

# Introduction

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## 1. THE BACKGROUND TO THIS VOLUME

Over my scholarly career, I have published papers on foreign direct investment (FDI) and international business (IB) topics in over 60 professional journals, and as chapters in 50 or so monographs. Since several of these are not normally read by mainstream IB scholars, every so often I have sought to reproduce them – appropriately amended and updated – in book form.

This volume is the eighth of this kind. In the past, I have attempted to set each collection of essays within the framework of an emerging issue in IB. For example, two of my volumes in the 1980s focused on the new theories on the determinants of Multinational Enterprise (MNE) activity then evolving,<sup>1</sup> and another on the increasingly important role played by created assets, and especially innovatory capacity, as a competitive advantage of MNEs. In the early 1990s, I turned my attention to the opening up of – both developed and developing – economies to the forces of globalisation, and its impact on the strategies of MNEs; and also to the increasing importance of service based MNEs. This was followed, in 1997, by a volume entitled *Alliance Capitalism and Global Business* (London: Routledge), which recognised and explored several new modalities by which IB operations were being conducted. In each of these volumes, I took an historical and analytical approach to the topic being explored, and in so doing discovered that, quite frequently, the germs of new scholarly advances in IB came from economists, organisational theorists and others working outside the subject area.<sup>2</sup> In the case of our alliance capitalism volume, for example, I drew heavily on the work of Michael Best, who in his book *The New Competition* (1990) focused on the non-equity but collaborative forms of Japanese foreign business involvement.

Taking the past half century as a whole, the 1990s and 2000s have, perhaps, witnessed the most profound and far reaching developments affecting the determinants, spread and strategy of IB activity. Key among these has been the opening up of the boundaries of China and India to trade and FDI, the digital revolution, several dramatic technological advances – for example in biotechnology and electronic instruments – and the growth of service MNEs.<sup>3</sup> The speed of these events has posed major

challenges not only for the core disciplines comprising IB, but for those on its periphery now being drawn into its main web, such as economic geography, business history, international law, political economy and sociology.

But perhaps most significant of all is the fact that, as scholars from each discipline have sought to explain events, they have increasingly come to realise that, treated independently, the impact of their knowledge, and analytical techniques and methodologies, can only partially explain the global developments now taking place. This is partly because these developments have become more multifaceted and value laden; and partly because the ontologies required are different from those which dominated IB scholarship in the 1970s and 1980s (Sullivan and Daniels, 2007).

My immediately previous collection of papers published in 2001, and the current monograph, contain some of my essays which address these issues. The former volume – *Global Capitalism at Bay* (Dunning, 2001) – looked at the adaptations of the macro-economic systems of most national economic regimes to the social and cultural environments emerging in the 1990s – and their implications for received IB thinking. For the first time too, I turned my attention to moral and ethical issues – now increasingly engaging the attention of scholars – as MNEs from a particular country or region are increasingly widening their geographical scope to penetrate unfamiliar cultures and belief systems. I also started to realise that, as an economist, my own approach to studying MNEs in the 1980s and 1990s had been too uni-dimensional, and rested upon a number of assumptions – notably to do with the rationality and fixed intentionality of decision takers. I now better appreciate that in a world comprising peoples of very different religious ideologies, values, social mores and educational standards such assumptions no longer hold good. In addition, both market failures, associated with new or more non-ergodic uncertainties and volatilities, and complexities have each pointed to the need to incorporate extra-market organisations – notably national governments and civil society – into a study of IB.

Within mainstream IB, some progress is being made, especially by cultural specialists, organisational theorists, economists and managerial strategists. In the global economic environment of the early 2000s, outward FDI most often takes the form of mergers and acquisitions; and is being directed to augmenting the competitive ownership specific (O) advantages of the investing companies, exploiting and accessing the resources, capabilities, and institutions comprising the location specific (L) advantages of particular countries, and identifying and implementing the most acceptable mode of relating these two sets of advantages via the internalisation (I) or the externalisation (E) of cross border intermediate product markets. This, in turn, has led both to a greater commonality of

interest between companies and countries, and the need to take a more dynamic or developmental view to assessing the interface between the OLI configuration affecting the decisions made by firms.

