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by Roger Hayter, Department of Geography, Simon Fraser University, Burnaby, 2004
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Chapter 11

The Growth of Multinational Firms

This chapter focuses on the growth of multinational (or international) manufacturing firms, defined as firms which control manufacturing establishment in at least two national jurisdictions. In particular, the chapter offers an explanation of why a firm which is based in one nation - its home or donor economy - can establish factories in foreign, more distant countries, that is, in host economies. The same question can be raised with respect to how firms based in one region can establish factories in more distant regions. Indeed, the multinational firm can be seen as a special case of the interregional firm.

The chapter is in three main parts. The first part offers a brief, broad perspective on the internationalization process by outlining general trends in direct foreign investment (DFI), that is the establishment of branch plants in foreign nations, and by recognizing alternative ways in which firms can internationalize their operations. The second part of the chapter reviews what is labeled as the theory of locational entry of multinational corporations (MNCs) which directly draws on the pioneering work of Hymer (1960; 1972) and other economists, notably Caves (1971, 1974) and Dunning (1973, 1977, 1980). At the heart of this theory is the idea that firms wishing to locate a factory in a foreign country must have some competitive or entry advantage in order to overcome the various problems of doing business in unfamiliar environments. The third part of the chapter offers two rival hypotheses about how foreign firms behave in host countries following entry. It might be noted that the chapter does not distinguish 'international' from 'multinational' but 'transnational corporations' are seen as representing a new type of development. In addition, the chapter focuses on DFI, or equity investment while
portfolio investments, involving loans from institutional investors to (other) institutional borrowers, are ignored.

PERSPECTIVE ON INTERNATIONAL FIRMS

International companies which control facilities in more than one country have a long history and can be traced at least as far back as the 17th century and the development of the big, British based trading houses such as the Hudson Bay and the East India Companies. Even in the manufacturing sector international companies have a long history, particularly in the textile and iron industries which were key industries in the first Kondratiev. By 1770, for example, John Wilkinson and his brother, leading iron masters of the industrial revolution in England:

“were in possession of three important ironworks -- at Broseley, Bersham and Bradley. He gradually extended the Broseley works and connected them with the Birmingham canal. There he built one after another five or six blast furnaces, obtained coal from deposits which he owned and worked himself. He had interests in foundries in South Wales and was a shareholder in Cornish tin mines. He owned a big warehouse in London with five or six landing stages on the Thames. His activities were extended to France, where in 1977 he set up ironworks at Indret, near Nantes, and where in 1778 he built furnaces for the Creusot foundry. The whole made up a kind of kingdom, an industrial state, which Wilkinson governed with a strong and autocratic hand. This State, more important and much richer than many Italian or German principalities, enjoyed a credit which they might well envy and, like them, coined its own money (Mantoux 1928: 308) (Italics added).

This large, integrated empire or “kingdom” provides an interesting historical precedent to the corporate giants, such as GM, Ford and Exxon which comprise Galbraith’s (1967) New Industrial State. However, in Wilkinson’s time, and for decades to come, ownership, profit receiving, risk taking, decision making and often innovation were concentrated among a few individuals. The shift from the owner managed kingdom of Wilkinson to the
giant corporations led by “captains of industry” (Veblen 1932) and then to the even bigger publicly owned corporations controlled by “technostructures” (Galbraith 1967) was still to come. Yet, the Wilkinsons' firm does raise the central theme of the theory of location advantage - they were able to contemplate establishing an iron works far from their home base in country with a very different culture because they had competitive advantages in the form of expertise in iron making and considerable power and resources.

At the beginning of the Industrial Revolution, the possibilities for international manufacturing firms were severely limited by the still small scale nature of production, the customized or local nature of technology, financing problems, owner-management, and the difficulties of transportation and communication. With gathering momentum in the 19th century, and since, a variety of technological and institutional innovations facilitated the growth of international organizations (Dicken 1992). In an increasing number of industries the scale of production expanded significantly while improvements in transportation networks and communication systems allowed access to larger market areas and information between distant places to be more readily exchanged. Of equal, if not greater significance to the emergence of giant firms and MNCs was the innovation of limited liability and the public corporation. Indeed, according to Marris (1968) it was to overcome the disadvantages imposed by managerial diseconomies of scale and the restrictions of internal financing to the growth of firms that:

the social architects of the nineteenth century invented the public, joint stock, limited liability company, and thus invented modern capitalism: the managerial restraint on scale was overcome by resort to collective ownership and delegated control, while the financial restraint was handled by the issue of marketable shares carrying limited liability.

Above all else, these social inventions permitted the separation of ownership from control, the hallmark of the modern corporation (Berle and Means 1928). Organization and the managerial division of labour, in effect, became a factor of production in which firms
could invest to facilitate growth - and if General Motors is used as a guide, as of 1995
firm sizes of $168 billion were possible and there is no reason to believe that this size is
some defining limit. Indeed, it is important to recognize that the MNC is an evolving
form of organizations - the MNCs of the present time are different from those of 100
years, not simply in terms of size and scope but also with respect to organization. Several
Sheffield-based specialty steel manufacturers, for example, established branch plants in
the US in the late 19th century and the first two decades of the 20th century following the
imposition of a tariff by the US government to protect domestic competition from exports
from Sheffield (Table 11.1).

Table 11.1

Sheffield High-grade Steel Firms in America 1860 - 1940

<table>
<thead>
<tr>
<th>Sheffield Firm</th>
<th>Product</th>
<th>Location</th>
<th>Start-up</th>
<th>Product</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. W&amp;S Butcher</td>
<td>Crucible steel; tools</td>
<td>Philadelphia</td>
<td>1867</td>
<td>Steel castings</td>
<td>Reorgan. 1870</td>
</tr>
<tr>
<td>2. Sanderson Bros</td>
<td>Crucible steel</td>
<td>Syracuse</td>
<td>1876</td>
<td>Crucible steel</td>
<td>Sold 1900</td>
</tr>
<tr>
<td>3. Thos Firth &amp; Sons</td>
<td>Crucible steel; arms</td>
<td>McKeesport, PA</td>
<td>1896</td>
<td>Crucible steel, arms</td>
<td>Sold 1949</td>
</tr>
<tr>
<td>4. Wm Jessop</td>
<td>Crucible steel; castings</td>
<td>Washington, PA</td>
<td>1901</td>
<td>Saw steel</td>
<td>Sold 1920</td>
</tr>
<tr>
<td>5. Edgar Allen</td>
<td>Manganese steel castings</td>
<td>Chicago Heights</td>
<td>1910</td>
<td>Manganese steel castings</td>
<td>Sold 1920</td>
</tr>
<tr>
<td>6. Hadfields</td>
<td>Steel castings, arms</td>
<td>Bucyrus, Ill</td>
<td>1917</td>
<td>Projectiles castings</td>
<td>Failed 1927</td>
</tr>
</tbody>
</table>

Source: Tweedale 1986: 79
As Tweedale (1986; see also 1987b) notes, these branch plants were created by the re-location of skilled workers and managers and operated in a largely autonomous manner with only limited forms of communication and integration with their parents back in Sheffield. Tweedale concludes that the Sheffield parents received few benefits from these ventures several of which were closed or sold within a decade or so of opening. Primarily since 1950, however, branch plants have typically been closely integrated within the overall parent company strategy. Thus, while forms of organization vary including with respect to the degree of decision making decentralization, the contemporary MNC is distinguished from its predecessors by the centralization of policy making and closely knit integration of facilities across national boundaries (Behrman 1969; Barnet and Muller 1975).

**DFI as a form of internationalization**

If internationalization is broadly defined as "the process of increasing involvement in international operations" (Welch and Luostarinen 1988: 36), individual firms internationalize their activities by exporting to foreign countries, selling licenses of a product they have developed to foreign firms and participating in strategic alliances with foreign firms, as well as through DFI. In addition, firms can internationalize by procuring foreign sources of raw materials and other inputs which may or may not be transformed into products for export. To some extent, the export, licensing, strategic alliance and DFI alternatives substitute for one another. These alternative forms of internationalization, however, also complement each other and these complementarities are significant, especially those between trade and DFI.

