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# Outbound Foreign Direct Investment (FDI) Motivation and Domestic Employment by Multinational Enterprises (MNEs)☆

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ABSTRACT

This study investigates whether and how outbound foreign direct investment (FDI) boosts or reduces domestic employment by multinational enterprises (MNEs). Based on analyses of a firm-level sample of 18,252 subsidiary-year cases of Japanese MNEs in 59 countries from 1996 to 2010, the findings indicate that outbound FDI motivated by (1) market seeking for scale and scope expansion, (2) natural resource seeking, or (3) strategic asset seeking tends to serve as a "strategic complement" that enhances domestic employment by MNEs. However, outbound FDI motivated by (4) market seeking associated with declines in domestic demand or (5) labor resource seeking tends to act as a "strategic substitute" that reduces domestic employment by MNEs. The implications for theory, practice, and policymaking are discussed.

## 1. Introduction

Scholars have long debated the relationship between outbound foreign direct investment (FDI) by multinational enterprises (MNEs) and the MNEs' employment of domestic personnel. Yet despite five decades of debate, the empirical results remain inconclusive (Lipsey and Weiss, 1981; Head and Ries, 2004). Some studies find that outbound FDI and domestic employment are substitutable and have a negative relationship (e.g., Yeaple, 2003; Becker et al., 2005; Kokko, 2006). Other studies find a complementary, positive relation between outbound FDI and domestic employment (e.g., Hijzen et al., 2007; Becker and Muendler, 2008; Federico and Minerva, 2008; Desai et al., 2009). In addition, numerous studies report mixed results that are conditional on firm, country, or industry variations (e.g., Mariotti et al., 2003; Head and Ries, 2004; Chen and Ku, 2005; Harrison and McMillan, 2007; Konigs and Murphy, 2006; Ekholm et al., 2007; Debaere et al., 2010; Mitra and Ranjan, 2010; Hijzen et al., 2011; Driffield et al., 2017).

These inconsistent findings suggest an interaction between two opposite effects that outbound FDI can have on domestic employment levels. On the one hand, an MNE's outbound FDI may replace its domestic employees with new employees hired by their foreign affiliates (Mariotti et al., 2003; Greenaway and Kneller, 2007; Federico and Minerva, 2008). This kind of replacement typically happens when MNEs engage in a "vertical FDI," especially a labor-seeking FDI into a developing country. In this kind of FDI,

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the labor-intensive aspects of an MNE's domestic production are transferred to foreign subsidiaries (Blomström et al., 1997; Fors and Kokko, 2001), resulting in reductions of the MNE's domestic employees. On the other hand, an MNE's outbound FDI may generate more domestic employment due to expanded operations (Lipsey, 1994). This outcome typically happens when MNEs engage in a “horizontal FDI,” especially a market-seeking FDI, into an established foreign market where the MNE expands its production base and global market access into developed countries. As horizontal FDI requires an MNE to boost its initial input for the expanded operations (Helpman et al., 2004; Greenaway and Kneller, 2007), this initiative results in an increase of long-term outputs. Therefore, horizontal FDI can increase subsequent domestic employment to satisfy both the increased output demand (Ekholm et al., 2007; Hijzen et al., 2011) and the increased demand for skilled headquarters services (such as management, financial, legal, R&D, and marketing) to support the foreign subsidiary operations (Fors and Kokko, 2001; Mitra and Ranjan, 2010). In essence, the literature on international economics shares a general consensus that a vertical FDI tends to reduce domestic employment, whereas a horizontal FDI tends to increase domestic employment.

One critical unresolved issue in current discussions on the relationship between outbound FDI and domestic employment is that the literature is preliminarily based on country-level aggregate data, and these data have not effectively addressed the impact of firm heterogeneity. Although the importance of firm heterogeneity has recently been recognized in the literature on international economics (Helpman et al., 2004; Bernard et al., 2007), many researchers have only just begun to examine the ways that firm heterogeneity can affect the flow of FDI and its outcomes. Also, the literature on international business has traditionally regarded FDI from a strategic management point of view, in which firms are assumed to possess heterogeneous resources, capabilities, and motivations to engage in FDI. However, this literature has not yet provided clear insights into under which conditions MNEs can enhance societal welfare, such as domestic employment, through FDI.

