

# **The organizational and geographical boundaries of the firm.**

## **Strategic and policy issues for labour and governments.**

**Grazia Ietto-Gillies<sup>1</sup>**

**London South Bank University**

**Birkbeck University of London**

### **Plan**

- 1. Introduction**
- 2. Boundaries: perspectives, stakeholders and dimensions**
- 3. Boundaries and the organization of production**
- 4. Cross-country boundaries: the transnational corporation**
- 5. Nation-states generate advantages for TNCs**
- 6. Labour as stakeholders in the boundaries of the firm**
- 7. Boundaries: an approach based on labour**
- 8. Boundaries and governments**
- 9. Summary and conclusions**

**Abstract.** Analysis of the firm's boundaries in terms of: *perspectives* – legal/proprietary; responsibility; control - ; *stakeholders* – shareholders and managers but also others and specifically labour and governments -; *dimensions* – organization of production; geographical/by nation-state; sectoral -. The organization of production in hierarchical as well as in a variety of hybrid forms and to the position of labour in the context of these hybrid forms. The geographical – by nation-states - dimension leads to a discussion of transnational companies, the advantages they derive from operating across borders and the source of such advantages. Detailed analysis of the position of two stakeholders vis-à-vis the changing boundaries of the firm: labour and governments. How organizational and geographical fragmentation of production lead to a more fragmented and weaker labour force. The geographical dimension and the position of governments in relation to transnational companies. How the changing boundaries of the firm particularly with respect to organizational forms and to the geography of direct foreign operations by TNCs put both labour and governments in a weaker position.

**Key words:** Firms and its boundaries; internalization v externalization; hybrid forms of organization; transnational companies; labour as stakeholder; nation-states and transnationals; governments as stakeholders.

---

<sup>1</sup> I am grateful to Giovanni Balcet, Jan Drahokoupil, Marion Frenz and Mario Tiberi for useful comments on previous drafts. I gratefully acknowledge financial support from the European Trade Union Institute (ETUI) for this project. [iettog@lsbu.ac.uk](mailto:iettog@lsbu.ac.uk)

## 1. Introduction

The firm has been the subject of study by economists, sociologists, management scientists, finance and accountancy experts for a long time. A variety of issues are dealt with in the literature. Their richness makes it difficult to arrive at neat classifications and discipline boundaries. A recent volume by Dietrich and Krafft (2012) bundles the issues between ‘Economics of the firm’ and ‘Theory of the Firm’. The former is supposed to be concerned with issues related to organizational boundaries and the internal structure of the firm. The latter is more concerned with issues of firms’ strategies in the context of the market. That the two aspects interact is recognized by the authors in their introductory chapter and their book, indeed, aims to build bridges and highlight interactions between the ‘Economics’ and the ‘Theory’ of the firm.

The present author considers the interaction to be so strong as to make it impossible to distinguish between so called ‘Economics’ and so called ‘Theory’ of the firm. Of course researchers may concentrate on a specific issue but, in the real world, a change, say, in the organizational structure of a large firm may impact – and be affected by – its strategic behaviour towards other stakeholders or by changes in the market. Though the issue of boundaries affects both large and smaller firms, we shall concentrate on large and transnational corporations. Smaller firms will come into the discourse mainly in terms of their contractual relationships with the larger corporation.

The paper proceeds as follows. The next section discusses a variety of perspectives, stakeholders and dimensions of boundaries. This is followed, in Section three, by an analysis of boundaries in terms of the organization of production. Section four considers cross-countries boundaries and the transnational corporation (TNC). Section five analyses how the existence of nation-states can create advantages for TNCs. Sections six and seven approach and analyse boundaries from the point of view of labour as stakeholder. Section eight discusses the issue of boundaries in relation to governments as stakeholders. The last section summarises and concludes with some discussion about possible work ahead.

### 1. Boundaries: perspectives, stakeholders and dimensions

#### *A variety of perspectives*

Where does the firm begin and where does it end? Is a small contractor working exclusively for a large department store part of the same retailing firm or a separate firm and if so why? Is a Japanese subcontractor working in the 1980s exclusively for a car manufacturer part of the latter corporation or not? If not, why not? Are the boundaries of the firm a legal matter as in the property rights approach? Or are they an organizational matter: hierarchies versus markets and their respective efficiency? Or are they connected with control? But what is the meaning of control and why does it matter? Are there several dimensions to boundaries?

If we want to understand the relevance of boundaries and their impact on various stakeholders to the firm, we must attempt to answer these questions. To facilitate our task, we shall begin with an analysis of perspectives, dimensions and stakeholders of boundaries as summarized in Table 1. The table consists of three vertical sections to be read separately (1a; 1b; and 1c).

We can consider boundaries from a variety of *perspectives* and specifically the following. We can take the *legal/proprietary perspective* and this is mostly what is done in the literature: the

activity is part of the firm if the resources invested in it and the outcome/product belongs to the firm. From this perspective when part of the production process is outsourced the process itself and its inputs do not belong to the firm and do not form part of it; therefore the principal firm has no responsibility for them. However, the product belongs, contractually to the principal; it therefore becomes part of the firm and can be sold to clients or used for further processing. Both the transaction cost and the property rights approaches to the firm can be subsumed under the legal/proprietary perspective.

A second perspective relates to *control*. Control has several connotations. We can look at control from the perspective of the *equity ownership* necessary to exercise control at Board level. What percentage of shares is necessary to secure control of the firm vis-a'-vis other shareholders? Working in the context of international firm, Hymer (1960) analysed this question and came out with the breakthrough distinction between portfolio investment and direct foreign investment.

A second connotation of control relates to the relationship between shareholders and managers. Following Berle and Means (1932) seminal work a large amount of literature has focused on the control exercised by managers who are the real decision makers within the modern corporation. Their interests do not always coincide with those of the shareholders<sup>2</sup>. Moreover, the interest of divisional managers may clash with those of headquarters' managers.

**Table 1. Boundaries of the firm: perspectives (1a); stakeholders (1b); dimensions (1c).**

Perspectives (1a)	Stakeholders (1b)	Dimensions (1c)
<p><i>Legal/proprietary</i></p> <p><i>Control:</i> Within the firm:</p> <ul style="list-style-type: none"> <li>• Equity</li> <li>• Managerial</li> </ul> <p>Outside the proprietary boundaries</p> <p><i>Responsibility for:</i></p> <ul style="list-style-type: none"> <li>• Labour force</li> <li>• Brand reputation</li> <li>• Risk taking</li> </ul>	<p><i>Shareholders, managers</i></p> <p><i>Labour</i></p> <p><i>Governments; tax payers:</i></p> <ul style="list-style-type: none"> <li>• of regions</li> <li>• of nation-states</li> </ul> <p><i>Suppliers and distributors</i></p> <p><i>Consumers</i></p> <p><i>Rival firms</i></p>	<p><i>Organisation of production:</i></p> <ul style="list-style-type: none"> <li>• hierarchical</li> <li>• externalization</li> <li>• hybrid forms</li> </ul> <p><i>Geographical:</i></p> <ul style="list-style-type: none"> <li>• uninationa</li> <li>• transnational</li> </ul> <p><i>Sectoral field:</i></p> <ul style="list-style-type: none"> <li>• Single sector</li> <li>• Diversified</li> </ul> <p><i>Growth strategies and processes:</i></p> <ul style="list-style-type: none"> <li>• Organic growth</li> <li>• Mergers and acquisitions</li> </ul> <p><i>Origin of profits and value:</i></p> <ul style="list-style-type: none"> <li>• Main activities</li> </ul>

<sup>2</sup> There is a huge literature on this issue. See Baumol (1959), Marris (1967); Bengt and Holmstrom (1998), Bolton and Scharfstein (1998) and, more recently, Bo and Driver (2012).

		<ul style="list-style-type: none"> <li>• Speculative investment</li> </ul>
--	--	--

Hymer (1971) looked at it from a different angle than the dichotomy managers v shareholders. He considers the necessary technical and organizational structures for the effective exercise of control by managers. In particular, he highlights how, in the modern multidivisional, geographically-spread corporation, the exercise of control over far away subsidiaries may be impossible if the system of communications and the organization of the business across countries are not suitable. This was indeed the case of much foreign business prior to the First World War (WWI). There were then a large number of enterprises whose assets were owned wholly or in large part by a person or groups or companies in foreign countries (often in Britain or The Netherlands). However, though these owners from foreign countries had controlling stakes in the business, they were not in a position to exercise managerial control because of the large distance between the home and host countries under conditions of poor communication and transportation systems<sup>3</sup>.

The following decades saw the development of two relevant and interconnected innovations both of which form the *sufficient conditions* for the exercise of managerial control. First, the technological innovation in personal communications which started with the telegraph and telephone and, more recently, with electronic communications. Second, organizational innovations<sup>4</sup> which were made possible (and/or strongly facilitated) by the communication technologies.

