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Why Transnational Corporations?*

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This paper is circulated for discussion purposes only and its contents should be considered preliminary.

1. INTRODUCTION

Consider a firm with production facilities in various countries - a transnational corporation (TNC). The problem to be discussed in this paper is: why are there such firms? The analysis is essentially theoretical. It attempts to develop a general approach to the problem by drawing upon a critical evaluation of what Hood and Young (1979) call the "orthodox" literature on TNC's. No attempt is made to empirically verify conclusions, and there is no consideration of the so-called "radical" literature on TNC's. Both of these issues await a subsequent treatment. The aim is to examine some of the deficiencies in the orthodox theoretical literature on TNC's, suggest improvements, and thus formulate a general approach to the problem "why TNC's?".

The plan of the paper is as follows. Section 2 examines the interpretation of Hymer (1960) by Kindleberger (1969), an analysis which emphasises "costs of operating at a distance" and imperfect markets. Bearing in mind a criticism levelled at this approach by Buckley (1981) - namely, that established TNC's do not incur costs of operating at a distance - it is concluded that the question "why TNC's?" needs to be considered within the more general context of the question "why firms?" Two approaches to the latter are then contrasted.

Section 3 examines the influential concept of "internalisation", developed as regards TNC's by, in particular, Buckley and Casson (1976). The emphasis upon efficiency is criticised and, in Section 4, compared to Marglin's work - see, especially, Marglin (1974)

Whether or not Marglin's analysis of the rise of the factory in the English textile industry 1750-1850 is correct is not in issue in this paper. Rather, the concern here is with the modern firm. Thus, Section 5 pursues the lessons of Marglin's analysis for the latter. The conflict between workers and managers over wages is discussed. It is argued that a firm with production facilities in various countries is able to separate its workforce into country specific groups. As a result, managers improve their bargaining position vis-à-vis workers. The crucial point to note is that problems of distribution are at the heart of the analysis.

Section 5 views the driving force behind the existence of firms as profit maximisation. In Section 6, attention shifts from the labour market and, in the light of the maximum profits objective, focuses upon attempts to dominate product markets. The importance of differentiated products is considered and, drawing upon Baran and Sweezy (1966), inter-firm collusion. Several explanations for the existence of TNC's emerge, based primarily upon Caves (1971) and Knickerbocker (1973). Section 7 maintains the concern with profit maximisation by considering the significance of transport costs and government taxes. The general principle that the latter are important elements in firms' calculations is not controversial. As such, having noted that firms will bargain with governments over tax cuts, the paper quickly moves to further comparisons of the framework developed in Sections5-7 with the existing literature on TNC's.

Section 8 is divided into four parts, the first two of which return respectively to the imperfect markets analysis of Kindleberger (1969), and the issue of efficiency. Subsection 1

acknowledges the similarity between Kindleberger (1969) and the approach of Sections 5-7: in both, imperfect markets are critical and, indeed, literature in the Kindleberger (1969) tradition - for example, Caves (1971) - is used to elucidate some important points in Sections 6 and 7. However, a subtle but vital distinction between the analyses is recognised. Whereas Kindleberger (1969) begins with the costs of operating at a distance and concludes that markets must be imperfect, the analysis of Sections 5-7 begins with an explanation of why markets are imperfect and concludes with the implication for why there are TNC's. Section 8.2 returns to the significance of efficiency. Two factors are considered, namely:the welfare of consumers in a world where firms attempt to dominate product markets, and the implications of bargaining between a firm and governments.

Attention is then given to other, comparatively recent studies of TNC's. Following, in particular, Rugman (1975), the possibility of risk averse managers acquiring production facilities in various countries is depicted in Subsection 3. In Section 8.4 Dunning's "eclectic theory" is commented upon. Given that this relies very much on "monopolistic advantages" and internalisation à la Kindleberger (1969) and Buckley and Casson (1976), it is not surprising that Dunning's theory is found wanting.

Finally, Section 9 draws some conclusions.

2. IMPERFECT MARKETS

A good starting point is the interpretation of Hymer (1960) by Kindleberger (1969).

To illustrate the argument, consider firm A, with its administrative headquarters and only production facilities in the U.K. Suppose A contemplates the acquisition of production facilities in the U.S.A., over 3000 miles away. Kindleberger (1969) notes:

> "There are costs of operating at a distance, costs not only of travel, communication and time lost in communicating information and decisions, but also costs of misunderstanding that leads to errors". (p.12)

These costs would not be faced, for example, by firm B, with its administrative headquarters and only production facilities in the U.S.A. Thus, with perfect international markets in technology, factor inputs, and products, an indigenous U.S. firm would always prevent firm A from acquiring U.S. production facilities. If firm A does acquire such facilities, there must be a market imperfection.

This view is expressed by Kindleberger (1969)[1/]:

> "For a firm to undertake direct investment in a foreign country it must have an advantage over existing or potentially competitive firms in that country. If not, those firms operating more cheaply in other respects because nearer the locus of decision-making and without the filter of long lines to distort communication, would put the intruder out of business.
>
> Put the matter another way: in a world of perfect competition for goods and factors, direct investment cannot exist. In these conditions, domestic firms would have an advantage over foreign firms in the proximity of their operations to their decision-making centres, so that no firm could survive in foreign operation. For direct investment to thrive there must be some imperfection in markets for goods or factors, including among the latter technology, or some interference in competition by government or by firms, which separates markets". (pp.12-13).

The advantage the firm requires is called a "monopolistic advantage". (It is not always clear exactly what the particular advantage associated with a given market imperfection actually is - e.g. in the case of oligopolistic reaction considered below. However, this is merely a problem of terminology; the vital requirement is an imperfect market.)

Given the assumption that TNC's face the additional costs of operating at a distance, Kindleberger's (1969) analysis is, by definition of perfect markets, correct. But there is considerable room for debate regarding the actual imperfection most important in practice.

For example, Kindleberger (1969) lists numerous possibilities, such as patented technology, and heterogeneous management. An interesting illustration of the departure from perfect competition in the goods market considers the role of oligopolistic reaction:

> "in concentrated industries there is pressure for each firm to develop a position in each important or potentially important market ... to prevent any of its few competitors from obtaining a substantial advantage which it could put to use over a wider area. The threat of competition by a foreign firm in the home market may be reduced if the domestic firm stands ready to retaliate through an existing subsidiary in the market of the threatener". (p.15).

This possibility will be taken up again later in the paper, with a discussion of, in particular, Knickerbocker (1973).

However, the imperfect markets analysis is only a starting point. In particular, as Buckley (1981) indicates, the assumption of

increased costs from operating at a distance is invalid for established TNC's:[2/]

> "Established multinational firms have gained worldwide dominance and have developed techniques to 'learn in advance' local conditions-products, processes, management style, marketing techniques are continually adapted to local markets. The ability of a multinational to forecast and to adapt is one of the major competitive skills. It is now only the entry into unusually isolated markets (such as the People's Republic of China) where heavy 'costs of foreigness' are still encountered. The advantages of locals in other instances can be discounted in advance by an experienced multinational firm". (p.73).

