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Injecting demand through spillovers: Foreign direct investment, domestic socio-political conditions, and host-country entrepreneurial activity☆

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A B S T R A C T

This study examines how foreign direct investment (FDI) spurs entrepreneurial activity in host countries. We also investigate why this relationship varies across countries because of domestic socio-political conditions. The findings from our panel analyses of 104 countries from 2000 to 2009 are consistent with our predictions that foreign direct investment positively relates to business creation and this positive effect is strongest in countries with poor institutional support, weak political stability, and low general human capital. Our work provides new insights into how cross-border investments and domestic socio-political conditions jointly influence entrepreneurial activity, especially in emerging and developing economies.

1. Executive summary

A review of the international entrepreneurship literature reveals that this research domain has historically focused on the activities of entrepreneurial actors that cross borders from one country to another and the comparisons of entrepreneurs, their firms, and their operating environments cross-nationally among countries. Extant literature has primarily focused on individual or cultural differences (Jones et al., 2011; Mitchell et al., 2000) and has yet to fully investigate how these contextual characteristics operate at the country level using large-scale, multi-country, longitudinal study designs required for sufficient empirical exploration of the comparative questions (Baker et al., 2005; Hoskisson et al., 2011).

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In this paper, we set out to expand a new research front regarding the study of international entrepreneurship by investigating whether inward foreign direct investment (FDI) contributes to entrepreneurial activity within the host country and why this influence on domestic entrepreneurial activity could vary across countries.This study explores the outcomes of FDI in host economies, particularly within the context of emerging economies, with their varying levels of institutional support, political stability, and general human capital. Specifically, we argue that the presence of foreign investment can act as a stimulus for entrepreneurial activity within the host country.

To investigate these cross-boundary conditions, we develop theory based on three country-level contextual characteristics–institutional support for private enterprise, political stability of governing policies, and general human capital achievement–drawn from macro-societal theories used in cross-national entrepreneurship research (Bowen and De Clercq, 2008; Di Gregorio, 2005; Levie and Autio, 2011; Stenholm et al., 2013).

We tested our theory using a 10-year panel of foreign direct investment and new firm registration levels for 104 countries between 2000 and 2009. This study design enabled us to systematically generalize our findings and highlight the context-dependent nature of the FDI main-effect relationship. This analytical design also allowed us to reconcile the contradictory conclusions reported by scholars using single-country designs in their respective analyses (Acs et al., 2007; Ayyagari and Kosová, 2010; De Backer and Sleuwaegen, 2003; Görg and Strobl, 2002). Finally, the design is also innovative regarding the breadth of emerging and developing economies included in our sample; this feature allowed us to make stronger inferences about the application of our study's findings to regions of growing importance in the global economy.

Consistent with our theory, our analyses revealed that foreign direct investment is positively related to the level of new firm registration. We also found the strength of this main effect varies across countries, depending on certain socio-political conditions. Specifically, our research indicates positive FDI influence is stronger in countries with weak institutional support for private enterprise, lacking political stability, and having lower general human capital. Supplementary analyses regarding spillover longevity also revealed FDI is positively related to higher entrepreneurial activity both during the short-term (within one year) and over extended periods (up to three years).

Our study contributes to the international entrepreneurship literature in several ways. Our work is among the first to systematically test a general framework for understanding how country-level entrepreneurial activity may fluctuate as a result of cross-border investments into host economies, and to investigate these variations cross-nationally in a large, longitudinal sample of advanced and developing countries. Our sample included both advanced and developing economies, which allowed us to test theories about differences in FDI's influence on entrepreneurial activity across different types of economies. Our supplementary analyses also revealed positive spillover effects on entrepreneurial activity regardless of the timing of the foreign investment. We also provide new theory and evidence to advance explanations of why entrepreneurial activity can occur even in regions characterized by weak institutional and low educational conditions. Our findings support our argument that FDI's positive effects on entrepreneurial activity intensify in developing host economies. It is clear from our results that foreign investment helps new firms in emerging economies overcome the obstacles weak socio-political conditions impose on their development.

2. Introduction

As the dawn of the 21st century recedes, once distant economies have become increasingly interdependent hubs of commerce. Many of these connections have been created through a dramatic rise in global foreign direct investment (FDI)—financial capital invested by foreign firms into host economies resulting in long-term ownership and significant management influence in their host-country affiliates (Bandelj, 2008; Graham and Krugman, 1995). These trends call for a serious consideration of foreign investment's influence on economic outcomes in host countries. As such, this study sets out to explore the outcomes of FDI in host economies, particularly within the context of emerging economies, with their varying levels of institutional support, political stability, and general human capital. Specifically, we argue that the presence of foreign investment can act as a stimulus for entrepreneurial activity within the host country.

Our focus on foreign direct investment expands a new research front regarding the study of international entrepreneurship (IE). A review of the IE literature reveals that this research domain has historically focused on both 1) the activities of entrepreneurial actors that cross borders from one country to another and 2) the comparisons of entrepreneurs, their firms, and their operating environments cross-nationally among countries (Coviello et al., 2011; Oviatt and McDougall, 2005). With respect to cross-border activities, the thrust of the international entrepreneurship literature has been on theories of *outward* expansion of new and young firms into foreign markets (e.g., Jones et al., 2011; Kiss et al., 2011; McDougall and Oviatt, 2000).

Our first objective is to investigate whether *inward* foreign direct investment contributes to entrepreneurial activity within the host country. This reorientation is theoretically appealing because it emphasizes FDI both as a source of business opportunities and a channel for injecting new knowledge, skills, and practices through foreign subsidiaries operating in host countries. To advance the comparative, cross-national domain of international entrepreneurship research, we also investigate why inward foreign investment's influence on domestic entrepreneurial activity could vary across countries. This particular emphasis is theoretically attractive because it explicitly addresses the context-dependent nature of entrepreneurial activity (Aldrich, 1979; Stinchcombe, 1965). To investigate these boundary conditions, we develop a theory based on three country-level contextual characteristics–institutional support for private enterprise, political stability of governing policies, and general human capital achievement–drawn from macro-societal theories used in cross-national entrepreneurship research (Bowen and De Clercq, 2008; Di Gregorio, 2005; Levie and Autio, 2011; Stenholm et al., 2013). Scholars have argued for more research devoted to the sources of cross-national variations such as the ones we examine (Kiss et al., 2011; Welter, 2011). Extant IE literature has primarily focused on

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