УДК 339.92

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THE THEORY OF MULTINATIONAL ENTERPRISE AND CONTEMPORARY TRENDS IN INTERNATIONAL PRODUCTION

Annotation. *This paper analyses the theory of multinational enterprise (MNE) based on theevolving literature of the past four decades. It shows the basic methodological approaches and concepts of international production as well as MNE activities. The article studies the contemporary trends of international production development in post crises period.*

Key words: multinational enterprise, international production, foreign direct investment.

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ТЕОРІЯ БАГАТОНАЦІОНАЛЬНОГО ПІДПРИЄМСТВА І СУЧАСНІ ТЕНДЕНЦІЇ МІЖНАРОДНОГО ВИРОБНИЦТВА

Анотація. *Ця стаття аналізує теорію багатонаціонального підприємства (БНП) на основі еволюції досліджень останніх чотирьох десятиліть. Вона показує основні методологічні підходи та концепції аналізу міжнародного виробництва, а також діяльності БНП. У статті досліджуються сучасні тенденції розвитку міжнародного виробництва в посткризовий період.*

Ключові слова: багатонаціональне підприємство, міжнародне виробництво, прямі іноземні інвестиції.

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ТЕОРИЯ МНОГОНАЦИОНАЛЬНОГО ПРЕДПРИЯТИЯ И СОВРЕМЕННЫЕ ТЕНДЕНЦИИ МЕЖДУНАРОДНОГО ПРОИЗВОДСТВА

Аннотация. *Эта статья анализирует теорию многонационального предприятия (МНП) на основе эволюции исследований последних четырех десятилетий. Она показывает основные методологические подходы и концепции анализа международного производства, а также деятельности МНП. В статье исследуются современные тенденции развития международного производства в посткризисный период.*

Ключевые слова: многонациональное предприятие, международное производство, прямые иностранные инвестиции.

In the last decades, the theoretical issues of the multinational firms were among the most important issues of economic research. They were and remain at the center of the debates in world economic literature. Over the years, several main theoretical approaches to the analysis of MNE emerged and several schools of their modern analysis arose. Attention to this issue is reinforced by new trends in the development of international production.

The global financial crisis had a significant impact on the movement of foreign direct investments and international production by MNEs. It broke off the wave of investment boom observed since 2003, and led to significant changes in the structure and geographical areas of foreign investment. The decline in annual FDI outflows lasted almost two years and stopped only in mid-2009, and then the growth of capital export resumed. Although the international production by multinational enterprises has not decreased significantly, some changes in the strategy and directions of the investment activity of MNEs took place. Also in the post-crisis years new features of modern global companies revealed even brighter that require improvement of the international firm theory and research methodology of their external operations.

The evolution of MNE theories. Beginning with the scientific papers of S.Hymer that actually initiated the study of FDI and MNEs as a new special area of economic theory in 60-70s of the XX century, the issue of direct control or specific assets of international firms was considered in various aspects[1]. S.Hymer was among the first to draw attention to the need of distinguishing between foreign direct and portfolio investments, based on the criteria of direct control over foreign assets. Such control is required for the company, engaged in international investment, primarily to overcome the competition of other foreign enterprises and companies of the country, where the capital is exported.

R.Vernon analyzed the emergence process of international firms and their networks of enterprises through the study of new product introduction into the market and its life cycle. He tried to prove the correlation between the evolution of cross-border exchange and international production of commodities and the phases of their life [2, p.190-207]. The product life-cycle model gave a scientific credence to the hypothesis that at the mature product stage international firms carry out direct investments mainly in the industrialized countries and organize the production of commodities in its affiliates for sale on local markets. At the standardized product stage the cost-related motives lead to the search for a new location of production – with lowest possible wages. The new direct investment flows occur and the production is transferred to the developing countries with a current demand for commodities in the bargain (newly industrialized countries). Oligopolistic competition loses its force and the delocalization of production can be carried out not only in the form of direct investment, but also through the sale of license or subcontract [3, p.255].

Further empirical verification of the product life-cycle theory and study of the situation on the example of individual industries (electronic, oil industry and others) revealed a number of specific models of the strategy and features of investment by MNEs [4; 5].

