Difference Is Good: Evidence from the Effect of Ethnicity Diversity on Corporate Interstate Investments

Ying Mao[1]; Zheng Wang[2]; Hong Zou[3]
[1]Lingnan University, [2]City University of Hong Kong, [3]University of Hong Kong

Summary

- We examine the effect of local ethnicity diversity on attracting interstate capital investments.
- Using a novel dataset of interstate investments at the project level, we show that a county's ethnicity diversity is positively associated with its likelihood of being chosen as the location of interstate investments from firms in other states, which is robust to a widely used instrumental variable estimation strategy. We find stronger result when the investing firm has an ethnically diverse culture, has higher R&D intensity, or operates in a high-technology industry.
- The evidence speaks to the debate over the effects of ethnicity diversity on economic development.

Motivation

- The choice of investment locations often crucially affects the financial outcome of business ventures and shapes the outlook of regional economies (Strotmann 2007).

- Extant literature on investment location choices focuses mainly on local neoclassical and formal institutional factors, such as industry concentration, education attainment, taxes, local labor market, wages, and incentive programs.

➢ Lack of empirical evidence on whether local social environment, particularly local ethnicity diversity affects investment location choices.

Research Question

Does local ethnicity diversity make a place more attractive for interstate investments?

- Trade-off between benefits and costs:

➢ Benefits:

Different skills, experience, culture, and ways of thinking among people with different ethnicity backgrounds can facilitate knowledge diffusion, offer greater resources for problem solving, and create a complementary effect in production and innovation (Cox 2001; Herring 2009).

Ethnicity diversity also enhances the efficiency of government bureaucracies (Rasul and Rogger 2015).

➢ Costs:

Potential preference and communication conflicts, and potential discriminations among people with different ethnicity backgrounds may reduce productivity and lead to low economic performance (Alesina and La Ferrara 2000, 2002; Hjort 2014).

Ethnicity heterogeneity may also decrease the efficiency of public policies and the provisions of productive public goods because individuals with different ethnicities may have different preferences for public goods (Alesina and La Ferrara 2005).

✓ **Yes, when the benefit dominates the cost.**

➢ No, when the cost dominates the benefit.

Research Design

- Selection Model at the project-county level:

$$\textit{Choose}_{p,j,t} = \alpha + \beta_1 \textit{Ethnicity Diversity}_{j,t-1} + \textit{County-Level Characteristics}_{j,t-1} + \textit{County-Firm Pair Characteristics}_{p,j,t-1} + \textit{Project FE} + \textit{County FE} + \textit{State-by-Year FE} + \varepsilon_{p,j,t},$$

➢ *Ethnicity Diversity* is measured as one minus the Herfindahl index calculated across four basic Census tract ethnic categories including Hispanic, non-Hispanic black, non-Hispanic white, and Asian in each county.

➢ *County-Level Characteristics* include GDP growth, average household income, Gini index, unemployment rate, workforce population growth, age diversity, and local education level.

➢ *County-Firm Pair Characteristics* include the geographic distance between the investing firm's home county and a candidate county, the industry concentration, and the existence of the investing firm's customers and suppliers.

Sample

- We obtain the data on interstate investment in the U.S. from Financial Times fDi Markets database. The final interstate investment sample comprises 5,857 investment projects by 1,306 firms during the period of 2011 to 2018.

- Three methods of selecting candidate counties for each investment project:

1. The *Same State Sample:* all non-chosen counties in the same state where the chosen county is located as alternative candidates – control for state-level economic conditions
2. The *Neighboring County Sample:* nineteen geographically closest counties as alternative locations – control for similar regional characteristics
3. The *PSM Sample:* matched by other county level and county-firm pair level characteristics

Results

- **Baseline results:**

Y = *Choose*	Same State	Neighboring County	PSM
Ethnicity Diversity	**0.054*****	**0.250****	**0.364*****
	(2.87)	**(2.49)**	**(3.03)**
Controls	Yes	Yes	Yes
County FE	Yes	Yes	Yes
State-by-year FE	Yes	Yes	Yes
Project FE	Yes	Yes	Yes
Observations	459,638	114,286	114,400
Adjusted_ R^2	0.153	0.191	0.032

- **Cross-sectional analyses:**
- The positive association between local ethnicity diversity and the likelihood of receiving interstate investments is stronger when…

➢ the investing firm's headquarters/home county has a higher level of ethnicity diversity or when the firm itself has a higher score on the diversity policies.

➢ the investing firm has higher R&D intensity or operates in a high-technology industry.

- To mitigate the endogeneity concern, we implement an **instrumental variable analysis** based on the "shift-share" methodology and obtain robust results.

- **Other robustness checks:**

✓ Control for the population percentage of the three minority groups
✓ Conditional logistic regressions
✓ Exclusion of 5 most popular destination counties
✓ County-level portfolio analyses

Contribution

- We add additional evidence to the unsolved literature examining the economic effects of ethnicity diversity. We provide evidence that within the U.S., firms are more likely to choose regions with higher ethnicity diversity as their investment locations when they decide to expand their operations into other states, suggesting that firms perceive local ethnicity diversity to have greater benefits than costs in this long-term-oriented decision context.
- We contribute to the literature that aims at understanding firms' location choices for their investments. In addition to the formal institutional factors, we show evidence that a culturally diversified local environment as captured by ethnicity diversity has a significant influence on firms' location decisions.
- We contribute to the growing literature on local culture and corporate decisions.

Contact

Ying Mao
Email: yingmao@ln.edu.hk

Zheng Wang
Email: zwang22@cityu.edu.hk

Hong Zou
Email: hongzou@hku.hk

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