**Exports** - From a product market perspective, firms typically first internationalize by exporting. Many manufacturing firms do not export and among those that do the relative importance of exports as a percentage of sales (the export-sales ratio) and the commitment
to exporting varies substantially (LeHeron 1980; Hayter 1986a and b). For some firms, exporting can be an occasional, 'one-off' type of sale which is arranged through an export wholesaler, export association or foreign based sales agent in which the exporting firm itself has little or not direct contact with the foreign market. Traditionally, in fact, many small and medium size firms (SMEs) have developed relatively significant export sales without making direct contact with foreign consumers. In other cases, foreign consumers visit potential exporters to establish contacts. Exporting in this fashion, however, necessarily limits exporting firms' understandings of foreign market dynamics such as arise from changes in taste and new competition. Indeed, an important features of greater export commitment is the establishment of direct contacts in foreign markets and more control of sales channels.

The initiation of exports is often a difficult process as firms must make contact with distant and unknown customers, arrange some form of financing and insurance, complete the necessary protocols and documentation demanded by the importing nation, arrange for transportation and distribution and absorb the risks of costs incurred prior to payment (Bilkley 1978). Nevertheless, as firms grow in size, markets must be enlarged and in most countries such growth quickly implies exports. In the Sheffield region of the UK, for example, medium size and large cutlery, tools and steel firms virtually all had developed substantial exports, as measured by the export-sales ratio (Figure 11.1). On the other hand, the export behaviour of the smallest firms in these industries is far more variable; some firms have high export-sales ratios and others do not export at all. The narrowing of the 'envelope' of export-sale ratios as firms increase in size, however, indicates that the development of an export trade is an important challenge typically facing the growth of manufacturing firms.
To some extent exporting and DFI are alternatives available to firms in accessing foreign markets. They are often complementary processes. Thus, exports can prepare the way for DFI by establishing business contacts and sources of information while once established DFI allows firms to gain a much better understanding of foreign markets thus facilitating exports. It can also be argued that as firms grow they will need to extend their purchasing patterns. Moreover, as with sales, purchasing links can prepare the way for
DFI. However, DFI to secure inputs, almost always is designed to institutionalize established trade links or create new ones.

**Direct foreign investment**

Frequently, if not inevitably, DFI occurs in places the firm already has export or sourcing connections (Welch and Luostarinen 1988: 44-6; Yoshihara 1978). The establishment of foreign operations, by acquisition of existing facilities or investment in new ones, typically involves firms in complex learning and bargaining processes comprising long run, strategic decisions. In terms of control, international firms may chose to establish wholly owned and controlled subsidiaries and branch plants or share ownership and control with local firms and governments or other international firms. Joint ventures typically involve agreements between two or more firms or government organizations to build a new factory in which ownership and control is shared, often according to share of financial commitment. Joint ventures may also share marketing responsibilities.

For the individual firm, the most costly, uncertain and sophisticated form of internationalization is DFI. Even so, international firms have grown massively throughout the 20th century (Dunning 1958; 1992; Wilkins 1994). In fact, although estimates are crude, by 1914 accumulated DFI was already substantial (Table 11.1). Comparing the major sources or host economies of DFI in 1914 with 1988 two major points may be made. First, the origins of DFI in 1988 remained highly concentrated among leading industrialized countries, if slightly less so than in 1914. Second, among leading industrialized countries, the origins of DFI remained concentrated in 1988 but notably less so than in 1914. In 1914, four countries (the US, UK, France and Germany) accounted for almost 87% of accumulated DFI and MNCs in the UK (Jones 1986) and the US (Wilkins 1970) were especially important. By 1988, the leading four countries (the US, the UK, Germany and Japan) accounted for 65.6% of accumulated DFI and between 1914 and
1988 the US replaced the UK as the world's leading supplier of DFI. Indeed, in the 1950s and 1960s the US accounted for an astonishing 40-50% of DFI. In 1988, the US was still easily the largest donor economy and US based MNCs continue to invest aggressively in different parts of the world (Schoenberger 1990). Since the 1960s Germany and Japan have emerged as major donors. The growth of Japanese MNCs has been particularly noteworthy in recent years and has been particularly focused on Australasia, North America and Europe (Dicken 1988; Edgington 1987 and 1990; Yoshihara 1978).

With respect to the destination of DFI, patterns are more diverse and developing countries are important, especially prior to 1939 (Table 11.3).

Table 11.3

| Estimated Stock of Accumulated Foreign Direct Investment by Recipient Country or Area |
|-----------------------------------------------|---------|---------|---------|---------|---------|---------|
| USA              | 10.3   | 7.4    | 13.9   | 10.4   | 23.2   | 27.0   |
| Canada           | 5.7    | 9.4    | 23.7   | 16.8   | 10.2   |
| W. Europe (UK)   | 7.8    | 7.4    | 22.9   | 36.5   | 35.8   | 36.5   |
| (Germany)        | (1.4)  | (2.9)  | (9.2)  | (8.9)  | (9.1)  | (9.8)  |
| Japan            | 0.2    | 0.4    | 0.2    | (0.8)  | (0.7)  | 0.9    |
| Latin America    | 32.7   | 30.8   | 15.6   | (12.5) | (12.6) | 9.4    |
| Africa           | 6.4    | 7.4    | 5.5    | (2.9)  | (2.2)  | 2.5    |
| Asia             | 20.9   | 25.0   | 7.5    | (4.8)  | (7.2)  | 9.3    |
| TOTAL ($B)       | 14.1   | 24.3   | 54.5   | 166.7  | 552.6  | 1219.3 |

Source: Dunning 1988: 75 (except for 1988 which are extracted from Dunning 1993: 20).

In 1988, developing countries accounted for about 20% of accumulated DFI. While the amount of DFI destined for developing countries is significant, the majority of DFI occurs among already industrialized countries. Since before the turn of the century, Canada has
always been a significant host country for its size (Britton 1980; Hayter 1981; McNaughton 1992; Ray 1965; see chapter 15). Western Europe, especially the UK, has a long tradition of receiving DFI and after 1950, stimulated by the Marshall Plan, western Europe received a considerable amount of DFI by US-based MNCs (Blackbourn 1974; Dunning 1958; Servan Schreiber 1968). DFI in the EC continues to be important and involves much intra-European flows, such as from European countries to the UK (Watts 1979, 1980b; 1982). Since 1970, DFI in Asia, including China and the ASEAN countries, has grown very rapidly in relative as well as absolute terms (Eng 1994; Leung 1994). Latin America's relative share of DFI continues to decline but in some countries notably Mexico there has been massive growth in recent years (Kenney and Florida 1994; South 1990) In addition, in the 1990s, since the break-up of Soviet controlled east Europe there has been a flood of investment there in a variety of industries (Michalak 1993; Murphy 1992). Finally, if in the 1980s Europe was the most important destination region for DFI, the US has emerged as the single most important national destination (McConnell 1980, 1983; MacPherson and McConnell 1992; Ó'hUallachain 1985; Ó'hUallachain and Reid 1992).

The location conditions affecting DFI on an international scale are varied. In a highly generalized way, however, at this scale access to markets has arguably been the most important concern. In primary and primary manufacturing sectors, access to resources is a more important location condition. In addition, DFI has occurred in low wage countries to access cheap, pliable labour. Even so, DFI in poor countries is relatively small compared to flows occurring in the developed countries and among developing countries, DFI tends to be highly concentrated among relatively few countries. Moreover, some DFI in poor countries, including China, is market driven as MNCs have established branch plants with an eye on the country's vast market potential. It might also be noted that historically firm based in OECD countries have been the most important foreign investors in recent decades firms from other parts of the world have established
foreign operations. While in many cases, these operations are small, there are examples of newly emerging corporate giants, such as Daewoo of South Korea which has invested extensively in foreign countries, most recently in the automobile industry of east Europe (Kraar 1996).

