

# Multinational Enterprises and Sustainable Development in Emerging Markets

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**Abstract** Foreign direct investment (FDI) is often considered positive for the host countries in emerging markets as it brings in foreign capital and job opportunities. The relationship between MNEs and local governments has however seen its ups and down. Over the years, it has changed from a period of conflict after the World War II, where MNEs were investing for purposes felt to be detrimental to government policies, to a more co-operative nature. The 1980s and major part of 1990s saw the co-operative relationship leading to the danger of race to the bottom through excessive locational competition. In this paper, we examine the most influential literature from 1970s onwards and the current state of this relationship. Our analysis reveals that the increased tensions caused by anxiety due to 9/11 and subsequent development in the political economy, company strategies and government policies. We examine the changing relationship between multinationals and national governments. Thanks to globalisation MNEs are increasingly becoming more powerful and often this process is accelerated due to lack of any collaboration between MNEs and the governments. Thus, governments, particularly in emerging markets, are becoming more and more dependent on multinationals from the developed countries. In this study, we intend to evaluate whether MNEs can play a positive role towards problems of emerging markets such as poverty reduction and economic development.

## Introduction

This chapter examines the relationship between multinational firms and sustainable development in emerging markets. In the period from the 1950s to the first decade of the new millennium, there have been profound changes in this relationship. Governments and MNEs have moved from a situation of conflict, to one

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where government policies were seen as a constraint on the activities of MNEs and then finally to an era of co-operation (Boddewyn 1992). But now there is a situation of great uncertainty following the '9-11' and subsequent changes in the political economy which this paper seeks to illuminate. In recent years, the conditions and the landscape for MNEs have changed as compared to earlier decades. The multinationals and emerging markets (EMs) relationship is manifested by suspicion and anxiety. The host governments are now uncertain of strategic implication of multinational decision making (Prasad and Ghauri 2004; UNCTAD 2015). It is interesting to see whether the welcoming approach of EMs towards MNEs will continue. Some of these issues are old that the role of MNEs is seen both as contributing to host country's economic development and as a hindrance to local firms' development and loss of jobs due to rent-extracting power of MNEs, loss of control over national resources and displacement of indigenous firms (Ghauri and Yamin 2009).

A key issue determining the impact of globalisation on emerging markets on international business is the nature of the relationship between national governments and multinational firms. Our contention is that the conceptualisation of this relationship has mirrored the changing balance of power between states and firms and between rich and poor nations. The current configuration of the global economy has brought us to a point of inflexion in this relationship, which might lead to a totally new world order.

The most profound change in the world economy in the first post-war period is however, the emergence of successive waves of Asian countries as key players in the world economy, bringing new competition to Western nations and fostering the notion of a 'loss of competitiveness' in the developed countries. This had a number of effects. First, FDI in these countries changed in nature and its conceptualisation ceased to regard the host economy as purely a pliable object. Second, as outward oriented policies replaced protectionist ones, emerging country multinationals became salient and the analysis of their strategies became important (Ghauri and Buckley 2002). Third, the policies of host governments towards inward investment have been shaped by the increasing interdependence of global economic activity (Buckley and Ghauri 2015). Asian emerging countries went beyond Newly Industrialised countries (NIC) to become full global competitors and the post communist nations began to enter the world economy as transitional economies. The danger facing many economies was that of being left on the fringes as globalisation drew countries together either through expanded world trade and FDI or through the creation of Multinational Enterprises and Sustainable Development in Emerging Markets creating WTO and trading blocs (EU, NAFTA, ASEAN-AFTA). Some of these issues, such as privatisation, the emergence of China, the Asian crisis and 9-11 have made scholars and policy makers rethink their strategies and priorities.

