

Mapping MNEs in Cuba and barriers to their growth

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ABSTRACT

Very little is known about the investment climate and operations of MNEs in Cuba due to limited data provided by the Cuban government. In this paper, we explore the investment climate in Cuba and identify factors that limit the activities of MNEs. We also assess the impact of the COVID-19 pandemic and the future prospects for MNEs in Cuba. Our research is based on questionnaires and semi-structured interviews in MNEs operating in Cuba. MNEs consider low macroeconomic stability, the impossibility of acquiring real estate, access to financing and the movement of capital, and profit repatriation as the most problematic factors for their business activities. On the other hand, IPR protection, corruption, the skills and education of the available workforce and the availability of electricity were assessed as the least problematic. Less than half of the MNEs interviewed found positive changes concerning the investment climate in Cuba during recent years. This implies limited prospects for economic growth in the near future.

KEYWORDS

investment climate; MNEs; Cuba; foreign direct investment

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1. Introduction

The role of multinational enterprises (MNEs) and foreign direct investment (FDI) has increased significantly in recent decades due to the finer division of labor and more complex location decisions of MNEs (Dicken 2015). FDI has thus become an important source of foreign capital and technology for emerging markets (Lall 2000; Dunning and Lundan 2008). At the same time, negative impacts are also widespread, such as the crowding out effect for domestic companies, layoffs and negative impacts on the environment (Aitken and Harrison 1999; Hardy 1998; Doytch and Uctum 2016). Most developing and emerging countries are trying to attract MNEs to promote their economic growth. The scope of MNEs operations and the impact of FDI depends on the economic, financial and socio-political conditions of host countries, referred to as the investment climate (Aisedu 2006; Bayraktar 2013) and also on host countries' income levels (Borensztein, De Gregorio, and Lee 1998; Alvarado, Inguez, and Ponce 2017).

Since the revolution in 1959, Cuba has been a predominantly closed country with a centrally planned economy and a significant role played by state-owned companies. However, to address its deepening economic problems, Cuba has partially opened to multinational companies, particularly since the 1990s. MNEs have been allowed to operate in the country under limited conditions. Due to the absence or unreliability of official data (see e.g. Feinberg 2016 or Vidal 2020), we have very little information about their activities, the conditions under which they operate and the impact of their activities on the Cuban economy as a whole.

FDI represents an important source of foreign capital as Cuba has limited access to foreign loans (Travieso-Diaz and Tumbull 2002; Luis 2017), restrictions on remittances from the US (Mesa-Lago and Vidal 2019) and a decrease in international tourism due to the COVID-19 pandemic. At the same time, only a few studies have explored the operations of MNEs in Cuba in the last decade (Walsh 2017; Rottig, Muscarella, and de Oliveira 2019). Furthermore, researchers mainly focused on US companies. This paper thus aims to assess the conditions under which MNEs operate in Cuba. We focus especially on these research questions: What are the major barriers to MNEs operations in terms of the Cuban investment climate? Is there space to increase MNEs' activities in Cuba? Attention is given to the development of the investment climate, the impact of COVID-19, and future prospects. Given the limited number of studies devoted to MNEs and the investment climate in Cuba, this paper contributes to extending the knowledge about Cuba's investment climate and considers the latest events. This paper is based on questionnaires and follow-up semi-structured interviews conducted with executives of companies operating in Cuba,

allowing for a comparison with studies focused mainly on US firms.

The paper is structured as follows. First, a literature review on MNEs, the investment climate, and the Cuban economy and policies are analyzed. We then describe the applied methodology related to questionnaires and semi-structured interviews. In the third chapter, the results from the qualitative research are presented, including the discussion. Conclusions summarize the main findings of the paper.

2. Literature review

In this literature review first, we summarize the theoretical and empirical findings regarding the role of MNEs in host economies and the assessment of different aspects of the investment climate in developing countries. Second, we describe the development of the Cuban economy with a focus on its investment climate and the role of MNEs and we review empirical literature that evaluates the Cuban investment climate.

2.1 MNEs and the investment climate

In recent decades, globalization has led to a significant increase in the number of MNEs i. e. companies that have established branches or subsidiaries in countries other than their countries of origin (OECD 2018). The importance of MNEs in the world economy can be demonstrated, for example, by their share of world GDP estimated at 32%, or by their percentage of global exports, reaching 64% in 2016 (De Backer, Miroudot, and Rigo 2019). Activities of MNEs are closely related to increasing global FDI flows. These have expanded substantially since the 1970s, despite relative stagnation in the recent decade (UNCTAD 2021).

MNEs can play an essential role in host economies. Many theoretical and empirical studies highlight their positive impact on the economic growth of host countries through the inflow of capital, more advanced technologies or more advanced management skills, and other knowledge that contribute to increasing productivity in the economy (Lall 2000; OECD 2002; Moran, Graham, and Blomström 2005; Dunning and Lundan 2008). The operations of MNEs often also intensify the competitive environment, which can increase the efficiency of the use of resources by the host country (Blomstrom and Kokko 1998; Marlevede and Schoors 2005; Dunning and Lundan 2008). On the other hand, negative impacts are also mentioned, such as excessive displacement and/or crowding out of local companies that cannot compete with MNEs – the so-called crowding out effect (Lall 2000; Dunning and Lundan 2008; Aitken and Harrison 1999). Furthermore, downsizing of production and labor layoffs (Hardy 1998) and negative impacts on

the environment (Doytch and Uctum 2016) are also recorded. Last but not least, FDI contributes to uneven development across different geographic scales (Pavlínek 2022).

The impacts of FDI on the host country/region are dependent on many factors ranging from the type of investment, mode of entry and attributes (e.g. industry type, scale of operations) to the nature of the local economy and the length of investment (Dicken 2015). The positive relationship between FDI inflows and economic growth in host economies was confirmed, for example, by data from 15 developing countries (Desbordes and Franssen 2019), West Asian countries (Suliman, Elian, and Ali 2018) and India (Choi and Baek 2017). At the same time, several studies have not confirmed this relationship at all or only to a limited extent (e.g. Carkovic and Levine 2002; Choe 2003; Li and Tanna 2019). In general, more positive effects of FDI are observed in high income countries where horizontal FDI prevails compared to emerging and developing countries with predominant vertical FDI (Borensztein, De Gregorio, and Lee 1998, Alvarado, Inguez, and Ponce 2017).

