advantages.

Finally, empirical evidence that looks at the impact of FDI in Chile at a macroeconomic level, and at the industry level, is reviewed. This evidence shows that, overall, FDI in Chile has contributed in terms of capital formation, technology, export development, and productivity. The conclusion presents a number of caveats regarding current research that give rise to the need for research to understand the process of local industry upgrading through FDI.
3.2.0 Investment Mechanisms

Before reviewing the historical and current importance of FDI in Chile, there is a need to point out that FDI in Chile is required to register in accordance with either of the two following procedures: the DL 600 or the Chapter XIV.

Historically, most FDI in Chile has come through Decree Law 600 (DL 600), managed by the Foreign Investment Committee. (Refer to Table 3.1.) By this procedure, an investor signs a legally binding contract with the State for the implementation of an individual project and, in return, receives a number of specific guarantees and rights.

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Source: Chile Foreign Investment Committee (2009)

The other procedure for investing in Chile is Chapter XIV managed by the Central Bank. This is a foreign exchange regulation that gives the investor freedom to exchange currency with the only obligation being to do so through the formal exchange market system and inform the Central Bank. This method does not guarantee access to foreign exchange if the Central Bank restricts this access in the future.

It is important to notice that the figures for foreign investment, and related data, presented in the following sections vary according to the source of information as a result of differences in methodology. For instance, figures for inflows of FDI provided by the Committee of Foreign Investment reflect FDI coming through DL
600 only. Hence, due to differences in the nature of the data, the figures presented in one table do not necessarily correspond to the figures presented in another table.

### 3.3.0 Historical Importance of FDI in Chile

The earliest foreign investment in Chile was in 1822, 4 years after the declaration of its independence from Spain. Since then three main periods can be distinguished (Behrens, 1992):

1. **Period of British investment predominance (1822-1918)**
2. **Period of United States’ investment predominance (1919-1973)**
3. **Period of DL 600 (1974-present)**

The first two periods are discussed in this section while the last period will be the focus of attention of the following section.

#### 3.3.1 Period of British Investment Predominance (1822-1918)

In the first half of the nineteenth century, the Chilean situation seemed exceptional among the Spanish colonies (Cardoso & Faletto, 1979). Chile already had reasonably stable institutions, and the Chilean port of Valparaiso was well situated, considering the reorganization of Latin American relations with metropolitan markets. Chile’s numerous exports included copper, agricultural products and livestock, for which there were favourable prospects on the world market.

Most foreign investment, mainly British, entered marketing and inter-oceanic transport (Behrens, 1992), whereas local investment continued to be limited to the primary activities, which meant that production was controlled nationally while marketing and transportation were controlled from abroad. This pattern changed after with the flow of foreign investment mainly into the extractive industries.

Cardoso and Faletto (1979) notice that the reason for a division of functions between locals and foreigners was because foreign investment in these sectors increased the income of the local landowner by expanding production. They argue that local capital was available for the investments made by foreigners, but the fact was that the owners
of this capital were not interested in investing in such activities. However, the expansion of the economy started to demand large capital investments, especially in mining and the railway business, as well as increasingly complex transportation and marketing services. This expansion required a volume of investment beyond the possibilities of local private capital. As a result, Chile could not keep foreign interests from gaining control of national production sectors. Indeed, between 1822 and 1830, British investors started to enter the railway business and the mining sector. For instance, three British mining firms were established in the 1820s.

In the years following 1850, Chile entered a period of greater prosperity. The economic order was better integrated around the metropolitan powers. The new market stimulated Chile to develop an industrial economy; Chilean copper was an excellent example (Behrens, 1992). Within this context, enclave investments were embedded in the Chilean economy (between the end of the nineteenth century and the beginning of the twentieth century), when national political groups already had power and controlled important economic sectors. The structure of domination was a direct manifestation of the political subordination of the workers and peasant sectors to the dominant classes. The national dominant groups were linked to foreign firms more as a politically dominant class than as an “entrepreneurial sector” (Cardoso & Faletto, 1979).

During this period (the nineteenth century) British investment continued to predominate in the Chilean economy, as demonstrated by its involvement in a range of sectors, specially the food industry, textiles, printing, and metals (Muñoz, 1977), and by the development of the exports sector. For instance, exports between 1844 and 1860 quadrupled in value. In mining, the boom in silver was reached with the opening of the Chañarcillo mine in 1832. Copper later came to represent, at its peak, 40 % of world production, and it supplied 65 % of the needs of British industry and consumption. Agriculture continued to be important in exports. Agricultural production in 1844-1860 went up five times and its proportion in the export total in 1844-1880 reached an average of 45 % (Cardoso & Faletto, 1979).

After the “Guerra del Pacifico”\(^2\), the Chilean economy changed dramatically since the country gained land rich in nitrate (Chilean nitrate). The importance of nitrate for the
Chilean economy vastly exceeded the importance of copper. Consequently, in 1890, the value of Chilean exports was 17% higher than in 1879. In the same year the involvement of British investors in export activities was a considerable 56%, which finally reached 74% in 1895 (Behrens, 1992). This boom was mainly the result of British investors becoming the owners of the major part of the nitrate industry.

In the following years, until World War I (WWI), British investment continued to increase. However, FDI coming from the United States and Germany started to grow as well. As a result, by 1919 its relative importance for the Chilean economy relative to other investors started to decline. Towards the end of the nineteenth century, for instance, German investors controlled 18% of the nitrate sector, and trade activities between Chile and the United States showed a rapid increase – which was mainly directed to the mining sector, especially copper (Behrens, 1992).

In sum, until 1915 the main foreign investors in Chile came from England, the United States and Germany, representing 52%, 34%, and 13% of total investment respectively (Behrens, 1992).

3.3.2 Period of United States’ Investment Predominance (1919-1973)

Despite “enclave” features, during the first quarter of the twentieth century the Chilean economy was characterized by a relatively successful and commercialized nineteenth century agricultural base, coupled with a locally-controlled “small-mining” sector, which supported quite high levels of pre-industrial modernization (Kaufman, 1979). Most of mining and agricultural products were exported to Europe. As a result, the external market played a crucial role in the economic development of Chile (Behrens, 1992).

After 1884, the nitrate economy, in the hands of British capital, continued to be the major source of revenue, and exports increased notably during World War I. United States capital began to displace British capital at this time. One technological reason was that the Guggenheim system of nitrate exploitation made possible the use of lower-grade limestone than did the British Shank system. United States banks supplanted the British Rothschilds as creditors of the State (Cardoso & Faletto, 1979).
However, although conditions for the change in foreign trade were favourable, the post-war years were a period of bond issues, inflation, and unconvertible paper currency. Speculation and negotiations with the State were everyday events. With the end of WWI the situation became worse since Chilean nitrate was less in demand and was also being replaced by synthetic nitrate. Nitrate revenues fell 36% from 1918 to 1922 (Cardoso & Faletto, 1979). In this period of recession and stagnation of FDI in Chile, the United States maintained its position as the main source of capital. For instance, investors coming from the United States acquired firms in the nitrate and railway sectors which were previously owned by British firms. As a result, after World War I, the United States positioned itself as Chile’s main source of FDI. The importance of FDI inflows coming from the United States showed a rapid increase, in 1926 it represented 50% of total FDI and in 1930 it rose to 70% (Ramirez, 1970).

The world crisis of 1929-1930 affected the enclave economy and the economy as a whole. For instance, in 1930, exports decreased 42% from 1929, and until 1955 (in nominal value) were still less than in 1929 (Cardoso & Faletto, 1979). In terms of inflows of foreign investment, the crisis represented a considerable breakdown for the Chilean economy. Table 3.2 shows that FDI reached its highest point in 1936, thereafter decreasing until 1943. The decrease in FDI inflows was a result of the worldwide recession which slowed down overseas investment from OECD countries. Decreasing FDI inflows in certain periods were a result of remittances of capital and the acquisition of foreign-owned firms, mainly British, by local investors (Behrens, 1992). The inflows of FDI started to rise again only in the mid-1940s. Their recovery, in 1944, could be attributed to the worldwide resurgence of FDI in the mid-1940s.

After the 1929 crisis, employment could be maintained only by State subsidies. With Chilean nitrate being replaced by synthetic nitrate on the world market, foreign firms began to dismantle their plants. If balance were to be restored, a new economic structure had to be created to sustain it. During this period, the government took measures to expand, or in some cases to create the industrial sector.

In addition to the repercussions of the “Great Depression” in the economy, the limited availability of finished products during the period of World War II (WWII) also played an important role in the shift from an “outward-growth model” to an “import
substitution” type of development, which was characterized by industrialization and the formation of a local market. The import-substitution strategy was supposed to prompt Chile to abandon its economic reliance on the production of primary products and become an economy “on its way to industrialization” (“en vías de industrialización”), in terms of economic growth and industry structure (Behrens, 1992; Cardoso and Faletto, 1979). The dominant social groups allied themselves and worked together after the Great Depression to impose their own system of domination and to organize production (Cardoso & Faletto, 1979; Quijano, 1974).

<table>
<thead>
<tr>
<th>Year</th>
<th>FDI Inflows (in nominal US millions dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1925</td>
<td>535</td>
</tr>
<tr>
<td>1929</td>
<td>649</td>
</tr>
<tr>
<td>1930</td>
<td>646</td>
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<td>702</td>
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<tr>
<td>1933</td>
<td>761</td>
</tr>
<tr>
<td>1934</td>
<td>824</td>
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<tr>
<td>1935</td>
<td>828</td>
</tr>
<tr>
<td>1936</td>
<td>841</td>
</tr>
<tr>
<td>1939</td>
<td>729</td>
</tr>
<tr>
<td>1943</td>
<td>442</td>
</tr>
<tr>
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<td>470</td>
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<tr>
<td>1948</td>
<td>617</td>
</tr>
<tr>
<td>1952</td>
<td>733</td>
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<td>1954-57</td>
<td>338</td>
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<tr>
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<td>985</td>
</tr>
<tr>
<td>1962-65</td>
<td>779</td>
</tr>
<tr>
<td>1966-69</td>
<td>1375</td>
</tr>
<tr>
<td>1970-73</td>
<td>62</td>
</tr>
</tbody>
</table>

Source: Behrens (1992)

Economic factors, political ideologies and the importance given to the development of local industry resulted in the emergence of a nationalist sentiment in Chile, which resulted in the adoption of policies that encouraged State intervention (Cardoso & Faletto, 1979). Within this process, in 1939, the Corporacion de Fomento de la Produccion (CORFO) was created. Its main role was to establish and maintain an economic policy in which the State would also play an entrepreneurial role. The CORFO would have two main objectives: (1) to coordinate the diverse interests of the
productive sectors of the economy, and (2) to develop State enterprises by making public direct investments in activities other than those related to development of infrastructure.

Between the years 1940 and 1970, CORFO invested in a range of activities. Two periods of development can be distinguished (Behrens, 1992). The first, from 1940 until the mid-1950s, was characterized by the focus on the substitution of imports. During this period important State firms were created: ENDESA (Empresa Nacional de Electricidad S.A.), in the energy industry; CAP (Compañía de Aceros del Pacífico) in the steel industry; ENAP (Empresa Nacional del Petróleo) in the exploitation and refining of oil; and IANSA (Industria Azucarera Nacional S.A.), in the sugar beet industry. The second period, from the end of the 1950s until 1970, focused on exports diversification, by developing the forestry, fishing, and fruit sectors. In this structure of national production the importance of the State grew both as a supplier and as a consumer of products.

In terms of foreign investment, a study of the Central Bank of Chile stated that, in 1948, 69.5% of total FDI inflows came from the United States, 23.4% from England and 3% from Argentina. FDI inflows were mainly directed to the mining sector (69%), and public services (18.1%). CEPAL (1954) estimated the following figures for the importance of FDI to total investment (FDI inflows as a proportion of gross capital formation) in Chile for the period 1925-1951:

- for 1925-1929, 36%;
- for 1930-1933, 52.1%;
- for 1934-1939, 39.9%;
- for 1940-1945, 24.7%;
- for 1946-1950, 21.2%; and
- for 1951, 21.1%.

These figures show that the importance of foreign investment in the process of capital formation in Chile was higher in the period previous to the “Great Depression”. Since then it decreased before stabilizing at about 21%, reflecting the implementation of the “import-substitution” strategy after 1930.
By the late 1940s Chile had reached the point where local producers could supply most of the existing demand for light industrial products. Protectionist barriers had narrowed US-European markets, and revenues from the traditional exports of Chile began a sharp decline in the aftermath of the Korean War. These difficulties, coupled with the rapid exhaustion of wartime foreign exchange reserves, overstated the importance of international lending institutions and private creditors in dealing with constant balance of payments difficulties. The other important component of the new international environment was the competitive growth of multinational oligopolies, which sought to defend or enlarge international markets through direct investments (Kaufman, 1979). The external sector, now totally controlled by the United States, recovered. Copper replaced nitrate, and the State could count on revenue from this sector. Nevertheless, this recovery signified a slowdown in industrial development. The rate of growth in this sector declined, and in that sense there was stagnation (Cardoso & Faletto, 1979; Quijano, 1974).

Changes in FDI regulations during the administration of President Carlos Ibáñez del Campo (1954-1958) resulted in a significant increase in manufacturing investments, although mining continued to be the main attraction for foreign firms. Specifically, in 1954, the first Foreign Investment Statute, which promulgated a positive attitude towards FDI, was established. Until 1969 this positive attitude increasingly attracted inflows of FDI, as shown by the figures in Table 3.2. Between 1959 and 1970, capital inflows were concentrated in the mining sector, manufacturing\(^4\), and to a much smaller extent, in services. During this period, United States and Canadian firms accounted for the bulk of foreign inflows (ECLAC, 2000).

At the end of the 1960s Chile had one of the biggest stocks of foreign investment in relation with its GDP in comparison with the rest of the world, mainly because of the huge investments made by Anaconda and Kennecott in the copper mining industry (Desormeaux, 1993). However, in the late 1960s Chile’s economic scenery was substantially altered by a series of reforms, particularly the nationalization of large-scale copper mining\(^5\) and agrarian reform (ECLAC, 2000; Cardoso & Faletto, 1979; Behrens, 1992). Some economists and reformist politicians argued that redistributive policies which enlarged the local market would provide a new impetus to manufacturing growth, primarily in non durable consumer goods and in some low-
price consumer durables sectors. This strategy was one component of the general policies of Frei’s and of Allende’s administrations. It implied, for one thing, tax and land reforms which antagonized not only traditional elites, but much of the urban middle class (Kaufman, 1979). Of these, only Frei’s comparatively moderate version was able to manage conflicting pressures for a short period of time. Between 1965 and 1967, income and land redistribution, rising copper revenues, massive Alliance for Progress aid, and some direct foreign investment, all combined to stimulate a three-year period of industrial expansion. By 1968, however, prices started to rise and the economy slowed again. Moreover, foreign manufacturing investment also dropped off sharply after 1968, apparently in response to the growing local conflict and the forthcoming 1970 presidential elections (Kaufman, 1979).

The late 1960s and early 1970s were marked by a growth of the left in Latin America and a number of popular victories. As an ideology, developmentalism was discredited for large sectors of the population by the late 1960s. Dependency theory was in vogue. In Chile, the regime of president Salvador Allende instituted policies to control MNEs very strictly, a strategy which also appealed strongly to nationalism for legitimacy (Jenkins, 1984). Indeed, in 1970, Chile signed the Andean pact, which established a range of measures and policies that considerably restricted foreign activity, in this way stopping the flow of FDI to Chile. Salvador Allende’s statement clearly illustrates the “dependency” attitude towards MNEs:

“At the third UNCTAD I was able to discuss the phenomenon of the transnational corporations. I mentioned the great growth in their economic power, political influence and corrupting action…They make huge profits and drain off tremendous resources from the developing countries.” (Allende, 1972 as cited in Jenkins, 1984, p. 3)

Consequently, with the advent of the socialist government of President Salvador Allende, the State became more deeply involved in the economy, and the scope of action for private agents narrowed. In addition to carrying out land reform and initiating a new policy of income redistribution, the Allende government nationalized foreign firms, from the mines to the banks (Ianni, 1975).
Under the Popular Unity\textsuperscript{6} government, Chile’s foreign policy was that of a socialist State. Chilean foreign policy attempted to discard assumptions or practices that contradicted the interests of the wage-earning classes. Foreign policy adopted the viewpoint of these classes, not that of the bourgeoisie\textsuperscript{7} (Ianni, 1975; Quijano, 1974). It has been argued that in Chile a national bourgeoisie was able to develop industry in the period before WWII because, among other factors, foreign capital was mainly interested in the primary sector. On the other hand, extensive sectors of industry were controlled by foreign capital even in the inter-war period and that there is no justification for the view that local industrialists constitute a class opposed to foreign capital and imperialism\textsuperscript{8} (Kaufman, 1979).

As a result, Allende’s hostile position towards MNEs prompted extreme reactions from local sectors\textsuperscript{9} and international economic powers, particularly from the United States. Indeed, in February 1972 President Nixon made official the governmental policy proposed by ITT in October 1970 following Allende’s victory in the Chilean elections. One of the conglomerate’s proposals was for systemization of United States pressures against Chile. Subsequently, without informing President Allende, all United States aid funds already committed to Chile were given the “under review” status so that entry of money into Chile was temporarily stopped with a view to a permanent cut-off if necessary\textsuperscript{10} (Ianni, 1975).

Consequently, within a relatively short period of time the country suffered from a severe political and economic crisis and, as conditions for foreign capital were found to be discouraging, a sharp fall in FDI inflows resulted. The stock of FDI decreased towards the end of 1973 to US$500 million, one of the lowest in Latin America (Desormeaux, 1993).

The crisis was so intense, the economic disturbance so severe, that on September 11 1973, a coup coalition – formed by civilian and military technocrats with the support of international agents (Ianni, 1975) – put an end to Salvador Allende’s government through the institution of a Bureaucratic Authoritarian (B-A)\textsuperscript{11} rule (Jenkins, 1984) headed by Augusto Pinochet.
The change of regime brought about different policies in the economic arena, which resulted in a change of the extent and pattern of FDI for the following years, as will be demonstrated in the following section. However, the politico-economic crisis during the Popular Unity, the nationalization (without compensation) of the copper industry, and the post-coup repression were so violent that for a substantial period the government had difficulty in attracting foreign investment in spite of extreme economic orthodoxy (Collier, 1979).

### 3.4.0 Extent and Pattern of FDI in Chile: Analysis of the Period 1974-2004

This section presents the position of FDI in Chile since the military coup – which denoted a radical shift in the economic policy of Chile – using official statistics and previously published data. Specifically, this section describes the extent of FDI in Chile relative to total investment; trends in flows of investment; FDI by country of origin, and FDI inflows by sector.

Data on FDI inflows by country and industry come from the Foreign Investment Committee; hence, they reflect realized investments coming only through DL 600.

The NOI position is calculated based on data of inward and outward direct investment stocks compiled by the Central Bank on the basis of annual firm surveys and other information, and on data provided in the World Investment Report by ECLAC.

### 3.4.1 Inward FDI Flows

The military government, which took power in 1973, called upon several internationally respected technocrats to frame policies that made radical changes in economic policy with the introduction of a neo-liberal model (ECLAC, 2000). Cardoso and Faletto (1979) refer to this approach as a “peculiar kind of liberal economy”, in the sense that the State redistributed wealth to those groups of private interests that economically controlled the regime. Kaufman (1979) also refers to the new economic approach as unusual; however, in terms of the extent to which the military government embraced the tenets of conservative economic orthodoxy. The ideological influence to which policy makers were primarily responding was an
antiplanning, anti-ISI, and anti-ECLA reaction (Hirschman, 1979). The most absolutist component of this movement was a group of Latin American economists, who had received graduate training at the University of Chicago, the so-called “Chicago boys”, in whose Department of Economics strict neo-\textit{laissez-faire} views had long been dominant (Desormeaux, 1993).

Policy makers imported virtually without reservation the strict monetarist and \textit{laissez-faire} doctrines, inspired by Milton Friedman, apparently convinced that exceptional measures were essential to control the desperate inflationary and balance of payments crises and to restore the confidence of international lenders and investors. Import, price and distribution controls, installed under previous administrations, were removed; wages were frozen; and credit was severely restricted. Also, much of the “State enterprise” sector was dismantled (Kaufman, 1979; ECLAC, 2000; Cardoso & Faletto, 1979).

The B-A regime implemented a range of measures for attracting FDI. It was committed to provide information to foreign investors through an “open-discussion behind closed doors” policy, in which it would openly discuss the Chilean reality with foreign investors (Bitar et al., 1980). Furthermore, as argued by Cardoso and Faletto (1979), those in power\textsuperscript{12} simply accepted local and eventually international private interests as if they corresponded to the needs of the nation and of the people. Between 1973 and 1977, over three hundred firms nationalized by Allende were returned to their former owners; another two hundred State firms, many of which had originated in the public sector, were sold into private hands (ECLAC, 2000). In addition, in order to reinstate MNEs’ confidence, the military government refused to adhere to Andean Pact restrictions on MNEs and, in 1976, Chile withdrew from the Andean Pact itself (Kaufman, 1979). To promote copper sales, the junta negotiated a settlement with the expropriated American mining firms, in exchange for promises of marketing assistance for new investment in copper-refining industries (ECLAC, 2000; Kaufman, 1979).

In 1974, the government enacted a new Foreign Investment Statute, the Decree Law 600 (DL 600), which regulates the conditions of market entry, capitalization and remittances of foreign capital. This legal instrument was used to raise the profile of
foreign investment, and it soon became one of the main sources of financing for a renewed development strategy based on an extensive opening of the economy (ECLAC, 2000; Bitar et al., 1980). Since 1974, the vast majority of foreign investors have chosen to use this mechanism (DL 600). (Refer to Tables 3.3 and 3.4.) Between 1974 and 2003, investments representing 83% of total FDI inflows used this mechanism (Foreign Investment Committee, 2004). The popularity of the DL 600 with investors stems not only from the fiscal advantages it offers but also from the long-term security, which it provides (Ffrench-Davis, 2003). (This mechanism will be further explained later in this chapter.) However, the DL 600 was not always the preferred investment mechanism – as will be shown later in this section.

With these measures, the new government sought to turn the market into the main agent of resource allocation, private enterprise into the driving force of the economy, and comparative advantage-based exports into the foundation for the country’s economic development (ECLAC, 2000; Behrens, 1992). The main focus of the government’s long-term strategy of recovery was the expansion and diversification of exports. Export diversification was portrayed as a fundamental departure from Chile’s long-standing dependence on industrial protectionism and mineral exports. Commitment to the promotion of non-traditional exports was reflected by, among other things, the formation of a new agency, ProChile, charged with developing foreign markets for Chilean wines, fruits, shoes, textiles, leather products, and paper (Kaufman, 1979).

For the first three or four years of military rule, the impact of these policies seemed at best ineffective and at worst counterproductive (Kaufman, 1979; Cardoso & Faletto, 1979; ECLAC, 2000). It was expected that FDI would help to strengthen and broaden the Chilean export sector. Indeed, FDI inflows for the period 1974-1977 were not significant (Refer to Table 3.3) (ECLAC, 2000; Desormeaux, 1993; Behrens, 1992). However, although European creditors refused in 1975 to refinance Chile’s large external debt, private American banks and the World Bank began in the mid-1970s to provide a substantial inflow of financial aid and credit. As a result, in 1976 the economy started to show scattered signs of recovery, and by 1977 these began to
provide some basis for official optimism. For the period 1977-1979, Chile had a balance of payments surplus; its inflation rate had come down to about 60%; and its economy continued the modest recovery begun in 1976 (Kaufman, 1979).

From Table 3.3 and Table 3.4 it can be observed that FDI inflows increased considerably in the late 1970s; however, this trend slowed at the beginning of the 1980s due to an economic recession in Chile. A strong external shock, generated by a sudden break in foreign financing, rising international interest rates and deterioration in the terms of trade intensified by heavy local borrowing and an inflexible economic policy, caused GDP to decrease by 14% in 1982. In response, the government adopted a more realistic economic policy, particularly regarding foreign exchange rate policies (Kaufman, 1979; ECLAC, 2000; Behrens, 1992).

As one of the solutions to the 1980s debt crisis, and as a way to increase inflows of FDI, Chapter XIX was created. It was a mechanism for converting debt into equity. This mechanism consisted of foreign investors buying debt documents – their market value was significantly lower than their nominal value – and using them as capital for investing in Chile. The debt-conversion program was promoted widely abroad, which helped to create a favourable climate for foreign investors and encouraged them to consider Chile as an investment prospect (ECLAC, 2000). Indeed, a number of non-traditional investors were attracted by this mechanism, for example, investors from Holland and New Zealand (Behrens, 1992).

Chapter XIX was discriminatory in terms of access to productive activities. For instance, only 10% of investments in the mining sector were allowed to use this mechanism (Riveros & Vatter, 1994). However, Chapter XIX made it possible to finance major projects in the promising resource-based manufacturing industry, particularly the forestry sector. These investments – like those made in agricultural activities, mainly fresh fruit, and fisheries – boosted Chilean exports (ECLAC, 2000). Services activities also received a large share of the resources that flowed into the country under Chapter XIX, particularly telecommunications, electrical energy, banking, pension fund administrators, and tourism.
### Table 3.3
Realized FDI Inflows by Investment Mechanism 1974-1987
(Millions of US dollars, annual averages)

<table>
<thead>
<tr>
<th>Period</th>
<th>DL 600 + Chapter XIV</th>
<th>Chapter XIX</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1974-77</td>
<td>18.1</td>
<td>-</td>
<td>18.1</td>
</tr>
<tr>
<td>1978-82</td>
<td>364.2</td>
<td>-</td>
<td>364.2</td>
</tr>
<tr>
<td>1983-87</td>
<td>184.4</td>
<td>178</td>
<td>362.3</td>
</tr>
</tbody>
</table>


### Table 3.4
Realized FDI Inflows by Investment Mechanism 1985-2004
(in nominal US millions dollars)

<table>
<thead>
<tr>
<th>Period</th>
<th>DL 600</th>
<th>Chapter XIV</th>
<th>Chapter XIX</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>167</td>
<td>6</td>
<td>-</td>
<td>205</td>
</tr>
<tr>
<td>1986</td>
<td>261</td>
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<td>1,262</td>
</tr>
<tr>
<td>1988</td>
<td>844</td>
<td>18</td>
<td>707</td>
<td>1,748</td>
</tr>
<tr>
<td>1989</td>
<td>981</td>
<td>16</td>
<td>886</td>
<td>2,318</td>
</tr>
<tr>
<td>1990</td>
<td>1,280</td>
<td>35</td>
<td>1,321</td>
<td>1,733</td>
</tr>
<tr>
<td>1991</td>
<td>982</td>
<td>98</td>
<td>418</td>
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</tr>
<tr>
<td>1992</td>
<td>995</td>
<td>158</td>
<td>22</td>
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<tr>
<td>1993</td>
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<td>-</td>
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</tr>
<tr>
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<td>-</td>
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<td>921</td>
<td>-</td>
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</tr>
<tr>
<td>1998</td>
<td>6,039</td>
<td>539</td>
<td>-</td>
<td>6,578</td>
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<tr>
<td>1999</td>
<td>9,186</td>
<td>689</td>
<td>-</td>
<td>9,875</td>
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<tr>
<td>2000</td>
<td>3,039</td>
<td>1,931</td>
<td>-</td>
<td>4,970</td>
</tr>
<tr>
<td>2001</td>
<td>5,017</td>
<td>1,037</td>
<td>-</td>
<td>6,054</td>
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<tr>
<td>2002</td>
<td>3,381</td>
<td>1,654</td>
<td>-</td>
<td>5,035</td>
</tr>
<tr>
<td>2003</td>
<td>1,286</td>
<td>1,334</td>
<td>-</td>
<td>2,620</td>
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<tr>
<td>2004</td>
<td>5,004</td>
<td>2,144</td>
<td>-</td>
<td>7,148</td>
</tr>
</tbody>
</table>

Source: Foreign Investment Committee (Chile) (2004)

During the second half of the 1980s FDI inflows increased as a result of inflows of FDI coming through Chapter XIX coupled with a positive investment environment (Desormeaux, 1993). At the same time, FDI inflows channelled through the traditional mechanism of DL 600 also increased, with most of these going to new mining projects (ECLAC, 2000). However, in 1990 this figure decreased again as a result of a considerable drop in FDI coming through Chapter XIX. When the market
value of the debt documents started to match their nominal value, which occurred in 1991, Chapter XIX lost its importance since it was more expensive to use this mechanism than the DL 600 in terms of capital repatriation and profits remittance. For instance, Chapter XIX established that investors could repatriate capital only 10 years after their entry and remit profits only 5 years after their entry (Wilska, 2002). As a result, total FDI inflows decreased between 1990 and 1992.

The beginning of the 1990s was a key period for the Chilean society. First, the resurgence of a democratic regime took place through a peaceful and organized process, which brought about the reintegration of Chile into the international arena. Second, it represented the beginning of the most productive period of the Chilean economy, which continued until the consequences of the Asian crisis reached Latin America. In the 1990s the effects of the debt crisis disappeared and the new government was successful in reconciling macroeconomic and social objectives by promulgating appropriate policies (Ffrench-Davis & Tapia, 2001).

The Chilean environment of the 1990s attracted considerable amounts of FDI. Between 1991 and 1999 inflows of FDI increased steadily reaching their highest point in 1999, despite the disappearance of the Chapter XIX mechanism. This phenomenon was due not only to the positive economic environment of Chile, but was also the result of a global trend. However, in Latin America, Chile has been one of the most preferred locations for FDI. Chile has offered a dynamic and strong economy relative to other Latin American countries, something which constituted a crucial factor for attracting FDI in the 1990s, despite its small local market. Most FDI entering the Chilean economy during this decade was directed to mergers and acquisitions (M&A) of successful Chilean firms (Muñoz, 2003). Towards the end of the decade, large-scale flows of FDI into services activities began to shape a new pattern in the involvement of MNEs in the Chilean economy (ECLAC, 2000).

More recent figures, given in Table 3.4, show considerable fluctuation in the levels of inflows of FDI. FDI flows for 2000 dropped by 49% from 1999, recovered in 2001, then fell again in 2002 and 2003. The Foreign Investment Committee of Chile (2005) argues that FDI figures in recent years reflect the collapse of the M&A market –
previously the driving force of FDI around the world and in Chile – and a trend towards greater use of the local capital market by foreign investors. That is, an increasing number of foreign firms are sidestepping exchange rate risk by raising finance locally, either borrowing from local banks or placing bonds on the local market, encouraged by the high liquidity and dynamism of Chile’s financial sector and historically low interest rates. This trend, although very positive for Chile's financial market, is reflected negatively in the figures for inward FDI. However, in 2004, FDI inflows into Chile again started to show an increase. This change reflected a fresh surge in M&A as well as the development of new projects in the mining, telecommunication and infrastructure sectors.

3.4.2 Outward FDI Flows

Table 3.5 shows that until the 1990s FDI outflows were almost nonexistent. However, this situation changed in 1991 as a result of the lifting of restrictions on capital flows. In the process of internationalisation of Chilean capital two stages can be distinguished. First, the period between 1991 and 2000, which presented a steady growth of FDI outflows, especially directed to other Latin American economies (Muñoz, 2003). The second one, from 2000 onwards, is characterized by extreme fluctuations in investment.

3.4.3 Extent of FDI

3.4.3.1 FDI flows to total investment

Table 3.6 shows the contribution of FDI to investment in Chile in terms of inward FDI flows as a percentage of nominal gross capital formation for the period 1992-2003. From 1992 to 1997 FDI accounted for an average of 17.5% of all investment. The proportion continued to rise until 1999 when it reached an impressive 57.6%. In 2000, this figure decreased to 31.2% due to a drop in the inward flow of investment. The figure continued decreasing until FDI inflows accounted for only 13.2% of gross capital formation in 2002. However, in 2003, it increased to 19.6%.

| Table 3.5 |
|------------|------------|
### Table 3.6

<table>
<thead>
<tr>
<th>Year</th>
<th>Outward flows</th>
<th>Year</th>
<th>Outward flows</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>2</td>
<td>1995</td>
<td>752</td>
</tr>
<tr>
<td>1986</td>
<td>3</td>
<td>1996</td>
<td>1133</td>
</tr>
<tr>
<td>1987</td>
<td>6</td>
<td>1997</td>
<td>1463</td>
</tr>
<tr>
<td>1988</td>
<td>16</td>
<td>1998</td>
<td>1483</td>
</tr>
<tr>
<td>1989</td>
<td>6</td>
<td>1999</td>
<td>2558</td>
</tr>
<tr>
<td>1990</td>
<td>8</td>
<td>2000</td>
<td>3987</td>
</tr>
<tr>
<td>1991</td>
<td>125</td>
<td>2001</td>
<td>1610</td>
</tr>
<tr>
<td>1992</td>
<td>398</td>
<td>2002</td>
<td>343</td>
</tr>
<tr>
<td>1993</td>
<td>434</td>
<td>2003</td>
<td>1884</td>
</tr>
<tr>
<td>1994</td>
<td>911</td>
<td>2004</td>
<td>943</td>
</tr>
</tbody>
</table>

Source: Banco Central de Chile (2005)

### Table 3.7

<table>
<thead>
<tr>
<th>Year</th>
<th>Inward FDI Flows as a Percentage of Gross Fixed Capital Formation 1992-2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inward FDI flow as a percent of Gross Capital Formation</td>
<td>17.5</td>
</tr>
</tbody>
</table>

Source: UNCTAD 2004

#### 3.4.3.2 FDI stock to GDP

Table 3.7 shows that as a proportion of Gross Domestic Product (GDP), inward stock of FDI increased from 3.2% in 1980 to 33.2% in 1990, and declined to 19.2% in 1994. However, it showed a steady recovery for the remainder of the 1990s. In the year 2000, this figure reached 60.7%. From 2001 to 2002, it showed a slight decrease from 67.3% to 65.1%. In 2003, the stock of FDI was almost the same as in 2002.

### Table 3.7

<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Inward FDI stock as a percent of GDP</td>
<td>3.2</td>
</tr>
</tbody>
</table>

3.4.4 Investment by Country of Origin

Between 1974 and 2004, 28.4% of DL 600 investments in Chile originated in the United States, followed by Spain (21.7%), Canada (14.4%), the United Kingdom (9.3%), Australia (3.4%), and Japan (3.1%). (Refer to Table 3.8 for nominal values.) During that period, the 15 pre-enlargement European Union member States accounted for 42.5% of total FDI materialized through DL 600, while, as a group, the OECD countries accounted for 93.7% of the total (Foreign Investment Committee, 2005).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>45,000</td>
<td>134,728</td>
<td>6,059,136</td>
<td>2,255,809</td>
</tr>
<tr>
<td>Canada</td>
<td>191,000</td>
<td>367,730</td>
<td>13,971,054</td>
<td>8,331,861</td>
</tr>
<tr>
<td>Japan</td>
<td>0</td>
<td>18,323</td>
<td>2,985,829</td>
<td>1,740,122</td>
</tr>
<tr>
<td>Spain</td>
<td>2,162,433</td>
<td>4,004,902</td>
<td>16,324,982</td>
<td>13,720,913</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>50,000</td>
<td>101,656</td>
<td>8,808,016</td>
<td>5,248,119</td>
</tr>
<tr>
<td>United States</td>
<td>755,600</td>
<td>116,845</td>
<td>29,387,803</td>
<td>15,971,477</td>
</tr>
<tr>
<td>TOTAL</td>
<td>3,835,247</td>
<td>5,004,176</td>
<td>94,431,729</td>
<td>58,672,134</td>
</tr>
</tbody>
</table>

* Source: Foreign Investment Committee (2005). Provisional figures as of December 31, 2004

3.4.5 FDI Inflows by Sector

3.4.5.1 Between 1974 and 1989

During this period, mining projects represented almost half of the flows which entered through the DL 600 mechanism. Other sectors of some importance were
manufacturing and services. Most of the FDI in the manufacturing sector went to forestry, paper, and chemicals, mainly oriented to international markets. It is estimated that almost two thirds of the inflows of FDI were localized in export-oriented sectors. In the service sector, FDI was concentrated in financial services (Ffrench-Davis, 2003; Behrens, 1992; Riveros & Vatter, 1994; Desormeux, 1993; Wilska, 2002).

The sectoral distribution of FDI until 1989 was a consequence of the sectoral selectivity of the Chapter XIX mechanism (Wilska, 2002). The restrictions imposed on the mining investments explain the low participation of the sector in this mechanism. On the other hand, some export-oriented manufacturing sectors (processed food, paper and chemicals), forestry, fishing, and agriculture benefited most from the Chapter XIX mechanism. Within the service sector foreign investments were concentrated in telecommunications (privatised from the mid-1980s), financial services, electricity, and hotels. In sum, it is possible that of the investment which used the debt-swap mechanism between half and two thirds went to export-oriented sectors. In contrast with those investments, which used the DL 600 mechanism, these investments were concentrated in sectors related to non-mining primary products (Ffrench-Davis, 2003).

3.4.5.2 Since the 1990s

In the first half of the 1990s, a considerable amount of FDI inflows was directed to sectors associated with the exploitation of natural resources, especially in the mining sector, which absorbed 57 % of FDI inflows via DL 600 in 1990-95 (Foreign Investment Committee, 2004). Since 1990, however, other sectors have gained in importance. Consequently, the mining sector represented 22 % of GDP for the period 1996-2001. The service sector became the most attractive sector, representing 26 % of GDP in 1996-2001 without including the electricity, gas, and water industries. A considerable amount of the inflows was directed to the banking industry; in fact, foreign banks increased their participation in the local financial system from 14 % in 1995 to 45 % in 2000 (CEPAL, 2001). The public services sector (electricity, gas, and water) became the second most attractive sector for foreign investors, representing 24 % of GDP in 1996-2001 (Ffrench-Davis, 2003). The service sector
represented 50% of the GDP for the period 1996-2001 when the electricity, gas and water industries are included.

The relative decrease in the pre-eminence of mining investments during the 1990s was mainly the result of privatisations in the energy and telecommunications sectors and of the intense competition that followed the deregulation of mobile and long-distance telephone services. In addition, an infrastructure concessions programme, launched in 1995, opened the way for the participation of private capital, mostly from abroad, in the construction and operation of roads and airports. Water privatisations and a concessions programme for water treatment services have also captured important inflows of FDI in recent years (Wilska, 2002).

From 1997 to 2001, in line with a worldwide trend, Chile saw a dramatic surge in M&A activity, mainly in the services, electricity and telecommunications sectors. Since 2001, the trend has again changed, shifting towards projects that require smaller amounts of capital but have a high impact in terms of job creation and the transfer of technology. In addition, projects of this type have reinforced Chile's position as a regional business centre from which to export goods, or provide services, to other countries. This eventually has, in turn, attracted new investment in service sectors, such as the hotel and office property markets (Ffrench-Davis, 2003).

These smaller, high-impact projects are numerous and diverse, ranging from software development initiatives, call centres and shared services centres to new investment in the manufacturing and agribusiness sectors. Examples of the latter include a US$ 25 million breakfast cereal plant in Santiago, launched in April 2004, from which Switzerland's Nestlé supplies regional and international markets, and a new salmon feed plant, also representing an investment of US$ 25 million, inaugurated in southern Chile by Netherlands-based Nutreco.

3.4.5.3 Between 1974 and 2004

For the whole period, between 1974 and 2004, mining accounts for 32.6% of FDI materialized via DL 600, followed by the electricity, gas and water industries (19.6%), services (19.6%), manufacturing (12.9%), transport and communications (11.5%); construction (2.4%); and agriculture, forestry and fishing (0.5% each). In the services
sector, the most important segments are banking (22%), investment companies (20.6%), insurance (17.1%), and the wholesale and retail trade (11.6%). (Refer to Table 3.7.)

In sum, FDI in Chile in the last two decades has been highly concentrated in two areas. In the 1980s and the first half of the 1990s, FDI went mostly to developing export activities related to resource extraction and processing, with investors in this area gradually shifting towards segments offering greater value-added (CEPAL, 2000). In the second half of the 1990s, however, investments were directly mainly at acquiring firms in the main areas of services.

In 2004, FDI inflows into Chile reflected a fresh surge in mergers and acquisitions as well as the development of new projects in the mining, telecommunication and infrastructure sectors. However, signs of depletion in some of the main activities associated with resource processing and the fact that the country’s services sector are already strongly transnationalized have raised some concerns about the future trend of foreign investment and its potential impact on the country’s development. In response to these concerns the Chilean government has undertaken some efforts to attract new investments in more technologically sophisticated sectors. For instance, it has made a major commitment to attract FDI taking advantage of the growing trend to relocate corporate service centres. More than 40 major firms have set up their headquarters for shared services in the Chilean capital of Santiago. Their software development offices and call centres manage operations throughout Latin America and even outside the region (CORFO, 2005).

In sum, variations in FDI figures for the period 1970-2004 indicate that the Chilean economy has experienced significant changes, which have boosted economic development. The next section will look into the development path followed by Chile for the period 1980-2003.

3.5.0 Chile’s IDP: The NOI Position

The Investment Development Path (IDP) is constructed on the basis of a country’s Net Outward Investment (NOI) position. The NOI position is calculated by subtracting the inward FDI stock from the outward FDI stock over time. Table 3.9

The figures show that, overall, the stocks of inward FDI have followed an upward path; however, two short periods of slowdown can be noticed: 1990-1992, and 2000-2001. These periods of slump are the result of a considerable decrease in FDI inflows. As mentioned previously, during 1990-1991 there was a sharp drop in FDI inflows coming through the Chapter XIX mechanism. In 2000 and 2001, there was a collapse in the M&A market, coupled with the trend of foreign firms preferring to use the local capital market. Outward FDI stocks showed a steady increase up until 1999. In the year 2000, as well as the stock of inward FDI stock, outward FDI stock decreased. Nonetheless, it started its recovery a year earlier than the stock of inward FDI.

Chile’s NOI position has been calculated in Table 3.9 and is shown in Figure 3.1. The figure is consistently negative over the 1980-2003 periods, which reflects the much higher levels of inward investment. As a result of availability restrictions, it is difficult to analyse the NOI position for the period 1980-1990. However, it could be speculated that the NOI position started to worsen faster between 1985 and 1990 which coincides with the period when the debt-conversion mechanism was in place. Once this mechanism stopped being profitable, the sharp drop in the stock of inward FDI resulted in an “improvement” of the NOI position during the period 1990-1992. Nevertheless, during the 1990s, the NOI position seemed to return to its “expected” path.

Figure 3.1 shows that from 1992 until 2000 the NOI position worsened, then improved slightly in 2001, and finally started to worsen again in 2002. However, when comparing the NOI position of 2000 and 2003, in 2003 it is slightly higher than in 2000. Moreover, it can be noticed that even though they do fluctuate the figures from 1998 to 2003 do not show significant changes in the NOI position. That is, Chile’s NOI position seems to have stabilized over the last few years.
According to a typical IDP, Figure 3.1 suggests that Chile may be in the latter phases of Stage Two or entering Stage Three, when the increases to the stock of inward FDI start to level off and outward FDI continues to increase. The latter phases of Stage Two parallel those of Porter’s (1990) investment-driven countries, who shift their reliance from primary industries, to large-scale capital intensive industry and consumer goods. Until the first half of the 1990s, most FDI in Chile was directed to sectors associated with the exploitation of natural resources (primary industries). However, other sectors have gained in importance since then. For instance, FDI has been directed to the services and public services sectors, specifically telecommunications, water, and electricity, which are capital-intensive. This shift suggests that Chile is in the latter phases of Stage Two.

In the words of Narula (2002), Chile is a “catching-up” country indicating that it has developed basic infrastructure, some level of knowledge infrastructure and a certain domestic industrial capacity. The considerable amount of FDI inflows into the service sector (including public utilities) has played a key role in the development of infrastructure in Chile by providing telecommunications services, financial services, and public utilities.

Even though, resource-based sectors are diminishing in importance relative to other sectors in Chile they still play a major role in its economy. Hence, as a resource-based economy there is a need for Chile to develop created-assets to complement and even replace natural assets. While natural assets have traditionally provided a basis for its economic growth, there is a need to be internationally competitive. In order to do so, Chile, like other countries in a similar position, needs to encourage activities that are based on created assets. Inward FDI can play a vital role in the creation and improvement of such assets. The next section will look into this issue.

<table>
<thead>
<tr>
<th>Year</th>
<th>Outward FDI</th>
<th>Inward FDI</th>
<th>Net Outward Investment (NOI)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

TABLE 3.9

FDI STOCKS IN CHILE 1980-2003

(in millions of dollars, nominal values)
### Table 3.1
Chile's Net Outward Investment Position 1980-2003

<table>
<thead>
<tr>
<th>Year</th>
<th>NOI</th>
<th>UN</th>
<th>NOI-UN</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>42</td>
<td>886</td>
<td>-844</td>
</tr>
<tr>
<td>1985</td>
<td>102</td>
<td>2,321</td>
<td>-2,219</td>
</tr>
<tr>
<td>1990</td>
<td>178</td>
<td>10,067</td>
<td>-9,889</td>
</tr>
<tr>
<td>1992</td>
<td>713</td>
<td>7,475</td>
<td>-6,762</td>
</tr>
<tr>
<td>1993</td>
<td>1,144</td>
<td>8,238</td>
<td>-7,094</td>
</tr>
<tr>
<td>1994</td>
<td>2,027</td>
<td>10,756</td>
<td>-8,729</td>
</tr>
<tr>
<td>1995</td>
<td>2,425</td>
<td>15,547</td>
<td>-13,122</td>
</tr>
<tr>
<td>1996</td>
<td>3,848</td>
<td>19,639</td>
<td>-15,791</td>
</tr>
<tr>
<td>1997</td>
<td>4,890</td>
<td>33,950</td>
<td>-29,060</td>
</tr>
<tr>
<td>1998</td>
<td>6,348</td>
<td>38,483</td>
<td>-32,135</td>
</tr>
<tr>
<td>1999</td>
<td>12,919</td>
<td>45,839</td>
<td>-32,920</td>
</tr>
<tr>
<td>2000</td>
<td>11,793</td>
<td>44,955</td>
<td>-33,162</td>
</tr>
<tr>
<td>2001</td>
<td>12,976</td>
<td>44,693</td>
<td>-31,717</td>
</tr>
<tr>
<td>2002</td>
<td>13,439</td>
<td>46,296</td>
<td>-32,857</td>
</tr>
<tr>
<td>2003</td>
<td>13,784</td>
<td>46,843</td>
<td>-33,059</td>
</tr>
</tbody>
</table>


### Figure 3.1
Chile's Net Outward Investment Position 1980-2003

#### 3.6.0 Determinants of Chile’s IDP Trajectory

A country’s IDP trajectory does not necessarily follow the typical path presented in theory. Empirical evidence has shown that a country’s investment development path is largely determined by the host country’s L-advantages, economic systems and
strategy of economic development, government policy, and the role of the host country’s government in shaping L-advantages (Scott-Kennel, 2001).

These characteristics determine the nature and extent of O-specific assets of both foreign and local firms operating in the host country. Each of these determinants is examined in the context of the Chilean environment.

3.6.1 Location-specific Advantages

Countries are increasingly competing to attract FDI. This competition can come in many guises which could be grouped into two main types – direct incentives, usually in the form of tax rebates and direct subsidies, or a “beauty contest” approach (Oman, 2000).

Under a “beauty contest” strategy, a country does not offer direct incentives to foreign investors, but relies on its competitive advantages (L-specific advantages) to attract FDI. This approach usually involves, but is not limited to, upgrading infrastructure, strengthening macroeconomic fundamentals, increasing educational standards, guaranteeing the rule of law, and, in general, improving a country’s “business climate” (Poniachik, 2002).

It has been stated that Chile has embraced a “beauty contest” approach and has focused on improving its fundamentals as a strategy to become more attractive to foreign investors (Poniachik, 2002). As a result, during the 1990s Chile positioned itself as one of the principal locations for international investors in Latin America (CEPAL, 2001). Chile has been an important location for MNEs that look for primary resources (resource-seeking investment) and for MNEs which look for national and/or regional market access in the service sector (market-seeking investment) (Mortimore et al., 2001).

Chile has several L-advantages, relative to other Latin American countries, which have made it an attractive location for foreign investors. Among the factors that have influenced the increase in FDI inflows, its abundance of natural resources has played
an important role over time, relying mainly on the mining sector. However, Chile has also been attractive to foreign investors due to its political and economic stability and its straightforward business environment since the 1970s.

Its propitious business climate has made Chile one of the most preferred investment locations in Latin America. Many factors go to make up this favourable business climate. However, they can be grouped into five basic categories (Poniachik, 2002): macroeconomic environment, international integration, institutions and governance, social cohesion and infrastructure.

3.6.1.1 Macroeconomic Environment

Chile’s sound macroeconomic fundamentals have been recognized by many international institutions. For instance, the 2004-2005 Global Competitiveness Report of the World Economic Forum (WEF) ranked Chile as the most competitive country in Latin America, way ahead of Mexico (48th). In the Macroeconomic Environment Rank of the Global Competitiveness report 2002-2003, Chile is ranked in thirteenth place out of 104 economies.

Between 1990 and 2000, Chile experienced annual average growth of 6.4%, ahead of other Latin American countries and among the fastest rates in the world. Even in the negative global scenario at the beginning of the century, Chile managed to grow by 2.9% in 2001, and 5.8% in 2004.

Economic growth has been accompanied by decreasing inflation, a sharp drop in public debt, stable external accounts and strong international reserves. This achievement is the result of Chile’s commitment to economic liberalization and free-market policies, as well as of its pledge to maintain sound and responsible economic management (Poniachik, 2002).

3.6.1.2 International Integration

International integration favours FDI not only because it increases the market to which a country has access, but also because investors view it as a seal of good
behaviour (Poniachik, 2002). In order to achieve international integration, a country needs to fulfil certain conditions, such as macroeconomic stability, which in themselves make a country more attractive for FDI (Blomstrom, 2002).

The fact that Chile’s local market is relatively small and its per capita income is still under US$5,000 means integration into global markets is vital. Chile has adopted a policy of market enlargement by establishing an extensive network of trade agreements that include Free Trade Agreements (FTA) with Canada, Costa Rica, El Salvador, Mexico, South Korea, the European Union and the United States, 52 Bilateral Investment Treaties (BITs), an association agreement with the MERCOSUR block, and an agreement with the Central American countries, as well as membership of the APEC forum. By early 2005, negotiations on FTAs with Japan and New Zealand had made substantial progress.

Because of its increasing network of trade agreements, firms in Chile now enjoy privileged, and in many cases zero-tariff, access to a market of almost 1.2 billion consumers around the world. Responding to this opportunity, an increasing number of foreign firms are now using facilities in Chile to export to other markets around Latin America and in the rest of the world (Foreign Investment Committee, 2005).

3.6.1.3 Institutions and Governance

According to Transparency International (2004), Chile is one of the most transparent countries in the world. In its Corruption Perceptions Index 2004, the organization ranked Chile in twentieth place out of 145 countries.

PriceWaterhouseCoopers in 2001 published a study of transparency in 35 countries, which looked at a country’s legal and judicial system, its regulatory environment, economic policies, accounting standards, corporate governance, and corruption. Chile and the United States tied in second place after Singapore. Chile achieved its highest scores on legal and regulatory environment, accounting standards and macroeconomic policy.
The WEF also recognizes Chile’s high level of transparency by placing the country in nineteenth place in the world in the Public Institutions Index in the 2002-2003 report of Global Competitiveness and in tenth place in the Corruption Subindex.

Strong institutions have been a feature of Chile’s history, helping to provide predictability. Nevertheless, through its commitment to modernization, the government is also striving to ensure their ongoing efficiency and fairness. This modernization programme includes a major transformation of Chile’s judicial system. The reform, which is being implemented gradually as from 2001, seeks to improve access to justice and reduce trial times.

3.6.1.4 Social Cohesion

Social issues are not typically included as a determinant of FDI. However, as argued by the Foreign Investment Committee (2005) – and as discussed in previous sections – in Chile’s experience, social issues increasingly concern foreign investors, both as issues in their own right and from the point of view of political and institutional stability.

Chile's sustained economic growth has gone a long way to improve social conditions. In addition, since the return of democracy in 1990, the government has implemented active social investment policies, accelerating progress in education, healthcare, housing and other fields. Chile is, for example, recognized internationally for its success in combating poverty which, by 2003, had dropped to 18.8%, down from 38.6% in 1990 and, in the case of extreme poverty, from 12.9% to 4.7% (Foreign Investment Committee, 2005).

Due partly to these advances, Chile has a talented and well-qualified workforce, with skills that have evolved in line with the demands of the country's international integration. However, as the government is aware, a number of important challenges remain in this area, including further improvements in educational standards.

The high professional standards of Chilean executives are a key factor in the international competitiveness of the country's firms. Many executives have undertaken postgraduate studies abroad, often in leading US business schools, but
high-quality training is also available in Chile. AméricaEconomía, a business magazine, found that four of Latin America's top 10 business schools are in Chile (Business Wire, 2000). Chile's high professional standards are also reflected in the Institute for Management Development's World Competitiveness Yearbook 2005. Among the 60 countries assessed in 2005, Chile took overall nineteenth place, but scored particularly well on professional standards, taking first place for the availability of finance skills and second place for the credibility of managers (Foreign Investment Committee, 2005).

3.6.1.5 Infrastructure

The privatization process, which commenced in the 1980s, coupled with the deregulation of the market in Chile, has resulted in a well-developed infrastructure in telecommunications, financial institutions, transport, and public services. For instance, in the energy sector, private investment has given Chile one of the region’s lowest levels of service interruption, while international telephone calls from Chile are identified as the cheapest in Latin America. Indeed, a number of foreign investors have been attracted to Chile by its world-class telecommunications infrastructure, and are using the country as a service platform for business in Latin America.

The government’s infrastructure concessions programme, launched in 1993, initially focused on roads and airports, in which it has made substantial improvements. The scheme has been expanded to include public-private partnerships for the construction and operation of new prisons, irrigation reservoirs, urban development projects, and recreational facilities.

In sum, Chile’s attractive business environment is the result of a policy-driven strategy that has focused on building sound macroeconomic fundamentals and strong institutions, promoting competition and international integration, and developing appropriate infrastructure. In turn, its business environment has been a key determinant of Chile’s success in attracting FDI.

3.6.2 Economic Systems and Economic Development Strategy
As mentioned above, Chile has experienced several changes to its economic system. To summarize, before the crisis of the 1930s, Chile had adopted a liberal regime which embraced openness to international markets. However, after the crisis, especially during the 1950s, successive governments implemented an import-substitution strategy as part of the industrialization process, which implied a highly restricted market. Later, the nationalization of key sectors of the economy and the agrarian reform of the 1960s and 1970s practically implied the isolation of the Chilean market from the rest of the world. The political and social process underlying this transformation ended violently with the military coup of 1973, which opened the way to a new period of economic liberalization and deregulation characterized by far-reaching market reforms and economic policies. This process has taken even greater steps forward since the country’s return to democracy in 1990. Chile has seen three elected governments since Pinochet’s fall in 1990. None of these governments has broken sharply with the neo-liberal economic model instituted during the B-A regime. Indeed, they have intensified the free-trade, export-oriented model. For instance, a rising number of free-trade agreements have been signed during the last decade.

Since the adoption of neo-liberalism, a stable macroeconomic environment and a comparatively consistent model of export-driven growth have been the main strategies for economic development of successive governments. Ffrench-Davis (2002) indicates that the consensus among the political elites on the principles of an export-led and market-friendly development model has provided the political basis for governments to secure macroeconomic stability and concentrate on those areas that are most important for sustaining export-led growth. However Cypher (2004) and Richards (1997) argue that despite the claims of free marketers, Chilean export-led growth has not been the result of market-friendly regulation. They specify that its economic successes – such as the boom in resource-based exports - owe more to State intervention than to the invisible hand of the free market.

Joseph Collins and John Lear (1995) point out that the military regime was heavily involved in subsidizing the structural transformation of the Chilean economy to favour the interests of a collection of capitalists, local and international, tied to the export sector. They claim that both fruit and lumber production have benefited from generous subsidy programs and government planning. For instance, in the forestry
sector, CORFO introduced forest management techniques, provided credits and subsidies, and financed projects for technological development of the related paper, cardboard, and wood industries. It also created the Forestry Institute, which launched a marketing and information campaign designed to promote forestry exports, while carrying on massive reforestation programmes and introducing new tree varieties (Cypher, 2004). Likewise, developments in the fishing industry - as well as for most of the developments in fresh produce and processed food – were the result of State intervention, through Fundacion Chile\textsuperscript{13}, rather than the work of the invisible hand of the free market. Another instance of State intervention is in the mining industry where the government has facilitated a boom by allowing private firms to operate essentially tax-free. From 1992 to 2002, eight of the top 10 private mining firms paid no taxes, in spite of the fact that Chile has the most profitable copper mining firms in the world (Cypher, 2004).

Oppenheim (1993) suggests that post-Pinochet governments have felt forced to give priority to maintaining continuity in the economic model over achieving social justice. She argues that changing the economic model would meet not only with local opposition but with international disapproval, especially from the United States. Failure to maintain the neo-liberal reforms risk an investment boycott, international financial alienation, and local capital flight. As a result, the strategy of subsequent governments has been shaped to respect the fundamentals of the neo-liberal vision so that the “capitalist elites” would not feel threatened.

The government led by President Ricardo Lagos (2000-2006) focused on building sound macroeconomic fundamentals and strong institutions, promoting competition and international integration – in this way following the fundamentals of the neo-liberal doctrine. However, it was also concerned with creating a fairer society in which all citizens enjoy the benefits of economic development. Among these objectives, international integration received a lot of attention; as a result, several trade agreements were negotiated.

According to the World Economic Forum (WEF) (2004, 2005), the transition from a middle-income to a high-income economy means evolving from a technology importing economy into a technology-generating one. This requires changes in government priorities and spending patterns, as well as the design and implementation
of public policies that foster innovation through investment in R&D and education. The Chilean government has acknowledged this strategy and also taken into account that most of Chile’s productive activities and public services are now privately owned; in turn, future FDI in these sectors will be confined largely to mergers and acquisitions, which depend on global markets and the strategic goals of international corporations, rather than exclusively on the business environment of a particular country. Hence, as a response the government has embraced a number of measures to further increase connectivity, encourage the growth of e-commerce and e-learning and to promote the development of a venture capital industry, as well as continuing to advance in the use of e-government. As part of these measures, the government is making a specific effort to encourage investment in high-technology industries. After analyzing Chile’s competitiveness – principally its infrastructure, the availability of skilled labour and its low operating costs – the government identified service industries, such as call and contact centres and back office operations, and software development as its main targets (Poniachik, 2002).

Overall it seems that the Chilean government has had an active role in the business affairs of the country by undertaking a policy-driven strategy for economic development. As Dani Rodrik (2004), Professor of International Economics at Harvard University states, it is a myth that Chile’s success is purely the result of fundamentalist free-market policies. While Chile is nearly always portrayed as a neo-liberal success story in Latin America, the reality is that Chile’s transformation has not been neo-liberal at its core – that is, at the microeconomic level (Cypher, 2004).

As suggested by Petras, Leiva, and Veltmeyer (1994), in practice, the Chilean government has embraced a neo-structuralism\textsuperscript{14} doctrine, or “Chilean-style neo-liberalism” (Richards, 1997, p. 159) rather than a neo-liberal approach. (Refer to Appendix A for a detailed description of neo-structuralism.) The main difference between the two doctrines, according to the authors, is that neo-liberalism allows market forces to dictate the direction and pace of economic restructuring while neo-structuralism holds that the State is a necessary and active agent in the restructuring process. This distinction helps explain the active role of government in developing the export-sector while adhering to strict monetarism in conducting macroeconomic policy.
3.6.3 Government Policy

As suggested by Balasubramanyam (2001), a country’s policy framework is an important determinant of its ability to attract FDI. Moreover, government policy may play a critical role in determining the extent of diffusion of the benefits of foreign investment.

It has been repeatedly acknowledged that Chile’s stable and transparent policy framework has been a key factor in attracting FDI (Poniachik, 2002). This section will examine areas of government policy which shape the L-specific factors most significant to foreign investors entering and conducting business in Chile.

3.6.3.1 FDI Policy

One of the country’s most valuable assets is its stable and transparent policy framework for FDI, embodied both in the 1980 Political Constitution and in the Foreign Investment Statute, known as Decree Law 600 (DL 600), which has been characterized by its stability over time. In addition, it has been officially stated that the DL 600 is non discriminatory in nature. However, there are other mechanisms that can be used by foreign investors, such as Chapter XIV of the Central Bank's Compendium of Foreign Exchange Regulations.

Chapter XIV establishes rules for investment (including portfolio investment), capital contributions, and foreign credit. Under Chapter XIV, the Central Bank is not allowed to reject foreign investments, although it may impose conditions based on its monetary policy on the transfer of funds into and out of Chile, such as the one-year retention requirement. Foreign capital entering Chile under Chapter XIV receives national treatment, but it is excluded from the benefits of the foreign investment contracts possible under the Foreign Investment Statute (DL 600), in particular the choice of invariable taxation. Foreign capital entering Chile under Chapter XIV has to be registered with the Central Bank. This registration may be carried out at any commercial bank, prior to converting the capital into Chilean pesos.
Based on constitutional principles, the Foreign Investment Statute (DL 600) guarantees non-discriminatory and non-discretionary treatment of foreign investors. The former assures all people, regardless of their nationality, will be treated by the State and its bodies in economic matters without arbitrary discrimination. Therefore, foreign investors enjoy the same rights and guarantees as local investors. The principle of non-discretionary treatment governs the activities in every economic sector and entails the existence of clear, well-known and transparent rules, which assure foreign investors they will be treated fairly and impartially.

Under DL 600, investors enter into a legally binding contract with the Chilean State, which cannot be modified unilaterally by the State or by subsequent changes in the law. However, investors may, at any time, request amendment of the contract to increase the amount of the investment, change its purpose, or assign its rights to another foreign investor.

The DL 600 establishes that foreign investors in Chile can own up to 100% of a Chilean-based company, and there is no time limit on property rights. DL 600 guarantees investors the right to repatriate capital one year after its entry and to remit profits at any time. Once all relevant taxes have been paid, investors are assured access to freely convertible foreign currency without any limits on the amount, for both capital and profit remittances. The repatriation of all capital invested is devoid of any tax, duty or charge up to the amount of the originally realized investment. Only capital gains over that amount are subject to the general regulations contained in the tax code.

It should be noted that the Central Bank has the right to restrict access to the formal exchange market, made up by banks and other authorized dealers, if adverse macroeconomic conditions make this necessary. However, DL 600 investors are exempt from these restrictions and their right to access the market in order to repatriate profits or capital is not affected.

They also have access to all productive activities and sectors of the economy, except for a few restrictions in areas that include coastal trade, air transport, and the mass media. The State has a very minor productive role in Chile. Only a few strategic activities – such as exploration and exploitation of lithium, liquid and gaseous
hydrocarbons deposits in coastal waters under national jurisdiction or located in areas classified as important to national security, and the production of nuclear energy – are restricted to the State. However, under certain circumstances, foreign firms can invest even in these sectors.

In line with its commitment to free-market economic policies and free trade, since the disappearance of the debt/equity conversion mechanism, Chile has not used explicit incentives for the entrance of resources to specific sectors of the market, hence taking a neutral sectoral position of the law. However, it does provide certain inducements for investments in some isolated geographic regions and new industries, particularly those in the technology field. For instance, in the year 2000, a noticeable innovation took place. CORFO introduced a programme of special incentives for investments in high-technology projects. As well as information technology and biotechnology projects, firms that introduce new methods in traditional processes qualify for support under this program, which is available to investments with a minimum value of US$ 1 million. It was recognized that important positive externalities related to high-technology projects exist. Hence, it encouraged the government to adopt a role as a promoter. This programme intends to promote the Chilean economy as a convenient alternative location for high-technology projects while offering incentives related to R&D and development of human resources between others (Mortimore et al., 2001).

Moreover, investors can, for example, tap into government schemes to promote workplace training and to increase industrial productivity. All these schemes, in the form of grants and tax rebates, are available equally to both local and foreign investors and are part of a wider government strategy designed to increase competitiveness by extending the benefits of economic growth to all areas of the country, promoting education and training and encouraging technological innovation.

Although Chile's Constitution is based on the principle of non-discrimination, DL 600 offers tax advantages for foreign investors. That is, the option of invariable taxation. These are not "tax breaks" or "tax holidays", but are intended to provide a stable tax horizon, acting as a form of "tax insurance". DL 600 offers several different tax options, but basically allows the investor to lock into the tax regime prevailing at the time an investment is made.
All Chilean firms have to pay a First-Category Tax (or Corporate Tax) equivalent to 17% under Chile's Common Tax Regime; a 35% tax is currently levied on distributed or remitted profits. Interest paid to non residents is also subject to a 35% additional withholding tax. However, interest on loans granted by foreign banking or other financial institutions is subject to a 4% tax, provided that excess indebtedness provisions do not apply. Under DL 600, a foreign investor can opt to lock into an effective fixed overall tax rate of 42% on taxable income for up to 10 years, or for up to 20 years in the case of industrial and extractive investments of US$ 50 million or more. The investor, thereby, acquires immunity from any tax increases in the Common Tax Regime that may occur during that period. The lock-in can be waived at any time, but an investor cannot subsequently revert to the guaranteed 42% rate. The First-Category payment of 17% can be set against tax returns under both the Common Tax and Invariable Tax Regimes.

In addition, DL 600 states that foreign investments brought into the country in the form of tangible assets are subject to the general VAT (Value Added Tax) taxation regime and customs regulations. However, foreign investors are entitled to include a clause in their contracts giving them access to a regime that freezes VAT, as well as import tariffs on capital goods for the project, at their rate at the date of the investment. This special regime applies throughout the period authorized for carrying out the investment. Additionally, imports of some of these capital goods such as machinery or equipment are exempt from VAT in the case they are not produced in Chile and are on a list compiled, prepared and published by the Ministry of Economy's Foreign Trade Department.

Regarding restrictions, it is worth of mention that even though foreign and Chilean workers are subject to the same legislation, firms with more than 25 employees can employ only up to a maximum of 15% foreigners, calculated as a fraction of their total labour force in Chile. This limit does not apply to highly specialised technical staff that cannot be replaced by Chilean workers. The Central Bank of Chile can authorize access to the formal exchange market for the payment of salaries in foreign currency. Foreigners must obtain a work permit from Chile's immigration authorities. This permit is granted for a period of up to 2 years and is renewable.
Most investment projects require additional permits and/or must fulfill other requirements besides those set forth in DL 600. All investment projects, both local and foreign, must comply with the country's local and sector-specific legislation, at the national, regional and municipal levels. For instance, when an application for investments in the mining sector is presented under DL 600, the Foreign Investment Committee asks the Chilean Commission of Copper (Cochilco) to issue a report on the project; the Under Secretary of Fishing reports on activities in that sector; the Banks and Financial Institutions Regulatory Agency must authorize operations in the financial banking area; and the Securities and Exchange Commission reports on activities in the insurance and investment funds fields.

3.6.3.2 Trade Policy

Chile's trade policy follows a number of objectives, the most important being stimulating the efficiency and competitiveness of national producers; reducing the level of effective protection and any existing anti-export bias in the tariff structure; and fostering regional economic cooperation. Consistent with these objectives, Chile has increasingly reformed and liberalized its trade and investment regimes. For instance, it has unilaterally reduced tariffs, streamlined customs procedures, ceased to apply capital controls, and floated the exchange rate.

Moreover, the government considers secured and permanent access to foreign markets, together with the capacity to attract foreign investment, essential to Chile's economic growth. To this end, efforts towards the negotiation of new preferential trade agreements have been intensified in recent years. For instance, Chile has shown a strong commitment to the multilateral trading system, while also maintaining vigorous involvement in free-trade agreements (FTAs). The growing number of FTAs is enhancing market access for some partners and increasing competition in Chile's economy. However, injecting complexity into its trade regime may undermine the neutrality of economic policies, and may result in trade and investment diversion. Any resulting inefficiencies would be reduced if Chile carries on the unilateral liberalization of its economy, a strategy that has allowed it to achieve an enviable development record (World Trade Organization, 2003).
Tariffs are Chile's main trade policy instrument. Chile grants at least MFN (Most Favoured Nation) treatment to all its trading partners. The average applied MFN tariff has fallen from 11% in 1997 to 6% in 2003. Tariffs are applied at a generally uniform rate; exceptions include aircraft and vessels, which receive duty-free treatment, and a handful of agricultural goods (wheat and wheat flour, edible vegetable oils, sugar) subject to a price band system. Since June 2002, Chile has been applying a customs valuation system based on the World Trade Organization (WTO) Customs Valuation Agreement.

The use of non tariff barriers appears to be limited. No import licensing system exists. Chile maintains various import restrictions and prohibitions, which apply equally to all trading partners, for reasons of health and environmental protection. It makes modest use of contingency measures. For instance, it does not impose antidumping or countervailing duties.

3.6.3.3 Competition Policy

Decree Law 211 (DL 211) of 1973 of the Ministry of Economy, Development and Reconstruction, as revised and published on 27 October 1980 by Decree 511, establishes the rules for the defence of free competition. Specifically, the DL 211, or Antimonopoly Law, prohibits the granting of monopolies to private persons or companies engaged in commercial or industrial activities, though the government may grant itself monopolies in specific activities. Under Chilean law, monopolies per se are not illegal; the authorities act only against those that abuse their market dominance – as defined in the Act, anybody who takes measures, individually or collectively, to prevent free competition.

The Competition Law establishes the practices to be considered anticompetitive. These are described as any Act that tends to hinder, or is aimed at eliminating, restricting and obstructing competition. The norms that regulate competition apply to both nationals and foreigners, and to the goods and services sectors. They also apply to uncompetitive behaviour that takes place outside the country but has domestic repercussions. The opening up of the economy has become another facet of competition policy in Chile, in that international competition provides a discipline on anticompetitive behaviour by firms located in Chile.
Practices deemed illegal include: price-fixing; assigning quotas or zones for production, transport and distribution; establishing exclusive agencies for marketing specific products; and obstructing free competition in the labour market, such as preventing the organization of unions or collective bargaining negotiations. Foreign trade is subject to scrutiny only when it has a direct effect on the internal market.

This law created a National Economic Prosecutor's Office (Fiscalia Nacional Economica (FNE)) and antitrust commissions that are empowered to prevent and resolve anticompetitive conduct within a market structure.

The antitrust commissions act as special tribunals for competition. They state as a criminal offense any act or convention tending to lessen or impair competition. Furthermore, since the Chilean economy is very open, with no barriers to trade or foreign direct investment, and with a low tariff level, the application of this law is increasingly important in dealing with the efficient operation of markets and with the effective benefits of a globalized economy.

To strengthen the FNE further and to put an end to erratic rulings, the Congress approved a law in August 2003 that created an independent court known as the Free-Competition Defence Tribunal (Tribunal de Defensa de la Libre Competencia (TDLC)) that came into operation in May 2004. The new competition tribunal aims to prevent monopolistic practices, including collusion and abuse of a dominant position. The TDLC can initiate proceedings at the request of the FNE or a private person or institution, and it has greatly expanded powers. These include imposing fines of up to 20,000 annual tax units (unidades de tributacion anual (UTAs) - UTA is an inflation-indexed unit of account).

### 3.6.3.4 Industry Policy

Today, there is no formalized industry policy implemented in Chile. Direct industry support is limited to that provided by CORFO and ProChile.

CORFO is a State agency, created in 1939, mandated to carry out the ISI (Import Substitution Industrialization) strategy and build the national production base.
CORFO's many new public and mixed public/private firms accounted for the great bulk of Chile's industrial growth from 1940 to 1974. In 1993, a study pointed out that of the 20 top private exporting companies at least 13 had been created by CORFO (Cypher, 2004).

ProChile is an organization, created by the military government in 1974, which assists the private sector in locating and selling to foreign markets. Today, many of the activities of ProChile are coordinated with support programs fostered by CORFO. Through its Export Promotion Fund, ProChile has co-financed export projects, providing up to 50% of the necessary capital often using funds obtained from or through CORFO.

3.6.3.5 Regulatory Management

For the analysis of regulatory management in the perspective of development and of the globalization of the economies, all instruments of competition policy and of economic regulation should be considered. The main task is to make all these instruments work in the same direction, including the action of the State and its institutional arrangements, in order to achieve a pro competitive environment rather than consolidate some exemptions or isolated areas of the economy where the market does not operate properly.

Although there are still several problems to solve, the experience of regulating and deregulating the sectors of the Chilean economy has been a successful one. For instance, in the telecommunications sector, firms were privatized by the end of the 1980s, and successive regulatory reforms took place. The government sent to Congress a new law that was approved by March 1994. It established the obligation to separate the activities of local and long-distance communications, improved the regulations about interconnections, and left to the Resolving Commission the power to decide precisely what activities should be regulated within the sector and for which ones maximum prices are to be set, and other aspects. The deregulation and competition in long distance caused a significant fall in rates. There has been a big increase in traffic. Local telecommunications have also had substantial development under the regulatory system. The number of lines has more than tripled in the last 8 years, with a significant increase in quality of service.
Overall, there has been a good exercise of regulatory management. Antitrust commissions have played a central role, laws have been modified, and there have been simultaneous advances in regulation and deregulation. As a result, the Chilean market has become more competitive.

In summary, there has been considerable emphasis in policy-making in Chile on the importance of economic fundamentals. That is, Chile has undertaken a policy-driven strategy for economic development. So far, Chilean authorities have made a good job of developing a sound policy framework. Indeed, over time, its transparency and reliability have played a key role in attracting FDI. However, some international institutions, such as the World Trade Organization, have been concerned about the effects that may arise from the growing number of Chile’s FTAs.

The following section presents a review of the literature that has considered the potential impacts of FDI in Chile.

**3.7.0 The Impact of FDI in Chile– Empirical Evidence**

Chile has undergone a dramatic economic and political restructuring since the 1970s. While not a determinative factor, foreign investment played an important role in this process, expanding local production and linking the country to foreign markets and economic resources (Kline, 1992).

Most of the existent studies have mainly based their analysis of the impact of FDI on the Chilean economy on general evidence regarding productive capacity, export development, productivity and technological innovation. In so doing, they provide insights as to the direct and indirect effects of FDI in the Chilean industry. However, it is important to keep in mind that even though indirect effects have been referred to in these studies, they have hardly been formally assessed.

**3.7.1 Direct Effects**

**3.7.1.1 Macroeconomic Effects**

FDI and the development of productive capacity - Riveros and Vatter (1994), from their econometric analysis conclude that there is a positive relationship between FDI
and gross capital formation. Moreover, the information they obtained from 15 surveys answered by foreign investors, indicate that the initial investment made by foreign investors is only a starting point. Usually, foreign investors already present in the economy continue contributing to capital formation by expanding their operations or undertaking new investments.

Agosin (1998) concludes that FDI positively affects both productive private investment and its component of machinery and equipment. Ffrench-Davis (2003) suggests that a complementary interpretation is that FDI responds to the same productive signals, including the quality of the macroeconomic environment, as the rest of the capital formation undertaken in the country.

Ffrench-Davis (2003) concludes that until 1997, when the Asian crisis took place, a stable macroeconomic environment and a dynamic productive cycle resulted in historical levels of gross fixed capital formation (GFCF), which presented an increase of 10% of GDP relative to the levels of the 1980s. The presence of FDI contributes to the levels of savings, both internationally and locally. Empirical evidence is supportive of this relationship for the first half of the 1990s. However, FDI does not play the main role in the levels of gross fixed capital formation. Local private investment plays the main role – more than two thirds for the period 1990-98 – with FDI representing 20% of the total. Since 1997 there has been no evident relationship between FDI and GFCF. He suggests that the “boom” of mergers and acquisitions (M&A) of Chilean companies explains the lack of relationship between the variables by foreign conglomerates.

Agreeing with the conclusions presented by Ffrench-Davis, CEPAL (2000) notices that the intensive wave of M&A of local private firms by foreign firms – particularly energy firms – and the privatization of some public utilities in the water and sanitation sector have implied that a large proportion of recent direct investments have corresponded to ownership transfers and have thus not helped to increase Chile’s productive capacity.

**FDI and export capacity development** - There are two opposing effects of FDI on export capacity. On the one hand, there is a positive and direct impact that foreign capital may have on the development of the sectors oriented to international markets.
On the other hand, there is an indirect effect on the exchange market. Inflows of FDI may result in a decrease of the rate of exchange, which may hinder the competitiveness of exportable products.

In Chile, the growth path during the 1990s was considerably influenced by FDI through its direct and indirect effects. In fact, FDI has considerably contributed to the export capacity of Chile. A conservative estimate shows that in the period 1990-2000, about one third of the resources invested in tradable goods came from FDI, and were mainly directed to the production of copper. Its strong contribution decreased in the second half of the 1990s. In 1990-95, two thirds of FDI were concentrated on export-oriented sectors while in 1996-2000 only one third of FDI flows was directed to these sectors (Foreign Investment Committee, 2004).

