BOOK REVIEWS

The Growth and Evolution of Multinational Enterprise: Patterns of Geographical and Industrial Diversification

Robert Pearce

(Aldershot, Hants.: Edward Elgar, 1993), 176 pages.

This book looks at the ways in which firms grow, whether through industrial or geographical diversification. Are they complementary or alternative strategies? When geographical diversification is chosen, are exports or local production preferred? What role does the technological competence of the firm play in this process of growth?

The answers to these questions are based on an extensive data base on the activities of 792 of the world's largest firms from several different home countries. The data base is based largely on work carried out in the 1980s by John H. Dunning, Robert Pearce and John Stopford and allows the author to consider these issues at the level of the firm. Explanatory variables are various measures of firm size, research intensity, concentration and penetration. The latter is defined as the share of an industry represented by firms whose main product is in another industry. With these variables, the author seeks to explain four different measures of the degree of internationalization of firms, three of which relate to foreign direct investment (FDI) and one to parent-company exports.

Robert Pearce found that the percentage of the total production carried out overseas by these firms depends on the size of the firm, its technological competence and the degree of penetration of its industry by outside firms. In contrast, the percentage of a firm's domestic output which is exported hinges on its technological strength and on the degree of concentration in its industry. Thus, as it has been shown in other studies, larger firms generally conduct more overseas production, while all firms that are active in foreign markets (regardless of the mode of market servicing) tend to spend relatively more on research and development.

The author found a significant positive relationship between parent exports and the overseas-production ratio, which suggests that the two are complementary. This result concurs with the multitude of tests that have also pointed towards complementarity. He went beyond many of these tests, however, by separating intra-firm from arm's-length exports. He found that overseas production stimulates intra-firm exports, and that it is only partially offset by a weak substitution effect on arm's-length exports. He then applied these same tests to the level of industrial diversification and found weak support for the suggestion that large firms diversify more than smaller ones. As it does with overseas production, research and development tends to promote industrial diversification. Somewhat surprisingly, diversification is greater in high-growth industries than in slow-growth ones. Penetration by outside firms also encourages diversification. The final group of regressions ran by the author concerned the interesting question of whether industrial and geographical diversification are complements or substitutes. He found that internationalization and industrial diversification tend to go hand in hand except at relatively high levels where the firm encounters resource constraints. This result should, perhaps, not come as a surprise given his earlier finding that research-and-development intensity promotes both forms of growth. Indeed, the implicit model suggested by these results is that both geographical and industrial diversification represent outlets for underutilized competitive advantages of firms.

In terms of the questions posed in this book, the author deserves high praise. They are both topical and perennial, and the regression results provide some interesting findings. In contrast to the common notion that firms look abroad or to other industries when they face constraints on growth in their domestic markets, these results suggest the idea of diversification as an aggressive strategy of firms eager to reap the maximum returns from the technological competencies that they have developed.

Discussions of the method of market servicing by firms will probably never lose currency; nor should they. The predominance of foreign production over exporting for large firms is one of the most ubiquitous characteristics of the world economy. Understanding this fact is vital if we are to shape appropriate trade and investment policies.

The main criticism of the book is methodological. Without an ideological axe to grind, the author is admirably candid in his results. He is pragmatic in recognising that simply throwing numbers at each other may not always produce sensible results and he is always quick to point out potential sources of bias. But, at the same time, a slightly less neutral approach might have made for a more interesting and indeed controversial book. The book is highly quantitative and relies heavily on regression analysis, so much so that, in fact, almost one third of the pages are devoted entirely to regression results. Regression analysis may be too strong a word for what is essentially an examination of correlations among a handful of variables. Running hundreds of such seemingly ad hoc regressions may sometimes throw out some interesting results, but without a wider frame of reference and a discussion of possible implications the book remains frustratingly descriptive. For those interested in prescriptive and normative issues, this book will provide endless ammunition. For the rest, this review will probably suffice. ■

Stephen Thomsen
Consultant
Royal Institute of International Affairs
London, United Kingdom

Multinational Enterprise and Public Policy: A Study of the Industrial Countries

A. Edward Safarian

(Hampshire, United Kingdom: Edward Elgar 1993)
581 pages.

Multinational Enterprise and Public Policy offers a sophisticated treatment and systematic analysis of the problems that exist between transnational corporations (TNCs), Governments, and public policy. The book investigates the link between country-specific public policy and investment activities, exporting, and licensing by TNCs. Unlike the view developed in the late 1960s and 1970s, which declared an ambiguous and occasionally hostile relationship between TNCs and host countries, A. Edward Safarian asserts that TNCs exert a significant influence on investment, as well as on other relevant public policy decisions of host and home countries.

