Alliance Capitalism and Global Business

John H. Dunning

Routledge Studies in International Business and the World Economy

Routledge
Taylor & Francis Group

Also available as a printed book
see title verso for ISBN details

ALLIANCE CAPITALISM AND GLOBAL BUSINESS

Placing the evolution of alliance capitalism in the context of the globalizing economy, John Dunning explores the consequences of the economic and political events of the past twenty years for the economic jurisdiction of firms, markets and nation states, their impact on the structural organization of firms and on the domestic policies of national governments. Other key issues discussed include:

- global restructuring and alliance capitalism
- the interaction between trade and integration
- a re-evaluation of the costs and benefits of FDI
- the competitiveness of firms and countries
- the spatial dimensions of globalization

The volume includes some personal reminiscences by the author about the evolution of his ideas and writings over the last thirty years and a comparative look at US and Japanese FDI in Europe. The volume also includes an evalution of the current, and likely future, foreign MNE activity in Japan. The volume concludes with some forward-looking insights by the author into the paradoxes at the contemporary globalizing economy and of how these might be managed or resolved.

Professor John H.Dunning is currently State of New Jersey Professor of International Business at Rutgers University 1996–7 and is also Professor Emeritus at the University of Reading. He also holds an honorary Professorship in International Business at Beijing's University of International Business and Economics. He is past President of the International Trade and Finance Association, and of the Academy of International Business. He has published extensively on international direct investment and the multinational enterprise, and on industrial and regional economics.

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ALLIANCE CAPITALISM AND GLOBAL BUSINESS

John H.Dunning

London and New York

To my past and current Ph.D. students

First published 1997
by Routledge
11 New Fetter Lane, London EC4P 4EE

Simultaneously published in the USA and Canada
by Routledge
29 West 35th Street, New York, NY 10001

Routledge is an imprint of the Taylor & Francis Group

This edition published in the Taylor & Francis e-Library, 2006.

To purchase your own copy of this or any of Taylor & Francis or Routledge's collection of thousands of eBooks please go to www.eBookstore.tandf.co.uk.

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British Library Cataloguing in Publication Data

A catalogue record for this book is available from the British Library

Library of Congress Cataloging in Publication Data
Dunning, John H.
Alliance capitalism and global business/John H.Dunning.
p. cm.
Includes bibliographical references and index.
1. Strategic alliances (Business) 2. International business enterprises—Management. 3. Investments, Foreign.
I. Title. HD69.S8D86 1997 658.1′6–dc20 96–25974 CIP

ISBN 0-203-01652-1 Master e-book ISBN

ISBN 0-203-13060-X (Adobe e-Reader Format)
ISBN 0-415-14828-6 (Print Edition)

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ACKNOWLEDGEMENTS

I am grateful to the editors of several journals and the publishers of books in which earlier versions of some of these chapters first appeared for permission to make use of the material. Two of the studies were originally co-authored with PhD students at Rutgers University: one with Rajneesh Narula, now Assistant Professor of International Business at the University of Limburg in Maastricht; and the other with Sarianna Lundan, now Lecturer in International Business at the University of Reading. I much appreciate the contribution of these scholars to the volume.

Most of the typing of this volume was undertaken by Mrs Phyllis Miller of the Faculty of Management at Rutgers University. As on previous occasions, I owe her a great debt of gratitude, not least for her helpful suggestions on stylistic improvements.

Acknowledgement is also due to the copyright holders for their permission to reprint the following contributions. Chapter 2 is a reprint of a chapter (of the same name) in *Globalization and Developing Countries,* edited by K.Hamdani and myself and published by the United Nations in April 1996. Chapter 3 is a largely unrevised reproduction of an article published in the *Journal of International Business Studies,* Vol. 26(3), 1995, pp. 461–93. Chapter 4 was first published as a chapter in *Strategies and Structural Interdependencies,* edited by Gavin Boyd and Alan Rugman, published by Edward Elgar in 1996. Chapter 5 is a revised version of an article of the same name, which first appeared in the *International Trade Journal,* Vol. IX(2), 1995, pp. 153–202. Chapter 6 is an updated and enlarged version of a chapter in an edited volume by Lorraine Eden, *Multinationals in North America,* published by the University of Calgary Press in 1994 (pp. 277–308); and Chapter 7 is a modified version of a chapter in a volume *The Dynamic Firm,* edited by A.D.Chandler, P.Hagström and O.Sölvell and published by the University of Stockholm Press in 1996.

