

Exploring the Link between Foreign Direct Investment, Multinational Enterprises and Spillover Effects in Developing Economies

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Abstract

Multinational enterprises exist because they hold certain competitive advantages over their local counterparts and affect local economies through their spillover effects. Research streams exploring the raison d'etre and consequences of MNEs are quite distant and remote. This paper analyzes and integrates these two streams of literature, i.e. the competitive advantages that MNEs hold and their spillover effects in developing countries. The paper proposes a relationship and predicts the nature of spillover effects on the basis of competitive advantages of MNEs. This paper can guide the policymakers of developing countries to differentiate between the FDI that is good for their countries and FDI that weakens the already fragile economies of developing countries. The paper also opens a new avenue for the researchers by pointing towards a potential connection between MNEs' competitive advantages and their spillover effects for the local economies. The relationship between FDI and competitive advantages of MNEs has rarely been researched previously and thus this paper contributes significantly to the existing literature.

Keywords: Foreign Direct Investment (FDI), Multinational Enterprises (MNEs), Developing economies, Competitive advantages, Spillover effects

1. Introduction

FDI is the largest single source of external finance for the developing countries and almost equals half of the total capital flows to the developing countries (Aitken & Harrison, 1999). Foreign direct investment (FDI) is prized by most of the developing countries and many countries put intentional efforts to attract FDI (Agosin &

Machado, 2005). It is generally believed by these countries that FDI is inherently good for their economies and it brings valuable assets, both tangible and intangible for them (Kosova, 2010; Backer & Sleuwaegen, 2003; Aleksynska et al., 2003). Jakobsen and Jakobsen (2011) found that FDI is welcomed in developing countries, except for the countries with high economic nationalism, whereas Buthe & Milner (2008) found that all countries that are members of trade agreements such as GATT (General Agreement on Tariffs and Trade) and WTO (World Trade Organization) receive more FDI than the non members. FDI is not only considered as a healthy sign for the over all national economy but also a positive indication for the local industry considering its positive spillover effects. The proposed positive effects of FDI have generated a lot of research interest in studying the determinants of FDI into a country, so that it can be enhanced (Adams, 2010; Kok & Ersoy, 2009; Kinda, 2010; Majeed & Ahmad, 2009).

In this paper we suggest that the actual picture of FDI and its benefits is not that simple. The effects of FDI are not always positive and it is difficult to predict with certainty about the spillover effects of FDI in advance. Recent trends such as sharp increase in the FDI flows in emerging economies from other emerging economies (Gammeltoft, Pradhan & Goldstein, 2010) and even differences in MNEs coming from a single country such as state and private MNEs (Lin, 2010) has made the picture more complex. Though the spillover effects of FDI has gained a lot of research interest, little research efforts have been diverted towards studying the negative effects of FDI. There are few researchers who have worked in this direction and there are limited examples of the negative spillover effects of FDI. Wells (1998, p 102) noticed, "Some FDI is good, almost certainly some is harmful. But exactly what kind of investment falls in each category is frightfully difficult to determine, even if the effects are measured against only economic criteria". Similarly, Caves (1996, p 237) suggested that "...relationship between a less developed country's stock of foreign investment and its subsequent economic growth is a matter on which we totally lack trustworthy conclusions".

Driffield & Hughes (2003) in their study, conducted in different parts of the United Kingdom, shared an interesting finding. They reported that the regions that suffered greatest from the negative effects of FDI are the ones which spent large amounts of public money and policy efforts on attracting FDI as part of their regional development policy. Yamin & Sinkovics (2009) reported that the data on FDI flows and its effects provide clear indications that large investments by MNEs into Less Developed Countries (LDCs) have "typically resulted in extremely shallow levels and types of investment in these countries with low or absent potential for positive spillovers" (p 4). In a recent study of 42 developed and developing countries, Dimelis and Papaioannou (2009) found that the effects of FDI were positive and significant for developed countries, whereas these were positive but insignificant for developing countries.

