

*Perspectives*  
on Multinational Enterprises in Emerging Economies<sup>1</sup>

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*Perspectives*  
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**Abstract**

Multinational enterprises (MNEs) play a pivotal role in the development of many emerging economies. In consequence, they became the focus of scholarly research by economists and policy analysts. In contrast, international business scholars have been comparatively uninterested in analyzing this role of MNEs. Yet, they could make important contributions to these debates. Firstly, studies taking the individual firms as starting point would enhance understanding of the interaction between MNEs and the local environment. Secondly, theories and research methodologies developed in international business research could provide new insights into the dynamics of MNEs in emerging economies.

The objective of this paper is to motivate more international business scholars to engage in research on positive and negative spillovers from foreign direct investment (FDI) in emerging economy societies. To advance this research agenda, scholars need to analyze the specific activities and capabilities of the firms involved, and the impact of FDI on the broader social and environmental context. For management, this agenda raises the ethical question to what extent businesses ought to care about their local stakeholders.

**Introduction**

Multinational enterprises (MNEs) play a pivotal role in linking rich and poor economies, and transmitting capital, knowledge, ideas and value systems across borders. Their interaction with institutions, organizations and individuals is generating positive and negative spillovers for various groups of stakeholders in both home and host countries. In consequence, they are focal points in the popular debate on the merits and dangers of globalization, especially when it comes to developing and emerging economies.

A solid understanding of the role of MNEs in emerging economics is vital for both policy makers and for MNEs themselves. Policy makers are influencing the regulatory regime under which MNEs as well as local business partners operate. They are interested in understanding *how* foreign direct investment (FDI) influences economic development and national welfare. The expectation that FDI benefits the local economy has motivated

many governments to offer attractive incentive packages to entice investors. The rationale is that the social benefits of inward FDI would exceed the private benefits of FDI, and investors would take into account only the latter when deciding over investment locations (Oman, 2000; Blomström and Kokko, 2003). The policy debate needs scientific evidence how and how much FDI influences the local environment.

Despite the policy relevance, the impact of MNEs on host economies is not well understood. Wells (1998, p. 102) observed, “some FDI is good, almost certainly some is harmful. But exactly what kind of investment falls in each category is frightfully difficult to determine, even if the effects are measured against only economic criteria”. Similarly, Caves (1996, p. 237) concludes his review of the literature: “The relationship between a less developed country’s stock of foreign investment and its subsequent economic growth is a matter on which we totally lack trustworthy conclusions”; and Rodrik (1999, p.39) infers, “Today’s policy literature is filled with extravagant claims about positive spillovers from FDI, ... [yet] the hard evidence is sobering.” Having reviewed the empirical literature aiming to identify spillovers, I concur.

The impact of multinational firms on their environment is, or should be, equally relevant to managers. Positive spillovers help build a company’s reputation as an actor concerned for its stakeholders. Negative spillovers risk triggering adverse reactions from stakeholders such as local politicians concerned about employment, and consumer NGOs concerned about ethics. Recognizing both complementary and conflicting interests helps during negotiation processes to identify strategies that benefit both MNEs and stakeholders in host economies. In fact, there are cases where MNEs have commissioned independent studies to document their spillovers, as this might enhance their bargaining position (Woodward et al., 1995).

This paper presents suggestions on how to advance research on the impact of MNEs on emerging economies. The interaction with MNEs may benefit or harm local firms and individuals, which creates what is known as positive and negative *spillovers*. Spillovers arise from non-market transactions when resources, notably knowledge, are spread without a contractual relationship, so-called *externalities*. MNEs are profit maximizing, and thus naturally *not* interested in creating benefits for others without being paid for it. Whether foreign investors allow positive externalities depends on their opportunity costs of sharing the knowledge, and the transaction costs of establishing

barriers to knowledge flows. Moreover, spillovers may arise from market transactions if a buyer values a resource higher than the price paid, known in economics as the *consumer surplus*. Vice versa, sellers gain a producer surplus when they value a good less than the price they charge. Thus unless one side is able to apply perfect price discrimination, both parties will be better off as a result of the transaction.

These issues are particularly relevant for emerging economies, that is middle or low income economies with growth potential that makes them attractive for foreign investors. These economies typically have less sophisticated market supporting institutions and fewer locational advantages based on created assets, such as infrastructure and human capital (Hoskisson, Eden, Lau and Wright, 2000; Narula and Dunning, 2000). Therefore, both policy makers and managers are interested in how MNEs may contribute to the economic development of these economies. To derive policy advice, they need to understand the specific circumstances that influence spillovers, including characteristics of investment projects, local firms, and the institutional framework. These circumstances however change with the evolution of the global economy, and thus require a continuous reassessment.

Scholarly research has for many years analyzed FDI, aiming to contribute to a rational assessment of the impact of MNEs on their host societies. Yet business scholars have largely been sitting on the sidelines while the scholarly debate has been dominated by economists (e.g. Blomström and Kokko, 2003; Bhagwati, 2004), and political scientists (e.g. Spar and Yoffie, 1999; Moran, 2002). However, international business scholars would be able to contribute a deeper understanding of the inner logic of multinational firms.

International business is an interdisciplinary field of study drawing on several social science disciplines: Economics has been most influential in the past two decades, yet other disciplines also made their mark on the field, including political science, history, psychology, sociology and anthropology (Shenkar, 2004). This community of scholars is specially experienced in studying multinational enterprises and in comparative management, incorporating contextual variables derived from multiple disciplines, as well as area studies. However, international business research has been largely looking into the MNE, rather than 'looking out' from MNEs to the societies in which they are operating. Moreover, in the words of Buckley and Casson (2003: 3):

*“Although political debates continue to rage over globalization, academic research has become increasingly divorced from the political, social and economic issues involved. Most international business scholars, it appears, would rather influence the boardroom than the office of the president or prime minister. It certainly pays better, and appeals to people with narrow ethical horizons.”*

It may be a paradox: Buckley and Casson’s seminal work *“The Future of the Multinational Enterprise”* (1976) was intended as a contribution to political debates at the time (Buckley and Casson, 2003), yet it has mainly stimulated research on how to run businesses better – in terms of profits, not as socially-responsible citizens. Buckley and Casson (1976) rejected the excessive concerns about MNE’s monopoly power by providing a new, theoretically grounded understanding of how MNEs operate, and why they exist. However, few scholars pursued this aspect of their work further. Rather, Buckley and Casson (1976) has become the foundations of many studies of the MNE itself, and recent discussions outline research agendas that push further in that direction (Yeung 2003, Rugman and Verbeke 2003; Ghemawat 2003). Yet, are these better run MNEs also becoming better citizens?

