Stephen Hymer: Three phases, one approach?

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Abstract

Stephen Hymer is a seminal figure in the development of the theory of the multinational enterprise (MNE). This paper argues that the three separate phases of his writing—his thesis (1960), his neoclassical 1968 paper and later radical pieces—can be reconciled around the central core of the economics of the MNE and the attempt to build in a dynamic element.

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1. Introduction

Stephen Hymer (1934–1974) is regarded as a seminal figure in the establishment of the theory of the multinational enterprise (MNE) and a founder of the academic subject of international business. This reputation is largely built on Hymer’s thesis, written in 1960 (published only as Hymer 1976) but also on his later writings which, after Hymer’s conversion to Marxism, took a critical view of the activities of MNEs and their impact on the world economy from the viewpoint of a radical economist.

This paper suggests that there were three phases in Hymer’s work. The first phase was the 1960 PhD thesis, the second is a neoclassical phase represented by his strange 1968 paper in French in Revue Économique, and the third his ‘radical phase’.

The intriguing question, which this paper explores, is whether these three phases are consistent, contradictory or non-overlapping sets.
2. The three phases of Hymer’s work


Hymer’s thesis deserves the epithet ‘seminal’. Its title is significant. Hymer saw firms as primarily national and their international operations were seen as expansions from their home, national, base rather than as a firm might diversify from its original industry. This parallel is instructive.

In Hymer’s view firms have a nationality in three senses. First, they have a legal nationality which provide legal constraints on the firm’s behaviour. Second, most shareholders reside in a certain nation and the firm is obliged to pay dividends in a certain currency. Third, managers have a nationality and this may affect their allegiance and behaviour. Hymer’s firms are committed to earning and (their shareholders) to receiving profits in their ‘own’ currency. Firms have a distinct, definitive nationality. They are in no sense ‘global’ firms.

Hymer made a profound and enduring distinction between portfolio and direct foreign investment. The distinguishing feature between the two is that direct foreign investment (DFI) implies control of the operation whilst portfolio foreign investment confers a share of ownership, but not control. This is important because the traditional theory of investment based on differential interest rates, after accounting for the risk premium, does not explain DFI. This profound empirical observation prepared the ground for a separate and separable theory of DFI. It was supported by the following stylised facts.

1. There was little, or no, correlation between high interest rates and inflows of DFI.
2. Cross DFI occurred. Firms of country A were investing in country B at the same time (and often in the same industry) as country B’s firms were investing in country A.
3. Most DFI (in Hymer’s observation period) was undertaken by firms of one nationality—the USA. Thus the motivation must be other than interest rate differentials.
4. There was distinct, definite pattern of industrial composition of DFI. Some industries were characterised by a great deal of DFI, others by little. And, DFI took place in both directions between countries simultaneously.

The motivation for DFI was the desire to control foreign operations. It was often profitable to control enterprises in more than one country in order to remove competition. Some firms have advantages in a particular activity and may find it profitable to exploit these advantages by establishing foreign operations. They need to do this in order to fully appropriate the returns from these advantages. The profits from these operations are related to control. A minor motivation relates to the diversification advantages of international operations. (In fact, DFI is a poor way to diversity. The need to control operations necessitates putting more investment in one location than would be dictated by an optimal portfolio, which would tend to be more widely spread.)

Hymer thus begins where the firm already has an advantage, developed in its home market. There are managerial or organisational advantages which favour centralised or at least unified decision making. The direction of DFI will also be influenced by the ease of entry into particular foreign locations.

Hymer further needed to explain why the firm does not license its advantage to a third party, given that the foreign firm necessarily incurs costs of operating in an alien environment. (The costs of information in operating in a foreign market he may have seen as a fixed cost.) Hymer’s answer was made up of two parts. First, there is not necessarily joint maximisation of profits if
two firms pursue their own course. Integration increases joint profits. Second, the two firms (licensor and licensee) may have a different valuation of the worth of the ‘patent’ on the advantage. This arises because of asymmetric information. The owner knows the value better than the buyer. This conflict of evaluations causes uncertainty. There is also the danger of the owner losing the advantage by diffusion (intended or unintended on the part of the licensee).

The external market, and, in particular, market imperfections play a huge role in Hymer’s contribution. Imperfections allow exploitation of advantages and these are specifically imperfections in the market for knowledge. The thesis starts ‘one stage too far forward’ (Buckley & Casson, 1976, p. 69) and pays no attention to the process of generating the advantage. In particular, the innovation process is not linked to its exploitation.

