

# INTERNATIONALISATION: MOTIVES AND CONSEQUENCES

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## Abstract

In recent decades, the global business environment has been growing dramatically. We are living in a more-than-ever-interdependent world. Many firms involve in the process of internationalisation, engaging their operations outside the boundary of their home country. The level of involvement of firms in international process can be specified by different types of foreign market entry modes ranging from import/export, contractual and investment entry modes. Import and export entry modes are the traditional form of international activities of firms. International licensing and franchising are the example of contractual entry modes.

Firms can undergo international operations by investment entry modes. These entail joint ventures, consisting of contractual operations, equity joint-venture and strategic alliance, and sole ventures or the establishment of a wholly owned subsidiary

The advanced technological change, trade liberalisation and intensified international competition are the factors that facilitate and drive such process of economic activities. Yet, it is not sufficient to explain the reason why firms decide to operate their activities abroad. As the business environment has increased in uncertainty and complexity, firms must immediately recognise the critical changes and respond to them rapidly to

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survive in the industry. It is generally accepted that the first and the most important motive of the businesses in the capitalism economy is the profit maximisation by either increasing the revenue or decreasing the cost of production. In the face of an globally increasing competition, firms not only compete with the rivals in home countries but also the international competitors. Therefore, the pursuit of global profit becomes the key motive of the enterprises (Dicken; 1992). Every activity of the firms, including the expansion of their activities across border, is aimed at increasing or protecting the profits. The sheer variety of competing explanations derived from different theories and motivations have been advanced to explain the internationalisation of businesses.

The transition of social relation also emerges along the processes of internationalisation of business. In an era of globalisation, it is possible to say that the process of internationalisation of the commerce and industry has an implication for political power of nation state. Clearly, historical evidences suggest that it substantially affects the world political landscape. Particularly, the proliferation of the worldwide-basis operation of MNCs in the past two decades requires us to rethink the traditional thought of the relationship between the governments of the nation states and the firms.

The purpose of this paper is to investigate some explanatory frameworks and motivations to explain the process of internationalisation of the firms. The second part of the paper is devoted to the examination of the consequence of such development of the political power of the nation states.

### **The Motives of Internationalisation of Firms**

The origins of the internationalisation of the commerce and industry can be traced by both macroeconomics approach, regarded as a general-system approach which is focused on the capitalist system as a whole, and microeconomics approach, based upon a firm-specific level. In a macroeconomics approach, the expansion of firms' activities beyond their home countries can be explained by the circuits of capital and the theory of new international division of labour. A microeconomics approach entails the Dunning's eclectic paradigm and the theory of product life cycle.

### **The Macroeconomics Approach**

#### **1) The New International Division of Labour Concept**

The new international division of labour, first proposed by Stephen Hymer, is used to explain the shift of

industrial production from the core, the industrialised countries, to the periphery, the developing countries. Firms in developed countries facing increasing wage in their home countries are forced to seek the alternative locations, which are the third world countries, providing cheap labour. Dicken (1992) points out that even though this concept has some validity in explanation of internationalisation process, it also contains several drawbacks. Firstly, it is excessively narrow and one-dimensional. In other words, it oversimplifies the variety of strategic options available to firms. Secondly, it overstates the extent to which industrial production has been relocated to the global periphery.

## 2) The Circuits of Capital Concept

The circuits of capital concept are based on the capital system as a whole. As quoted 'this capitalist world must be subject as a whole to the laws of motion of capitalism...international firms must be understood in term of the internationalisation of capital and the accumulation of capital (Radice; 1975). The idea behind this concept is to increase profits and accumulate capital by extracting surplus value from the production process as a continuous circuit

## The Microeconomics Approach

### □ ECLECTIC PARADIGM

First articulated by John Dunning in 1976, the eclectic paradigm of international production is derived from various theoretical approaches such as theory of firm, trade theory, organisation theory and location theory. It attempts to integrate three general and interrelated concepts to identify and evaluate the significance of factors influencing both the initial act of cross-border production by firms and the growth of such production.

Within the increasing competitive pressure on firms to sustain or increase profits, the eclectic paradigm avers that at any given moment of time, the extent and pattern of international production can be determined by a set of three factors which are *ownership-specific advantage*, *internalisation advantage* and *location-specific advantage*. Each factor will be discussed in turn.