As an inter-disciplinary field, international business is well positioned to advance a broader research agenda. The role of FDI in developing countries has been an occasional topic in the *Journal of International Business Studies* (de la Torre, 1981; Wells, 1998), and in recent years several studies have analyzed FDI spillovers (Hejazi and Safarian, 1999; Liu, Siler and Wang, 2000; Feinberg and Majumdar, 2001; Buckley, Clegg and Wang, 2002; Chung, Mitchell and Yeung 2003). However, these closely follow the tradition of similar studies in economics, and make little use of the interdisciplinary nature of the field to develop new theoretical insights, let alone agenda-setting insights for policy or management.

Thus while international business scholars are arguably the prime experts on MNEs, they have contributed relatively little to explaining and evaluating “the role of MNEs in society”. Few studies on the impact of FDI consider more recent developments in strategic management research, such as the resource based view, organizational learning theories, and institutional perspectives. This paper presents a research agenda with the aim

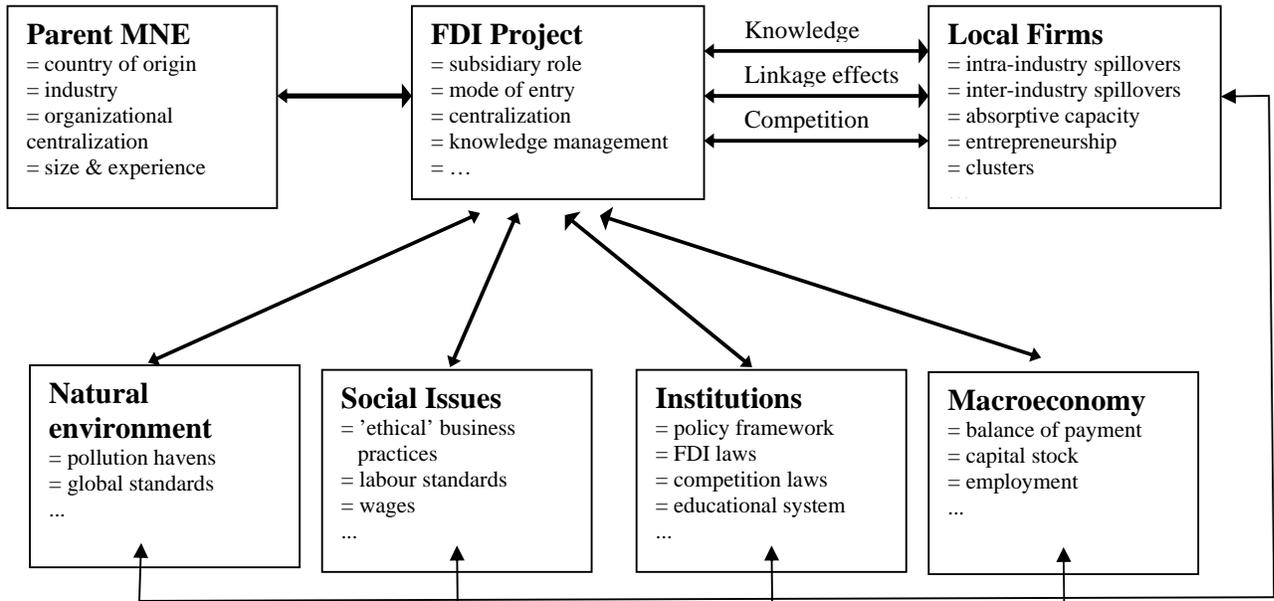
to engage international business scholars in the broader scholarly debates on the role of business in society, and in emerging economies in particular. This research agenda on MNEs in emerging economies is broad. One of the challenges is to tie the partial views discussed in different literatures together to allow comprehensive assessments.

The next section reviews the literature on spillovers from MNEs to local firms in the same or related industries. On that basis, I outline a research agenda that focuses on the different agents involved, following the broadly the organizational framework of Figure 1. International business may in particular contribute a better understanding of the multinational and local firms involved in the process. Moreover, impact on non-economic aspects of societies ought to receive greater attention, including the natural environment, social issues and institutional development. In section 4, I discuss ethical dimensions of conducting business and emerging economies, before concluding in section 5.

#### **Industry level perspectives: A review of the literature**

A major focus of the literature has been on the interaction of MNEs and local firms via knowledge diffusion, forward and backward linkages, and competition. This review section focuses on key issues pertaining to the impact on local businesses in the same industry or in related industries; for more comprehensive reviews see Altenburg (2000), Blomström and Kokko (2002), and Fan (2002).

Figure 1: An organizational Framework for FDI Impact in Emerging economies



*Intra-industry spillovers*

A large body of empirical literature has analyzed how FDI influences local firms in the same industry. The main theoretical foundations of these studies are knowledge spillovers on the basis of demonstration effects and the movement of labor. *Demonstration effects* work through the direct contact between local agents and an MNE operating at different levels of technology. After observing a product innovation or a novel form of organization adapted to local conditions, local entrepreneurs may recognize their feasibility, and thus strive to imitate them. Prior to such an encounter, local entrepreneurs have limited information about the costs and benefits of new methods, and may thus perceive the risk of investment as too high. However, FDI introduces an ‘existing proof’ of viable paths of development. As local businesses come into contact with existing users, information about technological innovations and new management techniques is diffused, the uncertainty is reduced, and imitation levels increase (Blomström and Kokko, 2002).

A second channel of spillovers is the *movement of employees*. MNEs build local human capital through training of local employees, yet these highly skilled individuals may move to locally owned firms or start their own entrepreneurial businesses. Within MNEs, even rank and file staff acquire skills, attitudes and ideas on the job through

exposure to modern organization forms and international quality standards. If these employees then move to local firms, they can take some of this tacit knowledge with them, thus enhancing productivity throughout the economy.

The benefits of demonstration effects and labor mobility are often assumed to have quasi-public good characteristics as firms can observe the outcome of organizational innovations by successful companies. On this basis, a popular proposition in the economics literature has been the '*technology gap*' hypothesis originally proposed by Gerschenkron (1962). It stipulates that spillovers are increasing with the difference in technology levels between domestic and foreign firms in the industry.

Empirical tests face the obstacle that spillovers are difficult to quantify or to measure directly. Many studies thus proxy spillovers by the observed improvements in productivity among the firms that came in contact with FDI, so-called productivity spillovers.

Caves (1974) analyzed cross-sectional data in his pioneering work, and similar data have been used in many subsequent studies. However, this methodology does not capture the often long lags between FDI entry and their impact on local firms. Moreover, the cross-sectional association between FDI and industry productivity may be a result of MNEs entering industries with higher productivity, rather than productivity being raised by FDI. Theoretical perspectives such as the OLI paradigm (Dunning 1993) suggest that MNEs operate in technology intensive industries, such that reverse causality is highly plausible.

With the emergence of panel data techniques and the corresponding software, most recent studies analyzed panel data, which leads to systematically different results. Görg and Strobl (2001) show that studies using cross-section data obtain *systematically more positive* estimates of the spillover coefficients than panel data studies. In consequence, the latter should be used to assess the overall message arising from this research.

