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External and Internal Growth of Multinational Enterprises – Empirical Findings and Implications for the OLI Paradigm

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INTRODUCTION

Today, in the media and in public discussions, the topic of multinational companies is closely related with seemingly ever larger international mergers and acquisitions. But, at the time, when the first theories on multinational companies (MNCs) and foreign direct investment (FDI) were developed in the 1960s, external growth through mergers and acquisitions (M&A) was much less important, compared to internal growth through setting up new facilities and expanding existing capacities. Thus the pioneers of FDI-theory, like Hymer (1960/1976) or Vernon (1966) assumed that FDI was oriented at “production units set up abroad” (Vernon, 1966, p.198). Similarly, the stage model developed by Perlmutter (1969) on the evolution of MNCs assumed that foreign production of a certain product followed and substituted the export of the very same product. It seems that today’s theories on MNCs and FDI are – at least implicitly – still taking internal growth as the “normal” case. This article will argue that some very special characteristics of external growth are neglected by such theories as the eclectic paradigm (Dunning, 1993) or the internalization school (Buckley and Casson, 1976; Caves, 1986). The question arises whether these theories meet the claim of their authors to be general theories of the MNC or of FDI.

In the first two following sections, some empirical evidence on the relative importance of external and internal growth will be presented. Total foreign direct investment (FDI) flows will be compared with cross-border mergers and acquisitions (M&A) and the numbers of newly founded affiliates or factories will be compared to the numbers of those that have been acquired. An empirical study will be presented showing that today German MNCs grow abroad nearly entirely through mergers and acquisitions (M&A).

The following sections will then deal with the theoretical implications of external growth for FDI theory. They will concentrate primarily on the eclectic paradigm, as developed by Dunning. Implications for the three elements of this paradigm – internalization, ownership-specific and location-specific advantages – will be analyzed, followed by a short discussion of empirical literature on the validity of location-specific advantages. A typology of investment motives used later by Dunning, which supplements his former paradigm and explicitly includes strategic asset seeking through M&A, will also be discussed. Finally, some conclusions for FDI theory will be summarized.

SOME EMPIRICAL EVIDENCE ON THE GROWING IMPORTANCE OF EXTERNAL FOREIGN GROWTH

A first empirical analysis of the importance of external growth can be made on the basis of data published by UNCTAD in its annual World Investment Report. In addition to data on worldwide FDI flows, UNCTAD has also published data on the volume of cross-border mergers and acquisitions (M&A) since 1988, which were obtained from the consulting firm KPMG.

These data show an enormous increase of FDI flows during the last ten years. They have grown from \$159 billion in 1988 to \$644 billion in 1998. In the same period, cross border M&A has grown from \$113 billion to \$544 billion in 1998. A comparison of the data sets of both FDI flows and M&A (cf. Table 1) is problematic due to the methodological differences in the collection of the data.¹ But it can clearly be concluded that the largest and probably still growing share of FDI flows is accounted for by cross-border M&A (for a more detailed interpretation of these data cf. Wortmann, 2000a). External growth is increasingly dominating over internal growth.

Table 1:
FDI flows (inward) and cross-border M&A (in billion US\$)

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
FDI flows	159	201	211	159	176	219	243	329	359	464	644
cross-border M&A	113	123	160	85	122	162	196	237	275	342	544
<i>difference</i>	<i>46</i>	<i>78</i>	<i>51</i>	<i>74</i>	<i>54</i>	<i>57</i>	<i>47</i>	<i>92</i>	<i>84</i>	<i>122</i>	<i>100</i>

source: UNCTAD: World Investment Report, various years, M&A data based on KPMG; own calculations

The increasing importance – in the long term – of external growth is also supported by earlier data collected by the Harvard Multinationals Research Project (Vaupel and Curhan, 1974) data on external and internal growth, which extends back to the turn of the century. Before 1914 and yet also before 1945 there were significantly more new formations than acquisitions of foreign manufacturing affiliates. In the post war era, the volume of acquisitions grew continuously (cf. Table 2). Soon after the end of

1 Such a comparison is also made by UNCTAD (1998, pp. 19-23). But here, only majority M&A is compared with total FDI, even though FDI also includes flows to minority participations.

the 1960s, about two thirds of the newly entering manufacturing foreign firms were acquisitions and only about one third were newly founded.