There are two main *foci* of this particular volume: both reflect my own reactions to recent changes in the global economic scenario and in the direction of scholarly research.<sup>4</sup> The first is to more explicitly introduce an institutional and evolutionary approach to our understanding of the motives for, and the determinants and effects of, FDI and MNE activity. In doing so, I have drawn upon the thinking and writing of a number of scholars outside IB. Of these, Douglass North (1990, 2005) on institutional theory, Richard Nelson (with S.G. Winter, 1982; 2002) on evolutionary theory, Amartya Sen (1999) on a value based approach to development, and Joseph Stiglitz (2006) on the dynamic interface between the institutional instruments of international organisations, and the structural upgrading of developing countries, have been among the most influential in affecting the thinking of IB scholars – including myself.

In particular, in several of my recent contributions, some of which have been jointly written with Sarianna Lundan,<sup>5</sup> I have sought to give more emphasis to the role of institutions in shaping the OLI configuration of MNEs, and its impact on economic and social development. But I am also persuaded that, in spite of a ground-swell of interest in this topic from sociologists and organisational scholars,<sup>6</sup> mainstream IB economists have not made a major scholarly contribution; nor has the research by non-IB economists been well integrated with that of other disciplines comprising IB. In Parts 2 and 3 of this volume, I try to give attention to both by more explicitly incorporating institutions into the eclectic paradigm of MNE activity; and also to evaluating the relevant roles of the content and quality of different kinds of institutions, and the received indices of country specific competitiveness – viz. the content and quality of resources and capabilities – as determinants of inbound and outbound FDI.

The second of my scholarly interests of the 2000s is related to the first, but is more specifically directed to the ethical and moral underpinnings of evolving global capitalism, as it affects both corporate and country level institutions, and the resources, capabilities and markets to which firms can gain access.

## 2. THE CONTENTS OF THE VOLUME

In Chapters 1 and 2 of Part 1, I review the contributions of Edith Penrose and Stephen Hymer to both the determinants of IB activity and the political economy of FDI. Although Edith's classic volume on the *Theory of the*

*Growth of the Firm*, published in 1959, had little to do with the geography of value added activity, her insights were invaluable on how firms, through internal growth, might exploit or enhance their competitive (O specific) advantages, by extending and/or upgrading their transactional and coordinating competences. In spite of one of the first case studies – in this case General Motors, in Australia – of how inbound FDI might help investing firms in their growth strategies (Penrose, 1956), it was not until the 1990s that Mrs Penrose specifically addressed the unique characteristics of the MNE *qua* MNE (Penrose, 1992).

In the intervening years, as set out in Chapter 1, Professor Penrose's main interest in FDI related to its impact upon the welfare of recipient countries – and especially that of developing countries. Here, like Stephen Hymer – whose research on MNEs ranged from applying industrial organisation theory to explaining the internationalisation of firms, and a Marxist approach to analysing the political economy of the impact of such activity on recipient countries – she wrote quite extensively on how developing nations, and the international community, might counteract any adverse use of monopoly power by foreign MNEs.

In Chapter 2, I and my co-author take a different stance to the 'back to the future' debate on IB related issues. In this chapter, we speculate on how far, and in what directions, Stephen Hymer, were he writing in the early 2000s, might modify his views of the 1960s and 1970s. We suggest that both the changing global scenario and advances in scholarly thinking may well have caused him to reconsider the balance between the *value creating* and *value capturing* role of MNEs, but that much of his earlier examination on the political economy of IB activity still holds good, particularly when set in the framework of contemporary institutional and evolutionary economic theory.

One of the main contentions in Chapter 3 is that, in their writings internalisation economists have not fully exploited the richness of their own approach to explaining the dynamics of MNE activity. In tracing its evolution, I distinguish between two approaches to understanding the distinctive characteristics of the firm. The first is that the firm is, first and foremost, a producer, that is a value creating organisation, whose main function is to convert a combination of less valued inputs into more valued outputs. Historically, this has been thought of as the main and unique task of the firm.

The second view is that the firm is primarily a coordinator of transactions, some of which, at least, could be achieved by other institutional arrangements, for example the market.

It is this latter interpretation of the firm, as a value capturing organisation, which the internalisation economists have mainly focused upon. In

this chapter, while accepting the concept of the firm as a production unit, I also argue that the way(s) in which inputs are converted into outputs can be undertaken solely by the internalised firm or shared jointly by some kind of external collaborative agreement with another firm. I further observe that the choice of modalities is likely to vary at different stages of the production process. Finally I distinguish between the internalisation of value creating activities and that of the transaction and coordinating function of the firm.

