

Performance of Multinational vs. Domestic Firms: Review of Related Literature

Abstract

This paper reviews and summarises the results of selected studies on performance gaps between multinational enterprises and their domestic counterparts. Performance gaps arise in such fields as productivity, technology, profitability, wages, skills and growth. To compare the performance the study is divided into four types of indicators viz. trade performance, technical performance, financial or economic performance and overall performance. The study covered India and many other countries. Content analysis technique has been used to draw a conclusion. It is found that foreign owned firms are better performed than domestic firms in case of Japan, Russia, Columbia, Vietnam, Kenyan, Germany, Sri Lanka with respect to their overall, technical, Economic (productivity), Firm specific assets, export & technical productivity, employment & sales and export & technical capabilities respectively. But in case of China and Canada domestic owned firms performed better in the field of R&D. In the Indian context foreign owned firms are less export intensive before liberalization but well performed in other variables.

Keywords: Multinational Corporations (MNCs), Performance Indicators
Introduction

Much of the international business research is built upon the idea that multinational firms draw on their location advantages to expand to other countries and outperform domestic firms. To measure their performance four dimensions of performance viz. trade performance, technical performance, financial or economic performance are the focus of the study. Trade performance indicators relates to export and import performance. Technical performance indicators analyzed by their R&D intensity, embodied and disembodied technology import intensity and innovations. Financial performance is measured by the financial ratio analysis technique. Other variables e.g. size and age of the firm, their value addition to sales, employment, total factor productivity, market share and growth of the firm are important economic variables are studied.

Objectives of the Study

1. To put a light on the related literature of the performance of Multinational and domestic firms.
2. To compare those indicators that can be used to measure the performance.

Review of Literature

Many scholars conducted empirical studies on the relative differences in the performance of foreign affiliates of MNCs and of indigenous firms.

This section has been divided into four types of performance indicators viz. trade performance, technology performance, economic / financial performance and overall performance.

Trade performance

Cohen (1975) studied the contribution made by multinationals to the Asian exports. He analyzed the export contribution of MNCs in South Korea, Taiwan and Singapore and found that foreign firms tend to import more and buy less from local firms than their counterparts. Chen (1983) in his study could not find any empirical support for the hypothesis that foreign firms export a higher proportion of their sales than local firms in South Asian countries.

Nayyar Deepak (1978) considered the role of U.S. MNCs in exports of manufactured products in general by developing countries and found that MNCs do not contribute significantly for the growth of exports.



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Wilimore (1976) and Jenkins (1979) in their studies, found MNCs to have relatively better export performance than local firms. But these studies do not really establish the point that MNCs in fact have different export propensities from those of local firms.

Subramaniam and Pillai (1979) compared the export performance across the four clusters of firms with varying degrees of foreign association in engineering pharmaceutical and dyestuff industries in India. Their findings suggest that export performance is inversely related to the level of foreign association. Many studies have been conducted on the role of MNCs in the export of manufacturing sector in India.

Indian Institute of Foreign Trade (1981) conducted a study on the export intensity of MNCs. It compared the ratio of exports to sales of 28 MNCs and 18 local firms spreading over six different industries and concluded that in most cases the non MNCs performed better in export performance.

New farmer and Marsh (1981) examined the electrical industry in Brazil and found that Brazilian foreign owned firms import marketed more than the local firms. By analyzing a sample of over 500 local and foreign firms they concluded that US MNCs do not appear to have different export propensities from local Brazilian firms while other MNCs have significantly higher export propensities.

Mohammed (1983) attempted to examine the impact of foreign ownership on export propensities using RBI data on 1100 companies belonging to 24 manufacturing industries. They found that foreign ownership and incentives are positively associated with export performance whereas managerial skill and capital output ratio are negatively associated with exports. This study found that foreign presence has a positive and significant effect on export propensities.

