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COMMENTARY

Developing countries and MNEs: extending and enriching the research agenda

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Abstract

Foreign direct investment (FDI) through multinational enterprises (MNEs) has emerged in the last decade as the principal source of foreign capital for developing countries. Meyer (this issue) underlines the need for international business (IB) scholars to understand the impact of these investments on host developing countries. He offers a useful assessment of the literature and proposes a rich set of questions for further research. However, his research agenda can be extended and enriched in two ways. First, IB scholars must study, as they always have, causation in the opposite direction—namely, the impact of developing country context on MNE behavior and the co-evolution of these two variables over time. In doing so, they must incorporate into their models contemporary issues, such as the continued inadequacy of rules for FDI in infrastructure sectors, or the clever means by which MNEs are rewriting the global rules under which they operate in developing countries (e.g., on intellectual property rights). Second, IB scholars must pay more attention to topics that are not mainstream within the field but are of great importance to developing countries. Examples include the behavior and performance of a new generation of home-grown MNEs, the role of diaspora in homeland FDI (in countries like China and India), and the implications of global outsourcing of services.

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Introduction

The stock of foreign direct investment (FDI) in developing countries nearly doubled from 1980 to 1990 and has since more than quadrupled, reaching $2340 billion in 2002.[1] In the process, FDI has become the single most important source of foreign capital for these countries, displacing by a wide margin previously popular alternatives, such as official aid and private commercial bank lending.[2]

By definition, FDI flows through multinational enterprises (MNEs). We know that about one-third of world trade occurs between two affiliates of the same MNE, and another one-third involves an MNE at one end or the other of the international transaction. In the 1990s, MNEs extended their dominance to the realm of global capital flows, including capital destined for high-risk developing countries. A monumental transformation of the global economy is under way.

In light of these facts, Meyer's perspective paper on the role of MNEs in emerging economies (Meyer, 2004) could not be timelier. He makes two main points in his essay. First, he argues that international business (IB) scholars pay too much attention to the interests and challenges facing MNEs and not enough to how MNEs help or hurt developing countries. Meyer's concern may seem passé in an era when developing countries are courting MNEs, and FDI-screening agencies in these countries have been turned into FDI promotion agencies (Wells and Wint, 2000). Yet, recurring anti-globalization protests in rich and poor countries remind us that the political foundations of globalization are shaky (Eden and Lenway, 2001). Meyer's plea for more research on how MNEs affect developing countries is also consistent with Vernon's (1998) warning that relations between these parties could turn adversarial, despite appearances to the contrary.[3] Thus Meyer's research agenda has both predictive and prescriptive value, and he performs a service by restoring this topic to center stage within IB.[4] At the same time, by featuring this theme, *JIBS* and its Editor-in-Chief legitimize it and pave the way for more work by IB scholars.

Meyer's second point is that IB scholars can make a unique contribution to the literature, because they, more than any other group of scholars, understand the motivations and conduct of MNEs. Meyer argues rightly that IB scholars should use this insight into MNE behavior to inform the analysis of scholars in other disciplines, such as economists, political scientists, sociologists, and anthropologists, who focus on more macro issues. IB scholars should shed light on firm-level behavior, while controlling for known macro, contextual variables. And, hopefully, scholars in other fields will close the loop by building on insights from IB research.

Meyer makes a further contribution by pulling together in one place several streams of research by IB scholars on how MNEs impact on developing countries. He focuses on five areas of impact: local firms, the social context, local institutions, the natural environment, and the macroeconomy. (Government is not listed separately in his Figure 1 but is subsumed under 'institutions'.). Given the breadth of these topics it is not surprising that he covers some of them more comprehensively than others: for example, he provides an excellent synthesis of the literature on spillover effects of MNEs on local competitors, suppliers, and

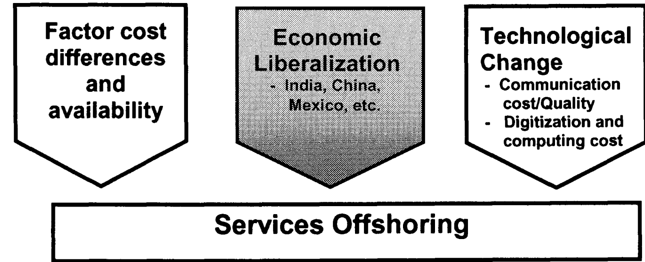

Figure 1 Drivers of Outsourcing.

customers. Meyer's essay also shows how research in some of these areas is not yet well developed, theoretically or empirically. He thus offers IB scholars a useful assessment of the literature and a rich menu of topics for further study.