The results for panel data research in developing countries show *negative* effects in two major studies by Aitken and Harrison (1999) on Venezuela 1976-89 and Kathuria (2000) on India 1975-89. Other studies such as Haddad and Harrison (1993) on Morocco 1985-89 or Kugler (2001) on Columbia 1974-98 find insignificant effects. For transition economies, the evidence is less clear. Liu (2002) in China and Sinani and Meyer (2004) in Estonia find positive effects, while other studies find negative effects in Bulgaria, Romania (Koning 2001) and the Czech Republic (Djankov and Hoekman 2001). Hence, the overall

evidence does not support the proposition of positive intra-industry productivity spillovers, with the possible exception of special circumstances, such as the transition from central planning to a market economy.

The technology gap hypothesis does not find convincing support either. Haddad and Harrison (1993) find that FDI in Morocco has a greater impact on reducing the productivity gap between foreign and domestic firms in the case of a *low* initial gap. Similar results were obtained by Kokko (1994) for Mexico and Kokko, Tasini and Zejan (1996) for Uruguay. Hence, the empirical evidence is insufficient to maintain the traditional (linear) technological gap hypothesis widely assumed in economic models.

Partly in response to the lack of support for the technological gap proposition, recent theoretical work emphasizes the recipient's own capabilities and initiatives. A broad consensus suggests that local firms need a certain level of indigenous human capital to be able to benefit from knowledge transfer by multinational enterprises (e.g. Lall 1996). This argument has been theoretically developed with reference to concept of '*absorptive capacity*', i.e. the firms' ability to recognize valuable new knowledge, integrate it into the firm and use it productively (Cohen and Levinthal, 1990; Zahra and George, 2002). Hence, the extent of knowledge transfer depends on actions of both firms, and is not quasi-automatic.

Recent empirical studies suggest that *absorptive capacity* is crucial for local firms to benefit. For example, Liu, Siler, Wang and Wei (2000) find for the UK that foreign presence in a sector positively affects the labor productivity of domestic firms, but is positively moderated by the local firms' intangible assets (a proxy for absorptive capacity). This result extends to emerging economies; as Kathuria (2000) finds that spillovers in India depend to a large extent on the investment by local firms in learning and R&D.

The concepts of technology gap and absorptive capacity have been connected in recent empirical research that suggests that opportunities for knowledge acquisition increase with the technology gap, but recipients' ability to use it declines. *Potential* spillovers increase with the technology available in the FDI firm, which increases with the technology gap. However, *realized* spillovers decline as firms fall too far behind to be able to absorb the technology (Blomström and Sjöholm 1999). Thus, technology spillovers may be related to the technology gap in an inverse-U-shaped function (Liu et al. 2000). However, the concept of absorptive capacity is not well understood; and intangible assets

or R&D expenditures are weak proxies. I thus return to the concept of absorptive capacity when discussing local firms.

In conclusion, two of the concepts widely used in the theoretical literature do not gather convincing empirical support. The evidence of intra-industry knowledge spillovers is weak if appropriate panel data methodology is used (Görg and Strobl 2001).<sup>2</sup> Similarly the (linear) technology gap hypothesis fails the empirical test. Thus, this vast literature leads to a puzzle: why are there, except in two studies, no positive spillovers to local firms? If some firms gain, then others must be losing for the average effect to be neutral or negative. What negative productivity effects counterbalance the positive spillovers?

In the short run, local firms may retain overcapacity as they lose market share to foreign competitors, which lowers their productivity (Aitken and Harrison 1999). Moreover, crowding out effects may harm local firms through various channels (De Backer and Sleuwagen 2003). Foreign investment firms may attract capital and labor that may otherwise be employed in local firms, thus inhibiting their growth and productivity. Moreover, if a local firm develops valuable technology or brands, it may be acquired by a foreign investor and thus no longer generate value to the domestic-owned sector. Such negative effects are theoretically feasible, yet, it is unclear how important they are, and with what time lags they occur. There are indications that crowding out occurs shortly after the entry, but positive spillovers emerge with longer time lags (Kosova 2004).

Moreover, the literature suggests two partial answers on why spillovers benefit only some firms, and not the average firm. First, spillovers emerge if local firms develop capabilities to decode, interpret and apply knowledge, or if employees leave the MNE to set up their own business. Second, these spillovers would not necessarily benefit firms in the same industry while the hypothesized negative spillovers would. Hence, future research ought to pursue two avenues, the implications of absorptive capacity and human resource mobility; and possible negative spillovers.

### *Inter-industry spillovers*

Spillovers through forward and backward linkages are, in my view, based on more convincing theoretical arguments, yet methodological problems make it difficult to

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<sup>2</sup> Even increased productivity in an industry does not necessarily imply a positive spillover: Inefficient producers may be crowded out, which increases the average productivity in the remaining domestic industry even if no change occurred in the surviving firms (Smarzynska 2002).

demonstrate them empirically. These vertical spillovers do not rely on externalities but are in part of the consumer and producer surplus created by market transactions.

Foreign firms often purchase intermediate goods from domestic suppliers, which can create spillovers through several mechanisms (Lall, 1978; Smarzynska 2002): MNEs improve the productivity of indigenous firms by providing technical assistance and training of employees to increase the quality of suppliers products', by helping in management and organization, and by assisting them in purchasing of raw materials. They may set higher requirements regarding product quality and service-aspects of the supply relationships, such as just in time delivery, thus providing incentives for improving product quality and production processes. At the same time, FDI may increase demand for intermediate goods, and thus allow local suppliers to realize scale economies.

Forward linkages receive less attention in the literature, yet downstream businesses can benefit through similar, complementary channels. Local firms acting as marketing outlets for foreign investors may receive support in form of training in sales techniques and supply of sales equipment, and by generating more economies of scale. MNEs may moreover supply intermediate goods and machinery of better quality, and with more comprehensive after-sales services than provided by previous local suppliers. FDI in infrastructure and business services directly influences productivity of its customers if services required by businesses improve, or are newly introduced.

Supplier relationships are in particular associated with *international production networks* (Chandler, Hagström and Sölvell 1998; Rugman and d'Cruz 2000). MNEs at the core of a production network transplant network structures when undertaking FDI, and thus change the nature of market transactions in the industry. Local businesses can link into such networks as subcontractors or original-equipment manufacturers.

Empirical evidence of vertical spillovers is hard to establish as this requires data on industry-level input-output relationships. Among recent studies, Smarzynska (2002) finds in Lithuania higher productivity in supplier industries to industries with high foreign presence, while at the same time finding no evidence of spillovers within the same industry. She moreover shows that the productivity effect is larger when the foreign investors are domestic market-oriented rather than export oriented. In a similar study for Indonesia, Blalock and Gertler (2003) find strong evidence of spillovers from FDI in vertically related industries, while FDI in the same industry has no significant effect.

Similar patterns of backward linkages emerge in Kugler (2001) for Columbia, Aitken and Harrison (1991) for Venezuela and Schoors and van der Toel (2002) for Hungary.