Safarian attempts to clarify two key aspects of TNCs and public policy. First, TNCs will invest in a particular country if the expected rate of return on the investment is positive. While it is assumed that firms that invest in country-specific projects with a positive rate of return will grow and enhance their influence on public policy makers, this does not always occur. The complicating element is that policy makers may utilize State instruments to further control the performance of TNCs.

Secondly, due to the nature of the TNC activities, policy makers cannot accurately gauge the quality of investment projects. As a result, different countries respond differently to TNCs. For instance, Japan restricts TNC activities to exporting or licensing, while the United Kingdom does not have a cohesive policy except in specific extractive or strategic industries. A related implication is that investment decisions of individual TNCs and, hence, economic activities as a whole, are significantly affected by the ability of TNCs to generate revenues for the firm, and for the home and host countries. If TNCs can put up a significant part of their own funds to finance an investment project, they are less reliant on external financial markets and country-specific financial institutions. One result is that financial institutions may provide funds to TNCs with fewer (public policy) strings attached than to firms without internally generated financial support.

Those readers relatively new to this literature will benefit from reading the section on policies of 15 developed countries on inward and outward foreign direct investment (FDI). Part I, probably the core study in the entire volume, surveys national and FDI policies from a political economy perspective. Among the broad commonalities that Safarian observes are the overwhelming preponderance of corporate motives and country responses, and the importance attached to market positioning and to bargaining for the greatest advantages.

The author's conclusions are different for each country studied. For example, the success of re-industrialization in Japan is not necessarily due to a grandiose industrial policy, but rather to the Japanese private corporate structure and a business culture that induces monopolies and concentrates heavily on domestic production. This is evident by the fact that less than four per cent of Japanese manufacturing is performed outside the country, while the comparable figures for the United States is over 20 per cent. For example, Safarian suggests that firms in regulated industries prefer external guidelines because these enable companies to position themselves more effectively in dealing with actual or potential competitors.

Safarian studies the impact of TNC activities on policy and vice versa, as it relates specifically to economic growth or to the State's political power. He recognizes that mature TNCs probably experience fewer constraints than smaller multi-plant firms. He finds that the smaller multi-plant firms lack the ability to take full advantage of economies of scale.

In his country-specific section, Safarian focuses on the changing structure of Japanese outward FDI, and the recent deregulation of Japanese financial markets. He determines that the members of *keiretsu* industrial groups, with close relationships to the Government of Japan, are pressured by the United States and the European Union to change some of the restrictions and exclusionary practices surrounding FDI into Japan. In the case of the United States, the pressure has been exerted specifically through talks held under the Structural Impediments Initiative arising from the United States Trade Act of 1988.

The book also contains studies of natural-resource-based economies such as Australia, Canada, New Zealand, Norway and Sweden and the location of FDI in these countries. He concludes that, in the case of Australia, the federal Government is anxious to avoid low export prices which would reduce tax revenues. Despite Canada's proximity to the United States, its policies regarding natural resources and TNCs are more akin to those of Australia. The petroleum-incentive programmes of Canada favoured Canadian ownership and hence were explicitly discriminatory against the established TNCs. Both Australian and Canadian tax laws have been used in ways that distinguish established firms by nationality of ownership. Unlike other countries in this study, New Zealand was not particularly restrictive in this area and hence did not have to undergo major liberalization in response to the changing circumstances of the 1980s. Safarian concludes that New Zealand's policies, in fact, showed considerable continuity over the 1970s and 1980s in contrast to the experience of the other countries reviewed.

Safarian's study of oil and gas in Norway points out the key role these resources play in the Norwegian economy, accounting, by the early 1980s, for one third of the value of exports and one sixth of the State's revenues. Safarian argues that the relatively homogeneous structure of the industry and its output provide a good opportunity to study the impact of the industry on overall FDI activity and related policies. The study of Sweden contains a good review of the role of Swedish policy regarding foreign affiliates and provides information on the potential impact of these firms on the Swedish economy.

Two chapters discuss aggregate economic investment and business effects of the activities of TNCs in host countries, such as Belgium, Ireland, Italy, and home countries, such as Germany (before unification), the Netherlands, Switzerland, the United Kingdom and the United States.

While the sophisticated nature of much of the analysis here might deter some readers, Safarian succeeds in identifying and clarifying how TNCs affect the public policies of a select group of industrial countries, with useful insights into industrial policy developments and international business. ■

Masood Kavoossi

Associate Professor of International Business
School of Business
Howard University
Washington, D.C.