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The global recession and the shift to re-shoring: Myth or reality?

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ABSTRACT

Despite the high degree of attention that re-shoring has recently attracted in the media, we lack detailed understanding of the drivers of such an important strategic change by a multinational enterprise (MNE). We offer the first large-scale analysis of the factors that influence a firm's decision to re-shore. Our analysis is based on 3683 MNEs from 14 developed countries investing in 66 host countries over the period 2006–2013. Our results suggest that increased re-shoring was triggered by the downturn in the West resulting from the recent global financial crisis. However, our results show that the effect of the global financial crisis on re-shoring is smaller when the distance between parent and subsidiaries becomes larger. In turn, as distance increases, the importance of relative costs declines in explaining re-shoring activity. Finally, MNEs who have engaged in re-shoring in the past are more likely to re-shore again.

1. Introduction

Recent political events surrounding the election of US president Donald Trump and the UK “Brexit” vote have created much uncertainty and speculation by the media surrounding the increasing rise of populist and anti-globalisation rhetoric by politicians throughout the West. Similarly, academic discourse from politics, sociology to economics and international business (IB) is concerned with whether we are witnessing the demise (or at least a decline) in globalisation. Among the supporting evidence invoked by politicians and media commentators with respect to IB trends is the issue of “bringing jobs back home”, also known as “re-shoring” in the academic literature. As the Financial Times[1] notes, the political mantra of President Trump appears to have boosted re-shoring activity in the US, with firms recognising the political expediency of this, as well as the potential threat of tariffs on goods imported into the US by American multinational enterprises (MNEs). However, while such moves have made the headlines, our understanding of the re-shoring phenomenon is still in many ways underdeveloped.

A related issue to re-shoring is the management of MNE global supply chains which has come under scrutiny from the perspective of corporate social responsibility (CSR). Walker, Seuring, Sarkis, and Klassen (2014) discusses in detail the pressure on firms to avoid locations with little labour protection, wages below subsistence level and little regard for health and safety. These pressures have intensified with public campaigns, such as Oxfam's “Behind the Brands”. In the IB literature, these issues have also been explored by Luo (2006), Rodriguez, Siegel, Hillman, and Eden (2006), Husted and Allen (2006) and Strike, Gao, and Bansal (2006). For example, Luo (2006) bases his analysis on political conduct of the firm generating a more socially desirable outcome. One could therefore argue that political expediency, along with the desire for firms to align themselves with a new sense of nationalism could potentially be important drivers of re-shoring.

The recent focus on re-shoring comes on the back of at least three decades of offshoring activities by MNEs. Offshoring has been well-documented empirically and explored from the perspective of the dominant paradigms and theories of the IB literature (see review by Doh, 2005). The main premise of offshoring is to be found in the determinants of the boundaries of the firm (Pereira & Malik, 2015). Indeed, offshoring is at the heart of much of the global value chain analysis in the IB literature and more recently in the international economics literature (Baldwin, 2016). This work tries to explain the location decision, in terms of how a firm divides up its value chain, which in turn is linked to financial performance (Mudambi, 2007). Another strand of the literature explores how value chains can be employed in the context of economic development (see e.g. Taglioni & Winkler, 2016).

However, more recently the analysis in this tradition has recognised that offshoring is no longer a uni-directional phenomenon, such that firms are also exploring the scope for reversing the process of

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[1] Re-shoring and FDI boost US manufacturing jobs, Financial Times 29th March 2017.

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offshoring. We, therefore, seek to analyse empirically the determinants of "re-shoring" within the dominant theoretical traditions applied to offshoring. Hitherto, most of the comments on this phenomenon has been confined to the more popular media and political commentators focussing on specific cases. For example, when the UK motorsports firm McLaren recently announced it was repatriating its supply chain due to Brexit, this was interpreted as simply a cost based response to the devaluation of sterling. However, in the current economic and political climate, there is an increasing desire for politicians to engage with popularising the repatriation of MNE supply chains for domestic economic and political objectives. This was no different with the McLaren case, where politicians seized upon this opportunity to highlight the superior location advantages of the UK coupled with the supposed national sentiment of UK MNEs. Such examples highlight the need to understand these motives for reshoring, based on evidence rather than comments in the popular press in order to identify causality.

Therefore, as some MNEs decide to bring back activities that were once established as efficiency seeking foreign direct investment (FDI), we know little about the drivers of this process, and even less about how prevalent it is. In the post-crisis world, this is seen as an important "rebalancing" of developed economies, creating employment for less skilled workers, particularly in depressed regions of a developed country. In this context, this paper aims to contribute to two of the special issue areas highlighted, namely what factors influence a firm's decision to re-shore and when do relationships with subsidiaries become less valuable and more risky to maintain.