In any event, common to each of the chapters in Part 1 of this volume – not always explicitly spelled out – is the distinctive role of the MNE as a *producer* and *transactor* of value. In their writings, Edith Penrose and most economists viewing the firm as a production unit took the first view: Stephen Hymer took the second. Internalisation economists also took the second but, in contrast to Hymer, believed that by internalising markets MNEs were engaging in both value creating activity (by increasing the efficiency of transactions) and value capturing activity (by the rent they were able to extract from this particular activity.)

The chapters in Part 2 of the volume primarily focus on incorporating institutions into IB scholarship. Chapter 4 argues that globalisation is forcing mainstream IB researchers to pay more attention to (differences in) the *human* (in addition to the *physical*) environment, as the former influences the nature and content of IB activity; on the respective role played by the private and public organisations, notably firms, governments and civil society, in determining the objectives of such activity (particularly in respect of economic development and restructuring); and the institutions, policies and strategies underpinning its environment.

In entitling Chapter 4 ‘A new Zeitgeist for international business activity and scholarship’, I argue that the recent focus of mainstream IB scholars on *knowledge*, be it embodied in physical assets or human beings, as the key competition enhancing resource of firms and countries, needs to be supplemented by an examination of its institutional underpinnings, which will determine the motives and behaviour of firms in accessing, creating and utilising such assets. This chapter and also Chapter 6 strongly assert that the inter-connectedness of our contemporary global economy is compelling IB scholars to recognise that its endemic complexity, uncertainty and volatility, coupled with the widening and changing prioritisation of national economic and social goals, require a serious reconsideration of received explanatory models and their underpinning methodologies.

Chapter 5 illustrates some of the points made in Chapter 4 by focusing on how, and why, the spatial dimension of IB activity has changed over the past 30 years or so. It suggests that, although some of the locational determinants of FDI, for example access to natural resources and

capabilities and existing markets, still remain important; others – for example access to evolving markets, to knowledge, to nodes or networks of related organisations, the interface between private and public organizations, the content and quality of innovatory activities, the offshoring of services, and the institutional infrastructure underpinning the creation of resources and capabilities and their deployment – have become more important. Chapter 5 concludes by suggesting that, as the digital revolution and the lowering of artificial barriers to trade have reduced physical distance costs, institutional distance costs – at least in the present stage of globalisation – for many MNEs, have become more difficult to overcome.

I believe Chapter 6 makes an important contribution to the debate on the institutional framework underpinning IB activity. Building on the points made in Chapters 4 and 5 it argues that, because change, uncertainty and complexity are inherent features of our current age, IB scholars need to take a more time related or dynamic approach to their subject. This chapter lays the groundwork for my most recent writings, where I assert that IB scholars should not only draw upon Douglass North's approach to understanding the *process* of economic change; but also that of Richard Nelson's evolutionary theory of path dependency, which may be applied at both the level of the firm and the country. In this work John Cantwell – who himself has made a major contribution to IB scholarship by helping to apply evolutionary theory to an explanation of MNE activity (Cantwell, 1989), Sarianna Lundan and myself attempt to incorporate the Northian and Nelsonian perspectives into our framework (Cantwell, Dunning and Lundan, 2010). In so doing we believe that it will be a richer and more relevant paradigm for examining the (economic) determinants and effects of IB activity in the early 21st century.

Chapter 7 presents an additional challenge to IB researchers. This arises partly because of the emergence of several new important players from developing countries on the global economic stage; and partly because of a greater appreciation by scholars of the widening and often diverse goals of human development. After reviewing the approach of three Nobel Laureates to the multifaceted nature of development, the chapter goes on to examine how the OLI paradigm may require to be modified; and, once again, concludes that it needs to more explicitly incorporate elements of the human environment into its framework. While I would be the first to acknowledge that scholars working on culture, human resource management and organisational structure have long recognised the critical importance of institutions, it has only been in the last decade that mainstream IB researchers have begun to take the subject seriously.

Perhaps nowhere has institutional reconfiguration been more apparent

in affecting the level and geography of inward FDI than in Central and Eastern Europe, since the fall of the Berlin Wall in 1989. Using a variety of secondary statistics, and business opinion surveys, Chapter 8 assesses the relationship between the content and quality of institutions in a range of middle income and least developed erstwhile Communist countries, and FDI inflows to these countries. The data reveal that not only is there a positive, and often significant, correlation between the two sets of variables; but that, relative to the more traditional L variables, for example market size, and labour, materials and transport costs, institutions play a more important role in affecting FDI in the least developed Eastern European countries.

