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THE IMPACT OF FOREIGN DIRECT INVESTMENT ON LOCAL INDUSTRY IN CHILE

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RESUMEN

Por medio de transferencia tecnológica, externalidades (o spillovers) y vínculos con entidades locales las empresas multinacionales poseen el potencial de asistir en el desarrollo económico de las economías emergentes. Este artículo argumenta que filiales extranjeras operando en una economía emergente (Chile) mostrarán múltiples tipos de vínculos tales como vínculos competitivos y de colaboración con empresas locales. Las filiales extranjeras compensarán sus desventajas derivadas de su origen extranjero por medio del establecimiento de vínculos colaborativos, los cuales incrementan las ventajas provenientes de sus activos (ownership advantages) en términos de producción de productos y procesos que son socialmente responsables (Responsabilidad Social Empresarial, RSE). Para el análisis del grado de vinculación (Degree of Linkage, DOL) entre las filiales extranjeras y las empresas locales una muestra de empresas del sector servicios en Chile fue analizada utilizando técnicas de estudio de casos. Se encontró que las filiales extranjeras efectivamente establecen múltiples tipos de vínculos con otras empresas, y las filiales que han establecido un nivel de vínculos por sobre el promedio, en términos de cantidad y calidad, también han establecido vínculos de RSE por sobre el promedio. Se discuten las implicaciones de estos resultados en términos de políticas y para la teoría de negocios internacionales.

Palabras clave: *Multinacionales, rol de subsidiarias, desarrollo económico, análisis de estudio de casos, Chile, Responsabilidad Social Empresarial (RSE).*

ABSTRACT

Technology transfer, spillovers and linkages from MNEs to local industry may aid economic development in emerging economies. This paper argues that foreign affiliates in an emerging

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economy (Chile) will demonstrate multiple patterns of linkage formation which is a combination of competitive and collaborative linkages with local firms. Foreign affiliates will overcome their liability of foreignness (LOF) by engaging in collaborative relationships which augment their ownership advantages in terms of producing socially responsible products and processes (Corporate Social Responsibility, CSR). Using a sample of firms from the service sector in Chile case study techniques are employed within and across to analyse the degree of linkage (DOL) between foreign affiliates and local firms. Foreign affiliates do demonstrate multiple patterns of linkage formation and those firms with above average extent and quality of linkages are also likely to have above average scores for CSR linkages. The implications of these findings for policy and IB theory are discussed.

Key words: *MNEs, subsidiary roles, economic development, case study analysis, Chile, Corporate Social Responsibility (CSR).*

Clasificación JEL: F21; F23, F37; F47; M16

INTRODUCTION

Chile, along with a number of emerging (developing) countries in Latin America has recently begun to acknowledge the potentially positive impacts of FDI. This has not always been the case. During the immediate post war period, multinational enterprises (MNEs), principally from the United States investing in Latin America, displayed a voracious appetite for raw materials including copper, aluminum and oil to fuel the insatiable demand for US made goods. This rapid expansion created tension between multinationals who were bent on maximizing the well-being of their stakeholders without accepting direct responsibility for the consequences of its actions in individual national jurisdictions and the regimes of nation states which were built on the principle that people within national jurisdictions had to the right to maximize their well being (Vernon, 1998).

From 1960-1985 there was an unprecedented number of expropriations and nationalizations of MNE investment in developing countries (Kennedy, 1992). These countries believed that their resources were important elements of external forces that perpetuated structural dependency in developing countries (Cardoso & Enzo, 1979). Neo-Marxist theorists such as Jenkins (1984; 1987) viewed multinationals as the agents of external processes that produced under-development at the periphery, while Hymer (1972) argued that MNEs create a spatial division of labor across the globe that corresponds to the vertical division of labor within the MNE which he described as ‘uneven development’.

During the 1980s, the pendulum against FDI in developing economies swung in the opposite direction. Vernon (1998) ascribes this shift to the pressures from non-government agencies and the role of the UN agencies in demystifying the activities of MNEs as well as the increasing number of bilateral, regional and global negotiations to smooth the path for multinational investment. Since the 1980s, MNEs have been acknowledged as the principal bearers of technology, capital resources and management skills with countries offering ‘carrots’ to MNEs in the form of financial concessions such as preferential income tax, tax holidays, import exemptions and import duty refunds set against exports. These policies have demonstrated the persuasive power of MNEs to influence foreign governments to change their policies.