In this paper, we focus mainly on the perspectives of MNEs operating in Cuba. The main challenges and obstacles to the further development of the activities of MNEs, assessment of host country conditions and their impact on MNEs, etc., are reflected in the investment climate of the host country. The investment climate is understood as the sum of all external factors that affect MNEs in the host country (Silvia-Leander 2005). The World Bank (2013) defines the term investment climate as the policy, institutional and behavioral environment, both present and expected, that affects the returns and risks associated with investments. Several institutions provide various investment climate rankings such as the Global Competitiveness Index (GCI) of the World Economic Forum and the World Bank's Ease of Doing Business (the issuance of the report was ended in 2021). Other rankings cover sub-areas of the investment climate, such as corruption (e.g. Transparency International's Corruption Perception Index), the quality of governance (e.g. World Bank Governance Indicators) and human development (e.g. UNDP's Human Development Index). These rankings usually work with data from several sources including surveys and public/private/NGO experts' views. The assessment of the investment environment for MNEs can further be found in the Business Environment and Enterprise Performance Survey (BEEPS) and the Economist Intelligence Unit.

The level of both tangible and intangible aspects of the investment climate may also boost the development impact on the host countries (Lin 2011; Horneberger, Battat, and Kusek 2011). Lin argues that the quality of infrastructure determines the transaction costs of individual firms and plays an important role in facilitating the allocation of resources in

accordance with the country's comparative advantage. To support the country's industrial development, Lin highlights the role of the state in the improvement of tangible and intangible infrastructure rather than any intervention in the functioning of markets by protectionist measures (import tariffs to protect infant industries), rigid exchange-rate policies or the creation of state-owned enterprises. Moreover, the quality of the investment climate also impacts the size of benefits from spillover effects that the host country receives from MNEs activities (Amin 1999; Blalock and Gertler 2008).

Categorizations of particular aspects of the investment climate, and procedures for their evaluation are also widespread in academic literature. Among the first ones belongs Stobaugh (1969), who addressed the issue of the complexity of the investment climate and its impact on decisions by MNEs, and highlighted the need to decide on a multi-factor rating scale covering criteria such as the repatriation of capital, the maximum possible share of foreign ownership of a company, etc. Li and Li (1999) divide the individual factors of the investment climate into hard ones (natural resources, infrastructure and telecommunications equipment) and soft ones (e.g. economic, political, legal, managerial factors). Ng and Tuan (2002) use 48 variables divided into seven categories: socio-economic factors, the availability and costs of inputs, infrastructure, government policies on FDI, restrictions on business operations, government administration and living conditions to assess the investment climate in China. Human capital, the availability of natural resources, the quality of infrastructure, and the administrative and legal environment are the four main categories of factors of the investment climate applied by Abushhewa and Zarook (2016). Institutional theory has been widely employed to study emerging or low-income countries (e.g. Kostova 1997; Trevino, Thomas and Cullen 2007; Rottig, Muscarella, and de Oliveira 2018). Most of these researchers follow the theory introduced by Scott (1995). He divides the factors influencing the decision-making of organizations into three categories – regulatory (e.g. legislation), normative (societal norms, values, etc.), and cognitive (cultural aspects).

Several studies assess the investment climate in developing countries and its impact on FDI. Based on firm-level evidence Kinda (2010) showed that constraints related to the investment climate hamper FDI in developing countries. Accordingly, Bayraktar (2013) found that developing countries ranking higher in the World Bank's Doing Business attract more FDI, and an upward shift in the ranking is associated with higher FDI flows. Furthermore, research focused on the evolution of the investment climate. For example, Bhaumik, Bhandari, and Gokarn (2003) have shown improvements in the Indian investment climate in the areas of managerial and skilled non-managerial workforce qualifications and the quality of

local resources needed for business (especially IT services), with stagnation or deterioration in the institutional environment and the legal framework for business. In Kosovo, improvements in the area of taxes and labor have been recorded despite negative development in terms of competition and the political situation (Hajrizi and Hasani 2013). On the other hand, in the Georgian investment climate the hindering of the development of MNEs was related particularly to the unavailability of a skilled workforce and an insufficiently credible legal system (Gürsoy and Kurşun 2008). Ershova (2017) identified problems in the regulatory environment (especially regarding employment and immigration) and customs clearance as the main obstacles to the development of Japanese MNEs doing business in Russia. Overall, the rule of law (Li and Resnick 2003; Jensen 2008; Alexander 2014; Staats and Biglaiser 2012), corruption (Wei 2000), political uncertainty (Trevino, Thomas, and Cullen 2007), the quality of physical infrastructure (Kinda 2010) and economic aspects such as macroeconomic stability, the quality of the banking system, market size and structure, etc. (Dunning 2004; Asiedu 2006; Khachoo and Khan 2012) have been identified as the most important ones for the activities of MNEs in host countries.

2.2 The Investment Climate in Cuba

Cuba is one of the last countries with a predominantly centrally planned economy. After the revolution in 1959, the United States imposed a trade embargo against Cuba, which despite some softening, still exists today. Cuba's more economically successful periods were thus associated with the support of foreign partners. Initially, the support stemmed from the Soviet Union (1962–1990), since the year 2000 from Venezuela. In 2014, the support from Venezuela started to decline following Venezuela's economic downturn. In the intervening periods, Cuba had constantly plunged into economic crises. It confirms the considerable failure of the Cuban economic model, which is unable to achieve long-term sustainable growth without significant foreign support (Feinberg 2016). According to the Cuban statistical office, Cuba's GDP per capita in 2020 was at the level of \$9,601 USD (ONEI: Anuario Estadístico de Cuba 2020; Cuentas nacionales, Edición

2021). However, Vidal (2020) draws attention to the considerable unreliability of the official data and estimates the real level of GDP at around one-third of that amount. The developments of the main macroeconomic indicators can be seen in Tab. 1.