An innovative approach to study vertical linkages has been applied by Belderbos, Capannelli and Fukao (2001). They analyze local content ratios of Japanese overseas manufacturing affiliates across 14 countries to identify project and country-specific determinants of the extent of interaction with local suppliers. They find that more linkages exist for older affiliates, acquisitions and joint ventures, and in less developed countries also FDI by less-R&D intensive investors. Moreover, local content requirements appear to have a positive effect while FDI established to jump tariff barriers has less local content.

Thus, the literature on vertical spillovers is overwhelmingly confirmatory, despite the methodological obstacles, but our understanding on how they occur at a micro-level is limited. Future research ought to prioritize the study of vertical relationships by analyzing *how* spillovers arise in individual interactions of a multinational firm and a local agent or firm. What characteristics of relationships facilitate spillovers? For example, does integration in international production networks or industrial clusters help local firms?

These research questions require direct measures of interactions between MNEs and local firms to assert under which conditions local firms benefit from vertical spillovers. Such research may apply the approach of Chung, Mitchell and Yeung (2003) who focus on a single industry and used information on which US supplier is supplying which Japanese MNE in the automotive industry. This approach can be expected to yield interesting insights in emerging economies as well.

### **Firm level perspectives: A Research Agenda**

International business scholars have comparative advantages in investigating firm-level effects, while recognizing and controlling for known country-level effects. Future research ought to provide a better understanding of the actors involved, and of their interactions. An interesting empirical question would be how important firm characteristics are, relative to country-level variables, in generating spillovers. In outlining key research issues, I loosely follow Figure 1 in outlining a research agenda to analyze MNE strategies and operations, the local firms receiving spillovers, and the broader societal implications for the environment, labor and institutional development. Given space limitations, I leave

out macroeconomic dimensions, such as the impact on the balance of payments and unemployment.

### ***Focus on the multinational enterprise***

A variety of different strategic objectives can motivate FDI in emerging economies. Consequently, subsidiaries play many different roles within MNEs and vary in their interactions with the local environment and the spillovers they create. However, the FDI impact literature has paid scant attention to the diversity of business strategies that influence type and extent of spillovers. Here, international business literature on, for example, entry strategies (Anderson and Gatignon, 1986; Hennart and Park, 1993; Estrin and Meyer, 2004) and subsidiary roles (Galunic and Eisenhard, 1996; Birkinshaw, 2000) provides a basis to analyze the link between FDI strategies and their potential impact.

#### *Entry strategies*

Foreign investors establish their operations using different modes, which are commonly classified as joint venture, acquisition and Greenfield. The impact on the host economy varies between FDI with different modes, at least in the short term. Yet, the assessment of the variations of impact is often based on theoretical considerations and but only thin empirical evidence, especially with respect to long-term impact (UNCTAD 2000). So far, these differences have rarely been analyzed systematically, apart from studies that include entry mode as control variable (e.g. Belderbos et al. 2001).

In a *joint venture*, two partners share their resources in return for access to the partner's resources. This can lead to mutual learning, and thus extend linkages and knowledge transfers in the local business community. Many observers thus expect joint ventures to generate more spillovers. Yet MNEs would be more concerned about unwanted technology diffusion and thus reluctant to share crucial knowledge.

Impact also varies between *Greenfield* projects and *acquisitions*. While Greenfield projects are generally regarded as having positive spillovers, acquisitions are seen with reservations. Greenfield create new businesses and thus have direct positive effects on employment and domestic value added, and increase competitive pressures on local competitors, which may lead to them improving their efficiency, or being forced to exit the market.

*Acquisitions*, on the other hand, are at the time of entry fully operating enterprises. Following the acquisition, the new owners may or may not continue traditional business relationships, or reorganize the modes of interaction with suppliers, which would strongly impact on related industries. However, based on inherited operations, acquisitions are more likely than Greenfield projects to engage in R&D (Belderbos 2003). Hence, the variation of impact across entry modes is theoretically ambiguous and requires systematic empirical analysis. In particular, we have little empirical evidence on the impact of acquisitions, in part because rigorous analysis needs to establish the *ceteris paribus* case, i.e. how the local firm would have developed without FDI involvement (Estrin and Meyer, 2004).

The implications of selling firms to foreign investors are particularly pertinent in the context of *privatization*. Acquirers have to restructure and integrate the acquired firm, as seen especially in Eastern Europe in the 1990s (Meyer, 2002; Uhlenbruck and de Castro, 1998). Proponents of privatization by sale to foreign investors argue that foreign investors are often well positioned to restructure firms in crisis. In the short term, the take-over often may require layoffs of employees, but if the alternative would be even more drastic adjustment, the foreign investor in fact may 'save jobs'. A foreign investor taking over a non-viable local firm can add crucial resources, and thus ensure the survival of the firm. Empirical evidence suggests that foreign ownership has improved productivity and profitability in Central and Eastern Europe in the first years after privatization (Estrin, 2002; Djankov and Murrell, 2002). However, we lack empirical evidence of the long-term implications of different methods of privatization in emerging economies.

### *Subsidiary Roles*

FDI is undertaken to pursue a variety of objectives, and MNE subsidiaries serve many roles within global corporations. Consequently, they vary in their interactions with the parent, with other business units of the parent's network, as well as with local businesses. The impact in terms of for example knowledge transfer varies with the subsidiary role, but the link between subsidiary roles and impact has yet to be analyzed systematically.

Policy makers often favor export oriented FDI projects, which are expected to transfer knowledge on operating production and to enhance the trade balance by selling foreign markets. But some export processing operations operate in enclaves with few

linkages to the local economy. Other FDI operations sell the global MNE's products and services to the local market, with or without local processing. Such FDI would transfer mainly operational and marketing knowledge, and benefit the local economy by providing higher quality products. It also impacts on local competition, whereas export-oriented FDI normally does not. Thus both types of FDI potentially transfer resources and capabilities that may give rise to spillovers, but their nature varies greatly. Empirical evidence on the relative merits of either type of evidence is however scarce.

A broader consensus exists on the potential knowledge spillovers from higher value added activities, especially with local research and development (R&D). As a relatively new trend, MNEs use FDI to access R&D competences around the world, either by locating near major centers of innovation, or by acquiring firms with R&D capabilities (Kuemmerle 1999). Yet, can emerging economies expect to benefit from R&D spillovers? In India, Feinberg and Majumdar (2001) find that affiliates of different MNEs benefit from each other's R&D activity, but they find no spillovers to local firms, nor do they observe reverse benefits of MNEs tapping R&D capabilities of local firms. Thus, the questions remains how can emerging economies attract and benefit from subsidiaries that pursue higher value added activities?

One answer may be to develop subsidiaries over time. Many affiliates upgrade their activities as they mature and more advanced inputs become available locally. This may be a process prepared in headquarters, but subsidiaries can also themselves take initiative, for instance, to attain a global mandate (Birkinshaw, 2000). However, what factors drive the evolution of subsidiary roles in emerging economies, and thus the nature of their interaction with local businesses?