A more detailed analysis is therefore necessary. A revealing approach is to consider the question "why TNC's?" within the more general context of the question "why firms?" The next task is thus to contrast two approaches to the latter question, and examine how they can be used to answer the problem posed by "why TNC's?" This is not to claim that imperfect markets are unimportant; rather, as will become clear, the reverse is true.

3. EFFICIENCY

The first approach to consider, based on Coase (1937), has been developed as regards TNC's by, in particular, Buckley and Casson (1976). It is initially necessary to outline what Buckley and Casson (1976) actually argue.

A firm is seen as the means for

> "bringing under common ownership and control several interdependent activities linked by flows of intermediate products". (p.36)

These products may be semi-processed materials or knowledge. The issue "why firms?" really asks: why should interdependent activities be coordinated "internally" by a firm's management rather than "externally" by market forces?

The answer is that internal coordination is used because of the incentives to bypass imperfect external markets, i.e.

> "It is well known to economists that under certain conditions ... the coordination of interdependent activities by a complete set of perfectly competitive markets cannot be improved upon. An important corollary of this is that there is no advantage in replacing a perfect system of markets by a centrally administered control system. Thus the incentive for internal coordination of activities by a firm does not rest on the advantages of centralisation per se ... In fact, it is a consequence of the result above that a necessary condition for an internal market to be more efficient than an external one is that the external market is imperfect.
>
> The benefits of internalisation stem from the avoidance of imperfections in the external market, but there are also certain costs of internalisation which may affect the potential benefits. The optimal scale of the firm is set at the margin where costs and benefits of further internalisation are equalised". (pp.36-37).

The authors go on to consider a number of important market imperfections allegedly leading to significant benefits from internalisation. For example, the absence of futures markets, unequal knowledge between buyer and seller regarding the value of the intermediate product, or the imposition by governments of taxes which can be avoided by internalising a market. Similarly, various important costs of internalisation are outlined, including the "distance costs" considered by Kindleberger (1969).

Why, then, are there TNC's? A TNC "is created whenever markets are internalised across national boundaries" (p.45). Exactly when this is likely is explored in more detail in Buckley and Casson (1976). However, this part of their analysis will not be examined here, because the concept of internalisation can be contrasted directly with an alternative, preferable foundation.

Insofar as it goes, it is not wrong to view a firm as the means for bringing under common ownership and control interdependent activities linked by flows of intermediate products. Similarly, insofar as it goes, it is not wrong to argue that the raison d'être of a firm is the net benefits that arise from its existence. But such general statements do not go very far. They immediately suggest two important questions:

(i) how is the control of the interdependent activities exercised?

(ii) from whose viewpoint are the net benefits defined?

The answers to both questions are closely related.

The internalisation analysis emphasises the role of "efficiency". An understanding of this concept gives an answer to each question.

A situation in which no-one can be made better off without making someone else worse off is said to be "efficient". It is in this sense that a complete set of perfectly competitive markets cannot be improved upon. A situation is said to be "more efficient" than an alternative if no individual is worse off and at least one

individual is better off than in the alternative. Thus, the consequence that an internal market is only more efficient than an external one if the latter is imperfect is undoubtedly correct. But, so what? The implication is that an internal market is in fact more efficient than an external market. Otherwise, it would not exist.

This implication is crucial. The underlying reasoning can be shown by a simple example. Suppose individuals M and N are engaged in interdependent activities which are coordinated within a firm. The argument typically runs: the fact that a firm exists implies that M and N are better off - or at least, that neither is worse off - using a firm organisation rather than an external market, otherwise they would have chosen to use the external market.

I.e. control within a firm is exercised in the interests of all participants, all of whom receive non-negative benefits from the internalisation.

However, this argument assumes that the option of using the external market is available, and it says nothing about any other options. More generally, a third important question must be asked:

(iii) what is the set of options over which a choice is made?

The importance of this question is best shown by considering a more detailed illustration. Simultaneously, it is possible to outline a second approach to the problem "why firms?". This alternative view emphasises conflict between distinct classes in society.

4. CLASS CONFLICT AND THE RISE OF THE FACTORY

The discussion by Marglin (1974) of the rise of the factory system in the English textile industry, 1750-1850, is particularly illuminating.

Prior to the factory, production was organised by the "putting-out" system. Individual M - a "capitalist" - divided the production of a given product into separate tasks. Each task was assigned to a "worker", who carried out the job at his own home at the pace he dictated. A worker was only given one task. Under the factory system, the division of labour remained, but now workers were brought under one roof and the capitalist dictated "when and how much the worker would exert himself" (p.28). Under both systems, the capitalist's return derived from his ability to organise production.

The question "why firms?" becomes, in this specific example: why was there a transition from the putting-out system to the factory system? Marglin (1974) argues that the transition was not due to the factory being more efficient. Rather, the explanation is provided by the capitalists' control of the work process:

> "The key to the success of the factory, as well as its inspiration, was the substitution of capitalists' for workers' control of the production proces ..." (p.29)

Capitalist control was characterised by two vital elements - discipline and supervision:

> "To a great extent, supervision and discipline meant the same thing in the factory. Under the watchful eye of the foreman, the worker was no longer free to pace himself according to his own standards. But supervision was important for another reason: under the putting-out system materials inevitably came under the control of the workman during the process of manufacture. This created a variety of ways for the workman to augment his earnings; in the woollen trade a worker might exchange poor wool for good, or conceal imperfections in spinning, or wet the wool to make it seem heavier. Above all, there was the possibility of outright embezzlement". (pp.35-36).

Why did capitalists want to discipline and supervise the workers? If the worker controlled the work process, he could maximise his utility by substituting leisure for work, but thereby constraining the capitalist in his pursuit of maximum profits. Moreover, the worker could increase his real wage - and thus his utility - by, for example, embezzlement - i.e. more for the worker, less for the capitalist. Thus, the factory arose out of the conflict between capitalist and worker.

What of the efficiency approach outlined in the previous section? This would suggest that by actually working in a factory, a worker, who after all was under no legal compulsion, revealed a preference for the factory. The answer to this argument in Marglin (1974) is one of the most important passages in that paper:

> "The question is not so much whether or not factory employment was better for workers than starving - let us grant that it was - but whether or not it was better than alternative forces of productive organisation that would have allowed the worker a measure of control of product and process, even at the cost of a lower level of output and earnings. But to grow and develop in

> nineteenth century Britain (or in twentieth century America) such alternatives would have had to have been profitable for the organiser of production. Since worker control of product and process ultimately leaves no place for the capitalist, it is hardly surprising that the development of capitalism ... did not create a long list of employment opportunities in which workers displaced from the traditional occupation of their parents could control product and process". (p.37)

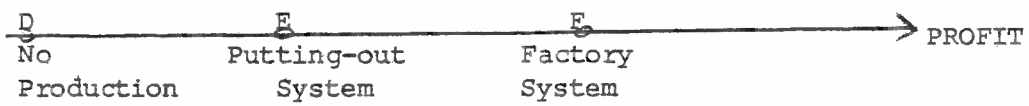
I.e. the option faced by the worker was whether or not to work at all. The option faced by the capitalist was which form of organising production - be this use of the price mechanism (i.e. an external market) or one of the many possibilities for internal organisation - would benefit <u>him</u> the most. As the choice between working and not working posed no real option at all, and as the method of production was chosen by the capitalists, the rise of the factory had nothing at all to do with efficiency. By working in a factory, a worker revealed nothing about his preferences for forms of work organisation which the capitalist did not offer.