So far, I have deliberately used the term 'developing countries' rather than 'emerging economies', which figures in Meyer's title and which he defines as 'middle or low income economies with growth potential that makes them attractive for foreign investors'. If the intent is to understand how MNEs impact on economic development, then Meyer's focus on emerging economies, as defined, is narrow, because it limits us to the handful of developing countries that receive the bulk of FDI, and it excludes dozens of developing countries that foreign investors have not (yet) found attractive.[5] However, the narrow focus on emerging economies serves Meyer's purpose well, because he is interested mainly in how MNEs impact on host countries. What better setting in which to examine that question than the subset of developing countries receiving the lion's share of FDI? There is nevertheless a vast IB literature that focuses on causation in the opposite direction – that is, the impact of host country context and policies on MNE behavior and FDI flows (e.g., Root and Ahmed, 1978; Guisinger and Associates, 1985; Caves, 1996; Ramamurti, 2001) – and that too deserves further exploration.

Which brings me to the main point of this commentary: although Meyer takes a broad view of his topic, I believe it can and should be broadened further, by including the impact of host country context on MNE behavior, and the co-evolution of these two variables over time.[6] It should encompass the role of powerful international players, such as MNEs' home governments, international institutions, and a variety of NGOs – all of which influence the rules under which MNEs operate in developing countries. And, finally, it

should include new issues at the interface between MNE and developing country, such as the growth of outsourcing of services for or by MNEs, the role of diasporas as sources of precious FDI and technology for developing countries (especially in China and India), and the emergence of a new breed of 'Third-World MNEs' (TW-MNEs). These topics are not entirely new, but they extend Meyer's research agenda, and help keep the IB field abreast of new developments in globalization.

Extending and enriching the research agenda

Meyer notes that an important issue for developing countries is how the gains from FDI are shared between investor and host country. That division depends vitally on the rules under which MNEs operate in developing countries. IB researchers should help develop policies and institutional arrangements that will increase FDI flows to developing countries, while ensuring a fair allocation of risks and rewards. They should also study the processes by which global rules and arrangements are developed in the first place. I shall illustrate these points with two examples, one dealing with FDI in infrastructure, and the other with how global rules were negotiated for intellectual property (IP) protection.

Rules for infrastructure FDI

In the 1990s, about one-third of the FDI flowing into developing countries was tied to the privatization and deregulation of infrastructure sectors, such as power, telecommunications, transportation, and water – all of which present knotty problems of regulation. Historically, foreign ownership in these industries has been problematic, with bouts of nationalization and administrative expropriation by host governments (Henisz and Zelner, 1999). Yet FDI surged in these sectors from 1990 to 1997 and then fell off sharply, and has since shown no sign of returning to former peak levels. By the mid-1990s, historical patterns of conflict between MNE and host country resurfaced in these sectors, and host governments seemed unable once again to make credible promises to foreign investors (Doh and Ramamurti, 2003; Ramamurti, 2003a).[7]

Yet developing countries need FDI in infrastructure to achieve their growth aspirations, because they need foreign capital to augment domestic savings. What must developing countries do to regain credibility with foreign investors? Innovative safeguards that were introduced for the first time in the 1990s, such as international arbitration of disputes, bilateral investment treaties to secure investor rights, and the creation of specialized regulatory agencies, have proven inadequate (Ramamurti, 2003a). Wells (2004) argues that existing arrangements are not flexible enough to accommodate the uncertainties and shifting bargaining power of host governments and investors over the life of infrastructure projects. Based on a solid understanding of ground experience, IB scholars should propose new arrangements that will help reverse the decline in infrastructure FDI. They should suggest new arrangements to balance contract sanctity with contract flexibility, and MNEs interests with developing countries' interests.

How are rules made?

The previous discussion assumes that developing countries have the latitude to change the rules under which MNEs operate. Yet these rules are frequently the product of complex international negotiations.[8] IB scholars must understand how MNEs and developing countries influence that process. I suspect that in the last 10–15 years MNEs have become particularly adept at working through home governments and international institutions to rewrite global rules to suit their own interests (Ramamurti, 2001). As a result, developing countries have found themselves with less and less policy wiggle-room for regulating MNEs.[9]

Consider the case of intellectual property (IP), wherein a remarkable agreement to harmonize IP laws worldwide was achieved as part of the Uruguay Round (Cheek, 2001). A few US-based MNEs, led by Pfizer and a dozen other IP-intensive companies, orchestrated that global regulatory convergence (Santoro and Paine, 1992). They not only managed to inject IP into the Uruguay Round agenda but also built a 'Tripartite Coalition' with industry associations in the other triad markets of Europe and Japan. The Tripartite Coalition hammered out an agreement among its own members on the minimum standards that any IP deal would have to meet, and then lobbied their respective home governments to fight for those standards in multilateral trade talks. Thus, bargaining among home governments was replaced by bargaining among MNEs within the Tripartite Coalition: in other words, a form of global regulatory capture occurred (Ramamurti, 2004).