FDI typically comprises a bundle of assets, including capital, technology, human resources, and knowledge (Dunning, 1988) and the economies of scale and scope associated with multinational operations (Scott-Kennel, 2007). 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 (liabilities of foreignness or LOF, Oetzel & Doh, 2009) in a foreign location and has implications for the extent and pattern of local development in a host country. For emerging (developing) countries, like Chile, seeking to create location-advantages and extend existing assets, this bundle of resources offers potential for local spillovers of firm-specific advantages.

The unique characteristics of MNEs are crucial when analyzing 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. This phenomenon known as the degree of linkage (DOL) was first identified by Enderwick & Scott-Kennel (2004) and Scott-Kennel (2007). Measured on a continuum the DOL can be low, moderate or high. However, whether upgrading of local industry occurs does not only depend 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 developing countries since these countries usually have a very different structure from those who are capital exporters. They have, for example, less developed local capacities, which may lead to different effects.

The purpose of this paper is to determine how MNE activity (inward FDI) may influence the upgrading of local industry in Chile in a specific sector (services). To our knowledge this is the only study that has empirically examined the linkages between MNEs and local firms in the service sector context of an emerging (developing) country. This is the first intended contribution. The second contribution is to explore the nature of inward FDI and the nature of linkage formation in an emerging country context. The paper draws on empirical evidence through examining the activities of eight firms in the service sector.

The remainder of the paper is structured in the following way. Part one of the paper reviews the extant literature on linkages and spillovers from the perspectives of International Business (IB) and the welfare impact of FDI. Part two outlines the methodology and method used to analyze the case studies in this investigation. Part three outlines the results of the main findings and develops a conceptual model based on the findings. Implications for theory and policy and concluding remarks are offered in Part four.

LITERATURE REVIEW

Upgrading local firm competences – IB perspective

Dunning (1981, 1986) in his seminal articles on The Investment Development Path or Cycle (IDP) suggests that increasing inward foreign direct investment over time leads to the upgrading of the competitive advantages of domestic firms and these firms then become outward direct investors in their own right. The IDP framework offered a convincing explanation for the rise of developing country MNEs (DCMNEs) using a dynamic extension of Dunning's (1988) own OLI framework. MNEs transfer their ownership (O) specific advantages using the mechanism of internalization (I) advantages. I-specific advantages refer to the creation of an internal market in goods and services (intra firm transfers of intangible assets) which gave MNEs competitive advantages vis-à-vis local firms. The location or L-specific advantages are where MNEs chose to locate their O-I advantages either to access resources, labor or acquire strategic assets (depending on their motivation).

The IDP framework hypothesized that domestic firms in some way would benefit from the transfer of O advantages. However, since the IDP framework used macro economic data to explain what was essentially a micro economic activity (upgrading of local firms' competitive advantages) a credible explanation for how this occurred was missing. The IDP laid the groundwork for understanding that there needed to be necessary conditions in place before skills and technology transfer were possible. The IDP identified the different stages at which the country would be more or less attractive to FDI, ranging from Stage 1 (unattractive to FDI) to Stage 5, where FDI between host and home countries would be in equilibrium as both countries were investing/ acquiring strategic assets in each others' industries (Dunning & Narula, 1996). The IDP posits that changes to the economic structure of a country are the result of the interplay between FDI induced changes and non-FDI induced changes such as policy orientation (Dunning & Narula, 1996). Policy orientations may shift over time from Inward-Looking, Import Substituting (IL/ IS) to Outward-Looking, Export Oriented (OL/EO) or some hybrid of the two (Ozawa, 1992).

Our understanding of the linkages that may occur between MNEs and local firms has been developed by more recent work on the impact of FDI at the micro level of the firm (Scott-Kennel, 2007; Scott-Kennel & Enderwick, 2004). 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.

Indirect effects take place via linkages between the foreign affiliate and local firms. These indirect effects can be broken down into forward linkages (between MNE affiliates and local firms as customers) and backward linkages. In backward or so-called vertical linkages the MNE affiliate uses local supply industries. Local supply industries will be encouraged to upgrade their competences to meet the standards required by the affiliate and may even receive technology support to do so. There is strong evidence in the IB literature that when this knowledge is diffused to local firms, it enhances the capabilities of endogenous firms (Giroud, 2003; Hoekman & Javorcik Smarzynska, 2006; Lall & Narula, 2004).