INTERNATIONAL FIRMS: A THEORY OF LOCATIONAL ENTRY

There are many explanations for the international firm (Dicken 1992: 120-45). Thus, there are theories of internationalization which are abstract, focusing on aggregate capital shifts rather than the strategies of individual firms from conventional and radical perspectives (Palloix 1977). There are theories which focus on how international firms function, rather than how they grow, and these in turn comprise conventional approaches (for example, McManus 1972), which stress the efficiency of MNCs in allocating resources, and radical approaches, which stress how MNCs underpin spatially uneven development (for example, Frank 1967). Another set of theories explain how firms grow internationally. Some of these theories are 'partial' (by highlighting one particular dimension of the internationalization process) such as the Scandinavian model which interprets internationalization in terms of market learning processes (Hakanson 1979; Johanson and Vahlne 1977; Figure 8. 4). Another partial approach interprets internationalization as a bargaining process (Contreras and Gregerson 1975; Krumme 1981; Soyez 1988; Figure 7. 6). From the perspective of how individual firms grow to become MNCs, however, the most influential tradition is provided by the so-called theories of oligopolistic advantage pioneered by Hymer (1960), Caves (1971), Dunning (1973) and others (Vernon 1966) primarily in the context of the massive expansion of US-based MNCs in the 1950s and 1960s. In this chapter, this approach is summarized as a model of locational entry (Figure 11.2).
Basically, the locational entry model argues that firms internationalize their operations to exploit some internally generated entry or competitive advantages, for example, in the form of marketing, production or technological know-how. These entry advantages are of sufficient strength to overcome various spatial 'barriers to entry,' defined ultimately by the problems of competing with local firms in foreign markets (Hayter 1981).

The oligopolistic advantage/locational entry model has several advantages for geographical inquiry. First, if this approach is not a macro theory of international capital movement, it does provide a relatively general framework within which to understand the internationalization of individual firms. Thus, the idea that internationalization is a learning or bargaining process is readily incorporated within its terms of reference. Second, it makes no \textit{a priori} assumptions about the contributions of the international firm to local development. Alternatively, this approach allows MNCs to be recognized as efficient resource allocators or as exploiters reinforcing local dependency. Third, the locational entry model imparts to studies of industrial location studies, especially those
from a behavioural and institutional perspective (chapters 6 and 7), greater significance
than is commonly supposed in the geographical literature (Hayter 1981). Fourth, the
model explicitly incorporates alternative forms of internationalization, notably the export
behaviour of firms (Hirsch 1976). The locational entry model is briefly and simply
summarized in this chapter in terms of two basic dimensions: entry advantages and entry
barriers. It might be noted that a much more complicated variant of this approach is
provided by Dunning’s (1973; 1977) eclectic theory of international production (see
Edgington 1987).

**Spatial entry barriers**

The essence of the location entry model is that firms contemplating investments in foreign
environments must have some entry or competitive advantage *vis-à-vis* potential local
competitors in order to compensate for various spatial ‘barriers to entry’ (Caves 1971;
Hayter 1981). Local entrepreneurs, for example, do not face communication problems
across national boundaries and they typically ‘inherit’ without cost much information
pertaining to local legal, cultural, political, economic and physical conditions which in
one way or another impinge upon the viability of plants. In addition, they have a better
idea of where relevant information can be found. In other words, spatial entry barriers
pertain to the additional managerial costs and uncertainties incurred by foreign investors
over and above those facing (potential) local entrepreneurs during the selection of regions,
communities and sites.

To use the terminology introduced in Part II, spatial entry barriers are defined for
behaviouralists by the costs, time and uncertainties involved in attempts to reduce the
‘knowledge gap’ in making locational choices (chapter 6). Alternatively, for the
institutionalists, spatial entry barriers are defined by the costs, time and uncertainties in
negotiating locational choices (chapter 7). In practice, both information search and
bargaining processes are closely intertwined and to some extent they can be measured, for
example, in terms of managerial costs and the price of consultant studies. However, given that location conditions comprise intangible features, that knowledge gaps cannot be defined precisely and because the behaviour of others cannot be completely controlled, locational search and bargaining processes are inherently uncertain. Consequently, any *a priori* assessment of spatial entry barriers is necessarily judgmental. Certainly, these barriers should not be underestimated. Studies in the geographical (Hayter 1978; Stafford 1972; Townroe 1972) and non-geographical (Ricks et al, 1974; Tweedale 1986) literature provide numerous examples of industrial problems which occur when firms, unfamiliar with local conditions, made decisions based on inadequate and inappropriate information (chapter 6).

A case study by Soyez (1988) systematically analyses the concept of spatial entry barriers that faced the Swedish firm, Stora Kopparberg, when it established a pulp mill in Nova Scotia, Canada (Table 11.3). Nova Scotia offered a fundamentally different host environment, in terms of its physical environment, as well as economy and culture, compared to Stora Kopparberg’s home or donor environment. These differences implicated the firm in years of collecting information and negotiating with local interests. Stora found that it could not simply transfer its ‘state of the art technology,’ for example, concerning silviculture, from Sweden in order to ‘improve’ local practices. The problem for Stora was that Swedish practices were not entirely appropriate for local conditions while local interests did not regard Swedish practices as necessarily constituting improvements.

*Psychological distance* - Countries constitute different kinds of cultural, institutional and economic environments in which to conduct business and these differences have physical, social, political and economic foundations which are reinforced by varying degrees of geographic separation. These differences (or distances) form the basis of Johansson and Vahlne's (1977: 24) concept of 'psychological distance' which they define (in the context
of exporting) as 'the sum of factors preventing the flow of information from and to the market. Examples are differences in language, education, business practices, culture and industrial development.' In the 19th century, geographic distance alone constituted major problems for intra-corporate communication and control. In recent decades, as these problems have been reduced if not eliminated, other forms of ‘distance’ have become more important such as the distances created by different languages and business culture. On the whole, the greater the psychological distance between countries the greater the size of spatial entry barriers. From this point of view, corporate preferences for investment in adjacent, similar environments are not only ‘conservative’ but economically rational. This helps explain, for example, the timing, extent and location of American corporate penetration in the Canadian economy (Marshall, Southard and Taylor 1936; Aitken 1961; Wilkins 1970; Ray 1965) and the preference of Canadian firms to locate in the US (Litvak and Maule 1981; Niosi 1985). Similarly, the often observed corporate support for such policies as free trade, common market agreements, metrification and related measures, which have the effect of facilitating movement and reducing regional differences, are explicable as attempts at reducing the costs of adjusting business practices to particular local circumstances (see Levitt, 1970; Christopherson 1989; Schoenberger 1994).

Even between countries considered close in terms of psychological distance, such as Canada and the US, spatial entry barriers exist and can be significant. Gates (1992: U2), for example, warned Canadian firms contemplating investment in the US that, even following the Free Trade Agreement of 1989, “rules can be different and harder.” This report acknowledged the growth of non-tariff barriers since the Canada-US Free Trade Agreement of 1989 while also paying particular attention to differences in tax laws. The general, and correct, view, is that income tax in the US is lower than Canada and so in this respect the US is more attractive to firms. Yet, in the US, there is a “minefield of other taxes” (Bianchi 1992: U3) which are different to those in Canada (Exhibit 11.1). For two
countries typically considered as relatively close in terms of 'psychological distance,' the differences in the US and Canadian tax systems alone are impressive.

