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## Coordinates and Dynamics of the Relationships between Multinational Enterprises and Economic Development – A Theoretical Approach

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### Abstract

The paper aims to configure, based on the historical analyses of the theories regarding multinational enterprises and economic development (which, most of them, are unilateral, unidimensional and focused on just one theoretical background) a conceptual framework – subsumed to the idea of a matrix with variable architecture that integrates existing models – able to allow and favour the exhaustive and dynamic analysis of the relationships between multinational enterprises and economic development within the current and future spatial and temporal context – characterized by (enormous) complexity, turbulence and volatility.

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*Keywords:* multinational enterprises (MNEs); economic development; theories of development; foreign direct investments (FDI).

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### 1. Introduction

The analysis of the relationships between multinational enterprises (MNEs) and economic development was one of the last half of century's constant topics on the agenda of researchers (in Economics, International Economics, International Business, International Strategy). But their levels of approach, depth and relevance in terms of results were very different: (a). some of the studies exclusively treated the path and dynamics of these relationships regarding the MNEs of the Triad – so they resulted into theories and models of development for the developed

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countries (emphasizing in the same time their contribution to the global economic development), with mostly post-factum and unilateral character (Axinn and Matthysens, 2002; Rugman and Verbeke, 2004; Asmussen, 2009); (b). another were preoccupied with the impacts and interdependencies between MNEs from developed countries and the development of the developing countries (Ahiakpor, 1990; Rodríguez-Clare, 1996; Rugman, 2010); (c). there were also studies and researches trying to exclusively capture the relationships between MNEs and economic development in the case of the developing countries and transition economies (Cuervo-Cazurra and Genc, 2008; Kiggundu and Ji, 2008; Gammeltoft, Pradhan and Goldstein, 2010).

## **2. James Ahiakpor's approach (1990): "Multinationals and Economic Development. An integration of competing theories"**

Ahiakpor's approach (1990) in order to identify the specific contributions of the MNEs to economic development (specific contributions being used here in order to differentiate the exclusive contributions of MNEs to the process of economic growth and development from all the other kind of contribution that any other domestic firm may have on these processes) ended with the following conclusions (Ahiakpor, 1990):

- In specific and pure numeric terms, the interrelations between MNEs and economic development can be measured, firstly, in terms of the degree of contribution that MNEs (through their productive activities) bring to the economic growth of a given country. But this is a schematic and simplistic approach because it limits the economic development to economic growth. Even so, there is a possibility to refine or nuance the impact: MNEs extend the production into a country based on their operational efficiency; therefore, size can also be an indicator of the technical, managerial or marketing related efficiency and a significant determinant of the impact that MNEs have on development.

- Another indicator of the relative contribution of MNEs to the economic growth is total profits – because profits reflect the economic efficiency of firms (able to satisfy market preferences and to reward the factors) and also they are indicators of the potential for expansion through the transition from internal development (exclusively based on their own capitals) to external development (thanks to the ability to attract capitals).

- The attitude toward economic socks or the elasticities of substitution represent another indicator of the relative contribution of MNEs to economic growth and development: a delayed response to the changes taking place regarding economic conditions (and related to the interest rate, land or equipment rental costs, labor costs) may lead the firm to average operational costs higher than if it has timely adjusted the inputs. This inertia may also indicate a limited ability of MNE to extend its production in response to lower input costs, having as result a lower contribution to economic growth and development, as a result of its inhibitions to intensively use factors with lower relative costs.

- Finally, the relative contribution of MNEs to economic development can be observed through the quality of goods and services they offer, comparative to those of products and services supplied by domestic firms. This criterion is based on the acceptance of the quality of life as dimension of economic development; but quality has to be judged according to the preferences of the consumers, as indicator of their state of well, and not according to other (imposed) standards, in order to be a real indicator.