The decreasing participation of FDI in export-oriented activities was compensated for by the considerable increase in the total inflows of FDI. This resulted in a sharp decrease of the exchange rate in 1996-97, which brought about negative macroeconomic effects. These effects were intensified due to the fact that most FDI inflows were not directed to generate export capacity; instead they were directed to non export-oriented sectors. As a result only copper exports continued their growth path while non copper exports diminished considerably (Ffrench-Davis, 2003).

The decrease in the real exchange rate in the second half of the 1990s and its impact on the competitiveness of the export sector emerges as the principal cause of the deterioration of non traditional sales volume (Diaz & Ramos, 1998).

3.7.1.2 Direct Effects over the Affiliate

FDI and productivity - In his study Alvarez (2003) analyses panel data from more than 7,000 firms in the manufacturing industry for the period 1990-96. He concludes that MNEs’ affiliates present much higher levels of productivity than do local firms. He further notices that FDI does positively impact the level of productivity. However, the impact seems to be small in magnitude.

FDI and technological innovation - Thomsen (1998) in his case analysis study concludes that, in Chile, foreign firms have brought their skills and expertise to bear
in transforming former State-owned monopolies into competitive, privatised enterprises. In terms of conventional FDI, FDI in Chile, for example, has permitted the exploitation of formerly inaccessible copper and other mineral resources.

Paredes and Sanchez (1996) stress the impact of FDI due to a modernization effect in specific cases, for example, the formation of joint ventures between global leaders and local economic groups. Paulaner, the most important beer-producer in Germany, formed a joint venture with the Luksic group; Simpson Paper, world leader in the production of high-quality cellulose, with the Matte group; Procter & Gamble, the main producer and trader of nappies and towels in the world, also with Matte group; UAP, of vast international experience in the insurance sector, with the CAP group. In this way the local economic conglomerates not only gain access to capital but also to the expertise and technologies of the international groups.

3.7.2 Indirect Effects

FDI and productivity spillovers - In terms of FDI spillovers to local firms, the results of Alvarez’s (2003) study confirm their existence, but it seems that there is not a significant impact on the growth rate of the productivity levels of local firms. Nonetheless, he argues that the small impact of FDI on the manufacturing sector may be due to the low number of foreign firms operating in the industry, suggesting that a bigger number of foreign firms may be necessary to generate more significant effects on local firms. He also stresses that since most of FDI inflows have been directed to the mining and services industries it could be helpful to study the effects FDI in these particular industries.

In a study by Alvarez and Gorg (2005), the impact of FDI on the Chilean economy was assessed in terms of how the presence of MNEs affects the survival of other firms in the economy by using plant level data of manufacturing industries. They argue that two opposite effects may be observed. On the one hand, the entry and presence of MNEs increases competition in the host country and, therefore, may lead to the exit of local firms that are unable to cope with the increased competitive pressure. On the other hand, the presence of MNEs may generate spillovers, which allow local firms to learn and improve their productivity and efficiency. As the survival of firms is positively linked to efficiency this would be expected to have positive effects on the
survival of firms. In their study they found some evidence of a survival-enhancing effect, particularly for the early 1990s. This effect seems to be completely due to productivity improvements in firms following an influx of foreign MNEs.

**FDI and technological innovation** - Benavente and Crespi (1998) argue that most of the FDI inflows have been concentrated on the production of primary goods. Most of these sectors represent productive enclaves in isolated regions, which make it difficult to take advantage of FDI spillovers. They further suggest that in most cases significant innovations are difficult to imagine since local firms are already at the frontier of knowledge in the area, being between the most productive of the world. The most supportive example is the copper industry.

Riveros and Vatter (1994) also suggest that, overall, it seems that FDI has not played a mayor role in the introduction of innovations in most of the activities in which it has been involved. They argue that the technological impact has not been so clear since most of the technological improvements have been a result of the import of technologies rather than the creation of innovative technologies.

On the other hand, Ffrench-Davis (2003) states that there are interesting cases of local productivity development in which foreign investors seem to have played an important role in the diffusion of know-how. In the wine industry, wine production has presented a noticeable development in the latter years since the establishment of the Spanish firm Miguel Torres at the end of the 1970s. In the 1990s several French and North American firms invested in the industry, which has contributed to the improvement of the international image of Chilean wine, transforming it into one of the main export products of the country (CEPAL, 2001).

Another case of intense technology transfer is in the telecommunications industry (Ffrench-Davis, 2003). Since the privatisation of CTC in the second half of the 1980s, there has been an enormous improvement in the quality and variety of telecommunication services, which was further encouraged by the increase in competition in the international long-distance telephone service in 1994 and the licenses granted for cell-phone services in 1997. However, he argues that not all the improvements are solely associated with the entrance of international companies into the industry. It also needs to be recognized the technological revolution in this
industry, for example, the Internet and cell-phone services, has affected, even though at different levels, all countries around the world.

### 3.8.0 Conclusion

For a relatively small country located far from most major markets, Chile has been remarkably successful at attracting inward investment. Overall, the literature suggests that inflows of foreign direct investment have played an important role as a source of capital, technology, expertise and ultimately, economic growth. However, despite Chile’s historical and present reliance on FDI, the literature available in Chile concerning FDI provides only a narrow view of the overall situation, due to the use of techniques such as statistical analysis of secondary data. An in-depth analysis of the nature and extent of its effects has not been attempted. In particular, there is scant evidence of the impact of foreign-owned affiliates at the industry level – or, indirect effects.

Since the advent of the military government, successive governments have embraced similar objectives as well as similar economic development strategies. That is, Chile’s economy has been systematically restructured in order to become an export oriented and market friendly economy. Chile has used a policy-driven strategy for developing an attractive business environment, which has been successful in attracting considerable amounts of FDI. As a result, Chile has been highly reliant on FDI, especially for the development of key sectors such as the mining and services sectors.

It has been repeatedly claimed that in line with its commitment to free-market economic policies and free trade, since the disappearance of the debt/equity conversion mechanism, Chile has not used incentives for the entrance of resources to specific sectors of the market, hence a neutral sectoral position of the law. However, while macroeconomic policies are consistent with the government’s strong commitment with the neo-liberal doctrine, at the industrial level, State institutions such as CORFO and ProChile represent a conscious attempt by the government to direct particular sectors and guide the restructuring process. Moreover, recent changes in policy have introduced a programme of special incentives for investments in high-
technology projects. From this perspective, interpreting the Chilean economic development strategy as essentially market-liberal is not accurate.

Even though Chile has been remarkably successful in attracting FDI, recent studies and articles suggest that the positive effects of FDI on the Chilean industry are not strong enough. It has been suggested that the type of FDI that has been attracted is mainly resource-seeking; in turn, it has not contributed much in terms of local firms upgrading. In other words, it has been questioned whether the type of FDI attracted contributes to the upgrading of the Chilean economy (Mortimore et al., 2001).

Empirical research on foreign investment in Chile can be summarised as follows. The principal objectives of the studies were to assess the impact of FDI in terms of macroeconomic effects (Agosin, 1998; Diaz & Ramos, 1998); effects at the industry level (Alvarez, 2003; Thomsen, 1998; Paredes & Sanchez, 1996; Alvarez & Gorg, 2005, Benavente & Crespi, 1998); or both (Riveros & Vatter, 1994; Ffrench-Davis, 2003).

In terms of macroeconomic effects, most of the studies agree on the positive effects that FDI has had on capital formation. However, the effect of FDI on export development has not been that clear. At the industry level, the studies conclude that FDI has positive effects on foreign-owned affiliates. However, there is no consensus as to the impact of FDI on local firms. Some conclude that the effects have been positive – especially those studies focusing on case analysis – while others argue that the nature of FDI in Chile may indicate scant spillovers.

For the purpose of evaluating the impact of FDI on the Chilean economy, there are several issues that should be considered regarding existing Chilean data and research. First, much of the existing studies in Chile have provided isolated case analysis of specific benefits associated with FDI rather than a comprehensive analysis of the influence of foreign affiliates on the upgrading of local firms. Second, there are two recent studies that have attempted empirical research on a larger sample of firms. Although they help in assessing the potential impacts of FDI on the Chilean economy, they do not provide a comprehensive analysis of them. Moreover, these studies focus on the manufacturing sector, which may not be ideal for the assessment of the impact of FDI since it has a low presence of foreign firms. Hence, since most FDI inflows
have been directed to the services industries, including public utilities, it could be helpful to study the effects of FDI in this particular sector.

Third, studies that have attempted to assess the extent and pattern of FDI have suffered from the inadequacies of official data since FDI-related figures vary according to the information source. For instance, total inflows of FDI are obtained by combining data from the Central Bank of Chile and the Foreign Investment Committee while FDI inflows by sector are provided only by the Foreign Investment Committee. Even though differences in data may not be significant they do imply a restrictive and complex assessment of the extent and pattern of FDI in Chile.

Fourth, the literature focuses on the direct effects of FDI on the economy or the foreign affiliate. Even though indirect effects have been assessed by a couple of studies, there is no evidence as to what leads to the diffusion of the O-specific advantages of foreign firms to local firms in Chile and how it may happen.

As a result of the limitations of empirical research regarding the impact of FDI on the Chilean industry, there is a need for a comprehensive study that provides evidence for understanding the process by which FDI may influence the upgrading of local firms’ assets in Chile and the determining factors of diffusion of O-specific advantages. In the following chapter, the research model is presented along with the research questions and propositions that attempt to address the limitations of the existing literature.

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1 In enclave economies, foreign invested capital originates in the exterior, is incorporated into local productive processes, and transforms parts of itself into wages and taxes. Its value is increased by the exploitation of local labour forces, which transform nature and produce goods that realize again the life of this capital when staples are sold in the external market. In the case of copper mining in Chile, foreign firms assumed control of firms that have been created and expanded by local entrepreneurs (Cardoso & Faletto, 1979, p. 19).

2 A war where Chile fought against Peru and Bolivia, between 1879 and 1883, and was won by Chile.

3 Corporation for the promotion of production.

4 Mainly the manufacture of paper and petroleum-based chemicals.

5 For an illustration of the effects of the “nationalization” of the mining sector in Chile see the cases of Kennecott and Anaconda in Shapiro, 1996.
The Popular Unity is a coalition of predominantly leftist parties that form the political base of the government.

Indeed, it has been argued that the local industrial bourgeoisie in the region was not opposed to foreign capital. Surveys of industrialists in Chile confirmed this, finding that far from being opposed to foreign capital, they were generally in favor of foreign investment (Kaufman, 1979).

Writings on “dependent development” have emphasized the interdependent relationship between the local bourgeoisie and international capital. While local capital may depend on foreign capital for technology, trademarks, access to export markets, and so on, MNEs may depend on the local bourgeoisie to play an integrative role because of their greater involvement in local networks through personal and family ties (Jenkins, 1984).

For the local bourgeoisie and military officers and technocrats, who were not tied directly to contending class interests, political-economic patterns seemed to support the view that the costs of tolerating populist pressures had increased – a perspective which undoubtedly grew and hardened among MNEs in the course of the 1950s and 1960s (Kaufman, 1979).

Documentos Secretos de la ITT, quotation p. 81 in Octavio Ianni (1974).

This system is “excluding” and nondemocratic. Central actors in the dominant coalition include high-level technocrats – military and civilian, within and outside the State- working in close association with foreign capital. This new elite eliminates electoral competition and severely controls the political participation of the popular sector. Public policy is centrally concerned with promoting advanced industrialization (Collier, 1979).

Technocrats, both military and civilians, and the bourgeoisie (economic elite).

Fundacion Chile is a public-private agency designed to develop firms in new areas where private capital would not invest, then sell them to the private sector. Fundación Chile began in 1976, with the assistance of a prominent economist, Raul Saez, who had headed CORFO for many years. Like many of the military officers in the highest ranks of the dictatorship, Saez was disapproving of the neo-liberal approach established by the “Chicago Boys”. With CORFO under attack from this quarter, Saez moved laterally and gathered a group of experts who achieved major changes in the productive apparatus of the Chilean economy (Cypher, 2004).

Ideologically, the Aylwin government required that Latin American structuralism, a political-economic doctrine born of the Economic Commission for Latin America (ECLA), be eschewed in favor of neo-structuralism. Whereas Latin American structuralism had long criticized unrestrained economic liberalism as a recipe for unbalanced and dependent growth, neo-structuralism exhibits a notable convergence with the neoliberal policy agenda (Petras, Leiva, & Veltmeyer, 1994).
Chapter 4    Research Model

4.1.0 Introduction

The IDP constitutes the theoretical framework of the thesis. The IDP suggests that, over time, inward FDI has the potential to assist local industry through upgrading, later leading to outward FDI activity by local firms. Industrial upgrading presupposes that there is a virtuous interaction between the O-specific advantages of the foreign affiliate, the location-specific advantages of the local economy, and the way the foreign affiliate organizes and uses its O-advantages in the host economy.

The distinctive characteristics of MNEs are pivotal when analysing the impact of FDI on host countries. The transfer of a unique set of resources from the parent firm to the foreign affiliate may improve the latter’s performance relative to local firms, as well as presenting the potential for indirect effects. That is, it has the potential for upgrading local firms’ capability. However, whether upgrading of local industry occurs depends not only on the O-advantages of the foreign affiliate, but also on the L-specific advantages of the host economy (Scott-Kennel, 2001). This point needs to be considered carefully when assessing the impact of FDI in the context of a developing country. Developing countries usually have a very different structure from the capital exporting ones. For instance, in many developing countries, local capacities are less developed than in developed countries. Hence, the entry of the foreign affiliate may have effects, both positive and negative, which are substantially different from the effects evident in developed countries (Blomstrom, 1989).

Scott-Kennel’s (2001) model refers to the interaction between the O-, and I-advantages of the foreign affiliate, and the L-advantages of the host economy. In so doing, it provides a guideline for addressing the central research issue of this thesis, which can be stated as: How does inward FDI impact on local industry in Chile? However, Scott-Kennel’s (2001) model is based on the New Zealand context, which may be different from the Chilean context. Hence, the aim of this thesis is to assess how MNE activity impacts on the development of local industry in the context of Chile, while also assessing Scott-Kennel’s (2001) model in a different context.
The focus of the thesis is on assessing the indirect and direct linkages that foreign affiliates form with local firms and through which they may influence the upgrading of local industry, in addition to identifying factors that may influence linkage formation. In order to do so, the present chapter begins by presenting Scott-Kennel’s (2001) model of local industry upgrading followed by an assessment of its applicability in the Chilean context. Then the model is reviewed in the context of developing countries. Finally, a number of questions and propositions are presented in order to assess how FDI impacts the local industry in more detail.

### 4.2.0 Scott-Kennel’s Model of Local Industry Upgrading

In her doctoral thesis, Joanna Scott-Kennel (2001) proposes a model of local industry upgrading, which applies the framework of the IDP at the micro level. The model proposes a typical process of local asset augmentation as well as the contribution of inward FDI to industrial development as a continuum from enclave to full integration. This section begins by describing the process of O-advantages augmentation and then presents the diagrammatic model.

### 4.2.1 Process of Local Asset Augmentation

This process operationalises the IDP by illustrating the mechanisms by which local upgrading may occur as a result of the interaction between foreign and local firms. The process includes four different stages. Each stage represents a step towards the upgrading of O-specific advantages of local firms and/or the foreign affiliate.

What the model aims to present is an evolving, stage process. It does not mean that this evolving process once started, will continue uninterrupted, because the process will be determined by the upgrading in the host country’s location-specific advantages. In other words, the extent and rate of progression through these stages is determined by the specific OLI configuration of the foreign affiliate, and especially the L-specific advantages of the host country.
Stage One: Entry of the Affiliate

The foreign affiliate enters the host economy and brings certain O-specific advantages. These are unique to the firm and/or are not available to local firms. The O-specific advantages transferred from the parent firm to the affiliate will be determined by the motives for investment and will correspond to the L-specific factors of the host country – defined by the host country and industry context. Moreover, L-specific factors will influence the affiliate’s strategy, determined autonomously or at the parent firm level, that direct its use of inter- versus intra-firm trade, production and internalization of O-advantages.

The starting position at phase one is the enclave position, where only the affiliate benefits from the upgrading of its O-advantages by employing full internalization. As a result, the foreign affiliate has no linkages with local firms. The absence of linkages at this stage means that indirect effects are unlikely to emerge. Hence, the impact of FDI on the host economy is exclusively thought of in terms of direct effects over the affiliate. That is, affiliation with the MNE will improve the competitiveness of the affiliate relative to local firms. In order to assess these effects, a profile of the unique characteristics of the affiliate needs to be constructed.

Stage Two: Linkage Formation

In Stage Two, after the entry of the affiliate, linkages will be formed between the foreign affiliate and local firms. However, the extent and quality of these linkages will be determined by the conditions in the host economy and the unique characteristics of the affiliate. Scott-Kennel (2001) identifies five key types of linkage:

- Indirect linkages with local competitors;
- Direct forward linkages with local agents and/or customers;
- Direct backward linkages with local suppliers and/or subcontractors;
- Direct knowledge agreement linkages with local licensees and/or franchisees; and
- Direct collaborative linkages with local collaborative partners.
Indirect effects arising from linkage formation occur at Stage Three and Four. In order to assess this stage, the types of linkages between foreign affiliate and local firms, and determinants of those linkages, need to be examined.

**Stage Three: Diffusion and Transfer of O-specific Advantages**

In Stage Three, the effects arising from linkage formation between the affiliate and local firms emerge. This linkage involves the direct transfer and/or indirect diffusion of O-advantages by either/both the foreign and local firm. The extent of indirect effects is expected to be related to the degree of linkage (DOL) of the affiliate with local industry. It is expected that as the affiliate increases its local DOL, the potential for indirect effects increases. The linkages described above can be grouped into three categories based on their potential for local upgrading (Scott-Kennel, 2001):

- **Low**: Low quality linkages refer to those that have the potential for indirect diffusion only, rather than transfer, of O-advantages. For instance, indirect linkages with competitors may lead to the gradual diffusion of O-advantages through agglomeration or demonstration effects only, which may give rise to changes to technology, managerial practices, and the availability and cost of goods and services.

- ** Moderate**: Backward and forward linkages can be described as moderate linkages, as there is potential for the direct transfer of knowledge and assistance from the affiliate to local firms.

- **High**: Knowledge agreements and collaborative linkages, represent high quality linkages, because of the potential for a bidirectional transfer of O-advantages between the affiliate and local firms.

Scott-Kennel (2001) proposes that the quality of linkages is positively related to the level of embeddedness of the affiliate in the local industry. In other words, she proposes that if the quality of linkages is higher, the affiliate is more integrated with the local economy and the DOL is higher. The greater the DOL, the greater the potential for quasi-internalisation, in turn, the potential for indirect effects is high.
Hence, the DOL of the affiliate is expected to be positively related to the possibility of upgrading by local firms.

**Stage Four: Ownership-Advantage Augmentation**

The final stage of the process is when the local firm, and/or the foreign affiliate, is able to augment its O-advantages as a result of indirect or direct linkages with foreign affiliates. There are three possible outcomes from the interaction between a local firm and the foreign affiliate:

- Both the local and foreign firm may upgrade their O-advantages;
- One firm may upgrade with negligible impact on the other, or
- One firm may upgrade at the expense of the other.

To conclude the process, Scott-Kennel (2001) proposes that the overall outcome on local industry is determined by local firm capability and by the complementarity of the activities of local firms and the activities of the affiliate.

**4.2.2 Diagrammatic Model of Local Industry Upgrading**

To complete the model, Scott-Kennel (2001) proposes a diagrammatic representation of the degree of linkage (DOL) of the foreign affiliate into the local economy. In so doing, the model acts as a guideline for assessing the DOL of the foreign affiliate in the local economy.

Figure 4.1 presents the diagrammatic model. At the top, the model illustrates the DOL via a continuum, with enclave FDI at one end and developmental FDI at the other. Under an enclave scenario, the foreign affiliate fully internalizes its O-advantages and does not establish direct linkages with local firms.

The DOL and the quality of linkages increase as it moves along the continuum. For instance, the affiliate may form forward linkages with local firms in the initial stages of investment as a way to learn from the locally experienced and knowledgeable firm.
In this scenario, according to the model, the DOL is higher than in an enclave scenario, but lower than in a developmental scenario. In other words, the DOL is moderate.

At the other end of the continuum, the DOL is high. In this scenario, the affiliate forms high-quality linkages, such as alliances, which implies partial internalization of its O-advantages. At this point, the transfer of O-advantages is bidirectional between the affiliate and the local firm.

Specifically, the diagram presents three possible scenarios of DOL which are related to the three categories of linkages previously described namely low, moderate, and high.

**Low** - The DOL is low when the foreign affiliate fully internalises its O-advantages; in turn, only indirect linkages may emerge through competitive and agglomeration effects. As a result, indirect diffusion, rather than direct transfer, of O-advantages may occur over time.

**Moderate** - The DOL is moderate when the foreign affiliate forms forward and/or backward linkages with local firms. In this scenario, partial internalisation may occur as a way to assist local suppliers and/or customers. However, the interaction between the affiliate and local firms is expected to involve the direct transfer of noncore, codifiable knowledge only.

**High** - The DOL is high when the foreign affiliate forms knowledge agreements or collaborative linkages with local firms. In this scenario, both the foreign affiliate and the local firm may partially internalize their resources; in turn, mutual transfer of O-advantages – core and/or noncore – may take place.
FIGURE 4.1  Model of Local Industry Upgrading (Degree of Linkage and Linkage Type)

Indirect Linkages
DIFFUSION of O-advantages

Direct Linkages
TRANSFER of O-advantages

Enclave FDI

Low
Competitive Linkage

Moderate
Forward Linkage

High
Backward Linkage

Locally Integrated FDI

Full Internalisation

Competitors

Agents/Custumers

Suppliers/Subcontractors

Knowledge Agreement

Collaborative Partners

Foreign Affiliate

Of

Of + Oh

Of + Oh

=Of' + Oh'

Local Firms

O-advantage Augmentation Process
Figure 4.1 shows the relationships between the OLI configurations of the affiliate and of the local firms, and how each type of linkage with local firms can represent each of the three categories of DOL. It suggests an evolving scenario of development, placing the different types of linkages in different phases along a continuum. In other words, the process of local asset augmentation suggests that linkage formation occurs after the entry of the affiliate in the local economy. As the affiliate forms more complex linkages with local firms, it becomes more integrated into the local economy, and the potential for local industry upgrading increases.

In sum, Scott-Kennel’s (2001) model of local industry upgrading proposes an evolving scenario of development in which each type of linkage, and DOL, is related to different OLI configurations. In other words, the model suggests that the contribution of inward FDI to a country’s economic development is positively related to the DOL at the firm level, which at the same time depends on the OLI configuration of the affiliates.

Since the model was elaborated to assess the impact of MNEs’ activity on New Zealand industry, it may be context-specific. The following section now discusses to what extent the model is applicable to the Chilean context.

### 4.3.0 Is the Model Applicable to the Chilean Context?

This discussion acknowledges a range of factors that may play a determining role in the process of linkage formation. Specifically, it recognizes factors that are either related to the characteristics of the foreign affiliate or the host economy (L-factors).

Scott-Kennel (2001) presented a schema (Figure 4.2) for analysing the role of MNEs in host country industry to present her findings and conclusions in diagrammatic form. The schema incorporates the model of local industry upgrading with regards to transactional relationships and acknowledges FDI and non-FDI variables as determinants of DOL. Under the rubric of the ESP paradigm, the schema includes economic systems and
government policies as potential determinants of linkage formation. However, it does not include economic environment (Dunning, 1993; Koopman & Montias, 1971).

Scott-Kennel’s study (2001) was done by surveying foreign affiliates operating in the New Zealand industry context. The focus was on evaluating the extent and quality of linkages, and the factors that may act as determinants of linkage formation. Scott-Kennel included a range of foreign affiliate’s features that are found to influence linkage formation in local industry (FDI-induced change). Regarding the role of L-specific advantages (non FDI-induced change) on linkage formation, she included local firm capability, but she did not include other variables related to economic environment, economic system, and government policy in her research questions. In order to develop the model, the study used quantitative methods for analyzing the data – collected through questionnaires – for example, descriptive statistical analysis, multiple linear regression, logistic regression, factor analysis, and cluster analysis.

Omitting a comprehensive range of location-specific variables in the analysis of determinants of linkage formation may not be appropriate in the context of developing countries since the extent of FDI as a driver of industrial upgrading depends on the quality of L-specific advantages and how these advantages are developed over time. In an optimal scenario, location advantages in developing countries should be transformed from generic to more ‘created’ asset types (Narula & Dunning, 2000). The point is that the process of developing location advantages, primarily through improved capabilities of local firms, determines the application of more sophisticated O-specific advantages of the MNE, which are tenable to industrial and technological development. Hence, it is essentially non-FDI changes in a host country (L-specific advantages) that determine FDI-induced changes key to industrial upgrading (Portelli, 2002).
Figure 4.2  Schema for Analysing the Role of MNEs in Host Country Industry

Source: Scott-Kennel 2001, p. 345

Organizational Routes
(I-specific advantages, including L-specific advantages of hierarchies compared to markets or inter-firm cooperation)

Quasi-internalization

Impact on Upgrading of Industry

MNE/Affiliate Welfare
- Level, pattern & location of MNE activity
- Organizational structures, managerial strategies, control
- Resources and capabilities transferred to affiliate
- Opportunities for upgrading via MNE affiliation
- Collaboration and mutual development

Host Country Welfare
- Capital, balance of payments
- Employment, human capabilities
- Technology
- Upgrading of market structure and productivity:
  - Competition, demonstration effects
  - Access to international markets, resources
    - Demand & supply
- Transfer/diffusion of resources
- Collaboration and mutual development

Competitive Advantages of Firms
(O-specific advantages)
Foreign-owned Affiliates and Local Firms

Competitive Advantages of Countries
(L-specific advantages)
- National level
- Industry level
- Firm level

FDI Induced Change

- Motive for Investment
- Autonomy/Integration
- Ownership Form

Firm Strategy: Exit or Voice

Transactionl Relationships (Degree of Linkage)

LOW MODERATE HIGH

Enclave Competitors Agents/Customer Suppliers Knowledge Agreements Collaborators

Impact on Upgrading of Industry

Non-FDI Induced Change

- Economic Systems
- Government Policies

NZ-Neutral, Market-led
Ozawa (1992) distinguishes two types of trade and investment regimes: an outward-looking, export-oriented (OL-EO) type, and an inward-looking, import substituting (IL-IS) type. He goes further by indicating that it is frequently found that countries combine features of both regimes (strategies) to produce a hybrid regime. However, a specific regime can still be identified as either more strongly or weakly characterized by one approach. With regard to government policy and economic system Scott-Kennel (2001) points out that in New Zealand the government has implemented an OL-EO strategy, which does not provide artificial and transitory incentives to FDI. Hence, due to the neutrality of its economic strategy, government policy towards FDI does not play a significant determining role on linkage formation. Excluding government policy (which reflects the economic system in place) when assessing the determinants of linkage formation may be appropriate in certain contexts where FDI policies are neutral – neither benefits foreign firms nor local firms. However, in the context of developing countries excluding government policy may not be appropriate since it may play an important moderating role in the process of local firm upgrading. For instance, Balasubramanyam et al. (1996) found evidence indicating that, in the context of developing countries, FDI is a driving force in the growth process in OL-EO countries, but it does not exert significant influence on growth in IL-IS countries. This finding implies that the impact of FDI varies across developing countries and that government policy can influence the role of FDI in economic growth.

Although most developing countries have adopted an economic liberalization doctrine, fundamental changes in political ideologies and economic systems among a large number of developing countries, since the early 1980s, have led to a variety of attitudes and policies of national governments towards FDI. Heterogeneity regarding government policy is a result of differences in terms of stage of development, political ideologies, cultural norms, and history and institutional infrastructure of countries (Narula & Dunning, 2000). Furthermore, Portelli (2002) indicates that industrial policies and productive capacities in many developing countries are still influenced by inward-looking, import substitution policy stances.
Scott-Kennel’s (2001) model shows the mechanisms by which local upgrading might take place as a result of the interaction between foreign and local firms, presupposing that the government of the host country adopts a “hands-off” approach towards FDI. This presupposition suggests that these mechanisms may not take place in the context of a developing country where government policy takes a more active approach.

However, as noted by Narula and Dunning (2000), it is important to acknowledge the heterogeneity of developing countries and its influence on their L-advantages (including government policy). Under the rubric of the IDP, most developing countries are in stage one and two; however, some of them are in advanced stage two and stage three. As Chile belongs to the latter group (as shown in Chapter Three), its policy context may not be significantly different from the New Zealand policy context. Hence, it is essential to review the New Zealand policy context, which constitutes the underlying assumption of Scott-Kennel’s (2001) model, while re-examining the Chilean policy context. In so doing, it is possible to recognize differences in terms of policy that might limit the usefulness of the model in the Chilean context.

### 4.3.1 Comparing the New Zealand and Chilean Policy Contexts

#### 4.3.1.1 Changes in policy orientation in New Zealand

Before comparing the current New Zealand and Chilean government policy, the changing role of government policy in New Zealand is reviewed. Based on changes in economic orientation, the development of the New Zealand can be divided into four main periods (Akoorie, 1998):

1. Period 19th century until 1938: Export-oriented, outward-looking (EO/OL)
Akkoorie and Scott-Kennel (2005) indicate that FDI (strategies of MNEs) and non-FDI influences (changes in government policy) have both shaped the New Zealand economy, though their relative importance has varied over time. In the first period, foreign investment strongly influenced the extent of economic activity while the government took an increasingly important role in shaping the economic structure in New Zealand (Akkoorie, 1998). During this period, the export sector – including wool, dairy products, and frozen meat – was developed. Both public and private investment in infrastructure facilitated the movement of agricultural products (internally and externally), and assisted in the rapid development of the economy. In terms of government intervention, the government was initially in charge of developing infrastructure, but it then took a paternalistic role by intervening in key areas such as land acquisition, commercial activity, labour relations, and education.

The effects of the “Great Depression” (1930s) on the New Zealand economy prompted the government to adopt an IL/ARE policy orientation. The objectives of the government were to maintain full employment and to insulate the economy from external shocks (Akkoorie & Scott-Kennel, 2005). The government intervened directly in private economic activity through regulatory measures such as restrictions on entry to particular activities. Overall, during this period of IS/IL orientation the pattern of policy was a stop-go cycle of import licensing relaxation during a period of boom and reversion to full license coverage when the terms of trade were not favourable for the economy. Varying levels of severity in terms of import substitution policy implied that FDI could make limited contribution to the restructuring of the economy (Akkoorie, 1998).

Following the period of import-substitution, the New Zealand economy went through a period of transition (IS-IL/OL, from 1967 to 1984). During this period the motivating factor underlying government policies was the need for economic change. In general, government policy pointed in two contradictory directions. On the one hand, there was a trend towards trade liberalization and greater reliance on market forces. On the other hand, there was increased government intervention in economic affairs (Akkoorie, 1998).
As a result of the poor relative performance of the New Zealand economy over the last three decades the government was open to new ways of managing the economy (Enderwick, 1994). The radical economic liberalization from 1984 onwards involved a reversion to the OL/EO economy of a previous era (Akoorie & Scott-Kennel, 2005). In undertaking economic liberalization, the government has emphasized an increasing openness and international orientation of the economy (Akoorie, 1998). Generally, this period can be distinguished from previous ones in two main ways. First, the government has played a very limited role in the restructuring of the economy – the government played a much more significant and positive role in earlier stages. Second, the economy has been fully exposed to the effects of external shocks through a belief in the need for a “level playing field” (Enderwick, 1995). In terms of foreign investment, government policy has no longer directly influenced the strategies of MNEs by adopting a nondiscriminatory approach (Akoorie & Scott-Kennel, 2005).

4.3.1.2 The Chilean and New Zealand policy orientation: A comparison

In general terms, Chile and New Zealand have taken similar paths in terms of policy orientation. Both economies adopted an OL/EO orientation at early stages, then moved to an IL/IS approach (as a response to the effects of the Great Depression) and finally returned to an OL/EO policy. However, while New Zealand’s reversion to the OL/EO orientation was the result of a period of policy transition, Chile’s change of policy orientation was the result of a military coup (as discussed in Chapter Three), which drastically implemented the principles of the neo-liberal doctrine.

The military government in Chile (in 1973) and the 1984 Labour government in New Zealand both embraced a new economic approach, which opened the way to a period of economic liberalization and deregulation characterized by far-reaching market reforms and economic policies. Overall, in both countries policy has been guided by export-oriented, outward-looking (EO-OL) principles. Consistently, successive Chilean and New Zealand governments have aimed to provide a nondiscriminatory, market-driven environment for local and foreign firms through widespread deregulation of industry,
privatization of State-owned assets and firms, and liberalization of policies towards capital flows, foreign investments, and trade.

In general, the tenets of liberalization have guided both internal and external policy in Chile and New Zealand and have resulted in a shift from public to private operation of business. However, as argued by several authors (Cypher, 2004; Rodrik, 2004; Petras et al., 1994), it is a myth that Chile’s success is purely the result of fundamentalist free-market policies. While Chile officially follows the principles of neo-liberalism, in practice, it seems that it follows the tenets of neo-structuralism. For instance, it has been repeatedly claimed that in line with its commitment to free-market economic policies and free trade, Chile has not used incentives for the entrance of resources to specific sectors of the market, hence creating a neutral sectoral position of the law. However, while macroeconomic policies are consistent with the government’s strong commitment to the neo-liberal doctrine, at the industrial level, State institutions such as CORFO and ProChile represent a conscious attempt by the government to direct particular sectors and guide the restructuring process. Moreover, recent changes in policy have introduced a programme of special incentives for investments in high-technology projects. From this perspective, interpreting the Chilean economic development strategy as essentially market-liberal is not quite accurate.

In terms of FDI policy, as suggested in Table 4.1, there are a number of differences between Chile and New Zealand. As with New Zealand’s FDI policy, Chile’s FDI policy is officially based on the principle of nondiscrimination. However, in practice some aspects of the Chilean policy either discriminate in favour of or against foreign investors.

In conclusion, for the process of local industry upgrading to occur, as proposed by Scott-Kennel (2001), the underlying assumption is that the host country adopts an OL-EO strategy, which is strictly neutral towards FDI. Although the Chilean government officially states that its policy framework is strictly based on the tenets of liberalization (OL-EO oriented), in practice, the existence of restrictions and incentives towards FDI rather suggests a “neo-structuralist” approach. While neo-structuralism shows a remarkable convergence with the neo-liberal approach, especially in terms of
macroeconomic policy, it differs from it in terms of government intervention. Therefore, in the context of Chile, government policy may play a moderating role in the process of local industry upgrading. In other words, it is possible that the model, as it is, may not be appropriate in the Chilean context.

The comparison presented above focuses on the economic systems (S) and government policy (P) elements of the ESP paradigm. In terms of economic environment (E), it refers to the host country’s resources and capabilities (human resources, natural resources), as well as the capability of local firms to absorb knowledge. A specific economic environment results in a specific level and structure of output (primary, industrial services, specializations). Hence, the components of (E) can be likened to L-specific advantages, and determine the ability of the host country to absorb and utilize the assets that accompany inward FDI.

Scott-Kennel (2001) included firm capability as a determinant of linkage formation. However, the literature suggests that there are other elements of the economic environment that are relevant in the context of developing countries (Bloningen, 2005; Olofsdotter, 1998; Wei, 2000a, 2000b). Specifically, the quality of institutions is likely to be an important determinant of FDI activity, particularly for developing countries. Poor quality of institutions increases the cost of doing business and, thus, may diminish FDI activity. Hence, differences between Chile and New Zealand in terms of economic development suggest that elements of the economic environment, besides local firm capability, may also play a role on linkage formation.

Hence, it is necessary to compare Chile and New Zealand in terms of the economic environment in order to determine if there are any significant differences. In so doing, it is possible to identify elements that may play a role in linkage formation in the context of a developing country.
### Table 4.1
Comparison of New Zealand and Chilean FDI Policy

<table>
<thead>
<tr>
<th>New Zealand</th>
<th>Chile</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Similarities</strong></td>
<td><strong>Differences</strong></td>
</tr>
<tr>
<td>• Access to a wide range of industries. However, there are regulations that may limit foreign participation in a few sectors. In New Zealand, approval requirements apply to investments in the commercial fishing industry (under a quota system). Consent from the Overseas Investment Commission (OIC) is based on a national interest determination. In Chile, foreign investors need to get authorization for operating in the following industries: coastal trade, air transport, mining industry and mass media. And there is restriction to foreign participation in the defence and nuclear energy industries.</td>
<td>• Under DL 600, investors wishing to get access to certain benefits and guarantees must sign a contract with the Foreign Investment Committee. Investors may go through the Central Bank instead without the need for authorization. In addition, most investment projects require additional permits and/or must fulfil other requirements besides those set forth in DL 600. All investment projects, both local and foreign, must comply with the country's local and sector-specific legislation, at the national, regional, and municipal levels.</td>
</tr>
<tr>
<td>• Both present some restrictions to foreign investment in terms of land-ownership. In New Zealand, land purchases and land-related investments are subject to greater restrictions to foreign investment. Ownership of any land that is “sensitive”, such as the foreshore, lakes and islands, is restricted to foreign investors. Investment in farmland is required to be in the “national interest”, and these criteria also apply to investments in “sensitive” areas* (Scott-Kennel, 2001). In Chile, foreign investors are not allowed to buy property near the borders.</td>
<td>• Provides certain inducements for investments in some isolated geographic regions and new industries, particularly those in the technology field**.</td>
</tr>
<tr>
<td>• Full access to foreign exchange</td>
<td>• DL 600 offers the choice of invariable taxation*** in order to provide a stable tax horizon. Foreign investors also have access to a regime that freezes VAT, as well as import tariffs on capital goods for the project. In addition, imports of some of these capital goods are exempt from VAT in the case they are not produced in Chile and are on a list published by the Ministry of Economy’s Foreign Trade Department.</td>
</tr>
</tbody>
</table>

*Scott-Kennel, 2001

**Includes technological advancement, rural development and regions with a low GDP per capita.

***Permanent income in real terms.
NZ does have a restrictive policy on the dairy industry. If an entity intends to become a shareholder in a dairy cooperative (such as Fonterra, Tatua & Westland) it has to buy a dairy farm and it is allocated shares on the milk solids (output) of that farm, which it has to fund. In this way, no foreign investment in dairying is possible as long as these cooperative structures remain (Akoorie & Scott Kennel, 1999).

**Although these incentives are officially offered to both local and foreign investors, implicitly foreign investors are “expected” to benefit more from these incentives due to their greater capacity in terms of capital and technology relative to local firms.**

*** These are not "tax breaks" or "tax holidays", but are intended to provide a stable tax horizon, acting as a form of "tax insurance". DL 600 offers several different tax options, but basically allows the investor to lock into the tax regime prevailing at the time an investment is made.


### 4.3.2 Comparing the Economic Environment of New Zealand and Chile

Table 4.2 provides a comparison of selected economic and social indicators for New Zealand and Chile. They present similarities in terms of trade indicators (volumes of imports and exports) and industrial structure indicators (agriculture, industry and services). For instance, both are primary product traders whose exports are largely made up of unprocessed and processed items for consumption in the Northern Hemisphere (Murray, 1999). In order to deal with increased globalisation of world trade both have restructured their economies which has been done through a now familiar course of privatisation, State expenditure, rationalisation, and export orientation (Murray & Challies, 2004). As a consequence of structural change and the considerable natural comparative advantages enjoyed by both countries, they have become relatively highly export-oriented. In many sectors, such as fruit, wine and forestry, the two countries occupy similar competitive spaces in global markets (McKenna & Murray, 2002).

Despite these similarities, there are significant differences in terms of income per capita and population. The facts that Chile presents a much lower income per capita than New Zealand and that it stills has a percentage of the population earning below US$1 a day demonstrate that they are different in terms of economic development. This reality is also supported by other indicators such as the number of phones and Internet users per 100 population, which are both considerably lower for Chile in comparison to New Zealand, The Gini Index – which indicates income distribution within a country from 0 to 100,
with 0 for a totally equal distribution and 100 for a totally unequal distribution – also shows differences in economic development between Chile and New Zealand. The former has a higher score implying more inequality in terms of income distribution. Furthermore, the table shows that the growth rate of GDP per capita is higher for Chile confirming its “developing” economy profile.

Table 4.2
Selected Economic and Social Indicators, New Zealand and Chile (2005 unless specified)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Chile</th>
<th>New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population (thousands)</td>
<td>16,295</td>
<td>4,028</td>
</tr>
<tr>
<td>GDP/PPP (US$ billion) (2006)</td>
<td>202.7</td>
<td>97.59</td>
</tr>
<tr>
<td>GDP/PPP per capita (US$) (2006)</td>
<td>12,700</td>
<td>24,200</td>
</tr>
<tr>
<td>Exports (US$ billion)</td>
<td>17.4</td>
<td>13.0</td>
</tr>
<tr>
<td>Imports (US$ billion)</td>
<td>15.9</td>
<td>12.4</td>
</tr>
<tr>
<td>GDP per capita average annual growth rate (%)</td>
<td>3.8</td>
<td>2.1</td>
</tr>
<tr>
<td>(1990-2005)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture as % of GDP</td>
<td>7.1</td>
<td>8.3</td>
</tr>
<tr>
<td>Industry as % of GDP</td>
<td>27.1</td>
<td>23.4</td>
</tr>
<tr>
<td>Services as % of GDP</td>
<td>54.1</td>
<td>68.3</td>
</tr>
<tr>
<td>% Labour force in Agriculture (2003)</td>
<td>13.6</td>
<td>10</td>
</tr>
<tr>
<td>% Labour force in Industry (2003)</td>
<td>23.4</td>
<td>25</td>
</tr>
<tr>
<td>% Labour force in Services (2003)</td>
<td>63</td>
<td>65</td>
</tr>
<tr>
<td>% of population below US$1 a day, (1994-2004)</td>
<td>Less than 2%</td>
<td>-</td>
</tr>
<tr>
<td>% of central government expenditure (1994-2004)</td>
<td>18</td>
<td>21</td>
</tr>
<tr>
<td>allocated to: education</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number per 100 population (2002-2004), phones</td>
<td>84</td>
<td>124</td>
</tr>
<tr>
<td>Number per 100 population (2002-2004), Internet users</td>
<td>28</td>
<td>53</td>
</tr>
<tr>
<td>Corruption Index, CPI Score (2006)</td>
<td>7.3</td>
<td>9.8</td>
</tr>
</tbody>
</table>

Sources: UNICEF (2007); The World Bank (2007); Transparency International (2006); Central Intelligence Agency (CIA) (2007)
Regarding the quality of institutions, the 2006 Transparency International Corruption Perceptions Index indicated that Iceland, Finland, and New Zealand are perceived as the world’s least corrupt countries. Chile was placed twentieth indicating than even though corruption is low there is still work to do in that area.

In terms of human capital, it can be appreciated from Table 4.2 that Chile’s government expenditure is lower than that in New Zealand. This information suggests that human capital may not be as well developed as it is in New Zealand. For instance, Table 4.3 indicates the educational attainment of the adult population in Chile in comparison to that in New Zealand. Only 14.5% of the population in Chile has attained a higher level of education, while 41.5% of the population in New Zealand has attained that level. This disparity is also reflected in the average years of school, which are 7.55 for Chile and 11.74 for New Zealand. Although measuring educational attainment is the most commonly used method due to the availability of data, it is an imperfect proxy for human capital (Stroombergen, Rose & Nane, 2002). Educational attainment does not guarantee that the skills, knowledge and competence that are trying to be measured have been acquired. In addition, differences in education systems between countries can limit international comparability (Stroombergen, Rose, & Nane, 2002).

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Chile</th>
<th>New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population over 15 (thousands)</td>
<td>10,942</td>
<td>2,879</td>
</tr>
<tr>
<td>No Schooling</td>
<td>7.1%</td>
<td>0.0%</td>
</tr>
<tr>
<td>First Level</td>
<td>44.3%</td>
<td>28%</td>
</tr>
<tr>
<td>Second Level</td>
<td>34.1%</td>
<td>30.5%</td>
</tr>
<tr>
<td>Post-Secondary Level</td>
<td>14.5%</td>
<td>41.5%</td>
</tr>
<tr>
<td>Average Years of School</td>
<td>7.55</td>
<td>11.74</td>
</tr>
</tbody>
</table>


In order to get a more direct indication of human capital it is necessary to measure skills directly. This approach involves questionnaire-based assessment of skills (Stroombergen, Rose, & Nane, 2002). The Programme for International Student Assessment (PISA)⁴ is
an example of this approach. This assessment is run across many countries using a consistent methodology in this way thus aiding comparability. Table 4.4 summarizes the results of PISA for Chile and New Zealand in the year 2000.

<table>
<thead>
<tr>
<th>Area of Assessment</th>
<th>Chile (position in parenthesis)</th>
<th>New Zealand (position in parenthesis)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reading</td>
<td>410 (31)</td>
<td>529 (2)</td>
</tr>
<tr>
<td>Mathematics</td>
<td>384 (31)</td>
<td>537 (3)</td>
</tr>
<tr>
<td>Science</td>
<td>415 (31)</td>
<td>528 (4)</td>
</tr>
</tbody>
</table>

Source: OECD (2001) and Ministerio de Educacion, Chile (2004)

Table 4.4 shows that in all of the areas assessed New Zealand presents an average score which is much higher than that of Chile. This is reflected in the relative position of each country within the group of participant countries, second to fourth position (depending on the area assessed) for New Zealand while Chile is placed in the thirty-first position, which gives an indication of New Zealand having a higher quality of human capital than Chile.

In conclusion, New Zealand and Chile present similarities in terms of industrial structure and trade; however, they present significant differences in terms of economic development. Differences in terms of economic development suggest that there are elements of the economic environment that are less developed in Chile in comparison to New Zealand, such as the quality of institutions (corruption), market size (defined by income per capita and level of phone and Internet connection), economic conditions (poverty), and human capital (government expenditure on education, educational attainment, and skills). Hence, it is important to identify whether there are elements of the economic environment, besides local firm capability, that may act as determinants of linkage formation.
4.4.0 Reassessing Scott-Kennel’s Model of Local Industry Upgrading

This section reviews the model of local industry upgrading proposed by Scott-Kennel (2001) in the context of developing countries. Specifically, it refers to the contribution of FDI as a continuum from enclave to full integration. The following discussion refers to developing countries in general; however, it is important to consider that, as mentioned previously, there are differences among them in terms of economic development. This variation implies that the contribution of FDI to each developing country might be at different places along the continuum.

4.4.1 Scott-Kennel’s Model of Local Industry Upgrading in the Context of Developing Countries

The model illustrates the DOL via a continuum, with enclave FDI at one end and developmental FDI at the other.

**Enclave Position**

Developing countries are generally characterized by sluggish industrial contexts in which local capabilities are weak and there is a small private sector. In this context, Portelli (2002) indicates that FDI is attracted by generic L-specific advantages, primarily natural resources. At this stage, the generic L-specific advantages are just adequate to attract FDI but not sufficiently attractive enough to establish linkages with local firms. That is, enclave investments take place where only the affiliate benefits from the upgrading of its O-advantages by employing full internalisation.

The proposition is that at this stage FDI is attracted to developing countries in order to take advantage of their abundance of natural resources and/or privatization processes. In other words, an enclave scenario is characterized by investment and/or rehabilitation of industrial equipment and facilities. No linkages at this stage mean that indirect effects are
unlikely to emerge. Hence, the effect on host country industrial upgrading is at best neutral (Portelli, 2002; Dunning, 1981, 1986).

**Low DOL**

After the entry of the foreign affiliate, depending on the conditions in the host country, the foreign affiliate will form linkages with local firms. In the context of developing countries, non-FDI induced changes, specifically in terms of government policy and infrastructure, will determine the quality of linkages established.

At the beginning only indirect linkages are expected to take place – through the engagement of local labour and competitive effects – since L-factors at this stage are not developed enough to encourage direct linkages. In the context of developing countries, an unfavourable business environment, weak local demand conditions, and unstable socioeconomic conditions may all form part of the L-specific factors that prevent the formation of direct linkages with local firms. Since only indirect linkages may occur at this stage, the effects of MNE activity on local upgrading are expected to be low. In other words, the DOL is low and the process of local industry upgrading is considered to be weak since the affiliate fully internalises its O-advantages.

**Moderate DOL**

Improved economic conditions, regulatory frameworks, local industry capacity, all may lead to the establishment of further linkages. The improvement of local conditions makes possible the establishment of forward and/or backward linkages between the foreign affiliate and local firms. In this context, the DOL and, hence, the process of local industry upgrading, are considered to be moderate.

The emergence and incremental process of linkages are associated with the strengthening of a virtuous process between the O-advantages of the foreign affiliate and L-advantages of the host economy, in the sense that the emergence of more linkages will reflect an
upgrading of L-advantages (Portelli, 2002). Hence, a moderate DOL reflects the improved potential for indirect effects emerging from better quality linkages as the L-advantages of the host economy improve.

**High DOL**

The DOL is high when high quality linkages are established between the foreign affiliate and local firms, for example, knowledge agreements or collaborative linkages. At this stage, upgrading of O-advantages and full embeddedness of FDI take place and represent the optimal integration of FDI in the host economy. In this scenario, the process of local industry upgrading is considered to be strong (where the DOL is high).

A high DOL has the potential of resulting in a bidirectional transfer of O-advantages between the foreign affiliate and local firms. The advantages transferred may or may not be core advantages. O-advantages augmentation is at its highest possible level, made possible by the upgrading of L-advantages to a level where local firms are on a par with the foreign affiliate (Portelli, 2002). Hence, the strongest contribution to upgrading is registered.

A strong process of local industry upgrading is not expected to occur in the context of developing countries since local firms’ capabilities are not typically equal with the capabilities of the foreign affiliate.

In sum, central to the realization of different linkages and subsequent augmentation of O-advantages is the interaction between the affiliate’s O-advantages and L-specific advantages of the host economy, and how changes in L-factors determine changes in O-advantages.

In the context of developing countries, generic L-advantages, such as abundance of natural resources, have attracted a considerable amount of FDI to these economies. However, weak local conditions suggest that no linkages will take place if the host country does not improve in terms of local capability, policy framework, and
infrastructure. This has been the reality for a group of developing countries, usually referred to as Least Developed Countries (LDCs) (Portelli, 2002).

Some developing countries, such as Chile, have been successful in improving local conditions by developing sound policy frameworks, a stable economic environment, better infrastructure, and local capability. These countries might benefit from the presence of foreign investors in their economies since their local conditions may encourage linkage formation. However, relative to developed economies, these countries are still underdeveloped in some respects, which imply that higher quality linkages may not take place.

The following section presents specific research questions and propositions for assessing how FDI influences the local Chilean industry.

### 4.5.0 Research Questions and Propositions

The Scott-Kennel (2001) model presented above described the distinct stages of a process by which local firms upgrade their O-advantages via linkages with foreign affiliates. The model was then reviewed in the context of developing countries. The analysis suggested that the model may not be appropriate in this context since there are other variables at play related to government policy and economic environment. Hence, this section first presents research propositions and questions for assessing whether Scott-Kennel’s (2001) model is applicable in the context of developing countries, specifically Chile. The following step is to assess how FDI impacts the local Chilean industry. Research propositions and questions are presented, which investigate direct and indirect linkages at the firm level. This investigation is done in three stages (Scott-Kennel, 2001): the affiliate profile, the extent and determinants of linkage formation, and the overall degree of linkage.
4.5.1 Scott-Ken nell’s Model of Local Industry Upgrading

Before assessing in which ways FDI influences local industry upgrading in Chile, it is necessary to identify if the underlying assumptions of Scott-Ken nell’s (2001) model limit its usefulness in the Chilean context. Therefore, it is important to answer the following question:

- Is Scott-Ken nell’s model applicable in the context of Chile?

4.5.1.1 Government Policy

Theory has proposed that the level of economic development of an economy is influenced by its policy orientation. In general, it is argued that market-oriented economies tend to show more economic growth than inward-oriented economies. Although Chile has been recognized as the most liberalized economy in Latin America, in contrast to New Zealand, its economic approach towards FDI seems to follow the tenets of neo-structuralism rather than neo-liberalism. In other words, its policy is not as neutral as officially proclaimed; hence, it is possible that, in some respects, its policy framework moderates the process of local industry upgrading proposed by Scott-Ken nell’s (2001) model. This possibility implies that government policy may play a determining role on linkage formation. This is, differences in terms of policy orientation will lead to different levels of economic development, which in turn is reflected in the DOL of FDI in the economy. However, it may be possible that government policy does not play a role in linkage formation. The literature suggests that the quasi-internalisation route of organisation might be taken for a number of strategic, rather than L-specific, reasons (Scott-Ken nell, 2001). That is, MNEs may choose to form or not to form linkages with local firms as part of its strategy rather than as a response to government policies. To examine this issue, the following research proposition and question are presented:
**RP1: Policy orientation**
Policy orientation (regulations and policies) influences linkage formation either positively or negatively, or policy orientation does not influence linkage formation since the MNE’s strategy plays a role in linkage formation.

**RQ1: Policy framework**
Does Chile’s policy framework influence linkage formation?

The comparison between the New Zealand and Chilean contexts identified a number of differences in terms of FDI policy. It showed that Chilean FDI policy is not as neutral as the New Zealand one since it includes specific policies that discriminate either in favour of or against foreign investors. The following research questions assess specific aspects of Chilean FDI policy that may play a moderating role in the process of local industry upgrading:

**RQ2: Screening Mechanism**
To what extent does the requirement to sign a contract with the Chilean government influence linkage formation?

**RQ3: Capital Repatriation**
To what extent does the restriction on capital repatriation (1 year after the entry of the foreign affiliate) influence linkage formation?

**RQ4: Expatriate Employees**
To what extent does the requirement that at least 85% of a firm’s employees must be Chilean citizens influence linkage formation?

**RQ5: Tax Incentives**
To what extent do tax benefits (tax horizon) influence linkage formation?
**RQ6: Industry and Location Incentives**

To what extent does the existence of certain inducements for investments in some isolated geographic regions and new industries, particularly those in the technology field, influence linkage formation?

**4.5.1.2 Economic Environment**

The fact that Chile is a developing economy suggests that, besides the capability of its local firms, there might be other elements of the economic environment that are not as developed as those same elements in a developed economy like New Zealand. Portelli (2002) argues that L-specific factors must present a certain level of development in order to be able to benefit from FDI through linkages, and that non-FDI induced changes are essentially the ones that determine FDI-induced changes. He notices that underdeveloped capacity in terms of institutions, physical and human capital, and private sector, undermine the ability of the host industry to benefit from the activities of MNEs. Noorbakhsh, Paloni, and Youssef (2001) argue that a significant factor in influencing locational decisions is the presence of sophisticated conditions. This argument suggests that since Chile is a developing country there might be elements of the economic environment besides local firm capability (discussed later) that may influence linkage formation. However, the same argument presented for government policy as a determinant of linkage formation also applies for the economic environment. That is, MNEs may choose to form or not to form linkages with local firms as part of their strategy rather than as a response to elements of the economic environment. The following research proposition and question assess this issue:

**RP2: Economic Environment**

Economic environment influences linkage formation either positively or negatively or the economic environment does not influence linkage formation since the MNE’s strategy plays a role in linkage formation.
**RQ7: Economic Environment**
Does Chile’s economic environment influence linkage formation?

The comparison between the New Zealand and Chilean economic environments identified a number of differences. The following research questions assess specific aspects of the Chilean economic environment that may play a moderating role in the process of local industry upgrading:

**RQ8: Quality of Institutions**
To what extent does the quality of institutions influence linkage formation?

**RQ9: Market Size**
To what extent does Chile’s market size influence linkage formation?

**RQ10: Human Capital**
To what extent does the quality of human capital influence linkage formation?

**RQ11: Economic Conditions**
To what extent do Chile’s economic conditions influence linkage formation?

### 4.5.2 Affiliate Profile

First of all, in order to assess which O-specific advantages may be diffused to the Chilean industry, we need to estimate the direct effects on the affiliate. That is, to identify the O-specific advantages which are transferred from the MNE to the Chilean affiliate. For instance, if the transfer of O-specific advantages from the parent firm to the Chilean affiliate is limited, then it is less likely that indirect effects will occur. Hence, it is important to first answer the following question:

- What impacts do parent MNEs have on the characteristics, activities, and competitiveness of its affiliate in Chile?
It is proposed that the contribution of FDI to the upgrading and increased productivity of the host country’s resources and firms is strongly conditional on the motives for the investment, the extent of internalization of firm-specific advantages by the affiliate and the type of investment. As well, it is important to include country of origin, affiliate’s local experience, entry mode/ownership form, and degree of autonomy. Hence, a detailed profile of the affiliates would be necessary in order to address these issues.

In sum, besides describing the unique advantages that the affiliate has internalized, the profile must include the range of affiliate-related variables that act as determinants of linkage formation.

RQ12: Motive for Investment
Why do MNEs invest and operate in Chile?

RQ13: Role of the Affiliate or MNE’s Strategy
Do affiliates follow a simple-integration strategy or a complex-integration strategy?

RQ13: Autonomy
To what extent do the affiliates have autonomy over short- and long-term decision-making?

RQ14: Mode of Entry/Age/Ownership form
How long have the affiliates operated in Chile, and were they established or acquired by their current foreign owners?

RQ15: Main Activity
What is the main area of activity of the surveyed affiliate?

RQ16: Country of Origin
What is the country of origin of the surveyed affiliate?
RQ17: Ownership-advantages
To what extent do MNEs transfer internalized O-advantages and resources via the FDI medium to the affiliates in Chile?

RQ18: Innovation
a. Are the affiliates responsible for introducing unique innovations to Chile, and where do these innovations originate (the parent firm, the affiliate, or through joint development)?
b. Do MNEs internalize local innovation via acquisition of local firms?

RQ18: Competitive Advantages
What are the key sources of competitive advantage for affiliates in Chile?

It is expected that the affiliate will use the O-advantages, resources and innovation from the parent firm (MNE) as a source of competitive advantage in Chile. As a way to assess the O-advantages and I-advantages of the affiliate in Chile, the following research propositions are presented:

RP3: Affiliates rely on internalized MNE O-advantages and resources transferred from the parent firm as sources of competitive advantage in Chile.

RP4: Affiliates rely on internalized innovations introduced to Chile via the parent firm as sources of competitive advantage.

4.5.3 Linkage Formation

In terms of the indirect effects of FDI the question is:

- In what ways do the activities of foreign affiliates in Chile contribute to the upgrading of local firms?
In order to answer this question the extent and type of linkages formed between foreign affiliates and local firms in Chile need to be assessed. In particular, the study needs to investigate the ways in which the O-specific advantages or other resources belonging to the affiliate might diffuse/transfer to local firms via linkage formation.

4.5.3.1 Indirect Linkages

Indirect linkages within an industry may emerge as a result of demonstration effects, movement of labour, and emulation. The underlying assumption is that foreign affiliates will not transfer O-specific advantages to local competitors, except when collaborative agreements are established. However, there is potential for the diffusion of these O-advantages.

Since only foreign affiliates will be interviewed it is not possible to directly measure the extent of indirect linkages in the Chilean industry. However, there are three main ways by which inferences about the extent of indirect competitive linkages can be determined (Scott-Kennel, 2001).

First, the capability gap can be evaluated based on the strength of foreign affiliates versus local competitors. Empirical evidence suggests three possible scenarios:

- When the capabilities of the foreign affiliate largely exceed the capabilities of the local firm and, as a result, the latter is forced to exit the market (crowding out effect);
- When the capabilities of local firms exceed the capabilities of the foreign affiliate. In this scenario, foreign affiliates may hollow out local capability;
- When the levels of capability are similar, hence, there is a small capability gap between the firms, and then the potential for asset augmentation by the local firm is higher.
Thus, by assessing the competitive position of the affiliate relative to local competitors it is possible to estimate the indirect competitive effect of the affiliates. Specifically, the following research question is asked:

**RQ19: Competitive Position**
Do the affiliates have strong competitive positions relative to their Chilean competitors?

Secondly, by investigating whether the activities of the affiliate have changed the competitive environment, it is possible to assess the competitive effects on local firms. The competitive environment is measured by changes to the number of competitors (crowding out effect) and the competitiveness of firms overall (demonstration effects). The following research questions are presented:

**RQ20: Competitive Environment**
Do the affiliates influence the competitive environment – in terms of level of competition, competitiveness of other firms and number of competitors – in their industries in Chile?

In order to complete the assessment of the extent of indirect linkages in the Chilean industry, there is a need to investigate the degree to which foreign firms may have invested in Chile to take advantage of agglomeration of firms in specific industries, or to locate in close proximity to competitors or other firms with complementary capabilities. Specifically, the following research question is asked:

**RQ21: Clusters**
Is there any evidence of competitive clusters where the affiliates gain access to local innovation?

**4.5.3.2 Direct Linkages**

In order to better capture the quality of local linkages, only direct linkages that involve specialised, rather than standardised, products and services are analysed (Scott-Kennel,
2001). Linkages involving specialised products/services are associated with the transfer of resources or quasi-internalization by the affiliate. The following sections present research questions specific to the investigation of each type of direct linkage.

**Forward Linkages**

The foreign affiliate may form forward linkages with local firms that act as agents for distribution, marketing, and services. The affiliate does so in order to take advantage of local firms’ experience in the Chilean market and/or established distribution networks or as a way to focus on core activities. This kind of linkage may result in the foreign affiliate assisting local firms with marketing, selling, or after-sale service. The foreign affiliate may also form forward linkages with local customers, especially when the latter need guidance about use and servicing.

**RQ22: Forward Linkages with Local Agents**
To what extent do the affiliates form forward linkages with Chilean firms for the marketing or distribution of products and/or services?

**RQ23: Forward Linkages with Local Customers**
To what extent do the affiliates form forward linkages with Chilean customers for the supply of specialised inputs?

**RQ24: Assistance**
What types of assistance do the affiliates provide to Chilean agents and customers for the purpose of improving their products and/or services?

**Backward Linkages**

When the foreign affiliate purchases inputs from local firms or subcontracts part of the production process or service function out to other firms, there is potential for the formation of backward linkages. The foreign affiliate may provide local suppliers with
technical assistance, organisational techniques, and financial support, among others. Hence, through backward linkages there is potential for the transfer of skills and technology. The following research questions are presented to investigate these issues:

**RQ25: Local Sourcing**
To what extent do the affiliates source specialised products and services from Chilean firms?

**RQ26: Backward Linkages**
To what extent do the affiliates form backward linkages with Chilean suppliers or subcontractors for the purchase of specialised inputs?

**RQ27: Types of Assistance**
What types of assistance do the affiliates provide to Chilean suppliers and subcontractors for the purpose of improving their products and/or services?

**Knowledge Agreement Linkages**

Licensing or franchising contracts undertaken by local firms with foreign affiliates constitute knowledge agreements. These types of agreements imply that intermediate assets, in the form of standardised and codifiable firm resources, are transferred from the foreign firm to the local franchisee/licensee. The set of resources that are typically transferred include: product or process technology, marketing practices and brands, as well as business practices and procedures (Scott-Kennel, 2001). These linkages are examined in the following research questions:

**RQ28: Knowledge Agreement Linkages**
To what extent do the affiliates form knowledge agreements with Chilean licensees and/or franchisees for the production or marketing of products/components or services?
RQ29: Types of Assistance
What types of assistance do the affiliates provide to Chilean licensees and/or franchisees for the purpose of improving their products/components or services?

Collaborative Linkages

An assumed condition for the establishment of collaborative linkages is that local firms possess capabilities and/or resources that complement those of the foreign affiliate. This assumption implies that local firms possess high levels of competency in complementary value-added activities; hence, they are attractive to the foreign affiliate as alliance partners (Scott-Kennel, 2001). There are a number of reasons why foreign affiliates may choose to form collaborative linkages with local firms, such as:

- To collaborate in the design of technology to suit the local market;
- To help a local firm that may have an innovative product that needs financial or marketing support from a larger firm;
- To get access to research at a lower cost;
- To undertake competitive activities;
- To gain exclusionary market or manufacturing rights; and
- To specialise core activities while allowing external firms to develop others.

Collaborative agreements have the potential for mutual gain by each firm; however, this outcome is not always the case if one firm is able to gain more from the alliance than the other. The following research questions are presented for examining these issues:

RQ30: Collaborative Linkages
To what extent do the affiliates form collaborative agreements (e.g., strategic alliances, technology agreements, or management contracts) with Chilean firms?
RQ31: Transfer of O-advantages
What types of resources (O-advantages) do the affiliates provide to Chilean collaborative partners (and vice versa)?

RQ32: O-advantages augmentation
Are resources (O-advantages) developed (in either firm) as a result of the collaborative agreement?

RQ33: Motive of Collaborative Agreement
Why do the affiliates form collaborative agreements with Chilean firms?

4.5.4 Determinants of Linkage Formation

To identify those factors that have a determining role in the formation of linkages between the foreign affiliate and local firms is as crucial as assessing the extent and quality of linkages. Specifically, firm specific and location-specific factors need to be assessed. The analysis is limited to direct linkages due to their higher potential for local industry upgrading.

Linkage formation refers to both the quantity and quality of linkages. The following propositions examine the characteristics of the foreign affiliate (O-advantages) as determinants of linkage formation.

RP5: Motive for Investment
The motive for investment will influence linkage formation. Specifically, resource-seeking investment is less likely to result in linkages than efficiency-seeking, market-seeking, or strategic-seeking investment.

RP6: Autonomy
Greater influence of the foreign parent firm/shareholder over the affiliate’s short- and long-term decision-making will have a negative influence on linkage formation.
RP7: Age of the Affiliate
The length of operation in the local market of the affiliate will be positively related to the formation of linkages.

RP8: Main Activity
The affiliate’s main activity will influence linkage formation.

RP9: Ownership-advantages
Intra-firm transfer of resources from the foreign parent firm/shareholder to the affiliate will have a positive influence on linkage formation.

Regarding innovation, there are two possible scenarios. First, when the innovation is introduced by the parent firm there is more incentive to continue to internalize the resources developed offshore. Second, when the innovation is developed locally by the affiliate or jointly with local firms then it is more likely that local firms are involved in the process through linkages or indirectly via demonstration or competitive effects. The following research propositions address this issue:

RP10: Innovation
The introduction by the affiliate of innovation that originates from the parent firm/shareholder will have a negative influence on linkage formation.

RP11: Innovation
The introduction of innovation by the Chilean affiliate or jointly with the foreign parent firm will have a positive influence on linkage formation.

Earlier in this chapter, research questions and propositions for the examination of determinants of linkage formation were presented. In addition, empirical evidence suggests that both direct linkage formation and the impact on local firms are dependent on the capability of local firms. Specifically, when the technology gap between the affiliate and local firms is small (greater local capability) there is more potential for
linkage formation. In other words, whether foreign affiliates establish linkages or not depends on the ability of local firms to respond to the demands of the foreign affiliate effectively. To examine the capability of local firms, the following research questions and propositions are presented:

**RQ35: Local Firm Capability**
How do the affiliates rate the capability (availability, price, quality, reliability, and technical sophistication) of Chilean firms?

**RQ36: Suppliers/Agents Capability**
To what extent do the affiliates perceive that Chilean firms are able to supply standardised/specialised products/services they require?

**RP12: Local Firm Capability**
Greater capability of local firms (in terms of relative availability, price, quality, reliability, and technical sophistication) will have a positive influence on linkage formation.

**RP13: Local Suppliers/Agents Capability**
Greater ability of local firms to supply standardised/specialised inputs will have a positive influence on linkage formation.

Scott-Kennel and Enderwick (2005) provide a summary of the expected outcome for upgrading by the local firm and/or the affiliate given certain OLI configurations. It is presented in Table 4.5. It shows that the type of linkage, and hence, the expected outcome, is influenced by the O-advantages of the affiliate and local firms, the degree to which the affiliate internalizes its O-advantages, and whether the L-advantages of the host country can support such linkages.

As discussed earlier in this chapter, in the context of developing countries, government policy may act as a determinant of linkage formation. In other words, it may play a
<table>
<thead>
<tr>
<th>Linkage</th>
<th>OLI configuration</th>
<th>O-advantages transfer (or diffusion)</th>
<th>Expected impact on O-advantage augmentation</th>
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<tr>
<td><strong>Enclave</strong></td>
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</tbody>
</table>
| Low          | • Oh weak         | • Diffusion of Of possible via emulation, demonstration or worker mobility effects | • Changes to market/industry structure over time  
• Augmentation of O-advantages limited to the affiliate |
|              | • Lh unsupportive of local development | • No direct transfer of Of by affiliate |                                                                                                          |
|              | • Full If         |                                      |                                                                                                          |
|              |                   |                                      |                                                                                                          |
| **Competitive** |                   |                                      |                                                                                                          |
| Low          | If Of and Oh dissimilar  
• Oh weak  
• Lh unsupportive of local development  
• Full If | • Diffusion of Of unlikely given weak Oh (capability)  
• No direct transfer of Of by affiliate | • Local competitors either do not exist or are insufficiently developed to compete with the affiliate  
• Increase in market concentration, decrease in competition if local firms are squeezed out  
• Loss/decline of Oh (if present) in favour of Of due to competitive pressure. Oh may increase in related/supporting industries |
|              |                   |                                      |                                                                                                          |
|              | If Of and Oh similar  
• Oh strong  
• Lh supportive of local development  
• Full If | • Diffusion of Of probable via emulation or demonstration effects given strong Oh (capability)  
• No direct transfer of Of by affiliate | • Direct competitive pressure may force upgrading by local firm and/or affiliate  
• Former employees may leave to establish their own firms  
• Local competition may prompt hostile action by affiliate (e.g. acquisition of Oh)  
• Changes to industry structure, market competition over time augments Oh |
| **Forward Linkages** |                   |                                      |                                                                                                          |
| Moderate     | • Oh sufficient for linkage formation  
• Lh supportive of local development  
• Full or partial If possible | • Of transfer likely through assistance, products, marketing specifications, after-sales service, etc. | • Of coupled with existing Oh leads to Oh augmentation by local firm due to: demands by affiliate for improvement to the quality of service; assistance and resources given by affiliate to improve local agent/customer output; supply of improved variety and quality of products/services by the affiliate. |
<table>
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<tr>
<th>Linkage</th>
<th>OLI configuration</th>
<th>O-advantages transfer (or diffusion)</th>
<th>Expected impact on O-advantage augmentation</th>
</tr>
</thead>
</table>
| Backward Linkages  
Moderate | • Oh sufficient for linkage formation  
• Lh supportive of local development  
• Full If, if inputs standardised  
• Partial If, if inputs specialised | • Of transfer likely in areas of product/process technology, design specifications, quality control, information, etc. | • Of coupled with existing Oh leads to Oh augmentation by local firm due to: demands by affiliate for improvements to the quality of product/service; assistance and resources given by affiliate to improve local supplier/subcontractor output. |
| Knowledge Agreements  
High (Contractual) | • Oh complementary  
• Lh supportive of local development, possibly not supportive of foreign activity  
• Partial If – core/noncore Of | • Transfer of Of, unique to the foreign firm but given to all licensees/franchisees, such as technology, products, processes, expertise, etc. | • Of coupled with existing Oh leads to Oh augmentation by local firm due to: the transfer of resources and assistance; and the need for the local licensee/franchisee to meet the affiliate’s standards and specifications for output. |
| Collaborative  
High | • Of and Oh strong and complementary  
• Lh supportive of local development  
• Partial If and Lh | • Reciprocal transfer of Of and Oh advantages such as technology, products, processes, expertise, etc. | • Collaborative relationship likely to prompt O-advantage augmentation (Of and Oh) via innovation, technology development, human resource development, and sharing of competences by both firms. |

**Source:** Scott-Kennel (2001); Scott-Kennel & Enderwick (2005)

**Note:** Oh = Ownership-specific advantages of host county firms  
Of = Ownership-specific advantages of foreign affiliates  
Lh = Location-specific advantages of host country  
If = Internalization-specific advantages of foreign affiliates  
Ih = Internalization-specific advantages of host country firms
moderating role in the process of local industry upgrading. In the context of Chile, some aspects of FDI policy may influence linkage formation by either encouraging or restricting FDI operations. Specifically, the following research propositions are put forward:

**RP14: Screening Mechanism**
The existence of a screening mechanism will have a negative influence on linkage formation.

There are two possible scenarios regarding capital repatriation. First, large investments that operate with expected long periods of return might be relatively unaffected by the restriction to repatriate capital after one year of operation. Second, certain small projects, which have a shorter time horizon, might be affected by this restriction. The following research propositions address this issue:

**RP15: Capital Repatriation**
Capital repatriation restrictions will have no influence on linkage formation when the foreign affiliate is involved in long-term projects.

**RP16: Capital Repatriation**
Capital repatriation restrictions will have a negative influence on linkage formation when the foreign affiliate is involved in short-term projects.

The following research propositions evaluate aspects of the Chilean FDI policy that may have a positive influence on linkage formation, since all of them encourage the foreign affiliate to operate in Chile on a long-term basis:

**RP17: Expatriate Employees**
The requirement that at least 85% of a firm’s employees must be Chilean citizens will have a positive influence on linkage formation.
**RP18: Tax Incentives**
Tax incentives will have a positive influence on linkage formation.

There are two possible scenarios regarding industry and location incentives. First, inducements for investments in some isolated geographic regions and new industries will have a positive influence on linkage formation when the foreign affiliate operates in selected regions/industries, or when the foreign affiliate operates in related industries. Second, it will have no influence when the foreign affiliate does not intend to operate in selected regions/industries. The following research propositions address these issues:

**RP19: Industry and Location Incentives**
Industry/location incentives will have a positive influence on linkage formation when the foreign affiliate operates in selected regions/industries, or in related industries.

**RP20: Industry and Location Incentives**
Industry/location incentives will have no influence on linkage formation when the foreign affiliate does not operate in selected regions/industries, or in related industries.

In addition elements of the economic environment may also play a role as a determinant of linkage formation. In other words, they may influence the affiliates’ decisions regarding internalization of resources. In the context of Chile, some aspects of the economic environment may either encourage or discourage linkage formation. The following propositions refer to specific aspects of the economic environment.

**RP21: Quality of Institutions**
The quality of institutions will influence linkage formation.

**RP22: Market Size**
Chile’s market size will influence linkage formation.
**RP23: Human Capital**
The quality of human capital (professionals, technicians) will influence linkage formation.

**RP24: Economic Conditions**
Chile’s economic conditions will influence linkage formation.

### 4.5.5 Degree of Linkage

However, since the main concern is how the foreign affiliate may influence the upgrading of the Chilean economy, the following research question is proposed:

- Are there specific factors that are likely to bring about a greater degree of linkage with the local economy than others?

It is proposed that the degree of linkage of the foreign affiliate with local industry will determine the extent and nature of its overall impact on local industry upgrading. The study will also address the issue of whether certain types of FDI are more likely to form linkages that result in such upgrading. That is, by investigating the determinants of the DOL, the study will identify types of investment activity which are most beneficial to Chile.

**RQ32: Degree of Linkage**
Are the affiliates able to be categorised as to their degree of linkage with the local Chilean economy?

If the affiliates can be categorised into different DOL, then there is a need to investigate the unique characteristics of the affiliate related to different DOL (Scott-Kennel, 2001). These characteristics are addressed by the following research questions:
RQ33: DOL Characteristics
How do the following characteristics of the affiliates differ between the low, moderate, and high degree of linkage categories?

RQ33a: Motive for investment
RQ33b: Role of the affiliate
RQ33c: Autonomy
RQ33d: Mode of entry/Ownership form
RQ33e: Age (Number of years of operation in Chile; and ownership by current foreign investor)
RQ33f: Main activity
RQ33g: Competitive position
RQ33h: Access to technology from foreign parent firm/shareholder

4.6.0 Conclusion

This chapter presented Scott-Kennel’s model of local industry upgrading which applies the framework of the IDP at the microlevel. The model first proposes a process of local asset augmentation (upgrading) that operationalises the IDP by illustrating the mechanisms by which local firms may upgrade their resources and capabilities via linkages with foreign affiliates. The process would be initiated by the entry of the foreign affiliate into the host country after which its strategy and O-specific advantages would shape the nature of its direct effects. Affiliation with the MNE will give rise to direct effects on the affiliate, such as improved competitiveness relative to local firms.

The second stage would involve linkage formation between foreign and local firms. These linkages give rise to indirect effects on local industry, which occur at stages three and four. Stage three refers to the diffusion and transfer of ownership advantages. It involves the direct and/or indirect diffusion of ownership advantages by either/both foreign and local firms. The extent of diffusion or transfer is expected to be associated
with the degree of linkage (DOL) of the foreign affiliate with local industry. The final stage of the process comes when the local firm, and/or the foreign affiliate, is able to augment its ownership advantages as a result of indirect and direct linkages with foreign affiliates.

The diagrammatic presentation of the model suggests an evolving scenario of development, placing the different types of linkages, and DOL, in different phases along a continuum. In so doing, it suggests that the process of local upgrading would differ according to the OLI configuration of foreign affiliates. In other words, different OLI configurations are related to different levels of industrial upgrading. In sum, the model suggests that the contribution of inward FDI to a country’s economic development is positively related to the DOL at the firm level.

