Theories of the Multinational Firm

A Multidimensional Creature in the Global Economy

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To Britta

Preface

A lot has been said about the multinational firm and its role in the global economy. Some view these firms as agents for economic development. Other people take the standpoint that they constitute potential threats to welfare and democracy. Some have more mixed feelings about them, in maintaining that they can contribute to different countries' economic welfare if they are sufficiently controlled by governments and international regulating bodies.

The different views mirror different theoretical assumptions of the multinational firm as an organization and of its relationship with the surrounding society. Often these assumptions are implicit rather than explicit. But they are always there, somewhere. If we discover the main theory behind a statement we can also reach a better understanding of it. We may not agree with the statement, but at least we can reach a better understanding of why we do not agree.

The purpose of this book is to present six perspectives, or theories, of the multinational firm that have dominated the research in international business during the last forty years. My aim is to help the reader to discover the basic building blocks on which each perspective is grounded. This will contribute to a better understanding as to why the multinational firm is looked upon so differently among various stakeholders. The multinational firm is a multidimensional creature which is also reflected in the richness and variety of our attempts to theorize about it.

I have called the perspectives 'tales', not because they are fictitious, but because they emphasize certain elements at the expense of others. They have strengths and weaknesses, but together they present a more fully fledged picture of the phenomenon we call a multinational firm.

The intention is not to present some kind of final 'super-model' in which the different perspectives and theories can be completely integrated. Such an attempt would probably lead to an incoherent mishmash of ideas. My conviction is instead that the perspectives are fundamentally different in certain respects and that we have to accept this fact. But this also makes it such a fascinating task to try to understand not only why a certain perspective stands out from the rest, but also why different perspectives sometimes share the same underlying premise.

The intended readership of this book is students in international business courses at undergraduate, postgraduate and MBA levels. My experience from PhD education, though, makes me believe that the book could also be quite useful at the PhD level.

Mats Forsgren
Uppsala, March 2008

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Contents

1. The multinational firm: a beauty or a beast?

INTRODUCTION

A Janus face of our time? A beauty or a beast in the global economy? The economic and political debate on globalization contains many conflicting views on multinational firms. Some people emphasize the 'bright side' in terms of their potential contribution to economic growth and national welfare. Multinational firms are said to be important agents of change and of 'creative destruction'. They increase the competitive pressure on domestic firms. They demonstrate and diffuse new technologies throughout the economy. They are necessary agents for globalization (Eden and Lenway 2001).

Other people emphasize the 'dark side', represented by their negative impacts on environment, labour and human rights. Multinational firms have goals that are directed to maximization of profits. Nation states have goals directed to job creation, tax revenues, regional development and a high and rising standard of living. It is argued that these goals are not compatible. The multinational firms' greater access to mobile resources and their character of being 'footloose' belongs to the story on the 'dark side' (Eden and Lenway 2001; Rugman 1993).

Some quotes may illustrate the contrasting views. First some quotes from the 'bright side':

> MNEs [multinational enterprises] are, then, increasingly being evaluated by both home and host countries in terms of their contribution towards upgrading the quality of indigenous resources and capabilities, and advancing long term comparative advantage . . . this change in philosophy is leading to a less adversarial and more symbiotic relationship between many governments and MNEs – much along the style of that which has been adopted by the Japanese and Korean governments for the past two decades or so. (Dunning 1993, p. 362)

Most governments are 'now acclaiming foreign direct investments as good news after a period of hostility in the 1970s and early 1980s' (Dunning 1994).

These quotes reflect a conviction of an overriding, harmonious relationship between multinational firms and governments. Multinational firms are agents for technology development and welfare. Some people see the multinational firm as the main actor in the globalization process which in itself reflects the core meaning of the information society due to its intricate, global network structure. For instance, a well-known writer about globalization and the information society, Castells, states that the multinational firm as a 'network enterprise makes material the culture of the informational, global economy: it transforms signals into commodities by processing knowledge' (Castells 1996, p. 188).

An even more optimistic version of the 'bright side' is mirrored in the following quote:

> By virtue of their numbers, the poor represent a significant latent purchasing power that must be unlocked . . . Research indicates that this poverty penalty is universal, although the magnitude differs by country. The poverty penalty is the result of local monopolies, inadequate access, poor distribution, and strong traditional intermediaries. Large-scale private-sector business can 'unlock this poverty penalty' . . . MNCs and large firms have to start from a deep understanding of the nature and the requirements of the BOP[1] . . . and then architect the business models and the management processes around these requirements. This approach to the BOP market will not only allow large firms to succeed in local markets but will also provide the knowledge base to challenge the way they manage the developed markets. (Prahalad 2006, p. 48)

This view reflects a strong belief in the possibility to combine the profit-seeking behaviour of the multinational firms with the needs of the 4 billion people at the bottom of the pyramid. It is claimed that if multinationals realize their potential fortunes that can be exploited in this 'market', the poverty in the world will disappear and the multinational firms will be the main agents for this change.

