

**Written evidence submitted by
Manchester Metropolitan University
to
International Trade Select Committee
Inquiry into inward Foreign Direct Investment (FDI)
26 February 2021**

About this submission

This is a submission of evidence from Dr Stephen R. Buzdugan, Senior Lecturer in International Political Economy, and Professor Heinz Tüselmann, Professor in International Business, at Manchester Metropolitan University Business School. Dr Buzdugan and Professor Tüselmann have authored journal articles and policy briefs on industrial policy and foreign direct investment for the United Nations Conference on Trade and Development (UNCTAD) in Geneva. It has been supplied in response to a short inquiry launched by the International Trade Select Committee on inward foreign direct investment (FDI).

Dr Buzdugan and Professor Tüselmann are available to attend as witnesses for the Committee's inquiry on inward FDI, and can provide supporting research papers on request. They can be contacted on s.buzdugan@mmu.ac.uk and h.tuselman@mmu.ac.uk

Executive Summary:

The main evidence points are summarised as follows:

- A. The Government's Industrial Strategy has the *potential* to contribute to the objectives of its Investment Strategy, if the Industrial Strategy is oriented toward the attraction and retention of a higher *quality* of inward FDI.
- B. An industrial strategy designed to attract a high *volume* of inward FDI is not sufficient for FDI to contribute to the types of objectives within the Government's Investment Strategy.
- C. There is a strong regional dimension to an industrial strategy which seeks to achieve the goals of the Government's Investment Strategy. High value-added activities by foreign firms in the United Kingdom are associated with them being deeply embedded within specific *regions* and within efficient local networks.
- D. Therefore, in conjunction with investment in skills, infrastructure and industry, the committee may consider that the Government's Industrial Strategy should include policies which bolster regional networks of firms, markets and knowledge-based institutions, as well as facilitate the strategic autonomy of foreign-owned firms, in order to promote higher-value added activities within these regional economies, making inward investment less footloose, maximise the benefits of inward FDI and helping to narrow the productivity and skills gaps between regions.
- E. Furthermore, the Committee may also consider that the Government's Industrial Strategy and Investment Strategy need be informed by the complex internationalisation processes within multinational enterprises (MNEs), strategic objectives of investors and the need of subsidiaries to deliver outcomes that help to boost competitive advantage for the multinational corporation as a whole.

Inquiry Question:

How does the Government's Investment Strategy relate to its Industrial Strategy, its regional policy and the "levelling up" agenda?

1. The evidence below is based on a series of large-scale representative firm-level surveys in relation to foreign owned firms in the UK, with a combined evidence base of over two thousand firms. The results on which the evidence below is based have been published in variety of academic journal articles, a selection of which can be found in the reference section of this written evidence.
2. The relationship between the Government's Investment Strategy and its Industrial Strategy:
 - a. The Government's Industrial Strategy is at the forefront of policy in terms of its attention to investment in skills, infrastructure and industry to promote inward FDI.
 - b. Thus, the Government's Industrial Strategy has the *potential* to contribute to the 'levelling up' of regional investment outside of the South East and to maximising the economic and social benefits of inward FDI to the United Kingdom (UK), if the strategy is oriented toward the attraction and retention of a higher quality of inward FDI.
 - c. As our research shows, an industrial strategy designed to attract a high *volume* of inward FDI is not sufficient for FDI to contribute to the types of objectives within the Government's Investment Strategy.
 - d. What matters is the *quality* of FDI, in terms of being associated with high value-added activities (i.e. activities associated with higher productivity and upskilling), in order to contribute to positive spillover effects in the UK's economy.
 - e. An industrial strategy designed to maximise the benefits of inward FDI would therefore include policies that would aim to encourage the attraction and retention of higher quality FDI, as well support the 'upgrading' of existing inward investment in the UK toward higher value activities.
 - f. In this regard, there is a strong regional dimension to an industrial strategy which seeks to achieve the goals of the Government's Investment Strategy. High value added activities by foreign firms in the UK are associated with them being deeply embedded within specific *regions* and within efficient local networks (consisting of suppliers, customers, competitors, clusters of domestic firms, research institutes and universities, supportive government agencies and local authorities), in order for them to effectively access and leverage the physical and knowledge-based assets which underlie the development of high value-added, high-productivity and high-skills employment activities.
 - g. Furthermore, our research has shown that an often-ignored aspect of industrial strategies is the degree to which they may influence the structures and strategies of inward investing firms. The findings of this research strongly suggest that foreign-owned subsidiaries in the domestic economy which have a high degree of strategic decision-making autonomy tend to embed themselves in regional and local networks which promote the development higher value-added activities in the economy.
 - h. Therefore, in conjunction with investment in skills, infrastructure and industry, the committee may consider that the Government's Industrial Strategy should include policies which bolster regional networks of firms, regional supply chains, markets and knowledge-based institutions, as well as facilitate the strategic autonomy of foreign firms, in order to promote higher-value added activities within these regional economies, making inward investment less footloose and maximise the benefits on inward FDI and helping to narrow the productivity and skills gaps between regions.
3. Evidence of and lessons from the upgrading of FDI upgrading within the UK economy
 - a. Only a significant minority of multinational enterprises (MNEs) were found to be strategically developing their subsidiaries by granting them higher-level mandates and

