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The theory of international business pre-Hymer☆

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ABSTRACT

This paper examines the theory of international business before 1960 when Stephen Hymer wrote his seminal thesis. It is shown that there existed a considerable amount of theory, but this was uncodified, unsystematic, fragmented and not institutionalised in a single academic discipline. Hymer achieved his insights in a parsimonious fashion, but this has resulted in some interesting and relevant theory being subsequently ignored. It is of considerable benefit to international business theorising to revisit this earlier theory and to recognise its insights.

1. Introduction

It is conventional to date the genesis of international business theory to the PhD dissertation of Stephen Hymer (1960, eventually published in 1976) The International Operations of National Firms (Buckley, 2006). It would be fairer to date the start point to John Dunning's 1958 book American Investment in UK Manufacturing, on which Hymer relied for empirical data, but taking a 1960 date for the beginnings of a widely accepted theory of international business provides a useful cut-off point.

There was, in fact, a great deal of international business theorising before 1960 but it simply did not have the required labelling. It existed in fragments, not in a unified and packaged form.[1] Hymer and Dunning provided synoptic views of the multinational firm which have been refined and improved upon since 1960. This article suggests that useful insights and partial theories were extant before our conventional starting date. Indeed, it is further argued that many theoretical advances have been ignored, or forgotten, largely because of the terminology in which they were expressed or because they were embedded in empirical, descriptive or wide ranging writings.

Intellectual history is written backwards. It is arguable that insights and fragments of theory only become relevant once the tide of theorising has passed them by, and in the light of these advances, they then look relevant. Alternatively, there may be insights and advances that have been overlooked in the light of general theoretical advance. David Teece believes that "Hymer could write on an almost clean sheet of paper" (2006, p. 138). Teece (2006, p. 126) says "Hymer's insights laid the foundation for a new paradigm of the multinational enterprise. Admittedly, there was not much in place at the time that might be characterized as a theory of MNE. He touched upon many important ideas; the weakness of his analysis is that he did a poor job of sorting amongst them, and elaborating the more promising". This paper examines the truth of this claim and attempts to evaluate writings on the multinational enterprise and foreign direct investment before 1960.

There is a profound and important interaction between theorising and empirical work in the social sciences. Theories are necessary to define areas of interest, to group similar and divide dissimilar phenomena and to track changes in important social and economic categories. Theory and definition interact by gradually, repeatedly and continually redefining concepts. This interaction between theory, empirical investigation and conceptual refinement is also reflected in the collection of social "facts"—in our case, statistics. International business provides an important case study of the development of these processes. From the time of Dunning (1958) and Hymer (1960), a recognisable subject area grew. Before these seminal works, it seems, there was little conceptualisation

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[1] John Dunning and Sarianna Lundan (2008) sum up their views as follows:

"Prior to the 1960s there was no established theory of the MNE or of FDI. Attempts to explain the activities of firms outside their national boundaries represented an amalgam of:

1. A fairly well-formalised theory of (portfolio) capital movements (Iversen, 1935);
2. A number of empirical and largely country-specific studies on the factors influencing the location of FDI (Barlow, 1953; Dunning, 1958; Marshall et al., 1936; Southard, 1931);
3. A recognition by some economists, notably Williams (1929), that the internationalisation of some industries required a modification to neoclassical theories of trade;
4. An appreciation that the common ownership of the cross-border activities of firms could not only be considered as a substitute for the international cartels and combines (Plummer, 1934), but could also be explained, in part at least, by the perceived gains of vertical or horizontal integration (Penrose, 1956; Byé, 1958a): and
5. An extension of the extant theory of international capital movements to embrace the role of entrepreneurship and business competence (Lund, 1944). Lund refers to this combination of entrepreneurial ideas and financial capital as an 'international wandering combination'."

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and theorising in international business. This article will show that important, if fragmentary, work had been completed before 1960. Some of it suffered from a concentration on issues of management and business strategy rather than on theorising (plus ça change!) In other cases there was a confusion, or a lack of recognition, of levels of analysis. In international business the choice of level of analysis (manager, firm, network, nation, world economy) is often difficult. It is also difficult to control for the impact of the other levels whilst concentrating on one–ceteris paribus is difficult to maintain in a dynamic situation (Buckley & Lessard, 2005). Careful distinctions were often not made in the pre-1960 literature—between direct versus portfolio investment, between different forms of foreign market servicing, between ownership (internalised) and non-ownership (arms length, contractual) international modes of doing business and between different forms of internal foreign operation (branch, subsidiary, licensee). The nature of the multinational enterprise as an institution was not explored in depth.

The following sections examine the available literature on international business and the multinational enterprise from the standpoints of economics including writings on cartels up to 1960, theories of imperialism and then the literatures extant on international competitiveness, managing foreign operations (international management), foreign direct investment and multinational enterprise are reviewed. The emergence of modern theory is traced from the 1950s up to the time of Hymer's thesis and the conclusion brings together the material both that Hymer did use and literature that he could have used.

2. The heritage of economics

Hymer (1960) wrote his thesis in the tradition of economics, but did not acknowledge many intellectual debts. Bain (1956), Iversen (1935), Arndt (1957), Penrose (1956) and Wu (1946) of Hymer's economist precursors are included in his bibliography. But these are a mere selection of the rich economics literature on foreign direct investment extant in 1960 (e.g. Cairncross, 1953).

3. International economics

The difficulties of incorporating capital movements into (international) economics are astutely summarised in the following quote by Nurkse (1933) "The theory of capital movements has not been treated systematically, so far, in the literature of economics. The reason for this neglect may well be found largely in the fact that the classical doctrine of international trade, the theory of comparative costs, rests on the fundamental assumption that while the factors of production, labor and capital, are freely mobile inside a given country, they are lacking external freedom of mobility. This basis premise of the international immobility of capital seems to have prevented the possibility of a theoretical approach to capital movements, at least from the standpoint of international trade theory. It is significant that whenever the so-called problem of transfers comes up in the orthodox theory of international trade, the discussion is always concerned with indemnity payments between governments and matters of this kind, never with spontaneous, economic money transfers, i.e. with capital movements in the strict sense". English translation from Dunning (1972, p. 97).

This difficulty was progressively eased by Nurkse (1933), Jasay (1960), MacDougall (1960), among others, by an analytical device that treated foreign investment as a marginal addition to the host country's capital stock. Progressive removal of restrictions on the restrictive assumptions surrounding this model enabled theoretical deductions about the impact of foreign investment to be made. It is fair to say that by 1960, the model was being stretched to breaking point and no real allowance for the "directness" of FDI was being made. A separate theory of FDI was clearly required.

4. Industrial economics

Industrial economics discusses industrial structure as made up of the size of firms, entry conditions, concentration, vertical integration and diversification. Each of these factors has an international dimension and each had rich discussion in the specialist literature before 1960. For instance, the role of vertical integration in the creation of international companies was extensively analysed in McLean and Haigh (1954) with respect to oil companies. The international dimension of each element of industrial structure had not been brought together and had not been combined with international economics, largely because of the different traditions and starting assumptions from which each evolved. Hymer did rely heavily on Bain (1956), utilising "the types and strength of advantages in connection with his study of the conditions of entry" (Hymer, 1960, p. 42 referring to Bain, 1956).

The period immediately before Hymer's thesis was a rich one in industrial economics. Not only Bain's (1956) classic work on competition, but also Penrose's seminal Theory of the Growth of the Firm (1959) and John Dunning's (1958) empirical study had appeared. Hymer quoted Penrose's (1956) article on "Foreign Investment and the growth of the firm" and was therefore influenced by some of Penrose's key insights. It should be noted that Hymer (1960) made the crucial distinction between FDI (internalised transactions) and licensing (externalised transactions). This led to the incorporation of Coasean ideas into international business by Hymer (1968), Buckley and Casson (1976) and by Dunning (1977) (Coase, 1937). For Hymer (1960) the distinction was in terms of control, not ownership.[2] This distinction came to be the basis of much of the foreign entry mode literature (e.g. Sanchez-Peinado & Pla-Barber, 2006). The conceptual and methodological distinctions that Hymer made between different modes of foreign operation and their governance implications (for instance between FDI and licensing) "arguably established Hymer as the founder of the modern theory of the MNE and FDI" (Dunning & Pitelis, 2008, p. 167).

