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Essays on entrepreneurship, worker mobility and firm performance

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Chapter 6

Conclusion

This dissertation studies firm performance from two different perspectives, namely knowledge spillovers and government involvement. One of the major sources of knowledge spillovers is labor mobility (Görg and Strobl (2005)). If workers move from one firm to another they bring the obtained knowledge and experience to the receiving firm (see e.g Almeida and Kogut (1999)). Labor mobility can increase firm productivity in two ways. First, knowledge transfer from new employees to incumbent workers can lead to a higher quality of human capital in the receiving firm, thereby increasing its productivity. Second, labor mobility can increase the likelihood of a good match between the tasks at hand and workers' skills. The allocation of workers to the 'right' job can increase firm efficiency and, consequently, labor productivity. Therefore, labor mobility is expected to have a positive impact on the productivity of enterprises.

A handful of studies focuses on multinationals' R&D investment and knowledge transfer across countries. Griffith (1999) argues that multinationals and domestic firms differ in many respects such as technology, new product and managerial skills, and that multinationals are usually large and have more market power. Additionally, foreign-owned companies devote more of their resources to R&D activities. Theory suggests that these differences are the sources of FDI spillovers in host countries (see, for instance, Caves (1974)). There are several channels through which foreign firms may generate positive spillovers. First, positive spillovers may occur via worker mobility (Görg and Strobl (2005)). Second, domestic firms can apply reverse engineering by closely observing and imitating multinationals' technology and organizational practice (Görg and Strobl (2001)).

The third knowledge spillover mechanism due to the presence of multinationals recognized in the literature is entrepreneurship (Audretsch and Feldman (2004); Navaretti and Venables (2004)). Audretsch (1995) proposes that if a scientist or engineer gives higher value to his/her ideas than do the decision-making bureaucracy of the incumbent enterprise, (s)he may choose to establish a new firm to take the value of his/her knowledge. According to Schumpeter (1934) entrepreneurship leads to economic development through a process of creative destruction. The entrepreneur in his model is responsible for destroying the equilibrium by canalizing the factors of

production into better usage. Motivated by the findings in the existing literature, this thesis investigates different dimensions of the effects of multinationals and labor mobility on the host country.

Chapter 2 focuses on two prominent channels, namely –industry competition and wage levels –, through which FDI can affect entrepreneurial activities. With regard to industry competition, several advantages (like advanced technology, product differentiation, scale economies, and organizational capabilities) enable foreign firms to enter and expand quickly in local markets, altering competition between incumbents. However, whether competition increases or decreases is less clear. In fact, there are two theoretical points of view. The first one suggests that FDI reduces the level of industry concentration and increases competition. The second argument poses that FDI raises the level of industry concentration and reduces competition. The high concentration, in return, facilitates collusion and predatory behavior among firms thereby discouraging firm entry. Previous empirical studies confirm that the degree of competition is a key factor in determining the rates of firm entry (Geroski (1995)), although the direction of this effect is not always clear-cut (Geroski (1995)), and warrants additional empirical verification.

Regarding wage levels, several papers have concluded that foreign firms often pay higher wages even after controlling for the quality of the workforce (Görg and Greenaway (2004)). Furthermore, by attracting innovative human capital, foreign firms may reduce local labor supply, increasing wages across the whole industry.

The contribution of this chapter is to show that both wage level and industry concentration act as two channels through which FDI affects domestic new firm entry. Data for the Dutch manufacturing industries as provided by Statistics Netherlands (CBS) is used in a simultaneous three-equation system to investigate whether FDI presence in Dutch manufacturing industries is directly or indirectly related to domestic new firm creation via the wage and/or competition channels.

The results of Chapter 2 show that there is a significant negative direct effect of FDI on domestic entrepreneurship, which is measured as the rate of gross new firm

entry at the 5-digit NACE level. FDI decreases competition and increases wage levels, the former impacts firm entry positively and the latter negatively. The total effect of FDI is negative, but small and virtually disappears after one year. The combination of higher wages in foreign firms and positive wage spillovers to domestic firms leads to higher overall wages. These results have important implications for domestic entrepreneurship. By increasing overall wage rates and offering wage premiums in host countries, foreign firms may influence the trade-off between waged employment and entrepreneurship in favor of the former and therefore reduce the entry rate.