Table 2:
Number of newly founded (n) and acquired (a) foreign manufacturing affiliates of the world's largest MNCs

	non-US MNCs				US MNCs			
	n	a	n	a	n	a	n	a
1900-14	143	66	68%	32%	80	32	71%	29%
1914-45	402	305	57%	43%	458	275	62%	38%
1946-61	617	628	50%	50%	973	860	53%	47%
1962-67	663	968	41%	59%	696	1017	41%	59%
1968-70	491	1079	31%	69%	---	---	---	---

comment: on the sample cf. Vaupel and Curhan (1974, p. 1-30); data have been recalculated in order to exclude affiliates that resulted from restructuring.

source: Vaupel and Curhan 1974, tables 13.17.1 and 13.17.2; own calculations

The same trend, continuing well into the 1990s, is confirmed by the results of our inquiry among foreign manufacturing plants of German MNCs (cf. Table 3). Just as the internal growth through the construction of new facilities abroad dominated the 1950s and 1960s, so today the enterprises grow primarily through the acquisition of previously existing facilities.

Table 3:
Newly founded and acquired foreign factories of German MNCs

	50s		60s		70s		80s		90s	
newly founded factories	4	100%	10	67%	14	58%	10	37%	9	18%
acquired factories	0	0%	5	33%	10	42%	17	63%	41	82%

source: own survey within the above-mentioned research project

The data presented indicate a shift between internal and external growth. The relative quantitative relevance of the two modes cannot be precisely deduced from the given data: The aforementioned comparison between FDI data and data on cross-border M&A is, as mentioned, problematic because of the different survey methods. Also the comparisons of the number of newly founded and acquired entities – be it companies or factories – do not take into account the size of these entities. While

newly founded entities – at least in the first phase of their development – are relatively small, acquisitions sometimes are very large. On the other hand, the creation of new entities is not the only form of internal growth; of greater importance might be the extension of previously existing entities – be they originally newly created or acquired.

EXTERNAL AND INTERNAL FOREIGN GROWTH OF GERMAN MNCs IN THE MANUFACTURING INDUSTRY

In this section, another approach, which is based on employee counts and allows a more precise measurement of external and internal growth of MNCs (Wortmann and Dörrenbächer, 1997), will be presented. The method can be summarized as follows: a total growth in employment during a ten-year period was calculated from the position data of the Deutsche Bundesbank for the end of 1984 and the end of 1994. This total growth can be caused internally or externally. Data on external employment growth are taken from a database generated by FAST, Berlin, which will be more closely described below. There are no statistical data for internal employment growth, but its net effect can be calculated as the difference between total growth and external growth.

The Deutsche Bundesbank has collected various supplemental data concerning the direct investment position of German enterprises abroad, including employee counts. The starting point of this analysis is the employee counts of year's-end 1984 and 1994 of the affiliated companies in the manufacturing industries.² The total employment growth for the ten-year period under analysis is calculated.

The data on the external employment growth is taken from a database, which was built by FAST in a ten-year investment study (Dörrenbächer et al., 1995). It contains a total of over 1,300 external transactions: acquisitions and sales of manufacturing enterprises or parts of enterprises (factories) from 1985 through 1994.³ For roughly half of the over 1,300 transactions – and here especially for the large transactions – the number of the affected employees was available. The collection of employment

2 There is a slight inconsistency in these data because in the middle of the period under analysis the threshold for affiliates was reduced from 25% to 20% ownership. But this only marginally changed the position (Deutsche Bundesbank, 1991, fn. 1).

3 The threshold for acquisitions and sales to be included was 25% from 1985 through 1988 and 20% from 1989 through 1994 (cf. also fn. 2).

data for Eastern Europe presented a special problem: here, often sections of the former combines were bought, for which no employee counts were available. The following representation therefore excludes Eastern Europe. From the sum of the employee counts for the acquired enterprises less the sum of the employee counts of the sold enterprises the total, net external employment growth during the ten-year period of analysis is calculated.