### Ownership-Specific Advantages

They arise when a firm of one nationality possesses certain specific advantage over the competing firm of other nationalities. They are internal assets which are not available to other firms. These include those created by the firm itself, such as knowledge, organisational and human skill, purchased from other institutions, taken the form of a legally protected right or

of a commercial monopoly, and those of size, diversity or technical characteristics of firms (Dunning; 1980). Stephen Hymer first states that outbound activities could occur only if the firm possesses a particular advantage over the local firms to compensate for the lack of the understanding of the local market environment.

### **Internalisation Advantages**

These advantages arise when a firm internalises the use of its ownership-specific advantage. To this extent, the firm perceives it to be in its best interest to exploit its ownership-specific advantage rather than sell them or the right to use them to foreign firms. According to Dicken (1992), the key incentives for firm to internalise market are market imperfection and uncertainty. The greater degree of market imperfection and uncertainty, the greater the incentive and advantage for firm to perform the function of the market itself by internalising the market transactions. Internalisation is especially likely to occur in the case of knowledge and technology because they contain public-goods characteristics which is easily transmitted across the country boundary. Because of huge amount of money spent on R&D, firm will have incentive to retain technology and exploit it directly on the world-wide basis rather than sell or lease it to foreign firms.

### **Location-Specific Advantages**

This factor affects the decision of the location of production. To this extent, firm finds that it must be more profitable to exploit its assets in overseas location rather than domestic location. Dunning defines location-specific factors as 'those which are available, on the same terms, to all firms whatever their size and nationality, but which are specific in origin to particular locations and have to be used in those locations'. As classified by Dicken, there are several major types of location-specific advantages which will be identified in turn.

- *Variations in Size and Nature of the Market:* The global market exhibits an enormous variation in income level, an approximate measure of market size, suggesting the difference in magnitude and nature of consumption patterns across countries.
- *The Political and Cultural Dimension:* This includes political climate, government policies, trade policies, national attitude, language and culture. It has been accepted that the important source of market imperfection is the government interventions. For this reason, government policies significantly affect the pattern of international production. The historical evidences also suggest that many overseas

investments occur in the countries of similar culture and language.

- *Variation in Production Costs:* The spatial variation in production costs, especially in labour factor, has contributed significantly to the shape of international production in the worldwide basis. To the context of different labour factor across countries, several aspects of variation are in presence. These are geographical variation in wage cost, labour productivity, degree of labour controllability, and mobility of labour. Dicken (1992) points out that one way to handle the uncertainty of future production cost in different locations is to locate similar activities in the various different locations and adopt a flexible system of production allocations between locations.

According to the paradigm, firms will involve in international production if and only if these all three conditions are satisfied. The configuration of ownership, location and internalisation (OLI) advantages and disadvantages determine the structure, nature and strategy of the firm. The merit of this paradigm is that it incorporates a major characteristic of the diversity of transnational investment in the global economy (Dicken; 1992). Yet, Taylor and Thrift (1986) contend that this paradigm is merely ‘a list of factors likely to be important in the explanation of the modern... (transnational corporations)... rather than the

explanation itself. Theoretical relations between the different factors too often remain untheorised’.

#### □ THE PRODUCT-LIFE-CYCLE THEORY

The product life cycle theory, first articulated by Professor Raymond Vernon in 1966, was developed to explain the locational tendencies for each phase of the product cycle-particular the US MNCs.

In the beginning of the cycle, the production facilities take place in the home country (the US) with high income and labour costs. The products are exported to overseas markets. To increase the competitiveness and reduce the production costs, firms start moving the production activities to the other developed markets. In the last stage, within the intense competition in standardised products, firms are forced to move their production facilities to exploit the relatively cheap labours in the developing countries. To this extent, the developed countries become net importers whereas the developing countries become net exporters.

