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# The impact of FDI on entrepreneurship in the European Countries

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## Abstract

This paper considers the impact of foreign direct investments (FDI) on the entrepreneurial activity in 16 European countries. Data for the early-stage entrepreneurial activity are provided by the Global Entrepreneurship Monitor (GEM), which made also a distinction between necessity- and opportunity-driven entrepreneurs. We assess the role of both inwards and outwards FDI for the period 2005-2011. Our results show that the inwards FDI positively influence the opportunity-driven entrepreneurs while the outwards FDI have a positive influence on the necessity-driven entrepreneurs and a negative impact on the other category of entrepreneurs. The results regarding the FDI impact on the opportunity-driven entrepreneurs are strongly robust in terms of panel data expansion and control variables. Our findings show also that the opportunity entrepreneurship is associated with more developed, innovation-driven economies, while the necessity entrepreneurship characterizes the European efficiency-driven economies.

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## 1. Introduction

As the entrepreneurial activity is considered the main engine of economic growth, the entrepreneurship literature historically focused on the identification of entrepreneurship determinants, including the economic context, government policies, entrepreneurial culture and the operating environment. Only recently researchers have started to assess the effects of the foreign direct investments (FDI) on the new firm setup (Ayyagari & Kosová, 2010). This

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effect is expected to be two-fold (Doythch & Epperson, 2012). On the one hand, domestic firms are expected to benefit from the know-how that multinational enterprises transfer, but also from the demand creation (positive spillovers). On the other hand, the domestic entrepreneurs are expected to suffer from negative externalities because of increased competition and of technological barriers to entry (negative spillovers). Both the demand creation effect and the entry barrier effect were documented in the empirical literature.

Nevertheless, to the best of our knowledge, none of the studies approaching the impact of the FDI on the entrepreneurship makes the distinction between necessity driven entrepreneurs (*nde*) and opportunity driven entrepreneurs (*ode*). This particular emphasis is theoretically attractive because the expected impact of the FDI may be different, depending on the motivation for entrepreneurship. Therefore, the first contribution of our paper is represented by the assessment of FDI impact on both necessity and opportunity-driven entrepreneurs.

Most of the scholars have focused on the host country effect, analyzing the impact of the inwards FDI on the new firm creation. However, the role of the outwards FDI is also important in terms of entrepreneurial activity as they may act as a driver for necessity entrepreneurs. This category of entrepreneurs is represented by persons who lose their job or do not find any job on the market. They are trying to ensure their revenues by starting a business. The fact that a part of the domestic capital leaves the country or the region in order to find investment opportunities abroad (outwards FDI), can then stimulate the necessity entrepreneurial activity. Thus, the second contribution of our paper consists in the analysis of the impact of both inwards and outwards FDI on the entrepreneurial activity.

The extensive literature studying incentives and impediments to firm entry and exit associates the entrepreneurial activity with the setup of new firms (Kim & Li, 2012). Indeed, the regular way to assess the entrepreneurial activity regards the persons operating new businesses. However, this measure does not take into account the persons involved in the process of starting businesses (nascent activity). The GEM statistics cover early-stage entrepreneurial activity (*tea*) which combines nascent and new entrepreneurial activities. Consequently, the third contribution of the paper is represented by the use of *tea* for assessing the entrepreneurial activity. The last contribution is associated with the empirical methodology. While most papers conduct single-country analysis, the present work relies on a panel data approach for 16 European countries, for the period 2005-2011 (strongly-balanced panel). We employ several macroeconomic control variables as the growth rate and the GDP per capita, but also a series of control variables which represent the entrepreneurial attitude, as the fear of failure, and the entrepreneurial intentions. In order to test for the robustness of our results, we extend in the first step the original panel for the period 2001-2011. In the second step, we extend both the time dimension (2001-2011) and the panel dimension, including in the analysis four European countries for which data are available starting with 2007.

The remainder of the paper is the following. Section 2 presents a brief overview of the literature on FDI – entrepreneurship relationship. Section 3 describes the stylized facts regarding the entrepreneurial activity in the selected European countries, the data and the methodology. Section 4 highlights the empirical findings. The last section concludes.

## 2. Literature review on entrepreneurship and FDI relationship

Our paper on entrepreneurship and FDI relationship expands the new research front regarding the determinants of entrepreneurship literature. On the one side, as Kim & Li (2012) show, the FDI – entrepreneurship relationship has been for the first time explored in the context of the spillover effects produced by inward FDI in host economies. Starting with McDougall (1960), the researchers have been interested in the relationship between foreign direct investment and a variety of economic development outcomes in the destination country, including the activity of local firms. The surveys have shown that FDI improve labor productivity (Liu et al., 2000) and increase the production capabilities of local firms (Hejazi & Safarian, 1999).

On the other side, as Ayyagari & Kosová (2010) states, a huge body of literature has focused on the determinants of entrepreneurial activity. Theoretical papers are oriented towards the entrepreneurial culture and gradual learning or to the role of technological innovation in supporting the entrepreneurial intentions (Jovanovic, 1982; Jovanovic & MacDonald, 1994; Ericson & Pakes, 1995). Empirical works consider in particular the role of the economic context and institutional framework in promoting the entrepreneurship.

The effects of the FDI on the entrepreneurship were assessed in particular in the last three decades, due to the internationalization of large and small firms (De Maeseneire & Claeys, 2012). Most of the studies focus on the role

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