In this study, we argue that firm heterogeneity can provide additional explanatory power regarding the impact of outbound FDI on domestic employment beyond the conventional “vertical-horizontal” FDI dichotomy. Specifically, we argue that MNEs have specific strategic motivations for FDI, determined through searching for optimal configurations of firm-specific advantages (FSAs) and country-specific advantages (CSAs). These motivations, which include market seeking, labor resource seeking, natural resource seeking, and strategic asset seeking, integrate FSA configurations (exploitation vs. exploration) with CSA configurations (home vs. host countries) to guide outbound FDI effects. Therefore, the goal of this study is to provide a more nuanced set of predictions regarding the effects of outbound FDI on domestic employment from the perspective of firm heterogeneity. As such, we attempt to answer the following key research questions. (1) *Do MNEs' heterogeneous motivations for launching outbound FDI (resulting in the establishment of foreign subsidiaries) directly affect their levels of domestic employment?* (2) *Which motivations for FDI strategically complement or substitute for an MNE's domestic employment as the firm develops parent-subsidiary relationships?* We apply the basic concepts of strategic “complements” vs. “substitutes” to indicate a potential interrelatedness between two strategic decisions by competing firms. If a strategic decision by Firm A enhances (or discourages) the same component of Firm B's strategy, then these two firms' decisions are called strategic complements (or strategic substitutes, respectively) (Bulow et al., 1985). Applying these concepts to our research setting, we argue that an outbound FDI motivation and a related domestic employment decision are strategic complements (or substitutes) for each other if the specific outbound FDI motivation for establishing foreign subsidiaries increases (or decreases) domestic employment by the parent MNE.

These research questions arise from theoretical observations regarding two distinct but interrelated strategic decisions that MNEs face regarding their international investments. First, MNEs make outbound FDI decisions that involve self-selecting behavior, triggered by specific motivations for outbound FDI projects. Second, the MNEs make simultaneous decisions regarding their (human) resource allocations between parent MNE and foreign subsidiary employment. The initial decision to engage in outbound FDI is critical for an MNE, because this decision determines whether the firm will maintain a shallow integration with foreign markets through exports alone or become deeply integrated into foreign contexts through launching direct investment projects. Therefore, we consider the initial motivation for investment as the main reason for direct foreign entry, as this motivation has the strongest impact on the headquarters-subsidiary structure of an MNE, including its human resource allocations between home and foreign operations. To reflect this theoretical decision structure in our empirical setting, we construct a simultaneous equation model (SEM) with a system of two equations (i.e., one equation for parent MNE employment, and the other for subsidiary employment). Then we estimate the resulting system using three-stage least squares (3SLS) regressions, with the FDI motivation as a key independent decision variable.

We tackle our research questions using a comprehensive dataset on the FDI of Japanese MNEs with established overseas subsidiaries. We use Japanese MNEs and their subsidiaries for two reasons. First, Japan has suffered from severe economic downturns over the past decade, which have caused great debates over whether outbound FDI by Japanese MNEs affects the home economy positively or negatively (Kambayashi and Kiyota, 2015). Due to the urgent relevance of this issue in the Japanese context, a series of both conceptual and empirical studies has been conducted, yielding mixed findings (e.g., Branstetter, 2006; Lipsey et al., 2000; Todo, 2011). This ambiguity has led to calls for more fine-grained studies based on larger samples. A second reason to focus on Japanese MNEs is that the Toyo Keizai dataset now provides the best available information on Japanese MNEs and their subsidiaries. This dataset contains a wide range of subsidiary-level information on Japanese MNEs, including the purposes for overseas establishments and other basic financial indices. The comprehensiveness and accuracy of this dataset has been acknowledged in previous empirical studies (e.g., Beamish et al., 2001). Through the extensive use of these firm-level FDI data, we can better understand the strategic