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Strategies of Japanese MNEs in the changing world economy
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STRATEGIES OF JAPANESE MNEs IN CHANGING WORLD ECONOMY

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Abstract

Japan has emerged as a major source of FDI flows, especially since the mid-1980s. Japanese corporations (MNEs) have set up production bases in a large number of countries, particularly in East and Southeast Asia, which feeds back to their home market in Japan. This paper theoretically explains why a Japanese domestic corporation goes beyond the national boundary, invests abroad, and becomes an MNEs. In this context, some practical questions are examined that focuses on whether the Japanese MNEs were successful in gaining market share of the host country. More importantly, with the current changes in world economy such as globalisation and fluctuations in foreign exchange, the MNEs have adopted different business strategies and approaches that are more in-tune with market climate of the host country.

Introduction

Multinationals Enterprises (MNEs) are to devote a firm with Foreign Direct Investment (FDI), whether in manufacturing or in services, over which it maintains effective controls. A firm might have investment in only one foreign market, but since this investment is effectively controlled by it, this firm can be called an MNE.

World Investment Report (UNCTAD, 2001) has shown that almost 90 percent of companies on Top 100 list are from Triad countries, namely the United States, the European Union, and Japan, which together accounted for 85 percent of Foreign Direct Investment (FDI) flows in 1999. Among the largest Japanese MNEs, as at the end of 1999, were Toyota Motor Corporation, Nippon Oil Co. Ltd., Sony Corporation, Mitsubishi Corporation, Honda Motor Co. Ltd., Nissan Motor Co. Ltd., Mitsui & Co. Ltd. and Fujitsu Ltd.

In the *Birth of Multinational*, Moore and Lewis (2000) stated that current MNEs, as for the previous ones, had to overcome many of the same obstacles such as tariffs and nationalist opposition to foreign trade and investment, using their competitive advantages and market power to prevail.

Japanese MNEs faces various challenges. The appreciation of the yen currency following Plaza Accord 1985 increased the cost of production in Japan. Japanese firms found their business expansion at crossroad. This phenomenon caused the hollowing-out of capital from Japan to other countries through foreign direct investment. Some of the host

countries also protect their countries with trade barriers that make it difficult for Japanese firms to export their product to foreign markets.

Table 1: The largest Japanese MNEs (at the end of 1999)

1998	1999	Corporation	Industry
6	6	Toyota Motor Corporation	Motor Vehicles
-	13	Nippon Oil Co. Ltd.	Petroleum
20	22	Sony Corporation	Electronics
24	26	Mitsubishi Corporation	Diversified
18	29	Honda Motor Co. Ltd.	Motor Vehicles
25	34	Nissan Motor Co. Ltd.	Motor Vehicles
37	45	Mitsui & Co. Ltd.	Diversified
56	50	Fujitsu Ltd.	Electronics

Source: UNCTAD, World Investment Report 2001.

This paper examined the strategies played by the Japanese firms in order to secure the international markets. Should all Japanese firms invest abroad and becomes multinational enterprises? Are they going to get a high profit? What area of international trade theories to be used to clarify their action?

Examination 1: To Invest or Not: A ‘Paradox’ of Advantage

This section is concerned with a ‘paradox’ of advantage. By a ‘paradox’, high technology may well turn out to be *disadvantageous* against low technology. Another example, is that a firm with an advantage in its home country may experience opposite position and becomes *disadvantage* in a host country. On the other hand, a technologically declining industry in the world competition may well resume its competitiveness as a result of its FDI in a host country. Such ‘paradox’ demand us to thoroughly examine the economic meaning of the concept ‘advantage’.

It should be carefully noted that the *technological advantage* is categorically different from the *economic advantage*. A car with more fuel efficiency, a medicine of higher curing ratio, a computer that can process information more speedily, a machine tool with more productivity, a lipstick with more attractive and fashionable color, can be identified with the technological advantage in a broad sense. This technological advantage may well turn out to be an economic disadvantage to host country or parent company, and a technological disadvantage may bring an economic advantage to them.

