

# Former Foreign Affiliates: Cast Out and Outperformed?

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**Abstract** The literature has documented a positive effect of foreign ownership on firm performance. But is this effect due to a one-time knowledge transfer or does it rely on continuous injections of knowledge? To shed light on this question we focus on divestments, that is, foreign affiliates that are sold to local owners. To establish a causal effect of the ownership change we combine a difference-in-differences approach with propensity score matching. We use plant-level panel data from the Indonesian Census of Manufacturing covering the period 1990-2009. We consider 157 cases of divestment, where a large set of plant characteristics is available two years before and three years after the ownership change and for which observationally similar control plants exist. The results indicate that divestment is associated with a drop in total factor productivity accompanied by a decline in output, markups as well as export and import intensity. The findings are consistent with the benefits of foreign ownership being driven by continuous supply of headquarter services from the foreign parent.

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## I. Introduction

Countries around the world compete fiercely to attract foreign direct investment (FDI). Their interest in bringing FDI is motivated by the belief that foreign investors not only create jobs but are also a channel of knowledge transfer across international borders. Indeed many studies have documented superior performance of foreign affiliates with a few being able to establish a causal effect. Among the latter, Arnold and Javorcik (2009) found that foreign acquisitions of Indonesian plants resulted in a 13.5 percent productivity boost after three years under foreign ownership. The rise in productivity was a result of restructuring, as acquired plants increased investment outlays, employment and wages. Foreign ownership also enhanced the integration of acquired plants into the global economy through increased export and import intensity. A similar result was established in the Spanish context where Guadalupe et al. (2012) showed that foreign acquisitions resulted in more product and process innovation and adoption of foreign technologies, leading to higher productivity.<sup>1</sup> The superior performance of foreign affiliates is not surprising given that only the most productive firms are able to incur the fixed cost of undertaking FDI (see Helpman et al. 2004).

But how persistent are the benefits of foreign ownership? Is the superior performance of foreign affiliates due to a one-time knowledge and knowhow transfer or does it depend on continuous flow of knowledge and headquarter services from the parent firm? These questions matter profoundly for policy. Foreign investors are often given tax incentives or tax holidays in the hope that their affiliates will become a source of knowledge spillovers to indigenous firms. How long they can remain such a source enters the cost-benefit calculation. The length of the tax incentives is usually prescribed by law, and tax incentives cannot be awarded after the foreign parent leaves. However, we know little about the horizon over which the benefits accrue. If foreign affiliates retain their productivity advantage even after the foreign parent leaves, the value proposition of such tax policies is much greater than if the advantage evaporates once the parent divests.

To shed light on these issues we examine developments in foreign affiliates that were sold by their parents to local owners. We use plant-level data from the Indonesian Census of Manufacturing covering the period 1990-2009 and consider cases of foreign affiliates whose ownership was transferred to Indonesian hands. More specifically, we focus on plants that were at least 50 percent foreign owned and whose foreign ownership dropped to less than 10 percent (a

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<sup>1</sup> A positive, albeit much smaller, effect of foreign ownership was also found by Fons-Rosen et al. (2014). In contrast, Wang and Wang (2014), who compared foreign acquisitions to domestic ones, did not find a positive impact of foreign ownership on productivity, though they did document a positive impact on target firms' financial conditions, exports, output, employment and wages. A related literature has shown that foreign affiliates perform better in the times of crises (see Blalock, Gertler and Levine 2008; Alfaro and Chen 2012).

standard threshold used in the literature to denote foreign direct investment) and remained so for at least three years. We are able to consider 157 cases of divestment where a large set of plant characteristics are observed two years before and three years after divestment and for which observationally similar control plants exist.<sup>2</sup>

To establish a causal effect of the ownership change we combine a difference-in-differences approach with propensity score matching. To create a missing counterfactual of how foreign plants would have performed in the absence of divestment we use as a control group foreign affiliates similar in terms of observable characteristics, operating in the same narrowly defined industry in the same year, which remain in foreign hands. Then we compare changes in various aspects of plant performance between the year prior to divestment and years following the ownership change among the treated (divested) plants and the control group.

If the divestment decision was driven by observable affiliate characteristics, it will be controlled for through our matching exercise. If it was driven by unobservable time-invariant heterogeneity related either to the parent or the affiliate, it will be controlled for through the difference-in-differences approach. As we consider a relatively short time horizon, the latter method will capture developments such as financial shocks or a permanent productivity increase experienced by the parent company.

Our variables of interest include the total factor productivity (TFP), output, markups, employment, average wage, export intensity and reliance on imported inputs. Markups are estimated following a method proposed by De Loecker and Warzynski (2012). The advantage of this method lies in allowing for markup estimation based on plant-level data without the need to specify how producers compete in the product market.

The results indicate that divestment is associated with a 0.038 log point productivity drop among divested plants relative to the control group. The decline is registered in the year of ownership change and persists over time. A large and growing gap in output emerges between the divested plants and the control group. It ranges from 0.35 log points in the year of divestment to 0.54 log points two years later. This gap is driven by export sales. The decline in output is accompanied by lower markups and lower reliance on imported inputs. Perhaps to compensate for the smaller scale of production, divested plants lower their employment by shedding production workers. Blue-collar employment goes down by 0.153 log points in the year of divestment relative to the control group, although in the subsequent years the difference between the treated and the control plants ceases to be statistically significant. Interestingly, we do not find statistically significant effects of divestment on the probability of exit, investment or access to various sources

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<sup>2</sup> As we show in robustness checks, the same conclusions can be reached based on a larger sample of divestment cases.

used to finance investment. However, we do find that affiliates initially set up as greenfield projects experience a larger negative effect on their performance.

While transfer pricing is usually a concern in studies of foreign affiliates, our results are unlikely to be driven by this phenomenon. Transfer pricing could potentially affect outcomes such as the value of output, markups and the TFP, but it does not affect employment figures. Moreover, if transfer pricing were responsible for the patterns observed, we would expect to see larger effects of divestment on former fully foreign-owned affiliates than on other affiliates. No such difference is observed in the data.

A battery of robustness checks confirms our findings. The observed patterns are robust to considering a longer time horizon (of 5 years) after divestment. They are also robust to controlling for longer pre-trends in the matching procedure or addressing the issue of potential spillovers confounding the effects. Finally, by comparing the impact of foreign divestments to the impact of privatizations we address the concern that any ownership change (rather than the loss of the foreign parent) would have produced similar effects.

The observed pattern is consistent with sold affiliates being partially cut off from the distribution network of their former parent company which results in a negative demand shock. They are also in line with the divested affiliates being negatively affected by the loss of access to knowledge and know-how provided by the headquarters of the former parent as well as by possible departure of expatriate managers employed by the former foreign parent. In sum, our findings are broadly consistent with the view that the superior performance of foreign affiliates observed around the world is driven by continuous injections of headquarter services from the parent company to their overseas affiliates. To the best of our knowledge, this is the first study to document this pattern.

The remainder of the paper is structured as follows. The next section presents the data. Section III focuses on determinants of divestments. Section IV discusses the empirical strategy and variable definitions. Section V presents the baseline results and interprets the findings. Section VI shows the robustness checks. The last section contains the conclusions of the study.

## **II. Data**

Our data come from the *Survei Manufaktur*, the Indonesian Census of Manufacturing conducted by the National Statistical Office (BPS) on annual basis since 1975. The census surveys all registered manufacturing plants with more than 20 employees. It contains detailed information on a large number of variables, including output, inputs, ownership and participation in international trade. Our dataset covers the period 1990-2009 and contains more than 432,215 plant observations, of which about seven percent belong to foreign-owned plants. The average spell a plant remains in our sample is about 12 years.

Indonesia is a suitable country for studying consequences of FDI. It has received large inflows of FDI, worth over 41 billion dollars during the period under consideration. It has also experienced exit of many foreign investors, notably in the aftermath of the Asian Crisis.<sup>3</sup> The high quality of the data collected by the BPS has also attracted many academics. For instance, the works of Arnold and Javorcik (2009) and Blalock, Gertler, and Levine (2008) rely on the same data, although they focus on the earlier time period.

### III. Determinants of Divestments

Why do divestments happen? There is wide range of factors that can potentially explain divestments. The first set of factors is related to the parent company and its home country. For instance, a negative shock experienced by the parent company may force it to liquidate its assets abroad to avoid bankruptcy. Alternatively, an increase in the costs of borrowing in the home country may force it to curb its operations abroad.<sup>4</sup> Based on recent theoretical developments, one can also argue that productivity *growth* enjoyed by the parent company may lead it to reverse its earlier decisions about undertaking FDI.<sup>5</sup>

The second (and related) set of factors pertains to the whole network of subsidiaries belonging to the parent company. As argued in a widely cited paper by Kogut and Kulatilaka (1994), a network of subsidiaries spread over multiple countries provides a multinational firm with an 'operating flexibility' that adds value to the firm. This flexibility can be thought of as owning the option to respond to uncertain events, such as government policies, competitors' decisions, or the arrival of new technologies, by relocating production and sales across the globe. For instance,

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<sup>3</sup> Indonesia lost 14.7 billion dollar worth of FDI between 1998 and 2003 (this figure is expressed in 2005 USD, source: the *World Development Indicators*).

<sup>4</sup> Chen and Wu (1996) who study the survival rates of foreign affiliates in Taiwan find that affiliates of Japanese and US companies are less likely to exit or be divested relative to affiliates of parents originating from other countries. This finding is consistent with the view that home country conditions matter for divestment.

Denis et al. (1997) show that decreases in corporate diversification (which often happen through divestment) are associated with external corporate control threats, financial distress, and management turnover, which is consistent with the view that shocks to the parent firm may drive sales of foreign affiliates.

<sup>5</sup> Helpman et al. (2004) show that more productive firms can increase profits by paying the fixed costs of setting up overseas operations and saving on transportation costs. These are, therefore, more likely to engage in FDI rather than exports to serve a foreign market. Mrázová and Neary (2013) show that this result holds only if variable costs of production and marginal cost of serving the market are complementary. Lower trade costs will then benefit low cost firms more than they benefit high cost firms, since the former firm will already sell more abroad. They show that if this does *not* hold (which itself depends on the preference structure for example), then it is possible that a very productive firm may have little to gain from engaging in FDI because its trade costs are already very low: paying an additional fixed cost to save on (small) trade costs may then not increase profits anymore. Similarly, very productive firms may choose not to invest directly in foreign markets if their productivity advantage over other firms is large enough that they have little to gain in terms of wage costs from offshoring to low wage countries. Their wage bill is too low to warrant paying the additional fixed cost of engaging in vertical FDI. Although this argument relates mostly to the cross-section productivity distribution of firms, it is possible to envisage that a growing multinational firm will reverse previous offshoring decisions once they become even more productive. For example, Yeaple (2009) shows that there is less evidence for FDI in US data than would be expected from the distribution of productivity.

strong growth in the home country may induce a multinational to expand in the home market while divesting from a host country with less enticing growth prospects. Thus what matters here are the relative changes in growth rates, production costs, regulation, etc. in all countries of operation.

The third set of factors pertains to the affiliate's characteristics and performance. For instance, Jovanovic (1982) models firm expansion as an adaptive learning process where firms only gradually learn about their efficiency and are induced to start small. In the context of our study, we can think of parent firms facing uncertainty about whether their products or technology will be appropriate given the host country conditions, or uncertainty about the quality of the assets purchased if the entry happened through an acquisition (as opposed to setting up a greenfield project), or the quality and compatibility of the local partner in the case of joint venture projects (as opposed to fully foreign owned project). As the uncertainty reveals itself, successful affiliates grow while unsuccessful ones may be divested. Thus we would expect a negative correlation between the affiliate's size and the probability of divestment. Other affiliate-specific reasons for divestment may include expiration of tax holidays, actions of rivals, or low capital intensity which makes the affiliate unprofitable as a result of rising wages in the host country.

Finally, divestments may also be driven by shocks experienced by the potential buyers. For instance, a positive shock to an Indonesian company may encourage it to make a lucrative offer to the owners of a foreign affiliate that fits particularly well with the rest of its Indonesian business.

Unfortunately, our data set is not ideally suited for examining the determinants of divestments. It does not include information on the parent companies of foreign affiliates. Therefore, we are unable to show that shocks experienced by the parents or other subsidiaries belonging to the same parent indeed determine divestments. However, for a subsample of plants we have information on the nationality of foreign owners in 1996 and 2006.<sup>6</sup> This allows us to examine the link between divestment and the economic conditions in the parent's home country. We are also able to investigate the link between affiliate characteristics and the probability of divestment. As is evident from the left panel of Table 1 (the unmatched sample), there are large differences across a range of characteristics between affiliates that will be divested and those that will remain under foreign control. Almost all of these differences are statistically significant at the one percent level.