Hymer’s thesis must be one of the most photocopied and circulated documents in business academia. It was largely disseminated, however, by the 1969 publication of Kindlberger’s American Business Abroad. It was through the lens of his supervisor’s publication that Hymer’s work reached a wider public and the Hymer/Kindleberger theory was named. The thesis finally appeared in book form in 1976.

A major source of controversy has been the issue of whether Hymer took on board the issue of internalisation (Dunning & Rugman, 1985; Horaguchi & Toyne, 1990; Kindleberger, 1969). In the thesis, Hymer generally used the term ‘integration’ although he once uses the phrase ‘the firm internalises or supersedes the market’ on page 48 (Pitelis, 2002). He was to take up the Coasean approach (Coase, 1937) in the second phase of his contribution.

2.2. Phase 2: post-thesis, the 1968 neoclassical article

Hymer’s (1968) Revue Economique paper is an enigma. It was written in French and is regarded by its translators to be written in poor French. It does appear to have been written in 1968 as it contains references to publications of that year. The article contains many mistakes (see, Mark Casson’s 1990 introduction) and it misquotes Coase. Perhaps, the ‘quotations’ from Coase are meant to be Hymer’s paraphrasing. The article has no clear conclusion it just ends. Despite this, the piece is wide-ranging and (as usual with Hymer) insightful.

The paper not only includes a discussion of internalisation, it integrates this notion with external market imperfections to give a satisfying explanation of the direction of growth of the international expansion of firms (Buckley, 1990). Hymer’s Coasian, neoclassical theory of the international firm embraces both horizontal and vertical integration. Not only does this work show that market power and internalisation are not competing explanations of international expansion, it also demonstrates that both are necessary for a complete explanation. Hymer shows the systemic interaction between them. To paraphrase Casson (1990, pp. 3–4) internalisation in an industry of a given size determines the number of firms, and therefore, also industrial concentration and market structure. Market structure feeds back in two ways. First, it governs the opportunities for further horizontal expansion of the firm within the industry. Thus, high industrial concentration encourages the firm to expand by diversifying. Second, imperfections in competition at one stage of production induce price distortions within a multi-stage production process and so create an incentive for backward or forward integration.

As Casson points out, Hymer has moved on from the preoccupation of his thesis with technological advantages to emphasise the role of large firms in the international division of labour. (Here, is a link to the concerns of Marxist thinkers.) The emphasis is indeed upon backward integration into raw materials rather than on the way that preparatory technology is
exploited (taken up by Buckley & Casson, 1976). Again, there is a link to Hymer’s later concern with the problems of labour in the primary sectors of less developed countries.

Hymer follows Coase in seeing internalisation as a general theory of the existence of firms. The international firm is a special case where market imperfections and the direction of the internalisation of markets takes the firm’s control across national boundaries.

Hymer focuses on imperfections in the capital market in this paper. These imperfections explain why shareholders prefer to diversify themselves rather than hold shares in ‘pre-diversified’ firms. Again the underlying rationale arises from indivisibilities in information. The multidivisional firm can be explained by the internal allocation of capital mimicking an external bank. Profits are reallocated by retention and reinvestment (this explains the large firm’s preference for retaining profits rather than paying out dividends). This anticipates the argument that internal forward markets coordinate vertically linked supply chains (Buckley & Casson, 1976, p. 37). However, the discipline of the market constrains managers of even the largest firms. This is a distinctly neo-classical paper emphasising marginalist principles.

2.3. Phase 3: the radical economist and critic of international capitalism

The three phases of Hymer’s work are not temporarily distinct. As a Canadian, Hymer was critical of foreign (particularly US) domination of Canadian industry. In ‘Direct foreign investment and the national interest’ (1966), Hymer took a critical stance, but the early work’s purpose is ‘to analyse rather than prescribe’ (Hymer, 1966, p. 201). It is notable that there is little or no discussion of policy issues in Hymer’s dissertation.

Hymer’s approach evolved into a ‘on the one hand, on the other’ type of analysis as exemplified by his 1970 piece ‘The efficiency (contradictions) of Multinational Corporations’ (Hymer, 1970a) which showed that the dual nature of the multinational corporation arose from its external market dominance combined with its ability to achieve efficiency by successful coordination of internally controlled markets.

Later pieces were hostile to multinational corporations as agents of an international capitalist system which was causing inequality, poverty and distortions in the world economy.

Hymer never changed his view on the welfare impact MNEs from the original duality of welfare gains (from the replacement of an imperfect external market by a more perfect internal one or where a new market is created where none existed before—the internalisation of an externality) and welfare loses (where MNEs maximise profits by restricting the output of goods and services or where vertical integration is used as a barrier to entry) (Buckley, 1990). Further, MNEs may reduce social efficiency because they provide a more suitable mechanism for exploiting a collusive agreement than does a cartel. By internalising a collusive agreement, MNEs make the enforcement of collusion more effective (Casson, 1985).