To understand this point, let us take an example of Japanese automobile MNEs as follows:

Table 2: Product Innovation

	Firm 1	Firm 2	Firm 3
	Car A	Car B	Car C
Speed	200 km/h	150km/h	120 km/h
Fuel	6 km/litre	8 km/litre	11 km/litre
Price	6 mil. yen	2 mil.yen	2.2 mil.yen

Suppose that Firm1, Firm 2, Firm 3 produces Car A, Car B and Car C respectively, and that their maximum speed, fuel efficiency, and price are as shown in Table 2. There are three types of the car e.g. Car A is a sports car, Car B is a family car, and Car C is a mini car. Each type of car is a specialty of each firm and we assume that the firms cannot manufacture other types of car. In other words, they have accomplished a product innovation.

The first glance at the table enables us to understand that Car A has an advantage in the maximum speed, Car B in price, and Car C in the fuel efficiency. Which car has the *total technological advantage* over the others? Unfortunately, the question cannot be answered as we do not have a common measure, which makes it possible to measure speed, fuel, and price. All we can say is that Car A (or Firm 1) has the speed advantage, Car B (or Firm 2) has the price advantage, and Car C (or Firm 3) has fuel-efficiency; but, we cannot say that either car (or firm) has the total technological advantage over the others, or we cannot compare different kind of technological advantages by a common measure.

Let us next focus on the productivity innovation with an assumption that both Firm 1 and Firm 2 produces the same type of car (i.e. Car A) with labor, steel, and petroleum as the inputs for their car manufacturing, as shown in Table 3.

Table 3: Productivity Innovation

	Input Units		Input Units	
	Firm 1	Firm 2	Firm 1	Firm 2
	Car A	Car A	Car A	Car A
Labor	10	12	10	12
Steel	1,000	1,000	1,000	800
Petroleum	100	90	100	140

Look at the left half of the table below. Firm 1 produces one Car A with 10 workers, 1,000 kilograms of steel as the material, and 100 litres of petroleum as the energy and Firm 2 produces the same type of car with 10 workers, 1,000 kilograms of steel, but only 90 litres of petroleum. It is clear that Firm 2 has the fuel-efficiency advantage and, at the same time, the total technological advantage. This is a rare and exceptional case in which we can unambiguously identify the total technological advantage of a firm.

By contrast, let us consider another example in the right half of the table. The Firm 1 is supposed to have the same input coefficients but Firm 2 produces a car with 12 workers, 800 kilograms of steel, and 140 litres of petroleum. Which firm is more productive and has the total technological advantage?

As we have already seen above in the case of the product innovation, we cannot answer the question either here in the case of the productivity innovation. It is impossible to compare labor-productivity (i.e. labor-advantage), material-productivity (i.e. material-advantage), and fuel-productivity (i.e. fuel-advantage), for both firms. However, in the case of the productivity innovation, the total economic advantage can be measured in monetary terms with the unit of prices. Assume that both Firm 1 and 2 manufacture cars in country A of Japan, and that one unit of labor, steel, and petroleum costs \$200, \$1, and \$1 respectively, and the result shows in Table 4 as below:

Table 4: Productivity Innovation in Monetary Term

			Country A-Japan (HOME)			Country B (HOST)		
	Input Units		Unit Price	Input Value		Unit Price	Input Value	
	Firm 1	Firm 2		Firm 1	Firm 2		Firm 1	Firm 2
Labor	10	12	200	2,000	2,400	100	1,000	1,200
Steel	1,000	800	1	1,000	800	1.5	1,500	1,200
Petroleum	100	140	1	100	140	1	100	140
TOTAL	-	-	-	3,100	3,340	-	2,600	2,540

We can calculate each input value of labor, steel, and petroleum and the total input value of Firm 1 and 2. As a result, it is now clear that Firm 1 has an economic advantage over Firm 2 of productivity in manufacturing Car A by \$240 per car (i.e. \$3,340 - \$3,100). A set of price provides us with a common measurement-standard of all the inputs in terms of money. The economic advantage means an advantage in terms of money. As shown in the above Table 4, although Firm 2 has an advantage in material-saving technology (i.e. steel: 800 kilogram < 1,000 kilograms), it has lost the total economic advantage over Firm 1.