## The Critical Literature

One of the very early pieces on foreign investments and the growth of the firm by Edith Penrose (1956) pointed out the controversial aspects of foreign investment, where in spite of the successful establishment of a subsidiary, local benefits may be low because excessive returns may be transmitted out of the host country. It revealed that for the year ending 1954, GM earned a return of 590% on its original dollar investment in Australia. Later, Stephen Hymer (1971) looked into ‘two basic laws of development’; namely the Law of Uneven Economic Development and the Law of Increasing Firm Size. He claimed that the multinationalisation would continue through giant firms from both sides of the Atlantic. He suggested that MNEs would spread their day-to-day, i.e. manufacturing, activities all over the globe, thus diffusing industrialisation to developing countries and creating new centres of production. The other activities, i.e. co-ordination and communication, would stay closer to the head offices which would be completely centralised. As a result, ‘the best’ highly skilled and highly paid manpower would concentrate in the major cities of the US and Europe, while lower level skills and manpower would remain in other parts and cities of the world. MNEs would thus be greatly interested in the markets of these less-developed countries. This was further confirmed by Buckley and Ghauri (2004) in their global factory study.

Whenever we discuss MNEs and developing countries, it becomes inevitable to enter a discussion of the determinants of development. Streeten (1974) started with the assumption that countries are poor because they are poor and thus need large injections of foreign investments as they cannot raise their own capital. The low investment ratio was considered both the cause and effect of poverty. While discussing MNEs and developing countries it suggested that the bulk of FDI in developing countries consisted of the re-investment of local earnings. The analysis of Barnett and Muller (1975) addressed the myth of development, ‘the struggle of human beings to realise their full potential’ and an evaluation of FDI. Already by the end of the 1960s, the gap between rich and the poor world was widening. Moreover, the gap within countries was also widening, a small minority was becoming affluent but for a large majority the miseries were increasing. Although in absolute terms there has been growth in most countries. The positive impact of MNEs as regards job opportunities, should be compared with the negative impact of maintaining and increasing poverty and having conflicting interests to those of developing country governments and masses of population. As the primary objective of MNEs is profit maximisation, MNEs thus use all their resources and superior knowledge and power to achieve this. Moreover, MNEs are often blamed to serve only the elite population in emerging markets and considered to create unfair competition for local firms who do not have the knowledge and resources to compete with foreign firms. This has had an adverse effect on the distribution of income, poverty and employment levels in emerging markets.

Raymond Vernon's *Sovereignty at Bay* (1971), and his later analyses, *Ten Years After* (1981), also analysed the developments which took place in the field of MNE growth in the subsequent decade. In trying to predict the behaviour of US based MNEs, Vernon explained that although his product life cycle hypothesis (1966) has worked well over the years, it needs to be modified as the innovation lead of US firms was declining. The later study admits that MNEs from Europe and Japan have gained somewhat more in importance as compared to 10 years earlier. Moreover, there are a number of new MNEs based in Brazil, Mexico, Hong Kong, India and other developing countries that have also emerged by 1981. Developing countries had competitive advantage, particularly in the raw material and extractive sectors, but in manufacturing and the emerging service sector, control of the key competitive advantages remained firmly under the control of innovative MNEs. Vernon concluded that a new stability was emerging, based on mutual recognition of goals and control of key resources.

Later studies by Dunning (1988, 1994, 2000 and Dunning and McKaig-Berliner 2002) re-evaluated the benefits of FDI and pointed out that both country and firm specific factors have changed considerably. Countries have a more welcoming attitude towards foreign firms which they see as a positive means for creating jobs and of enhancing the competitiveness of their local capabilities and firms. For firms, a more systematic and integrated approach combining production and marketing was becoming a strategic issue. These issues are creating a new balance of benefits and costs for both parties that needs to be investigated.