A final connotation of control relates to control that the large firm can exercise outside its proprietary boundaries on other firms usually smaller ones such as sub-contractors, franchisers and general suppliers or distributors. If the principal firm controls the design, brand, quantity and quality of the process and its output then – strategically – the activity of the subcontractor can be seen as part of the principal firm: they are part of the overall strategy of the larger company and these strategies shape their own business fortunes and moves. In this vein, Cowling and Sugden (1987:12) define the firm within the perspective of strategic control: ‘*A firm is the means of coordinating production from one center of strategic decision-making.*’ They then go on to extend their definition to the TNC: ‘*A transnational is the means of coordinating production from one center of strategic decision-making when this coordination takes a firm across national boundaries.*’

A final perspective on the firm’s boundaries relates to spheres of *responsibility and risk taking*. This is another side of the strategic control coin, in the relationship between the large principal firm and its network of suppliers. The outsourcing of some or most of the production process usually involves passing on responsibility for the workforce used in that part of the process to the subcontractors. In many cases the latter provide also the equipment

---

<sup>3</sup> Mira Wilkins (1988) calls these businesses ‘*free-standing enterprises*’ to highlight the fact that though they were owned wholly or partially by foreign nationals (whether individuals or groups or companies), they were managed and developed as independent concerns.

<sup>4</sup> Developments in internal organization of companies have been analysed under several theoretical approaches. From Penrose (1959) to Chandler (1962) to Williamson (1975; 1981; 1984) to Hymer (1970). Westney and Zaheer (2001) consider grid structures. See also Ietto-Gillies (2012: ch. 1) for a discussion on this issue.

and assets necessary in the process. They bear the responsibility and risks for them. An extreme example is that of Uber, the Californian digital taxi company which – so far – appears to own no taxis and to employ no taxi drivers. It supplies the technology.

#### *A variety of stakeholders*

The boundaries of the firm have, usually, been analysed from the point of view of shareholders and managers as the main stakeholders. This is in accordance with the legal/proprietary perspective on the firm. There is, of course, a huge literature on the shareholders versus managers' perspective and interests and on possible divergence between these two groups of stakeholders as mentioned in the previous sub-section. I am not going to delve further into this issue as the interest of the present paper is more on those stakeholders that seem to have been rather forgotten by the literature. There are, in fact, several groups of people who are greatly affected by the boundaries of the firm over and above the shareholders and managers. They are: labour; governments of regions and nation-states; suppliers and distributors (Table 1b).

As the companies' strategies have become more complex, the impact on these rather forgotten shareholders has become more profound and yet more opaque. It is, for example, not easy to understand whether and how the loss of bargaining power by labour or governments vis-à-vis the corporate sector in the last three decades may be due to externalization of activities or to strategies of transnationality or to sectoral diversification or to the financialization of the firm (Gallino, 2005).

Many of the problems derive from the fact that researchers analysing firm's boundaries have tended to use theoretical frameworks with a specific point of view only: that of shareholders and managers. In the following sections I will emphasize how: (a) the strategies of firms are often directed at stakeholders other than the consumers and rival firms; and (b) any of these stakeholders can be greatly affected by the firm's strategies even if the latter are not directly aimed at them.

#### *A variety of dimensions*

The issues discussed in this section are highlighted in Table 1c. Most literature dealing with boundaries takes the view that the boundaries of the firm are an important issue and has to do with the organization/coordination of production and wider business activities and, generally, with governance structures. Traditionally two main governance and coordination structures were seen as relevant: hierarchical coordination via the firm and coordination via the market. The former is also seen as a form of internal organization/coordination and the latter as a form of externalization. In this perspective, the various business activities and stages of the production process can all be organized internally to the firm and run via managerial and hierarchical structures; or some of them can be bought out and thus organized via the market. Casson and Wadeson (2012: 172) write on this: 'Internalization is a theory of the boundaries of a firm. It does not claim to be a complete and self-sufficient theory of the firm, but rather a necessary component of any comprehensive theory of the firm.' Whether the managerial/hierarchical or the market coordination prevails depends on specific costs and constraints of operating in the market versus operating internally to the firm. This is the basis of the internalization theory of the firm built up from the seminal work of Coase (1937). The further work, in a similar direction, by Williamson (1975; 1985) is seen by some authors as different enough to constitute a different theory and approach.

I acknowledge that *internalization versus externalization/market coordination* is an essential dimension of the debate on boundaries. For this reason it is further considered in details in the next section. Nonetheless, there are other dimensions in the discourse on boundaries.

A second very important dimension relates to the *geography of operations*. Within a fully internalized structure – or within the context of those activities and processes that are internalized - the production process may be organized in *single or multi-plant or multi branch structures*. In the latter case the various plants or branches tend to be spread geographically. The geographical spread may span a *single country or several*. When more than one country is involved the firm becomes a transnational on which more in section four. It should, however, be noted that transnationality can occur also within the externalization form of coordination. For example, a TNC from country A can subcontract work or give franchises in countries B, C and D.

Another dimension of boundaries pertains to the *sectoral field*: many firms operate their activities within a single sector such as mechanical engineering; others may be more diversified and span their activities within more than one sector. The diversification may grow organically – for example a firm producing dishwashers may branch out into the chemical sector by producing washing powder. Or the diversification may relate to completely unrelated sectors or to sectors connected by the potential capture of customers. The latter may be the case of supermarkets selling financial products. Whichever the motivations and strategies leading to diversification, the spreading of firm's boundaries to sectors other than the original or primary one has implications for the long term life of the firm as well as for its various stakeholders.

A further dimension relates to growth strategies: organic growth versus growth via mergers and acquisitions (M&As). These two very different growth strategies. They lead to changes in the boundaries of the firm that have wide implications for the destiny of the company and for its stakeholders, in particular for labour.

Finally, we could look at dimensionality in terms of *where the profits and values* come from. Some firms derive all or most of their profits and value from investment in activities related to their sector(s) of operations. Others may derive a large part of their value and profit from speculative operations i.e. from operations in which they only have a short term speculative interest rather than a long term interest. The latter strategy has long term implications for the firm and thus for its stakeholders.

There are many differences generated by these various dimensions. There are also some commonalities and, in particular, the following. (1) The boundaries of the various dimensions are the results of strategic behaviour by the firm. (2) Conversely, once these strategies are implemented and the boundaries are redrawn – by whatever dimension -, future strategies are affected by them. Moreover, (3) the new boundaries affect the position of different stakeholders: from the owners/shareholders to the managers, to the workforce, to the State to suppliers, to customers to rival firms. We note that the dimensionality issue acquires particular relevance in the context of an analysis based on a variety of stakeholders such as labour, governments and suppliers because they may be particularly affected by the various dimensional strategies.. When one or two stakeholders only are considered - shareholders and managers as in much literature on companies - the dimensionality issue is relatively less relevant.

In the next two sections we shall concentrate on discussions about the two most relevant dimensions of boundaries: (a) internalization v externalization v hybrid forms; and (b) the

transnationality dimension. Before we embark on that discussion we should, however, consider the motivations behind the drawing and changing of boundaries whatever their dimension. The traditional, orthodox theory of the firm assumes that the motivation behind the firm is profit maximization. If the market conditions in which our firm operates are competitive and the firm has little or no control over the price of its products, then this means, in effect, efficiency-driven cost minimization. In the real world the situation is complicated by the existence of imperfections in the markets for our firm's final outputs and/or its inputs. Moreover, the horizon over which profits are to be maximized is not clear-cut leading to unclear outcomes as regards the firm's behaviour. Behaviour that may lead to losses in the next year, may lead to profits if the horizon is five years and viceversa.

A different approach is to take the view that, in the context of market imperfection and uncertainty the firm and its managers act strategically rather than – or not just under the motivation of - search for efficiency. Strategic behaviour is considered as part and parcel of firms' behaviour within business schools. It is also taken into account by economists operating under assumption of oligopolistic behaviour. The strategies given most attention to are usually the ones towards rival firms. What is given less attention is the strategic behaviour towards other players in the economic system: from labour to governments to suppliers. These are the players of interest in this paper. They are stakeholders in the destiny and thus in the strategies of the firm.

## **2. Boundaries and the organization of production**

As mentioned above the issue of externalization versus internalization is seen by many authors as being *the* issue on boundaries of the firm. Though not seen as the only dimension of boundaries (Table 1c) it is here considered as a most relevant one for the firm and its various stakeholders.

There is now a vast literature on internalization v externalization. Most of it goes back to Coase (1937) seminal work. Why do firm internalize rather than acquire through the market? Indeed were the markets to be as perfect as neoclassical theory has given them credit for, there should be no firms: all business activities would be carried out through market transactions. The answer to why business activities tend to be internalized and why, indeed, firms exist was found in the existence of transaction costs for market operations: costs that are low and negligible when operating internally to a firm/ institution.

This view pits hierarchy versus market as two extreme forms of business governance. However, there have always been intermediate forms such as the put-out system of production; cooperatives organizing business and firms linking with other firms in a variety of ways<sup>5</sup>. These intermediate forms of organization of production have been mushrooming since the 1980s both in terms of typology of forms and in terms of number and values of activities they are responsible for. De Man (2004: 159) writes on this: ' Just as the divisional form was the organization form of the industrial economy, networks are the organization form of the late twentieth and early twenty-first centuries' economy.' The mushrooming has also – predictably – extended to the literature on such *hybrid forms* (Jolink and Niesten, 2012). Economists, sociologists and business strategies have all contributed and continue to do so.

---

<sup>5</sup> Casson and Cox (1997) point out that in the 19<sup>th</sup> century international business networks originating with British businesses were quite common.