Hence, the results from Chapter 2 enrich the literature by quantifying and comparing these channels' effects on entry, which work in opposite directions. This is of theoretical interest as well, as the trade-off between concentration and wages implies the need for their joint consideration in future FDI studies. We also challenge the premise that high concentration acts as entry deterrent. Furthermore, this study contributes to the theory by suggesting that the neglect of essential factors can result in biased assessments of the effects of FDI on firm entry.

The analysis leads to the following policy implications. Policy makers may develop strategies to curb the negative effects of FDI on entrepreneurship conveyed through the wage channel. Yet, from a welfare point of view, an effective policy design should not necessarily equate the selection of entrepreneurial talent into wage-employment to being undesirable. Under certain circumstances, the added welfare of employment filled with innovative and creative practices may be comparable to, or even larger than that arising from new firm activity, given the persistent high failure rates of start-ups. For instance, if a motivated entrepreneur takes a position in a technologically strong foreign firm offering good remuneration and promotion prospects, this move may generate welfare-enhancing opportunities through intrapreneurship. Therefore, policy-making may be directed towards increasing the awareness on the importance of intrapreneurship among private sector actors, especially among large businesses that are capable of devoting more resources to innovation. Hence, an effective government policy supporting entrepreneurial activities within existing businesses may, to some degree, counterbalance the reduced entrepreneurship rates stemming from high

wages.

The findings in Chapter 2 should be interpreted in the context of potential limitations of the analysis. The presence of foreign firms is likely to be endogenous, while our empirical approach treats FDI as a predetermined variable. Although we control for the most common observed (and unobserved but constant) factors that the literature identifies to explain wages and competition, using three-stage least squares estimation, we cannot completely rule out that endogeneity of FDI affects our results. With regard to wages, we expect the omitted variable bias to be small, as wages are measured at the industry level, and the FDI share is on average 16%, and therefore the wage premium will be relatively small. Furthermore, we show the robustness of the findings, using lags of FDI to avoid a simultaneity bias in the estimations. To completely rule out remaining concerns related to the endogeneity of FDI, one needs a (quasi-)natural experiment; this is left for future research. Another future research opportunity is to take the heterogeneity in FDI source countries into account. Specifically, the current study depicts the North-North case with regard to the direction of FDI as the lion's share of inflows into the Netherlands originates from advanced countries. In contrast, developing countries attract foreign investment both from advanced and developing economies, meaning that South-South FDI inflows have recently grown in importance.

Chapter 3 argues that knowledge spillovers from FDI occur mainly through highly skilled workers. This study contributes to the literature in several ways. To the best of my knowledge, not only is this study the first to examine spillovers via worker mobility taking skill and education levels of mobile workers into account, it is also the first of this kind for the Netherlands. I hypothesize that hiring from multinational firms increases domestic firms' productivity, driven by the mobility of high-skilled workers. This hypothesis is tested using a comprehensive matched employee-employer data set for manufacturing in the Netherlands. In this chapter the spillover effect is identified based on the relationship between domestic firms' labor productivity and their share of employees hired from multinationals. I formulate a dynamic fixed effects model and estimate the model using a comprehensive matched employee-employment data

set for manufacturing in the Netherlands. I find a positive and significant association between hiring from multinational enterprises and the productivity of the receiving domestic firm. Moreover, the results show hiring highly skilled workers from multinationals has a significantly positive effect on productivity in the receiving domestic firm. Additionally, the findings suggest that hiring highly skilled workers from domestic firms has also a significantly positive effect on the productivity in the receiving domestic firm. Finally, evidenced is provided that hiring low-skilled employees from domestic firms is negatively associated with the receiving firm's performance after one year.

Although an individual country study of the Netherlands does not lend itself easily to generalizations, the consistency of these results with those of studies for other countries in the European Union, suggests that these findings are relevant for other developed countries as well. Consequently, I believe that even though this research focuses on a single country, the empirical evidence provides valuable insights into the role of FDI in transferring knowledge and technology into the host countries' enterprises, and may be applied to other European country settings. It has been argued that knowledge diffusion via worker mobility and the ability of workers to apply new knowledge can be dependent on workers' occupation (Song et al. (2003). Therefore, an interesting avenue for future work may be to examine whether workers' previous occupation and position in multinationals plays a role in the knowledge spillovers of multinational firms to domestic firms.