Chapter 8 appeared as an article of the same name, first published in *Transnational Corporations* Vol. 3, February 1994, pp. 23–52. Chapter 9 is a largely unrevised reproduction of Chapter 1 in an edited volume by

Rajneesh Narula and myself, *Foreign Investment and Governments,* published by Routledge in London and New York in 1996 (pp. 1–41). Chapter 10 is a slightly modified version of an article entitled 'Think again Professor Krugman: competitiveness does matter', which was first published in *The International Executive,* Vol. 37(4), July/August 1995, pp. 315–24; while Chapter 11 was initially published in *Transnational Corporations,* Vol. 5, Summer 1996.

Chapter 12 is a largely unrevised reproduction of a chapter of the same name published in an edited volume by D.Encarnation and M.Mason entitled *Does Ownership Matter?,* Oxford University Press, 1994, pp. 59–96; while Chapter 13, which was co-authored with Sarianna Lundan, is due to be published as an article in *International Trade Journal* early in 1997. The contents of Chapter 14, which have not previously been published, were the subject of the 1996 Tore Browaldh Lecture delivered by myself at the University of Göteborg in April 1996.

John H.Dunning
Rutgers & Reading Universities

1

INTRODUCTION

Some personal reminiscences

THE 1960s: THE EFFECTS OF FDI

This is the sixth volume of my readings that Routledge (and previous publishers now part of the Routledge family)[1] has published. The contents of each very much reflect both the contemporary state of international business activities in the world economy and the evolution of my own thinking—and those of my colleagues—about the determinants and effects of foreign direct investment (FDI) and the multinational enterprise (MNE).[2]

The first book of readings, *Studies in International Investment,* appeared in 1970. Essentially, it updated and expanded a series of articles originally published in the 1960s, with the emphasis directed to the impact of FDI on both investing and host countries. Little attention was given to the determinants or institutional aspects of FDI, although it was clearly recognized even then that the study of international direct investment straddled the borders of international economics and the theory of the firm (Dunning 1970:11). Shades of later theoretical discussion were also contained in such statements as 'FDI is only likely to occur when there is an imperfect market in the dissemination of knowledge and, where it is not profitable, to exploit the foreign markets in question by alternative means' (Dunning 1970:10). At the time of writing (early 1969), my only exposure to Stephen Hymer's thesis (Hymer 1960) had been via his supervisor's series of essays on *American Business Abroad* (Kindleberger 1969), and it was not until later in that year, when *Studies in International Investment* was already in press, that I became fully familiar with Hymer's work.[3]

There were two main themes addressed in *Studies in International Investment*. Both, in rather different ways, were an extension of my earlier work on US FDI in the United Kingdom (Dunning 1958). The first was to look at the consequences of UK *outward* direct investment (which in the 1960s was growing faster than inward investment). This interest was stimulated by my participation in a study, commissioned by the British government[4] and conducted by Brian Reddaway and a team of Cambridge economists, on the effects of UK direct investment on domestic income and the balance of payments. In particular, I was interested in the role played by UK firms in fashioning the growth of the US economy—a subject which had not been addressed by scholars since before the First World War.[5]

The second theme was to give further attention to the nature of the competitive advantages of foreign manufacturing affiliates, cf. indigenous producers, and the consequences of those advantages for productivity, profitability, market and growth shares. There were separate chapters in *Studies in International Investment* both on the comparative efficiency of UK affiliates in the United States and Canada, and of US affiliates in the United Kingdom.