More significant differences in language, culture and business philosophy that exist between nations (and regions) widen the psychological distance and therefore the size of spatial entry barriers. Many western corporations, for example, wish to export to and invest in the Chinese and Japanese economies. Both the countries, however, pose formidable entry barriers. In the case of Japan, its chosen path of industrialization, which has given priority to reverse engineering and the development of indigenous enterprise, has traditionally restricted opportunities for foreign firms and confirmed by policy restrictions on DFI (Freeman 1988; Kudo 1994). While these policy restrictions have softened in the 1980s and 1990s, Japan's distinctive culture, language and market preferences mean that most foreign firms face significant learning and bargaining costs as a prerequisite to selling or investing there (Encarnation 1992; Safarian and Dobson 1995). Moreover, western companies complain about high tariff and non-tariff barriers including deeply embedded inter-firm relations and complex distribution systems controlled by powerful enterprise groups (keiretsu) and affiliated sogo shosha. For most western firms, substantial participation in the Japanese economy requires considerable patience and effort (Hayter and Edgington 1994). In the case of China, while it has welcomed DFI since the economic reforms of the late 1970s, most western firms find the political, social and economic system, and the ways business transactions are conducted, to be extremely difficult (Ho and Heunemann 1984). Indeed, these problems have encourage the Singapore government to establish an agency to help western firms and Chinese authorities negotiate with each other (Fortune 1996). For the western firms the Singaporeans provide an understanding of Asian business culture and for the Chinese considerable experience in developing industrial parks and attracting DFI. For Singapore, such services are a way of further exploiting their know how of the industrialization
process in an Asian context which is consistent with a high wage economy which is less able to attract low wage industry itself.

**Method of entry** - Even within a given industry given host and donor environments, the spatial entry barriers facing internationally expanding firms may differ. Thus firms vary in competence and willingness to substitute a higher (lower) degree of uncertainty for lower (higher) costs of collecting information on new environments. Some firms may accept the higher risk associated with not spending time and money on locational choice by mistake or to avoid ‘procrastinating’ and possibly losing business opportunities. Spatial entry barriers facing firms also vary depending on whether entry is realized by investments in wholly owned new site branch plants or as joint venture with local firms, or by acquisitions of existing firms. Acquisition as a method of entry is particularly attractive since it involves fewer uncertainties compared to building new plant as foreign firms inherit both existing locations (accumulated capital resources) and existing management and workers (accumulated human resources).

In other words, acquisition offers an ‘instant’ and possibly cheap way of understanding local conditions especially if local owners of capital underestimate the importance of such geographical knowledge. Given its inherited and implicit nature, local ‘know-how’ may well be underestimated, a tendency that may be reinforced by fears among management and workers over job security following the take-over. Acquisition also facilitates relatively rapid expansion and from this point of view local firms may constitute not so much a rival to the foreign firm as an opportunity to gain advantage over, or react to, its ‘real’ international competitors. Acquisition is not always an option, however, and foreign firms may have to build new plant. In this case, foreign firms can sometimes arrange joint ventures with local firms and in so doing obtain the necessary geographic know-how and circumvent foreign ownership criticisms. Otherwise, the
foreign firm must accept the costs and uncertainties of establishing a manufacturing plant in a new environment. On the other, from the point of view of local development, the benefits to be derived from acquisition are typically much less obvious, even if they exist, than entry by internal growth.

The importance of acquisitions and joint ventures in the internationalizing process is well demonstrated by the interregional and international expansion of MacMillan Bloedel (MB), a forest product giant based in British Columbia (Table 8. 10). These expansions have been dominated by acquisition as a method of entry while new mills were only built as part of joint ventures. Subsequently, MB did acquire full control of some of the joint ventures once they had proved successful. Similarly, the numerous foreign firms entering the forest sector of British Columbia prior to 1980 did so either by acquiring an existing operation or by building a new plant as part of a joint venture with firms already operating in the province (Hayter 1981).

**Host government policy** - Governments, even among OECD countries, vary in their openness to DFI, especially as regards acquisition. Thus, Canada, Australia, the UK and the US have favoured relatively liberal 'wide open’ door policies to DFI. In contrast, countries such as Sweden, South Korea and especially Japan have limited the possibilities for DFI, especially in the past. Government policies towards DFI can change and in recent times there are several dramatic turn arounds in this regard. The most significant changes have occurred in still Communist China and in former USSR and its satellite east European countries. Thus, China in 1979 completely reversed its existing attitudes and began to welcome foreign firms, in selected economic zones at first and in more and more regions of the country since then (Sit 1986). The majority of the firms that have invested in China are in fact Hong Kong based and are of Chinese origin while firms from elsewhere have been slower to participate (Eng 1994; Leung 1993). Clearly, the entry barriers for the Hong Kong based firms are less than for western firms. Similarly, in east
Europe, the leading foreign firms participating in the newly liberalized economies are from other European countries and these firms to further compensate for lack of familiarity with local situations typically have formed joint ventures with local partners (Michalak 1993). Other examples of developing countries radically changing their policies in favour of more liberal attitudes to DFI include Brazil in the 1960s and Chile following the overthrow of the Allende regime in the 1970s.

Differences in host country policies towards DFI constitute formal, institutional variations in entry barriers facing internationally expanding firms (and simultaneously reveal the controversial nature of DFI in the local development process). While some countries have deliberately restricted DFI others have been far more welcoming not only by allowing DFI but by offering monetary incentives and other forms of inducements. Similarly, many regional and local governments actively seek to welcome and induce DFI to their jurisdictions. From this perspective, the incentives made available to entice foreign firms, such as tax breaks, cash grants, low resource royalties, favourable profit repatriation schemes and attractive investment depreciation allowances, and the range of services offered to investing firms, including the provision of low cost buildings and more commonly much free information on the local economy, are specifically designed to reduce entry barriers. At the same time, since incentive schemes reduce the entry barriers of foreign firms it may be argued that they simultaneously discriminate against local entrepreneurs by reducing their natural advantage vis à vis international competitors (Hayter 1982).

Apart from specific host country policies affecting DFI, firms contemplating international expansion are widely reported to be influenced by questions of ‘political stability.’ In general, it is argued that firms seek out areas which are politically stable. As a location condition, ‘politically stability’ is not without ambiguity since the principle of ‘free enterprise’ is closely associated with the principle of democracy and yet the very nature of democracy invokes the right to change government. Yet, what appears to be
crucial for international business in its interpretation of political stability is that rules and regulations affecting business will not change in unanticipated ways. Issues of individual freedom and human rights, on the other hand, are typically seen as beyond the legitimate concerns of international business. Thus, *ceteris paribus*, countries with military dictatorships can be attractive to firms because they guarantee ‘stability.’ On the other hand, countries which democratically elect a government that introduces new (‘anti-business’) laws may well be regarded as unstable and not a suitable place to invest.

*Size of firm* - According to Caves (1971: 13) spatial entry barriers are greater for small compared to large firms. His argument is that international investment involves relatively high and to a large extent fixed planning costs and that larger firms are better able to bear this burden. In addition, it may be argued that the high level of uncertainty associated with international investment in new plant can be more effectively borne by the already large firm. Moreover, large firms are powerful simply because they are big. Thus, they enjoy “economies of size,” that is the bargaining advantages associated with size and which include the ability to locate somewhere else. They also enjoy what Penrose (1959) calls the “economies of expansion”, which are resources the firm has available for planning purposes, notably under-utilized managerial resources. Consequently, large firms are in a better position to negotiate the conditions of entry compared to small firms (Krumme 1981; Soyez 1991; chapter 7). In general terms, in contrast to small firms, large corporations already dominant in domestic markets, typically enjoy broader spatial planning horizons, are able to draw on past experience in adapting organizational structures to growth, may perceive geographical concentration itself to be a source of uncertainty, or at least a constraint on expansion plans, and, by no means least, are more likely to have acquisition (and joint venture) possibilities (McNee 1974; Taylor 1975; Hayter 1976).
Historically, the evidence indicates that aggregate patterns of DFI have been dominated by large firms while the size of branch plants also tends to be much larger than industry averages (Britton and Gilmour 1978). As Caves (1971) notes, small firms able and willing to internationalize their operations may find the planning costs associated with establishing licensing arrangements more compatible with their resources and abilities to withstand uncertainty. There are, however, many small firms that have invested in foreign countries. Large numbers of Japanese SMEs in the textile industry, for example, established operations in various Asian countries in the 1970s. Even so, in this case, the small firms were aided in financial, marketing and planning terms by the huge Japanese trading companies or soga shoshas (Yoshihara 1976). Another example is provided by the numerous Canadian SMEs who have invested in the US. In this case, it seems that Canadian entrepreneurs have frequently found the spatial entry barriers of establishing a branch plant at nearby locations in the US less than establishing a more distant branch plant in another Canadian province. In addition, as the previous chapter noted, medium sized firms within the contemporary global economy frequently internationalize operations by exporting and by DFI. Their behaviour may well denote a new trend of the 1980s and 1990s in the organizational structure of DFI.

