The integration and fragmentation role of transnational companies

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Abstract
Following an introduction to the transnational corporations (TNCs), their activities and growth, the paper considers the issue of control in relation to strategic behaviour by companies. A discussion of how TNCs relate to nation-states leads to the analysis of the opportunities generated by nation-states for companies that can plan, organize and manage across frontiers. The nation-states are considered in terms of spatial, cultural/linguistic and regulatory regimes dimensions.

It is argued that differentials in regulatory regimes between different countries create scope for advantages and for strategic behaviour by TNCs. The strategic behaviour is seen in relation to other actors (specifically labour and governments) as well as other elements such as risk minimization. Analysis of fragmentation and integration and the role of TNCs in them. The role of TNCs in regional integration and brief discussion of evolving TNCs’ strategies towards labour and their consequences in the current recession.

JEL classification: F23; F15

Key words: Transnational corporations’ strategies; corporate integration; regional integration; fragmentation strategies; labour and transnationals; governments and transnationals.

1. Introduction

The popular image sees transnational companies (TNCs) as huge and all powerful companies based in developed countries and investing in developing countries. This profile may never have been fully accurate and it is increasingly less so.

Most large companies are indeed transnationals. However, an increasing number of smaller companies are also setting up production facilities abroad and becoming transnationals. This trend has been facilitated by developments in the cultural, political and technological environments that are enhancing internationalization in many spheres of life: from production to consumption from culture to business.

UNCTAD (2008) gives 78817 as the total number of TNCs worldwide. Of these, 72 per cent are located in developed countries, a share that has been declining steadily from 91.3 percent in 1994 to 76.9 in 2000 to 74.3 in 2007 and 72 in 2008. The same developments that facilitate the transnationalization of smaller companies may also facilitate the branching out of companies from developing countries often into neighbouring countries and within the regional confines.

1 I am grateful to Ken-ichi Ando and Miroslav Jovanovic for very useful comments on an earlier draft of this chapter; they have led to improvements.
The volume of foreign direct investment (FDI) has been increasing considerably in the last three decades. A large percentage of it takes the form of mergers and acquisitions (M&As) by companies based in different countries. As regards the geographical pattern of FDI, the developed countries are both home and host to the largest shares of FDI, i.e. they are the main originators and the main recipient of investment by TNCs. In 2007 their share of outward and inward stock of FDI was, respectively, 86.6 and 69 percent. Though the share of FDI into developing countries (31 percent) is considerably smaller than that going to developed countries, the inward stock of FDI has a bigger impact on the former being a higher share of their GDP: 29.8 percent against 27.2 in developed countries.

The transnational or multinational companies are much talked about as if they were a totally different type of institution from the normal company or firm. Are they? And if they are, what makes them so? The distant antecedents of the transnational company can be dated back many centuries whether to the Medici Bank in Renaissance Florence or to the seventeenth and nineteenth centuries trading companies from Northern Europe. Many business historians (Cox 1997; Jones 2002) agree that the key factor that led to the development of the TNC was the formation of joint stock companies. Nonetheless a TNC is not just another joint stock company. What are the key elements that make a company a TNC? The defining element is operations across frontiers. But not just any type of cross-border operations. Imports and exports on their own are not operations that identify a company as a TNC. The specific requirement is for ownership of assets abroad leading to direct business operations and for the ability to control those operations.

Various issues arise in this context. They will be dealt with in the following sections with the rest of the chapter organized as follows. First, we shall consider the type of control exercised over assets and operations and, second, the strategic behaviour of TNCs and its relationship to control (section two). Third, we shall analyse the relevance of national frontiers and thus of nation-states for the existence and characteristics of TNCs (section three). Sections four and five will argue that national frontiers may generate scope for specific strategies by TNCs and for specific advantages by them in relation to other actors. Fourth, the extent to which strategic behaviour can lead to fragmentation and/or integration and the meaning attached to these processes will be considered in section six. Fifth, the chapter will analyse how the above issues relate to the process of regional integration in section seven. The last section summarizes and concludes.

2. TNCs’ operations: control and strategic behaviour

Business operations across frontiers have been established for centuries if not millennia. In fact, most records of early civilization show signs of trade between different peoples often across frontiers well before the establishment of nation-states. Imports and exports have indeed been the main type of cross-border business operations. Worldwide, trade is still the most relevant modality of international business transactions though its relative importance – as a percentage of total value of transactions – is declining. Transnational companies are strongly involved in trade and their overall activities have effects not only

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2 Many of the issues considered in sections 2-5 are developed in greater details in Ietto-Gillies (2005).
on the volume but also on the structure of world trade. Intra-firm, intra-industry and the geography of trade are all affected by the world wide operations of TNCs (UNCTAD 1996; Ietto-Gillies 2005: ch. 19). The last few decades have seen the growth of other business modalities across frontiers in all of which the TNCs are greatly involved: from licensing and franchising to collaborative agreements to sub-contracting.