### *MNE operations*

The impact of MNEs on their local environment depends not only on what they do, but how they do it. In addition to MNE strategies, researchers thus ought incorporate MNEs' internal operations, including for instance the degree of centralization of decision making (Bartlett and Ghoshal, 1989), the organizational cultures, and the human resource management practices (Lane et al., 2004). Yet, how do MNEs' internal processes affect their impact on the local business environment?

One aspect of particular relevance for MNE spillovers is *intra-firm knowledge transfer*. The sharing of knowledge within the multinational enterprise is a precondition for knowledge spillovers. Despite a large and growing literature on knowledge management in MNEs (Nonaka and Takeuchi, 1995; Grant, 1996; Despres and Chauvel, 2000), few studies systematically analyze transfer of knowledge from MNEs to their affiliates in emerging economies.

MNEs typically train local employees at all levels of the organization, providing formal training courses in the subsidiary or elsewhere in the network of the multinational enterprises, as well as on-the job training in close contact with expatriates or trained local staff (Estrin and Meyer 2004). There is ample evidence that MNEs invest more than local firms in training and staff development (Gerschenberg, 1987; Chen, 1983). Yet, internal knowledge sharing varies, for instance with human resource management practices and methods of training (Husted and Michailova, 2002; Minbaeva, Pederson, Björkman, Fey and Park, 2003). How and to what extent does such training create benefits that are not appropriated by the investing firm? On the other hand, to what extent does training serve to identify the most qualified individuals for international careers within the MNE outside their home country, thus contributing to a brain drain? Future research may incorporate proxies for the MNE's organizational structures and practices when analyzing the impact of FDI on local businesses.

#### *Conclusions on the Multinational Enterprises*

Explicit focus on the MNE should stimulate new theoretical reasoning concerning FDI impact, and provide a better understanding of which types of FDI projects create most spillovers. International business research studying MNE impact on the basis of firm-level datasets may want to focus on investor and project specific variables, such as entry modes and subsidiary roles and their evolution over time. Moreover, researchers should analyze internal processes of knowledge sharing not only in terms of its organizational consequences but also in view of the wider impact on society.

#### *Focus on Recipients*

Local firms have long been treated as passive recipients of spillovers, but benefits are not obtained quasi-automatically (Blomström and Kokko, 2002; Fan, 2002). As noted in the

discussion on intra-industry spillovers, firms' own strategies and resource endowment are crucial for benefiting from interaction with foreign investors. Yet, what specifically improves local firms' ability to benefit from interaction with MNEs? I see promising research opportunities to explore the role of absorptive capacity, entrepreneurship and industrial clusters.

### *Absorptive capacity*

International business researchers have analyzed absorptive capacity in the contexts of knowledge transfers within MNEs and within strategic alliances (Lane and Lubatkin, 1998), including joint venture in emerging economies. For example, Lane, Salk and Lyles (2001) and Lyles and Salk (1996) find that local joint venture partners improve their capacity to learn if organizational flexibility is promoted, and if collaboration and exchange of information within the organization is encouraged, if employees are given greater latitude in altering activity patterns, and if processes are adapted to perceived changing needs and conditions.

Knowledge acquisition by local joint venture partners is an important means by which a host economy may gain; yet how do other local firms benefit? The processes of learning from an MNE partner willing to share knowledge are different than learning from unrelated businesses (Martin and Salomon, 2003).

To push the research on the conditions under which spillovers emerge further, researchers ought to explore the concept of absorptive capacity more profoundly. In the management literature, absorptive capacity is conceptualised as dynamic capability, which is broader than its usage in the empirical spillover literature. In a recent restatement, Zahra and George (2002: 186) define absorptive capacity as "a set of organizational routines and processes by which firms acquire, assimilate, transform, and exploit knowledge to produce a dynamic organizational capability". It encompasses not only human capital (Cohen and Levinthal 1990) but also structural characteristics of the organization abilities to value, assimilate and commercialize new knowledge (Lane and Lubatkin, 1998). This in turn has been associated with structural features of the organization, such as strategic and organizational flexibility which appear particularly important in emerging economies due to the high volatility of the environment (Lane, Salk and Lyles, 2001; Uhlenbruck, Meyer and Hitt, 2003).

Yet, what contributes to local firms developing such capabilities in emerging economies? Buckley et al. (2002) and Sinani and Meyer (2004) find that received spillovers vary across firms in different forms of ownership, which they attribute to different absorptive capacity. The management literature provides more precise theorizing on how firms enhance their absorptive capacity, including human resource management practices (Minbaeva, Pederson, Björkman, Fey and Park, 2003), interactive top management teams (Uhlenbruck, Meyer and Hitt, 2003), and managerial cognition of opportunities for knowledge transfer and organizational change (Newman, 2000). These concepts ought to be explored further in qualitative research, and then be introduced to firm-level studies of spillovers.

### *Entrepreneurship*

Entrepreneurs are a major source of economic growth in emerging economies. They are moreover an important source of innovation, often developing new knowledge by combination of knowledge obtained from foreign partners with local knowledge. In this process, experimentation helps developing innovations specific to the context, and promotes the process of “economic development as discovery” (Hausmann and Roderik, 2003). How do MNEs influence local entrepreneurship in their host economies?

Some observers are concerned that MNEs crowd out local entrepreneurs, or at last inhibit the emergence of locally controlled MNEs.<sup>3</sup> However, FDI also can act as a stimulus to evolutionary processes of resource creation by promoting innovation and discovery (Kogut 1996). Moreover, entrepreneurial activity by individuals leaving a foreign-owned affiliate to establish their own business generates potentially large spillovers. Studies of successful local firms find that many entrepreneurs or top managers had prior links to MNEs. For example, Katz (1987) reports that many managers of local firms in Latin America started their career with MNE subsidiaries. Altenburg (2000) reports that spin-off electronics companies in Malaysia maintain close relations as suppliers and subcontractors with the MNE, while Hill (1982) makes similar observations in the Philippine appliance and motorcycle industry. Hence, the movement of employees may not be large in terms of the number of individuals involved, but those that leave may have a substantive impact if as entrepreneurs they set up their own businesses.

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<sup>3</sup> Thanks to an anonymous reviewer for pointing to this and other potentially negative consequences of MNE.

Future research may draw on the literature on entrepreneurship and spin-offs in emerging economies to further investigate the linkage between MNEs and the growth of new firms. The evidence is so far mainly based on case evidence. Yet how widespread is the phenomenon, and under which circumstance do individuals leave an MNE to set up their own business and succeed in growing it?

### *Industrial clusters*

Industrial clusters have attracted the imagination of policy makers in emerging economies because they provide opportunities for direct interaction between firms, and thus for various forms of spillovers and for economies of specialization. The evolution of industrial clusters is often driven by network organizations (Chandler, Hagström, and Sölvell, 1998; Lall 1996), or by singular large multinational firms acting as flagship firms for an entire industry (Rugman and d’Cruz, 2000). FDI by a lead firm may draw other network members to the same location, and thus create a larger impact than the initial investment alone.

