Multinational Corporations

- It would seem that to prosper many firms need to produce and sell in a number of countries

- Indeed, MNCs now outweigh exports as dominant means of servicing foreign markets.

- Top 100 MNCs control about 20% world production (UNCTAD, Held). MNCs on some estimates pp=control around 70% world trade

- Many firms are multinational and some have a high proportion of their assets overseas: Top100WIR2002.pdf

- Mangers have to decide whether to - and if so where to – establish sales outlets manufacturing plants, R&D labs etc abroad

- Changes over time marked –firms and industries T10090.pdf

- Managers reasons for moving abroad will include:
  - Control foreign sources of raw materials
  - Set up to exploit technological lead
  - Search for economies of scale
  - Reduce transport costs

- Locational factors will include:
  - Size of local market
  - Tariff and other barriers
  - Countries investment and political climate
  - Availability of skilled labour
  - Availability of labour

- Channels available:
  - Exports of goods and services
  - Direct investment in wholly owned subsidiaries
  - Licensed production
  - Joint ventures
  - Strategic Alliances between number of firms

- Which managers choose generally depends on the nature of the product, industry, firm

- Consider the direct investment abroad and in particular the development of the Multinational Corporation (MNC) or MNE

- Caves defines as an enterprise that controls and manages production establishments ie plants located in at least two countries.
  - What proportion of plant abroad makes and MNE is judgemental
  - Is direct investment rather than portfolio

    - Can distinguish transnationals

- Models of multiplant firm group into:
    - Horizontally integrated –producing same line of goods in different geographical markets
    - Vertically integrated –produce outputs in some plants that act as inputs into others
    - Diversified: plant outputs nether vertically or horizontally related to each other

- From the late 1980s literature has grown developing theories of firm to take account of international production.

- Theoretical diversity because:
    1. International production can take different forms with different implications for host and home country –resource based import substit , export platform, global integration
    2. Theories reflect issues addressed and questions asked: MNCs or FDI in general
    3. International production can be analysed at macroeconmic, mesoeconmic and microeconomic level.

- Cantwell in Pitelis and Sugden groups theories of international production as:
    - Market power theory of the firm
    - Internalisation theory of the firm
    - Eclectic theory of the firm
    - Analysis of competitive international industries
    - Macroeconomic developmental theories

Market power theory of the firm

- Traditional classical:
    - Smith: FDI provides outlet for surplus capital as rate of profit driven down by competition
    - Marx: falling rate of profit, tendency to underconsumption leads to export capital to countries at earlier stage

- Post 1945: trade and FDI between developed economies overtook that between developed and developing –theories didn't explain

- Hymer in 70s pointed out that NC theory did not explain foreign operations of MNCs, in particular two way flows of FDI. Expected export capital to developing countries that are less capital scarce –didn't happen

- Argued that internationalisation was a means by which firms could increase extent of their market power (dominant mkts; be more secure; be less efficient; monopsonists and sellers)
    - Early stages growth firms merge and increase capacity and as concentration increases so do profits

    - Get to point difficult to increase concentration so invest in monopoly foreign operations
    - Also increase barriers to entry
    - May lead to reduction of efficiency

- Cowling and Sugden developed Hymer analysis: moving abroad increase market power and increases profits, also improve bargaining over wages and increase profit share; network of dependent subcontractors allow cost reductions; integrated into stagnationist argument –share of profit rising and increasing market power educes incentive to invest and decrease demand leading to stagnation a al Baran and Sweezy.

- Kindleberger reinterpreted to SCP approach considering monopolistic competition

Internalisation

- Consider trade between individual and groups but have transaction costs that vary with the type of exchange

- Administered exchange costs are lower than market ones so incentive to internalise

- Reasons are: reduced costs economies of scope –intangible assets particularly expensive to exchange in market

- Not more efficient to manage at arms length -subcontract

- So invest abroad to internalise exchange

- Context of gaining competitive advantage over rivals so increase competition rather than reduce it through barriers to entry

- Really only valid for horizontal integration

- Static model

- Can apply to services as well as manufacturing

Eclectic paradigm: Dunning

- Synthesises the two

- MNCs have competitive advantage:
    - Ownership of particular unique intangible assets (proprietary assets) or their services, such as firm specific technology
    - Joint ownership of complementary assets such as ability to create new technologies

- MNCs retain control over such productive and financial assets because internalisation advantages of doing so

- Integrated form can more easily exploit such assets
  - Transactional market failure: means internalisation advantages from coordinating complementary assets. Reasons:
    1. Risk and uncertainty substantial
    2. Externalities attached to transactions
    3. Economies of scope

- So overlaps with internalisation, but this is wider as there are differences between types of assets:
  - Some ownership advantages from particular asset can be sold –licenced production
  - Others have no market: ability to produce innovations
  - Both can develop alongside

- Locational factors specific to the host country are also still considered important. Proprietary assets distributed among several markets.

- Concept of ownership advantages open to different theoretical interpretations
  - Market power theory: anti compet to gain barriers
  - Competitive international industry: weapon that sustains competition between rivals
  - Dunning emphasises internalisation but Cantwell argues no need to

Competitive International Industry Approach

- Focus on industry rather than theory of firm –mesoeconomic

- Focus on rivalry and technological competition: interaction of firms and pocess of industrial development

- Early theory: Oligopolostic version of Vernon's product cycle theory
    - Firms retain position thru scale econ rather than market leadership
    - Locate abroad profit maximising and risk reducing as avoid price wars in mature markets –don't need compete at home.

- Search for security also in market power theory, but there is thru collusion and monopolisation rather than competition

- Can integrate oligopolistic interaction with other ideas:
    - Penroses theory of growth; smaller share grow quickly so move to where smaller
    - Internalisation theory
    - Technological competition/accumulation/diversification
    - Growing connections between technologies

Macroeconomic developmental theories

- Really concerned/linked with general theories of FDI: consider next lecture

Horizontally versus Vertically Integrated MNCs

- Above demand side analysis (eclectic/internalisation) best suited to horizontal

- Supply side ones will apply to both

- Can understand using transactions costs: parties prefer internalising inputs than arms length relations because of monitoring costs, efforts of setting up contracts

- For MNCs processing natural resources –evade problems of impacted information:
    - Moral hazard/asymmetric information on available resources

- Can have forms of backward intergration subdividing production processes and placing labour intensive abroad

- Considerable vertical integration can be involved in horizontal
    - Entwined; ancillary services; internal transfers; screwdriver operations.

Theories of MNCs: Some conclusions

- **Debate continues:**

    - Reasons why multinationals start
    - How they behave when they exist

- Seems no reason to focus on unidimensional theories

- Need to understand dynamics and historical specificity

- There are important demand and supply aspects

- Policy conclusion MNCs have both efficiency and inefficiency implications –
    - Remove inefficiencies –internalisation, technology transfer, create new markets
    - Danger that can close markets limit growth

- Need to understand in general context: next lecture