Figure 1 may help to explain Marglin's analysis. In Figure 1(a), a typical worker's utility is represented by a straight line, utility increasing from left to right. Figure 1(b) similarly

<u>Figure 1 : Worker and Capitalist in the English Textile Industry, 1750-1850.</u>

(a) A Typical Worker's Utility

(b) Profit



represents profit. Initially, capitalists were unaware of the advantages of the factory system. Production was carried out using the putting-out system, leaving the typical worker at point C and profits at E. However, when capitalists learnt the advantages obtainable from factory organisation vis-à-vis profits, they offered workers the choice of A or B. Because workers were supervised and disciplined in the factories, B is to the left of C. Moreover, workers were in no position to argue; they had to work otherwise they would have starved. The crucial factor is that both B and C are to the right of the worker's next best alternative to working for a capitalist, namely starvation.

For the purposes of this paper, the essence of Marglin's analysis can be simply stated. Consider two propositions:

(i) the concern of a subset of the population - "capitalists" - was to coordinate the activities of others - "workers" - in producing goods and services, and thereby obtain an income

(ii) in organising production, capitalists sought to maximise profits.

If these propositions are accepted as true, it follows that, if capitalists had had the capability, they would readily have reorganised production to increase profits evenif workers' utility thereby fell. When did they have the capability? Two further propositions need to be accepted:

(iii) There was an alternative method of production which would in fact increase profits even though workers' utility thereby fell.

(iv) Capitalists could impose this alternative on workers.

The importance of (iv) is illustrated by considering a potential criticism of Marglin's analysis. Suppose initially that a firm is obtaining normal profits, but that it proposes a reorganisation of production to increase profits, albeit the typical worker's utility would thereby fall. If there is perfect competition between capitalists, such a reorganisation is impossible; there will always be other capitalists prepared and able to enter the industry, receive normal profits and thus employ the workers at their original level of utility.

It is an empirical problem whether or not these four propositions in fact characterised the rise of the factory. However, such empirical issues will not be examined here. The concern of this paper is the modern firm, not the English textile industry 1750-1850. (For empirical details on the latter, see Marglin (1974).)

Rather, the next task here is to consider more specifically the implications of Marglin's work for an analysis of the modern firm. In particular, can it be shown that a set of propositions akin to (i)-(iv) explain the existence of TNC's?

5. SEPARATE AND DOMINATE

In the early days of capitalism, one person owned and organised each firm. Today ownership and organisation tend to be separated - ownership is divided amongst "shareholders", organisation amongst "managers". This can be verified by examining many a modern firm. It is doubtful if it would be disputed by anybody. See, for example, Scherer (1980). Thus:

PROPOSITION 1: the concern of a subset of the population - "managers" - is to coordinate the activities of others - "workers" - in producing goods and services, and thereby obtain an income.

However, there is dispute regarding the objective pursued by managers. The best view - shared, for whatever reason, throughout most of the TNC literature - is that managers maximise profits. Baran and Sweezy (1966) provide a persuasive justification for this, arguing:

> "To be a going concern, a social order must instil in its members the ambition to be a success in its own terms. Under capitalism the highest form of success is business success, and under monopoly capitalism the highest form of business is the big corporation". (p.49)

The importance of this is that managers therefore pursue their company's success, measured by size, growth, and "strength" (denoted, for example, by share price). These objectives

> "are reducible to the single common denominator of profitability. Profits provide the internal funds for expansion.

> Profits are the sinew and muscle of strength, which in turn gives access to outside funds if and when they are needed. Internal expansion, acquisition, and merger are the ways in which corporations grow, and growth is the road to size. Thus profits, even though not the ultimate goal, are the necessary means to all ultimate goals". (p.51)

I.e.:

PROPOSITION 2: In organising production, managers seek maximum profits.

See also Miliband (1969) and Cowling (1982).

The consequence of Propositions 1 and 2 is: if managers have the capability, they will readily reorganise production to increase profits even if workers' utility thereby falls. The problem now is to analyse how such capability might give rise to TNC's.

Consider a typical worker in country X - individual I - who is employed by firm A. Define U_i as I's level of utility, where

$$U_i = f(\text{Wages, Effort}) \qquad (1)$$

I.e. a worker's utility is a function of the wages earned from and the effort put into his job. "Effort" captures the intensity of working. $f(\cdot)$ is an increasing function of wages and a decreasing function of effort. Define firm A's profits as Π_a, where

$$\Pi_a = g(\text{Wages, Effort}) \qquad (2)$$

I.e. a firm's profits is a function of the wages it pays its workers,

and the effort its workers put into their jobs. A given level of output yields higher profits the lower are wages and the more intensive is effort; the less a worker has to be paid, and the fewer workers that are required, the greater a firm's profits, other things being equal. (There are other arguments in a firm's profit function and they will be considered later).

(Before continuing with the main analysis, it is worth noting that it is generally easier to consider only movements in wages. Henceforth, this will be done, remembering: reference to a rise in wages is equivalent to a rise in wages and/or a decrease in effort.)

The implication of (1) and (2) is that there is a conflict over wages; the <u>higher</u> are wages, the better off is I, whilst the <u>lower</u> are wages, the better off are A's managers. Consider the situation where firm A can choose between two methods of production, namely: the firm can be a "national corporation" (NC), with production facilities only in country X, or it can be a TNC, with production facilities in countries X and Y. Define:

$w^T \equiv$ the wage paid to I by firm A, if it is a TNC

$w^N \equiv$ the wage paid to I by firm A, if it is a NC .

The crucial question arises: is there reason to believe that $w^T < w^N$? The answer is yes, because of the relative bargaining power of managers and workers under the alternative production methods.

The outcome of the conflict over wages is determined by the bargaining power of managers and workers. This is discussed by, for example, Burkitt and Bowers (1979), which concludes that workers generally have a stronger bargaining position when they act collectively. Several factors explain the dominance of managers in unorganised labour markets - i.e. markets where there is no collective worker action. For instance:

(i) The loss of potential utility to workers and managers from failure to settle the conflict is more severe for workers. A worker's sole means of livelihood is the sale of his labour power, a quick sale being essential because accumulated savings are usually small relative to expenditure commitments. See also Preiser (1971). In contrast, the manager can often replace a specific worker and, even when he cannot, any loss of profit can frequently be offset by rearranging the activities of remaining employees.

(ii) Usually, many sellers of a specific type of labour confront a small number of buyers.