Expanding the nature and quality of the linkages in the same way that Dunning (1995) re-conceptualized the OLI paradigm to incorporate strategic alliances as a form of quasi-internalization, led Scott-Kennel & Enderwick (2004) and Scott-Kennel (2007) to conclude that external network relationships are formed at the subsidiary level via quasi-internalization. Firm specific advantages and resources between the subsidiary and local customers, suppliers and alliance partners are transferred via this mechanism which is neither pure market (arms lengths relationships) nor hierarchical forms of internalization, where the MNE was viewed as a singular corporate hierarchy. Furthermore, Scott-Kennel & Enderwick (2004) found that contrary to the traditional FDI literature which states that FDI is driven by the full-internalization of ownership specific advantages in foreign locations, MNEs also engage in quasi-internalization through their non-equity, external network and alliance-based linkages with local firms. These studies provided the initial impetus for the research outlined in this paper. Our first research proposition then is to test for the presence of multiple linkage patterns in the context of a developing country. Thus:

*Research Proposition 1.*Foreign affiliates in an emerging (developing) country will demonstrate multiple patterns of linkage formation which is a combination of competitive and collaborative linkages with host country firms.

WELFARE IMPLICATIONS OF FDI

As Oetzel & Doh (2009) point out the IB (or International Management, IM) literature has largely ignored the 'Third World'. Much of the IM research over the last few decades has focused on countries in the Triad such as the United States, Western Europe and Japan rather than emerging markets and developing countries. Cooke (2004) goes so far as to say that the economic efficiency goals adopted by the World Trade Organization (WTO) and promoted for the developing world, advance the MNE expansion and profit motives rather than economic development. Ghauri & Yamin (2009) suggest that the issues around the impact of MNE activities on economic development are taking a more central position in IB scholarship – moving away from the firm as the sole unit of analysis. Buckley & Ghauri, (2004) and Ghauri & Buckley (2006) also suggest that reframing the role of MNEs in developing countries requires an acknowledgement of the foreign character of the MNE (LOF) and the need for a more direct contribution to economic development by engaging with locally based organizations such as non-government organizations or NGOs.

Oetzel & Doh (2009) note the rapid rise of the NGO sector in both developing and developed economies. By 1995 it had been estimated that 15 per cent of total overseas development aid was channeled through NGO's. Teegan, Doh & Vachani (2004) suggest that the activism of NGOs has broad implications for the international business field and the alliance literature with its emphasis on exchanges between private firms must be re-specified to include nonprofit NGOs.

Following Khanna & Palepu (1997) Oetzel & Doh (2009) argue that MNEs need to work actively to build local capacity through partnerships with NGOs not only as a means of bypassing corrupt or inefficient existing institutions and organizations in the country but also use these partnerships to learn more about the genuine needs of the country, to contribute to social development needs and to confer legitimacy on the MNE. We refer to it in this study as Corporate Social Responsibility (CSR). In this manner a partnership between NGOs and MNEs has the same synergistic ability to combine and synthesize resources in the way that strategic alliances between private firms can generate innovative responses to rapidly evolving environments (Kogut & Zander, 1992).

This conceptualization of a NGO-MNE partnering is not merely altruistic in orientation. As Oetzel & Doh (2009) point out foreign firms need to be aware of the benefits that social legitimacy through local stakeholder involvement can confer. Moreover even though the policy climate towards FDI has become arguably less hostile than in the 1970s, policy changes are not irreversible.

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 in an emerging economy. Beyond philanthropic modes of CSR, the change in the conceptualization of CSR (the way in which the firms does 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 need further improvement (such as housing, education, and health)– 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. This gives rise to our second research proposition:

Research Proposition 2. MNEs in an emerging (developing) country context will engage in CSR (NGO partnerships) to learn more about the genuine needs of the country, to contribute to social development needs and to confer legitimacy on their activities.