5. Cartels—a neglected body of literature

A considerable body of theory was developed on cartels from the last few decades of the nineteenth century to the post World War II era, reaching a formalised statement in Fellner (1949). Cartels were first seen as primarily a domestic phenomenon in Germany: Hexner (1946, p. 3) writes that "Eugen Richter first used the term cartel publicly on May 5, 1879, in a meeting of the German Reichstag". Then in Britain, France and the USA attention was drawn to the power of cartels. Burns (1936, pp. 456–460) talks of the "territorial integration" of cartels, but by 1946 Hexner's book is entitled International Cartels and Mason's is Controlling World Trade: Cartels and Commodity Agreements (Mason, 1946). Casson (1985a) and Wilkins (1977) both make the point that the growth of (international) enterprises is greatly bound up with cartelization. The parallels between integrated multinational firms and international cartels are instructive. As Casson (1985a) points out, cartels are more likely to be chosen as the favoured institutional form under conditions of product homogeneity, the absence of economies of scale, low capital intensity, static technology, a general absence of innovation and a high risk of appropriation of foreign assets. The absence of these conditions is a set of

[2] I owe the emphases of this paragraph to an anonymous referee. For other works on Hymer see special issues of *International Business Review* (2006) and *Contributions to Political Economy* (2002).

circumstances favouring the creation of MNEs (Buckley & Casson, 1976). The literature on cartels is therefore useful in examining MNEs and FDI even if from a counter-factual viewpoint (cartels as a substitute for the integrated MNE).

6. International business as the logical intersection of industrial economics, international economics and the theory of the firm

Casson (1985b) argues that "the theory of FDI is a logical intersection of three distinct theories—the theory of international capital markets, the theory of the international firm, and the theory of international trade" (p. 114). His summary following this quote lists very much the same factors as covered here under international and industrial economics and the theory of cartels and contain echoes of another old debate on "overforeignisation" (Überfremdung) (Benaerts, 1933). In 1960 it was much more difficult to see these elements as contributory factors in an overarching theory of FDI. Theories of imperialism were extant and had an overarching element but they did not focus on the level of the firm (the MNE), the key actor in FDI.

7. The literature on imperialism

A parallel tradition of work on which Hymer could have drawn but did not (ironically, since he later became a Marxist) was economic theories of imperialism. J. A. Hobson belonged to the left wing of the British Liberal Party and was an opponent of imperialism. Hobson was an advocate of an active social policy and, in essence, a free trade who believed that, in principle, capitalism was capable of bringing a new and more humane world order (Townshend, 1990). Hobson's Imperialism (1902) argued that the expansion of the British Empire was directly connected to the huge increase in British overseas investment. He suggested that the decisive factor in imperial expansion was the attempt of financial capitalists to find profitable investments overseas in the face of saturation of the home market. Diminishing returns at home were due to under-consumption because of the relative poverty of the lower classes and excessive "over-saving" to accumulate capital by the upper classes. Inadequate purchasing power therefore led to the search for profitable outlets for capital in captive colonial markets. Hobson's copious statistics suggested that British foreign investment was directly linked to the relative stagnation of the domestic economy and the low standard of living (and purchasing power) of the working class. Hobson saw imperialism as a loss from the point of view of society at large. His statistics pointed to the fact that colonial trade was of marginal importance compared to British trade with Europe and there were huge administrative costs in organising the Empire. However, it was not the trader nor the entrepreneur that gained but the investor—the true capitalist. Interests rates in Britain were at an historically low point and overseas returns on capital were high (although they were riskier). Overseas investment doubled between 1880 and 1913 and it was natural to associate this with stagnation and underconsumption (Mommsen, 1980). Hobson's solution was a social programme that would increase the purchasing power of the masses. The way to overcome imperialism was not to do away with capitalism but to remove the monopolistic structures that resulted from an anachronistic social order. Imperialism was a transitional state on the road to an advanced democratic social order.

Schumpeter (1951, written 1918/19) also did not regard imperialism as the highest form of capitalism but as the irrational expansionist tendencies of an outmoded social order. Indeed imperialism was alien to a free market capitalist society. The forces of competition and autonomous entrepreneurs would, in the absence of restrictive and protectionist policies implemented by a pre-capitalist aristocratic class, destroy monopolistic structures and with this, imperialism.

Marxist analysis saw imperialism as much more intrinsic to capitalism. Imperialism was seen as staving off the inevitable (to Marxists) stagnation brought about by increasing inequalities. Rudolf Hilferding, an Austrian Marxist who became a leader of the German Social Democratic Party and Finance Minister of Austria (1928–1929) published Das Finanzcapital in 1910. He portrays imperialism as a stage of development beyond free trade. Hilferding describes the emergence of large concerns, trusts, cartels and combines, protectionism and dumping as culminating in the predominance of banks or "finance capital". In contrast to Schumpeter, Hilferding argues that monopoly capitalism and imperialism are a logical stage of development of capitalism. Finance capital is also diametrically opposed to lassez faire capitalism and competition. The absence of earlier capitalist "crises" was due to the opening up of new territories at the turn of the nineteenth century. Finance capital links to the dominance of a tight capitalist oligarchy. The dominance of banks links closely to the particular development trajectory of Germany.

Bukharin (1918) saw imperialism as the intersection of two conflicting trends in the world economy: internationalisation and nationalisation (Radice, 1975). Internationalisation represents the spread of capitalist economic relations throughout the world economy and nationalisation the concentration of capital in larger combinations (trusts and cartels) leading to larger firms and links to the home state. Like Hilferding, Bukharin saw banks as crucial to these processes.

Rosa Luxemberg (1913 translation 1951) proposed that overseas markets were necessary for the continued existence of capitalism, to prevent under consumption and to realise the untapped surplus value of capitalist production in industrial countries by transferring it into foreign investment capital. The corollary of this was that imperialism extended the life of capitalism until, of course the final cataclysm arrived—and Luxemburg drew a link between imperialism and militarism (Frolich, 1940). Luxemburg's arguments were not welcomed in Marxist circles because of the implied longevity of capitalism.

Lenin wrote Imperialism: the Highest Stage of Capitalism in Switzerland in 1916 and drew on the thinking of Hilferding and Hobson. Imperialism involved a temporary postponement of the inevitable capitalist collapse. It predicted the formation of international monopoly capitalist associations that divided the world economy amongst themselves but led to steadily increasing conflict. Lenin also foresaw the "usurer state" relying on rentier income.

The role of firms themselves (and therefore of foreign direct investment) is not specifically addressed in theories of imperialism. Indeed, it can be argued that shareholders of imperialist or colonialist firms were never particularly happy to export capital. Wilson (1954, p. 110) quotes William Lever himself averring that his shareholders were never anxious (in the 1890s) "to put too much money in these associated companies" (Barratt Brown, 1974, p. 201). Theories of imperialism did draw attention to the divergent interests of rentiers, business managers/entrepreneurs and financiers. (Casson (1985b) points out that the development of capital markets makes such functional separation possible.)

Theories of imperialism are pitched at the macro economic level and lump all capital exports into an undifferentiated mass. However, the long term dynamics are worthy of consideration and the institutional setting of both home and host countries are demonstrated to be important. The underlying issue that is unresolved is the role of technological progress. This is both an antidote to stagnation and gives a dynamic to the system as a whole that invalidates the "oversaving" alleged to stall

development in these models. Given the current theoretical attention to institutional explanations of FDI, the theories of imperialism are worth consideration. Theories of imperialism also focus attention on (increasing) concentration among large firms and oligopolistic competition.

8. International competitiveness

One of the earliest places to look for international business theory is the work of writers on national competitiveness. This goes back to the concern of mercantilist writers to build the 'national treasure' by ensuring a surplus of exports over imports and thus an inflow of 'specie' (under the gold standard as inflows of gold) (Mun, 1664). Concerns also arose over foreign investment, notably over the efficiency and management of (Chartered) trading companies such as Adam Smith's (1776) criticisms of the governance of the (British) East India Company. Smith's criticism is of joint stock companies in general but he felt that his was especially objectionable when "joint stock" (or chartered) companies ventured into international business. "Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company. It is upon this account that joint stock companies for foreign trade have seldom been able to maintain the competition against private adventurers. They have, accordingly, very seldom succeeded without an exclusive privilege, and frequently have not succeeded with one. Without an excusive privilege they have commonly mismanaged the trade. With an exclusive privilege, they have both mismanaged and confined it (Smith, 1776/1976, ii, 264-5). Smith argues that the principal-agent problems of joint stock companies in general become compounded with costs of doing business abroad and problems of monopoly, here confined by regulations restricting entry (the "Charter" itself). These are all very modern concerns—governance, "costs of foreigness" and imperfect competition!