(iii) asymmetric knowledge. Individual workers are often ignorant of their value to particular employers, and are less skillful than managers at negotiation:

> "The employer's greater knowledge extends to the art of bargaining; his experience of wage negotiation is usually wider, so that he can often achieve his desired goal by skillful

> manipulation of the weak position of most potential employees". (p.8)

In comparison, collective worker organisations - "trade unions" - are better able to confront employers:

(i) by acting together, workers can inflict on managers a greater loss of potential utility from failure to settle the wage conflict. E.g. collective action prevents managers from replacing specific recalcitrant workers.

(ii) When employees act together, there is no possibility of many sellers negotiating with a few buyers.

(iii) At relatively very little cost to each worker, trade unions can acquire both information about a firm's activities, and negotiating skill.

Where does the distinction between TNC's and NC's fit into this framework? It affects the ability of workers to act collectively. Lane (1982), for example, discusses the problems faced by British trade unionists in a firm with a number of plants in one country, let alone in various countries. Workers could theoretically elect representatives which would plan collective action across the various plants - i.e. they could form so-called "combine committees". However, in practice there are difficulties due to inter-plant differences in trade union development, and the historical organisation of unions . I.e.

> "From the trade unionist's point of view the multi-plant firm raises a host of not readily resolvable problems. The wide dispersion of plants over considerable distances, with location in areas differing in their labour movement traditions, mean that within the divisional structure of any one firm uneven development of trade union practice as between plants is the norm. Attempts at forming combine committees always fall foul of this problem - and doubly so where combine committees organise on an inter-divisional or inter-company basis. If there are difficulties in involving activists in such schemes, imagine the problems of interesting the rank and file". (p.11)

Lane (1982) continues by examining union organisation:

> "These circumstances are compounded by internal union organisation. Full time officers in most unions have, so to speak, a portfolio of companies within a given geographic area for which they are responsible. It follows that the employees of a multi-plant company operating in a number of regions must have contact with a number of full time officers. Constraints of time, resources and variation in outlook as between these officers ensures that they neither meet nor exchange information on a regular and systematic basis. The only point of convergence is through the national officer responsible for the company concerned - who suffers from precisely the same constraints". (p.11)

When a number of plants are spread across various countries, these difficulties increase considerably. For instance, CIS(1978) points out with regard to Ford workers across Europe:

> "It's difficult enough for Ford workers in one country, sharinga common language and separated by comparatively small distances, to organise effectively against the company on anything more than a local plant or shop level. Even here, major problems of communication, sectionalism, and cumbersome national union machinery arise. On a European scale the problems are multiplied

> many times. Workers in France, Germany, Belgium, Spain and the U.K. use six different languages plus those of the immigrants. It means much greater distances - over a thousand miles from Halewood to Valencia, with disproportionately large travel and telephone costs as a result. There are that many more unions - and another layer, the international union organisation, on top". (p.30)

Thus, the argument can be summarised:

(i) worker I's utility is a function of the wage paid by his employer, firm A.

(ii) The wage is determinated by the relative bargaining power of worker and manager.

(iii) Collective action by workers generally increases their bargaining power vis-à-vis managers.

(iv) In a TNC, the geographical separation of workers makes collective action very difficult to organise.

Therefore, if firm A employs some workers in country X and some in country Y, i.e. it is a TNC, it is in a stronger bargaining position relative to its workers than if all of its workers were employed in one country, i.e. than if it is a NC. Worker I will then be worse off than when A has all of its production facilities in country X. This possibility is depicted in Figure 2.

FIGURE 2: Worker I and Firm A; TNC Versus NC.

(a) Worker I

(b) Firm A

This bargaining analysis also suggests a second, closely related explanation for the existence of TNC's. Suppose firm A decides to erect production facilities for the manufacture of a particular good. Other things being equal, it will employ the workers who accept the lowest wages, which will again be determined by bargaining between managers and workers. If all potential workers bargain collectively via a trade union, management will simply have to settle for the best possible outcome that the union will agree to. However, if workers do not act collectively, managers can exploit this to secure lower wages.

For example, firm A can ask workers in country X what wages they require. The firm will then tell workers in country Y that if they accept lower wages, they will get the jobs. When workers in Y concede, firm A can return to the workers in C and seek still more

gains. On some occasions a firm may always locate in the same country, and therefore be labelled a NC, simply because workers from that country always accept the lowest wages. But this will not always be so, in which case TNC's arise.

An appropriate description of the reason underlying the existence of TNC's in either of these bargaining situations is "separate and dominate". By separating workers into country specific groups, managers are able to improve their bargaining position, thereby gaining at the expense of workers. Thus:

PROPOSITION 3: The concept of separate and dominate implies that a TNC will, as compared to a NC, raise profits by decreasing each of its employee's wages.

It remains to be determined whether or not workers can prevent a firm from being a TNC - i.e. can managers impose a transnational organisation on workers? This again depends upon the relative bargaining power of managers and workers, and as such is easily answered. I.e. the implication of the reasoning underlying Proposition 3 is that TNC's emerge as a result of bargaining between managers and workers, and thus:

PROPOSITION 4: managers can impose a transnational organisation on workers.

If propositions 1-4 are accepted as accurate, they can explain the existence of TNC's. Such an explanation is in stark contrast to the efficiency approach implied by internalisation.

The foundation for the analysis is a conflict between managers and workers over wages, the outcome being determined by the bargaining power of each class. The crucial point to note is that bargaining implies a problem of distribution, i.e. one individual or group versus another. Notions of the relative efficiency of an internal versus an external means of organising production have no relevance.

More generally, propositions 1-4 imply that, when TNC's are observed to exist, it cannot be presumed that they represent the most efficient outcome.

This is not to claim that the manager/worker conflict is the only basis upon which to explain the existence of TNC's. The task now is to explore these other possibilities, beginning with an examination of product market domination, and then considering the importance of transport costs and government taxes. The relevance of efficiency will be returned to again in Section 8.

6. PRODUCT MARKET DOMINATION

It is clear from Section 5 that the driving force behind a firm's activities is profit maximisation. Hence the explanation for the existence of TNC's based upon management's desire to dominate labour. In this and the following section, the labour market will be ignored and attention focussed on the other ways in which TNC's enable profits to rise.

If a firm operates in a perfectly competitive product market, it receives normal profits. Clearly, because management

seeks the maximum attainable profits, it will attempt to get away from a perfectly competitive environment and dominate its product market. The crucial issue is: can it? If so, does this explain why some firms have production facilities in more than one country? In fact there are two ways in which firms get away from perfect competition and which have implications for the existence of TNC's.