RESEARCH CONTEXT

New Zealand (the research context of the country which inspired this present study) and Chile share some apparent similarities but have some significant differences. First, both economies are heavily dependent (and competitive) in the primary processing industry sector (such as wine, dairy and kiwifruit). Second, both economies are highly reliant on a high level of FDI for capitalization to upgrade their knowledge based assets.

However, there are significant differences in terms of size, level of development and policy orientation. New Zealand is a small (4.2 million, 2008) open, advanced economy although on the lower quartile of developed economies as determined by its income per capita. Chile is four times larger than New Zealand in terms of population and is classified, in terms of income per capita as an emerging or developing economy (IMF 2010). Both countries have an open orientation to FDI.[1] They both share the characteristics of having been import substituting, inward looking economies during the 1950s and both countries have shifted towards a more liberal orientation towards FDI since the 1980s. (A fuller explanation of the shift in policy orientation in the case of New Zealand can be found in Akoorie (1996; 1998). However the differences in orientation in the case of Chile warrant a fuller explanation.

Chile: a neo-liberal or neo structuralist economy?

Chile has experienced several changes to its economic system. 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 larger steps forward since the country's return to democracy in 1990 intensifying a free-trade, export-oriented model.

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 in creating a fairer society in which all citizens enjoy the benefits of economic development.

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 Rodrik (2004) states

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1 Approval from the Overseas Investment Office of New Zealand is required in the case of investors intending to buy sensitive land or an interest in sensitive land (e.g. by buying shares in a company that owns sensitive land), or business assets worth more than $100 million, or fishing quota or an interest in fishing quota. It is not possible for overseas investors to purchase shares in the dairy industry. The unique structure of cooperatives in New Zealand means that only farmers have voting rights in the cooperative which are tied to their milk production. The purchase of dairy land by overseas investors would be classified as an interest in sensitive land.

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).[2]

Regulations for FDI in Chile are 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 overtime. In addition, it has been officially stated that the DL 600 is non-discriminatory in nature. 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 XIX was created as one of the solutions to the 1980s debt crisis, and as a way to increase inflows of FDI. 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 programme was promoted widely abroad, and this 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 such as investors from Holland and New Zealand (Behrens, 1992). 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.

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. Table 1 shows the extent of FDI by Inflow Mechanism as a percentage of the total inflows:

Table 1. Foreign Direct Investment by Inflow Mechanism (% of total)

Investment Mechanism	1974-2008	2005	2006	2007	2008
Foreign Investment Statute (D.L. 600)	67.3	45.8	53.5	18.3	43.1
D.L. 600 Equity	51.9	41.9	34.8	17.4	37.8
D.L. 600 Associated Loans	15.4	3.9	18.7	0.9	5.3
Chapter XIV (CFER)	29.9	54.2	46.5	81.7	56.9
Chapter XIV Equity	23.6	31.0	41.5	76.7	47.1
Chapter XIV Associated Loans	5.6	15.2	5.0	5.0	9.8
Chapter XIX (CFER)	3.5	0	0	0	0
Total	100	100	100	100	100

Source: Foreign Investment Committee, Chile (CINVER) (2009)

The FDI figures for Chile need to be interpreted with care since 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 only provided by the Foreign Investment Committee.

2 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).

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.

RESEARCH QUESTIONS AND METHODOLOGY

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 L-specific advantages of the local economy, and the way the foreign affiliate organizes and uses its O-advantages in the host economy (I-advantages). Scott-Kennel's (2007; 2001) model refers to this interaction. However, Scott-Kennel's (2007, 2001) model is based on the New Zealand context, which is different from the Chilean context in terms of government policy and economic environment. 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 (2001) 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 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.

The research questions put forward in this study have never been assessed in the Chilean literature thus no data exists to help answer them. As a result, it was necessary to collect primary data. Initially, the intention was to use a quantitative approach since the research is based on Scott-Kennel's (2001) study, which used postal surveys. Nevertheless, 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 and to collect qualitative data.

In order to find out the reason(s) for this low response it was decided to contact some of the firms by telephone 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. Of these, 10 some had changed their telephone number, others no longer existed, and a few did not answer. Those that were able to be contacted indicated that they had forgotten about the invitation or that they had been too busy.

This situation provides evidence that the main reason for the low response is a cultural issue (Harari & 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. 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 will inevitably prove to be unsuccessful. 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.

As Marschan-Piekkari & Welch, (2004) point out 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.

