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Foreign multinationals and domestic innovation: Intra-industry effects and firm heterogeneity



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ABSTRACT

This paper looks at foreign Multinational Enterprises (MNEs) investing in the UK and at their impact on the innovation performance of domestic firms active in their same sector. By employing data on Foreign Direct Investments matched with firm-level information the paper develops a direct measure of capital inflows at a three-digit industry level. In order to capture innovation in both manufacturing and services the paper relies on a broader proxy for firm innovativeness based on the Community Innovation Survey (CIS). The results suggest that domestic firms active in sectors with greater investments by MNEs show a stronger innovative performance. However, the heterogeneity across domestic firms in terms of internationalization of both their market engagement and ownership structure is the main driver of this effect.

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1. Introduction

Over the last few decades the importance of Multinational Enterprises (MNEs) in the global economy has grown substantially, stimulating the attention of scholars and policy makers. MNEs are amongst the main ‘creators’ of new technology – see among other Cantwell (1994) and Cantwell and Iammarino (2000) – since they represent the largest source of technology generation, transfer and diffusion in the world economy (Iammarino and McCann, 2013).

Countries increasingly compete to attract MNEs on the ground of the potential benefits that may stem from their presence and activities in the host economies. Scholars have long debated the rationale of these policies by investigating the effects of MNE investments on the recipient economies. However, the empirical evidence on the impact of MNEs on local firms in advanced economies is still mixed and inconclusive (see, for example, the reviews in Rodrik, 1999 and Smeets, 2008).

The aim of this paper is to provide new empirical evidence on the impact of MNE investments in the UK. By building on a novel database that merges data on foreign direct investments (FDI) with firm-level information, we test whether the innovation capacity of domestic firms operating in the same industrial sector as foreign enterprises benefits from their presence and activities. The paper contributes to the existing literature in a number of ways. First, we look at the impact of MNEs on the probability that domestic firms carry out innovation by employing a measure of innovativeness that accounts also for innovation in services. Previous studies have mainly focused on productivity or patent outputs, failing to grasp the full impact on recipient economies – such as the UK – characterized by a strong relevance of services. Second, we measure the impact of MNEs also in terms of the magnitude of their investments, rather than only on the basis of their mere physical presence as in the majority of existing studies. Third, and more importantly, we shed light on how the heterogeneous characteristics of domestic firms shape their capability to benefit from MNE activities. In so doing the paper aims to contribute to the (still) scant literature modelling spillover mechanisms as two-way relationships rather than as unidirectional flows (Barnard and Cantwell, 2007).

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