Another well researched stream in international economic literature is the study of the reasons or the firm specific advantages that enable MNEs to compete with the local firms despite the cost of foreignness (Dunning, 1993; Kosova, 2010). However, it is surprising, if not disappointing that the research on the reasons of FDI is so remote from its consequences. The relationship between reasons and spillover effects of FDI is largely a neglected research area. This neglect is one reason that the research to explore the spillover effects in developing countries has yielded mixed, non conclusive or even conflicting findings. Though many studies have tried to link mode of entry with the spill over effects (i.e. Balsvik, 2006) but little attention is given to the competitive advantages of MNE to explain the spillover effects. This neglect is surprising as the mode of entry itself depends upon the competitive and company specific advantages of MNE.

In this paper we suggest that there is a strong link between the core competitive advantages of MNEs that enable them to invest in other countries and the extent and type of spillover effects that arise as the result of this FDI. Hence, in this paper we review the literature regarding both research streams. First we review the literature regarding the competitive advantages of MNEs that enable them to compete in foreign markets with the local firms, despite the cost of foreignness. Then we briefly explore the negative spillover effects of MNE in the developing countries. In the third part of this paper we link these two streams suggesting that the spillover effects depends to a large extent on the competitive advantages that the foreign firms hold over their local competitors. The policy and research implications are discussed in the end.

2. Competitive Advantages of MNEs

One of the most discussed and well researched model that indicates towards the competitive advantage of MNEs is given by Dunning (1993). This famous framework has become known as the OLI-framework, which suggests that there should be three conditions in order for a company to invest in a foreign country. These three conditions (or advantages) are Ownership, Location and Internalization. The ownership advantage means that the firm possesses the ownership of a product, process or some knowledge that other firms do not have. The location

advantage represents that there are some advantages (such as low labor or raw material cost) associated with the foreign country and thus it is cheaper to manufacture in that country instead of producing the product in homeland and then exporting to the foreign country. The internalization condition suggests that the first two advantages can more effectively and efficiently be obtained while carrying out the operations within the firm as a subsidiary instead of some market arrangements such as exporting, licensing or franchising.

Kosova (2010) points towards several competitive advantages of MNEs such as operating at lower costs, better management and technology, early entry advantages, economies of scale, favorable public policies and a superior product. Here, we will discuss some of the competitive advantages that MNEs hold and which determines the nature and magnitude of spill over effects.

2.1 Technical capability, Productivity & R&D

Better technology and high productivity is one of the core advantages that many MNEs possess. Backer & Sleuwaegen (2001), in a comparison of domestic firms and MNEs in Belgium concluded that the foreign firms in Belgium are on an average 38% more productive than the average Belgian owned firms. They also noticed that the level of inefficiency in some domestic firms is almost double than that in foreign firms. Zhou et al. (2002), in a study of foreign and domestic firms in China concluded that the productivity of foreign firms is significantly higher than domestic firms, even after controlling for regional, industry and firm level factors. Aitken & Harrison (1999) and Sasidharan (2006) found similar results for Indian manufacturing firms. Balsvik (2006) in his study on Norwegian firms found that for all the years from 1980 to 2000, the average size of MNEs and their labor efficiency is larger than the domestic firms. Kwon (2010) concluded that the MNEs with superior technology and market orientation perform better than their counterparts.

2.2 Management practices / Strategic decision making

It is generally accepted that owing to their long history of learning, international experience and knowledge accumulation, MNEs have developed better management skills (Agosin & Machado, 2005; Zhou et al., 2002; Kathuria, 1998) and ability to take long term strategic decisions (Rui & Yip, 2008). In some cases, these serve as the core advantage of MNEs. Balsvik (2006) suggests that foreign owners do not acquire highly productive domestic plants as their acquisition can be costly. In turn MNEs prefer to acquire domestic plants of average performance and then convert these into highly successful plants. Balsvik (2006) also showed that in the two years prior to a foreign takeover, the domestic plants concerned have on an average negative productivity growth. Hence MNEs can acquire these plants at less than their actual value. Mata & Portugal (2004) also shares similar findings that MNEs acquire domestic firms at less than their actual value. Parthasarathy & Aoyama (2006) suggested that MNEs normally target the niche markets leaving the low cost low margin markets for the domestic firms. Kathuria (1998), Aitken & Harrison (1999), Zhou et al. (2002), Agosin & Machado (2005) and Kosova (2010) also attributes success of MNEs to their better managerial practices.

Zhou et al. (2002) suggests that the senior management of MNEs firms often designs aggressive strategies to secure their market shares. These aggressive strategies lead to fierce price competition. As the pockets of domestic firms are usually shallow than MNEs, the price wars normally go against the domestic firms.