In Table 2, we present the results of a probit model whether the dependent variable is equal to one if the affiliate in question was divested at time  $t$ , and zero otherwise. The sample includes only plants that were foreign owned at time  $t - 1$ .<sup>7</sup> It is not clear *a priori* whether the developments

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<sup>6</sup> We are grateful to Joel Rodrigue for sharing the data with us.

<sup>7</sup> Note that in order to remain consistent with the subsequent analysis we consider only divestment cases such that the divested affiliate is not re-acquired by foreign interests within the two years after divestment. For a detailed discussion of this issue, see Section IV.1.

in the home country at time  $t$  or time  $t - 1$  are the most relevant to the divestment decision, so we estimate two alternative specifications, which nevertheless lead to the same conclusions. We find that proxies for an expanding domestic economy – GDP growth and Credit to private sector extended by banks expressed as a percentage of GDP – are positively correlated with the probability of divestment. A high lending rate in the home country also tends to induce divestments.<sup>8</sup> Moving on to project characteristics, we find that affiliates set up as greenfield projects are less likely to be divested.<sup>9</sup> The same is true of larger affiliates (in terms of output) and affiliates participating in global value chains (as proxied by the share of imports in total intermediates used).<sup>10</sup> The affiliate age, 100 percent foreign ownership and export intensity do not appear to have a statistically significant impact on the probability of divestment.

While quite informative, the analysis in Table 2 has a downside related to the limited sample considered. Controlling for home country characteristics allows us to consider only between 100 and 111 divestments depending on the control variables included.<sup>11</sup> Therefore, in our next exercise we aim to use the largest possible number of divestment cases by considering possible affiliate-specific determinants of divestment one at the time. All the determinants pertain to the year prior to divestment. We also control for 4-digit-industry-year fixed effects to account for time-varying industry-specific shocks taking place in Indonesia or global markets.<sup>12</sup> This allows us to consider between 509 and 707 divestment cases depending on the specification.

The results, presented in Table 3, confirm that affiliates established as greenfield projects, larger affiliates (in terms of employment) and those more reliant on imported inputs, as well as those with a higher export intensity, are less likely to be divested. In other words, affiliates that are more integrated into global value chains are more likely to continue operating under foreign ownership. The same is true for affiliates paying higher wages, investing more and using more capital-intensive technology. The latter finding are in line with the view that rising labor costs may entice affiliates using more labor-intensive technologies to relocate to countries with lower labor costs. Finally, fully foreign-owned affiliates, affiliates charging lower markups and those experiencing faster TFP and markup growth appear to have a slightly higher probability of divestment. That is also the case for older affiliates.<sup>13</sup>

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<sup>8</sup> The data on all three home country variables come from the World Bank's *World Development Indicators* database.

<sup>9</sup> A greenfield dummy takes on a value of one for a foreign affiliate that appears in the data for the first time as a 100 percent foreign owned and was not in the database in the year 1990 (which is the first year available in the data), and zero otherwise.

<sup>10</sup> Our results with respect to size and greenfield entry confirm the finding of Li (1995) who investigated the entry and survival of foreign subsidiaries in the U.S. computer and pharmaceutical industries.

<sup>11</sup> This is because the data on parent nationality are available only for a subset of affiliates.

<sup>12</sup> Due to a large number of fixed effects we estimate a linear probability model instead of a probit.

<sup>13</sup> The positive link between the past TFP growth and probability of divestment is consistent with the private equity

## IV. Empirical Strategy and Variable Definitions

### IV.1 Empirical strategy

As discussed in the previous section and clearly visible in the left panel of Table 1, the affiliates that undergo divestment are quite different from those that do not in the year prior to the ownership change. These differences are visible in almost every dimension of plant operations pointing to the importance of addressing the selection issue.

In our analysis, we follow the approach of Arnold and Javorcik (2009), but rather than focusing on foreign acquisitions we consider cases of divestment. We examine changes from foreign to domestic ownership taking place within the same plant. More specifically, we consider plants in which initially at least fifty percent of equity belongs to foreign owners and where the foreign equity share drops to less than ten percent and remains below this threshold for at least three years.<sup>14</sup>

To compare the performance of divested plants with the performance of plants remaining in foreign hands we use a difference-in-differences approach. In this way, we eliminate the influence of all observable and unobservable non-random elements of the divestment decision that are constant or strongly persistent over time. More specifically, we compare the change in variables of interest taking place between the pre- and post-ownership-change years in the divested plants to those in the control group.

As this comparison is still vulnerable to problems of non-random sample selection, we combine the difference-in-differences approach with propensity score matching. The latter technique controls for the selection bias by restricting the comparison to differences within carefully selected pairs of plants with similar observable characteristics and similar pre-treatment trends prior to ownership change. Its purpose is to construct the missing counterfactual of how the divested plants would have behaved had they not been sold by their foreign owners. The underlying assumption for the validity of the procedure is that conditional on the observable characteristics that are relevant for the divestment decision, potential outcomes for the treated (divested) and non-treated plants (those remaining in foreign hands) are orthogonal to the treatment status.

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business model. Private equity acquires controlling stakes in mature but underperforming companies, implements some value-enhancing changes, including management change, and then quickly disposes of the overturned company. The lack of detailed information on the foreign ex-owners prevents us from investigating the possible role of private equity in depth. However, the data on investor nationality, which are available for a limited number of plants in 1996 and 2006, show that Anglo-Saxon countries (the UK, US, Australia, British Virgin Island), i.e., those with the most active private equity funds, represent less than 10 percent of parent companies. The majority parent companies are from Japan, Korea and Taiwan. This leads us to conclude that private equity firms are unlikely to be the main driver of divestments in our dataset.

<sup>14</sup> Note that changing the threshold from ten percent to no foreign ownership at all leads to very similar results.



In the context of our exercise, the propensity score is the predicted probability of the foreign equity share in a plant changing from above fifty to under ten percent. When constructing the pairs of observations matched on the propensity score (nearest neighbor matching), we make sure that the matched control observations are assigned only from the same year and the same 4-digit ISIC sector as the divested plants. Moreover, we impose the common support restriction. We also make sure that the matched pair's probability of divestment differs by at most three percentage points. This eliminates the possibility that differences in plant performance observed across sector-year combinations exert influence on our estimated effects.

The combination of matching and a difference-in-differences approach means that we look for divergence in the paths of performance between the divested plants and the matched control plants that had similar characteristics prior to the ownership change. The analysis begins in the year prior to divestment and focuses on the (cumulative) change in performance over the following year and then each of the subsequent two periods.

In the raw data, we observe 1,709 cases of plants with foreign ownership of least 50% at time  $t-1$  which drops to less than 10% at time  $t$ . In 1,008 of these, foreign ownership remains below the 10% threshold in  $t+1$  and  $t+2$  as well. As we cannot distinguish coding errors from the situation in which a divested affiliate is reacquired, we choose to be conservative and focus only on the 1,008 cases.<sup>15</sup> Estimating the propensity score taking into account only levels of affiliate characteristics would reduce the number of divestments to 424 due to missing observations on control variables. Given the importance of common pre-trends, we also include in the propensity score changes in the TFP and markup in the pre-divestment period (i.e., changes between  $t-2$  and  $t-1$ ). Doing so cuts the number of divestments to 348. As we match within industry-year cells, for obvious reasons we need to drop cases where the divested affiliate is the only affiliate in the cell. This brings the divestment number to 322. Dropping plants with missing outcome variables in the  $[t, t+2]$  period costs us further 17 divestment. Finally, restricting the caliper so that the difference in propensity score between the treated and the control group does not exceed 3% bring us to the final sample of 157 divestments.<sup>16</sup>

The percentage of foreign equity share prior to divestment is depicted in Figure 1. Our sample encompasses a large number of affiliates which are 100 percent foreign owned, a large number of affiliates with 50 percent foreign ownership as well as many cases in between.

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<sup>15</sup> For instance, while a sequence of ownership shares of 80, 8, 80, 80 meets our definition of a divestment in the second period, it is most likely reflecting a key punch error rather than a true temporary divestment.

<sup>16</sup> In the robustness checks, we will show that our results are confirmed when we consider a larger sample of divestment cases.

The distribution of matched divested plants across ISIC 2-digit industries is presented in Table A1 in the Appendix. The largest number of divestments is found in food and beverages, apparel, textiles, furniture, and leather and leather products.

#### *IV.2 Propensity score matching*

Our estimation of the propensity score (divestment decision) proceeds as follows. We estimate a probit model where the dependent variable takes on the value of one when plant  $i$ , which used to have at least fifty percent foreign equity at time  $t-1$ , sees a decline in its foreign equity share to less than ten percent at time  $t$ . In all other cases, the dependent variable is equal to zero. We narrow our attention to the sample of foreign-owned plants in which foreign owners hold at least half of the equity at  $t-1$ .

The choice of explanatory variables is guided by the work of Arnold and Javorcik (2009). All explanatory variables are lagged one period and, where appropriate, they enter in a log form and are measured in constant Indonesian rupiahs (with base year 2000).<sup>17</sup> The level variables pertain to  $t-1$ , while variables expressed as growth rates capture pre-treatment trends and are expressed as changes between  $t-2$  and  $t-1$ .<sup>18</sup> The explanatory variables include TFP, TFP growth, markups, markup square, cube and growth rate, employment, its square and cube, share of output exported, share of imported inputs, skill intensity (ratio of non-production workers to total workers), capital intensity, output (value of goods produced), average wage, loan-financed investment normalized by output, dummies for 100 percent foreign ownership and entry as greenfield investment, plant's age and some interaction terms between explanatory variables. The model also controls for the time trend and includes a dummy for the years of the Asian crisis and the Great Recession.<sup>19</sup>

The probit results, presented in Table A2 in the Appendix, confirm the patterns found in Table 3 where we considered determinants of divestments one at the time. We find that foreign owners are more likely to sell smaller (though the relationship is nonlinear) and less skill-intensive affiliates as well as affiliates that are less reliant on imported inputs, pay lower wages and affiliates charging lower markups. While these findings point to less sophisticated affiliates being divested

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<sup>17</sup> Nominal values were deflated using producer price indices specific to 5-digit ISIC industries.

<sup>18</sup> Section VI.4 shows that all our results are robust to including longer pre-trends for a larger number of variables. To avoid shrinking the sample size further, we choose to include only TFP and markup trends between  $t-2$  to  $t-1$  in the baseline specification.

<sup>19</sup> The last year of divestment included in the sample is 2007. The crisis dummy also takes on the value 1 in 2007, the first year of the Great Recession. The peak in divestments in the sample on which propensity score is calculated occurs in 1997 (with 37 cases), the first year of the Asian crisis. In 1998 and 1999 only 15 and 13 more divestments are made, respectively. In term of the number of divestments observed, 2007 was an average year (21 divestments). In the raw data the peak of divestments is actually in 2002, but for many of the plants we observe too little information to be able to include them in the analysis.

more frequently, we also find that the probability of divestment is also higher for affiliates experiencing a faster TFP growth. Affiliates which are 100 percent foreign owned are more likely to be divested as well. In contrast, affiliates set up as greenfield projects are less likely to be sold. Finally, fewer divestments take place during the years of the Asian crisis, potentially reflecting deteriorated financial health of potential domestic buyers.

Once we obtain the propensity score, we use the nearest neighbor method to build the control group. Our matches come from the same 4-digit-ISIC-sector-year cell as the treated plants. Our matching procedure performs quite well as there is no statistically significant difference in terms of any plant characteristics between the treated and the control group (see the right panel of Table 1), implying that the groups are balanced.<sup>20</sup> This contrasts with the unmatched sample, shown in the left panel of Table 1, where the future divested affiliates and affiliates that do not experience divestments have different means across almost all the characteristics.

One may wonder whether the matched subsample is representative of the population of foreign affiliates in Indonesia. The left panel of Figure 2 plots the distribution of log TFP for the population of foreign plants not included in the matched sample and the foreign plants included in the matched sample. The figure suggests that the two distributions are very similar and thus our matched pairs in the pre-divestment period are representative of the sample of foreign plants.

The middle panel of the same figure plots the distribution of log TFP in the pre-treatment year for the treated and the control plants in the matched sample. The two distributions look very similar giving us confidence in our matching procedure.

Finally, to foreshadow our findings, the right panel shows the distribution of TFP growth between the year prior to divestment and the divestment year for the treated and the controls in the matched sample. We can clearly see from the graph that the distribution of productivity growth among the control plants is shifted to the right relative to the divested plants, indicating the negative effect of divestment on plant performance.