Ahiakpor (1990) recognizes that his approach is different from the previous ones (traditional, as he called them), that emphasized on the contribution of MNEs to the capital stock, the technological progress, the access to external markets, the rising of state revenues through taxes – aspects that are essential for the developing countries in their early stages of development, but that are losing of their relative importance when talking about economic progress and development.

## **3. Dunning and Lundan's approach (2008): "Multinational Enterprises and the Global Economy"**

If we take into consideration the comprehensive definition of (economic) development, it must be emphasized that the above mentioned conclusions are rather poor when trying to estimate and evaluate all the impact factors of MNEs on development, as well as the complexity of the interrelations between the two dimensions (MNEs and

economic development). That's why a brief review of those factors has to be made; one of the best benchmarks in this field of analysis (together with Piscitello and Santangelo, 2007; Rugman and Doh, 2008) is given by Dunning and Lundan's approach (2008). The two authors reveal the following categories of impact when talking about MNEs (Dunning and Lundan, 2008):

- FDI (Foreign Direct Investments), growth and development – at macroeconomic level, the ability to attract the activity of MNEs does not guarantee the economic growth; however, the countries that seem to mostly benefit from the presence of the MNEs are: those that are capable to modernize their institutions (especially through investments in education and technological capabilities), those that manifest ability to adjust their institutions to the global market demands, and those that are able to use MNEs related activities (in and out) as instruments within their restructuring processes;

- Technology and innovatory capacity: the role of firms versus the role of government – regarding the contribution of the MNEs to knowledge creation and to the international transfer of technologies, the two authors emphasize on one hand the multiplication of the locations – base for innovative activities and, on the other hand, the strong concentration of the technological intensive activities within a small group of countries (especially developed ones); then, that the internal innovative activities of MNEs are more and more complemented by external ones (much more diversified) – augmenting the heterogeneity of the technological capabilities that MNEs develop. When talking about the effects that MNEs bring to the technological and innovative capacities of host and home countries, Dunning and Lundan (2008) argue that: countries can not be technologically competent in all sectors; in order to be able to effectively use the technological expertise of foreign MNEs, host countries must follow a well defined technological strategy and to build the necessary institutions to implement it; some countries may have limited powers to influence the type of technology or the terms of the technological transfer; all national policies aiming to technological development must have a holistic and integrated in terms of means and ends; any positive results must be evaluated in order to find the next optimal solution;

- Employment and human resource development – the impact of MNEs on the level and structure of the internal employment rate is basically given by the type of result that the MNEs generate and by the methods they choose to produce them; thanks to the unique specific advantages, this kind of impact tends to be different from that of domestic firms. The government actions can take diverse forms, from providing educational and technological infrastructure and ethos that are favourable to development to stimulating a whole series of economic measures and institutions meant to: encourage the development of productive processes and of high quality products, to boost firms in opening production units in areas with high unemployment, to better finance research and development and to reduce the transaction costs of the structural adjustments, etc.;

- The balance of payments and the structure of trade – the composition of FDI and foreign trade has change during the industrialization process: in early development stages, the two forms of international activity tended to be complementary – both being organized base on Heckscher-Ohlin comparative advantage; in today's global economic world, the links between foreign trader and FDI are strongly intensified, and an important contribution belongs to MNEs: while MNEs become more integrated regarding their value chain, the nature of trade slides from natural endowment with factors to specific created assets;

- Market structure, performance and business practices – although MNEs activity is likely to have a distinct impact on the market structure and on the efficiency of value creating activities within the countries they operate, the extent and nature are often exaggerated, according to Dunning and Lundan (2008); more than that, they are difficult to interpret and are highly dependent on the MNE's entrance mode, on the existing market structure, on the type of investment and on the support structures and policies of host and home countries. However, some remarks can be made: MNEs' activities more strongly connect to the international division of labour the countries where they operate; while firms become multinationals, the same happens with the market structures; comparative to the similar domestic firms, MNEs' subsidiaries earn their market power by being part of a bigger and more diversified organization; because of the market structures where they compete, MNEs are tempted to engage into excessive diversification and not to adjust their institutional structures to the economic and social needs of the countries where they operate; due to some specific MNEs attributes, governments are forced to reconfigure their institutions and to re-evaluate their macroeconomic and institutional policies; etc;