Other people are sceptical about such a conclusion. They claim, for instance, that there will always be serious conflicts between the multinational firms and the people at the bottom of the pyramid. The following quote is an example of this scepticism:

> The claim for this form of 'inclusive' capitalism' seems somewhat of an (ideological) overstatement . . . It primarily applies to MNEs that are not

> represented in these locations. The 'market' at the bottom of the pyramid is, in practise, of course already served by the local firms. Where MNEs – with their extremely efficient production methods and deep financial pockets, let alone transfer price methods – focus on this market segment, there is no doubt that they can out-compete local firms. They therefore also 'crowd-out' local firms and local employment, which in the end might generate more poverty than it alleviates. (van Tulder and van der Zwart 2006, p. 268)

An even stronger proponent of the 'dark side' is mirrored in the following:

> Such is our legacy. A world in which consumerism is equated with economic policy, where corporate interests reign, where corporations spew their jargon on to the airwaves and stifle nations with their imperial rule. Corporations have become behemoths, huge global giants that wield immense political power . . . fifty-one of the hundred biggest economies in the world are now corporations (twenty-nine out of the top hundred, if measured in value-added terms). The sales of General Motors and Ford are greater than the GDP [gross domestic product] of the whole of sub Saharan Africa; the assets of IBM, BP and General Electric outstrip the economic capabilities of most small nations; Wal-Mart, the supermarket retailer, has higher revenues than most Central and Eastern European states; and Exxon is comparable in economic size to the economies of Chile and Pakistan . . . Business is in the driver's seat, corporations determine the rules of the game, and governments have become referees, enforcing rules laid down by others. (Hertz 2003, pp. 7–8)

Some scholars also question the efficiency of the large multinationals as agents for technological change. For instance: 'It is a widespread perception that the massive corporate giants have become too large and bureaucratic to compete against the more nimble and innovative smaller firms that we are told are rapidly gaining the advantage in highly competitive global markets' (Korten 2001, p. 206).

The quotes above demonstrate totally divergent views on the political and economical role of multinational firms. Are they beasts or beauties? There is no simple answer to that question. But behind a view there is always a theory. Most often the theories are implicit rather than explicit. But they are always there, somewhere. If we discover the theory with its basic assumptions we can also reach a better understanding of a certain position. We may not agree with the position. But at least we understand better why we do not agree. This book claims that different theories produce different views on the 'bright side' and the 'dark side' of the multinational firm. For instance, some theories are more 'functionalistic' than other theories. They tend to assume that multinational firms, as firms, are more efficient than other firms, also from a societal point of view. Simply speaking, we have the firms we have because they are the best ones. Other theories are less conditional in that sense. They claim that multinational firms are social agents with their pros and cons. They can be beauties but they can also be beasts.

Theories may also differ substantially in their view on the multinational firm as an organization. Some theories assume that they function as hierarchies over which the top management has full control. Other theories stress the loosely coupled character in which the power is distributed among several sub-units. Some theories posit that multinational firms are efficient vehicles for transfer of knowledge and capabilities across border. Other theories emphasize the existence of organizational barriers within the multinational firm which limit such knowledge transfer. Some theories claim that multinational firms exist and survive because they are able to adapt their strategy, organization and control systems to changes in the environment. Other theories, on the contrary, argue that the multinational firm has the ability to shape the environment in accordance with its own interest.

These differences between different theories largely explain the contradictory views among scholars. The basic building blocks in a theory reveal the reason for a certain position. An important task, therefore, is to make the different theories more explicit. By doing so it becomes easier to understand the view. Sometimes a specific view follows straightforwardly and simply from the underlying theory. Sometimes the relationship between theory and a certain statement is more indicative. In both cases, though, it is easier to understand the reason for the specific opinion if the underlying theoretical platform becomes more visible.

In this book six different theoretical approaches on the multinational firm will be presented and analysed. During the last forty years these approaches have dominated the writings on the multinational firm, at least among scholars within the field of international business. But first we should say a few words about the multinational firm as an empirical phenomenon.

THE MULTINATIONAL FIRM IN THE WORLD ECONOMY

There is no doubt that the multinational firm as a business actor has increased its relative importance in the world economy over the years. At the end of the 1960s there were approximately 7000 registered multinationals (van Tulder and van der Zwart 2006). In the early 1990s the number had increased to approximately 37 000 with at least 170 000 foreign affiliates. Fifteen years later the number of multinational firms had almost doubled, 70 000, and the number of foreign affiliates had quadrupled (United Nations World Investment Report 2005). The increasing importance of the multinational firm is mirrored in the investments made by firms in foreign subsidiaries in relation to world production and export. Table 1.1 shows some selected indicators of foreign direct investment, export and international production, 1982–2006.[2]

Between 1982 and 2006 the world's outflow of foreign direct investment increased from $28 billion to $1216 billion, that is, an

Table 1.1 Selected indicators of foreign direct investment (FDI), export and international production 1982–2006 (billions of dollars)