strategic decision-making autonomy, to be deeply embedded into local networks in the UK and to be performing some form of high value-added activities.

- b. Embeddedness in local, regional or national supply chains was found to be particularly low.
- c. Furthermore, the majority of subsidiaries in the countries surveyed were shown to be only lightly embedded in their host location, as a result of being geared to supplying and developing domestic markets, which highlights the continuing importance of market-oriented FDI and the export-enhancing nature of FDI within the UK.
- d. There was little evidence that in recent years a large number of subsidiaries have considerably increased value added; deepened linkages with local networks and to local, regional or national supply chains; or experienced a substantial upgrade in their strategic decision-making autonomy, which is associated with fostering subsidiary development and specialization.
- e. This is despite the fact that the majority of foreign-owned subsidiaries are relatively mature, having been in foreign ownership for many years and having had a long period in which to develop host-location linkages.
- f. The insights provided by this research may indicate that a number of regions in the UK may lack desirable asset bases, the type of network infrastructure and capabilities that are attractive for a large number of MNEs to develop and upgrade their FDI.
- g. The findings of the study also indicate that the many MNEs are not looking for such embeddedness factors for their investments.
- h. Indeed, the parent companies surveyed in our studies highlighted that they attached less importance to embeddedness factors than subsidiary managers do.
- i. This highlights that even if subsidiaries embed deeply in the UK, not all are candidates for upgrading, which may point to an overinvestment of a portion of subsidiaries into these factors without a related increase in high value-added activities.
- j. Our studies demonstrate that subsidiary upgrading with deep integration in the regional economy is associated with mutual beneficial outcomes for both the host region and investors, in terms of above average productivity growth, skilled job creation, export growth, as well as good subsidiary performance and contribution to overall MNE competitiveness.
- k. Yet, achieving such outcomes is not straightforward and entails direct and indirect routes. The deepening of embeddedness in host locations in terms of network relationships was found to be among the main contributors to positive mutual beneficial outcomes, with the granting of strategic decision-making autonomy to the subsidiary and bringing the subsidiary into a more central position within the MNE network being primary facilitators in the development of networks in the host location.
- l. An important take-away from our studies for policymakers and regional development and inward investment agencies is that policies aimed at upgrading inward investment towards higher value-added activities and capturing associated economic benefits for the region, require not only the cultivation of requisite regional asset bases and network infrastructures, they also need be informed by the complex internationalisation processes within MNEs, strategic objectives of investors and the need of subsidiaries to deliver outcomes that help to boost competitive advantage for the MNE as a whole.

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