For small ambitious firms in emerging economies, access to such production networks is of increasing importance, yet the long term-nature of supplier relationships and the global reach of incumbents raise entry barriers. Incumbents benefit from their long-standing relationship, their reputation and their customer-specific know-how. Also, large firms are better able to guarantee quality and just-in-time delivery. Thus attaining access to an international value chain is a major challenge for small firms in emerging economies.

This key role of clusters for economic development, and the potentially central role of MNEs in clusters, raises many research questions. First, how convincing is the empirical evidence for spillovers to occur at sub-national level? On aggregate level, it is not very strong. Aitken and Harrison (1999) and Smarzynska (2002) test for the spillovers pertaining to a “local” region smaller than the host economy, but they find no evidence to support this claim in respectively Venezuela and Lithuania. However, Zhang (2001) finds positive evidence of spillovers at regional level within China, as does Sjöholm (1999b) in Indonesia. More favorable evidence comes from case research, showing how FDI can facilitate cluster development. For instance, Patibandla and Petersen (2002) argue that the early investment by Texas Instruments in Bangalore was instrumental in developing the Indian software cluster. Similar case evidence shows contributions of FDI during the

inception phase of industrial clusters, such as the textile industry in Bangla Desh and Mauritius (Rhee and Belot, 1990), and the electronics industry in Penang, Malaysia (Altenburg, 2000). Yet are these typical? Under which conditions do they emerge? To assess the questions beyond the case study approach, future research needs better ways to delineate clusters to capture intra-cluster spillover effects.

Secondly, how do MNEs contribute to cluster evolution? The contribution of the foreign investor may lie in both transfer of knowledge to local partners, possibly in exchange for other knowledge, and in their role as intermediaries in the international cross-fertilization of knowledge clusters. By establishing operations within a cluster, MNEs can both contribute to and benefit from the knowledge exchange within the cluster.

Longitudinal case studies have followed global industry evolution over several years or even decades to observe both winners and losers, tracing the emergence of new clusters in a dynamic context and recording not only entries, but also exits (McKendrick, Doner and Haggard, 2001; Murtha, Lenway and Hart, 2001). Research on industrial clusters needs more such longitudinal studies. This qualitative research may then stimulate theoretical development applying for instance theories of organizational learning, knowledge creation and evolutionary economics, as well as focused empirical tests.

#### *Distribution of Benefits*

Market transactions normally create a producer and a consumer surplus as the market price is below the maximum price that the buyer would be willing to pay, and above the minimum price at which the seller is willing to sell. How this economic surplus is divided depends on the relative bargaining power of the two partners to the transaction. This distribution may be very imbalanced in cases of monopoly power, perfect price discrimination, or asymmetric information at the time of contracting.

In relationships between a foreign investor and local suppliers, bargaining power is likely to be uneven. Suppliers that manufacture intermediate goods with technological specialization and/or economies of scale have some degree of autonomy and bargaining power. On the other hand, local suppliers providing products based on low labor costs face less favorable terms, while suppliers serving during peak demand periods need to be very flexible to cope with high uncertainty (Altenburg, 2000). The dominant role of flagship firms in industrial networks may create new dependencies as other participants, including

non-business infrastructure such as universities and public agencies “have no reciprocal influence over the flagship strategy” (Rugman and d’Cruz, 2000:84).

In extreme cases, the balance of benefits might even be negative for local partners facing asymmetric information and high sunk costs. If local firms invest heavily in fixed equipment, but the price is subsequently driven down to marginal costs due to additional entry, local firms may not be able to recover their initial investment and thus be worse off. This extreme scenario is unlikely, but illustrates that foreign investors may under certain circumstances be able to accrue all or most of the value added created. Similar concerns arise for individuals signing employment contracts with foreign investors employing ‘sweatshop’ production facilities, as discussed below.

In conclusion, the contribution of foreign investors to a host economy depends not only on their local value creation, but on who accrues the economic gain, which in turn depends on bargaining power. While a common assumption is that both partners benefit (provided they entered the relationship voluntarily), researchers ought to incorporate the distribution of benefits when assessing contribution of FDI. Research of supplier relationships thus ought to pay more attention to the role of smaller businesses in international production networks. For instance, what types of relationships generate the largest benefits for local partners, and how can relationships be managed such as to generate spillovers for local firms without harming the interests of the MNE?

#### *Conclusion on recipients*

Research taking the local firms as starting point can be expected to substantially advance our understanding how MNEs affect their local environment. In my view, studies of absorptive capacity and capability development processes in individual firms as well as clusters would greatly help to explain the impact of MNEs. However, these studies should also pay attention to who accrues the benefits of the new value created.

#### ***Focus on the Environment***

The literature on social and environmental impact of FDI has developed largely separate from the literature on economic impact, as neither business scholars nor mainstream economists appear to take a particular interest. The impact of MNEs on the social and natural environment of host economies can be positive or negative (Dasgupta,

Laplante, Wang and Wheeler, 2002). Some authors stress the transfer of modern, environmentally friendly technology and production processes by MNEs, which improve the standards prevalent in the host economy, a ‘pollution halo’ effect. Other scholars are concerned that MNEs choose to transfer outdated technology to locations with less stringent environmental regulation, a ‘pollution haven’ effect. A major research challenge is the assessment of the relative importance of these opposing hypotheses.

MNEs have two motivations to transfer advanced environmentally friendly technology to emerging economies, even where this is not required by local legal or ethical standards. Firstly, MNEs employing their global technology and procedures can realize scale economies in engineering standards for design, equipment purchases and maintenance; integrate global production and logistics, and reduce potential liability from regulatory changes (Dowell, Hart and Yeung 2000). The second motivation arises from the reputation of being seen to act ethically, or, more precisely, the potential dangers of damaging the global brand by a major scandal. Globalization increases institutional and customer pressures on firms to surpass local requirements in emerging economies.

Thus, some observers expect a ‘pollution halo’ effect as foreign investors introduce environmentally friendly technology that then diffuses locally. Eskeland and Harrison (2002) show that foreign investors are more efficient in using energy, an important aspect of environmental impact. Christmann and Taylor (2001) find that firms’ international linkages contribute to their adaptation of industry self-regulation standards. However other studies, such as Hettige, Huq, Pargal and Wheeler (1996), point out that local community pressure is more important than ownership in explaining environmental performance (Zarsky 1999).

On the other hand, the ‘pollution haven’ effect has become a major concern among environmental NGOs. Multinational firms are feared to evade stringent environmental standards in their home countries and locate to ‘pollution havens’, thus triggering a ‘race to the bottom’ in environmental standards. Empirical evidence suggests that escaping environmental regulation is not a substantive motivation for relocation of production as compliance costs are for most firms small relative to total costs of production, and legal changes in developing countries have narrowed the regulatory gap that may have existed in the 1970s (Jaffe, Petersen and Portney, 1995; Zarsky, 1999; Dasgupta et al., 2002).

