



# Industrial clusters, entrepreneurial culture and the social environment: The effects on FDI distribution

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## ABSTRACT

Using balance sheet data from a sample of 3498 foreign firms in the manufacturing industry we analyse the distribution of foreign direct investments (FDI) in Italy at a very detailed geographical level, i.e. the provincial level, a region which comprises an urban area and the limited geographical area surrounding it. In this paper, we test the impact that agglomeration economies, entrepreneurial culture and social capital have on the distribution of foreign investments. While the findings regarding the social variables are mixed, the important role played by agglomeration economies is confirmed. Our analysis shows that investments by multinationals are attracted by those areas that combine industrial cluster characteristics with an agglomeration of foreign firms and that have a high level of entrepreneurial culture. The role that this last variable plays is fundamental and suggests the idea that multinational corporations (MNCs) invest in regions with entrepreneurial resources.

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## 1. Introduction

In recent years international business literature has frequently underlined the role that location has on firms' competitiveness. Different authors, with different theoretical lens, have shown that multinational corporations (MNCs) are selecting the location of their foreign investments to tap knowledge linked to a specific local context (Almeida, 1996; Frost, Birkinshaw, & Ensign, 2002), to benefit from the opportunities of fast-growing markets (Brouthers et al., 1996) or to access valuable resources (Almeida & Kogut, 1997; Dunning, 1996; Frost, 2001). In this paper, we aim to make a contribution to the debate on the drivers of FDI geographical distribution shedding new light on previous findings. In particular, we studied the effects that industrial clusters and the agglomeration of foreign firms together with the social environment and entrepreneurial culture may exercise on the investment decision of multinational firms. First of all, we consider the effects of these variables at an individual level and then we study the effects of interaction among these variables. This approach allows us to validate the thesis that agglomeration economies play an important role in attracting foreign firms and we improve on this general conclusion by showing that not all industrial clusters attract multinational firms at the same level. Moreover, we illustrate the crucial role that entrepreneurial culture and, to a less extent, the social environment play in affecting foreign firm investment decisions. In fact Italy represents a significant setting to test for the effects of location variables on multinational firm attraction. Not only is the Italian economy characterized by a network of highly differentiated and competitive industrial clusters and a high level of territorial specialisation (Porter, 1998) but also the

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country itself presents a great variety of institutional arrangements and marked differences among local entrepreneurial culture and social environment (Fernhaber, Gilbert, & McDougall, 2008; Narula & Zanfei, 2006). Moreover, unlike most studies, in this paper we focus on provincial characteristics as determinants of MNE location decisions in Italy. A province, according to Italian administrative law, covers a small area around a pivotal town and therefore allows us to examine the factors attracting foreign investments almost at town level. At the time of our analysis the number of provinces in Italy was 103. The average area of a province is 1120 squared miles (i.e. 1.6 times the size of the town of London) with an average number of urban areas of 78 and an average population of 562,000. While State or regions characteristics were commonly used as the determinants of foreign direct investment in the existing literature, the impact of more detailed factors at such a fine-grained level was examined only sporadically. In this way, we address both the limitations that Nachum (2000) attributed to previous research on firm location choice and agglomeration economies. The first limitation referred to the use of countries or large regions as a unit of analysis, a dimension that is clearly too large and ineffective for the purpose of measuring agglomeration economies. Using the small areas around pivotal town we adopt the correct spatial unit of analysis for the study of agglomeration economies. Secondly, we take the differences between the different industry sectors into account, controlling for possible industry effects. The paper is structured in the following way: the next two sections develop the theoretical framework and define the main research hypotheses; then we give a brief description of the data and of the methodology used and supply details of the empirical results, discussing our findings. The final section discusses the research and management implications of our main findings, highlighting the limitations of our analysis and possible future research development.

## 2. Theoretical background

One of the main fields of research within international business literature is devoted to study the potential factors able to influence the geographical distribution of investments of multinational firms (Hood & Young, 1999; Malmberg & Maskell, 1999). This strong interest, manifest in the literature, can be explained by the dominant role of multinational firms in an increasingly globalised world, due to their capacity both to promote growth in their host country (Rugman, 2000; Van Den Bulcke & Verbeke, 2001) but also to the significance that the geographical distribution of the firm assets plays in shaping the firm competitiveness. From a theoretical and empirical point of view previous researchers have identified either firm-level characteristics or host country characteristics as the key determinants of the distribution of investment decisions. Firm-specific characteristics have only been analysed in a limited number of empirical works and range from firm size or technological capacity to previous international experience (Chung & Alcácer, 2000; Pak & Park, 2005; Shaver & Flyer, 2000). The debate on host country characteristics has been much wider in scope and depth. In these studies, the concept of locational advantages, considered as significant place-specific factors able to influence the location decisions of some potential investors, has been well documented (Rugman, Verbeke, & Cruz, 1995). Really, while traditional studies have concentrated on factor endowments as the main locational advantages, a more recent approach tends to focus increasingly on “created assets” (Narula & Dunning, 2000), including knowledge-based assets, infrastructure and technology (Dunning, 1997; Rugman, 2000). This recent approach is also indicative of the influence of institutional development on the localization of inward foreign investment, since multinationals appear to react positively to any government policy that reinforces their own competences, knowledge and intangible resources (Bevan, Estrin, & Meyer, 2004). Finally, the new economic geography literature (Fujita et al., 1999) focuses on the influence of industry agglomeration and spatial clustering on the location decisions of multinationals, following the evidence that a significant concentration of related firms in a restricted place may strongly reinforce co-location by other firms (Maskell & Malmberg, 1999; Storper, 1997). Based on Dunning's work (1997), all these factors can be classified into two broad main groups: economic and institutional factors. These two features are not to be considered as mutually exclusive but tend to reinforce each other. From a strictly economic point of view, the differences both in price of factors of production and in market size (Haddad & Harrison, 1993) have received consistent empirical support as drivers of MNC investment location. This means that the investments decisions of multinationals are closely tied to the comparative advantage of a country, which in turn affects the expected profitability of foreign investments (Casson, 1990). Taking this approach, vertical investments develop when foreign firms move their production process to countries in order to take advantage of less expensive factors of production, such as labour, mainly by delocalising the low-skilled production stages towards low-wage countries. Sun, Tong, and Yu (2002) in the Chinese context and Campos and Kinoshita (2003) in the countries of Central and Eastern Europe both empirically validate the conclusion that low labour costs attract foreign direct investors. By contrast, the FDI inflows to developed countries are mainly driven by market-seeking and strategic asset-seeking motives and they represent location of activities towards the foreign countries, which are potentially a large and significant market or a source of strategic resources (Narula & Dunning, 2000). Typically, market-seeking motives are the driving factor in the initial stages of the development of a new subsidiary, later followed by more complex goals. As Birkinshaw, Hood, and Young (2005, p. 228) clearly state: “The received wisdom today is that subsidiaries start out with market-seeking responsibilities . . . and as subsidiaries develop resources and capabilities of their own they take on additional responsibilities”. The responsibilities of these new subsidiaries range from the identification of new markets opportunities to the development of new ideas and products and of new resources to share within the firm. In order to take on this more developed role the subsidiaries need to look for valuable human resources and this explains the importance that the quality of the local labour force and its productivity plays in attracting multinational firms (Cantwell & Piscitello, 2002). Recent literature (Birkinshaw, 1997) has clearly demonstrated that entrepreneurial abilities are among the competences

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