**Spatial entry advantages**

In a general sense, firms expand internationally to meet strategic motivations which relate, on the one hand, to profitability and efficiency considerations, and on the other hand, to control of markets and resources and related security reasons (chapter 7). More specifically, given the constraints of important, even formidable entry barriers, firms pursue international expansion strategies which further extend established entry (competitive) advantages. In this regard, Caves (1971) distinguishes between horizontally and vertically integrating firms (Figure 7.1)
Horizontal and vertical integration - Horizontal integration occurs when firms expand in their existing or closely related line of business. In this case, entry advantages comprise some internally developed asset or expertise related to technique, product organization, marketing, financing and/or human skill which can be invested in a new host economy without the need to incur much or any of the fixed costs associated with its original development. In other words, the size of the horizontally expanding firm’s entry advantage is fundamentally the fixed costs and uncertainties of acquiring or imitating its distinctive asset by local entrepreneurs (Vernon 1970).

Vertical integration occurs when firms grow by investing in facilities which provide a market for existing products (forwards vertical integration) or in facilities which supply inputs to existing activities (backwards vertical integration). The entry advantages associated with vertical integration, whether forwards into markets or backwards into raw materials, emphasizes the (cost) advantages of supplanting the market mechanism. By definition, vertical integration means that corporations gain control over technically linked stages in the production process in terms of decisions about the timing, quantity and quality of flows of goods and services. In part, the advantages of vertical integration have a technical base where there are clear economies of continuous flow operations such as exists between pulp and paper or iron and steel. But corporations often vertical integrate physically separate production stages. One important theory argues that firms vertically integrate for efficiency reasons, specifically to reduce the "transactions costs" of utilizing markets, that is, independent suppliers and consumers (Coase 1937; Malmgren 1961; McManus 1971). These transactions costs relate to the costs of searching for information about markets and supplies, the costs and uncertainties of negotiating contracts and the vulnerability that potentially arises from failures by independent firms in meeting the terms of contracts for a variety of reasons. Another theory argues firms vertically integrate to reduce uncertainty in supply and marketing chains and threats from rivals, that is to realize greater stability and security of operations (Galbraith 1967). MB's first
international venture to acquire paper box plants in the UK which were markets for its pulp and paperboard, for example, was stimulated when a rival threatened to acquire these same plants (Table 8.3; Hayter 1976). In like manner, vertical integration may provide firms with bargaining power in order to ensure prices of inputs and outputs are ‘fair’ and to compete with equally large vertically integrated rivals. In principle, the size of the vertically integrating firm’s entry advantage is 'measured' by either the savings in “transaction costs” or by the advantages of greater security in lines of supply and markets (see chapter 13).

In practice, FDI typically incorporates elements of both horizontal and vertical integration. In summary, branch plants can be interpreted as a bundle of integrated production, marketing, financial, planning and technological assets and expertise which collectively can comprise extremely powerful entry advantages in a foreign country. In addition, corporations planning on international expansion may be able to draw upon what Penrose (1959) calls ‘economies of expansion,’ and economies of size. The former refer to under-utilized resources within the firm (especially managerial resources) which may disappear once the firm has grown, and the latter to the power of already large firms.

However precisely defined, entry advantages, or in the vernacular 'head-starts,' that firms accumulate over time both permit, and are reinforced by, the building of new branch plants or the acquisition of new subsidiaries. Thus, branch plants add to the rate of return on established entry advantages. In addition, branch plants ensure that these entry advantages remain under the control of the firm while at the same time adding to them by acquiring knowledge of the host economy. Moreover, over the past four decades the literature suggests a change in the defining characteristics of leading corporate exemplars of entry advantages. This shift may be summarized in terms of the (fordist) 'American Challenge' and the (flexible) German/Japanese Challenge.
The (fordist) American challenge: technology and marketing - From a European perspective, Servan-Schrieber (1968) interpreted "the American Challenge," in a book with that title, as a result of the power, leadership and innovativeness shown by US based MNCs during the 1950s and 1960s when US based MNCs dominated aggregate patterns of DFI (Table 11.2).

Table 11.2

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<td>48.3</td>
<td>48.1</td>
<td>39.6</td>
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<tr>
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<tr>
<td>UK</td>
<td>45.5</td>
<td>39.8</td>
<td>16.3</td>
<td>12.8</td>
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<tr>
<td>Germany</td>
<td>10.5</td>
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<td>France</td>
<td>12.2</td>
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<tr>
<td>Netherlands</td>
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<td>10.6</td>
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<td>Switzerland</td>
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<tr>
<td>Japan</td>
<td>0.1</td>
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<td>Developing Countries</td>
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Percentage Distribution

TOTAL ($B) | 14.5 | 26.4 | 66.1 | 210.5 | 572.8 | 1140.5 |

Source: Dunning 1988: 74 (except for 1988 data which are extracted from Dunning 1993: 17).

He saw the US-based MNC as the model form of corporation and for Servan-Schrieber the American challenge was how to stimulate similar types of European companies and similar types of business practices throughout European industry. For Servan Schrieber, the defining core assets of US corporations lay in their technology and marketing. Indeed, two well known models, the product cycle and market linkage models, both emphasize technological and marketing expertise as the guiding forces underlying international investment by US-based MNCs. The product cycle model gives particular priority to
technological advantages (Vernon 1966; Hirsch 1967) and the market linkage model to marketing advantages (Kolde 1972).

The product cycle model interprets, the entry advantage of horizontally expanding firms primarily in terms of technological expertise or ‘head starts’ (chapter 4). Thus, Vernon’s (1966) original formulation of the product cycle model emphasizes that US corporations, specifically manufacturers of consumer durables, were able to pioneer new product developments in part because of access to large pools of scientists, engineers, skilled labour, and related external economies, and in part because of access to a huge domestic market comprising wealthy consumers willing to try new products. Thus US corporations were often the first to innovate new products and the profits gained by such 'head starts' further reinforced investments in corporate R&D to provide firm-specific technological advantages and to ensure a continuing stream of products. As individual products mature, however, input conditions change as firms increasingly rely on mass production technology and relatively unskilled labour. According to this model, US MNCs internationalize in search of unskilled labour with relatively low labour costs.

Kolde (1971) recognizes the technological strengths of the US corporation while stressing marketing know-how, networks and power. Thus, for Kolde, in the first instance, market knowledge directs the R&D process with critical information about consumer needs. Second, investment in marketing channels, distribution channels, advertising, product differentiation and brand names seek to influence and control consumer demands to ensure that the firm's technological advantages are extended as far as possible and investments in R&D (and marketing efforts) are profitable. Initially, these investments concentrate in the US. Subsequently, US firms expand internationally as an extension of their marketing tentacles. Thus, over time firms develop exports and related marketing infrastructure (from agents and occasional personal contact to sales offices, warehousing and distribution systems) and as exports increase, the associated
development of market power and market information prepares the way for international investments.