This example seems to be part of a larger phenomenon. MNEs pursue global strategies and operate in global markets, but the regulations

governing their operations are often national in scope. Regulatory heterogeneity demands matching complexity in MNEs' strategies and operations. Just as convergence in tastes worldwide creates opportunities for MNEs to produce globally standardized products, so too convergence of regulations allows them to adopt globally standardized methods of operation, which can lower costs and reduce policy uncertainty. Therefore triad-based MNEs are allying with one another to push for global convergence of regulations in several domains, including e-commerce, accounting standards, capital market regulation, health and safety standards, and antitrust policy (e.g., Stern, 1997; Vogel, 1999; Quinn, 2003). The rise of global NGOs may be explained partly as a reaction to the growing influence of MNEs over global public policymaking. IB scholars can make a real contribution by investigating whether these trends are in fact occurring, understanding their dynamics, and extracting their implications for developing countries.

Transformation of Third-World MNEs

Another useful extension of the research agenda proposed by Meyer is to study the old and new breeds of TW-MNEs, which are at least as important for the prosperity of poor countries as foreign MNEs. The original crop of TW-MNEs emerged in the context of import-substitution oriented policies (e.g., Lall, 1983; Wells, 1983; Kumar and Kim, 1984). These firms operated in a resource- and capital-constrained context, protected by high tariff walls. Their competitive advantage lay in having products adapted to local conditions; in using local rather than imported inputs; in conserving capital, for instance, by using imported second-hand machinery; and in employing labor-intensive rather than capital-intensive production methods ('appropriate technology'). They exported their products mostly to still poorer countries (Wells, 1983). And many of them were part of a business group rather than stand-alone firms (Khanna and Palepu, 1997).

Economic liberalization has forced this earlier generation of TW-MNEs to restructure. One interesting issue is: Which ones have done so successfully, and why? For instance, why have some state-owned enterprises in China emerged as global contenders in their industries (e.g., Heier or Legend), while many others have not (see, Ramamurti, 2000; Nolan and Zhang, 2002; Rimmer and Comtois, 2002)? Which business groups have focused their business portfolios, and which ones have not, and with what implications (Khanna and Palepu, 1997)?

At the same time, economic liberalization has bred a new generation of TW-MNEs that have blossomed in the context of open markets and global competition (e.g., software services firms in India, or Cemex in Mexico). Some of these firms are family controlled (e.g., Slim Group in Mexico, or Wipro and Tata Consultancy Services in India), whereas others are run as publicly traded companies by founder-managers (e.g., Infosys or Dr Reddy's Laboratories).[10] There has also been an impressive surge in entrepreneurship in many transitional economies (Zahra *et al.*, 2000). Today's thriving TW-MNEs seem to target the much larger market of rich countries than the small markets of other developing countries, but this is only one example of the differences between the new crop of TW-MNEs and the old crop. IB scholars should systematically study these differences as well as those between TW-MNEs and rich-country MNEs. They should explore the circumstances under which the new crop of TW-MNEs are likely to remain independent actors rather than get gobbled up by their larger, Western counterparts, as has happened frequently in Latin America. And they should compare the spillover effects of TW-MNEs with those of foreign MNEs.[11]

Diaspora capitalism

While MNEs have been rich sources of capital and technology for developing countries, overseas nationals – the so-called diaspora – have been a special but important subset of foreign investors in countries such as China, and are playing a catalytic role in creating home-grown MNEs in another large country, India. It is well recognized that in China nearly 80% of inbound FDI in the 1980s came from overseas Chinese investors; the flood of non-Chinese FDI began only in the 1990s. In other words, China's development might have been very different had there not been 50 million people of Chinese origin living in the Asia-Pacific Rim, many of whom pooled their capital, technology, and access to export markets with cheap Chinese labor to produce China's export boom. Similarly, the Indian software and knowledge-based industries have profited from the know-how, market access, capital, and guidance of the Indian diaspora in the United States and Europe (Kapur and Ramamurti, 2001). The huge distance separating India's software cluster from its main market (the United

States) is overcome partly by modern communication links but partly by social networks that connect Indians at home with Indians abroad. Again, Western MNEs rushed into India's software and services clusters only after the country's competitiveness in this sector was demonstrated beyond doubt (Ramamurti, 2003b). My point is that FDI by industrialized-country MNEs tends to lag behind economic growth in developing countries rather than lead it. Apparently, a country's diaspora is more likely to invest in the homeland than other foreign investors, for reasons that are not hard to guess. Therefore, more IB scholars should follow the examples of Gillespie *et al.* (1999) and Buckley *et al.* (2002) in investigating the impact of diaspora on economic development in poor countries. Overseas Chinese and overseas Indians may well have generated more technological spillovers in their respective homelands than Western MNEs.