Aggarwal (2001) attempted to analyze the export enhancing role of MNEs in Indian manufacturing sector. The study was based on 916 firms classified into 33 industries operative during the period 1996-2000. By application of the Fixed and Random Effects Tobit models of Regression analysis, the exports model with technology, cost and scale variables was estimated. The results revealed that MNE affiliates were better performers than domestic firms in the post liberalization era though no such evidence for pre-liberalization era was available. Therefore, the results of this study confirmed that post liberalization measures had their contribution in enhancing the export-performance of MNEs operating in India. However, the study argued that such evidence of MNEs better performance didn't suggest that these MNEs were attracting efficiency-seeking outward-oriented FDI. Along with, performance of foreign firms was found to be different in low-tech sector while same was not found for high tech sector. The study concluded that in post- liberalization era, Indian economy seemed to be fully integrated with the global economy but the existing industrial and technological capabilities needed a reorientation in order to attract efficiency seeking FDI.

Mahambare (2001) conducted a study on FDI performance of foreign firms in the post reforms era. The study was based on a sample of 2,417 firms

in the manufacturing sectors for a nine year period of both pre -reforms (1988-89 to 1991-and post-reforms (1992-93 to 1997-98) period. The study observed that foreign firms increased their exports in the post - reform period in sectors such as chemicals, drugs and non-electrical machinery sectors. The evidence also suggested that the reforms were having a favourable impact on the productivity of foreign firms. The study also found an improvement in the efficiency of foreign firms in the post - reforms period. Further, by using Data Development technique, the study reported that 61 per cent of foreign firms showed an improvement in efficiency after the reforms compared to 35 per cent of domestic firms. Furthermore, changes in the pattern of financing such as a decline in the debt - equity ratio in the post-reforms period also appeared to exert a positive impact on efficiency of foreign owned firms in chemicals, inorganic chemicals, drugs, computer hardware, and software industries.

NCAER (1971) and United Nations (1992) conducted a study on the transfer of technology to India and suggested that companies that did their own R & D got a better return on their technology imports in a number of ways, they unpackaged their technology requirements and imported only those components, that they could not generate economically or fast enough and they received greater benefits from technology imports in terms of their own product and process development.

Caves Richard E. (1974) in his attempt to analyse systematically the determinants of industry R & D intensity in Canada finds that a high foreign subsidiary share indeed lowers R & D intensity in Canadian industry. Palda and Pazderka (1982) for Canadian Pharmaceutical industry, Nagesh Kumar (1985) for India also found similar evidence. Scherer (1965) found that more than 50 per cent of variation in innovative activity in the US manufacturing industry depended upon broad advances of Science and technological knowledge. They are often referred to as Technological opportunities, Later studies by Rosenberg (1976), Wilson (1977), Kumar (1987) also found the technological opportunities to be important determinants of R & D intensity.

Ragachand (1981) finds evidence that locally controlled firms were more R & D intensive than their foreign controlled counterparts in Canada. Rugman (1981) finds some support for the hypothesis that innovations occur in the home country of MNC rather than in the country of its subsidiaries.

Lall (1985) analysed the relationship between technological change, employment generation and multinationals. Comparing the employment generation by an MNC and local firms he concluded that affiliates of MNCs tend to respond favourably to local conditions in activities which permit adaptations. Given the policy regime, there is no apparent difference in the adaptive responsiveness of 991 foreign and local firms.

Kumar and Aggarwal (2000) analyzed the determinants of R&D activity of Indian enterprises using an unbalanced panel data set of 840 companies in manufacturing sector for a seven year post-liberalization period of 1992-93 to 1998-99. The study

found that R&D activities of MNEs had increased with a rapid pace in the post - liberalization era despite of a nasty start initially. However, application of Multiple Regression Analysis revealed that after controlling for extraneous factors such as firm size and profit margins, R&D intensity of MNE affiliates turned out to be lower than domestic firms, probably due to the captive access to their parent and associated.