The first is by the firm being the only producer of a particular good, and thus facing a downward sloping demand curve for its output, This can result from the production of a product for which there are no substitutes. More generally, however, firms will produce "differentiated products". Caves (1971) describes this:

> "A 'differentiated product' is a collection of functionally similar goods produced by competing sellers, but with each seller's product distinguishable from its rivals by minor physical variations, 'brand name', and subjective distinctions created by advertising, or differences in the ancilliary terms and conditions of sale. Differentiation is inherent in many products because of the number of minor options available in their physical design and fabrication, or because they are subject to taste diversity inherent in 'style'; but to some extent it is a (wasting) capital asset created by the firm through advertising outlays". (p.5)

For a firm to be able to exploit its downward sloping demand curve and earn above normal profits, it must be assumed that there are barriers to other firms producing the same good. This is a reasonable assumption. Insofar as the differentiation is based upon brand name or advertising, for example, the barrier is inherent in the product. Moreover, there may be other barriers to entering the industry, such as scale economies, access to raw materials - a

possibility that will later be pursued further - or, most importantly, excess capacity. See, for instance, Encaoua et al (1982).

Where do TNC's fit into this framework? Caves (1971) provides the answer, namely: if firms actually produce a good where it is marketed, they are in a better position to adapt it to local tastes. Consider the following scenario. Firm A produces good G in country X and sells it to consumers in countries X and Y. The fact that A is located in county X suggests that it can more readily observe the characteristics of consumers in X, and thus models G accordingly. However, if it observed consumers in country Y more closely, firm A might be able to take account of their peculiar characteristics and modify its product to increase profits. Vernon (1966) makes a similar point regarding the introduction of new products. I.e.

> "producers in any market are more likely to be aware of the possibility of introducing new products in that market than producers located elsewhere would be". (p.192)

Why?

> "There is good reason to believe ... that the entrepreneur's consciousness of and responsiveness to opportunity are a function of ease of communication; and, further, that ease of communication is a function of geographical proximity". (p.192)

The second possibility for escaping from a perfectly competitive environment is for firms in an industry to assume an attitude of live and let live towards each other, i.e. for firms to collude.

For example, in an industry comprising two firms selling an identical product, rather than engaging in blind competition that pushes product price down to the perfectly competitive level, the firms are likely to realise that, if they tolerate each other's presence, both can earn above normal profits. Baran and Sweezy (1966) makes this point:

> "The typical giant corporation ... is one of several corporations producing commodities which are more or less adequate substitutes for each other. When one of them varies its price, the effect will immediately be felt by the others. If firm A lowers its price, some new demand will be tapped, but the main effect will be to attract customers away from firms B, C and D. The latter, not willing to give up their business to A, will retaliate by lowering their prices, perhaps even undercutting A. While A's original move was made in the expectation of increasing its profit, the net result may be to leave all the firms in a worse position.
> ...
> Unstable market situations of this sort were very common in the earlier phases of monopoly capitalism, and still occur from time to time, but they are not typical of present-day monopoly capitalism. And clearly they are anathema to the big corporations with their penchant for looking ahead, planning carefully, and betting only on the sure thing. To avoid such situations therefore becomes the first concern of corporate policy, the sine qua non of orderly and profitable business operation". (p.67).

Thus, the existence of collusion derives from recognition of the "retaliatory power" of rival producers. Again, entry barriers are essential; existing firms in an industry cannot earn above normal profits if there are potential entrants ready and willing to drive down profits. However, as already stated, it is reasonable to assume that there are entry barriers.

As regards the existence of TNC's, the vital point to realise

is that a firm accomodates its rivals' presence because it cannot drive them from the industry. This is implied by the concept of retaliatory power. If circumstances arise in which rivals can be driven out, a firm will not hesitate to become a pure monopolist. Likewise, a firm will appreciate that rivals tolerate its presence because of its own retaliatory power.

Bearing this in mind, the literature on oligopolistic reaction and TNC's is of interest. Consider, for instance, Knickerbocker (1973). Suppose that rivals A and B initially serve the market in country X from production facilities outside X, but that A then acquires production facilities inside X. B's management could see A's move as posing important risks. For example, as regards production it could be that:

> "When firm A starts to manufacture in country X, its subsidiary management, and perhaps its headquarters management, are exposed to factor inputs and technologies that may differ in terms of type, quality, or cost from those previously encountered ... elsewhere. In responding to this new matrix of factors, firm A may find that it can use new raw materials, or it may devise new manufacturing processes, or it may even uncover new product possibilities. Moreover, information about the discoveries can be transferred to other parts of A's organisation". (p.26)

There are also marketing risks, e.g.:

> "First, A's subsidiary may take on the colour of a local, not a foreign-controlled, firm, thus reducing the threat to its sales of any

> nationalistic sentiment against foreign-produced goods. B, of course, has no such protection. Second, A's close proximity to the market place may permit it to tailor its advertising and selling campaign to local buyer characteristics in ways that B cannot do from a distance. One important consequence of this can be that A so well establishes its trademark or brand name in country X that B has little chance of securing a market franchise even if it should decide to invest locally in order to upgrade its own marketing efforts. Third, because A has its own supply of locally produced goods, it may have advantages in distribution, e.g. regional warehousing, not open to firm B. Alternatively, A may capture all or partial control of a distribution channel essential to the successful marketing of its, and B's, product. B then sells, if at all, at the mercy of A. Finally, if A's and B's products require after-sales servicing, firm A will almost certainly have a competitive edge over B since A has both parts and technicians locally available". (p.27)

Given these possible risks, Knickerbocker (1973) suggests:

> "prudence argued for the adoption of a risk-minimising strategy of industry rivals matching each other's moves. To illustrate, if firm B matched, move for move, the acts of its rival, firm A, B would have roughly the same chance as A to exploit each new foreign market opportunity. Thus for eachnew market penetrated by both A and B, B's gain, either in terms of earnings or in terms of new capabilities, would parallel those of A. And if some of firm A's moves turned out to be failures, B's losses would be in the range of those of A. Neither firm would be better or worse off. From the point of view of firm B, this matching strategy guaranteed that its competitive capabilities would remain roughly in balance with those of firm A". (p.24-25).

I.e., firm B simply does not know what advantages, if any, rival A will obtain from acquiring production facilities in country X, but fear that A will gain advantages implies that B follows.

Buckley and Casson (1976) criticise Knickerbocker (1973) on the fundamental grounds that the objectives of firms are never clearly stated. This is correct. It is by no means certain from Kickerbocker (1973) why firms pursue a risk-minimising strategy. Whilst it is reasonable to state that a firm will not undertake unnecessary risks, the risk-minimisation hypothesis goes too far. It implies that if a risk can be avoided, it will not be taken, no matter what the potential rewards. In reality, even though a firm may be risk averse - an issue that will be taken up later - it seems likely that it will take some risks. Nevertheless, the analysis in Knickerbocker (1973) has some relevance.

In a world characterised by collusion, the risks taken by B in not matching firm A ultimately reduce to one thing, namely : firm A may be able to acquire such a dominant position in market X , or sufficient new knowledge, that B can be driven out. Even if B does not mind taking risks, i.e. is risk neutral, this threat may induce B to acquire production facilities in X.

A more specific example may clarify the argument. Assume the initial position, in which both firms supply X by international trade, leaves B with profits of Π_b^* from that market. Suppose now that firm A acquires production facilities in country X. B has two choices. It either

(i) matches A, or

(ii) continues to supply X from elsewhere.