Finally, the internal employment change was calculated as the difference between the total employment growth, as calculated from Deutsche Bundesbank data, and the net external employment growth, as calculated from the FAST database. This too is a net value comprising the internal creation as well as the internal cuts of jobs.⁴

At the end of 1984, the foreign subsidiaries of German enterprises in developing and industrialized countries employed 1,133,000 people; by the end of 1994 that number increased to 1,645,000. The total employment growth during the period of study was therefore 512,000. In the same time period, German enterprises abroad have acquired manufacturing enterprises or parts thereof with at least 461,000 employees, while at the same time selling enterprises or parts thereof with at least 32,000 employees. Through external changes alone, foreign employment has increased by about 430,000 employees. Net internal employment growth, therefore, is calculated as a balance of at least 80,000 employees. It becomes clear that the majority of employment growth abroad results from acquisitions (cf. Table 4).

There are considerable regional differences in the structure of foreign growth of German MNCs. In the industrialized countries, employee counts have risen by 423,000 from 681,000 to 1,104,000, which is an increase of 62%. The total employment growth in the industrialized countries is just about equivalent to the external growth through acquisitions. This means that in the industrialized countries of Western Europe and North America the German MNCs have created internally no additional employment in the manufacturing industries. Obviously, job creation at some locations, e.g. through spectacular green-field investments, balances job cuts at other locations.

4 It should be noted here that in light of the incompleteness of the database of external changes and the problems explained in footnote 2 all of the following presented data should be treated as approximations. This is especially true for the disaggregated results for single countries. But still these data show a relatively parallel development in the most important countries which confirms the general interpretation.

In the developing countries the total growth of foreign employment was significantly less than in industrialized countries; employment grew from 452,000 to 542,000, which is an increase by 90,000. It is striking that here, in the comparison with industrialized nations, external growth through acquisitions plays a negligible role and the

Table 4:
Development of employment at foreign manufacturing affiliates of German MNCs between 1984 and 1994 (1000 employees)

	Position (year end)		total (3)=(2-1)	Change	
	1984 (1)	1994 (2)		external (4)	internal (5)=(3-4)
World (except Eastern Europe)	1133	1645	512	429	83
Developed Countries	681	1104	423	421	1
Western Europe	493	760	267	253	13
France	121	148	27	43	-16
Austria	70	85	15	17	-2
Spain	74	101	27	38	-11
UK	31	111	80	85	-5
Portugal	16	36	20	2	18
others	188	344	156	168	-12
USA	149	292	143	157	-14
Japan	16	26	9	1	9
Less Developed Countries	452	542	90	8	82
in Africa	73	72	-1	2	-3
South Africa	43	43	1	2	-1
in America	277	298	21	3	19
Brazil	197	205	9	3	6
in Asia, Oceania	102	172	69	3	66
India	50	61	11	0	11
China	1	23	22	3	19
others	51	88	37	0	37

comments: cf. text

source: Wortmann and Dörrenbächer (1997) based on special evaluations prepared by Deutsche Bundesbank and FAST-Datenbank

German MNCs grow primarily internally through the creation and expansion of new production facilities.⁵

5 For the strongly increased investment in East Europe since 1990, about which we have no empirical data, we can assume that the dominance of external growth is similar to that in the industrialized countries.

The empirical findings on MNCs' mode of growth can be summarized as follows: During the post-war period, the general growth pattern of MNCs has shifted more and more from internal to external growth. German MNCs have developed – at least in the area of manufacturing – a strikingly clear pattern: In other industrialized countries they grow primarily externally through the acquisition of already existing capacities while in developing countries they grow primarily internally through the creation of new capacities. It may well be assumed that today the growth pattern of MNCs based in other industrialized countries is similar to that of German MNCs.⁶

EXTERNAL GROWTH AS A BLIND SPOT OF FDI THEORY

In the 1970s, Dunning (1977; 1979; 1981) formulated the so-called eclectic paradigm, which is probably today's most influential theory on MNCs and FDI. This paradigm combines central ideas of the literature on MNCs mentioned in the introduction with thoughts coming from economic geography (location theory) as well as from the theory of the firm and transaction costs (Coase, 1937), which had also been used to explain MNCs (Buckley and Casson, 1976). According to this paradigm, the following three conditions must be fulfilled if direct investment is to occur:

1. The investing firm must possess an ownership-specific advantage (O-advantage), which makes it competitive over other firms operating in the host country. The O-advantage can lie, for example, in the areas of product or production technology, of marketing or market access, of finance or of general managerial capabilities.
2. The host country must have a location-specific advantage (L-advantage). The L-advantage may stem from the availability of and low costs for production factors like simple or qualified labor, energy or materials. It may also result from easier market access, be it due to import restrictions or transport costs that hamper servicing a foreign market through exports.
3. Finally, there must be an internalization incentive advantage (I-advantage). I.e. it must be more advantageous for the investing firm to use its O-advantages in a foreign country by itself than selling them to other (local) companies e.g. through licensing (sinking transaction costs through internalization).

