

The Impact of Foreign Direct Investment on New Firm Survival: Static v. Dynamic Industries

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Abstract/Executive Summary

The paper examines the impact of Foreign Direct Investment (FDI) on the survival of business start-ups. FDI has potential for both negative displacement/competition effects as well as positive knowledge spillover and linkage effects on new ventures. We find a net positive effect for the whole dataset. However, a major contribution of the paper is to outline and test an argument that this effect is likely to be comprised of a net negative effect in dynamic industries (high churn: firm entry plus exit relative to the stock of firms) alongside a net positive effect in static (low churn) industries. We find evidence to support this view. The results identify new effects of globalisation on enterprise development with associated challenges for industrial policy.

The paper forms part of a wider research project of the Bettany Centre investigating how the performance of new ventures differ in static compared to dynamic markets. Static markets tend to be less innovative with little new firm entry alongside limited exit. Dominant incumbent firms often occupy these markets. By contrast, dynamic markets are more usually associated with turbulence where new firms introduce innovation and compete among themselves as they seek to establish a dominant position. Our joint research with Nottingham Business School so far indicates that the factors affecting new ventures differs significantly between these two types of markets; particularly in terms of the threat faced by competition from large firms and as a consequence the best type of strategies that new ventures should adopt.

The current paper highlights that FDI cannot be generalised into either a good or bad thing for new ventures as it depends on whether the market is dynamic or static. Entrepreneurs should regard FDI as an opportunity in a static market and threat in a dynamic market and adjust their strategy appropriately. The paper has also ramifications for government policy which across the globe has tended to promote FDI. Our research results indicate that this is likely to have contrasting effects in terms of short-medium term impact on the local enterprise base – diminishing it in dynamic markets and boosting it in static markets. Further research is planned and needed to assess the longer term effect on the enterprise base as FDI may later lead to spawning of new ventures by entrepreneurs who formerly worked at multi-nationals and who later leave (with expertise/knowledge) to launch a new venture in a related market or technical field.

JEL classification: F20, L11, L25, M13

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