For simplicity, assume that if (i) is chosen, B obtains profits of Π_b^+, and if (ii), it will get zero profits with probability p and Π_b^* with probability (1-p), where:

p ≡ the probability B attaches to being driven from market X if it does not acquire production facilities in X.

The magnitude of p will depend upon B's assessment of the risks outlined by Knickerbocker (1973).

If (i) is chosen, B's profits are Π_b^+. If (ii), B's expected profits, $E(\Pi_b)$, are

$$E(\Pi_b) = (1-p)\Pi_b^* + p0 = (1-p)\Pi_b^*$$

Then, even if B is a risk neutral profit maximiser, it will acquire production facilities in X if $(1-p)\Pi_b^* < \Pi_b^+$. The higher is p, the more likely is B to acquire facilities abroad. If, for example, B is convinced that A will gain no advantage from producing in X, $p \to 0$ and B is unlikely to follow suit. Similarly, the higher is Π_b^+/Π_b^*, the more likely is B to match A's move.

The important point to note is that the acquisition of production facilities in other countries by rivals can alter the position of firm B. As a result, B may follow its rivals' lead. This results from the fact that firms maximise expected profits. It does not require that firms minimise risk. The difference from Knickerbocker (1973) is emphasised by the latter's conclusion that B

matches A's behaviour to guarantee that "its competitive capabilities would remain roughly in balance" with A's. But this rules out the reasonable possibility that B will only match A if it believes its profits will thereby exceed those expected from continuing to serve X by international trade.

Two further comments are necessary. Firstly, the analysis does not attempt to explain why firm A makes the initial move in acquiring production facilities in X. Secondly, it is an analysis of rivals supplying the same market. When collusion amongst rivals is particularly strong, they may decide to divide world markets between themselves - for example, firm A will be the only seller in country X, firm B the only seller in county Y. In such a situation, there is no question of matching rivals' behaviour. Both of these points are made very clearly in Knickerbocker (1973).

A closely related analysis pursued in particular by Graham (1978) is also revealing. This suggests a second plausible reason for the acquisition of production facilities in various countries as a means of defending an oligopoly position. Suppose initially that firms A and B produce and sell all of their output in country X. With no other rivals, these two pursue a policy of live and let live; i.e. they collude to maximise joint profits. However, firm C, producer of a similar good in country Y, then acquires production facilities in X and begins to sell in that market. Graham (1978) hypothesises that C's entry into X

> "is likely to disrupt established patterns of conduct within that market, since the foreign subsidiary engages in pricing and product

> strategies designed to capture some of the market share from local firms". (p.88)

To preempt C's becoming too disruptive, A and B could acquire production facilities in Y. This would be "a purely retaliatory defensive move" - if A and B can threaten C in country Y, it might refrain from disrupting the equilibrium in X.

Finally in this section, the peculiar importance of raw materials requires examination. Again, the analysis in Knickerbocker (1973) is a useful starting point. If firms A and B must use raw material R as an input in their production processes, both will be very concerned to secure reliable supplies of R. In such cases

> "contest among industry members over sources of supply for minerals or for other raw materials could be expected to prompt checkmating moves by rival firms. To a high degree success in such industries depends on how well firms operate at the extractive and processing stages of production. With respect to operation at these stages, firms try to counterbalance one another not only in terms of costs but also in terms of certainty and reliability of supply. That is, a firm will have the edge over its rivals should it have exclusive access to an especially low-cost source of raw materials or to a source that is much more assured than those available to rivals". (pp.28-29).

Again Knickerbocker (1973) refers to risk-minimisation, but the same general principle holds for profit maximisers. Each firm must retain its retaliatory power vis-à-vis rivals, otherwise it will be forced from the industry. Firms will therefore be concerned to secure good raw material supplies, which may require the acquisition of production facilities in various countries, especially when the geographical locations of supplies is fixed.

Moreover, this suggests two further possibilities regarding raw materials and industry entry barriers. As already indicated, barriers are particularly important to a firm's attempts to dominate its product market. Firstly, as Caves (1971) points out, if firms A and B can get control of the total supply of R

> "a new entrant to the processing industry must endure the extra costs and uncertainties of finding and developing his own source of raw materials". (p.11)

Clearly, this would pose a substantial entry barrier. The second possibility is, for example, that firm A's main activity is the extraction of raw material R from underground deposits. If A can acquire all sources of R, it will be a pure monopolist. No other firm could possibly enter the industry and produce the same product! Both of these cases may require the acquisition of production facilities abroad.

7. TRANSPORT COSTS AND GOVERNMENT TAXES

A third strand in the analysis of "why TNC's?" that needs discussion is the issue of transport costs and government taxes.

The concern of firms to maximise profits clearly requires that the costs of transporting a product from factory to market - and, indeed, between factories - needs to be taken into account when deciding where to produce. This is recognised throughout the existing literature. For instance, Vernon (1974) notes that where the costs of transporting a good to market X from country Y are high, production in X becomes more likely.

As regards taxes, firms will undoubtedly consider:

(i) import tariffs. It is again widely accepted throughout the existing literature that import tariffs in country X will encourage firms to actually produce in X. Tariffs are in fact similar to transport costs in the sense that they are only incurred by producers outside X. See, for instance, Caves (1971).

(ii) Investment subsidies. Some countries - for example, Eire - subsidise those firms willing to acquire production facilities within their borders.

(iii) Tax rates. Firms will bear in mind the differences in tax rates across countries on, for example, profits, and the possibility for avoiding these taxes by "transfer pricing". See, for instance, Hood and Young (1979).

The general principle that transport costs and taxes are important elements in firm's calculations is not controversial. They will influence location decisions. As such, extensive further discussion here is of limited value. Rather, it would be more fruitful to further compare some of the existing literature on TNC's with the general framework outlined in this and the previous two sections. Nevertheless, before turning to such an examination, an important point needs to be made, namely: firms are not passive in their relationships with governments.

Thus, Cowling (1982), for example, comments:

> "the rate of profits tax can be bid down by threatening to export investment, and similarly the rate of subsidy for investment can be bid up. Such threats will stimulate competitive profits-tax cutting and competitive subsidisation of investment by national governments, with each government seeking to maximise the rate of investment in its own country". (pp.146-147).

I.e. similarly to the way in which firms bargain with workers to increase profits at the expense of wages, they will also bargain with governments. The latter can be analysed analogously to the discussion of wage bargaining in Section 5.

8. A FURTHER COMPARISON WITH THE EXISTING LITERATURE

The aim of this section is to clarify and extend some of the points raised earlier. The section is divided into four parts. The first two briefly return to the imperfect markets and efficiency analyses. Attention is then given to other, more recent studies of TNC's.

8.1. Kindleberger (1969) Again

In Section 2 it was suggested that the interpretation of Hymer (1960) by Kindleberger (1969) is a good starting point for the analysis of "why TNC's?" This can now be explained in more detail.