### *IV.3 Estimating markups and TFP*

When measuring markups (defined as the price-marginal-cost margin), we follow the method proposed by De Loecker and Warzynski (2012). These authors provide an empirical framework for estimating markups in the spirit of Hall (1986). The methodology builds on the insight that the output elasticity of a variable factor of production is equal to its expenditure share in

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<sup>20</sup> In all our results, we make sure that the two groups are balanced in terms of each of the characteristics included in the probit. We also require that balancing is achieved before matching within all blocks of the same propensity score range in the sample used for the probit regression. After matching, the median propensity score difference (probability of divestment) within matched pairs is only 0.46% points.

total revenue only when price equals marginal cost of production. Under any form of imperfect competition, a markup will drive a wedge between the input's revenue share and its output elasticity and thus will be equal to

$$\mu_{it} = \theta_{it}^X / \alpha_{it}^X \quad (1)$$

where  $\theta_{it}^X$  is the output elasticity of input  $X$  and  $\alpha_{it}^X$  is the share of expenditures on input  $X_{it}$  (in our case labor) in total sales of plant  $i$  at time  $t$ . The former is obtained by estimating a production function.

Given that this approach requires estimating output elasticities, ideally we would like to have a measure of physical output, rather than a revenue-based measure of output because the latter may reflect price differences across plants. While we do not have physical measures of output, De Loecker and Warzynski (2012) show that when relying on revenue data, only the level of the markups is potentially affected but not how markups change over time. This is fortunate for us because our analysis focuses on changes in outcomes, including the change in markups, and not levels.

To measure markups properly we need to obtain an unbiased estimate of the output elasticity of labor. The main challenge here is controlling for unobservable productivity shocks that could affect the choice of variable inputs. De Loecker and Warzynski (2012) advocate using the approach pioneered by Olley and Pakes (1996) and Levinsohn and Petrin (2003) and later extended by Akerberg, Caves and Frazer (2006), which we follow.

For the methodological details of the TFP estimation we refer the reader to the Akerberg et al. (2006) paper, noting only the key details of our implementation here. We estimate a separate translog production function for each 2-digit ISIC sector. The production function relates the log value added to (the log of) capital and labor (including squared terms and all interactions) and year and 4-digit ISIC industry fixed effects. We allow input coefficients to vary by exporter and foreign ownership status.<sup>21</sup> In the first step of the procedure, unobservable productivity shocks are proxied with the plant-specific demand for materials which enters as a second order polynomial including single and double interactions with the state variables. In the second step, we use the GMM approach and instrument current labor with lagged labor as suggested by Akerberg et al.

Value added is reported directly in the Census of Manufacturing. Capital input is proxied with the value of fixed assets, labor with the number of employees. Value added, capital and material inputs are expressed in constant Indonesian rupiahs. Nominal values are deflated using

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<sup>21</sup> By treating exporter and foreign ownership status of plants as state variables, we allow for differences in optimal input demand and do not have to make further assumptions on the underlying model of competition in each sector. We do recognize, however, that during restructuring that may be taking place at firms being divested some of the assumptions underlying the De Loecker Warzynski methodology may not hold.

producer price indices specific to 5-digit ISIC industries.

To calculate markups, we use the output elasticity of labor estimated in the production function. Dividing it by the ratio of the wage bill and expected output yields the markup.<sup>22</sup>

## V. Results from the Difference-in-Differences Analysis on the Matched Sample

### V.1 Impact on the TFP, output and markups

Once we find the control group, we estimate the following regression:

$$\Delta Outcome_{it+s} = Outcome_{it+s} - Outcome_{it-1} = \alpha + \beta_s Divestment_{it} + \varepsilon_{it} \quad (2)$$

where outcome denotes various outcomes of interest,  $i$  denotes plant and  $t$  year, and  $s \in \{0,1,2\}$ . A separate model is estimated for each value of  $s$ . In other words, we focus on the change in outcome between the year prior to divestment and the year of divestment or each of the two subsequent years. The coefficient  $\beta$  captures the average treatment effect on the treated (ATT), that is, the effect of divestment. We bootstrap standard errors using 1000 replications.<sup>23</sup>

The first outcome we consider is the TFP (see the top panel of Table 4). We find that divested plants experience a drop in productivity relative to the control group. The TFP declines by 0.038 log points in the year of ownership change and the decline persists in the two subsequent years. The left panel of Figure 3 presents productivity trajectories of the two groups. Both groups display very similar paths in the two years leading up to divestment. While the control plants continue to experience steady productivity growth, the divested affiliates register a dip in the year of divestment and then recover a bit, but they do not manage to catch up with the control group. Thus our results suggest that had the divested affiliates remained in foreign hands, they would have become more productive.

The decline in performance is accompanied by a steep drop in output growth relative to the control group: 0.345 log points in the year of divestment and 0.537 log points two years later. As can be seen from the middle panel of Figure 3, output of divested plants drops in absolute terms in the year of divestment and keeps declining. By the second year after divestment the gap between treated and control plants widens even further. In other words, had the affiliates remained foreign owned, they would have seen a much faster increase in output.

We also observe a large drop in markups relative to the control group of 0.28 or 0.29 log points in the first two years after the ownership change. The difference between the two groups is

<sup>22</sup> The wage bill is divided by expected output rather than output to make sure that the price ratio is only driven by variation in variables that drive input demand.

<sup>23</sup> Using heteroskedasticity-robust standard errors (instead of bootstrapped standard errors) would not affect our results.

somewhat smaller in the last period considered, but it remains statistically significant. Again Figure 3 (right panel) is quite informative here. It shows a relatively stable path of markups in the control group in the first two years after divestment and a very steep and persistent drop among the divested plants. After two years, markups converge a bit on average, but the difference between the two groups persists.<sup>24</sup>

### *V.2 Access to the former parent's production and distribution network*

To get a better understanding of what leads to lower output, in Table 5 we focus on international trade and domestic sales. We find that divested affiliates decrease the share of output that is exported. While this effect is not statistically significant in the year of divestment, it is significant at the one and five percent level one and two years later, respectively. The gap between the two groups widens over time and in the last year considered the difference reaches 12 percentage points. Figure 4 illustrates this point nicely. The control plants export a stable share of output (almost 43 percent) over time, while the divested plants see a steady decline in their reliance on exports to about 35 percent in the year of divestment, 28.8 percent a year later and 27.2 percent in the following year. This pattern is consistent with the divested affiliate losing access to the parent company's distribution networks abroad.

As the reliance on exports goes down in the divested plants, little seems to be happening to local market sales. There is no statistically significant difference between the two groups, and Figure 4 indicates that, if anything, the treated plants on average seem to increase their domestic sales by more than the control group. Apparently, divested plants cannot make up for the loss in exports by finding new domestic customers, which is why their output falls substantially.

In the bottom panel of Table 5, we examine the impact of divestments on the share of imported inputs (in total inputs). We find that divested plants register a 6.8 percentage point drop in their reliance on imported inputs already in the year of divestment. This drop seems to persist in subsequent years. It is another piece of evidence suggesting that divested affiliates lose their connection to the parent firm's production and distribution networks.<sup>25</sup>

### *V.3 Other aspects of plant performance*

How do divested plants cope with the new circumstances? As illustrated in Figure 5, they cut their workforce in absolute terms in the divestment year. While they increase employment in the

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<sup>24</sup> There is, however, a lot of variation in terms of markups within each group.

<sup>25</sup> Alternatively, this pattern is consistent with lower quality products, which do not require imported inputs, being sold on the domestic market.

two subsequent years, its level remains below the original one. During the same timeframe, affiliates remaining under foreign control see a substantial increase in their workforce. When compared to the plants remaining in foreign hands, the treated plants cut their employment by about 0.12 log points in the first year under new ownership. The difference between the two groups declines in the subsequent year and ceases to be statistically significant (see Table 6). It is most likely this drastic cut in employment that allows the divested plants to limit the decline in productivity stemming from a lower scale of operations. When we consider separately employment of production and non-production workers, we find that the former group bears the brunt of the layoffs.

Finally, we find that divested plants register a slower growth in the average wage relative to the control group. The difference between the two groups is not statistically significant until the last year considered when it reaches 0.183 log points. The average wage declines in the divested plants in absolute terms, while wages keep increasing in the control group (see Figure 5).<sup>26</sup>

How large are these effects in absolute terms? A back-of-the-envelope calculation suggests that one million dollars of divestment is associated with 239 jobs lost in the year of divestment.

We also consider the probability of exit as an outcome of interest (the results are not reported to save space) and find no statistically significant difference between the two groups.

#### *V.4 Access to the former parent's financing*

If foreign affiliates rely heavily on access to financing from the foreign parent, divestments should hurt their performance. Investment is the most likely outcome where this effect should be visible. However, we did not find a statistically significant difference between the treated and the control group in terms of investment. We also examined in detail the sources of financing. More specifically, we considered the impact of the share of investment that is financed by private funding, reinvested earnings, stocks and bonds, domestic loans, foreign loans, and foreign investment. Each of these sources of financing was considered separately. The figures were normalized by the total investment.

The results were not statistically significant with two exceptions. The share of reinvested earnings appears to have gone down at  $t+1$  and  $t+2$ , which may be a direct result of the drop in output. The share financed by foreign funding decreased in the year of divestment, but the effect was not statistically significant in the subsequent periods. The tables are not reported to save space.

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<sup>26</sup> In the regressions not reported here, we find that the skill intensity increases in the divested plants, though the effect is statistically significant only weakly and only in the year of divestment.

## *V.6 Transfer pricing*

One may be concerned that our results are affected by transfer pricing. If tax rates faced by multinationals in Indonesia are lower than those in other countries either because of differences in statutory tax rates or because of tax holidays, multinationals may have an incentive to inflate their profits registered in Indonesia, thus artificially inflating the TFP, markups or value of output. Transfer pricing activities stop after divestment, which brings the value of the TFP, markups and output down, consistent with the patterns observed in the data.<sup>27</sup>

There are two reasons why we do not believe that transfer pricing can be the primary driver of our findings. First, the observed changes in employment suggest that the output decline is a real rather than an accounting phenomenon. Second, Indonesia has explicit regulation against transfer pricing in place since 1984, giving tax authorities the ability to adjust related party transactions (KPMG 2013). In 1999, Indonesia was among only 32 countries in the world to have such rules (Merlo et al. 2014). Thailand for example, introduced such rules only in 2002, and China did not have comprehensive rules on transfer pricing until 2008 (KPMG 2013).

Nevertheless, to gain a better understanding of the issue we perform an additional exercise. We take advantage of the observation that the incentives to engage in transfer pricing are strong in the case of fully-owned foreign affiliates, but not in the case of partially-owned ones. This is because in the latter case the profits shifted to Indonesia would have to be shared with a local partner. In 49 out of 157 cases, foreign affiliates we consider were 100 percent foreign owned before divestment.

The results, presented in Table 7, suggest that the effects of divestment on the TFP, markups and output are not significantly different for the former fully-owned foreign affiliates. While our earlier conclusions about divestments leading to inferior performance are confirmed, we find no evidence of affiliates which were 100 percent foreign owned prior to being sold being more negatively affected. None of the interactions between the divested dummy and the full foreign ownership dummy is statistically significant and in most cases the coefficients bear a positive sign. These results attenuate our concerns about transfer pricing driving the patterns observed in the data.

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<sup>27</sup> Of course, it is not obvious that on average the tax regime is more advantageous in Indonesia than in other countries. According to KPMG, the corporate tax rate in Indonesia is 25 percent, while the OECD average is 24 percent (<http://www.kpmg.com/global/en/services/tax/tax-tools-and-resources/pages/corporate-tax-rates-table.aspx>).



## *V.7 Interpretation of the findings*

What can we conclude about the mechanism responsible for the decline in the TFP experienced by divested affiliates? The most likely explanation is that a negative demand shock, in the form of being excluded from the former parent's global value chain, leads to losing economies of scale.<sup>28</sup> While we cannot disprove that loss of access to the parent firm's financing and transfer pricing matter, the results we have presented suggest that their role (if any) would have been limited. Another very likely explanation for the worsened performance includes the loss of headquarter services (such as, for instance, assistance with marketing, information about foreign markets, etc.) and expatriate managers.

To go a bit deeper into the last point, we examine whether the effects of divestment are stronger for former affiliates that were originally set up as 100 percent foreign owned greenfield projects. It is widely believed that multinational firms tend to transfer more knowledge and know-how to their fully owned affiliates (Mansfield and Romero 1980; Ramacharandran 1993; and Javorcik and Saggi 2010). Moreover, greenfield affiliates are likely to be less embedded in the local economy, and thus in the event of expatriate management leaving less well positioned to replace them with local staff.

Indeed Table 8 suggests that the TFP decline is much larger (twice or three times as large) for former greenfield affiliates. This effect is statistically significant in the year following the ownership change and one year later. It is also robust to controlling for 100 percent foreign ownership in the year prior to divestment.

In sum, our results are suggestive of the change in ownership leading to a disruption in performance, most likely due to the loss of access to export markets previously provided by the foreign parent, loss of access to injections of knowledge and know-how from the headquarters of the former parents, management change, and possible departure of expatriate managers employed by the former foreign parent.<sup>29</sup>

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<sup>28</sup> There is ample evidence suggesting that improved access to foreign markets leads to product upgrading, product innovation and productivity improvements (see Verhoogen 2008, Bustos 2011, Guadalupe et al. 2012, and Iacovone and Javorcik 2012). Thus it is likely that loss of foreign markets will also result in less product and process innovation which over time will translate into a lower productivity growth.