Item	1982	1990	2003	2006
FDI inflows	59	202	633	1 306
FDI outflows	28	230	617	1 216
FDI inward stock	637	1 779	7 997	11 999
FDI outward stock	627	1 815	8 731	12 474
Cross-border M&As	–	151	297	880
Sales of foreign affiliates	2 741	6 126	16 963	18 677
Gross product of foreign affiliates	676	1 501	3 573	4 862
Total assets of foreign affiliates	2 206	6 036	32 186	51 187
Exports of foreign affiliates	688	1 523	3 073	4 707
Employment of foreign affiliates (thousands)	21 524	25 103	53 196	72 627
GDP (in current prices)	12 002	22 060	36 327	48 293
Gross fixed capital formation	2 611	5 083	7 853	10 307
Royalties and fee receipts	9	29	93	132
Exports of goods and services	2 124	4 329	9 216	14 120

Source: United Nations World Investment Report (2005, 2007).

increase of well above 4000 per cent. The corresponding figure for the world's exports is 565 per cent and for the world's production 300 per cent. Behind these figures is a dramatic increase in terms of expansion across country borders by multinational firms. It is mainly an expansion through investments in production, marketing and research and development facilities in other countries, rather than through exporting goods and services. As a result of this expansion the estimated employment in foreign affiliates rose by more than 200 per cent, the estimated production by more than 600 per cent, the estimated sales by more than 800 per cent and the total assets by more than 2200 per cent.

The table also reveals that foreign direct investment is largely carried out by one firm buying another firm in a foreign country. The estimated amount of mergers and acquisitions across borders is on average about two-thirds of the total amount of the outflow of foreign direct investment in the world for 1990, 2003 and 2006. In the developed countries this figure is often close to 80 per cent (United Nations World Investment Report 2000). As foreign direct investment includes retained earnings and intra-company loans the relative importance of mergers and acquisitions relative to greenfield investment is even higher. This means that globalization in terms of multinational firms expanding cross-border activities is as much a change and expansion in terms of ownership as it is in terms of organic growth. To a large extent this also explains why the increase in foreign direct investment is so much higher than the increase in world production.

Who are these multinational firms which gradually have spread their activities in a large number of countries to a larger and larger degree? Where do they come from and how dominating are they today?

Table A.1 in the Appendix contains a list of the 100 largest non-financial multinational firms. Although the total number of multinational firms is very high, approximately around 70 000, the global scene is dominated by some few, large multinationals. The 100 largest non-financial multinationals account for 13 per cent of the employment of all multinationals in the world. The ten largest in 2005 ranked by foreign assets were General Electric, Vodafone, General Motors, BP, Royal Dutch Shell, Exxon, Toyota, Ford, Total and Electricité de France. Seven of these were also in the top five in the year 2000. On the whole the list of the 100 largest is relatively stable over time. Two-thirds of those on the list for 2000 were also on the list five years later. Dominating industries on the list are motor vehicles (General Motors, Toyota, Ford, Volkswagen, Honda, BMW, Nissan, DaimlerChrysler, Fiat, Renault, Volvo), electrical equipment (General Electric, Siemens, IBM, Sony, Hewlett-Packard, Philips, Hitachi, Matsushita, LG Corp.), telecommunications (Vodafone, France Telecom, Deutsche Telecom, Telecom Italia, Telefonica, Liberty Global, Singapore Telecom, Nokia, Telenor), petroleum/gas extraction (BP, Royal Dutch Shell, Exxon, Total, Chevron, ConocoPhillips, ENI, Repsol, Petronas, Statoil), pharmaceuticals (Pfizer, Roche, GlaxoSmithKline, Novartis, Bayer, Johnson & Johnson, Abbott Laboratories, Wyeth) and retail (Wal-Mart, Carrefour, Ahold Koninklijke, Bertelsmann, Metro).

The dominance of large multinationals is also apparent when it comes to geographical concentration of where the parent company is located. Table A.1 in the Appendix reveals that the majority of the 100 largest multinationals have their home base in five countries, namely the USA (25), France (13), the UK (13), Germany (11) and Japan (9). Among the 100 largest there are only 21 home countries represented, of which all but five – Hong Kong, Singapore, Malaysia, Mexico and South Korea – belong to the western hemisphere.

Another indicator of the size of these firms on the global scene is the number of foreign affiliates and the 'transnationality index'. As seen from Table A.1 the overwhelming majority have more than 100 foreign affiliates, 25 multinationals have over 300 affiliates abroad, four have over 600 and one, General Electric, has over 1000 affiliates. The management problems related to these enormously geographically and operationally dispersed structures should not be underestimated.

The transnationality index in a company is composed of an average of foreign sales, assets and employment as a percentage of total sales, assets and employment. For the 100 largest multinationals the index is on average 60 per cent. A look at the individual companies, though, reveals that some of these firms have a much higher index, including for instance, Thomson (97 per cent), Liberty Global (96.5 per cent), Roche (90.5 per cent), Philips (87 per cent), Nestlé (86 per cent), Vodafone (82 per cent), Honda (80 per cent) and Hutchison (80 per cent).

Table A.2 in the Appendix contains a list of the 100 largest multinationals from developing economies in 2005. Asia dominates as the home region on the list, with 78 companies, while the rest come from