The model’s underlying assumptions were then reviewed to assess its suitability for evaluating the process of local industry upgrading in the context of developing countries. The analysis suggested that the underlying assumptions of Scott-Kennel’s (2001) model may not be appropriate in the context of developing countries. The model assumes that the host country adopts an EO-OL economic strategy, in which FDI policy is based on the principle of nondiscrimination. This may not be the case in developing countries, where government policy tends to either discriminate in favour of or against foreign investors, or a combination of both.

In order to determine if Scott-Kennel’s (2001) model is appropriate for assessing the main research issue of the thesis, namely the impact of FDI on local Chilean industry, the Chilean context was compared to the New Zealand context. Overall the comparison indicates that both countries adopt an EO-OL strategy, and recognize liberalization as the means for achieving economic growth. However, in terms of FDI policy, New Zealand presents a more neutral position towards FDI than Chile. In other words, some aspects of the Chilean FDI policy tend to discriminate either in favour of or against foreign investors. In so doing, it is possible that government policy, in the Chilean context, plays a determining role in linkage formation.
In terms of economic environment, New Zealand and Chile present similarities in industrial structure and trade; however, they present significant differences in terms of economic development. Differences in terms of economic development suggest that there are elements of the economic environment that are less developed in Chile in comparison to New Zealand, for example, the quality of institutions (corruption), market size (defined by income per capita and level of phone and Internet connection), economic conditions (poverty), and human capital (government expenditure on education, educational attainment, and skills). Hence, it is important to identify whether there are elements of the economic environment, besides local firm capability, that may act as determinants of linkage formation. Hence, the model may not be appropriate, as it stands, for evaluating the process of local Chilean industry upgrading via FDI since it does not consider government policy and economic environment.

The model was then reviewed in the context of developing countries. The contribution of FDI as a continuum from enclave to full integration was revisited considering the specific L-conditions of developing countries. It was suggested that developing countries that have improved local conditions in terms of policy framework, economic environment, infrastructure and local capability are able to move from an enclave scenario to a low DOL or even a moderate DOL. Nonetheless, L-factors may not be developed enough to encourage better quality linkages – moderate to high DOL. In other words, the movement along the continuum is highly dependent on the nature and extent of upgrading in the L-factors of the host country, which will lead to more created and less generic type of location factors (Portelli, 2002).

Then, a range of research propositions were presented as well as research questions for making the research propositions testable. First, research propositions and questions for assessing whether Scott-Kennel’s (2001) model is applicable in the context of developing countries, specifically Chile, were put forward. Subsequently, research propositions and questions for assessing the process of local asset augmentation proposed by the model were presented. Specifically, the focus is on evaluating the extent and quality of linkages, as well as the factors that may act as determinants of linkage formation. Regarding the
latter issue, research propositions and questions focus on those factors influencing the formation of direct linkages, rather than indirect linkages. In addition, a set of research questions for assessing the role of government policy and economic environment on linkage formation are included.

In summary, the purpose of the chapter was to present an appropriate model that would provide the basis for assessing the impact of FDI on local Chilean industry. Scott-Kennel’s (2001) model provides a microlevel explanation of the IDP, in turn, making it feasible to examine how the impact of FDI on local industry upgrading may occur. However, the underlying assumptions of the model need to be considered carefully in the Chilean context. This end is achieved by reviewing the model in the context of developing countries, so as to provide insights into the factors that may play a moderating role in the process. Hence, Scott-Kennel’s (2001) model and its revision constitute the foundation of a set of research propositions and questions for evaluating the process of local asset augmentation.

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1 Whether adopted voluntarily or through Structural Adjustment Programs (SAPs). SAPs refer to economic policies imposed on developing country governments by international financial institutions such as the International Monetary Fund and the World Bank as a condition for borrowing money, usually to get out of a foreign debt crisis. SAPs have also been imposed bilaterally by industrialized countries that make similar loans to developing countries. As the name implies, the point of SAPs is to induce structural changes in an economy, changes based on Neoliberalism that typically include: liberalization of trade, finance, and investment, as well as the privatization of public assets, and a parallel decline in government spending and the scope of its regulation. SAPs have been widely criticized as introducing extreme hardship into a country, with little in the way of positive results and often only to the benefit of a country's debtors (Rodrik, 2004).

2 The 1989 privatization programme in New Zealand, and the Chapter XIX in the 1980s.

3 The definition of neo-structuralism becomes obvious in the term ‘desarrollo desde dentro’ (endogenous industrialization). While neo-liberalism proposes a minimum of State intervention, neo-structuralism prefers a state that provides a framework that stimulates productivity and growth. The formula is neither “extensive non-selective regulation” nor "general liberalization", in the scheme of neo-liberalism, but it makes a connection of both: "As much State as necessary, as much market as possible". The State should be a leader state that provides a form of guidance that the market does not provide. It pleads for a strong
state that intervenes selectively. The world market is accepted as framework for industrialization. Economic development is sought as well as social equity (Steiner, 2006).

4 The Programme for International Student Assessment (PISA) is a project of the Organisation for Economic Co-operation and Development (OECD) designed to provide policy-oriented international indicators of the skills and knowledge of 15-year-old students. Three literacy domains are being assessed in PISA: Reading, Mathematics, and Science.

5 A total of 43 countries participated in PISA 2000, which includes OECD members and some non-members.

6 Reduction of the technology gap between the foreign affiliate and local firms as well as local infrastructure and regulatory framework.
Chapter 5     Research Methodology

5.1.0 Introduction

The aim of this thesis is to assess how MNE activity impacts on the development of local industry in the context of Chile. Since the study is based on the model developed by Scott-Kennel (2001), using the same research approach (survey questionnaire and quantitative methods) seemed appropriate. However, during the data collection stage a series of unexpected events took place which affected the research methodology of the thesis. Of these events, the low response obtained by using online surveys, even after three follow-ups, was the one that triggered the decision to change the methodology to collect data.

Although there was a change in methodology the purpose of the study remained unchanged. Taking into consideration the aim of this thesis, the challenges faced during the data collection stage and the context for this study qualitative and ideographic, methodologies were identified as being the most appropriate for this research and phenomenology was identified as the most suitable of these. Phenomenology is an ideographic research methodology that utilizes qualitative methodology. Drawing on the principles of phenomenology, the case study method was selected as a strategy for the data gathering and analysis process.

This chapter begins with a brief description of the research approach used before the change of methodology, while indicating the challenges faced during the data collection period that ultimately led to the selection of qualitative methodology. The following section describes the process by which phenomenology was selected as the most appropriate methodology while discussing the characteristics of alternative methodologies. The process of research method selection is explained in the following section, including the details of the specific case study design for fieldwork and analysis. Limitations of the methodology and methods are considered in the next section. The final section concludes the chapter.
5.2.0 Initial Research Approach and Challenges Encountered

Since the research questions proposed have never been assessed in the Chilean literature, no data exist that may help answer them. Hence, it was necessary to collect primary data. Scott-Kennel (2001) indicates that mail questionnaires enabled her to collect comparable data from a large representative sample while meeting both time and cost restraints. Since this study is based on the model developed by Scott-Kennel (for a detailed description of the model refer to Chapter Four), using the same data collection method seemed suitable. Nevertheless, as explained later in this section, various challenges were encountered when using this method in this study as a result of not giving sufficient consideration to the differences in economic development between New Zealand and Chile¹.

Scott-Kennel’s (2001) questionnaire was used as a starting point for building up the questionnaire since the study intends to assess her research model – specifically the underlying assumption that government policy plays a neutral role. Scott-Kennel’s (2001) questionnaire was reviewed in order to identify those issues that are not addressed in it and are important to assess in this study. As a result, three questions were added and two were adapted to suit the context of the study. Once the questionnaire was finished, it was translated into Spanish and then it was back-translated by a Spanish teacher.

The questionnaire was then pretested by two Spanish-speaking managers residing in New Zealand and four Chilean managers residing in Chile. The questionnaires were sent by email and comments were made by the respondents by email as well. A few comments were made and, as a result, some questions were modified. The modified questions were written in Spanish and then back-translated. The finished questionnaire, Spanish and English versions, were reviewed by the Ethics Committee of the University of Waikato and ethical approval was granted.

Along with the questionnaire, an invitation letter for potential participants was written and reviewed by the Ethics Committee of the University of Waikato. Once the
suggested changes from the review were addressed the final letter was translated into Spanish and back-translated by a Spanish teacher.

After considering both time and cost constraints, it was decided that potential respondents should be reached by using e-mail addresses. The cost of posting the invitation letter to potential respondents from New Zealand to Chile considerably surpassed the expected costs for data collection. Hence, instead of building up a mailing list using postal addresses, a mailing list using e-mail addresses was constructed. The directory constructed by the Commercial Intelligence Service, a division of Business Monitor International, entitled “Foreign Companies in Chile: 2003”, was used as a base to build the database. The directory listed a total of 1,187 firms, and provided e-mail addresses for a total of 745 firms. In order to get e-mail addresses for the remaining firms, Internet search engines were used to look for the web site of each firm and then look for the e-mail address of a senior manager, a total of 92 e-mail addresses was obtained. It was not possible to get the e-mail address of 350 firms. These 350 firms were contacted by post and the remaining 837 firms were contacted by e-mail.

A website for displaying the questionnaire was set up by a technician at the University of Waikato. The web-survey was checked several times to ensure that it was easy to answer, and no spelling and/or structure/form mistakes were present. With the web-survey in place, a unique web link was assigned to each firm. The next step was to personalize the invitation letters and include the unique web link. This process was done for a total of 1,187 firms.

During the period within which the invitation letters were sent an unexpected event occurred. About 50% of the e-mails sent did not reach the manager. This situation arose because the e-mail addresses were not current, either because the firm no longer existed or because the manager it was sent to no longer worked for the firm. In order to overcome the situation, an up-to-date database, which included an e-mail address and contact person for each firm, was bought. The invitation letters were sent to those firms that had not been contacted.
Regarding the invitation letters sent by post, 50 of them were returned from Chile. This return rate also reflects the fact that a considerable number of firms do not operate in Chile any more, or the manager it was sent to no longer worked for the firm or the firm had changed its address. For these firms, some were able to be contacted by e-mail since their current contact information was found in the database purchased. It is important to mention that this database included “all” the firms operating in Chile, including local firms. Hence, the original database was used in conjunction with the new one to contact these firms.

In addition, 30 firms replied to the invitation by e-mail indicating that they were not significantly foreign-owned firms. As a result, it was necessary to build a new database by eliminating those firms that had identified themselves as local firms and by updating the contact information of those firms that were not contacted the first time. A total of 900 firms were contacted either by e-mail or post. Those firms that were able to be contacted by e-mail were contacted three times. However, only five firms answered the web-survey.

In order to find out the reason(s) for this low response it was decided to contact some of the firms by phone to ask them the reason why they had not responded and to invite them to participate in the study again. Of the 20 firms that were randomly selected, it was possible to contact only 10 of them. From these, some had changed their phone number, others did not exist anymore, and a few did not answer the phone call. Those that were able to be contacted indicated that they forgot about the invitation or that they had been too busy. However, they agreed to answer the web-survey. A time-frame of 10 days was allowed for these firms to answer the survey, but none of them did, even though they said they were going to. This situation provides evidence that the main reason for the low response is a cultural issue (Harari & Beaty, 1990). Moreover, another important obstacle in contacting firms in Chile is the fact that there is a high rotation of managers (Los Recursos Humanos, 2006), which makes it very difficult to maintain up-to-date contact information. As a consequence, it was necessary to look for another way to collect the data.

The change of methodology from quantitative to qualitative, in this study, is mainly supported by the argument given by Marschan-Piekkari and Welch (2004) that
research methods need to be chosen to suit the particular location in which the study is being conducted. In the case of this study the challenges encountered suggest that Chilean managers are reluctant to answer questionnaires due to underlying beliefs in the Chilean culture. As pointed out by Harari and Beaty (1990), in some cultures there is particular emphasis on the development of social, face-to-face relations and trust, which applies to the Chilean culture.

In an assessment of various countries based on cultural dimensions, Hofstede’s (1980) analysis for Chile indicated that in the Chilean culture there is high concern for rules, regulations, and control – typically, a society that does not readily accept change and is risk adverse. He also indicated that Chile is a society of a more collectivist nature where strong relationships are of high importance. Accordingly, in Chilean business culture, interpersonal skills such as the ability to "fit in" and maintain cordial relations with the group are sometimes considered more important than professional competence and experience. Moreover, establishing trust and connecting as people is fundamental to successful business relationships (Executive Planet, 2009; International Business Center, 2008).

The implication of these cultural features of Chile is that, for research purposes, using an approach that does not recognize the risk aversion and the collectivist nature of Chilean society inevitably proves to be unsuccessful.

The following section explains the research methodology selection.

5.3.0 Methodology

5.3.1 Quantitative vs. Qualitative Approach

Thinking about natural and social phenomena can be framed in philosophical terms, with these terms manifest in the methodologies selected for research activities. There are some fundamental differences between quantitative and qualitative research. These differences primarily lie at the level of assumptions about research (epistemological and ontological assumptions) (Trochim, 2006).
Quantitative research reflects the traditional scientific approach to problem solving. It assumes that there is a single reality that can be broken down into variables, which help establish cause, effect and relationship between variables. The purpose of this type of research is to test hypotheses that have been developed before the research project started and to form conclusions that can be generalized to other situations. The emphasis in this approach is upon measurement, comparison, and objectivity (Hurmerinta-Peltomaki & Nummela, 2006). The purpose of a quantitative approach is to gather, analyze and measure statistical data. The questions asked are usually not of a complex nature and they are close-ended. It is possible to gather a large sample selection which meets the appropriate criteria for sampling size thus making it possible to generalize the findings from a sample to the whole population of firms (in whatever industry or industries are being sampled). Finally, the findings can be presented in the form of numbers.

In contrast, qualitative research is based upon the assumption that multiple realities exist in people’s perceptions of the world. For this reason, in order to understand phenomena, information from a wide variety of sources must be sought and combined in a meaningful way (Hurmerinta-Peltomaki & Nummela, 2006). One of the prime methods for obtaining information is by talking with people. The purpose of qualitative research is to gain deeper understanding of a phenomenon through the gathering and analysis of detailed data of ideas, feelings, motivations, and attitudes. It is achievable, among others, through conducting in-depth interviews in one or a limited number of firms in order to obtain comprehensive information (Tull & Hawkins, 1990). The emphasis in this approach is on description, uncovering patterns in the data, giving voice to the participants, and maintaining flexibility as the research project develops. Consequently, in qualitative interviews the questions are usually open-ended. The gathered empirical data is not easy to transform into numbers, and is best described in words (Tull & Hawkins, 1990).

The impact of FDI is normally thought of in terms of its static direct contribution to host countries. Indeed, most research has sought to explain the changes to net levels of investment and economic development at the macro-level (Potter, Moore & Spires, 2002). Within FDI research thinking a positivist view of the world is evident in the methodology and methods employed in research. The predominant use of research
tools such as surveys and statistical analysis to conduct and translate FDI research suggests that FDI phenomena are real and objectively definable, indicating a nomothetic methodology. This methodology suggests an ontology of realism in which reality is seen as external to the individual and a positivist epistemology in which knowledge is clearly true and false (Burrell & Morgan, 1979). This is consistent with the tendency in international business research to favour quantitative methods over qualitative methods. Indeed, Andersen and Skaates (2004) found that only 10 percent of all published international business research used qualitative methods.

Paradoxically, at the same time as qualitative research continues to be marginalized in practice, calls for more research of this kind are made at regular intervals (Marschan-Piekkari & Welch, 2004). Indeed, the Journal of International Business Studies has recently called for more papers using qualitative approaches, as stated by Anne Hoekman (A. Hoekman, personal communication, September 17, 2008):

“There is a great deal of awareness of the merits of qualitative research methods in international business, and recently there have been some attempts to bring it closer to the fore...Despite the efforts of some scholars and journal editors, the number of articles in leading journals using qualitative methods continues to fall. We would like to reverse this trend and use this Special Issue to bring qualitative methods back into the mainstream of international business research.”

As a result, certain arguments in favour of qualitative international business research have been popularized. Essentially, these arguments discuss the suitability of qualitative methodology with regards to the specific characteristics of international business research, in turn, validating the decision to adopt a qualitative approach in this study. First, qualitative research is less likely to suffer from cultural bias and ethnocentric assumptions on the part of the researcher than survey instruments (Wright, 1996). Compared to quantitative methods, qualitative research takes a more holistic approach to the research object and studies a phenomenon in its context. Second, research instruments need to be chosen to suit the particular location in which the research is being conducted. It is argued that qualitative research may be preferable in developing countries, where the secondary data required may be scant and/or respondents might be unfamiliar with questionnaires, and in those cultures in which trust and face-to-face relationships are of high importance. This was certainly the experience of the researcher in the case of Chile. Third, qualitative research goes
beyond the measurement of observable behaviour and seeks to understand the meanings and beliefs underlying phenomena – the “why” and “how”. Qualitative research provides answers to complex issues that are typical of international business research (Wright, 1996).

5.3.2 Research Paradigms

The most conventional paradigms available to researchers are positivism, realism; critical theory and constructivism (Burrell & Morgan, 1979). (Refer to Table 5.1.) The research paradigm is based on a number of key assumptions. The first of these to consider is the issue of ontology. In terms of ontology, it is necessary to consider how people view their world and to understand what they see as reality. Creswell (1994) indicates that multiple realities exist in any given situation – those of the researcher, those of the individuals under investigation, and the reader or audience interpreting the study. Therefore, to understand this world means that the researcher must represent or reconstruct the world as seen by others. The second philosophical issue prevailing in the research position is that of a suitable epistemology. Epistemology describes the nature of the relationship between the researcher and the subject of the research.

There are many proposed differences between quantitative and qualitative epistemologies; however, they lie primarily at the level of assumptions about research (epistemological and ontological assumptions) rather than at the level of the data (Trochim, 2006). Philosophical assumptions or theoretical paradigms about the nature of reality are critical to understanding the whole perspective from which the study is designed and carried out. A theoretical paradigm gives the underlying basis that is used to construct a scientific investigation since a paradigm is the “basic belief system or world view that guides the investigation” (Guba & Lincoln, 1994, p. 105).
<table>
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<th>Paradigm</th>
<th>Description</th>
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| **Positivism**               | - **Ontology:** Naïve realism: reality is real and apprehensible.  
- Assumes that science quantitatively measures independent facts about a single apprehensible reality (Healy & Perry, 2000).  
- Positivism holds the position that the goal of knowledge is simply to describe the phenomena that we experience. Hence, positivists separate themselves from the world they study.  
- **Epistemology:** objective, findings are true.  
- Positivism embraces a four point doctrine: (1) the rule of phenomenalism, which asserts that there is only experience; all abstractions have to be rejected; (2) the rule of nominalism – which asserts that words, generalizations and abstractions are linguistic phenomena and do not give new insight into the world; (3) the separation of facts from values; and (4) the unity of the scientific method.  
- **Methodology:** Experiments/surveys for verification of hypotheses, chiefly quantitative methods. |
| **Constructivism**           | - **Ontology:** Critical relativism: multiple local and specific ‘constructed’ realities  
- The constructivist posture contends that epistemologically, the inquirer, and the inquired, is interlocked in such a way that the findings of the investigation are the literal creation of the inquiry process. The constructivist, therefore, takes the position that the knower and the known are co-created during the inquiry.  
- **Methodology:** Hermeneutical/dialectical, the researcher is a “passionate participant” with the world being investigated. |
| **Realism (Post-positivism)**| - **Ontology:** Reality is ‘real’ but only imperfectly and probabilistically apprehensible; triangulation from many sources is required to try to know it.  
- It has elements of both positivism and constructivism (Healy & Perry, 2000): 1) Realism concerns multiple perceptions about a single, mind-independent reality; 2) Rather than being supposedly value-free, as in positive research, or value-laden as in interpretive research, realism is instead value cognizant; conscious of the values of human systems and of researchers; 3) Realism recognizes that there are differences between reality and people’s perceptions of reality.  
- **Epistemology:** Modified objectivist, findings are probably true.  
- **Methodology:** Case studies/convergent interviewing: triangulation, interpretation of research issues by qualitative and quantitative methods. |
| **Critical Theory**          | - **Ontology:** Historical realism: ‘virtual’ reality shaped by social, economic, ethnic, political, cultural, and gender values, crystallized over time.  
- **Epistemology:** Subjectivist: value mediated findings.  
- **Methodology:** Dialogic/dialectical: researcher is a ‘transformative intellectual’ who changes the social world within which participants live. |

Source: Adapted from Perry, Alizadeh and Riege (1997, p. 547).

Methodological decisions are not made in isolation, but are always related to the researcher’s assumptions of the phenomenon itself (ontology), the basis of the knowledge (epistemology), and the relationship between human beings and their environment (Burrell and Morgan, 1979). Thus, a researcher with a
positivist/objective approach emphasizes the methods and values of research in the natural sciences and is bound to adopt quantitative methods. On the other hand, a researcher with a constructivist/subjectivist orientation attempts to get as close as possible to the phenomenon in question in order to acquire a more hermeneutic understanding. This in turn, requires the use of qualitative methods (Burrell & Morgan, 1979).

**5.3.3 Methodology Selection**

The selection of a qualitative methodology for this study was driven by the challenges encountered during the data collection stage using a quantitative approach. Based on the reassessment of the context of the study as well as the research questions the selection of a qualitative, ideographic methodology was identified as the most appropriate. Within the philosophical range of ideographic methodologies there are a number of methodologies, such as those shown in Table 5.2, which, while overlapping significantly, have their own distinct characteristics. Of these methodologies, phenomenology was considered to be the most appropriate to investigate the research questions in its specific context.

The selection of phenomenology draws on the underlying ontology of nominalism and an epistemology of realism evident in the conceptualization of the process of local industry upgrading. These underlying indicators provided a basis for the philosophical and the practical framework for this study as illustrated in Figure 5.1. The conceptualization that provided the basis for this study was drawn from Scott-Kennel’s (2001) model of local industry upgrading through foreign direct investment. The concepts were revisited in the context of Chile by reviewing theory and empirical studies in foreign direct investment which resulted in an arrangement of constructs, in the research model, suggesting an epistemology of realism.

Working from a realist perspective implies observing the empirical domain to discover a “mixture of theoretical reasoning and experimentation” (Outhwaite, 1983, p. 332) knowledge of the real world, by naming and describing the generative mechanisms that operate in the world. Within a critical realism framework, both
qualitative and quantitative methodologies are seen as appropriate (Healy & Perry, 2000). Methods such as case studies and unstructured or semistructured in-depth interviews are acceptable and appropriate within the paradigm, as are statistical analyses (Perry et al., 1997). With realism, the apparent disagreement between quantitative and qualitative is replaced by an approach that is considered appropriate given the research topic of interest and level of existing knowledge related to it (Healy & Perry, 2000).

**Figure 5.1**

Framework suggested by research questions and context

```
Ontology  ➔ Nominalism
          (World View)

                      ➔ Realism

Methodology  ➔ Phenomenology
              (Ideographic)

Method  ➔ Case Study
```

The context within which this study was undertaken was significantly foreign-owned firms operating in the service sector in Chile. Understanding the complex issues influencing the level of embeddedness of the foreign affiliate in the local industry required getting close to the action to understand the reality of the individuals involved (in this study top managers at Head Office). In addition, the challenges encountered during the data collection process, while taking a quantitative approach and when contacting potential participants for the case studies, suggested that trust was a key issue for getting access to the information required for this study. Hence, to
achieve understanding the researcher needed to get close to the context of the research employing a methodology suitable for the investigation of social reality.

<table>
<thead>
<tr>
<th>Research Issues</th>
<th>Ethnography Qualities</th>
<th>Phenomenology Qualities</th>
<th>Grounded Theory Qualities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Context Issues</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Understanding of action and relationships required</td>
<td>Focuses on social relationships and phenomena</td>
<td>Investigates the direct experience of subjects</td>
<td>Uses a range of research approaches</td>
</tr>
<tr>
<td>Understanding of subject’s perceptions required</td>
<td>Focuses on the cultural significance of phenomena</td>
<td>Focuses on subject’s subjective experience of phenomena</td>
<td>Uses a range of research approaches</td>
</tr>
<tr>
<td>Need to get close to the context</td>
<td>Participant observation a key tool</td>
<td>Seeks to understand through subject’s experience</td>
<td>Uses a range of research approaches</td>
</tr>
<tr>
<td><strong>Question Issues</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Presence of a conceptual framework</td>
<td>Starts from theory to ground in the context</td>
<td>Draws on theory to identify phenomena and things</td>
<td>Seeks to discover new concepts and theory</td>
</tr>
<tr>
<td>Some theoretical basis for the question</td>
<td>Findings grounded in the reality of the social group</td>
<td>Assumes some theoretical basis for the question</td>
<td>Rejects a priory assumptions and theory</td>
</tr>
</tbody>
</table>


The search for a suitable methodology concluded with the qualities of ethnography, phenomenology and grounded theory being considered in terms of the research questions and context issues specific to this study. The comparisons between these methodologies are presented in Table 5.2.

From a contextual perspective the study required a methodology that would allow the researcher to get close to the context to discover the realities and perceptions of the respondents. Although all three methodologies seek, or can seek, a close relationship with the subject matter they focus on drawing different information from those relationships. Ethnography seeks to observe social and cultural information through participation (Fetterman, 1989); phenomenology seeks to identify phenomena and events through the experience of informants (Spiegelberg, 1970), while grounded
theory can utilize a variety of approaches (Strauss & Corbin, 1998). With their focus on experience of phenomena, as opposed to ethnography’s cultural and social focus, phenomenology and grounded theory appeared to be the most appropriate methodologies for investigation in the context of this study.

In consideration of the research questions, these are built on existing theoretical models of the process of local industry upgrading through FDI. On this basis, grounded theory rejects a priori theory, seeking to discover new concepts and theory from a zero base (Strauss & Corbin, 1990); ethnography draws on theory but seeks to ground findings in the subjective reality of the respondents (Baszanger & Dodier, 1997), and phenomenology assumes a theoretical basis for the identification of things and phenomena experienced (Crotty, 1998). Hence, grounded theory and ethnography appeared to be inappropriate to investigate research questions which sought to build on a specific theoretical framework. In contrast, phenomenology, in seeking to build and expand on existing thinking appeared more appropriate to address the research questions.

Phenomenology is one of a number of ideographic research methodologies which utilize qualitative information to understand what lies behind poorly understood social phenomena (Strauss & Corbin, 1990). Phenomenology calls for a focus on “the things themselves” in an effort to gain meaningful understanding (Alvesson & Skoldberg, 2000). Phenomenology seeks to view everyday objects and experience, principally through the medium of language, to explain how those objects and experiences are meaningful (Holstein & Gubrium, 1998). In pursuit of this understanding phenomenology draws on the richness of direct experience to heighten perception and provide new meaning or enhance former meanings (Crotty, 1998). This experience must be that of those who participate in the context of the research as no one can experience things on behalf of the participants (Crotty, 1998).

The following phenomenological principles (Crotty, 1998) provided a basis to address the research questions within the context of significantly foreign-owned firms in the service sector in Chile, these are:
1. In pursuit of a phenomenological methodology, the researcher strives to take a fresh look at the phenomena by probing in an effort to understand the subjective experience of research respondents.

2. Phenomenology builds on the initial contemplation of phenomena by repeatedly revisiting the experience of respondents as a benchmark to assist in the development of insight.

3. In the process of developing insight the researcher can take a sceptical view considering both the static and dynamic to build a progressive cognitive adventure.

4. Before phenomenology can be effective the researcher must first put aside his or her usual understanding or involvement with the phenomena being researched in order to be able to take a fresh view.

In sum, when evaluated from both the perspective of the context and the research questions, phenomenology was the most appropriate methodological approach among those considered for this study. While the principles of phenomenology define the essence of the research process, the actual process of collecting qualitative data to address the research questions required a specific framework and data collecting methods. These are described in the next section.

5.4.0 Research Method Selection and Design

Qualitative methods have been defined as procedures for coming to terms with the meaning not the frequency of a phenomenon by studying it in its social context (Van Maanen, 1983). Qualitative methods are particularly well suited to new research areas (Eisenhardt, 1989) and are appropriate when the requirement is to build new theories, synthesize existing theories (Ragin, 1989) or develop a theoretical framework which can then be subjected to hypothesis testing and quantitative analysis. Therefore, a qualitative strategy is appropriate since the process through which inward FDI influences local industry in Chile is not well understood, in the absence of prior research.
A variety of methods are available within the qualitative paradigm. Yin (1994) indicates that qualitative research requires more than one data-gathering instrument to accommodate the situations which arise in a research context. Hence, a method which uses a range of qualitative data-gathering instruments, borrowing from several qualitative methods, is essential. Knowing the principles of phenomenology and in consideration of the research questions and context, the case study was selected as a strategy for the data collecting and analysis process.

5.4.1 Research Method Selection

Ghauri (2004) indicates that case study is a useful method for gaining insight into an issue, a management situation or new theory. Case studies involve data collection through multiple sources such as verbal reports, personal interviews, observation and written reports. The main characteristics are therefore the depth of and focus on the research object. This approach relies on the integrative powers of research; the ability to study an object with many dimensions and then to draw the various elements together in a cohesive interpretation (Selltiz, Wrightsman, & Cook, 1976).

According to Yin (1994) case studies are a preferred approach when “how” and “why” questions are to be answered, when the researcher has little control over events, and when the focus is on a current phenomenon in a real-life context. The review of the characteristics of the present study using Yin’s (1994) criteria indicates that case study is a suitable research method. (Refer to Table 5.3)

Case studies keep with the principles of phenomenology by focusing on real life phenomena and events to observe and understand the experience of research respondents (Crotty, 1998). Case studies have the potential to deepen the understanding of the research phenomenon because of its contextuality and holistic approach. That is, case studies are particularly useful when the phenomenon under study is difficult to assess outside its natural setting, as is commonly the case in international business research. The case study method provides excellent opportunities for respondents and researchers to check their understanding and keep
on asking questions until they obtain sufficient answers and interpretations (Ghauri, 2004).

Table 5.3
Identification of Appropriate Research Method

<table>
<thead>
<tr>
<th>Yin’s Indicators</th>
<th>Characteristics of the Study</th>
<th>Yin’s suggested Research Strategies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Form of research question</td>
<td>Asks How?</td>
<td>History, <em>Case study</em></td>
</tr>
<tr>
<td>Requires control over behaviour?</td>
<td>No control</td>
<td>Survey, Archival Analysis, History, <em>Case study</em></td>
</tr>
<tr>
<td>Focuses on contemporary events?</td>
<td>Main focus on contemporary events</td>
<td>Experiment, Survey, <em>Case study</em></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Adapted from Yin (1994)</td>
</tr>
</tbody>
</table>

The concept of case study as a research strategy provides a framework within which specific research methods such as surveys, interviews, and observation can be applied. In this research the structured approach provided by case study facilitated data comparison across several sources within the study and facilitated a focus on understanding the dynamics present within individual cases (Maxwell, 1998).

The selection of cases to be examined, and the specific tools to be used in the collection of evidence and analysis processes, was made within the framework provided by case study strategy.

5.4.2 Case Study Design

After identifying case study as the best strategy for the study the processes of data collection and interpretation were planned. During the design process a number of issues were considered, namely the degree of prestructuring, definition of the unit of analysis, identification of case firms, and details of specific research tools. These issues were incorporated in the case study protocol.

Before fieldwork commenced, a case study protocol was constructed to establish the instruments to be used in evidence gathering and analysis. The case study protocol provided guidance and ensured consistency in the research process.
5.4.2.1 Degree of prestructuring

As noted by Maxwell (1998) a key decision when designing a qualitative study is to what extent the research methods should be decided in advance rather than developing or modifying these during the research. He further indicates that a loosely structured design is useful for exploring socially complex phenomena about which little is known and where high levels of induction are desirable, but such a design requires a considerable amount of time and resources. On the other hand, structured approaches can help to ensure the comparability of data across individuals, times, settings and researchers, and are thus particularly useful in answering questions that deal with differences between things. Hence, since this study deals with known phenomena in a familiar culture (with the researcher being Chilean) and intends to answer variance questions a pre-structured approach was considered appropriate (Miles & Huberman, 1994).

Moreover, a prestructured approach reduces the amount of data involved and simplifies the analysis required (Maxwell, 1998) and improves the potential for generalisability, comparability, and internal validation (Yin, 1998). This case study design was prestructured by identifying the empirical field for the study, the data collecting methods to be employed, and a framework for the management of the research (Yin, 1998).

5.4.2.2 Unit and levels of analysis and sampling decisions

The first step in the design process was to identify the unit of analysis for the study. The focus of the research is on assessing the indirect and direct linkages that foreign affiliates form with local firms, and through which they may influence the upgrading of local industry, as well as identifying factors that may influence linkage formation, making the foreign affiliates and their relationships with other Chilean-based entities the units of analysis. Specifically, the head offices of firms operating in Chile that are 25 percent or more foreign owned were the key source of evidence for the study. In addition to being appropriate to the research focus, the foreign affiliates and their relationships with other Chilean-based entities are the units of analysis identified in Scott-Kennel’s (2001) study thus their use in this study will facilitate comparisons
(Yin, 1998). Although it would have been more appropriate to include other entities (related to the foreign affiliates, but not by ownership) in the study, it was not possible due to constraints in time and resources (Maxwell, 1998). That is, using the Head Office of foreign affiliates as the main source of evidence implies that the assessment of linkages (relationships with other entities) is limited to the foreign affiliate’s perspective.

A multiple-case study design was selected to strengthen and potentially expand the analytic generalisations of the study (Yin, 1998). Theoretical or literal replication was used in the selection of cases in order to anticipate propositions across cases enhancing the external validity of this study (Yin, 1998).

Case studies are holistic (Ragin, 1989) in that each individual case represents an entire study in which convergent evidence is sought regarding the facts and conclusions for the case in relation to the theoretical framework. Guidelines for a reasonable number of cases and a basis for adequacy for the study have been established with reference to the literature.

Ragin (1989) argues that the case-oriented approach is limited in terms of the difficulty in maintaining attention to complexity across a large number of cases. He indicates that eight cases are a “modest number” and 20 cases are “thorough” (p. 20), while drawing attention to the associated number of possible comparisons which increase geometrically as the number of cases increase. The main criteria for determining the number of cases for this study was time and resources. The demands of a survey approach to case selection and management interviews in data collection were measured against the number of such firms in Chile. Given these limitations, a total range of eight cases was considered to be appropriate for this work.

In consideration to the objectives of the study and the diversity of the sample frame (significantly foreign-owned firms), it was decided to reduce the sample to certain industries. The industries selected were those that have received most foreign direct investment in the last three decades in Chile, namely mining; services; and electricity, gas and water (under the classification of the Chilean Foreign Investment Committee).
The cases included in this study belonged to the services sector\textsuperscript{11} (including electricity and water). Particular care was taken to ensure consistency among them.

The eight cases, which made up the study, were drawn from a database of significantly foreign-owned firms operating in the mining, service, and electricity, gas and water sectors in Chile. This database was compiled by the researcher by using the database constructed for the quantitative approach in conjunction with a list of foreign firms operating in Chile (classified into sectors) provided by the Chilean Foreign Investment Committee. Suitable cases were identified from published material, through consultation with the Chilean Foreign Investment Committee and local intermediaries\textsuperscript{12}. These firms were selected, based on geographic convenience and accessibility to the Head Office, from a database of potential firms compiled by the researcher. The Head Offices of all case firms were visited where the interviews were to be conducted. In addition, the researcher collected further additional and supporting evidence directly from firms and through the media.

Case selection was focused on specific criteria (see Table 5.4) which were considered appropriate to the selection of a purposive sample.

<table>
<thead>
<tr>
<th>Firm Criteria</th>
<th>Measure</th>
<th>Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belongs to either mining, service or electricity, gas and water industries</td>
<td>Main activity</td>
<td>Indicates that the firm operates in a sector where foreign direct investment is considerable; hence, potential impact in the local industry is likely to be observed.</td>
</tr>
<tr>
<td>Foreign ownership</td>
<td>25% or more of the voting shares or control of the firm is held by non-Chilean residents.</td>
<td>Confirms fit with the context of the research</td>
</tr>
<tr>
<td>Location</td>
<td>Head office located in Santiago de Chile</td>
<td>Geographically convenient for the researcher</td>
</tr>
</tbody>
</table>

This selection procedure provided a group of cases, which addressed theoretical and practical objectives. Being significantly foreign-owned suggested that they would
have O-advantages that differ from those of local firms thus presenting potential for influencing the local industry. Belonging to the mining, services or electricity, gas and water sector (sectors that concentrate most of foreign direct investment in Chile) suggested that there may be a similarity of practices among them, a possibility that enhanced the concept of theoretical replication (Eisenhardt, 1989; Yin, 1994). In addition to being likely to show the phenomena sought in the research question the firms were geographically convenient for the researcher, allowing ready, quick access to the appropriate date (Silverman, 2000).

Because the constant iteration between data collection and analysis is a key feature of much qualitative research, it is difficult and even misleading to separate a discussion on data collection from that on analysis (Welch, 2001). However, for reasons of methodological clarity these two processes are described separately in the following sections.

### 5.4.3 Data Collection

The case study protocol is a key tactic to increase the reliability of case study research; is intended as a guide for the investigator in carrying out the case study (Yin, 1994), and is essential when using multiple case study design. The case study protocol is the specification for a specific case study research project. As recommended by Yin (1998) the case study protocol included the following sections:

- Overview of the project (project objectives and case study issues)
- Field procedures (credentials and access to sites)
- Questions (specific questions that the investigator must keep in mind during data collection)
- A set of codes for data identification and analysis
- Analysis procedures
- Guide for the report (outline, format for the narrative)

A well-constructed protocol was the key tool in this research project, giving credibility to the process and the resulting theory. Consistently, changes in the case study protocol were made at an early stage of the data collection process in order to
avoid the risk of ignoring or distorting a discovery (Yin, 1998). That is, a type of relationship not included in the initial research propositions was noticed while interviewing the first case study which led to the inclusion of a specific question for subsequent cases. In addition, field procedures regarding initial contacts needed to be amended in order to ensure accessibility to top managers.

As determined in the case study protocol, two main sources of evidence were used to gather data, namely documentation and interviews. The use of multiple sources of evidence facilitated triangulation in data processing serving to enhance the construct validity of the finding (Yin, 1994). Each of these sources of evidence made its own specific contribution to the body of case study evidence. These data collection methods were selected after taking into consideration the six sources of evidence suggested by Yin (1998). Table 5.5 presents these methods indicating their strengths, weaknesses and suitability for the study. With regard to documentary information, it was obtained from a variety of documents, specifically:

- Written reports: i.e., annual reports
- Administrative documents: i.e. proposals, progress reports and other internal records
- Formal studies or evaluations of the same “site” under study
- Media: articles published in the international and national business media

Because case studies are usually about human behaviour and social processes, Yin (1998) regards interviews as one of the most important sources of case study information. For the investigation, personal interviews were conducted with appropriate top-level managers of eight foreign affiliates that operate within the service sector in Chile. Interviews were semistructured as they were controlled through the use of an interview guide listing the topic areas to be covered in the discussion. (See Appendix B.) The set of topics and questions were based on the questionnaire developed during the quantitative approach and on the preliminary conceptual framework and initial propositions. Interviews were controlled by the question guidelines not only in providing a general structure for the discussion, but also in ensuring that the same questions were addressed by each informant. However, flexibility existed in the interview process when areas of investigation that might not
have been foreseen or planned appeared to provide insight to the area of investigation. The adjustments in the current study were the addition of cases to probe particular themes or issues which emerge from previous cases. Changes of this nature were systematically identified and noted, together with the situations arising from them.

<table>
<thead>
<tr>
<th>Source of Evidence</th>
<th>Strengths</th>
<th>Weaknesses</th>
<th>Suitability</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Documents</strong></td>
<td>Stable, can be reviewed repeatedly</td>
<td>Risk of reporting bias, reflects (unknown) bias of author</td>
<td>Good</td>
</tr>
<tr>
<td></td>
<td>Unobtrusive, not created as a result of the case study</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Exact, contains exact names references and details of an event</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Archival Records</strong></td>
<td>(Same as above for documentation)</td>
<td>Access may be difficult due to privacy reasons</td>
<td>Poor</td>
</tr>
<tr>
<td></td>
<td>Precise and quantitative</td>
<td>retrievability can be low</td>
<td></td>
</tr>
<tr>
<td><strong>Interviews</strong></td>
<td>Targeted, focuses directly on case study topic</td>
<td>Risk of bias of interviewee</td>
<td>Good</td>
</tr>
<tr>
<td></td>
<td>Insightful, provides perceived causal inferences</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Direct Observation</strong></td>
<td>Contextual, covers context of event</td>
<td>Time-consuming</td>
<td>Poor</td>
</tr>
<tr>
<td></td>
<td>Reality, covers events in real time</td>
<td>Reflexivity</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Cost, hours needed by human observers</td>
<td></td>
</tr>
<tr>
<td><strong>Participant Observation</strong></td>
<td>Contextual, covers context of event</td>
<td>Access not likely to be available</td>
<td>Poor</td>
</tr>
<tr>
<td></td>
<td></td>
<td>A risk of investigator influence on events</td>
<td></td>
</tr>
<tr>
<td><strong>Physical Artefacts</strong></td>
<td>Insightful into cultural features and technical operations</td>
<td>Selectivity</td>
<td>Poor</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Availability</td>
<td></td>
</tr>
</tbody>
</table>

Source: Adapted from Yin (1998)

In order to obtain interviews a few adjustments during the process of contacting potential participants needed to be made in order to overcome challenges. Contacting firms was a very challenging process that required taking a different approach than the one indicated in the case study protocol. A new document was developed, prior to
contacting potential participants that guaranteed the interviewee total confidentiality and required the researcher to assume **personal** responsibility for any unauthorized usage of confidential information. This reflects the fact that approval from the *University of Waikato Ethics Committee* (obtained prior to the interviews) was apparently not deemed to be adequate in terms of confidentiality. In other words, institutional approval from a foreign university is not considered an adequate substitute for personal indemnity by participants in the research process in Chile. This characteristic reflects the risk aversion feature of the Chilean culture identified by Hofstede (1980) which indicates a high concern for rules, regulations, and control.

This document was developed in conjunction with a local lawyer. At the same time it was absolutely essential to contact potential candidates through someone that they knew. This approach implied building up a network of people that “promoted” the researcher and helped to get interviews with people they knew that met the selection criteria. As a result, 12 interviews were carried out from which eight firms were selected following the criteria that all of them must have a common factor that would facilitate cross-case analysis. The firms vary in size, country of origin, mode of entry and level of embeddedness, but all of them operate in the service sector (including electricity, gas and water).

Pilot case studies were not conducted as such. Nevertheless, the firms that were not included in the study, but were interviewed, provided the opportunity to refine the data collection protocol and the questions posed. Specifically, four foreign-owned affiliates were interviewed besides the eight firms included in this study.

Referral to the *“University’s of Waikato Handbook of Ethical Conduct in Research 2001”* was done continuously during the process of evidence collection in order to comply with the requirements established by the Ethics Committee\textsuperscript{14} at all stages of the research. Accordingly, each potential participant was initially contacted by the correspondent intermediary by telephone or in person. The intermediary provided the potential participant with a “participant information sheet” that gave the participant detailed information about the study, confidentiality issues, researcher details, supervisors details, sponsorship, and archiving. A guarantee of confidentiality was assured to the potential participant through a separate document signed by the
researcher as participants wished to hold the researcher personally liable for guarantees of confidentiality. Once the intermediary informed the researcher of the willingness of the potential participant to participate in the study, the researcher contacted the potential participant by telephone for confirmation and to set an appointment for a personal interview.

The question guidelines were e-mailed to participants several days before the scheduled interview to enable them to give thought to the areas of questioning and to allow access to specific data if required for some questions. Participants could also clarify before the interview any areas of questioning about which they were uncertain. At the time of the interview the researcher asked the participant to sign a consent form and a guarantee of confidentiality document. Interviews with case participants were conducted on an informal discussion basis using the interview question guidelines.

All participants were personally interviewed by the researcher. The interviews were of 40 minutes to 90 minutes duration. All interviews were tape-recorded for later transcription and supported by field notes taken during each interview. The field notes were systematically written up in memo form, and included in the analysis. Brief summaries were also prepared immediately following each interview, thereby combining reasonable immediacy with reflective review. These transcriptions, notes and summaries provided not only a basis for data analysis, but also served a number of other purposes including planning for the next interviews.

Seven of the eight case studies interviews were conducted in Spanish. To interview the participants in Spanish was not a challenge since the researcher is Chilean. One interview was done in English since the participant was a native from Canada and preferred to be interviewed in English when given the option. The interviews that were done in Spanish were transcribed in Spanish and then translated into English by the researcher. The transcripts were then back-translated by an Argentinean Spanish teacher residing in New Zealand.

Verbal transcripts and interview reports were corroborated using other sources of evidence (Yin, 1998). The interaction between the multiple sources of evidence was predetermined in order to minimize the potential weaknesses of the two sources of
evidence selected. The process of analysis consisted in collecting documentary information for each case firm accessible through various sources – such as media – before interviewing. The revision of documents pre-interview provided a basis for minimizing interviewee bias. That is when the interviewee provided information that did not match with the information contained in the documents the researcher looked further into the issue during the interview (not explicitly) in order to get the necessary understanding for resolving the contradiction. In addition, at the time of the interview additional sources of evidence were provided by the case firm. These documents were reviewed in conjunction with the previously gathered information.

5.4.4 Analysis Strategy and Methods

The most serious and central difficulty in the use of qualitative data is that the method of data analysis is not well formulated … the analyst faced with a bank of data has very few guidelines for protection against self-delusion, let alone the presentation of unreliable or invalid conclusion to scientific or policy-making decisions. How can we be sure that an ‘earthy’, ‘undeniable’, ‘serendipitous’ finding is not, in fact, wrong? (Miles, 1979, p. 591)

According to Ghauri (2004) to ensure that an interpretation is authentic, data analysis and data collection need to be closely interconnected during the life cycle of the case study research. Analysis in this study was not a consecutive activity, but was carried out concurrently with evidence collection process, as shown in Figure 4.1 (Phases 1 to 3), right from the first case/interview (Miles & Huberman, 1994). This approach enabled the researcher to identify new concepts and to improve the data collection techniques.

One problem in data interpretation may be the researcher’s non-native familiarity and mastery of the semantics and pragmatics of nonverbal and verbal communication strategies in the country where the research is being undertaken (Andersen & Skaates, 2004). The meaning of concepts, such as “power” or “organisational commitment”, vary significantly across cultures, while certain concepts such as “achievement” have no direct equivalent in some languages (Wright, 1996). All these issues have important implications for qualitative data analysis and interpretations, and hence the soundness of the conclusions. “Cultural/language errors” in the interpretation of data were avoided in this study. The researcher is a native from Chile\textsuperscript{15}, which facilitated
the interview process by allowing adaptation of questions and/or clarification of concepts according to the participants’ understanding.

In order to organize and manage the data, a digital folder was created for each case firm. Each folder included document files that included the transcript of the interview and a separate file for each source of data (articles, external studies, annual reports, etc.). Each file was coded\textsuperscript{16} for easy retrieval. This system was possible since most sources of data were stored in digital form. In order to include information that was in paper form, a computer file was created which included extracts of the document that were identified as useful during review.

Zalan and Lewis (2004) note that computer software is becoming increasingly popular for data analysis in qualitative research, and the expectation is that it should continue this way. Hence, in an attempt to enhance the quality of the analysis in this study Catpac software was used. Nevertheless, after several trials it did not seem useful. The software usefulness resides in its ability to identify themes and/or relationships within a text. That is, it is useful if the researcher is looking for “hints” in order to identify concepts and/or relationships. Since the research model used in this study clearly states the major concepts and relationships that are under study, the software did not fit the research requirements.

Before commencing detailed systematic analysis a loose “play with the data” (Yin, 1994), carried out concurrently with the transcription of recorded interviews and revision of field notes, provided preliminary ideas about what to analyze and what not to analyze. This process suggested the need for increased focus or additional evidence and so informed future interviews through revisions to the interview guide. The transcripts of interviews were referred back to informants for their comments. This practice provided an opportunity for informants to identify any inaccuracy in the transcripts and was a vehicle to extend informant involvement in the research process.

One of the major challenges of qualitative research is dealing with complexity (Zalan & Lewis, 2004) due to the use of multiple sources of evidence. Specific and systematic procedures were used to reduce, store, and manage the evidence for easy
retrieval. Figure 5.2 reflects the data reduction and analysis procedure used in this study.

While analysis may not form an isolated process, it evolves progressively. First, a description of each case study was made by showing how the component parts fit together according to the research model (Bernard, 1988). By building upon this description, it was possible to identify how the variables are connected together and how they influence each other (Miles & Huberman, 1994). The analysis started by coding and categorizing the evidence, then identifying trends and establishing findings. Classifying the data helped in the interpretation of the evidence and relating the information to the questions and conceptual framework. Finally, the data were integrated into an explanatory framework (Ghauri, 2004). Triangulation was used to build concepts and understanding of the research questions while contributing to validity and reliability (Yin, 1994). The techniques used for case study analysis are summarized in Table 5.6.

Phenomenological methodology, which framed the evidence collection process, implied the use of relatively non-invasive research methods, suggesting that evidence is kept intact, not condensed, with transcripts and source material read repeatedly in an effort to capture the essence of informant experience (Miles & Huberman, 1994). Within phenomenology, with its emphasis on understanding the person's experience of the world and his/her situation, the research methods are the methods of philosophy. Those methods include, for example, conceptual analysis; linguistic analysis; hermeneutical method and praxis; historical-critical method; literary philosophy; and formal logic. Nevertheless, this approach to analysis would have restricted the potential breadth of evidence processed given the limited human resources available for this study. For minimizing this limitation the evidence gathered was reduced, coded and analyzed using more specific methods than phenomenology suggests. Specifically, this study used coding, clustering, matrices and pattern matching as techniques for analyzing the data, an approach which may be more invasive than the methods used in philosophy. However, to maintain contact with the originality of the evidence through the analysis process connections and conclusions were reviewed in the context of the full interview transcripts and other supporting evidence.
Evidence was examined and classified in order to make connections between concepts as a basis to address the research questions (Dey, 1993). The identification of a general strategy for the case study analysis process provided a framework for the application of techniques of analysis to the evidence (Yin, 1994).

Yin (1994) notes that relying on theoretical propositions is a useful analytical strategy when the results from previous studies concerning the research questions are compared to the researcher’s findings from the case study and when “how” and “why” questions need to be answered. The research model used in this study put forward several theoretical propositions to assess how foreign direct investment influences local industry upgrading in Chile while also evaluating Scott-Kennel’s model (2001) suitability in the context of Chile. Hence, relying on theoretical propositions was the analytical strategy selected for this study. The detail in drawing on preconceived theoretical concepts to focus on informants’ real experience of phenomena provided a basis for a general analysis strategy.

Testing the propositions was done by cross-checking for commonality and integrating the data in one single framework through a meticulous case comparison. Ghauri (2004) asserts that the most important reason for testing propositions is to enhance our understanding and explanation, as this helps explaining under what conditions the propositions/model work and under what conditions they do not.

According to Oyen (1990), comparison in its broadest sense is defined as the process of discovering similarities and differences among social phenomena. There are several characteristics of the comparative method that are particularly consistent with the requirements of this study. First, the comparative method is a strategy where cases are examined as a combination of characteristics and each case is directly examined and compared with all other relevant cases in order to arrive at modest generalization concerning relatively narrow classes of phenomena. Second, the comparative method highlights variation of cases and requires explanation of this variation, thus is well suited for the task of building new theories. Third, it is common to work with small and theoretically defined sets of cases, with the boundaries of the study set by the researcher.
Across-case analysis (case comparison) was done by forming groups or clusters in order to identify trends. This technique involves inspecting cases and trying to put them into groups or clusters that share similar patterns of configurations or sorted according to some dimensions (Ghauri, 2004). For the purpose of this study, cases were sorted according to their degree of linkage. (For a detailed description of the clustering process refer to Appendix C.)

Another approach used is the strategy suggested by Miles and Huberman (1994, p.176): “stacking comparable cases” or “replication strategy” (Eisenhardt, 1989). According to this strategy, each case was written up using standard variables. Then matrices were used to analyse each case in depth, and explore the interrelationship between different factors. After individual case analysis the case-level display was “stacked” in a “meta-matrix”, which was then further condensed, permitting systematic comparison.

Pattern matching was also used within and across cases for relating several pieces of information (from one or several cases) to a priori assumptions (Yin, 1994). By finding a systematic or unsystematic pattern, propositions can be accepted or rejected (Ghauri, 2004). The pattern matching mode of analysis used the research model as a basis to identify themes, and constructs, in informant evidence within cases. These phenomena were further compared later in across-case analysis. The internal validity of the study was strengthened by the identification of pattern matches within and across cases (Yin, 1998).

A mixture of strategies was used (Refer to Table 5.6): case comparison based on pattern seeking, clustering, and matrices. Although these techniques can be identified individually, they were employed cohesively in an effort to achieve a flawless analysis process. Within these modes of analysis, ongoing reduction of data was done to increase the focus on key elements of the evidence. Less relevant evidence was put aside and the more relevant evidence was coded and classified. In addition to facilitating comprehension through the focus and reduction of data, modes of analysis employed graphic data displays as an aid to understanding. Graphical tools such as matrices and tables were used to illustrate the magnitude and relationships of constructs and phenomena identified in analysis. As data were continually reduced
and focused, regular reference to the original transcripts and field notes was made to ensure that data was not taken away from its contextual content.

Figure 5.2  Funnel of data collection, management and analysis

1. Gathering of Material
Annual reports, strategy documents, articles from media, analysts’ reports, interviews, field notes and miscellaneous documents

Theories, concepts and frameworks

2. Ordered Material
Data extracted from material considered relevant to/example of/evidence of a code concept

List of categories and subcategories and theoretical notes

Theoretical notes, describing and explaining emerging theory, Matrix displays.

3. Description and explanation
Data linked with concepts for each case study

Theoretical notes
Comparison
Matrix displays
Meta-matrices

4. Search for patterns across cases

Theories, concepts and frameworks

5. Linking explanations to theory

Theoretical inferences

THEORY

Source: Adapted from Zalan & Lewis (2004, p. 517)
Table 5.6
Techniques for case study analysis

<table>
<thead>
<tr>
<th>Techniques</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coding</td>
<td>Sorting data according to concepts and themes</td>
</tr>
<tr>
<td>Clustering</td>
<td>Categorising cases according to common characteristics (DOL)</td>
</tr>
<tr>
<td>Matrices</td>
<td>Provide a basis to consider case firms on a “variable basis” using the major conceptual categories and the specific variables within each category.</td>
</tr>
<tr>
<td>Pattern matching</td>
<td>Comparison between a predicted and an empirically based pattern</td>
</tr>
</tbody>
</table>

Adapted from Ghauri (2004), p. 118

5.5.0 Limitations of Methodology and Methods

The methodology, research method and research design for this study might be subject to criticism. These criticisms may suggest limitations in the research findings on ideological grounds or for practical reasons of validity and reliability. These potential limitations were acknowledged and efforts were made to minimize them during the selection of methodology, development of research design and when carrying out the study.

Trochim (2006) argues that researchers that consider themselves primarily qualitative or primarily quantitative tend to be almost as diverse as those from the opposing camps. There are qualitative researchers who fit comfortably into the post-positivist tradition common to much contemporary quantitative research. And there are quantitative researchers (albeit, probably fewer) who use quantitative information as the basis for exploration, recognizing the inherent limitations and complex assumptions beneath all numbers. And, increasingly, we find researchers who are interested in blending the two traditions, attempting to get the advantages of each. Significant diversity of epistemological views about the appropriateness of research approaches (Phillips, 1987) implies that, on ideological grounds, suggestions of limitations for this study may come from both extremes of qualitative and quantitative thinking.
The positivist/post-positivist extreme of epistemology may suggest that this qualitative research is based on “soft science” (Marschan-Piekkari & Welch, 2004). “Quantitative researchers” may see their approach as more rigorous and accurate. On the other hand, ideological schools such as post-modernism and post-structuralism may suggest that since each of us approaches our experiences from our own point of view, each of us experiences a different reality. Conducting research without taking this into account violates the fundamental view that defenders of post-modernism and post-structuralism have of the individual. Consequently, defenders of post-modernism and post-structuralism may be opposed to methods that attempt to aggregate across individuals on the grounds that each individual is unique (Trochim, 2006).

It was within this diversity of ideological views that the epistemology and methodology for this study were defined. Acknowledging alternative views served to strengthen the selection process. Indeed, international business research is richer for the wider variety of views and methods that the “quantitative versus qualitative” debate generates (Trochim, 2006).

Although the nature of quantitative research and qualitative research is quite different both aim to facilitate the advancement of knowledge through sound research strategies. The two primary criteria for soundness are reliability and validity (Pauwels & Matthyssens, 2004). Concerns regarding reliability and validity are applicable to all researchers, qualitative as well as quantitative.

Sitting alongside issues of reliability and validity is that of triangulation. Triangulation aims at the integration of multiple data sources in a multimethod design (Pauwels & Matthyssens, 2004). The basic assumption of triangulation is that the weaknesses in each single data collection method/source are compensated for by the counterbalancing strengths of another method/source. In practice, researchers can triangulate by data source, by method, by researcher, or by data type (Miles & Huberman, 1994).

For this research, to enhance the potential for validity and reliability, triangulation was considered at every stage of the process, from research design to writing up of findings. Specifically, this research project was triangulated by:
1. Data sources - interviewing various respondents on the same topic (data collection), as well as by the combination of primary and secondary data sources (data sources).

2. Analytical triangulation - by using dissimilar analytical methods (analysis).

3. Among different evaluators – reporting back to the research “stakeholders” (case firms) to ensure “peer” review and reliability.

According to Yin (1998), there are four tests when judging the quality of the design for the research: construct validity, internal validity, external validity, and reliability. Specific tactics for addressing these matters during research design, data collection, data analysis and composition were applied as indicated in Table 5.7.

<table>
<thead>
<tr>
<th>Consideration of Validity and Reliability</th>
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<td>Tests</td>
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<td><strong>Construct Validity</strong></td>
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<td><strong>External Validity</strong></td>
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<td><strong>Reliability</strong></td>
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Source: Adapted from Yin (1994, p. 33)

With respect to construct validity, the use of specific tools and processes strengthened the qualities of the concepts identified in the findings and their internal and external relationships. The use of multiple sources of evidence and “peer review” (key case informant) ensured that concepts were clearly understood and that the boundaries between them were defined. In addition, a chain of evidence was established for an external observer to be able to follow the source of any evidence throughout the study.
The internal validity of concepts was strengthened by the identification of patterns in evidence within and across cases, the challenging of emergent ideas with alternative explanations, and by using various manipulation techniques to categorize the evidence.

External validity, that is the potential generalization of findings, was enhanced by using replication logic in multiple case studies. The theoretical framework put forward in the research model was used for stating the conditions under which a particular phenomenon is likely to be found (a literal replication) as well as the conditions when it is not likely to be found (a theoretical replication). High external validity is difficult to obtain since people might be answering incorrectly. This possibility was taken into account by ensuring that the respondent was an appropriate and knowledgeable person to interview, and also by offering anonymity to the firm and to the respondent.

With regard to reliability, the underlying design and prestructuring of the study clearly identified the procedures used in the research process. The use of a case study protocol (and its modifications) to specify these procedures ensured the consistent application within and across cases while the maintenance of a case study database ensured consistent retrieval of within – and across – informant evidence. In addition, the reliability in this study was increased by sending out a preliminary variant of the interview guide to the respondents to prepare them for the interviews.

In summary, during the identification of the methodology, the method selection and the design and tools selected for the study potential criticisms were kept in mind. The research design laid the foundation for the study in which the boundaries of evidence collection were clear, methods facilitated a clear connection between evidence and finding and in which the design and execution of the study were consistent with the research questions, context and research objectives.

5.6.0 Conclusion

This chapter has sought to describe the “methodological journey” of this study. First, it presented the initial research approach, quantitative methodology, by describing the various steps undertaken and the issues to be considered for data collection as well as the challenges encountered during this process.
The challenges encountered by using quantitative methods (an online survey) triggered the reconsideration of the research context and research questions that ultimately led to a change in methodology. In selecting an appropriate methodology, research method and specific research tools for this study, particular care was taken to consider the previously experienced obstacles, the research objectives and the production of reliable findings.

Specific characteristics of qualitative methodology addressed the particular requirements of this study thus validating the decision to adopt a qualitative approach. First, studying a phenomenon in its context means qualitative research is less likely to suffer from cultural bias and ethnocentric assumptions on the part of the researcher than the use of survey instruments. Second, it is argued that qualitative research may be preferable in developing countries, where the secondary data required may be scant and/or respondents might be unfamiliar with questionnaires, and in those cultures in which trust and face-to-face relationships are of high importance. Third, qualitative research provides answers to complex issues that are typical of international business research by providing the means for answering “why” and “how” questions.

Within the qualitative, ideographic, approach a range of methodologies were considered from which phenomenology was selected as the most suitable for this study. Phenomenology allowed a focus on the depth of understanding that the research questions demanded. In addition, phenomenology’s quality of drawing on existing theory allowed the use of a previously conceived research model to frame the study, and facilitated a grounding of the findings in existing thinking.

The case study method proved to be an efficient vehicle for deploying a variety of research instruments, within a phenomenological framework, in the research context. The structured approach provided by case study facilitated data comparison across several sources within the study and facilitated a focus on understanding the dynamics present within individual cases. The selection of cases to be examined, and the specific tools to be used in the collection of evidence and analysis processes, was made within the framework provided by case study strategy and incorporated in the case study protocol during the study’s design process. This prestructured framework
provided consistency that extended into the analysis process and provided a framework for reporting the findings.

The design and execution of the study has endeavoured to provide a better picture of the process of local industry upgrading through FDI. The validity and reliability of the study’s findings are reinforced by the inclusion of specific research design features to address such concerns. In addition, particular actions were taken for ensuring high ethical standards in accordance with the “University of Waikato Handbook of Ethical Conduct in Research, 2001”.

The most significant contribution of this phase of the thesis was the presentation of the various challenges encountered during data collection that triggered the change in methodology. This occurrence highlights the importance of being open-minded and going beyond the “qualitative-quantitative” debate in order to obtain reliable and valuable evidence by considering the specific requirements posed by the research questions and context.

The following chapter presents the results from the case studies. The results are presented in individual case studies according to the major concepts identified in the research model.

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1 Differences between New Zealand (a developed economy) and Chile (a developing economy) translate into differences in terms of infrastructure and culture, which are relevant for data collection. While New Zealand has reliable business directories, a developed and reliable postal system and managers who are accustomed to questionnaire surveys Chile, on the other hand, does not have reliable business directories, less efficient postal systems and managers are concerned about issues of trust and confidentiality, which makes the administration of postal survey questionnaires difficult.

2 Each firm was assigned a unique web link for follow-up purposes. By using the unique link the participant could be identified, hence was not invited again.

3 The database is contained in a CD, with up-to-date contact information, built by Tinternet08. The CD was bought from the firm’s office in Santiago, Chile.

4 Financial support was received from the University of Waikato Management School.

5 Hofstede identified five basic cultural dimensions to compare countries values and practices, and categorized a wide range of countries based on these dimensions by assigning a country score. For a detailed description of these cultural dimensions and country scores refer to [www.geer-hofstede.com](http://www.geer-hofstede.com) or Hofstede, Geert. (1980). *Culture's Consequences, International Differences in Work-Related Values (Cross Cultural Research and Methodology)* Newbury Park, CA: Sage.
6 Essentially, ontology is’ reality’, epistemology is the relationship between that reality and the researcher and the methodology is the technique used by the researcher to discover that reality.

7 One of the objectives of the present study is to identify firm characteristics that might be associated with a higher degree of linkage. In order to do this, variance questions are used.

8 Refers to other, unrelated by ownership, Chilean-based competitors, suppliers, subcontractors, agents, customers, licensees, franchisees and collaborative partners.

9 The researcher resides in New Zealand and it was required to go personally to Chile to interview managers in Chile. The costs involved in going to Chile were partially financed by the Department of Strategy and Human Resource Management, Waikato Management School, The University of Waikato. Besides limited availability of financial resources time constraint was also a determining factor in the selection of number of cases to be included since the researcher was only able to stay in Chile for a period of 10 weeks.

10 1) To assess Scott-Kennel’s model in the context of Chile, 2) to assess direct effects of FDI over the affiliate, 3) to assess indirect effects via linkages and identify the factors influencing linkage formation, 4) to assess the overall degree of linkage of the affiliates in the local industry.

11 There is no clear-cut definition of services thus no commonly accepted definition exists. This study consider as services all economic activities included under the “tertiary sector” in the United Nations International Standard Industrial Classification (ISIC). The broad categories of services in this classification include electricity, gas and water supply (UNCTAD, 2004).

12 As explained in the data collection section of this chapter it was necessary to contact firms through intermediaries.

13 The type of relationship identified was Corporate Social Responsibility (CSR), which refers to a non-equity relationship between the foreign-affiliate and a local entity (institution, firm and/or university).

14 The university’s ethics approval was required before fieldwork proceeded. This approval was sought by the researcher and granted by the University in 2006, ethics approval number WMS 06/81.

15 In addition to being born in Chile, the researcher has completed a bachelor’s degree in management and economics at a Chilean university. This facilitated the interviews by being able to communicate in “professional-Spanish” language. At the same time since the researcher has completed a Master degree in International Business at a New Zealand University meant the researcher had the ability to accurately translate the evidence into English.

16 For instance, case study 1’s folder included 9 files. The interview transcript was coded 1.1. The first number (1) indicates the case number while the second number (1) indicates the number of the file. Number 1 file was given for every interview transcript, i.e. Interview transcript of case two was coded 2.1.
Chapter 6  Within-Case Analysis and Findings

6.1.0 Introduction

This chapter presents the findings of within-case analysis in each firm. Understanding of individual cases drawn from within-case analysis provided the foundations for across-case analysis and the findings of the study. Within-case analysis for each case was carried out concurrently with data collection using the research tools discussed in Chapter Five, Research Methodology. Analysis of the case data concurrently with data collection resulted in an increasing focus in data collection as past analysis informed future field work. As a result, a high level of detailed insight has been achieved.

Both the data collection and analysis processes were framed using the research model (Chapter Four) and case study protocol (discussed in Chapter Five). As analysis and data collection proceeded using predetermined instrumentation, new concepts were discovered. That is, affiliates’ characteristics, indirect and direct linkages and determinants of linkage formation revealed themselves, including an unexpected type of linkage, namely “social responsibility” linkage. This type of linkage was identified during case analysis number four, which highlighted the firm’s social responsibility policy and how it has influenced its level of embeddedness in the local economy. This type of linkage does not fit the categorization of linkages included in the research model since, while it results in a positive impact on the local industry, it does not necessarily involve a relationship with a nonrelated entity. As a result, subsequent fieldwork involved the collection of additional data for previous case studies in addition to the inclusion of social responsibility questions in remaining interviews.

The case reports below are presented in the sequence in which fieldwork was undertaken. In order to facilitate understanding of the concepts under study and cross-case analysis, each case study report is divided into sections based on the concepts included in the research model, namely affiliate profile, indirect linkages, direct linkages, determinants of linkage formation, and degree of linkage. The affiliate profile includes the firm’s characteristics while identifying the impact of the parent
firm on the affiliate. The Indirect Linkages section provides an overview of the competitive environment of the sector, which the affiliate is operating in, and presents the influence that the affiliate has had on it. Direct Linkages includes the extent and quality of linkages formed with nonrelated (by ownership) firms such as agents and customers, suppliers, collaborative partners, and other entities. Next, the determinants for each type of linkage are presented. Each report concludes by considering the overall degree of linkage of the affiliate based on the categorization presented in the research model.
6.2 Case 1: BK (Chile), Legal Services

Affiliate Profile

This firm is an office of a global law firm from the United States, BK. Previously it was a local law firm that had been operating in Chile for more than 30 years. After a long relationship with BK, the local firm merged on July 1995 into the international law firm (1.3, p.3, 4).

BK came to Chile for market-seeking reasons. Specifically, since Chile was undergoing a period of rapid growth a considerable number of international firms were entering the Chilean economy and “there were many kinds of transactions that needed very sophisticated procedures” (1.1, p.1, 45). Accordingly, since the merger “the Chilean office mainly focuses on the legal management of big companies and investment associations” (2.1, p.1, 10-11).

BK (Chile) is one of 60 offices that BK has globally. The office is totally integrated into the global network. As a result, BK (Chile) is not autonomous with regard to the decision-making process since “decisions are made in conjunction” (1.1, p.1, 37) with the parent firm.

In terms of resources BK (Chile) has “the same processes, technology, and the same training systems” (1.1, p.1, 16-17) as the parent firm. In addition, it has complete access to BK’s global network. These resources constitute competitive advantages for BK (Chile). For instance, “the quality of the training is way superior to the training given by competitors” (1.1, p.2, 30) as a result it has human capital of international standards, “with a legal team licensed both in Chile and in other international jurisdictions” (1.6, p.1, 15-16).

The integrated international network of offices provides “a cohesive, efficient and cost effective service for companies doing business in more than one jurisdiction” (1.3, p.2, 19-20); in turn, “no other law firm in Santiago can offer a network of such maturity, sophistication and global coverage” (1.3, p.2, 22-23). Information and communication technology (ICT) have been an essential element supporting BK’s
global network. By using ICT BK (Chile) is able to share resources with BK’s worldwide network, which enables BK (Chile) to “offer services that are more sophisticated because we are highly integrated and can rely on global experience and expertise” (1.1, p.3, 40-41).

As the only foreign-owned law firm in Chile, BK (Chile)’s way of operating is innovative in many respects. By having access to BK’s global network, the affiliate is able to offer “a rare combination of local and international experience necessary to serve clients in today's global economy” (1.6, p.1, 19-20). In other words, BK (Chile) has introduced global experience in the legal services sector, which has translated into the affiliate being “clearly recognized as one of the best in corporate, mergers & acquisitions, commercial and banking and finance areas. “We are also noted for our work in bond and equity issues and commercial lending transactions” (1.6, p.1, 21-23).

**Linkage Formation: Indirect Linkages**

The increasing openness of the Chilean economy has triggered important changes in the market. The number of foreign firms doing business in Chile, as well as local firms doing business abroad, has increased. As a consequence, “the need for legal services at a corporate level has increased and so has the number of law firms in Chile” (1.1, p.3, 21).

Apart from BK (Chile) there are no other foreign-owned law firms in Chile. There are some that have associations with foreign firms, “but they are not integrated” (1.1, p.2, 25). In other words, big international law firms are not present in Chile. Nevertheless, there are some local players that are well established and constitute major competitors of BK (Chile).

BK’s growth, “both internationally and in Santiago, has been dramatic over the last decade. “We have expanded to follow developing trade and investment patterns” (1.3, p.2, 11-12). As a result, BK (Chile) “is among the largest law firms in Chile and a
key player in some of the largest business transactions in the country” (1.6, p.1, 14-15). Its strength is in commercial law, corporate law, and real estate law (1.2, p.1).

BK (Chile) has served as “a bridge for more sophisticated ways of operations” (1.1, p.3, 23). However, local competitors “have other sources” (1.1, p.3, 41) of expertise and knowledge, specifically through associations with international law firms; hence, “they do not copy” (1.1, p.3, 40) the affiliate’s way of operating. Rather, the presence of BK (Chile) has influenced the legal service sector by raising the quality and range of services provided to local and foreign firms.

**Linkage Formation: Direct Linkages**

**Backward Linkages and Local Sourcing**

In line with the service nature of the affiliate’s main activity, information and communication technology and human resources (training) are the main specialized inputs it requires for its operations. Technology is obtained from the parent firm; hence, it is not acquired locally. With regard to human resources, training is also provided by the parent firm through several mechanisms such as online training courses and overseas training.

In terms of local sourcing, BK (Chile) sources a range of standardized services and products that are not relevant to the main activity of the firm, such as “electricity, furniture, cleaning services, etc.” (1.1, p.2, 9).

In sum, BK (Chile) has not established backward linkages with local suppliers.

**Forward Linkages**

BK (Chile)’s customers range from individuals to large corporations. However, its focus is on big companies, both foreign and local. BK (Chile) “represents a large number of foreign firms and has been involved with many of them since their establishment in Chile” (1.6, p.1, 42). The service provided to these firms involves “assist[ing] our clients” (1.1, p.3, 4) by providing “legal support” (1.3, p.3, 31). For
example, in the banking sector, its involvement with clients “ranges from establishing a bank in Chile to day to day compliance with banking regulations to complex financing transactions including swaps; American Depository Receipts, aircraft financing, leaseback finance, among others” (1.6, p.2, 12-14). With regard to corporate clients, BK (Chile) gives regular “advice on matters related to the Commercial and Corporations Codes and on regulations issued by the Superintendence of Stocks and Insurance” (1.7, p.1, 12-14).

On the whole, BK (Chile) has established long-term relationships with its clients, specifically large corporations, by giving ongoing assistance to them. In other words it has established a considerable number of forward linkages with its clients.

**Corporate Social Responsibility**

In terms of social responsibility, BK (Chile) as a firm has not been involved in any project or association. However, a percentage of its attorneys are “involved in a wide range of other activities including lecturing in various facets of the Law at some of Chile's most respected universities and participation on the Boards of Directors of some of Chile's largest companies” (1.3, p.2, 33-35). In addition, some of its attorneys are associated to the Chilean Institute of Tax Law – an independent entity whose objective is to do research studies in order to upgrade Chilean tax law (1.5, p.1). For instance, “we have even helped draft legislation, such as the outsourcing laws” (1.6, p.4,30).

Although BK (Chile) has not got involved in one-to-one relationships with local firms, the willingness of its attorneys to share their knowledge and experience with local institutions implies that there is “spillage” of knowledge to the local economy.

**Collaborative Agreements**

BK (Chile) has not established collaborative agreements with local firms or any firm operating in Chile.
Determinants of Linkages

Backward Linkages and Local Sourcing

BK (Chile) has not established backward linkages since BK buys “at a global level for the whole corporation” (1.1, p.2, 5-6) for two main reasons. First, through global contracts the cost of technology is lower than if each affiliate acquires technology on its own. Second, “if every office uses another type of software we wouldn’t be able to be as integrated as we are now” (1.1, p.2, 7-8). Hence, the strategy of the parent firm has determined the absence of backward linkages of BK (Chile) with local firms.

Forward Linkages

Overall, BK (Chile)’s relationship with a particular client depends on the type of service provided to the customer. Nevertheless, a considerable number of these relationships are long-term as demonstrated “by the strength of our client list across the full commercial spectrum” (1.3, p.2, 32).

The economic environment of Chile, in terms of economic conditions and quality of institutions, as well as the regulatory framework has motivated large foreign firms to enter the Chilean economy; these require ongoing assistance with regard to local regulations. As a result, BK (Chile) has established forward linkages with a number of these firms. In other words, the economic environment has influenced the extent of forward linkages that the affiliate has established in Chile. However, it is the “assistance” nature of the main activity of BK (Chile) that leads to long-term, high quality, linkages.

It is important to notice that although the economic environment in Chile has positively influenced the formation of linkages between BK (Chile) and predominantly “foreign” firms, it has not played a determining role on the extent of forward linkages with local firms.
Corporate Social Responsibility

The quality of “law education in Chile is not at international standards, it needs to be modernized” (1.1, p.4, 24-25). As a result, BK (Chile) has a strong focus on training; hence, it has attorneys of high quality. By teaching at universities and participating in research projects, BK (Chile)’s attorneys are able to “assist in the academic, and regulatory life of Chile and keep abreast of developments within Chile in order to provide advice which is both practical and relevant” (1.3, p.3, 2-3). In other words, the quality of law education in Chile has motivated BK (Chile) to get involved with local entities in order to help improve law education.

Knowledge and Collaborative Agreements

The firm has not made a direct attempt to improve law education in Chile since “the problem is that the resources are limited…in Chile, teachers are not the best lawyers and it is because of an economic reason, they are not well paid” (1.1, p.4, 43-46). Hence, the economic environment relevant to the legal sector, in terms of education, discourages the affiliate from establishing higher-quality linkages.

Although BK (Chile) perceives that law education in Chile is not high quality, FDI restrictions in terms of expatriate employees are not perceived as such since “the product has to be adapted to local conditions so you need locals” (1.1, p.4, 39-40). In addition, the local legal framework establishes that foreign lawyers are not allowed to practice in Chile if they do not have a law degree from Chile. This situation implies that BK needs BK (Chile) to operate since it needs locally certified lawyers to practice law in Chile. Regarding other aspects of FDI policy, they do not affect the operations of BK (Chile).

In relation to the potential to establish collaborative agreements with firms in “related industries”, these have not been the interest of BK (Chile) since “We do not have fixed agreements. When a client comes to Chile and doesn’t know the market and they ask for service firms we give them alternatives but we do not offer a specific firm” (1.1, p.2, 16-18). That is, the strategy of the firm has influenced it not to establish long-term relationships with other services firms (auditing, marketing).
In conclusion, it is neither the regulatory framework nor the capability of local firms that discourages the establishment of high quality linkages, but the global strategy of BK and the quality of education.