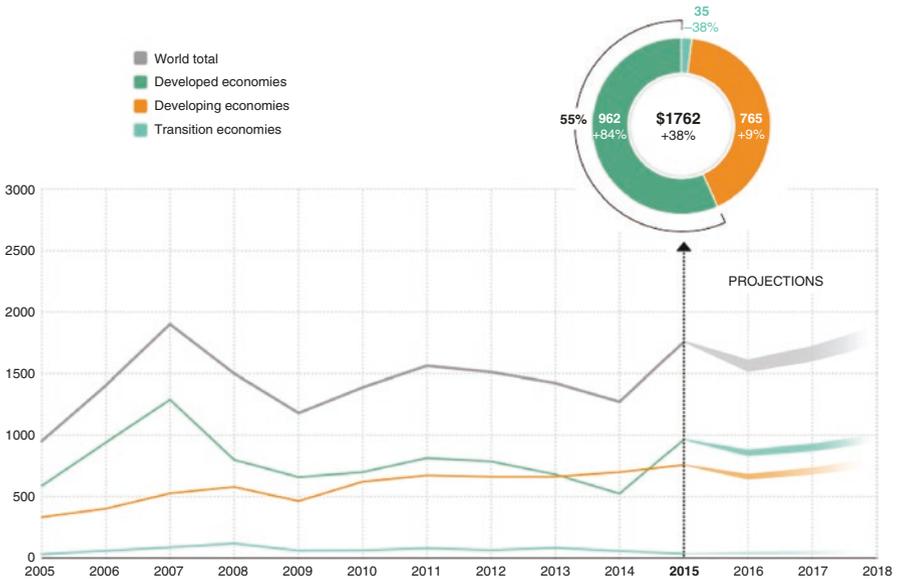
More recently, Krugman's work has come in the forefront starting with historical material and referring to the fact that only a short while ago several scholars and writers were warning that the biggest threat to US prosperity was competition from other developed nations. According to Krugman (1994), now that many economic writers have lost interest in the much-hyped threat of Japan to the USA's dominance, they have started seeing a new enemy: the emerging economies of the Third World. While the advanced nations had shown a disappointing performance over the past decades, Asia, especially China and South East Asia, had shown a remarkable and rapid growth. However, in Krugman's opinion, the fears about the economic impact of Third World competition were entirely unjustified. Theoretically, there were some reasons for concern about the possible impact of Third World competition on the distribution of income in the West, but in practice there was almost no evidence that this was as serious as some countries suspected. The only effect of Third World growth was on the distribution of income between skilled and unskilled labour within the First World. Assuming that there was more skilled labour in the North and more unskilled labour in the South, the North will export skilled-intensive products. Thus, the two parts in fact trade in skilled and unskilled labour. Northern skilled labour becoming scarcer will increase the wages of skilled labour and will reduce the wages of unskilled labour. The same type of mechanism has now shifted between the North and the South at a global level. This was the effect of North-South trade and it has very little to do with growth or performance, which is dependent on domestic productivity. On the other hand, if the West creates barriers to imports from emerging markets, it may destroy the most promising aspects of

today's world economy: widespread economic development for the benefit of all. Buckley and Ghauri (2004) suggest that the consequences of the globalisation represent political challenges and reaction against these changes has led to a questioning of the effects of global capitalism as well as its moral basis.

## Multinationals in Emerging Markets

The role of developing countries 'The South' has not been seen by academic authors as merely an inert recipient of investments from 'The North'. Although Gereffi and Evans (1981) highlighted the dependence of developing countries like Mexico and Brazil on MNEs, and their policies to handle this dependence, they argued that countries like Mexico and Brazil should not be considered as typical developing countries as they are 'too industrialised' and have also developed sophisticated administrative apparatuses capable of protecting local interests. Hill and Johns (1985) discussed the role of FDI in developing East Asian countries. In the later years however, there have been profound changes in the makeup of global economy and flows of FDI. In 2015 FDI inflows recovered strongly as compared to previous years increasing by 38% to \$1762 billion—their highest level since the global economic and financial crisis of 2008–2009 (UNCTAD 2016). The FDI inflow to developing countries also continued to grow and at \$765 billion was 9% higher than in 2014 (UNCTAD 2016). As in 2014, half of the top ten recipients of FDI inflows continued to be from developing countries, receiving 43.4% of total FDI inflows, as shown in Fig. 1 (UNCTAD 2016).

Buckley and Casson (1991) analyzed MNEs in developing countries in terms of the interplay between two types of culture, a highly entrepreneurial culture in developed countries versus less entrepreneurial social groups in developing countries. It was claimed that the limited entrepreneurial culture in developing countries is one of the reasons for their underdevelopment. These two types of culture describe the values which stimulate the emergence of individual performances and competencies. The paper dealt with 'the poorest and most persistently' underdeveloped countries, such as sub-Saharan African countries. MNEs also differed from each other because of differences in their home countries. One condition for development was that there are resources with the potential to be exploited. Some countries, however, failed to realize their potential due to lack of education and training, inefficient use of labor due to lack of infrastructure. They claim that the technical culture stimulates the study of laws and experimentation while the moral culture influences organization building, commitments, honesty, stewardship, and other values related to contractual arrangements. MNEs are considered to be a major instrument for transferring both the technology and the entrepreneurial culture of DCs to EMs, which according to these cultural differences are difficult to transfer. This explains the limited spill-overs of MNEs operations in EMs. In the later years however, their analysis has proven to be shaky as the emergence of successful entrepreneurs from China and India has proven to be no less capable than their Western counterparts.