However, the modality that defines a company as a TNC is international production via foreign direct investment (FDI) i.e. via the ownership of assets abroad, be they acquired via greenfield investment or via M&As. For operations abroad to be seen as part and parcel of a company’s operations and thus for the company under consideration to be seen as a TNC the same company must be able to exercise control over its foreign assets and businesses. Control has two main connotations in the context of a TNC.

The first connotation is the equity stake in the foreign enterprise. What percentage of the foreign assets must be owned by the main company for the latter to have control? The International Monetary Fund (1977) guidelines set a minimum of 10 per cent. Equity control is a necessary condition but not necessarily a sufficient condition to ensure control of operations and directions of the foreign concern. Equity control by itself does not lead to strategic managerial control if the means of exercising such control are not available. In particular, if the system of communications and the organization of the business across countries are not suitable for the exercise of such managerial control. This was indeed the case of much foreign business prior to the First World War when there was, in fact, a very considerable amount of foreign investment. There were indeed many enterprises whose assets were owned wholly or in large part by person or groups or companies in foreign countries (usually in Britain or Holland or the US). However, though the owners had controlling stakes in the businesses they were not in a position to exercise managerial control because of the large distance between home and host countries and the poor transportation and communication systems. Wilkins (1988) has termed these businesses as ‘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.

The modern transnational corporation is characterised by having both equity control and ability to manage the foreign affiliates at a distance. The relevant type of management in our context is the one related to the setting of strategic goals and the monitoring of performance, rather than the day-to-day operational management.

The ability to manage at a distance is the product of two relevant and interconnected innovations both of which form the sufficient conditions for the exercise of control. First, the technological innovation not only in transportation but also in personal communications which, starting with the telegraph and telephone, were greatly enhanced, more recently, by electronic communications. Second, organizational innovations which were made possible (and/or strongly facilitated) by the communication technologies as well as by the experience of firms operating large manufacturing projects - particularly the building of railways - during the 19th century.

Developments in the internal organization of companies have been analyzed under two different ‘paradigms’: the ‘efficiency’ and the ‘strategy’ paradigms. Williamson (1975, 1981 and 1984) sees changes in the internal organization as driven by efficiency objectives; specifically, by the desire to economize on transactions costs, as
well as to minimize the pursuit of individual goals within the organization. Chandler (1962) sees the internal organization of corporations evolving mainly in response to strategic objectives, in particular growth strategies. Chandler’s line is taken up by Hymer (1970) which analyses the relationship between the evolution in the internal structure of the firm and multinationality; in particular, how the former facilitated the latter. Other authors have emphasized the link between control and strategic behaviour (Cowling and Sugden 1987 and 1998).

Strategic behaviour has many connotations and can be analyzed in relation to two specific dimensions in respect to ‘what’ (a) and to ‘whom’ (b). Regarding (a), it is seen in relation to the activities of the firm such as: its products’ range; the markets it seeks to penetrate; its production processes; the technologies used; the organization of the value chain; and the geographical configuration of its production activities. As regards (b), the analysis is in relation to specific actors such as: rival companies; consumers; suppliers, distributors and sub-contractors; the labour force; and governments.

Closely linked to the latter dimension is the relationship between strategic behaviour and power. Zetlin (1974: 1090) argues that power (and control) “…is essentially relative and relational: how much power, with respect to whom?”. Companies’ power has usually been analysed in relation to market power and therefore with respect to rival firms. However, power may also relate to other players in the economic system and specifically to labour, governments, suppliers/distributors, subcontractors or consumers.

Power and strategies can be used to resolve conflicts between the specific company under analysis and other actors. The conflicts are usually over distributional issues arising from production or market conditions. In the case of conflicts with rivals the distribution relates to market shares; in the case of labour, the conflict is over distribution between profits and wages; in the case of conflicts with governments the issue is distribution over the overall surplus and how much should go to the private or public sphere (via taxation or financial incentives or subsidies).

In the next three sections we shall analyse how transnationalization generates opportunities for strategic behaviour by firms operating across nation-states. The strategic behaviour considered will be specifically in relation to labour and governments rather than directly in relation to rival companies. This is not because the latter is not considered important but mainly because it has been well covered in the literature.