**Degree of Linkage**

The following table summarizes whether the different types of linkages are established by BK (Chile) and their correspondent determinants.

<table>
<thead>
<tr>
<th>Type of Linkage</th>
<th>Yes/No</th>
<th>Determinants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Backward Linkages</td>
<td>No</td>
<td>Strategy</td>
</tr>
<tr>
<td>Forward Linkages</td>
<td>Yes, but most with foreign firms</td>
<td>Extent: Economic Environment (economic conditions, quality of institutions) Quality: Main activity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Economic Environment (Education)</td>
</tr>
<tr>
<td>Corporate Social</td>
<td>Yes</td>
<td>Economic Environment (Education)</td>
</tr>
<tr>
<td>Responsibility</td>
<td></td>
<td>Strategy</td>
</tr>
<tr>
<td>Collaborative Agreements</td>
<td>No</td>
<td>Economic Environment (Education)</td>
</tr>
</tbody>
</table>

From the table it can be observed that the degree of linkage of BK (Chile) is moderate, following the categorization proposed in the research model. This outcome is consistent with the proposition in Table 2.3 (Chapter 2) which establishes that market-seeking investment has the potential for moderate integration into the local economy.
6.3 Case 2: ABC (Chile), Financial Services for the Wholesale Sector

Affiliate Profile

This firm is a branch of a Dutch bank. ABC (Chile) was established in Chile in April 1990 by buying a bank license from a local family. It did not acquire an established bank, but a “right” to establish one. Hence, it started its operations through Greenfield investment.

The firm first came to Chile motivated by “the big inflow of foreign capital and the potential for developing the small and medium size companies sector and the retail sector” (2.1, p.2, 11-12). The characteristics of the Chilean market stimulated the foreign bank to invest in Chile. In other words, ABC’s motive for investing in Chile was market-seeking. Although the bank achieved a strong presence by having “about 27 branches in Chile” (2.1, p.2, 13-14), in the year 2000 the parent firm decided to sell these branches and kept the portfolio of small and medium enterprises (SMEs). Again in 2005, “the parent firm decided to reduce the number of firms and only kept a small number which operate in the wholesale sector” (2.1, p.2, 18-19). Since then “in accordance to the global strategy defined by its parent firm, the bank in Chile focuses on corporate banking and on the treasury business” (2.6, p.1, 14-16). Hence, the main activity of ABC (Chile) has changed over time as a result of the change in the global strategy of the parent firm.

ABC (Chile) is part of a global network that is organized in business units. These business units “are responsible for managing a distinct region, client segment or product segment, while also sharing expertise and operational excellence across the Group” (2.10, p.1, 29-30). As a result, the Chilean affiliate reports to the business unit it belongs to as well as to the parent firm due to the matrix organizational structure of the group. This situation results in a limited autonomy of the Chilean affiliate to make decisions since “there is a need for global coordination” (2.1, p.3, 39-40).

In terms of size, ABC (Chile) is a small player in the local market. It has 150 employees and a market share in terms of total assets of “0.36% in December 2006”
because “in accordance to the global strategy defined by its parent firm, from 2006, the bank in Chile focuses on corporate banking and on the treasury business. Traditionally, both activities have been the most profitable for the bank at the global level” (2.6, p.1, 14-16).

ABC (Chile) gets “a wide range of products and services…from the bank overseas” (2.1, p.3, 24-25). All the technology comes from the parent firm, “all the software and programs are the ones that the parent firm uses” (2.1, p.6, 20-21). Moreover, training is done at a global level since “there is focus on training locals at an international level” (2.1, p.7, 5). These resources are obtained from the parent firm either directly or through the Latin American business unit.

The resources obtained from the parent firm, coupled with the global nature of the bank, “allows offering local experience that is complemented with the expertise of work teams located in the main financial centres of the world” (2.8, p.1, 20-21). By making use of the parent firm’s global reputation and expertise, ABC (Chile) enjoys competitive advantages in terms of “value added such as quality, transparency, and strong brand recognition locally and internationally.” (2.1, p.9, 24). The affiliate offers “products and services that are more sophisticated than what others offer” (2.1, p.4, 19).

ABC (Chile) has introduced innovations to the Chilean financial sector in terms of global financial solutions. For instance, it introduced the idea of financing major investment projects by issuing bonds on the New York financial market. These kinds of innovations have been made possible by the use of expertise and international experience of the parent firm’s business units around the globe. The parent firm’s “global operational structure maximizes the allocation of capital and resources and assures that [the bank] optimizes the supply and development of products” (2.8, p.3, 22-23). The executives of the bank “focus on offering innovative financing solutions, adapting them to the specific needs of the client. These executives are strategically located around the world working hand in hand with local executives” (2.8, p.3, 28-30). As a result, “diverse financing solutions for companies have been introduced in the financial sector. The traditional notion of bank credit has been challenged by new ways of financing such as bond issues and asset securities” (2.2, p.5, 12-14).
Linkage Formation: Indirect Linkages

There have been important changes in the Chilean banking sector as well as at the affiliate’s level. “In only twenty years the Chilean banking sector experienced the worst economic depression of the Chilean history and became the stronger sector in Latin America” (2.2, p.1, 1-3). In terms of numbers, “the number of banks in Chile has decreased from 55 in 1980 to 26 in 2003” (2.2, p.4, 6-7). This considerable decrease in the number of banks was the result of several mergers within the sector since “there was no longer the need to direct big amounts of money” (2.1, p.1, 36-37). After major changes in the industry, 40% of the market nowadays, in terms of total assets, is in the hands of foreign banks, with 30% belonging to one Spanish bank. This is, there are only a few big players that focus on serving a wide range of customers. The other banks focus on serving niche markets.

ABC (Chile) has also changed its position in the sector since it first invested in Chile. It started its operations by having 27 branches nationwide to serve individuals as well as SMEs. But in the year 2000 the parent firm decided that all the branches that were focused on servicing individuals had to be sold. These branches were sold to another foreign bank. “After that a portfolio of about 500 to 600 SMEs was kept. But then about 2 years ago (2005) the parent firm decided to reduce the number of firms” (2.1, p.2, 18). Currently ABC (Chile) does not have “individuals or medium firms as clients anymore. So, basically the bank is very well positioned in our niche market which is the wholesale, which are the big corporations in Chile” (2.1, p.3, 44-46). The objective for serving this segment is to leverage off the global profitability and positioning of the bank in financial services at the expense of market share in terms of assets volume. “As a consequence, ABC (Chile) has encountered a decrease in its market share being only 0,36% in December 2006” (2.6, p.1, 23-24). “In order to have more opportunities in the financial market in Chile the most successful banks are those that have a wide range of services and customers, since Chile is an investment grade country" (2.1, p.2, 36-37).

Although ABC (Chile) is small in terms of size, market share, and range of operations it does influence the banking sector by introducing new types of financing as well as international standards of business practices, in particular it states “we are proud of
[the fact] that they copy our transparency and do things well” (2.1, p.6, 2). For instance, ABC (Chile) was one of the first banks in Chile to participate in the “Principios del Ecuador” project, which establishes guidelines that are voluntarily followed by banks, for the assessment of social and environmental impacts of projects and/or firms financed by banks. “In Chile, only some foreign-owned banks follow these guidelines” (2.4, p.4, 1).

**Linkage Formation: Direct Linkages**

**Backward Linkages and Local Sourcing**

In terms of ABC (Chile)’s suppliers, the range of services and products that it sources locally are standardized products and services that are not directly related to the activities of the firm, for example, “maintenance services, cleaning services, electricity, internet, etc.” (2.1, p.6, 14-15). These products and services are widely available, reliable, and of good quality. However, in terms of specialized products and services, “in general, the suppliers of MNEs are also MNEs. This is because usually contracts are made at a global level, at the parent firm level, to supply the whole network, especially in terms of technology” (2.1, p.7, 21-24).

ABC (Chile) gets the technology from the parent firm “because of an internal policy. It is just because we all want to talk the same language in terms of ICT, we use the same systems around the world so anyone in the world that is part of ABC understands what we are saying because we have our own coding that is embedded in these systems” (2.1, p.7, 14-16).

Another relevant input of ABC (Chile) is market research studies. These studies are made at a regional level through outsourcing. However, the firms that provide the service are not Chilean firms, but firms that operate globally. Hence, ABC (Chile) has not established backward linkages with local suppliers.
Forward Linkages

ABC (Chile)’s clients are big corporations that mainly operate in the wholesale sector in Chile. These corporations are either foreign-owned or local (2.12, p.1, 6-7). Since, in most cases, the clients outsource their financial operations to ABC (Chile), they engage in a long-term relationship in which the bank becomes part of the client’s business (2.12, p.1, 13-14). This arrangement implies ongoing assistance to the client, “for example, there is a new regulation at the level of the International Chamber of Commerce…we teach our clients these new regulations and how they can affect them” (2.1, p.6, 30-31). For instance, credit letters were regulated by the UCP-500 for many years, but were changed for the UCP-600; hence, ABC (Chile) assesses clients on how to include these new practices in their operations (2.13). Therefore, although the extent of forward linkages is limited, their quality is high.

Corporate Social Responsibility

ABC (Chile) is involved in two main projects regarding social responsibility. First, the bank became involved with ABIF (Association of Banks and Financial Institutions of Chile), UNEP FI (United Nations Environment Programme Finance Initiative) and Accion RSE (Responsabilidad Social Empresarial) in order to assess the local environmental impact of projects financed by locally-established banks. They are offering seminars to discuss diverse topics related to the financial sector such as the risks and opportunities of sustainable development for the Chilean financial sector (2.4, p.2).

The second project is the first “contest of business projects 2007” organized in conjunction with a non profit organization from the USA. The objective is to support the social entrepreneurship in Chile (2.9, p.1, 6-9). The initiative has the financial support of ABC Foundation (parent firm) and ABC (Chile)’s local team. The support goes hand in hand with the “Sustainable development strategy” that ABC is implementing in Chile (2.9, p.1, 12-13).
Although the projects do not involve one-to-one relationships with local firms, they both represent a “direct” attempt on the part of the bank to share its experience and knowledge with the local economy.

**Collaborative Agreements**

The bank has not established collaborative agreements with local firms or any firm operating in Chile “because the opportunity hasn’t risen, it is not because of the presence of discouraging factors” (2.1, p.6, 38-39).

**Determinants of Linkages**

**Backward Linkages and Local Sourcing**

The Chilean regulatory framework from the perspective of industrial policy does not influence the operations of ABC (Chile) since the “parent firm has its own international policies that are more restrictive than the ones here [in Chile]” (2.1, p. 1, 17-18). However, changes in regulations regarding outsourcing of personnel “is something that has affected firms lately and affected us as well” (2.1, p.6, 42). The regulations are becoming stricter in terms of the conditions that need to be met when outsourcing personnel. This change has had a negative impact on linkage formation since the bank relies less on outsourcing and internalizes its operations more.

ABC (Chile) positively rates the capability of local firms in terms of “availability, quality, and price” (2.1, p.7, 23). However, the affiliate buys standardized products and services locally while specialized products and services are obtained from overseas. For instance, ABC (Chile) gets the technology from the parent firm “because of an internal policy. It is just because we all want to talk the same language in terms of ICT” (2.1, p.7, 14-15). ABC’s suppliers of specialized products and services are also MNEs “because usually contracts are made at a global level, at the parent firm level, to supply the whole network, especially in terms of technology” (2.1, p.7, 23-24). As a result of the strategy of the parent firm at a global level, ABC (Chile)
does not buy specialized products and services locally, which eliminates the potential for the establishment of backward linkages with local firms.

**Forward Linkages**

ABC (Chile) has established strong relationships with its clients. It provides continuous assistance to them because it is embedded in the service they provide. In other words, it is the main activity of the bank – outsourcing financial activities for big corporations – that encourages the establishment of forward linkages.

**Corporate Social Responsibility**

In Chile, the regulatory framework in terms of environmental regulations is evolving rapidly, which offers increasingly demanding challenges. This challenge has motivated ABC (Chile) to get involved in projects, within the framework of social responsibility, which “will drive the implementation of adequate socio-environmental practices”, in the financial sector (2.4). In other words, the embracing of international initiatives regarding environmental policy by the Chilean government has had a positive impact on linkage formation.

**Knowledge and Collaborative Agreements**

Although ABC (Chile) perceives the Chilean market to be “sophisticated at the regional level” (2.1, p.6, 40), it does not encourage the affiliate to get involved in knowledge or collaborative agreements.

Regarding FDI policy, it does not affect the operations of ABC (Chile). Specifically, FDI policy restrictions in terms of screening mechanism, expatriate employees and capital repatriation are not perceived as such. For example, the expatriate employees’ restriction is not perceived as a restriction by ABC (Chile) since “we have very good professionals who are local and already have international experience” (2.1, p.8, 16-17). Furthermore, FDI policy in terms of tax, industry and location incentives does not have an effect on the affiliate’s operations. For instance, ABC (Chile) pays taxes as “a local firm does…Because the tax rate is higher under that regime (DL 600 invariable
taxation privilege), and Chile has been very stable in terms of tax. So, there is no need to do that” (2.1, p.8, 31-32).

The range of activities of ABC (Chile) has changed over time according to the changes in the Chilean market. For instance, with regard to the reasons why ABC first invested in Chile, what “played an important role was the huge amount of money that entered Chile, so that money needed a financial sector; hence, there was a great need for banks” (2.1, p.1, 34-35). Subsequently, as the financial market became more mature, the bank decided to decrease its range of activities until the point it is now, focused on serving big corporations. “Where there are big firms there is less profitability since the sector is already mature, so you need to look for niche markets” (2.1, p.2, 38-39).

In conclusion, it is neither the regulatory framework nor the capability of local firms that discourages the establishment of high-quality linkages, but the global strategy of ABC (2.1, p.7, 1-3).

**Degree of Linkage**

The following table summarizes whether the different types of linkages are established by ABC (Chile) and their correspondent determinants.

<table>
<thead>
<tr>
<th>Type of Linkage</th>
<th>Yes/No</th>
<th>Determinants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Backward Linkages</td>
<td>No</td>
<td>Strategy</td>
</tr>
<tr>
<td>Forward Linkages</td>
<td>Yes, with major clients</td>
<td>Main activity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Strategy</td>
</tr>
<tr>
<td>Corporate Social Responsibility</td>
<td>Yes, two</td>
<td>Regulatory Framework</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(Industry Policy)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Strategy</td>
</tr>
<tr>
<td>Collaborative Agreements</td>
<td>No</td>
<td>Strategy</td>
</tr>
</tbody>
</table>

Table 6.2  
ABC (Chile): Types of Linkages and Determinants

From the table it can be observed that the degree of linkage of ABC (Chile) is moderate, following the categorization proposed in the research model. This position is consistent with the proposition in Table 2.3 (Chapter 2) which establishes that
market-seeking investment has the potential for moderate integration into the local economy.
6.4 Case 3: SP (Chile), Oil and Gas Services

Affiliate Profile

SP is “a Canadian owned Energy Company” (3.8, p.1, 11), which is operating in Argentina and Chile. SP (Chile) is a Chilean company owned by foreign (Canadian) individuals (shareholders). It started its operations in Chile through Greenfield investment by establishing SP (Chile) in 2005. “The principal objective of the firm is to bring technology from the largest oilfield countries like USA and Canada to countries like Chile and Argentina, where there are not many manufacturers or creators of technology for oil firms” (3.1, p.1, 4-6). As part of its service, SP (Chile) offers oil and gas firms expertise on the drilling process by providing “the knowledge of how to use that tool with that tool and then design this drill and make it work better for you” (3.1, p.1, 15-16). In other words, SP (Chile)’s main activity is to provide consulting services and high-tech tools for the drilling process (3.8, p.1).

SP came to Chile motivated by the opportunity to develop the oil and gas drilling sector, which did not at that time exist. “Even today the indicators show no official activity in Chile regarding oil and gas drilling. So we detected that opportunity and started to offer services from Argentina and as the business grew decided to come and operate here” (3.1, p.1, 44-46). Moreover, the economic environment of Chile, especially its low level of corruption, motivated SP to move its operative base from Argentina to Chile in 2006 since “we were working in Argentina and there is lot of corruption there…we had problems” (3.1, p.2, 4-5). Although its board of directors is still located in Argentina (3.5, p.1), the firm’s operative base is in Chile, from which it offers support to all the operations of the company in the region (3.2, p.1). In other words, SP (Chile) was established motivated by market-seeking and strategy reasons.

SP and SP (Chile) are small in terms of number of employees, “between Chile and Argentina about 40” (3.1, p.5, 34). SP (Chile) is particularly small as a result of its “young age” and pioneer position in the almost nonexistent oil and gas drilling sector in Chile. In other words, the firm intends “to grow [in Chile] along with the development of the sector” (3.1, p.2, 41).
The organizational structure of SP (3.5, p.1) indicates that it is organized in business units across Argentina, each depending on the president of the firm. In the case of SP (Chile), it communicates directly with the board of directors; as a result, the influence of the parent firm on decision-making is moderate.

SP and, hence SP (Chile), act as a bridge between oil firms in the southern cone and international manufacturers of technology for the oil and gas sector by holding “exclusive representation of a wide number of international firms for a vast range of products and services” (3.6, p.2). In addition, SP (Chile) brings “knowledge and experience in a sector that was not existent before” (3.1, p.4, 11); therefore, its main resource is human capital. The firm has people with wide experience in oil and gas projects in more than 45 countries as well as experience in geothermic projects, which enables the firm to provide a wide range of specialized services and products (3.2, p.1). As a result of the international experience in the oil and gas industry of its managers as well as its technicians, SP (Chile) has experienced an impressive curve of growth (3.6, p.2) and is “the only one with experience in oil and gas drilling processes to provide this kind of services” (3.1, p.1, 43).

SP (Chile) is also supported by its branches in Argentina, which have a solid presence in the most important projects of oil perforation in Argentina (3.2, p.1). Moreover, SP (Chile) is an advanced centre for the repair of special tools, which is made possible by its commercial relation with the Chilean National Oil Company (ENAP), “we are provided with access to the technical services of certified arsenal at the facilities of ENAP in Punta Arenas (3.2, p.2).

Since SP (Chile) is “very knowledge based [and has] a very experienced team” (3.1, p.1, 22), and it is an early entrant of the oil and gas drilling sector in Chile, it is a leader in “introducing innovations for optimizing procedures and make things faster and safer” (3.1, p.3, 12). “We bring international practices such as safety management that local firms do not have. We are very focused on safety and we teach that here. It is our firm’s culture [to be focused on the] environment [and] safety” (3.1, p.4, 12-14). That is, SP (Chile), through its pioneer position in the sector, has introduced innovations in various areas, specifically human resources and skills, culture and management practices, and product technology.
Linkage Formation: Indirect Linkages

The latest Chile Oil and Gas report from BMI (Business Monitor International) forecasts that the country will account for 3.93% of Latin America regional oil demand by 2010, while providing less than 1.0% of supply (3.9, p.1). The State-owned Chilean National Oil Company (ENAP) controls Chile’s oil sector. The company is the sole producer and refiner in the country. In 1990, ENAP formed an international subsidiary to seek foreign production that could offset declining domestic fields. The subsidiary has pursued investments in places such as Argentina, Colombia, Ecuador, and Egypt (3.9, p.2).

The State oil and gas company – ENAP – is also responsible for all domestic gas production, with volumes in decline (3.9, p.2). As a response, the company has had long-term contracts with Argentinean suppliers of natural gas. However, several problems in Argentina, such as a considerable increase in demand, weather challenges and labour disputes, have resulted in concurrent natural gas supply shortages for Chile.

Although the oil and gas sector in Chile is limited in terms of production, it is not in terms of exploration. Gas exploration projects have increased dramatically as a result of the supply problems with Argentina. At the same time, oil exploration projects have been persistently pursued by ENAP. This increase in exploration projects constitutes an opportunity for firms offering drilling products and services. Hence, despite the forecast that the oil and gas sector growth in Chile in terms of production is limited, there are several opportunities for SP (Chile), and competitors, to offer their services for the exploration stage (3.10, p.1).

SP (Chile)’s participation and scope in the Chilean market are in a phase of important growth (3.6, p.1). “In Chile we don’t have many [competitors]…but sometimes our clients are our main competitors. They can go straight to the manufacturers to buy the products, they can bypass us. But, they usually do not have the time, skills or energy to do that” (3.1, p.1, 31-33). SP (Chile)’s customers in Chile are ENAP, Schlumberger and Geopark, the only three firms that are directly involved in the perforation and exploitation of hydrocarbons (3.7, p.2).
“As the industry develops foreign firms will come and practices would improve and become more dynamic” (3.1, p.4, 23). From this perspective, SP (Chile) “will influence other firms to get involved in business, in the sense that we are dealing in a market in Chile that is just starting” (3.1, p.4, 9-10).

**Linkage Formation: Direct Linkages**

**Backward Linkages and Local Sourcing**

SP (Chile)’s main inputs are technology and human resources. In terms of technology, their suppliers are international firms that do not operate locally, “we have several supply contracts with them, [and] our relationship is very solid” (3.1, p.5, 27). Similarly, most of its employees are foreigners. “As we grow we find the challenge to find people here…so we’ll have to bring them from overseas and/or train people” (3.1, p.5, 9-10).

As regards to local sourcing, it is limited mainly to some standard services such as transport (trucks) and general services (cleaning, electricity, etc.). However, it has established backward linkages with local suppliers of transport services by providing them with assistance, “they are willing to acquire different safety procedures” (3.1, p.5, 15).

In sum, although SP (Chile) does not buy specialized services and products locally it has established backward linkages with local suppliers of standard services.

**Forward Linkages**

SP (Chile)’s customers are ENAP, and two international oil companies, which are the only three firms that are directly involved in the perforation and exploitation of hydrocarbons in Chile (3.7, p.1).

The firm is highly involved in projects of perforation and exploration of oil in the southern region of Chile, supplying with success a wide variety of services to the
various operator firms of the region, from which ENAP stands out (3.2, p.1). “We are not specifically selling products as much as we are helping design [our clients] their way of doing things” (3.1, p.1, 13). As a result, SP (Chile) is “helping ENAP and other firms to improve the way they do things regarding technical procedures” (3.1, p.3, 7-8) by giving them “knowledge and experience (3.1, p.3, 16).

The number of firms operating in the oil and gas sector in Chile is limited, which limits the extent of forward linkages that could be formed. However, the quality of these linkages is high. Through them SP (Chile) provides customers with assistance that involves the transfer of knowledge and experience.

**Corporate Social Responsibility**

SP (Chile) has not established social responsibility linkages.

**Collaborative Agreements**

SP (Chile) has established a collaborative agreement with GBB – a merger, since 1974, between a big US mining services company and a Chilean association of geological technical services – to “pursue one particular project” (3.1, p.3, 21), which is “not in the oil sector, it is geothermal” (3.1, p.3, 22). Specifically, the alliance between SP (Chile) and GBB is for presenting a tender to provide technical services and equipment to ENAG (National Geothermal Company of Chile) (3.6, p.1).

GBB brings to the alliance well-established infrastructure in Chile such as more than 60 pieces of perforation equipment and 250 vehicles. It also has more than 1000 employees that are highly qualified to work in offshore projects complying with high standard requirements. It also has several storage facilities and repair centres round the country as well as facilities for the construction of high-tech tools complying with international quality standards (3.6, p.2). To complement GBB’s resources, SP (Chile) is providing the knowledge and international experience of its professional team, which “are skills necessary to develop technology” (3.1, p.3, 22).
As a result, the alliance has selected a proven model of perforation equipment and has adapted it to the special characteristics of the project in question (geothermal perforation). This technology offers advantages in terms of less operational time, less environmental impact, high safety standards, fewer related operational costs, and higher performance indicators (3.6, p.4).

**Determinants of Linkages**

**Backward Linkages and Local Sourcing**

The Chilean regulatory framework does not play a direct role on linkage formation for SP (Chile) but it was an underlying factor in the firm’s decision to establish its operations in Chile. Transparent trade policy, good quality of institutions, and a well-organized financial market are factors that positively influenced SP (Chile) to move its operational centre from Argentina to Chile despite the fact that the oil and gas sector in Chile is much less developed than that in Argentina. Moreover, SP (Chile) was motivated to establish its operations in Punta Arenas “because you need to be there to get the benefits of the Free Trade Zone” (3.1, p.2, 14).

“In the south of Chile everything is more expensive, there is not much available…Chile is not an oil country and the sector is just starting at the moment after a long time so the supportive industries are not developed. There are not many big firms; many are family-owned firms, small” (3.1, p.3, 41-45). As a result, SP (Chile) does not source specialized products and services locally. However, it has established backward linkages with local suppliers of standard products and services. Although “they don’t have the infrastructure…the attitude of the owners is so good. They are willing to help you, so we assist them and this can be an advantage” (3.1, p.4, 3).

With regard to human resources, despite the regulation establishing that 85% of a firm’s employees must be Chilean, the limited availability of qualified people with oil knowledge and experience in Chile has forced the firm to apply for special permission for hiring foreigners despite its willingness to hire Chileans. However, the firm has not established linkages with local suppliers of human resources (such as universities)
since “our level of activities does not demand the need to do that. So at the moment we have to bring people from overseas. But I see that happening in the future” (3.1, p.5, 19-21).

In sum, the fact that the oil and gas sector is almost non-existent in Chile results in the absence or underdevelopment of supportive industries. Nevertheless, the economic environment has played a key role in attracting the firm to operate in Chile, which has subsequently motivated SP (Chile) to get involved with local firms that provide non-specialized products and services.

**Forward Linkages**

SP (Chile) has established close relationships with all of its clients due to the nature of its activities. Although it provides its clients with drilling equipment it is complemented with ongoing consulting services, which entails being involved in the client’s activities “for optimizing procedures and making things faster and safer” (3.1, p.3, 12).

Moreover, regulations regarding the environment “are very strict in comparison with the regulations in the rest of Latin America” (3.1, p.4, 29). Hence, “we bring international practices such as safety management that local firms do not have…we have changed the way they do things, their practices” (3.1, p.4, 13-15).

In sum, SP (Chile) has established high quality forward linkages with its clients as a result of the nature of its activities. In addition, the underdevelopment of the oil and gas sector has exacerbated the service aspect of SP (Chile)’s activities, especially in terms of environmental regulations.

**Corporate Social Responsibility**

SP (Chile) is not involved in social responsibility activities mainly due to its size, “we are still small….when we are bigger and the industry is more developed we may do that…to integrate the community” (3.1, p.5, 19-20).
Collaborative Agreements

The establishment of a collaborative agreement between SP (Chile) and a local firm “allows us to work in a position that we wouldn’t have been able to have in ten years. It is a firm [partner firm] with a thousand employees, logistics, services, infrastructure that we could have never provided” (3.1, p.3, 25-26). In other words, the complementarity of the ownership-advantages of the local firm is what motivated SP (Chile) to pursue this agreement. Although, SP (Chile) has experience and knowledge, its infrastructure and local network are limited (size). Hence, a locally established firm that has long-term relationships with local agents plus well-established infrastructure constitutes an opportunity for a small firm like SP (Chile) to pursue major scale projects.

Degree of Linkage

The following table summarizes whether the different types of linkages are established by SP (Chile) and their correspondent determinants.

<table>
<thead>
<tr>
<th>Type of Linkage</th>
<th>Yes/No</th>
<th>Determinants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Backward Linkages</td>
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<td>Economic environment/Local firm capability</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Main activity</td>
</tr>
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<td></td>
<td></td>
<td>Industry size</td>
</tr>
<tr>
<td>Forward Linkages</td>
<td>Yes</td>
<td>Main activity</td>
</tr>
<tr>
<td>Social Responsibility</td>
<td>No</td>
<td>Size of affiliate</td>
</tr>
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<td>Size of affiliate</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Local firm capability</td>
</tr>
</tbody>
</table>

From Table 6.3 it can be seen that the degree of linkage of SP (Chile) is high, following the categorization proposed in the research model.
6.5 Case 4: AA, Water Services

Affiliate Profile

AA is a sanitation company serving the Santiago department including water and sewerage services (4.4, p.1, 9-10), and the Chilean branch of AB. AB is originally a Spanish sanitary firm which is currently “the head of a big holding group consisting of more than 230 companies and 140 years of history” (4.6, p.2, 1-2), “which operate in diverse sectors its main three activities being: the water cycle, health insurance, and inspection and certification activities” (4.3, p.14).

AA was created in 1861 by the government. In 1989 the firm was transformed into a corporation, a branch of a government institution (GI). In 1999, through a privatization process, 51.2% of the corporation was acquired by a Spanish Investment Association (SIA) of which AB is the controller (56.6%) (4.3). As a result, AA is a public company which is currently owned by SIA (50.1%), GI (35%), others (14.9%) (4.3), and controlled by AB.

AB decided to acquire the Chilean company motivated by its success in the local market supported by the “economic, political, legal and social stability of the country” (4.1, p.2, 11). At the industry level, the existence of a clear and well-established regulatory framework as a result of the privatization process also triggered AB’s decision to invest in the sanitary firm (4.1). Hence, AB invested in AA for market-seeking reasons.

Since becoming a branch of AB, AA has expanded considerably by acquiring locally-owned sanitary plants in the metropolitan region of Santiago and establishing two firms in related sectors. These firms offer treatment services for industrial waste and commercialization of laboratory equipment and analysis services (4.3). As a result, AA has 1,091 employees and annual sales of $233,000 million pesos (2006) (4.3), which make it a big player in the Chilean market. In addition, in 2002, AB – which is present in Argentina – moved “its Latin American management unit from Buenos
Aires to Chile” (4.5, p.1, 19). As a result, AA supervises “the management of AB firms in Argentina, Brazil and Uruguay” (4.5, p.1, 21). Hence, AA follows a complex-integration strategy as a result of its role within the international network of AB.

In terms of organizational structure, AA follows a hierarchical organization in which the board of directors is at the top followed by the CEO, who is over each division manager (4.3). The president of the board of directors is from AB, the parent firm. As a result, “the strategic decisions, long-term decisions, are made at the parent firm level” (4.1, p.4, 20-21). With regard to short- and medium-term decisions, these are made at the local level. Specifically, AA divides its customers in geographical zones, “the areas are decentralized, each zone has its own manager, everything is not managed by one department” (4.1, p.1, 16-17). In other words operational decisions are made locally and are made by the manager in charge of each customer zone. Consequently, AA is considerably autonomous in relation to its local activities.

AA’s operations comprise all the activities of the water cycle. “This integral management of the water cycle demands highly efficient operations to guarantee continued and uninterrupted supply of water” (4.7, p.1, 18-19). As a result, AA’s operations are highly technology-based, which makes technology a key resource. Accordingly, AA’s “competitive advantage is based on technology” (4.1, p.4, 29), which mainly “comes from the parent company” (4.1, p.4, 32) and it is adapted “to the local needs” (4.1, p.2, 37). Besides technology, “there are some things that the corporation implements at a global level” (4.1, p.4, 21-22), and hence, are adopted by AA, specifically in terms of management such as “human resources evaluations, common values, culture, etc.” (4.1, p.4, 23).

Although AA gets “know-how and technology from the parent firm…at the same time we have alliances with local universities” (4.1, p.3, 11). That is, the parent firm is not the only source of technology and know-how. AA invests in “research and development” (4.1, p.2, 39) mainly triggered by its main sewerage plant “which is the biggest in Latin America and the fifth largest globally. So many processes are improved to perfection here…the whole corporation benefits from research done here, and it is because the plant is very big and provides the conditions to do so” (4.1, p.2, 38-41).
AA has introduced a considerable number of innovations in a wide range of areas. For instance, in 2002, it inaugurated “the most advanced System of Operative Control of Latin America” (4.3, p.6). The CCO (Centre of Operative Control) “is a technological tool which allows operating the plants efficiently. It is a world-class application for the public services sector” (4.3, p.28). AA has also implemented the SIG (Geographic Information System), “this system has allowed the development of operational applications such as those related to flaws of drinkable water, maintenance of faucets, and handling of crisis” (4.3, p.29)

AA developed a project for improving the quality of the service. “It comprises a number of changes such as: implementing a new model of satisfaction measurement; coordinating operative processes, commercial activities and communication channels. For example, it has incorporated technological tools to improve efficiency in field projects” (4.3, p.19). Also, for the improvement of service it implemented ICT tools that allow “individuals to track their accounts and pay” (4.3, p.19) through AA’s website.

In order to maintain high standards in the treatment of used water, innovative technological applications, pioneered in the sanitary sector, were implemented, for example, predictive maintenance techniques, alignment laser, and dialysis of oils (4.3, p.42). In addition, “a model of the process of digestion was developed as a tool to support the operation, management and planning of the digesters” (4.7, p.2). Also, other models for the study of hydrodynamic behaviour of digesters were developed. These models were developed with the support of local universities and expert national consultants (4.3, p.42).

**Linkage Formation: Indirect Linkages**

The sanitary industry in Chile from its beginning until the end of the 1980s was developed by the State. The State regulated as well as provided the service across the country (4.9, p1). In 1988, the State modernized the sanitary sector through new regulations establishing that the State would no longer be the provider of the service and would focus on its supervisory role. As a result, between 1990 and 1998 the
sector underwent a gradual process of privatization\textsuperscript{7}. The government acknowledged as essential a need to develop a stable and clear regulatory framework that would be implemented before the privatization of the sector. In 1998 major reforms were enacted which mainly established property boundaries for providers of the service in order to avoid monopolies, supervisory procedures, and calculation and establishment of tariffs (4.8, p.13).

The privatization process was initiated in 1998 by selling the firm that provided sanitary services to the fifth region in Chile to a local economic group. As a result the sanitary sector now consists of private firms, each serving a determined geographical area of the country. There are two foreign firms operating in the sector: AB through AA, servicing the Santiago region, and TW, servicing four regions in the south of Chile. Foreign firms are concentrated in the central-southern regions of Chile where sanitary services are less dispersed; they have a higher number of consumers, and are associated with cities with a higher demographic and economic growth potential. As a result, foreign firms constitute 61.6\% of the total sales volume of the sector (4.9, p.2). AA is “the biggest company” servicing 45\% of the consumers in Chile (4.1, p.2, 44) and “is the only one that covers all the water cycle, and that is unique in the industry” (4.1, p.3, 3).

As a result of the property restrictions imposed by the government “each firm has its own market, so there is no rivalry. On the contrary we support each other; we exchange information through ANDES (National Association of Sanitary Enterprises)” (4.1, p.4, 37-39). In this context, AA compares itself with a “model firm\textsuperscript{8}; we compete with it since it establishes the tariffs. This ideal firm has everything working at the most efficient level...gives an “efficient” tariff that is charged to the customers...hence, we have to do things exactly as indicated by this firm in order to be efficient and minimize costs” (4.1, p.5, 1-4).

In terms of its influence in the sector, “it was the first firm dealing with the certificates ISO12000\textsuperscript{9} and the like. So everyone watches what AA does, it is the leader here and in Latin America.” (4.1, p.3, 2-3). In other words, AA influences the sector by setting the path for the other sanitary firms in terms of the implementation of international standards, especially those related to public services.
Linkage Formation: Direct Linkages

Backward Linkages and Local Sourcing

AA locally sources a wide range of products and services both standard and specialized. It uses “tenders for suppliers of equipment and services” (4.1, p.7, 4) and establishes “a contract relationship with them” (4.1, p.3, 34).

With regard to medium- to long-term relationships, AA has established nine contracts with nonrelated firms. One of them provides AA with electricity; hence, it is not a specialized service. The remaining suppliers provide specialized services and products such as maintenance of sewerage treatment facilities, sewage equipment, technical maintenance of water distribution networks, engineering services, water treatment services, cleaning of septic tanks, services for the environment, etc. The suppliers of specialized products and services are mostly locally-owned; specifically five of them are Chilean, two are from Spain and one is from France (4.3, p.76).

In terms of the quality of these relationships, these are contract-based, are established for a minimum of 5 years, and involve assistance. Therefore, AA has established backward linkages with local firms.

Forward Linkages

AA has not established forward linkages with local clients.

Corporate Social Responsibility

AA has taken an open position towards corporate social responsibility, “we are socially responsible, we go further than just providing water” (4.1, p.5, 38). As a result, it has developed a number of community projects oriented to improve social conditions in those neighbourhoods that locate close to the plants such as: Good Neighbour Policy; “Neighbourhood dreams” Fund; “Pro Til Til” Corporation; and “Water at home” (4.3, p.51).
AA is also involved in the “Plan Agua Potable Rural” (Rural Drinkable Water Project), in accordance with the agreement with “Direccion de Obras Hidraulicas del Ministerio de Obras Publicas” (Direction of Hydraulic Projects of the Ministry of Public Projects). As part of this project AA provides training and consulting services for the maintenance and execution of projects in rural locations which do not have water distribution networks (4.3, p.24).

In sum, AA is involved in a considerable number of social projects. However, most of AA’s initiatives are oriented to the community. In this kind of project the affiliate is not sharing its knowledge and expertise with local firms; hence, their quality is limited to the improvement in social conditions rather than local industry upgrading. Nevertheless, two of AA’s projects have the potential to upgrade local industry since through these projects, “Plan Agua Potable Rural” and “Pro Til Til” Corporation, the affiliate provides advice by sharing its expertise with local firms and institutions.

**Collaborative Agreements**

I2TA stands for “Instituto Internacional de Tecnología del Agua” (International Institute of Water Technology). This is a project developed between AA and a Chilean university for the creation of an international institute of water technology. The main objectives of this project are to become a national reference organization, independent, and of maximum scientific-technological level in terms of the water cycle. In addition, it intends to join and promote university and entrepreneurship competences. AA provides its knowledge and expertise regarding the water cycle while the university provides knowledge in terms of research (Doc 4.3, p.29).

AA has also established an association with another local university and a government institution which intends to do a “zoning” of Santiago regarding risks of earthquakes. The objective of the alliance is “to develop a methodology and software for the region (Santiago) to determine the risk of earthquakes in various zones” of the region. AA provides geological information to the project (gathered along its years of operations) that is needed by the university in order to develop software that “labels the subsoils in Santiago according to their characteristics” (4.1, p.3, 28). “This [information] will help us improve the design of our equipment to minimize damage in case there is an
earthquake” (4.1, p.3, 15-16). In other words, “we give information and we get new information back” (4.1, p.3, 31).

AA has also established several associations with “other universities to study the water and its impact on health; projects for the treatment of mud, biologic solids, studies to determine what to do with this mud” (4.1, p.5, 20-22).

In sum, AA has established several collaborative agreements with local entities, specifically universities, mainly oriented to research and development.

**Determinants of Linkages**

**Backward Linkages and Local Sourcing**

Although AA covers the whole water cycle its focus is on “getting the water, cleaning used water and building the necessary infrastructure to distribute it to the final consumer” (4.1, p.7, 3-4); hence, it uses “tenders for suppliers of equipment and services” (4.1, p.7, 5). With regard to whether it uses local or foreign suppliers, it has relied mostly on local firms since “there is a wide range of availability, quality and price” (4.1, p.5, 17).

In addition, “Chile’s stability in terms of economy and politics has made the market attractive since it encourages long-term commitment; hence, more projects are developed” (4.1, p.6, 34-35). Therefore, as a result, AA’s long-term commitment to the local economy and its positive perception of local suppliers has motivated the firm to establish backward linkages. In other words, the economic environment and the capability of local firms have acted as determinants of backward linkages.

**Forward Linkages**

AA has not established forward linkages with clients because of the range of its activities. That is, “since we cover the whole water cycle, individuals, the final
consumer is our customer” (4.1, p.1, 13). As a result, there are no opportunities for establishing forward linkages with customers.

In sum, the main reason why AA has not established forward linkages is because of the range of its activities.

Corporate Social Responsibility

“To be socially responsible is a compromise that we have embraced as a company because it is not only about growing but to accomplish sustainable growth, always in harmony with the development of our collaborators, community and environment” (4.3, p.44). “We are a public service company, we are socially responsible” (4.1, p.5, 38).

In sum, the public service nature of AA’s activities, coupled with its aim to accomplish sustainable growth in the Chilean market, implies that the embracing of social projects by AA is a result of its long-term commitment to the Chilean economy, and its strategy – the latter in terms of how it intends to grow.

Collaborative Agreements

“The focus of AA is to improve constantly because we are competing with an ideal company. This ideal company is within the regulatory framework” (4.1, p.5, 8-9). As a consequence, “there is investment in research and development…and it is because the plant is very big and provides the conditions to do so” (4.1, p.2, 39-41). In order to do this, AA has established various alliances with local universities, “They help us with projects” (4.1, p.3, 13). In other words, AA’s size of operations and the regulatory framework encourage AA to establish linkages with universities for the development of R&D projects.

Degree of Linkage
The following table summarizes whether the different types of linkages are established by AA and their correspondent determinants.

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<thead>
<tr>
<th>Type of Linkage</th>
<th>Yes/No</th>
<th>Determinants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Backward Linkages</td>
<td>Yes</td>
<td>Economic environment</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Local firm capability</td>
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<td>Strategy</td>
</tr>
<tr>
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<td>Main activity</td>
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<td>Forward Linkages</td>
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<td>Main activity</td>
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<td>Corporate Social</td>
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<td>Strategy</td>
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<td>Collaborative Agreements</td>
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<tr>
<td></td>
<td></td>
<td>Regulatory framework (Industry policy)</td>
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<tr>
<td></td>
<td></td>
<td>Local firm capability</td>
</tr>
</tbody>
</table>

From Table 6.4 it can be observed that, following the categorization proposed in the research model, the degree of linkage of AA is high.
6.6  Case 5: RT (Chile), Financial Information Services

Affiliate Profile

RT (Chile) was established in Chile “more than 40 years ago” (5.1, p.1, 16) through Greenfield investment. It is an office of RT, which is a “news agency with more than 150 years of history…a global company [from the UK] … its main focus is on the financial market” (5.1, p.1, 4-5). RT (Chile) focuses on offering information and transaction services for the financial market.

RT came to Chile because it “saw the need to be globally present, hence the need to be in Santiago” (5.1, p.2, 2-3). However, due to the small size of the Chilean market in comparison with other Latin American markets such as Mexico and Brazil, “Chile is not the focus of RT Latin America” (5.1, p.7, 5). Accordingly, RT (Chile) is a small-medium sized firm. In other words, the motive of investment is market-seeking and responds to the “global presence” strategy of RT.

The Chilean office has undergone a succession of changes during recent years due to changes of RT at the global level. RT (Chile) “dismantled the whole hierarchical structure and decided to outsource all the non-core activities and some activities are performed by one centre for all Latin American offices” (5.1, p.2, 5-6). RT “decided to keep the commercial people…since the focus is the client…the employees that deal with those clients that generate 80% of the profit must be in Santiago” (5.1, p.2, 14-16). As a result, in terms of decision-making, RT (Chile) depends on the Latin American centre of RT for short- to medium-term decisions while “all the medium and long term decisions come from the parent firm” (5.1, p.5, 36). In other words, the Chilean office has limited autonomy.

As part of RT’s global network, RT (Chile) gets its main resources from the parent firm or RT’s Latin American Centre. RT focuses on offering information, technology and connectivity in an integrated form. RT has implemented these solutions for the financial sector and big corporations in Latin America (5.2, p.1). However, as “all markets are different, so RT has to make minor adaptations to the system in order to
fit the characteristics of the Chilean market, and this is done overseas. We provide the parent firm with all the information but they do the adaptation” (5.1, p.2, 32-34). In addition, the parent firm provides financial support for local employees that want to get further trained and/or directly provides training, which “is done though e-learning, the teachers live outside Chile and do not have to come here, they teach new products, new markets, etc., and if it is necessary someone will be sent overseas” (5.1, p.7, 26-28).

The resources obtained from the parent firm constitute competitive advantages for RT (Chile). RT (Chile)’s position in the Chilean market is supported by RT’s global reputation based on “the quality, quantity, speed of delivery and reliability of the news generated” (5.1, p.6, 29-30) and continuous technological innovation (5.4, p.2). In addition, “the way we provide the service. We work openly with our clients while our competitors are less adaptable to the client” (5.1, p.6, 32); for instance, “our software applications are more user-friendly…we work with a windows platform while our competitor does not” (5.1, p.6, 34-35). In other words, the core strengths of RT, and hence RT (Chile), lie in providing the content, analytics, trading, and messaging capabilities needed by financial professionals (5.8, p.1).

In terms of innovation, “many [of them] originate from new demands from the clients due to changes in the environment” (5.1, p.5, 6-7). As a result, technological solutions for the financial sector, such as: solutions for the coordination of systems; solutions for Internet and Intranet websites; electronic trade solutions; risk management and order track have been developed by RT (5.4, p.1). In other words, RT (Chile) provides financial institutions with specially designed tools to help them reduce risk and distribute and manage the ever-increasing volumes of market data (5.8, p.1). For example,

If a client…needs a system for bonds transaction…it will trade the bonds with its clients, which probably are my clients too. So, I install this system in its offices and will promote this new system in conjunction with the stockbroker to our clients who trade bonds. So, this new demand of my client resulted in a new product/service which will impact the whole market since we’ll jointly promote the adoption of this new system (5.1, p.4, 29-34).
Although, RT (Chile) has to innovate continuously in order to adapt to the changing needs of its current and potential clients, the development of these innovations is done at the parent firm. “We’ve done a couple of R&D activities here, but they have been an exception. We did adapt some components of the system that were later used in the Latin American market…but it was a one thing event” (5.1, p.5, 31-33). “If Chile was a 60 million market…I assure you that we would have a R&D department here” (5.1, p.5, 30).

Overall, RT (Chile) has introduced innovations in the areas of product and service delivery technology.

**Linkage Formation: Indirect Linkages**

The business information services sector in Chile is composed by 41 companies that offer their services to firms operating in the Chilean industry. These firms are not necessarily established in Chile, but they do operate in the Latin American region. Six of these firms are present in various countries within – but not restricted to – Latin America, and constitute the major players in the sector (5.9, p.1). However, with regard to the financial information services subsector, only two of these six firms take most of the market share. “In Chile the market leaders are RT (Chile) and BL (Chile)” (5.1, p.5, 45), which are both foreign-owned firms. “Local firms are too small and they focus on niche markets…the highest profits are made by international players” (5.1, p.5, 42-43). With regard to small players, “there is a huge difference…our products are 15 times more expensive than theirs, and that obviously must reflect on the profits. They don’t develop specific products for their clients…so they work with firms that are also small and … their requirements are simple” (5.1, p.8, 20-23).

In terms of number of competitors the sector “has been stable…there are new small firms …but their influence in the market is minimal…so new big competitors …not at all” (5.1, p.6, 2-4). As a result, “the market share of RT (Chile) and BL (Chile) has been stable” (5.1, p.6, 8). This translates into a highly competitive environment in which the leaders “take the eyes from each other…if I lose a contract [RT (Chile)] it
is because of BL (Chile) and if they lose a contract it is because of us” (5.1, p.6, 11-13).

In order to respond to fierce competition, in 2002, RT (Chile) reinforced its position as a leader provider of information and technology for the financial market by acquiring ValorFuturo, one of the principal players in the sector, to add information and news of Chile provided by this firm (5.5, p.1). In addition, one of the main objectives of RT (Chile) is to consolidate its competitive position through the positioning of premium products (5.4, p.1).

As one of the two leaders in the financial information services sector, RT (Chile) greatly influences the industry by incorporating new products and services (innovations) in response to changes in the market and, hence, the demands of its clients. For example, if RT (Chile) realizes “that the plastic bags business is going up [RT (Chile)] would generate information and tools to deal with that market, then if my competitor realizes that that is going well, then they’ll do something similar” (5.1, p.6, 17-18).

**Linkage Formation: Direct Linkages**

**Backward Linkages and Local Sourcing**

RT (Chile) key resources are obtained from the parent firm, specifically technological innovations for the financial sector. On the other hand, responding to RT’s global strategy, RT (Chile) outsources all of its noncore activities. Some of these noncore activities “are performed by one centre for all Latin American offices” (5.1, p.2, 10). The remaining activities are in hands of multinational firms established in Chile, “multinationals have played an important role, for example, IBM has replaced the technical department we used to have in Santiago. British Telecom is replacing our communication department” (5.1, p.2, 18-20).

RT (Chile) has developed close relationships with its suppliers since “we outsource many activities…we do share information [with our suppliers], they need to know
what is going on in order to serve us” (5.1, p.3, 36-37). RT (Chile) “highly demands that they adapt their services to [RT (Chile)] needs” (5.1, p.3, 41). In order to ensure proper service RT (Chile) provides training to its suppliers. For example,

The IBM people that install the software needs to know about the service we are providing in order to do it right, hence, we as RT (Chile) give training to local IBM employees. RT’s people from Brazil, Mexico come to Chile to train technical employees of IBM. In this way the people that work with me (IBM) in providing the software to the client have enough understanding of what is needed (5.1, p.4, 3-7).

In terms of human capital, RT (Chile) hires local professionals, and has recently established the Spanish department in Chile to serve RT’s offices around the world.

In sum, RT (Chile) has established several backward linkages of high quality by providing training to its suppliers. Although its suppliers are multinational firms established in Chile, these firms hire local people that are in need of training, which is provided by RT (Chile). Hence, the standard of services is improved no matter the origin of the supplier.

**Forward Linkages**

RT (Chile) divides its customers into the following segments: asset management; investment banking and brokerage; treasury; mass media and corporate customers (5.6, p.1). Most of its clients operate in, or are related to, the financial sector.

RT (Chile) establishes “long-term relationship (with customers)...a contract has a minimum term of 2 years and on average the contracts are for 10 or more years” (5.1, p.4, 15-16). As part of this contract “the client is trained in using and understanding the system” (5.1, p.4, 22). The relationship established with the client is ongoing as RT (Chile) is “constantly monitoring any problems, new needs...adapting my service to the needs of the client” (5.1, p.4, 22-24). For example,

“One of my clients...wants to implement a transaction system in the financial market. So I provide the technology and knowledge to install and operate the system. Once the system is
implemented in my client’s operations, my people promote the system in the rest of the market. So, my client does not pay for the promotion of the system they use” (5.1, p.7, 39-42).

In sum, the extent of forward linkages that RT (Chile) has established with local firms is considerable according to its market share – various firms operating in, or related to, the financial sector are RT (Chile) clients. In addition, the quality of these linkages is high by providing training, ongoing assistance, and new solutions.

Corporate Social Responsibility

RT (Chile) has not established social responsibility linkages in Chile.

Collaborative Agreements

RT (Chile) has established two types of collaborative agreements. One refers to the association between RT (Chile) and a local university with the objective to introduce new products to the market, “the market changes through new ideas of how to do business….new services products are created and then the university teaches the market how to do it” (5.1, p.5, 12-13). This association represents an opportunity for the university since it provides the institution with new and exclusive knowledge to offer through courses. RT (Chile) benefits from the association since, through the university’s courses, the new product/service is introduced as the standard for operating in the new business activity, this way RT (Chile) “forces them [i.e., financial firms] to adopt the [new] system” (5.1, p.4, 37). For example, in 2002, the local university incorporated a technical analysis program course in order to introduce a new system, developed by RT, to the market (5.3, p.1).

The second type of collaborative agreement refers to the association that RT (Chile) has established “with a group of small firms14 that need to promote their operations” (5.1, p.7, 10). The objective of this association is to offer mass promotion at no cost to these firms since “they do not have the capacity [to do so]” (5.1, p.7, 12). Hence, RT (Chile) allows “these firms to put their information in [its] network [to] get exposure to a wide range of firms in the financial market” (5.1, p.7, 14-15). RT (Chile) benefits from this association by having more information to offer, “I give information that my
competitor does not give because I demand exclusivity from these firms” (5.1, p.7, 16-17).

Both types of collaborative agreements have been established with local firms. However, the second type does not involve major transfer of knowledge or experience.

**Determinants of Linkages**

**Backward Linkages and Local Sourcing**

RT (Chile) has established backward linkages with multinational firms operating in Chile “because our contracts are global” (5.1, p.2, 23). In other words, it is the parent firm’s global strategy that has limited RT (Chile) to consider outsourcing its activities to local firms.

In terms of assistance given to suppliers, RT (Chile) provides them with training in order for them to adapt their services to the special needs of RT (Chile), “if they do not meet my requirements that affects the way I serve my clients” (5.1, p.3, 40-41). In addition, although RT (Chile) suppliers are multinational firms, these firms employ local people, which “in terms of technical skills, are not at international standards” (5.1, p.9, 10). As a result, the need for providing training increases.

The Spanish department of RT has been established in Chile since the country “is well rated in terms of corruption, especially in comparison with the rest of Latin America…the transparency of the market makes it stable and a pleasant place to be” (5.1, p.8, 44-45). In other words, the economic environment in Chile has been a motivator for RT to extend its range of operations by employing local Chilean professionals (bilingual journalists) to serve the Latin American offices of RT. Although Chile offers an attractive economic environment “it doesn’t make sense [to RT] to centralize all the operations for Latin America in Santiago…because the market is not big enough” (5.1, p.2, 43). That is, it is the size of the market which limits the range of activities that RT (Chile) undertakes in Chile, hence, diminishing its potential to establish backward linkages with local firms.
In sum, the extent of backward linkages is limited by the global strategy of RT and the small size of the Chilean market, and encouraged, to some degree, by the Chilean economic environment. The quality of the backward linkages that RT (Chile) has established, with multinationals operating in Chile, is high since they involve transfer of knowledge and expertise through ongoing training. The main activity of RT (Chile) coupled with the level of technical skills of local people, encourage the firm to establish backward linkages with its suppliers.

**Forward Linkages**

RT (Chile) has established strong relationships with its clients. It provides continuous assistance to them because it is embedded in the service they provide. In other words, it is the main activity of the firm, its financial information and transaction services, which encourages the establishment of forward linkages.

**Corporate Social Responsibility**

The role of RT (Chile) is restricted to offering RT’s services to firms operating in Chile. It is not part of RT’s strategy to get involved in projects that go beyond its scope of activities; hence, no social responsibility linkages are established.

**Collaborative Agreements**

“Chile is not the focus of RT Latin America. So the resources allocated for the development of new products in Chile is limited. So as a creative way of doing things I have to look for collaborators” (5.1, p.7, 6-8). It is the size of the Chilean market that has discouraged RT from allocating more resources to the Chilean office. This situation has motivated RT (Chile) to look for low-cost alternative ways to innovate by establishing collaborative agreements with local agents.

The negative effect that the size of the Chilean market has on RT’s strategic decisions has two aspects. On the one hand, it has a positive effect on the Chilean office by motivating it to look for local collaborators to compensate for its limited resources.
On the other hand, the limited interest of RT in the Chilean market diminishes the potential for more collaborative agreements, especially those that could be established for the development of new products and services rather than “marketing solutions”.

**Degree of Linkage**

The following table summarizes whether the different types of linkages are established by RT (Chile) and their correspondent determinants.

<table>
<thead>
<tr>
<th>Type of Linkage</th>
<th>Yes/No</th>
<th>Determinants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Backward Linkages</td>
<td>Yes</td>
<td>Strategy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Size of market</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Economic environment</td>
</tr>
<tr>
<td>Forward Linkages</td>
<td>Yes</td>
<td>Main activity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Competitive position</td>
</tr>
<tr>
<td>Corporate Social Responsibility</td>
<td>No</td>
<td>Strategy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Size of market</td>
</tr>
<tr>
<td>Collaborative Agreements</td>
<td>Yes</td>
<td>Size of market</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Strategy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Local firm capability</td>
</tr>
</tbody>
</table>

From Table 6.5 it can be observed that the degree of linkage of ABC (Chile) is moderate. Although it has established collaborative agreements, these are not of high quality. This position is consistent with the proposition in Table 2.3 (Chapter 2) which establishes that market-seeking investment has the potential for moderate integration in the local economy.
6.7 Case 6: HH (Chile), Financial Services for Big Corporations

Affiliate Profile

This firm is a branch of an English bank, HH. HH (Chile) was established in Chile in 1981 through Greenfield investment. However, in 1993, the operations of HH (Chile) were transferred to a local bank, OH, with HH buying 10% of the shares of OH. After that, OH merged with another local bank, SB; in turn, HH’s participation percentage decreased. In 1997, HH increased its participation to 8%. In 2002, there was a merger between SB and a Spanish bank, SS; so, HH decided to sell its shares. Nevertheless, in 2000, HH bought the NR, a USA bank, which had a subsidiary in Chile that is now HH (Chile) (6.2, p.2).

HH is one of the bank groups of major size on a global scale; it is currently present in 82 countries. It focuses its activities on serving companies of large size, and offering international trade services, treasury and intermediation of investments (6.2, p.1). HH’s motive to invest in Chile was consistent with its strategy to be globally present. Although it has been present in Chile in various ways, it currently has its own subsidiary, HH (Chile), which is used as a platform “since Chile is a strong economy” (6.1, p.1, 42). “Through the network we work as a bridge for big MNEs. Also, for Chilean firms that want to go to China” (6.1, p.1, 23-24). That is, the characteristics of the Chilean market stimulated the foreign bank to invest in Chile; hence, HH’s motive to invest in Chile was market-seeking.

Since HH (Chile) is part of HH’s global network “each department has its own policies that are applied at a global level and we follow those standards policies” (6.1, p.3, 5-6). Nevertheless, “some things are adapted to the local reality, such as marketing” (6.1, p.3, 7). In terms of decision-making, “if it is about day-to-day operations decisions are made here” (6.1, p.4, 7-8). On the other hand, strategic decisions are made “at a regional level then they go to the parent firm” (6.1, p.4, 5). For example, although HH (Chile) is willing to expand its range of operations by offering its services to small and medium firms (SMEs), “the parent firm has the final
word” (6.1, p.4, 38). In other words, the scope of autonomy of the Chilean subsidiary is limited to short-term decisions.

HH (Chile) is highly dependent on its parent firm in terms of resources. The Chilean subsidiary is positively graded by financial rating agencies based on the support it gets from its parent firm (6.2, p.2). Specifically, HH (Chile) gets considerable capital contributions from its parent firm which allows it to have a capital to total assets ratio over the industry average (6.2, p.8). In addition, technology and training are also provided by HH.

Being part of a global network allows HH (Chile) “to develop specific solutions for the needs of the client, for instance international trade solutions” (6.1, p.). Moreover, “to be part of the global network allows us to support clients” (6.1, p.) since HH (Chile) “has the expertise and know-how to do all the documentation and all the necessary interactions that a firm or corporation needs to deal with when entering or operating in the Asian market, especially China” (6.1, p.). Specifically, it offers a wide range of global markets/treasury services, including local FX/money market products (spot, forwards, deposits, interest rate/FX derivatives); provides access to the financial markets with securities, repurchase agreements, and other sophisticated products; and has capabilities in the areas of payments and cash management (PCM), trade services and finance, export finance, and private banking. “We combine our extensive local market experience, sound trade service knowledge, and competitive pricing to give our corporate clients the solutions for their various business needs” (6.4, p.1, 6-8). In other words, HH (Chile)’s competitive advantage is its extensive expertise and know-how on how to do business with the Asian market supported by a wide range of sophisticated products and services, which are a result of being part of HH’s global network.

With regard to innovations, “at the moment we are receptors” (6.1, p.). The focus of HH is on developing new technological solutions for improving its service. For example, during 2006 and 2007, HH (Chile) has been in the process of implementing a new technological system, developed by the parent firm, for treasury transactions (6.2, p.3). In other words, it is the parent firm’s focus on innovation that has enabled HH (Chile) to introduce new systems to the financial sector in Chile.
**Linkage Formation: Indirect Linkages**

The banking sector has experienced important changes since 1980. The number of firms has decreased by more than 50% mainly due to several mergers. As a result, there are only a few big players, most of them foreign banks, that offer their services to various segments of the market. The remaining banks are of small size and focus on serving niche markets (2.2, p.1-4).

Within the Chilean banking sector, the Chilean branch has mainly focused on providing a suite of services for corporate customers (6.4, p.1). The strategy of HH (Chile) is to strengthen its position in niche segments such as middle market, corporates, and treasury activities by providing sophisticated products and services (6.2, p.1). “Based on banks that offer similar products it is well positioned” (6.1, p.2, 5). However, it has a market share of 0.42% as a result of its focus on niche markets (6.2, p.2). “A limitation is that many SMEs want to use the bank, but the bank doesn’t take them because they don’t match the profile of the firms the parent firm is willing to include in the portfolio” (6.1, p.2, 5-7).

Despite HH (Chile)’s small size in terms of employees (140), and market share, it influences the banking sector since “it dominates all the operations in Chile (regarding operations with the Asian market)” (6.1, p.1, 30). Specifically, “we affect in the sense that we offer much more sophisticated products/services related to the Asian market, so they can’t compete with us there. So, if they (competitors) have clients that want to operate in Asia, they’ll be in trouble” (6.1, p.4, 29-31).

**Linkage Formation: Direct Linkages**

**Backward Linkages and Local Sourcing**

HH (Chile) has not established backward linkages with local suppliers. “Technological products such as software are bought locally” (6.1, p.3, 18); however, “we evaluate alternatives; we don’t stick with one supplier” (6.1, p.3, 22-23). As a result, “we haven’t given any assistance to suppliers” (6.1, p.3, 28). In addition,
although technological products are sourced locally, “the firms we get it from are MNEs” (6.1, p.3, 15).

Besides technology, “we only get typical services and products locally” (6.1, p.3, 29). For instance, in terms of training “the corporation has centres that are very well recognized around the world” (6.1, p.4, 12).

In sum, although HH (Chile) sources standard and specialized products (technology) locally, it has not established backward linkages with local suppliers.

**Forward Linkages**

HH (Chile)’s clients are big local corporations such as the National Oil Corporation and the National Copper Corporation as well as affiliates of foreign firms (6.3, p.1). The Chilean branch provides assistance to clients to make investments, especially in the Asian market (6.4, p.1). Specifically, the bank provides its “expertise and know-how to do all the documentation and all the necessary interactions that a firm or corporation needs to deal with when entering or operating in the Asian market, especially China” (6.1, p.1, 30-32).

In sum, HH (Chile) has established a considerable number of forward linkages with clients. These linkages involve high quality and ongoing assistance.

**Corporate Social Responsibility**

HH (Chile) is involved in two social responsibility projects. The first project refers to its association to SIFE (Students in Free Enterprise). SIFE is a global non profit organization active in more than 40 countries. SIFE is funded by financial contributions from corporations, entrepreneurs, foundations, government agencies, and individuals. Working in partnership with business and higher education, SIFE establishes student teams on university campuses. These teams are led by faculty advisors and they are challenged to develop community outreach projects (6.7, p.1). HH (Chile) gives financial support to SIFE (Chile) with the objective to sustain the development of projects focused on finance education (6.5, p.1). The second project
refers to a “global warming” fund to be launched in December 2007. The fund will invest in firms dedicated to the development of global warming solutions.

In sum, HH (Chile) has established two social responsibility projects. However, its participation in these projects is limited to financial support; that is, there is no transfer of knowledge or expertise. However, it does have a positive impact on local industry by empowering local entrepreneurs to develop new businesses.

**Collaborative and Knowledge Agreements**

HH (Chile) has not established collaborative nor knowledge agreements with local firms.

**Determinants of Linkages**

**Backward Linkages and Local Sourcing**

The Chilean regulatory framework from the perspective of industrial policy does not influence the operations of HH (Chile) since “we take it as part of the rules, what has to be done, but does not influence our decisions” (6.1, p.2, 31).

In terms of capability of local firms, HH (Chile) perceives that “in general, the quality of services is at an international level” (6.1, p.5, 20). However, the affiliate buys standardized products and services locally while specialized products, except for technology, and services are obtained from overseas. With regard to technology, although it is sourced locally the suppliers are local branches of MNEs, with which the parent firm has signed a global contract. In addition, “we don’t stick with one supplier” (6.1, p.3, 23) in accordance with the parent firm’s policies. As a result of the strategy of the parent firm at a global level, HH (Chile) does not buy specialized products and services from local firms, which eliminates the potential for the establishment of backward linkages with them.
Forward Linkages

HH (Chile) provides continuous assistance to its clients because it is embedded in the service they provide. In other words, it is the main activity of the bank that encourages the establishment of forward linkages.

Corporate Social Responsibility

The Chilean branch is involved in two corporate social responsibility projects as a result of HH’s global strategy. HH has embraced “socially responsible” investment as a way to be competitive (6.6, p.1).

Collaborative Agreements

Even though HH (Chile) perceives the Chilean economic environment to be good – in terms of quality of institutions, local firms, and human capital – its range of operations is limited because “the market is not big enough … it is already saturated” (6.1, p.2, 24). As a result, the Chilean branch is used as a platform. That is, HH (Chile) is not encouraged to form high quality linkages with local firms due to its range of operations, which is determined by the size of the Chilean market.

Regarding FDI policy it does not affect the operations of HH (Chile). Specifically, FDI policy restrictions in terms of screening mechanism, expatriate employees, and capital repatriation are not perceived as limitations. For example, the expatriate employee’s restriction is not perceived as limiting by HH (Chile) since it “hires local employees. There is no need to bring people from overseas” (6.1, p.2, 38). Also, FDI policy in terms of tax, industry and location incentives does not have an effect on HH (Chile)’s operations. For instance, HH (Chile) pays taxes as a local firm does “because the tax is higher under that regime (DL 600)” (6.1, p.2, 41).

In conclusion, it is neither the regulatory framework nor the capability of local firms that discourages the establishment of high-quality linkages, but the size of the Chilean market.
**Degree of Linkage**

The following table summarizes whether the different types of linkages are established by HH (Chile) and their correspondent determinants.

<table>
<thead>
<tr>
<th>Type of Linkage</th>
<th>Yes/No</th>
<th>Determinants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Backward Linkages</td>
<td>No</td>
<td>Strategy</td>
</tr>
<tr>
<td>Forward Linkages</td>
<td>Yes</td>
<td>Main activity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Strategy</td>
</tr>
<tr>
<td>Corporate Social</td>
<td>Yes, two</td>
<td>Global strategy</td>
</tr>
<tr>
<td>Responsibility</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Collaborative Agreements</td>
<td>No</td>
<td>Size of market</td>
</tr>
</tbody>
</table>

From Table 6.6 it can be observed that the degree of linkage of HH (Chile) is low to moderate, following the categorization proposed in the research model. This position is partly consistent with the proposition in Table 2.3 (Chapter 2) which establishes that market-seeking investment has the potential for moderate integration in the local economy.
6.8  Case 7: EE (Chile), Electricity Services

Affiliate Profile

EE (Chile) was created in 1943 by GI, a government institution. During the 1980s it went through a privatization process that was completed in 1989. In 1992, EE (Chile) started its internationalization process establishing operations in Argentina followed by Peru, Colombia and Brazil. During its internationalization process EE, a Spanish corporation, progressively acquired 25.3% of EE (Chile). EE’s principal activities are generating, transmitting and distributing electric power, and related activities, which include engineering services and properties. In May 1999, EE bought an additional 34.7% of the shares, in this way becoming the controlling owner of EE (Chile) (7.7, p.1).

The principal activities of EE (Chile) and its subsidiaries are related to the generation and sale of electricity and also the sale of consultancy and engineering services of all kinds. Although EE (Chile) “generates the electricity…[it does] not distribute it to the final consumer” (7.1, p.1, 5). “Our focus is on the development of engineering projects to generate enough energy to supply our clients” (7.1, p.1, 14-15).

EE acquired the Chilean company motivated by the economic growth of Chile. “They had invested in Europe which is a much more mature continent than Latin America. So there was more potential for growth. Also there is closeness in terms of culture and language. They saw Latin America as an opportunity, with big growth potential” (7.1, p.4-5, 45-1). That is, EE acquired EE (Chile) for market-seeking reasons.

In terms of autonomy, although EE is the controlling parent company of EE (Chile), the remaining 40% is in hands of individual investors (from the New York stock market mainly), which “means that we need to comply with the highest norms of transparency and also they demand (40% individual shareholders) that the corporative norms are followed closely. So, we are not unilateral with regard to EE, we also operate in accordance with our shareholders’ demands” (7.1, p.4, 1-2). As regards to
EE (Chile)’s relationship with its parent firm “all the activities are coordinated…This means that I have to report to higher positions within EE (Chile), but at the same time I have to deal directly with people in EE who are in the same area that I am” (7.1, p.3, 33-35). In order to simultaneously coordinate activities with EE and comply with the other shareholders’ requirements EE (Chile) has “a Board of Directors who make the decisions” (7.1, p.3, 32). In other words, EE (Chile) is autonomous in terms of decision-making as to satisfy the demands of all of its shareholders.

Since EE (Chile)’s main operations focus on generating electricity its key inputs are infrastructure, technology, and human resources. While EE (Chile) was a State-owned company, the government invested enormous amounts of money on engineering projects for the construction of plants for generating electricity and the supporting infrastructure for the distribution of electricity (7.7, p.1). That is, “EE bought a MNE (EE (Chile)) that was already present in five countries. So the firm was already operating efficiently. However, there have been some improvements” (7.1, p.4, 35-37). For instance, “we are using the SAP system which is used by the whole group (EE) that allows us to manage our accounts almost like a bank” (7.1, p.4, 40-42). In other words, “we have adopted management practices from EE. This enables them to coordinate their activities with ours, in order to consolidate the corporation” (7.1, p.4, 7-8).

In terms of technology, EE (Chile) is “autonomous in that sense, we do not bring the technology from Spain. We look for what we think is the best around the world and sign contracts with suppliers of these technologies” (7.1, p.4, 31-33). Similarly, EE (Chile) does not rely on the parent firm in terms of human capital, “we do not have Spanish engineers coming here. We can do it with our own professionals. Moreover, some of our engineers go to Spain to help them” (7.1, p.4, 20-21). With regard to human resources practices, these have been originated both from the parent firm and from EE (Chile)’s human resources department. These practices are focused on continually improving work conditions and the capacities of the employees. For instance, in 2006, the firm focused on safety and health, and a comprehensive training plan to implement new working styles to improve capacities in terms of innovation, corporate social responsibility, and entrepreneurship (7.11, p.28).
EE (Chile)’s capabilities translate into vast expertise, solid operating performance, and continuous concern for improving sustainability. These capabilities, within an industrial environment characterized by increasing electricity demand, attractive investment opportunities and reasonable regulatory frameworks, have positioned EE (Chile) among the main power producers in Latin America (7.2, p.1).

EE (Chile) has introduced various innovations to the electricity services sector. Innovations in terms of generation of energy are originated at the affiliate’s level. For instance, EE (Chile) has embraced a project for the development of non-conventional renewable energies by constructing a wind park for the generation of electricity (7.8, p.1). In addition, the affiliate is involved in technological research projects with a local university to promote research and innovation applied to the electricity sector (7.11, p.32). Moreover, EE (Chile) has introduced innovations with regard to energy efficiency through modernization of hydraulic turbines, improving efficiency and increasing potency; and the implementation of an optimization system to obtain more energy per unit of combustibles (7.11, p. 32). Also, in terms of process control, a modern diagnostic and monitoring centre (CMD) was implemented in the main building of EE (Chile) as well as a control of energy generation centre (CCG).

Innovations in business practices have mainly originated from the parent firm, involving projects to identify new processes and business models to give value to society in accordance with the competencies of EE (Chile). In addition, EE (Chile) participates in NOVARE, a programme to motivate employees to generate innovative ideas. The programme selects innovative ideas and in a ceremony it gives prizes to the best ideas. The 19 firms of the EE group (Europe and Latin America) participate in this programme. In 2006, the prize for the best idea was given to a Chilean employee working in EE (Chile) (7.11, p.33).

As a result, EE (Chile) has introduced various innovations in the areas of product technology, production technology, distribution systems, management practices, and employment practices.
Linkage Formation: Indirect Linkages

Over the past decade, Chile completely privatized its electricity industry and unbundled the national generation, transmission, and distribution systems (7.13, p.3). All the activities within the electricity sector are in the hands of private firms while the government takes a regulatory role by establishing and monitoring the regulations to be followed by firms. There are 70 firms operating in the electricity sector across the country, 31 of them are generators of electricity, 5 are in the electricity transmission subsector, and 34 are distributors of electricity (7.12, p.1).

Chile has four electric grids in operation: the Central Grid, serving over 90% of Chile's population and more than 40% of the land area; the Northern Grid, which is mainly thermal and serves mostly mineral-processing centres in the region; and the Aisén and the Magallanes systems, located in the south of the country, serving remote areas, with a combined capacity of about 1% of the total. Coordination within each system is carried out by the economic dispatching centre (CDEC), an autonomous entity composed of members from all utilities within each system to ensure efficiency and security of the electric system. Aside from these four grids, "self producers" account for about 12% of national generation (7.13, p.3).

Among electricity generators, EE (Chile) is Chile's largest electricity producer, producing about 50% of the country's power. Chile's second largest electric power generator is GG, owned by a US firm, which produces just over 20% of total electric generation (7.13, p.3). In 2000 and 2001, several additional US and other international firms have become involved in the Chilean electricity sector through purchases of shares in generation and distribution companies (7.12, p.1). That is “there have been changes in the ownership of the firms in the sector. But, in terms of numbers we are about the same” (7.1, p.5, 10-11).

EE (Chile) is the largest electricity generation company in Chile measured by installed capacity and one of the largest electricity generation companies in Latin America, with investments in Chile, Argentina, Colombia, Peru, and Brazil. EE (Chile) participates in the Central Electricity Grid (SIC), Chile’s main interconnected system covering some 93% of the population. EE (Chile) and its Chilean subsidiaries have an installed capacity that represents approximately 50% of the SIC. The company also
participates in the Northern Electricity Grid (SING) through a subsidiary and a joint venture (of which EE (Chile) owns 50%) supplying various mining companies. The combined installed capacity of the subsidiary and the joint venture represents 27% of the grid (7.2, p.1). In terms of sales, EE (Chile) has 52% participation in the Central Electricity Grid (SIC), and has 35.7% participation in the electricity grid for the north of Chile (SING) (7.11, p.50).

As a result of its leading position as a generator, EE (Chile) has major impacts on the industry. Among electricity generators, it is a pioneer with regard to the practices to be taken in accordance with the “sustainable development” philosophy. In other words, EE (Chile) introduces innovations and reinforces practices that while contributing to profitability are socially responsible (7.14, p.4).

**Linkage Formation: Direct Linkages**

**Backward Linkages and Local Sourcing**

As a generator of electricity EE (Chile) needs specialized products (equipment, plant parts, turbines, etc.) that are tailored to the specific requirements of the production activities and investment projects of the firm (7.4, p.1). EE (Chile) makes its purchases and arranges its contracts on competitive conditions between suppliers and contractors, for which it calls private tenders. “Usually the firms that provide us with parts and equipment are from overseas” (7.1, p.7, 13). The firm requires its contractors to provide their services to the highest standards of quality and rigorous compliance with technical specifications, with tender bases, and with current regulations with respect to legal, labour, safety and environmental protection measures (7.4, p.1). As a result, EE (Chile) establishes collaborative relations with its suppliers and contractors (7.2, p.1).

With regard to local sourcing, EE (Chile) buys standardized products and services from local firms while it outsources non-core activities, such as finance, to MNEs established in Chile. Assistance with the maintenance of generation plants and equipment is also sourced locally, and granted to either local or foreign firms based on tenders (7.4, p.1).
In sum, the affiliate has established backward linkages with suppliers of specialized products; these suppliers are mainly MNEs.

**Forward Linkages**

EE (Chile)’s clients are “electricity distributors and any company that has a capacity of demand higher than 2 mega, like the big mining companies, cellulose producers, etc.” (7.1, p.1, 16-17). The firm signs contracts with its clients that stipulate the amount of electricity to be supplied and for how long. The clients need to be connected to the relevant grid, according to its physical location, for which they need appropriate technology “to be connected properly with the network. In this sense we interact with the clients so their technology is up-to-date” (7.1, p.1, 35-37). In addition, “since our clients are big companies we only have a few. So, we do have a close relationship” (7.1, p.1, 11-12).

In sum, EE (Chile) has established forward linkages with most of its clients in order to ensure that the supply of electricity is efficient.

**Corporate Social Responsibility**

EE (Chile) has embraced a strong policy of corporate social responsibility which is based on the vision and values it shares with its parent firm in Spain (7.3, p.1). This policy also assumes as its own the principles defined by the Sociedad de Fomento Fabril de Chile (Sofofa) (the Chilean manufacturers’ association), of which EE (Chile) is a member (7.3, p.2).

As a result of its policy, EE (Chile) is involved in various projects that are focused on three main areas: development of education in the communities where it operates; social and cultural development of the families in the communities where it operates; and protection of the environmental surroundings of its generating plants (7.3, p.4)

On the 21st July 2006, EE (Chile) was recognized by ACCION RSE\textsuperscript{16} to be the pioneer in terms of publication of sustainability reports and the constant
improvements in terms of integration with the community and the environment (7.11, p.1).

As part of its corporate social responsibility policy, EE (Chile) has established collaborative agreements with local universities (explained in detail in the next section) with the purpose of increasing the efficient use of resources so that the impact on the environment is minimal.

In sum, EE (Chile) is involved in a considerable number of social projects. However, most of the affiliate’s initiatives are oriented to the community. In these kinds of projects the affiliate is not sharing its knowledge and expertise with local firms; hence, their quality is limited to the improvement in social conditions rather than local industry upgrading. Nevertheless, those projects that focus on environmental issues have the potential to upgrade local industry since as a result of these projects the affiliate introduces new processes and practices to the electricity sector which have minimal impact on the environment while increasing the efficiency of operations.