**Fig. 1** Global FDI inflows by group of economies, 2005–2015, and projections, 2016–2018 (Billions of dollars and per cent). Source: ©UNCTAD, FD/MNE database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics))

The shift in the recent years from extreme liberalization and minimal state to a more general disenchantment with globalization and emphasis on presentation of civil societies in EMs is leading towards increasing tension between MNEs and EMs (Lall and Tenbal 1998; Buckley and Ghauri 2015; Firth and Ghauri 2010). This shift has also its roots in the increasing realization that industrialization in East Asia was a governed process and was not market led (Lall 1984, 1994; Havila et al. 2002). The government policies in Korea, Singapore and Taiwan to govern market forces played a greater role in generating economic development than anything else (Ghauri and Yamin 2009). In more recent years however, we have several entrepreneurial and competitive businesses such as Alibaba, ZTE, Lenovo and TATA from China and India.

### Factors Influencing MNEs and Governments Relationship

While discussing the MNE-government relations and questions whether MNEs have been causing stability or discontinuity in the third world, Kaplinsky (1991) provided some statistical evidence that the world’s largest 350 MNEs employed 25 million people and their liquid financial assets were three times larger than the total global assets of gold and foreign exchange. These 350 MNEs accounted for more

than 40% of the total global trade of a number of the world's largest economies. The MNEs located their production in a limited number of countries and those developing countries where MNEs concentrated production for export generally achieved significant economic growth. This type of FDI contributed to the New International Division of Labour (NIDL). However, the basis of globalization began to change, as far back as the 1980s. The principles of optimal location and scale began to change. It is now no longer self-evident that NIDL-type strategies for FDI, which have been successful in the past, are likely to be fruitful in the coming years. Issues such as the transformation of the basic rules of competitiveness, the changing determinants of optimum location, unevenness in the world economy and the changing parameters of scale economies have all influenced the above changes. The changing patterns of production are directly related to EMs (Buckley and Ghauri 2004).

Stopford (1994) also dealt with the issue of growing interdependence between transnational corporations and governments. The starting point was the idea that the rapid growth of FDI has brought MNEs center-stage in the international political economy. This development challenges traditional comparative advantage and directs attention towards created assets instead of natural endowments. As suggested, in wealth creation and a greater degree of partnership between MNEs and governments. In this respect, both parties needed to understand each other's objectives and consider policy co-ordination as a positive-sum game and not as a zero-sum game. Four factors were considered to be central in this increasing interdependence:

1. The growth of MNEs; that the output from assets located in one country was owned and controlled in another, which makes it very hard for governments to control foreign investors;
2. The growth share of MNEs in exports, both from home and host countries given that MNEs manage about three-quarters of the world trade;
3. MNEs are primary sources of R&D in technology and thus dominate world trade in technology payments, often through transfer pricing. An understanding of MNE decisions on the location and transfer of R&D is of the utmost importance for governments;
4. The growth of strategic alliances and other forms of collaboration among MNEs.

These collaborations have changed the structure of competition and challenge the power of governments. There is a triangular diplomacy model: government-government, company-company and government-company to illustrate competing national and international resources. More recently however, non-governmental organizations (NGOs) have been playing a major role in reshaping the global political-economic landscape. A number of studies are thus challenging the two sectors bargaining model (e.g. Teegen et al. 2004). These studies claim that NGO's many and varied interactions with MNEs and governments represent new challenges to both parties.