In fact, in the international business literature the strategic behaviour of companies has been considered by many authors in the context of developing theories of why companies operate across frontiers and which modalities they employ. The strategic behaviour towards rivals is considered in Hymer (1960), Vernon (1966), Knickerbocker (1973) and Cowling and Sugden (1987). Sugden (1991) and Letto-Gillies (2002 and 2005) stress strategic behaviour towards labour. Other authors have followed the ‘efficiency’ route and developed theories that explain internationalization activities and modalities in term of cost efficiency and, specifically, minimization of transaction costs (McManus 1972; Buckley and Casson 1976; Helpman 1984 and 1985; Markusen 1984, 1995; Helpman and Krugman 1985). Dunning’s well known eclectic framework has elements of both efficiency and strategic behaviour (1977, 1980).

3. **TNCs and the nation-states.**
In this section we shall consider the relevance of national frontiers for the activities and strategies of companies. At the semantic level trans-nationalization implies the existence of national borders. In this sense we can say that in a world with no nation-states there would be no TNCs meaning that we would not characterize a company as a TNC just as we do not currently attach a special label (such as ‘trans-regional’) to companies that operate in many regions of the same country.

This begs the question as to why – in a world in which nation-states exist – we see the need to attach a special label to companies that operate across several of them. It therefore raises the wider issue of the relationship between nation-states and companies and of the relevance of the nation-state for companies. Is there something specific to the nation-state in relation to corporations which is not to be found at the level of regions within a country? The answer to these questions will lead us to examine the evolution of this relationship in – and its relevance for – the context of regional integration. The adjective regional in the last sentence refers to geographic areas encompassing several nation-states such as the EU or NAFTA.

In order to tackle these issues and attempt to answer the questions let us examine the relevant dimensions of operating across national frontiers. There are three main dimensions to business operations across nation-states: a spatial or geographic dimension; a cultural dimension; and a dimension related to specific regulatory regimes.

The **spatial/geographic dimension** has to do with distance between locations and its relevance is largely linked to transportation and transaction costs. 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 spatial distance between Turin and Palermo is greater than the one between Turin and Geneva. Similarly, the distance between New York and Montreal is less than the one between New York and San Francisco.

The **linguistic/cultural dimension** - particularly the business culture element - affects the operations of companies in terms of transaction, organizational and managerial costs. The cultural distance is usually greater between nation-states than between regions of the same nation-state. But again, this is not always the case. Regions close to the border of two nation-states often have more similar business cultures than distant regions within the same nation-state.

The **regulatory regimes dimension** encompasses 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 roots. Nation-states differ – sometimes substantially – in terms of their specific regulatory regimes. Regulatory regimes tend to be more – though not completely - homogeneous and consistent within each nation-state than between different nation-states.

The nation-state can be seen as the locus of a set of ‘regulatory regimes’ that is of a set of specific institutions, rules and regulations which affect people, firms and wider organizations within the borders of the nation-state. Some of these rules and regulations stem from the legal or institutional system, some from government policies; several have more than one connotation, i.e. they incorporate legal, institutional and/or policy elements. Specific elements of nation-states’ regulatory regimes relevant for businesses
are the following: (a) currency regimes; (b) fiscal regimes; and (c) rules and regulations regarding the social security system and in particular different regimes regarding labour and its organization.

All three dimensions discussed here have costs implications. A company operating across frontiers may face additional costs and risks ranging from transportation and transactions costs to managerial and organization costs. They include also costs specific to the third dimension such as: costs of insurance against risks of currency fluctuations; additional costs of acquiring information about fiscal and social security regulations in other countries as well as information about their labour market conditions; costs of mastering – and managing in the context of - different laws, regulations and customs.

However, there are also advantages of operating across frontiers. Companies that can truly plan, organise and control across frontiers can also develop strategies to take advantage of differences in regulatory regimes across frontiers. This is particularly the case when the strategies are in relation to actors who cannot – or not yet – plan and organise across national frontiers, or not to the same extent as the TNCs. Specific advantages of transnationality can be developed in the following spheres.

- Towards labour
- In negotiations with governments
- With regard to different currency and tax regimes
- In relation to risk spreading

4. **International production and strategies towards labour**

As already mentioned most international business literature on companies’ strategic behaviour has concentrated on strategies towards rivals rather than on strategic behaviour towards labour. From the perspective of the company and its profitability the best position to be in is one in which it has power over both its rivals and its labour force; i.e. it commands market power and faces a labour force which lacks power - or is made less powerful – because it is segmented and has difficulties in its collective organization and thus in bargaining.