Dicken (1992) points out that this model has its own merit in such a way that it is an ideal-type model which sheds the light on the dynamic nature of the processes. However, some authors and even Vernon himself began to cast some doubts that the model is losing some of its relevance as the explanation of international investment. Giddy (1978) stated that ‘as an explanation of

international business behaviour, the product cycle model has only limited explanatory power.....The multinational enterprise, however, has succeeded in developing a number of other strategies for surviving in overseas production and marketing. Hence, the product cycle model must now take its place as only one facet of the more general phenomenon of large international firms successfully applying a diversity of monopolistic advantages across national boundaries in order to internalise imperfectly competitive factor markets'. Dicken (1992) also criticises that the model can no longer explain the international investment pattern by the MNCs. Firstly, it explains merely a general sequence but it fails to provide the length of each stage and the timing of the transition from one stage to another. Secondly, as being in the more complex and uncertain global environment, it is unwise to assume evolutionary sequence from home country to foreign country. Rather, the initial source of innovation and production may be from any point in global network of the firm. Thirdly, it fails to explain the fact that much of international investment occurs between advanced industrial countries. At last, he points out that the application to real-world circumstance must be time- and place-specific.

However, the product-life-cycle theory still has significant power for explanation of internationalisation process of firms. Carnoy (1996) points out that "The equalisation of labour

costs and income per capita among the developed countries has not altered the power of product-cycle theory to explain the location of multinational production and R&D: the theory predicts that new product development will spread, and it has".

So far, the preceding theories have been advanced to explain the motivation of the internationalisation of the firms. In general, it can be said that companies are attracted to cross-border activities because of the dynamic of and interaction between external and internal factors. In fact, internationalisation results from a combination of factors rather a single factor. Both kind of factors not only provide the explanation of cross-border activities of firms but also shed the light of organisations' strategic response (Ellis and Williams;1995).

The **external factors** which are influential in internationalisation process are described by the factors outside the control of the firms. In other words, they represent the opportunities and threats of the firm. Ellis and Williams (1995) classify external factors into three level; Meta level, industry level and firm-specific level. Meta level factors are concerned with the changes in the broad environment including political, economic, ecological, social, and technological factors. Industry-level factor is competitive forces within the industry. Firm-specific factors involve either a merger/take-over resulting in

change in ownership or shareholder pressure.

**Internal factors** deal with the change within the organisation and vision of the firms' executives i.e. risk aversion of the decision makers of the companies. To put it more simply, they are strengths and weaknesses of the firm. According to Ellis and Williams (1995), they embrace organisational crisis, management succession, business performance and internal dissent. They also point out that the importance of the internal context is substantially affected by the culture of the company. This proposition explains why different companies respond differently to the same external stimulus.

As indicated earlier, the international expansion of firms' activities has to be seen within the context of the firms' attempts to maintain or increase their profit in an increasingly competitive, complex and uncertain global environment. To this extent, the reasons of cross-border expansion may be regarded as either defensive or aggressive or a combination of both.

The **defensive or reactive reasons** are considered the push factors that drive firms to engage crossing national borders when firms perceive some difficulties in their business performances and try to maintain their profitability and competitive position in the markets. These difficulties include

decreasing profits, market saturation in home or existing market, increasing costs of production and government regulations, and fierce competition.

Conversely, the **aggressive or proactive reasons** are regarded as the pull factors that entice firms to move into foreign boundaries. They arise out of realised attractiveness and profitability of cross-border operations. These include the attractiveness in potential new-open markets, cheaper operating costs, and favourable incentive offered by host government.

According to Dunning (1994), the motives of cross-border operations of firms can be divided into four groups. Firstly, companies decide to internationally disperse their operations because of the **resource related** factors. In this respect, the availability of cheaper resources and security of supply sources can be powerful incentives to drive firms to invest abroad. These resources include labour force, natural resources and managerial and technological skills. The second group of factors are **market related**. The traditional way to attract FDI is to impose trade barriers on the imports. The more recent instrument is to offer the most favourable incentive to attract FDI. The market related motives can be aimed at protecting existing markets (defensive) or exploiting new markets (aggressive). Firms may have to follow their customers and suppliers abroad to sustain the business. To prevent themselves from being left behind, firms want to set a foothold in the

markets that their competitors are already there or going to enter the markets. MNCs are also attracted by country-specific attractiveness such as large, increasing-grow markets. Thirdly, firms are motivated by **strategy related** factors. The international operations may be part of the global strategy to increase the global awareness of products and build up a global brand. Being international entity creates good image, prestige and power to the company and in turn boosts sales in home and host countries. Further, companies acquire the assets of foreign firms to pursue their long-term strategic objectives. Forth are **efficiency related** factors. Companies involve in beyond-border activities in order to benefit from economies of scope and scale and risk diversification. Investing in several countries can help diversify and reduce risks.