Cuba has very limited access to foreign loans, thus an important source of foreign capital is foreign direct investment (Travieso-Diaz and Trumbull 2002; Luis 2017). Therefore, during the periods without foreign aid, which resulted in deepening economic problems, Cuba had to adjust its policies. For example, between 1991 and 1993 Cuba's GDP declined by more than 10% year on year and trade by 80% (Benzing 2005; World Bank 2021). Thus, in the 1990s, Cuba opened up limited opportunities for foreign investment in tourism, mining, energy, and telecommunications. Several MNEs took advantage of this, and the level of foreign direct investment reached almost 2% of GDP in 1994 (Spadoni 2014 – Fig. 1). Nevertheless, in the late 1990s, after Hugo Chávez came to power in Venezuela and established close economic cooperation with Cuba, the conditions for MNEs deteriorated again, for example by not renewing licenses of many MNEs (Romero 2017). Horizontal FDI is the major type of investment in Cuba as companies want to capture the Cuban market, resource-seeking investment is also present to some extent (Feinberg 2016).

Although Venezuelan economic support, consisting mainly of supplying cheap oil to Cuba and hiring Cuban state employees (particularly doctors) in Venezuela at high prices, represented a significant boost for the Cuban economy, many weaknesses remained. Cuba was still dealing with lagging industrial and agricultural production, insufficient savings and investment rates, sluggish exports and a chronic deficit in merchandise trade (Feinberg 2016). To address these issues in 2011, the Sixth Congress of the Communist Party approved the document entitled “Guidelines for the Party's Economic and Social Policies and Revolutions,” which contained reform proposals aimed at some economic decentralization and support for private enterprises (Lineamientos de la Política Económica y Social del Partido y la Revolución 2011). This document launched another wave of economic opening. In 2013, the government expanded the possibilities for private business (in particular, the number of companies that can be conducted privately was

Tab. 1 The main macroeconomic indicators for Cuba.

	2015	2016	2017	2018	2019	2020	2021
GDP Growth	4%	1%	2%	2%	0%	-11%	1%
Inflation (GDP deflator)	3%	4%	4%	1%	4%	17%	
Unemployment	2%	2%	2%	2%	1%	1%	
Government debt to GDP	18.2%	19.9%	18.3%	18.4%	19.0%		
Budget deficit to GDP	5.8%	6.6%	8.6%	8.1%	6.2%	17.7%	11.7%

Source: World Bank (2022); Trading Economics (2022); ONEI (2021)

increased), and Law No. 313 was passed, which regulated the conditions for foreign investors in the Mariel Free Trade Zone. The Mariel Free Trade Zone, located approximately 50 km west of Havana, allows MNEs to be licensed for up to 50 years and offers them additional tax benefits. Further, in this zone, it is possible to pay employees higher wages than in other parts of Cuba (Spadoni 2014).

In 2014, a new law on Foreign Direct Investment, Law No. 118, was approved (Ley No. 118, 2014). It guarantees foreign investors protection against expropriation (except in the public interest, investors should be fully compensated). National courts should settle any litigation between MNEs and Cuban state-owned companies. All sectors of the economy are accessible to MNEs, except health services, education, the financial sector, and defense (though military-owned companies are not excluded). MNEs are also guaranteed many tax benefits. Profits and dividends should be fully convertible into foreign currency. Nonetheless, MNEs can only hire employees through a state agency. Further, Law No. 118 requires the approval of each MNE capital injection by the Cuban government.

The resumption of diplomatic relations with the US in 2015 led to some easing of barriers and a change in the overall atmosphere. It led to an inflow of new capital, especially in tourism, energy, and biotechnology (Feinberg 2016). Another significant step by the Cuban government towards creating a more open economy occurred in 2021 when Cuban citizens living in Cuba were allowed to set up small and medium-sized companies (The Economist 2021). Decree No. 32 of the Council of Ministers was also issued, further easing the conditions for establishing MNEs representations and branches in Cuba. The MNEs are no longer required to have had a previous business relationship with Cuban companies when applying for registration in Cuba (Andersen 2021). At the beginning of 2021, to, among other things, clarify the system for foreign investors, Cuba unified its two currencies. However, it resulted in a significant increase in inflation in the short term (Mesa-Lago 2021). In 2014 US president Barack Obama initiated a more friendly US approach to Cuba, leading, for example, to some easing of the rules for traveling between the two countries and sending remittances from Cubans living in the US to their relatives in Cuba. His successor Donald Trump terminated this initiative, and after 2017, the US administration repealed most of the previous liberalization measures (Vidal 2019). The approach of US president Joseph Biden, elected in 2020, seems to be slowly returning back to the more friendly approach of President Obama. As a first step, in May 2022 he announced the easing of restrictions on remittances and travel of US citizens to Cuba (Financial Times 2022).

Diplomatic relations with the European Union (EU) improved in 2017, when the EU and Cuba concluded the Political Dialogue and Cooperation Agreement

(PDCA). This Dialogue ended more than 20 years of limited cooperation framed with the so-called Common Position, under which the EU conditioned any strengthening of mutual relations by progress in the field of human rights. The PDCA mainly focuses on strengthening the development cooperation and does not contain any concrete measures regarding trade liberalization or investment protection. Nevertheless, it is expected that the improved diplomatic ties and broadened mutual dialogue will contribute to a more attractive and predictable economic environment (Tvevad 2017).

The operation of MNEs in Cuba can currently take several forms. MNEs may establish a legal entity in Cuba in the form of branches (owned 100% by foreign companies) and subsidiaries (less than 100% owned by foreign companies) under Law No. 118 of 2014 or a branch without the need for capital input under Decree No. 32 of 2021. However, implementing a subsidiary (a so-called joint-venture) is possible only if formed with a state-owned enterprise. Another possible way for foreign companies to enter Cuba is to conclude a hotel management contract. Foreign companies can manage a hotel owned by a Cuban state-owned enterprise under agreed-upon conditions. By completing a hotel management contract, the foreign entity does not acquire a share of the company's capital (Spadoni 2014).

Estimates of FDI flows and their relation to GDP have been presented in several studies and are visualized in Fig. 1. More significant stages in which the volume of incoming FDI was above 1% of GDP were during the 1990s and in 2018-2020 (newer data are not available). The data for 2018-2020 were announced by the government but are questioned by international analysts. The data seem to be surprisingly high, given sanctions applied by the US and complications caused by the COVID-19 crisis (EIU, 2021). In Fig. 2 comparison of Cuba's FDI inflows with several Central American and Caribbean countries of similar size can be seen. Until 2015 the inflows of FDI to Cuba were among the lowest compared to the other countries in the figure. The amount of incoming FDI in 2018-2020 as announced by the Cuban government would put Cuba significantly closer to the best performers in the selection.

