1. Multinationals: in theory and practice

INTRODUCTION

The academic discipline and research agenda that we now designate as International Business (IB) emerged in a gradual, almost subliminal, way during the 1960s. We can here accept the widely held view that the decisive starting point for this theoretical process was the completion of Stephen Hymer’s PhD thesis in 1960 and then locate the most clear-cut evidence of its provisional maturity in two conferences held at the end of the decade that, for the first time, took firms with international operating perspectives as their central theme. In terms of theorising Hymer’s defining transformative insight was the need to replace a visibly redundant macro-level theory of foreign direct investment (FDI) with a micro-level theory of (what we came to call) the Multinational Enterprise (MNE), initially perceived as the firms that did FDI. But, for the purposes of the narrative we will develop here, the way Hymer did this is crucially indicative. By confronting observed practicalities of the world he could study in the 1950s he both demonstrated the manifest inadequacies of the dominant existing theory and also showed how elements of the newly observed reality not only negated the earlier perspective, but also provided precise insights towards the genesis of revised theorising.1

During the 1960s interest in IB progressed, at least initially, through an often ad hoc series of intuitive and informal interactions between a growing group of scholars bringing a range of differently focused, mainly practically based, insights into a discussion of the behaviour of these internationalised firms. The two conferences referred to earlier became a testament to the fact that, by the end of the decade, there were enough recognised scholars with acknowledged expertise in the area to allow for the assembly and exchange of high-quality knowledge and facilitate rewarding debate. The titles of the conferences and their published volumes also testified that, beyond doubt, the agenda was now firmly focused on the firms, with Charles Kindleberger (1970) referring to the International Corporation2 and John Dunning (1971) to the Multinational Enterprise.3 But whereas the central aims of the conferences and the overarching
interests of their convenors/editors was to build a coherent understanding of these firms (working towards a theory) the range of contributors, and their intellectual origins, also underlined that to do this realistically needed to draw in multifaceted aspects of their practice and the contexts in which they were learning to operate.

It is also very indicative of the ad hoc formulation of early insights into what we now consider to be IB that what became its single most influential contribution from the 1960s, Raymond Vernon’s Product Cycle Model (1966), was in no way, shape or form intended as such, and originated from very different concerns. In terms that we would now recognise, Vernon’s concern was, in effect, to investigate the macro-level relationship between FDI and trade. What emerges though is that in order to understand the bases of the relationship it is necessary to understand the capacities and the motivations of the firms that do the FDI. Indeed, in a way that precisely presages a central concern of our narrative here, Vernon shows that whether FDI complements or substitutes for trade depends on the practicalities of the specific motivation pursued by the MNE’s operation; whether it is efficiency seeking (complementarity) or market seeking (substitution). Feeding back into theory we will see how this aspect of strategic practice affects the performance implications (on firms and locations) of IB.

This ‘early days’ preamble, in fact, already points towards the two key themes that will underpin and motivate our narrative of the ways in which IB, in theory and practice, went on to evolve into the analytical and operative reality we need to understand and address today. The first of these themes is that in order to comprehend and evaluate the operation of the international economy it is necessary to accept the MNE as the emblematic agent in determining its functioning and outcomes. Whereas national and international institutions and policies are clearly central in conditioning the potentials of the international economy, it is the MNE whose innate nature is most oriented to building these opportunities into its own strategic imperatives and competitive behaviour. Theory has always told us that national economies differ in terms of their formulation and sources of competitiveness and that the international economy works best where these distinctive national comparative advantages can be most effectively realised globally. What mainstream theorising seemed reluctant to recognise was just how often these national potentials were activated by MNEs towards their internationalised competitive imperatives. The emergence of IB as a (perhaps unnecessarily) independent area of theorising set out to address this lacuna in mainstream economics by building frameworks and analytical structures that could distinguish the nature of the MNE as a distinctive agent actively operating very much within the wider perceptions.
Many of the major contributors to the theoretical approaches we will review here were, unreservedly, economists addressing issues they defined as economics; this certainly applies to those (Hymer, Dunning, Vernon, Kindleberger) we have already cited. Overall, we argue, the ultimate objective of the IB strand we aim to develop here is, therefore, to achieve an understanding of the MNE as an agent in the global economy; its objectives there, how it is able to go about their achievement, and the implications of this for the global economy and its constituent national economies.