- Linkages, spillovers and clustering – the two authors consider that the measure, the form, the pattern and the effects of the linkages and spillovers determined by the presence of MNEs depend on eight main factors: the

measure and nature of the firm specific advantages of MNEs; the economic and social objectives and policies of the home and host countries; the existence of the supply and absorptive capacity of domestic firms within the host economies and their reacts to inward FDI; the human and physical environment of the host country; the competitive position and the market structure within the sectors where already exist foreign participations; the characteristics of markets for intermediary products; the type of inward investments; the institutional characteristics and the global strategies of the MNEs. On the other hand, clusters encourage the development of specialized supplying firms and strengthen specialized labour markets; MNEs subsidiaries are attracted to local clusters where is likely to develop spillover effects and, once they are implanted there they contribute to the vitality of those clusters;

- Distribution of the value added created by MNEs – the combination between the differences in national taxation systems and the globalization of MNEs activities can generate advantages for MNEs – in productions, as well as in transactions, comparative to their domestic and local competitors. The nature of these advantages will depend on the international profile of the MNE that owns them, but also on the institutional incentives and constraints that guide its activities. So, is was observed that fiscal facilities generally has a lower importance in influencing the decision concerning MNE's location that other factors, but, for a given network of locations, the differences between taxation can influence the financing forms of subsidiaries and the transfer prices;

- Political, cultural and social responsibility issues – the above mentioned authors consider that the main responsibility of firms is to engage into value creating activities and transactions that meet in the best possible way the objectives of the society – beyond creating material wealth, by including a whole plethora of social and environmental goals. On the other hand, while there is a high demand for cheaper consumer goods and a low demand for social performance, the activities that MNEs develop can reflect this aspect too; more than that, even when MNEs play a beneficial role, they only can offer partial solution, they can not solve the major social problems such as human rights or working standards. But, except from any corporate social responsibility programmes that MNEs develop, their contributions to sustainable development can be substantial, through technological transfer and managerial good practices transfer.

#### **4. Combining Rugman and Hoh's (2008) approach of "Multinationals and Development" with Narula and Dunning's (2009) approach of "Multinational enterprises, development and globalisation: Some clarifications and a research agenda"**

In the context of the new economic geography of globalization (Sirkin et.al, 2008; Mayrhofer and Urban, 2011; Ocrean and Herciu, 2011) on one hand, and of the new development paradigm (Dunning, 2006; Dunning and Fortanier, 2007), on the other hand, is it necessary, more than ever before, to revisit the traditional patterns of thinking regarding the interrelations between multinationals firms and economic development. Thereby, it is necessary to outline a complex, holistic multifaceted and multidimensional image on the phenomena taking place at global level. Many recent studies and researches argue, with strong arguments, the impossibility to develop a single measure capable to fit all – given to a lot of causes (objective and subjective, assumed or implied, possible or impossible to control and change) on one hand, and to a lot of correlations determined by these causalities, on the other hand.

The complex structure and the extremely fluid dynamics of the global system – as a whole, but especially considering the kaleidoscope of effects that any minor change within its structure determines (and the butterfly effect is a good example here) suggest that is necessary a new conceptual model / approach subsumed to the idea of a matrix with variable architecture, able to allow the exhaustive and dynamical analysis of the relationships between multinational firms and economic development within the spatial-temporal context of nowadays. The form of this matrix can result by gathering together the contributions brought by two of the contemporary most relevant contributions: Rugman and Doh (2008) model of the matrix of firm specific advantages and country specific advantages (FSA/CSA matrix) combined with the social triangle (government – markets – society) – a rather macroeconomic analysis model, and Narula and Dunning (2009) model concerning multinational enterprises contributions to economic development through the investment development path (IDP) – macroeconomic model that enlarge the research area – both in time and space.

