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Multinationals and institutional competitiveness

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Abstract
This article discusses how institutional competitiveness and multinationals are mutually enriching concepts. Multinationals transfer capital, technology, and knowledge into new settings. They allow subsidiaries access to new markets, new resources, and new processes. Potentially, therefore, institutional competitiveness can be increased by the presence of multinational corporations (MNCs) and their subsidiaries. However, this depends on the type of multinational and the type of institutional context. By differentiating two types of MNC in terms of short-term and long-term orientations to investment, and two types of host institutional setting in terms of strength of institutional complementarities and interconnectedness, we develop a typology of four types of interaction between MNCs and institutional settings. We then analyze how each type influences institutional competitiveness. We conclude that these outcomes, while structurally shaped, are still dependent on how actors (individuals, firms, collective organizations, and governments) strategize to develop institutional frameworks in the context of highly competitive global markets.

Keywords: institution, multinational, subsidiary, varieties of capitalism.

Introduction

As the papers in this special issue of *Regulation & Governance* make clear, the concept of "institutional competitiveness" is of relatively recent origin. It emerges with the observation that globalization does not create what Friedman (2005) has called a "flat world." It does not reduce all differences between societies to a minimum. On the contrary, it enables those areas that can generate and sustain institutional competitiveness to find expanding markets in the world economy, thus reinforcing national institutional differences rather than causing them to disappear. The editors to this special issue identify different faces of institutional competitiveness. These models of institutional competitiveness are predominantly based on the analysis of societies and states. They tend to revolve around how particular societies, political actors, and institutions are able to respond to or adapt to the pressures of globalization. Firms as active participants in

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the formation of institutional competitiveness are relatively absent from these discussions. In this paper, however, we suggest that firms, and in particular, multinationals, which are our main concern, cannot be treated merely as relays for forces and processes outside themselves. On the contrary, multinationals are major actors in the contestation and development of institutional competitiveness. In the following section, we examine the nature of multinationals and their activities before proceeding to discuss the impact that they have on institutional competitiveness.

Institutional competitiveness in theories of multinationals

Recent studies of multinational corporations (MNCs) have been profoundly influenced by Bartlett and Ghoshal's (1989) discussion of the "transnational solution." They emphasize that transnationals "decide task by task and even decision by decision where issues should be managed. Some decisions will tend to be made on a global basis, often at the corporate centre…; others will be the appropriate responsibility of local management. But for some issues, multiple perspectives are important and shared responsibility is necessary" (Bartlett & Ghoshal 1989, p. 209). The task of the headquarters is not to impose on subsidiaries, but to facilitate not only flows of capital and physical resources but just as importantly, the flow of information, knowledge, and best practice around the firm. Knowledge and new practices could be combined and developed into new products, processes, and services at any point in the MNC structure – headquarters, regional offices, subsidiaries, and research and development (R&D) centers of excellence. Bartlett and Ghoshal described this type of MNC as more like a "differentiated and interdependent network …. integrated with a flexible coordinating mechanism" (Bartlett & Ghoshal 1989, p. 210). Hedlund described such multinationals as "rich in recomposition opportunities" (1999, p. 22). The "transnational corporation" was to be "dispersed, interdependent and specialized" with "differentiated contributions by national units to integrated worldwide operations" and "knowledge developed jointly and shared worldwide" (Bartlett & Ghoshal 1989, p. 65). They particularly emphasized that this sort of an MNC possessed a distinctive competitive advantage because it was located across different settings with distinctive capabilities, which gave it a capacity to combine and recompose in new ways making it more innovative than firms lacking this internal diversity. From this perspective, multinationals become engineers of cross-country complementarities.

It is important to note that the term "transnational" was used by those authors to identify a particular sort of multinational firm. The central feature of such firms is that they are competing in markets where innovation, cost, and quality are all equally important for survival and success. Such markets combine sensitivity to local consumer demands with a commitment to global sourcing and global economies of scale to achieve cost reductions and quality improvements. Other types of multinational based either on highly centralized systems (that deliver standard products to all contexts, for example, in the arena of fast food) or highly decentralized systems (where production is locally concentrated and serves the home market) were excluded from the definition of the "transnational". In this respect, we follow Bartlett and Ghoshal in their concern for the transnational. In the highly centralized MNC, the subsidiary is self-contained and dependent on processes and practices delivered from the center. There is no attempt to engage with the local institutional context in anything other than a minimal way. Many