The fundamental point to be appreciated is that most MNCs' motives of going abroad are identified by several reasons rather than a single motive. Internationalisation process may be characterised in term of defensive or aggressive and motivated by either internal or external triggers or a combination of both. For given firm, these factors can change over time for each circumstance and stage of development of firms. However, as mentioned earlier, the principal objective of firms is long-term profit maximisation. It appears that the process of internationalisation is a rational decision-making activity (Ellis

and Williams;1995). Therefore, to justify any cross-border activities, the expected benefits must outweigh the costs or risk of such activities.

Operating the business beyond home-country boundary inevitably involves costs or risk such as exchange rate exposure, country risk, and any other risks that may arise from cross-border operations. Clearly, these risks results from complex and uncertain environment. The risks involved can be either systematic (undiversifiable) or unsystematic (diversifiable) risks. The diversifiable risk such as exchange rate exposure can be managed by the so-called hedging. The country risk regarded as systematic risk can also be reduced via insurance.

### **Consequences of Internationalisation of Firms for Political Power of States**

The rapid growth of degree of interdependence in international political economy require us to reassess the landscape of contemporary world. The processes result in a new economic, political and cultural transition. The internationalisation of the commerce and industry is the starting point of the huge empire of the MNCs. In fact, MNCs are one of the vehicles for increasing global interdependence. To date, these giant corporations exert a pervasive influence over the particular countries. Their global operations contribute a lion share of world trade and production. The dominant and expanding economic and



political power of these MNCs is a result of their firm-specific advantage which is the capacity to pool the resources through the financial resources and established worldwide network. The advanced technology and better managerial practices also give the MNCs a worldwide specific advantage.

As their increasing economic power corresponds to the growing social and political influence over the other state, the relationship between the MNCs and host countries is a primary site of debate in the past two decades. It is argued that the national governments loss their power to control and impose any constraint toward the MNCs due to the increasing power of the MNCs. Clearly, in the battlefield between MNCs and host countries, there is a conflict of interests leading to an uneasy relationship between them. This is because they pursue different objectives. The MNCs, like any business enterprise, want to maximise the corporate profits regardless the interests of any particular country. In contrast, nation states want to achieve their national goals of promoting economic growth and welfare for national citizen. As the world economy is dominated by multinational capital, the challenge has been posed to the nation states' ability to regulate the MNCs operating in their territory. Thanks to their high efficiency of the worldwide operations, the MNCs can easily escape the regulations imposed by the national governments. Given the internationalisation of capital through

the MNCs' operations, it is argued that this might be the end of the sovereignty of the nation state. Yet, as we will discuss later on, it might not be necessarily the case.

In the early day, the MNCs' expansion was dominated by American MNCs. Consequently, the Western European and Japanese counterparts follow the American's footstep. As a result, today, most of the leading MNCs are from the Triad area. The proliferation of Triad's MNCs is equivalent to the expansion of the political power of these nations.

The existence of these large corporations with international monopoly power undoubtedly has an effect on the redistribution of power on the global basis. The national governments are competing with each other, by offering the most favourable incentive such as grant, subsidy, unlimited repatriation of profits and favourable taxation, to attract FDI because they hope to use the MNCs' operations as an engine for promoting their economic growth. The FDI is expected to bring a host of benefits to the host countries. These include increasing local production, increasing the demand for local inputs, a wider range of goods at lower prices. Further, the MNCs give the contribution to capital inflows, exports, supply of foreign exchange, improvement of balance of payment, transfer of managerial skills and technological

capabilities to local producers, and employment creation.

Despite the positive roles of the MNCs, the capital inflow of FDI from MNCs also induce costs to host countries. The issues of a lack of commitment, uneven development, dependency, screwdriver plants, environmental degradation and transfer pricing have been big concerns for the host countries. The MNCs spend a lot of time and resources on R&D to acquire new technology and then rarely willing to transfer the technology and skill to the local managers and entrepreneurs. Therefore, not much will be left behind when they decide to shut down the activities in host countries. The existence of MNCs also discourages the locals to acquire and build up their own technology and capacity. This is nothing but economic and technological dependency. Further, It is unlikely that the MNCs will place the highest-return and highest-level activities in foreign country (Carnoy; 1996). The investment in recipient countries, particularly in the third world countries, can only be a assembly base or so-called screwdriver plant. In addition, the national governments are aware of the exploitation of the indigenous resources resulting in environmental damage. Even though FDI creates employment, it can also create unemployment when MNCs drive out the small indigenous business, causing a net loss of employment. The increasing monopolistic power may finally lead to the higher local prices.