The purpose of the study remained unchanged despite the radical change in methodology. The selection of a qualitative approach was based on the aim of this study, 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.

A multiple-case study design was selected to strengthen and potentially expand the analytic generalizations of the study (Yin, 1994). 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, 1994).

The unit of analysis of this study was the head offices of firms operating in Chile that are 25 percent or more foreign owned. In addition to being appropriate to the research focus, the foreign affiliates and their relationships with other locally-based entities are the units of analysis identified in Scott-Kennel's (2001) study thus their use in this study will facilitate comparisons (Yin, 1994).

Considering the objectives of the study and the diversity of the sample frame (significantly foreign-owned firms), we 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*). During the period 1996-2001 FDI in the services sector, accounted for 26 per cent of GDP. Table 2 summarizes the case selection criteria followed in this study.

The selection procedure provided a group of eight 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 services sector suggested that there may be a similarity of practices among them, a possibility that enhanced the concept of theoretical replication.

Table 2. Case Selection Criteria

Firm Criteria	Measure	Rationale
Belongs to either mining, service or electricity, gas and water industries	Main activity	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.
Foreign ownership	25% or more of the voting shares or control of the firm is held by non-Chilean residents.	Confirms fit with the context of the research.
Location	Head office located in Santiago de Chile	Most headquarters are established in Santiago de Chile

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 findings. For the investigation, personal interviews were conducted with appropriate top-level managers. With regard to documentary information, it was obtained from a variety of documents.

A mixture of strategies was used for the analysis of data, namely: case comparison based on pattern seeking, clustering, and matrices. 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. 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.

For this research, to enhance the potential for validity and reliability, triangulation was used at every stage of the process, from research design to writing up of findings. Specifically, this research project was triangulated by: (a) using 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), (b) analytical triangulation - by using dissimilar analytical methods (analysis) and (c) among different evaluators – reporting back to the research "stakeholders" (case firms) to ensure "peer" review and reliability.

ANALYSIS OF THE RESULTS

As an initial step a within case analysis was conducted on all eight cases. The semi-structured interview technique developed an affiliate profile for each case, then determined the type of linkage formation, from direct linkages (backward linkages and local sourcing), to forward linkages. The interview protocol also asked firms about the projects they had been involved (corporate social responsibility, CSR). This equates to the social and economic developmental impact of their investments. Finally, the interviewees were asked whether or not they had established collaborative linkages and what the determinants of their linkages were. The interviews and notes were transcribed and translated from Spanish to English. The within case analysis included direct quotes from the interviewees. The data from the within case analyses was compressed and entered into a meta-matrix. 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.

To get a better understanding across cases, we identified groups of like cases within the sample frame. As a result, the analysis process was condensed from one of looking over eight cases to one of looking across three groups of cases. 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, 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).

The overall DOL of each affiliate was estimated by adding the scores of the affiliate for each type of linkage. Each type of linkage was assigned a score based on a single variable, or set of variables that together 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 was the 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.