Regarding the number of MNEs operating in Cuba, according to official data, in 2020 there were 50 companies fully owned by foreign companies, 103 companies operating in the form of a branch jointly owned with a Cuban state-owned enterprise (i.e. a joint-venture), and 165 companies operating in the format allowed through the use of a hotel management agreement (ONEI 2021). More detailed information regarding the names of the companies or their representation in different sectors of the economy was not published. Further, the information on branches of foreign companies without capital participation is also not available.

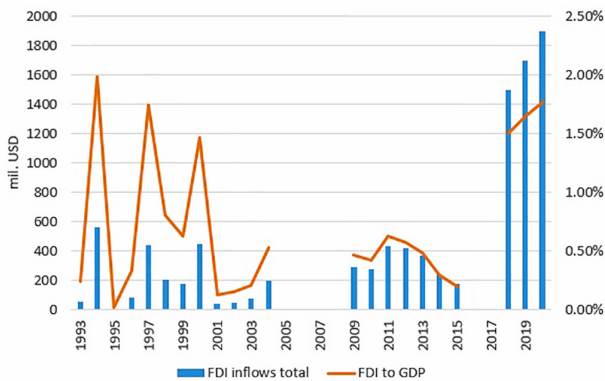


Fig. 1 The Development of FDI in Cuba.

Source: Spadoni (2014) for 1993–2004; Luis (2017) for 2009–2015; Reuters (2020) for 2018–2020

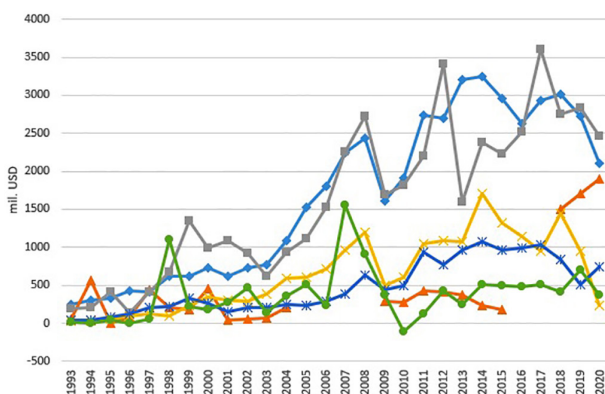


Fig. 2 The comparison of FDI inflows among selected countries from the Central American and Caribbean region.

Source: for Cuba: Spadoni (2014) for 1993–2004; Luis (2017) for 2009–2015; Reuters (2020) for 2018–2020; for other countries: World Bank (2022)

Most reports assessing the quality of the investment climate do not include Cuba (Cuba has not been evaluated in the World Bank's Ease of Doing Business, World Economic Forum's Global Competitiveness Index or the International Institute for Management Development's World Competitiveness Scoreboard). The Economist Intelligence Unit ranked Cuba 77th out of 82 countries evaluated in the 2016–2020 period (EIU 2020). In the 2020 World Bank's Worldwide Governance Index (WGI 2021), Cuba performed worst in the areas of regulatory quality (assessed at the 6th percentile of the countries evaluated) and government accountability (this category refers mainly to the extent to which the country's citizens are able to participate in selecting their governments, as well as freedom of expression, association and media) (at the 11th percentile). Cuba fared slightly better in the areas of political stability (at the 65th percentile), government effectiveness (at the 45th percentile), the rule of law (at the 43rd percentile) and control of corruption (at the 49th percentile). In the 2021 Transparency International's Corruption Perceptions Index Cuba ranked 64th out of 108 countries.

There are several older studies on the Cuban economy (e.g. Benzing 2005; Corrales 2007). In most cases, they do not focus on FDI and the investment climate and do not reflect the current situation. Because of the communist political regime, Cuba differs significantly from other emerging markets. Their unique institutional environment is thus unique and poses a big challenge for MNEs. In order to analyze the main challenges associated with the entry and operation of MNEs particularly in tourism in Cuba Walsh (2017) interviewed representatives of 18 MNEs from the USA, Canada, Australia and Spain. She identified the US trade embargo and local financing, the existence of a dual currency, property ownership and excessive operating costs as the crucial obstacles. Respondents mentioned the need to build strong informal relationships with local partners, thorough consideration of the potential target group and the need to significantly adapt the business strategy to the Cuban environment as key to a successful business in Cuba. On the other hand, corruption, issues of taxation, labor law and security were not identified as being problematic. Rottig, Muscarella, and de Oliveira (2019) with the use of Scott's institutional theory evaluated the challenges that US-based MNEs face in various areas of the Cuban institutional environment. The authors conducted 34 interviews with MNEs executives, US government officials and diplomats, identifying challenges most often related to the non-existence or insufficient degree of development of some formal institutions and in the area of gaining local legitimacy by foreign companies. More specifically, these were challenges related to infrastructure, the lack of integration of payment systems between the US and Cuba, the impossibility of local financing for the purchasing of consumer goods, the obligation to hire Cuban workers only through a state agency, and law enforcement and the protection of investments. Vidal and Alonso (2021) found that the changes in the institutional environment in Cuba over recent years have only been marginal. The main obstacles to the development of MNEs identified in the questionnaire surveys, are in particular, the US trade embargo, excessive bureaucracy and regulation, the inefficiency of state-owned companies and problems associated with legal proceedings.

3. Methodology

The investment climate of individual countries and its impact on the activities of MNEs can be identified by quantitative methods (questionnaires) or qualitative interviews. Often mixed methods are applied, such as quantitative questionnaires with follow-up semi-structured interviews (Mendoza and Woolcock 2014; Walsh 2017). Further, econometric methods are used to evaluate investment climates in several countries, and their impact on FDI flows and activities of MNEs (Quazi 2007; Hayakawa, Kimura and Lee 2013).

Due to the very limited, non-transparent and often outdated data the Cuban Statistical Office provides, such an analysis is not possible in the case of Cuba. Therefore, in this paper, we applied the mixed method.