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fast-food franchises fall into this category as do highly branded drink and retail products. In the decentralized MNC, the subsidiary is embedded in the local context, but there is no pressure from the headquarters to change this or to engage with the local institutions in a different way from the existing pattern. Such patterns have been characteristic of conglomerate holding companies with highly diverse portfolios of subsidiaries. In contrast, the largest multinationals by assets and employment are increasingly transnational in form. They have complex internal supply chains that link different functions, products, and processes across geographical areas via networks of subsidiaries and external contractors and suppliers. Their purpose is to gain the advantages of scale, scope, and learning as described by Bartlett and Ghoshal. In this process, their structural shape is ever changing – subsidiaries are bought, sold and closed, developed from scratch, restructured, downsized, and developed according to logics derived from the broader decision-making framework of the multinational. In our view it is those firms that are pursuing transnational strategies that are likely to have the most impact on local institutional settings. Our paper, therefore, concentrates on this type of multinational.

The issue of location has become a central concern. MNCs make choices about how to organize their systems and where to organize them. Recent analyses of MNCs have made clear that this process needs to be understood in terms of the differential capacities of localities. In particular, it is clear that while MNCs are influenced by issues such as access to market and access to cheap labor, low regulation, and compliant governments, they also have a substantial agenda concerned with accessing distinctive skills and capabilities that have developed in particular areas. These skills and capabilities, which reside not in individual firms but in the institutions (of education, training, industrial relations, interfirm relations, and knowledge-based organizations) are the basis of institutional competitiveness. These capacities have often grown up independent of and autonomous from MNC involvement, but as their distinctiveness becomes recognized, MNCs are drawn toward these localities to gain access to these capacities. At the same time, MNCs are likely to seek to transfer what they identified as best practice in a particular locality to other subsidiaries through processes of learning and diffusion. New combinations of expertise and knowledge are likely to be engineered in the MNC to create a new set of competitive advantages, which are distinctive to the firm and not embedded in the particular localities where they originated (Birkenshaw 2000). It is this dynamic between the conditions of local institutional competitiveness and the strategies of MNCs to locate in such areas and to learn from the specific contexts that is our concern. What does this mean for institutional competitiveness in the long term?

Multinationals, strategies, and institutions

The model of the transnational so described can emerge in various ways. In this section, we focus on two main approaches, which relate to the timescale of the MNC in its relationship with local institutional settings. We define short-term and long-term orientations by reference to the objectives of senior managers as structured through their relationship to capital markets, owners, and other stakeholders. In doing so, we draw on the established literature concerning the varieties of capitalism (Whitley 1999; Hall & Soskice 2001), and the development of this approach in relation to multinationals (Morgan *et al.* 2001; Geppert *et al.* 2002, 2003a,b; Kristensen & Zeitlin 2005; Almond & Ferner 2006; Ferner *et al.* 2006; Morgan & Kristensen 2006).

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In considering UK and US multinationals, creating shareholder value is one of the major drivers of senior management decision-making (Froud *et al.* 2000; Lazonick & O'Sullivan 2000; Williams 2000). Shareholders currently are predominantly institutional investors, which actively monitor share prices and engage in frequent transactions on the capital markets to maximize returns. Failure to satisfy shareholders even in the short term leads to falling stock prices, which in turn increases the cost of borrowing for management, making mergers, innovation, and growth more difficult, and instead posing the threat of takeover or ultimately bankruptcy. These differential pressures make MNCs engage in continuous restructuring of activities (through divestments, closures, and reorganizations). To keep up the share price of their company, top managers must show that they comply with market expectations in terms of financial performance. Senior managers achieve legitimacy by responding quickly and effectively to financial market pressures by using the managerial hierarchy to implement corporate restructuring (Lazonick 2005) and initiate moves in the market for corporate control.

These pressures in particular impact on how multinationals from these contexts deal with subsidiaries. The financialization thesis (Froud *et al.* 2006) predicts that the pressure for performance gains in capital markets leads managers to translate those goals directly into financial performance targets inside the firm. In effect, this becomes a cascading process down the organization of target setting, performance impacts, the monitoring of targets, and the achievement (or not) of targets leading to rewards (or punishment/ discipline). This reflects the use of sophisticated business planning techniques in head offices facilitated by professionalizing strategic management (particularly within US multinationals) and powerful IT systems for measuring real-time performance (Edwards *et al.* 1996; Ferner *et al.* 2004; Almond & Ferner 2006). To increase shareholder value returns, managers focus on how each part of the business may contribute and set targets for unit managers that reduce costs and improve performance. This makes visible different performance levels across activities and sites (in terms of productivity, manpower reduction, employment costs, down-times, speed of set-ups, stocks, and so on).