A major early contribution is due to Oliver Williamson (1979) who considers ‘intermediate forms of organization’ (p. 234). He identifies the overall objective in choosing between different organizations of business transactions when he writes: ‘The criterion for organizing commercial transactions is assumed to be the strictly instrumental one of cost economizing. Essentially this takes two parts: economizing on production expense and economizing on transaction costs. ...the object is to economize on the *sum* of production and transaction costs.’ (p. 245; italics in original). The aim of his study is to identify the critical dimension with respect to which transactions differ. He identifies the principal dimensions as: ‘uncertainty, frequency of exchange, and the degree to which investments are transaction-specific...’ (p.261).

Grandori and Soda (1995) give us the term of ‘inter-firm networks’ for these hybrid forms. ‘An inter-firm network is a mode of regulating interdependence between forms which is different from the aggregation of these units within a single firm and from coordination through market signals...’ (p. 184-5). They highlight how different studies have concentrated on a variety of elements and variables observed in the networks: from the differentiation of the units to be coordinated to the complementarity of their resources; to the intensity of inter-firm interdependence; to the number of units to be coordinated; to the complexity of interdependent activities; to the asymmetry of resources controlled by the various firms in the networks. The latter issue – symmetry v asymmetry – is a particularly relevant one. It ranges from fully symmetric relationships such as cooperatives or trade associations or industrial districts to asymmetric ones: putting-out system; licensing and franchising contracts or subcontracting in which there is a principal and one or more sub-contractors with well defined and differing degrees of control over resources and over contracts. Many of these contracts do not usually involve investment by the principal. In other network forms assets are invested by the parties such as in: joint ventures or capital ventures.

The excellent survey and analysis by Menard (2004) starts with a review of the large terminology used in relation to hybrid forms of business organizations. They include: ‘... clusters, networks, symbiotic arrangements, supply-chain systems, administered channels, nonstandard contracts,...’ (p. 347). Indeed he quotes Oliver and Ebers (1998: 550) as remarking on the ‘of heterogeneous concepts, theories and research results’. Menard reviews the ‘more extensively documented forms’ of business organization. They range from:

- Subcontracting. The relationship is particularly common in the building industry as documented by Eccles (1981). The contractual relationship may be of long duration though each individual contract may have a short duration.
- Networks of firms linked in supply or distribution chains
- Franchising with asymmetrical relationship between principal and franchisee
- Collective trademarks
- Partnerships
- Cooperatives
- Alliances

What is the position of different participant firms in the network? De Man (2004: ch 3, 39-56) considers three position for firms in a network; as: (a) group member; (b) bridge; and (c)



orchestrator of the network. Position (a) leads to symmetry of power and control for all members. These include most cases of collective trademarks and cooperative as well as many partnerships. A firm may be a 'bridge' linking several networks with the firms in each network having no contacts or interests in those belonging to a different network. The position of the bridge is, again, asymmetrical with respect to the other firm. The orchestrator firm is the one that finds itself in the position of most power with respect to other firms in the network. 'An orchestrator is a central player in the network, for example because of its market power (Microsoft), brand name (Nike) or position in the supply chain (Toyota).' (p. 44). Because of these reasons and also because the amount of assets invested in the network may differ, the power position of different firms within the network may not be symmetrical. This echoes our remarks in section two, first subsection, regarding strategic control by large firms of their suppliers/distributors.

Menard concludes his analysis by stating that: '...hybrid organizations represent a challenge to *competition policies* built on the simplistic trade-off between firms and markets.' (p. 370; italics in original). I would like to add that they represent also a challenge for: (a) the theory of the firm; and (b) the strategies of labour and trade unions.

### **3. Cross-countries boundaries: the transnational corporation**

The boundaries of the firm can also be identified in terms of geography of direct operations (Table 1c). Firms can have all their activities within the same location or they may disperse them. The dispersion may involve a single country or more than one. The dispersion can be horizontal or vertical. In the latter case the dispersion of activities pertains to different stages of the production process and of the value chain. When direct production activities involve two or more countries we have the transnational corporation.

#### *Theoretical approaches to the TNC*

As the organizational boundaries needed explanation so do the geographical – by nation state – boundaries. Why do firms invest abroad? The answer is not so straightforward since firms could, after all, produce at home and source foreign markets via exports. This is something they always did and still do to a large extent. So why invest and produce directly abroad? Steven Herbert Hymer a Canadian researcher working at the Massachusetts Institute of Technology was the first to delve into the question. Many researchers since have dealt with the same or similar problems and several theories have been developed. They do not all deal with the same issues and type of activity. Some are theory of the TNC as a firm; some deal with the whole range of its activities. Some deal with both the firm and its activities. The most prevalent theories are the following<sup>6</sup>:

Dunning's eclectic theory based on Ownership, Location and Internalization (OLI) advantages (Dunning, 1977; 1980). Dunning's emphasis is on: (i) advantages that firms have over rivals and which allow them to take up investment opportunities abroad. These are the O advantages which have a basis in Hymer (1960). (ii) Advantages that some locations have over others in attracting foreign investment (L advantages). (iii) Advantages of direct investment – and thus of internalizing activities - over the use of external arrangements such as licensing (I advantages).

---

<sup>6</sup> All the theories mentioned here – as well as others including Vernon (1966) - are presented and commented on in Ietto-Gillies (2012). See also Ietto-Gillies (2014a and b) and commentary on them by Cantwell (2014).

The internalization theory (Buckley and Casson, 1976; Teece, 1977; Caves 1982; Hennart (1982) focus is on the efficiency of internal activities versus externalization strategies. The approach builds on Coase's transaction costs theory (Coase, 1937) and on Williamson (1975; 1981). It therefore emphasises the efficiency of internal – within the firm – transaction rather than market transaction where search, trust and dealing costs are higher. Regarding TNCs the development of activities internally has the added advantage of avoiding the leakage of research and innovation results and of keeping proprietary knowledge in-house.

In the evolutionary theories (Cantwell, 1989; Kogut and Zander, 1993) the emphasis is on: (a) the TNC as focus of knowledge, innovation and technology; (b) how its internal organization helps to develop networks on which knowledge flows and disseminate from country to country; and (c) how it supports agglomeration and localities.

A theory that has been very successful with marketing and strategist academics is that put forward by the Scandinavian School (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977; 1990). This approach focuses on the modalities and stages of the internationalization process from the development of activities via through export with the aid of independent representatives; to the establishment of sales subsidiaries to the setting up of production subsidiaries via FDI.

A theory which has gained great relevance in economics departments is the New Trade Theory applied to TNCs (See Helpman, 1984; Markusen, 1984 and 1995; Krugman and Venables, 1996; Venables, 1998; Barba Navaretti and Venables, 2004. The conceptual basis for this approach is the internalization theory – with some additions from Dunning's OLI scheme. The additional contribution of these theorists relates to the analysis of partial equilibrium mathematical models along the lines of new trade theories and imperfect competition.

#### *Liability of foreignness versus advantages of multinationality*

The study of TNCs and international production takes the point of view of the company as a whole, with the shareholders and possibly the managers as sole stakeholders. The traditional approach is based on the assumption that there is *liability of foreignness (LoF)* (Hymer, 1960; Zaheer, 1995; Forsgren, 2008<sup>7</sup>), i.e. that producing abroad is more disadvantageous and costly and compared with producing in domestic locations, and that we must therefore look for compensating advantages in explaining international production. In the 1960s, at the time the pioneer analyses by Hymer and others were developed, it was very reasonable to emphasize the disadvantages of producing in foreign countries. But is it now? Currently we have a situation in which: (i) International production has been increasing at a very fast pace; it is involving more and more countries, more and more companies. (ii) Large TNCs are spreading their geographical networks of activities wider and wider. (iii) Moreover, the direct international involvement of smaller companies is now considerable and growing.

The following developments have generated very favourable conditions for TNCs and their activities leading to the above developments. First, *learning and information*. The growing internationalization has meant that companies have learned more about their international environment. They can use the experience of investing abroad in developing strategies for future investment in the same country as well as in others. The acquisition of information on

---

<sup>7</sup> See also various articles in the *Journal of International Management* (2002).

the conditions in different countries gives companies added advantages. Already in the 1970s, Vernon (1979) considered large TNCs to be ‘*global scanners*’ capable of scanning the world for investment opportunities and locations. Cowling and Sugden (1987) emphasize TNCs’ ‘*detection power*’, that is power to obtain, process and use information to their own advantage; for example, to get a stronger market position. Thus, TNCs learn to become more involved in international production partly through their own experience: because they have done it in the past, the process becomes easier. International involvement, in whatever mode (exports or direct production or licensing), may lower the cost of further involvement in the same or different mode(s) (Petri, 1994). This dynamic process points to the possibility of high LoF when a firm first invests abroad and to progressive lower costs as the firm’s foreign position becomes established<sup>8</sup>.

Second, *the political context*. The neo-liberal ideology and related policies of the last few decades have strongly encouraged the activities of transnational companies. The 1960s and 1970s were decades of *confrontation* between TNCs and many national governments. At the academic level the attack against US investment in Europe was led by Servan-Schreiber (1968). There were a number of nationalizations of foreign assets as well threats of it. Nationalizations picked in mid 1970s and became non existent after the mid 1980s (UNCTAD-PTC, 1993: fig. 1, p. 17). The changes in the political environment led to decades of *cooperation* (Dunning 1993: ch.13). In the last 30 years+, far from threatening nationalizations most governments of both developed and developing countries have encouraged and supported the inward investment by TNCs. Moreover, they have engaged in massive privatization programmes in which assets have often been acquired by foreign companies.