However, possible relocation is occasionally used as argument by MNEs bargaining with governments.

Studies of actual pollution in overseas affiliates have to operationalize environmental impact by using a single indicator as dependent variable, which is problematic for a complex construct like environmental impact. Case studies provide a more rounded picture of environmental impact of specific projects and their evolution over time (Gentry 1998). They point to industry-specific problems, such as the dangers of monocultural plantation for exported food products. However, there are too few such studies to permit a more general conclusion.

More systematic research ought to explore the impact on the natural environment. Empirically, this research may employ survey studies that capture multiple dimensions of impact, preferably integrating economic and environmental impact. Theoretical research ought to further investigate for instance the motives for imposing high standards in foreign operations and on foreign suppliers, notably the effectiveness of the reputation effect and of industry self-regulation. Work sponsored by international organizations provides some starting points for such research (Zarsky, 1999; Hansen 2002).

### ***Focus on Labor and other local stakeholders***

The labor standards in MNE affiliates and subcontractors in emerging economies are a major concern in globalization debates. Some observers fear that the strong bargaining power of multinational firms vis-à-vis their employees, and vis-à-vis potential host countries leads to a lowering of standards and wages (Cerny, 1994; Palley, 2002). Does the downward spiral of rivalry lower labor standards in MNE operations in developing countries, triggering a "race to the bottom" (Spar and Yoffie, 1999)?

The theoretical arguments concerning impact on social variables resemble those on environmental impact. On the one hand, concern with global standardization and the firm's reputation induces many MNE affiliates to pay higher wages and to employ high labor standards with respect to working hours, sick leave, child labor, unionization etc. (Caves, 1996: 228; Moran, 2002). Since MNE's generally wish to retain their qualified staff, they have incentives to keep them satisfied, unless they are employing unskilled labor with few outside job opportunities. On the other hand, lower labor standards and lower wages present opportunities to reduce production costs. This incentive is generally larger than for

environmental issues, as labor costs often account for a larger share of production costs. Host countries eager to attract investment are said to compromise their standards under pressure from MNEs, thus undermining democratic principles (Cerny, 1994; Scherer and Smid 2000).<sup>4</sup>

The unease about the "race to the bottom" is of concern in certain industries, such as textiles, footwear and assembly of electronics. Spar and Yoffie (1999:565) argue that necessary conditions for a race to the bottom are first mobility of firms and goods across borders, i.e. free trade, and, second, that "regulation and factor costs are heterogeneous – and the heterogeneity leaves gaps that can be turned into the firm's competitive advantage". Moreover lowering of standards is facilitated by

- Homogeneity of products (or components at certain stages of the value chain), such that price is a key competitive parameter.
- Regulatory differentials are important for the cost structure of the industry, such as labor law for textiles and footwear.
- MNEs would not incur major transaction costs or sunk costs when relocating a production plant, i.e. location is not sticky.

Such a race to the bottom would not necessarily be in the business interest. Theoretically, if firms were to cooperate and implement common standards, the race would stop. This would require a cartel-like cooperation. However, as cartels, agreements over standards are hard to enforce, especially if firms are heterogeneous. But contrary to cartels, policy makers may have incentives to support the creation of standards cartels (Spar and Yoffie, 1999). Industry self-regulation can achieve part of such regulation by creating common standards and certification (O'Rourke, 2003).

Yet, this theoretical discussion requires more empirical support: are industries with the aforementioned characteristics actually engaging in races to the bottom? Are standards cartels, with or without government involvement, moderating races to the bottom? How

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<sup>4</sup> Many economists point out that as long as the contract is entered voluntarily, both partners would be better off. Notably, local wages reflect outside earning opportunities, which are typically low in those countries where so-called sweatshops are located. However, this assumes *ex ante* full information and the absence of switching costs. Both conditions are unlikely to be fulfilled in labor markets, especially for migrant workers in developing countries. Moreover, bargaining power and even the ability to price discriminate may allow locally important employers to accrue most of the surplus created.

effective is industry self-regulation? The issue of labor standards has gained renewed prominence in the globalization debates (Bhagwati, 2004), and international business research ought to offer both theoretical and empirical evidence on how globalization of supply chains (with or without FDI) affects employees at the bottom of the hierarchy.

Moreover, concern about labor conditions has to go one step further. Poor working conditions, including child labor, have been common during early stages of industrialization in Europe and North America. Some authors thus argue that sweatshops are a necessary step of economic development. For example, Kristof and WuDunn (2000) argue that Asian economies that permitted sweatshops, like Taiwan and South Korea, have substantially improved their standards of living of the past three decades, while citizens of countries who resisted foreign exploitation, like India, continue to suffer for widespread poverty. This discussion too needs more solid empirical foundations.

### *Focus on Institutions*

Institutions failing to ensure efficient functioning of markets are widespread in emerging economies. Formal institutions such as the legal code may be less sophisticated, and, just as important, law enforcement may be inefficient. Local firms may thus rely on network based coordination mechanisms to overcome various forms of market failure (Peng 2000). Yet how does this institutional heterogeneity interact with FDI? On the one hand, foreign investors may influence the institutional development, but at the same time they adjust to local institutions. Moreover, institutions moderate interactions with local firms and individuals.

The literature has analyzed the issues largely separate: strategy scholars analyze how FDI strategies are adjusted to local contexts, and institutions in particular (Peng, 2000; Henisz, 2000; Meyer, 2001), while development scholars analyze how FDI influences the local context. However, FDI strategies and the local environment in emerging economies are mutually interdependent. Informal institutions may be influenced by the living example of businesses based on different values and norms, and even formal institutions may be influenced by governments changing legislation in view of attracting FDI, possibly even under direct negotiations or lobbying by MNEs. On the other hand, the local environment, in particular the institutional framework, influences MNEs' entry and subsidiary strategies.

Moreover, institutions moderate many of the afore discussed relationships between foreign and local firms, for instance:

- Labor market institutions moderate the mobility of people between local and FDI firms, and thus the diffusion of knowledge, but also local firms' loss of employees to foreign competitors. Labor laws and their enforcement regulate minimum wages and working conditions.
- Capital market institutions moderate the ease of local sourcing of capital, but also the possible crowding out of local investment.
- Environmental regulation and enforcement influence the potential negative effects on the local environment.
- Competition and industry regulation influence foreign investors ability to extract monopoly rents or otherwise benefit from market power.
- Education systems enhance the availability of skilled labor and the absorptive capacity.
- Special economic zones may attract more FDI, but at the same time limit the interaction with indigenous industry and thus spillovers.

Corporate strategies, institutional change and the development of local resources and capabilities are thus mutually interdependent. This suggests two directions for future research. Firstly, institutions are important moderating variables to be included in many studies of FDI impact. Secondly, scholars should build on recent research on the co-evolution of corporate strategies and institutions (Lewin and Kim, 2003) and apply this line of thought to emerging economies (Meyer and Nguyen, 2003). This should lead to clearer empirical evidence on long run processes of institutional and corporate change.