While Chapter 3 focuses on knowledge spillover from multinationals to domestic firms, Chapter 4 poses that when workers move from more productive to less productive firms (no matter whether they multinational or domestic firms) they bring obtained knowledge and experience to the receiving firm.¹ The hypothesis is that hiring workers from more productive firms increases firms productivity. This hypothesis was first tested by Stoyanov and Zubanov (2012)) for Denmark. In this study, I apply a similar approach as Stoyanov and Zubanov (2012) for the Dutch manufacturing

¹Note that in this study I do not take the type of ownership of firms into account. However, based on labor productivity, I distinguish high- and low-productivity firms and the focal point is the effect of labor movement from the first to the second type on hiring firms' productivity after one year.

sectors. I identify spillovers based on the relationship between hiring former workers of more productive firms and labor productivity of the receiving firms. I use similar data and estimation methods as in Chapter 3, but the model used contains other explanatory variables. The analysis suggests a positive association between hiring from more productive firms and labor productivity of the receiving firm. Furthermore, I find that worker mobility within the same sector is associated with more diffusion of knowledge and skills than worker mobility across sectors. Moreover, my results suggest that hiring within the same sector diffuses more knowledge and skills than what can be brought by workers from other sectors. The results are robust to using different proxies for productivity, such as the turnover-labor ratio and the value-added-labor ratio. My findings are consistent with those of Stoyanov and Zubanov (2012) who provide evidence that enterprises that employ new workers from more productive firms experience a productivity gain one year after hiring.

While the empirical results for Chapter 4 generally support the worker mobility theories and empirical studies, I have left a number of issues unaddressed. First, this study ignores the occupation of moving workers and their job position in sending firms due to data limitations. It has been argued that knowledge diffusion via worker mobility and ability of workers in application of new knowledge can be dependent on workers' occupation (Song et al. (2003)). Therefore, future studies can exploit knowledge transfer via job switcher respect to their occupation in previous firms (For example future research can study knowledge transfer via mobile workers who were manager, engineer or R&D researcher in sending firms. Second, this study ignores the effect of a departing workers on sending firms' productivity. This can be the subject of a new study.

Chapter 5 takes a different perspective on firm performance by analyzing the effects of government involvement in the private sector. It proposes that government involvement could result in a 'supporting hand' and a 'grabbing hand'. For example, government interventions could address problems such as natural monopolies, externalities and information asymmetries, thus tackling market failure ('supporting hand'). However, politicians could also pursue their own political or private goals at the cost of sacrificing public interests and distorting market allocation ('grabbing hand') (Shleifer

and Vishny (1994)). In the literature, government-owned firms are found to be less efficient and less profitable than privately owned firms. This difference is often attributed to principal-agent deficiencies, such as less monitoring of management and the lack of incentives to maximize profits (Vining and Boardman (1992); La Porta et al. (1999)). Compared to non-government-controlled firms, firms under government control face the issue that politicians have both the motives and the power to impose their social and political goals on affiliated companies, which may result in poorer performance (Xu and Wang (1999); Hanwen et al. (2011); Yu (2013)). This final chapter investigates how government involvement affects firm performance. It uses a panel data set of publicly traded firms from the stock exchanges of Shanghai and Shenzhen over the period of 2009-2013 and investigates how (central and local) government control influences the financial performance of Chinese publicly listed firms.

Using three widely accepted proxies for firm performance, namely return on assets, return on equity and Tobin's Q, this chapter shows that government control of firms, measured by the shareholdings that are directly and indirectly controlled by the government, is negatively related with firms' financial performance. Both central and local government control is undermining firm performance. These results remain robust when using different proxies for performance, and provide support for the 'grabbing hand' theory of the government. The findings also suggest that the negative effect of government control becomes stronger when firm profitability is higher. Firms with a poor financial performance benefit from government control, which supports the 'supporting hand' theory of the government.

This analysis in this chapter has a number of limitations. First, government control is defined as a binary variable and ignores any possible influence of government in firms which are defined as non-government controlled. Since, the concentration of control is based on the biggest shareholder only, there may be non-government controlled firms in which the government is one of the larger (but not the biggest) shareholders. Government might still influence such firms even if it is not the largest shareholder. Future studies may come up with measures that take this influence into account. Second, the distribution of authorities in the pyramidal ownership structure

is complex. Although our measurement of the concentration of control is an improvement, there exist other factors in the pyramidal structure that could influence the actual implementation of control rights. Future research could focus on differentiating the intricacy of these influential factors and construct even better measures of government control.