Now, technological advantage and the economic advantage can be clearly distinguished. A technological advantage may well lead to an economic disadvantage, and *vice versa*. This ‘paradox’ of the technological advantage and the economic advantage becomes an important issue for MNEs before deciding about investing their capital and technology abroad.

There is another type of ‘paradox’ of advantage, i.e. the possibility of the *advantage reversal* from country to country. Look at the Table 4, and suppose that Firm 1 and 2 manufacture cars in country A, and that they have made FDI in host country B. Country A transferred their specific technology of manufacturing cars to the host country of B. However, parent company of Country A found that there a different set of price to be

emulated, as two countries share a different set of currency exchange. The unit prices of labor, steel, and petroleum are assumed at \$100, \$1.5, and \$1 respectively. The table shows, to our surprise, that although in home country A shows Firm 1 has an economic advantage over Firm 2 (i.e. $\$3,100 < \$3,340$), it has lost its competitiveness in host country B (i.e. $\$2,600 > \$2,340$) and thus, suffered the competitive defeat. This is an example of the possibility of the advantage reversal between country A and country B. However, this does not mean that the advantages reversal always occurs in the international economy; but it actually means that an economic advantage in one country may well be reversed in another country as a result of different sets of prices between countries.

Examination 2: To Invest or Not: The Eclectic Paradigm

The eclectic paradigm offers the importance of three advantage variables: Ownership (O), Location (L), and Internationalisation (I), i.e. OLI framework. The technological advantages typically exemplify the ownership advantage of a firm. Cheap labor, well-equipped infrastructure, and natural resources are some good example of the location advantages. An OLI framework combines and integrates country-specific, ownership-specific, and internationalization factors in articulating the logic and benefits of international productions. It explains why Japanese FDI takes place and where Japanese MNEs' returns come from.

Nissan Motor Co. Ltd has decided to invest in the United Kingdom (UK) since it has an 'ownership advantage' in its quality control of manufacturing and also for 'location advantage' in cheap labor with good skills. This argument probably sounds fairly reasonable. However, although Nissan indeed possesses an engineering or technological advantage in its quality control of automobile production, there is no guarantee that this advantage will turn out to be an economic advantage at the host country. The fact that Nissan chose the UK as its location of FDI is to implement her sophisticated quality control and to transform into an economic advantage. The FDI of Nissan, investment in the United States (US) may well result in a failure and lose its economic advantage, simply due to engineering advantage and the high cost of quality control. Toyota Motor Corporation, by contrast, with engineering advantage of one kind or another are able to invest in the US but not successful in the UK. Nissan-Toyota argument implies that a technological disadvantage could turn out to be an economic advantage in particular locations. The experience of the Japanese textile industry, which engaged in massive FDI in the first half of the 1970s, and the recent FDI from the Third World countries may exemplify this argument.

Examination 3: What Makes the Japanese firms becomes Multinational?

This section concern with the question: what makes the Japanese international firms becomes *multinational*? The MNE operates internationally on the basis of comparative

principle and seeks the international rent. We need a rigorous analysis here to understand fully the rationale of the Japanese MNEs.