2.3 Product and their brand image / marketing

Kosova (2010) suggests that in most of the developing countries, MNEs have got two advantages. First they have better and more known brands and they spent a lot to advertise them. Secondly, the psyche of many people in developing countries is that they feel their life style to be improved if they use the branded products of MNEs. Kosova (2010) also suggests that one of the competitive advantages of MNEs over their domestic rivals is their superior product. He further suggests that the superiority may just be due to the reputation for quality.

Agosin & Machado (2005) suggest that the products of MNEs are better not only because of their superior design and quality characteristics but also due to their brand names. Zhou et al. (2002) suggest that to produce superior products, superior technology is an essential requirement and note that many of the new products and inventions have been carried out by MNEs. Aitken & Harrison (1999) also shares similar views.

2.4 Attracting best talents

It is well established in research that MNEs pays higher wages to its employees, compared to the local firms. Zhou et al. (2002) found that in China the wage gap between foreign and local firms ranges from 50% to 1000%. Attracting the best available talent is associated with most of the MNEs.

Kosova (2010) suggests that when MNEs enter a country normally the wage rates go up. This is due to the fact that MNE pays higher wages to its employees and local firms have to raise their wages to retain their talented

employees. Tomohara and Takii (2011) also found that the wages of local establishments rose after FDI flow into a country. MNEs are more automated and despite of high wages, their labor efficiency in dollar terms is higher than locals. Local firms are also more labor intensive and thus these are hit more severely by the increased wages.

Working for MNEs is a pride in many developing countries. Further, working for MNEs means more international exposure and better training and learning abilities. Hence, even if the MNEs pay similar wages as their domestic rivals do, they still attract the best talent in a developing country and attracting the best talent becomes their competitive advantage. Driffield & Hughes (2003) agree that MNEs pay higher wages to attract the best talent in developing countries and the domestic firms due to their financial constraints can not match the wages. The fact that domestic firms are more labor intensive due to less atomization and normally are less labor efficient, severs this problem for domestic firms.

2.5 International networking and State support

One of the core advantages of MNEs is their international linkages. It is much easier for MNEs than the local firms to relocate their suppliers and to take the advantages of differences in input and output markets in different countries (Porter, 1985). Due to their international linkages, specially with the parent MNEs, the foreign companies has to spent less than local firms on building capabilities such as R&D and on expenses such as advertisement.

Coucke (2005) suggests that MNEs can use global sourcing as a competitive advantage and as a strategic instrument against the local firms without international linkage. Agosin & Machado (2005) and Aitken & Harrison (1999) share similar findings. Another advantage of international linkages is that due to its secure supplies, the MNEs have not to face the adverse effects of slipping economies in the host countries. Advantages of having a link with stable economies, such as access to capital at lower debt rates, give a competitive advantage to MNEs over the local firms.

Support from the home government is another advantage that most of MNEs enjoy. In absence of other advantages (such as superior technology and products), this support becomes very crucial. Fornes and Butt-Philip (2011) consider the support from the government as one of the most important reasons of Chinese firms' FDI in Latin American countries.

3. Effects of FDI on Developing Countries

The research to explore the spillover effects of FDI on developing countries is limited in many ways. There are several factors - other than FDI – that are responsible for positive effects in the economies of developing countries, however, these are frequently taken as indication of positive spillover effects of FDI. We will discuss some of these here.

3.1 Measuring Spillover Effect

Goldberg (2007) suggests that many researchers assume that since the industries with high FDI concentration are more productive, the high productivity is due to the MNE presence. However it is quite possible that those industries were more productive even before the arrival of MNE and actually MNE selected those industries due to their high productivity. Cross sectional studies can not deal with such reverse causation problems that FDI leads growth or follows it. As an example the rise of Indian software industry is frequently associated with FDI coming from North America, however, Parthasarathy & Aoyama (2006) attribute the rise of the Indian software industry to the diaspora effect and not to the FDI. They suggest that FDI actually comes to Indian software industry when the initial development and growth has already taken place. They propose that the return of Indians from USA made a wide range of skills including managerial skills and international marketing and networking locally available which initiated the boom in Indian software industry.