Tang and Rao (2001) examined R&D propensity of foreign and domestic manufacturing firms in Canada. A balanced panel data set of 58 firms (28 domestic Canadian controlled and 30 foreign controlled) was selected for a ten year period from 1985-1994. Application of Pooled Regression Analysis revealed that foreign - controlled firms were spending significantly lesser on R&D than domestic Canadian firms. Despite of this, the R&D propensity of both foreign -controlled and Canadian-controlled firms during the study period was showing an increasing trend. However, this study did not support the notion that this indicated a narrowing R&D propensity gap between domestic Canadian and foreign-controlled firms over the period of time. The study further found that in spite of lower spending on R&D, foreign controlled firms were still more productive than Canadian-controlled firms due to the import of superior technological and managerial capabilities from their parent companies. Therefore, the study pointed out that the innovative performance of foreign -controlled firms should be judged on a broad set of performance indicators such as output and productivity growth, export orientation and technology adoption.

Economic Performance

Jenkins (1984) suggest that firm- specific variables, such as age and experience are important. In his study pertaining to pharmaceutical industry in Latin America he showed that value added to sales ratio of foreign affiliates varied according to their age and the size of the local market. More research has been done on the vertical integration of multinational affiliates as compared to their local counterparts.

Chhiber et al. (1997) in his research attempted to investigate the impact of factors such as size and age on economic performance of firms in Indian industry. An extensive firm-level data set for 1,020 Indian firms for a six year period ranging from 1988 to 1994 was taken from CMIE PROWESS Database. Results of Regression Analysis revealed that larger firms were less productive but more profitable than smaller firms in India. Furthermore, older firms were found to be more productive but less profitable as compared to young firms. The study also found that firms with foreign ownership outperformed domestic owned firms. The study concluded that these findings can be attributed to the institutional framework and industrial policy instruments such as restrictive entry policies of Indian economy.

Kathuria (1998) attempted to compare the performance of foreign and domestic firms in India. The study was based on 277 firms drawn from 18 manufacturing industries covering a five year period from 1984-85 to 1988-89. The study found that foreign firms were more vertically integrated; having a higher

capital goods import intensity as well as export orientation. Foreign owned firms were also paying higher salaries as compared to domestic firms and were also more R&D oriented. Moreover, the total factor productivity of the foreign firms was also observed to be higher than their local counterparts.

Liu Xiaming (2000) conducted a study to compare the labor productivity of Foreign Invested Enterprises (FIEs) with that of State Owned Enterprises (SOEs) and Other Locally Owned Enterprises (OLOEs) in China. A Cross section dataset for 191 firms during the year 1997 formed the sample of the study. Application of Regression analysis revealed that Foreign Invested Enterprises (FIEs) were exhibiting a significantly higher value added per worker than both State Owned Enterprises (SOEs) as well as Other Locally Owned Enterprises (OLOEs). Liu was of the opinion that this higher productivity of FIEs could be attributed to the higher level of embodied technology, higher labor quality and other advantages specific to FIEs such as managerial skills and superior technologies. The study suggested that though FDI should be further encouraged but at the same time domestic investment in physical and human capital should also be encouraged. The study also recommended the further deepening of economic reforms to increase allocation efficiency.

Pfaffermayr and Bellak (2000) examined performance gaps among 524 foreign - owned and domestically-owned Austrian manufacturing firms for a three year period of 1997-2000. Rather than taking a random and representative sample, only 'fixed test group' consisting of mainly large and mature firms was formed to achieve the objectives. Application of Kruskal-Wallis Test revealed noticeable differences in the characteristics of foreign and domestic firms in terms of productivity and profitability. The study further found that foreign firms were significantly larger than domestic firms in terms of employment, sales, productivity, capital intensity and export orientation as well. However, as far as growth in size and productivity were concerned, no significant differences were observed in both group of firms.