Within the frame of industrial organization theories the study of internal (intrafirm) operations and transaction costs also contributed to better understanding of the nature of international corporations. M. Casson, P. Buckley and R. Caves argued for the need of analysis of the international production by MNEs through the study of the effectiveness of transactions between the separate production units most insistently [6, p.32-66; 7]. An important component of the theory is the introduction of the concept of markets internalization (exchange), resulting in a reduction of "expenditures for business" – transaction costs[8]. The study of this issue has not still lost its relevance, especially in the context of the development of international production fragmentation and intra-firm trade.

Macroeconomic view of the process of FDI export, whether in the interpretation of K. Kojima and T. Ozawa, or in the context of the theory of capital-market imperfections of R. Aliber, also expanded the idea of the possible causes of internationalization and motives of firms to transfer production abroad [9; 10]. They attracted the attention of researchers to the nature of monopolistic advantages of MNEs, such as ownership of patents and special knowledge, the role of translation risks and exchange premium in determining of the capital flows directions, as well as trading strategies of these firms and their impact on the host country [11, p.29].

The previously mentioned areas of researches of the international production became the basis of the formation of MNEs theory at an early stage of its development (60-80s of the XX century). Subsequently, many of these ideas were reflected in the new methodological approach to the study of capital internationalization reasons – the eclectic paradigm of J. Dunning [12; 13]. The name of J. Dunning concept by itself says that it combines some elements of very different theoretical approaches to the study of MNEs. In this sense it is not a completely new theory. The eclectic paradigm attempted to offer a general approach to the study of reasons of international production growth by MNEs. The advantages of ownership, internalization and location became its key categories. In terms of these categories J. Dunning studied why the firm is trying to retain full control over its assets abroad, why it does not transmit them to other companies through licensing agreements, as well as what determines the choice of affiliates location of international companies [14].

Although the eclectic paradigm does not give comprehensive answers to all the issues related to the emergence of multinational enterprises and the features of their modern practices, it gave systematic approaches to the study of many aspects of MNEs activities. In 80-90s of the XX century a large number of researchers studied the peculiarities of MNEs foreign operations in reliance on this methodology. However, at the beginning of the XXI century an increasing number of scientists began to use other research methodologies of multinational enterprises.

The evidence of new approaches to the determination of MNEs' essence became a development of the network theory of the firm [15]. Ch. Bartlett, S. Ghoshal among the first offered to treat the international firm as a network of various structural units. The network character determines the key difference between MNEs and national firms, and hence can be considered as the distinguishing feature of such firms. MNEs network theory focuses on the fact that the greatest competitive advantage of these firms is creation of a complex system of long-term relationships with private and independent enterprises. M. Forsgren, U. Holm, U. Anderson consider the MNE affiliates to be the main source of its competitive advantage as they build deep and lasting relationships with local business partners, and with the related departments of the company. Special competitive assets of the firm can be created and saved because of these particular relationships [16, p.802]. An important element of MNE network structure are subcontracting suppliers linked to these firms through the non-equity control mechanisms. Therefore, the network theory focuses also on the distribution of non-equity forms of MNE operations in recent years. Namely this network of relationships is the main asset of the company and creates a synergy of industrial, financial and marketing effectiveness [17, 1095-1110].

Another group of researchers (B. Kogut, U. Zander) consider the capability to accumulate, create and transfer knowledge to be a key characteristic of MNE [18,p.625]. The competitive advantages of MNEs are caused by features of their knowledge. This feature of MNE knowledge prevents the possibility of its imitation by competitors [19, p.768-790]. There are certain characteristics of knowledge, such as uncertainty of cause-and-effect relationships, complexity and lack of a formalized knowledge that makes it extremely difficult to copy these specific assets. B. Kogut, N. Foss, U. Zander in their theory of the firm, based on knowledge, justify that MNE is a social institution that creates knowledge and organize its international transfer. They believe that the capability to create and transfer knowledge within the corporation is a key competitive advantage of MNE [20, p.405-410]. The adherents of this approach consider the concept of 'tacit' or 'embedded knowledge'. MNE is an extremely effective mechanism for the transfer of such tacit knowledge as compared to traditional external market mechanisms [21,p.340-345]. Tacit knowledge, opposed to conventional knowledge in form of patents, licenses, drawings, documentation, are a set of skills, practices and models of communication. They occur on the basis of long-term relationships with partners – customers, suppliers, subcontractors and other actors of MNE network.