'Offshoring' of services

A final area of considerable promise for developing countries is the growth in 'offshoring' of services for or by MNEs, a trend that has been under way for more than a decade, even if it received media attention in the US only in 2003–2004 (Heeks, 1996; Kapur and Ramamurti, 2001). It is driven by three powerful forces (see Figure 1): large wage differentials between rich and poor countries, creating arbitrage opportunities, especially as competition has intensified in the global economy; the integration in the 1990s of countries with large pools of skilled, English-speaking workers, notably India; and, finally, dramatic improvements in the 1990s in the quality, and reductions in the cost, of computing and communications, including the emergence of the Internet.

By all indications, we have seen only the tip of this iceberg. The trend looks unstoppable, although it may be slowed by protectionist policies in industrialized countries. It is also becoming clear that more and more services will be outsourced to countries such as India, China, and the Philippines, and that the skill level of these services will rise as developing countries gain experience and reputation as service providers. We could be on the cusp of a trend that will parallel what happened three or more decades ago in manufacturing, with the 'slicing and dicing' of the value chain and its global dispersion. IB scholars have the opportunity to lay bare the implications of this new trend, compare it with past trends in manufacturing, and highlight the managerial implications for MNEs and the policy implications for developing countries.

Conclusion

MNEs are playing an increasingly important role in developing countries. Meyer rightly points out that IB scholars should be alert to the positive and negative impact that MNEs have on host developing countries, including spillovers and externalities. He also presents a rich set of questions for future research. I have complemented his menu with two types of additional issues. The first has to do with reverse causation – namely, the impact of developing country context and policies on MNE behavior. The second has to do with phenomena that receive less attention from IB scholars than they deserve (in my view). The origin and transformation of TW-MNEs, the role of diaspora in homeland FDI, the future prospects for services outsourcing in poor countries, and the clever means by which MNEs are working to rewrite the global rules under which they operate in developing countries – these are all fascinating and important topics on which IB scholars, and only IB scholars, can make valuable research contributions.

Notes

[1]FDI stock in developing countries grew from $307 billion in 1980, to $551 billion in 1990, and to $2340 billion in 2002, according to UNCTAD (2003: Annex Table B.3, 257). In 2002, the FDI stock in Africa (traditionally a laggard in receiving FDI) stood at $171 billion, which was higher than the FDI stock in Latin America (traditionally a major destination for FDI) in 1990. (Figures are not inflation adjusted, but nevertheless illustrate the extent of FDI growth in the 1990s.)

[2]Between 1975–1982 and 1990–1998, the share of FDI in aggregate net flows of capital to developing countries rose from 9 to 34%, whereas official flows (bilateral and multilateral) fell from 32 to 20%, and private bank loans fell from 50 to 24%. Thus, in the 1990s, FDI became the single largest source of foreign net capital flows to developing countries (Akyuz and Cornford, 1999, 8).

[3]Vernon (1998: 108) wrote: 'Much as they [emerging economies] may welcome the contributions of foreign-owned enterprises in their jurisdictions, I anticipate that these countries will have grave doubts from time to time about the long-term contributions of such enterprises, especially as they observe that the grand strategy of the enterprise is built upon the

pursuit of global sources and global markets. Aware that they cannot cut themselves off from the global economy except at great cost, such countries nevertheless are likely to resort to restrictive measures from time to time that seem necessary to satisfy their internal political needs. And measures of that kind can easily prove costly both to the initiating country and to the enterprises that are the targets of their actions.'

[4]This issue was central to IB in the 1970s but thereafter took backstage (e.g., Vernon, 1971, 1977; Lall and Streeten, 1977).

[5]In 2002, for instance, 10 developing countries received 79% of the total FDI inflows to all developing countries (UNCTAD, 2003).

[6]The value of studying how MNEs and host countries impact on each other over a period of time is illustrated by Vernon's influential 'obsolescing bargain' theory.

[7]The experience in Latin America is striking: fully 70% of all infrastructure concession agreements in that region in the 1990s were renegotiated within three years of signing, with a 90% renegotiation rate for water concessions, according to Guasch et al. (2002).

[8]In the absence of a single multilateral agreement on FDI, similar to that for international trade, a hodgepodge of arrangements has emerged, consisting of MNE codes of conduct, voluntary standards, bilateral investment treaties, assorted regional agreements, and piecemeal coverage of FDI issues through multilateral institutions meant for other purposes, such as the WTO, IMF, and World Bank.

[9]This point is elaborated in Ramamurti (2001) and emerges as a central theme in the UNCTAD (2003) issue of the *World Investment Report*, which has a whole chapter on 'The importance of national policy space' (Chapter V).

[10]For a pessimistic view of state-owned MNEs in China, see Economist (2004a). On the Slim group, see Economist (2004b).

[11]For one example of a good start in this area, see Khanna and Palepu (2002).

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