The two sets of power relations – with rivals and with labour – are affected by two different aspects of the organization of production: specifically, the market concentration and the internationalization of production activities. Both market concentration and internationalization have increased in the decades immediately after WWII. However, the last quarter of the XXth century saw considerable changes in the companies’ strategic behaviour with respect to the organization of production and the production process. Specifically, changes in the organization of the production process within and between firms and changes in the companies’ strategies towards the geographical location of their activities. In the late 70s, 80s and to some extent also the 90s many large companies have been downsizing i.e. outsourcing the production of part of their activities, usually the non-core part but, at times, some core activities as well. This meant that whereas the decades following WWII have seen an increase in the internalization of production activities, the later decades of the century have seen the opposite process: many large firms have subcontracted part of their activities to smaller firms who are usually independent in terms of ownership though, often, dependent in
terms of strategic control of their activities (Cowling and Sugden 1987). The same late decades of the XXth century have also seen acceleration in the expansion of activities abroad by large companies some on an internalized basis and some outsourced to smaller firms in foreign countries.

The explanation of these historical patterns can be aided if we see them in the context of possible strategies of companies towards labour. The concentration of production leads to oligopolies and thus to market power. However, it may at the same time strengthen the power of labour because labour employed within the same ownership unit – that is within business enterprises all belonging to the same company - may find it easier to organise and take action compared to a situation in which it is dispersed across units belonging to different owners.

As regards the international location of production, labour has, traditionally, found it easier to organize and resist when working within the same country. Proximity, shared condition of labour and shared contractual obligations lay the foundations for easier organization and resistance. Moreover, shared historical, cultural and social environments give labour a stronger feeling of solidarity. On the whole, the differentials in the actual and potential for labour organisation and for bargaining power are higher between countries separated by institutional, political, cultural, legal and governmental borders than within each border. We can identify areas of ‘labour organisation regimes’ as those geographical areas within which – ceteris paribus - labour finds it easy to organise itself effectively due to shared cultures, contracts and working conditions.

We can therefore identify two main dimensions in the organization of production: (a) an ownership dimension by which we mean to capture whether or to what extent the firm internalizes its production activities or uses external, arm’s length transactions with other firms for part of its value chain activities; and (b) a geographical dimension which tends to capture the extent to which production activities take place within the same location or near-by ones or the extent to which they are dispersed in several locations. In the latter context of particularly relevance is whether the activities are located in different nation-states for the reason explained in the next two sections; or (c) a mixture of ownership and geographic dimension. The latter is a combination of dimensions (a) and (b). Thus companies within a sector may – ceteris paribus – face a more powerful labour force when the same is employed: (a) within the same company/institution rather than being dispersed into many; and (b) within the same country.

It is in the interest of companies to develop strategies that increase their power towards labour while not diminishing – and possibly increasing – their power over rivals. Possible strategies in this direction involve the segmentation/fragmentation of labour while retaining their market power. Two specific types of fragmentation strategies are possible and have been followed: (i) organisational fragmentation through the externalisation of some activities; and (ii) geographical (by nation-state) fragmentation through the location of production in various countries characterized by different regulatory regimes.

These two strategies are not incompatible and they can be implemented together. The first strategy (organisational fragmentation) involves the company in the externalisation of labour through out-sourcing (such as sub-contracting arrangements) which allow considerable control of production without the added responsibility for the
labour employed\(^3\). The second strategy involves the spread of production in countries, areas not linked by common labour organisation regimes i.e. areas that have different trade unions and/or different labour and social security laws, regulations and standards. These elements make the organisation of labour and its resistance to the demands of capital more difficult.

Two consequences derive from this, both relevant for TNCs’ strategic decision in terms of the location of international production. First, that - ceteris paribus - companies may seek to locate in areas of weak labour organisation regimes; thus foreign direct investment would flow - ceteris paribus - from areas of strong labour organisation regimes towards areas of weak regimes.

Second, even if the differentials in labour organisation regimes across nation-states are not high, the dispersion of employment across many countries - though within the same company - fragments the employed labour force and thus makes its organisation more difficult and its bargaining position weaker. Such dispersion gives a stronger position to companies vis-à-vis labour compared to a situation in which the growth of production within the same company were to occur all or most within a single country. Thus, we have a situation in which the internationalization of production per sé may generate advantages for companies.