Given the developments in international business and the favourable environment to it, it seems appropriate to move away from the emphasis on disadvantages of foreign investment and start stressing the advantages of transnationalization as such. However, the stress on the advantages of transnationalization does not mean denying that foreign production may involve some additional costs; it just means that conditions are ripe for emphasizing the advantages of operating abroad and of spreading activities in host countries.

## **5. Nation-states generate advantages for TNCs**

The advantages of transnationality can thus be classified.

(a) *In relation to a variety of stakeholders and in particular:*

- Labour
- Governments
- Suppliers and distributors
- Rival firms

(b) *Independently of specific stakeholders*

---

<sup>8</sup> Giovanni Balcet has pointed out to me that this applies also to FDI from a whole country. Japanese abroad in the 1970 were less welcome than they are now by host countries nationals. The same may be true for current Chinese FDI.

- Acquisition of knowledge and innovation
- Risk spreading

The following points are relevant in the acquisition of all these advantages. First, strategic behaviour is essential for companies to realize advantages. Second, the role of the nation-state is key to the development of strategies by TNCs. To understand the latter point we must look at key aspects of the nation-state.

### *The nation-state and regulatory regimes*

The nation-state can be a very significant player in the establishment of firm's advantages in the transnational context. In order to understand how this comes about let us start with an analysis of the following *three dimensions of operating across national frontiers*.

1. *Spatial/geographical dimension*. The distance between locations in different nation-states is often greater than the distance between locations within the same nation-state. But this is not always the case. For example, the distance between Milan and Reggio Calabria is greater than the one between Milan and Geneva. Similarly, the spatial distance between Boston and Montreal is less than the one between Boston and Los Angeles.
2. *Cultural and linguistic dimension*. The cultural distance – including business culture - is usually greater between nation-states than between regions of the same nation-state. But again, this is not always the case. The cultural distance between Milan and Geneva is not necessarily higher than the one between Milan and Reggio Calabria.
3. *Regulatory regimes dimension*. By regulatory regime I mean the sets of all laws, regulations and customs governing the economic, social and political life of a country. It therefore includes the sets of institutions and regulations governing production, markets and the movement of resources across countries. Each country has a specific regulatory regime and thus a specific set of rules and regulations which often have historical as well as institutional origins and connotations. Countries differ – sometimes substantially – in terms of their specific regulatory regime. However, the regulatory regime tends to be fairly – though not completely – homogeneous and consistent within each nation-state.

Business across national frontiers may involve additional costs compared to business within the boundaries of the nation-state. The costs are associated mainly with the first two dimensions: spatial and cultural dimensions. The third dimension may also involve extra costs because, for the TNCs, the mastering of – and managing in the context of – different laws, regulations and customs by their managers, may also be costly.

However, the third dimension can also be the source of considerable advantages for firms operating transnationally. To understand why this is so, we shall delve further into it. In the context of the third dimension, the nation-state is here seen as the locus of a set of *regulatory regimes*, that is, of a set of specific, rules and regulations which apply to people, firms and institutions within the borders of the nation-state. Some of these rules and regulations stem from the legal or institutional system, some from government policies. Most of the following elements embrace several or all aspects of both institutional and policy frameworks.

### *Elements of nation-states' regulatory regimes*

- Rules and regulations regarding the social security system and in particular different regimes regarding labour and its organisation
- Fiscal regimes
- Currency regimes
- Regimes of industrial policy
- Rules and regulations regarding environmental and safety standards

The existence of differences in regulatory regimes across nation-states allows companies that can truly plan, organize and control across frontiers to develop strategies to take advantage of such differences. This is particularly the case when the strategies aim to enhance power vis-à-vis actors who cannot – or not yet – plan and organize across national frontiers, or not to the same extent as TNCs. Transnationality generates asymmetry of power between TNCs and other players. Moreover, companies can enhance the asymmetry through their strategic behaviour.

There is a good amount of literature of firm's market power and therefore on power towards rival companies. However, power may also relate to other players in the economic system and specifically labour, governments, suppliers/distributors, subcontractors. Power towards these other players can be turned into market power towards rival firms because it gives companies opportunities for higher profitability.

Power can be used to shift the distribution of resources, surpluses, markets. In the case of power towards rivals – one of Hymer's (1960) key points - the distribution relates to market shares; in the case of conflicts with labour, the power can be used to change the distribution between profits and wages; in the case of power towards governments the issue is distribution over the overall surplus and how much should go to the private sphere - companies - or the public sphere - governments and taxpayers.

Thus the first set of advantages (a) listed at the beginning of this section involve distributional issues and conflicts with labour, governments, suppliers or rival firms. The last two advantages - acquisition of knowledge and risk spreading - (b) - can put the TNC in a better position towards rivals and therefore involve distribution over market shares. We here briefly touch on advantages towards suppliers; towards the acquisition of knowledge and towards risk. The advantages towards labour and towards government will be given more space and attention in the following sections.

### *Advantages towards suppliers*

Operations across different nation-states can enhance the bargaining power of companies towards their suppliers and, as a consequence, enhance its competitive power towards rivals. The existence of multiple sourcing channels (whether actual or potential) in the various countries gives the TNCs a powerful bargaining position towards suppliers. This is particularly the case because many suppliers have specific characteristics which make them liable to low bargaining power with large TNCs. In particular:

- suppliers are often smaller companies<sup>9</sup> operating in a more competitive environment than their customer;
- they are often located in developing countries;
- they cannot easily develop alternative international networks.

---

<sup>9</sup> Some suppliers can, however, be large firms as is the case in the automotive industry.

In this situation it is not difficult to see how a big TNC with a large transnational network and which can rely on several actual or potential suppliers may use its international position to enhance its bargaining power towards specific suppliers.

### *Knowledge acquisition*

TNCs are the big players in innovation and technology and their activities aid the diffusion of knowledge and innovation. This process is enhanced because TNCs operate within a double network (Hedlund, 1986; Hedlund and Rolander, 1990; Forsgren, Holm and Johanson, 2005):

- The internal network of their units spread across the world; and
- The external networks that each unit of the TNC has in the country in which it is located: networks with customers; suppliers; distributors and local universities and research centres.

The external network favours exchange of knowledge between the TNC's unit and the local context with flow of knowledge in both directions. The internal network facilitates diffusion of knowledge internally to the TNC and across countries.

It is an approach in which geographical diversification of production enables each unit of the TNC to learn from the environment. The acquired knowledge is then transferred to other units of the company via the internal network of subsidiaries. In this perspective, transnationality generates benefits from operating in a diverse environment with diverse knowledge and innovation histories: different nation-states with different cultural environments in terms of knowledge, innovation and technology. Moreover, Cantwell (1989) points out how there are two-way spillover effects: from the locality to the company and from the company to the locality.

For knowledge diffusion to take place the mobility of labour and of products across countries is important. They are vehicles for such diffusion. The extent to which transfer of knowledge and innovation takes place partly depends on: (i) The internal organization of the company (how free is the unit to liaise with the local business and research environment?); (ii) The degree of embeddedness of the unit into the locality; and (iii) The absorption capacity (AC) of the receiver be it individual, firm, industry or country.

### *Advantages towards risk spreading.*

A further advantage of operating across several nation-states is connected with risk spreading. A strategy of dispersion of production and multiple sourcing can also be a diversification strategy which allows the spread of risks of disruptions to production due, for example, to political upheavals or industrial disputes in any one country. Disruptions to production can come about also through other problems such as natural disasters. Most risks linked to the latter are not nation-specific but are more likely to be specific to the physical and geographical environment. However, the ability of countries to cope with them and to minimize risks and costs for business is, to a large extent, nation-specific and thus specific to the social, economic and governance environment and not just to the physical environment. Thus a strategy of fragmentation by nation-states may become also a strategy of geographical diversification in order to spread risks deriving from the social and political as well as the physical environment.

## 6. Labour as stakeholder in the boundaries of the firm

Let us now go back to Table 1 section c: different stakeholders in the boundaries of the firm. The most striking feature in reading works on the organization of business transactions – be they by hierarchical structures or coordinated via the market or via hybrid forms – is the fact that the perspective is always the efficiency and effectiveness of the individual firm in relation to the interests of shareholders and managers. De Man (2004) sees the advantages for firms and the wider economy in terms of more productive use of resources linked to specialization between the various partners in the network. The point of view of other stakeholders such as labour and governments hardly comes in. Labour in particular, seems to be the forgotten stakeholder in these studies<sup>10</sup>. De Man (2004: pp.164-66) does devote one section (The individual in the Network) to labour. However, the discourse is entirely in terms of the need for the workforce to upgrade its knowledge and to be flexible to meet the demands of the firm as well as the network. The point of view is again the firm not the employee; for the latter, only duties are considered; no mention of problems and of changing contractual position. Yet the position of labour is greatly affected by the various dimension and particularly by the organizational and the geographical (by nation-states) dimensions discussed in sections three to five. Moreover, labour and its bargaining power may be key in the development of firms' strategies leading to various dimensions.