<sup>29</sup> Our results are consistent with the conclusions of Arnold and Javorcik (2009) suggesting that foreign acquisitions boost the performance of acquired plants in Indonesia through introduction of better management practices. Thus it is quite likely that departure of expatriate managers in the aftermath of divestment has a negative effect on performance. They are also consistent with the conclusions of the recent economics literature which has drawn attention to the importance of manager's quality and management practices for firm performance (see Bertrand and Schoar 2003; Bloom and Van Reenen 2007; Bloom et al. 2014). The literature has also documented that foreign firms transplant their management practices to host countries (Bloom et al. 2012) and that improvements in management practices translate into better performance within months (Bloom et al. 2013).

## VI. Robustness checks

### VI.1 Longer time horizon

As the first robustness check, we consider a longer time horizon by narrowing our attention to divested plants observed for at least five years after the ownership change. This exercise is performed on a different sample of treated plants, so it involves a new estimation of the propensity score and a new choice of the control group.<sup>30</sup> Although focusing on the longer time horizon means considering only 103 cases of divestments, the results from this exercise are broadly consistent with those we have found earlier, but, as expected, they are less precisely estimated.

The results, presented in Table 9, confirm our earlier finding of a persistent decline in productivity among divested plants relative to the control group. We also find a persistent output gap between the divested and the control plants. The estimated coefficients in the markup regression bear a negative sign but reach conventional significance levels only two and four years after divestment.

In sum, we confirm our main message that losing foreign owners negatively affects the plant performance.

### VI.2 Loss of a foreign parent vs ownership change in general

An obvious question that can be raised in the context of our analysis is whether the effects we observe are due to the loss of foreign ownership *per se* or whether they would have been induced by *any ownership change*. Ideally, we would like to make a comparison between a foreign affiliate being divested into domestic hands and a domestic establishment being divested into domestic hands. Unfortunately, in our data it is not possible to observe divestment from domestic sellers to domestic buyers. However, we do observe public ownership, so we can investigate privatizations. We define privatization as a situation where the public ownership share drops from more than fifty percent to less than ten percent (to mirror the thresholds we used for foreign divestments).

This exercise, however, poses some difficulties. For propensity score matching to work we need to find foreign affiliates (that will be divested in the future) that are very similar to state-owned establishments (that will be privatized in the future). The trouble is that foreign affiliates and state-owned entities tend to be very different. There are very few foreign plants that are similar enough to state-owned plants and that are both divested in the same sector-year cell.

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<sup>30</sup> For instance, we are unable to consider divestments during the last four years of the sample period, which means that we lose two years relative to the baseline exercise.

To achieve a sample that meets these requirements and thus passes the balancing test we implement a less stringent matching procedure. We match only on (the lag of) TFP, markup and output. We find matches in a sample of 474 plants. While we acknowledge the limitations on this exercise, we still believe that it is informative.

The results, presented in Table 10, indicate that compared to privatized plants, former foreign affiliates experience a greater loss in terms of the TFP, markups, the share of output exported and the reliance on imported inputs. The magnitudes of the effects are only slightly smaller than those found in the baseline table. These results suggest that it is the loss of foreign ownership, and not just ownership change, that matters. We do not find a statistically significant effect on output, employment or wages. This is because former foreign affiliates seem to be replacing lost exports with domestic sales.

### *VI.3 Considering all divestment cases (unmatched sample)*

One may be concerned about our baseline results being based on a limited number of divestment cases. To check whether our findings are robust to including all usable divestments we perform our difference-in-difference estimation on the unmatched sample (for summary statistics, see the left panel of Table 1). In other words, we ignore the selection bias.

The results, shown in Table 11, confirm our baseline findings. We find that divested affiliates experience a large and statistically significant drop in productivity, output and markups. This dip is partially driven by lower exports intensity and partially by lower domestic sales, though in both cases the effects are not very robust. As before, we find a decline in import intensity suggestive of (at least partial) exclusion from global value chains. Not surprisingly, the divested affiliates decrease their employment by laying off production workers and lowering the average wage they pay.

In sum, most of our main results are qualitatively insensitive to the estimation method (matching vs the OLS estimator). However, the matching estimator produces larger effects and thus suggests an upward biased OLS coefficients. This is most apparent in the case of imported inputs and the share of output exported. The bias decreases once we control for pre-divestment characteristics that were used to construct the matched sample (as we do in on-line Appendix Table W1). This suggests that the OLS estimator fails to account for some unobserved characteristics of plants that are positively correlated with both divestment and import and export intensity.<sup>31</sup>

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<sup>31</sup> The direction of bias may be counterintuitive if one expects foreign parents to divest their worst performing plants first. As documented in Section II and also evident from Appendix Table A2, we find no evidence that the worst performing plants are more likely to be divested. This is consistent with the view that the decision to divest may also depend on many factors other than the characteristics of the sold affiliate. In an earlier version of this study, we have

#### *VI.4 Alternative matching controlling for longer pre-treatment trends*

In the next exercise, we aim to achieve two objectives: (i) test the robustness of our results to using a larger sample while still performing propensity score matching, and (ii) take into account a larger number and longer pre-divestment trends for the main outcomes of interest. The latter goal requires additional information and implies losing some divestment cases. To balance these objectives we include fewer variables in the propensity score regression and match within sectors (instead of sector-year cells). The propensity score controls include (the lag of) TFP, markups, output, employment and its square, investment, share of imported intermediates and share of output exported. Additionally, we control for longer pre-treatment trends by including the log (if appropriate) difference between  $t-3$  and  $t-1$  of all the variables mentioned. Finally, we control for (lagged) age, age squared, and a crisis dummy. This exercise yields 732 observations or 366 divestments, which is more than double the original sample size.

The results, shown in Table 12, paint a picture very similar to our baseline findings. We confirm that divested affiliates experience a large and statistically significant drop in productivity, output and markup. As before, this dip is driven by lower exports intensity, which together with a decline in import intensity, suggests (at least partial) exclusion from the former parent's global value chains. Not surprisingly, the divested affiliates decrease their employment by laying off production workers.

#### *VI.5 Other robustness checks*

We have also performed a robustness check by adding a crisis dummy taking on the value of one if the post-divestment year considered was a year of the Asian crisis or the recent Great Recession (i.e., 1997-99 and 2007-9), and zero otherwise, to equation (2). The augmented specification has produced very similar results.

Finally, we have addressed a concern that spillovers may be influencing our results.<sup>32</sup> For instance, redirecting exports to domestic market may mean that divested affiliates increase competitive pressures on the control group thus leading to the worsened performance of control plants. This would lead us to underestimate the effects of divestment on domestic sales and perhaps employment. At the same time, employee layoffs by divested affiliates may encourage the affiliates remaining in foreign hands (the control group) to increase employment, thus leading us to overestimate the effect on employment. These effects are most likely to be felt in the same

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shown that divested plants outperform always domestic plants in many ways (at least in the year of divestment), suggesting that the divested plants are not especially poor performers.

<sup>32</sup> We are grateful to an anonymous referee for pointing out this possibility.

geographic location.

To address this possibility we have adjusted the baseline matching procedure so that the matched and the control plant are located in different counties (*'kapupaten'*), although they are still from the same year and 4-digit industry cell. In this way, we avoid the effects of local layoffs and competition in the local market confounding the results. The estimates are presented in the on-line Appendix Table W2. They are very similar to our baseline findings. The augmented procedure has mostly improved the precision of the estimates, even though it has somewhat diminished the sample size. The only exception is the average wage, where the previously found negative effect for  $t-2$  ceased to be statistically significant.

## VII. Conclusions

To gain a better understanding of the contribution multinationals make to their foreign subsidiaries, and thus indirectly to the economy of the host country, this paper has considered developments in divested foreign affiliates.

Our analysis used plant-level panel data from the Indonesian Census of Manufacturing covering the period 1990-2009 and focused on 157 cases of divested foreign affiliates for whom information on a large set of plant characteristics was available for two years prior and three years after the ownership change and for whom we could find observationally equivalent control plants. To obtain a causal effect of foreign divestment on plant performance, our empirical strategy combined propensity score matching with a difference-in-differences approach.

We found that divested plants experience a large drop in productivity relative to the affiliates remaining in foreign hands. The TFP declines by 0.038 log points in the year of divestment and the decline persists in the two subsequent years. Similarly, divested affiliates see a large decline in their output, markups, export and import intensity. These developments are accompanied by a decline in employment driven by production workers being laid off and a decline in wages, though these effects are less pronounced.

These results are consistent with the parent company providing distribution networks and thus allowing their affiliates to benefit from scale economies. They are also in line with foreign affiliates benefiting from the superior management practices, possibly reinforced by the presence of expatriate managers, and access to knowledge and know-how transfers from the parent's headquarters. In sum, we conclude that the benefits of foreign ownership, which manifest themselves in a superior performance of foreign affiliates (relative to indigenous plants) around the world, are due to continuous injections of knowledge and access to headquarter services.

Our findings have implications for the design of FDI incentives. They suggest that any externalities associated with the presence of foreign affiliates are likely to fade away after foreign owners leave. More future research is, however, needed to examine the developments in productivity spillovers in the aftermath of foreign divestments.

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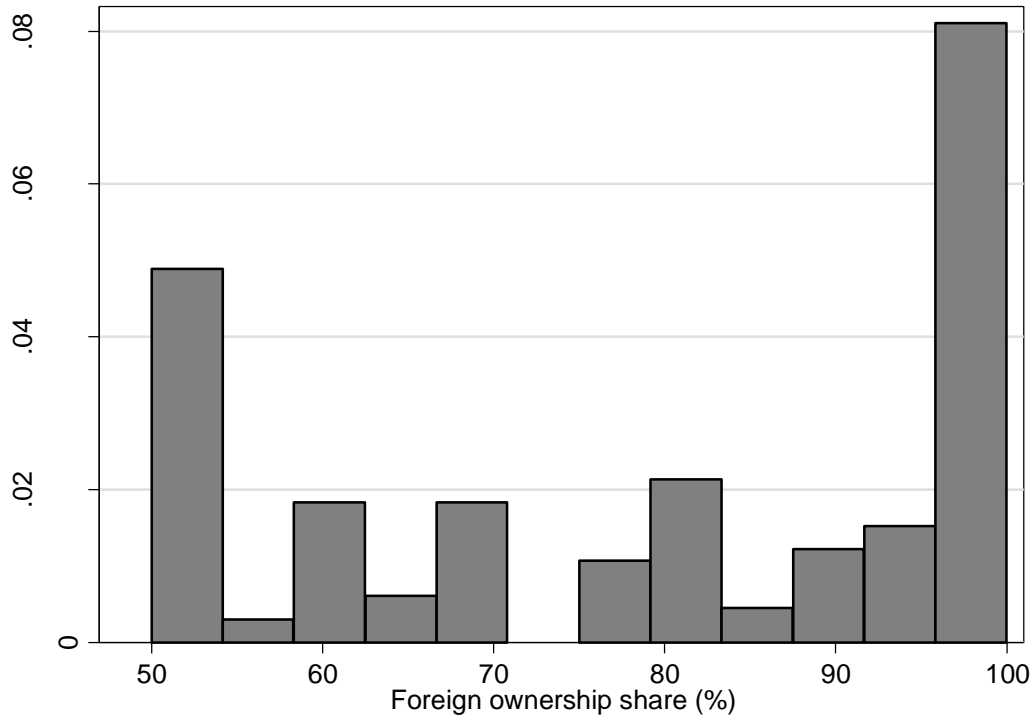
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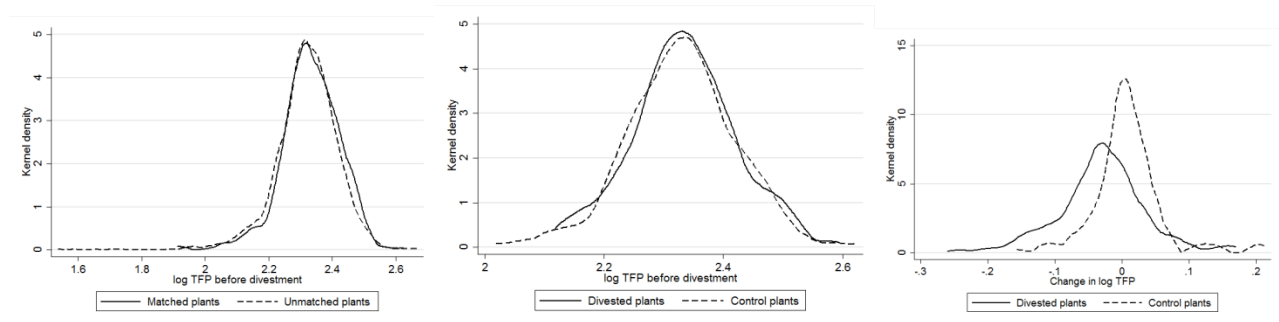
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**Figure 1. Distribution of foreign equity share prior to divestment**



Notes: The sample pools all matched treated plant prior to the year of divestment.