The fragmentation/segmentation of labour can take place on the basis of organisational dispersion thus leading to the various degrees of externalisation of production: from full out-sourcing and use of market transactions to varying degrees of control through sub-contracting and similar arrangements; from the employment of labour full time and on permanent contracts to the casualization of labour (Ietto-Gillies, 2002: ch. three). Fragmentation may also take a geographical (by nation-states) route. This involves the dispersion of production over many nation-states, countries/areas albeit within the internal, hierarchical organisation route. Some degree of both geographical and organisational dispersion and fragmentation is also possible for example through international sub-contracting. The two strategies reinforce each other in the labour fragmentation potential and therefore in the difficulties they generate for the organisation and resistance of labour in its bargaining with capital.

The organizational pattern of production that arose from the late 70s onwards – outsourcing and increased international location – can be seen as a strategic reaction by companies to the increased power of labour in the decades after WWII. The latter being aided by the concentration of production into large units often developed in the same site or in spatially close sites.

Before leaving the issue of possible strategies towards labour we must deal with some caveats. Are outsourcing strategies and international location of production to be interpreted only in terms of strategic behaviour towards labour? The answer is emphatically: no. There are many other reasons why companies want to outsource (such as the achievement of more flexibility of supply to demand conditions or the lowering of fixed costs) and want to locate abroad (such as proximity to markets or sources of materials or of labour). However, whatever the reasons – and there are likely to be several – one of the outcomes is that both outsourcing strategies and international

\(^3\) The issue of strategic control over sub-contractors is explored in Cowling and Sugden (1987).
location of production lead to a weakening of the employed labour and thus to strengthening of the power of management towards the workforce they employ.

Another caveat arises from the assumption on social security regimes. We assumed that they differ between nation-states but are fairly homogeneous within each nation-state. In reality there can be considerable differences even within region of the same country such as regions of the UK or states within the US.

5. Regulatory regimes and TNCs’ wider advantages

Differentials in regulatory regimes can be turned into advantages some of which are actor-specific and others are not. Among the former are advantages towards labour considered in the previous section. Having production locations and business activities in several nation-states can also 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 (Oman, 2000; Phelps and Raines, 2002). If a company has production facilities in many countries, its threat of relocation becomes very credible and can be used as bargaining power to gain high incentives4.

Moreover, the existence of multiple sourcing channels (whether actual or potential) in the various countries gives the TNCs also a powerful bargaining position towards suppliers. Are there also advantages to be gained towards rivals? As already mentioned international location can be in response to a variety of strategies including those in relation to market penetration and expansion and in relation to sources of materials and labour. Moreover, any advantages towards labour and/or governments deriving from location strategies and leading to higher profits can be turned into indirect advantages towards rivals as it increases the potential for higher market shares.

Among those strategies and advantages that are not actor-specific are the following. Nation-states as loci of regulatory regimes are also loci of specific currency and taxation regimes. Operating across several such regimes puts the company in a position to: (a) maximise its returns from exchange rate fluctuations; and (b) minimise 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 (Ietto-Gillies 2005: ch. 20).

Moreover, the locational diversification of technological and production activities allows the company to learn from its environment and thus to increase its ownership advantages (Cantwell 1989; Castellani and Zanfei 2006; Frenz and Ietto-Gillies 2007) on which more in the next section.

A further advantage is connected with risk spreading. A strategy of dispersion of production and multiple sourcing can also be a diversification strategy which allows the spreading the 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

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4Kogut (1983) mentions the threat of relocation as a bargaining power towards governments.
environment. However, the ability of countries to cope with them and to minimise risks and costs for business is, to a large extent, nation-specific and thus specific to the social, economic and political 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 geographical environment

Do companies derive only advantages from a strategy of fragmentation of production across different nation-states? The answer is certainly negative. First of all, because the fragmentation strategy may lead to higher unit costs if it requires operating below the most efficient size in some, if not all, the locations. Moreover, the diversity of regulatory regimes across which TNCs operate may, in itself, generate extra costs and uncertainties. For example, different currencies generate transaction costs; exchange rates fluctuations may bring losses as well as gains; operating across different cultures and institutional contexts may result in higher transaction, organizational and managerial costs.

6. TNCs as agents of integration and fragmentation

So far we have explored the fragmentation side of TNCs’ activities whether they are the result of deliberate strategies or not. But TNCs have been hailed as agents of integration across countries. Indeed, they may be considered as the main agent in the globalization process which is the process of integration par excellence (Ietto-Gillies 2002: ch.10). So, are TNCs agents of fragmentation or integration? The answer is that they are both and it all depends on the perspective we consider. In the previous two sections we took mainly the perspective of labour and of governments and came to the conclusion that strategies of international location are likely to lead to the fragmentation of labour, of governments and other relevant actors – such as suppliers - in their dealings with TNCs’ management.