6 Perhaps with the exception of Japanese MNCs where internal growth (trans-plants) might still play a somewhat larger role.

All these three conditions must be fulfilled, in order to lead to a direct investment:

“The more a country’s enterprises possess ownership specific advantages, relative to enterprises of other nationalities, the greater the incentive they have to internalise rather than externalise the use, and the more they find it in their interest to exploit them from a foreign location, the more they (and the country as a whole) are likely to engage in international production.” (Dunning, 1981, p. 31)

This scheme – also called OLI paradigm, using the initials of the three conditions – obviously has considerable value in explaining MNCs’ internal growth and the relocation of production to a foreign country. It explains very well the internal growth of German MNCs in developing countries, especially in Asia. Vis-a-vis local companies many German companies own various O-advantages, and the host countries have clear L-advantages like relatively low labor costs and growing and/or protected markets.

But can the OLI paradigm also explain external growth, which dominates German – and other countries’ – FDI in industrialized countries? In general, it is remarkable that research on FDI on the one hand and on M&A on the other do not relate to one another to a larger extent. Many studies on FDI do not ever mention acquisitions. The work of Dunning, too, deals with acquisitions rather on the periphery – e.g. in his extensive summarizing book on „Multinational Enterprises and the Global Economy“ (Dunning, 1993).⁷

The peculiarity of external growth through acquisitions is that the acquired firm always possesses O-advantages of its own, which might be an important factor in explaining the investment decision. The OLI paradigm does not explicitly take account of O-advantages of investment targets as an independent variable explaining FDI. The following paragraphs will deal with the problems that arise when one tries to systematically integrate O-advantages of acquired firms into the OLI paradigm, i.e. on the conceptualization of I-, O- and L-advantages as determinants of FDI.

7 On the other hand, the literature on international M&A, which is largely management oriented, does not deal with more general questions like why MNCs from which countries and which industries undertake M&A in which other countries (e.g. Cooke, 1988; Bühner, 1991).

External Growth and the Concept of I-Advantage

The concept of the I-advantage seems to go without problems. Synergy effects are seen as the decisive motive for acquisitions. Obviously behind an acquisition there must be an I-advantage, or more precisely: it must be possible to realize an I-advantage following the acquisition through integration management.⁸ But here too, synergy effects might not only be based on the broader utilization of the O-advantages of the acquiring firm, but possibly also on a broader utilization of the O-advantages of the acquired firm which might be transferred to the operations of the acquiring firm. Synergy effects might also be realized through a concentration of production (economies of scale), in which case production might be relocated from the acquiring firm to the acquired firm but also vice versa.

Here, a note on a strand of FDI theory which tries to explain FDI solely by the advantage of internalization may be useful. Surprisingly, this approach when dealing with M&A focuses on the question of the form of market entry (e.g. Buckley and Casson, 1976; 1998; Caves and Mehra, 1986; Caves, 1996, pp. 69-73). Acquisitions are interpreted as an alternative to green-field investments – and both are seen as an alternative to servicing a foreign market through exports.⁹ At the core of the interpretation is the assumption that the investing firm seeks to enter a market in order to internally exploit its own proprietary assets, i.e. in the language of Dunning: its O-advantages. Thus, despite the potential of the broader approach of the internationalization school, explaining FDI primarily as internalization, its conception of FDI remains to be very similar to that of the OLI paradigm.

External Growth and the Concept of O-Advantage

The eclectic paradigm assumes that the O-advantages which are decisive for a foreign investment are owned by the investing firm. At least, O-advantages of acquired firms are not taken into account as an explanatory variable for FDI. Dunning (1993, p.81) distinguishes between two types of O-advantages of the investing firm: They

8 If the acquiring firm undertakes no attempt to integrate the acquired firm at any level, this kind of investment might be characterized as a portfolio investment, and thus would not have to be explained by FDI theory. We will not follow the debate on whether these synergy effects are realized successfully or not.