Understanding of globalization is crucial to an understanding of international political economy. Globalization is often referred to as varied phenomena, which suggests a multiple level analysis in terms of economics, politics, culture and ideology. However, globalization is driven mostly by economic forces such as;

reorganization of production, international trade and the integration of financial markets (Buckley and Ghauri 1999, 2004). It is not uniform across countries and the strategies of multinationals are therefore crucial to its causes and consequences (Ghauri and Buckley 2002). While discussing production, the state and new social movements, we detect a series of relationships among: (a) economic globalization and the state; (b) pressures on the state from below by subnationalism and from above by supra-national institutions such as EU and NAFTA, (c) globalization and democratization and, finally, (d) resistance to globalization to prevent the eruption of social tension. Globalization thus encompasses contradictory trends (Mittelman 1994). On the one hand, there are the unaccountable forces of globalization, which are largely beyond the control of effective state regulations. On the other hand, the state pulls in the opposite direction by using a variety of government intervention measures to create a competitive edge. Power is dispersed among more actors and interregional competition is heightened between the ‘triads’ of Europe, North America and Asia.

The globalization of production has also led to a globalization of consumption which is threatening local cultures, tastes and buying behavior and is provoking nationalistic sentiments (Buckley and Ghauri 2004). A recent emphasis on social responsibility and behavior of MNEs, pharmaceutical firms in particular, regarding pricing of drugs (e.g. AIDS drugs) in EMs have widened the rift between MNEs and EM governments (Vachani and Smith 2004; Ghauri and Rao 2009). All this is thus causing tensions at global, national and sub-national levels (Dunning and Wallace 1999; Firth and Ghauri 2010; Ghauri et al. 2015).

## **The Changing Nature of the Relationship**

Privatization (the transfer of productive assets from public to private ownership) has been part of most structural adjustment policies in EMs since the 1990s. It has been undertaken to achieve a variety of objectives, such as enhanced economic efficiency, reduction of financial deficits and reducing the role of the state. If we summarize experiences with privatization strategies showing that there is now a sufficient body of evidence to review its progress made and to assess what works and what does not. We end up with the cautionary point that privatization alone is unlikely to ease significantly the burden of the state-owned sector in many EMs.

The emergence of China as a major player in the world economy and its full membership in WTO since 2001 has already had an impact equal to that of Japan in earlier decades of the Post War World. An initial, almost blanket acceptance of FDI has now become more targeted in terms of priority sectors and regions. China represents a non-uniform environment for the inward investor and there are currently difficulties in the implementation and transparency of business law, contractual difficulties, regional differences and uncertainties about the direction of future economic policies. These challenges need to be addressed by careful adaptation of company strategies.

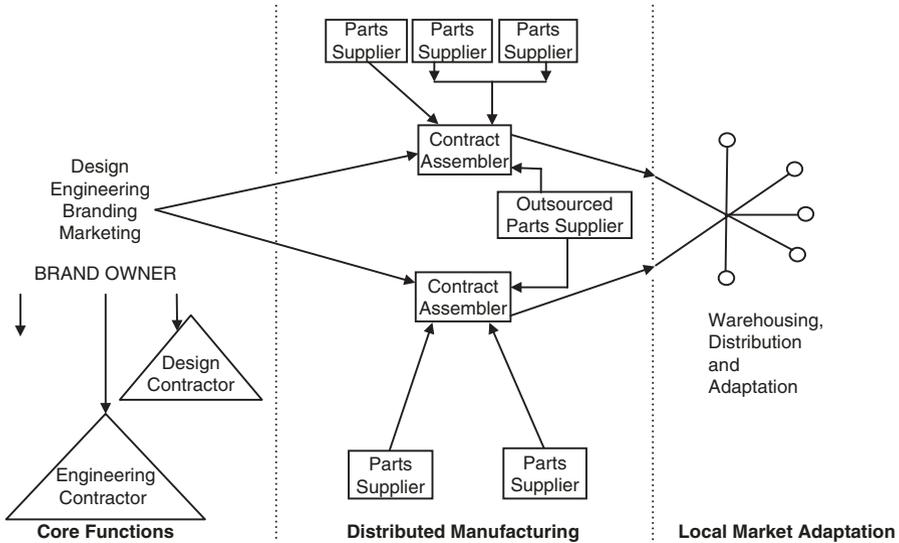
We are in a state where MNE-host country relations in a world in which middle income countries have fully emerged onto the world stage, leaving behind a group of largely poor less developed countries which have so far been bypassed by globalization. Increasing locational ‘tournaments’, to attract FDI may have reduced the benefits to the host countries as have the increasing skill of the managers of MNEs in making their investments more ‘footloose’ (Oxelheim and Ghauri 2004). Differences within developing countries may lead to divergence between those which can develop the velocity to catch up and those which will fall behind as the world economy becomes more interdependent.