The threat to the previously dominant British manufacturing base from Germany, U.S.A. and France in particular led to demands for protection of British industry against foreign competition in the period up to the First World War. A turn-of-the-century example is provided by Williamson's (1894) British Industry and Foreign Competition. This is essentially a polemical case for protection of key industries and for a move away from the traditional (by then) pro-free trade stance of Great Britain. The arguments on foreign investment are confused and not linked to the trade arguments (a common problem that still persists). Distinctions are not made between portfolio and direct investment, the notion that firms can have a strategy (least of all a global strategy) is missing and the argument is cast as a "migration of manufacturing capitalists" issue. The argument is that entrepreneurial skill is scarce and the migration of capitalists reduces domestic capability and strengthens foreign manufacturing locations. The fact that capitalists also take capital with them strengthens the argument.

Williamson makes the tariff–jumping motive for foreign migration of capitalists central. British firms (he alleges) cannot export to the foreign markets therefore capitalists migrate to protected markets. Protection therefore denies British companies access to foreign markets but also induces British capitalists to move there. Interestingly, he implies that British free trade policies do not encourage inward migration of capitalists "While, everywhere, we meet here (Britain) foreign agents, striving to push the sale of their wares, there is not, so far as we know, even one instance of a foreign manufacturer transferring his works to this country. Why should he? By manufacturing abroad, he retains his own market, with its cheaper labour, which did he come here he would lose, while by remaining where he is, he has both markets" (Williamson, p. 205). In this quotation, we can see that Williamson comprehends market-orientated foreign investment as the primary motive and has an efficiency motive for location, based solely on labour costs. Given the conditions of the time, his analysis has some merit.

The lack of analytical distinctions between shifts in location and domicile of manufacturing, and between portfolio foreign investments and direct foreign investments lead to all of these different issues being condemned as migration of manufacturing and therefore as deadweight losses to Britain. The loss of competitiveness of Britain as a manufacturing location for (often) labour intensive production, such as textiles, is mixed with arguments on protectionism and with company strategies as firms seek to find the optimum production locations using a mix of the three different "migration" strategies. Williamson lists close and move transplant strategies (Marshal & Co., flax spinners of Holbeck, Leeds to new mills in Massachusetts) together with the opening of branches (manufacture in Germany including lace, Mudellas hosiery works in Saxony, Titus Salt (Bradford) in America, Wilkinsons lace in U.S.A.) and even foreign takeovers (the purchase of the South Boston Iron works by "an English syndicate"). This illustrates the importance of distinctions between different kinds of migration of industry and the need to integrate the theories of trade and foreign investment.

9. Managing foreign operations

Dudley Maynard Phelps (1936) Migration of Industry to South America is a remarkable book beginning the tradition of what we now call "International Management". Phelps's chapters (8) "Policies of migrating companies", (4) "Difficulties encountered by migrating firms" and (7) "Operating Differences and Difficulties" are excellent discussions of the management of operations abroad and the familiar tension of local and global pressures on multinational firms.

Phelps saw that "Industrial migration involves not only the exportation of physical products and of capital but also the transfer of managerial abilities and industrial techniques. It may be considered a hybrid of foreign trade and foreign investment, with a greater measure of managerial supervision and control" (1936, p.v). This is a startlingly modern view. Phelps also differentiates earlier migration of industries from the period he is analysing by the fact that "All ties with the parent organisation were cut, and the new industrial enterprise lacked connection with the old" (p.vi). Control from the parent, the distinguishing feature of FDI, was crucial.

Phelps's analysis of motives for migration (FDI) is also modern. He lists "the influence of raw material resources", "production incentives" (relative cost of production abroad compared to home), "the effect of competition", tariff jumping and "marketing inducements to migration". The third and fifth of these motives require expansion. In "The effect of competition", Phelps theorises that market size and the nature of competition (from importers, local firms or other foreign branch plants) will influence the FDI decision. He adduces "first mover advantages"—"securing an early foothold on a manufacturer conceivably might, forestall like action by competitions" (p. 58) and he suggests that local demand might be increased by "the presence effect" (p. 58). The assessments of current and likely future market size and competition are argued from interviews with parent company executives and competitive strategies are analysed. In "marketing inducements to migration", Phelps suggests that with local production, there is less need for forecasting demand, greater flexibility in meeting local demand, lower transportation costs, better adaptation of product to market needs, superior control over distribution and the ability to tap "national sentiment" (p. 83) by playing to the "Buy at Home" attitude. This is a precisely argued and documented list of the marketing advantages of a local presence. In summarising motives,

Phelps resist a single cause explanation and gives due weight to uncertainty in the investment decision, prefiguring Aharoni (1966).

The modern concerns about the "costs of foreignness" are covered by Phelps. He includes "distance from the Home-office organisation", "prejudice against foreign capital", "race and nationality factors" and "lack of stability in (host) Government" among the key difficulties encountered by migrating companies. He also adds "lack of information on which to base decisions" as a difficulty. Overestimation of market size he pinpoints as the most usual mistake.

It is probably Chapter 8 of Phelps's book "Policies of migrating companies" (reproduced in Buckley, 2003) that makes the greatest contribution to theorising international management. Phelps's recommendation is clearly to "glocalize". "A firm that attempts to stimulate the economic development of a country, which attempts to become as national as possible, which, in a sense, merges its interests in the national economy of which it is a part, is more likely to enjoy successful, long continued operation. It will be considered a part of the national economy, rather than an extraneous element, even though it is of foreign origin. By following these policies, a company strengthens its position against prejudicial action by governmental agencies" (p. 287).

Phelps's conceptual and theoretical work has been largely ignored and then bypassed. An unfortunate bifurcation has occurred latterly between "international business" theory and "international management". This was not evident in the works of Phelps (1936) who, not seeing this separation, ignored it, and managed to integrate management practice with theoretical insight. Hymer cites Phelps as a source of empirical information (Hymer, 1960, p. 109, p. 155 [where Hymer gets the date wrong!], p. 156) but not as a source of theoretical insight.

J. Fred Rippy's Latin America and the Industrial Age (1944, second edition 1947) assumes that foreign investment in Latin America will be temporary, economic nationalism requiring disinvestment after a time. "Latin American leaders are convinced that political independence has little meaning without a large measure of economic independence, and foreign investors will continue to feel the pressure of this conviction. In the use of new processes and techniques to produce new commodities or improve the quality of old ones, however, opportunities for foreign pioneers will always be found, and no serious grievances need arise provided the pioneers can reconcile themselves to the transitory nature of their operations. The future seems to promise no abatement of economic nationalism in the retarded countries" (1947, p. 240). This strong version of the "obsolescing bargain" was a stark prediction.

10. Foreign direct investment—the concept

Until the development of statistics that separated "direct" from "portfolio" foreign investment (see Brecher & Reisman, 1957) the conceptual isolation of direct foreign investment was not complete (see for instance Jenks, 1927). Lewis (1948, pp. 25–27) explained foreign investment largely in respect of the "capacity to invest abroad", an analogue of the excess of exports over imports rather than as a reflection of the relative competitive ability of different national firms. This macro, impersonal approach fitted with an interest rate driven model of flows of funds. The inter-war period saw a gradual process of conceptual clarification.

Staley (1935) is clear that direct investments are dependent on the transfer of management as well as capital. "In the case of direct investment, management, as well as capital, migrates across national boundaries. The foreign investor is a proprietor, not merely a lender", (p. 22). Staley attributes the distinction between portfolio and direct investment to the U.S. Department of Commerce in its estimates of American holdings abroad from 1930 onwards (p. 23) [see U.S. Department of Commerce (1931)].

Cleona Lewis (1938, 1948) provides pre and post World War II inventories of the USA's international credit and debit position. The national accounting purpose of these important books is evident but for our needs they provide fascinating insights into the conceptualisation of foreign direct investment (FDI).

In the first book (1938) the definition of FDI is implicit. In an analytical narrative of "America's Foreign Liabilities" (Part I of the volume), Lewis traces the predominant liabilities through loans, to the financing of railroads, to government bonds sold abroad, foreign funds in American industry (portfolio foreign investment) and finally to "foreign-controlled enterprise in the United States" (FDI) (Chapter V). This is followed by a similar narrative of "America's Foreign Investments" beginning with trade and banking ventures abroad, prospecting and mining, oil minerals and agriculture and (Chapter XIV) "America Factories Abroad" FDI is nowhere explicitly defined. The central issue dividing portfolio from direct foreign investment, the issue of control, is implicit. Foreign controlled enterprises "in which the role of entrepreneur or majority stockholder has been taken by foreigners" (p. 78) is equated with FDI in Appendix C: The "Direct" Investments of Foreigners". Note the quotation marks. In the consideration of "America Factories Abroad" (Chapter XIV beginning p. 292) the term "Branch factories abroad" is introduced without explicit definition. It is also noted (p. 293) that "The American factory was scarcely established at home before it appeared in foreign countries". An early appearance of the "born global" concept, it seems!