However, Hymer began to place more emphasis on global macro-dynamics (Rowthorne, 1971). In contrast to Buckley and Casson’s approach which addresses dynamic benefits from internal markets on the grounds that an internal market allows greater inter-plant integration and cross functional integration between production, marketing and R&D which in the long run, they argue, will stimulate both the undertaking of R&D and its effective implementation in production and marketing, Hymer took a malign view of MNE dynamics.

In ‘The efficiency contradictions of multinational corporations’ (1970a), Hymer begins with the famous quote from D.H. Robertson that multinational corporations (firms in the
original) are ‘islands of conscious power in an ocean of unconscious co-operation’ (Hymer, 1970a, p. 441). Hymer questions whether such powerful MNEs can be analysed by economics alone, but his argument rests almost solely on economics. Hymer examines and contrasts the division of labour between firms coordinated by markets with the division of labour within firms, he notes scale effects (big firms, small countries) and questions the extent of trickle-down to less developed countries. He further notes the supranational power of MNEs. The conclusion however is a list of advantages and disadvantages of MNEs with the reader left to attach weights to the points and arrive at a view of the balance—duality again.

‘The multinational corporation and the law of uneven development’ (Hymer, 1972b) is futuristic in outlook. Hymer examines the hierarchical division of labour implanted by firms on states and regions. Hymer contrasts Marshall and Marx. Both, he believes, stress the internal division of labour but Marx stressed the authoritarian and unequal nature of this relationship based on the cohesive power of property. Hymer believed that Marshall’s answer, based on cooperation between labour and capital and on the power of the market to reconcile individual freedom and collective production was an inadequate response. Hymer argues that the increasing size and power of firms as MNEs subverted the power of the market and that conscious coordination widened whilst market directed division of labour contracted. This is Coasean dualism at a macro and dynamic level with a strong (unsubstantiated, as Hymer acknowledges) assumption of weakening global market forces.

Hymer goes on to project that increasing specialisation by MNEs will force the global economy to become increasingly locationally or spatially specialised with a hierarchy of specialised locations (and therefore nations) emerging. Hymer’s condemnation of the role of MNEs spreading inequality cannot disguise his admiration (like Marx) for its dynamism. Surprisingly, the Epilogue to the paper is anti-pessimistic. Countervailing forces will pressurise the centre—although this is seen to come from ‘alternative methods of organising the international economy’ such as regional planning, rather than from competitive forces and innovation.

Similarly, in ‘The internationalisation of capital’ (Hymer, 1972a), although MNEs, through their internal division of labour, are wasteful and corporate structure is seen as ‘divide and rule’ Hymer again believes that the contradictions within the system will force ultimately beneficial change. This would partly be due to competition from Europe and Japan to the world hegemon—USA—and partly to the fact that capitalism is not satisfying and does not fulfil human needs. Here Hymer anticipates the anti-globalisation movement (Cohen et al. 1979).

Perhaps, one’s view of this period of Hymer’s writing depends on whether Marx is regarded as providing the correct interpretation of long-run social and economic dynamics or whether he is seen as a minor post-Ricardian economist.

2.4. The three phases—discussion

As we move through the three phases Hymer’s work evolves from the micro (transactions and the firm) to the macro (the world system) although the emphasis is always on the multinational corporation as the main actor. The combination of the market imperfections or ‘firm-specific advantages’ of the thesis with Coasean internalisation gives a rounded approach which, nevertheless, lacks a dynamic at the level of the firm in that Hymer’s focus on innovation is weak. This basic analytical apparatus feeds through into the radical critique of later work when a macro-dynamic based on Marx is introduced.
2.5. The three phases—commonalities

Six common attributes of Hymer’s work feed through all the phases of his oeuvre. First, the analysis is always economics based or, at least, economistic. The analytical apparatus does not include cultural elements nor does the explanation rely on ‘managerial capitalism’. The discipline of the market ensures that even though large firms may have a distinct ‘personality’ (Hymer, 1968), deviations in behaviour from a profit-maximising firm can be indulged only within very definite limits (Casson, 1990).

Second, hierarchy is central to the explanation. Initially, this is observed within the firm. In later writings, hierarchy is seen as a key feature of the global economy.

Third, power is crucial. Power is observed in industrial concentration, in spatial concentration, in monopoly and monopsony. Market imperfections, especially those in information and in the capital market are major drivers of the explanation of outcomes in the world economy. Yet, the discipline of the market can constrain power as in the disciplinary threat of takeovers to the policies of multinational corporations.