In their basic forms, as just reviewed, the product cycle and market linkage models suggest alternative paths of internationalization (Figure 11.3). In the product cycle model, for example, exports from the donor economy (the US) primarily to other rich countries in stage 1 are replaced by DFI in poor (low wage) countries in stage 2 and exports from this 'platforms' base supply the donor (the US) and rich host markets (Figure 11.3a). In the market linkage model, on the other hand, DFI follows (stage 2) and replace previously established exports (stage 1) and both exports and investments predominantly favour rich countries (Figure 11.3b). The existence of tariff barriers protecting host countries from exports further reinforce this trend.

However, several 'hybrid' cases can be readily identified in which product cycle and trade linkage mechanisms complement each other. Thus, in one hybrid version, firms select host countries on the basis of market linkage but within the hosts chose regions and communities which offer low labour costs (and government inducements) for a product which is mature (Figure 11.3c). Foreign firms in the US auto industry have recently pursued this kind of strategy (Krumme 1981). Another hybrid is that MNCs chose low labour cost 'platforms' which are nevertheless closer the markets they wish to serve (Figure 8.3d). European and Japanese MNCs that locate in the Mexican maquiladora zone to supply US markets (Kenney and Florida 1994) or US and Japanese MNCs locating in Spain (and increasingly the UK) to serve European markets provide examples of this hybrid strategy. Indeed, as trade barriers decline, particularly within continental trading blocs, such strategies have become increasingly important.
In general terms, both the search for low labour costs and market access remain important to the pattern of MNC evolution. If the spectacular growth of DFI in low wage economic zones in Mexico, China and other countries gives weight to product cycle mechanisms, market access also provides an enormous pull on DFI. Schoenberger (1990),
for example, has documented that at least until the 1980s the predominant national pattern of DFIs by American multinationals has reflected a market orientation and has favoured Europe has a host region. At the same time, DFI is no longer as dominated by US based MNCs as it once was. Indeed, for many observers, in the 1980s and 1990s, German and Japanese MNCs have taken on the mantle as 'model' corporations.

The (flexible) German/Japanese challenge: firms organized as learning systems - As the hegemony of the US has experienced relative decline, the primacy of the US-based MNC has also been challenged, particularly by German and Japanese MNCs. Technology and marketing expertise remain vital parts of the entry advantages of MNCs, wherever based. However, the defining characteristics of this challenge relate to work organization and labour relations. In particular, German and Japanese corporations, in admittedly different ways, have given priority to the continuing and comprehensive development of worker skills and to the more effective integration of workers in the operation of factories and, particularly in Germany, in corporate level decision making.

The basis of the German and Japanese challenge is that firms are explicitly and comprehensively organized as learning systems. Streeck (1989; 1992) and Kioke (19XX) model German and Japanese corporations respectively as learning systems in which skill formation among the workforce is a deliberative strategy in order to enhance productivity, willingness to think innovatively and a commitment to high quality work. Moreover, in Germany and especially Japan, this same strategy is extended by large corporations to incorporate the activities of subcontractors (chapter 14). There are differences between German and Japanese corporations, qua learning organizations. In Japan, worker-management participation primarily occurs within factories on the 'shop floor' while in Germany unions have representatives on boards of directors (Krumme 1981). With respect to skill formation, Germany has developed an extensive apprenticeship system while in Japan on the job training is more critical (Kioke and Inoke 1990; Patchell and Hayter 1995).
Nevertheless, the development of sophisticated forms of work organization, along with technological and marketing strengths, have provided Japanese and German MNCs with formidable entry advantages which other corporations and regions are seeking to emulate. Thus, an important reason stimulating the big US auto manufacturers to enter into joint ventures with Japanese corporations is to learn more about the Japanese approach to work organization and labour relations (and related subcontracting practices). Similarly, the arrival of a Nissan branch plant in Sunderland, in northern England has been welcomed for its new approach to management and labour relations in a region characterized by 'entrenched union attitudes'. At the same time, the success of this plant has given more credence to the growing view in the UK that British deindustrialization has more to do with managerial failure than unions (Williams et al 1989).

In the US, Marshall and Tucker (1992) argue that corporations organized along Taylorist lines are not as competitive as firms organized as learning organizations. Marshall and Tucker (1992: 37) argue that US manufacturers have to reject Taylorism, which seeks to restrict thinking and learning to management, in favour of the German model in which work is organized "around highly skilled, well paid workers, using high performance work organizations." In this view, the key to corporate competitiveness with high wages (and living standards) is technological change in new products and processes and an associated commitment to product quality (Figure 11.4). In firms organized for learning, emphasis is placed on labour-management interaction and a high level of worker involvement in supervision, monitoring and design; the organization of workers in teams involving the development of polyvalent skills and continuous training; and on managerial attitudes which promote participatory styles, quality, the continual up-grading of their own and worker skills and 'bench marking' which requires constant learning about markets and rivals. The expected advantages of such interactiveness are: thin (lower cost) management ranks; improved quality because of better coordination of myriad functions and because of fewer mistakes; improved design; enhanced worker motivation and morale; and improved ability to serve more quality conscious and differentiated markets.
It should be emphasized that there exists a considerable variation around national corporate 'models' within and among countries and corporations also adapt to local conditions. Moreover, in the fifth Kondratiev competitive conditions are intense and sources of DFI increasingly wide. Even Japanese and German leading edge MNCs are having to adjust to new challenges. For the first time since 1945, for example, a major car assembly factory was closed in 1995, by Nissan in Tokyo. Indeed, both Japanese and German MNCs are also establishing branch plants in low wage platforms around the world as they re-locate factories to places where labour costs are consistent with skill levels. Even for 'nationally' oriented and loyal German and Japanese MNCs, the pressure to innovate in order maintain a high skill-high wage base in their home or donor economies is becoming more intense.
The locational advantage model of the international firm, as articulated by Caves (1971), can be readily accommodated to explain export behaviour (Hirsch 1976; see also Hayter 1986a and 1986b). Thus, as in the case of DFI, the essence of the theory is that firms contemplating exporting must have some entry advantage over local competitors in order to compensate for various spatial barriers to entry. That is, the advantages enjoyed by domestic firms, in the form of knowledge about local conditions and information sources and proximity to customers, may be viewed as barriers to potential exporters. Thus, for exporters, the spatial entry barriers are the additional transportation, information, communication and transaction costs and uncertainties associated with exporting compared to domestic sales.

‘National entry barriers’ that arise from the (potential) existence of locally based entrepreneurs are often supplemented by problems created by competitors based in other countries. These ‘international’ barriers to exporting are naturally greater whenever foreign rivals enjoy advantages as a result of specific institutional arrangements. For example, in the case of western Canadian secondary manufacturers wishing to export around the Pacific Rim, strong barriers exist as a result of bilateral and even multilateral trade agreements that do not include Canada and, most important, the control of trade by multinationals, primarily of American and Japanese origin (Hayter 1986b: 27-8). Thus, a Japanese multinational that establishes a manufacturing plant in the Pacific Rim country will eliminate opportunities for the small Canadian exporter. If the purchase of capital equipment from Japan is part of the investment package, then exports from Canadian equipment manufactures are also blocked. In addition, the sourcing of inputs by these subsidiaries to affiliated plants further reduces Canadian export potentials. Indeed, given the significance of affiliated trade within international firms, these observations have widespread implications.

Given the existence of various kinds of spatial entry barriers, companies wishing to export must possess some entry advantages. These entry advantages are similar to those already
discussed in relation to direct investment and refer to firm-specific revenue-producing factors, such as access to, or control over, some scarce natural resource or product, or to some technological and marketing expertise the firm has developed over time.