**Figure 2. Pre-divestment TFP level of the matched sample and the population of foreign owned plants (left panel). Distribution of TFP growth between the year before and the year of divestment among the matched divested and control plants (right panel)**



Notes: The left panel depicts the distribution of log TFP for all foreign affiliates included in the unmatched sample but not the matched sample (dashed line) and for all foreign affiliates in the matched sample (solid line). The middle panel depicts the distribution of log TFP for the matched divested affiliates (solid line) and the matched control affiliates (dashed line). The right panel depicts the change in log TFP growth between  $t-1$  and  $t$  for the matched treated (solid line) and the matched control plants (dashed line). The procedure used to obtain the matched sample is described in Section IV.2 of the paper.

**Table 1. Summary statistics for the full and the matched sample**

	unmatched sample (N=12,472)				matched sample (N=314)			
	Treated	Control	t-test	p-value	Treated	Control	t-test	p-value
log TFP <sub>t-1</sub>	2.312	2.346	-7.210	0.000	2.334	2.329	0.500	0.618
Δlog TFP <sub>t-1</sub>	0.017	0.005	3.850	0.000	0.004	0.006	-0.460	0.649
log Markup <sub>t-1</sub>	1.580	1.828	-5.970	0.000	1.782	1.800	-0.160	0.870
Δlog Markup <sub>t-1</sub>	0.157	0.031	3.130	0.002	0.074	0.002	0.720	0.473
100% foreign owned <sub>t-1</sub>	0.532	0.353	8.950	0.000	0.312	0.325	-0.240	0.809
Entered as greenfield <sub>t-1</sub>	0.101	0.169	-4.340	0.000	0.076	0.064	0.440	0.660
log Employment <sub>t-1</sub>	5.098	5.607	-10.060	0.000	5.800	5.802	-0.020	0.987
log Employment <sub>t-1</sub> <sup>2</sup>	27.635	32.897	-8.980	0.000	34.884	35.038	-0.100	0.920
log Employment <sub>t-1</sub> <sup>3</sup>	158.130	201.280	-8.010	0.000	216.960	219.550	-0.180	0.857
Skilled labor share <sub>t-1</sub>	0.182	0.217	-4.570	0.000	0.195	0.183	0.630	0.528
log Average wage <sub>t-1</sub>	8.511	8.978	-12.770	0.000	8.747	8.742	0.050	0.957
Imported input share <sub>t-1</sub>	0.244	0.450	-12.340	0.000	0.325	0.341	-0.390	0.698
Age <sub>t</sub>	13.580	12.442	2.170	0.030	13.197	12.019	0.850	0.397
Age <sub>t</sub> <sup>2</sup>	399.890	309.800	2.460	0.014	369.660	250.200	1.290	0.198
Age <sub>t</sub> <sup>3</sup>	21017.000	13560.000	2.590	0.010	18358.000	7732.300	1.500	0.134
log Capital per worker <sub>t-1</sub>	9.798	10.681	-10.080	0.000	10.227	10.258	-0.140	0.886
log Capital per worker <sub>t-1</sub> * Age	124.510	123.960	0.090	0.929	138.560	124.510	0.880	0.378
Loan-financed investment <sub>t-1</sub> /Output <sub>t-1</sub>	0.128	0.470	-0.950	0.340	0.141	0.081	1.030	0.304
log Output <sub>t-1</sub>	16.009	17.319	-17.770	0.000	17.250	17.257	-0.050	0.963
Share of output exported <sub>t-1</sub>	0.277	0.349	-4.050	0.000	0.403	0.421	-0.350	0.723
log(Investment +1) <sub>t-1</sub>	6.478	7.444	-2.810	0.005	7.944	7.986	-0.050	0.962
Share of output exported <sub>t-1</sub> * TFP <sub>t-1</sub>	0.641	0.815	-4.200	0.000	0.938	0.981	-0.370	0.713
log Average wage <sub>t-1</sub> * Markup <sub>t-1</sub>	13.134	16.068	-8.330	0.000	14.931	15.506	-0.680	0.500
Share of output exported <sub>t-1</sub> * Markup <sub>t-1</sub>	0.421	0.599	-4.970	0.000	0.670	0.661	0.080	0.934
log Output <sub>t-1</sub> * Skilled labor share <sub>t-1</sub>	2.963	3.777	-5.880	0.000	3.354	3.146	0.640	0.524
Crisis <sub>t-1</sub>	0.131	0.200	-4.130	0.000	0.178	0.178	0.000	1.000
Log Markup <sub>t-1</sub> <sup>2</sup>	3.547	4.327	-3.790	0.000	4.3405	4.0441	0.45	0.651
log Markup <sub>t-1</sub> <sup>3</sup>	9.851	12.083	-1.800	0.072	14.735	10.281	0.87	0.385
log(Investment +1) <sub>t-1</sub> * log Employment <sub>t-1</sub>	33.168	42.372	-4.480	0.000	45.866	47.597	-0.32	0.752
log Output <sub>t-1</sub> * log Employment <sub>t-1</sub>	83.953	98.477	-12.090	0.000	101.04	101.2	-0.05	0.959
Time trend	1999.600	2000.100	-3.010	0.003	1999.3	1999.3	0	1

Notes: Treated affiliates are those that will be divested next period and remain domestic for at least two more years, while control affiliates are those that will not be divested during the sample period. The procedure used to obtain the matched sample is described in Section IV.2 of the paper.

**Table 2. Determinants of divestments**

	Divestment					
	[1]	[2]	[3]	[4]	[5]	[6]
GDP growth $t$	0.028* (0.015)					
Credit to private sector by banks (% GDP) $t$	0.003** (0.001)					
Lending interest rate $t$	0.058*** (0.015)					
GDP growth $t-1$		0.050** (0.016)	0.055*** (0.016)	0.057*** (0.017)	0.057*** (0.017)	0.057*** (0.017)
Credit to private sector by banks (% GDP) $t-1$		0.003** (0.001)	0.003** (0.001)	0.003** (0.001)	0.003** (0.001)	0.003** (0.001)
Lending interest rate $t-1$		0.047** (0.016)	0.044** (0.017)	0.047** (0.017)	0.047** (0.017)	0.046** (0.018)
Fully foreign owned $t-1$			0.001 (0.001)	0.001 (0.001)	0.001 (0.001)	0.001 (0.001)
Greenfield			-0.355** (0.148)	-0.285* (0.161)	-0.290* (0.159)	-0.260 (0.161)
log Output $t-1$				-0.096*** (0.027)	-0.093*** (0.027)	-0.082** (0.028)
Age				0.002 (0.004)	0.002 (0.004)	0.000 (0.004)
Loan-financed investment $t-1$ / Output $t-1$				-0.006 (0.023)	-0.007 (0.026)	-0.005 (0.021)
Share of output exported $t-1$					-0.110 (0.105)	-0.105 (0.105)
Share of imported inputs $t-1$						-0.269** (0.117)
Year fixed effects	yes	yes	yes	yes	yes	yes
Pseudo R-squared	0.06	0.06	0.07	0.08	0.08	0.09
No of obs	5080	5100	5100	4767	4767	4750
No of divestments	111	110	110	100	100	100

Notes: The table presents estimates of a probit model where the dependent variable is the probability that foreign affiliate  $i$  is divested at time  $t$ , and zero otherwise. Only plants that are foreign affiliates at  $t-1$  are included in the sample. The sample includes only foreign affiliates for which information on the nationality of the foreign parent company is available. Country specific variables pertain to the home country of the foreign parent. Plant specific characteristics pertain to the affiliate itself. Standard errors are listed in parentheses.

\*, \*\*, and \*\*\* represent significance at the 10, 5, and 1 percent levels, respectively.

**Table 3. Affiliate characteristics as determinants of divestment**

	100% lag	Greenfield	TFP lag	ΔTFP lag	Markup lag	ΔMarkup lag	Employment lag
	[1]	[2]	[3]	[4]	[5]	[6]	[7]
Estimate	0.0004*** (0.00004)	-0.014** (0.005)	-0.021 (0.024)	0.076** (0.032)	-0.010*** (0.002)	0.005* (0.003)	-0.022*** (0.002)
Industry-year FE	yes	yes	Yes	yes	yes	yes	yes
R-squared	0.07	0.06	0.06	0.07	0.07	0.11	0.07
No of obs	14470	14470	13042	11339	13033	11323	14470
No of divestments	707	707	638	525	637	524	707

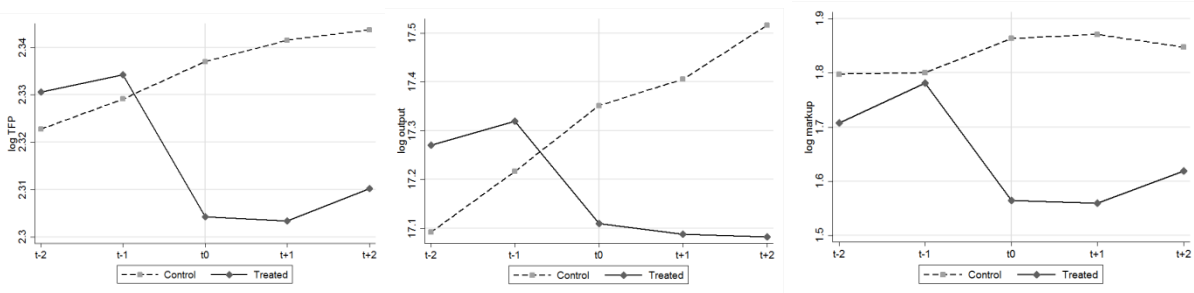
	Avg wage lag	Imported in-puts lag	Age	K/L lag	Loan/output lag	Share of output exported lag	Investment lag
	[8]	[9]	[10]	[11]	[12]	[13]	[14]
Estimate	-0.021*** (0.002)	-0.054*** (0.006)	0.0004*** (0.0001)	-0.009*** (0.001)	-0.0002 (0.0001)	-0.038*** (0.005)	-0.001** (0.0003)
Industry-year FE	yes	yes	Yes	yes	yes	yes	yes
R-squared	0.06	0.07	0.06	0.07	0.06	0.06	0.06
No of obs	14460	13884	14470	9813	13466	14470	13461
No of divestments	705	675	707	509	674	707	677

Notes: The table presents estimates of a linear probability model where the dependent variable is the probability that foreign affiliate  $i$  is divested at time  $t$ , and zero otherwise. Only plants that are foreign affiliates at  $t-1$  are included in the sample. The sample includes only foreign affiliates for which information on the nationality of the foreign parent company is available. Plant specific characteristics pertain to the affiliate. Standard errors are listed in parentheses. \*, \*\*, and \*\*\* represent significance at the 10, 5, and 1 percent levels, respectively.

**Table 4. Results for TFP, output and markups**

	[1]	[2]	[3]
<b>Panel A</b>		$\Delta_s \log(\text{TFP})$	
s =	t (year of divestment)	t+1	t+2
Divestment	-0.038*** (0.007)	-0.043*** (0.007)	-0.038*** (0.008)
Observations	314	314	314
R-squared	0.090	0.095	0.065
<b>Panel B</b>		$\Delta_s \log(\text{Output})$	
s =	t (year of divestment)	t+1	t+2
Divestment	-0.345*** (0.101)	-0.421*** (0.126)	-0.537*** (0.131)
Observations	328	328	328
R-squared	0.033	0.032	0.047
<b>Panel C</b>		$\Delta_s \log(\text{Markup})$	
s =	t (year of divestment)	t+1	t+2
Divestment	-0.280*** (0.107)	-0.293** (0.119)	-0.210* (0.120)
Observations	314	314	314
R-squared	0.021	0.019	0.010

Notes:  $\Delta_s = s - (t-1)$ . The estimation is performed on the matched sample described in Section IV.2 of the paper. The propensity score probit controls for the lagged value of (logged if appropriate) TFP, TFP growth, markup, its square, cube and growth rate, employment, its square and cube, share of output exported, share of imported inputs, skill intensity (ratio of non-production workers to total workers), capital intensity, output (value of goods produced), average wage, plant's age, share in output of investment financed by loans, investment, time trend, dummy for the years of the Asian crisis and the Great Recession, dummy for 100% foreign ownership, dummy for greenfield investment, and the interaction terms between explanatory variables listed in Table 1. The dependent variables are expressed as differences between  $t-1$  (i.e., the year prior to divestment) and year  $t$  (column 1),  $t+1$  (column 2) and  $t+2$  (column 3). Divestment is a time-invariant dummy taking on the value of one for foreign affiliates divested in year  $t$ , and zero otherwise. Bootstrapped standard errors are listed in parentheses. A constant is included in all specifications, but not reported. \*, \*\*, and \*\*\* represent significance at the 10, 5, and 1 percent levels, respectively.