Let us suppose two countries (i.e. Japan and South Korea) and two commodities (i.e. yarn and fabrics). Based on David Ricardo's theory, we assume four sets of labor-hours, which are required to produce one unit of each commodity as in Table 5:

Table 5: Comparative Advantage

(Labor-hours)	Japan	South Korea
Yarn	10	20
Fabrics	16	50

The absolute advantage and disadvantage of Japanese and South Korean yarn and fabrics industries are shown in Figure 1 and 2, as follows:

Fig. 1 Absolute Advantage

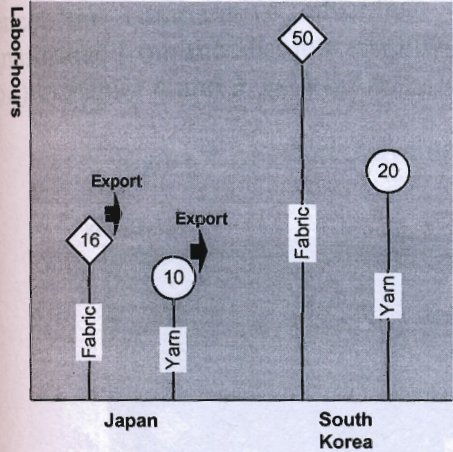
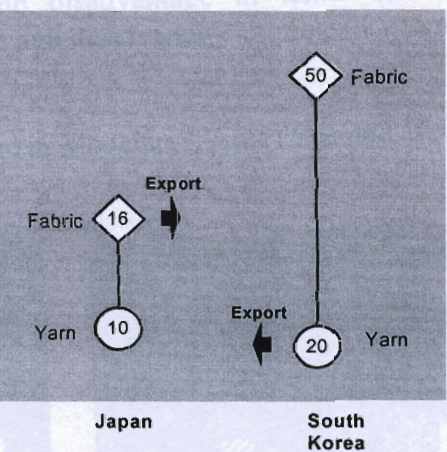


Fig. 2 Comparative Advantage



Let us suppose that one-hour labor produces 1,000 yen of monetary value in Japan and 2,000 won in South Korea. This does not mean that the wage rate per hour is 1,000 yen in Japan and 2,000 won in South Korea. Because of exploitation of labor, the wage rate may be around 800 yen and 1,600 won respectively. The difference means profit. Now, we rewrite the table above as follows:

Table 6: Conversion in Local Currency

	Japan	South Korea
Yarn	10,000 yen	40,000 won
Fabrics	16,000 yen	100,000 won

Foreign exchange rate between Japanese Yen and Korean Won is based on floating rate. Assuming the foreign exchange rate to be 1 yen = 5 won, and the figures can be rewrite as below:

Table 7: Price in Yen

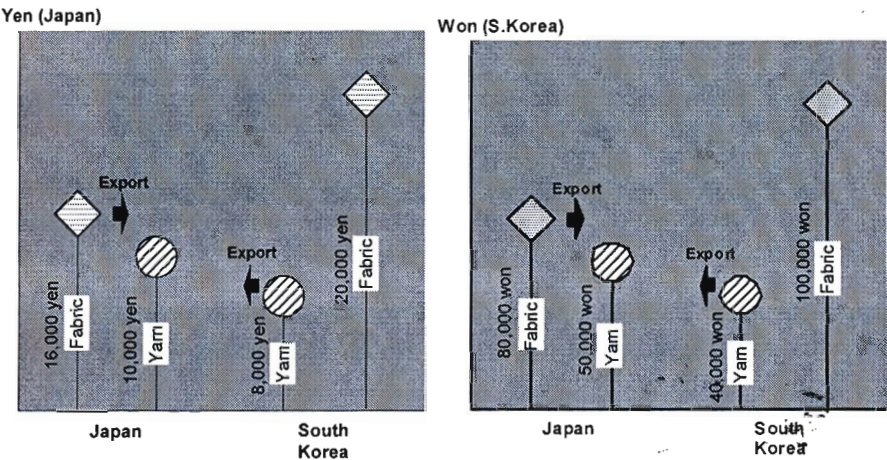
(In Yen)	Japan	South Korea
Yarn	10,000 yen	8,000 yen
Fabrics	16,000 yen	20,000 yen

Table 8: Price in Won

(In Won)	Japan	South Korea
Yarn	50,000 won	40,000 won
Fabrics	80,000 won	100,000 won

Hence, the comparative advantage and disadvantage in terms of labor-hours are transformed from the absolute advantage and disadvantage in monetary terms (in yen and won) in Figure 4 and 3, as follows:

Figure 4 Absolute Advantage in Monetary Terms (Yen and Won)



Examination 4: Is Tariff Barriers in the Host Country good for Japanese MNEs?