Far from allowing the concept of FDI to emerge implicitly, Lewis's 1948 volume goes to great length to define concepts overtly. Chapter III "The Character of Foreign Investments" separates out portfolio and direct foreign investment definitionally. Lewis's definition follows (1948, pp. 17–18) "The direct investments of a given country include (1) the foreign subsidiaries, branches and other foreign properties owned and controlled by its domestic enterprises; (2) companies controlled by its nationals but organised to operate exclusively abroad—whether such companies are incorporated (or registered) at home or abroad; (3) holdings by individual and groups of individuals of important equity interests in foreign corporations; and (4) real property owned by nationals of the country, such as mines, timber lands and plantations. The authority Lewis gives for this definition is Sammonds and Abelson (1942), US Department of Commerce.

The discussion of the status of foreign companies in law had been a point of contention from the beginning of the 20th century. Hilton Young (1912) analyses the position of "foreign companies and other corporations in English law". This issue had become salient following "the important case of Risdon Iron and Locomotive Works in Furness" (p. 185) when a company formed under the Company Acts to acquire and work mines in California became insolvent. The defendant, a shareholder in the company, was sued by suppliers of machinery for his proportion of the price of the machines. The company was held to be under English law and no foreign legislation was deemed valid. The issues of international jurisdictions and local versus source country laws have thus been at issue for over a century.

11. Foreign direct investment and development

C. F. Remer (1933) produced a formidable survey of foreign investments in China. He adopted the heuristic definition of "direct investment" that became familiar in pre-1960s writing. "The methods by which foreign capital has actually come are, then, business investments and government borrowings. The first of these I call direct, since the property remains under foreign control

and management. The directness lies in the fact that no-one stands between the foreign investor and the business risk involved in his investment. To avoid any possible misunderstanding it should be added that in the few cases in which foreigners have invested in the obligations of a Chinese corporation we have a business investment which is indirect since capital equipment is not in the legal possession of the foreigner who has in his hands the obligation of a Chinese company" (pp. 65–66). In a footnote (14) Remer says "The terms "direct" and indirect and used here in a way which is consistent with their use by others in this new field of business investments. Paul D. Dickens of the Bureau of Foreign and Domestic Commerce uses direct investments, without specifically saying so, to mean investments in which the business risk and, usually, the legal ownership remain with the investor. See the introduction to his "American Direct Investments in Foreign Countries" Washington, 1930, Trade Information Bulletin No. 731". If we allow bearing of business risk to equate to ultimate control then we have a viable distinction between direct and portfolio foreign investment.

The fact that practically no foreign capital had entered China through the Chinese corporation means that the capital which "has come through the foreign "colony" and it has remained under the control and management of the foreigner" (1933, pp. 115–116). "In this sense direct investments may be said to be connected with extraterritoriality. Extraterritoriality is inconsistent with the development of Chinese nationalism and will, no doubt, come to an end" (p. 116). This prescient prediction was based on the enclave nature of foreign investment in the 1930s and the dualistic nature of the Chinese economy, with linkages to the domestic sector limited, foretold its demise.

As with many early studies of FDI, Remer (1933) is concerned with the "capacity to receive"—what we would now call the absorptive capacity of the Chinese economy. "The checks and hindrances to the flow of capital lie in China rather than in the capital exporting countries. The effective limitations are on the demand rather than the supply side" (Remer, p. 231). Remer identifies "the ineffectiveness of the Chinese government in the economic field (p. 233), "the failure of the Chinese economic and social organisation to develop the concepts, in various fields, which are required for the importation and effective use of foreign capital" (p. 234) and the instability (and rapaciousness) of the Chinese government which raises uncertainty as key obstacles to inward FDI. These are all institutional factors related to the host economy. In addition, Remer identifies "the political difficulties created by the ambition and jealousy of the foreign powers" leading to "fear and distrust of the Chinese people" (p. 233) as a constraint on inward investment. He specifically mentions Manchuria: "the Chinese people have been in the greatest danger of losing the very region in which direct business investment have been greatest" (p. 233). In the introduction to the 1968 reprint, Remer says "When I left China in June, 1931 I was of the opinion that the greatest threat to the success of the new nationalist government lay in Japanese policy, and I believe it to have been a prime factor in the defeat of that government" (Remer, 1968, p. xxiv). Ironically, "On September 18th, 1931, I reached Ann Arbour, Michigan, after more than a year of field work... That was the very day on which Japanese troops marched into Manchuria" (Remer, 1968 p. xxiii). Remer's study highlights the importance of (global) political circumstances that influence flows of FDI. The study of international business theory must have a political element. Remer's meticulous fieldwork with individual studies of American, British, Japanese, Russian, French, German and other (Belgian, Dutch, Italian and "Scandinavian") investments in China was rendered of historical interest only by the cataclysm that the Japanese invasion precipitated.

Hubbard (1935) also examines foreign investment in China. No definition is provided but the terms "foreign factories" and "foreign owned classes of factories" (p. 222) imply that manufacturing facilities are being examined. "The explanation of the large foreign element in China's modern industrial development lies in the opportunity afforded of uniting foreign enterprise, experience, and efficiency with abnormally cheap labour in conditions which assure entrepreneurs the special advantages attached to the Treaty Port system, including, hitherto, low rates of taxation" (p. 222) "In more or less recent years a further inducement to found foreign factories in China has come from the rise in import duties and the consequences of "getting inside the tariff wall" (p. 222). Thus, both efficiency and market motives are identified. Financing of foreign companies is found to be largely from local banks, and Hong Kong banks. A short case study of the textile industry finds that foreign (Japanese) textile companies pay higher wages, the workers have shorter working days and suffer less from Government interference than do domestically owned cotton mills. Japanese investments in China's textile industry are described as classic offshore operations—"The Japanese mills mostly belong to powerful combines with manufacturing interests in Japan to which they act as 'feeders'" (Hubbard, p. 226). (Note the parallels with modern Japanese investment in China, including locational aspects (see Ma & Delios, 2007).

Frankel's (1938) study of Capital investment in Africa is one of several works on foreign investment in less developed areas that is rich in data gathering but is hampered by the lack of clear conceptual distinctions between types of foreign investment. Frankel is strong on uncovering the problems of increasing the absorptive capacity of the host countries but struggles to gain tractable definitions to enable a fruitful classification of foreign capital. He uses "long term foreign investment owned by residents of the capital exporting countries" as his object of investigation but notes that it is difficult to arrive at the amount of international capital investment. "The task bristles with difficulties due to differences of classification and method, paucity of statistical data, diversity in the purposes for which the calculations were made, and extreme variation in the reliability and objectivity of those making them" (1938, p. 18).

Allen and Donnithorne (1957) examine firms of foreign business in "Instruments of Western Enterprise" (Chapter II, p. 49–66). Given the diverse nature of sectors into which foreign capital has migrated – including, plantations, other agriculture, rubber, banking, shipping, public utilities and commerce as well as manufacturing – their focus is wide and does not emphasise the 'direct' versus 'portfolio' status of FDI until they reach manufacturing. Their typology encompasses managing agencies, joint public–private partnerships with Government, various forms of rentier or portfolio investment and "In the mining and manufacturing industries, apart from the large concerns with widely dispersed interests, direct management by owning companies that specialise in a relatively narrow range of industries is common" (p. 64). Control is mentioned as a key feature and in the statistical Appendix (pp. 288 and 290) "Business (or Direct) Investments" are distinguished from "Rentier Investments, mainly in Government Securities". The authors note that they have followed Callis's (1942) practice in using the term "rentier investments" instead of the usual "portfolio investments". Allen and Donnithorne take a comparative approach, finding Dutch influence on Indonesia contrasts with British in Malaysia. Unfortunately the disparities in organisation of the sectors that they examine rather obscures any firm conclusion on direct investment.

These studies are testimony to the need for sound theory to reinforce important analytical distinctions that can be translated into statistics so that these "social facts" can lead to a new round

of theorising. Although insightful, lack of precision on phenomena and lack of clarity and focus on the organisation of firm and foreign investment mode limited their inputs into future theorising.