### **Ethics of Business in Emerging Economies**

So far, I have discussed how international business research may contribute to enhance our understanding of how MNEs influence the local environment. However, this question can hardly be separated from ethical questions concerning how MNEs *should* treat their local environment and their local stakeholders. Should they feel obliged to create positive, or at least non-negative, spillovers to the local economy? What standards of behavior would be appropriate in a world of hugely varying cultures, incomes, and cost of living? These

issues have to be addressed by scholars working on the interface of ethics and business. Given space limitations, I briefly raise some key issues.

Authors on business ethics can be broadly distinguished between those taking a normative view and those taking an instrumental view. The **normative view** believes that MNEs have a moral responsibility to their stakeholders, and thus reject the primacy of shareholders over other stakeholders (Donaldson and Dunfee, 1999; Scherer and Smid 2000). Thus, moral standards are independent of profits. A normative view is implicit for example in the following UN declaration:

*“Recognizing that even though states have the primary responsibility to promote, secure the fulfillment of, respect, ensure respect of, and protect human rights, transnational corporations and other business enterprises, as organs of society, are also responsible for promoting and securing the human rights set forth in the Universal Declaration of Human Rights...” (United National Social and Economic Council, 2003: 1).*

On some issues, such as child labor or slavery, a broad international consensus supports certain standards, known as hypernorms. Yet on other issues such as CO<sub>2</sub> pollution or employees’ right to annual leave, standards vary greatly between and within countries. Certain ethical principles are considered appropriate for some but not all cultures, which creates a ‘moral free space’ (Donaldson and Dunfee, 1999). For example, many business practices considered ethical in the USA are not necessarily so in Russia, and vice versa (Puffer and McCarthy 1995).

Those adopting a normative view need to discuss how a consensus might be achieved to establish global standards that recognize diversity of cultures (Scherer and Smid, 2000; Hartman, Shaw and Stevenson, 2003). More practically, international business research should analyze how MNEs manage the variation of moral standards in their countries of operation, and provide guidelines for managers facing normative decisions. Yet this is a thorny challenge:

*“It is testament to the philosophical and logistical complexity of the sweatshop issue that even if a corporation’s leadership decides it want to assume a progressive posture, or at least sufficient progressive to protect the company from an*

*embarrassing publicity campaign, there is as yet no consensus about what the company must do” (Varley, 1998: 495).*

The **instrumental view** is more common in Anglo-Saxon countries. Its proponents argue, somewhat simplified, that firms should pursue high labor or environmental standards if it is good for profitability. If markets are efficient, and consumers are willing to pay higher prices for goods produced with higher standards, then meeting these standards will be good for profitability. This perspective lends itself more naturally to systematic analysis than normative views, as research questions pertain primarily to the efficiency of the proposed linkages between business practices and profits.

First, raising standards may in fact raise productivity if environmental standards reduce wastage, or labor standards increase work motivation. For example, Frenkel and Scott (2002) compare two similar subcontractors of adidas in China and found that the firm that took a collaborative approach to introducing a new corporate code of conduct achieved better performance in terms of for example reject rates or employee turnover.

Second, higher standard may shield MNEs against negative publicity. Traditionally, many MNEs took the legalistic view that they cannot be held responsible for the labor practices of their foreign suppliers. However, the new activism of NGOs and attention of the media put spotlights on incidences of practices considered unethical by these stakeholders, such that “the advantages of lower cost labor or lower cost inputs from more abusive suppliers must be weighted against the crush of negative publicity, the costs of public relations, and the possibility of consumer protests.” (Spar 1998). Many MNEs have over the past decade reacted by introducing corporate codes of conduct (Varley, 1998; van Tulder and Kolk, 2001), and by joining new non-governmental systems of labor standards and monitoring (O’Rourke, 2003). Such systems are expected to link ethical behavior to profitability: failure to comply to standards that a firm committed to may severely affect the firm’s reputation, and thus their sales and their bottom line (Spar, 1998).

This relatively new phenomenon, however, raises many research questions. As the nongovernmental systems are still relatively new, they are in constant flux, and have not yet been comprehensively evaluated. O’Rourke (2003) suggests they should be assessed in terms of legitimacy in terms of stakeholder involvement, rigor of the standards,

accountability of the monitoring process, as well as complementarity with state regulation and corporate learning processes. Empirical research needs to assess if and how NGO involvement and codes of conduct influence businesses to raise standards: Is it falling short because monitors can't observe all abuses, or is it overshooting as NGOs proclaim higher standards than a social consensus would approve? A crucial variable linking ethical behavior to financial performance is consumer's willingness to pay for ethical features of products. Auger, Burke, Devinney and Louviere (2003) provide first evidence that consumers are willing to for certain features, yet more such studies are required.

Ultimately, MNEs are concerned how their handling of ethical matters affects financial performance. While individual studies provide opposing results, a recent meta-analysis suggests that corporate virtue in the form of social responsibility is likely to pay off (Orlitzky, Schmidt and Rynes, 2003). However, further research based on outcomes in specific areas such as labor standards, rather than announced policies and processes, may provide more specific insights to guide managerial decisions.

In conclusion, ethical aspects of business have become a major issue in popular debates on multinational enterprises. Higher standards are expected increase the positive effects of MNEs on their host economies, albeit some argue that too fast rises of standards may undermine countries' competitiveness and thus inhibit economic growth. International business scholars in collaboration with political economists and business ethicists ought to raise the intellectual level of these debates.

### **Conclusion**

The role of MNEs in emerging economies is a key aspect of contemporary disputes over the merits of globalization (Bhagwati, 2004). International business scholars should contribute to the ongoing debates in scholarly, policy and public forums. The research agenda is broad, and I have argued that international business scholars may in particular contribute research that takes the individual multinational and local firms as starting point. They have key insight into the inner logic of multinational firms that should enhance both policy and management decisions crucial for the future of the global economy, and facilitate mutually beneficial outcomes. Future research should moreover look beyond technology spillovers and analyze a wider range of impact variables, including environmental and social variables, and the potential impact of non-governmental organizations and corporate codes of ethics.

While I share the view of most observers that MNEs play in most cases a positive role in the development of host economies, I would also like to see careful analysis of negative effects. A better understanding under which specific conditions these may emerge helps both creating remedies and countering exaggerated claims by those fundamentally opposed to globalization.

A good understanding of the role of MNEs in society is a precondition for discussing policy vis-à-vis MNEs. If impact is shown to be positive, an argument can be made for policy intervention to encourage FDI (Blomström and Kokko, 2003). This research thus establishes a foundation for policy oriented studies that could not be covered in this paper, for instance on the effectiveness of policy in influencing FDI (Oman 2000) or on negotiations between MNEs with local governments (De la Torre, 1981; Ramamurti, 2001).

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