The second key theme is that for IB to serve these analytical purposes it needed to be based around an understanding of the MNE that precisely encompassed its reality; what it really looked like, how it really behaved as a competitive entity, what attributes allowed it to do so. There was no real room in IB theorising to see its main player, the MNE, as in any way a convenient abstraction (as much of its analysis had tended to cast FDI). The starting point needed to be the MNE as a practical form, with comprehension of this then focusing on how it could undertake the step of internationalising its operations, when it decided to do so, where it chose to operate and what it expected to achieve through its own abilities and decisions. These concerns were not, of course, inherently anathema to mainstream economics and, as we will see, aspects of its thinking and methodologies feed positively into the propagation of IB’s own analysis. Nevertheless, the formulation of IB as a discipline operating at a certain degree of analytical distance from mainstream analysis did depend on its willingness to start from and accept the precise practical nature of its main player (the MNE) as a perhaps inconsistent, messy and always evolving real-world presence.

Though the theorising we will adopt here operates at a selectively informed distance from the established methodologies and models of mainstream international economics we will see that ultimately our objective is an essentially economic one; to understand and evaluate the relationship between MNEs and national economies (or, sometimes, specifically defined locations in them) and how this is mediated by the wider institutional context of the global economy. But the particular strength we will advocate for IB theorising is then its focal emphasis on building its analysis from an informed understanding of the reality of MNEs as the operative players, and the evolving contexts from which they have emerged and learnt to function in; we eschew abstractions and assumptions not informed by observed reality.

Responding to these perspectives an important theme within our narrative of the development of IB has been the beneficial interleaving of its practice and its theory. The enriching of vital elements of the relevant theoretical frameworks’ generation has come about from the perceived
necessity of explaining and encompassing new facets of the way MNEs were actually behaving in practice. But, at the same time, understanding and evaluating how and why the operating reality of MNEs was actually changing immediately benefitted from application of the formulations of the theory itself. The main theoretical basis of our exposition of the competitive nature of the MNE will be Dunning’s (1977, 1988, 1993; Dunning and Lundan, 2008) eclectic framework. This allows us to focus initially on the sources of the firms’ ability to expand internationally; that is, their ownership advantages (OAs). Then we move to those factors that lead to the decision to implement this step and to the choice of locations for these geographically extended operations. These are location advantages (LAs). The third element of the framework then addresses a key characteristic in their expanding organisation. Their ability to benefit competitively from the internalisation of the markets for intermediate goods, including OAs. This is described as an internalisation advantage (IAs). Then the aspect of MNE practice that we trace through time is how they have organised for global competitiveness through networks of subsidiaries. These, we emphasise, can address very different strategic motivations that will evolve within the overall competitive restructuring of MNEs as their internal competences develop and as the global environment they target changes.

This chapter ends by providing a definition of IB’s principal subject; the MNE. Chapter 2 begins our narrative of its evolution and elucidation with the presentation of two, closely interrelated, pioneering arguments deriving from the insights of Hymer. Firstly, we demonstrate how Hymer projected the need for a theory of the MNE from a careful analysis of the inability of antecedent theories of FDI to explain realities observable in the 1950s. Secondly, from Hymer’s advocation of the need to place specific sources of firm-level competitive advantage at the centre of MNE theorising we derive Dunning’s ownership advantage (OA) as the first element in his OLI framework. Two further perspectives are then derived from this. Firstly, a characterisation of OAs that indicates that these are most likely to be intangible competitive attributes that are expensive to create, but then very inexpensive to use (notably as a source of the ability to venture into international operations). Secondly, that this interpretation of OAs can be effectively modelled in Hymer’s argument that MNEs are very likely to occur in highly concentrated industries, with clear pointers to the presence of oligopolistic forces in their competitive behaviour.