The open-ended questions are recommended for exploratory questions and/or for analyzing novel phenomena (e.g. Eisenhardt and Graebner 2007). Furthermore, it allows additional data to be obtained beyond pre-prepared questions and can provide a better understanding of the specific features of the Cuban economy. With more rigidly structured questioning techniques the researcher could shape the interview with their own ideas and the answers of the respondents could be determined by a set of operationalized fragments (Hendl 2016). The respondents were guaranteed anonymity and offered the option of not answering any particular question to achieve a higher rate of return of the questionnaires and a higher degree of truthfulness of the answers given (Javorcik and Spatareanu 2005). Further, we controlled the primary data with secondary data from academic literature and Cuban policies to avoid biases (Ghauri 2004).

To answer our research questions, we compiled a questionnaire (Appendix 1) through which MNEs evaluated various aspects of the Cuban investment climate according to how problematic these aspects were for their activities: respondents were asked to describe the main challenges to their operation in Cuba. The set of questions in the questionnaire was compiled based on previous research focused on the evaluation of the investment climate and the identification of its major barriers for MNEs. In the first part of the questionnaire, MNEs evaluated the selected 21 investment climate factors on a scale of 1–5 according to the extent to which MNEs consider them problematic for their business activities in Cuba. The evaluated factors included the areas of regulation, governance, economics and infrastructure, following the BEEPS business limits survey, supplemented by several selected factors used in the Ease of Doing Business (World Bank 2022), Global Competitiveness Index (World Economic Forum 2019) and by the authors' Ng and Tuan (2002). We included both tangible and intangible factors of the investment environment. The number of evaluated factors was reduced in comparison to the above-mentioned reports in order to keep the questionnaire acceptably long. MNEs were also offered the opportunity to add additional factors if they considered any significant factor missing from the selection. In the second part, the questionnaire contained open questions about the main obstacles to the development of MNEs business activities and the most significant changes from the perspective of MNEs, which were formulated similarly to the works of Bhaumik, Bhandari, and Gokarn (2003), Gürsoy and Kurşun (2008) or Ershová (2017). We added a question about the effects of the COVID-19 pandemic on the activities of MNEs. The follow-up semi-structured interviews focused on further explanations of the

reasons behind MNEs' evaluations of different investment climate aspects from the questionnaire. They helped to deepen and better understand the specifics of operations in Cuba.

It is not easy to identify firms operating in Cuba. The Cuban statistical office only publishes data on the number of companies wholly or partially owned by foreign companies and also foreign companies operating in Cuba through hotel management agreements, but no detailed information on these companies could be found. In addition, apart from these MNEs, several foreign companies established branches in Cuba (sometimes with many local employees and significant economic turnover) without direct capital participation and also without any official information regarding them. Thus, it is difficult to estimate the number of MNEs operating in Cuba and collect further detailed information regarding their operations.

Considering the reachability for in-person interviews, in our research we focus on European MNEs. They are also less covered in previous research. We only identified 22 European companies with subsidiaries in Cuba which were listed in the Orbis database. These included very large MNEs such as Nestle, Unilever and Bayer as well as smaller companies. Five of these MNEs were from Spain (Bureau van Dijk 2022). Therefore, we used Internet searches, articles from trade fairs and the websites of various export promotion agencies to identify companies operating in Cuba. We also asked several export promotion agencies from different countries for a list of companies operating in Cuba but obtained no answer. Some of them state on their websites that they don't provide any information regarding companies with which they cooperate. A beneficial source was the database of the Spanish state export promotion agency ICEX España Exportación e Inversiones, which contains a list of Spanish companies registered in Cuba. Of the 241 listed companies, 56 have information regarding the existence of a local representation in Cuba on their websites and these were subsequently contacted. Further, we identified 6 Czech companies mainly during events focused on investment possibilities in Cuba organized by the Czech Ministry of Industry and Trade. Czech companies have historically strong relations with Cuba that follow the mutual cooperation of both countries during the Czechoslovak communist era. The representatives of MNEs further recommended two companies from Slovakia and Belgium during the interviews with MNEs. In the end, 64 MNEs operating in Cuba were contacted, mainly by email. Due to the initial very low response rate, we also contacted all companies by telephone.

Seventeen companies completed the questionnaire. The interviews were conducted with eight company directors or executives responsible for managing the company's activities in Cuba. The interviews took place in Madrid in December 2021 and Prague in February 2022. The entire research took place from July 2021 to March 2022. All of the respondents travel to

Cuba regularly. The surveyed companies are engaged in the production of medical supplies, the distribution of communication technologies, the purchase and sale of food products, the supply of technical solutions to refineries, and the construction sector. Thirteen of the companies are Spanish, two are Czech, one is Slovak, and one is Belgian. The vast majority of companies have been operating in Cuba for a long time, mainly since the 1990s. The most frequent motivation for the companies' entry was the business opportunities in the unsaturated Cuban market with a shortage of products in many areas. Fifteen of the companies have active branches in Cuba. One company temporarily suspended its Cuban activities in 2021, and one company temporarily closed its branch as it was managing its business activities remotely. The companies operating branches in Cuba employ Cuban citizens (from two to 280). Twelve of the companies have a branch of a foreign parent company established in Cuba according to the Decree No. 32 of the Council of Ministers (before Decree No. 206), three companies have a branch with capital participation according to Law No. 118 and two companies established a subsidiary in Cuba with a 49% share in the share capital (a Cuban state-owned enterprise owned 51%) also according to Law No. 118.

4. Results

4.1 Evaluation of the investment climate

We asked the companies to evaluate selected factors of the investment climate regarding the problematic nature of their business activities in Cuba in the questionnaire and during the structured interviews.

Individual factors were rated on a scale of 1 to 5 (1 for "not problematic at all" to 5 for "very problematic"). The average evaluation of individual factors is visualized in Fig. 3.