Knowledge-based theory determines that the main feature of international firms is the possibility of the tacit knowledge transfer, which cannot be successfully transmitted through market mechanisms. The capability of the business units of company to assimilate knowledge is a crucial parameter of the knowledge transfer process within the corporation. The affiliates differ in their capability to implement innovations and this will significantly affect the nature and extent of the knowledge transfer from other business units of MNE. As corporate structure of MNE affects the process of knowledge creation and transfer Ch. Bartlett and S. Ghoshal offer to consider MNE as ‘differentiated inter-organizational network’ [22]. The business units of MNE differ from each other, so these corporations can be defined as ‘differentiated inter-organizational systems’. The key knowledge of MNE is created in its various branches and then moves within integrated business units of the company [23,p.802-805]. Knowledge-based theory changes the traditional understanding of the role of affiliates in the innovation process. Instead of wide-spread stereotyped belief that main company (parent company) dominates in this process and subsidiaries play a secondary role, the theory, on the contrary, drew attention to the high competence and potential of foreign units of MNE in the creation of knowledge [24, p.87-94].

The distribution of global value chains produces increasing influence on the development of modern theory of the international production. Several modern concepts, in particular “trade in task” and “international fragmentation of production”, focuses on the new trends of evolution of international operations of firms [25, p.593; 26, p.794-780]. The founders of the theory of international fragmentation of production were G. Grossman and E. Rossi-Hansberg. In a series of publications for 2007-2012 years they proposed the term ‘international fragmentation of production’, and subsequently developed a new theory of “trade in task”, and the concept of fragmentation of international production became the part of it [27, p.1978].

The theory of international fragmentation of production argues that the production process is to be divided into separate stages (fragments that will be disposed in different locations). The distribution of the production process into separate blocks and arrangement of these units in the locations with the most attractive conditions reduces the overall production costs. The motives of fragmentation significantly expand when it covers different countries. This is due to the different prices of factors of production, distinctions in the access to technology and human capital.

Transferring the stage of assembly operations abroad occurs in those industries where the technological process allows separating labor-intensive operations from other stages of production. Assembly operations in the electronic and electrical industry are the one of the most vivid examples of this organizational model of production. One of the first models of such fragmentation of production by MNEs was the spread of offshoring between countries with different levels of factor endowments and distinctions in technological opportunities [28, p. 31-40].

The theory of international production fragmentation, which considers both production and exchange of intermediate goods and services in the global networks of MNEs, allows integrating new approaches to the international trade theory (the trade in task theory) and the latest concepts of FDI (the network concept of MNE, the concept of global value chains). Based on this, it explains the evolution of the international division of labor and the modern features of venture capital movement, as well as the exchange of goods and services. Namely fragmentation of international production underlies the evolution of international trade and the geographic relocation of industries from one country to another. It generates a distribution of separate, ever smaller functions, tasks between countries. Such distribution is carried out in the global value chains, organized and controlled by MNEs [29, p. 224-236].

Development of operating fragmentation as a key feature of the global system of international production was accelerated by two interrelated processes. The first one is a rapid progress of technology, allowing the industry to divide value chain into small, ‘compact’ links. The second one is that technological innovation ‘squeezed’ the distance separating the countries and improved the speed, efficiency and effectiveness of coordination of geographically dispersed production process [30, p. 224].

The new paradigm of international trade examines the impact of foreign production (value chain fragmentation) on the expansion of export-import flows. It is assumed that such fragmentation leads to a significant increase in trade of intermediate goods, which represents only separate tasks or functions of global production and marketing [31].

In the framework of the international business theory (thetheories of international companies) the microeconomic approach to the analysis of the international fragmentation of production predominates. In the definitions of global value chains the main focus is made on the distribution of tasks between the parties and the control of MNEs over this process. Thus FDI and exports are regarded as complementary but alternative operations of MNEs. L. Brainard, E. Helpman, M. Melitz restore the traditional methodological approach to FDI as a substitute for trade. These views are reflected in the theory of exchange of concentration on proximity developed by them (also known as – “proximity-concentration trade-off theory”)[32, p.520-534]. FDI will reduce the production concentration of the parent company in home, but in return the company will be in proximity to the market of the host country. In handling export instead of FDI, the firm will increase the concentration of production in the home country, but will lose proximity of the plant to the market of a foreign country. Under these conditions, higher transport costs and trade barriers and lower investment barriers and the economy of scale at factory level in comparison to corporate level will encourage the firms to choose FDI, not export.