Kumar Jayesh (2003) conducted a study to examine the trends in share of foreign enterprises in Indian manufacturing during nineties. The sample of the study ranged from nearly 1,400 to 3,000 firms (out of which ratio of foreign firms varied from 5 to 9 per cent) covering an 11 year period from 1990-2000. The study revealed that the average size of foreign firms was larger than domestic firms. Further, the share of foreign enterprises was following an increasing trend both in terms of value -added as well as sales, particularly in the late nineties. Therefore, the study was of the opinion that policy liberalization measures resulted in a rise in the place of foreign enterprises in the Indian industry. As far as R&D intensity was concerned, foreign firms appeared to be spending higher on R&D activity in India than domestic firms although gap between their R&D intensities tended to narrowing down after ten years of liberalization. Foreign firms R&D also seemed to be geared for customization of their technology for domestic markets. However, as far as profitability was

concerned, foreign affiliates enjoyed consistently high as well as stable profit.

Yudaeva *et al.* (2003) compared total factor productivity of foreign and domestic owned firms in Russia. Nearly 1,200 to 1,800 foreign firms and 19,000 to 25,000 domestic Russian firms were taken for a five year period of 1992 -1997. OLS Regression Technique was utilized to attain the results. The results suggest that the foreign firms were more productive than the domestic firms. The study found that foreign-owned firms were having advantages over domestic firms in terms of access to technologies and better management. The study also noted that foreign firms tended to invest in underdeveloped industries in Russian planned economy wherein the demand for products was quite high and failed to be met by non-competitive domestic companies. However, degree of foreign ownership was not found to have any significant influence on productivity. The results also suggest that foreign firms located in more reform-oriented regions tended to be more productive than others.

Lombaerde and Guevara (2004) in their study compared the productivity indicators of foreign and domestic companies covering a five year period of 1994 -1999 in Columbian manufacturing sector. Comparison of over 1,500 firms revealed that foreign affiliates were more productive than their domestic counterparts. Furthermore, these firms were found to be more capital intensive and having higher levels of labor productivity. Moreover, foreign firms have high per unit remuneration despite of lower labor cost than their domestic counterparts was also a visible attribute of these associates.

Ngoc and Ramstetter (2004) carried out a study to investigate the role of foreign MNCs in Vietnamese economy during the reform period of 1994 -2002 and also to compare their performance with that of local state owned (SOE) and non state owned Vietnamese firms. Simple statistical techniques such as percentages and t -test were applied to attain the objectives of the study. The study found that the MNC possessed relatively large amounts of firm-specific assets related to production technology, marketing networks and management know-how, thereby turning these to be larger in size and having higher labor productivity, capital intensity, wage levels, investment propensities and trade propensities than non -MNC firms. At the same time, foreign MNCs tended to have relatively lower capital productivity and wage shares of value added. Though the results regarding profitability were mixed, yet the performance difference between MNCs and State owned enterprises were smaller as compared to the differences between the MNCs and non state owned enterprises. The study asserted that its results were consistent with the other researches for other developing Asian economies.

Rasihah and Gachino (2004) attempted to examine differences in labor productivity and export and technological intensities between foreign and domestic firms in Kenyan manufacturing. 37 foreign and 68 domestically owned firms during the year 2001 formed the database of the study. Statistical

technique of 'two tailed t -test' was used to check the statistical significance of any such differences. In addition, the statistical technique of OLS as well as Tobit regressions was also applied. The outcomes of the study confirmed the existence of significant differences in technology and labor productivity of domestic and foreign firms. Whereas, for textiles and garments industry, foreign firms were enjoying a higher exports and technological productivity, on the other hand in case of food and beverage sector, foreign firms were having a higher labor and technology performance.