Host country policies which have changed in this period include the relaxing of controls, increasing incentives to inward FDI, privatization, provision of guarantees and arbitration. We have seen a trajectory of MNE-emerging market relations where tension increased 1950–1975 and then reduced, whilst the host country gained bargaining strength in the first period, which relaxed as the MNE gained ascendancy. The present state of globalization that has increased the mobility and flexibility of MNEs demands from the government to create and upgrade assets to derive advantages for local economies (Elg et al. 2015). This has to be done at specific industry level including the creation of institutional support from MNE activities (Cavusgil et al. 2013; Firth and Ghauri 2010).

If we re-examine some of the issues above, we can see that the penetration of Southern Multinationals in the North will increase. As asset prices fall in developed economies, more of the firms denominated in these assets will be acquired by Southern multinationals which is evidenced by Lenovo taking over IBM laptop business and TATA taking over Land Rover and Jaguar. The symmetry of the relationship will be further distorted by the decline of Northern multinationals in the South, which will be increasingly unable to fund outward FDI and which will be vulnerable to takeover. With increasing numbers of M&As, the balance of power will thus swing ever more decisively to the Southern firms.

All of this, of course, is not without cost to the multinationals. Prahalad and Lieberthal (1998) say: ‘In order to participate effectively in the big emerging markets, multinationals will increasingly have to reconfigure their resource base, rethink their cost structure, redesign their product development process, and challenge their assumptions about the cultural mix of their top managers. In short, they will have to develop a new mind-set and adopt new business models to achieve global competitiveness in the post imperialist age’ (page 79). Prahalad and Lieberthal thus predict the end of corporate imperialism and a more ‘accommodatory’ stance by multinational firms in emerging markets. At the same time, they advise MNEs to go beyond the elite segments in these markets and target consumers at the base of the pyramid if they want to have a sustainable competitive position in these markets (Tasavori et al. 2016).

There are also grounds for believing that bargaining power will continue to move in the direction of multinational firms. They have a wider choice of investment locations as new ‘emerging countries’ put themselves forward as export platforms—usually on a tax-free basis. Their proprietary technology is widely sought after by EMs and their branded products sell at a premium to upscale consumers globally.



**Fig. 2** The global factory (Source: Buckley and Ghauri 2004, p. 89)

Flexible manufacturing and production controlled by IT systems mean that more and more of the activities of MNEs are footloose. As suggested by Buckley and Ghauri (2004), the manufacturing system of future will use distributed manufacturing, where products are more and more responsive to customer needs through flexible factories (the global factory, see Fig. 2). In flexible factories, all plants can make all firms' products and brands and can switch between different firms' products very quickly using new technologies and robots. The global factory concept is thus already in place. The global factory is opposite to vertical integration and internalization. In this case, the production is shared by plants all over the globe that are manufacturing different parts that travel to another location to be assembled into a final product. In this system, most of these plants are not owned by brand owners who control the designing and marketing while most other parts of the value chain are outsourced all over the globe in quest of the most optimal location.

It is clear that increased globalization is beyond the control of any single nation state. One important response is the growth of regional co-operation which allows state policies to be coordinated to prevent wasteful competition or even combined to produce regional trading and investment blocs such as; EU, NAFTA and ASEAN. Table 1 examines the impact of policies of emerging countries on MNEs and the reciprocal impact of the strategies of MNEs on emerging markets. The final part of the table examines the impact of international developments. Several policies are listed which individual emerging countries may follow to attract inward investment by MNEs. The results of these policies may well increase competition among emerging countries, unless the final policy—regionalization is followed to ameliorate the impact of the others. Regionalization requires coordination of policies,