Despite the comparative advantage of Japanese fabrics and South Korean yarn, free trade between these commodities is blocked by trade barrier (i.e. tariff) on both sides of these countries for the sake of protecting their comparatively disadvantageous industries.

Fig. 5 Tariff Barriers

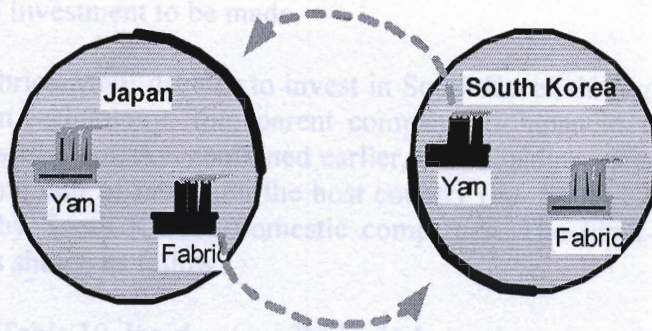
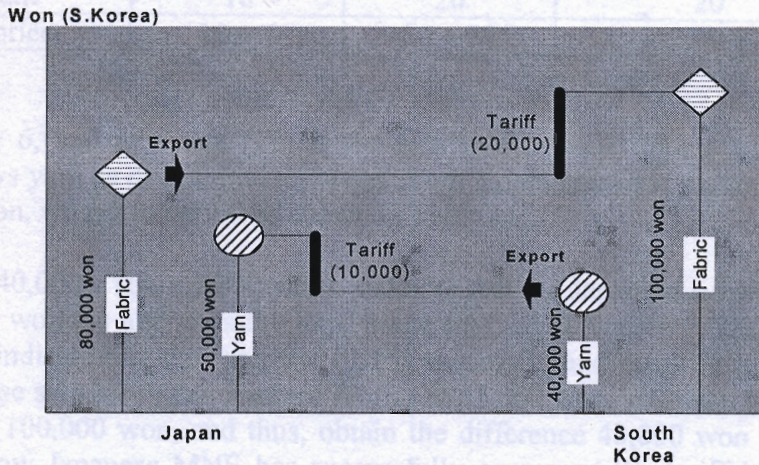


Fig. 6 Tariff Barriers: An Incentive to FDI



Now, let us introduce two more assumptions into our model. Yarn is input into the production of fabrics and assumed to be the only one material input.

Table 9 Input for Production of Fabric

(labor-hours)	Japan	South Korea
Yarn	10	20
Fabrics	10+6	20+30

Look at the input-output table. Japanese fabrics industry inputs yarn of 10 labor-hours, adds 6 labor-hours, and then produces fabrics of 16 labor-hours. Compared with the South Korean fabrics industry, it is clear that the Japanese fabrics industry is more productive in terms of labor-hours (i.e. 6 vs. 30). Despite its comparative advantage in production of fabrics, the tariff barriers block the export of Japanese fabrics to South Korean fabrics market.

In order to avoid the tariff barriers, the Japanese fabrics industry must find a strategy to deal with this type of domestic protection. With the comparative advantage in production

of fabrics it is reasonable for Japanese MNEs to invest in South Korea. However, the issue of a paradox of advantage and advantage reversal should be clearly considered before any decision of investment to be made.