12. Foreign direct investment—early theorising

C. K. Hobson's The Export of Capital, published in the fateful year of 1914 is, well described in Harrod's introduction to the reissue of 1963: "Its classic combination of very fine analysis of the many theoretical issues relating to foreign investment, extensive historical learning and pioneering ventures in statistical calculation entitle it to be regarded as a classic" (1963, p. v). For our purposes however, although it comes extremely close to identifying the distinction between direct and portfolio foreign investment, it never makes that distinction and so remains a classic analysis of the effects of indirect foreign investment largely on the source economy with particular attention to interest rate effects, exports, the balance of trade and emigration. Hobson notes (p. 28-9) the different methods of investing British and American capital in Canada, but attributes this to proximity, not explicitly to the directness of control. He emphasises knowledge barriers as key determinants to (direct) foreign investment in addition to risk and cultural/political distance. The nascent nature of "international companies" is illustrated by the loose nature of Hobson's discussion. "Foreign individuals are in most cases accommodated through the means of joint-stock enterprises such as banks and finance companies, which have grown up apace. Such organisations are often international in character; they are companies incorporated according to the law of one particular country, but carry on business in other countries as well" (Hobson, 1914, p. 123). However, the emerging multinational firm is well captured by Hobson (pp. 123-4). "The organisation of business on a large scale has made it more and more difficult to cramp a concern within political boundaries. The desire of investors to secure a higher return by investing in businesses abroad, while retaining substantial control over the management, was probably the dominant motive marking for international companies in other cases". This was written (also in a doctoral thesis) nearly 50 years before Hymer's thesis. Hobson is well aware of distance and communication problems that restricted the directness of foreign investment before World War I: ".cheaper quicker, and more regular communication has diminished the obstacles and assisted the development of such international companies; though even now they are at a disadvantage compared with companies which are controlled on the spot, in those industries in which flexibility and quick adaptability are required in the management" (Hobson, 1914, p. 124). Mining, land improvement and mortgage companies and railways are deemed to be industries where "the difficulties of management from a distance were comparatively small" (pp. 124-5) and thus Hobson provides a sector specific explanation of pre-First World War foreign investment. "The international company has even extended to manufacturing, but therein it is still somewhat rare, showing that the difficulties of management have not yet been fully overcome" (p. 125). This, and the lack of equal treatment by host countries of foreign owned companies, restricts the growth of international companies.

In the inter-war years, much of the concern about private economic power in the global economy was expressed with regard to cartels or "international combines" (Plummer, 1934, 1938, 1951). As noted previously, it is with respect to cartels that much inter-war theory on international operations was developed. However, the strategies of international firms became salient between the two world wars and U.S. foreign direct investment was noted as being significant especially in Canada but also in Europe and Latin America.

Southard's (1931) empirical study is strikingly modern in conception. Its first chapter examines modes of doing foreign business ("external form") and covers agent or representative, branch (house), majority control of subsidiary company (divided into (a) organised by American company (b) purchased), minority interests and contractual firms ("working agreements", "concession and contract", licensing agreement). The directness of investment is defined not by control but by directness of means, such as buying stock directly, lending money directly, building a factory (p. 190).

Southard's book examines the extent of American industry in Europe, organising and operating European subsidiaries and general problems arising including fears of the "industrial Americanization of Europe". The chapter on "Why American Industry Migrates to Europe" is an excellent checklist of elements of the theory of FDI. Staley lists these as follows: (1) Cost Factors: high tariffs, transportation, raw materials and fuel, wages, and taxation; (2) Supplement to home activities: raw materials, intercontinental services; (3) Servicing: catering to national peculiarities; (4) Expansion: patent exploitation; market control and (5) Nationalism (the desire of European countries to purchase local services and products). A little rearrangement gives us our familiar categories of motive: efficiency seeking, resource and asset seeking, market seeking. It is perhaps surprising in retrospect that Southard's book did not supply the basis of the theory of FDI nearly thirty years before Hymer as all the ingredients are present. Except, perhaps, that the theory is too far hidden behind empirical details.

Canadian-American Industry (1936) by Marshall, Southard, and Taylor explicitly analyses two way flows of foreign direct investment. The extent of "American Industry in Canada" is mapped as is Canadian industry in the United States. There is no explicit discussion of "direct" investment. The book opens with a chapter on the historical background of each country's investment in the other. Chapter II on American industry in Canada begins by referring to the "establishment of American subsidiaries across the Border" (p. 19) but the term "subsidiaries" is left undefined. In the opening paragraph on Canadian industry in the U.S. (where it is pointed out that as a proportion of Canada's wealth her direct investment in the US is larger than the US's in Canada), the term "direct investment" is undefined (p. 175). In contrast to the looseness of definition of (what are now regarded as) key terms, the discussion of motives for undertaking FDI is precise and is generalised from the evidence. The establishment of "branch factories" is attributed largely to tariffs, segmenting a markets which would otherwise be served by exports (p. 199). Differential consumer preferences also play a role, importing a local element of varying categories to differentiating the market. However, the tariff jumping motive is crucial. "In the absence of tariffs the remaining barriers would be insufficient to explain the establishment of many—probably the majority of the plants now in existence" (1936, p. 209). The analysis of tariff jumping ends with an analysis of the dynamics of the FDI decision—a balancing of costs and benefits that echoes Kindleberger's (1988) analysis of "close cases". The efficiency seeking motive is largely dismissed on the grounds that cost differentials, including wages are too similar—very few of the companies answering the questionnaire cited wage differentials as an important motive for entry. There were some areas (e.g. bulky goods) where lower costs of transportation in Canada improved the choice of FDI versus exporting. However the abilities of sales subsidiaries to have "Better control over the sales force, better adjustment to the market, close association with the customer, and quicker delivery of goods are all more surely obtainable through the medium of a

local subsidiary" (p. 209). For the sector of "mines, forests and fisheries" Marshall et al. invoke a resource-seeking explanation. For services, a straightforward market seeking explanation is given (p. 215). A final rather unclear motive is given for "auxiliary subsidiaries" (pp. 207-8). This appears to be a network of firms type argument as these companies "owe their existence to a contribution they make to the main product of an associated company" (p. 207). This is related diversification abroad—supplying parts or semi-fabricated materials from the foreign country or companies being pulled into the foreign market to supply "familiar customers" (p. 208). The authors simply do not have the language and concepts to describe these more complex relationships. In summary, two paramount motives are the search for raw materials and market seeking. It will be noted that efficiency seeking is investigated and dismissed as unimportant and wider influences such as network effects and pull factors from powerful stakeholders are also discussed.

In terms of the operations (international management) of the foreign direct investments, Marshall et al. set up a "typical" (idealtype) branch factory and contrast this with the findings from their questionnaire. The idealtype (of American plant in Canada) is "a limited company, (wholly) owned by the parent company, financed by it and closely controlled by it. It is a factory, not an assembly plant" (p. 219). The issues of joint ventures and of cross-continent coordination largely do not arise, the latter because of tariffs. Location strategy is discussed by comparison with Canadian industry in general. There is found to be a higher concentration of U.S. plants in the larger industrial centres in Canada (p. 222). In the form of organisation, most branch plants are incorporated under the laws of the host country although a few operate as "direct and unincorporated branches" because of the "simplicity" of that form of organisation. They can operate on the same basis as their American branches (p. 223). Acquisition and greenfield methods of entry are described, but in a non-analytical fashion. Financing is overwhelmingly from the parent company, although some funds (perhaps 10%) are raised in the local capital market. On "policy determination" (p. 229) or company strategy, the authors set up a continuum with at one end complete independence and at the other the "factory branch" completely controlled by the parent. Most situations are in between, of course, but only examples from the questionnaire, are given. Interestingly, "There is much evidence that Canada has been considered more a division of the domestic market than part of the foreign market" (p. 231) because where separate "International" companies have been formed by many American companies, they do not control Canadian affairs. This is early evidence of regional strategies forming—although crudely (North America and the rest of the world). Levels of integrated strategy, too, are considered on a continuum a completely self contained factory versus a packaging and assembly plant. From the questionnaire, the authors conclude that increased localisation of activities occurs over time. In generalising, they find a market size explanation best fit the empirical facts. "Where the market is reasonably large and no insuperable costs exist or hindrances the branch factory is more likely to turn out a complete product. If a factory for independent production is too large for the market, some, or all, of the parts will be imported" (1936, p. 236) (Tariffs permitting of course). On costs (unsurprisingly) the evidence they are able to adduce suggests higher costs (in Canada), "sheltered by a tariff, they pass those costs on to the customer" (p. 239). Wages were at the going rate, or slightly higher.