Recall that Kindleberger (1969) argues: owing to the costs of operating at a distance, a firm with its administrative headquarters in, for example, the UK will only be able to acquire production facilities in the US if there is a market imperfection. The

criticism of Buckley (1981) runs: established TNC's do not encounter costs of operating at a distance. The analysis presented in this paper is clearly very similar to Kindleberger (1969) insofar as the domination of labour and product markets, for instance, is all about imperfect markets. Indeed, literature in the Kindleberger (1969) tradition, for example, Caves (1971), is used to elucidate some important points. See also Yamin (1980). However, there is a subtle, but vital distinction which in fact enables the criticism in Buckley (1981) to be avoided.

Whereas Kindleberger (1969) begins with costs of operating at a distance and concludes that markets must be imperfect, the analysis of Sections 5-7 begins with an explanation of why markets are imperfect and concludes with the implications for why there are TNC's. Thus, the latter cannot be criticised on the grounds that established TNC's will not incur any additional costs in comparison to NC's. Buckley (1981) is quite right. But the fact remains that established TNC's operate in a world of imperfect markets. Taking this as the foundation for an analysis avoids any unnecessary confusion.

8.2. Efficiency Again

The efficiency approach implied by the internalisation concept was also considered in detail earlier in the paper. It was contrasted with the emphasis on distribution in the separate and dominate framework.

In addition, it should be noted that a framework based upon product market domination is very different from the internalisation

analysis. Again, the fact that a firm seeks product market domination implies that, when TNC's are observed to exist, it cannot be presumed that they represent the most efficient outcome. I.e. in becoming a TNC, a firm may increase its profits as compared to its next best alternative, but it is by no means certain that consumers of the firm's products are not worse off.

This proposition raises a hornets' nest of controversy surrounding, for instance, the implications for consumer utility of product differentiation via advertising. Nevertheless, one example suffices to establish its validity. Consider the case where a firm acquires production facilities in various countries to prevent others from entering its industry. The existence of entry barriers implies a higher product price than would otherwise be the case. Assuming their money incomes are unchanged, consumers of the firm's product are therefore worse off.

Similarly, if a firm bargains with governments over its tax bill, distribution is the crucial issue. The essence of bargaining is a problem of distribution. In this case, a firm against governments.

Thus, any analysis of TNC's that merely refers to efficiency is inadequate. The notion of distribution must be at the heart of any worthwhile framework.

8.3. Diversification

Rugman (1975) suggests that a firm will have production facil-

ities in various countries because the consequent international diversification of production will reduce the "risk" (variance) of profits. It is argued:

> "On a theoretical level a multinational firm will provide greater benefits to its shareholders than will a comparable firm which has few foreign operations. This is because individual investors are concerned about the risk of their earnings as well as the expected rate of return. In an international setting it may not be possible for investors to achieve portfolio diversification themselves, especially if there are institutional, or other, barriers to the free flow of financial capital. Instead, such investors can purchase the shares of multinational corporations and thereby enjoy the benefits of international diversification". (p.571).

Consider a firm with its administrative headquarters in country X. Its "foreign operations" are defined as its exports from X, plus the sales from its production facilities outside X. The idea is that exports increase the "stability" of profits because they constitute sales in different environments. Similarly, producing in various countries increases stability because production conditions will vary across countries, e.g. different union policies, weather conditions, etc. See also Rugman (1977).

The first point to note is the lack of clarity over the manager/shareholder distinction; by implication, shareholders control a firm's activities, presumably with managers as their agents. In contrast, Section 5 depicted the typical firm as controlled by managers. What of shareholders? Miliband (1969), drawing upon earlier work in a discussion of the class divisions in "advanced capitalist countries", notes:

> "It has, of course, long been recognised that the managerial element is very largely immune from the control and even from the effective pressure of individual shareholders; and the bigger the enterprise, the more dispersed its ownership, the more complete is that immunity likely to be". (p.29)

Nevertheless,

> "the notion of separation can, in terms of managerial ownership, be pushed too far. For, as has often been observed, managers are often large stockholders in their enterprises". (p.34).

Thus, the possibility that shareholders per se wish to stabilise profits is of little consequence. What matters is whether or not management desires this end.

Do managers desire international diversification to stabilise profits? The essence of Rugman's analysis is that firms are rise averse profit maximisers - see also Buckley (1981). It has already been indicated in Section 5 that managers may be risk averse, and they undoubtedly seek maximum profits. Clearly, it is feasible that they acquire production facilities in various countries to stabilise profits. A simple example can be used to illustrate this outcome.

Suppose firm A faces two options:

(i) to supply its market solely from production in country X, realising there is an even probability that a holocaust will totally destroy X. Suppose that, if there is no holocaust, A obtains profits of 100 units

(ii) To supply its market from production in countries X and Y, knowing that Y will not be destroyed, but that supplies from Y incur import tariffs. Suppose that, even with no holocaust in X, maximum profits under this option are 75 units - less than under (i) because of the tariffs - whilst if X is destroyed, production from Y yields profits of 25 units.

Both options give the same expected profits, but profits under (ii) are more stable. I.e. their variance is less, $(25)^2$ rather than $(50)^2$. Consequently, (ii) is preferable to (i) for the risk-averse profit maximiser. This is depicted by an expected utility framework in Figure 3. The curve represents the utility management derives from a level of profits obtained with certainty. The utility from an expected level of profits is given by a linear combination of points on the curve. For instance, points B and C represent utility from a certain profit of 25 and 75 units respectively; the utility from an even chance of receiving profits of 25 or 75 is given by the mid-point of the straight line joining B and C. Thus, D is the utility derived from option (ii). Similarly, E is the utility from (i).

The crucial question is: how important is risk aversion as an explanation for the existence of TNC's? Whether or not managers are in fact risk averse is ultimately an empirical issue, and therefore will not be pursued here. However, two points need to be mentioned. Firstly, it is at least clear that risk aversion is not all that matters; e.g. TNC's will exist because managers seek to dominate their workforce, regardless of the possibility of risk aversion. Secondly, if managers are risk averse, their concern is not simply