According to the questionnaires, the most problematic factor for doing business in Cuba is low macroeconomic stability with a rating of 4.4 (Fig. 3). During the interviews, respondents complained in particular about the unpredictability and significant fluctuations in economic development and the instability of the Cuban economic system. They also stressed that the Cuban economy is very sensitive to the development of relations between the USA and Cuba. The Cuban economy has been negatively affected by the reduction in remittances from the United States, whose flows increased after US President Obama eased restrictions on them in 2015 but they were tightened again by his successor President Trump (Vidal 2019). The decreased economic support from Venezuela is also having a negative effect. Venezuelan support has been gradually reduced since 2014 due to the economic crisis in Venezuela (Mesa-Lago and Vidal 2019). Furthermore, the respondents mentioned the high dependence of the Cuban economy on foreign tourism as a source of foreign currency. They complained, that any fluctuations in the number of tourists are immediately reflected in the state of the economy, which was particularly evident during the COVID-19 pandemic. According to the respondents, any drop in the state budget revenues is rapidly mirrored in the purchasing power of state-owned enterprises, which are the main (in most cases the only) business partners of MNEs.

The second most problematic factor (evaluated with an identical average mark of 3.8) identified by respondents was real estate acquisition and access to

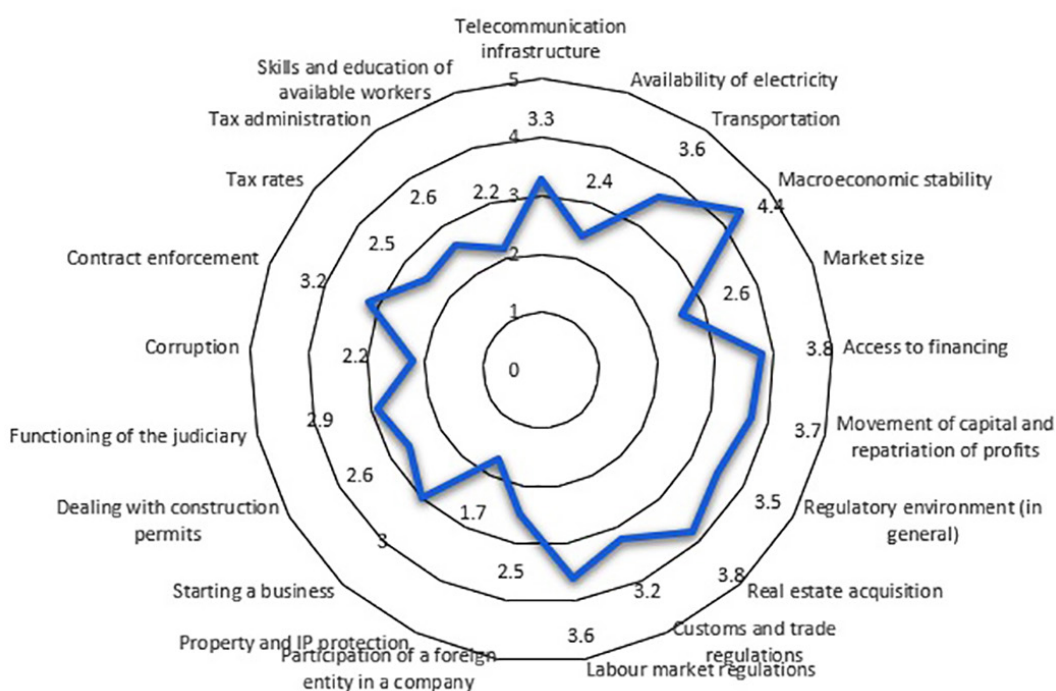


Fig. 3 Problematic factors of the Cuban investment climate.

Source: Original research done by the authors

financing. The acquisition of real estate is not allowed for foreign entities and thus, MNEs are dependent on renting the necessary premises. MNEs mentioned that this ban is sometimes circumvented by fictitiously registering the property acquired by an MNE to Cuban citizens, for example, the company employees. This option was used by one of the interviewed MNEs. However, this company highlighted that this solution is far from ideal and a high amount of trust and long-term relationship with the local employees is necessary. In the case of access to finance, the MNEs find very limiting the impossibility of obtaining a loan from a Cuban bank and rely only on financing from outside of Cuba. One Czech company mentioned the limited possibility to obtain loans for operations in Cuba via Spanish banks, which they had been granted for some Cuban projects in the past. However, this option was surprisingly evaluated as very difficult by the interviewed Spanish companies.

The movement of capital and profit repatriation was identified as the third most problematic factor (with an average rating of 3.7). MNEs perceive the transfer of profits into euros and their sending to bank accounts outside Cuba as the most problematic. Due to the regular shortage of foreign currency in the Cuban financial system, these transactions are regularly delayed by several months and repeated demands for payment are needed to complete them. Two other factors that were more adversely evaluated with an average rating of 3.6 were the labour market regulations and transportation. MNEs consider the impossibility of directly hiring Cuban workers and setting the employment conditions as very problematic. According to the criteria received from MNEs, employees are selected by a state agency, which also determines their remuneration. The salary determined by the state agency is usually very low and insufficient to keep employees motivated. MNEs often have to increase it by a certain amount paid unofficially above the normal salary to keep the motivation high. Nearly all interviewed MNEs mentioned this practice. Regarding transportation, MNEs mentioned that they have to face several obstacles when moving around Cuba. The main one is the real impossibility of purchasing a car. Cars are only available in Cuba at prices several times higher than that typical in Western markets. Some MNEs bring cars from Europe, but they have problems with their maintenance and finding spare parts in Cuba. The unavailability of cars makes the MNEs dependent on public transportation, which they claim to be very unreliable and slow. The respondents had the opportunity to add other problematic factors to the questionnaire. In eight cases, the companies stated the payment morale of Cuban state-owned enterprises. Except for one company, all the interviewed companies have outstanding claims in Cuba ranging up to millions of euros, up to several years overdue. MNEs mentioned that they tend to obtain the majority of their claims at some point, but the

constant debt recovery is time and resource-consuming. MNEs try to reduce the risk associated with the poor payment morale of Cuban companies through, for example, insurance in their home countries. They also seek to recover payments on claims through the courts or representatives of their countries during official visits. However, according to MNEs, these tools are only effective to a limited extent. In five cases, the companies mentioned the trade embargo imposed by the USA, which was not included among the evaluated factors, given that it is an external factor. In particular, the interviewed MNEs mentioned that many companies operating in the US are concerned about cooperating with them (as suppliers, for example) for fear of possible embargo violations and the imposition of sanctions.