Whilst these Hymer-based pointers were being moulded into the first phase of a more widely positioned framework in IB, Vernon’s (1966) product life-cycle model (the subject of Chapter 3) had emerged as an, initially, standalone contribution that, we can now see, provided insights that would mesh very valuably with both the theoretical and practical faces of
our investigation. Indeed, we can see both those dimensions as clearly and distinctly central to Vernon’s approach. The initial impetus to the analysis was to address a perceived theoretical issue in international economics; the relation between FDI and trade. But at the core of his approach to doing so was an accepted practical perception; the life cycle of a product from its market-dominating inception (innovation) to its status as a mass-market standardised good sold in a very price-sensitive market. Here the way Vernon modelled the innovation process proved to be valuable in two ways. Firstly, it provided an informed view of how OAs could be formulated in what would become an MNE’s home country. At the same time it set out a template for the organisation of innovation that (as we will see in Chapter 7) could transfer into the way these firms would eventually approach product development as an internationalised function.

Then, as we will elaborate in Chapter 3, Vernon’s explanations for the types of international activity adopted in the ‘mature’ and ‘standardised’ product stages of the PLCM provide us with very neat pointers towards the more wide-ranging perspectives of MNE’s organisational structures and their revisions that we will address in Chapter 4. Once successful innovation had given firms products of sufficient competitive maturity to generate significant demand in other, relatively high-income, markets Vernon expects this to lead to production in those markets. The main determinant for this relocation of supply would be the costs of trade (protection and transport) so that, in our terms, the motivation would be market seeking (MS). But if, by Vernon’s writing in the mid-1960s (mainly) US MNEs had adopted this approach to the supply of several foreign markets we have what Chapter 4 will discuss as the multi-domestic hierarchy (MH) MNE organisational form. Isolated local-market-focused subsidiaries each compete exclusively for the domestic market of their own host economy.

But these scenarios were very much blighted by the inefficiencies endemic to a highly protectionist international economy with production artificially fragmented between many separate locations. The narratives of Chapters 3 and 4 encompass different responses to this through the emergence of the efficiency-seeking (ES) motivation pursuing new dimensions of competitiveness. Within the compass of Vernon’s model this imperative towards ES supply is reached when the focal product has moved through its life cycle to the ‘standardised good’ stage. Here it has now become a mass-market good with many rival suppliers, so that cost-efficient price-competitive manufacturing becomes the major objective. This now requires a separation between where the good is produced (low-cost location) and where it will be sold (more prosperous market). For this to be viable Vernon adopted the expectation of a freer-trade situation facilitating such intra-group trade.
The actual emergence of such a development, we can now see, also provided the impetus for the decline of MS strategy (and of the multi-domestic hierarchy) and its replacement by the ES imperative (in what becomes a network hierarchy). As our discussion in Chapter 4 will elaborate the moves towards a freer-trade environment drove this process from two sides. Firstly, it removed the protection that inefficient MS subsidiaries had received and, thereby, rendered this positioning increasingly vulnerable as a dominant organising strategy for MNEs. But, at the same time, it facilitated the emergence of a new subsidiary-level positioning that could use the newly available trade options. Thus the subsidiaries could undergo a metamorphosis to the export-oriented ES role, where efficient production (based around a host-country’s major sources of comparative advantage) feeds into their group’s integrated global supply network. They become integral to MNEs’ reconfiguration as network hierarchies (NH).

In theoretical terms we can see the differing postures of MS and ES subsidiaries as responsive to two different categories of LAs; negative LAs for MS and positive LAs for ES. This is elaborated, and its implications developed, in Chapter 5 through the analysis of Kojima (1978). In its analytical essence Kojima’s models reverted to the more macro-level concern of the relationship between FDI and trade though, as we will emphasise in Chapter 5, this can be rewardingly interpreted in IB terms so that, we will assert, it becomes a valuable and clarifying contribution to our comprehension and evaluation of MNE behaviour in different contexts. This feeds, particularly strongly, into how our view of different conditioning LAs delineates the circumstances determining MNEs’ approach to their globalised operations. Thus we will project Kojima’s ‘trade-destroying FDI’ as describing our world of the MH, where a predominantly protectionist international economy (negative LAs) fragmented MNE production into a multiplicity of, innately inefficient, isolated and localised subsidiaries. Then, in contrast, the opening of the global economy and of its constituent locations provides the context for ‘trade-creating FDI’ where efficiency-targeting subsidiaries (activating host-country comparative advantages or positive LAs) enter into international supply networks.