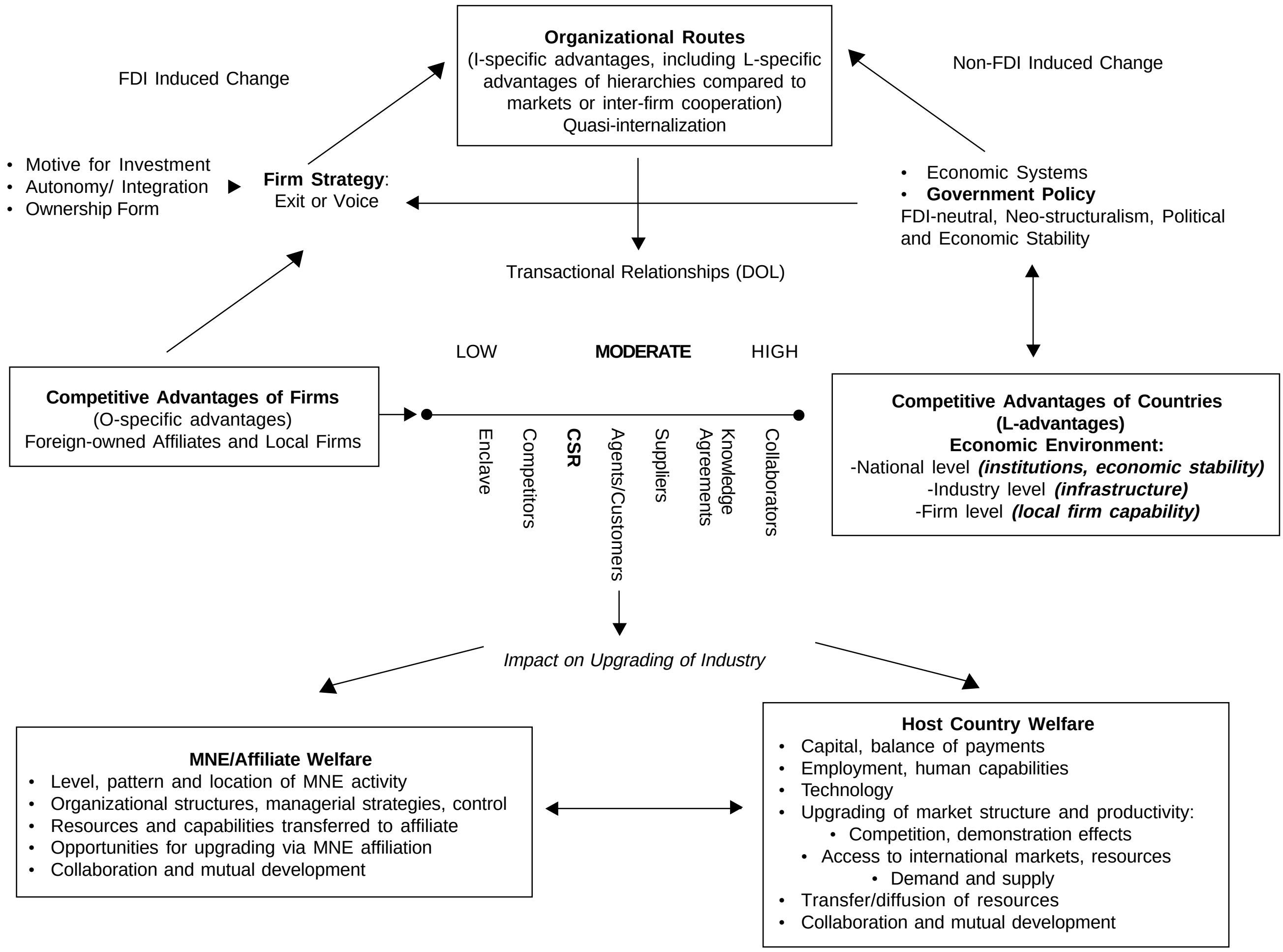
The extent score is a result of adding all the scores based on the number of relationships with clients and suppliers, number of CSR projects, number of collaborative agreements, and the type of product/services sourced locally. Group 1 cases (three) were those that had a below average degree of indirect competitive linkages and direct linkages. Their degree of linkage was assessed as being moderate. Group 2 firms (two) had above average quality linkages but below average extent of linkages. Their DOL was assessed as being moderate to high. The final group (Group 3) comprised three firms that had above average extent and quality of linkages; their degree of linkage was assessed as being high.

Table 3. Below shows the degree of linkage and the group characteristics.

Degree of Linkage Groups and Group Characteristics			
Group/ Variable	**Group 1**	**Group 2**	**Group 3**
DOL	Moderate	Moderate-High	High
Competitive Linkages	Minor to moderate influence on competitiveness	Major influence on competitiveness	Major influence on competitiveness
Types of Direct Linkages Established	Forward and CSR linkages	Forward and backward linkages and Collaborative agreements	Backward and/or forward and CSR linkages, and Collaborative agreements
Main Activity	Corporate financial services and legal services	Financial information services and consulting services in the oil and gas sector	Electricity and water services and consulting services
Country of origin	USA and Europe	Canada and UK	Spain
Age (as a foreign affiliate) **Ownership form**	Above 10 years	Mixed	Below or equal to 10 years
	Chilean branch	Mixed	Chilean firm owned by foreigners
Autonomy	Parent firm major-total influence on decision-making	Parent firm moderate-major influence on decision-making	Parent firm minor-moderate influence on decision-making
Size of firm	SME locally	SME locally	Big locally
Role of Affiliate	Highly integrated in global network	Mixed	Complex-Integration
Source of key resources and innovations	Only Parent firm	Mainly Parent firm	Both affiliate and parent firm
Competitive Position locally	Mainly small competitors	Major competitors	Major competitors

Finally, a schema was developed to provide a framework for the study by illustrating the relationship between the MNE, the host country and economic welfare. This schema provides insights into the process of local upgrading in the context of an emerging (developing) economy.(Figure 1).

