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# Factors determining supply linkages between transnational corporations and local suppliers in ASEAN

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Axèle Giroud\* and Hafiz Mirza\*\*

A significant potential beneficial impact of foreign direct investment arises from a foreign affiliate's propensity to purchase inputs from suppliers in the host economy. This issue is of particular interest where the host is a developing country and the linkage is likely to contribute to the development of local suppliers. We compare variations in local input linkages across four countries: Cambodia, Malaysia, Thailand and Viet Nam, all member countries of the Association of South-East Asian Nations (ASEAN). Using multiple linear regressions, our findings indicate that the degree of local input linkages is highest when foreign affiliates perform a strategic role in the transnational corporation network and are embedded in the host economy. Non-firm factors are also important determinants, especially the industry of investing firms and the existence of a supply base. Building on the findings, a series of policies to enhance supplier-foreign affiliate linkages are proposed.

**Key words:** transnational corporations, supply linkages, ASEAN, regionalization, electronics industry, garments industry

JEL classifications: F23, F02

## 1. Introduction

This article aims to analyse the sourcing patterns of transnational corporations (TNCs) in South-East Asia, with a focus on explaining *local* input linkages in the electronics and

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textile and garment industries. A supplementary aim, essentially cast by the findings, is to suggest appropriate policies that would enable governments to develop further supplier linkages with TNCs.

TNCs' linkages – and their expansion - in host economies have become a particularly important issue, especially in South-East Asia after the Asian financial crisis, as the inflows of foreign direct investment (FDI) have decreased and recent inward FDI is increasingly sustained by the reinvested earnings of existing foreign affiliates in the region. Through local supply linkages, TNCs potentially generate considerable benefits for host economies, both from value-chain multipliers and technology transfers and spillovers. Studies have shown that the linkage potential of TNCs is higher than that of domestic firms in some developing countries (Potter *et al.*, 2003; Alfaro and Rodríguez-Clare, 2004; Jensen, 2004). Given their importance, it is perhaps surprising that relatively few studies have examined the factors explaining the level of local sourcing by TNCs in host economies (McAleese and McDonald, 1978; Driffield and Noor, 1999; UNCTAD, 2001; Belderbos *et al.*, 2001; Tavares and Young, 2002). Even fewer have focused specifically on technology transfer to local suppliers (Halbach, 1989; Wong, 1991; IDE, 1994; Rasiah, 1995; Supapol, 1995; Crone and Roper, 2001; UNCTAD, 2001; Giroud, 2003) or how TNCs enhance local suppliers through the introduction of focused assistance programmes (Dries and Swinnen, 2004). This article contributes to the literature by analysing the determinants of TNCs' local supply linkages in two industries in South-East Asia: an analysis that is enhanced by comparing the issue in four countries that

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