

6-8-2013

FOREIGN DIRECT INVESTMENT AND DOMESTIC ENTREPRENEURSHIP: WHAT ARE THE LINKAGES? (SUMMARY)

Seçil Hülya Danakol
Utrecht University, s.h.danakol@uu.nl

Saul Estrin
London School of Economics

Paul Reynolds
George Washington University

Utz Weitzel
Radboud University Nijmegen

Recommended Citation

Danakol, Seçil Hülya; Estrin, Saul; Reynolds, Paul; and Weitzel, Utz (2013) "FOREIGN DIRECT INVESTMENT AND DOMESTIC ENTREPRENEURSHIP: WHAT ARE THE LINKAGES? (SUMMARY)," *Frontiers of Entrepreneurship Research*: Vol. 33 : Iss. 15 , Article 1.

Available at: <https://digitalknowledge.babson.edu/fer/vol33/iss15/1>

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≈ SUMMARY ≈

FOREIGN DIRECT INVESTMENT AND DOMESTIC ENTREPRENEURSHIP: WHAT ARE THE LINKAGES?

Seçil Hülya Danakol, Utrecht University, The Netherlands

Saul Estrin, London School of Economics, UK

Paul Reynolds, George Washington University, USA

Utz Weitzel, Radboud University Nijmegen, The Netherlands

Principal Topic

The literature linking foreign direct investment (FDI) and local economic development mostly addresses productivity effects on locally-owned firms. In this regard, domestic entrepreneurship also represents an interesting focus through to which to consider the direction of the spillover from FDI to the host economy. In this study, we investigate the effects of FDI inflows on domestic entrepreneurship. In particular, we study how the rates of entrepreneurship in host countries respond to foreign investment, and whether such effects depend on the industry type. Furthermore, entrepreneurial activities at different phases of their life span are considered to assess whether FDI effects vary by the type of entrepreneurship.

Method

This paper combines data from a variety of sources. We employ several country-level explanatory variables combined with entrepreneurship measures from Global Entrepreneurship Monitor (GEM) for the period 2000-2009. FDI is measured as annual cross-border mergers and acquisitions (M&A) inflow at the host country level, and is obtained from Thomson SDC database. We use in total 23126 M&A transactions to compute FDI inflows across seventy target countries including both developed and developing countries. Our study takes into account endogeneity of FDI with respect to entrepreneurship, and therefore uses 2SLS estimator. Analysis is conducted at three levels of aggregation using both whole sample and two subsamples by industry to disentangle the impact of FDI on domestic entrepreneurship.

Results and Implications

Results suggest that FDI has a negatively significant effect on domestic entrepreneurship, and this finding is consistent across different specifications. In aggregate analysis, we find that a 10% increase in FDI inflows causes nascent entrepreneurship, our preferred measure, to fall by an amount equal to 0.184%. Industry level results are also similar to those of reported for the whole sample. The main implication of our findings is that FDI presence results in crowding out of domestic entrepreneurship, and this negative effect is strongest in the very early stages of entrepreneurial process. In practice, the analysis suggests that the economic impact on domestic entrepreneurship, while negative, is quantitatively quite small.

CONTACT: Seçil Hülya Danakol; s.h.danakol@uu.nl; (T): +31 30 253 7936; Utrecht University School of Economics, P.O. box 80125, 3508 TC Utrecht, The Netherlands.