Arnold and Hussinger (2005) investigated productivity performance pattern of German manufacturing firms by sub-dividing these into three categories i.e. domestic non-exporters, domestic exporters and multinational with an outward investment in a foreign country. The sample of the study consisted of an unbalanced panel dataset of 2,148 firms from 43 manufacturing sectors during a seven year period of 1996 -2002 selected through stratified random sampling that included small, medium as well as large enterprises. The study found that firms with foreign investment tended to be the largest both in terms of employment as well as sales. Further application of Komlogorov-Smirnoff test confirmed foreign firms to be most productive among three groups of firms for each of the year under study.

Pradhan *et al.* (2006) conducted a study to analyze the factors determining export orientation of foreign manufacturing affiliates in India. The study also attempted to examine the factors motivating the existing market -seeking FDI in export activities. The sample of the study consisted of a panel data set for 14 Indian industries for a 14 year period ranging from 1992 to 2005 resulting into a final sample of a total of 4,975 firms including 522 foreign owned firms. Results derived through Fixed effects and GLS Regression models revealed that though exports of foreign manufacturing firms had increased considerably overtime but at the same time, improved performance of domestic firms had reduced the influence of ownership on export activities. The study also observed that export intensities of foreign affiliates were significantly lower in R&D and advertising intensive industries in India and were also more sensitive to the huge size of the Indian domestic market. Moreover, it was found that the export orientation of foreign affiliates had responded positively to liberalized trade and investment regime of post liberalization era that had created infrastructure in the form of export processing and special economic zones.

Sasidharan (2006) conducted a study to compare the performance of some foreign and domestic firms in India. The sample of the study consisted of an unbalanced panel data of nearly 2,700 firms from manufacturing sector of India for the period 1994 to 2002. The analysis revealed that foreign firms were more R&D intensive than the domestic firms. However, domestic firms were able to match their export performance with foreign firms over the study period as a result of liberalization adopted by the policy makers. Further, the study also noted a

decrease in technology imports due to increased number of joint ventures and strategic alliances in the post - liberalization era. Lastly, OLS Regression applied in a log -linear production function also substantiated that foreign firms turned out to be more productive than the domestic firms in India

Wignaraja (2008) examined the links between firm-level export performance, foreign ownership and the acquisition of technological capabilities in an outward - oriented developing country like Sri Lanka. A cross-section dataset for 205 clothing firms (47 foreign-owned and 158 domestic enterprises) for the year 2003 -2004 was collected. Statistical technique of t -test revealed that foreign firms were exhibiting better export performance, had larger employee base, better skilled CEOs and invested in modern equipment as compared to domestic Sri Lankan firms. Further, application of Tobit model of regression revealed that foreign firms were more successful exporters as compared to their domestic counterparts due to their access to marketing connections and know-how acquired from their parent companies, accumulated learning experience of export production and economies of scale resulting from their size. Technological capabilities also had a significant contribution in export performance. The importance of liberal FDI regime in attracting export oriented FDI in the developing countries was also emphasized in the study.

Overall Performance

Kimura and Kiyota (2004) conducted a study to examine any differences in dynamic and static corporate performance between foreign and domestically owned firms in Japan. The study utilized a longitudinal panel data for more than 22,000 firms for a four year period from 1994-98 to identify the determinants and impact of foreign ownership. The study found that foreign firms were having higher R&D expenditure, per capita value added productivity, number of domestic regular workers, domestic affiliates and establishments, capital intensity, wages, better return on assets and total factor productivity than domestic firms. On employing the dynamic analytical framework developed by Roberts and Tybout (1997) and Bernard and Jensen (1999), it was found that though return on assets and equity were not significant but per capita value added and TFP were found to be significant. Potential foreign -firms were larger, younger and more R&D-intensive than other firms; foreign investors select firms having potentially better performance in future thus ignoring short -term profits. Thus, the study found that foreign-owned firms were having superior characteristics such as profitability and productivity both in static and dynamic sense. However, employment in foreign-owned firms was decreasing faster than domestically-owned firms as these firms were restructuring their redundant workers more effectively as compared to domestic Japanese firms. The results also revealed that younger firms having more capital and R&D intensity were able to improve their corporate performance more than older, less labor-intensive and less R&D-intensive firms. The study found that foreign

firms brought useful firm -specific assets such as technology, managerial ability, and effective corporate governance into Japan.