US and UK multinationals use this process for two purposes. One purpose is to identify best practice and to de-contextualize it in order to transfer it as a set of techniques and processes to other locations where larger economies of scale can be achieved. This process has the partial effect of undermining the distinctiveness of the original location, although most research suggests that the deep social embedding of the characteristics of institutional competitiveness means that transfer is always less than perfect – more a matter of translation and adaptation rather than transfer per se (see, for example, the contributions in Ghoshal & Westney 1993; Elger & Smith 1994, 2005; Sölvell & Zander 1998). Second, this process becomes the basis of investment bargaining, where subsidiaries are pressured to give concessions, for example, on wage levels or work practices in order that they can match other sites' levels of performance. This means that MNC subsidiaries may be forced to engage in "coercive comparisons;" that is, competing against each other to survive (Mueller & Purcell 1992; Mueller 1996). Where subsidiaries fail to meet global standards, they are placed under threat of closure or divestment.

In US and UK multinationals, the speed of the process is central. Activist shareholders give senior managers a limited time to show the success of their overseas investment. Failure to meet expectations leads to falling share price and vulnerability to either management replacements (subsequent to major organizational restructuring, including divestments and sell-offs) or reshaping through the capital markets (merger or takeover).

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For this reason, MNCs from these contexts have to act quickly to achieve gains. This is likely therefore to be primarily a matter of focusing on the internal features of the subsidiary and less on the external institutional features, which take longer to change and develop. Even where such MNCs locate in an area because of its institutional competitiveness, the tendency is still to look for quick returns and not to engage in long-term commitment and development of existing institutional advantages. The central focus of accountability for managers in these multinationals is to the head office. This determines their career prospects and rewards. Positions in the management hierarchy are aspired for and depend on achieving the benchmarks set by top managers. Whether they are expatriate managers or not, managers are part of the authority structure of the entire MNC managerial hierarchy and relate quite passively to the particular social and institutional context of the site. They are willing participants in head office strategies of benchmarking, investment bargaining, and regime shopping (Mueller & Purcell 1992; Mueller 1996).

In contrast, Japanese multinationals are still controlled mainly by banks, insurance companies, and other firms within the same *keiretsu*. Although there are some indications of change in this model (Yamamura & Streeck 2003), Japanese managers of MNCs retain high levels of autonomy to develop their own internationalizing strategy without being subject to intense scrutiny by outside shareholders (Beechler & Bird 1999; Morgan *et al.* 2002; Whitley *et al.* 2003). They can invest in ways that need not benefit shareholders for some years. They therefore tend to take a more longer-term view of internationalization, based on what they need to have in place in a local context to make their business model work. Japanese multinationals prefer to start from scratch in locations that offer some basic requirements – an educated workforce, a supportive regulatory and investment environment, and facilities for encouraging interfirm supply chain collaborations. They can then seek to control access and entry to their production systems in ways that suit their model of organization. As a result, Japanese multinationals are likely to develop large greenfield sites that take big capital injections and take a long time to pay back the investment. In contrast, when engaging in brownfield investments, they find it more difficult to overcome local resistance (Sharpe 2001; Elger & Smith 2005).

German multinationals illustrate a position between the US and the UK firms and the Japanese firms. In recent decades, a combination of political and economic pressures has led the largest firms in Germany to grow internationally through mergers and acquisitions (M&A) (Wortmann 2000, 2001), to ensure that they are not outperformed by much larger US- or UK-based multinationals. Unlike Japanese firms, most German multinationals are growing through the purchase of brownfield investments. In contrast to US and UK multinationals, German companies engage in longer-term transformation processes of the subsidiaries that they purchase. In order to build the sorts of transnationals that are now common in the UK and US, German companies have had to enter international financial markets (Lane 2001, 2005; also Geppert *et al.* 2002, 2003a,b). They have had to get international investors on their side through foreign listings and new forms of transparency and decision-making to gain access to the funds enabling them to make large M&A activities in the US and UK. In this respect, it is clear that German firms are no longer able to undertake long-term investment with quite such impunity from outside scrutiny as was previously the case (see the contributions in Yamamura & Streeck 2003; Morgan *et al.* 2005). Nevertheless, German managers remain sensitive to the need to build their international operations for achieving long-term change and

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improvement. Studies of German MNCs show that budgets, targets, and benchmarks are rather used for negotiating improved performance in local sites than as disciplinary mechanisms in investment bargaining (Ferner 1997, 2000; Ferner & Quintanilla 1998; Ferner & Varul 2000). The continued presence of some "patient capital" facilitates this process by providing barriers against frequent and short-term reconfigurations and encourages the long-term focus of senior managers, identifying strongly with the firm.

