Comments on "Host-Country Financial Development and Multinational Activity?"

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Summary (1)

- **What** does the paper do?

  Examining how the financial development conditions in **host countries** affect multinational companies' activities, including

  - No. of affiliates;
  - Sales of affiliates by differentiating sales to local, to parent country, and to the third country.

Summary (2)

- **How** does the financial development work?

  In the theoretical model, the financial development works through η , the fraction of firms' profit to loss if default

$$a_S^{1-\varepsilon} = \frac{1}{\eta} \frac{R f_S \omega}{(1-\alpha) A_{ss} (\omega/\alpha)^{1-\varepsilon}}.$$

  An increase in η , lowers productivity cutoff for the south, but raise the cutoffs of the west to export and FDI in the south. However, since the fixed cost of entry is constant, the total profits from sales in west increase

Summary (3)

- Using the BEA data, empirically provide strong evidence on positive effects of financial development on

Dependent variable:	Local sales	3rd ctry sales	US sales	Local sales	3rd ctry sales	US sales
	Total sales	Total sales	Total sales	Total sales	Total sales	Total sales
	(1)	(2)	(3)	(4)	(5)	(6)
Fin Development	-0.057	0.033	0.023	-0.058	0.037	0.021
	(-2.81)***	(1.88)*	(3.53)***	(-2.87)***	(1.99)**	(3.27)***
Fin Development x Ext Fin Dependence				-0.013	0.010	0.003
				(-3.67)***	(3.02)***	(2.28)**

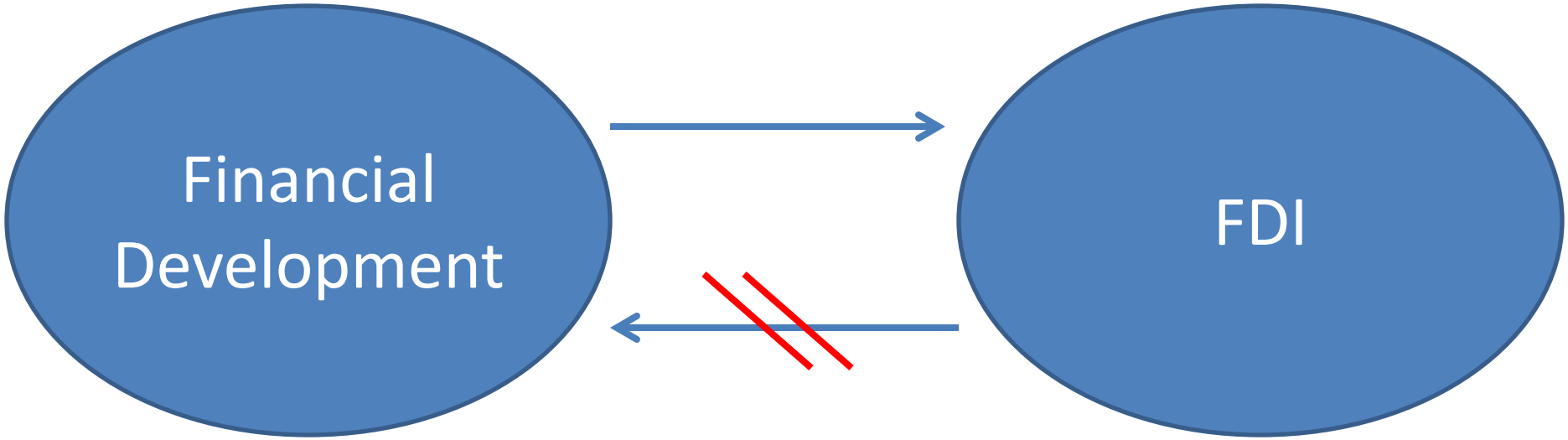
- A comprehensive and interesting paper!

- Contributions
  - Theoretically illustrate how the financial development of host country affects multinational companies' activities;
  - Very strong empirical evidence showing the positive effect from financial development of host countries

Comment 1: More illustrations on the key assumption

- An increase in η, lowers productivity cutoff for the south, but raise the cutoffs of the west to export and FDI in the south. However, since the fixed cost of entry is constant, **the total profits from sales in west and east must increase**.

Comment 2: On endogeneity…



Suggestions

- Using IVs to do the estimations, for example, Systematic GMM (Blundell and Bond, 1998);
- Selecting the number (or sales) of the affiliates which are the "new entries";

Comment 3

- Extend the analysis to include more "source" countries, rather than focusing on the US data alone…
- "Difference-in-Difference" estimation strategy as in Desbordes and Wei (2014)

$$FDI_{ijst} = exp(\beta_1[ln(SFD_{it-1}) \cdot FV_s] + \beta_2[ln(DFD_{jt-1}) \cdot FV_s] + \alpha_{ijt} + \alpha_{st})\epsilon_{ijst}$$

Comment 4

- In addition to the number of affiliates, **the value invested** matters too…
- To check whether the **“local sales” of local firms** improve with improving of the financial markets directly…
- In addition to the “trade” type of activities, it would be nice to include **“capital**” type of activities…

Comment 5

- Accommodate host countries' policies in favoring different types of industries…
- Measures on the external financial dependence from WB Doing Business index:
  - the strength of legal rights index;
  - the depth of credit information index.