In the final chapter (VII Consequences and Problems) the authors allow themselves wider generalisations. Canadian investment in the U.S.A. "can be accounted for under two heads—economic necessity and individual personalities" (p. 203). This need for a wide market and entrepreneurial abilities are the drivers. For U.S. companies in Canada, "certain types of production" are critical (p. 204). First "industries for which the United States has become particularly noted" (p. 246) i.e. where U.S. firms have built ownership-specific advantages. Second where US firms need to "maintain and develop the sales in Canada of well-known, well advertised, branded or patented articles, the demand for which has been fostered and extended by their familiarity to the Canadian customer through travel, magazines, radio and motion pictures" (p. 265). Market motivation is here combined with the internalisation of activities based on firm specific advantages. "A third class of American companies has entered Canada to obtain control of necessary raw materials or other industrial requirements" (p. 265). The authors then examine why other areas of industry and services are not colonised by FDI (banking, railways, textiles, animal products and flour and cereal products, iron and steel). They find regulation, lack of competitive advantage, high levels of domestic competition and lack of established distribution networks to explain the various cases. Their puzzlement arises of course from the lack of a complete theory of FDI and of foreign market servicing. Their list of low FDI industries looks remarkably similar to the 'stylised facts' adduced in Buckley and Casson's (1976) list of what a theory of FDI and the MNC needs to explain!

Finally, Marshall et al. look at the relationship of investment flows and trade flows. They reflect concern that FDI weakens the capital exporting industry and they exonive export-inducing versus export substituting effects of FDI. This is linked with the balance of payments problems that Canada (along with many other countries) experienced 1929–1935. The effect of tariffs is of course overwhelming at this time but the resultant tariff jumping FDI began to concern Canadians because of lack of control of domestic industry leading to the ultra protectionist "Watkins Report" and to the Canadian Stephen Hymer's theorising.

The Marshall et al. volume is an empirical piece of great quality. It was based on a questionnaire sent to 1200 American corporations "believed to be operating in Canada" (p. 331) and to 900 companies in Canada "believed to be American controlled" (p. 232). The text (p. 26) gives a figure of "1100 American companies which have Canadian subsidiaries". "Each of these questionnaires yielded about 170 usable replies. Allowing for duplications, they provide us with the experience of more than 300 companies that are directly a part of the "Canadian-American industry" (p. 26). Reporting of questionnaire results is not as rigorous as today, but the full questionnaires are reproduced as Appendix IV. It will be noted that only U.S. firms in Canada are surveyed but that results were obtained from both parent and subsidiary (or "branch plant"). The excellent empirical and descriptive work is constrained by the lack of a theoretical framework and of precision in conceptualisation. Nevertheless Marshall et al. may be considered to have advanced "theory". The notion of examining two-way flows of FDI, the crucial importance for explanation of understanding why FDI does not exist in certain sectors and circumstances, the relationship of flows of FDI and trade, the analysis of clear generalisations on motives for FDI, alternatives to FDI (largely exports), the preliminary establishment of a "typical" branch factory as an idealtype (and the understanding of deviation from the stereotype) and the groping towards the conceptualisation of regional (and global) strategies are key steps forward. Hymer took from Marshall et al. (1936) variations in the share of Canadian industries under American control. This formed part of the empirical evidence supporting an industrial organisation theory of FDI following Bain (1956).

Before the mid-1950s, foreign direct investment was largely studied separately from the institution directing the investment—the multinational enterprise. It was as if FDI had to be first proven to be salient before MNEs could be conceptualised as more than "national companies with international operations" as Hymer's (1960) title has it. Several studies of individual industries pointed

to the growth of integrated (cross-national) companies such and McLean and Haigh (1954) in the oil industry, but recognition of the MNE as an institution did not emerge in the literature until the 1960s. Staley's (1939) World Economy in Transition examined "The Future of International Investments". Interestingly in a Chapter (17) on the "Spread of Capital and Techniques," he predicts that "direct investment will loom large in future foreign investment" (Page 277). "Direct investment, consisting of branch factories or commercial facilities operated directly, and "equity" investment in general, have important advantages over international loans that bear a fixed rate of interest in the conditions of the modern world. The service payments on such investments are less likely to raise exchange difficulties, for their yield is likely to fall in times of depression, thus automatically decreasing the burden of external payments that has to be carried by the economies of borrowing countries. Direct investments also have the advantage of being undertaken, in most cases, by those who have a specialised knowledge of some branch of industry, and this knowledge goes along with the investment, making it more productive" Staley takes this point further in a prescient discussion that places foreign direct investment firmly in the context of international knowledge transfer. "The internationalization of science is notorious" (p. 280).

An "early and insightful piece of FDI thinking" (Pedersen & Strandskov, 2006) was the 1944 article in Danish by Arne Lund. Lund (1915–1995) was at the University of Aarhus, Denmark from 1946 to 1951, was managing director of the Association of Danish Employers 1959–1979 and was a member of Parliament for the Conservative Party 1984–1989 as well as a columnist for a social-liberal newspaper. His 1944 piece identifies FDI as different from other foreign investments because of the element of managerial control. FDI is seen as an entrepreneurial activity and the crucial aspect of FDI is the combination of ideas and capital together. International mobility of capital and ideas give the conditions for an explanatory sequence of the business decisions to go abroad. First is the "why"—spotting business opportunities. Second is "how"—mobilising international entrepreneurship and finally an investment calculus gives the "where" when opportunities abroad are compared to rank their relative return. Lund is particularly astute in picking up the interaction between entrepreneurial vision and monopolistic advantages arising from proprietary know how and technology. This is directly linked to exploitation via FDI. "Entrepreneurs in industrialised countries acquire power and monopoly advantages that can be capitalised and as such represent a value. This relates not only to monopolistic advantages based on the (increasing) concentration in industries, but in addition to specialised know-how and technology. This tendency is not clearly observed when innovations are patented or acquire a trade mark, but idiosyncratic technical or commercial insight will in its own right and even without protection give advantages when applied in a nation which is technical and commercially less developed. The initial investment may in such cases by quite limited, but the advantage guarantees an income which is accumulated and capitalised and thus contributes to financing the further expansion of the foreign business unit" (Lund, 1944, pp. 41–42, translation Pedersen & Standskov (2006, pp. 8–9). It will be noted that this passage not only anticipates "ownership advantages", it also contains suggestions on dynamics not dissimilar to Vernon's (1966) product cycle hypothesis and on "the Gambler's Earnings Hypothesis" (Barlow & Wender, 1955; Penrose, 1956) and Penrosian views of the autonomous expansion of foreign subsidiaries. Lund (1944) had identified an anomaly in received theory (the dichotomy between FDI and portfolio foreign investment). He identified an explanation based on managerial control, entrepreneurial insights and uncertainty revolving round the international exploitation of the firm's competitive advantages (Pedersen & Strandskov, 2006, p. 13).

13. Foreign direct investment and the control of domestic industry

Concern with the preponderance of U.S. activities in Canadian economic relationships led to a Royal Commission Report (Brecher & Reisman, 1957). The Report covers business cycle transmission, "non resident ownership and control of Canadian industry with special reference to United States investment" (Part II), commercial relations, trade union links and dimensions of economic growth in Canada and the US (see also Blyth & Carty, 1956 and Knox, 1957).

Brecher and Reisman (1957) analyse non-resident ownership and control of Canadian industries in three chapters, covering Canada's international investment position, the determinants of foreign financing in Canada and the meaning and effects of non-resident ownership and control of Canadian industry, followed by a conclusion. There is a clear division between direct and portfolio foreign investment. "In particular, the definition of direct investment and the statistical concept of control should be carefully noted" (p. 90). They then go on to quote from Dominion Board of Statistics Canada's International Investment Position. "The category of direct investments shown here generally includes all concerns in Canada which are known to have 50% or more of their voting stock held in one country outside Canada. In addition, a few instances of concerns are included where it is known that effective control is held by a parent firm with less than 50% of the stock. In effect, this category includes all known cases of unincorporated branches of foreign companies in Canada and all wholly-owned subsidiaries, together with a number of concerns with a parent company outside of Canada which holds less than all of the capital stock. In addition, there are a relatively small number of Canadian companies included in cases where more than one-half of their capital stock is owned in a single country outside of Canada where there is no parent concern. These exceptional cases are confined to instances where control is believed to rest with non-residents" (quoted by Brecher and Reisman p. 90). The authors note that this statistical concept of control is necessarily a formal one indicating the existence of potential control of the firm by non-residents, rather than the extent to which managerial control is in fact exercised. "Portfolio investments, by contrast, are typically scattered minority holdings of stocks and bonds which do not carry with them control of the enterprises" (Brecher & Reisman, 1957, p. 90). The rise in US investment in Canada is noted to be due to the establishment or acquisition of enterprises in Canada and to the expansion of existing enterprises—the latter being the dominant factor.

Brecher and Reisman note that both direct and portfolio investment are made up of debt as well as equity holdings. "For some purposes, it is useful to look at foreign investment in terms of the fixed monetary claims represented by debt and the variable real claims relating to equity financing" (p. 93). This neatly summarises a measurement and conceptual problem that is with us today. It also influences the host country's debt servicing problem—an issue taken up by Barlow and Wender (1955) and Penrose (1956) almost contemporaneously. Brecher and Reisman go on to examine changes in both ownership and control (noting that the two are not co-terminus) across sectors of Canadian industry, including the issue of concentration of foreign control (examining for instance large firms).