The institutional contexts of subsidiaries

If multinationals take different strategies toward their investments, it is equally the case that the actors in specific locations take different strategies toward the investment that is being made. In this section, therefore, we focus on these local institutional contexts, their dynamics, and their developments.

An important entry point to this discussion is provided by recent arguments concerning the way in which institutions fit together in particular contexts and what this means for actors. Some institutional contexts generate complementarities that benefit actors by reducing transaction costs and providing rules of the game (Amable 2003) that may make coordination possible. For example, contexts with highly developed skills and training institutions are supported by firms that pursue innovation and therefore need employees who can develop new ideas and take on new roles. This is also supported by the existence of technology transfer mechanisms that enable the sharing of knowledge and expertise in a local area, which in turn is facilitated by regular and stable contractual relationships between suppliers and customers. Financial institutions that support these developments through longer-term stable investment and through protection against takeovers further sustain such systems, which embed firms more deeply in the local institutional setting by reducing search and transaction costs. Institutional competitiveness derives from the interaction of these actors and structures in ways that facilitate renewal and change. These settings have a logic of their own that has developed in particular circumstances and it is a logic in which the actors have sunk costs. They are resistant to possible changes that may undermine the logic and look for ways to adapt to changes (and incomers) in ways that reinforce rather than damage their sunk assets. For this reason, such contexts are likely to be wary about incomers. While acknowledging that there are positive gains from the presence of MNCs (such as using the MNC as a pipeline to access both internal markets and more global external markets), insiders are likely to be concerned to maintain their local networks and not get too dependent on or drawn into the networks of the MNC.

Opposite to this are weakly coordinated systems, where actors are not strongly tied to each other or constrained into particular ways of doing things. Such settings may consist of a variety of labor market training systems that allow firms relative flexibility in the types of labor that they use and the strategies that they pursue. Such systems are likely to facilitate quick recombination of assets, since interlocking institutions and powerful actors do not exist in this case. In terms of institutional competitiveness, such settings do not have strong reflexive capacities in which consensual programs of renewal can be developed and established. However, they are relatively open, thus allowing newcomers to engage with the institutions in new ways. There is flexibility in such systems, which does not exist in strongly coordinated systems, but it requires investment in building the basis for new forms of cooperation (Crouch 2005). The tendency for such systems is that

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they are likely to remain fragmented and ineffective in supporting organizations to develop in the local context, but they can be reshaped by strong actors. This offers the interesting possibility that local institutional competitiveness can be built by outside actors in contexts where local actors have not been able to establish a unifying logic of action. The potential weakness of such contexts is that subsidiaries become highly dependent for their position in the global strategy of the MNC and therefore have little capacity for independent action if the MNC decides to withdraw from the locality.

Drawing these threads together, we are able to identify four principal types of interaction between MNC strategies and local institutional competitiveness (Table 1). This is illustrated with examples in the next section.

Institutional competitiveness and multinationals

In this section, we discuss how institutional competitiveness in different sorts of setting is affected by different types of multinational. We draw on several empirical examples from our research and others' to illustrate these interactions and provide potential areas for further research. We begin by examining those settings where MNCs with long-term orientations invest and follow this with an analysis of MNCs with short-term orientations.

Type 1: Institutional negotiation

This type is characterized first by strong local institutions and second by MNCs that are long term in their orientation. This leads to what can be labeled institutional negotiation. The first point to note is that settings with strong institutional systems (e.g. Germany, Japan, Finland, the Italian industrial districts) are hard for MNCs from other contexts to enter. They are often described as "insider" systems, which means that internal networks are strong and difficult for outsiders to penetrate. It is also clear that in many cases, MNCs are unable to get a foothold through traditional M&A activities because ownership is limited to a few blockholders (in Germany), controlled by interlocking share ownership (in Japan), or family based (in Italy). As a result, access to a locality through brownfield investment has to be negotiated with owners and cannot easily be forced, whereas greenfield investment is difficult to achieve because of the tight networks of governments and firms in these systems. Generally, therefore, we anticipate few examples of this particular type. In the main, these contexts are more likely to be net exporters of capital than vice versa and their system of institutional competitiveness continues to be reproduced.