Manikandan (2006) carried out a study to analyze the overall performance of foreign multinational and domestic companies in India in the post liberalization period. 246 foreign and 4,366 domestic firms operating in sectors such as chemicals, engineering, tea, textiles and trading for a period 1991 to 2004 formed the sample of the study. Three dimensions of performance i.e. finance, trade and technology were considered at aggregated as well as disaggregated level. Financial performance was measured by the technique of financial ratios. Further, for measuring trade performance, indicators relating to exports and imports were taken and technological performance was measured by analyzing research intensity and embodied and disembodied technology import intensity. Except chemical industry, the study found no significant differences between foreign and domestic companies at both aggregated as well as disaggregated levels. As far as trade performance was concerned, domestic companies showed a fairly better performance than their foreign counterparts at aggregate level during the period 1998-2004. However, at disaggregated level, no significant difference was found for sectors such as chemicals, engineering, trading and textiles. For technological performance, as against the available evidences, no statistical difference was found for foreign and domestic companies at aggregated as well as disaggregated (chemicals and engineering industries) level. The study recommended a policy providing incentives for multinationals to boost to their R&D activities and reduction of tariffs to encourage capital goods imports.

Gelubcke (2013) carried out a micro level study in German manufacturing sector to examine the performance of foreign controlled firms. Taking cross sectional data, unconditional means were compared to draw the conclusions. Variables such as productivity and R&D intensity variables, as well as the return on sales, per capita wages, and size were estimated using the probit and GLM estimators and OLS technique. The analysis revealed that there existed a foreign ownership performance premium with regard to productivity, research and development, export intensities, and average wages. However, as far as variable profitability was concerned, it did not seem to be different from domestic German-owned enterprises.

Schulze Linda *et al.* (2016) analyzed the effect of internationalization on the performance of Chinese and Indian firms and compared it with the United States. Furthermore they assessed whether the time period in which firms internationalize had an important impact on the internationalization-firm performance relationship. They found that Chindia firms have a great incentive to internationalize since the correlation between the internationalization and performance is positive and significant. Moreover, there seems to be no significant difference of performance between firms in India and China.

However, comparing Chindia with the US, their findings showed that internationalization lead to better performance in the US. Finally, internationalization does not seem to be a time variant.

Conclusion

We can conclude that at aggregate level foreign firms are better performed than domestic firms in terms of employment, sales, productivity, capital intensity and export orientation as well due to the fact that foreign ownership brings with it many benefits that domestic ownership fails to provide such as know-how, timely access to inputs, finance, maintenance personnel and sources of information about technology and markets. Foreign firms were also found to exert their market power through high investment in R&D, advertising, and other measures that resulted in a higher value of sales and raised barriers to entry. In the Indian context too the analysis revealed that the export performance of foreign owned firm had substantially increased after liberalization due to better infrastructure, ease of regulations and formation of special economic zones. It is also found that larger firms are less productive but more profitable than smaller firms in India. Furthermore, older firms were found to be more productive but less profitable as compared to young firms. Further, the share of foreign enterprises was following an increasing trend both in terms of value added as well as sales, particularly in the late nineties. Therefore, the study was of the opinion that policy liberalization measures resulted in a rise in the place of foreign enterprises in the Indian industry. As far as R&D intensity was concerned, foreign firms appeared to be spending higher on R&D activity in India than domestic firms although gap between their R&D intensities tended to narrowing down after ten years of liberalization. Foreign firms R&D also seemed to be geared for customization of their technology for domestic markets. However, as far as profitability was concerned, foreign affiliates enjoyed consistently high as well as stable profit margins as compared to domestic firms due to their economies of scale and greater efficiency.

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