In most cases, the identified problematic factors align with previous research (Walsh 2017; Rottig, Muscarella, and de Oliveira 2019; Vidal and Alonso 2021). However, we also identified financing, property ownership and the US embargo among the most limiting, although the emphasis on the US embargo was lower than in Walsh (2017) and Vidal and Alonso (2021). It can be explained by the high representation of US companies in the samples used in those studies, which naturally are more exposed to sanctions, while the European companies are affected somewhat indirectly. Unlike previous research, we found that macroeconomic stability seems to be the most problematic factor for MNEs. It might be due to the recent deterioration in Cuba's economic relations with the US and Venezuela and the COVID-19 pandemic. In contrast to previous studies, we also identified the payment morale of Cuban companies and problems with the repatriation of profits among the problematic factors.

In terms of the least problematic factors for their business, MNEs identified intellectual property rights protection (the average rating was 1.7), corruption and the skills and education of the available workforce (both 2.2) and the availability of electricity (2.4). During the structured interviews, the MNEs mentioned that they had not experienced any problems with protecting property rights. MNEs evaluated the development in the area of corruption positively, which is at a significantly lower level than it was during the 1990s. MNEs recognized the Cuban government's pressure to reduce corruption. In several cases, many Cuban executives, for example, currently even refuse to accept any gift out of fear of possible punishment. Respondents expressed satisfaction, especially with the level of skills of Cuban employees occupying both skilled and unskilled positions. The interviewed MNEs mentioned that the electricity supply has improved noticeably during recent years and nowadays, they face electricity shortages very rarely. The results are generally in line with previous studies. Like Walsh (2017), corruption and tax issues were not identified as problematic factors. Beyond the findings of other studies, we have

identified property and intellectual rights protection as the least challenging factor, which doesn't indicate different perceptions between EU and US companies.

4.2 The impact of the COVID-19 pandemic

The pandemic affected the activities of all respondents very negatively, except for one Spanish medical company supplying material for the production of the Cuban vaccine against COVID-19, which had the most successful year in 2021 throughout its 15 years of operation in Cuba. The other respondents mentioned a significant decline in revenues leading in most cases to losses in 2020 and 2021. According to the respondents, the decline in revenues was caused by a reduction in expenditures (especially for investments) by state-owned enterprises, which in most cases are the only customers of these MNEs. The decrease in expenses by state-owned enterprises was mainly due to a decline in revenue from tourism, which is one of the primary sources of foreign currency and a significant contributor to Cuban GDP. The interviewed MNEs reported a further deterioration in the payment morale of Cuban state-owned enterprises during the pandemic. In three cases, the companies mentioned the possibility of leaving the Cuban market if the situation did not improve. One company did temporarily suspend its business activities in Cuba. There were also problems in logistics, with companies noting significant transport delays. The issue of maintaining personal contacts, which according to the respondents, are crucial for a business to be successful in Cuba, was also mentioned repeatedly.

4.3 The development of the investment climate in the last five years

In the questionnaire, the MNEs were asked to evaluate the development of the Cuban investment climate over the last five years concerning their business. Nine of the companies surveyed stated that they had not seen any positive changes. During the structured interviews, three companies mentioned that they had not noticed any changes in the regulatory environment that would affect their operations in Cuba. Naturally, these companies have seen and experienced adverse economic developments in recent years, caused in particular by the COVID-19 pandemic, the reduction of economic support for the Cuban regime from Venezuela, and the evolution of relations between Cuba and the United States.

Five companies stated they had a positive view of some aspects of the opening up of the private sector in Cuba, notably a new law in August 2021 that allows Cuban residents to set up small and medium-sized businesses. This change has not yet had a direct impact on the interviewed MNEs, given that the ban on cooperation between MNEs and the Cuban private sector is still in force. However, the interviewed MNEs

recognized a certain amount of effort by the Cuban government to gradually relax this ban in the future, which could expand their business opportunities.

Two respondents stated that they had seen the benefits of unifying the two Cuban currencies in January 2021. Despite the rising inflation, primarily due to monetary reform, they welcome greater transparency in the monetary system. One company surveyed cited the development of a special Mariel Free Trade Zone in which investors can operate on more favorable terms.

4.4 The main obstacles to further development of MNEs

The companies were also asked about three main obstacles to further expanding their activities in Cuba. Therefore, if there were improvements in the areas concerned, this would probably lead to an increase in the business activities of MNEs. To a large extent, the mentioned obstacles logically overlap with the problematic factors described in the previous subchapters.

The most frequently mentioned obstacle (in eight cases) was, as with problematic factors, the payment morale of Cuban state-owned enterprises and the difficult recovery of old claims. The second most frequently mentioned obstacle (in seven cases) was the real impossibility of obtaining local funding in Cuba and the problem of converting profits in the Cuban currency into euros. The third most frequently mentioned obstacle (in five cases) was the problem with local transport, especially the fundamental impossibility of purchasing a car and the complications this created in terms of the movement of its employees in the country. Another obstacle mentioned again was the trade embargo imposed by the USA.

4.5 Implications for the development of the Cuban economy

The average evaluation of selected factors of the investment climate was 3.0. Similar levels of evaluation were received by both tangible (average 3.1) and intangible (average 3.0) factors. This indicates a certain general discontent of the surveyed MNEs with the Cuban investment climate. Apart from the implications for the MNEs activity, this could also indicate a significant limit to the market allocation process, which would be hindering the development of the Cuban economy. Lin (2011) suggests that regarding the development process, the state should focus mainly on improving infrastructure and leave the allocation of resources predominantly to market forces. Otherwise, the investments and other business decisions of firms will not be consistent with the country's comparative advantage which could harm the country's competitiveness. Cuba, as seen from the answers of surveyed MNEs, still focuses much more

on state intervention in key sectors of the economy and invests insufficiently in the infrastructure.

In addition to this, since the ties of MNEs to the Cuban private sector are limited by law, the extent of spillover effects from MNEs to local private companies is expected to be rather low. On the other hand, considering that in Cuba horizontal FDI prevails over vertical FDI, the Cuban economy should be able to gain certain benefits from MNEs activity (Dicken 2015). Nevertheless, to evaluate this, more research focused on the size of the spillover effects would be needed. Thus, to boost Cuba's development process it is important that the Cuban authorities systematically focus on the identified problematic institutional aspects.