Based on the analysis of the considerable gaps existing between the studies concerning MNEs (which, most of them, come from research fields such as International Economics and International Business) and those concerning

economic development (which, most of them, are originated within the Development Economics paradigm), Rugman and Doh (2008) have initiated an integrative approach, able not only to meet the need of conceptual clarification (and to cover a – real or perception – gap between scientific fields of research), but also to adjust the scientific research to the real evolutions and progresses that the global social and economic system have recently registered. Firstly, they proposed an analytical frame in order to understand the interactions (and linkages) between country specific advantages and resources (CSA) and firm specific advantages and resources (FSA). From this perspective, the impact of MNEs on the development of (developing) countries will be understood through the analysis of the interactions between these two sets of factors (CSA and FSA). The graphical image of this approach (Figure 1) is a matrix with two axes – on one axe having the MNE and its FSA, and on the other: the environmental factors that are relevant for both business strategies and public policies at country level, CSA.

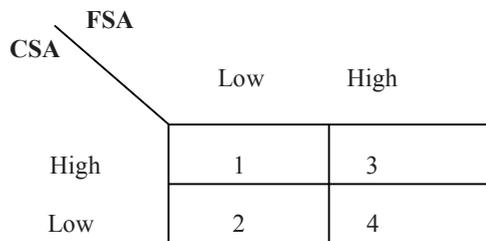


Figure 1 : FSA/CSA Matrix

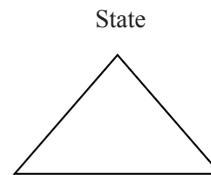


Figure 2: Social triangle

(Source: Rugman and Doh, 2008)

On these premises, the authors consider that can be identified the key interactions between CSA and FSA – in order to analyse the influence that MNEs (as efficiency seeking entities) have on development. So, the strategic and performance related objectives of MNEs can be identified, prioritized and set; then, the results will allow us to measure (based on MNEs operations and performances) the real impact of MNEs on development. The analytical framework also is favourable to comparisons – between the operations and performances of the MNEs and those of their competitors – or to sequential analysis – though the separation of activities between subsidiaries and headquarters.

In most of the cases, the MNE’s managers develop strategies built on the bases of the interactions between FSA and CSA; this kind of approach positions them within a unique competitive context. In order to formulate strategic options they need to identify the strengths and weaknesses of FSA and CSA comparative to those of the potential competitors. Strong FSAs represent a potential competitive advantage over the competitors – if CSAs are the same. In quadrants 1, 2, and 3 MNEs can develop different generic strategies (Rugman and Doh, 2008): Quadrant 1 is characteristic for firms that are looking for a cost leadership strategy – firms based on resources or mature firms that are internationally oriented and produce merchandise. Given their advanced stage on the product life cycle, FSA derived from the possession of intangible assets are less important than the CSA; Quadrant 2 represents inefficient firms, which have no consistent strategy and do not valorize FSA and CSA. These firms are likely to disappear or to restructure in the future; but this quadrant also indicates small and medium firms based on one country and with small global exposure; Quadrant 4 generally indicates differentiated firms, with strong FSA based on marketing and customization; that is why, on the long run and considering the global market, CSA do not count very much; Quadrant 3 represents firms that can choose between cost leadership and differentiation or can combine these two strategies, thanks to powerful FSA and CSA. Considering the business strategies, quadrants 2 and 3 are not ambiguous about implications – a firm which is positioned within quadrant 3 can benefit both from lower costs and from differentiation; quadrants 1 and 4 ask for specific strategies for different types of firms. Still, the model reveals

some asymmetries, because usually FSA are endogenous (and under MNEs control) while CSA are beyond firm control, and the public policies that determine them can have unwanted and unexpected impacts on MNEs.