The capacity of a host country to attract foreign capital is described as the "investment climate" by Brecher and Reisman (1957, p. 114). "This embraces the broad economic, political, and social framework of institutions and attitudes, which have a profound impact on the confidence of foreign investors". Similarity of institutions with major capital exporting nations, the U.S. and UK has favoured Canada they argue as well as cultural

factors—"language and social customs" (p. 114). Proximity to the U.S.A. also helps.

In examining the motives for direct investment, Brecher and Reisman (1957, p. 116) identify two broad types. "Much direct investment in Canada, particularly from the United States, has been undertaken basically to supply parent companies and other non-residents with raw or semi-processed materials. A second general type of direct investment is undertaken mainly to supply the Canadian market, and also certain export markets overseas. . ." The first motive "the "resource" type of investment usually resolves about the desire to develop and guarantee sources of supply for materials. In most instances, cost considerations have been dominant" (p. 115). "The second broad motive for direct investment is that of bringing a commodity or service into the Canadian market as an extension of the parent company's United States operations. . .. Export markets may also be involves. . . in the case of United States controlled companies the export interests have usually been confined to Commonwealth markets" (p. 117). Market driven investment is related to tariff protection and Brecher and Reisman consider market servicing alternatives—"given Canadian tariffs, the non-resident finds direct investment in Canada a convenient and profitable alternative to servicing the Canadian market through exports" (p. 117).

Brecher and Reisman (1957) include a fascinating section on capital requirements where they consider Canadian attitudes to risk taking. They speculate that Canadians (in contrast to U.S. citizens) and Canadian institutions prefer to purchase debt securities rather than equities which reflects risk-aversion (pp. 121–122). Institutions reinforce this preference and they speculate that Canadian taxation legislation also is culpable (pp. 126–128). They say (p. 122) "it would have been very difficult, and sometimes impossible, for Canadians to undertake many of Canada's larger investment projects. The basic proposition here is that risk is a relative concept: investment undertakings which entail a considerable element of risk for Canadians are often a routine operation for large non-resident corporations. The Canadian venture, large though it may be by Canadian standards, is typically only a small part of the non-resident's global operation. Furthermore, the non-resident corporation usually has the ancillary facilities – such as technology, skills and markets – in the abundant quantities necessary to minimise risk". This leads to a discussion of the wider advantages of belonging to a multinational enterprise. Brecher and Reisman have developed the 'package of advantages' view of multinational enterprises well ahead of Kindleberger (1969). "For the fact is that connections with a parent or affiliated company abroad often involve advantages which either cannot be duplicated by a purely Canadian enterprise, or can be duplicated only at greater cost to the firm and the public at large. These advantages to do not flow exclusively from the availability of capital in the form and amounts required. Availability of capital is extremely important, but so too are technology, research, product development, technical and managerial personnel, training facilities, market and supply contacts and accumulated experience over the whole range of business activity" (Brecher & Reisman, 1957, p. 138). A comprehensive listing of firm-specific advantages!

Chapter 8 of Brecher and Reisman's (1957) book is a superb analysis of the meaning and effects of non-resident ownership and control of Canadian industry. It sets out to answer three questions—"to what extent does statistical or potential non-resident control of a Canadian corporation constitute control in practice?" "does a corporation so controlled behave differently than a resident controlled company?" and "what are the consequences for the Canadian economy?" (p. 131). On the first question, a nuanced view is taken; "the concept of control is highly elusive and differs from case to case because of factors which are not measurable. For these reasons, it is useful to adopt a functional approach to this concept by asking what the effects of such control have been in specific areas of company operations" (p. 133). It is necessary to examine the composition of boards of directors and senior executives and the relationship between parent and subsidiary board to begin to answer this question. The extent of decentralisation is also important. This may be determined by motive of the subsidiary's operation and the nature and sources of financing. On the second question, Brecher and Reisman state "the key to an evaluation of the effects of foreign direct investment (as of investment generally) is the overriding consideration of maximising profits. . .. Companies operating in more than one country may be expected, in the long run, so to respond to market demands and cost considerations as to maximise their global profits" (1957, p. 137). In general, the results for Canada are benign. "The search for profits through direct investment has led to advantages for Canada which permeate every aspect of its development, including the rate of economic growth, standards of living and industrial diversification. The development of Canadian resources, of facilities for processing them, and of Canadian manufacturing industries has been stimulated by the activities of non-resident corporations in their energetic search for supplies and pursuit of markets" (p. 138). However, adverse effects may occur in "the development and expansion of competitive facilities in Canada where similar facilities—owned by the parent exist in the United States and elsewhere; marketing and purchasing policies; price policy and economic stability" (p. 138). The first such "competitive facilities" argument analysed is research facilities—where nascent concern for Canada's research base are expressed. Branch-plant concerns are expressed together with concerns that tariff-jumping motives may not out last the tariff, purchasing policy may be biased towards the parent plant rather than local suppliers and there is a concern that rate of resource development may be slower under foreign ownership (see Byé, 1958a). Finally, non-economic factors may cause foreign firms to differ in their decision making from locally-owned ones—personal preference arising from national biases and foreign governmental policy such as (US) anti-trust policy are mentioned by Brecher and Reisman.

Overall, Brecher and Reisman's (1957) account of foreign direct investment is precise and prescient. Many of the concerns – the nature and meaning of control in direct foreign investment, financing issues, risk-taking behaviour, motives and effects of FDI, the impact on the local economy and the question of the difference made by foreign ownership – are a comprehensive catalogue of the international business research agenda from the time of writing onwards. The close contextualisation of the analysis with the Canadian situation is a major strength, but perhaps obscured the conceptual and theoretical advances within this remarkable work.

14. The emergence of modern theory

Moving into the late 1950s and early 1960s, international business begins to become professionalised as an academic discipline. Key publications begin to appear in journals as well as books. Applied economists, such as Penrose (1956), Byé (1958a) and Dunning (1958), produce empirical works of substance based largely on the economic theory of the firm. Conceptual advances multiply and interact and an academic discipline starts to coalese around a body of work further stimulated by Hymer's conceptual advances in 1960. To a large extent these developments ignored earlier theorising, using the works of Phelps (1936), Lewis (1938, 1948), Southard (1931), Marshall et al. (1936) and Brecher and Reisman (1957) simply as data sources, not as theoretical precursors.

Edith Penrose's (1956) "Foreign investment and the growth of the firm" preceded her work on the growth of the firm (to come to

fruition in her classic 1959 book The Theory of the Growth of the Firm). In this article, Penrose evinced a version of the "Gambler's Earnings Hypothesis" (Barlow & Wender, 1955). This phenomena is the large plough-back of profits in foreign owned subsidiaries for an extended period which is then remitted as dividends (the "winnings" from the game). Multinational firms are thus likened to gamblers who, beginning the game with a small stake (the initial investment, usually small) continually ploughed back their "winnings" (profits) into the game until the real "killing" is made. Such behaviour poses adjustment problems for the host country because the eventual large repayment can disrupt its balance of payments stability.

Underlying this hypotheses are three relevant features. First, the subsidiary is assumed to be largely independent of the parent. This may be because of (physical or psychic) distance, because of the need for local judgement or because of the lack of a firm-wide (global) strategy. Second, the differences between establishing a foreign subsidiary rather than a domestic subsidiary are relevant. The rate of return on a foreign subsidiary needs to be higher in order to compensate for the greater risks. Moreover, foreign investment is often in the nature of an exploratory strategy in order to see if further foreign investment is desirable. Therefore, the risk averse firm is likely, initially at least, to under-invest and begin on a small scale. The initial, limited, investment economises on the costs of investment and organisation. Thus, the gambler's earnings hypothesis is a primitive form of the real options analysis of internationalisation (Buckley, Casson, & Gulamhussen, 2002). Third, this process has a dynamic. At the point when the firm has a (small) successful foreign subsidiary, uncertainty is lower and the costs of search for further profits approximate to zero. Rather than scanning the world for further, possibly more profitable opportunities, the firm will re-invest in its safest best—its existing subsidiary. It may well be that the firm will continue to re-invest long after this is justified by a comparison of rates of return with other alternatives, if they are considered at all. In other words, these approaches hypothesise that multinational firms exhibit a bias towards existing, profitable subsidiaries in their investment decisions (Buckley, 1989).