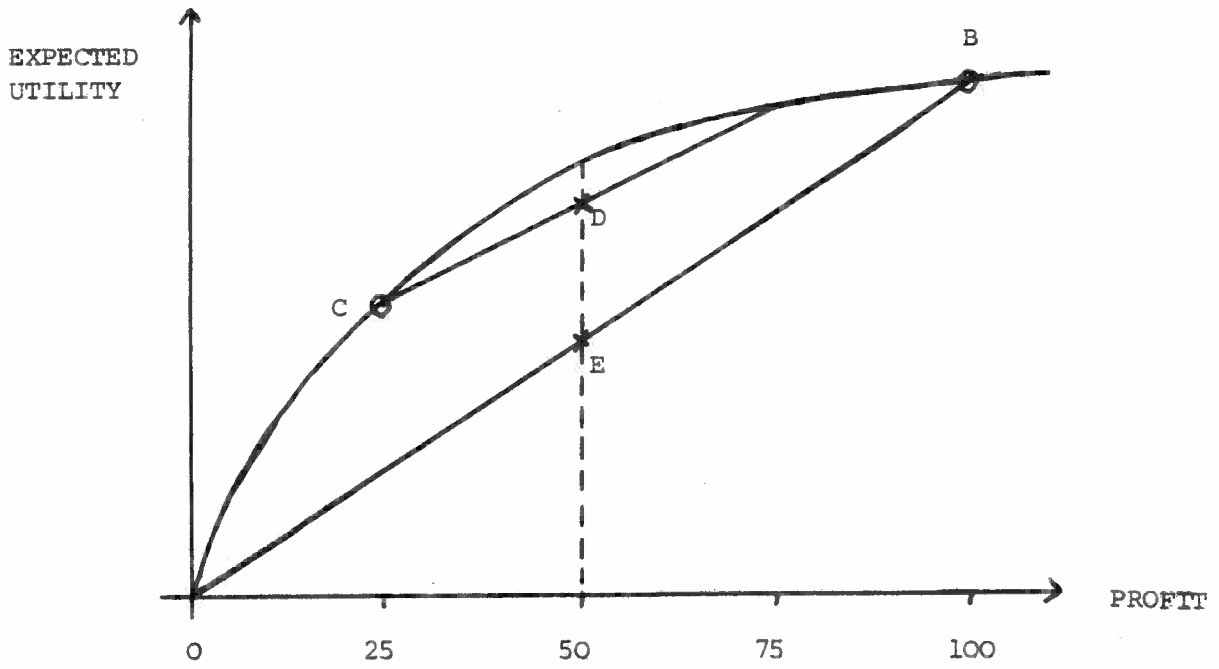


FIGURE 3 : International Diversification and Management Utility; An Example

with the probability of a holocaust. Uncertainty surrounding any determinant of profits - including, for instance, bargaining power vis-à-vis workers - will be of influence.

8.4. Dunning's "Eclectic Theory"

Dunning (1977), (1979), (1980) and (1981) has put forward an eclectic theory which purports to explain the acquisition by firms of production facilities in various countries. Because it represents a substantial section of the literature, this needs to be considered. But it is truly eclectic and therefore suffers from criticisms of the existing literature made throughout this paper.

Suppose firm A initially has all of its production facilities, and its administrative headquarters, in Great Britain, i.e.

it is a British corporation. Dunning (1979) highlights three conditions that A must satisfy if it is to acquire production facilities in other countries:

> "(1) it possesses net ownership advantages vis-à-vis firms of other nationalities serving particular markets. These ownership advantages largely take the form of the possession of intangible assets, which are, at least for a period of time, exclusive or specific to the firm possessing them.
> (2) Assuming condition (1) is satisfied, it must be more beneficial to the enterprise possessing these advantages to use them itself rather than to sell or lease them to foreign firms, i.e. for it to internalize its advantages through an extension of its own activities rather than externalize them through licensing and similar contracts with independent firms.
> (3) Assuming conditions (1) and (2) are satisfied, it must be profitable for the enterprise to utilize these advantages in conjunction with at least some factor inputs (including natural resources) outside its home country; otherwise foreign markets would be served entirely by exports and domestic markets entirely by domestic production". (p.275).

These three factors are seen as interrelated. For example, Dunning (1981) distinguishes between two kinds of ownership advantage:

(i) Those generating income "whether their use is externalised or internalised", e.g. most patents.

(ii) Those generating income only "if they are internalised within the firm". The link between ownership advantages and location is noted by Dunning (1980). I.e. a firm's ownership advantage may derive from the fact that it operates in different locations, for example a TNC's ability

> "to reduce the impact of strikes or industrial unrest in one country by operating parallel production capacity in another ..." (p.10)

How does this compare with the view put forward in this paper? The important point is that Dunning asserts Firm A must satisfy all three conditions. Condition (1) is drawn from the Kindleberger (1969) tradition, and means that A can produce outside Britain despite the disadvantages of operating at a distance. Conditions (2) and (3) mean that, given (1), it will produce outside Britain. The concept of internalisation in (2) is taken from the strand of the literature characterised by Buckley and Casson (1976). Thus, Dunning interprets the literature differently to the view given in Sections 2 and 3. Internalisation as perceived by Buckley and Casson (1976) is a general principle underlying the issue "why firms"?. It explains, on its own, the existence of firms. Not only is the concept of ownership advantages unnecessary, it is actually wrong to even include it as a separate condition. This is recognised in Casson (1980).

However, it could be argued that, in (2), Dunning is merely concerned with the licensing option; i.e., internalisation means that a firm will use its ownership advantages itself rather than license others to do so. For Dunning, "internalisation" then has a different meaning to that suggested by Buckley and Casson (1976). There is no implication of efficiency, merely "benefit to the enterprise"- i.e. more profits. The comment on industrial unrest in Dunning (1980) supports this view, which is consistent with the approach in Sections 5-7. But compare a comment in Dunning (1981)

referring to advantages of internalising rather than externalising an activity:

> "internalising advantages reflect the perceived efficiency of multinational hierachies compared with market mechanisms as asset administrators and allocators". (p.31)

It is at best unclear exactly what the eclectic theory really means. Moreover, there is nothing to be gained from further discussion of its exact meaning. If it follows Buckley and Cassson (1976), it suffers from the drawbacks with that analysis. If it does not follow Buckley and Casson (1976) and is consistent with the analysis of Sections 5-7, it certainly fails to pursue the analysis very far.

In addition, the notion that a firm must have an owernship advantage before it can acquire production facilities in various countries perpetuates the deception of Kindleberger (1969) explained in the first part of this section. That is, following the point raised by Buckley (1981), there is no necessity for established TNC's to have an ownership advantage. Nevertheless, they will possess advantages because firms in fact operate in imperfect markets, to some extent deliberately.

9. CONCLUSIONS

Why are there TNC's? Two particularly important factors have been highlighted:

(i) the conflict between managers and workers, leading to the concept of separate and dominate.

(ii) The attempts by each firm to get away from a perfectly competitive product market - i.e. to dominate product markets.

Given this environment, transport costs and government taxes will also be important and, possibly, risk aversion on the part of managers. The common element in all of these factors is profit maximisation. That is, TNC's exist because they represent the means by which firms obtain maximimum profits. Moreover, problems of distribution are at the heart of the analysis.

This view is in stark contrast to the tradition in the literature represented by Kindleberger (1969), and Buckley and Casson (1976). It also conflicts with Dunning's eclectic theory. Nevertheless, it draws upon and uses much of the existing "orthodox" literature.

However, this paper merely presents a general approach to the problem. There is undoubtedly a need to develop these ideas - particularly as regards the concept of separate and dominate, and the issues surrounding product market domination - a great deal further.

FOOTNOTES:

1/ Kindleberger (1969) refers to "direct investment in a foreign country". For the purposes of this paper, it suffices to define direct foreign investment as the acquisition by a firm of production facilities in countries where it does not have its administrative headquarters.

2/ Buckley (1981) refers to "multinational firms". For the purposes of this paper, they are the same as transnational corporations.

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