In Chapter 6 we complete our presentation of the basic elements of Dunning’s eclectic framework with a discussion of aspects of internalisation theory, building on the defining insights of Buckley and Casson (1976). This projects the positioning of ‘internalisation’ in theorising the MNE as reflecting imperfections in the markets for many intermediate goods so that these firms often organise such transactions within the firm, rather than operating as either a seller or buyer in a market transaction for such an intermediate. This points towards a distinction we offer, in
Chapter 6, between ‘outward’ and ‘inward’ internalisation. In these terms Dunning’s initial adoption of internalisation saw OAs as vital intermediate goods, whose use in an overseas FDI operation would render the firm an MNE. But, as was well known by the early 1970s, international markets for such OAs (licensing of technology, management contracts, trademark licensing, franchising) did exist. Internalisation theory needed to explain how firms that chose to become MNEs decided to forego the market option and, instead, to internalise the ‘outward’ transfer of such OAs. Here Buckley and Casson (1976) elaborate the case of technology as a potentially marketable OA that, in practice, was frequently internalised in ways that impelled the extension of the firm as an MNE.

What we then call ‘inward’ internalisation occurs where a firm decides to build the supply of inputs (components, raw materials, energy, services) into its controlled scope, rather than purchase them in an open market transaction. Chapter 6 invites us to revisit the role of OAs in another way, adding to its original definition in Chapter 2. Thus we will argue that a key attribute of OAs (in essence what Dunning designated as a ‘transaction’ OA) is the ability to organise and benefit from acts of internalisation. Many ‘inward’ internalisation opportunities (for example, access to raw materials or component parts supply) are initially available to several competitors in an industry. Possession of a superior ability to detect and act on such an opportunity can be considered as an OA, independent of the internalisation benefits that come on tap once the transaction is completed.

If Chapter 6 completes the basic introduction of our main theoretical framework (Dunning’s OLI) then Chapter 7 does the same for our dominant framework for strategic practice, by adding knowledge seeking (KS) to our earlier emphasis on MS and ES. Central to this is that, for both firms and economies, the sustainability of their development and competitive upgrading needs the generation of, or access to, new sources of knowledge. In the latter decades of the twentieth century more and more countries came to address these needs through the generation of ‘national systems of innovation’ (NSI). These established the institutions of new knowledge creation (for example, research laboratories in firms or universities) and the mechanisms for moving such knowledge towards active development of path-breaking new goods and services. This led to technological and market heterogeneity on a global basis, since the most successful NSI were those that generated genuinely unique and distinctive sources of new innovation-oriented knowledge.

But this meant that for MNEs, aiming to access new sources of creative potentials towards their own competitive enrichment, it became necessary to investigate such possibilities in a range of different locations with the
aim of drawing selections of these into their own innovation agendas. This engendered the emergence of KS as an increasingly internationalised component of their competitive strategies. Chapter 7 discusses, in some detail, how MNEs have addressed these new imperatives through the articulation of, sometimes interactive but often independent, globalised approaches to both R&D and innovation.

An important subtext through the narrative to be developed in this book has been the ways in which the formulations and refinement of theoretical approaches to IB have been impelled by the need to encompass, and respond to changes in, the practicalities of its operating context. A very important contemporary phenomenon which both challenges aspects of established theorising and which needs to be explained is the growth of MNEs from emerging economies. The conundrum is then that these MNEs are appearing whilst their home countries can still be described as ‘emerging’. This means that in terms of expectations derived from traditional theorising these MNEs are internationalising well before the maturing of their home economy would be expected to have generated the conditions to allow them to do so. Using the case of China, Chapter 8 seeks to elucidate both the nature of these new MNEs as a challenge to traditional theory and to indicate how the enigma can be addressed by logical extensions of the mature theorising.