**Table 1** The interdependence between MNEs and developing countries

| Policies of developing countries                              | Impact on MNEs   |
|---|--|
| Subsidizing Industries  | Increased local competition  |
| Education improvements  | Potential to recruit managers, scientists and develop new technologies in emerging markets |
| Stronger markets  | Development of new products specifically targeted at emerging markets                      |
| Developing export processing zones                            | Export platform opportunities  |
| Regionalisation   | Decreased opportunities for investment tournaments   |
| <i>Strategies of MNEs</i>                                     | <i>Impact on developing countries</i>  |
| Multiple sourcing   | Increase competition between host countries  |
| Reduced unskilled labour component in production and services | Reduce DFI in emerging markets   |
| Risk Management (shift away from political to financial risk) | Variable impact depending on financial “soundness”   |
| “Flexibility”   | Joint ventures<br>Danger of increasing “footloose”   |
| Local sourcing  | Increased spillovers and positive linkages   |

cooperation between countries and the willingness of countries to forge opportunities in the wider interests of the region—these factors are not always present.

The strategies of MNEs in the global economy are largely geared towards achieving flexibility of operation, including multiple sourcing and risk management (Buckley and Casson 1976, 1998). The reduction of the unskilled labor content in many areas of production, distribution and services, through substitution of capital and information technology, together with new method of operation, means that efficiency-seeking FDI is becoming more important where inputs from EMs play a dominant role.

Finally, recent developments at global level, such as increased volatility in political economy, protectionism and increasing importance of non-market actors such as NGOs, favour flexible strategies. However, the attempt to regulate trade (for example by the WTO) and to bring investment and services within the audit of international regulation have so far proved largely ineffectual.

## Managing Increasing Interdependence

The notion that increasing interdependence can in any sense be ‘managed’ is rather superficial. Who is to do the managing? There are two groups of actors that have been the focus of attention—firms and governments. Firms are often seen as ‘islands of conscious power’ within a sea of market relations. Their international strategies rule out the market and the boundaries of the firm are defined by the point at which the costs of using the market fall below the cost of internal organization (Coase 1937).

The second group of actors is made up of governments and governmental bodies who seek to regulate their economies in line with the perceived best interests of their population. Governments aim to plan their economies to seek goals which they believe a purely market outcome will not secure. This is particularly true for emerging countries for which the market outcome is, by definition, unsatisfactory. Conflicts between the operations of markets and government policies are greatest in these situations (Buckley and Ghauri 2015).

We can thus expect an increasing tension between the strategies of MNEs and government policies. However, we need to consider the fact that markets are not perfect and both firms and governments are attempting to appropriate rents in a world of imperfect markets (Buckley and Ghauri 2002). This opens the possibility of collusion between governments and MNEs in dividing rents and mitigating conflicts between them. It is this game which is taking place in a globalizing world where markets are becoming increasingly interdependent and this is critical in allocating the benefits of improving technology, communication, productivity and output leading towards a sustainable development in EMs.

Previously, the absence of strong local competitors in most emerging markets was one of the reasons that the FDI flow was predominantly from the industrialized countries of the North to the developing countries of the South. The import substitution and protectionist strategies of most emerging markets of that era made FDI a more viable mode than trade to gain access to these markets. Now government induced market imperfections are disappearing, there are many strong and competitive local firms that can beat off the entry of foreign firms. Moreover, most of the countries have moved away from protectionist politics and are opening up their markets to all types of entry by foreign firms; the nature of the resource flow has thus changed.

In addition to the above, agglomeration has become a major factor in MNE strategies towards FDI (Oxelheim and Ghauri 2004). This leads to synergetic effects such as foreign firms buying from each other. Moreover, the presence of a number of foreign firms helps to develop specialized know-how and skills with regard to the availability of skilled labor, suppliers and distribution networks. Thus, it is not surprising that the stock of FDI in a given country is often a good predictor of future FDI.