However, markets do change and localities cannot assume that their system will survive because of the knowledge and expertise located in these contexts. Thus, the entry of an overseas MNC into the area has the positive aspect that it offers new global markets and potential new investments for the locality, which can help in an upgrading of existing skills and technologies. Further in comparison to MNCs with shorter-term horizons, the MNCs of concern here do have time to develop and build up inside these contexts. Where this does happen, however, we can expect a complex period of negotiation, as bridging two strong institutional systems is likely to be very complicated. An interesting example of this appears in the Geppert *et al.* (2002) discussion of how a Finnish multinational dealt with its German subsidiary. The Finnish company had bought into Germany because it wanted to access the high skills and technological prowess of the

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Table 1 Types of interaction between MNC strategies and local institutional contexts and impacts on institutional competitiveness

	Long-term orientation of MNC strategy: patient, developmental approach to subsidiaries (e.g. Japan, Germany)	Short-term orientation of MNC strategy: frequent interventionist approach to subsidiaries (US, UK)
Context of subsidiary characterized by strong and coordinated local institutions	**Type 1: Institutional negotiation** Where long-term MNCs meet strong local institutional contexts, there is likely to be a prolonged period of negotiation characterized by the use of power	**Type 3: Institutional conflict** MNC attracted by institutional competitiveness of locality but unable to embed in local context. Actors in local contexts likely to fight back to defend their distinctiveness
Context of subsidiary characterized by fragmented and weak local institutions	**Type 2: Institutional development** MNC will establish subsidiaries mainly for market access purposes and then will try to rebuild some local institutions to support its business model; for example, increase skill levels, and improve interfirm cooperation on innovation	**Type 4 Institutional decline** Location decision will be based on cost considerations: unlikely to have an interest in institutional conditions. Because it is short term and likely to pull out at short notice, makes it difficult for other firms to develop institutional competitiveness

German system but they found that their efforts to introduce new systems that linked the different parts of their MNC more strongly were resisted by local managers. Geppert *et al.* state that "German managers were quite skilful in playing on their specific, nationally influenced power resources … national strengths are explicitly not "standardized" or "harmonised" out of existence but there is a struggle to integrate them into the global strategy of convergence of management systems … The case … reveals the recourse to the use of power to achieve this transition in a strong institutional and cultural context such as the German one" (Geppert *et al.* 2002, p. 55).

In conclusion, such contexts tend to be already high on institutional competitiveness. Part of this is strong interlinking between institutions and insiders to the system. This makes it difficult for outsiders to enter. Where they do enter, they face strong resistance to change. For MNCs with long-term horizons, the aim of capturing the advantages of the locality provides the rationale for long-term investment. Through a combination of negotiation and the power that the MNC has, it is possible to achieve this. This process is unlikely to threaten the existing system of institutional competitiveness and may even

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reinforce it by providing strong global markets to the subsidiary. In terms of future research, it is clear that more detailed examination of these sorts of contexts is needed.

Type 2: Institutional change and development

These types of setting have weakly integrated patterns of complementarity and reinforcement between different institutions, which may be studied from a positive and a negative perspective. Positively, they are settings where actors (individuals and firms) are used to developing their own strategies, selectively using and developing particular aspects of institutions. They are therefore potentially open for change and development. Negatively, however, because institutions are weak and weakly coordinated, there is generally opportunism and short-termism in product and labor markets, usually reinforced by financial markets, which are short term in orientation. Institutions that coordinate individuals and firms (such as trade unions and industry associations) into collective action are weak, meaning that forms of action and intervention can occur in many different places with relatively little warning. Such settings are weak on distinct forms of institutional competitiveness but strong on flexibility. They can attract MNCs partly for this reason as well as for more traditional reasons such as market access.

One of the most interesting examples of MNCs with long-term orientations entering these sorts of institutional contexts is the massive Japanese investment in the UK over the last 20 years. Two themes arise from this literature (Oliver & Wilkinson 1992; Morgan *et al.* 2002; Whitley *et al.* 2003). The first theme is flexibility. A range of studies examining Japanese MNCs in the UK engaged in the production of electronic consumer products has shown that subsidiaries (both greenfield and brownfield) were established mainly to get behind potential European Union (EU) tariff barriers. Investment in these sites was relatively low, and often encouraged by government grants. Although there were attempts at developing new patterns of work, including the use of Japanese models of just-in-time production (*kanban*) and continuous quality improvement (*kaizen*), the main focus was on relatively low-cost assembly. Not surprisingly, as the EU expanded, some of these investments have been moved into Eastern and Central Europe. Others have gone to China. Although the Japanese were relatively long term in their approach here, they were not deeply embedded in the localities and made few efforts to have a significant influence on skill levels and supply chains.