Turning to the first theme, it was most certainly the case that the main interest of home governments in FDI in the 1960s was its impact on the balance of payments and on domestic employment, and studies were commissioned in both the United States and the United Kingdom to assess this impact.[6] Understandably, economists tried to steer discussion to the wider consequences of FDI—particularly as it affected the productivity and restructuring of domestic economic activity, and part of the contribution of *Studies in International Investment* was to the debate on the nature of these costs and benefits. In particular, a good deal of emphasis was given to the differences between the social and private returns of outbound MNE activity, and also between the incremental and organic theories of FDI (see e.g. Dunning 1970:124–5).

In anticipation of some of the contemporary discussion on globalization and industrial competitiveness, studies also emphasized the importance of FDI in upgrading the competitiveness of the investing firms. To quote directly from Chapter 4:

> Both in Europe and North America, UK firms have benefited from the access to knowledge of new products, techniques, materials and managerial methods which might not otherwise be obtained, and in the US from operating in a more competitive environment than that to which they are usually accustomed.
>
> (p. 125)[7]

It was during the 1960s that the United Kingdom began to rebuild its pre-war reputation as a pre-eminent capital exporter;[8] although, unlike the interwar years, the greater part of the new capital flows took the form of direct, rather than portfolio, investment. While traditional Commonwealth markets continued to attract the bulk of such investment, an increasing proportion of manufacturing and service activities by UK MNEs was beginning to be directed to the United States and Continental Europe.[9] In *Studies in International Investment* and other of my writings around this time,[10] I examined the reasons for, and consequences of, this geographical restructuring, and, in particular, why UK firms investing in the United States and Canada were not performing as well as their US and Canadian counterparts investing in the United Kingdom. This I attributed largely to the inadequacies and lack of motivation of British management, although the UK economic climate at the time—and particularly the tax regime—did little to encourage innovation or entrepreneurship.

The subject of the comparative efficiency of US subsidiaries in the United Kingdom and their indigenous competitors continued to fascinate both UK academic researchers and politicians throughout the 1960s; and the final part of *Studies in International Investment* reproduced the results of some research undertaken by the author and a colleague at Southampton University for the (UK) National Economic Development Council (NEDC). This study confirmed the distinctive competencies or ownership-specific (O) advantages of US subsidiaries (as documented in my 1958 study (Dunning 1958), and that these tended to be concentrated in sectors in which US firms did relatively well in export markets. While, at the time, I ascribed most of the poorer performance of UK firms to managerial weaknesses, in retrospect, I probably underestimated the benefits accruing to US firms from their internalization and co-ordination of cross-border markets—particularly in intangible assets.

THE 1970s: THE DETERMINANTS OF MNE ACTIVITY

While my writings in the 1960s were mainly related to the economics of UK inward and outward direct investment, in the 1970s they took on a wider geographical perspective. I also became more interested in the institution of the multinational enterprise *per se*. This was partly due to my appointment as UK representative to the 'Group of Eminent Persons' set up in 1972 by the UN Economic and Social Council to examine the role of MNEs in economic development; partly a consequence of my acquaintance with Raymond Vernon and with Stephen Hymer's writings; and partly as a result of discussions with my own colleagues at the University of Reading.[11]

The outcome of this direction of my thinking, and also of the refocusing of the interest of both practitioners and governments towards the social and economic consequences of the growing significance of multinational (or transnational) activity,[12] was displayed in a series of articles and chapters in books written in the 1970s, which were reproduced as a set of readings in *International Production and the Multinational Enterprise* in 1981.

The volume was divided into three main parts. The first identified and described my own approach to understanding the determinants of international production—which I defined as production financed by FDI and undertaken by MNEs. This, I called the eclectic theory (later renamed paradigm) of international production. The word eclectic was deliberately chosen because of my attempt to integrate a variety of strands of thinking about the ownership, location and organizational form of cross-border value-added activities.[13] Until the early 1970s, most theorizing about the determinants of production financed by FDI had been partial in that it sought to explain a *particular* type or aspect of MNE activity. The eclectic paradigm (like its near neighbour, the internalization paradigm) offers an analytical framework by which the growth, industrial pattern, geographical disposition and form of *all* types and aspects of international business activity might be explained.