The new development paradigm – based and developed under the dominance of the new economic geography of globalization – brings with it a new, holistic, view of businesses and of their ends; the triple bottom line (profit – people – planet) is just one of the instruments that helps the implementation of sustainable development concept to organizational level. The category of stakeholders gets more and more importance and the concerns of firms toward the satisfying of their (often contradictory) needs are more and more visible. So, Rugman and Doh (2008) suggest, in addition to the above mentioned model, an alternative conceptual framework, which they called the social triangle model (Figure 2) in order to integrate stakeholders’ interests as distinct and independent set of influences. The social triangle reveals three axes: state; markets and firms; society (the institutions that define this axe are most likely actors of the civil society and their actions can be analysed separately from those of the state/firms; by doing so, the problems regarding corporate social responsibility can be treated from a different perspective, that differs from firm/state perspective).

In order to simplify the analysis of the relationships between MNEs and economic development, Rugman and Doh (2008) resort to the concatenation of the two models – basically, they include the social triangle model within the FSA/CSA matrix (Figure 3). By doing so, they place MNEs activity within the 4th quadrant – where FSA are high and CSA are low, so the exogenous factors are more likely irrelevant. On other words, only the firm – market axe of the social triangle is relevant. Similarly, state activities can be positioned on quadrant 1 (with strong CSA and low FSA) – only state activities are relevant here, while market and firms are irrelevant. Quadrant 3 is the one that reflects the society axe form the social triangle model; the civil society’s role is relevant here and it can manifest through corporate social responsibility (CSR).

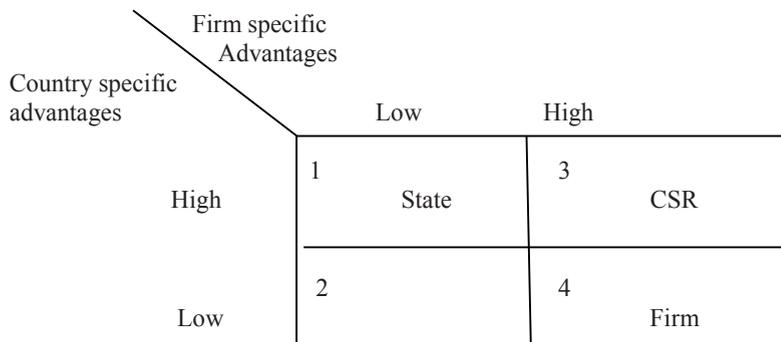


Figure 3: Reconciling the models

The conclusions of Rugman and Doh (2008) are based on the following: (1). by themselves, country specific factors are not enough in order to support economic development; (2). without supportive and stable institutions able to protect and encourage investments, firms are likely not to be attracted by a given country; the conclusions mostly refer to (as the authors have emphasized):

- MNEs positively contribute to the economic development of the poorest and the developing countries – directly as well as indirectly: (a). directly – through the role that MNEs play in attracting new knowledge assets (technologies, managerial abilities) for developing countries – FSAs that are internalized by MNEs and represent key competencies and capabilities to be valorized on the internal and external market; (b). indirectly – MNEs develop externalities such as technologies, linkages and spillovers, contributing to the improvement of the business infrastructure into the developing countries; the measure of these benefits depends on the investment conditions within the host countries and also on the MNEs policies;

- FSA can help to generate new business capabilities and competencies into the developing countries. Actually, Rugman and Doh (2008) approach emphasizes (as novelty) on the fact that developing countries generate

nowadays their own MNEs. Initially, emerging countries MNEs were based on CSA; then, indigenous MNEs from developing countries have developed their own knowledge based assets, which become FSA;

•Strong regional relationships between and within developed and developing countries. Because the world economy is not completely integrated, economic development can not be reduced to, and understood through a simplistic model of globalization; economic development is a more complex process than the development of international institutions in order to promote trade, investments and development and must be analysed in consequence.

