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Multinational status and firm exit in the Italian manufacturing and service sectors

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ABSTRACT

The aim of this paper is to investigate the determinants of survival for Italian firms according to their ownership status. To this end, we analyze firm survival distinguishing the Italian firms in foreign multinationals (FMNEs), domestic multinationals (DMNEs) and domestic non-multinational firms (NMNEs). The empirical analysis, carried out over the period 2004–2008, is based on the Cox Proportional Hazard Model, in which we look for the impact of ownership dummies on firm survival controlling for several firm and industry specific covariates. Our main findings reveal that FMNEs are more likely to exit the market than national firms in manufacturing and services. In contrast, DMNEs have a higher chance of survival compared with the other firm categories in services. However, when we conduct a finer level of industry classification, we observe the presence of some heterogeneity in the patterns of firm survival. Moreover, we find that the presence of foreign firms has a positive impact on firms' survival mainly in the service sectors.

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1. Introduction

Most of the literature on the effects of foreign direct investment (FDI) has focused on productivity spillovers (technological or pecuniary) and the analysis of their determinants. In recent years, some empirical works have introduced a new approach to the measure and transmission of technological and pecuniary externalities. Moving from a common criticism of the empirical measures of productivity, this literature "tries to look beyond productivity spillovers" (Görg and Strobl, 2004) and investigates the effect of FDI on firm survival. This issue is crucial because firm survival shapes the competitive landscape of the economy and is linked to the persistence of jobs, and both issues have an effect on the welfare of the economy. The aim of our paper is to follow this recent approach and search for different survival dynamics of Italian firms as a result of both inward and outward FDI.

Some authors have argued that multinational enterprises (MNEs) are more "footloose", i.e., more likely to exit the market than indigenous firms (Flamm, 1984; Rodrik, 1997) because their globalised networks enable them to react almost instantaneously to adverse changes in a host country by shifting their production to another location. This footloose behaviour of MNEs occurs regardless of the nationality of ownership and is also likely to be observed in domestic multinationals.

Therefore, we attempt to answer the following research questions: What is the relationship between multinational ownership and firm survival rates? Is there a "footloose nature" of multinationals? To what extent can this footloose nature be attributed to both foreign and domestic multinationals?

We analyze these issues by studying the different dynamics and determinants of survival and disentangling Italian firms in three categories: foreign multinationals

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(FMNEs), domestic multinationals (DMNEs) and purely domestic firms (NMNEs). To achieve this goal, we perform an econometric analysis based on Cox proportional hazard estimates and control for several firm- and industry-specific covariates. In our empirical analysis, we first divide our total sample into the manufacturing and service sectors. Additionally, to control for the existence of some sector-specific characteristics, we conduct a finer level of industry disaggregation.

Our paper contributes to the existing literature in several ways. First, we explore a void in the literature, as the studies of the effects of MNEs on survival and the exit dynamics of firms with respect to Italy have not yet compared domestic and foreign multinational firms' rates of survival.[1] More generally, within the literature pertaining to survival and ownership, the separation of indigenous firms (plants) into multinationals and non-multinationals is indeed restricted to a few recent papers.[2]

Second, our empirical analysis is based on a very large dataset with a much wider coverage of the firm universe than that which has been considered in previous studies on firm survival in Italy. Third, unlike most of the empirical literature samples, our sample of firms is not restricted to manufacturing sectors but also covers the service sector. To the best of our knowledge, only one study (Van Beveren, 2007) has extended the analysis of ownership and survival beyond the manufacturing sectors. Additionally, given the large size of our database, we implement a finer industrial classification to more accurately determine how sectoral characteristics may interact with the different determinants in explaining the survival of Italian firms.

The paper is organised as follows. Section 2 presents the basic theoretical and empirical premises regarding the determinants of survival and summarises the main empirical results of the literature. Section 3 describes the data and provides some descriptive statistics related to FMNEs, DMNEs and NMNEs disaggregated by manufacturing and services. Section 4 presents the model used in the paper and the results of the Cox Proportional Hazard Model. Finally, Section 5 summarises and concludes.

2. Multinational ownership and firm survival: a brief survey

The literature pertaining to firm survival has followed several lines of investigation. Dunne et al. (1988) established that plant survival is positively associated with size and that exit rates vary across industries. Subsequent studies have confirmed these findings for different periods and countries (e.g., Audretsch and Mahmood, 1995; Audretsch et al., 1999; Mata and Portugal, 1994; Disney et al., 2003),[3] controlling for other plant (firm) and industry characteristics, such as capital intensity, productivity, wages, industry concentration and growth. Some recent empirical literature has opened a further strand of research by attempting to answer the question of how foreign ownership influences firm survival (Mata and Portugal, 1994, 2002; Bernard and Sjöholm, 2003; Görg and Strobl, 2003a; Girma and Görg, 2004).

Theoretically, the expected relationship between multinational ownership and firm survival is ambiguous. The "footloose" character of multinational enterprises may be explained by these firms' position within an international production network; thus, they can easily relocate production between countries in response to adverse shocks in the host country (foreign multinationals) or changes in local costs (domestic multinationals). Using optimal portfolio theory, Flamm (1984) showed that U.S. multinationals rapidly adjust their operations to changes in host country environments based on particular country risks. The exit propensity may also depend on the nature of FDI involved: if FDI is horizontal, multinationals are mainly motivated by market-seeking determinants and are thus less likely to be influenced by changes in production costs in host countries. Conversely, vertical foreign investment, which is primarily driven by cost-saving forces, is more sensitive in reacting to changes in production costs and may be more likely to close as a result of sudden shocks (Inui et al., 2009).

However, the hypothesis of a more "rooted" character of multinational enterprises with respect to domestic firms may be explained by a result that has emerged from the finance literature, on the effect of sunk entry costs on firm exit (Dixit and Pindyck, 1994): the greater the amount of irrecoverable costs, the greater the value of waiting before making an exit decision. Thus, if the sunk costs of investing abroad are higher than those for establishing a purely domestic plant in the host country, foreign affiliates are less likely to exit.[4]

Recent empirical work on productivity differences between firms shows that multinationals, regardless of whether they are domestic or foreign-owned, exhibit a "productivity premium" compared with purely domestic firms (Criscuolo and Martin, 2009). This result corresponds to the literature on firm heterogeneity (Helpman et al., 2004), which shows that a firm's status in terms of global engagement is crucially related to the firm's performance. In this context, foreign MNEs may have a higher probability of survival because foreign capital

[1] Colombo and Delmastro (2000) and Giovannetti et al. (2009) are the only two studies that have examined the issue of survival and multinationals for Italy. However, in such works, no comparison between the survival rates of foreign and Italian multinationals has been conducted.

[2] Such papers include Kimura and Fujii (2003), Bandick (2010), Van Beveren (2007), and Inui et al. (2009). See the literature review in Section 2.

[3] However, two recent studies by Bottazzi and Tamagni (2011) and Bottazzi et al. (2011) on business failure proxied by financial firm defaults events have challenged the general wisdom that death rates of firms decrease as size increases and demonstrate a positive relationship between size and the event of default.

[4] However, the literature is controversial on this point. Some authors assert that multinationals should face higher sunk costs from establishing a new firm because new firms are typically more skill- and capital-intensive than incumbent firms. Other authors claim that multinationals, as multi-unit enterprises, are likely to benefit from lower sunk costs in terminating a plant's operations due to the greater efficiency of their internal factor markets in re-deploying production equipment and the labour force of the closed plant (Baden-Fuller, 1989).

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