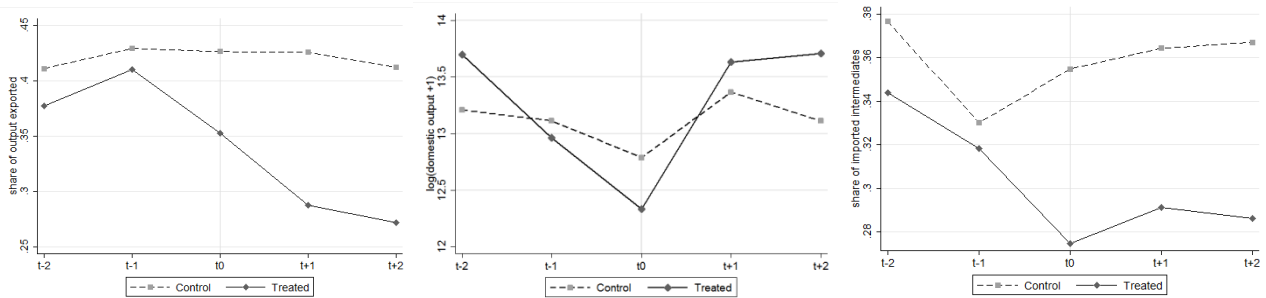
**Figure 3. Trajectories of divested and control plants: TFP, output and markups**

Notes:  $t=0$  refers to the year of divestment. Each panel depicts the trajectory of the relevant outcome variable in levels in the two years leading up to divestment and two years after divestment for the treated (solid line) and the control group (dashed line). The following outcomes are depicted: log TFP (left panel), log output (middle panel) and log markup (right panel). The samples are the same as those used in the corresponding regressions in Table 4.

**Table 5. Results for export share, domestic sales and imported inputs**

	[1]	[2]	[3]
<b>Panel A</b>	<b><math>\Delta_s</math> Share of output exported</b>		
s =	t (year of divestment)	t+1	t+2
Divestment	-0.055 (0.040)	-0.119*** (0.046)	-0.121** (0.049)
Observations	344	344	344
R-squared	0.005	0.019	0.018
<hr/>			
<b>Panel B</b>	<b><math>\Delta_s \log(\text{Domestic sales} + 1)</math><sup>33</sup></b>		
s =	t (year of divestment)	t+1	t+2
Divestment	-0.304 (0.714)	0.416 (0.772)	0.749 (0.856)
Observations	344	344	344
R-squared	0.001	0.001	0.002
<hr/>			
<b>Panel C</b>	<b><math>\Delta_s</math> Share of imported inputs</b>		
s =	t (year of divestment)	t+1	t+2
Divestment	-0.068** (0.029)	-0.061* (0.033)	-0.069** (0.034)
Observations	338	338	338
R-squared	0.017	0.010	0.013

Notes:  $\Delta_s = s - (t-1)$ . The estimation is performed on the matched sample described in Section IV.2 of the paper. The propensity score probit controls for the lagged value of (logged if appropriate) TFP, TFP growth, markup, its square, cube and growth rate, employment, its square and cube, share of output exported, share of imported inputs, skill intensity (ratio of non-production workers to total workers), capital intensity, output (value of goods produced), average wage, plant's age, share in output of investment financed by loans, investment, time trend, dummy for the years of the Asian crisis and the Great Recession, dummy for 100% foreign ownership, dummy for greenfield investment, and the interaction terms between explanatory variables listed in Table 1. The dependent variables are expressed as differences between  $t-1$  (i.e., the year prior to divestment) and year  $t$  (column 1),  $t+1$  (column 2) and  $t+2$  (column 3). Divestment is a time-invariant dummy taking on the value of one for foreign affiliates divested in year  $t$ , and zero otherwise. Bootstrapped standard errors are listed in parentheses. A constant is included in all specifications, but not reported. \*, \*\*, and \*\*\* represent significance at the 10, 5, and 1 percent levels, respectively.

**Figure 4. Trajectories of divested and control plants: export share, domestic sales and imported inputs**

Notes:  $t0$  refers to the year of divestment. Each panel depicts the trajectory of the relevant outcome variable in levels in the two years leading up to divestment and two years after divestment for the treated (solid line) and the control group (dashed line). The following outcomes are depicted: the share of output exported (left panel), log domestic sales (middle panel) and the share of imported intermediates (right panel). The samples are the same as those used in the corresponding regressions in Table 5.

<sup>33</sup> We added one before taking a log to avoid losing from the sample pure exporters.

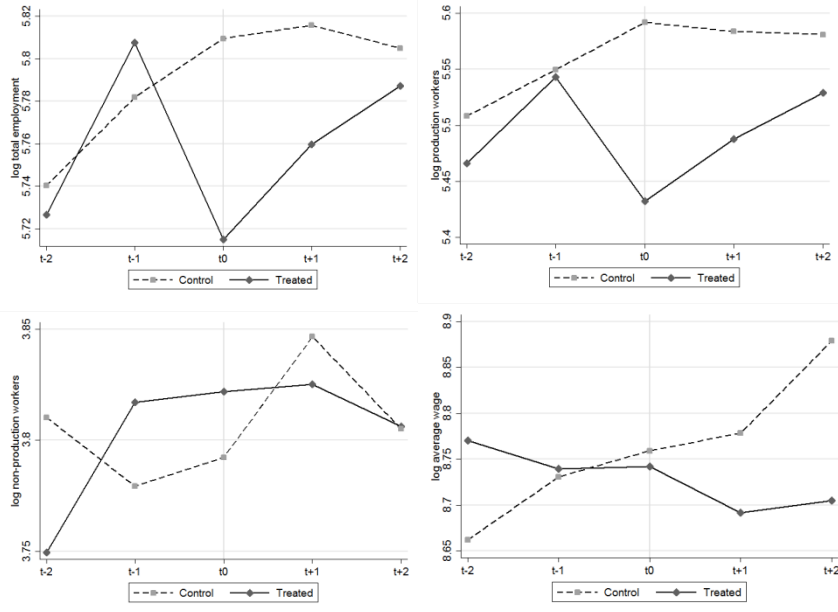
**Table 6. Results for employment and wages**

	[1]	[2]	[3]
<b>Panel A</b>			
$s =$	$t$ (year of divestment)	$\Delta_s \log(\text{Employment})$ $t+1$	$t+2$
Divestment	-0.120** (0.051)	-0.082 (0.051)	-0.043 (0.052)
Observations	344	344	344
R-squared	0.016	0.007	0.002
<b>Panel B</b>			
$s =$	$t$ (year of divestment)	$\Delta_s \log(\text{Employment of production workers})$ $t+1$	$t+2$
Divestment	-0.153*** (0.059)	-0.089 (0.063)	-0.045 (0.067)
Observations	344	344	344
R-squared	0.020	0.006	0.001
<b>Panel C</b>			
$s =$	$t$ (year of divestment)	$\Delta_s \log(\text{Employment of non-production workers})$ $t+1$	$t+2$
Divestment	-0.008 (0.078)	-0.059 (0.089)	-0.037 (0.094)
Observations	322	322	322
R-squared	0.000	0.001	0.000
<b>Panel D</b>			
$s =$	$t$ (year of divestment)	$\Delta_s \log(\text{Average wage})$ $t+1$	$t+2$
Divestment	-0.026 (0.082)	-0.095 (0.096)	-0.183** (0.092)
Observations	344	344	344
R-squared	0.000	0.003	0.011

Notes:  $\Delta_s = s - (t-1)$ . The estimation is performed on the matched sample described in Section IV.2 of the paper. The propensity score probit controls for the lagged value of (logged if appropriate) TFP, TFP growth, markup, its square, cube and growth rate, employment, its square and cube, share of output exported, share of imported inputs, skill intensity (ratio of non-production workers to total workers), capital intensity, output (value of goods produced), average wage, plant's age, share in output of investment financed by loans, investment, time trend, dummy for the years of the Asian crisis and the Great Recession, dummy for 100% foreign ownership, dummy for greenfield investment, and the interaction terms between explanatory variables listed in Table 1. The dependent variables are expressed as differences between  $t-1$  (i.e., the year prior to divestment) and year  $t$  (column 1),  $t+1$  (column 2) and  $t+2$  (column 3). Divestment is a time-invariant dummy taking on the value of one for foreign affiliates divested in year  $t$ , and zero otherwise. Bootstrapped standard errors are listed in parentheses. A constant is included in all specifications, but not reported. \*, \*\*, and \*\*\* represent significance at the 10, 5, and 1 percent levels, respectively.



**Figure 5. Trajectories of divested and control plants: Employment and wages**



Notes:  $t0$  refers to the year of divestment. Each panel depicts the trajectory of the relevant outcome variable in levels in the two years leading up to divestment and two years after divestment for the treated (solid line) and the control group (dashed line). The following outcomes are depicted: log total employment (top left panel), log production workers (top middle panel), log non-production workers (right panel) and log average wage (bottom panel). The samples are the same as those used in the corresponding regressions in Table 6.

**Table 7. Former fully versus partially foreign owned affiliates**

	[1]	[2]	[3]
<b>Panel A</b>	<b><math>\Delta_s \log(\text{TFP})</math></b>		
s =	t (year of divestment)	t+1	t+2
Divestment	-0.039*** (0.009)	-0.041*** (0.010)	-0.039*** (0.010)
Divestment * 100% foreign owned	0.005 (0.014)	-0.006 (0.015)	0.002 (0.016)
100% foreign owned	0.005 (0.008)	-0.000 (0.010)	0.006 (0.011)
Observations	314	314	314
R-squared	0.094	0.095	0.066
<b>Panel B</b>	<b><math>\Delta_s \log(\text{Markup})</math></b>		
s =	t (year of divestment)	t+1	t+2
Divestment	-0.292** (0.143)	-0.314** (0.153)	-0.229 (0.146)
Divestment * 100% foreign owned	0.037 (0.219)	0.064 (0.235)	0.057 (0.246)
100% foreign owned	-0.030 (0.122)	-0.095 (0.133)	-0.084 (0.153)
Observations	314	314	314
R-squared	0.021	0.020	0.011
<b>Panel C</b>	<b><math>\Delta_s \log(\text{Output})</math></b>		
s =	t (year of divestment)	t+1	t+2
Divestment	-0.372*** (0.125)	-0.512*** (0.163)	-0.674*** (0.169)
Divestment * 100% foreign owned	0.096 (0.213)	0.291 (0.264)	0.424 (0.283)
100% foreign owned	0.047 (0.127)	-0.077 (0.169)	-0.168 (0.195)
Observations	328	328	328
R-squared	0.036	0.036	0.053

Notes:  $\Delta_s = s - (t-1)$ . The estimation is performed on the matched sample described in Section IV.2 of the paper. The propensity score probit controls for the lagged value of (logged if appropriate) TFP, TFP growth, markup, its square, cube and growth rate, employment, its square and cube, share of output exported, share of imported inputs, skill intensity (ratio of non-production workers to total workers), capital intensity, output (value of goods produced), average wage, plant's age, share in output of investment financed by loans, investment, time trend, dummy for the years of the Asian crisis and the Great Recession, dummy for 100% foreign ownership, dummy for greenfield investment, and the interaction terms between explanatory variables listed in Table 1. The dependent variables are expressed as differences between  $t-1$  (i.e., the year prior to divestment) and year  $t$  (column 1),  $t+1$  (column 2) and  $t+2$  (column 3). Divestment is a time-invariant dummy taking on the value of one for foreign affiliates divested in year  $t$ , and zero otherwise. Bootstrapped standard errors are listed in parentheses. A constant is included in all specifications, but not reported. \*, \*\*, and \*\*\* represent significance at the 10, 5, and 1 percent levels, respectively.

