

# Heterogeneous Firms Serving Developing Countries\*

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## Abstract

Many previous studies based on a simple model of heterogeneous firms have identified characteristics of multinational firms engaging in export or foreign direct investment (FDI). While they focused mainly on firms that serve developed countries, this study analyzes both firms serving developing countries as well as those serving developed countries. The purpose was to identify the determining factors of firms' decision to either export or provide FDI. The results of our analyses indicated that the determining factors differ according to characteristics of the destination country; they differ between the two cases. In accordance with previous studies, firms that served developed countries were found to base their decision on the productivity level. On the other hand, firms that served developing countries were found to base their decision primarily on the capital-labor ratio, and secondarily on the productivity level. Thus, among the firms serving developing countries, capital-intensive firms chose to export while labor-intensive firms chose to provide FDI, regardless of the productivity level, and only firms with a mid-value capital-labor ratio based their decision on the productivity level. These findings, which were supported by empirical evidence derived from Japanese manufacturing firm-level data, indicated that productivity level is not as significant a factor for firms serving developing countries as it is for firms serving developed countries.

**JEL classification:** F12; F21; F23

**Key words:** Firm heterogeneity; Developing countries; Export; FDI

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