For most individual manufacturing firms, the difficulty of exporting varies considerably by national market. Foreign markets are different to domestic markets and the most vital of these differences relate to language and culture, including differences in business culture. During the 1970s and 1980s, for example, many Sheffield based cutlery, tool and steel firms, which in some cases had been exporting to Commonwealth countries and the United States for over 100 years, found that penetration of EC markets, characterized by business practices, consumer tastes and language, to be extremely difficult and often impossible (Hayter 1986b). Indeed, these difficulties support Johanson and Vahlne's In this regard, the hypothesis that firms export, *ceteris paribus*, first to the psychologically closest country, and subsequently to countries that are psychologically more distant, is confirmed by Luostarinen's (1980) analysis of Finnish firms and by Johanson and Wiedersheim-Paul's (1975) analysis of Swedish firms.

**Licensing** - As a substitute for, or complement of, exports (and DFI), firms can internationalize by selling (and procuring licenses) to foreign based firms and by entering into cross licensing arrangements with foreign based firms. For innovative firms, including small firms, licensing of production to other companies (for payment) is an attractive option whenever the difficulties facing exports or DFI and are substantial (Malecki 1991: 197-200). Such situations arise, for example, when small firms innovate a relatively bulky product which is expensive to transport and export and if the firms neither have the ability nor desire to establish branch plants. Small firms, even if they have patented their product, may also be concerned about copying by foreign competitors which in turn raises the specter of costly and uncertain court cases in foreign countries. In the early 1980, a small firm based in Edmonton, Alberta, for example, designed and
patented a new loading platform and while local sales grew rapidly the product is costly to distribute and could have been 'reverse engineered.' Consequently, as an alternative to exporting the product it chose to sell licenses to firms in the United States and contemplated the possibility of selling licenses elsewhere (Hayter 1986a). In addition, it might be surmised that the reason why Madge Networks is considering licensing some its products to foreign firms is a preemptive move to ensure some return on its R&D before competitors develop or copy a similar product (Chapter 9).

For similar reasons, SMEs may engage in cross-licensing arrangements especially in situations when firms in the same industry innovate products which serve distinct but related market niches. SMEs that manufacture machinery, for example, may wish to concentrate design and production resources on a limited product range that primarily serve a regional market but have potential for sales in export markets. The cross-licensing of products in this context creates a return on technological expertise and widens each partner’s product range in domestic markets without incurring additional R&D and patent costs. Many small Canadian firms in various industries have engaged in cross licensing with foreign partners (Ahern 1993b; Hayter 1988: 73).

THE POST-ENTRY BEHAVIOUR OF FOREIGN CONTROLLED ACTIVITIES

Foreign controlled manufacturing operations have several characteristics which distinguish them, as a group, from the domestic population of firms (Britton and Gilmour 1978; Caves 1971; Dicken 1976). On the whole, foreign controlled activities tend to be larger and are more likely to be found in either capital intensive industries or technologically sophisticated industries than is true for the domestic population of firms. Industries, for example, that often feature DFI occur where entry advantages can be best developed and include large scale resource processing, such as petroleum, aluminium, pulp and paper, and copper, and in more research intensive industries such as autos,
pharmaceuticals, machinery, electronics and computers. In comparison to domestic firms, foreign controlled activities, by definition, means they are ultimately controlled by a parent company whose head-office and technostructure is located in a foreign country. This control has significant implications for the actual and potential structures and strategies of foreign controlled firms in comparison to domestic firms. Within the population of foreign owned activities, structures and strategies also vary considerably.

**Foreign branch plants: does strategy follow structure?**

For parent or independent companies, as Chandler (1966) argues, organizational structure typically follows strategy (Figure 7.2). For foreign controlled subsidiary companies and branch plants, on the other hand, strategies frequently depend upon organizational structures. Thus the structure of a branch plant or subsidiary typically are defined by parent companies including with respect to autonomy and mandate which respectively define limits on decision making discretion (autonomy) and function (mandate). The scope of decision making within the subsidiaries then follow from these limits. Autonomy and mandate are closely related in that a branch plant that has an extremely limited mandate or purpose will likely have limited autonomy with respect to such functions as marketing, procurement, labour relations, planning, investment decision making, and research and development. Moreover, from the perspective of post-entry behaviour, the nature of local autonomy and mandates are crucially important. In general terms, branch plants and subsidiaries that have greater degrees of autonomy and a wider range of functions are more likely to plan strategies than subsidiaries with limited autonomy and functions. The structure of local subsidiaries can of course be changed, if parent companies so wish.

Clearly, parent company’s motivations in implementing investments play a decisive role in shaping the behaviour of foreign owned companies. Thus, highly specialized, export oriented operations set up by resource based companies seeking
additional supplies of raw material differ from highly specialized, domestically oriented operations set up by a secondary manufacturing company seeking additional national markets for an established product line. In this instance, different mandates imply different sales patterns (and potentially different implications for the balance of payments of the host economy). But, in both cases, the market mandate is closely prescribed by parent company policy; the former does not have the mandate, and therefore the capability, to ‘add value’ prior to exporting and the latter does not have the mandate, and therefore the capability, to export (or at least the particular market region designated by the parent company). Within the given mandates, the two subsidiaries may have varying degrees of autonomy for the actual market process. Thus, the parent company has the option of performing all market functions itself from the head-office or delegating them to the subsidiary. Similar observations can be made regarding other corporate functions.

Decision making autonomy of branch plants - Several factors affect the degree of autonomy of a foreign owned operation (Watts 1981). The first factor is the method of entry and the nature of equity ownership. In this regard, an important distinction is between wholly owned subsidiaries and joint venture companies. Joint venture companies, particularly those established on a 50-50 basis between two partners, one of which at least is foreign owned, are typically established to serve a specific purpose and are managed by representatives from both parent companies. Such companies usually exist simply to realize the initial motivation for the investment and they have no particular ‘growth dynamic’ of their own; further growth of the joint venture is likely to occur sporadically and according to the needs and agreement of two parent companies (Hayter 1981). Given the importance attached to joint ventures by host governments, as a way of alleviating foreign ownership criticisms, this limitation is potentially important. Wholly owned subsidiaries, on the whole, have more potential to grow so long as such growth is consistent with parent company plans.
The second, possibly most important factor affecting local autonomy is the size of the foreign owned subsidiary. Generally speaking bigger companies have more autonomy; indeed, for big, diverse operations, local decision making capability is likely critical for effective performance. In this regard, international firms frequently establish a large and diverse presence on entry into a foreign country through the acquisition of existing operations. In addition, some foreign owned subsidiaries may have the mandate to pursue active policies of growth within their host economy and thereby grow and become increasingly diverse. For these ‘active’ subsidiaries, a cause and effect relationship between growth and decision making autonomy is to be expected.

A third factor thought to affect degree of autonomy is the nationality of parent companies. Several observers suggest that US based multinationals control their subsidiaries differently from British or Japanese MNCs. This argument is that US firms are more likely to prefer to establish wholly owned subsidiaries and closer levels of integration between parents and subsidiaries compared to Japanese or British firms. Whatever the validity of such ‘national’ differences, it might be expected that the ‘style’ of individual corporations over matters such as local autonomy for subsidiaries will vary considerably. Michelon, for example, has a reputation for extremely tight, centralized control of operations combined with high levels of secrecy to the point where even the names of its senior executives are difficult to publicly access.

Several other factors are thought relevant to understanding the degree of a local subsidiary’s autonomy including the distance between parent company head-office and subsidiary location, the degree of product specialization of the subsidiary within the parent company, and the stability of product markets (Watts 1981). In general, it is argued that, *ceteris paribus*, the local autonomy of subsidiaries and branch plants increase with distance from parent company head-offices, with the degree to which their roles are specialized, and with increasing instability of product markets. It is difficult, however, to assess with precision the importance of these effects.
For parent firms too much centralization may lead to the dampening of initiative, the discarding of local opportunities and failure to recognize key trends while excessive delegation may lead to duplication, contradictory decisions and even threaten the integrity of the corporation as whole. Consequently, no matter how large and geographically diverse, subsidiary companies will be under some form of control and integration by parent companies. At one level, this integration occurs as regular flows of information in monthly, quarterly and annual reports, in person to person meetings, phone calls faxes, and e-mail. At another level, senior personnel may be occasionally moved among various subsidiary companies in several countries to help establish a corporate culture. At yet another level, capital budgets, investment and R&D programmes of foreign subsidiaries are typically closely scrutinized and ultimately subject to parent company control and priorities. That is, the strategies of subsidiaries need to be placed within a parent company context to make sense and these strategies inevitably have limited mandates in one way or another. Subsidiaries, even those with considerable autonomy, may not have the mandate to export, and/or to add value, and/or to engage in R&D, and/or to diversify their product range while in most cases subsidiaries do not have a mandate to invest in foreign countries themselves.