Part 3 of this volume turns its attention to the interface between inbound and outbound FDI and the competitiveness of (mainly host) countries; and also to the implications of this interface for both institutional reconfiguration and national economic policies. Chapter 9 examines both these issues from the perspective of the Korean economy in the light of changes in the global economic scenario over the last two decades. Drawing upon data published by the World Economic Forum, it compares and contrasts the strengths and weaknesses of indigenous Korean institutions, resources and capabilities, relative to those of other Asian countries; and shows, *inter alia*, that, on most institutional variables, the Korean economy performs reasonably well. The chapter then goes on to pinpoint what, in my opinion, are the lessons which national governments (and particularly in this case, the Korean government) may learn from such data, and from contemporary economic trends. More specifically it offers an 11 point *aide memoire*, or policy cum institutional agenda which, if taken seriously, I believe, would help ensure that both inward and outward FDI contributed the maximum benefit to the economies concerned.

In Chapter 10 I take a specific and fairly detailed look at the relative significance of resources, capabilities and markets, and of institutions as location specific competition enhancing variables, and attractions to inward FDI. Again using data published by the *Global Competitiveness Report* of the World Economic Forum, I classify some 90 competition related variables into the two groups first identified above, and, within these groups, into particular types of institutions, resources and capabilities. In this, one of the first econometric exercises of its kind, the results are somewhat mixed; and *inter alia* also dependent on the stage of development, economic structure and degree of openness of the host countries concerned. However, for the most part the exercise confirmed that IB scholars are fully justified in paying more attention to institutional variables in their analysis of the spatial distribution of FDI flows.

Chapter 11 addresses a rather different set of issues, namely those to

do with the geography of outbound IB activity and, more specifically, whether MNEs engage in regional rather than in global valued added activity. The chapter is essentially a comment on an influential paper by Alan Rugman and Alain Verbeke (2004) who, using sales data of the world's largest 400 or so enterprises, claim that only a minority of them operate value added activities in more than two of the three main regions of the world, viz. the Americas, Europe and Asia. In my chapter, I take a more macro-statistical stance and examine the geographical distribution of the FDI stock of countries in 2002, and how it has changed over the years. While the results are broadly consistent with those of Rugman and Verbeke, I argue that the locational emphasis of both the sales of MNEs and their FDIs strongly reflect that of the gross national products of the countries concerned and the extent of regional integration (as is occurring in the European Economic Community). I also hypothesise that, as the larger developing countries, notably China, India, Brazil and Russia, engage in more international economic activity, and particularly with developed countries, the trend towards globalisation of MNE activity will increase – both in the offshoring of parts of the supply chain and of the sales of final products.

What, then, determines the content and shape of institutions? Since, essentially, such institutions are intended to influence the cognition, behaviour and performance of individuals and organisations, it follows that there must be some value related objectives underpinning them. And once one introduces such objectives into the equation, one enters the realm of ethics and belief systems. So, even though a mainstream IB scholar may not wish to trespass too far on this territory, it *is* incumbent on him to recognise that, in our multicultural planet, an appreciation and understanding of the motives underpinning any set of institutions is a necessary ingredient to explaining the conduct of the organisations affected by such institutions.

This being so, Part 4 contains two contributions of mine which touch upon the ethical foundations of 21st century global capitalism. The first (Chapter 12) contains a general review of what, in my view, must be its moral and ethical underpinnings, if it is to be economically efficient, socially acceptable and environmentally sustainable. The contentions advanced in this chapter are explored in more detail in my edited volume *Making Globalisation Good* (Dunning, 2003), which contains the thoughts and opinions of a number of distinguished economists, religious leaders, business representatives and statesmen on this topic. Without exception, all agreed that if global capitalism were to adequately fulfil its wealth creating functions, there must be some global mechanism for harmonising, or at least recognising, the need to tolerate and respect the different cultural

values and belief systems guiding its institutions, and influencing the value enhancing activities of firms. This chapter has been extensively revised and extended to take account of the global financial and economic events of 2007 and 2008.