It can also be argued that a strategy in which various segments of the value chain are located in different countries leads to the fragmentation of the production process. But such strategies are often referred to as strategies of international vertical integration. Are we seeing integration or fragmentation with regard to the production process? The production process itself is locationally dispersed and thus fragmented. However, such a location strategy facilitates integration among countries linked by the value chain.

The integration role of TNCs can, in fact, best be analysed by taking the perspective of countries rather than of production processes and/or labour force. Are nation-states being integrated - linked together – more or less by the activities of TNCs? The answer must definitely be more for the following reasons. First, because the activities give rise to flows of products, capital, human resources, services and skills.

Second, because the activities involve also exchange of knowledge, technology and innovation including organizational and managerial innovation. Various units within the company – be they the headquarters or subsidiaries – form an internal network within which there is exchange of knowledge, innovation and technology (Hedlund 1986; Hedlund and Rolander 1990; Zanfei 2000; Castellani and Zanfei 2002; Frenz and Ietto-

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5 Rugman (1979) suggests that the international spread of activities may be a risk diversification strategy on the part of the company.
Gillies 2007). The exchanges are often facilitated by movements of highly skilled personnel whose flows have been increasing worldwide (Salt 1997; OECD 2002).

Moreover, each company unit will be in contact with the innovation context and system of the country in which it operates. The unit learns from these locational contexts and then transmits the acquired knowledge to other parts of the company via the latter’s internal network. Often the learning from the locational context and system is heightened by formal innovation-based collaborative agreements leading to external networks (Frenz and letto-Gillies 2009/10). Other external networks can also lead to learning and acquisition of knowledge such as the networks linking subsidiaries to their local suppliers and customers. The two types of networks, internal to the company and external to it, operate together to enhance the diffusion of knowledge and innovation, with significant effects for the local businesses, the TNCs and the various countries (home and hosts) in which they operate. Thus the geographically fragmented configuration of production activities increases the scope for integration across countries via the diffusion of knowledge and innovation.

Third, the learning process from the location context to the company is paralleled by an inverse process: knowledge and innovation spill over from the company’s units to the local environment in which they operate. The mechanisms through which this happens may be movement of labour between businesses or acquisition of products and components or contacts with suppliers, distributors and customers. Whatever the mechanism, the spillover effects have integrating effects between various countries linked by the internal networks of the TNCs.

Fourth, the production process organized internally to a company though across countries will bind the countries together more than if independent companies in each country were to organize segments of the value chain. It is a deeper integration process involving exchange of personnel and knowledge as well as responding to common goals and strategies.

Fifth, the labour force in one country may become more dependent on decisions and activities taking place in other countries. They may also become dependent on the skills used in other countries. Lastly, governments and their policies in several countries may become linked by the impact of strategies of TNCs operating within them. There are also implications for the effectiveness of economic policies.

7. TNCs and regional integration

In section six it was argued that the activities of TNCs tend to integrate countries; the more so the higher the level of those activities. We have also argued in sections 3-5 that TNCs’ activities generate fragmentation. These integration and fragmentation processes occur whether the countries are considered as being part of specific regions or not. In the case of regional integration the activities of TNCs contribute to the so-called ‘integration from below’ that is integration promoted by the activities of micro actors (Pelkmans 1984)\(^6\). There is also, usually, a parallel process of integration from above i.e via the policies of the governments of member states.

How does the process of regional integration from above affect the activities of the TNCs and the processes of integration and fragmentation set in motion by them?

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\(^6\) See also Ando in ch. of this book for an analysis of the integration role of Japanese TNCs in the EU.
Will it enhance or diminish the scope for TNCs’ strategies resulting in their own generated integration and fragmentation? Conversely, do the TNCs’ strategies enhance or hinder the regional integration process?7

In order to analyze how regional integration may affect the strategies of TNCs and the location of production we need to look at the various perspectives offered to companies by a given region. They are in terms of the region as: (a) Locus of distances between various points within it. This affects transportation costs for resources and final products. (b) Locus of areas of resources availability including human resources and the range of skills offered. This affects the costs of production. (c) Locus of knowledge and innovation which can be tapped into. There is evidence that one of the reasons why some countries attract inward FDI is, indeed, their good innovation environment (Driffield and Love 2003). (d) Locus of markets. In this respect key elements of differentiation between locations are their level of income per capita and the level of competition. (e) Loci of different national regulatory regimes with respect to fiscal, currency and social security regulations as seen in sections 3-5 where we argued that their impact is due to the ability of companies to devise strategies for benefiting from the differentials between the national regimes. (f) The region – such as the EU – as a locus of specific regulatory regimes applying to all its member states.