Another issue in estimating the spillover effects has been pointed out by Kosova (2010). He notes that researchers normally assume that in the developing country there are several of local firms and only one MNE. This assumption is over simplistic and can affect the research findings. Vertical linkages with suppliers and customers are considered as the most effective channel of positive spill over effects to the host economy, but what if the up and down stream companies are themselves MNE! In this case the positive spillover to host country will be greatly reduced. Kosova (2010) further suggested that measuring spillovers by estimating productivity enhancement is not a good idea, as measuring the productivity at the firm level is not easy from distance while using the industry level data. Hence all the studies that operationalize spillover effects in term of productivity increase of the local firms suffer with this issue. Kosova (2010) thus suggests that growth is not a good criterion to evaluate the effects of FDI. In a highly growing industry, the local firms will grow even if the

presence of MNEs has negative effects for them. Relative growth rates or changes in market share and profitability can be better indicators of firm's performance.

Kosova (2010) raised another interesting issue in measuring the spillover effects. In many studies, the number of firms at the start of study is different from the number when the study is concluded, as during the study time many firms exit from the industry. With the exit of each firm, some data is lost. For example, if there were hundred firms at the start when MNE arrives and after one year only ninety have survived, the firms that exited were most probably the least productive ones. Hence exit of these firms in itself will raise the average productivity of the remaining 90 firms without any positive spillover effect. A final issue in estimating the spillover effect comes from the criteria that how the firms are termed as local and foreign (Kosova, 2010). Sometimes the foreign investment in a firm is less than fifty percent. If such firms are considered as local, the improvement and growth of these firms will indicate that the local firms are growing. However it is quite possible that the 100% locally owned firms are forced to exit or are struggling. This phenomenon would be important if the size of Joint Venture firms is very large and the size of 100% locally owned firms is smaller. In this case, the weighted figures (for size) will show a net improvement in local firms. Employing cross sectional or panel data also impact s the research findings. Sasidharan (2006) in his research on Indian manufacturing industry concluded that no significant upstream spillovers were present and those domestic firms supplying to MNEs were not able to reap any productivity improvements. Similarly after the literature review, Meyer (2003) has reported 39 studies out of which 23 used panel and 16 used cross sectional data. 13 out of 16 studies that have used cross sectional data showed positive and significant results, whereas only 6 out of 23 studies employing panel data reported positive and significant spillovers. It clearly shows the bias of cross sectional data towards showing positive spillover effects.

Due to these issues, we find a lot of evidence for positive spillover in research and very few findings pointing out towards negative effects. However, the negative effects of FDI on developing countries can be classified in two groups. First are the effects on the local firms such as crowding out and reduction in new investments. Second are the effects on the national economies such as a negative impact on the balance of payments and trade deficit. In the coming lines, we will briefly discuss about both these effects as there is only scarce literature pointing out towards the negative spillovers of FDI.

3.2 Effects of FDI on local firms

One of the negative spillover effects of MNEs to the host economy that is well discussed in literature is crowding out of local firms (Kosova, 2010; Backer & Sleuwaegen, 2003; Mata & Portugal, 2004; Coucke, 2005). Some researchers suggest that crowding out is only a short term phenomenon and in the long run FDI actually increases the domestic growth rate (Backer & Sleuwaegen, 2003; Aleksynska et al., 2003). Kosova (2010) proposes that probably foreign firms filter out the domestic firms and force the less productive ones to exit. This increased exit rate is then followed by a period of fewer exits as most of the remaining firms are productive and can survive for longer period. Other researchers suggest that crowding out is not a short term phenomenon and its effects on host economy, even in the long run are negative (Mata & Portugal, 2004; Coucke, 2005; Driffield & Hughes, 2003; Balsvik, 2006). Then there are some studies which suggest that the crowding out effect, similar to other spillover effects depends upon multiple variables and hence varies from case to case (Agosin & Machado, 2005; Driffield & Love, 2007; Ghemawat & Nalebuff, 1985).

Meyer (2003) suggests that the nature of linkages define the type of spillover effects. If the MNEs tries to develop local suppliers for the raw material requirements, there is positive inter industry spillover effects. If the supply relations are switched to global suppliers, there would be no or negative spillover effects. With the increased globalization and reduction of trade barriers, the dependence of MNEs on global supplies will increase and hence the positive spillover to local firms and economy will decrease. Zhou et al. (2002) concludes that the productivity of local firms is negatively affected as the share and history of FDI (in the same industry as of the local firms) increases. Hence in the industries where more FDI comes and the industries where the FDI comes earlier, the productivity of local firms is at minimum level.