Narula and Dunning (2009) model regarding the contributions of MNEs to economic development through the Investment Development Path (IDP) was elaborated under the circumstance of the dynamics that took place within the last decade – when the intensification of globalization and the changes within its evolutionary patterns have determined a rapid growth of MNEs activities: they started to proactively reorganize their activities, by responding, in the same time, to the opportunities that globalization has brought with it. So, the changes regard the nature of MNEs, their subsidiaries, the way they interacted between them and with the other actors of the economic scene, and also the way MNEs influence economic development. The authors emphasize that we can not tell the same thing about the governments of the developing countries, which more likely have (if they had any) a reactive attitude: even if they liberalized their politics regarding FDI, it does not mean that they developed politics favourable to FDI.

According to Narula and Dunning (2009), IDP graphic (Figure 4) was initially meant to be a mechanism able to illustrate the systemic relationships between FDI and development; but, along time, the graphic itself became subject to different empirical studies that analysed – synchronically and diachronically – the relationships between FDI and development. A basic assumption of these studies argues that IDP is a strong and credible theoretical instrument when we are trying to predict the optimal level of FDI for a given level of the GDP. But, in order to be valuable, the studies that compare different countries have to take into consideration the uniqueness of each country on its journey through development. That is why the conclusions of these studies can not be taken for granted as long as the five stages are most likely indicative than categorial.

Even so, perhaps the most important issue regarding this model is that suggesting a predictive aspect of the IDP it means to admit a causality relationship between ISD and GDP; but, as the authors mentioned, there is no confirmation – above any doubt – of the fact that between ISD and development there is a direct causality. If there is a relationship between MNEs and development, this relationship hides a big black box of mechanisms and intervention processes. Except from the situation when these intervention mechanisms between MNEs and development are completely understand, we can only argue that the determinants of FDI are also the determinants of development. It does not mean that FDI / MNEs related activities have no role into the development process; it simply means that FDI / MNEs related activities are not a necessary and sufficient condition for development. Instead, the relationship between MNEs and development is rather an indirect one, in the following terms: when MNEs inward activities determine positive externalities, and when domestic/national firms have the capacity to usefully internalize these externalities, and if the non-firm sector sustains the consolidation of domestic/internal capacities, then industrial development exists.

The detailed framework where we can follow the temporal dynamics of the relationships between MNEs and the economic development of a country (Narula and Dunning, 2009) offers an image on the spillover effects that the two dimensions generate on each other. But, the empirical studies could not come with a generalized good practices guide until now.