9 The question of „form of market entry” really does not grasp the core of – especially the very big – acquisitions. E.g. conceiving the acquisition of Chrysler by Daimler-Benz as an alternative form of market entry to a green-field investment obviously does not make much sense.

can be based on property rights and intangible asset (O_a -advantages) or on the common governance of the firms O_a -advantages with complementary assets (O_t -advantages).

In many cases of M&A, the acquiring firm owns O_a -advantages decisive for the investment. These acquisitions are followed by a transfer of O_a -advantages from the acquiring firm to the acquired firm. The introduction of superior product and production technology from the acquiring firm might allow for a modernization and an improvement of productivity at the acquired firm. Thus, in these cases the assumption that the investing firm owns an – at least relative – O -advantage remains valid.

But, in some cases of M&A, the acquired firm might own superior O_a -advantages – and these might be the main target of the acquisition. Still, also in these cases – as with all acquisitions if they are to become successful – it could be argued that the acquiring firm must have an O_t -advantages in order to conduct the acquisition successfully. For example it must have the management skills to integrate the acquired firm and to realize synergy effects.

A fundamental problem of the concept of a (relative) O -advantage owned by the acquiring firm arises if one examines the special case of international equal-to-equal mergers. In these cases, a distinction between acquiring firm and acquired firm is no longer possible, and thus the concept of a (relative) O -advantage owned by the acquiring firm becomes meaningless. Such an equal-to-equal merger is an extreme case of an acquisition. It shows the fundamental problem of a concept which does not systematically account for the possibility of O -advantages located at the acquired firm being an independent explanatory variable of the investment. The decisive O -advantages of the acquired firm might not only be O_a - but also O_t -advantages, for example when the acquired firm becomes the headquarter of a new global product division within the merged MNC and post-merger integration depends primarily on the managerial capacities of the acquired firm.

External Growth and the Concept of L-Advantage

Among the three conditions of the OLI paradigm the L-advantage is the most problematic when considering acquisitions. In the case of external growth the acquiring firm does not only combine its O -advantages with the openly accessible L-

advantages of the host country¹⁰ but also with the very specific O-advantages of the acquired firm. Certainly, in some cases, the O-advantages of acquired firms – or at least parts thereof – might be location specific, e.g. the sales competence of companies delivering products to a local market or the research competence of high-tech laboratories that have developed within a regional cluster. In these cases, the locally embedded O-advantages and the L-advantages of the acquired firm cannot be separated.

In other cases, O- and L-advantages might not be linked so closely to each other. From the vantage point of the acquiring firm, there might be a trade-off between the O-advantage and the L-advantage (or disadvantage) of the acquired firm. The acquiring firm might accept locational disadvantages of the acquired firm in order to gain control over its O-advantages. This assumption is confirmed by an empirical survey on the foreign growth of large German MNCs by Pausenberger (1994):

“About half of these acquisitions (46%) lead – from the vantage point of the acquiring firm – to a deterioration of the location structure. The reason behind this is that the decision for an acquisition depends on many factors, whereby the location structure of the acquired firm, usually, is not in the fore.” (Pausenberger, 1994, p. 55; translation by author)

Through acquisition, MNCs come to possess factories or other value adding operations at locations which might not have any L-advantages compared to the operations the acquiring firm already possesses. Thus, following an acquisition, companies often undergo restructuring processes. These do not only concern management or coordination structures but also configuration structures, i.e. the regional dispersion of value adding activities.¹¹ Even though many acquisition are only undertaken with the intention of a consequent restructuring, this restructuring itself is not part of the acquisition. The restructuring is an internal process which might consist of various interlinked relocations, extensions and reductions of operating activities. As internal processes, these restructurings have much in common with the mode of internal expansion.

10 Location advantages like quality and price of production factors, market or market access (due to trade barriers or transportation costs), as well as infrastructural, societal or political conditions are advantages (or disadvantages) which may be utilized by all potential investors.

11 Literature on post-merger management (cf. Haspeslagh and Jemison, 1991) usually concentrates on managerial coordination and seldom deals with changes of the configuration.