To illustrate this point let us first delve into the question of how we got where we are in terms of prevailing governance structures and geography of direct activities. Coase started his analysis of governance structures by noting that the firm and internalization appear to be the odd one out in need of explanation. In fact, internalization and the growth of firms via internal activities was also the premise of Chandler (1962) work. This can be explained by the growing concentration of production and firm size alongside an economic theory that saw the market as sovereign and competition as the normal and desirable market structure. There was a need for a theory that kept the basic premises of the neo-classical theory while trying to explain why firms grew bigger and, therefore, why the market was not perfect. Coase's theory provided the explanation.

In the first decades after WWII the firm grew internally under the pull of growing economies and of favourable macro economic conditions with increasing demand for exports and consumption as well as investment. There was also plenty of labour supply due to more women entering the labour force and to the immigration policies in developed countries. All these conditions further favoured internal growth of firms, via hierarchical structures.

The next few decades bring higher demands by the employed labour force. Internalization has made it easier for labour employed under the same ownership umbrella to organize and feel solidarity. The demands of labour grow at a time when investment opportunities start declining and when the 1970s energy crisis adds to the problems. In this situation firms start looking for solutions that involve a decrease in the power of labour to organize and resist: externalization is one such solution. As time goes by, technology comes to the aid of such a solution: the information technologies make it easier to exercise control whether the production activities take place internally or externally. Moreover, logistics solutions – pressing under the externalization drive - are eased by the same technology as well as by the diminishing costs of transportation.

---

<sup>10</sup> My reviews are largely of economics and business strategy works; it may be – and I hope it is the case – that industrial relations studies are dealing more with the labour perspective on hybrids.

Move forward to the decades from 1980 onwards. Coase's internalization theory is now well developed and accepted. Yet, the business, economic and social situation has changed. Externalization has taken hold and is spreading rapidly – largely thanks to the work of Williamson - both in private and public sector institutions. If we stick to the logic of the neoclassical theory – now encompassing also Coase's theory – we have to look for fundamental changes in transaction costs between the decades around and after WWII and the decades from the 1980s onwards. The dichotomy internalization v externalization has always been there: why have we seen the system as a whole move – in time - in two completely different directions – internalization first and later externalization? The purely neo-classical theory cannot explain it; or, at least, I have not seen convincing explanations of why market transactions costs have changed between the two periods. Why they may have been very high in the decades after Coase's publication and why they may have been very low – thus leading to more externalization and market transactions - in the last four decades. I should, however, point out that most writers in this tradition rarely indulge in historical comparisons; they see their role mainly as analysing static situations. If confronted with such historical shifts, their conclusion might be that the shift from internalization to externalization is a sign that transaction costs have changed: in other words assume away what needs explaining. In this writer's view the shift needs explaining and, indeed, in explaining it, we can through light on wider issues regarding the firm and its stakeholders.

It is here suggested that the move towards externalization has roots in social and political elements as well as in economic ones. It is also suggested that strategic behaviour on the part of large firms led to externalization and that such strategic behaviour was largely in relation to labour. Faced with increasing bargaining power by labour, companies looked for ways of curtailing such power – in most cases with the assent and support of governments - via strategies of labour fragmentation. Thus the organization of production is here seen as closely related to the role and power of labour. Firms' strategies are greatly affected by conflicts with labour and developed partly as attempts to solve those conflicts.

#### *Labour fragmentation strategies*

In sections three to five we have analysed the changing boundaries of the firm with respect to two dimensions: the organizational dimension (hierarchical v hybrid v market) and the geographical (by nation-state) dimension. Both these dimensions have become more relevant in the last 35 years. Both involve labour in two respects: because the relationship between the firm and labour and their industrial relations record may be one of the determinants of strategies leading to specific boundaries; and because the change in boundaries has considerable effects on the bargaining position of labour. Labour is therefore a significant stakeholder in the boundaries of the firm (Table 1b).

What strategies are open to companies that want to prevent or make it difficult for labour to increase their bargaining power? It will be in the interest of companies to try and implement strategies leading to the *fragmentation* of labour and, in particular, the following:

- organizational fragmentation through the externalization of some activities within an overall strategy of control of production;
- fragmentation by nation-states through the location of production in various countries characterized by different labour, social security and labour organization regimes.

These two fragmentation strategies are not incompatible and they may indeed be implemented together. The first strategy (organizational fragmentation) involves the company in the externalization of labour through outsourcing strategies (such as subcontracting or franchising arrangements) that allow considerable control of production but without the



responsibility for the labour employed for such production. The second strategy involves the spread of production in regions, countries, areas not linked by common labour organization regimes, i.e. having different trade unions and/or different labour and social security laws and regulations. These elements make the organization of labour and its resistance to the demands of capital more difficult. The underlying assumptions in this analysis are the following:

- a That labour organization is easier whenever labour works for the same ‘ownership/management unit’ (the hierarchical form of organization); and, that labour organization is more difficult whenever employment is dispersed among many smaller units – be they wholly or partially independent firms – or among some large and some small units. Externalization involves costs and advantages. The costs are in terms of control over quality of products<sup>11</sup>, possible debasement of the brand and problems with delivery dates. The advantages are in terms of: low responsibility for labour; lower resistance by labour as labour organization is more difficult and often made illegal across different proprietary units; shift of much risk from the principal firm to the smaller subcontractors. The risk relates to both the labour force employed in the value chain and – in many cases – the equipment employed.
- b That labour organization is easier within a single country than between different nation-states. This does not imply that, for labour, full harmonization and homogeneity of organization and power exist within each country. Differences can arise at the level of regions due to local conditions and institutional structures, or between different industries or due to different structural features of production in terms of ownership/management arrangements. The main point made here is that, on the whole, there are greater difficulties for the actual and potential labour organization between countries separated by institutional, political, cultural, legal and governmental borders than within each border. We can then define areas of ‘*labour organization regimes*’ as those geographical areas within which – *ceteris paribus* – labour finds it easy to organize itself effectively. They are likely to be defined by the geographical boundaries of the nation-state though it is conceivable that they could extend only within smaller regions of the same country or that they could theoretically extend to various nation-states (such as the European Union – EU) if labour manages to organize and mobilize across nation-states. Up to now such organization and mobilization has not extended beyond the confines of single nation-states. It is interesting to note how governments of the right and centre within the EU have tended to favour unification of markets and the free movement of capital but have resisted the harmonization of fiscal, labour and social security regimes.

## **7. Boundaries: an approach based on labour**

So far the discussion on boundaries has placed the firm – as defined in the legal/proprietary perspective - centre stage; the firm as represented by its owners and managers. However, as discussed above (Table 1b), the firm has other stakeholders and particularly labour. One of the major theoretical and policy issues emerging from the analysis in previous sections, is what the boundaries of the firm imply for the boundaries of labour’s interests, strategies and actions. Currently, whenever the organization of production is non-hierarchical, it is widely assumed that the firm has no responsibility for the labour involved in the activities

---

<sup>11</sup> This is particularly relevant in services industries where the quality of the product cannot be inspected prior to acquisition and delivery.

bought/contracted out by the firm from outside its proprietary confines. The language of internalization versus externalization – widely used - lends itself to the idea of insider versus outsider labour.

No one would deny that labour is a major stakeholder in the firm's decisions regarding the organization of production and transactions. (Lazonick, 2012: 343-4) points out how labour as well as the State are major stakeholders – and should be considered as residual claimant – in strategic decisions. He considers decisions with regard to innovation and technology; in our case the decisions are with regard to the boundaries of the firm whose effects on labour are at least as relevant as those related to innovation strategies.

There are two major challenges in taking the perspective of labour as stakeholder in the boundaries of the firm. The first challenge (A) is a theoretical one: how can we argue the case at the theoretical level. How would a theory of the boundaries of the firm be constructed? The second challenge (B) arises at the strategy and policy level: what would be the strategies and policies of trade unions arguing the case for labour. Any progress on (A) would strengthen the case for (B). Viceversa, case studies and practical problems on the field would help develop and refine the theoretical side.

Table 2 helps to clarify the theoretical side. It lists a variety of organizational forms of production against a variety of characteristics. Between the two Coasian organizational extreme forms of hierarchy versus market (Table 2, col. 1, rows 2 and 3), there are a variety of other possibilities listed in Col one under: franchising; subcontracting; external distribution chains; and alliances. Columns two and three consider control by the principal firm over production and its process as well as over the firm's brand. Column four considers whether the power relationship between various partners in the contractual form is symmetric or asymmetric. Column five highlights whether the principal firm has responsibility for all the labour employed in the value chain. Column six attempts an assessment on the impact of organizational forms on labour's bargaining power and in relation to the whole labour employed in the value chain.

The strategies of the firm with regard to its boundaries seem to allocate to labour, boundaries that are more limited than the firm's boundaries of strategic control. Specifically, for example, in the case of contracts with suppliers or distributors, the responsibility for labour is within each firm separately, be they principal or contractor: labour's boundaries of actions and organization are confined within the principal firm and each subcontractor separately.

Currently, the principal company is able to exercise strategic control across a variety of firms, sectors and countries while having responsibility only for the labour directly employed by it. Yet larger number of workers – in various countries – may be contributing to the product which ultimately belongs to it – the principal firm – and is sold under its brand. The question is: should that be so, given that labour is greatly affected by the changing boundaries of the firm? There has been a tacit assumption that labour organization and power cannot and should not be all encompassing. This assumption has a basis in law but there is also a theoretical economics basis in it: the boundaries of the firm have been seen only from the perspective of the shareholders and managers. Is there a way of thinking in terms of a different viewpoint on the boundaries of the firm? Of a labour's point of view on boundaries?

