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Identifying patterns of outward foreign direct investments: Some empirical evidence

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ABSTRACT

This paper uses industry level panel data of all Austrian affiliates operating abroad during the period 1992–2005 to investigate the determinants of performance, as reflected by the number of affiliates, their productivity and returns on patents and licenses. The determinants of each performance indicator are found to be different. Moreover, the determinants vary further when the full dataset is disaggregated into manufacturing and service sectors.

1. Introduction

Removal of entry barriers, technological advances, increased financial integration as well as more general global processes over the last decade have lead to an increase in the number of companies entering overseas markets. This growth in internationalization is not only a feature of large manufacturing companies; foreign direct investment in the service sector has also grown very rapidly in the last few years. These trends are most evident in the European Union (EU) countries, many of which are characterized by relatively small domestic markets, advanced technology and high R&D investment, resulting in a long tradition of cross-border capital flow (see UNCTAD Investment Report, 2004).

One such country is Austria. Although income per capita in Austria has remained high, its performance in productivity and innovation has been near the bottom of EU-15 countries for a long time (see

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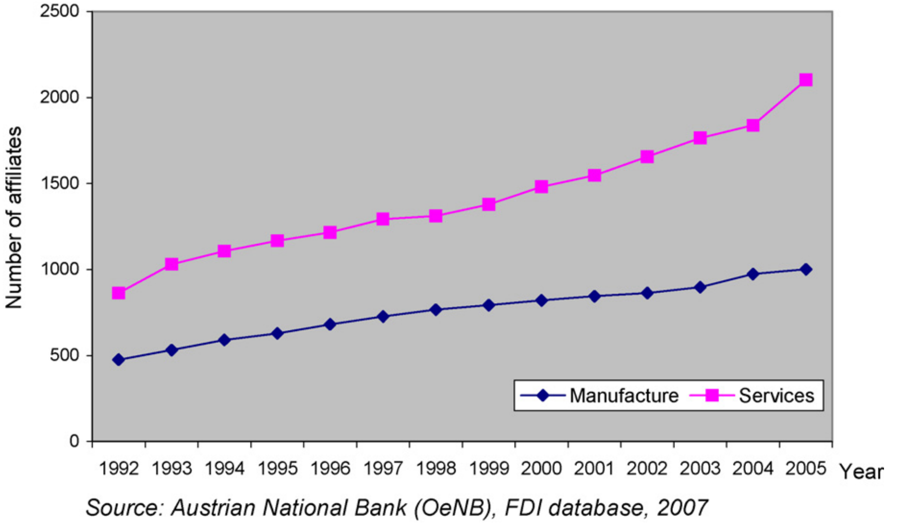

Fig. 1. Number of Austrian affiliates abroad, growth trends in manufacture and services, 1992–2005. *Source*: Austrian National Bank (OeNB), FDI database, 2007.

OECD Report, 2005). Among other factors, geographical limits have pushed the Austrian economy to a high level of internationalization. A small country, Austria is close to larger markets such as Germany and Italy, but also to new EU member states such as the Czech Republic and Hungary, which historically have had strong ties to Austria. The central question therefore is how do these issues influence the pattern of Austrian investment abroad?

Fig. 1 illustrates the increasing internationalization of Austrian companies during the last 15 years. Furthermore, the number of affiliates in the service sector exceeds the number in the traditional manufacturing sector, the rate of growth in the service sector increasing through time. Among the fastest growing areas of the services sectors are insurance, financial and banking services, where Austrian companies also provide a broad range of domestic services.

In making the decision to establish an affiliate abroad, companies have to weigh up the costs and risks of going abroad against both opportunities at home and the option of providing services across borders without creating an affiliate; for example, by means of cross-border lending. Furthermore, Austrian banks have many markets to choose from when deciding to establish a presence abroad. This paper aims to provide empirical evidence to determine what factors influence the companies' decision to go abroad, into which countries and into which sectors. In particular, the paper will focus on the determinants of growth in terms of the number of affiliates, their productivity, and their returns on patents and licenses in both the manufacturing and service sectors.

The rest of the paper is structured as follows: first, the main theoretical concepts are discussed in Section 2; Section 3 will describe data and methodology; and the results will be discussed in Section 4 before concluding in Section 5.

2. An overview of the literature

This paper relates to two principal themes in the literature. The first is the process of internationalization on the part of manufacturing and service sector firms, and the factors that motivate foreign direct investment (FDI).

Any firm entering a new market must have an advantage over local firms to be profitable. In the general FDI literature, internalization theory suggests why this may be the case (Dunning and Lundan, 2007). This theory asserts that firms expand abroad to exploit knowledge advantages created within the firm. This concept of internal knowledge is very broad, and includes technical, marketing and