Later E. Helpman, M. Melitz, S. Yeaple introduced an important new factor in this theoretical model – the heterogeneity of companies in terms of their productive capacity [33, p. 300-310]. They proved that firms differ significantly in terms of productive capacity and by this indicator are divided into a group of companies with low, medium and high productivity. Foreign operations are usually carried out by firms with high productivity; the most productive firms will serve the foreign market through FDI, and the least productive – through export from the home country. The empirical studies confirm that in sectors with greater heterogeneity of firms the share of high-productivity firms relative to low-productivity firms is much higher than in other sectors. So in named above sectors the share of firms that choose FDI rather than export will be higher than in other industries. [34; 35, p. 695-700].

Although the economic literature mainly refers to the global nature of value chains or global production networks of MNEs, some scientists believe that these companies are oriented on the regional market of its country of origin and don't diversify activities on the global markets, because the costs of monitoring and coordination of global operations don't cover the benefits of their implementation. A. Rugman substantiated the concept of "regional MNEs" [36]. He and other followers of this theory believe that the majority of the 500 largest MNEs, accounting for 90% of direct investment outflow and more than half of world trade, have not global but regional direction of their operations. Thus regionalization may be a result of two strategies – either serving a starting solution in process of internationalization of the firm or being an intermediate process on the way toward globalization [37, p. 479-485].

The contemporary trends of international production development. Modern international production by MNEs differs from the prototype of forty years ago. It involves a complex hierarchical system of production and market relations, both of enterprises owned by MNEs and formally independent from them firms. The enormous extent of the global value chains, the inclusion of a large number of participants in it, the use of different forms of partners' involvement in the creating value process determines the particular relevance of the issue of management, control and coordination of the international production.

The key feature of a new system of international production by MNEs is a dynamic development of global value chains (hereinafter – GVC). According to the degree of geographical coverage of the countries, the value chains can include several neighboring countries, be regional or global. These value chains of MNEs are in permanent transformation, which covers not only the functional segments of the production structure, but also its geographic dispersion. This determines an important trend of development of geographical configuration of the international production – the emergence of new factors and determinants of its localization.

According to the Table 1, in recent years the quantitative parameters of the international production have increased substantially.

Table 1

The international production by MNEs

		1990	2005-2007	2016
FDI inflows	billion US dollars	208	1493	1746
FDI, cumulative account	billion US dollars	2078	14790	26798
Sales *	billion US dollars	4723	21469	37570
Value added *	billion US dollars	881	4878	8355
Assets*	billion US dollars	3893	42179	112833
Export*	billion US dollars	1498	5012	6812
Employment*	thousandsof people	20625	53306	82100

* Data only on the foreign affiliates of MNEs, excluding the parent company.

Source: World Investment Report 2017. – Geneva and New York: United Nations, 2017. – p. 26.

In 2016 the annual volume of new direct investment amounted $1.76 trillion. The total amount of accumulated FDI has increased this year by 9% and is estimated at $26.8 trillion. Among the countries with the largest FDI inflow should be noted the US – $391 billion, China – $133 billion, Hong Kong – $108 billion, Netherlands – $91 billion, Singapore – $61 billion. [38, p. 224].

The global financial crisis has caused some changes in the balance of power of major exporters of capital. As before, considerable part of the capital export at present falls on the US multinational companies. After the global financial crisis they have strengthened its leadership in the capital export, and in 2016 they invested abroad almost $229 billion. The volume of capital export by US MNEs amounts now more than 1/5 of total world export of FDI.

The corporations of Japan, the UK and France hold the positions following after the US MNEs with a significant lag. The gap between them and the leader – the US MNEs, has even increased. The FDI of Japan MNEs in 2016 amounted $145 billion, FDI outflow from France – $57 billion. Opposed to the American firms, they failed to recover their pre-crisis positions on the volume of capital export.

