A NOTE ON THE TRANSNATIONAL SOLUTION AND THE TRANSACTION COST THEORY OF MULTINATIONAL STRATEGIC MANAGEMENT

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Abstract. This article assesses the extent to which the results of Bartlett and Ghoshal’s [1989] work can be incorporated in what has now become one of the core explanations of multinational strategic management, i.e., the transaction cost-based theory of international production. We demonstrate that the transaction cost approach fully incorporates the empirical findings of Bartlett and Ghoshal’s work. To do so requires that we make a new distinction between location-bound and non-location-bound firm-specific advantages. In addition, three possible uses of country-specific advantages by multinational enterprises need to be identified. While the transnational solution, as proposed by Bartlett and Ghoshal, is not itself a new theory of multinational strategic management, it is compatible with the transaction cost-based model of multinational strategic management.

Bartlett and Ghoshal state that “in the future, a company’s ability to develop a transnational organizational capability will be the key factor that separates the winners from the mere survivors in the international competitive environment” [1989, p. 212]. Their observation builds upon work on nine multinational enterprises (MNEs) in three industries. However, it is surprising to observe that very little attention is paid in their work to one of the core theories in multinational strategic management, namely the transaction cost-based model of international production.¹

The purpose of this article is threefold. First, transaction cost theory will be extended to allow it to incorporate some of the complexities of real world

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global strategic management. Second, the empirical data gathered by Bartlett and Ghoshal will be reassessed through a transaction cost lens. Third, the relationship of transaction cost theory to the transnational solution of Bartlett and Ghoshal as an explanation of multinational strategic management will be identified and discussed.

THE TRANSACTION COST THEORY OF INTERNATIONAL PRODUCTION

Transaction cost theory as a predictive model argues that both the form and competitiveness of the international operations of an MNE depend crucially upon the configuration of three elements; Dunning provides a comprehensive overview [1988a]. The three elements of the transaction cost theory of the multinational enterprises are:

First, *firm-specific* (or *ownership-specific*) advantages (FSAs), including both proprietary know-how (unique assets) and transactional advantages. The latter reflect the MNE’s capabilities of economizing on transaction costs as a result of the multinational coordination and control of assets [Buckley and Casson 1975; Casson 1987; Dunning 1983; Dunning and Rugman 1985; Rugman 1981, 1986]. In this context, recent research efforts have focussed on corporate capabilities to develop optimal internal coordination and control mechanisms, taking into account their costs and benefits [Hennart 1991].

Second, *country-specific* (or *locational*) advantages (CSAs), which state that some benefits are associated with locating certain activities in particular countries. These benefits may arise from (a) structural market imperfections such as government regulation [Rugman et al. 1985] and (b) the potential to economize on transaction costs by reducing risks and to benefit from local opportunities [Rugman 1990].

Third, *internalization advantages*. These refer to the relative benefits associated with different entry modes (e.g., exports, licensing, joint ventures, FDI and other forms of investment) when serving foreign markets [Buckley and Casson 1976, 1985; Rugman 1981; Hennart 1982, 1989; Teece 1983, 1985]. Here, market failure is the crucial reason for internalization. It can be related to both natural market imperfections (e.g., the public goods nature of knowledge) and government-imposed market imperfections.

EXTENDING THE TRANSACTION COST THEORY

From the perspective of strategic management there are two main problems with the transaction cost framework as described above, in terms of the use of its analysis of FSAs and CSAs (given that foreign direct investment has been chosen as a more efficient mode of entry than exporting licensing or a joint venture).