Central to this is to see the emergence of these new MNEs as being integral to the ongoing dynamics of their home-country’s development, rather than being seen simply as an organic manifestation of a certain level of achievement in this process, as was implicit in theorising on the traditional MNEs. Thus the core of the analytical challenge of these MNEs is that they are seen to be targeting internationalisation well before the level of development of their home economy should have allowed them to generate OAs of sufficient strength and distinctiveness to enter in a truly competitive way into international operations. The offered resolution of this seeming paradox comes in two stages. Firstly, the firms are able to expand in this way because of home-country government supports (access to capital, foreign exchange, diplomatic support) that help mitigate against the competitive limitations of their in-house capacities (OAs). Then, secondly, it is necessary to explain why they are able to avail themselves of this support. This, we will argue, is because they are seen as the best means of accessing, through carefully tailored and supported acts of FDI, resources needed to help overcome emerging bottlenecks in their national development. In the China case Chapter 8 elaborates two of these strategic motivations built into the MNEs’ government-assisted projects. Firstly, resource seeking, to alleviate threatened shortages in access to resources vital to the sustainability of current modes of development. Secondly, knowledge
seeking, to attempt to obtain new sources of innovation-supporting competences that can help build new dimensions of national development beyond those currently prevailing.

The ever-increasing visibility of MNEs as a key agent in the evolving global economy, and the concomitant deepening of their role in mediating the ways individual national economies are positioned in that wider economy has always provided concern, both inside and outside the confines of IB theorising, over the implications of their behaviour and performance. We conclude our narrative in Chapter 9 by suggesting four distinctive generic issues that can usefully be distinguished within that wider concern. Two of these can be seen as being purely economic and with their roots in many aspects of our earlier discussion. Firstly, *efficiency* from a static optimising perspective. Do the operations of MNEs (how they apply their current OAs) improve or compromise the allocative and productive efficiency of use of the world’s fixed supply of productive capacities at a point in time? Secondly, the scopes for *growth and development*, based around expansion, and improved efficiency in the use, of these resource potentials through time. Does MNEs’ pursuit of their own dynamic needs and possibilities on an increasingly internationalised basis (KS) enhance or constrain these potentials?

A more political-economic issue that nevertheless builds from roots in the economic concerns is that of *distribution*. Given that MNEs’ participation, along with capabilities of host locations, may generate discernible improvements in efficiency or assist in improved development performance, how are these gains distributed between the parties that contributed to them? Though our discussion in Chapter 9 will be able to set out clearly the nature of theoretical concerns over the fairness of distribution it will also suggest why their resolution in practice is so difficult. The core of this, we will argue, is the difficulty of achieving a means of evaluating the inputs from both parties. For MNEs their inputs tend to be intangible OAs that are not amenable to market pricing. For host economies MNEs’ access to the relevant local resources may be distorted (in terms of price or other favourable conditions) for policy-based reasons.

Finally, at a more purely political level, there is a pervasive concern that MNEs are often able to undermine the *sovereignty* of host economies, in terms of their ability to achieve the objectives of implemented policies, or even sometimes to fully complete the generation of policies to address predetermined (maybe electorally mandated) aims. Two characteristics of MNEs can be articulated as reasons for such concern; their sheer economic strength (hegemonic OAs) and the flexibility they can proclaim or leverage as players with a range of global options. A plausible context for MNEs to exercise such powers is that of bargaining with host locations.
Here an asymmetry of information may be prevalent. MNEs can often assert their strengths and alternative options without having to fully reveal details of these to hosts. By contrast, hosts may need to reveal, in much more complete detail, what they can offer to MNEs. In a sense then MNEs may ‘win’ bargains in ways that subvert the sovereign decision scopes of locations and, indeed, may also negatively distort the implied distribution outcomes.