By comparison, Japanese investments in the UK around car manufacturing were huge in greenfield sites for Nissan in the North East, Toyota in the East Midlands and Honda in Swindon. These have been very long-term investments for the companies. Set-up costs have been high and returns have only grown after some considerable time in the UK. Given the nature of Japanese companies, it is not possible to identify levels of profitability, but they seem to have been relatively low, partly because of the failure of the UK to join the Euro, the continued intense competition in the car industry, and the low utilization of capacity.

A significant cost factor has been the transfer of Japanese managerial practices as they have had to change the skills of labor and the capacities of local supply chains. These factories established a much stronger focus on *kanban* and *kaizen* than did the electronic investments. In turn, this required a focus on training and development of employees in the local context. As a result, there has been some engagement with local technical colleges and local authorities to develop courses for employees. Characteristically, Japanese firms prefer to train internally and this has also happened. The result has been

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an upgrading of skills in local areas at operative, supervisory, and management levels. Given the fragmented nature of the institutional system, the spillover effects for the broader locality are not clear. Nevertheless, it can be argued that a small but significant part of the UK manufacturing workforce has seen its skills upgraded by the presence of Japanese MNCs.

Because of rules on local supply, Japanese firms had to engage with UK suppliers and therefore triggered change in supply chains. Overall, UK car part suppliers had very low levels of quality before the Japanese arrived. Japanese firms, therefore, engaged in transferring techniques and skills to suppliers to increase standards. This required intensive and long-term cooperation between the supplier and the customer with knowledge and skills being transferred across organizational boundaries to achieve performance improvements. These efforts were supported by government and some academic engineering schools. The result has been that the institutional competitiveness of the UK in this area has been significantly improved by the entry of the Japanese car manufacturing companies.

In conclusion, MNCs with long-term orientations appear to engage in institution building in those contexts where existing institutions are fragmentary and weak. By exercising their strong power over such settings, they do renew and develop some local institutional capacity in terms of skills and supply chains. What is less clear, however, and should be the subject of further research, is a detailed understanding of the spillover effects. For example, have those suppliers who were helped to upgrade by Japanese MNCs gone on to build other collaborative networks with other firms? And have the employees that were trained in Japanese practices set out to create novel forms of working career, and have they reshaped labor markets from what they were in the past?

Type 3: Institutional conflict

The final two types are based on the presence of MNCs with short-term orientations. Type 3 considers these MNCs and their subsidiaries in strong institutional contexts. In such contexts, subsidiaries have the potential to integrate various interest groups into a joint strategy based on the reinforcement of the local context. This in turn depends on institutions that enable negotiations (voice) and procedures for decision-making that guarantee mutual loyalty. Corporatist bodies at central, local, and firm (e.g. work councils, employee representatives on boards) level, roles of shop stewards, and the ability of employees and employers dynamically to form partnerships gain new importance. At a deeper level, "careers at work" play a decisive role. Is the subsidiary and the local labor market (as opposed to the internal labor market of the MNC as a whole) seen by all as a space for organizing social mobility and as supportive for a desired life course? Are the potential conflicts of interest within the subsidiary narrated in a way that enables local managers and employee representatives to construct a shared community of fate, engaged with, but ultimately independent of, the position in the MNC?

Research by Kristensen and Zeitlin (2005) into a UK-headquartered MNC shows how local subsidiaries in places with strong institutional linkages respond to these processes. They show how the Danish subsidiary consisted of a strong community of interest based on shared understandings of the role of skill and expertise. In the subsidiary, managers as well as employee representatives saw their future in terms of sustaining the local basis of the high quality production system that had been the characteristic of the firm before it was bought by the MNC. This required that they met the short-term

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goals of the MNC. However, because the MNC head office had little understanding of the production process or the capabilities of the high skill Danish subsidiary, these were easily achievable by the subsidiary. As a result, the Danish subsidiary became seen as a star within the MNC as a whole and managers from there were transferred to other contexts to improve productivity along Danish lines. This position it gained by dramatically mobilizing institutions locally and nationally so that they could support high innovative performance and extraordinary skill improvements in its factory, while it could draw in very flexible ways on the capabilities of suppliers. Conversely, its linkages to the MNC were turned into an important mechanism for helping the local community of employees and suppliers learn how to play by the most recent rules of the competitive games in international business.