**Collaborative Agreements**

In 1998, EE (Chile) and a local university established the “San Ignacio del Huinay Foundation”. The foundation’s purpose is to facilitate ongoing scientific research as well as to seek to preserve the biogeographical heritage of Huinay by means of scientific research and sustainable development techniques. In 2001 the Scientific Field Station commenced facilitating pioneering research in a variety of fields for both local and foreign researchers. As a result, “there is a lot of knowledge exchange” (7.1, p.6, 5), which mainly benefits the local university. EE (Chile)’s objective for the establishment of the foundation is “to get known” (7.1, p.6, 11). In other words, to establish a reputation for commitment to the environment in order to respond to, and strengthen, its brand image in the Chilean market.

In March 2006, EE (Chile) established a collaborative agreement with a local university to promote research and innovation applied to the electricity sector focusing on two main aims: 1) to study the energetic potential of the sea (Chilean seashore) and define the most appropriate technology according to the specific characteristics of the Chilean seashore; 2) to conduct research on information tools
applied to the electricity sector for improving control and monitoring practices (7.11, p. 32). While EE (Chile) offers its knowledge and experience regarding generation of energy to the projects, the local university provides research skills. As a result, new knowledge is generated that benefits EE (Chile) by having alternative ways of generating electricity and new practices that enhance its operations. The university benefits by having new knowledge that adds to its reputation and curriculum.

In sum, EE (Chile) has established two main collaborative agreements with local entities, specifically universities, mainly oriented to research and development.

**Determinants of Linkages**

**Backward Linkages and Local Sourcing**

EE (Chile) has established limited backward linkages with local firms since it gets specialized products and services mostly from overseas and from MNEs established locally. Local firms do not have the capabilities to supply specialized products to EE (Chile). “Each part is unique, so they have to be tailored, and the technology to do so is available overseas …We deal with big projects, big turbines, big equipment…the capacity to do it is not available locally, at least not the main parts” (7.1, p.7, 13-15).

On the other hand, EE (Chile) has established backward linkages, with both local firms and locally-established MNEs, for the procurement of standard products and specialized services. EE (Chile) provides ongoing assistance to suppliers as part of its procurement policy and in order to comply with industry regulations regarding environmental impact and efficiency (7.4, p.1).

In summary, while the capability of local firms has discouraged EE (Chile) from establishing backward linkages with local firms its main activity, its strategy (procurement policy) and the regulatory framework (industry policy) have led the foreign affiliate to form backward linkages.
**Forward linkages**

EE (Chile) has established forward linkages with its clients in order to ensure efficient supply of electricity. The government has taken a proactive role in the electricity industry through several entities. The government acts as a regulator through CEDEC (*Centro de Estudios por la Democracia y Defensa del Ciudadano*), which regulates the coordination between the companies that generate electricity and those that distribute it in order to make sure that the energy is distributed in the most efficient way (7.11, p.38). The government simulates a “model plant” that operates most efficiently under certain assumptions (7.11, p.48). The model plant proposes a “methodology, which we know very well, for the delivery of energy to the distributors …We do give assistance to all of these distributors” (7.1, p.1, 25-26).

In sum, EE (Chile) has established forward linkages with its clients driven by industry policy.

**Corporate Social Responsibility**

“Social responsibility practices are a factor in the competitiveness, sustainability and positioning of our company in the country” (7.3, p.2). In other words, EE (Chile)’s involvement with social and environmental projects responds to its strategy to accomplish sustainable growth in the Chilean market. This response is driven by the affiliate’s long-term commitment to the Chilean economy based on the country’s economic environment. “Since Chile has showed a constant increase of its GDP, it has resulted in a constant increase in the demand for electricity…there is still a long way to go in terms of production of electricity. In Chile, the demand for electricity is growing by between 6-8% per year” (7.1, p.2, 37-44). In addition, the affiliate’s policy of corporate social responsibility is based on the vision and values it shares with its parent firm (7.3, p.1).

In sum, as a result of EE (Chile)’s long-term commitment to the Chilean economy – as a result of the attractiveness of the local economic environment – and its
relationship with its parent firm, the affiliate has embraced a strategy that involves socially responsible projects. Hence, strategy and economic environment have been the determinants of social responsibility linkages.

**Collaborative Agreements**

EE (Chile) has been motivated to establish collaborative agreements with local universities in order to accomplish two main purposes. First, it aims to establish an “environmentally committed” reputation; this purpose goes in hand with its sustainable growth strategy. Secondly, it aims to respond to the requirements established by environmental and industry regulations, especially in terms of the “model plant”. In other words, the regulatory framework and the strategy encourage EE (Chile) to establish linkages with universities for the development of R&D projects.

**Degree of Linkage**

The following table summarizes whether the different types of linkages are established by EE (Chile) and their correspondent determinants.

<table>
<thead>
<tr>
<th>Type of Linkage</th>
<th>Yes/No</th>
<th>Determinants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Backward Linkages</td>
<td>Yes</td>
<td>Local firm capability</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Main activity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Strategy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Regulatory framework</td>
</tr>
<tr>
<td>Forward Linkages</td>
<td>No</td>
<td>Regulatory framework</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(Industry policy)</td>
</tr>
<tr>
<td>Corporate Social Responsibility</td>
<td>Yes</td>
<td>Economic environment</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Strategy</td>
</tr>
<tr>
<td>Collaborative Agreements</td>
<td>Yes</td>
<td>Strategy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Regulatory framework</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Local firm capability</td>
</tr>
</tbody>
</table>

From Table 6.7 it can be observed that, following the categorization proposed in the research model, the degree of linkage of EE (Chile) is high.
6.9 Case 8: EV (Chile), Consulting Services

Affiliate Profile

EV (Chile) was established in 1998 by EV (Spain) through Greenfield investment. EV (Chile) and EV (Spain) were originally DR (Chile) and DR (Spain) respectively. Both firms changed their names in 2004 when the employees of EV (Spain) and its subsidiaries around the world decided to buy the company from FJ, a Japanese corporation that established DR (Spain) in 1996 (8.9, p.3). As a result, EV is currently 100% owned by its professional employees (8.8, p.1).

After EV (Spain)’s successful performance in the Spanish market, including the establishment of two offices – Lisboa and Barcelona, besides the first one in Madrid – it decided to expand its operations to Latin America (8.9, p.3). “When EV (Spain) decided to open its first office in Latin America, it chose Chile in order to develop projects with local firms” (8.1, p.4, 4-5). It was “the economic stability of Chile, which made them think that it was feasible to create an affiliate that would be successful in five years time” (8.1, p.5, 6-7). That is,

“What I mean is that a country that it is unstable it doesn’t show consistent economic development. As a consequence the firms operating in such an economy would rarely need our services. In the case of Chile, it is stable so firms have long-term objectives and hence, do need our services” (8.1, p.5, 11-14).

In addition, “it also considered the fact that the Chilean professional is considered of good level. This belief was demonstrated by the fact that the other offices in Latin America were opened from Chile” (8.1, p.4, 5-7). In other words, the motive of investment of EV (Spain) in Chile was market-seeking.

Although EV (Spain) was owned by FJ it “has always been autonomous from FJ. This means that we (EV (Chile)) have always had EV (Spain) as our parent company and we have a close relationship” (8.1, p.1, 19-21). Accordingly, the relationship between EV (Spain) and its subsidiaries did not change as a result of the change of ownership
in 2004. In terms of EV (Chile)’s autonomy, “the firm in Madrid is the parent firm in
terms of experience, management style, etc. However, we are autonomous [while
considering that]…the offices around the globe are all interdependent of each other,
we are a global network. We work closely together” (8.1, p.1, 31-33). In other words,

“Each office has its own structure. We make our own decisions. However, we do have an
“associates committee” for making long-term decisions, those that involve investment and
global strategies. We are all free to participate, to propose projects and the committee decide”
(8.1, p.1, 36-42).

As part of a global network, EV (Chile) shares common management practices and
methodologies with EV (Spain) and the other offices around the world. “We have two
methodologies. One that we inherited from FJ and the other one we have been
developing for two years” (8.1, p.2, 1-3). EV supports its methodology by using
Macroscope (inherited from FJ) as a guide; Macroscope is a registered brand of FJ. At
the same time EV has been developing COM (Corporate Methods) which is a
methodology for the management of knowledge (8.6, p.1). In addition, EV has a
Quality Management System which is used in every office of the network, and is
certified under the norm ISO 9001:2000 (8.6, p.2). With regard to the source of these
resources, although EV counts on an IT tool that “allows anyone in the global network
to work on a particular project …we are 550 people in Chile while in Spain there are
more than 2000. So, as a consequence most of the practices, methodologies and
processes are developed by people in Spain” (8.1, p.2, 8-14).

As a provider of consulting services, EV (Chile) offers global solutions to its clients,
covering all the activities of the value chain (8.9, p.1) including the development and
maintenance of software. For the development of software EV (Chile) relies on the
centres of EV in Madrid, Barcelona and Sao Paulo (8.6, p.2). Similarly, in terms of
human resources, “in order to further local capabilities, we are hiring recently
graduated people from university…and send them to work in EV (Spain) for two
years…as a result, they come back to Chile with new ideas and experiences that can
be implemented here” (8.1, p.4, 10-14). In other words, most of the key resources of
EV (Chile) – such as training, technology and methodologies – are obtained from EV
(Spain).
The supply of integrated services supported by its global network and alliance with ICT suppliers constitute a competitive advantage for EV (Chile) (8.9, p.2). The global nature of the firm means that “we are able to have ‘global knowledge’…This global knowledge enables us to suggest the client best practices, methodologies, etc.” (8.1, p.2, 41-44). In addition, its ownership form (100% owned by its professionals), makes EV (Chile) totally devoted to being successful and providing innovative and successful solutions to its clients from a global perspective (8.9, p.3). As a consulting firm, a key resource is human capital that constitutes a competitive advantage in view of the fact that they are highly trained, and always dealing with complex projects which provide experience and know-how for developing innovative solutions in accordance with the changes in the market (8.9, p.3).

In terms of innovation, the nature of EV (Chile) as a consulting firm is innovative. Every service it provides is innovative since it has to be tailored to the specific situation of the client, which is also always changing. As a result EV (Chile), in conjunction with suppliers of ICT solutions, is always involved in the development of new solutions for various sectors and activities. Moreover, it provides services to implement strategies to achieve a culture of innovation in organizations. In other words, EV (Chile) innovation is to provide methodologies for firms to become innovative (8.7, p.1).

**Linkage Formation: Indirect Linkages**

The consulting services sector in Chile experienced its major growth during the 1990s as a result of the increasing opening up of the economy which led to the internationalization of local firms and increasing inward foreign direct investment. As a response to the increase in the level of competitiveness (higher levels of productivity) of various sectors of the Chilean economy, consulting services became highly demanded by local and foreign firms in order to keep up with the dynamism of the market. The sector’s growth spurt slowed down at the beginning of the new century as a consequence of a global recession. Nevertheless, with the reactivation of the Chilean economy the consulting services sector has continued to grow, mainly due to the introduction of new concepts that offer opportunities for improvement to firms, and
access to innovative solutions in accordance with the global situation and the Chilean reality (8.9, p.7).

In Chile, the consulting services business has expanded in different directions such as human resources, taxation, marketing, management, and quality, which are the most demanded services. Most of the consulting firms are concentrated on accounting and taxation services, followed by legal services and those related with human resources. The consulting services sector is highly competitive as a result of the entry of MNEs into the sector. Consequently, the sector operates under international standards. Although the sector has been dominated by international firms, the experience of local consultants has led to the establishment of local consulting firms that have taken a considerable portion of the market share of foreign firms. In addition, local firms are focusing on small and medium sized firms in order not to compete directly with MNEs, which are very well positioned in the global companies market and leading local firms (8.9, p.8).

In terms of numbers, it is estimated that there are about 300 consulting firms in Chile, which vary in size and service provided. Accounting and taxation consulting MNEs take about 85% of the consulting services market, supporting their leadership on their global network and focus on innovation (8.9, p.30).

With regard to consulting services that provide solutions that include IT, such as the service provided by EV (Chile), this subsector has grown in line with the implementation of new technology that demands previous studies that allow choosing the most appropriate IT solution in accordance with the needs of the client (8.9, p.30). Within this sector, a study undertaken by a local university in 2006 positioned EV (Chile) as one of the leaders in the IT consulting sector. According to the study, based on surveys administered to users of consulting services and IT services, relative to all the other players in the IT industry (This includes providers of IT services which are not consulting firms.), EV (Chile) is highly rated in terms of quality of services and compliance (third to Orion 2000 and Equant) (8.10, p.3). Orion 2000 provides solutions for information safety; it does not provide services comparable to EV (Chile) while Equant provides similar services. Hence, EV (Chile) can be placed second within its subsector, as perceived by users of the services.
EV (Chile) has influenced the sector by introducing new ways of providing consulting services related to IT solutions, for example, the creation of a consortium of suppliers to introduce a new banking solution to several banks at the same time. In addition, competitors have followed EV (Chile)’s steps in terms of training, “we know that there are some firms that are imitating us with regard to the postgraduate courses” (8.1, p.7, 28).

**Linkage Formation: Direct Linkages**

**Backward Linkages and Local Sourcing**

EV (Chile)’s main input is information technology (IT). The affiliate works with IT suppliers based on “partner alliances, we do not have contracts” (8.1, p.7, 42). “To be a partner means that we know the technology and we are able to implement it. But that does not force us to use “that” IT tool” (8.1, p.7, 42). Although EV (Chile) does not grant exclusivity to a particular IT provider, it establishes close relationships with providers in order to develop new solutions, in conjunction, with meeting the specific needs of EV (Chile)’s clients. In other words, these “partnerships” involve the exchange of information and expertise.

In terms of training, EV (Chile) provides training to its newly hired professionals by sending them to EV (Spain). However, for “post-training” EV (Chile) works with a local university to provide postgraduate courses to its consultants. “The course focuses on those weaknesses that we see the professionals have such as new technologies, new types of business that are appearing in the market, which are not well known. So we work with the University to give training to our people in those areas” (8.1, p.7, 13-16).

Although EV (Chile) works with IT suppliers operating locally, these firms are MNEs. Hence, the affiliate has established backward linkages with several IT suppliers but these are not local firms. EV (Chile) has established one backward linkage with a local university in order to provide training to its professionals.
Forward Linkages

EV (Chile) has both local and foreign firms as clients. Nevertheless, most of them are regional players (not locally-owned firms), which are present in several countries in the Latin American region. A third of EV (Chile)’s clients operate in the telecommunications sector, another third in the financial sector, and the remaining third in the industrial sector (8.2, p.1).

EV (Chile) offers a wide range of services and solutions (methodologies, ICT, etc), specifically developed according to the specific characteristics of the sector the client is in (8.4, p.1). “More than just giving a service we create a long-term relationship with them (clients) … We want to grow with the client and if it is possible never leave them” (8.1, p.2, 29-31). “As a consulting firm you provide them (clients) with a methodology and you guide them through the implementation process” (8.1, p.2, 38-39).

In sum, EV (Chile) has established forward linkages with all of its clients. However, most of its clients are foreign- rather than locally-owned firms.

Corporate Social Responsibility

EV (Chile) has been involved in minor social projects such as “Un techo para Chile” (a roof for Chile), which provides homes to people living in extreme poverty. In addition, it donates its old computers to low-resourced schools. Although these initiatives help with the social conditions of the country they do not involve transfer of knowledge or experience.

EV (Chile) has established one major social project that involves transfer of knowledge and experience by providing work experience to university students. The affiliate has worked with five local universities in the south of Chile and has established “development centres” inside the universities. The universities have helped EV (Chile) to promote the part-time jobs offered by the affiliate. EV (Chile) offers a wide range of part-time jobs in order to suit the various areas of study
(management, IT, publicity, etc.). The students are supported and guided by EV (Chile) professionals, who are assigned to the onsite development centres (8.2, p.1).

In sum, EV (Chile) has established corporate social responsibility linkages which involve the transfer of knowledge with five local universities.

**Collaborative Agreements**

The “Development Centres” (corporate social responsibility project) are a result of collaborative agreements with local universities. EV (Chile) develops the centres and provides the universities with hardware and software. In addition, “we provide highly qualified employees to work with the students in order to introduce them to our methodologies and as well to expose them to real-life situations…The University provides us with the physical space and promotes us, so last year’s students get motivated to work in these centres” (8.1, p.4, 41-46). As a result, EV (Chile) benefits by preparing potential employees while the universities benefits by having the opportunity to further develop the skills of its students, hence, increasing its reputation.

EV (Chile) has established a collaborative agreement with a Spanish telecommunications company and an Indian IT company (providing core banking solutions). The agreement was established to implement new banking software in several banks operating in Chile. “The idea is that other banks of medium size in Chile join this consortium, so we can provide the same service to more clients within the same project” (8.1, p.6, 30-32). The banks benefit since “their size doesn’t allow them to make the necessary investment…They share the cost of the software…and help to improve the bank products” (8.1, p.6, 34-37). EV (Chile) and both of its partners benefit since in conjunction they provide a new service that becomes the standard of the banking sector, in this way, “forcing” other banks to hire them. From the perspective of EV (Chile), the Indian IT firm complements the affiliate’s experience in the banking sector by providing IT solutions that allow EV (Chile) to offer high-standard services for the banking sector (8.5, p.1).
In sum, EV (Chile) has established two collaborative agreements. The first involves local universities and helps to upgrade local human capital while the second one was established with foreign firms, but helps upgrade the banking sector, including local banks.

**Determinants of Linkages**

**Backward Linkages and Local Sourcing**

As part of its strategy, EV (Chile) establishes associations with suppliers of technology (software and hardware) but without engaging in exclusivity. These associations allow EV (Chile) to get access to knowledge about new ITC tools in advance so it can assess clients with their strategic decisions (8.5, p.1). Although the relationships are not exclusive they involve exchange of information and knowledge since “we need to train people [to] learn how to operate and implement the IT solution” (8.1, p.5, 41). In other words, EV (Chile)’s strategy of non-exclusivity positively influences the extent of backward linkages while its main activity – providing comprehensive consulting services including the implementation of IT solutions – determines the high quality of these linkages. Nevertheless, MNEs have been preferred over local firms (8.5, p.1) as providers of IT solutions based on the quality of their products; “we choose those IT solutions that are of high quality” (8.1, p.5, 42).

In terms of training, EV (Chile) has established an association with a local university to provide postgraduate courses to its employees since its main activity demands its consultants to be updated in terms of new business, new technologies, etc.

In sum, it is the main activity of EV (Chile) and its strategy that drives the firm to establish backward linkages. Nevertheless, the capability of local firms (IT sector) discourages the affiliate from forming linkages with local suppliers of IT.
Forward Linkages

EV (Chile) has established strong relationships with its clients. It provides continuous assistance to them because it is embedded in the service they provide. In other words, it is the main activity of the affiliate – consulting services – that encourages the establishment of forward linkages.

In addition, the regulatory framework has helped EV (Chile) to strengthen its relationships with its clients. For example,

“[the open position of the Chilean government towards international regulations facilitates our operations]…there is a new accountancy method that it is being implemented in Chile right now and will be compulsory from 2009, which is the European accountancy system. In Europe it has already been implemented, but it hasn’t in Chile. So, for us it means that our clients have to implement this new method and we can help them do it” (8.1, p.3, 28-32)

Corporate Social Responsibility

The establishment of corporate social responsibility linkages with local universities, “has to do with our social responsibility code. We think we have to give something to the society not by doing charity, but by training the future professionals of the country” (8.1, p.5, 1-3). Furthermore, it is Chile’s economic environment – in terms of local professionals, quality of institutions, and economic stability – which has motivated EV (Chile) to have a long-term commitment to the economy; “we think that Chile is an adequate platform for doing consulting…that is why we have been investing and working with Universities” (8.1, p.4, 20-22).

In sum, the affiliate’s strategy and Chile’s economic environment have influenced the decision to establish corporate social responsibility linkages.

Collaborative Agreements

The “Development Centres” (social responsibility project) are a result of collaborative agreements with local universities. EV (Chile) was driven to get involved in this project for the following reasons. First,
“In Chile, graduates start their work career with a lot of theoretical knowledge but no experience. This means that they do not have enough skills that are necessary to be successful in the workplace. It takes us about a year and a half of training to develop those skills…this “weakness” is not good for us as a country. So, we are trying to anticipate that year and a half by giving the opportunity to university students to work” (8.1, p.4, 23-28).

Secondly, by helping with the qualified workforce of the country EV (Chile) is preparing potential consultants, “our company’s only asset is human resources and we get it from universities” (8.1, p.7, 25).

The collaborative agreement established with two foreign-owned firms to create a consortium to provide with new banking software to a group of banks in Chile was enabled by changes in regulations in the banking sector. That is, banks will need to comply with new regulations (based on international regulations) that results in the need for new IT systems. Hence, in order to seize this opportunity EV (Chile) identified locally established players (foreign-owned firms) that complement its capabilities in order to provide “the same service to more clients within the same project” (8.1, p.6, 31-32). This way banks “gain optimization of processes, they become homogenized….so the changes in regulations can be adopted conjunctly with other members of the consortium” (8.1, p.6, 34-36).

In sum, EV (Chile)’s long-term commitment to the local economy and the “weaknesses” of local human capital (in terms of recent graduates) have motivated the affiliate to establish collaborative agreements with local universities, its main source of human resources. The regulatory framework has played an important role on EV (Chile)’s operations by creating an opportunity to expand its portfolio of clients by establishing collaborative agreements with locally-established firms.

**Degree of Linkage**

The following table summarizes whether the different types of linkages are established by EV (Chile) and their correspondent determinants.

From Table 6.8 it can be observed that the degree of linkage of EV (Chile) is high, according to the categorization proposed in the research model.
Table 6.8
EV (Chile): Types of Linkages and Determinants

<table>
<thead>
<tr>
<th>Type of Linkage</th>
<th>Yes/No</th>
<th>Determinants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Backward Linkages</td>
<td>Yes (several with MNEs, one with local entity)</td>
<td>Main activity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Strategy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Local firm capability</td>
</tr>
<tr>
<td>Forward Linkages</td>
<td>Yes</td>
<td>Main activity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Regulatory framework</td>
</tr>
<tr>
<td>Corporate Social</td>
<td>Yes, one major project</td>
<td>Strategy</td>
</tr>
<tr>
<td>Responsibility</td>
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<td>Economic environment</td>
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<tr>
<td>Collaborative Agreements</td>
<td>Yes, two</td>
<td>Local human capital</td>
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<tr>
<td></td>
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<td>Local firm capability</td>
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<td></td>
<td>Regulatory framework</td>
</tr>
</tbody>
</table>

6.10 Conclusion

The main purpose of this chapter was to present the within-case analysis and findings. Notwithstanding the individuality of each firm, they shared common features. Each firm could be adequately described in terms of profile, linkage formation, determinants of linkage formation, and degree of linkage. In addition, although the case firms operate in various sectors of the economy all of them fall under the UNCTAD’s (2004) categorization of services. Moreover, all the case firms have been motivated to invest in Chile for market-seeking reasons. This position is consistent with the UNCTAD’s (2004) statement that most services FDI is market-seeking.

Despite the fact that all the case firms have established some kind of linkage with the local economy, the degree of linkage of the affiliates presented differences. Some affiliates were moderately embedded in the local economy while others presented a high degree of linkage.

Whereas the focus in this chapter is on the individual character of each firm in the study, the fact that all of the case firms shared common features while presenting some interesting differences provided a basis to advance analysis. In the pursuit of understanding how FDI influences the local industry, based on similarities and
differences between foreign-owned affiliates, a process of across-case analysis was undertaken. It is presented in the next chapter.

1 For lawyers in Chile a practicing certificate is granted by the Supreme Court and a Chilean law degree is required. There are some exceptions for foreign lawyers with a law degree from a country which Chile has a previous agreement with (Andres Bello Agreement). In that case the foreign lawyer has to study the last two years of law degree in a Chilean University and finally get the practicing certificate from the Supreme Court (documents 1.8 and 1.9).

2 Credit rating agencies are independent companies that devote themselves to analyze the credit quality of different bond issuers, based on a deep analysis of the macroeconomic and sectorial environment and the analysis of the specific condition of the issuer (financial conditions, structure of income and expenses, management, etc.), qualifying them in different categories. Among the agencies of major international prestige there is Moody's, Standard and Poor's and Fitch IBCA, These agencies usually use similar nomenclature. There are two generally recognized categories “Investment grade” and “Speculative”, according to the high or low solvency of the issuer respectively (Business Wire, 2001). In a global economy, sovereign credit ratings are crucial to informing investors around the world of a country’s creditworthiness. Making investment grade signals that a country is viewed as nowhere near a default. Indeed, many institutional investors will not invest in a country that lacks the prestige of an investment grade rating (Business Wire, 2001).

3 Internationally the operations of commerce are regulated by the International Chamber of Commerce, which publishes the UCP that correspond to customs and common practices to handle conflicts between parts. There are several UCPs for collections, for international payments, for credit letters, etc. (document 2.13)

4 “We receive raw water in its original state to produce drinkable water and to distribute it to every household, business or industry in Santiago. Then, we treat the waste water, and finally, return it clean to the environment.” (4.7, p.1, 16-18).

5 In 1999 only 3% of served water was treated in Santiago. Today, after the strong plan of investment carried out by AA, the percentage is close to 70%. (4.7, p.2)

6 In this context, the investment in the sector was preferably public, and economic decisions of improvement of service quality and its coverage competed with the priorities of investment of the public expenditure, including expenses in social areas (4.9, p.1).

7 In 1995, the process of privatization accelerated since the need for investment was highly increased due to the requirement imposed by other countries through Free Trade Agreements. The requirements established that in the short-term Chile would have to invest heavily in sewerage systems and plants in every urban sector of the country (4.9, p.1).

8 The establishment of tariffs is done by the Superintendence of Sanitary Services of Chile (SISS), which simulates a model company that operates at efficient levels. From this simulation of efficient operations costs are calculated and finally an efficient tariff is determined (4.9, p.1).

9 ISO stands for International Organization for Standardization, which establishes international standards for business, government and society.

10 “For instance we had a problem where in poor neighborhoods the kids were playing with the fire hydrants so we were losing water, but instead of making harsh decisions we built fountains so the kids could play there. We also have a park where people can go and visit. In the middle of the park there is one of our plants…so the idea is to create walk paths and the community can walk through the park and kids can watch the ecosystem. We also did plumbing courses for stay-home mothers. This is a way to prevent people from wasting water through knowing how to fix leaks” (4.1, p.5, 40-46).
The aim of Pro Til Til Corporation is to support the sustainable development of the Til Til town by developing initiatives in terms of education, health, environment and entrepreneurship.

The company promotes the responsible use of the sewerage and drinkable water through its social program “Water at home”, which focuses on poor neighborhoods. Thanks to this initiative, the problems of obstruction of sewerage have decreased and consciousness concerning the correct use of the wastepipes and different sanitary infrastructures has increased (4.2, p.1).

“Through this software, for instance, before a building is built the software can be used to determine the risks involved and hence take appropriate measures to minimize potential damage.” (4.1, p.3, 21-22)

“For instance, some universities or small firms that are branches of big local firms” (5.1, p.7, 12).

“The economic factors are important since there is a high correlation between the GDP and the demand for electricity. Also, the electricity is in a privileged position since it is an important sector for the industrial development of a country. Hence, the more economically developed a country is, the higher is its demand for electricity. Since Chile has showed a constant increase of its GDP, it has resulted in a constant increase in the demand for electricity, [and]...there is still a long way to go in terms of production of electricity. In Chile, the demand for electricity is growing between 6-8% per year. At this rate the number of plants has to be duplicated every 10 years” (7.1, p.2, 34-45).

Accion RSE is a non-for-profit organization initiated by Chilean entrepreneurs to promote social responsibility to firms operating in Chile. The organization has been supported by the leading firms in Chile, which have driven the activities of the organization (7.15, p.1).

The territory nearly covers 34,000 hectares at the very south of Chile (tenth region).

EV refers to whole group of firms that operate in different locations, of which EV (Spain) is the parent firm.

During the economic recession at the beginning of the century many professionals were dismissed from their jobs, which lead to some of them to initiate new business in the consulting services sector (8.9, p.30).
Chapter 7  Across-Case Analysis and Findings

7.1.0 Introduction

This chapter describes the across-case analysis undertaken in this study and the understanding it generated of how FDI impacts local industry upgrading in the context of the firms included in the sample frame. While the within-case analysis (Chapter Six) focused on the level of embeddedness of individual firms, and the influencing factors, it also suggested the presence of common elements (firm characteristics, linkage formation, determinants of linkages) across firms. To achieve a clearer understanding of the elements that the firms share, the across-case analysis considers the cases in the sample frame in groups and as a whole.

The across-cases analysis synthesized the findings of within-case analysis to develop a wider level of understanding (Noblit & Hare, 1988). In order to do so, groups of similar firms across the sample frame were identified, analysed and compared as a stepping stone toward a focus across-cases as a whole. During the analytical process the tension between the issues that are specific to individual firms and those qualities that are shared across firms were reconciled (Silverstein, 1988). In accordance with the phenomenological methodology underlying the study, the experience of informants provided the basis for understanding the common elements across firms.

The chapter consists of 10 sections. The first two sections progressively describe the steps undertaken to identify a suitable framework for classifying like groups of firms. The third section describes how case firms are grouped using the selected framework. Section 4 considers the variables under study further by reordering the information into groups. Section 5 identifies the nature and types of determinants of linkages within groups and across-cases in order to provide a basis for reviewing case firms in terms of linkage formation and the factors identified during within-cases as influencing linkage formation (Section 6). Section 7 provides the findings from the across-cases analysis with regard to the factors, reported in individual cases, which influence linkage formation while reviewing the types of linkages established by case firms. Section 8 reviews case firms’ degree of linkage and profile in groups as well as
across-cases. Section 9 examines each of the case firms groups based on various characteristics. Finally, Section 10 provides the conclusions of the chapter.

### 7.2.0 Meta-matrix: Initial Look Across Cases

This section describes the first step in across-case analysis in which the affiliate profile, linkage formation, determinants of linkage formation, and degree of linkage from within-case analysis were reviewed and considered collectively. In order to have an initial look across cases a partially ordered meta-matrix of the individual within-case analyses was developed. The meta-matrix included rows for firm characteristics (affiliate profile), indirect and direct linkages (linkage formation), determinants of linkages and degree of linkage previously used to frame the within-case analysis.

The data from within-case analyses were compressed and entered into the meta-matrix. (To see the meta-matrix refer to Appendix D.) After several reviews the process of building the matrix produced six A4 pages similar to the “monster dog” (Miles & Huberman, 1994). The matrix provided a basis to consider the case firms on a “variable basis” (Miles & Huberman, 1994) using the major conceptual categories (affiliate profile, linkage formation, determinants of linkages, degree of linkage) and the specific variables within each category. Consideration of these concepts and variables across-cases was the first step in understanding the data set as a whole.

### 7.2.1 Affiliate Profile

Examination of firm characteristics indicated that all of the firms operate within the service industry, following the categorization used by the United Nations (2004). Consistently, all the firms came to Chile motivated by market-seeking reasons. In addition, to some extent, all of the firms rely on the resources gained from the parent firm as sources of competitive advantages. Accordingly, none of the firms has invested in Chile in order to gain or develop local innovation. Despite these common characteristics, the affiliates differ in terms of country of origin, age, mode of entry, ownership form, level of autonomy, role of the affiliate, and size.
The affiliate profile constitutes the basis for a deeper understanding of the process of local industry upgrading by providing firm-characteristics that may be related with a lower or higher degree of linkage. That is, by examining firm characteristics in conjunction with linkage formation and degree of linkage, it is possible to identify those firm characteristics that are related to a higher degree of linkage.

7.2.2 Linkage Formation

All the firms operate in sectors within the service industry that have experienced considerable changes in terms of competitiveness of firms. Most of the case firms are major competitors in Chile while those that are small competitors locally belong to big corporations that are major players internationally. As a result, although varying in extent, all the firms have influenced the competitive environment mainly by incorporating innovations into their respective sectors of operation.

With regard to direct linkages with local firms, almost all of the firms have established forward linkages with customers as a result of the service nature of their activities, and have provided some kind of assistance to customers and/or suppliers. Those firms that have established backward linkages have done so mainly with foreign-owned firms rather than locally-owned ones. These firms assist their suppliers in order to ensure that their specific needs are met consistently.

In terms of local sourcing, the majority of firms source only standard products and services since they either rely on the parent firm or MNEs not operating locally for the supply of specialized products and services. Those firms that source specialized products and/or services locally mainly deal with MNEs that are established in Chile.

None of the firms included in the sample frame has established knowledge agreements. On the other hand, more than half of them have established some kind of collaborative agreement¹. Most of the firms that have established collaborative agreements have done so with local universities.
Finally, during the data collection process a new type of linkages was identified that involves the transfer of knowledge and expertise from the foreign-owned affiliate to the local industry. These we have identified as corporate social responsibility (CSR) linkages. In most cases the transfer of knowledge and experience is done through projects that do not involve a direct relationship with local firms.

### 7.2.3 Determinants of Linkage Formation and Degree of Linkage

All firms have established direct linkages with local entities. As a result none of the case firms can be said to have a low degree of linkage. That is, all firms have either a moderate or high degree of linkage, following the categorization proposed in the research model. This situation is a result of the service nature of all the firms included in the sample frame, a nature which commonly leads to the establishment of forward linkages (moderate linkages).

For across-cases informants who have stated that they have not established backward linkages in the local economy, the main reported factor restricting this type of linkage is the strategy of the parent firm. As part of its strategy the parent firm establishes global contracts with other MNEs for the supply of specialized products and/or services, especially technology. Those firms which have established backward linkages in the local economy are motivated by varying factors. Nevertheless, the economic environment, in terms of economic stability, has played an important, positive role on linkage formation for several firms. Likewise, the economic environment has been a determining factor for the establishment of corporate social responsibility (CSR) linkages. In other words, the characteristics of the Chilean economic environment, such as economic and political stability and transparency of institutions, results in the foreign affiliate’s long-term commitment to the local industry, which encourages the formation of direct linkages.

Whether the foreign affiliates have established collaborative agreements with local entities or not mainly correspond to factors related to the affiliate’s profile. Nevertheless, those case firms that have established collaborative agreements have
been partly motivated by the regulatory framework (industry policy, changes in regulation, international standards).

The understanding drawn from the first consideration of the partially ordered meta-matrix of case information served to confirm the diversity of foreign affiliates’ influence on local industry through linkages across the firms. To generate a measure of initial clarity across cases, the partially ordered meta-matrix was further reviewed to search for patterns and groupings within the case information.

### 7.3.0 Seeking Order Across-cases

To get a better understanding across cases, groups of like cases within the sample frame were identified. As a result, the analysis process was condensed from one of looking over eight cases to one of looking across three groups of cases. This section describes the process of selecting a framework with which to identify and classify like groups of firms. In order to identify groups of like cases within the sample frame the partially ordered meta-matrix was condensed as shown in Table 7.1.

This increased focus provided a basis to search for commonality among firm characteristics and influence on local industry (linkage formation and determinants). This search focused first on the affiliates’ profiles and then on their level of embeddedness based on linkage formation.

Consideration of affiliate profile first reviewed the foreign affiliate’s country of origin. Although across the firms their countries of origin vary, it is possible to divide the sample frame into two groups. On one hand, there are those affiliates whose country of origin is Spain (three cases). On the other hand, the second group includes the remaining firms whose countries of origin are non-Spanish speaking countries (USA, UK, Canada, and Netherlands).

The main activity of the affiliate was then considered in order to identify whether the first attempt at clustering, based on country of origin, was an appropriate starting point. Some similarities were found among the firms’ activities within each group.
<table>
<thead>
<tr>
<th>Case/ Variable</th>
<th>Case 1</th>
<th>Case 2</th>
<th>Case 3</th>
<th>Case 4</th>
<th>Case 5</th>
<th>Case 6</th>
<th>Case 7</th>
<th>Case 8</th>
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</thead>
<tbody>
<tr>
<td><strong>AFFILIATE PROFILE</strong></td>
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<tr>
<td>Country of origin</td>
<td>USA</td>
<td>Netherlands</td>
<td>Canada</td>
<td>Spain</td>
<td>UK</td>
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<td>Spain</td>
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<td>Corporate financial services</td>
<td>Oil and gas consulting services</td>
<td>Water services</td>
<td>Financial information services</td>
<td>Corporate financial services</td>
<td>Electricity services</td>
<td>Consulting services</td>
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<tr>
<td>Age</td>
<td>30/12</td>
<td>17</td>
<td>2</td>
<td>146/8</td>
<td>40</td>
<td>26</td>
<td>64/10</td>
<td>9</td>
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<td>Chilean branch</td>
<td>Chilean branch</td>
<td>Chilean firm owned by foreign individuals</td>
<td>Chilean firm owned by foreign company</td>
<td>Chilean branch</td>
<td>Chilean branch</td>
<td>Chilean firm owned by foreign company</td>
<td>Chilean firm owned by individuals (local and foreign)</td>
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<td>Total influence</td>
<td>Major influence</td>
<td>Moderate influence</td>
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<td>Total influence</td>
<td>Major influence</td>
<td>Moderate influence</td>
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<td>SME</td>
<td>SME</td>
<td>Big</td>
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<td>Yes, many</td>
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<td>Yes, many</td>
<td>Yes, many</td>
<td>Yes, many</td>
<td>Yes, many</td>
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<tr>
<td>Innovations &amp; source</td>
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<td>Yes, parent</td>
<td>Yes, parent</td>
<td>Yes, both and affiliate</td>
<td>Yes, parent</td>
<td>Yes, parent</td>
<td>Yes, parent and affiliate</td>
<td>Yes, parent and both</td>
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<tr>
<td>Investment to gain or develop local innovation</td>
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<tr>
<td>Source of main competitive advantages</td>
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<td>Parent</td>
<td>Parent</td>
<td>Both and parent</td>
<td>Parent</td>
<td>Parent</td>
<td>Affiliate and parent</td>
<td>Parent</td>
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<tr>
<td>Main competitive advantages</td>
<td>-Experience expertise &amp; HR -MNE affiliation -quality of service</td>
<td>-service quality -MNE affiliation</td>
<td>-favoured access to inputs -experience Expertise &amp; HR</td>
<td>-technology -innovation</td>
<td>-service offering -technology -service quality</td>
<td>-MNE affiliation -expertise -sophisticated products</td>
<td>-expertise -product. Technology -management practices</td>
<td>-MNE affiliation -expertise</td>
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<tr>
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<td>-Technology</td>
<td>-Management practices</td>
<td>-Training</td>
<td>-expertise</td>
<td>-access to markets</td>
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<tr>
<th>LINKAGE FORMATION: Indirect Competitive Linkages</th>
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<tbody>
<tr>
<td>Competitive Position</td>
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<td>Competitive Environment/ competitive changes</td>
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<tr>
<td>Investment to access local innovation</td>
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<tr>
<th>LINKAGE FORMATION: Direct Linkages</th>
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<tr>
<td>Forward Linkages</td>
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<td>Backward Linkages</td>
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<tr>
<td>Local sourcing</td>
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<tr>
<td>Social Responsibility Linkages</td>
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<td>Knowledge Agreements</td>
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<td>Collaborative Agreements</td>
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<td>DETERMINANTS OF DIRECT LINKAGE FORMATION</td>
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Within the “Spanish” group of cases two of the three firms are involved in public services (water and electricity) and the remaining firm in consulting services. Within the “non-Spanish” group two firms are banks, two provide services related to information (legal and financial information) and the remaining one is involved in consulting services. This information suggests that country of origin is not strongly related to the main activity of the firm.

In the absence of a clear relationship between the firms’ countries of origin and main activity, their age, mode of entry, and ownership form were considered. In considering the age of the affiliate (how long the firm has been operating in Chile), their mode of entry, and ownership form in conjunction with the main activity there appeared to be a discernable pattern, with firms operating in comparable service sectors presenting a similar age, mode of entry, and ownership form, as illustrated in Table 7.2. For instance, for cases 4 and 7, both firms were established in Chile more than 60 years ago, were acquired by foreign firms about 10 years ago, are Chilean firms owned by a foreign company, and operate within the public services sector. Although most firms can be grouped in pairs based on these variables, when considering cases 1 and 5, these firms are not similar in terms of mode of entry. This relationship suggested that main activity, age, and ownership form may be a basis for classifying the case firms into groups.

Further consideration of possible group classification focused on firm size, level of autonomy, motive for investment, role of the affiliate, investment to gain or develop local innovation, source of innovations, and source of main competitive advantages. Of these concepts, motives for investment and investment to gain or develop local innovation do not vary across-cases. That is, all firms have invested because of market-seeking reasons and have not invested to gain or develop local innovations. Hence, this information is not useful as a basis for group classification. With regard to the remaining variables, there appears to be a strong relationship across cases between the concepts of autonomy, role of the affiliate, source of innovations and source of main competitive advantages. In considering the size of firm in conjunction with the other variables, although most firms can be grouped in pairs, when considering cases 3 and 8, these firms are not similar in terms of size. As a result, in terms of affiliate profile, based on main activity, age, ownership form, autonomy, source of innovations
and source of main competitive advantages, case firms could be classified into four
groups (case firm 1 and 5; 2 and 6; 3 and 8; 4 and 7).

<table>
<thead>
<tr>
<th>Case</th>
<th>Main Activity</th>
<th>Age¹</th>
<th>Ownership Form</th>
<th>Mode of entry</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Legal services</td>
<td>30 and 12</td>
<td>Chilean branch</td>
<td>M&amp;A</td>
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<td>2</td>
<td>Corporate financial services</td>
<td>17</td>
<td>Chilean branch</td>
<td>Greenfield</td>
</tr>
<tr>
<td>3</td>
<td>Oil and gas consulting services</td>
<td>2</td>
<td>Chilean firm owned by foreign individuals</td>
<td>Greenfield</td>
</tr>
<tr>
<td>4</td>
<td>Water services</td>
<td>146 and 8</td>
<td>Chilean firm owned by foreign company</td>
<td>M&amp;A</td>
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<td>5</td>
<td>Financial information services</td>
<td>40</td>
<td>Chilean branch</td>
<td>Greenfield</td>
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<tr>
<td>6</td>
<td>Corporate financial services</td>
<td>26</td>
<td>Chilean branch</td>
<td>Greenfield</td>
</tr>
<tr>
<td>7</td>
<td>Electricity services</td>
<td>64 and 10</td>
<td>Chilean firm owned by foreign company</td>
<td>M&amp;A</td>
</tr>
<tr>
<td>8</td>
<td>Consulting services</td>
<td>9</td>
<td>Chilean firm owned by local and foreign individuals</td>
<td>Greenfield</td>
</tr>
</tbody>
</table>

In considering the concepts related to indirect competitive linkages, the competitive
position of the affiliate and its perceived influence on competitive changes appear to
be related to some extent, as shown in Table 7.3.

Small competitors perceive that their firm’s operations have had a minor influence on
the changes to the competitive environment (competitive changes) while major
competitors perceive that their firm’s operations have had a major influence on the
changes to the competitive environment, with the exception of case firm 1 that
perceives itself to have a moderate influence on competitive changes despite being a
major competitor. None of the firms has invested in order to get access to local
innovation; hence, there is no variability based on this concept. Therefore, there are
no clear patterns for grouping firms based on indirect competitive effects.
Consideration of formation of direct linkages first reviewed the extent and quality of forward linkages. Across the firms the extent and type of assistance given to clients range in complexity without any clear pattern from, for example, the relatively straightforward technical assistance of case 7 to the comprehensive assistance of case 8. In the absence of a clear pattern among the firms’ forward linkages, local sourcing was considered. Firms could be classified into two groups based on this variable (Refer to Table 7.4): those that only source standard products and services locally, and those that source both standard and specialized products and services locally. When considering local sourcing in conjunction with backward linkages, no clear pattern appears. On the contrary, when considering backward linkages in conjunction with CSR linkages, there appeared to be a discernable pattern: firms that have not established backward linkages but have established CSR linkages; firms that have not established CSR linkages and have established a few (between 1 and 5) backward linkages; and firms that have established more than five backward linkages and have also established several CSR linkages.

Considering the establishment of collaborative agreements demonstrates that those firms that have not established backward linkages also have not established collaborative agreements, while those that have established backward linkages have also established collaborative agreements. When considering collaborative agreements in conjunction with CSR linkages, it is possible to divide firms into two

<table>
<thead>
<tr>
<th>Case</th>
<th>Competitive Position</th>
<th>Competitive Environment/competitive changes</th>
<th>Investment to access local innovation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Major competitor in Chile and International</td>
<td>Moderate influence</td>
<td>No</td>
</tr>
<tr>
<td>2</td>
<td>Small competitor in Chile/Major International</td>
<td>Minor influence</td>
<td>No</td>
</tr>
<tr>
<td>3</td>
<td>Only competitor in Chile/SME International</td>
<td>Major influence</td>
<td>No</td>
</tr>
<tr>
<td>4</td>
<td>Major competitor in Chile and International</td>
<td>Major influence</td>
<td>No</td>
</tr>
<tr>
<td>5</td>
<td>Major competitor in Chile and International</td>
<td>Major influence</td>
<td>No</td>
</tr>
<tr>
<td>6</td>
<td>Small competitor in Chile/Major International</td>
<td>Minor influence</td>
<td>No</td>
</tr>
<tr>
<td>7</td>
<td>Major competitor in Chile and International</td>
<td>Major influence</td>
<td>No</td>
</tr>
<tr>
<td>8</td>
<td>Major competitor in Chile/SME International</td>
<td>Major influence</td>
<td>No</td>
</tr>
</tbody>
</table>
groups: those that have not established collaborative agreements and have established at least two CSR linkages, and those that have established collaborative agreements and have either established several CSR linkages or have not established them at all, as shown in Table 7.4. With regard to the establishment of knowledge agreements, the variable is not useful for grouping like firms since none of the case firms has established knowledge agreements.

<table>
<thead>
<tr>
<th>Case</th>
<th>Forward Linkages</th>
<th>Local sourcing</th>
<th>Backward linkages</th>
<th>CSR</th>
<th>Collaborative agreements</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>More than 30</td>
<td>Standard</td>
<td>None</td>
<td>2</td>
<td>None</td>
</tr>
<tr>
<td>2</td>
<td>More than 10</td>
<td>Standard</td>
<td>None</td>
<td>2</td>
<td>None</td>
</tr>
<tr>
<td>3</td>
<td>3</td>
<td>Standard</td>
<td>2 or less</td>
<td>None</td>
<td>1</td>
</tr>
<tr>
<td>4</td>
<td>None</td>
<td>Both</td>
<td>9</td>
<td>Several</td>
<td>More than 3</td>
</tr>
<tr>
<td>5</td>
<td>More than 30</td>
<td>Standard</td>
<td>None</td>
<td>None</td>
<td>2</td>
</tr>
<tr>
<td>6</td>
<td>More than 10</td>
<td>Specialized, MNEs</td>
<td>None</td>
<td>2</td>
<td>None</td>
</tr>
<tr>
<td>7</td>
<td>More than 30</td>
<td>Specialized, MNEs</td>
<td>10 or less</td>
<td>Several</td>
<td>2</td>
</tr>
<tr>
<td>8</td>
<td>More than 30</td>
<td>Specialized, MNEs</td>
<td>10 or less</td>
<td>Several</td>
<td>2</td>
</tr>
</tbody>
</table>

To summarize, in terms of direct linkages, firms can be grouped into three groups. The first group includes those firms that have not established backward linkages or collaborative agreements but have established a few CSR linkages as well as forward linkages (case firms 1, 2 and 6). The second group includes those firms that have established a few backward linkages as well as collaborative agreements and forward linkages, but have not established CSR linkages (case firms 3 and 5). The last group includes case firms 4, 7 and 8, despite the fact that case firm 4 has not established forward linkages as the other two firms have, since the three firms have established several backward, CSR and collaborative agreements linkages.

Beyond considering the extent of local linkages of the case firms in terms of competitive effects, backward linkages, forward linkages, CSR linkages and collaborative agreements, it is possible to classify firms by determining the extent of
integration of the affiliates, not at each level of linkage, but across the entire spectrum of linkages. As was conceptualized in the research model (Chapter Four), the degree of linkage (DOL) of the affiliate could range from an enclave position where very few indirect or direct linkages exist, to a highly developmental position where the affiliate engages in mutually beneficial collaborative agreements with local partners. To briefly recap, the DOL was to be measured at three discreet stages:

- LOW where linkages were either negligible suggesting that affiliates operated in an enclave environment, or were limited to indirect competitive effects,
- MODERATE where the affiliates engaged in forward or backward linkages with local firms, and/or CSR linkages, as suggested during the data collection process, or
- HIGH where affiliates formed closer relationships with local firms either through knowledge agreements or collaborative agreements.

The initial consideration of potential groupings across firms suggested three potential frameworks, one based on firm characteristics (or affiliate profile), another one based on direct linkage formation, and finally, one based on degree of linkage. Of these potential frameworks, the DOL framework has support in direct linkage formation concepts. In other words, the direct linkage formation framework is contained in the DOL framework since the last synthesizes the concepts of the former framework giving a richer representation of the extent of involvement of the affiliate in the local industry.

In comparing the affiliate profile framework and the DOL framework, there are two main arguments in favour of adopting the last framework (DOL) as the basis to classify and analyze firms across the cases. First, the primary concern of this thesis is in the degree of linkage of the foreign affiliate in the Chilean industry and the determinants of linkage formation in order to understand how foreign direct investment influences local industry upgrading. From this perspective, by classifying firms based on their degree of linkage there is potential to identify those factors that are different among groups of firms that show differences in terms of degree of linkage. That is, it is possible to identify factors that are related to a certain level of embeddedness. Second, although the framework based on affiliate profile has merit by
providing groups of firms with similar characteristics based on a wide range of variables, it has the limitation that it does not provide a clear relationship between firm characteristics and influence on local industry. In other words, case firms within the same group, based on affiliate profile, do not share the same degree of linkage. This finding suggests that there are other factors that may play a role in linkage formation. By using the affiliate profile framework, some key factors that are not related to the affiliate profile could be missed out that could add to the understanding of local industry upgrading through linkages.

The determinants of linkage formation were not considered as a basis for grouping like firms since they vary in complexity for each firm. That is, the determinants of linkage formation across-case firms are idiosyncratic. As a result, there is not a clear pattern for classifying firms. In addition, analyzing determinants of linkage formation within and across predefined groups would allow for a deeper understanding of these variables than using them as a clustering framework would.

**7.4.0 Case Grouping Identification**

This section describes the classification of the case firms into like groups using the degree of linkage framework identified in the preceding section. This framework identifies three levels of embeddedness based on the extent and quality of linkages established by the case firms. In defining these concepts, the extent and quality of linkages, the understanding of informants, and complementary data were used in an effort to ensure that analysis remained in touch with the particular experience of each case firm.

The concept of degree of linkage is directly related to the concept of linkage formation. That is, the extent and quality of linkages established by the foreign affiliate determines its degree of linkage with the local economy. As a basis to identify the degree of linkage of case firms, consideration was given to informants’ understanding of linkage formation. Hence, linkage formation was considered in terms of any level of relationship that the affiliate has established with firms that are not related to the affiliate by ownership.
Drawing on the informants’ understanding of the concept of linkage formation, case firms identified relationships with suppliers, clients, firms in related industries, research institutions, communities, and private and government institutions. The extent and quality of these relationships shows case firms range from those with a moderate degree of linkage to a high degree of linkage. Those firms in the sample that limit their involvement with the local economy to minor competitive effects on the industry and the establishment of a few relationships with local entities have a moderate degree of linkage. On the other hand, firms that have major competitive effects on the industry and have established both, moderate and high-quality linkages, have a high degree of linkage.

The previous categorization suggests grouping case firms into two groups – moderate and high degree of linkage – based on whether the affiliate has established high-quality linkages or not. Nevertheless, case firms presenting a high degree of linkage by establishing collaborative agreements differ in terms of the extent and quality of the linkages established. On the one hand, there are those firms that have established collaborative agreements, but have established only certain types of moderate quality linkages. On the other hand, there are those firms that along with collaborative agreements have established several moderate quality linkages. That is, the “high DOL” group can be divided into two groups, one presenting a greater range of linkages than the other.

Using a more comprehensive criterion for assessing the affiliate’s DOL makes it possible to identify three groups of firms. From this perspective, in order to group firms according to their degree of linkage, a range of variables was selected for estimating the overall degree of linkage of each case firm; that is, the variables include both the quantity of linkages formed (measured by the number of relationships with clients, suppliers/subcontractors, other entities/firms, and collaborative partners), and the quality of those linkages (measured by the extent of assistance given via forward, backward and CSR linkages and the transfer of resources to collaborative partners) (Scott-Kennel, 2001). In addition, competitive linkages\(^4\) are included to assess the overall degree of linkage of the firm.
Specifically, five types of linkages are included for assessing the overall degree of linkage: namely, competitive linkages, forward linkages, backward linkages, CSR linkages, and collaborative linkages. Knowledge agreements were not included since none of the case firms has established either franchisee or licensee relationships with local firms. The CSR linkage, which was identified during the data collection/analysis process, is included. It is considered to be a moderate quality linkage. Although it does not necessarily involve a one-to-one relationship with local entities, it does represent an intended effort on the part of the affiliate to contribute to the upgrading of the local economy, either through community projects or industry-related projects.

The overall DOL of the affiliate is estimated by adding the scores of the affiliate for each type of linkage. That is, each type of linkage is assigned a score based on a single variable, or set of variables (Refer to Table 7.5 for a list of the independent variables measured and to the research methodology chapter for the scoring criteria.) that in conjunction estimate the extent and quality of the linkages established by the affiliate. Figure 7.1 shows the distribution of case firms according to their scores for each type of linkage and for their overall degree of linkage. In terms of DOL, each case firm can be placed along a continuum as shown in Figure 7.2.

<table>
<thead>
<tr>
<th>Type of Linkage</th>
<th>Independent variables</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitive Linkage</td>
<td>Influence on:</td>
</tr>
<tr>
<td></td>
<td>- Competitive changes</td>
</tr>
<tr>
<td>Backward Linkage</td>
<td>- Reliance on other Chilean firms (local sourcing)</td>
</tr>
<tr>
<td></td>
<td>- Supplier relationships (number)</td>
</tr>
<tr>
<td></td>
<td>- Assistance given to suppliers</td>
</tr>
<tr>
<td>Forward Linkage</td>
<td>- Clients relationships (number)</td>
</tr>
<tr>
<td></td>
<td>- Assistance given to clients</td>
</tr>
<tr>
<td>Corporate Social Responsibility Linkage</td>
<td>- Number of projects (number)</td>
</tr>
<tr>
<td></td>
<td>- Assistance given to entities</td>
</tr>
<tr>
<td>Collaborative Linkage</td>
<td>- Total collaborative agreements (number)</td>
</tr>
<tr>
<td></td>
<td>- Resources transferred</td>
</tr>
</tbody>
</table>
Figure 7.1 Distribution of firms according to their score for each type of linkage and degree of linkage

Along with the DOL score, each case firm was assigned a “quality score” and an “extent score”. (For case firms’ individual scores refer to Appendix E.) For each firm, the quality score is a result of adding the scores for the number of different types of assistance given to suppliers/subcontractors, clients, CSR-related entities, and the number of resources transferred from the affiliate to its collaborative partners. The extent score is the result of adding the scores based on the number of relationships with clients and suppliers, number of CSR projects, and the type of product/services sourced locally.

To clarify the differences in terms of quality and extent of linkages among firms, an informal scatter graph was used as illustrated in Figure 7.3. The position of case firms in this graph clearly identifies the three groups. Group 1 consists of case firms 1, 2 and 6 which have a below average extent score and below average quality score; group 2 includes case firms 3 and 5 which have a below average extent score and an above average quality score; and group 3 contains case firms 4, 7 and 8 which have an above average extent score and an above average quality score.

Among group 1 firms, case 2 has established fewer linkages than case 6 but of higher quality while case 1 has the best position within the group by having established more linkages than case 2 and of higher quality than case 6. Among group 2, both firms...
Figure 7.2 Case Firms Placed Along the Spectrum According to their Degree of Linkage

Indirect Linkages
DIFFUSION of O-advantages

Direct Linkages
TRANSFER of O-advantages

Low
Moderate
High

Full Internalisation

Partial Internalisation

DOL

Case Firm 4
Case Firm 8

Case Firm 2 and 6
Case Firm 1
Case Firm 3
Case Firm 5
Case Firm 4
Case Firm 7
Case Firm 8

Enclave (no linkages)
have established similar linkages in terms of quality; nonetheless case 5 surpasses case 3 in terms of extent. Finally, among group 3 firms, cases 7 and 8 are fairly similar in terms of extent and quality of linkages established while case 4, although similar in quality, presents a lesser extent of linkages than the other two.

**Figure 7.3  Graph of Case Firm Groups**

![Graph of Case Firm Groups]

The illustrated analysis indicates three clear groupings of cases across the sample frame in terms of degree of linkage based on extent and quality of linkages established in the local industry. However, as illustrated in Figure 7.3, the case firms remain distinct even within these groupings. Notwithstanding these variations, the firms fit within each group without “the use of a shoehorn” (Miles & Huberman, 1994) to form groupings sufficiently homogeneous to be used as a basis for further analysis.

### 7.5.0 Understanding the Concepts

The identification of groups of like firms within the sample frame provided a tool to further focus the study. This section describes how this focus was advanced by considering the variables under study within each group and then using the understanding generated to look at the variables across all firms. This analysis enhanced understanding of the variables in each group and those features that were shared by all firms.
Using the groups of case firms identified in the preceding section, a reordered meta-matrix using compressed data drawn from within-case analysis, as illustrated in Table 7.6, was prepared. This ordered meta-matrix provided a basis to focus on each group of cases in terms of the concepts, affiliate profile, linkages established, determinants of linkages, and degree of linkage, used to frame the study. This table with case firms in discrete groupings provided an opportunity to develop a deeper, more focused, understanding of the concepts within each group and provided a basis for subsequent analysis across all cases.

7.6.0 Determinants of Linkages: Origin and Influence

In within-case analysis specific factors influencing linkage formation were identified within each case firm. This section describes the analysis used to understand the presence and influence of these factors within firm groups and across firms. As a basis for this analysis the nature and types of determinants were first defined.

As data collection and within-case analysis progressed the determinants of linkage formation were identified for each type of linkage. That is, within each case firm a range of factors were recognized as influencing the establishment of forward linkages, backward linkages, CSR linkages and/or collaborative agreements. In addition, within each case firm the influence exerted by these factors on linkage formation was recognized to be positive, negative or both.

From within-case analysis each determinant of linkage formation could be classified according to what type of linkage it influences and what type of influence it exerts. A factor could influence the establishment of forward linkages, backward linkages, CSR linkages, or collaborative agreements. However, a certain factor is not restricted to a certain type of linkage. Similarly, a certain factor could have either a positive or negative influence on the establishment of a certain type of linkage while having the opposite influence for another type of linkage.

Besides the determining factors identified during within-case firm analysis, another group of factors was identified during the across firms analysis. By reassessing affiliates’ profiles within firm groups and across firms, it was possible to recognize
### Table 7.6
Firm Group Ordered Meta-Matrix

<table>
<thead>
<tr>
<th>Group</th>
<th>Case</th>
<th>Affiliate Profile</th>
<th>Indirect competitive linkages</th>
<th>Direct linkages</th>
<th>Determinants of linkages</th>
<th>DOI</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2 Netherlands, Corporate financial services, Chilean branch, Greenfield, 17, SME locally, market-seeking, highly integrated, parent major influence on decision-making. O-advantages as source of competitive advantage, MNE affiliation. Source of innovation only parent firm.</td>
<td>Small competitor in Chile/ Major Internationally. Minor influence on competitive changes.</td>
<td>Below average extent and quality of linkages. Linkages established: forward and CSR.</td>
<td>Negative: -strategy Positive: -Main activity -regulatory framework</td>
<td>Moderate</td>
<td></td>
</tr>
<tr>
<td></td>
<td>6 UK, Corporate financial services, Chilean branch, Greenfield, 26, SME locally, market-seeking, highly integrated, parent major influence on decision-making. O-advantages as source of competitive advantage, MNE affiliation. Source of innovation only parent firm.</td>
<td>Small competitor in Chile/ Major Internationally. Minor influence on competitive changes.</td>
<td>Below average extent and quality of linkages. Linkages established: forward and CSR.</td>
<td>Negative: -global strategy -size of local market Positive: -main activity -global strategy</td>
<td>Moderate</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Description</td>
<td>Major Competitor</td>
<td>Below Average Extent of Linkages</td>
<td>Positive:</td>
<td>Negative:</td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>------------------</td>
<td>----------------------------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>-----------------------------------------------------------------------------------------------------</td>
<td>---</td>
</tr>
</tbody>
</table>
  - size of market  
  - economic environment  
  - main activity  
  - local technical skills  
  - strategy / size of market | Moderate-high                                                                                                                                   |   |
  - economic environment  
  - local firm capability  
  - strategy  
  - main activity  
  - firm size  
  - industry policy | High                                                                                                                                            |   |
  - industry policy / regulatory framework  
  - economic environment  
  - strategy | High                                                                                                                                            |   |
| 8 | Spain, Consulting services, Chilean firm owned by individuals, Greenfield, 9, Big, market-seeking, complex integration, parent minor influence on decision-making. O-advantages as source of competitive advantage, MNE affiliation. Source of innovation both parent and foreign affiliate. | Major competitor in Chile and SME Internationally. Major influence on competitive changes. | Above average extent and quality of linkages. Linkages established: forward, backward, CSR and collaborative agreements. |  - local firm capability  
  - main activity  
  - strategy  
  - regulatory framework  
  - economic environment  
  - local human capital | High                                                                                                                                            |   |
those features shared by firms within each group which are different from the other firms, and that may be related to a certain degree of linkage.

As a result of reviewing the determinants identified during within-cases analysis in conjunction with the determinants identified during the across-cases analysis, two main groups of determinants were recognized based on their origin. First, there are those factors that are related to the characteristics of the foreign affiliate (FDI-related variables). Second, there are determinants that originate in the L-advantages of Chile, or non-FDI related variables, such as local firm capability, regulatory framework, etc. These groups coincide with the groups proposed in the research model (Chapter 4).

All of the non-FDI related determinants were identified during the within-cases analysis while most of FDI-related determinants were identified during the across-cases analysis. This phenomenon might be the result of case firms’ informants being mainly aware of “external” factors affecting their decision rather than “internal” factors. Nevertheless, the firm’s strategy and the main activity were consistently identified during the within-cases analysis as factors influencing linkage formation.

Finally, case firms’ affiliate profiles are compared for the purpose of recognizing those factors that could be related to a certain degree of linkage, that is, characteristics of the foreign affiliates that may act as determinants of linkage formation.

### 7.7.0 Within-case Determinants and Linkage Formation

This section reviews case firms in groups and across-cases in terms of linkages established and the factors identified during within-cases as influencing linkage formation.

#### 7.7.1 Group 1: Below quantity and quality scores

Group one case firms present below average scores for quantity of linkages. Table 7.7 shows that the overall extent score of each firm is lower than the total average score. This is a result of group 1 case firms not having established backward linkages or collaborative agreements with local firms. In addition, the extent of CSR linkages
established is low compared with the other case firms. The establishment of “above average” forward linkages is the main contributor to their overall extent scores.

In terms of quality of linkages group 1 case firms present below average scores. Table 7.8 shows that the overall quality score of each firm is lower than the total average score. This is a result of group 1 case firms not having established backward linkages or collaborative agreements with local firms. In addition, although these firms have established forward and CSR linkages their quality is below average, in turn, not contributing significantly to the overall quality scores.

<table>
<thead>
<tr>
<th>Case/Score</th>
<th>Forward Linkages</th>
<th>Backward Linkages</th>
<th>CSR Linkages</th>
<th>Collaborative Agreements</th>
<th>Local Sourcing</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>4</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>5</td>
</tr>
<tr>
<td>2</td>
<td>3</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>4</td>
</tr>
<tr>
<td>6</td>
<td>3</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2.875</strong></td>
<td><strong>1.5</strong></td>
<td><strong>1.375</strong></td>
<td><strong>0.875</strong></td>
<td><strong>0.625</strong></td>
<td><strong>7.25</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Case/Score</th>
<th>Backward Linkages</th>
<th>Forward Linkages</th>
<th>CSR Linkages</th>
<th>Collaborative Agreements</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0</td>
<td>3</td>
<td>2</td>
<td>0</td>
<td>5</td>
</tr>
<tr>
<td>2</td>
<td>0</td>
<td>3</td>
<td>2</td>
<td>0</td>
<td>5</td>
</tr>
<tr>
<td>6</td>
<td>0</td>
<td>3</td>
<td>1</td>
<td>0</td>
<td>4</td>
</tr>
<tr>
<td><strong>Average Score</strong></td>
<td><strong>1.75</strong></td>
<td><strong>3.125</strong></td>
<td><strong>2.125</strong></td>
<td><strong>1.75</strong></td>
<td><strong>8.75</strong></td>
</tr>
</tbody>
</table>

7.7.1.1 Backward linkages and determinants

Table 7.9 shows that, for all three firms, the parent firm global strategy, with regard to acquisition of specialized inputs, has been highlighted by informants as the main factor impeding them from establishing backward linkages locally. That is, either “Everything comes from the parent firm” (2.1, p.6, 18) or “we have global contracts...We buy at a global level for the whole corporation” (1.1, p.2, 4-5). As a result, these firms do not buy specialized products/services from local firms. In the case of case firm 6, it does buy technology (mainly hardware and software) locally,
but it buys it from MNEs that are locally-established since “technology is implemented at a regional level. We are regularly audited by the parent firm” (6.1, p.3, 11-12).

### 7.7.1.2 Forward linkages and determinants

The main activity of all case firms in group 1 has positively influenced the establishment of forward linkages. The “assistance” nature of the firms’ main activity is what has led to the establishment of long-term relationships with their clients. Group 1 case firms have established forward linkages of similar quality based on the number of different types of assistance given to clients. Table 7.9 shows that each firm gives three different types of assistance to its clients. Financial assistance is given by cases 2 and 6 since they both operate in the banking sector. Regulatory assistance is given by case 1, which is embedded in its main activity (legal services), and by case 2 when there are new regulations – “For example, there is a new regulation at the level of the international chamber of commerce … we teach our clients these new regulations and how they can affect them” (2.1, p.6, 29-31). Case 1 and case 6 give information about markets, suppliers, and contacts to their clients. Case 1 gives this type of assistance especially to foreign firms who do not know much about the local market while case 6 gives information mainly to local firms that are expanding operations to the Asian market. In addition, each case firm provides an additional type of assistance not given by either of the other two case firms in the group. Case 1 provides its clients with managerial assistance to help foreign and local firms in new ventures such as joint ventures, infrastructure projects, environmental issues, etc. Case 2 provides operational assistance to help clients to include new practices, which are made compulsory by new regulations, in their operation. Finally, case 6 helps its clients by giving trade or exporting assistance that is directly related to its competitive advantage based on vast expertise of international trading with a particular focus on the Asian market.

The fact that their service offering involves ongoing assistance to their clients implies that the extent of forward linkages established is directly related to the number of clients the firms have. This conclusion is reflected in the forward linkages extent scores of each firm where cases 2 and 6 present a lower score than case 1. That is
because for cases 2 and 6 the strategy of the parent firm towards the Chilean market is to focus on a niche market where its clients are big corporations. Hence the focus on a small group of firms results in a limited potential for establishing more forward linkages. On the other hand, case 1 perceives that the Chilean economic environment, in terms of stability and growth potential, has increased the number of firms that are potential clients, in turn, positively influencing the extent of forward linkages established.

<table>
<thead>
<tr>
<th>Table 7.9</th>
<th>Group 1: Types of assistance given/ resources transferred to non-related firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Case 1</td>
<td>Backward linkages: None</td>
</tr>
<tr>
<td>Case 2</td>
<td>Backward linkages: None</td>
</tr>
<tr>
<td>Case 6</td>
<td>Backward linkages: None</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Table 7.10</th>
<th>Group 1: Determinants for each type of linkage, similarities and differences</th>
</tr>
</thead>
<tbody>
<tr>
<td>Backward linkages</td>
<td>Similarities: Negative, Strategy of parent firm</td>
</tr>
<tr>
<td>Forward linkages</td>
<td>Similarities: Positive, Main activity</td>
</tr>
<tr>
<td>CSR linkages</td>
<td>Similarities: None</td>
</tr>
<tr>
<td>Collaborative agreements</td>
<td>Similarities: Negative, Strategy of foreign affiliate</td>
</tr>
</tbody>
</table>
7.7.1.3 Corporate Social Responsibility linkages and determinants

Group 1 case firms have established few CSR linkages. This situation is reflected in the CSR extent scores for these firms which are lower than the average. (Refer to Table 7.7.) The factors that have encouraged these firms to become further involved in the local economy through this type of linkage were identified during the within-case analysis. However, factors that could explain the limited extent of CSR linkages were not reported at individual case firm level. Hence, restricting factors might be related to the affiliates’ profile (reviewed later in this section).

As regards the determinants identified during the within-case analysis, the economic environment of Chile has motivated case 1 to get involved in “socially responsible” projects. The stability and growth potential of the local economy have resulted in a long-term commitment of the foreign affiliate to local operations, in turn, embracing initiatives to “assist in the academic, and regulatory life of Chile” (1.3, p.3, 2). As a result two main types of assistance have been provided to the local economy: namely, education assistance and research assistance.

Case 2 has been motivated by two factors: the parent firm’s global sustainable development policy, which allows the foreign affiliate to develop its own strategies and projects regarding CSR, and Chile’s embracing of international environmental policies (regulatory framework). These factors have motivated the foreign affiliate to assist the local economy through seminars and entrepreneurship support.

Case 6 has been involved in CSR projects that are an extension of the parent firm’s global strategy. That is, it participates in projects developed by global organizations that are established in Chile. These projects are concerned with education and environmental issues. Nevertheless, case 6 supports these projects through financial assistance only.

To summarise in terms of quality, the CSR linkages established by cases 1 and 2 are of higher quality than those in case 6, based on whether these linkages involve sharing expertise and knowledge which is reflected in the quality scores for each firm, which
are lower for case 6. In terms of determinants there are no major similarities except for the global strategy of the parent firm for cases 2 and 6.

7.7.1.4 Collaborative agreements and determinants

None of the case firms has established collaborative agreements. The strategy of the firm was referred to by all of the case firms as one, or the only, factor impeding the establishment of high-quality linkages. Nevertheless, the strategies adopted by each case firm are different in nature since some of them are a response to restricting local conditions while others are global strategies regardless of local conditions.

With regard to “internal” strategies, case 1 does not establish collaborative agreements with non-related firms since it has adopted a strategy which involves not establishing fixed agreements with any non-related firm in order to provide its clients with a range of alternatives rather than specific firms. For case 2, the only factor restricting its establishment of collaborative agreements is the global strategy of the parent firm which results in the foreign affiliate focusing on a niche market. As a consequence, the foreign affiliate has not established collaborative agreements “because the opportunity hasn’t arisen” (2.1, p.8, 35).

Case 1 and case 6 have not established collaborative agreements as a result of their strategies, which are a response to local conditions. Case 1 uses the global network of its parent firm to train locally-hired lawyers which results in not needing to establish alliances with local institutions. This circumstance is a result of the affiliate’s perception of the quality of legal education in Chile which is “not [up to] international standards, it needs to be modernized” (1.1, p.4, 24). For case 6, it is the small size of the market which makes the parent firm embrace a “niche-market” strategy in the Chilean market. This strategy limits the range of operations of the foreign affiliate, in turn, cutting down the need and/or opportunity to establish high-quality linkages.
7.7.2 Group 2: Above average quality, below average extent linkages

Group 2 case firms present below average scores for quantity of linkages. Table 7.11 shows that the overall extent score of each firm is lower than the total average score. Nevertheless, while the extent score of case 3 is significantly lower than the average, the extent score of case 5 is slightly lower. Both firms have established collaborative agreements locally as well as forward and backward linkages, but no CSR linkages. The difference in the overall extent score is due to case 3 establishing fewer forward and backward linkages than case 5.

<table>
<thead>
<tr>
<th>Case/Score</th>
<th>Forward Linkages</th>
<th>Backward Linkages</th>
<th>CSR Linkages</th>
<th>Collaborative Agreements</th>
<th>Local Sourcing</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>5</td>
<td>4</td>
<td>2</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>7</td>
</tr>
<tr>
<td>Total Average Score</td>
<td>2.875</td>
<td>1.5</td>
<td>1.375</td>
<td>0.875</td>
<td>0.625</td>
<td>7.25</td>
</tr>
</tbody>
</table>

In terms of quality of linkages, group 2 case firms present above average scores. Table 7.12 shows that the overall quality score of each firm is higher than the total average score. This is a result of group 2 case firms having established backward linkages, forward linkages, and collaborative agreements of high quality. The quality scores for each type of linkage show that both case firms have established linkages that are above average quality, especially forward linkages and collaborative agreements.

<table>
<thead>
<tr>
<th>Case/Score</th>
<th>Backward Linkages</th>
<th>Forward Linkages</th>
<th>CSR Linkages</th>
<th>Collaborative Agreements</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>2</td>
<td>5</td>
<td>0</td>
<td>3</td>
<td>10</td>
</tr>
<tr>
<td>5</td>
<td>2</td>
<td>5</td>
<td>0</td>
<td>3</td>
<td>10</td>
</tr>
<tr>
<td>Total Average Score</td>
<td>1.75</td>
<td>3.125</td>
<td>2.125</td>
<td>1.75</td>
<td>8.75</td>
</tr>
</tbody>
</table>
### 7.7.2.1 Backward linkages and determinants

The economic environment of Chile has positively influenced group 2 firms to establish backward linkages with locally-established firms, “the transparency of the market makes it a stable and pleasant place to be” (5.1, p.8, 44-45). However, the extent of backward linkages established is limited, especially for case 3. Since case 3 operates in an industry where supportive industries are not developed (local firm capability non-existent or underdeveloped), the foreign affiliate sources standard products/services locally while bringing technology and human capital from overseas. With regard to case 5, the global strategy of its parent firm involves global contracts for the supply of specialized services/products. As a result, case 5 is limited to establishing backward linkages with locally-established MNEs rather than local firms. In addition, the size of the Chilean market has limited the range of operations of the Chilean foreign affiliate within the global network.

In terms of quality, both firms show the same score, which is above average because the main activity of both firms involves the requirement of specific product/service specifications from their suppliers. In addition, case 3 provides local suppliers of transport services with quality control procedures assistance as part of the parent firm’s global strategy procedures on safety, while case 5 provides staff training to its suppliers since local people’s technical skills are not as yet up to international standards.

### 7.7.2.2 Forward linkages and determinants

The main activity of group 2 case firms has positively influenced the establishment of forward linkages. The “assistance” nature of the firms’ main activity is what has led to the establishment of long-term relationships with their clients. Group 2 case firms have established forward linkages of similar quality based on the number of different types of assistance given to clients. Table 7.13 shows that each firm gives five different types of assistance to its clients. Technical assistance is given by firms as well as product samples or prototypes. This is so because both firms provide their clients with tailored products which are highly technology-based and require on-going assistance and feedback. Case 3 provides its clients drilling-related equipment while case 5 provides its clients with financial information software (information
technology - IT). In addition, case 3 assists its clients with acquiring inputs from overseas by providing contacts as well as assisting with production technology. Case 5 further assists its clients by giving them information about markets and by providing training to their staff for using the software provided.

<table>
<thead>
<tr>
<th>Table 7.13</th>
<th>Group 2, Types of assistance given/ resources transferred to non-related firms</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Case 3</td>
</tr>
<tr>
<td>Backward linkages</td>
<td>Testing and quality control procedures (safety)</td>
</tr>
<tr>
<td></td>
<td>Product/service specifications</td>
</tr>
<tr>
<td>Forward linkages</td>
<td>Assistance with acquiring inputs</td>
</tr>
<tr>
<td></td>
<td>Product samples or prototypes</td>
</tr>
<tr>
<td></td>
<td>Equipment</td>
</tr>
<tr>
<td></td>
<td>Production technology</td>
</tr>
<tr>
<td></td>
<td>Technical assistance</td>
</tr>
<tr>
<td>CSR</td>
<td>None</td>
</tr>
<tr>
<td>Collaborative Agreements</td>
<td>Knowledge/expertise</td>
</tr>
<tr>
<td></td>
<td>International experience</td>
</tr>
<tr>
<td></td>
<td>Technology</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Table 7.14</th>
<th>Group 2: Determinants for each type of linkage, similarities and differences</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Backward linkages</td>
</tr>
<tr>
<td>Similarities</td>
<td>Positive, Economic environment</td>
</tr>
<tr>
<td></td>
<td>Positive, Main activity</td>
</tr>
<tr>
<td>Differences</td>
<td>Case 3: Negative, local firm capability</td>
</tr>
<tr>
<td></td>
<td>Positive, Global strategy</td>
</tr>
<tr>
<td></td>
<td>Case 5: Negative, Global strategy and market size</td>
</tr>
</tbody>
</table>

The fact that their service offering involves ongoing assistance to their clients implies that the extent of forward linkages established is directly related to the number of clients the firms have. This circumstance is reflected in the forward linkages extent scores of each firm, where case 3 presents a lower score than case 5 because for case 3 the size of the oil and gas industry in Chile is small. That is, there are a limited
number of firms operating in the sector which limits the extent of forward linkages that could be formed. On the other hand, case 5 has established a considerable number of forward linkages with locally established firms mainly due to its competitive position – it has a high market share which makes it one of the leaders in the sector.