1.1. Existing evidence

The issue of re-shoring has received only limited discussion within the academic literature, with supply chain management taking the lead (see e.g. Casson, 2013; Ellram, Tate, & Petersen, 2013; Gray, Skowronski, Esenduran, & Johnny Rungtusanatham, 2013). Bailey and De Propris (2014) present a policy framework, building on earlier survey based analysis (Bailey & De Propris, 2013). They argue that one needs to view re-shoring as an extension of the earlier analysis of offshoring and within the wider literature concerned with production dynamics and the international division of labour (Pereira & Budhwar, 2015). Small scale survey data for the UK reports that the decision to re-shore is taken by 1 out of 6 manufacturing MNEs (EEF, 2014) and this trend is estimated to account for 0.4 to 0.8 of annual gross domestic product (PwC, 2014). Indeed, this phenomenon has also been linked to a general slowdown in world trade (Financial Times 25th August 2015). Estimates for the US are more modest; around 700 cases are identified since 2010 by A.T. Kearney (2014) ranging across several sectors of varying strategic importance. For example, high tech industries such as electric equipment manufacturing; transportation equipment; computer and electronic component manufacturing make up 10–15% of the cases. Interestingly, industries such as apparel and textile manufacturing also make up around 12% of the cases, suggesting that low tech activity is also being re-shored.

Albertoni, Elia, Massini, and Piscitello (2017) explore this phenomenon in the context of business services, highlighting the extent to which skill shortages in the west may hinder this. The general strategic decision to re-shore depends on the type of product, service or component that is under consideration, ranging from relatively low cost products and services to high value-added items. Equally, one must consider re-shoring as a response to where the apparent benefits of outsourcing/offshoring have been previously over stated, or that the hidden costs of offshoring, particularly in terms of complexity of organization and the importance of experience in mitigating these costs (Larsen, Manning, & Pedersen, 2013) have been understated. Explanations based on casual empiricism seem to suggest that the potential cost advantages from offshoring have not been delivered, hence leading to more re-shoring (Monarch, Park, & Sivadasan, 2013). This presents an interesting dilemma for IB theory which assumes that the process of globalisation is, if not monotonically increasing, nevertheless uni-directional.

1.2. Our contribution

With the exception of some isolated case studies, mainly for the US and the UK (c.f. The re-shoring Initiative, 2016), there is limited evidence regarding the scale of this activity, and equally important few cross country comparisons at the firm level. Re-shoring may be triggered by changes in host country characteristics, which after initial MNE entry have become less attractive to the point that continuing operation in the host country is not an option. Moreover, we do not know whether certain types of firms and subsidiaries are more likely to be re-shored.

We analyse the factors that lead MNEs to decide to re-shore and explore this through a multi-level approach, incorporating both firm- and country level variables in both the host and home country. Further, we assume that the initial decision to offshore was linked to efficiency seeking FDI re-shoring. There is no formal, universally accepted definition of re-shoring, though it is widely recognised to be the practice of bringing activity that had previously been located abroad back to the home country or region. Albertoni et al. (2017) refer to reshoring to mean "the voluntary (i.e. not forced by host country governments) partial or total relocation of business initiatives previously offshored, whether to another location or back home", although the subsequently only focus on the service sector. We, however, focus on all firms across the largest European economies, all founding members of the OECD. These are a set of mature developed countries, who have all engaged in efficiency seeking FDI to various extents, both to Asia and to Central and Eastern Europe. We identify those firms who have reduced their investment in low wage countries, while simultaneously increasing similar activity at home. As we are able to identify (at the four digit industry level) both the home and foreign activity, it is reasonable to assume that where we observe these simultaneous changes, it represents a shift in emphasis away from foreign activity, and towards home activity.

We subsequently uncover the importance of distance, differences in labour market flexibility, and relative wages in order to control for other country level determinants. This is in the spirit of mirroring the well-developed literature on offshoring, which is typically based on internalisation theory and transaction cost analysis focussed on relative costs and benefits of offshoring (e.g. Doh, Bunyaratavej, & Hahn, 2009; Lewin, Massini, & Peeters, 2009). Our findings show that re-shoring is persistent, in that MNEs who have done this before are continuing to do so. Interestingly the re-shoring process has sped up during the financial crisis. We also explore the importance of relative costs, size, and distance between the host and home activities which in general has been argued to be the drivers of offshoring due to better technology improving our ability to coordinate across space and closer integration also narrowing the cultural distance between countries.

The rest of paper is structured as follows. Section 2 offers an overview of the theoretical perspectives on re-shoring and derives our hypothesis. Section 3 describes the methodology and Section 4 outlines the data set and offers descriptive statistics. Section 5 presents the results, while Section 6 presents a full set of robustness checks of the main results and Section 7 concludes and offers some future lines of research.

2. Theoretical perspectives and hypotheses

The standard approach to the issue of offshoring in IB is to apply the lens of internalisation theory. This application of internalisation theory can be explored within the setting of Rugman's (1981) CSA/FSA framework for IB, concerning the combination of firm specific factors and country specific factors that facilitate a given form of internationalisation. Offshoring is therefore a two stage process, rooted in the dominant paradigm of IB. The first stage concerns the identification of activities which may be moved abroad but retained within the firm (often efficiency seeking FDI). The second stage concerns the choice of foreign location for such activities.