The inter-firm trade, the cross-border transactions between subsidiaries of the same corporation, has been a significant growth in contribution to world trade. This intra-firm trade is manipulated and conducted on the transfer price basis, rather than an arm's length basis. By bypassing the market and setting up their own prices, the MNCs then can escape taxes and transfer the profits back home. MNCs also have little commitments to the recipient countries. Further, the capital inflows and exports created by FDI may be offset by larger foreign exchange outflows through imports of components, repatriated profits and licence and franchising fee.

The question is how to distribute the benefits and costs of MNC activities between two parties. Form the hosts' standpoint, they try to maximise the value added, created by the operation of the MNCs. In this respect, it largely depends on the relative bargaining power between two parties.

A single national market now seems to be self-insufficient to satisfy the economic requirements of its citizens. Nation state's control over its own economic affairs will give away to these international corporations that better suited the economic needs of people. The cost of inefficiency of the assertion of national sovereignty in order to achieve national goals would be too high. It is argued that national economic goal can only be achieved through participation in the world economy.

Given the advantages brought to host countries, no government would shut out the MNCs and thereby forgo benefits these corporations bring to countries. Up to this point, they seem to be more powerful than host governments as governments become incapable of legally controlling the activities and policies of MNCs. Then, they lose control over internal economic affairs. Can state retain its independence and sovereignty and simultaneously meet the expanding economic needs of its citizens? Unfortunately, it seems that the bargaining advantages are on the side of MNCs.

The attractiveness of host countries to MNCs depends on the local economic conditions. The countries will be in a better bargaining power if they have potential large markets, natural resources and high-skill, low-cost and trainable or well-trained local labour, and good communication systems and infrastructures. Similarly, the MNCs with high firm-specific advantages and high potential contribution are in a better position. Yet, the terms may be re-negotiated as the bargaining position is changing over time depending on the continued attractiveness of the host countries and the MNCs.

The intensifying competitive bidding of prospective host for FDI will increase the bargaining power of the MNCs. It is argued that once the plants are set up in host country, the national

government will gain an upper hand. This might not be the case. According to the footloose character of the MNCs and the shorten product life cycle, they can move to a more favourable country once the existing host country can no longer provide the acceptable condition for their business development. The freedom of host countries to regulate MNCs is not only restricted by the footloose ability of MNCs but also by the policies implemented by home countries' governments. That is, MNCs can lobby their home governments to put the pressures on the host countries on their behalf.

Nothing gives a better picture than the case of Japanese government, as pointed out by Dunning (1994). In earlier times, Japan pursued a restrictive policy towards the FDI. By doing so, governments decided to forgo the short-term benefits form FDI for long-term benefits. As a result of substantial investment in training, education, and technology, Japan now can welcome the FDI into the country without any fear of losing the autonomy.

The benefits enjoyed by MNCs, however, has been challenged by the rise of the economic nationalism. Governments try to get greater local control through joint venture, nationalisation, etc. National governments increasingly make MNCs serve local interests and prevent themselves not to be exploited by the big foreign company as they used to be.

The regulations toward the FDI and MNCs appear in various guises and can change over time depending upon the relative bargaining power we discussed earlier. Host governments may pose the regulations to increase local equity participation or specify the sectors or types of activities which are of importance in economic development. Often, the MNCs are forced to locate their activities in high unemployment area. To avoid being screwdriver plants, governments may implement the regulations to increase local value added. These include imposing trade barriers on the imports of components to encourage firms to buy locally and specifying the minimum amount or certain percentage of local value added. Host governments are increasingly aware of revenue leakage due to transfer pricing. They try to control such practices by encouraging arm's-length-basis transactions.

However, in an era of perceived powerful MNCs, the national unilateral regulation is no longer adequate. It appears that the multilateral or international regulatory framework might be the more effective way to control and regulate the behaviour of the MNCs. Countries realised that the collective actions by group of countries are far more effective than going-alone actions. The international codes of conduct or guidelines of MNC behaviour is one form of the collaborative actions. However, these guidelines are not legally forced.