The subsidiary was able to become a major player within the MNC through three forms of collaboration. First, it defended its particular mandate by complying with profitability targets and benchmarks that were relatively easy to achieve given the collective high skill nature of the workforce. Second, it was able to build up capabilities that were useful to many parties within the MNC. In this way, it gained strong coalition partners in many other MNC units, which supported it in headquarter negotiations. Third, it extended collaborative institutions and traditions to other subsidiaries or headquarters, so as to initiate processes of negotiation and procedural justice in ways that transform the existing governance form.

Paradoxically, therefore, the effect of being owned by an MNC with a short-term orientation was that the subsidiary had to think and act long term. It became more embedded in the local area as part of a local innovative system as it depended on this for its capabilities. Indeed, the more the subsidiary interacted in swift and easy ways with its local environment and found new ways to develop existing and new institutions, the better it helped improve the institutional competitiveness of the locality. Cultivating such abilities in localities calls for network or experimental governance, so that institutions and organization can swiftly recombine, across boundaries, resources in novel ways to create situational complementarities. In such cases, subsidiaries become important nodes to connect a locality to global impulses, challenges, and tendencies, and for this the maintenance of their position inside the MNC is crucial. At the very least, therefore, such subsidiaries reinforce the pulsating politics of institutional competitiveness, driving actors toward new forms of upgrading, innovation, and challenge as they struggle to survive in the highly competitive and uncertain setting of MNCs with short-term orientations.

Type 4: Institutional decline

The final type emerges in settings where institutions are weak and fragmentary and MNCs are short term in orientation. Again, Kristensen and Zeitlin (2005, ch. 4) provide an interesting example in their discussion of the US subsidiary of their UK domiciled case study company, APV. This subsidiary in the US Mid-west had a long history as an independent site and later a relatively autonomous subsidiary within the MNC. However, as the MNC became more short-term oriented in the stock market boom of the 1980s, head office managers began to impose frequent restructurings on the subsidiary, primarily to cut costs and thus improve profitability forecasts and delivery to the financial markets. Redundancy and lay-off was a significant means of cutting costs, even though in the process, skills and knowledge that had played an important part in

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sustaining the competitiveness of the plant were lost. In an effort to overcome these problems, the local trade union sought to devise ways of reorganizing the work. However, as senior managers restructured the firm into new divisions, the local site became more and more defensive. It lacked allies or support in the broader MNC network and had always resisted being dependent on wider institutional support from the wider business community outside a small hometown. As the authors state "membership in APV had increased volatility, cut the plant off from its historic learning path and restricted its range of operations" (Kristensen & Zeitlin 2005, p. 123). The study also describes a similar, more drastic evolution from a relatively successful and innovative plant to a site, which was starved of investment, and eventually closed in the case of a UK subsidiary.

A major pressure here arises from the restructurings, which MNCs from contexts with active capital markets undergo on a regular basis through M&A, divestment, downsizing, and delayering. These trends are frequently driven by head offices, which have to meet fairly simple, numerical expectations about performance developed by analysts, investors, and financial commentators. A key way to respond to these pressures is to ensure that the MNC has flexibility – to shift production to cheaper areas, to reshape its capital structure, to reorganize its sites and activities, and to bring in new managers. The growth of outsourcing to China and India has added a new power to this process, not just in terms of simple manufacturing but also in areas of services and software, some advanced manufacturing, and to an extent R&D departments. Outsourcing overseas and to independent companies is a relatively simple way for these firms to escape from long-term commitments to short-term contractual relations. Where local institutions provide few advantages because they are weak and poorly developed, these processes are likely to be most significant, thus further reinforcing frequent turnover of ownership, downsizing, and closure of sites.

Conclusions

This paper began by arguing that MNCs contribute to institutional competitiveness in a variety of ways. In the first section of the paper, we identified a particular category of MNCs that are likely to have this impact. These MNCs fit broadly into what Bartlett and Ghoshal termed "transnational firms;" that is, they aimed to build economies of scale, scope, and learning from their presence in multiple institutional settings. These firms are usually engaged in complex manufacturing, which requires the organization of production models, the development of global supply chains, and the construction of innovative manufacturing capabilities. This distinguishes them from simple franchise and brand type multinationals as well as multinationals that are essentially federations of national firms.

