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# MNE linkages in international business: A framework for analysis

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ABSTRACT

Empirical research demonstrates backward, forward and collaborative linkages between foreign subsidiaries and firms in host economies can have a major impact on the success of the development of these firms' capabilities and resources. However, there is insufficient conceptualisation of this phenomenon in the international business literature, which has either presented a list of determinants of the occurrence of inter-firm linkages without identifying underlying constructs, focused on aggregate impacts of specific types of linkages or explored individual firm case histories. Such approaches inhibit our understanding of linkages at the firm-level generally and how they impact both local and foreign participants, in particular. Drawing on insights from other disciplines, a framework for analysis and future research is developed in this paper. This framework identifies three underlying constructs that determine the efficacy of linkages. It is argued that potential for firm capability and resource development via foreign–local interaction depends on the scope, quantity and quality of linkages formed. This approach reinforces the notion that particular dimensions of linkages, such as type, depth or duration, cannot be considered in isolation. Further, the paper argues that the relative emphasis on linkage scope, quantity and quality will involve trade-offs between them and maintaining equilibrium between global and local considerations.



## 1. Introduction

MNEs create linkages when they are directly involved in relationships with other firms in the host economy (via transactions or alliance-based relationships within or across industries) and consequently influence the output, capability development and productivity of partner firms (Forsgren, Holm, & Johanson, 2005). Linkages, therefore, embody inter-firm transactions, interactions and on-going relationships (UNCTAD, 2006). Their importance, and thus interest from researchers, has grown as global firms increasingly pursue opportunities for specialisation through knowledge development and outsourcing, and as countries reconfigure their institutions and policies to encourage linkages between MNEs and local business partners (Battat, Frank, & Shen, 1996; UNCTAD, 2001, 2006).

Recognition that the intensity of linkages determines the extent of knowledge and technology spillovers to local firms (Driffield, Munday, & Roberts, 2002) has prompted calls by researchers to better assess the developmental potential of linkages (Turok, 1993). In 1980, Lall described inter-firm relationships a 'murky area' in the industrial economics literature (Lall, 1980: p. 203). Twenty-five years later, a statement by Meyer that 'future research ought to prioritise the study of ... individual interactions of a multinational firm and a local agent or firm' (Meyer, 2004: p. 264), suggests this 'murky' impasse remains unresolved by international business (IB) researchers. Because the body of literature on MNE linkages is relatively

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new and to-date has focused on developing economies (Moran, Graham, & Blomström, 2005; Santangelo, 2009), international business researchers lack a consistent theoretical foundation that would not only facilitate empirical research but also enhance comparability across studies. This paper's first aim and contribution, therefore, is to clarify and integrate concepts developed to-date with regard to linkages with the view of moving forward with research on linkages in the international business field.

Close examination of the work on FDI and host country development reveals emphasis on the subsidiaries themselves, the industries they operate in and national economies. Yet, there seems little by way of elucidation of the attributes of linkages that determine the extent of impact on local firms or agents (see the special issue in International Business Review, 1994). This gap can be attributed to the relatively recent emergence of the body of literature in IB on linkages at a firm-level. Work in this vein is useful but typically focused on manufacturing industries in developing economies where the technology gap between MNEs and local firms tends to be wide, and linkages with suppliers predominate. This scenario not only limits the scope of possible linkages that could be examined but also their developmental potential.

Authors suggest that the developmental impacts of MNEs must be a more central concern in the mainstream of IB research (Ghauri & Buckley, 2006). While the literature on spillovers suggest a passive stance on the part of MNEs, IB scholars emphasize the deliberate attempt of MNEs at developing local capabilities (Ghauri & Yamin, 2009); and there is a need to not only consider the means through which MNEs benefit the host economy, but also combine the potential for learning gained from local business interactions in host countries (Yamin, 2005). For this reason, scholars need to adopt a model that emphasizes the benefits to be drawn from linkages creation for foreign subsidiaries as well as for local firms. This paper's second aim and contribution is to balance the emphasis on these dual impacts on (host country) development and organisational learning by the foreign subsidiary.

The final impetus for this paper was the authors' search for a useable and comprehensive model of inter-firm linkages between foreign-owned multinational enterprises (MNEs) and locally based firms in host economies. Indeed, IB scholars have refined their definition of linkages to focus on inter-firm relationships (Hansen, Pedersen, & Petersen, 2009). Following this definition, we integrate concepts drawn from MNE theories and the existing linkages literature from multiple areas. Inter-disciplinary insights help to refine the definition of linkages and to unravel the complexity of linkage intensity, which lead us to develop a comprehensive foreign–local linkages analytical framework. The paper's final contribution is thus developing three linkage constructs that can be employed in future empirical research.

The starting point of the paper is to discuss the distinction between linkages and spillovers and refine the definition of inter-firm linkages (and specifically those formed between foreign and local firms) as a developmental mechanism. Then, a review of existing IB research in this area draws out contributions as well as limitations. Shifting the focus to other disciplines suggests there are a number of key insights on the impact of linkages on firm capabilities and resources for international business researchers worth considering for future research. The remainder of the paper integrates these ideas into a framework that can be used to analyse inter-firm linkage attributes at the firm-level.

## 2. MNE linkages

### *2.1. MNEs in host countries: spillovers vs. linkages*

FDI spillovers refer to externalities arising from the presence of MNEs (Blomström & Kokko, 1998: p. 5), and their existence provides a theoretical basis for FDI-assisted development of indigenous firms (Hoekman & Smarzynska Javorcik, 2006; Kugler, 2006). The assumption behind spillover creation lies in the belief that the MNE possesses superior firm-specific assets (Dunning & Lundan, 2008), which are transferrable at no cost due to the public good nature of technology (Girma, Görg, & Piso, 2008). Externalities arise from both direct and indirect mechanisms (Scott-Kennel & Enderwick, 2005). Indirect spillovers result from demonstration effects, labour turnover and enhanced competition, and thereby affect the behaviour (Moran, 2001; Saggi, 2002) and performance of the domestic firms (Castellani & Zanfei, 2006: p. 142). Direct spillovers are created as a result of direct relationships between MNEs and local firms, notably through vertical linkages, training of local employees and technical assistance (Blomström, Kokko, & Zejan, 2000). Direct spillovers induce improvement in quality and efficiency of local firms, such as in the case of suppliers, by creating demands to attain economies of scale and providing access to advanced resources (Saliola & Zanfei, 2009: p. 371).

Direct spillovers therefore occur through linkages MNEs establish with local actors, and although great attention has been devoted to spillover effects in host economies, the focus on linkages through which such effects may take place has been investigated mainly in the last decade, and primarily with reference to backward linkages (Santangelo, 2009: p. 194). Researchers who explicitly analyse the relationship between linkages and spillovers have highlighted the need to treat both concepts separately, particularly in empirical studies (Blomström et al., 2000; Javorcik, 2004); this is because most spillover studies are unable to disentangle direct and indirect effects at an aggregate level, and therefore capture both (Günther, 2005). Beyond spillovers, which imply a passive stance on the part of MNEs, IB scholars increasingly call for a reinvention of MNE strategies with a more deliberate attempt at developing local capabilities (Ghauri & Yamin, 2009: p. 105). Hence, the focus on linkages rather than spillovers, *per se*, is long overdue.

A broad definition of linkages includes transactions between foreign subsidiaries and local businesses as well as non-business entities like universities, training centres, research and technology institutes, export promotion agencies and other official or private institutions (Altenburg, 2000). Terminology differs considerably between studies, but linkages can be