The loci elements considered above are not static and fixed in time but vary and interact with each other dynamically. Skills and knowledge develop and so do markets. The development in the economic and business context leads to changes in the regulatory regimes of nation-states and the region. The companies’ activities and, particularly, their investments are key elements of such changes and interactions.

In the short term the elements that determine the loci (a) to (d) are largely independent of whether the region we are analyzing is politically and economically integrated or not. However, in the longer term integration may lead to changes in the elements described under (a) to (d) as well as those in (e) and (f).

Firms take account of elements in (a) to (d) in planning the location of their activities. They also take account of (e) and (f) and this is where the depth of regional integration and the various stages it goes through may have a direct impact on the location of production. Indirectly, the impact will also be felt through the effects of integration on elements within (a) to (d).

While firms’ strategies are linked to all six (a-f) loci elements, the issue of integration from above relates, directly, to (e) and (f) only. So, one question is: how do TNCs’ strategies relate to various stages and depths of regional integration from above? Deep integration starts with opening up of markets for capital, products and labour. Products can move across freely and so does capital and – up to a point - labour. This affects the ease of markets penetration and the availability of skills. Whether production will be located near resources or the latter moved to production locations will largely depend on transportation costs and the location of markets. The intra-regional FDI motivated by the aim of circumventing trade barriers will diminish as intra-regional markets can now be supplied by exports from the home country. However, it will increase extra-regional inward FDI as TNCs from outside the region will now have the

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7 Dunning and Robson (1987) analyze the relationship between regional economic integration and transnational corporate integration, the latter seen mainly in relation to the organization of production within the TNC.
opportunity of a larger market within which their products can freely move provided they are produced in one of the member countries.\(^8\)

Integration of markets may or may not be followed by integration in regulatory regimes. It is with the differentials in these that we dealt in sections 3-5. What if these differentials come down as integration deepens? Abolition of differentials in currency regimes – i.e. adoption of single currency – cuts down transaction costs and thus facilitates transnational activities.

Integration at the level of markets for products and financial assets and the freer movements of labour across frontiers is likely to help business in general. These developments lead to lower transaction costs as well as to high supply of labour – often skilled labour - in several EU countries.

Where we have seen and continue to see strong resistance by companies is in terms of possible integration in fiscal and social security regimes. The latter includes issues like length of the working week and pension rights. These are elements in which there are still very considerable differences between EU countries and great resistance to move towards common norms. They are also the elements in which differentials between countries – though they may entail some transactions costs – are likely to bring companies considerable benefits in terms of the following.

In the case of fiscal regimes, scope for taking advantage of different corporation tax regimes in member states by a strategic location of subsidiaries; scope for the manipulation of transfer prices designed to reach a tax-efficient geographical configuration of reported profits; and for taking advantage of different countries’ wider financial incentives for the attraction of inward FDI.

In the case of social security regimes, lower labour costs and, generally, increased power of companies towards labour. It is interesting to note that successive British Governments have always opposed the European Social Charter and any attempt at harmonising ‘labour and fiscal regimes’ within the EU. They have also repeatedly assured the employers’ association that they will continue to do so in the future.

To what extent and for how long can there be resistance to integration in fiscal and social security regimes across the EU? It is difficult to tell as political processes are always influenced by many, often unpredictable, events. Nonetheless changes in social and technological environments are likely to have an effect. As people move around more freely and communicate more cheaply and speedily the awareness of conditions in different member countries increases. This may increase the pressure for more consistency across member countries. Moreover, electronic communications increases the opportunity for coordination and planning across nation-states for actors who, so far, have not coordinated much such as labour and suppliers. There is evidence of some trade unions developing links across nation-states (The Guardian 2007) of the EU and beyond.

However, the current recession is likely to change the context within which the EU integration process takes place with far reaching consequences. Recent developments in Britain have brought attention to a new configuration of labour regimes giving scope for additional strategies likely to lead to more not less segmentation of European workforce. EU regulations stipulate that EU nationals are free to move to - and seek employment in - any of its member countries; moreover, companies may employ labour from any of the EU nationalities within its member states. However, a different

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\(^8\) See Balasubramanyam and Greenaway (1992) and Dunning (1997 a and b).
article/directive also allows companies to hire labour in other member countries – and move it to a host member country as ‘posted workers’ - at different contractual regimes from the ones applicable to local nationals in the same host country. The overall result seems to be that negotiated national agreements between workforce and employers in a specific country do not apply to posted workers. The contractor/employer must not pay below the legal minimum wage in the host country but otherwise it can stipulate its own contractual conditions on which, moreover, it appears to have no disclosure obligations.