If we take the purely legalistic perspective – in terms of labour law), the firm has no responsibility for labour in these forms and this makes the workforce operating along the value chain very weak. However, it can be noted that, unlike in the case of arm's length transactions, the principal firm has a considerable degree of control over production, its

process and its brand along the value chain. It could therefore, be argued that, on the basis of control, the boundaries of the firm are wider than those of the principal firm and that such wider boundaries should also apply to the boundaries of its responsibility, including responsibility for labour employed throughout the value chain..

**Table 2. Organizational forms by specific characteristic and impact on labour**

<b>Organizational Form</b>	<b>Control over production and its process</b>	<b>Control over brand</b>	<b>Power towards partners in value chain</b>	<b>Responsibility for labour within value chain</b>	<b>Bargaining power of labour employed in the value chain*</b>
<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>6</b>
Hierarchical	Full	Full	N.A.	Full	Very high
Arm's length, market	No	N.A.	No	No	Low
Franchising	Yes	Yes	Asymmetric	No	Low
Subcontracting	Yes	Yes	Asymmetric	No	Low
External distribution chains	Yes	Yes	Asymmetric	No	Low
Alliances/JVs	No	Yes	Sym/Asy depending on assets involvement	No	?

*\*In columns 2-5 the perspective is the principal firm. In col. 6 the perspective is that of labour.*

*NB. Any of the organizational forms above can be developed at the national or international level. Whenever several countries are involved – in whatever form – the negative impact on the bargaining power of labour is likely to decrease.*

Might we begin to think that the boundaries of interest and activity of labour should be extended to include all activities over which the company has strategic control? The case for a positive answer lies in the fact that all strategies regarding boundaries and all dimension and scope of the firm's boundaries have serious implications for the position of labour at both micro and macro levels: in terms of employment, wages, conditions, security and related social issues. An alternative view would see the boundaries of interest and activity as encompassing labour working for both the principal firm and the myriad of sub-contractors or franchisees or distributors. The boundaries of labour's interest, strategies and actions could also be seen to cross over the nation-state and become transnational whenever the company has activities in several countries directly or via its suppliers. The boundaries of labour interest, strategies and action could also be seen to span over more than a single sector, whenever the firm becomes diversified.

This is indeed the argument – though not necessarily the language – used in a recent case involving a service industry, one of the sectors in which hybrid forms of organization are used extensively and in which the labour force has systematically lost power over recent decades. I refer to the recent (May 15<sup>th</sup>, 2014) protest by fast food workers over wages and conditions. *The Observer* (2014) reports on the on going dispute between workers employed in franchises and the fast food companies such as McDonald's. It quotes one low paid franchisee employee as saying: "McDonald's says it's not a boss, but it certainly acts like one. Setting rules and controlling just about every aspect of its stores, so that the only thing that franchisees can skimp on is wages...". The National Labour Relations Board (NLRB) is reported as arguing that 'the company has too much say not to be counted as a 'joint employers'" The workers rejected the claim that each franchisee is an independent employer and they all came together to protest independently of the organizational fragmentation. Moreover, the action was coordinated in some 150 cities across the world: thus geography (by nation states) and organizational boundaries were overcome.

This seems like the beginning of something with great potential for further development in a variety of industries. The theoretical analysis developed in this section fits in well with this real case in industrial relations. The fast food workers are saying to firms and to economics and business studies academics: we have a strong stake in the firms we work for; we do not accept the boundaries set by the legal/proprietary approach to the firm; we see the boundaries as set by the strategic control view.

## **8. Boundaries and governments**

Let us now turn to another major stakeholder in the strategies and destiny of the firm and its boundaries. There are various ways in which the State and its government are involved and interested in the boundaries. For a start, in most countries the State is currently the largest employer and a very big funder - and often direct provider - of services. Three points can be highlighted with respect to this. The first point relates to hybrid governance structures. The state as well as private firms is involved in a variety of production activities – usually of services – and has choices regarding the organizational forms for supplying and delivering them: from full internalization within State enterprises to full arm's length acquisition on the market, to hybrid forms. The latter have become more and more common in the last thirty years, thus mirroring what has been happening in the private sector. So, many of the points made above for hybrid form used within the private sector apply equally well to the public sector. Specifically the need to: (a) consider the point of view of labour; (b) look at strategic control in order to make the case for joint employment responsibility along the value chain; and (c) further develop the theory side of the impact of boundaries change on wider stakeholders and particularly on labour.

The second point of involvement by the State is via policies and legislation. Specifically, two types of legislation. (a) Regarding labour and industrial relations and the possible rights of labour to be involved across the network in hybrid forms. (b) Competition policy. Menard (2004: 370) points out that competition policy has been developed with the internalization v externalization as either or categories. However, hybrid forms challenge this scheme and so create a need to see competition policy in the light of these diverse categories and what they involve for the market power of firms.

A third point derives from the increasing cross-country boundaries of the firm. In Section five we considered companies' advantages of cross country direct operations, i.e. of being a

transnational corporation. We specifically concentrated on advantages deriving from the existence of different regulatory regimes across nation-states. Here we consider such advantages in relation to governments.

### *TNCs' advantages towards governments*

Having production locations and business activities in several nation-states can give the company a strong bargaining position towards governments of the nation-states and their regions. Transnational companies can – and do – play governments of different countries or regions against each other with the objective of raising the offer of incentives for the location of inward FDI via so-called ‘attractivity policies’ (Oman, 2000; Phelps and Raines, 2002). For example, the lack of fiscal harmonization within the EU has led to competition by governments for attracting foreign companies – sometimes only nominally rather than with jobs and capital relocation – via lower and lower rates of corporation tax. Moreover, if a company has production facilities in many countries its threat of relocation (Kogut, 1983) becomes very credible and can be used as bargaining power with governments to gain high incentives<sup>12</sup>.

There are further advantages to be gained by a company with direct business activities in different nation-states. The latter, as loci of different governance systems and regulatory regimes are also loci of specific taxation and currency regimes. Operating across several fiscal regimes puts the company in a position to minimize its world-wide tax liability via the manipulation of transfer prices, i.e. prices charged for the exchange of goods and services within the firm but across national frontiers<sup>13</sup>. The manipulation of transfer prices can also be connected to operations across different currency regimes with a view to bypassing currency controls. This is not a new phenomenon<sup>14</sup>. The realization of these advantages by TNCs leads to a shift in the distribution of the economic surplus away from the public and towards the private sphere.

Different regulatory regimes regarding environmental and safety standards between different nation-states may also lead to advantages for TNCs and to a stronger position in their negotiations over the location of FDI. The Guardian (2010) reports that Transocean - the owner of the rig leased by BP in Gulf of Mexico disastrous oil exploration - was registered in The Marshall Islands. To what extent did this affect its environmental and safety standards?

This type of analysis has also implications for how we look at independence movements springing up across the globe and particularly in Europe. Separatist movements are now developed and active in many European countries from Britain to Italy to Spain. I have argued that the existence of nation-states with their different regulatory regimes generates advantages for companies that are truly multi and transnational. If nation-states are fragmented into smaller political units with their specific regulatory regimes, this creates

---

<sup>12</sup> In 2011 companies drilling for oil in the North Sea were threatening to relocate in response to the British (Coalition) Government introduction of a windfall tax on oil profits.

<sup>13</sup> On transfer prices see Eden (2001) and Ietto-Gillies (2012: 226-9).

<sup>14</sup> Cox (2000) discusses how the British American Tobacco (BAT) company in the 1930s was able to circumvent currency control via the manipulation of transfer prices for their intra-firm transfers.

further opportunities for exploiting differences by TNCs. Who is going to have advantages from the separatist movements that we see across Europe: Lega North in Italy; Basque countries in Spain; Scotland in the UK? *Cui bono?* In whose interest?

Academics and business experts are not averse to arguing for separate units. Ohmae (1995) strongly argues for the formation of strong regions free to bargain with TNCs directly without having to go via the institutions of the nation-state of which they are part. He advocates the formation of region-states oriented towards the global economy rather than the national economy. He writes:

‘Region states...are economic not political units, and they are anything but local in focus. They may lie within the border of an established nation state, but they are such powerful engine of development because their primary orientation is toward – and their primary linkage is with – the global economy. They are, in fact, among the most reliable ports of entry.’ (pp. 88-9)

According to my analysis the region-states advocated by Ohmae would lead to competition between different regions of the same nation-state for the attraction of inward investment. This is a situation which favours the TNCs in their bargaining for special concessions. Reliable ports of entry yes, but for whom and in whose interest? If, within each country, there is competition at the regional level for the attraction of inward FDI, the losers are likely to be the citizens and the gainers the TNCs. Similarly, regarding competition between nation-states via the offer of low tax rates, free land usage and the wider range of attractivity policies in general.