When the Japanese fabrics-MNE decides to invest in South Korea through FDI, transfers of superior production technology from parent company in Japan to its subsidiary in South Korea can be carried out. As mentioned earlier, the subsidiary needs only 6 labor-hours for producing one unit of fabrics in the host country (i.e. South Korea) against 30 labor-hours required by South Korean domestic companies. The input-output table in terms of labor-hours is shown as follow:

Table 10 Input-output Tables in Labor-hours

(Labor-hours)	Japan	South Korea	Japanese Subsidiary
Yarn	10	20	20
Fabrics	10 + 6	20 + 30	20 + 6

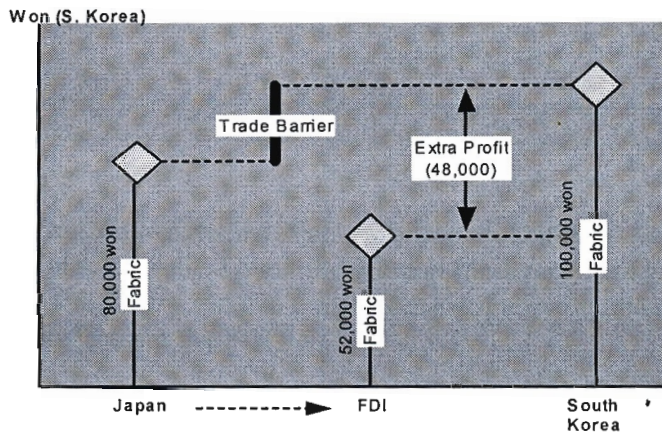
Look at 20 + 6, and note that (20) is the available material inputs and the Japanese subsidiary buys yarn as its material inputs in South Korea domestic market (6). Rewriting the table in won, we get the result as shown in Table 11.

Now, look at 40,000 + (6h x 2,000 won), and note that the Japanese subsidiary employed South Korean workers and pays the local wage rate, i.e. 1 hour = 2,000 won. Table 11 and Figure 7 indicate that the Japanese FDI is successful and result in high extra profit; i.e. the Japanese subsidiary can produce fabrics at 52,000 won, sell them at South Korean local price of 100,000 won, and thus, obtain the difference 48,000 won as extra profit. This shows how Japanese MNE has successfully overcome the tariff barrier in South Korea through FDI.

Table 11 Extra Profit of Japanese Subsidiary

Labor-hours	Yarn	Fabrics
Japan	10 h x 1,000 yen x 5 won =50,000 won	50,000 + (6 h x 1,000 yen x 5 won) =80,000
South Korea	20 h x 2,000 won =40,000	40,000 + (30 h x 2,000 won) =100,000 won
Japanese Subsidiary	20 h x 2,000 won =40,000	40,000 + (6 h x 2,000 won) =52,000 won

Fig 7 Extra Profit of Japanese Subsidiary



When Japanese firm operates only in the home markets, it would obtain the *ordinary profit* from fabrics production. However, but when this firm becomes MNE and invest abroad through FDI, they can obtain the *extra profit* as well. The desire of obtaining the extra profit becomes an incentive to Japanese MNE to carry out FDI abroad due to high cost of production in the home country.

Examination 5: Where does the Extra Profit come from?

The comparative advantages and disadvantages of international trade appears owing to unequal labor valuation between countries; i.e. 1 hour = 1,000 yen (= 5,000 won) in Japan and 1 hour = 2,000 won (= 400 yen) in South Korea, in our mode of assumption. In other words, labor in less productive countries is discounted in international market: i.e. South Korean labor is at $1/2.5$ (= $4000/1000$ or $2,000/5000$) of Japanese labor. Less productive countries suffer from the unfavorable of labor but, for the same reason, they can survive in the international market and export their technologically inferior products of comparatively advantageous industries. Nevertheless, less productive, as well as more productive countries have comparatively *disadvantageous* industries. Protectionist sentiment, if exists, would demand their government to build up trade barriers around these comparatively disadvantageous industries for giving breathing space to capitalists and workers of the industries.