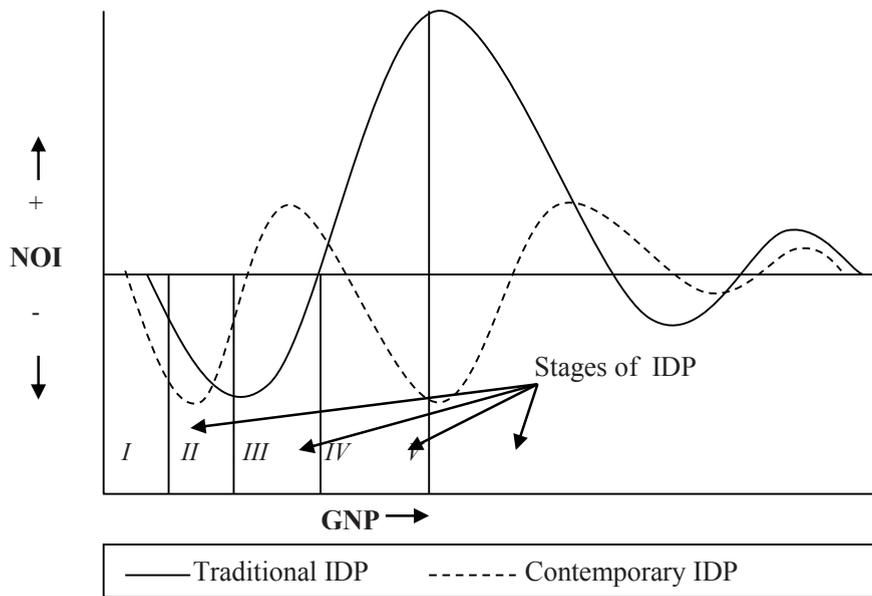


Figure 4: The Investment Development Path, Source: Narula and Dunning, 2009, <http://www.merit.unu.edu>

Not drawn to scale; for illustrative purpose only  
 NOI = net outward investment

Initially, the IDP theory mostly treated FDI and their impact on economic development; the new version of the model treats MNEs and their interrelations with development. As the two authors emphasize, we can find the reason of this change within the changes in the content of the MNEs: while initially the terms FDI and MNE were perceived as synonyms, in time MNEs have become autonomous from FDI (even if FDI remain one of the most important instruments that measure MNEs). Today, MNEs can engage themselves into value added activities also through another means that the ones that imply the engagement of their own capitals: cooperation and externalization agreements – sometimes without de jure property on the productive assets. Under these circumstances, MNEs are more about coordinating and controlling across borders of the interdependencies between operations that take place in different locations; property is no longer a defining element of the MNE, so the entire MNE concept is subject to challenges. Thus, the interrelations between MNEs and development did not diminish; they have just received new connotations and meanings.

The new development paradigm also brings new challenges to the dynamics between MNEs and development (Dunning and Fortanier, 2007): (a.) the measurability of some concepts such as social development or ecological sustainability – comparative to the classical concept of economic growth, the new development paradigm proposes development goals that are more difficult to quantify. Nevertheless, recent researches led to the formalization of some generally accepted (and sometimes assumed) goals in these directions (such as the UN and its well known Millennium Development Goals); (b.) the methods of networking / conditioning – of the MNEs activities to the social and ecological development objectives; from this perspective, the effects of MNEs on development are rather indirect (and very difficult to measure), comparative to, for instance, the growth of productivity thanks to FDI. However, it were identified possible contributions of MNEs to the achieving of each one of the Millennium Goals (for instance: providing of affordable products – especially for basic needs); (c.) the management of possible negative effects of interactions between ends/goals: not always economic growth has as result social equity and sometimes it can contribute to environmental damages; more than that, even the social goals are not always in consonance with the environmental goals.

All these new challenges further complicate the framework of the analysis and force: academia – to generate viable solutions, international institutions – to impose them, and organizational decision makers (whatever their level of competencies) – to apply them. So, it results that the number of variables that have to be taken into account

when analysing the relationships between MNEs and economic development within the context of the new development paradigm is multiplying and, along with it, the concerns in order to find the optimal solutions for these complex dynamics acquire new meanings

## 5. Conclusions

Obviously that, in order to optimize the relationships between MNEs and economic development (as a conscious act, not as post factum observation of some emerging realities) the two dimensions of the binomial multinational enterprises – economic development has to be treated inseparable, within a unique framework of analysis that is integrative, holistic, multilevel, dynamic and interdisciplinary. Although these kind of theories and empirical researches are more difficult and challenging (given the diversity of factors, determinants and consequences involved), they offer the only chance to an accurate and complex view of the phenomena and processes that define the global economic environment.

The new realities and perspectives of nowadays ask then for a new approach of the relationships between MNEs and economic development, able to extract – from all the revealed (theoretical and empirical as well) states and dynamics regarding the two dimensions – the most essential and general elements that determine the relationships between MNEs and economic development, in order to integrate them within a new holistic theoretical framework on one hand, and to allow the identification and valorization of the specific differences, on the other hand. So, a conceptual framework – subsumed to the idea of a matrix with variable architecture that integrates existing models – has been finally proposed.

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