While the companies are happy to overplay the role of sweeteners in their location decisions in order to gain as much as possible from the local/national government, in most cases the decision by TNCs to invest in a particular location is taken on the basis of different considerations such as: labour skills; market access; infrastructures; innovation context. In relation to the latter, Mazzucato (2013: 8) comments on the location decisions of Pfizer the pharmaceutical company:

‘Did Pfizer recently leave Sandwich, Kent (UK) to go to Boston in the US due to the latter’s lower tax and lower regulation? Or was it due to the fact that the public sector National Institutes of Health (NIH) have been spending close to \$30.9 billion per year in the USA funding the knowledge base on which private pharmaceutical firms thrive?’

Stopford and Strange with Henley (1991) saw the struggle for world market shares intensify the competition not only between firms but also between governments of nation-states and regions. They ask themselves: ‘...how has the intensified competition between states and between firms for world market shares affected the balance of bargaining power between states *as a group* and multinationals *as a group*? Their conclusion is: ‘that governments *as a group* have indeed lost bargaining power to the multinationals as the possibilities for collective action have diminished.’ The analysis in this paper lead to loss of bargaining power by nation-states vis-à-vis TNCs individually and collectively because of divergence in regulatory regimes by different nation-states. The authors just cited arrive at the same conclusion with regard TNCs as a group on the basis of lack of global regulatory institutions. This conclusion is made more poignantly in Strange (1996), a book that sees power moving away from states and democratic institutions towards ‘markets and thus to non-state authorities deriving power from their market shares’ (189). But...’none of the non-state

authorities to whom authority has shifted, is democratically governed. Firms – the new players in transnational economic diplomacy – are hierarchies, not democracies.’ (197). Thus the shift in bargaining power between the corporate sector – particularly the TNCs – has not only economic and social but also political effects in that it results in lower levels of accountability on the holders of power and in loss of democratic control.

## 9. Summary and conclusions

The paper starts with an analysis of the firm’s boundaries in terms of a variety of issues highlighted in Table 1 (a, b and c). *Perspectives* – legal/proprietary; responsibility; control - . *Stakeholders* – shareholders and managers but also others and specifically labour and governments. *Dimensions* – organization of production; geographical/by nation-state; sectoral. Specific consideration is given to the organization of production in hierarchical as well as in a variety of hybrid forms and to the position of labour in the context of these hybrid forms (Sections three, six and seven). The geographical – by nation-states - dimension is given particular relevance leading to a discussion of transnational companies, the advantages they derive from operating across borders and the source of such advantages (Sections four, five and eight).

The paper then moves on to a detailed analysis of the position of two stakeholders vis-à-vis the changing boundaries of the firm: labour and governments. Regarding labour both the organizational and geographical dimension of strategies of fragmentation are analysed. With regard to governments the major consideration relates to the geographical dimension and the position of governments in relation to transnational companies.

The conclusion is that the changing boundaries of the firm particularly with respect to organizational forms and to the geography of direct foreign operation by TNCs does put labour in a weaker position. And so it does with regards to governments. It is suggested that labour and its trade unions would benefit from taking a strategic view of the issue and by developing strategies based on the perspective of strategic control by companies. The main argument here is that, whenever a company exercises managerial strategic control over other firms in the value chain, it is appropriate to take the view that the principal firm may have responsibility for the whole labour along the value chain. In practice this requires a considerable amount of work in defining relevant element of control and in building up cases.

It is also suggested that, though this paper may be a step in the right direction, there is a need for further research for a better understanding of the boundaries of the firm from the point of view of two major neglected stakeholders: labour and governments. The existing literature considers the boundaries mainly from the point of view of shareholders and managers. In the context of the organizational and geographical (by nation-states) changes that have taken place in businesses we should move away from the concept of boundaries linked to property rights and towards boundaries linked to areas of effective responsibility and of strategic control.

The enhanced asymmetry of power, derived from strategies leading to new geographical and/or organizational boundaries, has distributional implications: in terms of the distribution between wages and profits; and the distribution of the economic surplus between the social and private sphere as happens when TNCs use their transnational power to minimize their tax liability. Our analysis has also strategy and policy implications for other actors. In general labour and governments should avoid strategies that generate scope for further fragmentation such as collision between trade unions and/or workers in different sectors or countries. There should be caution in embracing political moves leading to regional fragmentation of

regulatory regimes. Though decentralization of power to the regions may bring some benefits, full independence results in stronger bargaining power for TNCs in their dealings with local or regional governments. At the level of the EU, harmonization of social security and fiscal regimes would strengthen the power of labour and governments as well as leading to more stable economy and society within Europe.

In general, labour and governments should work towards strategies leading to the development of what Galbraith (1957) labelled ‘countervailing power’. In our specific case, this means development of strategies aiming to reduce the *asymmetry of power deriving from transnationalism and from organizational fragmentation*.

The analysis of hybrid forms in Section seven is tentative. In effect we still know little of these complex forms. We need, in particular, wider research that puts labour at the centre of analysis of the firm and its strategies. We need to study further what effects each form has on labour in terms of employment, bargaining power and compensation. We need to find out whether the involvement of assets and/or brand, or of strategic control can make a difference to a possible labour’ claim that the boundaries of the firm are more extensive. For example that the fast food franchises are in effect also the responsibility of the franchiser because the brand is involved throughout and because the franchiser or principal firm exercises strategic control over the franchisees or subcontractors. These are issues on which we need to acquire more knowledge and we need to utilize the expertise of trade unionists and of people working at the coal face to understand what goes on and what are the opportunities and limits of action. The road ahead is hard but not impossible.

## References

- Barba Navaretti G. and Venables, A. J. (2004), *Multinational Firms in the World Economy*” Princeton and Oxford: Princeton University Press,
- Baumol, W. J., (1959), *Business Behaviour, Value and Growth*, New York: Macmillan.
- Berle, A.A. and Means, G. C.,(1932), *The Modern Corporation and Private Property*, New York: Macmillan.
- Bo, H. and Driver, C., (2012), ‘Agency theory, corporate governance and finance’, in Dietrich, M. and Krafft, J. (eds), *Handbook on the Economics and Theory of the Firm*, Cheltenham, UK and Northampton, MA, USA: Edward Elgar, ch.11: 105-119.
- Bolton, P. and Scharfstein, D. S., (1998), ‘ Corporate Finance, the Theory of the Firm, and Organizations’, *Journal of Economic Perspectives*, 12, 4: 95-114.
- Buckley, P.J. and Casson, M.C. (1976), ‘A long-run theory of the multinational enterprise’, in P.J. Buckley and M.C. Casson (eds), *The Future of the Multinational Enterprise*, London: Macmillan, pp. 32–65
- Cantwell, J. (1989), *Technological Innovation and Multinational Corporations*, Oxford: Blackwell.
- Cantwell, J.A. (2014) ‘A commentary on Grazia Ietto-Gillies’ paper: “The Theory of the Transnational Corporation at 50+”’. *Economic Thought*, 3.2, pp. 58-66.
- <http://www.worldeconomicsassociation.org/files/journals/economicthought/WEA-ET-3-2-Cantwell.pdf>



Casson, M. and Cox, H., (1997), 'An Economic Model of Inter-Firm Networks', Ebers, Mark (ed.), *The Formation of Inter-Organizational Networks*, Oxford: Oxford University Press, ch 7: 174-196.

Casson M. and Wadeson N., (2012), 'Internalization Theory', in Dietrich, M. and Krafft, J. (eds), *Handbook on the Economics and Theory of the Firm*, Cheltenham, UK and Northampton, MA, USA: Edward Elgar, ch. 15: 172-193.

Caves, R.E. (1982), *Multinational Enterprise and Economic Analysis*, Cambridge: Cambridge University Press.

Chandler, A. D. (1962) *Strategy and Structure: Chapters in the History of the Industrial Enterprise*. Cambridge, MA: MIT Press.

Coase, R.H. (1937), 'The nature of the firm', *Economica*, 4 386–405; reprinted in G.J. Stigler and K.E. Boulding (eds) (1953), *Readings in Price Theory*, London: Allen and Unwin, pp. 331–51.

Cowling, K. and Sugden, R. (1987). *Transnational Monopoly Capitalism*. Brighton: Wheatsheaf

Cox, H. (2000), *The Global Cigarette. Origins and Evolution of British American Tobacco, 1880-1945*, Oxford: Oxford university Press.

De Man A.-P., (2004), *The Network Economy. Strategy, Structure and Management*. Cheltenham, UK and Nortampton, MA, USA: Edward Elgar.

Dietrich M. and Krafft J., (2012), 'The Economics and theory of the firm', in Dietrich, M. and Krafft, J. (eds), *Handbook on the Economics and Theory of the Firm*, Cheltenham, UK and Northampton, MA, USA: Edward Elgar, ch. 1: 3-26.

Dunning, J.H. (1977), 'Trade, location of economic activity and the MNE: a search for an eclectic approach', in B. Ohlin, P.O. Hesselborn and P.M. Wijkman (eds), *The International Allocation of Economic Activity*, London: Macmillan, pp. 395–431.

Dunning, J.H. (1980), 'Explaining changing patterns of international production: in defense of the eclectic theory', *Oxford Bulletin of Economics and Statistics*, 41 (4), 269–95.

Dunning, J.H. (1993b), *The Globalization of Business*, London: Routledge.

Eden, L. (2001), Taxes, Transfer Pricing, and the Multinational Enterprise, in A.M. Rugman and T.L. Brewer (eds), *The Oxford Handbook of International Business*, Oxford: Oxford University Press, ch. 21, pp591-619.