As many IB writers (e.g. Hofstede, 2001) have identified, institutions may be both corporate and country specific. In zeroing down to corporate institutions, over the last decade a huge amount of scholarly research has been directed to the subject of corporate social responsibility (CSR) and global corporate citizenship (GCC).<sup>7</sup> Quite understandably most researchers have examined the interface between the determinants, contents and consequences of CSR and the welfare of the wider community. In Chapter 13 I treat CSR as an institutional form, and part of a changing global human environment. I then go on to offer some suggestions of how, on the one hand, MNEs, as organisations responsible to the communities in which they operate, might appropriately modify their resource creative and allocative processes to advance the latter's varied objectives; and, on the other, how governments, on behalf of their constituents, might, by formal or informal means, influence the incentive structures and enforcement mechanisms of the corporations under their jurisdiction. Once again, my approach to this subject is very much that of an institutional economist; and, once again, I draw substantially on the insights of such scholars as Douglass North.

The concluding part of this volume – Part 5 – consists of two more personally oriented contributions. Chapter 14 sets out an updated version of a short autobiography of mine, first published in 2002 (Dunning, 2002). It describes the various stages of my scholarly career, and some of my thoughts on the current state of IB scholarship. For readers interested in my life's story in more detail, they might like to consult my book on the subject (Dunning, 2008).

As mentioned in Chapter 14 and in Chapter 10 of Dunning (2008), since the mid-1970s, I have been actively involved in the work of the United Nations, and its various agencies, on FDI related issues. During that time, I have been fascinated to trace the fluctuating attitudes and stances of the UN staff towards the role and contribution of MNEs (TNCs in UN parlance) to economic development. As described in the chapter and in Sagafi-nejad (2008), these were largely confrontational in the 1970s – with a strong emphasis on advising host developing countries how, *given their existing institutions and economic policies*, they might best capture the maximum share of economic rent generated by inbound FDI – to becoming largely cooperative in the 1990s and 2000s, and encouraging the volume and kind of FDI that was best thought to raise the global competitiveness of their indigenous firms. Chapter 15 presents my personal

assessment of the extent to which the UN has contributed, and is contributing, to our understanding of the political economy of IB activity.

In a real sense, then, the title I have chosen for this book is a meaningful one. Although, today, we live in a very different world from the one in which I wrote my PhD thesis in 1957, there is much that contemporary IB scholars can learn from the writings of their predecessors, and from teachers and researchers outside IB. In particular, as I have frequently stressed, the assessment of the determinants and effects of FDI on several host countries in the 1960s and 1970s<sup>8</sup> explores issues – for example the decentralisation of R&D, the role of subsidiarity, the tapping into foreign generated knowledge and the modality of foreign entry – which remain central to IB scholarship today. At the same time, in the US, and more than a half century ago as Jean Boddewyn (2008) has recently recounted, business school scholars were ‘internationalising’ their writings to embrace the foreign value added activities of firms. The early writings of John Fayerweather, Richard Robinson and Richard Farmer, among others, contain a wealth of insights, highly apposite to today’s discussion on the management, organisation and strategy of firms; while the methodologies of finance scholars such as Alan Rugman (1979), Donald Lessard (1976) and David Eitman and Art Stonehill (1979) are as pertinent in the early 2000s as in the 1970s.

All this, of course, is not to deny the far reaching changes which have taken place in IB scholarship over the last four decades or more; but, rather, that from my own personal experience, a ‘back to the future’ approach to both analytical and empirical research – and particularly that undertaken by younger scholars – is not a bad starting point. At least, it has served me well throughout my scholarly career.

## NOTES

1. Dunning (1988a, b).
2. Examples include Oliver Williamson (organisational theory), Peter Dicken (economic geography), Mira Wilkins (business history), the writings of John McManus and James Markusen (economics) and Michael Porter (strategic management).
3. In 2006, UNCTAD estimated that 62 per cent of the stock of inward FDI was directed to the services sector, compared with 49 per cent in 1990 (UNCTAD, 2008, p. 9).
4. See also my contribution to Rugman (2008).
5. See particularly Dunning and Lundan (2008, 2010).
6. See, for example, several contributions on this topic published in a special issue of the *Journal of International Business Studies* in 2008, edited by Witold Henisz and Anand Swaminathan.
7. See, for example, a recently edited volume by Scherer and Palazzo (2008).
8. As set out in Dunning and Lundan (2008).

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