It is clear that FDI of MNEs from home countries can totally change the situations. The Japanese fabrics industry observes the comparative principle as long as it produces fabrics in Japan, buying Japanese yarn and employing Japanese workers. The Japanese subsidiary in South Korea, by contrast, does not observe the *comparative principle* because they buy Korean yarn and employs Korean workers. On the contrary, the Japanese subsidiary and South Korean rivals (domestic producer) must observe the *absolute principle* for their competition in the South Korean fabrics market. Look at the input-output table as shown in Table 10.

(....from Table 10)

(Labor-hours)	Japan	South Korea	Japanese Subsidiary
Yarn	10	20	20
Fabrics	10 + 6	20 + 30	20 + 6

There is a gap in productivity between the Japanese subsidiary and its Korean competitors by 24 labor-hours (30 – 6). Given the Korean monetary values of labor-hour = 2,000 won, the Japanese subsidiary secures a price advantage by 48,000 won (= 2,000 won x 24h); i.e. the extra profit from the FDI.

Looking at the origin of the extra profit the MNEs viewpoint as shown above, the absolute advantage of the MNE generates the extra profit from the FDI. However, looking as it from the macro-economic viewpoint, the origin of the extra profit from the FDI can be resolved into three components:

Table 12 Extra Profit

Input-Price Gap (i.e. Tariff on Yarn)	10,000 won	(50,000 - 40,000)
Output-Price Gap (i.e. Tariff on Fabrics)	20,000 won	(100,000 - 80,000)
Labor-Valuation Gap	18,000 won	(5000 - 2,000) x 6h
Total Extra Profit	48,000 won	

The Japanese MNE has overcome the tariff barrier on fabrics (i.e. output) by means of FDI; i.e. the output-price gap. Without FDI in South Korea, when Japanese firm exports fabrics to South Korea, the MNE had to use expensive Japanese yarn as its material input. However, it can now purchase Korean yarn i.e. the input-price gap. Furthermore, the Japanese MNE employs cheaper Korean workers; i.e. the labor-valuation gap or '*cheap-labor effect*'.

Examination 6: Should Comparatively Disadvantageous Japanese Industry Undertake FDI and Invest Abroad?

Below is another example of two countries (i.e. Japan and South Korea) and two commodities (i.e. fabrics and clothes). Fabrics are assumed to be the single material input for producing clothes. Wages and exchange rate are considered do not change. From the Table 13, Japanese firm only needs 9 labor-hours compared to domestic Korean firm with 10 labor-hours. The differences show the gap in technology between Japan and South Korea in the clothes industry.

Table 13 Disadvantages Industry

(Labor-hours)	Japan	South Korea
Fabrics	16	50
Clothes	16 + 9	50 + 10

With the assumption that 1 hour in Japan cost about 5,000 won and 1 hour in South Korea cost about 2,000 won, and the exchange rate remained at 1 yen = 5 won, we can calculate the total cost as below;

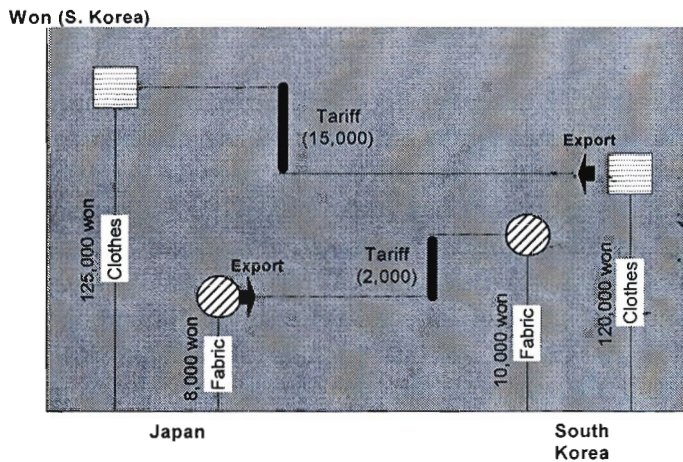
Table 14

(1h = 5,000 won in Japan, 1h = 2,000 won in South Korea, and 1 yen = 5 won)