Forsgren, M. (2008), *Theories of the Multinational Firm. A Multidimensional Creature in the Global Economy*, Cheltenham, UK and Northampton, US: Edward Elgar.

Forsgren, M., Holm, U. and Johanson, J. (2005), *Managing the Embedded Multinational. A Business Network View*, Cheltenham, UK and Northampton, US: Edward Elgar.

Galbraith, J. K. (1957), *American Capitalism. The concept of Countervailing Power*, London: Penguin Books.

- Gallino, L. (2005), *L'impresa irresponsabile*, Torino: Giulio Einaudi editore.
- Grandori, A. and Soda, G., (1995), 'Inter-firm Networks: Antecedents, mechanisms and Forms', *Organization Studies*, 16, 2: 183-214.
- Hedlund, G., 1986. The hypermodern MNC – a heterarchy? *Human Resource Management*, 25(1): 9-35.
- Hedlund, G. and Rolander, D. (1990), 'Action in heterarchies: new approaches to managing the MNC', in C.A. Bartlett, Y. Doz and G. Hedlund (eds), *Managing the Global Firm*, London: Routledge, pp. 1–15.
- Helpman, E. (1984), 'A simple theory of international trade with multinational corporations', *Journal of Political Economy*, 92 (3), 451–71.
- Hennart, J.-F. (1982), *A Theory of Multinational Enterprise*, Ann Arbor, MI: University of Michigan Press.
- Holmstrom, B. and Roberts, J., (1998), 'The Boundaries of the Firm Revisited', *Journal of Economic Perspectives*, 12, 4: 73-94.
- Hymer, S.H. (1960, published 1976), *The International Operations of National Firms: A Study of Direct Foreign Investment*, Cambridge, MA: MIT Press.
- Hymer, S. H. (1970) The efficiency (contradictions) of multinational corporations. *American Economic Review*, 60 (2), 411-8. Reprinted in Cohen, R. B., Felton, N., Van Liere, J. and Nkosi, M. (eds) (1979), *The Multinational Corporation: a Radical Approach*, Papers by S. H. Hymer. Cambridge: Cambridge University Press, 41-53.
- Hymer, S. H. (1971) The multinational corporation and the law of uneven development. In Bhagwati, J. W. (ed.), *Economics and World Order*. London: Macmillan, 113-40. Reproduced in Radice, H. (ed.) (1975), *International Firms and Modern Imperialism*. Harmondsworth: Penguin, 113-35.
- Hymer, S. H. (1970) The efficiency (contradictions) of multinational corporations, *American Economic Review*, 60 (2), 411-8. Reprinted in Cohen, R. B., Felton, N., Van Liere, J. and Nkosi, M. (eds) (1979), *The Multinational Corporation: a Radical Approach*, Papers by S. H. Hymer. Cambridge: Cambridge University Press, 41-53.
- Hymer, S. H. (1971) The multinational corporation and the law of uneven development. In Bhagwati, J. W. (ed.), *Economics and World Order*. London: Macmillan, 113-40. Reproduced in Radice, H. (ed.) (1975), *International Firms and Modern Imperialism*. Harmondsworth: Penguin, 113-35.
- Johanson, J and Vahlne, J-E. (1977), 'The Internationalization Process of the Firm- A model of Knowledge development and increasing Foreign Market Commitment' *Journal of International Business Studies*, 8(1): 23-32.
- Johanson, J. and Vahlne, J-E. (1990), 'The Mechanism of Internationalization' *International Marketing Review*, 7(4): 11-24.

Johanson, J. and Wiedersheim-Paul, F. (1975), 'The Internationalization of the Firm: Four Swedish Cases' *Journal of Management Studies*, October, 305-22.

Jolink, A. and Niesten, E., (2012), 'Hybrid governance', in Dietrich, M. and Krafft, J. (eds), *Handbook on the Economics and Theory of the Firm*, Cheltenham, UK and Northampton, MA, USA: Edward Elgar, ch. 12: 120-34.

*Journal of International Management*, (2002), vol. 8: 3, pp. 217-358.

Kogut, B. and Zander, U. (1993), 'Knowledge of the firm and the evolutionary theory of the multinational corporation', *Journal of International Business Studies*, 4th quarter, 625-45.

Krugman, P. and Venables, A. (1996), 'Integration, specialisation and adjustment', *European Economic Review*, 40, 959-67.

Ietto-Gillies, G. (2002), *Transnational Corporations. Fragmentation amidst Integration*, London: Routledge.

Ietto-Gillies, G. (2012), *Transnational Corporations and International Production. Concepts, Theories and Effects, Second Edition*, Cheltenham, UK and Northampton, MA, USA: Edward Elgar.

Ietto-Gillies, G. (2014a), Ietto-Gillies, G. (2014) 'The Theory of the Transnational Corporation at 50+'. *Economic Thought*, 3.2, pp. 38-57.

<http://www.worldeconomicsassociation.org/files/journals/economicthought/WEA-ET-3-2-Ietto-Gillies.pdf>

Ietto-Gillies, G. (2014b), Ietto-Gillies, G. (2014) 'Reply to John Cantwell's Commentary on Grazia Ietto-Gillies' paper: "The Theory of the Transnational Corporation at 50+"'. *Economic Thought*, 3.2, pp. 67-69.

<http://www.worldeconomicsassociation.org/files/journals/economicthought/WEA-ET-3-2-Ietto-Gillies-Reply.pdf>

Lazonick, W. (2012), 'Corporate governance, innovative enterprise and executive pay', in Dietrich, M. and Krafft, J. (eds), *Handbook on the Economics and Theory of the Firm*, Cheltenham, UK and Northampton, MA, USA: Edward Elgar, ch. 25: 339-57.

Ohmae, K. (1996, [1995]), *The End of the Nation State. The Rise of Regional Economies*, London: Harper Collins; first published by The Free Press in 1995.

Oliver, A. L. and Ebers, M., (1998), 'Networking Network Studies: An Analysis of Conceptual Configurations in the Study of Inter-Organizational Relationships', *Organization Studies*, 19:549-83.

Marris, R. (1964), *The Economic Theory of 'Managerial Capitalism'*, New York: Macmillan.

Mazzucato, M. (2013), *The Entrepreneurial State. Debunking Public vs. Private Sector Myths*. London: Anthem Press.

Menard, C. (2004), 'The Economics of Hybrid Organizations', *Journal of Institutional and Theoretical Economics*, 160, 3: 345-76.

- Penrose, E.T. (1959), *The theory of the Growth of the Firm*, Oxford: Blackwell.
- Petri, P.A. (1994), 'The regional clustering of foreign direct investment and trade', *Transnational Corporations*, 3, 3: 1-24.
- Phelps, N. and Raines, P. (eds), (2002), *The New Competition for Inward Investment*, Cheltenham, UK and Nortampton, MA, USA: Edward Elgar.
- Servan-Schreiber, J.J. (1968), *The American Challenge*, London: Penguin.
- Strange, S. (1996), *The Retreat of the State. The Diffusion of Power in the World Economy*, Cambridge: Cambridge University Press.
- Stopford, J. and Strange, S. with Helney, J. S. (1991), *Rival states, rival firms. Competition for world market shares*, Cambridge: Cambridge University Press.
- Teece, D.J. (1977), 'Technology transfer by multinational firms: the resource cost of transferring technological know-how', *The Economic Journal*, 87, 242–61.
- The Guardian*, (2010), 'Congress raises safety concerns over rig's Marshall Islands flag', 31 May.
- The Observer*, (2014), 'US fast food workers battle McDonald's as franchise ruling opens way to better wages' August 3d: p. 20.
- United Nations Conference on Trade and Development- Programme on Transnational Corporations (UNCTAD-PTC) (1993), *World Investment Report 1993. Transnational Corporations and Integrated International Production*, New York: United Nations.
- United Nations Conference on Trade and Development (UNCTAD) 2013. *World Investment Report. Global Value Chains: Investment and Trade for Development*, Geneva: United Nations.
- Venables, A.J. (1998), 'The assessment: trade and location', *Oxford Review of Economic Policy*, 14 (2), 1–6.
- Vernon, R. (1966), 'International investment and international trade in the product cycle', *The Quarterly Journal of Economics*, 80, 190–207.
- Westney, D.E. and Zaheer, S. (2001), The Multinational Enterprise as an Organization, in A.M. Rugman and T.L. Brewer (eds), *The Oxford Handbook of International Business*, Oxford: Oxford University Press, Ch. 13, pp. 349-79.
- Wilkins, M. (1988), 'The freestanding company, 1817–1914', *Economic History Review*, 61 (2), 259–82.
- Williamson, O. (1975), *Markets and Hierarchies: Analysis and Anti-trust Implications*, New York: Free Press.
- Williamson, O., (1979), 'Transaction-Cost Economics: the Governance of Contractual Relations', *Journal of Law and Economics*, 22,2: 233-61.

Williamson, O.E. (1981), 'The modern corporation: origins, evolution, attributes', *Journal of Economic Literature*, 19, 1537–68.

Williamson, O. E. (1984), Efficient labour organization. In Stephens, F. H. (ed.), *Firms, Organization and Labour: Approaches to the Economics of Work Organization*. London: Macmillan, 87-118.

Zaheer, S. (1995), Overcoming the liability of foreignness, *Academy of Management Journal*, 38(2): 341-63.