The 'gambler's earnings' hypothesis is not a complete explanation of FDI and especially of FDI by established multinational firms used to monitoring global, or even regional, opportunities. The hypotheses may still have validity for (small) firms where the costs of information and coordination are high. It may apply to first time or naïve foreign investors. In the long run, the behaviour hypothesised results in missed opportunities, declining rates of return and the loss of coordination gains from internationalisation. However, it does prefigure the current real options theorising on internationalisation.

Maurice Byé, drawing on the traditions of French, and English, economics, produced a stimulating but idiosyncratic paper "Self Financed Multi-Territorial Units and their Time Horizon" in 1957, published in English in 1958. Byé describes a "large unit" as "an organised set of resources depending on a single decision centre capable of autonomous action in the market" (p. 148). Thus the "large multiterritorial unit (LMU)" may not be a single firm—an important point given current attention to networks of firms (references) following single strategies or "global factories" (Buckley, 2003; Buckley & Ghauri, 2004). Byé however speaks throughout of large firms and concentrates particularly on the extractive industries. His key point is that "a large firm is one whose plans are to some extent independent of the market and which, by the same token, can choose the length of its planning period" (p. 148). LMU's do not simply react to market stimuli. Following Cournot, the firm is seen as a centre of decision making and planning. The conception is dynamic, because Byé (following Joan Robinson (1953)), wishes to include a theory of expectations. The decision of LMUs therefore depends on prices, the rate of output, the length of the planning period and the rate of investment. The time horizon is seen as a "strategic variable in the behaviour of the large firm" (p. 149). Byé explicitly compares the decisions of LMUs with those of governments "There is nothing absurd in comparing the decisions of such a firm, its optima, its growth, its foreign trade and its internal financing with those of governments responsible for the long-run objectives, optima, growth and control of the foreign trade of nations" (Byé, 1958a, p. 150).

Byé (1958a) goes on to provide a model of the LMU in the extractive industries. The model examines the optimum rate of extraction of existing reserves and the tapping of new reserves. The ability of LMUs to self-finance is related to the duration of exploitation—a composite of the time horizon of the firm and the level of uncertainty (including political uncertainty concerning nationalisation). "Uncertainty also encourages geographical diversification" (p. 159). The firm's decisions on keeping resources in reserve, exploiting first its high cost resources or its low cost resources depend on the marginal cost of developing resources and the financing of exploitation. Again, Byé comes back to the length of plan of the LMU as critical in developing and exploiting natural resources. Control over reserves is one source of power of the LMU; the other is control over the market. Byé considers that cartelisation is an attempt to coordinate the length of planning periods under the control of big (American) companies (p. 167). The planning periods of LMUs may conflict with national governments. This will be reflected in the conflict between the LMUs "balance of payments" (its exports, imports, profits and capital movements) versus the host countries' balance of payments. For Byé, this conflict is not ameliorated by the development impact of LMUs in the host country. "Large international units do not really constitute "development poles" in underdeveloped economies, but are merely very rich taxpayers" (Byé, 1958a, p. 174).

For Byé, international capital movements implied an overlapping of "areas of private control" with "areas of public control" (p. 174). He utilises the term "direct investment" when discussing U.S. Department of Commerce Statistics (p. 175). "Direct investment is almost entirely financed out of the firm's own profits and there are practically no transfers at all between one industry and another" (Byé, 1958a, p. 175). The intra-industry nature of FDI is forcefully noted—"There could be no other explanation for a situation in which capital returns are 17 per cent in the petroleum industry and 6 per cent in manufacturing industry" (p. 175). This is a point worthy of Hymer himself—the industrial organisation explanation of FDI is latent in Byés 1958aByé's 1958 paper. The world capital market clearly has strong, definite barriers to movement between industries. Byé also notes two way movement of capital within industries and the dualistic nature of development in poor countries caused by the enclaves of LMUs. LMUs are however a currency area phenomenon. "No LMU could cut itself loose from its currency area without modifying one of the fundamental data of its plans, namely its financing conditions" (Byé, 1958a, p. 177). This anticipates the "home currency advantage" theory of Aliber (1970, 1971).

Byé's final synthesis anticipates the later work of Hymer (1970, 1971) in suggesting an increasing concentration of the oil (or extractive) industries—"If it is true that self-financing implies that only the most powerful firms can engage in international ventures; if these firms try to optimize their planning periods by maintaining high reserves/output rates; and if long plans can be profitable only in connection with a very large capital market and a very large consumption market—then the firms satisfying all these conditions must tend to acquire a growing part of world reserves" (1958, p. 177). Byé's (1958) analysis focuses on (internal) finance and its

relation to the time horizon of large firms as a key explanation for FDI, particularly in extractive industries. In this it parallels Penrose's (1956) piece. It is perhaps international financial movements, and their salience that brought the MNE to the forefront of theorising (together with issues on the foreign control of domestic industry, particularly in Canada). Byé's work puts MNEs firmly in the industrial organisation mode of analysis but also emphasises currency area advantages. The solid differentiation between the LMU and its external markets (for finance, for resources) makes this rather curious paper fit well within the Coasean internalisation tradition. Its inferences for competition and more particularly for restriction of competition anticipate Hymer's emphasis on oligopoly and of the increasing power of autonomous MNEs.

Byé's paper is not referred to in Hymer (1960) (although Hymer later contributed a paper to a symposium of Byé's (1958b)) and, as a generalisation, Byé's paper did not have a large impact on theorising FDI. In this sense, Byé 1958aByé's 1958 paper became a neglected contribution, largely because of its unorthodox approach.

15. Conclusion

Hymer's thesis drew on a restricted range of then current economic theory. He eschewed works on imperialism to which he turned in a later phase of his career. He also ignored a rich vein of work on cartels that could have shed light on the competitive and anti-competitive behaviour of large firms.

It is untrue to say that there was no international business theory before Hymer (1960) and Dunning (1958). However, the theory that existed was uncodified, unsystematic, fragmented and not institutionalised in an academic discipline. Both "international management", superbly exemplified by Phelps (1936) and "international business" (Lewis, 1938, 1948) had generated testable hypotheses derived from data and had progressed to generalisation, the former from qualitative information collected from (largely) unstructured interviews, the latter from substantial datasets. The incorporation of their insights into theorising such as Dunning's eclectic theory (Dunning, 1977) has not been influential in subsequent theoretical development because more academic foundations were sought—notably Bain (1956) for Hymer (1960) and Coase (1937) for Buckley and Casson (1976). This is to some degree an opportunity missed, but perhaps not irretrievably.

Considered as a book of theory, Hymer drew on few sources—Bain (1956) in particular, Coase (1937) unwittingly and perhaps Penrose (1956, 1959). In giving a clear conceptual lead, Hymer was successful. The addition of Coasean concepts by Buckley and Casson (1976) and the parallel development of location theory provided further key theoretical building blocks. The neglect of (Schumpeterian) innovation as a driver has been corrected in more recent works (Schumpeter, 1934, 1942). However, much previous theoretical innovation was buried in largely empirical works such as Phelps (1934), Marshall et al. (1936) and Dunning (1958). A great deal of previous theorising has been ignored because of its lack of conceptual clarity and its non-cumulative nature. However, pre-Hymer theorising has several virtues. First, it is deeply empirically grounded. Second, it integrates international business theorising on FDI and the MNE with international management concepts such as cultural differences and methods of operating in foreign environments. Third, it provides avenues for the reconsideration of theoretical advances such as the relationship between FDI and trade at all levels (firm, region, industry, nation), the interaction between inflows and outflows of FDI and two-way investment, and the external consequences and effects of FDI. One of the underestimated advances of modern international business theory is to integrate macro perspectives (the country, balance of payments flows, national assets and liabilities) and micro elements (the multinational firm). This is done by the device of attributing a single nationality to "the firm". This has downsides too, because all the activities of Toyota, for example, are not attributable to Japan and subsidiaries are not simple unthinking appendages of the parent firm. Following Hymer, we are able to achieve a greater degree of synthesis. Hymer drew on a restricted range of sources and his virtue was to give the theory of the multinational enterprise a clear analytical core. The insights of Hymer were perhaps achieved precisely because he did not cast his conceptual net widely.

16. Managerial relevance

Early, pre-Hymer (1960) theorising on international business and the strategy of the multinational enterprise has several insights for current managers. First, it is necessary to have a clear understanding of the role of cultural differences and the impact that these are likely to have on operating strategies in particular host countries both when considering entry and in the operating period. Second, the modes of operating abroad are important and the subtleties of choice go beyond simplistic views of export versus foreign direct investment. Finally, early international business theorising encourages managers to think beyond immediate tactical decisions to the holistic relationship between the firm and its external environments.

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