Growing unemployment across Europe means that workers are prepared to move and take up jobs in other countries at worse conditions than is available to nationals in the host country or indeed than they themselves might have in their own country were jobs to be available there.

This is exacerbating divisions among European work force. As the 2008-? recession bites and jobs are lost, British workers have come out on unofficial strikes against the preference for posted foreign workers – brought in from Italy and Portugal – over British workers by an Italian oil contractor investing in Britain. The situation is relatively new but not unprecedented and indeed there are currently British posted workers operating in Italy and employed by the very same contractor. The social tensions may be flaring up now because the recession is deepening.

The outcome is that European labour appears more divided and fragmented than ever – with dangerous nationalistic overtones - while working within the same country. Here again we have clear strategies from TNCs that: (i) Reduce labour costs. This is achieved not by investing in low labour costs locations but by using EU regulations to freely move labour to another member state though at contractual conditions more favourable to the company than those it would have by employing indigenous labour. (ii) Manipulate contractual arrangements to circumvent national agreements in the host country. (iii) Fragment the overall labour force employed.

This issue has many wide implications in terms of theories, strategic behaviour and policies. Inward investment far from creating jobs for host country nationals – as books on international business tell us - depletes them. Moreover, it is perceived to be undermining employment terms and conditions and thus to be effectively a vehicle for ‘social dumping’. Locational advantages are being replaced or supplemented by advantages of using foreign work force at different contractual conditions thus increasing the segmentation of European labour. Within the same country different contractual conditions may be used not as a result of organizational fragmentation or locational advantages but as a result of freely moving workforce under EU integration policies.

Moreover, the differentials in labour regimes for host and posted workers are the result of legislation at the level of the region – the EU – rather than at the level of single member states as discussed in section four. In other words, the political integration process has created differentials in labour regimes – between posted and host country’s workers – which generate scope for new segmentation strategies by TNCs.

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9 See also chapter by M. Jovanovic in this volume.
10 It should be pointed out that in the specific case currently (February 2009) under media attention in Britain the Italian contractor claims that the pay of Italian and Portuguese ‘posted’ workers in not less than would have been available to British workers had they been employed. This may still leave open the issue of overall costs since the posted workers may be moved at the benefits regimes of the country of origin: an arrangement allowed by EU regulations. It also leaves open the issue of wider contractual terms and conditions such as length of working hours all of which affect costs.
Unfortunately as the recession deepens and companies sharpen their fragmentation strategies, divisions between EU workforce may increase. At the political and macro economic levels the consequences can be quite important: calls for the protection of jobs are bound to be mirrored by calls for the protection of products. Not only any aspirations of European social cohesion may be undermined but so will any hope of fast recovery. The jury is out on the medium to long term impact of the recession on European integration. It could lead to a slow down of the process as calls for protection of jobs and products increase. However, it could be that the social and political consequences of the unrests may force politicians to close loopholes and review legislation for posted workers. Divide and rule strategies may bring short term benefits to companies in terms of lower costs and higher productivity. However, when pushed too far - and under conditions of deep and worsening recession – they may lead to worrying social instability; not a welcome situation for either companies or governments.

The TNCs have both an integration and fragmentation role within the EU. It is up to governments of member states and the EU to develop appropriate policies and strategies that channel TNCs’ own strategies towards social and economic desirable goals including cohesion.

8. Summary and conclusions

Following a brief excursion into the growth of TNCs’ activities, the paper considers the issue of control in relation to strategic behaviour by companies. A discussion of how TNCs relate to nation-states leads to an analysis of the opportunities and scope generated by nation-states for companies that can plan, organize and manage across frontiers. The nation-states are considered in terms of spatial, cultural/linguistic and regulatory regimes dimensions.

It is argued that differentials in regulatory regimes between different countries create scope for advantages and for strategic behaviour by TNCs. The strategic behaviour is seen in relation to other actors (specifically labour and governments) as well as other elements such as risk minimization. An analysis of fragmentation and integration and the role of TNCs in them follows. The analysis is then extended to the role of TNCs in regional integration with a brief discussion of evolving TNCs’ strategies towards labour and their consequences in the current recession.

TNCs are seen as having both a fragmentation and integration role across nation-states. The differentials in social and fiscal regimes within the EU give scope for fragmentation strategies by TNCs and in relation to labour and governments. The social implications of these differentials and strategies, particularly in relation to the current recession, are briefly discussed in section seven.

References