Lall (2002) indicates the possibility that a MNE after acquiring a local technological leader strip some of the 'un required' assets such as R&D. This is one major reason that many developed countries try to prevent the take over of their national champions and hence preserve local source of innovation and research linkages. Kosova (2010) pointed out towards the possibility of the MNEs to sell their products at less than their cost to get the market share required to operate at higher economies of scale and to crowd out their local rivals. Afterwards they can charge higher premiums to compensate for the initial losses. Domestic firms with shallow pockets can not adopt the same strategy and hence are forced to exit.

3.3 Effects of FDI on host economies

Researchers have attributed the mixed results of spillover effects on host countries to the absorptive capacity of the host economy. This suggests that in order to be able to absorb the positive effects of FDI, the host economy must possess some characteristics and capabilities. Many different factors have been suggested as building the absorptive capacity of a developing economy. Some of these are the availability of human capital (Aleksynska et al., 2003; Blomstrom & Kokko, 2003), presence of strong institutions (Nunnenkamp, 2004; Yamin & Sinkovics, 2009), productivity of local firms (Castellani & Zanfei, 2003), policies of the host government (Meyer, 2003), composition and the characteristics of local firms (Blomstrom & Kokko, 2003; Kokko et al. 1996; Kathuria 1998; Kathuria, 2000), the industry in which FDI is targeted and local concentration in that industry (Fedderke, Perkins & Luiz, 2006; Kathuria, 1998), mode of entry (Lall, 2002; Chudnovsky & Lopez, 1999; Somleva & Hoshino, 2005), policies of the MNEs (Xu, 2000), subsidiary role (Todo & Miyamoto 2006) and linkages between MNEs and local firms (Chudnovsky & Lopez, 1999). Blomstrom et al. (1994) have analyzed the role of the host country's development level as an independent variable, impacting the spillover from MNEs to host economies. Their results based on a cross-country study of 101 economies suggest that positive spillovers are concentrated only to the middle-income developing countries, whereas they found no evidence of such positive spillover effects for the poorest developing countries.

When a MNE invests in a developing economy, it will find it difficult to get quality materials and services from the local suppliers. Hence the MNE will use its international linkages to get the materials and services and hence will generate a lot of imports. If the output of MNEs is consumed within the developing economy, the overall impact of MNEs on trade deficit can be negative (Chudnovsky & Lopez, 1999). Chudnovsky & Lopez (1999) also points out that just on the basis on initial investment by the MNEs, it should not be considered that the contribution of FDI is positive for the balance of payments in the long run. They suggest that sooner or later the profit flows from the host to the home country of MNE in the form of dividends, royalty or interest payments. In some cases these outflows have a greater impact on balance of payments than the initial positive impact of FDI.

Kosova (2010) points out that sometime the purpose of MNEs in acquiring a local firm is to buy it at less than the actual value due to the economic crisis. As soon as the crisis is over the MNEs sell the acquired firm at a higher price. These types of FDI investments may also represent a net cost to the host economy. Reiter and Steensma (2010) found that the effects of FDI on the human development of host country are more positive when FDI is restricted to certain economic sectors and the policy of host government discriminates against foreign investment compared to domestic investment.

Thus far we have explored the literature concerning the effects of FDI on host countries and the competitive advantages of MNEs that enable them to compete with their local counterparts, despite the cost of foreignness. Now we will bridge these two streams, arguing that the effects of FDI are closely related with these competitive advantages.

4. Linking FDI Effects with MNEs Competitive Advantages

In this part of paper, we will link the competitive advantages of MNEs to their spillover effects on the local firms and economy. We will discuss the competitive advantages that can affect the local firms negatively one by one.

