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Firm participation in financial incentive programmes: The case of subsidies for outward internationalisation

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Abstract

This study explores the process of firms' participation in financial subsidies supporting outward foreign direct investments. Policy makers should be concerned about the existence of self-selection mechanisms among eligible firms as they could fail to reach the target population. Using firm-level data on subsidised firms and potential applicants, we show that firms self-select according to the balance between application costs and expected benefits. These findings have interesting policy implications. First, participation rate among the target group could be enhanced by lowering application costs. Second, in order to avoid deadweight effects, expected benefits should carry a higher value for target firms.
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1. Introduction

Internationalisation is acknowledged as a determinant of competitiveness and a driver of development for both the host and the home country (Dunning & Lundan, 2008; Te Velde, 2007; Westhead, Wright, & Ucbasaran, 2007). For these reasons, since the 1990s firms' outward internationalisation is becoming an increasingly important target of public intervention in most OECD countries (UNCTAD, 2001) so that governments have implemented several home country measures (HCMs). These tools, which include financial support, investment insurance, fiscal intervention, information provision and technical assistance (Sarmah, 2003), are launched

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to mitigate information and co-ordination failures. The promotion of internationalisation seeks to reduce economic and political risks, to overcome uncertainties and to alleviate any shortfall in resources and capabilities in a company initiating the internationalisation process or seeking to invest in an environment that is distant in geographical, cultural and institutional terms (Sarmah, 2003; Te Velde, 2007).

Despite the increasing importance of such policy tools, HCMs have so far been neglected (Te Velde, 2007) and no evidence exists on the processes that drive the allocation of public incentives among firms (Tanayama, 2007). The general push to collect evidence on the impacts of policy measures has somehow diverted attention away from the problems surrounding the allocation process.[1] We argue that policy makers should be concerned about firm behaviour when applying for a subsidy as the motivations of firms participation can reveal unexpected barriers to firm involvement (Blanes & Busom, 2004; Heckman & Smith, 2004). In addition, the participation process has also important implications for evaluation strategies as it reveals possible misalignments between policy goals and allocation outcomes (Scheirer, 1994). The understanding of firm behaviour helps to draw the counterfactual scenario and provides important clues about what pieces of information are crucial for the effectiveness of the evaluation process (Heckman & Smith, 2004; Moffitt, 1991). For these reasons we provide evidence about the drivers of firm behaviour when filing a request for public financial support. On the basis of these findings, we draw some policy implications for the promotions of foreign investments and, more generally, the design of public incentives to private investment.

The empirical analysis is based on information on a sample of Italian firms that received at least one financial incentive for international growth outside of the European Union between 1992 and 2008 and on a sample of potential applicants that internationalised without the support of any public programme in the same period.

Our data show that firms self-select according to the balance between application costs and expected benefits. Consequently, we argue that policy makers can reduce barriers to participation by lowering application costs and encourage additional investments by increasing expected benefits for the target population.

The rest of this paper is structured as follows. The next section surveys the existing literature, and formulates the hypotheses that drive the empirical analysis. The following section presents the data and Section 4 describes the model tested in the empirical analysis. Section 5 illustrates the results of the econometric estimates. Final comments and policy implications are reported in Section 6.

2. The evaluation of incentive allocation: background literature and research hypotheses

Early literature framed the implementation process as a sequence of administrative routines that would occur of and by themselves once policy measures were brought into effect by a legislative act and agencies possessing administrative authority (Corbett & Lennon, 2002). This view has

[1] The allocative problem can be decomposed into five steps (Heckman & Smith, 2004). Policy makers set the criteria of eligibility, which will be implemented by the agencies in charge of incentive programme management. Based on their awareness (i.e., the extent to which eligible subjects are informed about the existence of a suitable public measure), firms decide whether to submit an application. Thus, firms self-select to participate in the allocation process. Finally, public agencies make granting decisions by choosing which applications will be accepted and which firms will be enrolled in the programme.

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