5. Conclusion

The Cuban investment climate is unique and differs from the investment environment of Western economies and other emerging countries. Cuba is one of the few countries with a predominantly centrally planned economy, and its stance on MNEs and foreign capital has been rather negative in the last few decades. However, specific opportunities for MNEs to enter the Cuban market have been possible since the 1990s, and several took advantage of this situation and now operate in many areas in Cuba. Their activities are primarily based on horizontal FDI with market-seeking motivation. Despite their long-term operations, MNEs' activities in Cuba remain relatively small. It is evident, for example, from the estimates of the volume of incoming FDI. There is a minimal amount of aggregated information on the business activities of MNEs in Cuba. Official data (e.g. on FDI volumes) are not published, or the data are delayed by several years (Feinberg 2016). In addition, many analysts find the provided data unreliable (Vidal 2020).

We evaluated the conditions for MNEs operations and the barriers for their activity and future growth based on a questionnaire survey and follow-up semi-structured interviews with MNEs. We focused on the development of the investment climate in Cuba over the last five years. We found that MNEs consider low macroeconomic stability, the impossibility of acquiring real estate, access to financing, and movement of capital and profit repatriation as the most problematic factors for their business activities in Cuba. During the semi-structured interviews, the companies also most often mentioned the poor payment morale of Cuban state-owned enterprises and the trade embargo imposed by the USA (as an external factor). On the other hand, MNEs executives view the protection of property rights and intellectual property, corruption, the skills and education of the available workforce, and the availability of electricity as the least problematic.

In terms of the development of the investment climate, over half of the MNEs have not seen any positive

changes concerning their business activities. Six companies have a positive view of some of the aspects of the opening up of the private sector that took place in 2021, which could create new opportunities for MNEs in the future.

Many of the findings are consistent with the results of previous research. Problems identified as very problematic factors were related to financing and property ownership as found by Walsh (2017) or issues related to transport infrastructure and labor market regulation as described by Rotting, Muscarella and de Oliveira (2018). Several companies (5 out of 17) mentioned the US embargo as a limiting factor. Still, they did not emphasize its limiting significance to the same extent as Walsh (2017) or Alejadro and Alonso (2021), partly because all companies were of European origin, thus not affected by the US embargo directly. As with Walsh (2017), we did not identify either corruption or tax issues as problematic factors. In contrast to previous research, the research identified macroeconomic stability as the most challenging factor, which may be due to the deteriorating economic situation in the last few years due to the reduction in Venezuelan support, the deterioration of relations between Cuba and the United States and the COVID-19 pandemic.

The MNEs' positive evaluations regarding property and intellectual rights protection, corruption and also contract enforcement can be seen as rather surprising, given the perception of Cuba in terms of governance (according to WGI and Corruption Perception Index or Walsh (2017)) it is not very satisfactory. These findings would thus not be in line with the view that the governance/rule of law factors are major determinants of MNEs activities as stated for example by Li and Resnick (2003).

Our results regarding the perception of the regulatory environment are fairly consistent with the WGI, as both WGI (in 2020 Cuba ranked among the worst countries – at the 6th percentile) and our respondents (Regulatory environment was rated 3,5 out of 5) have rated it very negatively. Some differences are also obvious in the evaluation of corruption perception. While our respondents have rated the corruption level rather positively (2,2 out of 5), in WGI Cuba ranked at the 55th percentile and also scored poorly in Transparency International's Corruption Perception Index with a score of 46/100.

The research conducted thus identifies the problematic factors in the regulatory and macroeconomic areas that limit the activities of MNEs and have further implications for the process of the Cuban development process. Should the Cuban government be interested in making MNEs a more active presence in the Cuban economy and benefit more from their presence, significant progress must be made, especially in these identified areas. MNEs considering entering Cuba must take into account the identified factors in their market entry strategies and consider

possible ways of hedging against the risks arising from them, for example, various types of insurance policies.

Some of our findings prompt further investigation. One of them is the issue of corruption, where we obtained slightly better results than the WGI and Corruption Perception Index. Also, it would be interesting to investigate, why some of the rules of law issues (contract enforcement or property and intellectual rights protection) were not marked as significantly problematic for the examined MNEs. Perhaps one of the reasons could be that the risks are sufficiently compensated by higher profits, but it would be beneficial to further investigate this issue. Additionally, we only researched companies that are already active in Cuba and thus only investigated how the operations of these companies would develop if certain changes in different investment environment aspects occurred. However, these changes might also attract the attention of other companies that until now were not active in Cuba. Therefore, future research should also include companies that are considering entering the Cuban market, these could possibly be reached at various fairs or Cuba-related events.

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Appendix 1: The questionnaire

1) What is the focus of your company's activities in Cuba?

2) For how many years has your company been operating in Cuba? _____

3) Does your company have permanent representation in Cuba? () yes () no

If yes:

- How many employees does your company have in Cuba? _____
- What is the proportion of foreign employees among all your employees in Cuba? _____
- What is the legal form of your business in Cuba (e.g. branch, joint venture etc.)? _____

4) What was the motivation for your company to start doing business in Cuba?

5) How problematic are the following factors for the activities and growth of your company in Cuba?

(Please rate the different factors from 1 to 5, 1 meaning "not problematic at all" and 5 meaning "very problematic". If possible, please add a short comment.)

- telecommunication infrastructure (Internet access, mobile data, mobile network, etc.):
- availability of electricity:
- transportation (roads, public transportation, etc.):
- real estate acquisition:
- tax rates:
- tax administration:
- customs and trade regulations:
- labour market regulations:
- skills and education of available workers:
- regulatory environment (in general):
- macroeconomic instability (inflation, exchange rate, etc.):
- functioning of the judiciary:
- corruption:
- access to financing:
- market size:
- movement of capital and repatriation of profits:
- limitations regarding the maximum participation of a foreign entity in a Cuban company:
- property and intellectual rights protection:
- contract enforcement:
- starting a business:
- dealing with construction permits:

6) Are there any other factors that significantly affect your business company in Cuba? If so, what are they and what is their impact?

7) What are the three main obstacles to the development of your company in Cuba?

8) What changes in the business environment in the last 5 years have been the most significant for your operations in Cuba?

9) How has Covid-19 affected the activities of your company in Cuba?