4.1 Technology & Productivity

Although MNEs are better places in comparison to their competitors as far as technology is concerned, the decision of bringing the latest technology to the host countries depend upon a number of factors, including the relative price factors, the intensity of competition in the host country market, the requirements of industrial and final customers, and the global strategy followed by MNEs (Chudnovsky & Lopez, 1999). The spillover effects from highly technologically advanced MNEs reach the host firms through the channels of labor turnover, competition, linkages and demonstration (Spencer, 2008). The channels of demonstration and competition are of more importance as these are not dependent on MNEs policy of establishing linkages with domestic firms and employing local managers. Based only on these two channels, we can suggest some spillover to host firms that will enable them to improve their technology and productivity. Hence we propose that:

Proposition 1a: The MNEs with core competitive advantage of superior technology and higher productivity will create positive spillover effects for the domestic firms.

It is well established in literature that in order to get the advantages of MNEs, the host firms must possess high absorptive capacity (Nunnenkamp, 2004; Castellani & Zanfei, 2003; Kathuria, 1998; Kathuria, 2000). Hence the superior technology of MNEs in itself does not assure positive spillover effect. Driffield & Hughes (2003) also suggest that the positive spillover effects are largely dependent on the extent to which multinational enterprises

(MNEs) introduce new technology to the host country and the ability of the domestic firms to assimilate this technology. Hence we propose that:

Proposition 1b: The positive spillover effects of superior technology are moderated through the absorptive capacity of the host economy, such that the spillover is positive in the presence of high absorptive capacity and with a low absorptive capacity, the spillover effects are negligible or even negative.

4.2 Better Management practices and strategic decisions

It is generally accepted that MNEs have better management skills (Agosin & Machado, 2005; Zhou et al., 2002; Kathuria, 1998) and ability to take long term strategic decisions (Rui & Yip, 2008). The relation of this advantage with spillover effects is similar to that of technological superiority and higher productivity. The spillover effects for host firms would be positive as the local firms will learn and adopt these management skills as well as taking long term strategic decision. Hence we propose that:

Proposition 2a: The MNEs with core competitive advantage of better management practices and strategic decision making ability will create positive spillover effects for the domestic firms.

Positive spillover from MNEs with better management and strategic decision making are not automatic. Better management practices and strategic decision making ability are not codify able. Transfer of tacit knowledge largely depends upon availability and quality of human capital which can absorb this type of knowledge. Borensztein et al. (1998) found that the effect of FDI on host economy growth depends largely on the human capital, measured by level of education, in the host economy. Availability of human capital is not the only requirement of transferring knowledge. MNEs policy about employing local managers or having expatriate managers from the home country also plays a significant role. In the case of expatriate management, the tacit knowledge is not assessable to the local managers. Hence we propose that:

Proposition 2b: The positive spillover effects of better management practices are moderated through the availability of human capital in the host economy and the policy of MNEs to employ local managers. The spillover is positive in the presence of highly educated human capital and with the policy of MNEs to employ local managers.

4.3 Products, Brand and Image

One of the competitive advantages of MNEs is their well established, well advertised and well reputed brands (Kosova, 2010). Consumers are often willing to pay extra price for these brands because of their high reputation of quality and performance and also because of the desire to associate with these brands. These brands can negatively affect the local firms as the niche segment of market would be attracted towards the international brands, leaving the low value market for the domestic firms.

On the other hand, if the FDI is coming in a relatively newer sector, where concentration of local firms is low, it can have positive spillover effects. MNEs will develop a market for similar products and many domestic firms will also jump into that industry and will try to establish their brand names. Pakistan fast food industry is an example of this phenomenon where the arrival of McDonalds, Pizza Hut and KFC has greatly motivated the local investors to invest in the fast food industry. Hence we propose that:

Proposition 3: Spillover from MNEs with core competitive advantage of strong brand image depends upon the industry in which FDI comes. If it is in a crowded industry, it has negative spillover for the local firms, while if it is in a relatively new sector, it has positive spillover effects.

4.4 Attracting best talent

It is well established in research that MNEs pay higher wages to its employees, compared to the local firms. Attracting best talent will result in two outcomes. First, local firms will be negatively affected as they will loose their star performers. The innovation and creativity of local firms will adversely affect as it is based on the more talented and performing employees. The increased wages will also add to the cost of local firms hence decreasing their margins. Secondly it can decrease the entrepreneurship in the host countries. If the wages of MNEs are higher than the expected returns of entrepreneurship activities, it will stimulate people to become workers instead of entrepreneurs (Backer & Sleuwaegen, 2003; Parthasarathy & Aoyama, 2006).