Rather, countries are encouraged to abide by such guidelines. The regional integration in several parts of the world is a clear manifestation of the collective actions towards MNC behaviour. Countries collaborate with each other to harmonise the policies against MNCs and increase their bargaining positions. UNCTC (United Nations Centre of Transnational corporations) was set up to advise and assist governments on how to be in the better bargaining position and gain the most benefits of the presence of FDI. However, the multilateral actions are difficult to enforce in practice. MNCs may ignore the international codes if they are against the interest of the firms. In the light of regional integration, it may be hard to unify and reconcile the interest of countries. The more powerful nations may gain at the expense of the small countries (Dunning; 1994).

It is accepted that both corporations and host governments seek to maximise their economic interest and were well aware of the useful support from each other. The MNCs help promote economic growth of the recipient countries. In return, nation states have a major role in providing well-educated, high-skill labour, sophisticated communication and infrastructure to maximise the operational efficiency of the MNCs.

It follows that nation states still play a major role. In other words, an effective private sector supports, and is

supported by, an efficient public sector. In this respect, there is an optimistic view that the MNCs and host government will consider each other with less confrontation and more constructive view to maximise mutual benefits for both parties

## **CONCLUDING REMARKS**

In the face of globalisation, firms learn to operate their activities with a number of geographically dispersed operations. The internationalisation process of the enterprises is one of the primary sites of attention. Discoveries in telecommunications and computer facilities lessen the costs of cross-border operations and encourage firms to internationally disperse their activities. In today's dynamic world, the geographical boundary between countries becomes irrelevant. Most firms are driven to internationalise their economic activities by global forces. This paper is intended to investigate the determinants and consequences of the processes of internationalisation of business.

It appears that internationalisation is an identifiable evolutionary sequential process. As discussed earlier, firms internalise their economic activities for a host of different motives. The explanation for that can be approached in various ways and levels. Many theories tried to explain such processes. Internationalisation process

may be characterised in terms of defensiveness or aggressiveness and motivated by either internal or external triggers or a combination of both. Clearly, there is no universally and single explanation of such expansion across national boundary. Each framework or theory has its own merit and pitfalls. It would be illusive to seek for an all-embracing explanation (Dicken; 1992). Therefore, it is unwise to put any effort to produce a single and clear-cut explanation. In stead, the triggers to the internationalisation process are the dynamic interact of a variety of factors.

To this extent, Dunning (1995) suggests that most behavioural and theoretical explanations do not explicitly identify the motives of the firms, but merely the variables that are likely to influence firms' behaviour. In addition, most explanations involve articulating what firms actually do rather than what they should do.

Furthermore, it is clear that it is no longer the choice for companies to involve in cross-border operation. In stead, firms are forced to undergo internationalisation process and compete globally. It become one of the key strategic decisions for firms to maximise or at least sustain profits to survive in the world of uncertainty and complexity.

The global economic expansion has been largely facilitated by the growth of MNCs. They dominate world

trade and capital movement. Some large MNCs have turnover exceeding the GNP of some countries. These corporations continue to grow and influence the landscape of the world economy.

The main concern is not only the economic consequences but also the political and social outcomes of MNC activities. It is argued that high economic power allows the MNCs to gain an upper hand over the host governments by exerting leverage over policy making. They have been accused of exploiting recipient countries, being a cause of uneven development and erosion of the sovereignty of home countries. Therefore, the relationships between host countries and MNCs seem to be contradictory rather than co-operative.

However, it might not be totally justified to claim that the host government lose the control over the multinationals. There has been the rise of economic nationalism and national identity. Being an Economic power and a key actor of re-shaping new world order of the MNCs do not invalidate the roles of the nation states. There is still a role for the nation states in providing a good-quality infrastructure for the MNCs. Clearly, both parties are likely to work together to promote economic welfare for both parties.

Taken all together, the international political economy has undergone a profound change. Government has to act like a business entity and the

business entity has to move toward diplomacy. The thrust of the argument is the conflicting interest between the nation state and the MNCs. The challenge facing the recipient countries is not whether to work with the MNCs or how to regulate and control MNCs but how to maximise the value-added or contribution, created by such activities, to long-run economic growth.

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