Fourth, boundaries are critical. The boundaries of the firm in the early writings (Hymer, 1960, 1968) are vital, even as regards the title of the thesis—‘The international operations of national firms’. National boundaries play a major role in determining the world’s distribution of income. Nationalism is a driving force and the example of Canada (earlier) and less developed countries (later) exemplify this. The combination of boundaries and neoclassical economics give Hymer a major intellectual engine—the notion of substitution at the margin.

Fifth, the role of communications and the control of information loom large, particularly within the firm. Good examples of this occur in the 1968 paper and in ‘Multinational corporations and the division of labour’ (Hymer, 1979), where Fig. 1 shows ‘degrees of downstream coupling’.

Sixth, disequilibrium is a feature of Hymer’s continuing world view. Graham (2002) feels that Hymer was constantly searching for an explanation of long run non-equilibrium dynamics in the world economy—a view very close to classical Marxism. Hymer (1975) saw Marx as trying to uncover the ‘economic laws of motion of modern society’ and Hymer’s later work might be seen as an attempt to introduce a dynamic into the basically static analysis of international firms which he had created. Graham distinguishes a true dynamic (non-equilibrium) analysis from one where a new static equilibrium is obtained when a system is perturbed away from an old such equilibrium. The path that Hymer chose to develop (along Marxist lines) differed from that taken by most international business academics, which is to try to introduce innovation into the system (see for instance, Buckley & Casson, 1976). If this is a correct interpretation, then Hymer’s vision can be rescued from the wreck of Marxism and Marxist theory. The search for a dynamic analysis of the world economy on non-comparative static equilibrium lines still has to be completed.

The argument that Hymer’s three phase contribution can be seen as evolutionary rather than separate or contradictory has to cope with the discontinuity in Hymer’s thought brought about by his conversion to Marxism and his concern with less developed countries such as Ghana. In my view, neither of these perceived discontinuities undermines the six common attributes of Hymer’s work. The Marxian framework is best regarded as a macro-dynamic element which is progressively and increasingly emphasised as Hymer observed globalisation advancing. Here,

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1 It should be re-iterated that Hymer died young and as Monty Graham pointed out, it is possible that ‘Hymer as Marxist’ may have been a transitional phase giving way to post-Marxism or some other mode. Sadly, we shall never know.

2 I owe this insight to Monty Graham’s notes for the Stockholm Conference, from Graham (2002).
Hymer diverged from conventional international business economics which concentrates on innovation as the driving force in the world economy (Buckley & Casson, 2003).

When Hymer was writing, as now, ‘the third world’ was at the sharp end of the interface between MNEs and their environment. The ‘colonisation’ of Canada by foreign capital occurred at high levels of GDP and the question arose whether the effects of FDI were different in less developed countries. To Hymer, the problems of FDI were put into sharper relief by poverty in the host country. Hymer spent time in Trinidad and Chile but his strongest engagement was with Ghana (Hymer, 1970b; Hymer & Green, 1965, 1966; Hymer & Resnick, 1969) immediately following his graduation from M.I.T. Here, MNEs are but one facet of the interaction between a ‘modern’ and a ‘traditional’ society, analysed at a time when an independent state (Ghana) was emerging from a colony (the Gold Coast). Even here, the themes of hierarchy, power, boundaries and communication are analysed in Hymer’s economics-based analytical system where disequilibrium is all too evident.

3. Conclusion

Hymer’s work on the multinational corporation was fundamental to the development of international business theory. This paper has argued that three separate phases of his career and writing can be reconciled around the central core of an economic theory of the multinational corporation that was truly dynamic and that reflected the rapid changes in the world economy co-evolving with his thought. In Hymer’s work it is a necessary condition for the existence of the multinational corporation that it possesses a ‘firm specific advantage’ and a sufficient condition that the firm can obtain more profit by exploiting the advantage internally than licensing it out to external organisations. The multinational corporation is both efficiency improving in the way that it integrates internal markets in goods, services, capital and information whilst at the same time such firms create distortions by the use of monopoly and monopsony power. Hymer constantly strives to cast his work into a dynamic frame. He chose to do this via Marxian macro dynamics rather than through a microdynamic analysis of innovation at the firm level.

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3 Hymer prepared the statistical abstract to Kay (1972) in collaboration with the editor. Kay planned the book “as a joint venture with Stephen Hymer and Reginald Green. The statistical abstract was finally completed in collaboration with Stephen Hymer, but his influence on the whole work goes much further. Without the advantages of long discussions with him, his comments on my numerous drafts and his many brilliant insights this book could hardly have been written” (Kay, Preface, p. xviii).
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