After the global financial crisis the significant changes in the geographical distribution of FDI inflows took place. A new situation has developed – for the first time since the II World War the share of developing countries and emerging economies exceeded the share of industrialized countries with a market economy (51% vs. 49%). Although the excess is quite small – it reflected different economic dynamics of these groups of countries in the post-crisis period. A significant increase in the capital export is observed into developing countries, including the countries of Southeast Asia, which, on the rates of new investment inflows, occupied the first place in the world in recent years. According to experts, this increase in the role of developing countries and emerging economies was also the consequence of the higher rates of growth of FDI in real sector of the economy, particularly, in the manufacturing industry (compared with the capital export into the financial services and banking sector, which experienced a significant decline after the crisis of 2007-2008 years). It is indicative that the countries with the highest activity of MNEs in the industrial sector of the economy felt considerably less the fall in the rate of FDI inflows during the global financial crisis (or didn't experience entirely).

The opposite trend is observed with respect to the role of these groups of countries in the outflow of FDI. During the pre-crisis period of the last decade the share of developing countries in the export of capital grew gradually.

It reflected the tendency of internationalization of companies in developing countries. The internationalization vigorously occurred both in the energy sector and in the processing industries. In the post-crisis period, the rate of FDI outflow from developing countries decreased significantly. However, it should be noted that the MNEs in developing countries or emerging economies increasingly compete with traditional MNEs of the industrialized countries. For example, the export of capital from China is growing rapidly. Only in 2016 it compiled $ 183 billion that even exceeded the corresponding figures for Japan, Germany, France or Italy. MNEs of Singapore and South Korea have invested this year abroad respectively $23 and $27 billion. The internationalization of firms in India and Malaysia is rapidly growing.

By the method of entry into the country a new trend is also observed that differs from previous years. If before the global financial crisis the investments in mergers and acquisitions traditionally dominated in the structure of FDI inflow, i.e., the acquisition of already existing assets, then in the post-crisis period for the first time a tendency of significant increase in the share of investments in new projects has appeared. Such FDI (greenfield investments) made up 63% of the total annual flow of investments in 2011. The investments in new projects are the main method of MNE entry into developing countries (66% of FDI inflow to these countries comes in the form of greenfield investments)[39].

The new trend of the last decade is the emergence of new actors of capital export. In addition to MNEs, mediating a dominant part of outward foreign direct investments, the private investment funds and sovereign wealth funds began to carry out the part of FDI. The global financial crisis differently affected the activity of these non-traditional participants in direct investments outflow. Private investment funds felt a significant negative effect of the crisis and significantly reduced their investment foreign operations. If before the global financial crisis such funds, for example, Apollo Management, RHJ International, KKR, turned into real multinational giants and performed the global investment activity, then the size of their capital subsequently halved to $180 billion. The activities of these funds are mainly concentrated in the acquisition of existing assets, i.e. implementation of mergers and acquisitions. The private funds generally carry out FDI in mergers and acquisitions for the period of 5-7 years, and then sell these assets to other multinational firms.

Another trend in the investment activities of sovereign wealth funds (or shortly – sovereign funds) is observed. Their role after the global financial crisis has significantly increased. Even during the global financial crisis FDI of these funds continued its growth (by an average 10% per year). Approximately $5 trillion of assets are managed by these public funds. The vast majority of assets of these funds have the form of portfolio investments. In 2013 the FDI volume of the sovereign funds was estimated at $130 billion or 5% of their total assets[40, p.20].

As private investment funds, the sovereign funds also generally carry out FDI in mergers and acquisitions. Although the direct investments of such funds cover different regions, the industrialized countries with a market economy are their main area of investment – 67% of their direct investments are made here. FDI growth rates of such funds in industrialized countries also exceed the same indicator for developing countries. One of the reasons for this is greater opportunities for the acquisition of existing assets in the first group of countries.

The capital export by sovereign funds has certain specific features. Firstly, it concerns the sectorial structure of FDI. They actively invest in the acquisition of lands, in the extraction of raw materials, the development of key infrastructure projects. The services sector (including real estate, construction, banking, etc.) accounted for almost 65% of the direct investments of these institutions. Secondly, the state, hosting the investments, very often acts as a partner in the investment process of these funds.