7.7.2.3 Corporate social responsibility linkages and determinants

For different reasons group 2 case firms have not established CSR linkages for different reasons. Case 3 has not got involved in CSR projects because of its small size. Hence, it does not have the necessary resources to establish these types of linkages. Nevertheless, it perceives a direct relationship between the size of the industry, the firm’s size, and the establishment of CSR linkages. In other words, when the industry develops and as the firm grows in size it may get involved in these kinds of projects. The same does not apply to case 5 which recognizes the parent firm strategy towards the Chilean market as an impediment to the establishment of CSR linkages. That is, case 5’s parent firm limits the operations of the Chilean affiliate as that it cannot go beyond its scope of activities because it considers the Chilean market to be too small.

7.7.2.4 Collaborative agreements and determinants

Group 2 firms have established collaborative agreements with local firms for different reasons. The small size of case firm 3 was acknowledged as a motivator to look for a partner that would complement its capabilities, which in turn, would enable it to pursue bigger projects. Accordingly, the presence of local firms that complement its resources consolidated the establishment of one strong collaborative agreement. For case 5, it is the parent firm strategy that motivates it to look for agreements with local firms. The parent firm allocates limited resources to the Chilean affiliate which has motivated it to look for alternative ways to maintain its position in the local market. As a result, the Chilean affiliate has established two types of agreements with local firms. One is with a local university as a way to introduce new products to the market and the second with a group of local small firms so it can add content to the information it gives to its clients.
In terms of extent these firms have established fewer agreements than the average. (Refer to Table 7.11) There is no explicit reason why case 3 has a limited extent of collaborative agreements. This situation could be explained by factors related to the affiliate profile (discussed later in this chapter). For case 5, the limited extent is a result of the parent firm strategy towards the Chilean market, which is to limit its presence to serving only local clients. This strategy is a response to the size of the Chilean market, which is perceived as being small relative to other Latin American markets.

Although the extent of linkages is limited for both firms the quality of these agreements is high, as shown by the score for each firm, which is higher than the average. (Refer to Table 7.12.) The collaborative agreement established by case 3 involves the transfer of three different types of resources from the affiliate to the local firm, namely: knowledge, international experience, and technology. In return the affiliate has access to infrastructure and local networks which would not be available to the firm otherwise. That is, the quality of the agreement is a result of the local firm’s capability. Similarly, the collaborative agreement established by case 5 with a local university involves the transfer of innovation and knowledge from the affiliate to the university since the latter provides case 5 with an efficient way to introduce new products to the market. In other words, the capabilities of the local university motivate the foreign affiliate to transfer key resources to it. On the contrary, the agreement established by case 5 with a group of local small firms involves the affiliate providing these firms with market access only. These local partners do not contribute significantly to case 5’s operations; in turn, the foreign affiliate does not transfer key resources to them.

### 7.7.3 Group 3: Above average quality and extent

Group 3 case firms present above average scores for number of linkages. Table 7.15 shows that the overall extent score of each firm is higher than the total average score. This scoring is a result of group 3 case firms having established backward linkages, CSR linkages, and collaborative agreements with local firms, as well as forward linkages on the part of cases 7 and 8. In addition, the score of each case firm with
regard to each type of linkages is above average (with the exception of forward linkages for case 4) indicating that each type of linkage contributes to the overall score.

Table 7.15
Group 3 Case firms’ score: Extent of linkages

<table>
<thead>
<tr>
<th>Case/Score</th>
<th>Forward Linkages</th>
<th>Backward Linkages</th>
<th>CSR Linkages</th>
<th>Collaborative Agreements</th>
<th>Local Sourcing</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td>0</td>
<td>3</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>10</td>
</tr>
<tr>
<td>7</td>
<td>4</td>
<td>3</td>
<td>3</td>
<td>1</td>
<td>1</td>
<td>12</td>
</tr>
<tr>
<td>8</td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>12</td>
</tr>
<tr>
<td>Total</td>
<td>2.875</td>
<td>1.5</td>
<td>1.375</td>
<td>0.875</td>
<td>0.625</td>
<td>7.25</td>
</tr>
</tbody>
</table>

In terms of quality of linkages, group 3 case firms present above average scores. Table 7.16 shows that the overall quality scores of each firm are similar. However, while group 3 case firms present similar collaborative agreements in terms of quality there are differences for the other types of linkages. Cases 4 and 7 are involved in higher quality backward linkages than case 8 by providing a wider range of assistance to their suppliers. On the other hand, the forward linkages established by case 8 are significantly higher in quality than those established by case 7. (Case 4 has not established forward linkages.) Indeed, while case 8’s forward linkages quality score is higher than the average, cases 4 and 7 are lower than the average. With regard to CSR linkages, case 4 stands out by providing six different types of assistance to the local economy through CSR projects, while cases 7 and 8 provide half of that number.

Table 7.16
Group 3 Case firms’ score: Quality of linkages

<table>
<thead>
<tr>
<th>Case/Score</th>
<th>Backward Linkages</th>
<th>Forward Linkages</th>
<th>CSR Linkages</th>
<th>Collaborative Agreements</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td>4</td>
<td>0</td>
<td>6</td>
<td>2</td>
<td>12</td>
</tr>
<tr>
<td>7</td>
<td>4</td>
<td>1</td>
<td>3</td>
<td>3</td>
<td>11</td>
</tr>
<tr>
<td>8</td>
<td>2</td>
<td>5</td>
<td>3</td>
<td>3</td>
<td>13</td>
</tr>
<tr>
<td>Average Score</td>
<td>1.75</td>
<td>3.125</td>
<td>2.125</td>
<td>1.75</td>
<td>8.75</td>
</tr>
</tbody>
</table>
7.7.3.1 Backward linkages and determinants

Although all case firms in group 3 show above average scores for extent of backward linkages, cases 7 and 8 have established linkages with suppliers that are not locally-owned indicating that local firm capability is not up to international standards. On the other hand, case 4 has established the most linkages with local suppliers indicating that “there is a wide range of availability, quality and price” (4.1, p.5, 17). In other words, local firm capability has played a key role for group 3 case firms, either negative or positive. In addition, case 4 regarded the stable economic environment of the Chilean market as positively influencing its commitment to the local economy, in turn, motivating the establishment of linkages with local firms.

For all group 3 case firms the strategy towards suppliers has played a determining role on the quality of backward linkages. The backward linkages quality scores of cases 4 and 7 are higher than for case 8. Cases 4 and 7 have embraced contract-based relationships with their suppliers which involve continuous assistance. On the contrary, case 8’s strategy entails non exclusivity with suppliers which limit the depth of the relationship while benefitting the extent of backward linkages. Nevertheless, the main activity of case 8 requires that the firm gives assistance to its suppliers. In other words, although there is no formal agreement between case 8 and its suppliers, since it requires specialized services/products to be tailored to its needs, the relationships are quality ones. The same is true for cases 4 and 7. Consistently, all three case firms provide assistance to their suppliers in terms of product/components specifications. Case 8 also provides its suppliers with information about markets since its suppliers need to incorporate this type of information into the product/service developed for the foreign affiliate.

Cases 4 and 7 give regulatory assistance to their suppliers since the regulatory framework in terms of industry policy relevant for cases 4 and 7 is constantly adding and/or amending regulations, especially in terms of environmental regulations. This situation results in these firms providing regulatory assistance to their suppliers in order to comply with these regulations. In addition, both firms provide technical assistance to their suppliers in order to ensure that the service/product is compatible with the firms’ operations. For the same reason case 7 also assists with testing and quality control procedures. Case 4 provides staff training to its suppliers of customer
relationship services in order to align the firm’s image with the supplier service delivery.

7.7.3.2 Forward linkages and determinants

With regard to forward linkages, group 3 case firms present significant differences in terms of quantity and quality. While cases 7 and 8 have established a considerable number of forward linkages, case 4 has not established any. Case 4 does not get involved in direct relationships with its clients since it serves the final consumer (individuals); hence, it is its range of activities (main activity) which stops the foreign affiliate from establishing forward linkages. On the other hand, the “assistance” nature of the main activity of case 8 is what has led the foreign affiliate to the establishment of long-term relationships with its clients. Case 7’s establishment of forward linkages is driven by industry policy. Strict regulations in terms of efficiency standards have motivated the foreign affiliate to provide assistance to its clients in order to ensure efficiency in the delivery of energy. The fact that for cases 7 and 8’s service offering involves giving assistance to their clients, either because of policy reasons or because it is embedded in the main activity implies that the extent of forward linkages established is directly related to the number of clients the firms have. This is reflected in the forward linkages extent scores of each firm and for which both firms show above average scores.

In terms of quality, cases 7 and 8 show marked differences, as reflected in their scores. Case 7’s quality score is below average while case 8 is above average. This is a result of the number of different types of assistance provided by the case firms to their clients. While both firms provide technical assistance, case 8 also provides service system management assistance, managerial assistance, staff training, and information about markets, suppliers, and contacts. For both firms the regulatory framework has played a role on the quality of the relationships established with their clients. Nevertheless, for case 7 the regulatory framework (through industry policy) is the main reason why the foreign affiliate gives assistance to its clients, while for case 8 it is a factor that strengthens its relationships with its clients. The main activity of case 8 is the main factor influencing the quality of these linkages since giving continuous assistance is embedded in the service it provides.
7.7.3.3 Corporate social responsibility linkages and determinants

Group 3 case firms present above average scores for both extent and quality of CSR linkages. (Refer to Tables 7.15 and 7.16.) The economic environment of Chile in terms of stability and growth potential has been a motivating factor for all the group 3 case firms. Besides the economic environment, the global strategy of the foreign affiliates’ parent firms towards CSR has also played a determining role on the level of involvement of the case firms with the local industry by encouraging the development of projects to assist the local economy. Motivated by these factors these firms have become involved with the local industry at two levels. First, these firms provide assistance at the community level through various projects such as education programmes, financial assistance, procurement of equipment and infrastructure, and cultural initiatives, with the intention of improving local social conditions. Second, the foreign affiliates provide assistance at the industry level for improving conditions that directly influence the economic performance of their respective sectors. For example, they assist local entities through environmental initiatives, entrepreneurship support, consulting services, technical procedures assistance, and research assistance.

In terms of scores, while their extent scores are similar, their quality scores show some differences. Cases 7 and 8 have the same quality score while case 4 has a significantly higher score. (Refer to Table 7.16.) The difference could be the result of case 4 being further motivated to assist the local economy by its main activity; in the words of case 4’s informant “we are a public service company, we are socially responsible” (4.1, p.5, 38). As a result, case 4 provides a wider range of assistance to the local economy through projects that either focus on improving social conditions or local industry.

7.7.3.4 Collaborative agreements and determinants

All group 3 case firms have established collaborative agreements locally. The regulatory framework has played a determining role for all cases. Cases 4 and 7 have established alliances with local universities (R&D projects) motivated by the fact that industry policy (sanitary sector and energy sector respectively) imposes high-efficiency standards that require ongoing improvement of operations through research
and development (R&D). New regulations in the banking sector have been the driver for case 8 to establish an alliance with two foreign-owned/locally-established firms to introduce a new service to the industry.

Table 7.17

| Group 3, Types of assistance given/ resources transferred to non-related firms |
|-------------------------------------------------|-----------------|-----------------|
| Backward linkages                               | Case 4          | Case 7          | Case 8          |
| Technical assistance                            | Regulatory assistance | Product/component specifications | Staff training |
| Regulatory assistance                            |                  | Product/component specifications | |
| Product/component specifications                | Testing and quality control procedures | |
| Staff training                                  | |
| Forward linkages                                | None            | Technical assistance | |
| None                                            | |
| CSR                                             | Technical procedures assistance | Financial support | |
| Environmental initiatives                       | Research assistance | |
| Entrepreneurship support                        | Financial support | |
| Education assistance                            |                | |
| Financial support                               |                | |
| Consulting services                             |                | |
| Equipment/infrastructure                        |                | |
| Collaborative Agreements                        | Information     | Financial support | Resources (IT) |
| Knowledge & expertise                           | Knowledge & expertise | |
| Equipment/infrastructure                        | Knowledge and expertise | |

Besides the regulatory framework, there are other factors that have influenced the foreign affiliates to establish collaborative agreements. Case 4 has gone beyond industry policy in terms of R&D motivated by the size of the firm (size of operations), which provides the conditions to get involved in R&D projects. Case 7 has been motivated by its strategy with regard to sustainable growth; in turn, it is involved in R&D projects that provide the firm with an “environmentally committed” reputation. The weaknesses of local human capital in conjunction with the attractiveness of the local economic environment have motivated case 8 to establish alliances with local universities. The attractiveness of the economic environment results in the long-term commitment of the foreign affiliate to the local economy, in turn, motivating the firm to improve local conditions (local human capital) through alliances.
Table 7.18

<table>
<thead>
<tr>
<th>Backward linkages</th>
<th>Forward linkages</th>
<th>CSR linkages</th>
<th>Collaborative agreements</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Similarities</strong></td>
<td></td>
<td>Case 7 and 8: Positive, regulatory framework</td>
<td>Positive, local firm capability and regulatory framework</td>
</tr>
<tr>
<td>Positive, main activity</td>
<td></td>
<td>Positive, economic environment and strategy</td>
<td>Positive, local firm capability and regulatory framework</td>
</tr>
<tr>
<td>Positive, strategy</td>
<td></td>
<td>Positive, economic environment and strategy</td>
<td>Positive, local firm capability and regulatory framework</td>
</tr>
<tr>
<td>Local firm capability, negative for cases 7 and 8, positive for case 4</td>
<td>Case 4:</td>
<td>Case 7 and 8: Positive, main activity</td>
<td>Case 4: Positive, economic environment and local human capital</td>
</tr>
</tbody>
</table>

| **Differences**  | Case 4: Positive, economic environment | Case 4: Positive, main activity | Case 4: Positive, main activity |
| Case 7: Positive, regulatory framework | Case 4: Positive, economic environment | Case 7: Positive, strategy | Case 8: Positive, economic environment and local human capital |
| Case 7: Positive, regulatory framework | Case 8: Positive, main activity | Case 7: Positive, strategy | Case 8: Positive, economic environment and local human capital |

In terms of extent of linkages, cases 4 and 8 have established more agreements than case 7 has. There is no explicit reason why case 7 has a limited extent of collaborative agreements. This could be explained by factors related to the affiliate profile (discussed later in this chapter). Cases 4 and 8’s extent scores (Refer to Table 7.15.) are a reflection of the several alliances established by these firms with local universities. Case 4 has done so motivated by its size and the regulatory framework, while case 8 has been motivated by the local economic environment.

In terms of quality of linkages group 3 case firms present similar scores, which are higher than the average. (Refer to Table 7.16.) Most of the collaborative agreements established by group 3 case firms involve the transfer of knowledge and expertise from the affiliates to the local entities. Specifically, the capabilities of local universities motivate the foreign affiliates to transfer key resources to them. In other words, since group 3 case firms perceive that local universities contribute significantly to the alliances, they are willing to share their knowledge and expertise. Slight differences in terms of quality scores among group 3 case firms reflect the fact
that case 7 and 8 provide partners with other resources, besides knowledge and expertise, such as equipment and infrastructure, human resources, and financial support.

7.8.0 Across Cases: Within Case Determinants of Linkages

This section provides the findings from the across-cases analysis with regard to the factors, reported in individual cases, which influence linkage formation while reviewing the types of linkages established by case firms. The determinants are reviewed for each type of linkage in order to shed light as to whether there are certain factors influencing certain types of linkages more than others.

7.8.1 Backward linkages and determinants

While all case firms source standard products/services locally not all of them source specialized products locally – cases 1, 2 and 3 source only standard products and services locally. Nevertheless, case 3 has established backward linkages with local suppliers of standard products/services. Of those case firms that buy specialized products/services locally, not all of them have established backward linkages with the suppliers; for example, case 6 sources specialized products locally but does not establish relationships with the suppliers. Case firms that have established backward linkages with suppliers of specialized products have done so mostly with MNEs that are locally-established, except for case 4 which has established linkages with both local and foreign-owned suppliers.

There are two factors that have been identified across-cases to influence backward linkages in terms of quality and/or extent. First, the strategy of the parent firm was consistently reported throughout the cases. For cases 1, 2, 5 and 6 the strategy of the parent firm towards procurement of specialized inputs has played a negative role on backward linkage formation. Cases 1 and 2’s parent firms provide their affiliates with specialized inputs while cases 5 and 6 are limited in their choice of suppliers to locally-established MNEs with which the parent firm has signed global contracts. In addition, while case 5 has established backward linkages with its suppliers, case 6 has not because of its parent firm’s strategy which does not grant exclusivity to suppliers.
For cases 3, 4, 7 and 8 the strategy of the firm has played a positive role on backward linkage formation. While for cases 3, 4 and 7 the strategy has influenced positively on the quality of backward linkages, for case 8 it has played a positive role on the extent of linkages. Case 3 parent firm’s strategy towards safety motivated the foreign affiliate to give assistance to local suppliers. Cases 4 and 7’s contract-based strategy for sourcing specialized inputs also involves giving assistance to suppliers. Conversely, case 8’s strategy entails non-exclusivity with suppliers which limit the depth of the relationship while benefitting the extent of backward linkages. Nevertheless, the main activity of case 8 requires that the firm gives assistance to its suppliers. In other words, although there is no formal agreement between case 8 and its suppliers, since it requires specialized services/products to be tailored to its needs, the relationships are quality ones. This requirement applies to all the case firms that have established backward linkages, namely cases 3, 5, 4, 7 and 8.

7.8.2 Forward linkages and determinants

Almost all case firms have established forward linkages with their clients, except for case 4. For those that have established relationships with their clients the extent has been significant except for case 3 which is limited by the size of the industry. In terms of quality, except for case 7, all firms give substantial assistance to their clients.

The firm’s main activity has played a role on forward linkage formation for each case firm. For cases 1, 2, 3, 5, 6, and 8 their main activity has played a positive role in the establishment and quality of forward linkages. The “assistance” nature of these firms’ main activity is what has led to the establishment of long-term relationships with their clients. These firms have established high-quality linkages based on the number of different types of assistance given to clients. Each firm gives three to five different types of assistance to its clients. On the other hand, cases 4 and 7’s main activity has played a negative role on either linkage formation or quality of linkages. Case 4 has not established forward linkages due to its main activity which includes providing water services to individuals. While case 7 has established a significant extent of forward linkages, these are the result of industry policy and its market share (competitive position) and not of its main activity. On the contrary, its main activity –
generation of electricity – limits the quality of the relationships with its clients to that which is determined by industry (government) policy.

Looking at those firms that have established forward linkages (either motivated by industry policy or main activity) since their service offering involves ongoing assistance to their clients, it appears that the extent of forward linkages established is directly related to the number of clients the firms have. Case informants reported different factors as influencing the extent of linkages established, things such as economic environment, strategy of parent firm, industry size, and the competitive position of the foreign affiliate.

7.8.3 Corporate Social Responsibility linkages and determinants

In terms of extent, case firms vary from not having established CSR linkages to having established several linkages. Quantity and quality of linkages seem to be related since for those case firms that have established only a few CSR linkages the quality of those linkages is below average. By contrast the quality of linkages for those firms which have established several CSR linkages is above average.

Although there is no single factor that seems to influence CSR linkages in all of the case firms, there are two factors that were consistently reported in most of the cases. First, the global strategy of the foreign affiliates’ parent firms towards CSR has played a determining role for 6 of the 8 case firms on the level of involvement with the local industry by either encouraging or discouraging these firms from getting involved in CSR projects to assist the local economy. Five case firms regarded the parent firm’s strategy as a positive influence for getting involved in CSR projects and one case firm saw it as a negative influence. For cases 2, 4, 6, 7 and 8 the parent firm’s global sustainable development policy results in the foreign affiliates either developing their own strategies and projects regarding CSR or getting involved in CSR projects that are an extension of the parent firm’s global strategy. The same does not apply to case 5 which recognizes the parent firm strategy towards the Chilean market as an impediment to establishing CSR linkages. The parent firm limits the operations of the Chilean affiliate to not going beyond its scope of activities.
Second, the economic environment of the local Chilean industry was acknowledged by 4 case firms – cases 1, 4, 7 and 8 – as positively influencing their decision to establish CSR linkages. The stability and growth potential of the local economy has resulted in a long-term commitment of the foreign affiliates to local operations, in turn, embracing initiatives to improve local conditions at the industry level and/or at the community level.

7.8.4 Collaborative agreements and determinants

Five case firms have established collaborative agreements locally. Most of these agreements are with local Chilean universities. For those firms that have not established collaborative agreements, the strategy of the firm was referred to by all of the case firms as one, or the only factor, impeding the establishment of collaborative agreements. The strategies adopted are either a response to restricting local conditions or are global strategies regardless of local conditions. Similarly, the strategy of the firm has played a determining role for two case firms that have established collaborative agreements. For case 5, it is the parent firm’s strategy towards the Chilean market – which involves the parent firm allocating limited resources to the Chilean affiliate – that has motivated the foreign affiliate to look for alternative ways to maintain its position in the local market. Case 7 has been motivated by its strategy with regard to sustainable growth.

Local firm capability was found to influence the quality of collaborative agreements in a positive way for all case firms that have established them. Most of the collaborative agreements established by case firms involve the transfer of knowledge and expertise from the affiliates to the local entities. The foreign affiliates have been willing to transfer key resources to their partners since they perceive that local firms/universities contribute significantly to the alliances.

The regulatory framework was referred to by 3 of the 5 case firms that have established collaborative agreements as motivating them to establish high-quality linkages. Cases 4 and 7 have established alliances with local universities motivated by the fact that industry policy imposes high-efficiency standards that require ongoing improvement of operations through research and development (R&D) while new
regulations in the banking sector have motivated case 8 to establish an alliance with two foreign-owned/locally-established firms to introduce a new service to the industry.

### 7.9.0 Affiliate Profile and Degree of Linkage

The DOL score assigned to each case firm is a result of the sum of individual scores of each type of direct linkage (presented in the previous section) and the score of competitive linkages. In so doing, it reflects the overall level of embeddedness of the foreign affiliate in the local industry. That is, the score reflects the extent and quality of direct linkages as well as an estimate of indirect linkages. Based on these scores and individual scores for extent and quality of direct linkages three groups of case firms were distinguished, which in terms of DOL were labelled moderate (group 1), moderate-high (group 2) and high (group 3).

The affiliate profile constitutes the basis for a deeper understanding of the process of local industry upgrading by providing firm-characteristics that may be related with a lower or higher degree of linkage. That is, by reassessing affiliates’ profiles within firm groups and across firms, it is possible to recognize those features shared by firms within each group, which are different from the other firms, which may be related to a certain degree of linkage. This section reviews case firms’ degree of linkage and profile in groups as well as across-cases for this purpose.

### 7.9.1 Group 1: Moderate Degree of Linkage

Group 1 case firms present DOL scores which are lower than the total average (Table 7.19). This score is mainly the result of group 1 case firms not having established backward linkages or collaborative agreements locally. In addition, in terms of competitive linkages, these firms also have below average scores (Table 7.19) indicating that their indirect effects through competitive influences are not significant. Nevertheless, since they have established moderate quality linkages, specifically forward and CSR linkages, their degree of linkage in the local industry can be regarded as moderate.
7.9.1.1 Affiliate Profile Similarities and Differences

Group 1 case firms share several firm characteristics such as ownership form, level of autonomy, size of firm, motive for investment, role of the affiliate, source of innovations and O-advantages as a source of competitive advantages. All three case firms are Chilean branches of their parent firm established with market-seeking purposes. These firms are highly integrated in the global network of the parent firm and have highly limited autonomy in terms of decision making. The parent firms of these foreign affiliates have total or major influence on the short-, medium- and long-term decisions. Accordingly, the case firms obtain all of their resources from their parent firms; these are sources of competitive advantages and innovations. In addition, these firms are SMEs with a total number of employees not exceeding 150.

<table>
<thead>
<tr>
<th>Case</th>
<th>Competitive Linkages</th>
<th>Backward linkages*</th>
<th>Forward linkages*</th>
<th>CSR linkages*</th>
<th>Collaborative agreements*</th>
<th>DOL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>0</td>
<td>7</td>
<td>3</td>
<td>0</td>
<td>12</td>
</tr>
<tr>
<td>2</td>
<td>1</td>
<td>0</td>
<td>6</td>
<td>3</td>
<td>0</td>
<td>10</td>
</tr>
<tr>
<td>6</td>
<td>1</td>
<td>1</td>
<td>6</td>
<td>2</td>
<td>0</td>
<td>10</td>
</tr>
<tr>
<td>Average</td>
<td>2.375</td>
<td>3.875</td>
<td>6</td>
<td>3.5</td>
<td>2.625</td>
<td>18.375</td>
</tr>
</tbody>
</table>

* The score of each firm for each type of direct linkage is a result of the sum of the quantity and quality score of that type of linkage.

Regarding differences between group 1 case firms, cases 2 and 6 are only different in terms of country of origin and age. That is, besides the similarities mentioned above, these case firms have further similarities such as mode of entry and main activity. Comparing all three case firms shows that case 1 differs from the other two foreign affiliates with regard to mode of entry, age, country of origin, main activity, and range of main competitive advantages.

Differences in terms of country of origin and age are not major when considering that all case firms’ origins are non-Spanish speaking countries and that all firms have been established in Chile as foreign affiliates for more than 10 years.
7.9.1.2 DOL and Affiliate Profile

Overall DOL scores show that case 1 is more integrated into the local industry than cases 2 and 6. Scores for each type of linkages indicate that case 1 has a higher score as a result of higher scores in competitive linkages and forward linkages. Case 1’s competitive position is strong, constituting one of the largest law firms in Chile, which differs from the competitive position of cases 2 and 6 where both firms have a low market share. Consistently, the extent of linkages to clients in case 1 is higher than the extent of linkages in cases 2 and 6. This result suggests that case 1 has established more forward linkages than cases 2 and 6 since the nature of their services implies that long-term relationships have been established with their clients.

<table>
<thead>
<tr>
<th>Table 7.20</th>
<th>Group 1: Affiliate Profile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Case/ Variable</td>
<td>Case 1</td>
</tr>
<tr>
<td><strong>AFFILIATE PROFILE</strong></td>
<td></td>
</tr>
<tr>
<td>Country of origin</td>
<td>USA</td>
</tr>
<tr>
<td>Main activity</td>
<td>Legal services</td>
</tr>
<tr>
<td>Age</td>
<td>30 in Chile</td>
</tr>
<tr>
<td>Mode of entry</td>
<td>M&amp;A</td>
</tr>
<tr>
<td>Ownership form</td>
<td>Chilean branch</td>
</tr>
<tr>
<td>Autonomy</td>
<td>Parent firm total influence on decision-making</td>
</tr>
<tr>
<td>Size of firm</td>
<td>SME locally</td>
</tr>
<tr>
<td>Motive for investment</td>
<td>Market-seeking</td>
</tr>
<tr>
<td>Role of Affiliate</td>
<td>Highly integrated in global network</td>
</tr>
<tr>
<td>Ownership advantages from parent firm</td>
<td>Technology, management practices, training, expertise, access to markets</td>
</tr>
<tr>
<td>Innovations &amp; source of competitive advantage</td>
<td>Only parent firm</td>
</tr>
<tr>
<td>Main competitive advantages</td>
<td>- Experience, expertise &amp; Human resources - Service quality - MNE affiliation</td>
</tr>
<tr>
<td>O-advantages as source of competitive advantage</td>
<td>Yes</td>
</tr>
</tbody>
</table>

After observing differences among group 1 case firms, it could be suggested that mode of entry and competitive linkages might be mostly responsible for case 1’s
higher degree of linkage. It could be that since case 1 was acquired by a foreign firm, as opposed to Greenfield investment (cases 2 and 6); the firm had already established a local presence that would lead to a higher integration through competitive linkages and forward linkages.

7.9.2 Group 2: Moderate-High Degree of Linkage

Group 2 case firms present DOL scores which are either slightly lower (case 3) or higher (case 5) than the total average (Table 7.21). Although group 2 case firms have noticeably different DOL scores between them, the difference is more significant relative to group 1 and group 3 case firms. As a group, cases 3 and 5 present lower DOL scores than group 3 case firms mainly as a consequence of not having established CSR linkages and lower backward linkages scores. On the other hand, group 2 case firms present higher scores than group 1 case firms since they have established higher quality linkages and higher competitive linkages scores. Since group 2 case firms have established several moderate quality linkages and high-quality linkages, their degree of linkage in the local industry can be regarded as moderate to high.

<table>
<thead>
<tr>
<th>Case</th>
<th>Competitive linkages</th>
<th>Backward linkages*</th>
<th>Forward linkages*</th>
<th>CSR linkages*</th>
<th>Collaborative agreements*</th>
<th>DOL</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>3</td>
<td>3</td>
<td>6</td>
<td>0</td>
<td>4</td>
<td>16</td>
</tr>
<tr>
<td>5</td>
<td>3</td>
<td>4</td>
<td>9</td>
<td>0</td>
<td>4</td>
<td>20</td>
</tr>
<tr>
<td>Average</td>
<td>2.375</td>
<td>3.875</td>
<td>6</td>
<td>3.5</td>
<td>2.625</td>
<td>18.375</td>
</tr>
</tbody>
</table>

* The score of each firm for each type of direct linkage is a result of the sum of the quantity and quality score of that type of linkage.

7.9.2.1 Affiliate Profile Similarities and Differences

Group 2 case firms present several similarities in terms of affiliate profile. Both foreign affiliates’ parent firms come from English-speaking countries (Canada, UK) and both used Greenfield investment as their entry mode motivated by market-seeking reasons. In addition, both affiliates are similar in size with a total number of employees between 30 and 40 and annual sales between US$5-US$8 million. Also, the
case firms obtain most of their resources from their parent firms, which are sources of competitive advantages and innovations.

Regarding differences between group 2 case firms, the ages of the foreign affiliates are dramatically different, 40 versus 2 years, reflecting the specific situation of their respective sectors. Case 5 has been in Chile for about 40 years since the beginning of the information services sector, which is mature and dominated by foreign multinationals. On the other hand, Case 3 has been for only 2 years in Chile since the oil and gas sector has been in the hands of the State. Case 3 has been a pioneer by offering specialized services to the firms operating in the sector. Accordingly, group 2 case firms differ in terms of main activity; Case 5 focuses on offering financial information services while Case 3 focuses on offering consulting and trade services in the oil and gas sector.

<table>
<thead>
<tr>
<th>Case/ Variable</th>
<th>Case 3</th>
<th>Case 5</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Country of origin</strong></td>
<td>Canada</td>
<td>UK</td>
</tr>
<tr>
<td><strong>Main activity</strong></td>
<td>Oil &amp; gas consulting and trade services</td>
<td>Financial information services</td>
</tr>
<tr>
<td><strong>Age</strong></td>
<td>2 in Chile and as foreign affiliate</td>
<td>40 in Chile and as foreign affiliate</td>
</tr>
<tr>
<td><strong>Mode of entry</strong></td>
<td>Greenfield</td>
<td>Greenfield</td>
</tr>
<tr>
<td><strong>Ownership form</strong></td>
<td>Chilean firm owned by foreign individuals</td>
<td>Chilean branch</td>
</tr>
<tr>
<td><strong>Autonomy</strong></td>
<td>Parent firm moderate influence on decision-making</td>
<td>Parent firm major influence on decision-making</td>
</tr>
<tr>
<td><strong>Size of firm</strong></td>
<td>SME locally</td>
<td>SME locally</td>
</tr>
<tr>
<td><strong>Motive for investment</strong></td>
<td>Market-seeking</td>
<td>Market-seeking</td>
</tr>
<tr>
<td><strong>Ownership advantages from parent firm</strong></td>
<td>Access to inputs, human resources and skills, capital</td>
<td>Technology, management practices, expertise, capital</td>
</tr>
<tr>
<td><strong>Innovations &amp; source</strong></td>
<td>Mainly parent firm</td>
<td>Mainly parent firm</td>
</tr>
<tr>
<td><strong>Main competitive advantages</strong></td>
<td>- Favoured access to inputs &lt;br&gt;- Experience, expertise &amp; Human resources</td>
<td>- Service quality &lt;br&gt;- Technology &lt;br&gt;- Service delivery &lt;br&gt;- MNE affiliation</td>
</tr>
<tr>
<td><strong>O-advantages as source of competitive advantage</strong></td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Although group 2 case firms are similar in size locally, the size of their parent firms is different. This fact is reflected in differences in ownership form, role of the affiliate, level of autonomy, and importance of MNE affiliation. While case 3 has been
established as a Chilean firm owned by foreign individuals which acts as an operational base for the parent firm (complex-integration strategy), case 5 has been established as the Chilean branch of a MNE being highly integrated in the global network of the parent firm. As a result, case 3’s parent firm exerts moderate influence on decision-making while case 5’s parent firm has major influence. In addition, since case 3’s parent firm is small in size and is a “young” MNE affiliation, this situation does not provide a source of competitive advantage. On the contrary, case 5’s parent firm is an MNE with more than 150 years of history; so being an MNE affiliate constitutes a key competitive advantage for case 5.

7.9.2.2 DOL and Affiliate Profile

The observable difference in DOL scores among group 2 case firms is mainly the result of different overall forward linkages scores. Case 3 has a significantly lower score than case 5 due to a major difference in the extent of forward linkages established. That is, even though both firms have established forward linkages of similar quality, the quantity has been considerably dissimilar. As mentioned previously, case 3 has established few forward linkages since the size of the industry is small in terms of number of firms operating in it.

After observing differences among 2 case firms, it could be suggested that age might be mostly responsible for case 5’s higher degree of linkage. It could be that since case 5 has been present in Chile for a long time the firm has established a local presence that would lead to a higher integration through forward linkages.

7.9.3 Group 3: High Degree of Linkage

Group 3 case firms present DOL scores which are significantly higher than the total average (Table 7.23). These scores are mainly the result of group 3 case firms having established both moderate and high-quality linkages. Moreover, in terms of competitive linkages these firms also have above average scores (Table 7.23) indicating that their indirect effects through competitive influences are significant.
Since they have established moderate and high-quality linkages, their degree of linkage in the local industry can be regarded as high.

<table>
<thead>
<tr>
<th>Case</th>
<th>Competitive linkages</th>
<th>Backward linkages*</th>
<th>Forward linkages*</th>
<th>CSR linkages*</th>
<th>Collaborative agreements*</th>
<th>DOL</th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td>3</td>
<td>9</td>
<td>0</td>
<td>9</td>
<td>4</td>
<td>25</td>
</tr>
<tr>
<td>7</td>
<td>3</td>
<td>8</td>
<td>5</td>
<td>6</td>
<td>4</td>
<td>26</td>
</tr>
<tr>
<td>8</td>
<td>3</td>
<td>6</td>
<td>9</td>
<td>5</td>
<td>5</td>
<td>28</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>2.375</strong></td>
<td><strong>3.875</strong></td>
<td><strong>6</strong></td>
<td><strong>3.5</strong></td>
<td><strong>2.625</strong></td>
<td><strong>18.375</strong></td>
</tr>
</tbody>
</table>

* The score of each firm for each type of direct linkage is a result of the sum of the quantity and quality score of that type of linkage.

### 7.9.3.1 Affiliate Profile Similarities and Differences

Group 3 case firms share several firm characteristics such as country of origin, size of firm, age of the foreign affiliate, motive for investment, role of the affiliate and types of resources obtained from the parent firm. All three case firms’ parent firms are from Spain, have established operations in Chile for market-seeking reasons, and follow a complex-integration strategy. All of group 3 parent firms provide the foreign affiliates with technology and management practices. As foreign affiliates, group 3 case firms have been present in the Chilean market between 8 and 10 years. In addition, these foreign affiliates are big in size with a total number of employees between 550 and 1090.

Regarding differences between group 3 case firms, cases 4 and 7 are only different in terms of main activity and level of autonomy. That is, besides the similarities mentioned above these case firms present further similarities such as mode of entry, ownership form, source of innovations, and O-advantages as source of competitive advantages. When comparing all three case firms it is observed that case 8 differs from the other two foreign affiliates with regard to mode of entry, ownership form, main activity, source of innovations, and competitive advantages.

The mode of entry used by cases 4 and 7 parent firms was the acquisition of long-established Chilean firms while case 8 entered the Chilean market through Greenfield investment. In addition, while all group 3 foreign affiliates are established as Chilean
firms, cases 4 and 7 are owned by foreign companies while case 8 is owned by foreign and local individuals.

In terms of main activity, although cases 4 and 7 operate in different service sectors their main activities are similar since both focus on providing “basic services” – water and electricity respectively – that involve the delivery of “a product” more than a service while case 8’s main activity is purely service-based.

<table>
<thead>
<tr>
<th>Table 7.24 Group 3: Affiliate Profile</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Case/ Variable</strong></td>
</tr>
<tr>
<td><strong>AFFILIATE PROFILE</strong></td>
</tr>
<tr>
<td><strong>Country of origin</strong></td>
</tr>
<tr>
<td><strong>Main activity</strong></td>
</tr>
<tr>
<td><strong>Age</strong></td>
</tr>
<tr>
<td><strong>Mode of entry</strong></td>
</tr>
<tr>
<td><strong>Ownership form</strong></td>
</tr>
<tr>
<td><strong>Autonomy</strong></td>
</tr>
<tr>
<td><strong>Size of firm</strong></td>
</tr>
<tr>
<td><strong>Motive for investment</strong></td>
</tr>
<tr>
<td><strong>Role of affiliate</strong></td>
</tr>
<tr>
<td><strong>Ownership advantages from parent firm</strong></td>
</tr>
<tr>
<td><strong>Innovations &amp; source</strong></td>
</tr>
<tr>
<td><strong>Main competitive advantages</strong></td>
</tr>
<tr>
<td><strong>O-advantages as source of competitive advantage</strong></td>
</tr>
</tbody>
</table>

While group 3 case firms obtain resources from their parent firms – such as technology and management practices – the extent to which these foreign affiliates rely on their parent firms as a source of innovations is limited. While case 8 obtains
innovations from its parent firm it also relies on innovations generated locally. Going further, cases 4 and 7 generate most of their innovations locally, in turn, not relying on the parent firms as a source of innovation. Similarly, the extent to which O-advantages constitute competitive advantages for cases 4 and 7 is minor, while for case 8 MNE affiliations is one of its key advantages.

When level of autonomy is considered, cases 7 and 8 are similar since both case firms’ decision-making process is influenced by their parent firms to a minor extent, while in case 4 the parent firm has a moderate level of influence on decision-making.

7.9.3.2 DOL and Affiliate Profile

Overall DOL scores show that case 8 is more integrated into the local industry than cases 4 and 7. Scores for each type of linkages indicate that case 8 has a higher score as a result of a significantly high forward linkages score. Case 4 has the lowest DOL score of the group as a result of not having established forward linkages while case 7 has a below average forward linkages score.

After observing differences among group 3 case firms, it could be suggested that the main activity might be mostly responsible for case 8’s higher degree of linkage. Case 8 main activity is consulting services which imply that the relationships established with its clients are of high quality since their service offering involves continuous assistance in various ways. On the other hand, case 4 does not provide assistance to its clients since its main activity is the production and distribution of water to individuals. Case 7 is also restricted by its main activity. While it does establish relationships with its major clients the quality of these relationships is low since it provides technical assistance only in order to comply with industry regulations. In sum, it is the service nature of case 8’s main activity which results in the foreign affiliate establishing high quality forward linkages, in turn, leading to a higher DOL score.
7.10.0 Across Cases: DOL and Affiliate Profile

This section examines each of the case firms groups based on various characteristics. This analysis will enable a better understanding of the types of firms which engage in different types of linkages. It will also provide insight as to whether the groups are able to be differentiated on the basis of the determinants of linkages identified in the literature.

Specifically, case firms groups will be compared based on the following variables: motive for investment, role of the affiliate, competitive position of the affiliate, mode of entry, ownership form, level of autonomy, reliance on O-advantages (competitive advantages and source of innovations), main activity, country of origin, size of firm (foreign affiliate and parent firm), and age (number of years in Chile, and number of years owned by its current foreign investor).

7.10.1 Motive for Investment

There are no differences between the groups. All case firms have established operations in Chile for market-seeking reasons since all of them operate within the service industry (although different sectors).

7.10.2 Role of the Affiliate

In terms of role of the affiliate or MNE’s strategy, case firms can be divided into two groups: those that are highly integrated in the global network of the parent firm, and those that follow a complex-integration strategy.

Group 1 case firms all referred to themselves as being highly integrated in the global network of their parent firm while group 3 case firms followed a complex-integration strategy. With regard to group 2 case firms, case 5 was highly integrated while case 3 followed a complex-integration strategy.
The difference between groups 1 and 3 suggests that those firms that are highly integrated into the global network of the parent firm present a lower DOL than those that follow a complex-integration strategy.

### 7.10.3 Competitive Position

The competitive position of the foreign affiliate was included in the analysis in order to better understand the role of the affiliate in the Chilean industry. From Table 7.25 it can be seen that most of case firms that regard themselves as major competitors in Chile, or the only competitor (case 3), belong to either group 2 or 3. That is, those firms that have a strong local presence are also those that have established higher-quality linkages, especially collaborative agreements. Nevertheless, case firm 1 is an exception since it is a major competitor in Chile but has not established high-quality linkages.

<table>
<thead>
<tr>
<th>DOL Group</th>
<th>Case</th>
<th>Competitive Position</th>
<th>Competitive Environment/competitive changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1</td>
<td>Major competitor in Chile and International</td>
<td>Moderate influence</td>
</tr>
<tr>
<td>1</td>
<td>2</td>
<td>Small competitor in Chile/ Major International</td>
<td>Minor influence</td>
</tr>
<tr>
<td>1</td>
<td>6</td>
<td>Small competitor in Chile/ Major International</td>
<td>Minor influence</td>
</tr>
<tr>
<td>2</td>
<td>3</td>
<td>Only competitor in Chile/ SME International</td>
<td>Major influence</td>
</tr>
<tr>
<td>2</td>
<td>5</td>
<td>Major competitor in Chile and International</td>
<td>Major influence</td>
</tr>
<tr>
<td>3</td>
<td>4</td>
<td>Major competitor in Chile and International</td>
<td>Major influence</td>
</tr>
<tr>
<td>3</td>
<td>7</td>
<td>Major competitor in Chile and International</td>
<td>Major influence</td>
</tr>
<tr>
<td>3</td>
<td>8</td>
<td>Major competitor in Chile/ SME International</td>
<td>Major influence</td>
</tr>
</tbody>
</table>

With regard to the competitive position of the parent firm internationally it is not clearly related to a higher degree of linkage locally. Indeed, all parent firms of foreign affiliates belonging to group 1 (moderate DOL) are major competitors internationally while cases 3’s (moderate-high DOL) and 8’s (High DOL) parent firms are SME firms internationally.

The perceived influence on the competitive environment and on competitive changes seems to be related to the DOL of foreign affiliates since, without exception, firms that perceive that they have a major influence are also those that have established
high-quality linkages (group 2 and 3). In addition, those firms that have a major influence also have strong positions in the industry either by being a major competitor or the only competitor.

### 7.10.4 Mode of entry / Ownership form

<table>
<thead>
<tr>
<th>DOL Group</th>
<th>Case</th>
<th>Ownership Form</th>
<th>Mode of entry</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1</td>
<td>Chilean branch</td>
<td>M&amp;A</td>
</tr>
<tr>
<td>1</td>
<td>2</td>
<td>Chilean branch</td>
<td>Greenfield</td>
</tr>
<tr>
<td>1</td>
<td>6</td>
<td>Chilean branch</td>
<td>Greenfield</td>
</tr>
<tr>
<td>2</td>
<td>3</td>
<td>Chilean firm owned by foreign individuals</td>
<td>Greenfield</td>
</tr>
<tr>
<td>2</td>
<td>5</td>
<td>Chilean branch</td>
<td>Greenfield</td>
</tr>
<tr>
<td>3</td>
<td>4</td>
<td>Chilean firm owned by foreign company</td>
<td>M&amp;A</td>
</tr>
<tr>
<td>3</td>
<td>7</td>
<td>Chilean firm owned by foreign company</td>
<td>M&amp;A</td>
</tr>
<tr>
<td>3</td>
<td>8</td>
<td>Chilean firm owned by local and foreign individuals</td>
<td>Greenfield</td>
</tr>
</tbody>
</table>

Table 7.26 shows that in terms of ownership forms of the affiliates, case firms are either a Chilean branch of a foreign company, or a Chilean firm owned by a foreign company/individuals.

Table 7.26 also shows that branches occur mostly in group 1. All case firms in group 1 and one firm in group 2 have been operating as Chilean branches. On the other hand, most firms operating as Chilean firms (owned by foreign company/individuals) belong to group 3. All case firms in group 3 and one firm in group 2 have been operating as Chilean firms.

These results suggest that the affiliates that are branches of foreign companies are less likely to take an active role in the local economy through indirect and direct linkages. On the other hand, firms that are owned by foreign company/individuals are more likely to establish linkages that contribute towards local upgrading.

As regards mode of entry, most case firms have established operations in Chile through Greenfield investment. Three out of eight affiliates have used M&A as an entry mode. The affiliates that were previously Chilean firms and have since been acquired by their foreign owners mostly belong to group 3. In fact, 2 out of 3 case
firms in group 3 are acquired firms. This finding implies that most firms that have used Greenfield investment as an entry mode either belong to groups 1 or 2, which present a lower DOL than group 3. However, there are exceptions at both ends of the range, specifically case 1 (group 1 – M&A) and case 8 (group 3 – Greenfield).

### 7.10.5 Level of Autonomy

Table 7.27 shows four levels of influence on decision making from parent firms that range from minor to total influence. By regrouping these four levels into two major groups: major to total influence (low level of autonomy) and minor to moderate influence (moderate to high level of autonomy), it is possible to observe that most affiliates with a low level of autonomy belong to group 1, which has the lowest DOL while affiliates with a high level of autonomy (minor influence) belong to group 3, which has the highest DOL. This finding suggests that when the foreign affiliate enjoys a higher level of autonomy with regard to decision making, this freedom may result in the affiliate establishing higher quality linkages.

<table>
<thead>
<tr>
<th>DOL Group</th>
<th>Case</th>
<th>Parent firm influence on decision making</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1</td>
<td>Total influence</td>
</tr>
<tr>
<td>1</td>
<td>2</td>
<td>Major influence</td>
</tr>
<tr>
<td>1</td>
<td>6</td>
<td>Major influence</td>
</tr>
<tr>
<td>2</td>
<td>3</td>
<td>Moderate influence</td>
</tr>
<tr>
<td>2</td>
<td>5</td>
<td>Major influence</td>
</tr>
<tr>
<td>3</td>
<td>4</td>
<td>Moderate influence</td>
</tr>
<tr>
<td>3</td>
<td>7</td>
<td>Minor influence</td>
</tr>
<tr>
<td>3</td>
<td>8</td>
<td>Minor influence</td>
</tr>
</tbody>
</table>

### 7.10.6 Reliance on O-advantages (parent firm resources)/Source of innovations

From Table 7.28 it can be observed that the majority of case firms rely on their foreign parents for resources (O-advantages) that translate into competitive advantages. Nevertheless, most case firms that rely on their parent firms’ O-advantages to a minor extent belong to group 3, which shows the highest DOL. That
is, the group of case firms that has the lowest reliance on parent resources is forming more direct linkages with local entities than the groups (1 and 2) that present a heavier reliance on their foreign parent.

<table>
<thead>
<tr>
<th>DOL Group</th>
<th>Case</th>
<th>O-advantages as source of competitive advantage</th>
<th>Source of innovations</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1</td>
<td>Yes, MNE affiliation</td>
<td>Only parent firm</td>
</tr>
<tr>
<td>1</td>
<td>2</td>
<td>Yes, MNE affiliation</td>
<td>Only parent firm</td>
</tr>
<tr>
<td>1</td>
<td>6</td>
<td>Yes, MNE affiliation</td>
<td>Only parent firm</td>
</tr>
<tr>
<td>2</td>
<td>3</td>
<td>Yes</td>
<td>Mainly parent firm</td>
</tr>
<tr>
<td>2</td>
<td>5</td>
<td>Yes, MNE affiliation</td>
<td>Mainly parent firm</td>
</tr>
<tr>
<td>3</td>
<td>4</td>
<td>Few O-advantages as source</td>
<td>Mainly foreign affiliate</td>
</tr>
<tr>
<td>3</td>
<td>7</td>
<td>Few O-advantages as source</td>
<td>Mainly foreign affiliate</td>
</tr>
<tr>
<td>3</td>
<td>8</td>
<td>Yes, MNE affiliation</td>
<td>Both parent and foreign affiliate</td>
</tr>
</tbody>
</table>

The relationship between reliance on parent firm and DOL is clearer when considering the source of innovations. All of the case firms belonging to group 1 totally rely on their parent firms as a source of innovations. Group 2 case firms also rely heavily on their parent firms while group 3 case firms rely only to a minor or moderate extent. That is, as the DOL score increases it seems that the reliance of the foreign affiliate on its parent firm as a source of innovation decreases, with the only exception being case 8 which shows the highest DOL score while depending equally on its parent firm and internal sources as sources of innovations.

Overall, it seems that the extent to which the foreign affiliate relies on the parent firm either as a source of resources or innovations is related to the level of embeddedness of the affiliate in the industry.

**7.10.7 Main Activity**

All case firms operate within the service industry, although in different sectors. For most firms their main activity is highly knowledge-based, for example, corporate financial services, consulting services, and information services. That is, their firm-specific advantages are bound up in the human capital of the managers and staff, not in plant and equipment (Lecraw, 1989). On the other hand, cases 4 and 7 operate within sectors which are not “pure-service” such as water and electricity services.
These sectors are highly focused on “production” involving installed capacity, in terms of equipment and technology, besides human capital.

In terms of the main activity of firms, it could be noticed that firms operating in the corporate financial sector belonged to group 1 while firms operating in the non pure services sectors belonged to group 3. Besides these differences, the other half of the sample belonged to any of the three groups of firms. Hence, there is no clear relationship between the main activity of the firm (in terms of subsector rather than industry) and DOL. However, the data suggest that those affiliates involved in activities that require significant investment in terms of installed capacity (water and electricity services) are more likely to establish more high-quality linkages than those that are “pure-service” providers.

7.10.8 Country of Origin

As shown in Table 7.29 case firms that belong to group 3 have the same nationality while case firms belonging to group 1 and 2 present different nationalities. Nevertheless, the affiliate’s country of origin could be differentiated in terms of Spanish-speaking and non-Spanish speaking countries. From this perspective the data suggest that those affiliates whose country of origin is Spain are more likely to establish more high-quality linkages than those affiliates that come from non-Spanish speaking countries.

<table>
<thead>
<tr>
<th>DOL Group</th>
<th>Case</th>
<th>Country of origin</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1</td>
<td>USA</td>
</tr>
<tr>
<td>1</td>
<td>2</td>
<td>Netherlands</td>
</tr>
<tr>
<td>1</td>
<td>6</td>
<td>UK</td>
</tr>
<tr>
<td>2</td>
<td>3</td>
<td>Canada</td>
</tr>
<tr>
<td>2</td>
<td>5</td>
<td>UK</td>
</tr>
<tr>
<td>3</td>
<td>4</td>
<td>Spain</td>
</tr>
<tr>
<td>3</td>
<td>7</td>
<td>Spain</td>
</tr>
<tr>
<td>3</td>
<td>8</td>
<td>Spain</td>
</tr>
</tbody>
</table>
7.10.9 Age and size

Case firms groups are compared in terms of the number of years since the firm was established in Chile and the number of years that the firm has been owned by its current foreign investor, as well as its size as measured by full-time employees.

<table>
<thead>
<tr>
<th>DOL Group</th>
<th>Case</th>
<th>Age (Number of years operating in Chile/owned by current foreign investor)</th>
<th>Size of affiliate (Number of employees)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1</td>
<td>30 / 12</td>
<td>SME (65)</td>
</tr>
<tr>
<td>1</td>
<td>2</td>
<td>17 / 17</td>
<td>SME (150)</td>
</tr>
<tr>
<td>1</td>
<td>6</td>
<td>26 / 26</td>
<td>SME (140)</td>
</tr>
<tr>
<td>2</td>
<td>3</td>
<td>2 / 2</td>
<td>SME (40)</td>
</tr>
<tr>
<td>2</td>
<td>5</td>
<td>40 / 40</td>
<td>SME (35)</td>
</tr>
<tr>
<td>3</td>
<td>4</td>
<td>146 / 8</td>
<td>Big (1091)</td>
</tr>
<tr>
<td>3</td>
<td>7</td>
<td>64 / 10</td>
<td>Big (789)</td>
</tr>
<tr>
<td>3</td>
<td>8</td>
<td>9 / 9</td>
<td>Big (550)</td>
</tr>
<tr>
<td>Average</td>
<td></td>
<td>41.75 / 15.5</td>
<td>357.5</td>
</tr>
</tbody>
</table>

Table 7.30 shows that case firms that exhibit an above average number of years operating in Chile (oldest firms) belong to group 3 (highest DOL). Nevertheless, the “youngest” case firms (cases 3 and 8) do not belong to the group with the lowest DOL. In other words, the age of the firm does not necessarily result into a higher degree of linkage with the local economy.

In terms of number of years owned by its current foreign investor, there is not a clear picture as to the influence of foreign ownership over time on the extent of linkage formation. However, it can be observed that firms that have been owned by foreign investors longer than the average mostly belong to group 1 (lowest DOL) while case firms that have been owned by foreign investors for a fewer number of years than the average mostly belong to group 3 (highest DOL).

With regard to the size of foreign affiliates, the biggest firms (above average number of employees) belong to the group with the highest DOL while the remaining case firms (below average number of employees) belong to either group 1 or 2. This finding suggests that the larger the firm the higher the degree of linkage it will have
with the local industry. However, when comparing case firms in group 1 and 2, the researcher observed that case firms in group 2 are smaller than firms in group 1 despite the fact that they have a higher DOL. Hence, the results cannot be interpreted in isolation and need to be viewed in light of other characteristics of the groups. This point will be discussed in the next chapter.

7.11.0 Conclusion

The main purpose of this chapter was to present the across-case analysis and findings. The first step in understanding the dataset as a whole was to consider the major conceptual categories (affiliate profile, linkage formation, determinants of linkages, degree of linkage), and the specific variables within each category, across-cases. From the examination of firm-characteristics, it was noticed that all the firms came to Chile motivated by market-seeking reasons since all firms operate within the service industry. In addition, to some extent, all of the firms rely on the resources gained from the parent firm as sources of competitive advantages. Accordingly, none of the firms has invested in Chile in order to gain or develop local innovation. Despite these common characteristics the affiliates differ in terms of country of origin, age, mode of entry, ownership form, level of autonomy, and size.

In terms of indirect competitive linkages, 6 of the 8 case firms held a major or even monopolistic market position in Chile. These firms mostly had a major influence on changes to the competitive environment.

With regard to direct linkage formation, all firms had established some type of direct linkage with local entities. All firms had established backward and/or forward linkages in the local Chilean industry. Nevertheless, while all case firms source standard products/services locally, not all of them source specialized products/services locally. Of those case firms that buy specialized products/services locally, not all of them have established backward linkages with the suppliers. However, one of the case firms had established backward linkages with local suppliers of standard products/services. Case firms that have established backward
linkages with suppliers of specialized products have done so mostly with MNEs which are locally-established.

Almost all the case firms had established forward linkages with their clients, except for one firm. From those that have established relationships with their clients, the extent of that linkage has been significant. In terms of quality, the foreign affiliates give substantial assistance to their clients.

None of the firms had established knowledge agreements with local licensees or franchisees. Nevertheless, CSR linkages were identified as a new type of linkage that involves the transfer of knowledge and experience through projects that, in most cases, do not involve a direct relationship with local firms. In terms of extent, case firms vary from not having established CSR linkages to having established several linkages. Quantity and quality of linkages seem to be related since for those case firms that have established only a few CSR linkages, the quality of those linkages is below average. By contrast, the quality of linkages for those firms which have established several CSR linkages is above average.

More than half of the firms included in the sample had formed a collaborative agreement with local entities. Most of these agreements were strategic alliances with local Chilean universities. These agreements were primarily for technology development, access to markets, transfer of information and expertise, and the development of human resources. Most of the collaborative agreements established involved the transfer of knowledge and expertise from the affiliates to the local entities.

From the across-cases analysis of the variables identified during within-case analysis as influencing linkage formation (within-case determinants), it was apparent that most of the variables reported by respondents were not related to the affiliate (non-FDI related determinants), although there were a couple of affiliate-related (FDI-related) variables that were recognized as influencing linkage formation. For instance, the strategy of the parent firm was consistently reported throughout the cases as influencing the establishment of backward linkages. For half of the firms, the strategy of the parent firm towards procurement of specialized inputs has played a negative
role because the parent firms provided their affiliates with specialized inputs or limited the affiliates in their choice of suppliers to locally-established MNEs with which the parent firm had signed global contracts. On the other hand, all of case firms that had formed backward linkages regarded their parent firm strategy as positively influencing backward linkage formation. Nevertheless, for most firms it is the combination of the parent firm’s strategy and the main activity of the affiliate that results in the establishment of backward linkages.

The main activity of the foreign affiliate was the main variable reported by respondents as influencing forward linkages formation. For almost all of the case firms, their main activity had played a positive role in the establishment and quality of forward linkages. The “assistance” nature of these firms’ main activity is what had led to the establishment of long-term relationships with their clients. On the other hand, for two case firms the main activity had played a negative role on either linkage formation or quality of linkages. With regard to the extent of forward linkages, case informants reported different factors as influencing the extent of linkages established, for example, economic environment, strategy of parent firm, industry size, and the competitive position of the foreign affiliate.

Although there was no single factor that seems to influence CSR linkages in all of the case firms, there were two factors that were consistently reported in most of the cases. First, the global strategy of the foreign affiliates’ parent firms towards CSR had played a determining role for most foreign affiliates by either encouraging or discouraging the affiliates’ getting involved in CSR projects. More than half of the case firms recognized the parent firm’s global sustainable development policy, resulting in the foreign affiliate either developing their own strategies and projects regarding CSR or getting involved in CSR projects that are an extension of the parent firm’s global strategy. Second, the economic environment of the local Chilean industry was acknowledged by half of case firms as positively influencing their decision to establish CSR linkages. The stability and growth potential of the local economy had resulted in a long-term commitment of the foreign affiliates with local operations, who in turn, embraced initiatives to improve local conditions at the industry level and/or at the community level.
The strategy of the foreign affiliate was recognized as an impediment to establishing collaborative agreements by all firms that had not formed collaborative agreements. The strategies adopted were either a response to restrictive local conditions – level of education and size of the market – or were global strategies regardless of local conditions. On the other hand, the strategy of the foreign affiliate had a positive influence on the formation of collaborative agreements for two of the case firms. Both firms had looked to partnership in order to sustain their position in the local market.

Local firm capability and the regulatory framework were acknowledged as positively influencing the establishment of collaborative agreements. The foreign affiliates had been willing to transfer key resources to their partners (mostly universities) since they perceived that local firms/universities contribute significantly to the alliances. With regard to the regulatory framework, two case firms had established alliances with local universities motivated by the fact that industry policy imposes high-efficiency standards that require ongoing improvement of operations through research and development (R&D), while new regulations in the banking sector motivated one of the affiliates to establish an alliance with two foreign-owned/locally-established firms to introduce a new service to the industry.

Case firms were grouped according to their overall extent and degree of linkage with local industry in Chile in order to identify firm-characteristics that may be related with a lower or higher degree of linkage. Three groups of firms were identified, each differentiated by its DOL and specific pattern of linkages. The first group included case firms with the lowest level of embeddedness. These firms had not established backward linkages or collaborative agreements locally. In addition, in terms of competitive linkages, these firms also had below average scores indicating that their indirect effects through competitive influences are not significant. Nevertheless, they had formed forward and CSR linkages. The second group had a moderate to high DOL. They had not formed CSR linkages and had lower backward linkages scores (in comparison to group 3 firms). On the other hand, they had established forward linkages and collaborative agreements. Finally, the third group included case firms with the highest DOL. In terms of competitive linkages, their indirect effects through competitive influences are significant (above average). These firms had also
established backward linkages, forward linkages (with one exception), CSR linkages, and collaborative agreements.

The groups of case firms showed certain characteristics according to their DOL. Firms that perceived that they had a major influence on the competitive environment and on competitive changes – group 2 and 3 – were also those that had established high-quality linkages. In addition, those firms that perceived a major influence also had strong positions in the industry. The affiliates that were branches of foreign companies were less likely to take an active role in the local economy through indirect and direct linkages. On the other hand, firms that were owned by foreign company/individuals were more likely to establish linkages that contribute towards local upgrading. Most affiliates with a low level of autonomy belong to group 1, while affiliates with a high level of autonomy belong to group 3. This finding suggests that when the foreign affiliate enjoyed a higher level of autonomy, it resulted in the affiliate establishing higher quality linkages. The group of case firms that had the lowest reliance on parent resources formed more direct linkages with local entities than the groups (1 and 2) that present a heavier reliance. Moreover, as the DOL score increased the reliance of foreign affiliates on their parent firm as a source of innovation decreased, with the exception of case 8 only. Those affiliates whose country of origin was Spain (group 3) were more likely to establish more high-quality linkages than those affiliates that came from non-Spanish speaking countries. With regard to the size of foreign affiliates, the biggest firms (above average number of employees) belong to the group with the highest DOL, while the remaining case firms (below average number of employees) belong to either group 1 or 2.

The purpose of the next chapter is to discuss these results, specifically, the possible explanations of these outcomes and some implications for this research. The results of this study are compared with previous literature in an attempt to better understand the implications within the Chilean context.

1 Knowledge agreements and collaborative agreements are both cooperative forms of economic activity. Knowledge agreements are inter-firm agreements with local licensees and/or franchisees while collaborative agreements refer to inter-firm agreements with local collaborative partners not related to the firm. Collaborative agreements encompass a wide range of organisational forms, such as strategic alliances, technology sharing or development agreements, and managerial contracts (Scott-Kennel, 2001).
Firms that show two numbers, the first number refers to the number of years the firm has been operating in Chile while the second number indicates the number of years the firm has been significantly foreign-owned.

For each case firm it is indicated the competitive position of the foreign affiliate in the Chilean market and the competitive position of the parent firm internationally.

Extent and quality of competitive linkages measured as the perceived influence of the affiliate’s operations on the changes to the competitive environment.

The latest Chile Oil & Gas Report from It forecasts that the country will account for 3.93% of Latin America regional oil demand by 2010, while providing less than 1.0% of supply (Bharat Book Bureau, 2008).

For each case firm it is indicated the competitive position of the foreign affiliate in the Chilean market and the competitive position of the parent firm internationally.
Chapter 8  Discussion of the Results

8.1.0 Introduction

The purpose of this chapter is to discuss the findings for each of the research questions presented in Chapter Four and analysed in Chapter Six and Seven. A summary and discussion of these results are given within the context of these questions, as well as a summary of the theoretical and empirical literature examined in Chapters Two and Three. This chapter provides the basis for the conclusions and implications for Chilean industry and policy which are presented in Chapter Nine.

To start this discussion, a post-hoc analysis is presented that indicates specific issues that arose during the data collection process that provide the context to better explain the results. Then, a discussion of the findings regarding the suitability of Scott-Kennel’s (2001) model in the Chilean context is presented. The following sections discuss the results related to the affiliates’ profile, linkage formation, determinants of linkage formation, and degree of linkage. The final section concludes this chapter.

8.2.0 Post-Hoc Analysis

The results in Chapter Six and Seven revealed two issues that arose after the research model was developed and after the data had been collected: 1) all case firms operating within the service sector, and 2) the establishment of Corporate Social Responsibility linkages. It is essential to include these issues to better explain the results in the context of the main research questions.

8.2.1 Service MNEs

In the methodology chapter (Chapter Five), it was indicated that it was decided to reduce the sample to the industries that have received most foreign direct investment in the last three decades in Chile: namely, mining, services, and electricity, gas and water (under the classification of the Chilean Foreign Investment Committee). While
Initially the intent of the study was to assess the research questions across industries, key considerations such as geographic convenience and accessibility to the head office ultimately determined the cases included in this study. As a result, all case firms belonged to the services sector (including electricity and water).

Previous literature states that service MNEs present distinct characteristics (Enderwick, 1989; Aharoni & Nachum, 2000; UNCTAD, 2004; Kundu et al., 2008). These characteristics may pose a challenge for theoretical explanations of foreign investment in terms of any claim to generality (Enderwick, 1989; Kundu et al., 2008; Kundu & Merchant, 2008). Among these features the most distinctive is the nature of service output which is characterized by its intangibility and frequent impermanence (UNCTAD, 2004; Grosse, 2000; Enderwick, 1989; Li, 1994, Fernández, 2001), and its being highly knowledge-based (Grosse, 2000; Markusen, 1989; Rugman & Verbeke, 2008). This distinction implies that, generally, service MNEs necessitate a foreign presence because consumption cannot be separated from production (Li, 1994; Fernández, 2001; Rugman & Verbeke, 2008). However, there is heterogeneity within the service sector which results in various factors that explain why service firms are more likely to engage in FDI rather than exports (Enderwick, 1989):

1. For some services a local presence is a prerequisite and exporting is never a viable alternative.
2. There are problems of separating out the technology package of many services. The effective transfer of technology necessitates the sharing of experience and provision of on-the-job training.
3. In information-intensive industries considerable knowledge is generated, which is better protected and more profitably applied within the firm.
4. For service establishments complementing goods production, there are obvious economies of common governance encouraging direct investment.
5. In the case of knowledge-based innovatory services, there are further incentives to internalization. Innovators, often with unique knowledge of their services, may be the best equipped to undertake buyer instruction. This circumstance suggests at least vertical integration of production and sales.
6. For those service activities where quality considerations are paramount, alternatives to patents may be necessary if services of the requisite quality are
to be developed. In these cases internalisation is an economically efficient solution.

These incentives to the internalisation of exchanges are reinforced by the high frequency of exchange for services of an intangible or transient form, serving to offset the formation costs of overseas affiliates. Evidence of dynamic economies of transfer (Teece, 1977) whereby transactions and production costs are reduced with repetitive transfer of the same technology encourages the retention of such benefits within the organization (Markusen, 1989). Internalisation of service outputs may also bring advantages to potential buyers. Multinational branding of services conveys valuable information about the quality and performance of services (Aharoni, 2000; Rugman & Verbeke, 2008). Similarly, existing customers in one market face lower search and transaction costs if they wish to purchase the same service in a second market where this market is serviced by an MNE (Enderwick, 1989; Kundu et al., 2008).

In terms of O-advantages, previous literature indicates that the capabilities acknowledged by service firms to be essential to their competitiveness are quite different from the traditional kinds of O-advantages of manufacturing firms (Grosse, 2000; Markusen, 1989). These are: knowledge of clients and relationships with them; global scope of the service firm’s affiliate network; methodologies for producing services; knowledge of the market for the services; management skills; and, technical/specialized information. Service firms tend to view relationships with clients as the single most important kind of knowledge that gives them competitive advantage (Grosse, 2000; Aharoni, 2000). This specific knowledge falls outside of all three traditional categories of technology management (product, process, and managerial) since it is knowledge of the market rather than that of the product. Since many of the service sector products are easily copied (for example, bank products), it may be the ability to understand the client’s needs and to thus offer products that best serve those needs that is key. Consistently, service firms have extended their operations overseas mainly to follow existing clients who have moved overseas (Grosse, 2000; UNCTAD, 2004; Enderwick, 1989; Kundu et al., 2008; Fernández, 2001; Li, 1994).
The issues presented above are further discussed in the context of the findings of this study in the following sections.

### 8.2.2 Corporate Social Responsibility Linkages

Another form through which foreign affiliates may influence local industry upgrading is related to the concept of corporate social responsibility (CSR). CSR is conventionally defined as the social involvement, responsiveness, and accountability of firms apart from their core profit activities and beyond the requirements of the law and what is otherwise required by governments (Chapple & Moon, 2005). However, this definition is becoming more and more challenging as various business cases for CSR are being made, governments are deploying incentives for CSR, and compliance with the law in a variety of global jurisdictions is emerging as a CSR issue (Chapple & Moon, 2005). As a result, CSR can be defined strategically. Corporate social responsibility goes beyond philanthropy and compliance and addresses how companies manage their economic, social, and environmental impacts, as well as their relationships in all key spheres of influence: the workplace, the marketplace, the supply chain, the community, and the public policy realm (Reinhardt, Stavins & Vietor, 2008).

Moon (2003) suggests that CSR of firms can be classified into three broad groups, namely: community involvement, socially responsible products and processes, and socially responsible employee relations. In addition, they indicate that the modes deployed to enact CSR (the way in which CSR is engaged in) range from add-on philanthropic modes to more institutionalized methods such as partnership, volunteering and trust fund activity.

CSR activities are usually regarded in terms of community involvement (Chapple & Moon, 2005). The first wave of community involvement refers to the traditional assumption about CSR that it is removed from the main business activity and is outside the firm such as general community issues, housing, arts and culture, environment and conservation, health, education and training, and other. Although community involvement is usually regarded as philanthropic in nature, there might be
more engaged forms of community involvement through partnerships, sponsorships, employee volunteering, and strategic alliances.

The second two waves reflect the change in the conceptualization of CSR in that it becomes the way in which the firm does business rather than how it uses its profits. Socially responsible production refers to the ability of the firm to demonstrate that both its supply chain and on-site operations are conducted in a socially responsible fashion. The final wave, employee relations, pertains to the issues of employee welfare and employee engagement. Socially responsible employer relations refers to the status of the workforce as a stakeholder in the context of company decision-making and the development of CSR practices and polices (Chapple & Moon 2005).

Several studies indicate that MNEs’ CSR activities have an impact on economic development (Monaghan & Weiser, 2003; Heal, 2005; Reinhardt, Stavins, & Vietor, 2008; Chapple & Moon, 2005; Fortanier & Kolk, 2007). However, there are no studies that have explicitly investigated the role of CSR activities of foreign affiliates in the development of local industry. Beyond philanthropic modes of CSR, the change in the conceptualization of CSR (the way in which the firms do business) suggests that foreign affiliates may engage in activities that augment their O-advantages in terms of socially responsible products and processes. In doing so, the local industry might benefit from the CSR activities of the foreign affiliate through community-related projects – especially in developing countries where local conditions (such as housing, education, and health) need further improvement – and collaboration arrangements with local entities. Zadek (2006) indicates that firms engage in collaborative arrangements with public institutions driven by the micro dynamics of competition, risk management, and reputation. Hence, the foreign affiliate is likely to collaborate with local institutions for strategic purposes, while CSR activities may strengthen the L-advantages of the local economy.

The remainder of this chapter discusses the findings in the context of the main research questions and the post-hoc analysis.
8.3.0 Scott-Kennel’s Model of Local Industry Upgrading

The applicability of Scott-Kennel’s (2001) model in the context of Chile was evaluated by assessing specific issues related to government policy and the economic environment.

8.3.1 Government Policy

With regard to previous literature, there is general agreement that the more competitive and outward-oriented an economy is the more linkages are encouraged (UNCTAD, 1999). Host government policy has been found to play a determining role in linkage formation (Brown, 1998; Lall, 1980). The results in this study are mixed with regard to the influence of government policy on linkage formation. On the one hand, FDI policy was regarded as neutral while on the other hand industry policy seemed to influence, to some extent, the establishment of assistance linkages and especially collaborative agreements. (This point is discussed further later in this chapter.) This finding is in line with previous literature that emphasizes that service MNEs are attracted by, among other factors, accommodative industrial policy encouraging collaboration between service users and suppliers and an atmosphere conducive to academic/industrial collaboration (Bullock, 1983).

Considering other factors influencing linkage formation reveals that the MNE’s strategy plays a bigger role on backward linkage formation than does industry policy. While industry policy was acknowledged by two case firms as a determinant of backward linkage formation, all case firms regarded the MNE’s strategy as playing either a positive or negative role on backward linkage formation. The same is observable for CSR linkages. In terms of forward linkages, the main activity of the affiliates is the factor most acknowledged by case firms. When compared to local firm capability and MNE’s strategy, industry policy also plays a significant role in terms of formation of collaborative agreements. While the MNE’s strategy played a mostly negative role for three case firms, industry policy, as well as local firm capability, played a positive role for three case firms.
Overall, the proposition that policy framework does not influence linkage formation since the MNE’s strategy plays a role on linkage formation is mostly supported by the results. The MNE’s strategy plays a bigger role with regard to the formation of backward linkages and CSR linkages than does the regulatory framework. However, the regulatory framework and MNE’s strategy both play a significant role when it comes to the formation of collaborative agreements, although in opposite directions. This finding suggests that when the strategy of the parent firm does not prevent the foreign affiliate from getting involved in the local industry, the regulatory framework has the potential to play a positive role as regards the formation of high quality linkages.

The findings suggest that government policy has played a limited role on linkage formation. This result could be explained by the fact that government policy was assessed only in terms of specific policies. The extant literature stresses that government policy plays a major role in attracting MNEs by providing infrastructure support (Enderwick, 1989, UNCTAD, 2004; Kundu et al., 2008). Hence, as discussed in the next section, the fact that the economic environment was commonly acknowledged as influencing linkage formation suggests that government policy has played a role in linkage formation for case firms both through industry policy and provision (or not) of supportive infrastructure.

In consideration of the limitation of this study, which only included service firms, it is possible that government policy might play a greater or lesser role on linkage formation in other sectors of the economy. Therefore, a comparative study of the role of government policy on linkage formation in various industries, in the context of Chile, needs to be addressed by future research in order to better estimate its overall influence in the process of local industry upgrading via FDI.

8.3.2 Economic Environment

The economic environment includes the country’s resources and capabilities, as well as the ability of local firms to use these to compete locally and in foreign markets. The specific aspects of the economic environment that were considered as influencing linkage formation were quality of institutions, market size, human capital and
economic conditions. Local firm capability, although part of the economic environment was considered separately for comparative purposes¹.

While specific aspects of the economic environment were proposed to influence linkage formation, case firms usually referred to the stability of the economic environment, as a whole, as positively influencing linkage formation. (This point is further discussed later in this chapter.) In other words, stable economic conditions and the good quality of institutions provided a stable economic environment that motivated most case firms to get involved in the local industry through direct linkages.

On the other hand, several case firms regarded Chilean market size as small and its human capital as not at international standards. Nevertheless, the strategic responses to this “weakness” were mixed depending on the case firm and/or on the type of linkage involved. That is, these negative aspects of the local Chilean conditions did not always negatively influenced linkage formation. (This point is further discussed later in this chapter.)

The proposition that the economic environment does not influence linkage formation, since the MNE’s strategy plays a role in linkage formation, is not supported by the results. Indeed, for several case firms the economic environment and the MNE’s strategy were related. That is, the characteristics of the economic environment either motivated or discouraged most foreign affiliates from forming direct linkages by influencing the MNE’s strategy.

Narula (2002) indicates that the government has played a key role in providing economic stability, which has much to do with political stability, in East-Asia². In other words, it has been the consistency of regulations that has triggered the development of local industry in this region. In line with previous studies, when considering both government policy and economic environment as determinants of linkage formation it is possible to notice that almost all case firms regarded the economic stability of Chile as positively influencing positively their operations. That is, although the evidence suggested that specific aspects of government policy either did not influence linkage formation or did so to a certain extent, when considering all the factors in play, it is observed that the government has played a key role in
providing economic stability which has led to foreign affiliates’ establishing a long-term commitment with the local economy, consequentially leading to linkage formation.

In addition, previous research has found that, in most developing countries, a coordination failure exists between the progress registered in outward-looking policies and the stagnant, underdeveloped local capability systems (Portelli, 2002). Therefore, whereas developing countries have registered some success in attracting much needed FDI flows to their economies, it is increasingly evident that the host socio-economic systems are still characterised by weak absorptive capacities. The extent of these local capacities is to a certain extent reflected in the generic L-advantages that developing countries possess, particularly with regard to the low quality of human capital and the weak absorptive capacity and capabilities of local firms. This study provided some evidence to suggest that this was occurring in Chile, mainly in terms of local firm capability. Where linkage formation did not occur, it was mainly a result of the MNE’s global strategy. The MNE’s strategy was either a response to specific local conditions or a result of global purposes. The local conditions that were perceived as weak by some case firms were local human capital, local firm capability, market size, and industry size.

The implications of these findings implications are that so far the government has played a triggering role on linkage formation mainly through industry policy and by providing a stable environment for investors. On the other hand, some aspects of the economic environment, especially local firm capability (discussed later in this chapter), present room for improvement.