Yet, in the case of restructuring, activities are not only transferred to the new subsidiaries, but – due to possible locational disadvantages of the acquired firms – might also be transferred from the newly acquired plants to the old plants of the acquiring firm – be they in the MNC's home or in third countries. Sometimes, the manufacturing operations of acquired firms are terminated shortly after the acquisition and its customers are supplied from other plants of the acquiring MNC.¹² But – and this is important in order to understand the international structures of MNCs – the restructuring that follows an acquisition is limited by considerable sunk costs.¹³ MNCs often continue to operate foreign operations which – as seen from the internal logic of the acquiring MNC – are not situated in optimal locations and which they would never have set up growing internally.

Both, O-advantages of acquired firms and sunk costs at these firms have a tremendous effect on the emerging structures of MNCs. The fact that high value adding activities including research and development can increasingly be found abroad largely is a result of the acquisition of such activities (cf. Wortmann, 1990). The fact that competence centers, product mandates or the headquarters of divisions can also be found increasingly abroad most times results from acquisitions of companies with considerable and/or specific O-advantages.¹⁴ Corporate structures resulting from acquisitions are – despite extensive post-merger restructuring – much more complex than corporate structures that would have evolved solely through internal growth (cf. in more detail Wortmann 2000b).

These evolving complex structures of MNCs cannot be explained as the result of L-advantages being combined with the O-advantages of the acquiring firm. In the case of external growth, host countries' L-advantages do not sufficiently explain the direction of MNCs expansion. The O-advantages of acquired firms – and their specific relation to the O-advantages of the acquiring firms – must be taken into account as an independent explanatory variable.

12 There are cases (e.g. in the European consumer chemicals industry) where FDI outflows first finance an acquisition and subsequently the costs of closing the acquired firm, leading to no business operations abroad but still following a strict economic logic.

13 Such sunk costs can also be related to internally created locational structures, which might become sub-optimal due to a changing environment. FDI theory of course assumes that – at least at the time of a change of the internal company structure – an optimization is achieved.

14 This might be O_a - as well as O_t -advantages.

Empirical Tests of the L-Advantage: Labor Costs

The theoretical problems of explaining the direction of MNCs' growth with the L-advantages of host countries are also reflected by empirical findings. Many empirical studies have been undertaken on why FDI is directed to which countries. One of the most frequently tested explanatory variables is labor costs, which constitutes one of the L-advantages of the eclectic paradigm. The studies (for a recent summary cf. Braunerhjelm and Lipsey, 1998) unanimously come to the conclusion that low labor costs as an explanatory variable for FDI only play a marginal role, if they do matter at all. And Dunning concludes an overview of the literature:

“A locational variable that has received surprisingly little support in explaining the mode of servicing foreign markets is that of relative wage costs.” (Dunning, 1993, p. 156)

If external growth through M&A had been explicitly and systematically taken into account, this finding would not have been so surprising, because M&A usually does not follow the logic of cost-reduction. When the same empirical studies find 'market access' to be the most important motive for FDI, this can also be explained by the dominant importance of external growth, where the access to the market of the acquired firm almost always is important. The finding of Lorz (1993), that geographical proximity and EU membership of host countries are positively correlated with German FDI in these countries, further indicates, that the 'market orientation' of these investments is not the result of L-advantages of these countries, since these markets could be served from Germany more easily than most other foreign markets. The 'market orientation' is probably rather an acquisition of market shares through M&A.¹⁵

“Strategic Asset Seeking”

While early versions of the OLI paradigm assumed – at least implicitly – that the transfer of O-advantages takes place on a one-way road from the parent firm to its foreign subsidiaries, later Dunning and Cantwell (Cantwell, 1989; Cantwell and Dunning, 1991) have qualified this one-sided perspective. They have shown that foreign subsidiaries often are concentrated in agglomerations, and that MNCs also use the O-advantages gained at these locations throughout the company. But, they still as-

15 Raines and Döhrn et al. (1999, pp. 36f) found, that for follow-up investments labor market factors were much more important than for first investments. This might be interpreted as a consequence of the fact that first investments often are acquisitions while follow-up investments are internal.

sumed that the O-advantages of the foreign subsidiaries had been created internally, i.e. while they were part of the MNC's network.