Figure 1. Schema for Analyzing the Role of MNEs in Host Country Industry in the Context of Developing Countries



SUMMARY OF FINDINGS

The purpose of this paper was to assess the impact of FDI by considering specific impacts at a firm-level. It focused on identifying the organizational routes taken by foreign affiliates (linkages) that might induce local industry upgrading. The study provided significant evidence that alternative organizational routes (to markets or hierarchies) that involve quasi-internalization of O-specific advantages by the MNE are employed as a complementary strategy to FDI.

The implications of flexible organizational 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 internalization 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.

This study contributed further to the understanding of quasi-internalization since the assessment of linkages was not limited to local sourcing, or to assistance linkages with local agents and/or clients. Instead, the study identified a much fuller range of both indirect and direct linkages, including collaborative linkages.

The study also distinguishes 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 mainly benefit 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.

CORPORATE SOCIAL RESPONSIBILITY LINKAGES

This study also identified 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. The results showed that over half of 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.

The results showed 10 specific types of assistance from which financial support was the most 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 undergone by case firms fall under the community involvement category mostly by providing financial support to local philanthropic projects. Chapple & Moon (2005) and Fortanier & Kolk (2007) also found that community involvement is the most predominant form of CSR. However, several affiliates engaged in partnerships, sponsored relationships, adopted CSR codes, and encouraged employee volunteering. The case firms build their CSR into mainstream activities; becoming less philanthropic and placing more emphasis on 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.

CONCLUSIONS

In this concluding section we discuss the main findings of the research in relation to the central propositions of the study. We then offer some thoughts about the implications for theory from our research and conclude with some indicators for policy.

Turning to the central propositions which guided this study our findings are as follows. We find strong support for research proposition 1, which stated that foreign affiliates in an emerging (developing) country will demonstrate multiple patterns of linkage formation which is a combination of competitive and collaborative linkages with host country firms.

The study contributes 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 paper makes a contribution to the understanding of indirect effects on local industry, especially in the service sector. 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.

As to our second proposition, that MNEs in an emerging (developing) country context will engage in CSR (NGO partnerships) to learn more about the genuine needs of the country, to contribute to social development needs and to confer legitimacy on their activities. We found partial support for this proposition as over half of the sample firms were engaged in forming CSR linkages with local entities. However, the extent and quality of these linkages vary among affiliates. Firms in the classification Group 3 (with above average extent and quality of linkages) also presented above average scores for both extent and quality of CSR linkages.

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 programs, financial assistance, procurement of equipment and infrastructure, 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.

IMPLICATIONS FOR THEORY

The study also makes a contribution to theory in terms of identifying the factors that influence the organizational 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 labor productivity.

The findings suggested that the level of autonomy and ownership form were significantly related to the strategy of the affiliate. That is, the study contributed to the body of existing knowledge by emphasizing the influence of MNEs' strategy on the organizational 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.

IMPLICATIONS FOR POLICY

Chile provides a very interesting context for the study because of its "neo-structuralism" approach towards economic development. We offer three policy implications based on our findings. Firstly, the findings suggested that specific aspects of FDI policy in Chile 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.

Second, 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.

Third, there may be an argument for government-funded initiatives to encourage linkage formation. While *Corporacion de Fomento de la Producción (CORFO)* 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.

Finally, the government should look at education policy since it contributes to 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 is particularly important since 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).

In conclusion, this study provides an in depth analysis of the way in which foreign firms in a specific industry sector (services) establish linkages with local firms. Further research using similar techniques could be replicated across other industry sectors either in Chile or in other emerging (developing) economies. The path taken by this research suggests that caution needs to be used in attempting to replicate survey method techniques (widely used in developed countries) in economies where there is little understanding or appreciation for this approach and where the main elements for establishing a research relationship are based on trust rather than objectivity.

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