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Leverhulme Centre for Research on Globalisation and Economic Policy

Research paper media briefing

The Impact of Foreign Direct Investment on New Firm Survival in the UK:

Evidence for Static v. Dynamic Industries

by Andrew Burke, Holger Görg and Aoife Hanley

New research from economists at the Globalisation and Economic Policy Centre (GEP) reveals that multinationals are killing some of Britain's most promising start-ups. The research shows that the presence of multinationals on UK soil increases significantly the chances of an enterprising new business going bust in its first year.

Ordinarily around one in five new ventures dies within its first year and two in five fail to survive beyond three years. But in dynamic economic sectors — where companies compete on the innovation of their products or services — the likelihood of failure increases substantially as a result of competition from multinationals locating in Britain.

One of new Chancellor Alistair Darling's last initiatives as Secretary of State for Trade and Industry was to set up an action group to identify innovation and share the lessons of Britain's best new enterprises. At the same time the UK is still keen to encourage multinationals firms to locate here and has attracted more foreign direct investment than any other EU country.

According to GEP's Dr Holger Görg, "Attracting foreign investment and encouraging enterprise are cornerstones of most governments' economic policy, but little research has been done on whether the two are mutually compatible. Our research raises some difficult questions.

"The chance to attract a big company and hundreds of jobs to the UK may make the demise of a new enterprise seem unimportant, but the impact could be enormous over the longer term. The companies being killed off are the Microsofts and Virgins of the future. Data suggest that many promising start-ups are being snuffed out before they have a chance to develop competitive resilience. And the more innovative they are, the more likely they are to struggle to survive."

Key Findings:

- The presence of multinationals on UK soil significantly increases chances of an enterprising start-up going bust
- The more innovative a new company is, the more likely it is to fail
- Policy makers may want to consider how to encourage multinational investment while mitigating the negative effect it can have on start-ups

Latest figures from UK Trade and Investment show that Britain attracted record levels of global investment last year (the fourth consecutive year the record has been broken). A total of 1,431 investment firms came to the UK either to set up here for the first time, or to expand existing business operations. The UK is the largest recipient of foreign direct investment in Europe and second only to the US worldwide. According to GEP, in 1998, 12% of UK employment was in foreign-owned multinational companies. By 2002 (the last year of data) this share rose to 17% — a 42% increase over the period.

The research highlights the considerable challenge the UK government faces in designing an industrial policy that balances the short-term gains of attracting foreign direct investment by multinationals and the negative impact those same multinationals have on start-up enterprises. "It is important for the government to realise that the instant gain of employment and investment by a multinational locating in Britain could be outweighed by its potential to kill off a small start-up that in future could employ a greater number of people," said Dr Görg.

Globalisation impact

Of all the drivers of globalisation — trade, migration of workers and foreign direct investment — FDI is probably the most visible. It is also likely to be the most important aspect of globalisation economically. For example, over recent decades global FDI flows have grown at least twice as fast as trade.

Positive influence in static industries

However, there is one encouraging impact of multinational investment. The report shows that multinationals have a positive effect on the survival of companies in "static industries" — where businesses produce similar products and services but compete mainly on price.

Dr Görg said: "Firms in static industries tend to be more imitative. In these sectors there is scope for new start-ups to learn from their bigger competitors and pick up tips on best practice and improving productivity."

Research implications

"This research could have public policy implications and may encourage the government to be more discriminating in terms of the types of multinationals it entices to come to the UK and the level of benefits and perks it offers different overseas companies looking to locate here. Alternatively the government may need to consider how it can support and encourage start-up enterprises that face competition from multinationals," said Dr Görg.

Research data source

This is the first in-depth analysis of the link between multinationals and the survival of start-up businesses in the host country. The research was based on data from over 179,000 start-up businesses in the service and manufacturing sectors between 1997 and 2002, compiled by the Inter-Departmental Business Register held at the Office for National Statistics. Data was also drawn from the Inter-Departmental Business Register (IDBR) database at the UK Office for National Statistics This register captures VAT-registered businesses and covers about 98% of UK business activity.

GEP — the Globalisation and Economic Policy Centre — is the major centre in Europe studying the impacts of globalisation and economic policy, and one of the biggest of its kind in the world. The centre has an impressive international reputation. Its academics have advised the Treasury, the OECD, the World Bank and WTO.

GEP is keen to promote its research work and is committed to communicating its expertise through the media and to assisting journalists whenever able.

GEP is based at the University of Nottingham and is substantially funded by grants from The Leverhulme Trust.

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Holger Görg focuses primarily on the impact of globalisation at a firm level. Recent GEP work includes exploring the effects of exporting and offshoring on a firm's productivity and the impact on wages when foreign multinationals buy UK firms. He has also produced interesting work showing how countries with higher corporate taxes are often actually more successful in attracting foreign investment.

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