A specific feature of the MNE investing process in post-crisis period was the reduction of their capital expenditures due to significant risks of uncertainty of the situation. The uncertainty of the situation has led to the delay of many projects and the transfer of large amounts of retained earnings in the category of cash funds held on the accounts of corporations. UNCTAD estimates that such deferred cash holdings of multinationals have achieved huge amounts in $5 trillion. This rate is significantly higher than pre-crisis figures and indicates that MNEs under conditions of instability of global financial markets, biding time, relying upon improvement of the investment environment in the future.

The global financial crisis has not ceased the growth trend of the international production by MNEs. The sales of MNE affiliates and the created added value are growing steadily. These figures are significantly higher than pre-crisis levels. In 2016 MNE affiliates sold goods and services to the value of $37.5 trillion, the annual growth rate of their sales in recent years were 7-9%, being significantly greater than the growth of world GDP and world trade in general. The total assets of MNE affiliates reached $112 trillion, nearly 82 million of people are employed by them. According to estimates, the international production by MNEs (excluding production of parent companies in home countries) reached 10% of world GDP (table 1).

In recent years, the noncorporate forms of MNE operations have been growing rapidly. A number of noncorporate forms of operations has obtained a wide circulation – for example, subcontracting agreement on supply of products and services, subcontracting farm production, franchising, management, leasing, engineering and various consulting agreements, agreements on contract construction, mining of raw materials (oil, gas), based on production sharing contracts. By analogy with the FDI, it can be noted that for some of them the main motive is access to raw materials (production sharing contracts, subcontracting farm production), for others – efficiency growth (subcontracts on supply of products and services). Finally, part of noncorporate forms is motivated by the access to market (franchising, licensing contracts).

After the global financial crisis the following trend intensifies – even the largest of MNEs narrow the scope of its specialization on the main, the most dynamic, business areas, and ‘transmit’ more functions to the independent firms in different countries on a contract basis in order to receive benefits from the disparities in levels of production and delivery costs. Such main independent contractors or suppliers are often, in turn, multinational firms, having their own international production network of enterprises and their own subcontractors and suppliers. MNEs also increasingly ‘transmit’ the specific links of their operations to local firms in host countries. They also actively generate various forms of cooperative, joint innovative mechanisms with other companies (customers, suppliers, competitors) and research institutions (universities, laboratories, etc.). Such cooperation makes consider the international production as a system with large number of economic agents.

The total volume of world trade associated with subcontracting delivery and MNE outsourcing (even without subcontracting farm transactions) was estimated at $1.1-1.3 trillion in 2010. This amount includes the sale both of the capital intensive high-tech products, such as electronics – $240 billion, automotive parts – $230 billion, pharmaceutical components – $30 billion, and low-technology labor-intensive products, such as clothing – $205 billion, shoes – $55 billion, toys – $15 billion. The export of software, information and telecommunication services under outsourcing contracts reached $100 billion. [41, p.132,133]. The extent of the use of noncorporate forms of MNE operations also shows that in the area of automotive parts, electronics, clothing, shoes, sporting goods, toys, the finished goods and components, obtained by subcontracting agreements, constitute more than 50% of the production costs of sold products.

The evolution of MNE theories, in particular, the development of the concepts of the network theory of the firm, the knowledge-based theory of the firm, the theory of international fragmentation of production and task trade, allows analyzing new qualitative features of the international firms and their foreign operations. But the dynamism and complexity of the MNE phenomenon puts on the agenda all the new issues about its role in the global economy and the impact on the economic development of the host countries. The global financial crisis has had a significant impact on the process of FDI outflow. It significantly slowed the dynamics of capital export and caused the changes in the balance of forces of the major capital exporters. During the crisis and post-crisis period the structure of the capital export by the criterion of the method of entry into the country has undergone transformation. Finally, some structural changes are associated with an exceedance of the share of annual FDI inflows to developing countries and emerging economies in comparison with a specific weight of the industrialized countries. However, the global financial crisis failed to stop the process of transnationalization. The international production by MNEs is gaining ground and weight in the world economy; the global value chains define the contours of growth of entire industries and significantly affect the development of the host countries. The process of international fragmentation of production gives rise to the new challenges that demand the response from the governments, the evolution of their foreign policy and its coordination at the global level.

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