Employee turnover from MNEs to local firms is an established source of positive spillover effects. Zhou et al. (2002) suggests that the spillover from MNEs to local firms is often credited to the turnover of employees, moving from MNE to Local firms. However, as the wage rates are higher in MNEs the tendency of best talent to move from local firms to MNEs is more than the reverse of it. Balsvik (2006) in his study of Norwegian firms found that the rate of employees leaving local firms and going to MNEs is higher than that of employees leaving

MNEs to join local firms. Hence sometimes, the positive spillover is from local firms to MNEs. Balsvik (2006) also suggests that MNEs can control the positive spillover to local firms by paying higher wages to their employees and hence reducing their mobility. Thus, if the core competitive advantage of MNE is to attract the best local talent, the MNE will affect the host economy negatively. Hence we propose that:

Proposition 4: The MNEs, whose core competitive advantage is to attract the best local talent by giving higher wages, will produce negative spillover effects for the host firms.

4.5 International Linkages

International linkages enable MNEs to take advantage of differences in input and output markets in different countries (Ghoshal, 1987). For example the MNE can decide to utilize global sources of raw materials if it is economically feasible. This strategy will have negative consequences on the local firms, especially in upstream industry. Many local firms in the same industry of MNEs, specially the well reputed local firms that see MNEs as their competition will also try to establish international suppliers, hence the local suppliers will be negatively affected. On the other hand by exporting their finished products to the international markets, MNEs can provide positive spillovers to the local firms by demonstrating these possibilities and hence providing them the access to international markets. Hence we propose:

Proposition 5: Spillover from MNEs with core competitive advantage of international linkages depends upon the policies of MNEs. If they are import oriented, the spillover effects would be negative, however if they are export oriented, the spillovers would be positive.

5. Conclusion and Implications

This paper connects two well explored research streams, running in parallel to each other. It suggests that the research to investigate the competitive advantages of MNEs and the research to explore the spillover effects of these MNEs on the developing economies and local firms should be connected with each other. This paper proposes that the effects of MNEs on developing economies and local firms can be predicted by the competitive advantages that the MNEs hold. Thus certain sets of competitive advantages will lead towards positive spillover effect and other set of competitive advantages would result in adverse effects for the local firms. It is therefore essential for the policy makers of the developing countries to identify the MNEs and FDI that can bring positive spillover to their countries. If the developing countries continue to promote all types of FDI, it could have negative impact for the developing economies, especially in the long run.

The relationship between the competitive advantages of MNEs and their spillover effects, which we have pointed out in this paper, is a neglected area in the international economic research. This paper confirms the previous research findings about the presence of both positive and negative spillover effects and also moves a step forward by proposing a reason (i.e. competitive advantages of MNEs) of these mixed results. There is no study to the best of our knowledge that has tried to predict the nature of spillover effects on the basis of MNEs' competitive advantages. The paper also summarizes the research findings regarding the competitive advantages of MNEs and presents them as a coherent list.

This paper has a lot of policy implications and it can guide the policy makers to differentiate between the MNEs that can bring positive spillover effects from the ones that have a potential of bringing negative effects. It is utmost important that the policy makers of developing countries pay attention in designing the promotion policies to attract FDI so that they can accumulate such FDI that can provide them with positive spillover effects.

This paper opens a new research avenue by pointing towards an unexplored relationship in the previous literature. The paper can guide future researchers to divert their research focus in further exploring this relationship. A cross country empirical study can help towards a better understanding of this relationship.

One of the limitations of this paper is that the list of competitive advantages discussed here is arbitrary and several other competitive advantages can be identified. Therefore, future researchers should also focus on the competitive advantages not discussed in this paper. Addressing the characteristics of developing countries in order to predict the nature of spillover effects of FDI on their economies was out of scope for this paper. However, it can be another fertile area for the future researchers. In other words, there can be a 'fit' between MNEs competitive advantages and characteristics of developing countries which predict positive spillover and absence of such a fit results in negative spillover effects. Thus, developing countries are not dealt with passively as a silent actor and they also contribute in predicting the impact of FDI on their economies. Exploring such 'fit' to find a relationship between characteristics of host countries and competitive advantages of MNEs that results in positive spillover for the developing countries can greatly facilitate the policy decisions of such countries.

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