In the context of developing countries such as Chile, the findings suggest that both government policy and the economic environment need to be considered in the assessment of local industry upgrading via FDI. Hence, while Scott-Kennel’s (2001) model provides a basis for assessing this process, it does not represent a comprehensive guide in the context of developing countries like Chile.
8.4.0 Affiliate Profile

The findings regarding the affiliate profile relate to the direct effects of FDI. The profile of case firms in the study that was presented in Chapter Six focused on those characteristics of the foreign-owned affiliate that made it unique relative to local firms in Chile. Scott-Kennel’s (2001) model (based on the OLI paradigm and IDP) was used as a framework for this profile. In particular, the literature suggested that the intra-firm transfer of O-advantages from parent to affiliate would confer advantages on the affiliate that were not available to other, local firms.

8.4.1 Motive for Investment, Role of the Affiliate and Level of Autonomy

From the examination of firm characteristics in this study, it was noticed that all the firms came to Chile motivated by market-seeking reasons; hence there was no variability to allow comparisons based on motive for investment. This uniformity could be explained by the fact that all case firms operate within the service sector. Due to the inseparability and perishability of service offerings, service providers need to locate themselves close to their customers (UNCTAD, 2004; Enderwick, 1989; Aharoni, 2000; Fernández, 2001; Li, 1994; Rugman & Verbeke, 2008; Kundu et al., 2008). In line with previous literature, case firms in this study stated that the need to offer services in Chile was a principal reason for investing there.

An important finding in the study was that although most case firms acknowledged Chile’s economic environment as stable and beneficial for foreign investment, half of them indicated that their presence in Chile was also due to a global strategy of the parent firm. As indicated by previous literature, service MNEs tend to follow their MNE clients to foreign markets (Enderwick, 1989; Nachum, 2000; Fernández, 2001; Li, 1994; Rugman & Verbeke, 2008; Kundu et al., 2008). Hence, it is most likely that case firms, that regarded their presence in the Chilean market as a part of the global strategy of the parent firm, entered the Chilean market for “client-following” reasons.
The possible implications of such investment depend on the role of the affiliate in Chile. If the affiliate acts as one part of a global MNE, and thus has a global rather than a local perspective, the implication is that the role of the affiliate is a singular function in the value-chain (i.e., marketing or sales), rather than more autonomous investment that involves more of the value-chain. That is, globally oriented investments could mean that, although the affiliate might benefit from intra-firm transfer of competencies and resources, the potential for moderate and high-quality linkages is diminished. Nevertheless, the services industry does not lend itself to the geographic division of the value-chain as well as manufacturing does. Hence, service affiliates are likely to act as a division of a globally-oriented firm rather than being limited to perform a singular business function as part of an integrated MNE network (Grosse, 2000; Li, 1994).

Half the case firms reported that they were highly integrated in the global network of the parent firm. That is, although their activities in Chile involved more than a single function, their DOL was limited by the strategy of the parent firm. For these firms, the parent firm usually established global contracts for the procurement of inputs, provided overseas training to local employees, and exerted a high level of control over the operations of the affiliate. On the other hand, case firms that followed a complex-integration strategy presented higher levels of integration in the Chilean industry. These firms presented higher levels of autonomy and were involved in a wide range of activities in Chile.

The implication of these findings is twofold. On the one hand, service FDI is likely to present a moderate level of integration in the local economy due to the “indivisibility” of service, regardless of the strategy of the firm. On the other hand, the results suggest that there is a relationship between the potential for establishing high quality linkages and the strategy of the parent firm. In line with previous empirical studies, foreign affiliates that follow a simple-integration, rather than complex-integration, strategy are less likely to establish higher-quality linkages in the local industry (UNCTAD, 1994).

With regard to level of autonomy, all case firms rely on the parent firm at some level for decision-making. Most case firms are autonomous in day-to-day operations and
short-term decision making, but have much less autonomy in long-term decision-making. As a result, managerial decisions, such as strategic direction and financial expenditure, are likely to rely on approval from the foreign parent company. This finding is very much in line with previous case study research (Duncan, Yeabsley, Akoorie & Enderwick, 1997; Scott-Kennel, 2001).

Evidence in this study showed that affiliates with a high level of autonomy presented a higher DOL than affiliates with a low level of autonomy. This finding suggests that when the foreign affiliate enjoys a higher level of autonomy with regard to decision-making, it may result in the affiliate establishing higher quality linkages.

**8.4.2 Age, Mode of Entry, and Ownership Form**

There was considerable variance among case firms in terms of age (in terms of years of operations in Chile). This variety provided a basis for evaluating the influence of age on linkage formation. Half of the case firms were Chilean-based branches, while the other half were Chilean firms owned by a foreign company or foreign individuals.

A key issue addressed in the study was that of foreign ownership, and specifically the number of years the affiliates had been owned by their current foreign investors. The analysis revealed that just two case firms were owned by their current foreign investors for more than 20 years. This finding is in line with the surge of services FDI in Chile since mid-1980s. Between 1974 and 2007, the services industry accounted for 39.9% of gross inflows of FDI, including the electricity, gas, and water sectors. Investment in specific sectors such as financial services, electricity and water began to increase due to the deregulation and/or privatization of these sectors (Foreign Investment Committee, 2009; UNCTAD, 2004). Consistently, the majority of case firms as foreign affiliates had been owned by foreign investors for fewer than 20 years.

With regard to mode of entry, over half of case firms were established through Greenfield investment while the remaining case firms were local firms acquired by a foreign company. This finding is in contrast to previous literature that suggests that service MNEs tend to prefer acquisitions as a mode of entry (Enderwick, 1989;
UNCTAD, 2004; Mallampally & Zimny, 2000). This situation could be explained by the main activity of the affiliates included in the study and their time of entry in the Chilean economy. Two of the three affiliates that chose M&A as entry mode operate in public utilities industries, which have undergone privatization processes. Case firms that used Greenfield investment offered financial services, consulting services, oil and gas services, and information services. Case firms in the financial services industry established operations in Chile at the beginning of the deregulation process of the banking industry. Similarly, case firms in the consulting, oil and gas services, and information services industries entered the economy when these sectors were just starting to develop. Thus, the availability of local firms for acquisition was limited or even nonexistent.

Acquisitions hold less potential for employment and economic output than Greenfield investments do. However, in terms of direct effects there is potential for an existing Chilean-owned firm to benefit from the advantages of affiliation with an MNE or foreign shareholder. The acquired firm is likely to maintain its Chilean staff; that is, it is able to draw on resources, training, experience, and market access from the foreign parent. It is also possible that Chile’s innovative assets may be drawn from the parent company. However, in line with Scott-Kennel’s (2001) findings, there was no evidence in the study to suggest that this transfer was taking place.

Similarly, FDI by acquisition, rather than by Greenfield investment, may present fewer direct effects, but more indirect effects. Chapter Seven showed that most affiliates that were former Chilean firms that had been acquired by foreign interests had stronger linkages with the local economy than did foreign branches. Scott-Kennel (2001) found a similar relationship for New Zealand firms, noting that former New Zealand firms which had been acquired by foreign interests were more likely to have stronger linkages with the local economy than foreign subsidiaries or branches were.

Most FDI entering the Chilean economy during the last decade was directed to mergers and acquisitions (M&A) of successful Chilean firms (Muñoz, 2003). Towards the end of the 1990s, large-scale flows of FDI into services activities began to shape a new pattern in the involvement of MNEs in the Chilean economy (ECLAC, 2000). Hence, the potential for stronger linkages from M&A than from Greenfield
investment has major implications for both the research on FDI in Chile and for other developing countries that have also experienced far more M&A rather than Greenfield activity over the past decade. This trend strongly suggests that direct effects of FDI, such as capital, employment and output that have captured more attention in the literature to date, may not be as important to host country welfare as are the indirect effects on local firms.

Many of the concerns over FDI relate to the direct effects on employment, capital, and technology. Nevertheless, where acquisition takes place the net effect on these direct effects is likely to be less than where Greenfield investment is concerned. The evidence in this study suggests that FDI is a complex phenomenon that can not be evaluated only on the basis of direct effects.

8.4.3 Main Activity

All case firms consisted of affiliates operating within the service industry, following the categorization used by UNCTAD (2004). This industry is an appropriate context for the findings since previous literature states that Chile has been highly reliant on FDI, especially for the development of key sectors, such as the mining and services sectors (Mortimore et al., 2001). Services FDI has grown more rapidly than FDI in other sectors. As a result, the composition of FDI has been shifting towards the services sector (Mallampally & Zimny, 2000; Li, 1994; Kundu & Merchant, 2008). One major reason is that many service industries have until recently been relatively closed to foreign entry for various reasons. Once the liberalization of FDI policies began around the mid-1980s, and gathered momentum during the 1990s, services FDI surged (UNCTAD, 2004; Kundu & Merchant, 2008).

Although all case firms operate within the service sector, they belong to different industries. While industries within the service sector might present similar characteristics due to the nature of service output, particularly its intangibility and frequent impermanence, they also present differences as a result of other factors such as source of demand for services (Enderwick, 1989; Kundu & Merchant, 2008; Kundu
et al., 2008). These differences result in differences in terms of linkage formation (further discussed in this chapter).

### 8.4.4 Country of Origin

Official statistics show that the majority of investment in Chile originates from the traditional sources of the United States, followed by Spain, Canada, and the United Kingdom (Foreign Investment Committee, 2005). Between 1974 and 2007, the member states of the enlarged European Union accounted for 40.5% of total FDI while the OECD countries, as a group, accounted for 94.2% of the total (Foreign Investment Committee, 2009).

The affiliates in the sample were either from the United States, the United Kingdom, Canada, the Netherlands or Spain. As such, most case firms originated from countries that have been traditional sources of FDI for Chile thus enabling them to assess the process of local industry upgrading within a representative context.

The main implication of these findings is that Chile should recognise the heavy reliance on certain countries as sources of FDI. In so doing, investment from non-traditional source countries is minimal thus limiting the potential to benefit from getting access to different managerial practices, new markets, and location-specific technologies (Scott-Kennel, 2001).

### 8.4.5 Ownership-advantages

According to the industrial organisation approach, the distinctive characteristics of MNEs are pivotal when analysing the impact of FDI on host countries. This consideration is of importance, particularly for developing economies, since such economies have a very different structure from the capital exporting ones (Blomstrom, 1989).

The results indicate that the affiliates in this study gained various resources from their foreign parent/shareholders. This finding shows that MNEs transfer internalized O-advantages via FDI to the affiliate in Chile, and that the affiliate benefits from such advantages.
Theory suggests that technology and tacit knowledge are the types of O-specific resources that are most likely to be internalized through foreign investment to appropriate the maximum rents from existing technology. Previous case studies in Chile (Paredes & Sanchez, 1996; Thomsen, 1998) found that foreign affiliates gain technology and expertise from their parent firms. In line with these studies, the results showed that affiliates gain technology and expertise more than any other resource from their parent/shareholder. Similarly, Scott-Kennel (2001) found that affiliates in New Zealand benefit considerably from internalized resources that are related to ownership of technology and tacit knowledge.

There was strong evidence to suggest that affiliates drew on the tacit knowledge of their parent firms/shareholders. Almost all case firms gained information, experience and expertise from their parent or related affiliate firms; in addition, more than half inherited management practices and business culture from them. Overall all case firms gain some form of tacit knowledge from their parent firms. This finding supports previous literature that indicates that the O-advantages of service firms are knowledge-based and are embodied in, among other assets, management know-how (Markusen, 1989; Fernández, 2001; Rugman & Verbeke, 2008).

Regarding management practices, FDI, through the control and influence it affords the foreign acquiring management, will stimulate the adoption of managerial practices consistent with those of the parent firm. For instance, research has found differences between firms with and without foreign participation in terms of market orientation, marketing objectives and marketing strategy, export orientation, and financial performance (Child et al., 2000; Hooley et al., 1996). In so doing, MNEs can provide a new source of management skill and expertise to an economy via the foreign affiliate. The results in this study show that most case firms have adopted management practices from their parent firms in order to coordinate their activities with the activities of the parent firm. This internalisation of such O-advantages suggests that there is considerable evidence of advantages of common governance of activities through the MNE network. Indeed, previous literature notes that economies of common governance in the service sector may be considerable since they arise from the high costs of market transactions in information (Enderwick, 1989; Kundu et al., 2008; Fernández, 2001).
Scott-Kennel (2001) found that resources that are more location-bound are less likely to be gained from the foreign parent. Specifically, access to inputs, distribution systems, labour-related resources including training, employment practices and human resources and skills, were less likely to be internalized through the MNE network and more likely to be developed in New Zealand. With regard to “location-bound” resources, the results in this study present some differences from Scott-Kennel’s results, specifically in terms of training. Most case firms indicated that they received some kind of training from the parent firm. Most of these firms indicated that the parent firm had training systems in place and these involved employees going overseas to get trained at the parent firm and/or other affiliates around the world. This finding could be explained by the nature of most service outputs in the sample which is highly knowledge-based. Knowledge-based assets in service firms are mainly embodied in human resources (Markusen, 1989) which suggests that training is a key tool for the transfer of tacit knowledge from the parent firm to the affiliate (Lecraw, 1989).

With regard to technology, most case firms identified product/service technology as being transferred from the parent firm. These case firms pointed out that the technology transferred is adapted to market conditions in Chile. In this way the initial research and development costs and risks borne by the parent firm are spread over more markets. That is, it is not profitable to redevelop products/services technology for a single, small market, and it is logical that product/service technology and R&D are internalized via the FDI medium rather than being developed independently in Chile. This finding supports previous literature indicating that the “joint-input” characteristic of knowledge-based assets allows affiliates of service MNEs to “free ride” on the R&D and other knowledge capital, or soft technology (Mallampally & Zimny, 2000; Fernández, 2001; Miozzo & Grimshaw; 2008) created at the parent firm’s, or affiliate’s level (Markusen, 1989).

However, one case firm acknowledged that it did not rely solely on the parent firm for technology, but also drew on technology developed locally by the affiliate and/or obtained the technology from other sources. This finding could be explained by the main activity of the firm which is ‘public utility’ in nature. This area results in the firm being capital-intensive and big in terms of size of operations and number of
employees, which allows the firm to invest in R&D locally (discussed further later in this chapter). In addition, this firm indicated that during the period the affiliate was a State-owned company, the government invested enormous amounts of money for the development of the firm. Following that, the firm went through a privatization process that involved the internationalization of the firm. As a result, the parent firm bought a Chilean-based MNE that was already present in five countries, and was already operating efficiently. Hence, the transfer of O-advantages from the parent firm to the affiliate was limited to management practices and management technology (for example, accounting systems technology). This example provides evidence of the active role of the government in the development of public utilities industries.

According to the economic nationalism view, FDI should be seen as part of the strategy of large oligopolistic firms and not simply as a resource flow. Hymer (1960) identified two major motives leading MNEs to control subsidiaries in foreign locations: 1) to make use of specific advantages which the MNE has over firms in host countries; 2) to remove competition between the firms concerned and to eliminate conflict. Taking this perspective into consideration, the individual findings of case firm 7 suggest that the parent firm acquired the affiliate to remove competition at a global level rather than to “further develop” a local firm. Since the affiliate was already an MNE itself, the parent firm may have decided to acquire the affiliate instead of entering the Latin American (hence the Chilean market) through Greenfield investment. In this way, competition is reduced. However, the economic nationalist view also stresses that MNEs impose restrictive clauses on subsidiaries and licensees through technology contracts (such as tying inputs of raw materials, machinery, etc.), the technology supplier, or restricting exports in order to divide world markets. Case 7’s findings do not support this argument since the affiliate enjoyed complete autonomy in terms of inputs procurement. Therefore, while the economic nationalist view helps in understanding the underlying motive for investment that may lead to a limited intra-firm transfer of resources, it does not shed light as to the factors that may limit the transfer of technology from parent firm to the affiliate.

This finding needs a research caveat. For a locally owned firm that is acquired by a MNE, the impact of additional capital injection, changes to both the quantity, and quality of employment, and the transfer of technology can be very beneficial to the
firm’s succeeding performance and competitiveness (Cantwell, 1991). Empirical evidence exists to support this perspective. Several studies have compared the capabilities of foreign affiliates and local firms (Hu & Jefferson, 2002; Alvarez, 2003; Kathuria, 2002; Child et al., 2000; Hooley et al., 1996; Girma et al., 2001). Overall these studies indicate that on average foreign affiliates are more productive than local firms. In this way, the extant literature takes intra-firm technology transfer as given. Nevertheless, as suggested by the finding, in some circumstances, intra-firm transfer of resources, in this case, the transfer of technology may be limited or even nonexistent. Therefore, the factors and/or conditions that may influence intra-firm transfer of resources in the context of developing countries needs to be addressed by future research.

Scott-Kennel (2001) found that affiliates in New Zealand gain capital from their parent/shareholder more than they gain any other resource. She suggests that in this way affiliates may be able to benefit from both an initial injection of capital as well as ongoing access to finance. The findings in this study show different results with only case firms in the financial services/banking industry relying on the parent firm as a source of capital. This difference could be partly a result of service industries O-advantages that are often bound up in the human capital, not in plant and equipment; thus substantial overseas activity can be undertaken without transferring substantial monetary capital (Lecraw, 1989; Rugman & Verbeke, 2008).

The explanation given above is suitable for case firms operating in legal services, information services and consulting services (including oil and gas) but not for case firms in public utilities industries, which are capital-intensive. A suitable explanation for capital-intensive firms not relying on the parent firm for capital is based on the size of the firm. The size of these firms was categorized as big both in terms of number of employees and revenues. When comparing Scott-Kennel’s (2001) findings with the findings in this study, it is possible to suggest that the size of the affiliate may influence the extent to which the affiliate relies on the parent firm as a source of ongoing finance. Since most firms in New Zealand can be categorized as SMEs, it makes sense to expect that they would rely more on the parent firm for finance.

This finding has important implications for FDI research and for Chile. First, intra-
firm transfer of capital is not as straightforward as commonly suggested in the literature; thus, as also mentioned previously with regard to technology, there may be certain factors and/or conditions that influence the extent to which capital is transferred from the parent firm to the affiliate. Second, although most FDI may involve initial injection of capital to the Chilean economy through the foreign affiliate, it does not guarantee ongoing finance.

In line with Scott-Kennel’s (2001) findings, more than half of the affiliates in the sample did not gain access to markets via the MNE. She suggests that since the affiliates focus mainly on the local market, rather than being unable to gain access to international markets, this group of affiliates does not require access to offshore markets as part of their role in New Zealand. Those case firms that did get access to markets via the MNE parent, mostly offering services to big corporations that require a comprehensive service that involves international operations indicated that the affiliate “needed” to gain access to international markets via the MNE. On the other hand, those case firms that did not gain access to international markets focused on serving the local market. This finding is in line with previous literature that suggests that service firms engage in FDI to service the host market (Aharoni, 2000; UNCTAD, 2004; Enderwick, 1989; Li, 1994; Kundu et al., 2008).

**8.4.6 Innovation**

Innovation refers to any service, product, process technology, or any aspect of management that constitutes a new development. As a result, innovation is an O-advantage that is not available to other firms because it has been developed and internalized within the MNE. Hence, the transfer of innovations from the parent firm to the foreign affiliate implies that these assets would not have been available to the host country through alternative mediums. The potential for upgrading local industry through the affiliates’ activities is considerably higher than in the absence of FDI (Scott-Kennel, 2001).

According to the results of this study, the affiliates have introduced various innovations in their respective sectors. Case firms recognized these innovations as new developments in their industries that have influenced the local market. The
innovations mentioned most often were in the area of product/service technology, which makes sense since most innovations were in the area of product/service technology as the services offered by most of these firms are highly technology-based.

Following product/service technology, innovations in the types of services offered were commonly mentioned. The international experience and expertise of the parent firm were referred to by several case firms as enabling the affiliate to offer services that are new to the Chilean market. This finding is in line with previous literature indicating that informational economies and the need for critical mass involvement overseas imply that O-advantages may be generated by overseas representation (Enderwick, 1989). In other words, affiliates operating within the global network of an MNE have access to services (knowledge) available in other locations that represent a new development in their region of operation.

The findings also show that the indivisibility of services implies that case firms not only introduce innovations into a specific area such as product/service technology, but also introduce innovations in terms of training, management practices, human resources and skills, production/service delivery technology, distribution systems, and employment practices. This reflects the problems in separating the technology package of services since technology in most services involves skills rather than disembodied information (Enderwick, 1989; Fernández, 2001). For instance, information- and human capital-intensive services such as banking and business and professional services embody a common pool of tacit or codifiable knowledge – "soft technology" – that is specific to the firm or the collective human resources of a firm (Mallampally & Zimny, 2000).

With regard to the origin of innovations, the literature suggests that the foreign affiliate may draw on the R&D output, technical know-how, and expertise of the parent firm. Core innovation can be adapted to suit local conditions and then used to gain competitive advantage (Dunning, 1998). Accordingly, most case firms in the sample relied solely on the parent firm as the source of innovations. Their contribution to the development of these innovations was limited to adapting the new developments to the local market. At the extreme, one case firm indicated that even adaptations were done by the parent firm and the affiliate provided only the necessary
information for the adaptation to be done. This example supports the idea that O-advantages of service MNEs can be transferred easily across space at low cost since they are mostly knowledge-based (Markusen, 1989; Rugman & Verbeke, 2008).

Case firms that have developed innovations at the affiliate level were the largest affiliates in terms of number of employees and revenues within the group and most of them were operating in capital-intensive industries (public utilities). Since innovations are closely related to R&D, it makes sense to expect that those firms that are bigger in size locally would invest more in R&D than smaller firms, thus presenting the potential to develop innovations at the affiliate level. Indeed, case firms 4 and 7 – which are big firms locally and internationally – have invested regularly in R&D and, as a result, have developed numerous innovations at the affiliate level, specifically in the areas of product technology and production technology. Although these firms do not rely solely on the parent firm as a source of technological innovations, they do gain innovations from the parent firm and/or develop innovations jointly with the parent firm in terms of management practices and culture.

Overall, for most case firms the parent firm is involved in the introduction – either solely or jointly with the affiliate – of the majority of innovations. That is, the role of the parent firm as a source of innovations is not limited to only the areas of technology and management practices since it also introduces innovations in those areas which are expected to be more location-bound, such as training. These findings are in line with those of the previous section on O-advantages, which also found that more than gaining tacit knowledge and technology from their parent firm, affiliates also gain resources that are more location-bound.

These findings have important implications since they indicate that affiliates are actively engaged in the introduction of innovations in Chile. As a result, the affiliates benefit from these innovations through improved performance. In addition, the sectors within which they operate also benefit since there is potential for the emulation of these practices by other firms.

In line with Scott-Kennel’s (2001) findings, in this study parent firms are involved in the development or introduction of most of the innovations. This finding provides
strong support for the proposition that affiliates, and eventually the Chilean service sector, are benefitting from the O-advantages of the MNE. Since these innovations are new to the Chilean industry this finding implies that the MNE is responsible for positive contributions that would be unavailable locally in the absence of FDI.

MNEs have also been known to reduce local R&D activities, or relocate them offshore following the acquisition of a local firm (Costa & Robles, 2002). In this case there is the possibility of hollowing out of local innovatory capability. There was no evidence in this study that indicated that this hollowing out was occurring since all case firms indicated that the parent firm had not invested to gain innovation already existing in Chile.

These findings suggest that most investment via M&A was not made to internalise local sources of innovations. Although two case firms indicated that most technological innovations were developed solely by the affiliate, these affiliates also indicated that investment in R&D was done locally for ongoing development of innovations. Furthermore, these affiliates have established various relationships with local entities for developing innovations.

8.4.7 Competitive Advantage

Although there are differing views towards MNEs in Latin America, all three main approaches – developmentalism, economic nationalism and dependency – recognize that MNE possess unique assets (O-advantages). Theory further suggests that these O-advantages enable the MNE to overcome the additional difficulties of operating in foreign locations (overcoming the liabilities of foreignness) and competing against local firms that are more familiar with the local business environment.

The results show that the most frequently mentioned sources of competitive advantage among affiliates in the sample were expertise followed by technology, innovation and access to global network of parent firm. As previously discussed, these firms offer services that are highly technology-based thus technology constitutes a key resource for their competitiveness. Similarly, the service nature of case firms implies that unique know-how, in terms of experience, expertise and innovation, contributes to a
major extent to their competitive advantage in Chile. And this knowledge is mostly obtained from the parent firm by having access to the global network of affiliates. These findings support previous literature that notes that in most service industries knowledge (soft technology) (Fernández, 2001; Rugman & Verbeke, 2008), information gathering, and processing capabilities embodied in technology have become a principal source of competitive advantage (Mallampally & Zimny, 2000).

Over half of the case firms indicated that human resources and accumulated skills also contributed significantly to their competitive advantages. Training, management practices/culture and access to markets were also mentioned as sources of competitive advantage. Service delivery and access to inputs were acknowledged by a few case firms.

With regard to main competitive advantages, the most acknowledged ones were access to the global network of the parent firm (MNE affiliation) and experience, expertise and human resources, followed by sophisticated products/services. These sources of competitive advantage were interrelated for most of the affiliates, because MNE affiliation enabled the affiliates to offer services that are more sophisticated because they can rely on the MNE’s global experience and expertise (access to parent firm’s global network). In addition, more than half of the affiliates indicated that MNE affiliation constituted one of their main competitive advantages since the international reputation of the parent firm strengthened their position in the Chilean market. This finding is in line with previous literature that indicates that reputation is a key asset of service firms since it embodies knowledge-based assets (Markusen, 1989; Fernández, 2001) such as accumulated experience and service quality (Enderwick, 1989; Mallampally & Zimny, 2000; Miozzo & Grimshaw, 2008).

Human resources and accumulated skills were considered as a part of expertise and experience since both resources were highly related. Most case firms indicated that local employees were constantly trained by the parent firm in order to gain the necessary skills for offering innovatory and sophisticated services. In addition, unlimited access to the global network of the parent firm for expertise implied that local employees were constantly exposed to new knowledge (innovation). This situation is explained by the fact that O-advantages of service firms are knowledge
based and are embodied in human capital of the employees (Markusen, 1989). In terms of innovation, the service nature of most case firms, especially firms offering professional services, implied that affiliates are innovative. That is, services are highly customised to each client’s needs (Mallampally & Zimny, 2000).

These findings suggest that the service nature of case firms involves ongoing innovation triggered by the specific needs of the clients. These innovations commonly result from the adaptation of know-how – expertise and experience originated at the parent firm, and accessed through the global network of the MNE – to the local needs of a particular client. These innovations result from the interaction between local human resources and accumulated skills and the expertise and experience of the parent firm. This finding is consistent with the findings presented in the previous section that indicate that for most case firms innovation originates from the parent firm.

Although technology was acknowledged as a source of competitive advantage by all case firms, it was not commonly recognized as being one of the main sources of competitive advantages. For most case firms, technology is embedded in the service provided thus, while technology is considered as a key input, it is perceived as a result of experience and expertise rather than a source itself. In other words, most case firms perceived that their competitive advantages originated mainly from the experience and expertise of the parent firm; thus, competitive advantages based on technology are a result of this know-how.

There were three case firms that did not acknowledge MNE affiliation as one of their main sources of competitive advantages. These firms’ main competitive advantages were technology, access to inputs, and experience and expertise. Technology constitutes a key resource for these firms due to their main activity; they all operate within the electricity, oil and gas, and water sectors. These firms are not “pure service” since their service offering involves delivery of tangibles (such as water, electricity, drilling equipment). Two of these firms are the ones that did not rely solely on the parent firm as a source of resources and innovation. Accordingly, technology as a source of competitive advantage does not originate solely at the
parent firm’s level. With regard to the other firm, it relies on the parent firm for having favoured access to inputs.

As with the other affiliates, experience and expertise were also acknowledged by these firms as being a main source of competitive advantages. Nevertheless, while for one firm (case 3) the source of experience and expertise was the parent firm for the other two affiliates know-how was also generated at the affiliate level. Hence, MNE affiliation was not a source of competitive advantages for these firms since they were significantly self-reliant in terms of technology and development of know-how. On the other hand, although case 3 was highly reliant on its parent firm as a source of experience and expertise, MNE affiliation did not constitute a source of competitive advantage since the parent firm was “young”; thus, the parent firm’s reputation was not strong in terms of helping the affiliate to compete in the Chilean market.

Overall, these findings suggest that foreign affiliates gain competitive advantages through their affiliation with their parent firm. The results suggest a positive relationship between reliance on the foreign parent for resources and innovation and the affiliate’s sources of competitive advantage in Chile. Therefore, in line with Scott-Kennel’s (2001) findings, research propositions three and four are supported: affiliates rely on internalized O-advantages, resources and innovations from the MNE as sources of competitive advantage in Chile. Consistently, the results also show that, when the affiliate does not rely solely on the parent firm for resources and innovation, the parent firm has a limited role as a source of competitive advantages.

8.5.0 Linkage Formation

8.5.1 Indirect competitive linkages

8.5.1.1 Competitive Position

The results show that most case firms occupied strong competitive positions relative to other firms in their industries. Most case firms indicated that they were a major
competitor in their industry in Chile. Similarly, more than half of the affiliates’ parent firms were major competitors internationally.

This result suggests that there might be a capability gap between foreign-owned and locally-owned firms. However, Scott-Kennel (2001) indicates that the affiliate’s competitors might also be foreign-owned, especially in industries dominated by large, foreign-owned affiliates. Nevertheless, her study was unable to make a distinction between foreign-owned and locally-owned competitors. This study was able to make such a distinction. The results vary from case to case with regard to this point. Case 1 indicated that it was the only foreign-owned firm in the legal services in Chile and, that although big international firms are not present, there are some local players that are well established and constitute major competitors. Previous studies found that firms offering legal services tend to prefer partnerships rather than equity links (UNCTAD, 2004), which explains why there is only one foreign-owned law firm in Chile. Case 3 is a major competitor since it is a pioneer in a sector which has been solely in the hands of the government until recently. Case 4 is the biggest firm in its sector and one of two foreign firms. However, the sector is also constituted of Chilean private firms, each serving a determined geographical area of the country. Case 5 is one of two major competitors in the Chilean market, both being foreign-owned, while local firms are small and offer simple services. This finding is explained by the fact that information agencies O-advantages are mainly based on longevity and a developed world orientation (Boyd-Barret, 1989). Case 7 is the biggest competitor in a sector where many of its competitors are also foreign-owned. Case 8 is a major competitor in a highly competitive sector where, although it has been dominated by international firms, the experience of local consultants has led to the establishment of local consulting firms that have taken a considerable portion of the market share of foreign firms. In addition, local firms are focusing on small and medium-sized firms in order to not compete directly with MNEs, which are very well positioned in the global companies’ market and leading local firms.

From the spectrum of results, it seems that although the foreign affiliates hold a strong position in the Chilean market, this position does not necessarily imply a capability gap between foreign-owned and locally-owned firms. Only case 5 clearly
acknowledged the capability difference between foreign and local competitors in the sector.

Two case firms were small competitors in Chile although their parent firms were strong competitors internationally. This circumstance suggests that the capabilities of local firms may exceed the capabilities of the foreign affiliate; thus, foreign affiliates may hollow out local capability. The evidence does not support this argument since both firms indicated that the strategy of the parent firm has influenced their position in the Chilean market, rather than not being able to be a bigger player. That is, both firms focused on niche markets in the financial sector thus, in comparison with other firms in their industries, their market share was very low. In addition, the banking industry in Chile was dominated by foreign-owned affiliates; hence, many of their competitors were also foreign-owned.

Overall, the evidence suggests that over half the case firms compete mainly against other foreign-owned firms rather than against local firms.

8.5.1.2 Competitive Environment

Most case firms indicated that the level of competitiveness of other firms in their respective sectors has increased over the last decade, but only a few operated in sectors where the number of competitors has increased. In the majority of cases the affiliates had some level of influence on the changes. Most of them exerted some level of influence over the competitiveness of other firms but not on the number of competitors. These results suggest that, overall; these firms have influenced their respective sectors through demonstration effects but that they do not influence the entry and/or exit of other players.

Consideration of each service industry separately, makes it possible to get a better idea of the impact of foreign affiliates on the competitive environment. For instance, the legal and consulting services industries both have experienced dramatic growth over the past decade as a result of the increasing openness of the Chilean economy. The number of foreign firms doing business in Chile, as well as local firms doing business abroad, has increased. As a consequence, the need for legal and consulting
services at a corporate level has increased and so has the number of legal and consulting firms in Chile. This finding supports previous literature indicating that service firms enter new economies to follow clients (Mallampally & Zimny, 2000, Li, 1994; Kundu & Merchant, 2008; Fernández, 2001; Kundu et al., 2008) and as a result of liberalisation of government policies (UNCTAD, 2004; Kundu & Merchant, 2008). That is, case firms operating in these sectors have no influence over the number of competitors. In terms of competitiveness these firms indicate that they have moderate (case 1) or major influence (case 8) through their practices. Although case 1 is a major competitor in its sector, it acknowledges that it exerts moderate influence over the competitiveness of local competitors since the latter have formed partnerships with international law firms, thus having other sources of expertise and knowledge. On the other hand, according to its position as a major competitor, case 8 perceives its influence over competitiveness of other firms to be major, since local firms “imitate” their practices in terms of quality of services, compliance, and training (demonstration effects).

The banking sector in Chile has undergone dramatic changes. In only 20 years the Chilean banking sector experienced the worst economic depression of Chilean history and became the stronger sector in Latin America, while the number of banks decreased from 55 in 1980 to 26 in 2003. This considerable decline in the number of banks was due to several mergers within the sector since there was no longer the need to assist inward FDI that involved big amounts of money. As a result, there are only a few big players that focus on serving a wide range of customers. The other banks focus on serving niche markets. Case 2 and case 6 are part of the latter group; thus, both of them have no influence over the changes in number of competitors. In addition, their influence over the competitiveness of other competitors is minimal. They influence competitors operating in niche markets through sophisticated practices (demonstration effects).

Changes in the competitive environment of the electricity, gas and oil, and water sectors are influenced mainly by government policy. For instance, the number of competitors in the electricity and water sectors has been stable – only changes in ownership have taken place. These sectors were developed by the State and underwent a gradual process of privatization. The government acknowledged as
essential the need to develop a stable and clear regulatory framework that would be implemented before the privatization of these sectors. As a result, major reforms were enacted which mainly established property boundaries for providers of the service in order to avoid monopolies, supervisory procedures, and calculation and establishment of tariffs. Case 3 (gas and oil sector) also operates in a sector that has been developed by the State; moreover, the sector is still in the hands of the government and has just started to license exploration activities to private firms. In terms of competitiveness, all firms have had major influence in their respective sectors. Cases 4 and 7 are both the biggest competitor and act as “benchmarks” in their sectors, not only in Chile but in Latin America as well. Interestingly, these firms indicated that besides their competitive position, the regulatory framework has also influenced their level of competitiveness (hence their influence over competitiveness of other firms). That is, these firms compare themselves with a “model firm” and “compete” with it since it establishes the tariffs. This was indicated in the *World Investment Report 2004* as a successful strategy used by the Chilean government (tariff regulation), especially in the water services industry (UNCTAD, 2004). The pioneer position of case 3 is the main reason behind its major influence over competitiveness.

Case 5 was the only case firm that provided evidence of crowding-out effects. It acknowledged having a major effect on the number of competitors since, in order to respond to fierce competition; it acquired one of the principal local players in the industry, to add to information and news about Chile provided by this firm. With regard to competitiveness and competition it also exerts major influence by introducing new products and services (innovations) in response to changes in the market, changes that are eventually imitated by its competitors (demonstration effects).

Overall, the findings suggest that changes in the competitive environment in terms of number of competitors have been mainly the result of changes in market conditions and government policies rather than the activities of foreign affiliates. Similarly, Scott-Kennel (2001) found that the affiliates were only one factor driving competitive changes in their industries. Market demand, changes to international business environment, government policies, and the actions of other competitors all exert an influence over the competitive environment.
On the other hand, case firms have influenced the competitive environment via demonstration effects. That is, the competitiveness of other firms has increased as a result of the activities of the foreign affiliates in the Chilean market. This finding is in line with Alvarez and Gorg’s (2005) results that indicate a survival enhancing effect in the manufacturing industry in Chile. In addition, in line with previous literature the findings suggest that foreign-owned affiliates have been a major player in the development of the service sector (UNCTAD, 2004; Fernández, 2001; Li, 1994).

8.5.1.3 Competitive Clusters

All case firms indicated that their parent firm did not invest in Chile to take advantage of agglomeration of firms, or to locate in close proximity to competitors or other firms with complementary capabilities. That is, there is no evidence of competitive clusters where the affiliates gain access to local innovation.

This finding differs from Scott-Kennel’s (2001) findings that found some evidence to suggest that foreign investments have been made in New Zealand to locate close to local agglomerations or clusters of firms with specific innovations. This finding could be explained by differences between Chile and New Zealand in terms of local resources. In Chile, these are expected to be less developed than in New Zealand due to differences in economic development. Another possible explanation is that this study focuses on the service industry which may present less potential for competitive clusters since the main reason for investing abroad is to follow clients (Enderwick, 1989; UNCTAD, 2004; Fernández, 2001; Li, 1994; Kundu et al., 2008; Kundu & Merchant, 2008).

8.5.2 Direct Linkages

8.5.2.1 Forward Linkages

Evidence suggests that forward linkages are typically not as common as backward linkages (for an example, see Batra and Tan, 2000). On the contrary, the results in Chapter Seven showed that affiliates had established a considerable number of
forward linkages with local industry in Chile (considerably more than backward linkages). While none of them had formed forward linkages with local agents, seven out of eight case firms had established relationships with their customers in Chile.

Forward linkages have received less attention in the literature mainly because empirical research has focused on manufacturing industries where backward linkages are more prevalent (Sun, 1998; Miozzo & Grimshaw, 2008). This fact gives a plausible reason for the differences between this study’s results and those of previous studies. The focus of this study was on the service sector, thus presenting a greater potential for forward linkages rather than backward linkages. This greater potential for forward linkages is explained by the fact that services are generally intangible and thus depend on the interaction between the buyer and the seller for their provision (Grosse, 2000; Miozzo & Grimshaw, 2008; Fernández, 2001). This situation is particularly evident for case firms operating in the consulting, banking, information services and legal services industries, which are knowledge-intensive firms where the delivery of services is highly tailored to the clients’ needs, thus requiring a high degree of interaction with clients (Lowendahl, 2000).

In terms of quality, most of these relationships involved the transfer of at least three different types of assistance, with the exception of case firms operating in public utilities industries. Assistance was given to their clients as part of the service offering. That is, the types of assistance provided by most case firms were embedded in the service they provided. This finding supports previous literature noticing that service firms provide some kind of assistance to the client firm including an intangible product (Grosse, 2000).

Accordingly, with the differences in main activity of affiliates, a wide range of assistance was given to local customers. The most common forms of assistance were technical assistance and information about markets, suppliers, and contacts. These two types of assistance were also identified as common forms of assistance in Scott-Kennel’s (2001) study. Staff training, financial assistance, and product samples and prototypes were also mentioned among others.
8.5.2.2 Backward Linkages

Scott-Kennel (2001) distinguishes three strategic responses in relation to local sourcing. First, when the MNE binds its affiliate to source inputs within the MNE, in turn, the affiliate uses very few locally produced inputs. In this case, the extent of local sourcing and opportunities for spillovers will be limited; hence, very few advantages can be expected to be passed on to local firms. Second, as a strategic response, the affiliate is forced to import when the technological capability of the host country is not sufficient to produce competitive and reliable input. A third strategic response may be that the affiliate recognises the potential for local sourcing (in the longer term) and works with local firms.

In terms of local sourcing, in line with Scott-Kennel’s (2001) findings the majority of case firms sourced only standard products and services since they either relied on the parent firm or MNEs not operating locally for the supply of specialized products and services. Those firms that sourced specialized products and/or services locally mainly dealt with MNEs that were established in Chile. That is, under the rubric of hierarchical capitalism, more than half of the affiliates had adopted “exit” rather than “voice” type strategies for the sourcing of specialized products and/or services.

The implications are that foreign-owned affiliates draw heavily on their parent firm and imports for sourcing of specialised products and services. This finding suggests that there may be potential to improve the capability of local firms or their ability to provide the required inputs to increase the extent of local sourcing. This possibility is particularly the case where affiliates are sourcing from unrelated firms overseas (importing) rather than purchasing locally. The results also provide evidence of the integrated nature of the MNE which encourages intra-firm rather than inter-firm trade. Regardless of local firm capability, it is probable that intra-firm sourcing will remain a part of the MNE’s operations. Indeed, several case firms indicated that they obtained most of their inputs from the parent firm’s network as part of the parent’s strategy. This finding is in line with previous literature that suggests that service firms in information-intensive industries generate considerable knowledge which is better protected and more profitably applied within the organisation (Enderwick, 1989; Fernández, 2001; Kundu et al., 2008).
The results revealed that over half the case firms had established backward linkages with locally-established suppliers and subcontractors. However, all of them had formed 10 or fewer of these relationships. These findings are in line with the previous discussion, suggesting a considerable reliance on offshore sourcing by many of the affiliates, and affiliates not purchasing specialised inputs locally. Moreover, those affiliates that did purchase specialised inputs locally indicated that they did so from locally established MNEs, thus suggesting that local firm capabilities are not at international standards with regard to specialised products and services.

Although the types of assistance given to suppliers varied from case to case, in line with Scott-Kennel’s findings (2001), product/component specifications were the type of assistance most commonly given by affiliates to suppliers and subcontractors. Also echoing Scott-Kennel’s findings, the results show that, overall, less assistance was given via backward linkages than via forward linkages.

The implications of these results are that only a few local suppliers are benefitting from foreign-owned affiliates since most backward linkages had been established with locally-established MNEs. This finding suggests that Chilean suppliers and subcontractors may be mainly benefitted through competitive linkages with MNEs that act locally as suppliers of foreign affiliates rather than directly through transfer of assistance. Hence, while local firms acting as clients to the affiliates are benefitting considerably from assistance linkages, there is less evidence of backward linkages occurring, particularly local sourcing of specialised inputs and assistance to local suppliers and subcontractors, and this finding suggests less potential for local firm upgrading.

In terms of previous research, the findings confirm that affiliates create demand through backward linkages and may contribute to the development of local firms. However, this thesis makes three important contributions to existing literature. First, the assessment of linkages is not limited to the extent of local sourcing, as has been the case in previous studies, but also includes assistance linkages and forward linkages. Second, the findings suggest that linkages created by affiliates are considerably underestimated through the failure to consider linkages other than local sourcing. Third, the assessment of the potential of local industry upgrading via
linkages without acknowledging the origin of the firms (foreign or local) being assisted may not be accurate. The findings suggest that local suppliers and subcontractors had been benefitted via backward linkages only in a very limited way since most assistance is given to locally-established MNEs; thus, the potential for the upgrading of local firms capabilities is limited.

8.5.2.3 Knowledge agreement linkages

Enderwick (1989) indicates that licensing is discouraged by a number of facets of service sector activity such as problems in separating out the technology package of services, sharing of experience, and on-the-job training and high transaction costs. Consistently, none of the affiliates had formed knowledge agreements with Chilean licensees and/or franchisees for the production or marketing of products/components or services.

These results also confirm that licensing and franchising are typically used as a substitute for FDI, rather than a complement to FDI (Kumar, 1990) because FDI involves an equity component while most licensing and franchise agreements are financed by the local licensee or franchisee.

8.5.2.4 Corporate Social Responsibility Linkages

Corporate social responsibility linkages (CSR) were identified during the data collection/analysis process. This type of linkages is considered to be a moderate quality linkage in this thesis since, although it does not necessarily involve a one-to-one relationship with local entities, it does represent an intended effort on the part of the affiliate to contribute to the upgrading of the local economy, either through community projects or industry-related projects.

The results showed that over half of the case firms had formed CSR linkages with local entities. The extent and quality of linkages vary among affiliates. Three main groups were distinguished: 1) affiliates that had not formed CSR linkages; 2) affiliates that had formed CSR linkages that are limited in terms of quantity and quality; 3) affiliates that had formed CSR linkages that are high in terms of quantity and quality.
CSR linkages had been formed by the affiliates in various ways, such as:

- Involvement of foreign-owned affiliate’s employees in local associations and research entities.
- Involvement of the foreign-owned affiliate in local associations through which the affiliate shares knowledge and expertise with the local market through various activities such as seminars.
- Association with non profit organizations for the development of projects and contests to support social development and local entrepreneurship.
- Development of independent projects that are focused on the development of education, social and cultural development, and protection of the environment.
- Provision by a foreign-owned affiliate of training and consulting services for the maintenance and execution of projects in rural locations.
- Establishment of development centres inside universities to provide work experience to tertiary students.

Through these activities the foreign affiliate provides various types of assistance to the local market. The results showed 10 specific types of assistance. Financial support was most frequently provided by the affiliate, followed by education, research, entrepreneurship support, and equipment and infrastructure. Other types of assistance given were seminars, environmental initiatives, technical procedures assistance, work experience, and consulting services.

Under the categorization suggested by Moon (2003) most activities undertaken by case firms fall under the community involvement category, mostly through provision of financial support to local philanthropic projects. This finding is in line with previous studies (Chapple & Moon, 2005; Fortanier & Kolk, 2007) that found that community involvement is the predominant wave of CSR. However, several CSR’s modes of affiliates depart from the relatively traditional philanthropic mode towards those modes that better institutionalize and embed the ways in which their CSR is employed. By engaging in partnerships, sponsor relationships, adopting CSR codes, and encouraging employee volunteering, case firms build their CSR into mainstream activities; activities which in turn become less philanthropic and more about stewardship.
The implication of these findings is that case firms are positively influencing the upgrading of the Chilean economy through community involvement and by engaging in projects that involve “knowledge spillovers” to the local economy. (Refer to individual case firms’ reports for examples, specifically case firms 1, 2, 4, 7, and 8).

8.5.2.5 Collaborative Linkages

The results showed that over half of the case firms had formed some type of collaborative agreement with another local entity. The most frequent form of agreement was an alliance, followed by a development agreement.

As regards the purposes of these agreements, most affiliates formed agreements to collaborate on the design of technology to suit the local market and for sharing or procurement of resources/supplies/information. Indeed, most of these collaborative agreements were with local universities and were oriented to research and development. One affiliate had formed an agreement with two other locally-established firms to implement new banking software to several banks operating in Chile. Collaborative agreements were also formed as a result of local firms that needed marketing support from the affiliate (case 5). In the same way, case 3 formed an agreement with a large local firm since it needed support in terms of infrastructure to meet local demand.

With regard to the transfer of resources, the results showed that most of the collaborative agreements established by case firms involved the transfer of knowledge and expertise from the affiliates to the local entities. The foreign affiliates have been willing to transfer key resources to their partners since they perceived that local firms/universities contributed significantly to the partnership. Other resources transferred from the affiliates to their partners were technology, innovation, market access, equipment and infrastructure, human resources, and financial support.

The results indicated that most collaborative agreements also involved the transfer of resources from the local partner to the affiliate. The most frequently acknowledged resource gained by the affiliate from the local partner was research skills followed by
infrastructure and human resources. Other resources transferred from the local partner to the affiliate were information, expertise, R&D, technology, and access to markets. In line with Scott-Kennel’s (2001) findings, overall the transfer of key resources such as knowledge and expertise occurred more frequently from foreign affiliate to the local partner than from the local partner to the foreign affiliate.

Various resources were developed as a result of the agreements, namely: product/service technology, production/service delivery technology, human resources and skills, information and expertise, R&D, and access to markets. The implications of these findings are that case firms are having a direct impact on the upgrading of local firm capability and competitiveness through collaborative linkages.

8.6.0 Determinants of Direct Linkage Formation

The results showed a number of factors that played a determining role in the formation of linkages between affiliates in the sample and other firms operating in Chile. Both, firm-specific (affiliate profile) and location-specific factors were identified.

8.6.1 Affiliate Profile

8.6.1.1 Motive for Investment

The extant literature on the role of motive for investment (Refer to chapter two) suggests that market-seeking FDI leads to strong direct effects. Specifically, Scott-Kennel (2001) proposes that market-seeking FDI is expected to present a moderate DOL in the local economy. Accordingly, the results in this study showed that all case firms had established moderate-quality linkages which might be influenced by their market-seeking motive for investment.

Despite the fact that the results and previous literature suggest that the motive of investment influences the formation of direct linkages, none of the affiliates acknowledged its motive for investment as a determinant of linkage formation. That is,
linkage formation could be the result of factors other than motive for investment. Besides, there was no variability among case firms in terms of motive for investment. Scott-Kennel (2001) found no significant relationship between market-seeking investment and the establishment of direct linkages. Hence, the extent to which motive for investment influences linkage formation is not clear.

8.6.1.2 Role of the Affiliate

Half of the case firms reported themselves to be highly integrated in the global network of the parent firm. That is, although their activities in Chile involved more than a single function, their DOL of linkage was limited by the strategy of the parent. For these firms the parent firm usually established global contracts for the procurement of inputs, provided overseas training to local employees, and exerted a high level of control over the operations of the affiliate. On the other hand, case firms that followed a complex-integration strategy presented higher levels of integration in the Chilean industry. These firms also presented high-levels of autonomy and were involved in a wide range of activities in Chile.

In addition, the strategy of the parent firm (role of the affiliate) was the factor most mentioned by case firms as influencing linkage formation. All case firms regarded the strategy of the parent firm as influencing, either in a positive or negative way, the extent and/or quality of backward linkages. For half of the case firms, the strategy of the parent firm towards procurement of specialized inputs played a negative role on backward linkage formation either because the parent firm provided the affiliates with specialized inputs or by limiting the affiliates’ choice of suppliers to locally-established MNEs with which the parent firm had signed global contracts. As previously discussed, this situation could relate to the many incentives that service firms have for internalizing activities (Enderwick, 1989; Fernández, 2001; Kundu et al., 2008).

For the other half of case firms, the strategy of the firm played a positive role on backward linkage formation. For most of these case firms, the strategy of the parent firm positively influenced the quality of backward linkages, while for one of them, it played a positive role on the extent of backward linkages.
For a couple of case firms, the strategy of the parent firm played a negative role on the extent of forward linkages due to the focus on a niche market. However, the rest of the case firms did not acknowledge their parent firm’s strategy as influencing forward linkages. On the other hand, for more than half the case firms, the parent firm’s global sustainable development policy resulted in the foreign affiliates either developing their own strategies and projects regarding CSR or getting involved in CSR projects that are an extension of the parent firm’s global strategy.

With regard to collaborative agreements, for those firms that had not established collaborative agreements, the strategy of the firm was referred to by all of the case firms as one, or the only, factor impeding the establishment of collaborative agreements. The strategies adopted were either a response to restricting local conditions or were global strategies regardless of local conditions. Similarly, the strategy of the firm played a determining role for two case firms that had established collaborative agreements.

In line with previous studies (UNCTAD 2004; Buckley 2004; Narula & Portelli 2004) these findings support the research proposition that the role of the affiliate (or MNE’s strategy) influences linkage formation. Specifically, affiliates following a simple-integration (or which are highly integrated in the global network of the parent firm), rather than complex-integration strategies are less likely to establish backward linkages and collaborative agreements, but are likely to form CSR linkages as part of the parent firm’s global strategy towards CSR.

**8.6.1.3 Autonomy**

Scott-Kennel (2001) found no evidence supporting the proposition that the degree of autonomy of the affiliates influences linkage formation. The results in this study showed the opposite. Foreign affiliates that enjoyed a low level of autonomy had established fewer linkages (in terms of quality and extent) than those affiliates with a high level of autonomy. That is, the evidence in this study supports the research proposition that a greater influence of the foreign parent firm over the affiliate’s decision-making would have a negative influence on linkage formation.
The implication of this finding is that influence over decision-making by the parent firm may extend to the operations of the affiliate in terms of linkage formation. In other words, where there is low level of autonomy, the foreign parent firm is requiring the affiliate to form intra-firm rather than inter-firm linkages.

Previous research has often associated integration into the corporate network (role of the affiliate) as an indication of low autonomy on the part of the affiliate. On the other hand, Scott-Kennel’s (2001) results suggest that the concept of autonomy and the concept of integration into the corporate network may be two quite different concepts. The results in this study suggest otherwise by showing that those case firms that presented a low level of autonomy were also those that were highly integrated into the global network of the parent firm.

8.6.1.4 Affiliate Experience

The results did not show a clear relationship between the age of the affiliate and linkage formation. Based on the total number of years the case firm had been operating in Chile, the evidence showed mixed results with the oldest firms establishing various direct linkages in the Chilean industry as well as the youngest firms. The same phenomenon was observable when considering the age of the firm in terms of number of years operating in Chile as a foreign affiliate.

This finding differs from Scott-Kennel’s (2001) findings and from what the extant literature suggests. While Scott-Kennel found a negative relationship between age of the affiliate and linkage formation, the extant literature suggests a positive relation.

It could be possible that other factors play a stronger role in influencing linkage formation than the age of the affiliate, thus leading to mixed results.

8.6.1.5 Main Activity

The main activity of the affiliate was acknowledged by most case firms as influencing the establishment of backward linkages and/or forward linkages.
All case firms that had established backward linkages indicated that their main activity required the firm’s giving assistance to suppliers. Specifically, these firms required specialized services/products to be tailored to their needs which involved the establishment of close relationships with suppliers.

The main activity played a major role on forward linkage formation for each case firm. For most case firms their main activity played a positive role in the establishment and quality of forward linkages. As previously discussed, the “assistance” nature of these firms’ main activity led to the establishment of forward linkages. In addition, the establishment of long-term relationships between service firms and clients is explained by the high switching costs that both sides face (Aharoni, 2000).

On the other hand, for two case firms, their main activity played a negative role on either linkage formation or quality of linkages. This finding could be explained by the fact that these firms operate in public utilities industries where there is no need to customize the service for each client.

The implication of this finding is that the affiliate’s main activity influences linkage formation, specifically the formation of forward linkages and backward linkages. Scott-Kennel (2001) found no evidence to suggest that service firms form more forward or backward linkages than other firms but they are significantly more likely to form collaborative agreements. Foreign affiliates in this study did not acknowledge their main activity as influencing the formation of collaborative agreements. However, the fact that more than half of the case firms had established collaborative agreements may provide some evidence supporting Scott-Kennel’s results.

These differences could be explained by the fact that Scott-Kennel’s (2001) findings are based on comparisons between various sectors while this study focused on the service sector only. That is, in Scott-Kennel’s study the influence of the affiliate’s main activity on the formation of assistance linkages in the service industries might be overshadowed by a stronger effect in other industries. Indeed, Scott-Kennel (2001) indicated that the survey might have been biased towards manufacturing. Since this study focused on service industries only, it was possible to capture the effect of main activity on the formation of assistance linkages.
Although all case firms operated within the service sector they did so in different industries. Firms operating in the corporate financial/banking industry had formed fewer direct linkages than the other firms, while firms operating in public utilities industries had formed more direct linkages. This finding suggests that those affiliates involved in activities that require significant investment in terms of installed capacity (water and electricity services) are more likely to establish high quality linkages than those that operate in the corporate financial services/banking sector. This finding could be explained by the argument that firms operating in information-intensive industries have greater incentives for internalizing operations than firms operating in capital-intensive industries (Enderwick, 1989; Fernández, 2001; Kundu et al., 2008).

8.6.1.6 Ownership-advantages

The results showed that the majority of case firms relied on their foreign parents for resources (O-advantages). Reliance by the affiliate on inputs from the foreign parent seems to be negatively related to linkage formation, specifically backward linkages and collaborative agreements.

Case firms that relied on their parent firms’ O-advantages to a minor or moderate extent had all established backward linkages while most case firms that relied heavily on parent resources had not. Specifically, where the affiliate was able to rely on the parent firm for inputs these were less likely to be purchased in Chile thus limiting the formation of backward linkages.

In terms of collaborative agreements, case firms that relied completely on the parent firm as a source of resources were also those that had not established collaborative agreements. Case firms that had formed collaborative agreements in Chile could be divided into two groups: 1) case firms that formed alliances as a way to overcome resource limitations; 2) case firms that formed alliances motivated by regulatory framework/industry policy. For case firms belonging to the first group, the limited transfer of financial resources (case 5) or the limited resources of the parent firm (case 3) resulted in a “need” to look for partners locally. That is, these firms did not rely completely on the parent firm as a source of resources thus motivating them to
establish collaborative agreements. Case firms belonging to the second group did not rely on the parent firm’s resources either.

The findings do not support the proposition that intra-firm transfer of resources from the foreign parent firm to the affiliate has a positive influence on linkage formation. On the contrary, the findings suggest that the more the affiliate relies on the parent firm’s O-advantages, the less likely it is to establish direct linkages.

The implications of these findings are discussed in the following section on innovation.

**8.6.1.7 Innovation**

The relationship between reliance on parent firm’s resources and linkage formation is clearer when considering the source of innovations. Case firms that had established fewer direct linkages within the sample were those that totally relied on their parent firms as a source of innovations. Those case firms that relied heavily on their parent firm’s resources, but not totally, had established more linkages than the previous group but fewer than the group of firms that rely on them only to a minor or moderate extent. That is, the results suggest that there is a negative relationship between reliance on parent firm’s innovations and linkage formation. Overall, as reliance of the foreign affiliate on its parent firm as a source of innovation decreases, the extent of linkages formed by the affiliate increases.

The findings support the proposition that reliance by the affiliate on innovations from the foreign parent seems to be negatively related to linkage formation, specifically backward linkages and collaborative agreements. The implications of these findings are that the introduction by the affiliate of innovation that originates from the parent firm has a negative influence on linkage formation while the introduction of innovation by the Chilean affiliate or jointly with the foreign parent firm has a positive influence on linkage formation.

Scott-Kennel (2001) found that involvement of the foreign affiliate in the introduction of innovation increased the likelihood of assistance linkages. This finding is in line
with the results that show a positive relationship between involvement of the foreign affiliate in the introduction of innovation and formation of backward linkages. However, the results of this study did not suggest the same relationship for forward linkages. This discrepancy could be explained by the stronger effect of main activity on the establishment of forward linkages for case firms in this study.

Scott-Kennel (2001) also found no significant evidence that innovations introduced by the parent firm (and internalized by the affiliate) decrease the likelihood of linkage formation. On the contrary, the results in this study show that the less involved the affiliate was in the introduction of innovation, the fewer backward linkages and collaborative agreements it established. Enderwick (1989) indicates that in order to benefit from service FDI, the host country needs to provide infrastructure support in terms of existence of a vigorous goods sector, highly educated labour, intangible support in the form of an accommodative industrial policy encouraging collaboration between service users and suppliers, and an atmosphere conductive to academic/industrial collaboration. Hence, these differences could be explained by differences in the local conditions of Chile and New Zealand. It could be that foreign affiliates in Chile are less willing to share innovations originated from the parent firm (through backward linkages and collaborative agreements) than foreign affiliates in New Zealand because they perceive a greater risk in terms of property rights or limitations in terms of local capabilities.

**8.6.1.8 Firm Size**

There were two case firms that acknowledged their size of operations as influencing linkage formation. One case firm indicated that since it was a small firm it had limited resources thus influencing negatively on the formation of CSR linkages while influencing positively on the formation of collaborative agreements. The size of the affiliate also influenced the decision to establish collaborative agreements for case 4; however, it indicated that it was its “big” size that encouraged the affiliate to develop numerous collaborative R&D projects.

Comparison of case firms based on their size (number of employees) and extent of linkage formation made it possible to observe that big firms all had established a
greater extent of linkages than SMEs firms. This finding suggests that the larger the firm the more likely it is to form linkages. However, when comparing SMEs case firms showed that the smallest case firms had established more linkages than the biggest ones.

Consideration of the specific results of case 3 and 4 and the across cases analysis made it possible to suggest that the size of the firm influences certain types of linkages. For instance, as indicated by case 3, when the affiliate is small its resources are limited thus it is less likely to form CSR linkages, which was the case for affiliates 3 and 5. Consistently, all affiliates that were bigger in size than cases 3 and 5 had established CSR linkages.

Chapple and Moon (2005) indicate that big firms tend to be agenda setters in CSR and have relatively greater financial and other resources to devote to it. In addition, empirical studies show that the size of the firm is important for CSR (Gray, Kouhy & Lavers, 1995; Neu, Warsame, & Pedwell, 1998). The logic behind these findings is that with increasing size firms become more visible and so does their social impact, thus exposing them to increased public pressure to report more extensively. Indeed, case 7 indicated that it had formed CSR linkages in order to strengthen its reputation in Chile.

Overall, the positive relationship between size of affiliate and formation of CSR linkages was not observable for backward linkages, forward linkages, and collaborative agreements. A possible implication of these findings is that while the size of the firm influences CSR linkages formation, regardless of size, affiliates may still engage in backward linkages, forward linkages, and collaborative agreements.

Scott-Kennel (2001) found a negative relationship between the size of the affiliate and the formation of forward linkages. This finding suggests that the larger firms may be less likely to give assistance to clients or agents. There was no evidence in this study suggesting this was occurring. As pointed out previously, the main activity of the affiliates in this study seems to play a greater role than other factors over the establishment of forward linkages.
8.6.1.9 Country of Origin

The affiliate’s country of origin could be differentiated in terms of Spanish-speaking and non-Spanish speaking countries. From this perspective, the results showed that those affiliates whose country of origin is Spain had established more linkages than those affiliates that come from non-Spanish speaking countries.

These results contradict previous studies that found that foreign affiliates are likely to generate more local linkages when they come from regions that are farther away and more different in terms of their cultural, social and legal structures (Rodríguez-Clare, 1996; Banga, 2003, Scott-Kennel, 2001). The results in this study indicated that when the psychic distance was lower (between Spain and Chile) it encouraged affiliates to link up with other firms in Chile. Previous literature indicates that services play a vital role in ensuring a competitive production sector (UNCTAD, 2004). Hence, a possible explanation for this finding is that, historically, Spain has always been economically involved with Chile thus suggesting a long-term commitment to the Chilean industry. As a result Spanish firms may be willing to provide assistance to local firms at various levels in order to improve the Chilean industry; hence, the economic environment within which they will operate.

8.6.2 Location-Advantages

The extant literature has acknowledged a range of factors influencing the formation of linkages between foreign and local firms, which are either related to the foreign affiliate – such as MNE’s strategy and motive for investment – or the host country – such as economic environment, economic system, and government policy. The latter set of factors is referred to as L-specific advantages by the OLI paradigm, and has been regarded as crucial for attracting, and benefitting from, FDI (Portelli, 2002).

8.6.2.1 Government Policy

The specific aspects of FDI policy that were proposed to be discriminatory either in favour of or against foreign investors, and potentially moderating the process of local industry upgrading in Chile, were found to have no influence over the affiliate’s
operations; thus, neither over linkage formation. Case firms consistently regarded these particular FDI policies\textsuperscript{11} as neutral.

These findings could be a result of affiliates belonging to industries in the economy which are not influenced by these policies. For instance, industry and location incentives were not relevant to the affiliates since they had chosen their location for strategic reasons rather than guided by policy. This finding supports the proposition that industry/location incentives have no influence on linkage formation when the foreign affiliate does not operate in selected regions/industries, or in related industries.

Tax incentives were also regarded as not relevant. This finding could be due to the stability of the economic environment in Chile which may motivate the firm to adopt the “common” tax regime rather than adopting a tax horizon, which, although it offers stability over time, has a higher tax rate\textsuperscript{12}. Hence, the findings do not support the proposition that tax incentives have a positive influence on linkage formation.

With regard to screening mechanism\textsuperscript{13}, expatriate employees\textsuperscript{14} and capital repatriation\textsuperscript{15}, the affiliates did not perceive these requirements as influencing their operations. The affiliates indicated that they had come to Chile on a long-term commitment thus these requirements were seen as part of the process rather than obstacles. This finding supports the proposition that capital repatriation restrictions have no influence on linkage formation when the foreign affiliate is involved in long-term projects. On the other hand, the findings do not support the proposition that the existence of a screening mechanism has a negative influence on linkage formation.

The proposition that the requirement that at least 85% of a firm’s employees must be Chilean citizens has a positive influence on linkage formation was not supported by the findings either. This finding is contradictory in relation of previous literature that suggests that in service industries firm-specific advantage is often bound up in the human capital of the managers and staff sent abroad (Lecraw, 1989). A reasonable explanation is that foreign affiliates have overcome the “employees’ restriction” by relying on their parent firms for high quality training. For most case firms, training was a key resource transferred from the parent firm to the affiliate. Hence, foreign affiliates were not “conscious” of the influence of this restriction on their operations
since training was perceived as part of their operations rather than a “solution” to overcome a local restriction.

Although FDI policy did not influence the affiliates’ operations, the regulatory framework, in terms of industry policy, played an important role for several case firms on linkage formation. The results showed that industry policy influenced the establishment of assistance linkages for several case firms. For cases 4 and 7 industry policy played a positive role on backward linkage formation. Constant changes in industry regulation, especially those related to the environment, had motivated these affiliates to give regulatory assistance to their suppliers. That is, these firms provided regulatory assistance to their suppliers in order to comply with these regulations.

Industry policy also motivated case 7 to establish forward linkages. Strict regulations in terms of efficiency standards motivated the foreign affiliate to provide assistance to its clients in order to ensure efficiency in the delivery of energy. In addition, for cases 7 and 8, the regulatory framework played a role on the quality of the relationships established with their clients. Nevertheless, while for case 7 the regulatory framework (through industry policy) was the main reason why the foreign affiliate provided assistance to its clients, for case 8 it was a factor that strengthened its relationships with its clients.

Chile’s embracing of international environmental policies (regulatory framework) motivated case 2 to assist the local economy through seminars and entrepreneurship support (CSR). While this finding suggests that the regulatory framework influences CSR linkage formation, there is scant evidence to indicate that there is a relationship between the variables.

In line with previous literature (Enderwick, 1989), industry policy played a determining role for several case firms in the formation of collaborative agreements. Cases 4 and 7 established alliances with local universities motivated by the fact that industry policy imposes high-efficiency standards that require ongoing improvement of operations through research and development (R&D). New regulations in the banking sector had been the driver for case 8 to establish an alliance to introduce a new service to the industry.
The implications of the findings are that government policy is neutral, in terms of FDI policy, towards linkage formation, while it is potentially beneficial for encouraging formation of collaborative agreements through industry policy.

8.6.2.2 Economic Environment

The results show that for most case firms the economic environment influenced linkage formation either positively or negatively. While in certain cases specific aspects of the economic environment were acknowledged as influencing linkage formation, case firms usually referred to the economic environment as a whole. Specifically, when the economic environment was acknowledged as having a positive influence on linkage formation, it was regarded as very stable and at international standards. This finding suggests that where the economic environment was regarded as positive case firms were referring to stable economic conditions and the transparency of institutions. Hence, stable economic conditions and the good quality of institutions had influenced linkage formation positively. This finding is in line with previous literature that argues that the quality of institutions is likely to be an important determinant of FDI activity, particularly for developing countries (Bloningen, 2005; Olofsdotter 1998; Wei 2000a, 2000b). Poor quality of institutions increases the cost of doing business and, thus, may diminish FDI activity.

Market size was referred to by two case firms as negatively influencing linkage formation. These firms indicated that the small size of the Chilean market has resulted in the parent firm limiting its scope of operations (strategy) thus affecting linkage formation. Similarly, the quality of human capital was perceived as negative by two case firms. However, its influence over linkage formation was mixed. On the one hand, it prevented case firm 1 from getting involved in collaborative agreements, while it encouraged it to form CSR linkages. Although case 8 referred to the quality of human capital as being at international standards it indicated that practical skills were lacking from recent tertiary graduates (negative). Nevertheless, this circumstance encouraged the affiliate to establish collaborative agreements with local universities. That is, the quality of human capital, for these firms, exerts mixed influence over linkage formation.
These findings suggest that, overall; the economic environment plays a significant role in linkage formation, specifically in a positive way in terms of economic conditions (stability) and quality of institutions (transparent). On the other hand, most case firms did not acknowledge market size and quality of human capital as determinants of linkage formation. In other words, the characteristics of the Chilean economic environment in terms of economic and political stability and transparency of institutions result in the foreign-affiliate’s long-term commitment to the local industry, which encourages the formation of direct linkages.

While all types of linkages were influenced to some extent by the economic environment, CSR linkages and collaborative agreements were the most heavily influenced. For instance, the economic environment has been a determining factor for the establishment of CSR linkages for over half of the case firms and for the formation of collaborative agreements for half the case firms.

The effect of economic environment over linkage formation is augmented when local firm capability is considered. That is, including local firm capability, the economic environment influences backward linkage formation for half the case firms and collaborative agreements for almost all case firms.

8.6.2.3 Local Firm Capability

The results reveal that the capability of local firms influences the formation of linkages. Specifically, half of the case firms indicated that local firm capability influenced local sourcing and backward linkage formation (either negatively or positively), and over half the case firms indicated that local firm capability influenced the establishment of collaborative agreements in a positive way. These results differ from Scott-Kennel’s (2001) findings that found that the capability of local firms does not significantly influence the extent or type of linkages. However, she found that the ability of local firms to supply specialized products and services had a significant positive influence on local sourcing and backward linkages.

Although over half the case firms source specialized products and services locally most of them do so from MNEs established locally. This finding suggests that local
firm capability in Chile is not up to international standards. Similarly, most case firms that had established backward linkages had done so with foreign-owned firms. On the other hand, case 4 regarded local firm capabilities as high in terms of quality and availability which was reflected in the extent and quality of backward linkages established with local firms.

On the extreme, case 3 indicated that since it operated in an industry where supportive industries were not developed, local firm capability was non-existent or underdeveloped; as a result, it imported specialized products and services. Interestingly, this firm had established backward linkages with local suppliers of standard services, although motivated by the strategy of the parent firm.

On the other hand, the capability of local firms had a positive influence on the formation of collaborative agreements for over half of the case firms. Specifically, case firms that had established collaborative agreements with locally-owned firms and/or universities indicated that the capabilities of local entities are of high standard, thus contributing significantly to the alliances.

Overall, these findings suggest that the capability of local suppliers in Chile (in several industries within the service sector) is below international standards since foreign affiliates either import specialized products and/or source them from locally-established MNEs. Similarly, most backward linkages had been established with foreign-owned suppliers. In other words, the findings support the proposition that a lower capability of local firms negatively influences backward linkage formation. On the other hand, local entities (firms and universities) which are neither clients nor suppliers of foreign affiliates present strong capabilities that motivate the affiliates to establish high-quality linkages (collaborative agreements), thus supporting the proposition that greater capability of local firms has a positive influence on linkage formation.
8.7.0 Degree of Linkage: Groups’ Characteristics

The research model (Chapter Four) proposed that foreign affiliates could have formed a number of linkages in the local economy, which combined, could suggest a Degree of Linkage (DOL) of the affiliates overall.

8.7.1 Degree of Linkage

As a result of the across-cases analysis in Chapter Seven, three groups of case firms were identified based on their DOL. Five types of linkages were included for assessing the overall degree of linkage, namely: competitive linkages, forward linkages, backward linkages, CSR linkages, and collaborative linkages. Case firms could be grouped into three distinct groups based on their DOL score (Refer to Chapter Seven for details.), which in terms of DOL were labelled moderate (group 1), moderate-high (group 2) and high (group 3).

This grouping provides evidence that foreign-owned affiliates engage in different types of linkages with local firms in Chile and different groups of affiliates can be distinguished by different DOL. This finding is in line with Scott-Kennel’s (2001) study that also found evidence that foreign affiliates could be grouped based on their DOL. This finding contributes to the understanding of how different sets of firms can be locally integrated into the local economy via indirect and direct linkages. Most importantly, different DOL groups are expected to have different influences on the development of local industry.

8.7.2 Degree of Linkage Characteristics

Chapter Seven presented results that looked at the differences between the three groups of case firms based on important characteristics relating to the affiliate’s profile. These results show that the affiliates in each group and each DOL are able to be distinguished by role of the affiliate, competitive position, ownership form, level of autonomy, reliance on O-advantages (competitive advantages and source of
innovations), country of origin, size of firm (foreign affiliate), and age (number of years owned by its current foreign investor). (Refer to Table 8.1.)

<table>
<thead>
<tr>
<th>Group/ Variable</th>
<th>Group 1</th>
<th>Group 2</th>
<th>Group 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>DOL</td>
<td>Moderate</td>
<td>Moderate-High</td>
<td>High</td>
</tr>
<tr>
<td>Competitive Linkages</td>
<td>Minor to moderate influence on competitiveness</td>
<td>Major influence on competitiveness</td>
<td>Major influence on competitiveness</td>
</tr>
<tr>
<td>Types of Direct Linkages Established</td>
<td>Forward and CSR linkages</td>
<td>Forward and backward linkages and Collaborative agreements</td>
<td>Backward and/or forward and CSR linkages, and Collaborative agreements</td>
</tr>
<tr>
<td>Main Activity</td>
<td>Corporate financial services and legal services</td>
<td>Financial information services and consulting services in the oil and gas sector</td>
<td>Electricity and water services and consulting services</td>
</tr>
<tr>
<td>Country of origin</td>
<td>USA and Europe</td>
<td>Canada and UK</td>
<td>Spain</td>
</tr>
<tr>
<td>Age (as a foreign affiliate)</td>
<td>Above 10 years</td>
<td>Mixed</td>
<td>Below or equal to 10 years</td>
</tr>
<tr>
<td>Ownership form</td>
<td>Chilean branch</td>
<td>Mixed</td>
<td>Chilean firm owned by foreigners</td>
</tr>
<tr>
<td>Autonomy</td>
<td>Parent firm major-total influence on decision-making</td>
<td>Parent firm moderate-major influence on decision-making</td>
<td>Parent firm minor-moderate influence on decision-making</td>
</tr>
<tr>
<td>Size of firm</td>
<td>SME locally</td>
<td>SME locally</td>
<td>Big locally</td>
</tr>
<tr>
<td>Role of Affiliate</td>
<td>Highly integrated in global network</td>
<td>Mixed</td>
<td>Complex-Integration</td>
</tr>
<tr>
<td>Source of key resources and innovations</td>
<td>Only Parent firm</td>
<td>Mainly Parent firm</td>
<td>Both affiliate and parent firm</td>
</tr>
<tr>
<td>Competitive Position locally</td>
<td>Mainly small competitors</td>
<td>Major competitors</td>
<td>Major competitors</td>
</tr>
</tbody>
</table>

Consideration of each group in terms of its DOL and other characteristics makes it easier to assess the extent to which FDI might be contributing to the development of local industry through: indirect competitive effects; direct sourcing or supply of products and services; the provision of assistance (backward, forward, and CSR linkages); and the formation of collaborative agreements.

A review of the key characteristics of the three groups, and the possible implications for local upgrading, is discussed in this section.
8.7.2.1 Group 1: Moderate Degree of Linkage

This group included the firms with the lowest DOL of the sample. Table 8.1 reveals that the impact of this group of firms over the competitive environment, in terms of influence on the competitiveness of other firms in their sectors, is minor to moderate. Their impact was mainly through demonstration effects (positive), although minor to moderate.

In terms of direct linkages, group one case firms present below average scores for quantity of linkages and quality of linkages. The analysis in Chapter Seven showed that the overall extent score of each firm is lower than the total average score. This situation is a result of group one case firms not having established backward linkages or collaborative agreements with local firms. In addition, the extent and quality of CSR linkages established were low compared with the other case firms. The establishment of “above average” forward linkages is the main contributor to their overall extent scores; however, their quality score is below average.

This group has more affiliates operating in the corporate financial/banking services sector and mostly includes small firms, in terms of number of employees and competitive position. They are branches of a foreign MNE that is based in non-Spanish speaking countries and, in comparison with the other groups, have been foreign affiliates for a longer period (more than 10 years). These firms are highly integrated in their parent firm’s network, have low levels of autonomy, and their parent firm represents the only source of key resources and innovations.

Despite the similarities between case firms in group one, based on overall DOL scores, case one is more integrated into the local industry than cases 2 and 6. This result reflects the differences in terms of competitive positions. Case 1’s competitive position is strong, constituting one of the largest law firms in Chile, which differs from the competitive position of cases two and six where both firms have a low market share. Consistently, the extent of forward linkages in case 1 is higher than the extent of linkages in cases 2 and 6.
The overall picture of this group suggests that these firms are primarily in Chile for the purposes of maintaining a local presence in a stable market, without actively being involved in high quality linkages with other local firms. The establishment of forward linkages is a result of the assistance nature of their activities, while their involvement in CSR responds to differing reasons.

8.7.2.2 Group 2: Moderate to High Degree of Linkage

This group is the most diverse group in the sample since case 3 and 5 differ in many ways. These differences are reflected in their DOL scores which are either slightly lower (case 3) or higher (case 5) than the total average. (Refer to Table 7.21.) However, as a group, these firms present lower DOL scores than do group three case firms, mainly as a consequence of not having established CSR linkages and having lower backward linkages scores. On the other hand, group two case firms present higher scores than group one case firms since they have established higher-quality linkages and higher-competitive linkages scores. This group has formed several moderate quality linkages and high quality linkages; thus, their degree of linkage in the local industry can be regarded as moderate to high.

This group of firms has had a positive impact on local development through providing assistance to local clients and suppliers, and by forming collaborative agreements with other local firms. In addition, these firms also have a strong influence on the competitiveness of other firms in their sectors through demonstration effects.