**Table 8. Are former greenfield affiliates affected more?**

	[1]	[2]	[3]	[4]	[5]	[6]
	$\Delta_s \log(\text{TFP})$					
s =	t (year of divestment)		t+1		t+2	
Divestment	-0.035*** (0.007)	-0.039*** (0.009)	-0.040*** (0.008)	-0.041*** (0.010)	-0.033*** (0.008)	-0.039*** (0.011)
Divestment * Greenfield	-0.031 (0.027)	-0.040 (0.028)	-0.045* (0.027)	-0.048 (0.029)	-0.078** (0.033)	-0.091*** (0.033)
Divestment * 100% foreign owned		0.013 (0.013)		0.005 (0.014)		0.021 (0.018)
Greenfield	0.003 (0.010)	-0.001 (0.011)	-0.001 (0.014)	-0.001 (0.016)	0.044* (0.023)	0.046** (0.023)
100% foreign owned		0.006 (0.009)		0.000 (0.010)		-0.003 (0.012)
Observations	314	314	314	314	314	314
R-squared	0.098	0.107	0.110	0.111	0.082	0.087

Notes:  $\Delta_s = s - (t-1)$ . The estimation is performed on the matched sample described in Section IV.2 of the paper. The propensity score probit controls for the lagged value of (logged if appropriate) TFP, TFP growth, markup, its square, cube and growth rate, employment, its square and cube, share of output exported, share of imported inputs, skill intensity (ratio of non-production workers to total workers), capital intensity, output (value of goods produced), average wage, plant's age, share in output of investment financed by loans, investment, time trend, dummy for the years of the Asian crisis and the Great Recession, dummy for 100% foreign ownership, dummy for greenfield investment, and the interaction terms between explanatory variables listed in Table 1. The dependent variables are expressed as differences between  $t-1$  (i.e., the year prior to divestment) and year  $t$  (column 1),  $t+1$  (column 2) and  $t+2$  (column 3). Divestment is a time-invariant dummy taking on the value of one for foreign affiliates divested in year  $t$ , and zero otherwise. 100% foreign owned is a time-invariant dummy taking on the value of one for foreign affiliates that were fully foreign owned at time  $t-1$ , and zero otherwise. Greenfield is a time-invariant dummy taking on the value of one for foreign affiliates that were set up as greenfield projects, and zero otherwise. Bootstrapped standard errors are listed in parentheses. A constant is included in all specifications, but not reported. \*, \*\*, and \*\*\* represent significance at the 10, 5, and 1 percent levels, respectively.

**Table 9. Results for TFP, output and markups. Longer time horizon**

	[1]	[2]	[3]	[4]	[5]
<b>Panel A</b>					
$s =$	$t$ (year of divestment)	$t+1$	$\Delta_s \log(\text{TFP})$ $t+2$	$t+3$	$t+4$
Divestment	-0.032*** (0.010)	-0.054*** (0.011)	-0.039*** (0.011)	-0.048*** (0.011)	-0.043*** (0.012)
Observations	206	206	206	206	206
R-squared	0.047	0.101	0.054	0.085	0.066
<b>Panel B</b>					
$s =$	$t$ (year of divestment)	$t+1$	$\Delta_s \log(\text{Output})$ $t+2$	$t+3$	$t+4$
Divestment	-0.063 (0.119)	-0.313** (0.142)	-0.381** (0.154)	-0.367** (0.162)	-0.318* (0.173)
Observations	214	214	214	214	214
R-squared	0.001	0.022	0.026	0.022	0.016
<b>Panel C</b>					
$s =$	$t$ (year of divestment)	$t+1$	$\Delta_s \log(\text{Markup})$ $t+2$	$t+3$	$t+4$
Divestment	-0.158 (0.115)	-0.307** (0.131)	-0.188 (0.136)	-0.264* (0.143)	-0.224 (0.149)
Observations	206	206	206	206	206
R-squared	0.009	0.027	0.010	0.017	0.011

Notes:  $\Delta_s = s - (t-1)$ . The estimation is performed on the matched sample described in Section VI.1 of the paper. The propensity score probit controls for lagged value of (logged if appropriate) TFP, TFP growth, markup, its square, cube and growth rate, employment, its square and cube, share of output exported, share of imported inputs, skill intensity (ratio of non-production workers to total workers), capital intensity, output (value of goods produced), average wage, plant's age, share in output of investment financed by loans, investment, time trend, dummy for the years of the Asian crisis and the Great Recession, dummy for 100% foreign ownership, dummy for greenfield investment, and the interaction terms between explanatory variables listed in Table 1. The dependent variables are expressed as differences between  $t-1$  (i.e., the year prior to divestment) and year  $t$  (column 1),  $t+1$  (column 2) and  $t+2$  (column 3). Divestment is a time-invariant dummy taking on the value of one for foreign affiliates divested in year  $t$ , and zero otherwise. Bootstrapped standard errors are listed in parentheses. A constant is included in all specifications, but not reported. \*, \*\*, and \*\*\* represent significance at the 10, 5, and 1 percent levels, respectively.

**Table 10. Matching results on a sample of divested foreign owned and privatized publicly owned plants**

[1]				[4]				[7]			
Panel A $\Delta_s \log(\text{TFP})$				Panel B $\Delta_s \log(\text{Output})$				Panel C $\Delta_s \log(\text{Markup})$			
s=	t	t+1	t+2	s=	t	t+1	t+2	s=	t	t+1	t+2
Divestment	-0.027*** (0.005)	-0.031*** (0.006)	-0.033*** (0.006)	Divestment	0.178 (0.108)	0.139 (0.103)	0.126 (0.111)	Divestment	-0.193** (0.076)	-0.212*** (0.074)	-0.213*** (0.073)
Observations	474	474	474	Observations	480	480	480	Observations	472	472	472
R-squared	0.048	0.052	0.057	R-squared	0.006	0.004	0.002	R-squared	0.013	0.017	0.018
Panel D $\Delta_s(\text{Share of output exported})$				Panel E $\Delta_s \log(\text{Domestic sales} + 1)$				Panel F $\Delta_s(\text{Share of imported inputs})$			
s=	t	t+1	t+2	s=	t	t+1	t+2	s=	t	t+1	t+2
Divestment	-0.094*** (0.033)	-0.149*** (0.033)	-0.114*** (0.037)	Divestment	1.683*** (0.548)	1.893*** (0.547)	0.841 (0.580)	Divestment	-0.043* (0.023)	-0.023 (0.023)	-0.042* (0.023)
Observations	514	514	514	Observations	514	514	514	Observations	484	484	484
R-squared	0.016	0.037	0.019	R-squared	0.019	0.023	0.004	R-squared	0.007	0.002	0.007
Panel G $\Delta_s \log(\text{Employment})$				Panel H $\Delta_s \log(\text{Employment of production workers})$				Panel I $\Delta_s \log(\text{Employment of non-production workers})$			
s=	t	t+1	t+2	s=	t	t+1	t+2	s=	t	t+1	t+2
Divestment	-0.046 (0.053)	-0.014 (0.058)	0.036 (0.062)	Divestment	-0.079 (0.059)	-0.017 (0.063)	0.005 (0.068)	Divestment	-0.020 (0.091)	-0.072 (0.091)	-0.088 (0.103)
Observations	514	514	514	Observations	504	504	504	Observations	416	416	416
R-squared	0.001	0.000	0.001	R-squared	0.004	0.000	0.000	R-squared	0.000	0.001	0.002
Panel J $\Delta_s \log(\text{Average wage})$											
s=	t	t+1	t+2								
Divestment	-0.045 (0.067)	-0.070 (0.069)	-0.068 (0.065)								
Observations	512	512	512								
R-squared	0.001	0.002	0.002								

Notes:  $\Delta_s = s - (t-1)$ . The estimation is performed on the matched sample described in Section VI.2 of the paper. The propensity score probit controls for the lagged value of logged TFP, markup and output. The dependent variables are expressed as differences between  $t-1$  (i.e., the year prior to divestment) and year  $t$  (year of divestment, columns 1, 4 and 7),  $t+1$  (column 2, 5, and 8) and  $t+2$  (column 3, 6, and 9). Divestment is a time-invariant dummy taking on the value of one for foreign affiliates divested in year  $t$ , and zero otherwise. Bootstrapped standard errors are listed in parentheses. A constant is included in all specifications, but not reported. \*, \*\*, and \*\*\* represent significance at the 10, 5, and 1 percent levels, respectively.

**Table 11. OLS results on full sample of foreign plants**

[1]				[4]				[7]			
Panel A				Panel B				Panel C			
$\Delta_s \log(\text{TFP})$				$\Delta_s \log(\text{Output})$				$\Delta_s \log(\text{Markup})$			
s=	t	t+1	t+2	s=	t	t+1	t+2	s=	t	t+1	t+2
Divestment	-0.032*** (0.004)	-0.030*** (0.004)	-0.030*** (0.004)	Divestment	-0.212*** (0.058)	-0.245*** (0.055)	-0.293*** (0.059)	Divestment	-0.267*** (0.046)	-0.289*** (0.050)	-0.271*** (0.048)
Observations	12472	12472	12472	Observations	13336	13336	13336	Observations	12452	12452	12452
R-squared	0.011	0.007	0.006	R-squared	0.002	0.002	0.003	R-squared	0.004	0.004	0.003
Panel D				Panel E				Panel F			
$\Delta_s(\text{Share of output exported})$				$\Delta_s \log(\text{Domestic sales} + 1)$				$\Delta_s(\text{Share of imported inputs})$			
s=	t	t+1	t+2	s=	t	t+1	t+2	s=	t	t+1	t+2
Divestment	0.019 (0.016)	-0.022 (0.016)	-0.029* (0.017)	Divestment	-0.979*** (0.262)	-0.264 (0.268)	-0.052 (0.313)	Divestment	-0.042*** (0.013)	-0.043*** (0.013)	-0.033** (0.013)
Observations	14470	14470	14470	Observations	14468	14468	14468	Observations	13465	13465	13465
R-squared	0.000	0.000	0.000	R-squared	0.001	0.000	0.000	R-squared	0.002	0.001	0.001
Panel G				Panel H				Panel I			
$\Delta_s \log(\text{Employment})$				$\Delta_s \log(\text{Employment of production workers})$				$\Delta_s \log(\text{Employment of non-production workers})$			
s=	t	t+1	t+2	s=	t	t+1	t+2	s=	t	t+1	t+2
Divestment	-0.070** (0.027)	-0.092*** (0.029)	-0.100*** (0.029)	Divestment	-0.067** (0.029)	-0.082*** (0.031)	-0.084*** (0.031)	Divestment	-0.038 (0.039)	-0.042 (0.043)	-0.059 (0.046)
Observations	14470	14470	14470	Observations	14295	14295	14295	Observations	13414	13414	13414
R-squared	0.002	0.002	0.002	R-squared	0.001	0.001	0.001	R-squared	0.000	0.000	0.000
Panel J											
$\Delta_s \log(\text{Average wage})$											
s=	t	t+1	t+2								
Divestment	-0.068* (0.036)	-0.060 (0.038)	-0.072** (0.036)								
Observations	14448	14448	14448								
R-squared	0.000	0.000	0.000								

Notes:  $\Delta_s = s - (t-1)$ . The estimation is performed on the full sample of foreign affiliates corresponding to the summary statistics presented in the left panel of Table 1. The dependent variables are expressed as differences between  $t-1$  (i.e., the year prior to divestment) and year  $t$  (year of divestment, columns 1, 4 and 7),  $t+1$  (column 2, 5, and 8) and  $t+2$  (column 3, 6, and 9). Divestment is a time-invariant dummy taking on the value of one for foreign affiliates divested in year  $t$ , and zero otherwise. Each regression includes industry-year fixed effects (not reported). Robust standard errors in parenthesis. \*, \*\*, and \*\*\* represent significance at the 10, 5, and 1 percent levels, respectively.

**Table 12. Matching results controlling for longer pre-treatment trends**

[1] [2] [3]				[4] [5] [6]				[7] [8] [9]			
Panel A $\Delta_s \log(\text{TFP})$				Panel B $\Delta_s \log(\text{Output})$				Panel C $\Delta_s \log(\text{Markup})$			
s=	t	t+1	t+2	s=	t	t+1	t+2	s=	t	t+1	t+2
Divestment	-0.036*** (0.006)	-0.031*** (0.006)	-0.036*** (0.007)	Divestment	-0.306*** (0.095)	-0.425*** (0.102)	-0.292*** (0.086)	Divestment	-0.296*** (0.069)	-0.286*** (0.074)	-0.343*** (0.076)
Observations	732	732	732	Observations	738	738	738	Observations	732	732	732
R-squared	0.051	0.030	0.034	R-squared	0.014	0.023	0.016	R-squared	0.026	0.019	0.027
Panel D $\Delta_s(\text{Share of output exported})$				Panel E $\Delta_s \log(\text{Domestic sales} + 1)$				Panel F $\Delta_s(\text{Share of imported inputs})$			
s=	t	t+1	t+2	s=	t	t+1	t+2	s=	t	t+1	t+2
Divestment	-0.009 (0.027)	-0.058** (0.028)	-0.069** (0.030)	Divestment	-0.734 (0.450)	-0.211 (0.488)	-0.535 (0.493)	Divestment	-0.045*** (0.016)	-0.067*** (0.018)	-0.069*** (0.019)
Observations	768	768	768	Observations	768	768	768	Observations	742	742	742
R-squared	0.000	0.006	0.007	R-squared	0.004	0.000	0.002	R-squared	0.010	0.018	0.019
Panel G $\Delta_s \log(\text{Employment})$				Panel H $\Delta_s \log(\text{Employment of production workers})$				Panel I $\Delta_s \log(\text{Employment of non-production workers})$			
s=	t	t+1	t+2	s=	t	t+1	t+2	s=	t	t+1	t+2
Divestment	-0.078** (0.037)	-0.127*** (0.040)	-0.126*** (0.043)	Divestment	-0.082** (0.041)	-0.127*** (0.042)	-0.124** (0.048)	Divestment	0.003 (0.052)	-0.066 (0.067)	-0.094 (0.075)
Observations	768	768	768	Observations	762	762	762	Observations	698	698	698
R-squared	0.006	0.012	0.011	R-squared	0.005	0.010	0.008	R-squared	0.000	0.001	0.002
Panel J $\Delta_s \log(\text{Average wage})$											
s=	t	t+1	t+2								
Divestment	-0.015 (0.061)	-0.045 (0.073)	-0.040 (0.067)								
Observations	768	768	768								
R-squared	0.000	0.000	0.000								

Notes:  $\Delta_s = s - (t-1)$ . The estimation is performed on the matched sample described in Section VI.4 of the paper. The propensity score probit controls for lagged value of (logged if appropriate) TFP, markup, output, employment and its square, investment, share of imported intermediates and share of output exported. Additionally, it controls for longer pre-treatment trends by including the log (if appropriate) difference between  $t-3$  and  $t-1$  of all the variables mentioned. Finally, it controls for (lagged) age, age squared, and a crisis dummy. Matching is done within sectors. The dependent variables are expressed as differences between  $t-1$  (i.e., the year prior to divestment) and year  $t$  (year of divestment, columns 1, 4 and 7),  $t+1$  (column 2, 5, and 8) and  $t+2$  (column 3, 6, and 9). Divestment is a time-invariant dummy taking on the value of one for foreign affiliates divested in year  $t$ , and zero otherwise. Bootstrapped standard errors are listed in parentheses. A constant is included in all specifications, but not reported. \*, \*\*, and \*\*\* represent significance at the 10, 5, and 1 percent levels, respectively.