## Conclusion

This paper charts a series of profound changes in the configuration of the world economy since the end of World War II. Many less developed or undeveloped economies now deserve the epithet 'emerging'. This reflects the reality of the waves of emerging economies that have become significant players in the globalizing world of economy. A new assertiveness has followed economic success and this is influencing future economic and political relationships. The new assertiveness in emerging markets came at a time of increasing interdependence between

**Table 2** Functions of state

|                        | Addressing market failure  |   |   | Improving equity   |
|------------------------|--|---|---|--|
| Minimal functions      | Providing pure public goods:<br>Defense<br>Law and order<br>Property rights<br>Macroeconomic management<br>Public health |   |   | <i>Protecting the poor:</i><br>Antipoverty programs<br>Disaster relief   |
| Intermediate functions | Addressing externalities<br>Basic education<br>Environmental protection  | <i>Regulating monopoly:</i><br>Utility regulation<br>Antitrust policy | <i>Overcoming imperfect information:</i><br>Insurance (health, life, pensions)<br>Financial regulation<br>Consumer protection | <i>Providing social insurance</i><br>Redistributive pensions<br>Family allowances<br>Unemployment insurance<br>environmental |
| Activist functions     | <i>Coordinating private activity:</i><br>Fostering markets<br>Cluster initiatives  |   |   | <i>Redistribution:</i><br>Asset redistribution   |

Source: (IBRD) (1997), p. 27

economies. This growing interdependence is manifested by an increasing amount of international trade (UNCTAD 2016) but is clearest in the quantum leap in international direct investment which flows between established developed countries (Buckley and Ghauri 2015). Foreign direct investment is strategic, not only from the point of view of the investing multinational firm but also from the viewpoints of both the parent and recipient countries. The globalization across markets create thus new challenges that need sophisticated decision making on parts of governments and multinationals. In this respect, multinationals are better equipped to handle these new conditions. The governments, particularly from developing countries, are not in a position to perform even the intermediate functions (see Table 2) as stipulated by IBRD (1997). Where the governments have to address basic education, environment protection, regulation of monopolies, overcoming imperfection and providing social insurance such as poverty reduction. The decline of FDI in the period after 9-11, the increasing oil prices due to the war on terror have demonstrated the increasing tensions between DC governments, MNEs and governments from EMs.

The recent development in the political economy has thus created an atmosphere of mistrust between DC governments and EM governments. Most EMs now believe that market economy is the only system that can increase sustainable development and poverty reduction. They however want to adopt this system under a certain controlled manner and not imposed by a third party. They fear that a focus on war on terror and increasing waves of patriotism in DCs are building walls between the DCs and common goals of poverty reduction and sustainable development in the South. These governments also want that the World Bank, IMF and WTO, who are often blamed to guard the interest of the Western world, should play a neutral role binding all members and asking DCs to open their markets for imports from EMs as well (Wolf 2004).

As suggested by Prahalad (2004), to be successful MNEs need to adapt their products and strategies to the markets and consumers of the developing countries. They must make products that are affordable and accessible to the majority of population in these countries. It seems that there are psychological barriers between MNEs and EMs. While MNEs believe that EM consumers are poor living under poverty without buying power and that EM governments are often corrupt regimes, the EMs on the other hand believe that MNEs and their governments exploit their powers through rent seeking behavior and have no intention to contribute towards local development and poverty reduction.

There has thus been a reassessment of the realignment of the goals of (EM) country government towards ‘competitiveness’—joining the globalizing world economy instead of resisting the impact through protectionism. Although several economies have achieved the breakthrough, many countries have been completely bypassed, gaining a minuscule fraction of the world growth. There has also been a growth of the ‘New Mercantilism’ where, through the rhetoric of competitiveness (as Krugman (1994) shows), beggar-my-neighbor policies are followed. Trade is described in terms of metaphors from warfare, rather than being regarded as mutually beneficial. In fact, it is now DCs, the proponents of the free market, that are becoming more and more protectionists.

The shareholder return-driven environment that prevailed in the last millennium and the perceived difficulties of global governance in MNEs have fueled the current crisis in governance of firms. This has led to opinions that MNEs are safely looking for control and benefit only owners and executives rather than other stakeholders such as society (Ghauri and Buckley 2002; Ghauri et al. 2014). It is therefore important to be aware of the dangers imposed by capitalism and risks of mismanaged liberalization. We need to re-divert our attention to ensuring effective responses to global environmental challenges instead of forcing EMs to follow Western style free markets and to do what they would not prefer to do. Globalization and global economic integration does not render states destitute or enhance poverty and inequality. It is the mismanagement of this process that is creating mistrust and inequality within and beyond countries.

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