We further argued that it was possible to distinguish in very broad terms two distinctive models of transnational. One set was defined primarily by the requirement to meet short-term demands from shareholders and capital markets. This is reflected in the approaches that they take toward establishing subsidiaries, monitoring their performance, and taking decisions on expansion or closure. Such multinationals are characterized by a short-term orientation and this reflects the reality of their situation where merger and acquisition activities and restructuring are common features. These MNCs are characterized by high levels of flexibility in terms of people, tasks, organization

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structures, and markets. The second set of multinationals is characterized more by a long-term orientation to investment, reflecting a different set of institutional arrangements concerning shareholders, managers, and other stakeholders. Decisions have to be negotiated and consensual and therefore are long term in nature. Decisions to invest overseas are taken as long-term commitments that cannot be jeopardized by short-term considerations.

We also argued that investment sites could be distinguished in terms of the degree to which the institutions and the actors in the local context were integrated and complementary. Strong institutional complementarities create contexts that are generally resistant to MNC investment because of their insider nature. However, the growth of global market competition may threaten these localities and therefore the presence of MNCs to provide a channel of access both to the internal market of the MNC and to its external market is a positive asset so such settings can be opened up for outside MNC investment. In contrast to these settings are contexts in which institutional complementarities are weak and poorly developed. They lack any obvious characteristics of institutional competitiveness. However, the other side of this is that such settings are relatively open and actors can seek to develop their own complementarities between institutions to enhance flexibility and performance.

Drawing on these distinctions, we developed a typology of four contexts with variable impacts on institutional competitiveness. In all of them, we identified dynamics of change and tension, which lead us to believe that while there is a path dependency trajectory at work here, there is also an openness that enables strategic actors to restructure, change, and develop institutional competitiveness. In this respect, we are most pessimistic concerning the impact of MNCs with short-term perspectives on weakly integrated institutional settings. This interaction seems only to deepen the downward spiral of such settings. The MNCs' presence is fragile, dependent on uncertain conditions, and not built on deep foundations. Further, by virtue of the way this sort of MNC links its subsidiaries into its wider system, it may actually destroy any existing distinctiveness, weakening the likely survival of the subsidiary even further. In all of the other types we find specific interactions that have potential impacts on institutional competitiveness, which we have labeled institutional negotiation, institutional development, and institutional conflict.

Arising from our approach, there are many potential research issues to be considered. Clearly, one central issue is the relative survival rates of the different types of MNC that we described. Is the long-term oriented MNC on its way out? Although there are many discussions about how Germany is changing in response to globalization and free flows of capital, we do not feel there is any definite evidence that German MNCs are becoming less long term in their orientation. Perhaps examples such as BMW-Rover and Daimler-Chrysler indicate that there is a limit to how long German companies can invest in local overseas without worrying about short-term value for shareholders. However, the length of time that these efforts were sustained is still far in excess of what could be imagined in UK or US MNCs. Nevertheless, there is clearly important empirical work to be done in understanding the development and evolution of German MNCs over the past decade and the effect that this is having on their subsidiaries and the institutional contexts of subsidiaries. If we turned the focus onto Japanese MNCs in complex manufacturing industries, we would find even less likelihood of them abandoning their investment. We also know too little about how MNCs with short-term orientations influence strong institutional settings. We can predict that such settings will be full of conflict, strategizing,

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and game playing between groups with different resources and powers, but we need to understand more about the impact in the local context, MNC strategy, and other parts of the MNC.

A further general point that we would make is that although MNCs are very significant in the world economy, they do depend on resources in local contexts. This means that subsidiaries are not helpless. Rather, the issue concerns the resources available to the subsidiaries and how these can be strategically engaged and operationalized within the MNC. There is an important element of active strategizing that goes on here. We do not want to be read as implying that localities are locked into a certain type of interaction that they cannot escape, be that positive or negative. Ultimately, it is how actors strategize to build institutions that is important, and in this process, as other papers in this special issue of *Regulation & Governance* show, political and social movements can make a huge difference.

Thus, societies cannot afford to keep out MNCs for fear of how they might undermine existing institutions, social solidarity, and economic performance. Indeed, societies that fail to attract MNCs are among the poorest in the world, so the point in terms of institutional competitiveness is how to make the opportunities offered by the MNC work to the advantage of the locality, not just the firm. This calls for novel, swift, and situational political processes in localities so that they can match the frequent restructurings going on in MNCs. How such political processes can be organized is under-researched, but if institutional competitiveness is to be dynamically sustained, it is of central importance. MNCs will play a central role when local actors try to sustain and develop institutional competitiveness. It is important therefore that they are placed centrally in this debate along with other actors such as states, labor unions, employers associations, and other stakeholders.

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