## APPENDIX

**Table A1. Distribution of divestments across industries. The matched sample**

Sector	Freq.	Percent
Food and beverages	23	14.65
Apparel	23	14.65
Textiles	19	12.1
Furniture	19	12.1
Leather and leather products	11	7.01
Chemicals and chemical products	10	6.37
Rubber and plastics products	9	5.73
Wood and wood products	7	4.46
Electrical machinery and apparatus n.e.c.	7	4.46
Fabricated metal products	6	3.82
Machinery and equipment n.e.c.	6	3.82
Other non-metallic mineral products	4	2.55
Basic metals	3	1.91
Motor vehicles	3	1.91
Publishing and printing	2	1.27
Other transport equipment	2	1.27
Paper and paper products	1	0.64
Coke, refined petroleum products	1	0.64
Radio, TV and communications equipment	1	0.64
Total	157	100

Notes: n.e.c. stand for not elsewhere classified



**Table A2. Predicting divestments**

	[1]
log TFP <sub>t-1</sub>	0.017 (0.028)
Δlog TFP <sub>t-1</sub>	0.053* (0.029)
log markup <sub>t-1</sub>	-0.033* (0.017)
Δlog markup <sub>t-1</sub>	0.001 (0.003)
100% foreign owned <sub>t-1</sub>	0.031*** (0.004)
Entered as greenfield <sub>t-1</sub>	-0.050*** (0.008)
log Employment <sub>t-1</sub>	-0.254*** (0.057)
log Employment <sub>t-1</sub> <sup>2</sup>	0.033*** (0.010)
log Employment <sub>t-1</sub> <sup>3</sup>	-0.002*** (0.001)
Skilled labor share <sub>t-1</sub>	-0.464*** (0.103)
log Average wage <sub>t-1</sub>	-0.022*** (0.006)
Imported input share <sub>t-1</sub>	-0.030*** (0.005)
Age <sub>t</sub>	-0.000 (0.001)
Age <sub>t</sub> <sup>2</sup>	-0.000 (0.000)
Age <sub>t</sub> <sup>3</sup>	0.000 (0.000)
log Capital per worker <sub>t-1</sub>	-0.004** (0.002)
log Capital per worker <sub>t-1</sub> * Age	0.000** (0.000)
Loan-financed investment <sub>t-1</sub> /Output <sub>t-1</sub>	-0.002 (0.002)
log Output <sub>t-1</sub>	-0.033*** (0.007)
Share of output exported <sub>t-1</sub>	-0.077 (0.098)
log(Investment +1) <sub>t-1</sub>	0.002* (0.001)
Share of output exported <sub>t-1</sub> * TFP <sub>t-1</sub>	0.023 (0.043)
log Average wage <sub>t-1</sub> * Markup <sub>t-1</sub>	0.001 (0.002)
Share of output exported <sub>t-1</sub> * Markup <sub>t-1</sub>	-0.001 (0.005)
log Output <sub>t-1</sub> * Skilled labor share <sub>t-1</sub>	0.027*** (0.006)
Crisis <sub>t-1</sub>	-0.012** (0.005)
log Markup <sub>t-1</sub> <sup>2</sup>	0.003* (0.002)
log Markup <sub>t-1</sub> <sup>3</sup>	-0.000 (0.000)
log(Investment +1) <sub>t-1</sub> * log Employment <sub>t-1</sub>	-0.000** (0.000)
log Output <sub>t-1</sub> * log Employment <sub>t-1</sub>	0.004*** (0.001)
Time trend	-0.001** (0.000)
Observations	7,120
Pseudo R2	0.200

Notes: Probit model. The results are presented in terms of marginal effects evaluated at the sample mean. Standard errors are listed in parentheses. \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

## ON-LINE APPENDIX

**Table W1. OLS results on full sample of foreign plants controlling for pre-divestment characteristics**

[1]				[4]				[7]			
Panel A				Panel B				Panel C			
$\Delta_s \log(\text{TFP})$				$\Delta_s \log(\text{Output})$				$\Delta_s \log(\text{Markup})$			
s=	t	t+1	t+2	s=	t	t+1	t+2	s=	t	t+1	t+2
Divestment	-0.036*** (0.004)	-0.039*** (0.005)	-0.036*** (0.005)	Divestment	-0.335*** (0.066)	-0.403*** (0.073)	-0.444*** (0.074)	Divestment	-0.267*** (0.049)	-0.299*** (0.054)	-0.240*** (0.051)
Observations	6,888	6,888	6,888	Observations	6,954	6,954	6,954	Observations	6,885	6,885	6,885
R-squared	0.339	0.304	0.282	R-squared	0.140	0.169	0.182	R-squared	0.280	0.343	0.366
Panel D				Panel E				Panel F			
$\Delta_s(\text{Share of output exported})$				$\Delta_s \log(\text{Domestic sales} + 1)$				$\Delta_s(\text{Share of imported inputs})$			
s=	t	t+1	t+2	s=	t	t+1	t+2	s=	t	t+1	t+2
Divestment	-0.045** (0.021)	-0.109*** (0.021)	-0.096*** (0.023)	Divestment	-0.532 (0.423)	0.926** (0.395)	0.317 (0.427)	Divestment	-0.044*** (0.016)	-0.042*** (0.016)	-0.042** (0.017)
Observations	7,120	7,120	7,120	Observations	7,119	7,119	7,119	Observations	6,974	6,974	6,974
R-squared	0.253	0.305	0.343	R-squared	0.120	0.152	0.173	R-squared	0.101	0.134	0.160
Panel G				Panel H				Panel I			
$\Delta_s \log(\text{Employment})$				$\Delta_s \log(\text{Employment of production workers})$				$\Delta_s \log(\text{Employment of non-production workers})$			
s=	t	t+1	t+2	s=	t	t+1	t+2	s=	t	t+1	t+2
Divestment	-0.124*** (0.037)	-0.115*** (0.037)	-0.088** (0.038)	Divestment	-0.135*** (0.041)	-0.102** (0.041)	-0.065 (0.042)	Divestment	-0.069 (0.052)	-0.097* (0.058)	-0.122** (0.061)
Observations	7,120	7,120	7,120	Observations	7,094	7,094	7,094	Observations	6,745	6,745	6,745
R-squared	0.044	0.061	0.070	R-squared	0.047	0.072	0.084	R-squared	0.073	0.093	0.108
Panel J											
$\Delta_s \log(\text{Average wage})$											
s=	t	t+1	t+2								
Divestment	-0.084** (0.041)	-0.132*** (0.040)	-0.162*** (0.039)								
Observations	7,117	7,117	7,117								
R-squared	0.276	0.355	0.389								

Notes:  $\Delta_s = s - (t-1)$ . The estimation is performed on the full sample of foreign affiliates corresponding to the summary statistics presented in the left panel of Table 1. The dependent variables are expressed as differences between  $t-1$  (i.e., the year prior to divestment) and year  $t$  (year of divestment, columns 1, 4 and 7),  $t+1$  (column 2, 5, and 8) and  $t+2$  (column 3, 6, and 9). Divestment is a time-invariant dummy taking on the value of one for foreign affiliates divested in year  $t$ , and zero otherwise. Each regression includes industry-year fixed effects and the full set of controls for pre-divestment characteristics (the same as those included in Table A2). Robust standard errors in parenthesis. \*, \*\*, and \*\*\* represent significance at the 10, 5, and 1 percent levels, respectively.

**Table W2. Baseline matching with treated and control plants located in different counties**

[1]				[4]				[7]			
Panel A				Panel B				Panel C			
$\Delta_s \log(\text{TFP})$				$\Delta_s \log(\text{Output})$				$\Delta_s \log(\text{Markup})$			
s=	t	t+1	t+2	s=	t	t+1	t+2	s=	t	t+1	t+2
Divestment	-0.038*** (0.007)	-0.044*** (0.008)	-0.038*** (0.008)	Divestment	-0.316*** (0.104)	-0.433*** (0.131)	-0.440*** (0.145)	Divestment	-0.300*** (0.111)	-0.319*** (0.120)	-0.235** (0.118)
Observations	308	308	308	Observations	296	296	296	Observations	308	308	308
R-squared	0.088	0.096	0.064	R-squared	0.028	0.037	0.033	R-squared	0.024	0.022	0.012
Panel D				Panel E				Panel F			
$\Delta_s(\text{Share of output exported})$				$\Delta_s \log(\text{Domestic sales} + 1)$				$\Delta_s(\text{Share of imported inputs})$			
s=	t	t+1	t+2	s=	t	t+1	t+2	s=	t	t+1	t+2
Divestment	-0.055 (0.041)	-0.128*** (0.049)	-0.132*** (0.051)	Divestment	-0.330 (0.724)	0.517 (0.823)	0.772 (0.857)	Divestment	-0.076*** (0.029)	-0.068* (0.036)	-0.076** (0.034)
Observations	308	308	308	Observations	308	308	308	Observations	306	306	306
R-squared	0.006	0.022	0.021	R-squared	0.001	0.001	0.003	R-squared	0.023	0.012	0.016
Panel G				Panel H				Panel I			
$\Delta_s \log(\text{Employment})$				$\Delta_s \log(\text{Employment of production workers})$				$\Delta_s \log(\text{Employment of non-production workers})$			
s=	t	t+1	t+2	s=	t	t+1	t+2	s=	t	t+1	t+2
Divestment	-0.091* (0.052)	-0.036 (0.050)	-0.010 (0.049)	Divestment	-0.122** (0.062)	-0.047 (0.062)	-0.006 (0.065)	Divestment	-0.011 (0.081)	-0.039 (0.093)	-0.048 (0.100)
Observations	308	308	308	Observations	308	308	308	Observations	292	292	292
R-squared	0.010	0.002	0.000	R-squared	0.014	0.002	0.000	R-squared	0.000	0.001	0.001
Panel J											
$\Delta_s \log(\text{Average wage})$											
s=	t	t+1	t+2								
Divestment	-0.015 (0.089)	-0.067 (0.104)	-0.140 (0.105)								
Observations	308	308	308								
R-squared	0.000	0.001	0.006								

Notes:  $\Delta_s = s - (t-1)$ . The estimation is performed on the matched sample described in Section VI.6 of the paper, where the baseline propensity score was used but the matched and the control plant were required to operate in the same year and 4-digit industry cell but be located in different counties ('kapupaten'). The propensity score probit controls for lagged value of (logged if appropriate) TFP, TFP growth, markup, its square, cube and growth rate, employment, its square and cube, share of output exported, share of imported inputs, skill intensity (ratio of non-production workers to total workers), capital intensity, output (value of goods produced), average wage, plant's age, share in output of investment financed by loans, investment, time trend, dummy for the years of the Asian crisis, dummy for 100% foreign ownership, dummy for greenfield investment, and the interaction terms between explanatory variables listed in Table 1. The dependent variables are expressed as differences between  $t-1$  (i.e., the year prior to divestment) and year  $t$  (year of divestment, columns 1, 4 and 7),  $t+1$  (column 2, 5, and 8) and  $t+2$  (column 3, 6, and 9). Divestment is a time-invariant dummy taking on the value of one for foreign affiliates divested in year  $t$ , and zero otherwise. Bootstrapped standard errors are listed in parentheses. A constant is included in all specifications, but not reported. \*, \*\*, and \*\*\* represent significance at the 10, 5, and 1 percent levels, respectively.