(Won)	Japan	South Korea
Fabrics	80,000	100,000
Clothes	80,000 + (9 h x 1,000 yen x 5 won) =125,000 won	100,000 + (10 h x 2,000 won x 1yen) =120,000 won

From the Table 14, it is clear that Japan has the comparative advantage in producing fabrics (and disadvantage in clothes industry) and South Korea has the comparative advantage in producing clothes (and disadvantage in fabric industry). This is shown as below:

Fig 8 Comparative Advantage & Disadvantage



We assume that under these conditions of production the Japanese clothes industry (i.e. the comparatively *disadvantageous* industry) decides to undertake FDI in South Korea. The Japanese subsidiary's production cost is as follows:

Table 15 Production Cost

(Won)	Japan	South Korea	<i>Japanese Subsidiary</i>
Fabrics	80,000	100,000	100,00
Clothes	$80,000 + 5,000 \times 9 \text{ h}$ =125,000 won	$100,000 + 2,000 \times 10 \text{ h}$ =120,000 won	$100,00 + 2,000 \times 9 \text{ h}$ =118,000 won

It is shows that, firstly, Japanese subsidiary introduces parent company's superior technology of producing clothes into South Korea and thus, it needs only 9 labor hours instead of 10 labor hours; secondly, Japanese subsidiary employs South Korean workers and pays them 2,000 won (i.e. the South Korean wage rate), instead of 5,000 won (i.e. the Japanese wage rate), and thirdly, as a result of South Korean tariff (i.e. 20,000 won) on fabrics imported from Japan (i.e. 80,000 won) the Japanese subsidiary has to purchase Korean fabrics (i.e. 100,000 won) as its material input for producing clothes.

The 15 shows that the cost of Japanese subsidiary in South Korea is 118,000 won compared to South Korean domestic firm of 120,000 won. Japanese subsidiary will obtain extra profit of 2,000 won. The extra profit of Japanese subsidiary in South Korea is resolved into the following three components as in Table 16 below:

Table 16 Extra Profit for Disadvantage Industry

Input-Price Gap (i.e. Tariff on Yarn)	-20,000 won	(80,000 - 100,000)
Output-Price Gap (i.e. Tariff on Fabrics)	-5,000 won	(120,000 - 125,000)
Labor-Valuation Gap	27,000 won	(5,000 - 2,000) x 9h
Total Extra Profit	2,000 won	

It is clear that the amount of the extra profit of Japanese FDI clothes-disadvantages industry (i.e. 2,000 won) is much smaller that that of Japanese FDI fabrics-advantages industry (i.e. 48,000 won). It is because, despite the large labor-valuation gap (i.e. 27,000 won), both the input-price gap (i.e. -20,000 won) and the output-price gap (i.e. -5,000 won) turn to be negative, since the Japanese fabrics industry is comparatively advantageous industry, and clothes industry is comparatively disadvantageous industry. Although the FDI of a comparatively disadvantageous industry may well be successful because of its absolute advantage in technology and the 'cheap labor effect' in the host country, the FDI is seriously discouraged by the comparative disadvantage of the industry.

Conclusion

We have discussed the cause of a 'paradox' of advantage and the *advantage reversal*. We have examined that the economic advantage in one country may turn out to be an economic disadvantage in another country, and *vice versa*. A 'paradox' of advantage and the advantage reversal becomes a very significant determinant before FDI take place.

Many MNEs undertake FDI on the principle of the absolute advantage. However, it is wrong to say that industries and firms with the absolute advantage in technology are equally encouraged to undertake FDI. The true proposition is that industries and firms with the comparative advantage are relatively more encouraged, while those with the comparative disadvantage are relatively less encouraged to undertake FDI.

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