Later, Dunning worked with another typology of FDI (Dunning, 1993, pp. 56ff) which seems to have been developed by Hogue (1967; cf. also Cooke 1988, p.10f). This typology distinguishes four motives of FDI: raw materials seekers, market seekers, production efficiency seekers, and knowledge seekers. MNCs – relabeled by Dunning as resource seekers – pursue the latter motive

“... usually by acquiring the assets of foreign corporations, to promote their long-term strategic objectives – especially that of sustaining or advancing their international competitiveness.” (Dunning, 1993, p. 60)

Here, it is explicitly taken into account that decisive competitive advantages – even though not labeled O-advantages – might not only be located with the acquiring firm but also with the acquired firm. Dunning (2000) claims that these strategic asset seeking investments can be integrated into the ‘envelope’ of the OLI paradigm. Concerning the most problematic part of the paradigm, the L-advantage, Dunning argues that

“... scholarly research on the kind of L advantages most likely to explain the ‘where’ of international production has taken on a new trajectory over the past decade. More particularly, the dramatic increase in cross-border mergers and acquisitions has reflected the availability and price of assets that firms wish to acquire or to protect or augment their competitive advantages. ... the extent to which the acquired assets – together with the business environment of which they are part – advances the competitiveness and strategic trajectories of the investing firms, are the critical locational determinants.” (Dunning 2000, pp. 178f)

Interpreting the “location and price of created assets, including those owned by firms likely to be acquired” Dunning (2000, p. 176, table 3) as a locational advantage departs from traditional location theory, which tries to explain why certain economic activities are located in which geographical area and not why they are likely to be owned by a domestic or a foreign firm.

CONCLUSIONS

Starting point of the above considerations was the increasing importance of external growth for the international expansion of MNCs and the empirical finding that foreign employment growth of German MNCs resulted primarily from acquisitions, while in-

ternal growth through setting up and extending additional capacities only played a marginal role.¹⁶

FDI theory and especially the OLI paradigm developed by Dunning systematically ignores the peculiarities of M&A. L-advantages of host countries cannot sufficiently explain the direction of external growth. A central element of external growth – the acquisition of the ownership-specific advantages at the acquired firm – can not, as has been shown, be integrated into the OLI paradigm even though it would be decisive for an explanation of the direction of FDI flows as well as of the evolving global structures of MNCs. Dunning has dealt with the acquisition of ownership-specific advantages within a framework of a typology of investment motives, but this typology remains either unconnected to the OLI paradigm or it over-wears the concept of locational advantage.

The fact that FDI theory basically ignores external growth through M&A, despite their obvious importance, might have its reason in the original intention of this theory. Especially Dunning's OLI paradigm was directed to the development of "a general explanation of international production" (Dunning, 1993, p. 80), it would supplement trade theory by explaining when and why foreign markets would not be supplied through exports but through a transfer of production, or when and why production would be transferred to low-cost locations abroad leading to additional (re-) exports. Acquisitions do not have an effect – at least immediately – on the international structure of production and trade. With an acquisition an acquiring firm does not take a location decision. A change in the location of production might only happen in the course of restructurings that often follow M&As. The M&A itself only changes the ownership structure.

From this it follows that a 'general theory of international production' and a 'theory of the multinational enterprise' are not identical and have to be developed – at least, in part – separately from each other. The greater the impact of cross-border M&A on the growth of MNCs, the smaller the overlap between the two theories will become. A theory that explains international external growth as well as the OLI paradigm explains internal growth of MNCs is not in sight. Considering the fact that MNCs today grow primarily through M&A, this implies that a useful overall theory of FDI and the

16 It can be assumed that external growth not only dominates the expansion of German MNCs but also that of MNCs from other industrialized countries alike – perhaps with a slight deviation from that pattern by Japanese MNCs.

development of MNCs presently is not available.¹⁷ A systematic consideration of external growth and of the specific peculiarities of this mode of growth are a precondition for a better understanding of the causes and consequences of FDI and of the internationalization processes of MNCs.

17 Dunning (1993, p.433) mentions one serious problem for the development of a systematic explanation of the direction of cross-border M&A: „At the end of the day, however, it must be accepted that many A&Ms cannot easily be explained by traditional FDI theory as they are so much creatures of firm-specific strategies and the opportunities which present themselves at a particular time and place. At times, firms – particularly conglomerates – seem to behave as speculators in the market.”

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