Affiliates in this group are characterized by their parent firm’s coming from English-speaking countries. In addition, both affiliates are small in size, in terms of number of employees, and obtain from their parent firms most of their resources, which are sources of competitive advantages and innovations. On the other hand, these firms differ in terms of ownership form, level of autonomy, role of the affiliate, age, and main activity. Case 3 has been established as a Chilean firm owned by foreign individuals, for a little over 2 years, and acts as an operational base for the parent firm (complex-integration strategy and moderate level of autonomy) in the oil and gas sector offering consulting and trade services. Case 5 has been established as the Chilean branch of a MNE, for about 40 years, offering financial information services,
and is highly integrated in the global network of the parent firm (low level of autonomy).

Comparison of case firms in group one and two indicates that while case 3 differs in many aspects from group one, cases 5 and 1 present similar profiles. This finding suggests that differences in DOL between these firms are a result of differences beyond the affiliates’ profile. Although these firms (cases 1 and 5) differ in terms of DOL, they are both major competitors, are small in size, have been operating in Chile for more than 30 years, are branches of a foreign MNE, rely heavily on the O-advantages of the parent firm, are highly integrated in the network of the parent firm, and have a low level of autonomy. However, they operate in different industries within the service sector. While case 1 is in the legal services industry case 5 is in the financial information industry. The main differences between these industries are: 1) the legal services industry is dominated by local firms while the financial information services industry is dominated by MNEs, and 2) the quality of human capital (education) relevant for the legal services industry is perceived as low, while the quality of human capital relevant for the financial information services industry is perceived as at international standards. Hence, this finding suggests that differences in DOL between affiliates with similar profiles are mainly the result of differences in the industries within which they operate.

In line with previous literature, the implication of this finding is that when the conditions of the sector within which the affiliate operates are perceived as not at international standards, the affiliate presents a lower DOL than when the conditions are perceived as good. In other words, the potential for a higher DOL is diminished when the L-advantages are not appropriate.

The overall picture of this group suggests two scenarios. On the one hand, case 5 represents the best scenario of an affiliate with a “moderate DOL profile”. That is, it presents a similar profile to firms in group one. Specifically, it is a branch of a foreign MNE, highly integrated in the global network of the parent firm, has low level of autonomy, is small in size, and is highly reliant on the resources of its parent firm. However, it is a major competitor in a sector where local conditions are at international standards. On the other hand, case 3 represents the scenario of a
“pioneer”. Its small size and young age reflect the conditions of the oil and gas industry. Since the industry is still mainly in the hands of the government case 3’s extent of operations is limited by the conditions in an underdeveloped industry. That is, under the assumption that the industry will develop and grow further, so will the firm, thus its DOL.

In sum, group two consists of firms that either represents the best scenario for a “moderate DOL” profile firm or the initial\(^6\) scenario of a “high DOL” profile firm. Hence, there is no single profile that could represent firms with a moderate-high DOL.

8.7.2.3 Group 3: High Degree of Linkage

Collaborative linkages have the most potential for local upgrading through a two-way transfer of resources and O-advantages. While group two has firms that conduct these agreements to a limited extent, group three includes firms that had formed more collaborative agreements than the average. Hence, this group is evidence that certain affiliates form more collaborative agreements and transfer more resources than others who engage in such linkages less frequently.

This group of firms has had a positive and significant impact on local development through providing assistance to local suppliers and/or clients, developing CSR projects, and by forming collaborative agreements with other local firms. In addition, these firms also have a strong influence on the competitiveness of other firms in their industries through demonstration effects.

These affiliates’ parent firms are from Spain, have established operations in Chile for market-seeking reasons, and follow a complex-integration strategy. They mostly enjoy a high level of autonomy and are more self-reliant in terms of resources and innovations than the other groups. As foreign affiliates, they have been present in the Chilean market between 8 and 10 years. In addition, these foreign affiliates are big in size and are major competitors locally.

The overall picture suggests that these affiliates are familiar with the Chilean business culture and economic environment, and thus have a long-term commitment to the
local industry. Their large size and strong competitive position coupled with their market-seeking motives result in these affiliates having a big impact on local industry upgrading via indirect and direct linkages.

Scott-Kennel’s results (2001) show that service providers are more likely to be backward competitive linkers or collaborators than firms in other clusters. That is, service providers belong to either the group of firms that have a moderate DOL or a high DOL. Consistently, the results in this study show that case firms, which are all service providers, present a moderate DOL, moderate-high DOL, or high DOL.

This finding implies that service providers, at least, are likely to influence local industry upgrading via moderate linkages. Furthermore, when the affiliate presents a “high DOL” profile its contribution to the local industry increases via high quality linkages.

8.8.0 Conclusion

The chapter began with a post-hoc analysis that provided an overview of the main issues that arose after the development of the research model and data collection, namely service MNEs and corporate social responsibility linkages. This overview allowed a better explanation of the results, especially with regard to service MNEs.

The post-hoc analysis was followed by a discussion of the results to answer the research questions regarding the suitability of Scott-Kennel’s model of local industry upgrading in the context of Chile. The main findings in this section were that while FDI policy did not influence affiliates’ operations at any level, industry policy was commonly acknowledged as influencing the operations of most affiliates especially in terms of collaborative agreements. The results also showed that for several case firms the economic environment and the MNE’s strategy were related. That is, the characteristics of the economic environment either motivated or discouraged most foreign affiliates’ forming direct linkages by influencing the MNE’s strategy.
There are two main implications of these findings. The first relates to the interplay between government policy and economic environment as determinants of linkage formation. Most affiliates regarded the economic stability of Chile as positively influencing their operations. That is, although the evidence suggested that specific aspects of government policy either did not influence linkage formation or did so to a certain extent, consideration of all the factors in play indicates that the government has played a key role in providing economic stability which has led to foreign affiliates establishing a long-term commitment to the local economy consequentially leading to linkage formation. On the other hand, there was some evidence to suggest that some aspects of the Chilean economic environment were perceived as weak, namely local human capital, local firm capability, market size, and industry size. Hence, overall, so far the government has played a triggering role on linkage formation mainly through industry policy and by providing a stable environment for investors, while some aspects of the economic environment, especially local firm capability, present room for improvement.

The second implication is that in the context of developing countries, such as Chile, the findings suggest that both government policy and the economic environment need to be considered in the assessment of local industry upgrading via FDI. Hence, while Scott-Kennel’s model provides a basis for assessing this process, it does not represent a comprehensive guide in the context of developing countries.

Overall, the results related to the affiliates’ profile in Chile show that:

- Case firms’ motive for investment was market-seeking and was not a single-unit of the parent firm. As indicated in the post-hoc analysis, these are common characteristics of service firms due to the inseparability and perishability of service offerings.
- While most affiliates have been operating in Chile for less than 20 years, which is explained by the surge of service FDI in Chile that began in the mid-1980s, ongoing ownership provides evidence of the long-term perspective of their investments.
- Greenfield investment was the most preferred mode of entry by case firms in contrast to what the literature on service MNEs suggests. This situation is
explained by the time of entry of the affiliates in particular industries within the service sector.

- Although all case firms operated within the service sector, they did so in differing industries.
- The country of origin of the affiliates in the sample is comparable to the data available from official sources.
- There is strong evidence to support the proposition that the MNE plays an influencing role in the operations and decision making of the affiliate.
- All case firms rely at some level on the O-advantages of the parent firm and most of them identify their affiliation with an MNE as a source of competitive advantage.

There are several implications of these findings. First, the justification for examining the impact of FDI is that the OLI configuration of the MNE is expected to result in a different outcome to that of a uninalional firm. The affiliate does not operate in the same way as a uninalional firm since it is able to draw on the multinational, cumulative strengths, and experiences of the MNEs. The profile of case firms confirms that the operations of affiliates in Chile are influenced by the intra-firm internalization of the MNE’s O-advantages, as well as the MNE’s strategic and operational decision-making. Hence, the findings support the assumption of the differential impact of foreign-owned versus locally-owned firms on economic development.

Second, the results showed that for all case firms the motive for investment was market-seeking. Predominant market-seeking investment suggests that Chile is not attractive as a site for research and development, efficient or low-cost manufacturing, processing of primary products, or for its workforce. However, the main activity of case firms explains the results since market-seeking investment is a common characteristic of service firms due to the inseparability and perishability of service offerings.

Third, the findings related to parent resources and innovations as sources of competitive advantage suggest that for most case firms the transfer of resources from the parent firm is the key influence on the most important areas of the affiliates’
competitive advantage (i.e., technology and expertise). Consistently, for most case firms access to the global network of the parent firm and experience and expertise were the main sources of competitive advantage. Interestingly, affiliates also gained resources such as training that are usually more location-bound. This finding could be explained by the nature of most service outputs in the sample which is highly knowledge-based. Knowledge-based assets in service firms being mainly embodied in human resources suggests that training is a key tool for the transfer of tacit knowledge from the parent firm to the affiliate. Similarly, the role of the parent firm as a source of innovations is not only limited to the areas of technology and management practices since it also introduces innovations in those areas which are expected to be more location-bound, for example, training.

These findings have important implications since they indicate that affiliates gain various resources from the parent firm and are actively engaged in the introduction of innovations in Chile. This finding provides strong support for the proposition that affiliates, and eventually the Chilean service sector, are benefitting from the O-advantages of the MNE. That is, foreign affiliates are drawing on parent resources and innovations as sources of competitive advantage relative to other Chilean competitors. This finding suggests that they are introducing unique assets that otherwise would not be available in Chile. These assets not only contribute to the foreign affiliate’s competitiveness, but also to the overall competitiveness of the industry in Chile as a consequence of the affiliate’s improved performance in the first instance, and through competitive, demonstration and agglomeration effects in the second instance.

Fourth, the findings show that case firms are having direct impacts on the upgrading of local firm capability and competitiveness through linkages, especially competitive influence, forward linkages, CSR linkages, and collaborative agreements. Indeed, there is evidence of inter-firm transfer of both core and noncore firm-specific assets by case firms. This finding indicates quasi-internalisation of O-advantages as suggested in the literature review (Chapter Two), whereby foreign firms may choose to externalise certain O-advantages where the net value of doing so is greater than internalising these within the firm.
The results show that quasi-internalisation of O-advantages is particularly evident in forward linkages. Case firms provide continuous assistance to their clients and the types of assistance provided were mainly knowledge-intensive and embedded in the service they provided. This fact is particularly evident for case firms operating in the consulting, banking, information services and legal services industries, which are knowledge-intensive firms where the delivery of services is highly tailored to the clients’ needs, thus requiring a high degree of interaction with clients.

The establishment of collaborative agreements by several case firms indicates that quasi-internalisation of O-advantages is complementing rather than substituting for, FDI. That is, this study provides clear evidence that FDI in Chile is associated with beneficial collaborative linkages that do not involve equity. This is the first study that has revealed this potential for upgrading via FDI and collaborative linkages in Chile.

Fifth, the key determinants of direct linkage formation can be divided in two groups. First, the determinants related to the affiliate’s profile were: the main activity of the affiliate, role of the affiliate (strategy), level of autonomy, reliance on parent firm as a source of competitive advantages and innovations, and to a lesser extent, country of origin and the size of the affiliate. Second, the determinants related to the L-advantages of Chile were: industry policy, local firm capability, and economic environment (in terms of economic and political stability). Within these determinants the strategy of the firm and L-specific advantages were the most significant, as discussed previously.

Local firm capability constitutes an interesting determinant since it reflects the “developing” profile of the Chilean economy. On the one hand, the results suggest that the capability of local suppliers in Chile (in several industries within the service sector) is below international standards since foreign affiliates either import specialized products and/or source them from locally-established MNEs. Similarly, most backward linkages had been established with foreign-owned suppliers. In other words, the lower capability of local suppliers has negatively influenced backward linkage formation. On the other hand, local entities (firms and universities) which are neither clients nor suppliers of foreign affiliates present strong capabilities that motivate the affiliates to establish high quality linkages (collaborative agreements),
thus supporting the proposition that greater capability of local firms has a positive influence on linkage formation. Hence, while Chile has been successful in providing local capabilities that encourage the establishment of high-quality linkages, it has not been so with regard to provision of specialized products and services.

Finally, there was strong evidence suggesting that foreign-owned affiliates engage in different types of linkages with local firms in Chile and different groups of affiliates can be distinguished by different DOL. This finding contributes to the understanding of how different sets of firms can be locally integrated into the local economy via indirect and direct linkages. Most importantly, different DOL groups are expected to have different influences on the development of local industry.

The DOL group analysis revealed important determinants of linkage formation related to the affiliate’s profile. These results show that the affiliates in each group and each DOL are able to be distinguished by role of the affiliate, competitive position, ownership form, level of autonomy, reliance on O-advantages (competitive advantages and source of innovations), country of origin, size of firm (foreign affiliate), and age (number of years owned by its current foreign investor). Hence, the DOL group characteristics confirmed the findings related to the determinants of linkage formation and also revealed other important determinants of linkage formation. The affiliates included in the high DOL group, for instance, were more likely to be big firms and major competitors whose parent firm is based in Spain, and which followed a complex-integration strategy. They mostly enjoy a high level of autonomy and are more self-reliant in terms of resources and innovations than the other groups. In addition, most of these firms were acquired by the parent firm as a result of the privatization process in public utilities industries.

On the other hand, affiliates that belonged to the group with the lowest DOL were more likely to be small firms and minor competitors locally whose parent firm is based in a non-Spanish speaking country, and which were highly integrated in the global network of the foreign parent. They mostly enjoy low levels of autonomy and are highly reliant on the parent firm as a source of resources and innovations. In addition, most of these firms used Greenfield investment as the mode of entry and operated in the corporate financial services/banking industry.
The final chapter of this thesis serves as a review of the key objectives of the study while highlighting the existing literature that provided the foundations upon which to begin the current investigation. It also explains how the thesis has sought to address the limitations of previous studies while identifying further issues for future research. Nevertheless, the focus of Chapter Nine is to elucidate the main contributions of this thesis to both existing knowledge on FDI in the Chilean context, as well as to the development of theory in the wider domain of influence of FDI on local industry upgrading. It also makes some broad recommendations for government policy in Chile based on key findings discussed in this chapter.

1 Scott-Kennel’s (2001) model included local firm capability as a determinant of linkage formation. Since one of the objectives of this study was to identify those L-advantages that may play a determining role on linkage formation that were not considered by Scott-Kennel’s model it was decided to assess the economic environment in terms of factors other than local firm capability.

2 Political stability implies long term continuance of economic policy.

3 “Knowledge often has a jointness or ‘public-goods’ characteristic in that it can be supplied to additional production facilities at very low cost” (Markusen, 1989, p.35).

4 During the economic recession at the beginning of the century many professionals were dismissed from their jobs, which lead to some of them to initiate new business in the consulting services sector (8.9, p.30).

5 The model firm is an ideal firm developed by State institutions in each sector (public services sectors) that has everything working at the most efficient level, and gives an “efficient” tariff that is charged to the customers. Hence, the firms are encouraged to be efficient and minimize costs.

6 The presence of MNEs may generate spillovers, which allow local firms to learn and improve their productivity and efficiency. As the survival of firms is positively linked to efficiency this would be expected to have positive effects on the survival of firms. In their study they found some evidence of a survival enhancing effect, particularly for the early 1990s. This effect seems to be completely due to productivity improvements in firms following an influx of foreign MNEs.

7 Refer to chapter two (literature review) for a detailed description of each category.

8 In an organizational context, stewardship refers to management's responsibility to properly utilize and develop its resources, including its people, its property and its financial assets.

9 Total number of years of operation of the firm includes the number of years that the firm had not been operating under foreign-ownership.

10 Assistance linkages refer to backward and forward linkages.

11 Specific FDI policies assessed were screening mechanism, capital repatriation, expatriate employees, tax incentives, and industry and location incentives.

12 While the tax horizon guarantees stability by offering a fixed tax rate, this tax rate is currently higher than the tax rate currently set for any firm.

13 Screening mechanism refers to the requirement to sign a contract with the Chilean government.
14 Expatriate employees refer to the requirement that at least 85% of a firm’s employees must be Chilean citizens.

15 Foreign investors are subject to the restriction on capital repatriation that indicates that they can only repatriate capital one year after their entry in Chile.

16 *Initial scenario* refers to the stage where a foreign affiliate acts as a pioneer in an industry/sector that has just started to “open its doors” to private investors.
Chapter 9  Conclusions, Implications and Limitations

9.1.0 Introduction

The principal objective of this thesis is to evaluate the impact of FDI on the Chilean industry. The focus of the research was on foreign-owned affiliates operating in the service sector in Chile and their impact on the local industry. In so doing, it makes a significant contribution to the existing knowledge on FDI in Chile, as well as the way in which the impact of FDI on industry upgrading might be examined by future researchers, specifically in the context of developing countries.

To address the limitations inherent in the existing literature, the specific purpose of this study was to assess how MNE activity impacts on the development of local industry in the context of Chile while assessing Scott-Kennel’s (2001) model in a different context. In asking “In which ways does MNE activity (inward FDI) influence the upgrading of local industry in Chile?” the central research question anticipated that there is a virtuous interaction between the O-specific advantages of the foreign affiliate, the location-specific advantages of the local economy, and the way the foreign affiliate organizes and uses its O-advantages in the host economy. This understanding suggested that foreign affiliates may influence the upgrading of local industry through indirect and direct linkages and that there are factors that may influence linkage formation which are related to the foreign affiliate and/or the host economy.

The unique characteristics of MNEs are pivotal when analysing the impact of FDI on host countries. The transfer of a unique set of resources from the parent firm to the foreign affiliate may improve the latter’s performance relative to local firms, as well as presenting the potential for indirect effects. However, whether upgrading of local industry occurs depends not only on the O-advantages of the foreign affiliate, but also depends on the L-specific advantages of the host economy. The L-specific advantages of developing countries usually differ from those of the developed ones. Accordingly, the factors that may influence linkage formation in the context of Chile might be different
from the factors that influence linkage formation in the context of a developed country such as New Zealand. This understanding provided the basis for using Scott-Kennel’s model of local industry upgrading as a guideline for assessing the central research question of this study while assessing the model in the Chilean context. In the light of this purpose, the main research objectives of this study were:

1. The applicability of Scott-Kennel’s model in the context of Chile, which was evaluated by assessing specific issues related to government policy and the economic environment.
2. The investigation of direct and indirect linkages at the firm level, which was done in three stages:
   a. First, for assessing which O-specific advantages may be diffused to the Chilean industry, the direct effects on the foreign affiliate were estimated by identifying the unique advantages that the affiliate has internalized as well as the range of affiliate-related variables that could act as determinants of linkage formation. That is, an affiliate profile was constructed for each case firm.
   b. Second, indirect effects were assessed by examining the extent and type of linkages formed between foreign affiliates and local firms. In addition, the determinants of linkage formation were assessed by identifying both affiliate-related and non affiliate-related factors that were acknowledged to influence linkage formation.
   c. Third, in order to assess whether certain types of FDI are more likely to form linkages that result in upgrading, the study classified case firms into three groups according to their DOL, and compared the groups to identify specific factors that are likely to bring about a greater degree of linkage with the local economy than others, based on the unique characteristics of the affiliate.
In order to achieve the depth of understanding that the research objectives demanded, and in light of the challenges encountered during the data collection process, a qualitative methodology using case studies was selected for this study.

The chapter comprises five sections. The first section summarizes each chapter followed by the second section which gives a summary of the major findings and implications for Chilean industry. The third section considers the implication of this study for FDI research in Chile, theory development, and policy. The next section addresses the limitations of the study and areas for future research, followed by the conclusion of the chapter.

9.2 Summary of the Study

Chapter One outlined the main objectives of the thesis as well as the theoretical framework of the research. It also presented a brief review of FDI in Chile in order to put the study into context and to provide the basis for explaining the reasons for conducting the study. The methodology and research approach employed were briefly described and explained. The chapter concluded by providing the structural design of the thesis.

Chapter Two established the theoretical foundation for the thesis by presenting an overview of relevant theories and empirical studies concerning the impact of MNE activity on economic development. In consideration of the context of the study (Chile), the chapter first presented a concise review of the alternative theoretical perspectives on MNEs in Latin America, which provided the basis for analysing Chile’s historical reliance on FDI in Chapter Three. The chapter then focused on reviewing the eclectic paradigm and the Investment Development Path (IDP) since they constitute the theoretical foundation of Scott-Kenell’s (2001) research model. To complement the discussion, recent research that assesses the impact of FDI on macroeconomic variables, the affiliate, and linkages between foreign and local firms was reviewed.
Chapter Three put the distinctive course of the thesis into the research context. This chapter considered the L-specific factors of Chile by reviewing the extant literature on the extent and pattern of FDI in Chile as well as empirical evidence that looks at the impact of FDI in Chile at a macroeconomic level, and at the industry level. For a relatively small country located far from most major markets, Chile has been remarkably successful at attracting inward investment. Overall, the literature suggests that inflows of foreign direct investment have played an important role as a source of capital, technology, expertise and ultimately, economic growth. However, the literature available in Chile concerning FDI provides only a narrow view of the overall situation, as a result of the use of techniques such as statistical analysis of secondary data.

Chapter Four’s purpose was to present an appropriate model that would provide the basis for assessing the impact of FDI on local Chilean industry. Scott-Kennel’s (2001) model provided a microlevel explanation of the IDP, in turn, making it feasible to examine how the impact of FDI on local industry upgrading may occur. The model proposed a process of local asset augmentation (upgrading) that operationalizes the IDP by illustrating the mechanisms by which local firms may upgrade their resources and capabilities via linkages with foreign affiliates. It proposed that these linkages subsequently determined the degree of linkage (DOL) of the affiliate with the local economy and the extent to which quasi-internalization of O-advantages by the MNE may occur. The diagrammatic presentation of the model suggests an evolving scenario of development, placing the different types of linkages, and DOL, in different phases along a continuum. In so doing, it suggests that the process of local upgrading would differ according to the OLI configuration of foreign affiliates, and that the contribution of inward FDI to a country’s economic development is positively related to the DOL at the firm level.

In order to determine if Scott-Kennel’s (2001) model was appropriate for assessing the main research issue of the thesis, the Chilean context was compared to the New Zealand context. Overall the comparison indicated that both countries adopt an EO-OL strategy (Ozawa, 1992), and recognize liberalization as the means for achieving economic growth. However, the countries differ in terms of FDI policy and specific aspects of their
economic environment. Hence, Scott-Kennel’s (2001) model and its revision constituted the foundation of a set of research propositions and questions for evaluating the process of local asset augmentation in Chile.

*Chapter Five* sought to describe the “methodological journey” of this study. Since the study was based on the model developed by Scott-Kennel (2001), using the same research approach (survey questionnaire and quantitative methods) seemed appropriate. However, the challenges encountered by using quantitative methods (an online survey and a postal questionnaire) triggered the reconsideration of the research context and research questions that ultimately led to a change in methodology. The presentation of the various challenges encountered during data collection was the most significant contribution of this phase of the thesis.

The specific characteristics of qualitative methodology addressed the particular requirements of this study. Among these characteristics the argument that qualitative research may be preferable in those cultures in which trust and face-to-face relationships are of high importance was the one that influenced the methodological decisions the most. Within the qualitative, ideographic approach, phenomenology was selected mainly due to its quality of drawing on existing theory which allowed the use of an already conceived research model to frame the study and facilitated a grounding of the findings in existing thinking. The case study method proved to be a competent vehicle for deploying a variety of research instruments, within a phenomenological framework, in the research context.

The validity and reliability of the study’s findings were reinforced by the inclusion of specific research design features to address such concerns. In addition, particular actions were taken for ensuring high ethical standards in accordance with the “*University of Waikato Handbook of Ethical Conduct in Research, 2001*”.

*Chapter Six* presented the results of the empirical research conducted for the study. The analysis looked at the data gathered using interviews and additional information, in relation to four major research areas (affiliate profile, linkage formation, determinants of
linkage formation and degree of linkage). The results were presented in individual case studies according to these major concepts.

Whereas the focus in this chapter was on the individual character of each firm in the study, the fact that all of the case firms shared common features while presenting some interesting differences provided a basis to advance analysis. In the pursuit of understanding how FDI influences the local industry based on similarities and differences between foreign-owned affiliates, a process of across cases analysis was undertaken, and was presented in Chapter Seven. The across cases analysis synthesized the findings of within case analysis to convey a wider level of understanding.

Chapter Eight evaluated the findings from the analysis in Chapter Six, and drew conclusions based on the research questions presented in Chapter Four. The key findings of the study and their implications in the Chilean context are presented in the following section.

### 9.3.0 Main Findings and Implications for Chilean Industry

#### 9.3.1 Scott-Kennel’s Model

In the context of developing countries such as Chile, the findings suggest that both government policy and the economic environment need to be considered in the assessment of local industry upgrading via FDI.

#### 9.3.2 Affiliate Profile

The thesis focused on impacts that might occur as a result of the uniqueness of the MNE relative to local firms, namely the direct and indirect effects that arise from the bundle of resources and firm-specific advantages. The results revealed that most affiliates were highly reliant on their foreign parents for technology in the form of service technology, R&D, and service delivery technology, as well as knowledge embodied in the
information and expertise of the global network of the parent firm. In addition, case firms inherited management practices from their parent firms as to coordinating their activities with the activities of the parent firm which reflects the advantages of common governance of service MNEs.

In addition, most case firms also gained “location-bound” resources such as training, since training is a key tool for the transfer of tacit knowledge from the parent firm to the affiliate. While the injection of capital is one of the most proclaimed benefits associated with FDI, the results showed that few case firms relied on the parent firm as a source of finance. Since service industries’ O-advantages are often bound up in human capital, not in plant and equipment, substantial overseas activity can be undertaken without transferring substantial financial capital.

Case firms have introduced various innovations in their respective sectors. The innovations mentioned most often were in the area of product/service technology followed by innovations in the types of services offered. The international experience and expertise of the parent firm was referred to by several case firms as enabling the affiliate to offer services that are new to the Chilean market. In addition, case firms also introduced innovations in terms of training, management practices, human resources and skills, service delivery technology, distribution systems, and employment practices.

The thesis found that many of these resources and innovations had wholly or partially originated from the parent firm or related affiliates, including location-bound resources such as training. Moreover, none of case firms invested in Chile to gain existing innovation; however, there was no evidence to suggest that a foreign investor may seek to “hollow out” innovatory capacity.

These findings imply that affiliates are actively engaged in the introduction of innovations in Chile. As a result, the affiliates, and eventually the Chilean service sector, are benefitting from the O-advantages of the MNE. The fact that these innovations are new to the Chilean industry implies that the MNE is responsible for positive contributions that would be unavailable locally in the absence of FDI.
As suggested by the post-hoc analysis, since all case firms operated within the service sector they presented distinct characteristics. Case firms’ motive for investment was unanimously market-seeking, explained by the need to have a local presence because consumption cannot be separated from production. The main implication of this finding is that service MNEs require a local presence in Chile which means that they are actively integrated within the local economy through both indirect and direct linkages. However, this presence does not necessarily translate into high-quality linkages which offer the most potential for local industry upgrading.

While all case firms acted as a division of the parent firm rather than being limited to perform a singular business function, case firms that operated as branches of MNEs were less likely to take an active role in the local economy through indirect and direct linkages. These firms relied on their parent firms for most decision making, and were highly integrated in the MNEs’ global network suggesting that local strategy is influenced by the global strategies of the MNE.

9.3.3 Linkage Formation and Determinants

In terms of competitive influence of the affiliates on local firms, the results revealed that most case firms were major competitors in Chile and had significant influence over the increased competitiveness of other firms. The implications of these results for Chilean industry are that foreign affiliates in the service sector are likely to influence the competitive environment via demonstration effects. However, the findings also showed that changes in the competitive environment were also the result of changes in market conditions and government policies. There is a need for further research to clarify the extent of competitive pressure of the affiliates versus other factors.

The results revealed that case firms had established a range of direct linkages with local entities. While none of the affiliates had formed forward linkages with local agents, most of them had established relationships with their customers in Chile since the service
offering involves assistance. In terms of local sourcing, most affiliates frequently rely on the parent firm’s network as a source of specialized products and services.

The results confirm that affiliates do not engage in knowledge agreements as a complement to FDI. Licensing is discouraged by a number of facets of service sector activity such as problems in separating out the technology package of services, sharing of experience, and on-the-job training and high transaction costs. On the other hand, local firms are benefitting through collaborative linkages. Most of these collaborative agreements were with local universities, were oriented to research and development, and involved a two-way transfer of resources, including some core O-advantages.

The implications of these findings are that certain Chilean-based firms can benefit from collaborative agreements through mutual sharing of competencies. Local firms, especially universities, are able to offer complementary resources, such as research skills followed by infrastructure and human resources, and in return are able to access the O-advantages of the foreign affiliate.

Collaborative linkages have a positive impact on the upgrading of industry in Chile in several ways. First, the local firm has the opportunity to benefit from the quasi-internalization of resources and competences from the affiliate, for example, offshore technologies, or draw on the knowledge and expertise accumulated by the MNE’s worldwide operations. Second, the foreign affiliate benefits from the resources transferred from local firms, which are expected to enhance its performance and/or competitiveness in Chile, and perhaps even internationally. This transfer may create further benefits to the Chilean economy through an increase in employment, a wider range of services available, local R&D, and innovation, etc. Third, both firms benefit through the development of resources such as technology, human resources and skills, information and expertise, R&D and access to markets. This exchange is also beneficial for Chilean industry which benefits from local development and innovation. Finally, there was no evidence to suggest that firms were undertaking such agreements for collusive or anticompetitive reasons.
Finally, during the data collection process a new type of linkage was identified that involved the transfer of knowledge and expertise from the foreign-owned affiliate to the local industry – what we identified as corporate social responsibility (CSR) linkages. Although CSR linkages did not necessarily involve a one-to-one relationship with local entities, they represented an intended effort on the part of the affiliates to contribute to the upgrading of the Chilean economy, either through community projects or industry-related projects that, in most cases, involved the transfer of knowledge and experience. The implication of these findings is that case firms are positively influencing the upgrading of the Chilean economy through community involvement and by engaging in projects that involve “knowledge spillovers” to the local economy.

The results showed a number of factors that played a determining role in linkage formation that were either firm-specific (affiliate profile) or location-specific factors. The unique characteristics of the affiliates that were associated with linkage formation included:

- the role of the affiliate or strategy (Most mentioned by case firms as influencing backward, CSR and collaborative linkage formation);
- the level of autonomy (Influence of parent firms over the affiliate’s decision-making was negatively related to linkage formation);
- the main activity of the affiliate (The activity was acknowledged by most case firms as influencing backward linkages and/or forward linkages);
- ownership form (Branches were less likely to establish high quality linkages than firms owned by foreign firms/individuals);
- reliance by the affiliate on inputs from the foreign parent (This reliance was negatively related to linkage formation, specifically backward linkages and collaborative agreements);
- reliance by the affiliate on innovations from the foreign parent (This reliance was negatively related to linkage formation, specifically backward linkages and collaborative agreement);
- the size of the firm (Size influenced the formation of CSR linkages); and
the country of origin (Spanish firms were engaged in more linkages than non-Spanish firms).

Location-specific factors that influenced linkage formation were government policy, economic environment, and local firm capability. While government policy seemed to play a neutral role through FDI policy, it played a significant role via industry policy especially for the formation of assistance linkages (mainly in public utilities industries) and collaborative agreements. The economic environment influenced linkage formation either positively or negatively. For most firms, stable economic conditions and the high quality of institutions had positively influenced linkage formation, especially CSR linkages and collaborative agreements.

Local firm capability influenced backward and collaborative linkage formation. Overall, the findings suggest that a lower capability of local suppliers influenced backward linkage formation negatively. On the other hand, local entities (firms and universities) which are neither clients nor suppliers of foreign affiliates presented strong capabilities that motivated the affiliates to establish high quality linkages (collaborative agreements).

Consideration of all the factors in play points to the conclusion that the government has played a key role in providing economic stability which has led to foreign affiliate’s establishing a long-term commitment with the local economy, consequently leading to linkage formation. On the other hand, where linkage formation did not occur, it was mainly a result of the MNE’s strategy. The MNE’s strategy was either a response to specific local conditions or a result of global strategic intent. The local conditions that were perceived as weak by some case firms were local human capital, local firm capability, market size, and industry size.

**9.3.4 Degree of Linkage**

The research model (Chapter Four) proposed that foreign affiliates could have formed a number of linkages in the local economy, which combined, could suggest a Degree of
Linkage (DOL) of the affiliates overall. Chapter Seven found that case firms could be grouped into three DOL groups based on the types of linkages formed, which in terms of DOL were labelled moderate, moderate-high, and high. This grouping provides evidence that foreign-owned affiliates engage in different types of linkages with local firms in Chile and different groups of affiliates can be distinguished by different DOL.

The implication of this finding is that it contributes to an understanding of how different sets of firms can be locally integrated into the local economy via indirect and direct linkages. Most importantly, different DOL groups are expected to have different influences on the development of local industry.

Chapter Eight provides a detailed discussion of affiliate characteristics associated with different DOL. Case firms in the high DOL group shed light as to the nature of the type of firm that is more likely to exert a positive impact on local industry. The results suggested that these affiliates’ parent firms are from Spain; they follow a complex-integration strategy, mostly enjoy a high level of autonomy; and are more self-reliant in terms of resources and innovations than the other groups. In addition, these foreign affiliates are large in size and are major competitors locally.

Some of the implications of these findings are discussed in the following section.

9.4.0 Contributions of the Research

9.4.1 Implications for Research in Chile

In relation to direct effects, the findings confirm previous case studies that have identified unique contributions made by foreign investors to affiliates in Chile. However, this thesis provides specific evidence that affiliates in the Chilean service sector are likely to gain access to resources that would otherwise be unavailable to that firm, or unavailable in Chile more generally. Specifically, the thesis contributed to existing knowledge by providing evidence that the bundle of resources, skills and knowledge transferred by the
parent firm contributed towards the affiliates’ ability to compete in Chile against other locally-based firms. However, the results also suggested that there was limited transfer of capital from the parent firm which implies that service MNEs are less likely to show direct effects in terms of capital than other MNEs which are more capital-intensive.

In addition, the evidence also revealed that in various industries within the service sector the main local competitors were also foreign-owned firms. Hence, the implication is that global corporate strengths are being pitted against one another in a highly competitive market and uninational firms may struggle to maintain a presence other than in niche markets. Similarly, those firms that sourced specialized products/services locally mainly dealt with MNEs established in Chile. Accordingly, backward linkages had been mainly formed with foreign-owned firms rather than locally-owned ones.

Since the extant literature focuses mostly on the more immediate, direct effects on macroeconomic variables, the thesis makes a contribution to the understanding of indirect effects on local industry, especially in the service sector. The thesis has attempted to assess the extent of linkage formation and the quality of linkage formation by considering a broad range of linkages, and the outcome of those linkages in terms of local upgrading. Overall, the results confirm the central proposition of the IDP; that is, the unique OLI configuration of the MNE, combined with appropriate receptor conditions, contributes to local upgrading. The implications of this for Chile are that foreign-owned firms are not only responsible for increased economic output through their own operations but are also facilitating the upgrading and economic output of other local firms.

The distinction between affiliates in terms of their DOL with the local economy constitutes a main contribution relevant to Chile, and other similar developing countries. Previous research has often regarded FDI as a homogeneous entity influencing on a local economy and has focused mainly on the impact of the foreign-owned manufacturing affiliate. The drawback of these approaches is that there is lack of consideration that all FDI is not the same and, consequently, cannot be assumed to have the same impact on local upgrading. The thesis provided evidence suggesting that, although most foreign
affiliates tend to encourage the intra-firm transfer of corporate resources, some are more likely than others to encourage the inter-firm transfer of these resources.

The implications for industry development and for future policy are that different types of FDI will have different impacts. While the evidence is based on a small sample of affiliates, this thesis has revealed that even within a specific sector affiliates present different characteristics that are related to different DOL with the local economy. The thesis sheds light as to the types of affiliates that are more likely to have a high DOL versus those that have a lower DOL within the service sector. In so doing, it provides a starting point for identifying certain types of investment that are likely to be more beneficial to local industry upgrading. In addition, it prompts the revision of FDI promotion policies which might be made more effective when targeting specific types of investment.

A further key contribution relevant to Chile is that the thesis provides findings that so far the government has played a pivotal role in linkage formation mainly through industry policy and by providing a stable environment for investors. On the other hand, some aspects of the economic environment, especially local firm capability, present room for improvement. In other words, the evidence suggests that the “neo-structuralism” approach that the Chilean government has undertaken has, overall, influenced the process of local industry upgrading via FDI by developing an economic environment that not only attracts foreign investors but also stimulates them to get involved with the local industry.

Collectively, the findings contribute to the understanding of the role of service FDI in development, by estimating its direct effects over the affiliate and indirect effects over the local industry. In addition, the thesis distinguished between different types of investment within the service sector and their likely impact over local industry.
9.4.2 Implications for Theory Development

The schema presented in Chapter Four as Figure 4.2 “Analysing the role of the MNE in host country industry” (Scott-Kennel, 2001) is shown in a revised form in Figure 9.1. This schema provided a framework for the thesis by attempting to illustrate the relationship between the MNE, the host country, and economic welfare. This research has given insights into the process of local upgrading in the context of developing countries, and allows building on the schema presented by Scott-Kennel (2001).

Figure 9.1 shows the main elements of the schema that have provided the focus for this thesis, and in this section the main contributions of the thesis to these elements to better illustrate the process of local upgrading are presented.

First, as in Scott-Kennel’s (2001) study this thesis sought to assess the impact of FDI by considering specific impacts at a firm-level. It focused on identifying the organisational routes taken by foreign affiliates (linkages) that might induce local industry upgrading. The thesis provided significant evidence that alternative organisational routes (to markets or hierarchies) that involve quasi-internalisation of O-specific advantages by the MNE are employed as a complementary strategy to FDI.

The implications of flexible organisational forms for the local upgrading of industry are that they present far greater potential for development than FDI alone. That is, not only do the affiliates’ activities impact on the welfare of the host country, but the interaction of their activities with those of local firms also impact on the capabilities of local firms, which in turn, build on the L-advantages of the host economy. Hence, in terms of theory, the recognition of the relationship between internalisation and the extent of transfer and/or diffusion of O-specific advantages could considerably further the investigation of the relationship between foreign firms, the extent of linkage, and the subsequent impact on local capability.
Figure 9.1  Schema for Analysing the Role of MNEs in Host Country Industry in the Context of Developing Countries

**Organizational Routes**
(L-specific advantages, including L-specific advantages of hierarchies compared to markets or inter-firm cooperation)

**Firm Strategy:**
- Exit or Voice

**Enclave**
- Competitors
- Agents/Customer
- Sup
- Pliers
- Knowledge Agreements
- Collaborators

**Knowledge Agreements**
- LOW
- MODERATE
- HIGH

**Impact on Upgrading of Industry**

**MNE/Affiliate Welfare**
- Level, pattern and location of MNE activity
- Organizational structures, managerial strategies, control
- Resources and capabilities transferred to affiliate
- Opportunities for upgrading via MNE affiliation
- Collaboration and mutual development

**Host Country Welfare**
- Capital, balance of payments
- Employment, human capabilities
- Technology
- Upgrading of market structure and productivity:
  - Competition, demonstration effects
  - Access to international markets, resources
  - Demand and supply
- Transfer/diffusion of resources
- Collaboration and mutual development

**Competitive Advantages of Firms**
(O-specific advantages)
- Foreign Owned Affiliates

**Competitive Advantages of Countries**
(L-advantages)
- Economic Environment:
  - National level (institutions, economic stability)
  - Industry level (infrastructure)
  - Firm level (local firm capability)

**Transaction Relationships**
(DOL)

**Non-FDI Induced Change**
- Economic Systems
- Government Policy
- FDI-neutral, Neo-Structuralism, Political and Economic Stability

**Organizational Routes**
(I-specific advantages, including L-specific advantages of hierarchies compared to markets or inter-firm cooperation)

**Firm Strategy:**
- Exit or Voice

**MNE/Affiliate Welfare**
- Level, pattern and location of MNE activity
- Organizational structures, managerial strategies, control
- Resources and capabilities transferred to affiliate
- Opportunities for upgrading via MNE affiliation
- Collaboration and mutual development
This thesis contributed further to the understanding of quasi-internalization since the assessment of linkages was not limited to local sourcing, neither to assistance linkages with local agents and/or clients. Instead, the thesis identified a much fuller range of both indirect and direct linkages, including collaborative linkages. In addition, it extended Scott-Kennel’s range of linkages by identifying a “new” type of linkage, namely corporate social responsibility (CSR) linkages. The findings suggested that affiliates influenced local industry by providing specific types of assistance to the local industry or transfer of firm-specific advantages through community projects or industry-related projects comes under the concept of CSR discussed in the post-hoc analysis.

The thesis makes a contribution by attempting to distinguish between different sources of local linkages; namely whether the linkages were formed with local Chilean firms or with other foreign-owned firms based in Chile. The findings suggested that most backward linkages had been established with locally-established MNEs. The implication for theory is that, in this scenario, local suppliers/subcontractors might be mainly benefitted through competitive linkages with MNEs, which act locally as suppliers of foreign affiliates, rather than directly through transfer of assistance. This situation suggests that there is less potential for local firm upgrading.

The thesis also makes a contribution to theory in terms of identifying the factors that influence the organisational route taken by the affiliate, and evaluating the influence of the MNE’s characteristics and L-specific factors on the types of linkages formed. Analysis of these linkages and their determinants reveals how the process of upgrading might occur, rather than simply observing a certain outcome, for example, increases in labour productivity.

The findings suggested that the level of autonomy and ownership form were significantly related to the strategy of the affiliate. That is, the thesis contributed to the body of existing knowledge by emphasizing the influence of MNEs’ strategy on the organisational routes taken by the affiliates in the local economy. Specifically, it provided evidence suggesting that when the global strategy of the parent firm involved global
contracts for the procurement of inputs, it influenced local sourcing and formation of backward linkages negatively.

The findings also revealed the interplay between government policy and economic environment as determinants of linkage formation. In so doing, the thesis gave evidence that while Scott-Kennel’s (2001) model provides a basis for assessing the process of local industry upgrading via FDI, it does not represent a comprehensive guide in the context of developing countries like Chile, since it does not explicitly take into account all the aspects of the ESP paradigm, specifically government policy and economic environment.

The thesis also contributed to extant theory by providing evidence regarding the relationship between FDI Induced Change (MNEs characteristics) and Non-FDI Induced Change (L-specific factors). The findings suggested that when the strategy of the parent firm does not prevent the foreign affiliate becoming involved with local industry, the regulatory framework had the potential to play a positive role on the formation of high quality linkages. Moreover, the findings also suggest that the economic environment and the MNE’s strategy were related. That is, the characteristics of the economic environment either motivated or discouraged most foreign affiliates when it came to forming direct linkages by influencing the MNE’s strategy.

In sum, the key contribution of this research to theory is its attempt to evaluate Scott-Kennel’s model in the context of a developing country. Chile provides a very interesting context for the study because of its “neo-structuralism” approach towards economic development, which is discussed in the next section.

9.4.3 Implications for Policy

The research model suggested that some aspects of FDI policy had the potential to influence linkage formation either positively or negatively. However, the findings suggested that these aspects had no effect over the affiliates’ activities. Overall, the affiliates perceived that they had been subject to the same regulation as locally-owned
firms. While this is in line with the “hands-off” proclaimed by the Chilean government, the recognition of industry policy as influencing foreign affiliates’ operations supports the proposition that the Chilean government follows a neo-structuralism approach rather than a free market policy.

Given the absence of local content or participation requirements and low levels of tariffs on importing, foreign-owned firms are likely to draw heavily on offshore sources of inputs. The implications of this finding are that efficiency will be maximised under such strategy. However, the implications for local development are less positive. In this scenario, the extent of investment as well as subsequent linkage formation depends on the strength of other L-advantages available in Chile relative to other L-advantages available elsewhere (such as workforce capability, local firm capabilities, quality of institutions, etc.). The government has played a key role in developing such advantages mainly by providing a stable political and economic environment relative to other Latin American countries. Nevertheless, as suggested by the findings, certain L-advantages are still in need of further development, especially local skills and local firm capability.

The findings also suggest that the government has used industry policy in certain industries to direct the operations of firms. Most importantly, the results revealed that directive industry policy resulted in affiliates engaging in high-quality linkages. The main implication of this finding is that directive industry policy provides incentives for foreign affiliates to engage in activities that contribute to local industry upgrading. Nevertheless, the findings also suggested that, while industry policy encourages the establishment of collaborative linkages with local firms, it does not necessarily result in the formation of backward linkages with locally-owned suppliers, but rather with MNEs established locally.

Hence, directive industry policy seems not to be sufficient to encourage linkage formation with local firms due to the weaknesses of local firms as suppliers. Therefore, while the government has created an effective industry policy and a stable environment, its ability to augment created resources as well as the ability of local firms to manage,
organise, and upgrade such resources will be a decisive factor in the extent and quality of linkages formed by the MNE and the eventual upgrading of wider industry.

In light of these findings, there may be an argument for government-funded initiatives to encourage linkage formation. While Corporacion de Fomento de la Produccion (CORFO)\textsuperscript{1} is currently offering a range of incentives to foreign investors in order to develop certain sectors of the local industry, these do not specify requirements to work with local firms (CORFO, 2009). Hence, these funds could be better used as an incentive for foreign affiliates, particularly those that are newly established in Chile, to work with local firms as suppliers, agents, and collaborators.

There also needs to be consideration of the technology gap when devising industry policy or targeting specific foreign investment. There is no sense in encouraging investment where the capability gap between the potential foreign investor and the local support network of firms is too wide. The results in this study suggest that it is likely that such disparity in the levels of capability will discourage local linkages.

Finally, the government should look into education policy since it contributes to created asset formation and the ability of local firms to absorb new technologies and knowledge. As suggested by the findings, development of local skills is particularly relevant in the service sector which is usually reliant on human resources. This need is particularly important if it is considered that the service sector is one of the largest sector in the Chilean economy (as in most economies), and their competitive production is critical to the welfare of a society as a whole, in addition to many services being crucial inputs into products that compete in local and international markets (UNCTAD, 2004).

\textbf{9.5.0 Limitations and Future Research}

The research approach identified as appropriate for this study proved to be suitable for providing the insight sought in the research questions, as well as overcoming challenges related to the context of the study. Nevertheless, this approach implies two limitations in terms of research design: 1) single sector data collection, and 2) self-reported data.
The data to investigate the conceptual model were collected on a single sector, rather than cross-sector and on a longitudinal basis. While initially the thesis intended to obtain data from various sectors, the challenges encountered during the data collection stage resulted in all case firms operating within the service sector. (Refer to Chapter Five for details.) Nonetheless, the single-sector data proved to be satisfactory to examine the conceptual model since the service sector has attracted a considerable amount of FDI into Chile over the last decades. However, the collection of longitudinal data might have provided additional insights into how the relationships between foreign affiliates and local firms change over time, and what are the impacts of these changes are.

The data collected in each case relied on self-reported information (interviews). When using interviews there was a risk of bias of interviewee, which may have diminished the quality of the data. In order to increase the reliability of the findings, a variety of sources were used. That is, the study built on the strengths of each type of data source while minimizing the weaknesses of any single approach.

Specific context and small sample size, which facilitated the research approach used in this study, restricts the application of the findings. In the future, the application of the findings over a wider sample frame may lead to a better understanding of the process of local industry upgrading via FDI in the context of developing countries.

Rather than being conclusive, the findings of this study open new opportunities for further research. Although the results show little evidence to suggest that MNE activity is ‘hollowing out’ local capabilities due to the difficulties of tracing firms, particularly those that no longer operate in Chile, the study did not consider cases where foreign investors had acquired a local innovatory firm and, subsequently, moved its innovatory operations offshore. Closer examination of the effects of FDI on the operations and entry of other firms into these industries might also be warranted, given that FDI dominates key sectors in Chile.

Finally, an extension of this study would be to verify the link between local firm upgrading via linkages and subsequent outward FDI, and to evaluate the impact of
outward FDI by Chilean firms on upgrading. The focus of this study has been limited to the role of inward FDI in the process of local firm upgrading, while the IDP shows that both inward FDI by foreign firms and outward FDI by local firms have the potential to contribute to economic development. Hence, there is clearly a need for an analysis of the impact of the activities of Chilean MNEs on the upgrading of local firms.

9.6.0 Conclusions

Following the research questions, which drew on the process of local industry upgrading via FDI and linkage in the context of developing countries, this thesis identified a clear gap in present thinking. While many studies have measured the extent of FDI at a macrolevel (aggregate statistics), and case studies and survey evidence have examined some of the impacts of FDI at the firm-level these studies have mostly focused on the direct effects of FDI on the economy or the foreign affiliate. Scott-Kennel’s (2001) study of the process of local industry upgrading via FDI in New Zealand constitutes a valuable contribution to fill this gap. However, its focus was on a developed economy and the different context suggests that this process may be different in the context of developing countries. This thesis provides evidence that FDI has a significant impact on the upgrading of local industry in the context of a developing country – Chile – through direct effects over the affiliate, competitive effects, local sourcing, assistance linkages, CSR linkages, and collaborative agreements.

A key contribution of this thesis relates to the role of government policy in the process of local industry upgrading via FDI in the context of developing countries. The evidence suggests that while FDI policy may be neutral, government policy plays a major role through directive industry policy and the provision of an investment environment which is stable politically and economically. Since these findings are based on a small, single-sector sample further research is highly recommended. Such research may focus on the relationship between government policy, FDI and local industry upgrading over a wider sample frame which may lead to a better understanding of the process of local industry upgrading via FDI in the context of developing countries.
Further, this thesis provides evidence supporting Scott-Kennel’s findings that not all FDI is the same. The thesis identified distinct groups of affiliates distinguished by their extent and quality of linkage formation. In so doing, it provides a starting point for identifying those affiliates that are more likely to be engaged in a variety of local linkages and those that are less likely to be so well integrated with the local industry.

Overall, the findings in this thesis relating to foreign affiliates and their activities in Chile will provide policy makers with a better understanding of the nature and outcomes of interaction between foreign and local firms.

\[1\] CORFO is a government institution created in 1939 with the objective to establish and maintain an economic policy in which the state would play an entrepreneurial role (for more details refer to Chapter Three).
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Appendix A  Development in Latin America - CEPAL

The CEPAL-Concept for Development in Latin America at the End of the XX Century: Neostructuralism

Source: Andreas Steiner


The CEPAL (Comisión Económica para América Latina), the economic commission of the United Nations (UN) for Latin America and the Caribbean, was founded in February 1948 by the economic and social council of the UN. The Chilean UN-delegation initiated its foundation by proposing the creation of an institution similar to the economic commissions for Europe and East Asia founded in 1947. Its headquarters are located in Santiago de Chile. As the US-delegation did not foster the creation of CEPAL, its development was marked by difficult and strained relations to the United States.

The main function of the CEPAL is to analyze the problems and processes of development in Latin America, to support and advise Latin American governments as well as to instruct planning staff of national administrations. Its intention is to offer holistic orientations as well as opinions on particular issues by providing the countries with a frame of reference for the development process.

It is noteworthy that in the first years of its existence the CEPAL pursued an offensive economic strategy by formulating its concept for development that later was called Cepalismo: the concept of import substitution industrialization. The CEPAL influence in development and economic policies in Latin America reached its climax in the 1960s. As a rule international bureaucracies try to find a consensus with their member states - the CEPAL numbers 36 members - so that own, innovative perspectives are rare. As for that the CEPAL seems to be an exception. On the contrary, a certain tension could be examined between the CEPAL and the conservative and often even authoritarian governments of the Latin American member states. Its political analyses are formulated in a general and not specific way since the protection of political
neutrality of its international civil servants and the avoidance of conflicts with the member governments are defined as main interests of the organization.

**The Cepalismo (IL/IS)**

The Cepalismo, for a few decades representing the main stream of Latin American development theory forms the basis of the structuralist approaches. The centre-periphery conception outlines that development between industrialized nations and the Third World does not proceed simultaneously because of structural differences and the decrease of the terms of trade. The periphery remains on the fringe of capitalism’s central dynamics receiving less than its fair share of the fruits of technological progress. According to this thesis underdevelopment is not caused by economic trends or the insufficient liberty of the market forces but it is due to remaining structures. Therefore, the only way for development is a change of these internal and external structures. The relations of the Latin American developing countries even contribute to the way that these structures are maintained. As a result of this, quick industrialization was seen as the only way for an autonomous development. This perceptions led to the creation of import substitution industrialization that later became the core element of the CEPAL-strategy. It intended a policy of creating a national industry promoted by state support and protectionist policies. Therefore, a strengthening of state influence and control was necessary. Nonetheless, the underlying intention was to seek a broad synthesis of elements of socialist and liberal economic concepts. Therefore, Cepalismo constitutes a "middle-of-the-road"-concept. As the orthodox liberal school rejected its ideas and the neo-liberals saw socialist and state capitalist tendencies in the CEPAL-works, the rupture with liberalism "must be seen as definitive". Left wing theorists reproached that Cepalismo got stuck in reformism.

**The change**

The triumph of neo-liberalism began at the beginning of the 1980s as positive economic tendencies discontinued in the wake of world depression. So the strategy of import substitution industrialization turned out to be no longer adequate. In addition, the programmes for adjustment and the financial support of the World Bank and IMF were bound up with neo-liberal policies in the respective countries. As there was a
need to adopt the strategy of neo-liberalism by national and international politicians. The classical structuralist theorists had to do some rethinking in order to leave their defensive position. Since the middle of the 1980s a concept for development emerged that builds up on classical structuralist assumptions and sees itself as an antithesis to neo-liberalism: neo-structuralism. The variety of political and economic positions within Latin America explains the fact that the CEPAL was not able to present its new concept earlier during the times of the obvious failure of Cepalismo and the debt crisis. A consensus could not be found. Only when neo-liberalism was generally accepted as the predominant economic practice the CEPAL could set up a new system based on neo-liberal fundamentals.

The new Cepalismo: Neo-structuralism or simply a repetition of neo-liberalism?

The new CEPAL-strategy for development in the 1990s follows its diagnosis that neither the industrialization in the framework of the local market of the post-war period nor the neo-liberal opening towards world market in the 1980s succeeded in a long-term productive model for development. Neo-structuralism is based on the CEPAL-concept of "Transformación productiva con equidad" (changing production patterns with social equity). It is a reorientation in development theory, as for the first time it to forge a better union between economic growth, equity and democracy. So far the concept stands in a complex relation of continuation and rupture with the neo-liberal heritage in most Latin American countries. The CEPAL, traditionally antagonist to neo-liberalism steps into an ambivalent relationship to its own history. Its ideas had to be formulated in a way that was compatible with the neo-liberal approach, even if they do not originate from neo-liberalism, so that these ideas could be accepted in the new age of neo-liberal paradigm. Thus, it remains a question of interpretation if neo-structuralism is seen as an opposite of neo-liberalism or if it is only a further development of neo-liberalism. The new programme "Changing production patterns with social equity" only tries to take advantage of all possibilities within the neo-liberal approach that are offered for an international competitive and efficient economy but, at the same time, allows democratic structures, pollution control and social adjustment.

The concept of 1990 is completed by two additional publications. In 1991 the CEPAL department of environmental issues presented the document "Sustained development:
Changing production patterns, social equity and environment" and one year later "Equity and changing production patterns: an integrated approach" deepened the term ‘equidad’ (Social equity).

Chile is considered as a ‘testing ground’ for the new CEPAL-concept. Nevertheless the question whether Chile follows the guideline of the CEPAL or, on the contrary, the CEPAL examines the Chilean model and deduces a general-valid theory from it, remains undecided. The economic policies of Chile are connected personally and conceptually with the CEPAL. Undoubtedly, it is important that the new CEPAL-approach evolved in the sphere of the intellectual climate of Santiago de Chile. Indeed, the political programme of the "Concertación de Partidos por la democracia" (Union of democratic political parties), the actual Chilean government, is clearly based on a consideration of the CEPAL-concept.

In accordance with neo-liberalism the CEPAL pleads for industrialization in the framework of the world economy, a change of state role in the developing process and for a policy of macroeconomic stability. Nonetheless, opposed to neo-liberalism, the CEPAL accentuates the state task to arrange technological, industrial and social policies as well as structural reforms (agrarian and educational reform) besides of offering stability-oriented macro-policies.

On the other hand some basic assumptions of Cepalismo are confirmed in neo-structuralist thinking of the CEPAL. Development is seen as an integral process that includes not only macro-economic elements but also social and political structures as well as institutional, cultural and psychological factors. The neo-structuralist approach endeavours to overcome false dilemmas that are the result of the opposition of structuralism and neo-liberalism (import-substitution versus export-oriented industrialization, state versus market, industry versus agricultural sector, social equity versus growth) by interlinking the approaches of both models symbiotically.

The international system is still seen as an asymmetrical relationship between centres and peripheral economies. However, the means to overcome international structural heterogeneity is no longer seen in isolation from the world market, but in active integration into the world economy. While in former times a new international economic order was demanded today it can be recognized a certain willingness to
emphasize the own responsibility instead of blaming the others for the remaining inequality.

**Short characterization of neo-structuralism**

The definition of neo-structuralism becomes obvious in the term ‘desarrollo desde dentro’ (endogenous industrialization). While neo-liberalism wants a minimum of state intervention, neo-structuralism prefers a state that provides a framework that stimulates productivity and growth. The formula is not "extensive non-selective regulation" anymore, like under the traditional approach of the CEPAL, nor "general liberalization" in the scheme of neo-liberalism, but it makes a connection of both: "As much state as necessary, as much market as possible". The state should be a leader state that provides a form of guidance that the market does not provide. It pleads for a strong state that intervenes selectively. The world market is accepted as framework for industrialization. According to the CEPAL, market forces alone are not able to link democracy and social equity with competitiveness. The CEPAL-approach calls for selective action by the State to make up for the most serious flaws and shortcomings in the factor markets, without which it is considered unlikely that the region can attain the high economic growth rates that past history has shown to be within the reach of late-industrializing countries, while it is even more unlikely that such growth can be attained with equity.
Appendix B  Interview Guide

Objectives:

- to explain how the affiliate influence local industry upgrading
- to construct an affiliate profile
- to what extent is the affiliate integrated in the local industry
- identify the factors influencing linkage formation
- to relate different affiliate profiles with different levels of DOL

FDI policy:

FDI policy refers to a government’s plan or course of action intended to influence the operations of foreign entities (individuals, companies, institutions, etc.) investing in the country.

- Does FDI policy influence the way your firm operates in Chile?
  - Which are the aspects of FDI policy that *positively* influence the way your firm operates in Chile?
  - Which are the aspects of FDI policy that *negatively* influence the way your firm operates in Chile?
- Are there any other policies that influence your activities?

Affiliate Profile:

- In what year was your firm *originally founded* in Chile?
- In what year did your parent company or largest foreign shareholder(s) first invest in, or set up your firm (if different from above)?
- What is the *country of origin* of your parent company or largest foreign shareholder(s)?
- Is your firm:
  - A Chilean branch or subsidiary of a foreign company
  - A Chilean firm acquired by a foreign company
  - A joint venture with both Chilean and foreign participation
  - A Chilean firm owned by foreign individual(s)
  - Other
- Please indicate which industry group your firm is best represented by

What is your firm’s *main* business activity?
Could you provide financial information for the last financial year? And/or an estimation of your firm’s size?

How many staff does your firm employ? Full-time and part-time

What influence does your parent company/major foreign shareholder(s) have over decision making in your firm?

What are your parent company/foreign shareholder(s) main reason for operating in Chile?

What types of resources does your firm gain from your parent or related companies/foreign shareholder(s)?

Innovation

Innovation is any service, product, process technology, or any aspect of management that you consider to be a new development in your industry.

In the past 3 years, has your firm introduced innovation(s) to Chile?

Did the innovation originated from your parent firm, your firm or both?

What do you consider to be your firm’s two main innovations?

Did your parent company/foreign shareholder(s) invest in, or set up your firm to gain existing innovation from your firm?

Did your parent company/foreign shareholder(s) invest in, or set up your firm to develop innovation in your firm?

Did your parent company/foreign shareholder(s) invest in, or set up your firm to be close to other local sources of innovation in Chile?

Competitive Profile:

Please indicate the competitive position of your firm relative to your competitors

Relative to competitors in Chile, what resources does your firm depend on as a source of competitive advantage?

Relative to competitors in Chile, what are your firm’s two main competitive advantages?

In the past 3 years, how have these features of your industry in Chile changed?

- Competition between firms
- Number of competitors
- Competitiveness of other firms in your industry
- Has your firm’s operations in Chile **influenced** these changes?
  1) Not at all,
  2) Minor,
  3) Moderate,
  4) Major,
  5) Completely

**Linkage formation:**
Any relationship established with Chilean entities that are not related to your firm by ownership.

**Sourcing of inputs:**
Inputs are any factors used in production or delivery of a service which are **NOT** made by your firm. These include products, services, raw materials, components, equipment and outsourcing of human resources.

- How would you rate the standard of inputs from Chilean firms relative to alternative sources of supply?
- Are Chilean firms able to supply standard and/or specialized inputs required by your firm?
- What sources of inputs does your firm rely on for specialized products and/or services?
- How many Chilean firms (other Chilean firms) acted as your firm’s:
  - Licensee
  - Franchisee
  - Supplier/subcontractor for specialized* inputs
  - Agent for wholesale/retail sales, marketing, distribution
  - Customer for specialized* inputs (from your firm)
  - Other
- Has your firm assisted other Chilean firms to improve their products or services?
- Which types of firms?
- Which **types of assistance** were given to these firms?

**Collaborative Agreements** include alliances, technology sharing or development agreements, management contracts but NOT joint ventures.
In the past 3 years, has your firm formed a collaborative agreement with any entity?

What types? How many?

Your firm’s most significant collaborative agreement with another Chilean firm (NOT a joint venture).

- What was the purpose of this agreement?
- Which resources were transferred
- Which of these transferred resources, were unique to either firm prior to this agreement?
- What resources, if any, were developed as a result of this agreement?
Appendix C  Clustering of Case Firms

One of the objectives for across cases analysis was to identify those characteristics of the foreign affiliate that are related to a higher degree of linkage with the local industry. Since case firms in this study could be clustered mainly into two groups according to their DOL in the local industry – moderate and high, according to the definition put forward in the research model1 – it was considered necessary to develop more refined criteria for grouping case firms. By using a more comprehensive criterion for assessing the affiliate’s DOL it was possible to identify three groups of firms, which provided a clearer perspective for associating certain features of the affiliate profile with a certain degree of linkage.

For comparison purposes the criteria developed was based on Scott-Kennel’s (2001) degree of linkage factor analysis. She used this data analysis technique for grouping independent variables (refer to table 7.5 in Chapter 7) that in conjunction would measure the degree to which the affiliate was linked or integrated into the local economy thus enabling the clustering of case firms according to their DOL. The variables included both the quantity of linkages formed and the quality of those linkages. In addition, competitive linkages2 were included to assess the overall degree of linkage of the firm. With regards to quantity of linkages each type of linkages was assigned a score according to the number of relationships established with locally-established firms (refer to table 5.1).

Specifically, five types of linkages are included for assessing the overall degree of linkage, namely competitive linkages, forward linkages, backward linkages, CSR linkages and collaborative linkages. Knowledge agreements were not included since none of the case firms have established either franchisee or licensee relationships with local firms. The CSR linkage, which was identified during the data collection/analysis process, is included. It is considered to be a moderate quality linkage. Although it does not necessarily involve a one-to-one relationship with local entities it does represent an intended effort from the affiliate to contribute to the upgrading of the local economy, either through community projects or industry-related projects.
In terms of measuring the quality of linkages, the level of assistance affiliates provide to other firms through linkages was measured based on the number of different types of assistance given to clients, suppliers/subcontractors and other entities (refer to table A.1). The minimum score is zero, indicating no assistance was given, and the maximum score was 14 indicating that all types of assistance had been given. 14 possible types of assistance given to clients and suppliers/subcontractors were listed. The types of assistance indicated by the informants were worded according to the types of assistance included in Joanna’s Scott-Kennel (2001) questionnaire. Scott-Kennel (2001) identified 13 types of assistance; all of them were mentioned at least once by one or more case firms. Another type of assistance was added to the 13 suggested by Scott-Kennel, namely, regulatory assistance, since there was not a similar type of assistance in her list that could represent this category. The types of assistance given to other entities (firms, institutions, communities, etc.) through social responsibility linkages were identified by reviewing the transcripts of case firms and then listed, a total of 10 types of assistance were identified. The quality of collaborative agreements was measured based on the number of resources transferred from the foreign affiliate to the partner firm. The types of resources transferred from the foreign affiliate to the partner firm were worded according to the list of resources indicated by Joanna Scott-Kennel (2001) (14 different types of resources).

To assess the extent and quality of competitive linkages the perceived influence of the affiliate on competitive changes as a whole was considered since informants either did not differentiated between influence on number of competitors, competition between firms and competitiveness of other firms; or only commented on their influence over a specific variable, for instance number of competitors. Hence, the respondent’s self-reported influence over competitive changes was used to assess competitive linkages. The respondent was given 5 possible answers: 1) not at all, 2) minor, 3) moderate, 4) Major, 5) Completely. Each possible answer was given a score as indicated in table A.1.
**Table A.1**

Scores for each independent variable

<table>
<thead>
<tr>
<th>Indirect linkage scoring: Influence on Competitive Changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Influence</td>
</tr>
<tr>
<td>Score</td>
</tr>
<tr>
<td>Not at all</td>
</tr>
<tr>
<td>Minor</td>
</tr>
<tr>
<td>Moderate</td>
</tr>
<tr>
<td>Major</td>
</tr>
<tr>
<td>Completely</td>
</tr>
<tr>
<td>Score</td>
</tr>
<tr>
<td>0</td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>2</td>
</tr>
<tr>
<td>3</td>
</tr>
<tr>
<td>4</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Reliance on other firms: Local sourcing (Specialized products and/or services)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product/service sourced locally</td>
</tr>
<tr>
<td>Standard</td>
</tr>
<tr>
<td>Specialized from MNEs established locally</td>
</tr>
<tr>
<td>Specialized from MNEs and local firms</td>
</tr>
<tr>
<td>Score</td>
</tr>
<tr>
<td>0</td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>2</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Number of relationships</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of relationships</td>
</tr>
<tr>
<td>none</td>
</tr>
<tr>
<td>1-5</td>
</tr>
<tr>
<td>More than 5, less than 10</td>
</tr>
<tr>
<td>10 or more, Less than 30</td>
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<td>More than 30</td>
</tr>
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<td>Forward Linkages score</td>
</tr>
<tr>
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</tr>
<tr>
<td>1</td>
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<td>4</td>
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<td>Backward Linkages score</td>
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<tr>
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</tr>
<tr>
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</tr>
<tr>
<td>2</td>
</tr>
<tr>
<td>3</td>
</tr>
<tr>
<td>4</td>
</tr>
<tr>
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<td>4</td>
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</tr>
<tr>
<td>2</td>
</tr>
<tr>
<td>3</td>
</tr>
<tr>
<td>4</td>
</tr>
</tbody>
</table>

**Level of Assistance**

Number of different types of assistance = score

<table>
<thead>
<tr>
<th>Forward Linkages score</th>
<th>Score range from 0, when no assistance was given, to 14, when all types of assistance were given.</th>
</tr>
</thead>
</table>

To quantify reliance of foreign affiliates on local sourcing (for specialized products and/or services) was done by identifying the possible scenarios with regards to this variable; each scenario was given a score as indicated in table A.1. Drawing from the transcripts and field notes it was possible to identify three situations:

1. The foreign affiliated relied on local sourcing for standard products and services
2. The foreign affiliated relied on local sourcing for specialized products and/or services but the suppliers were of foreign origin only (MNEs established in Chile).
3. The foreign affiliate relied on local sourcing for specialized products and/or services and the suppliers were both local firms and MNEs established in Chile.
The overall DOL of the affiliate is estimated by adding the scores of the affiliate for each type of linkage. This is, each type of linkage is assigned a score based on a single variable, or set of variables that in conjunction estimate the extent and quality of the linkages established by the affiliate. Along with the DOL score, each case firm was assigned a “quality score” and an “extent score”. For each firm, the quality score is a result of adding the scores for the number of different types of assistance given to suppliers/subcontractors, clients, CSR-related entities, and the number of resources transferred from the affiliate to its collaborative partners. The extent score is a result of adding the scores based on the number of relationships with clients and suppliers, number of CSR projects, and the type of product/services sourced locally.

1 Moderate degree of linkage is considered when the affiliate has established forward and backward linkages, and CSR linkages. High degree of linkage is considered when the affiliate has established knowledge and collaborative linkages.

2 Extent and quality of competitive linkages measured as the perceived influence of the affiliate’s operations on the changes to the competitive environment.

3 During the interview, based on the original questionnaire, the respondent was asked to what extent the firm has influenced competitive changes giving him/her 5 possible answers, as indicated in table A.1.
### Appendix D  Across-cases Analysis: Meta-matrix

<table>
<thead>
<tr>
<th>Case/ Variable</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>AFFILATE PROFILE</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Country of origin</td>
<td>USA</td>
<td>Netherlands</td>
<td>Canada</td>
<td>Spain</td>
<td>UK</td>
<td>UK</td>
<td>Spain</td>
<td>Spain</td>
</tr>
<tr>
<td>Main Activity</td>
<td>Legal services</td>
<td>Corporate Financial services</td>
<td>Oil and gas services</td>
<td>Water services</td>
<td>Financial information services</td>
<td>Corporate Financial services</td>
<td>Electricity services</td>
<td>Consulting services</td>
</tr>
<tr>
<td>Age</td>
<td>30/12</td>
<td>17</td>
<td>2</td>
<td>146/8</td>
<td>40</td>
<td>26</td>
<td>64/10</td>
<td>9</td>
</tr>
<tr>
<td>Ownership form</td>
<td>Chilean branch</td>
<td>Chilean branch</td>
<td>Chilean firm owned by foreign individuals</td>
<td>Chilean firm owned by foreign company</td>
<td>Chilean branch</td>
<td>Chilean branch</td>
<td>Chilean firm owned by foreign company</td>
<td>Chilean firm owned by individuals (local &amp; foreign)</td>
</tr>
<tr>
<td>Autonomy</td>
<td>Total influence</td>
<td>Major influence</td>
<td>Moderate influence</td>
<td>Moderate influence</td>
<td>Major influence</td>
<td>Major influence</td>
<td>Minor influence</td>
<td>Minor influence</td>
</tr>
<tr>
<td>Size of firm</td>
<td>SME</td>
<td>SME</td>
<td>SME</td>
<td>Big</td>
<td>SME</td>
<td>SME</td>
<td>Big</td>
<td>Big</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th>Inv. to G/D local innovation</th>
<th>Affiliate: -service offering (methods)</th>
<th>Both: -service delivery, quality, -production technology</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Competitive Advantages</td>
<td>Parent: -technology -management practices -Training -expertise -access to markets</td>
<td>Parent: -technology</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Both: -technology. Parent: -management -expertise -innovation</td>
</tr>
<tr>
<td></td>
<td>Parent: -access to inputs -human resources and skills</td>
<td>Parent: -technol. -innovation -service delivery</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Parent: -expertise -access to markets -capital -products</td>
</tr>
<tr>
<td>Main competitive advantages</td>
<td>experience expertise &amp; human resources -MNE affiliation -quality of service</td>
<td>-sophisticated products and services -MNE affiliation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>-favoured access to inputs -experience, expertise &amp; human resources</td>
</tr>
<tr>
<td></td>
<td></td>
<td>-technology. -innovation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>-service delivery -technology -service quality -MNE affiliation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>-MNE affiliation -expertise -sophisticated products and services</td>
</tr>
<tr>
<td>O-advantage as a source of competitive advantage</td>
<td>-technology -management practices -Training -expertise -access to markets</td>
<td>-technology -training -access to markets -expertise -capital</td>
</tr>
<tr>
<td></td>
<td></td>
<td>-access to inputs -human resources and skills -technology</td>
</tr>
<tr>
<td></td>
<td></td>
<td>-innovation (both) -service delivery -products</td>
</tr>
<tr>
<td></td>
<td></td>
<td>-management practices Parent: -management practices Parent: -training -expertise -technol. -methods</td>
</tr>
<tr>
<td></td>
<td></td>
<td>-MNE affiliation -expertise</td>
</tr>
<tr>
<td>Case/ Variable</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>---------------</td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td><strong>LINKAGE FORMATION</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Indirect Competitive Linkages</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Competitive Position</strong></td>
<td>Major competitor in Chile</td>
<td>Major competitor internationally</td>
</tr>
<tr>
<td><strong>Competitive Environment/competitive changes</strong></td>
<td>Increase in competitiveness (Major influence)</td>
<td>Minor influence Niche market</td>
</tr>
<tr>
<td><strong>Competitive Environ./number of competito</strong></td>
<td>Increase in small and average sized competitor (economy)</td>
<td>No influence</td>
</tr>
<tr>
<td><strong>Inv. to access local Inn.</strong></td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td><strong>Direct Linkages:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Forward Linkages</strong></td>
<td>More than 10</td>
<td>More than 10</td>
</tr>
<tr>
<td><strong>Backward Linkages</strong></td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td><strong>Local sourcing</strong></td>
<td>Standard Rely on parent</td>
<td>Standard Rely on parent</td>
</tr>
<tr>
<td><strong>Assistance, Forward linkages</strong></td>
<td>-information about markets, suppliers, contacts -regulatory assistance -managerial assistance</td>
<td>-regulatory assistance -financial assistance -managerial/operational assistance</td>
</tr>
<tr>
<td><strong>Assistance, Backward Linkages</strong></td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>---------------------------------</td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td><strong>Assistance Social Responsibility</strong></td>
<td>- education assistance - research assistance</td>
<td>- seminars (expertise &amp; knowledge transfer) - entrepreneurship support</td>
</tr>
<tr>
<td><strong>Social Responsibility</strong></td>
<td>2 or less - lecturing - research</td>
<td>Two - seminars - contest</td>
</tr>
<tr>
<td><strong>Knowledge Agreement</strong></td>
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<td>None</td>
</tr>
<tr>
<td><strong>Collaborative Linkages</strong></td>
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<td>None</td>
</tr>
<tr>
<td>Purpose of Collaborative Agreement</td>
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### DETERMINANTS OF DIRECT LINKAGE FORMATION

<table>
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<tr>
<th>Case/ Variable</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
</tr>
</thead>
<tbody>
<tr>
<td>Backward linkages</td>
<td>No -Strategy</td>
<td>No -motive of investment -strategy</td>
<td>Yes, standard -economic environment -local firm capability</td>
<td>Yes -economic environment -local firm capability -strategy</td>
<td>Yes, MNEs -strategy -size of market -economic environment -main activity -local tech skills</td>
<td>No -global strategy</td>
<td>No -Local firm capability</td>
<td>Yes -Main activity -Strategy -Local firm capability</td>
</tr>
<tr>
<td>Forward linkages</td>
<td>Yes -main activity -economic environment</td>
<td>Yes -main activity</td>
<td>Yes -main activity</td>
<td>No -main activity</td>
<td>Yes -main Activity</td>
<td>Yes -main activity</td>
<td>Yes -Industry Policy</td>
<td>Yes -main activity -regulatory framework</td>
</tr>
<tr>
<td>Corporate social responsibility</td>
<td>Yes -economic environment</td>
<td>Yes -Regulatory framework</td>
<td>No -size of firm -strategy</td>
<td>Yes -economic environment -main activity -strategy</td>
<td>No -Strategy</td>
<td>Yes -global strategy</td>
<td>Yes -economic environment -strategy</td>
<td>Yes -strategy -economic environment</td>
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<tr>
<td>Collaborative agreements</td>
<td>No -economic environment -strategy</td>
<td>No -motive of invest -strategy</td>
<td>Yes -size of firm -local firm capability</td>
<td>Yes -firm size -industry policy</td>
<td>Yes -size of market -strategy</td>
<td>No -size of market</td>
<td>Yes -strategy -regulatory framework</td>
<td>Yes -local human capital -economic environment -regulatory framework</td>
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<tr>
<td><strong>DEGREE OF LINKAGE</strong></td>
<td>Moderate</td>
<td>Low to moderate</td>
<td>Moderate to High</td>
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<td>Moderate</td>
<td>Low to Moderate</td>
<td>High</td>
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### Appendix E  Case Firms’ Scores

#### Case firms’ score: Extent of linkages

<table>
<thead>
<tr>
<th>Case/Score</th>
<th>Forward Linkages</th>
<th>Backward Linkages</th>
<th>Social Responsibility Linkages</th>
<th>Collaborative Agreements</th>
<th>Local Sourcing</th>
<th>Total</th>
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<tbody>
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#### Case firms’ score: Quality of linkages

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<th>Social Responsibility Linkages</th>
<th>Collaborative Agreements</th>
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#### Case firms’ score: Degree of linkage

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*Backward Score = Backward extent score + Backward quality score + Local sourcing score

**Forward Score = Forward extent score + Forward quality score

***Social Responsibility Score = Social R. extent score + Social R. quality score

****Collaborative Agreements Score = Collaborative A. extent score + Collaborative A. quality score