I like to believe that the eclectic paradigm has been one of the most powerful paradigms for explaining not only the foreign value-added activities of firms, but also the interaction between these activities and other forms of cross-border transactions, notably interfirm collaborative agreements and arm's length trade. At the same time, I have always acknowledged that the operational robustness of the eclectic paradigm is limited. This is partly because of the large number of possible OLI variables that may influence FDI, and partly because their value is likely to be dependent on contextual variables, such as those which are specific to countries, types of activities and the strategies of individual firms.

Hence, while FDI by Korean MNEs in the French consumer electronics sector can be examined within the same analytical framework as that of US-advertising MNEs in the Philippines, or that of the Chinese MNEs in the Australian copper mining industry, the precise nature of the OLI variables and their value (as, for example, identified and evaluated in a multiple regression equation) may be very different. This, I attempted to illustrate in an early empirical test of the eclectic paradigm, using data on the sales of US affiliates in seven countries and fifteen sectors in 1966 and 1970.[14] Both country- and sector-specific characteristics were shown to influence these activities strongly and their significance, relative to those of indigenous firms, independently of the value of the OLI variables tested in a series of multiple regression equations.

The second part of our 1981 collection of readings examined a number of specific consequences of the activities of MNEs which might be attributable to their foreignness or degree of multinationality. Such issues as the contribution of FDI to indigenous capital formation, and its impact on market structure, regional economic development and domestic macro-economic policies, were some of the themes being critically explored by analysts in the 1970s, along with the alternative policies towards FDI which might be adopted by host governments.

These latter issues were discussed in the third part of our volume, although, at the time, my own belief, that governments needed to get their own economic and political houses in order before they could appraise the true costs and benefits of either inbound or outbound MNE activity, was not generally upheld by policy makers, in either developed or developing countries.

THE 1980s: THE ECLECTIC PARADIGM AND COMPETITIVENESS ISSUES

The 1970s, then, saw most of my research interests directed to explaining the determinants of international production and of how they impinged upon different aspects of economic analysis. Indeed, parallel to the sequence of readings now being described, I also convened a number of conferences which attempted to review the state of scholarly thinking on FDI and the MNE.

The first of these conferences was held at Reading in May 1970 under the title 'The Multinational Enterprise'. At this conference, different aspects of this (relatively new) phenomenon were analysed by the leading scholars of the day, including Bob Aliber, Jack Behrman, David Lea, Keith Pavitt, Edith Penrose, Stephen Hymer and Paul Streeten. Many of the issues which have since commanded critical attention by both academic researchers and policy makers were first aired at this conference.[15] The edited volume of the conference proceedings, which was published in 1971 (Dunning 1971), was shortly followed by another, namely *Readings in International Investment* (Dunning 1972), in the Penguin Modern Economics Series, the purpose of which was to reproduce and comment upon some of the most influential articles on both direct and portfolio foreign investment (but not the MNE) published over the past half century.[16]

The second conference I arranged was held at Bellagio, Northern Italy, in September 1972 and, on this occasion, my objective was more focused. It was no less than to explore the implications of the increasing significance of FDI and MNE activity for received economic theory. The resulting volume, *Economic Analysis and the Multinational Enterprise,* was published in 1974.

Looking back over the past quarter century since the contributions to this volume were first written, one can see that some have stood the test of time much better than others. For example, Max Corden's analysis of how international trade theory needed to be modified in the light of the cross-border mobility of factors of production implicit in FDI still remains as relevant today as it did in the 1970s, as, indeed, does George Bort's treatment of long-run capital movements, Guy Stevens' analysis of the determinants of investment and Charles Kindleberger's discussion of how FDI affects integration theory.[17] By contrast, in his evaluation of how the theory of the firm might be affected by the territorial expansion of its boundaries, Tom Horst made no mention of the theory of internalization, nor, indeed, of Edith Penrose's earlier work on the theory of the growth of the firm (Penrose 1959); while neither Raymond Vernon nor Richard Caves fully took on board the implications of the cross-border co-ordination of intrafirm value-added activities for the theories of location and industrial organization.[18]

Other essays in *Economic Analysis and the Multinational Enterprise* tended to reflect—and understandably so—the economic, technological and