**DEFINITION**

We can define the Multinational Enterprise (MNE) as ‘a firm that owns or controls value-adding activities in two or more countries’. This wording aims at a succinct precision that can nevertheless recognise the extent of the strategic scope and organisational diversity of the MNE and International Business (IB). Three elements of the definition can then be usefully elaborated to reflect this.

Firstly, the definition specifies ‘value-adding activities’. This acknowledges that the ability of a firm to provide value to its ultimate consumers derives from a very large range of functional activities and that the location of any of these outside its home country will provide status as an MNE. Acceptance of this in pioneering definitions of the MNE may have served mainly for rhetorical completeness, since the early analysis did tend to see MNEs’ dispersed operations as activated around the supposed core activities (production; direct supply of services) with all the key strategic scopes (notably innovation and the creation of competitiveness) retained in the home country. But the definition did, of course, prove admirably prescient since, as will be a central theme here, a crucial feature of the repositioning of the MNE in subsequent decades has specifically been the decentralisation of many of such strategic functions. Indeed the recent emphasis on ‘global value chains’ fits precisely within the definition of the MNE.

A second carefully nuanced part of the definition refers to the value-adding activities being ‘owned or controlled’. Early repositioning of analytical focus from FDI to the MNE may have retained a residual myopic focus on capital, so that ownership of dispersed activities briefly remained prioritised. However, the analytical focus soon took two steps that allowed an escape from this. Firstly, it was accepted that for the firms involved the value of ownership was only that it was a means of securing control over such dispersed activities. Secondly, it was then recognised that ownership was by no means the only, or most relevant, means of activating the degree of control desired. What lay behind both these steps was
the growing acceptance that what was driving the international expansion of MNEs was the need and ability to utilise firm-specific sources of competitiveness (for example, technology, skills or expertise). These competitive attributes could themselves be isolated as intermediate goods and right to their use transferred to another firm, but under contractual terms (for example, licensing agreements for technology) that placed specified constraints on how that firm could use them. A desired degree of control is retained without ownership of the activity. Once again this perception has gained widespread traction in the ideas of global supply networks or value chains. In these a dominating MNE may desire overarching control of the whole network or chain and determine its aims, but allow the participation of independent enterprises that are nevertheless constrained contractually to particular predetermined interdependent roles in the process.

The third point to elaborate here is that the definition refers to ‘two or more countries’. Setting aside the small number of firms considered to have two home countries and accepting that MNEs are still routinely associated with a specific home, this thereby indicates that only one value-adding activity in one location abroad is needed to secure this status. In our practical perceptions this is an unrealistically low target to delineate firms that are likely to operate in the ways now associated with truly multinational enterprises. The point, however, is that there is no other threshold that would reflect a theoretical or conceptually rigorous basis. Thus beyond this low-level theoretical definition practical conceptualisations of the MNE have been research-based and pragmatic. Notably, the first extensive programme of collection of firm-level information on the MNE (Vaupel and Curhan, 1969, 1974) used six countries as an operative cut-off point. This in practice met little resistance and research derived from it had considerable acceptance and influence (Knickerbocker, 1973; Flowers, 1976; Graham, 1978). But this did not mean six was agreed as in any sense theoretically ‘correct’. It did not mean that seven could be rejected as too many or five as too few.

NOTES

1. It can, in fact, be plausibly argued that the ‘practical’ strand of this narrative can be placed a little earlier with the publication of Dunning’s (1958) detailed survey and case analysis of the operations of US firms operating in the UK.

2. The papers presented in Kindleberger (1970) derived from a symposium held at the Sloan School of Management at the Massachusetts Institute of Technology in spring 1969. In addition to three chapters addressing issues in theorising the ‘International Corporation’ other sections covered issues in practicalities such as ‘finance and technology’ and ‘law and politics’ and country and industry case studies.
3. The papers presented in Dunning (1971) derived from a conference held at the University of Reading from 28–30 May 1970. As well as papers aiming to contextualise the ‘Multinational Enterprise’ appropriate practical issues addressed included ‘labour relations’, ‘trade and balance of payments’, ‘less developed countries’ and ‘government relations’.