Over time, changes can occur in the nature of subsidiaries and their relation with parent companies; they can grow and decline, they can be bought and sold and the process of foreign ownership even reversed as well as increased in any specific host economy. They also may be subject to the so-called ‘obsolescing bargain’.

**The obsolescing bargain**

The obsolescing bargain hypothesis was developed in the context of the bargaining processes that take place between multinational corporations and host country governments (HCGs) during and following entry (Vernon 1971). In fact, this idea was
principally developed in relation to resource based multinationals and developing countries (Auty 1985; Pinelo 1973; Moran 1975; Shafer 1985; Sklar 1975) although Grieco’s (1982) study of Indian experience dealt with the international computer industry. The essential assertion of the obsolescing bargain hypothesis is that bargaining power between multinationals and host countries initially favours the multinational during the negotiations about entry but gradually shifts in favour of the host country following entry.

According to this hypothesis, the HCG and the MNC each strive to maximize benefits from investment (Figure 7. 6). To varying degrees their goals are congruent and in conflict. Moreover, the bargaining process involves risks and uncertainties and these risks and uncertainties change over time. Prior to the investment, negotiation typically favours the MNC since the MNC has more information about the relative profitability of the investment and alternative locations to invest. The MNC can potentially use this advantage to bargain for concessions from the HCG, especially if the host country is capital scarce, information poor and there is limited competition among MNCs. Subsequently, once the investment has been established, the bargaining position of HCGs becomes stronger to the extent that individuals and organizations within the host country gain information and experience as regard the operation of the investment and to the extent that the operations are capital intensive and difficult to re-locate, which is typically the case in resource based manufacturing or primary activities. In addition, as the operation becomes profitable, uncertainties over markets and technology are dissipated, not only for the MNC but also for the HCG. Consequently, for a variety of reasons, HCGs may be in a position to demand concessions from the MNC, rendering the initial bargain obsolescent, at least in part. Indeed, the HCG may threaten and implement a nationalization strategy.

Even if nationalization is not invoked, the obsolescing bargain hypothesis predicts that the initial bargain favouring the MNC will eventually be renegotiated over time, implying a decline in the MNC’s entry advantage. Several studies have supported this
prediction and have noted trends towards tightening the early beneficial terms granted by HCGs after new operations proved successful. These re-negotiations have included demands for higher taxes, greater local processing, joint marketing, a greater commitment to hiring locals in managerial positions and a higher share of domestic ownership by host country nationals or the HCG itself (Pinelo 1973; Moran 1975 and Sklar 1975).

At same time, even in resource base manufacturing, the obsolescing bargain should not be assumed or the power of MNCs underestimated. The entry advantages of MNCs are embodied both within plant and machinery and in the world wide facilities, networks, expertise and connections of the parent company as a whole. The former are often difficult to disaggregate and the latter inaccessible to HCGs. A plant or mine may be nationalized but it is far more difficult to acquire the built in engineering know-how and to duplicate the MNCs world wide marketing connections. Any one subsidiary serves a particular role within the parent company and these connections provide the MNC with sustained bargaining power. Moreover, MNCs, particularly those based in the US, can lobby for help by donor governments which may be in a position to sanction ‘unfair’ HCGs. It might also be noted that initial bargains may have been excessively favourable and the MNC may even anticipate a degree of renegotiation after start-up.

Furthermore, it needs to be stressed that if a host country may move up a learning curve following DFI, in that it learns something about the nature of the MNC's operation, MNCs inevitably acquire knowledge and connections within the host country. That is, over time, the MNC learns about a host country and acquires the capabilities and characteristics of local residents. Moreover, MNCs can still threaten to withdraw investments at existing operations and allow the possibility of technological obsolescence. There are always investment alternatives for MNCs in a general sense. Indeed, it is perhaps surprising that so much attention should have given to the obsolescing bargain hypothesis. There are strong arguments that DFI are good deals for MNCs, ones that imply accumulating bargains.
The accumulating bargain

While there may be debates as to whether in some cases the obsolescing bargain occurs, in which the MNCs entry advantage dissipates, there is little doubt that for many, perhaps most established foreign subsidiaries and branch plants, the concept of spatial entry barriers becomes obsolescent. Thus, over time the MNC becomes familiar with local conditions and sooner or later acquires the local know-how and connections inherited by domestic firms. Once established, a subsidiary can expand within a host economy and while it still has access to parent company expertise and resources (that is, entry advantages) post-entry expansions do not have to overcome the problem of spatial entry barriers.

Moreover, MNCs frequently negotiate financial support as a condition of entry. Such financial help may still be available for subsequent growth. Even if subsidies are not available, subsidiaries typically have access to domestic sources of funds through the normal channels including banks and investments by local shareholders of an equity and non-equity kind. Indeed, the post-entry growth of subsidiaries and branch plants may be entirely financed by local earnings and domestic funds (Hayter 1981). In this way, it may be argued that domestic sources of financing fund increases in the size of foreign owned companies. Yet, parent companies still retain control of assets which can be sold for their market value. In fact, subsidiaries are a source a funds to parent companies in the form of parent company charges for head-office services and as interest and dividend payments. In less tangible ways, the control of foreign operations also significantly increases the parent companies' geographic scope for adjusting to change.

For a variety of reasons, therefore, it may be argued that DFI is a cumulating bargain for MNCs. Available evidence strongly suggests that DFI has been extremely profitable to parent companies. Indeed, subsidiaries are potentially the ultimate cash cow
for parent companies looking for large injections of financing for modernization in facilities elsewhere, including the donor economy. Given the profitability of DFI, divestment may not be considered a normally preferred strategy. However, in times of severe corporate crisis, the sale of subsidiaries can readily be converted into cash. In the severe recession of the early 1980s, for example, several forest product corporations sold foreign subsidiaries for substantial sums (Hayter 1985). International Paper of New York, for example sold its Canadian subsidiary, which it had acquired in the 1920s and which had been self-financing since, for over $1 billion which it used for modernizing its US-based facilities. Similarly, MB sold several of its foreign subsidiaries and a large mill in Atlantic Canada in the early 1980s to help pay for large losses in the early 1980s (Barnes, Hayter and Grass 1990).

As noted many US states charge a foreign corporation tax (Exhibit 11.1) and given the nature of the accumulating bargain other jurisdictions may give some consideration to this idea.

**CONCLUSION**

Within the radical literature on the international firm a central theme is the enhanced mobility of capital and a more implied argument that this mobility has rendered the theory of locational entry redundant (Fröbel et al 1980). From this perspective, entry has already been accomplished around the world and MNCs can simply move from one known location to another; there is no unfamiliar territory. Yet, for many large MNCs entry into new host economies continues to be an important phenomena as, for example, European and North American companies try to crack Japan, MNCs from all over the world are seeking DFI in Russia, east Europe and China. In addition, there is an emerging stream of medium sized firms that are internationalizing for the first time and there are a growing number of MNCs coming out of the developing world. DFI, in other words, remains a
problematical process and the theory of locational entry remains a useful starting point to investigate the international evolution of firms.

At the same time, the tentacles of MNCs are continually expanding to remote parts of the globe, sometimes directly and sometimes indirectly through subcontracting patterns which literally reach right into the living rooms of people. This global reach (Barnet and Muller 1975) raises important implications for labour, some of which are discussed in the next chapter.