Economic Geography and the Location of TNCs: Financial and Professional Service FDI to the USA

Lilach Nachum*
CAMBRIDGE UNIVERSITY

This paper attempts to examine theoretically and empirically the explanatory power of concepts drawn from economic geography for the explanation of the location of TNCs. It combines concepts from economic geography and international business theories in a model that seeks to explain the location of Transnational Corporations (TNCs), and tests the model on financial and professional service FDI to the US. The findings suggest a need to extend the conventional location model of international business by acknowledging the processes taking place among firms located in geographic proximity.

INTRODUCTION

The efforts of international business scholars to identify the characteristics affecting the location choices of TNCs have traditionally been dominated by reference to the relative abundance of certain immobile assets in particular locations. This was an application to foreign direct investment (FDI) of the logic of classical and neo-classical trade theorists, who sought to explain the patterns of international trade with reference to the comparative advantages that arise from the resources abundant within the boundaries of particular countries. Later developments have extended the concept of comparative location advantage from the mere abundance of tangible immobile factors of production to include intangible assets such as culture, human capital and institutional frameworks. But the focus of explanations for the location of TNCs has remained the differences between countries and regions in terms of specific conditions and characteristics (this approach is summarised in great detail in Dunning, 1993).

* Lilach Nachum, Senior Research Fellow, Cambridge University, ESRC Centre for Business Research. She is currently leading a research project on the international competitiveness of UK- and foreign-owned financial service firms in the City of London. She is the author of The Origin of the International Competitiveness of Firms: The Impact of Ownership and Location in Professional Service Industries (Edward Elgar, 1999).

I wish to express my gratitude to Dr. D. Keeble for introducing me to the economic geography discipline and for valuable comments on earlier drafts. I would also like to acknowledge a most illuminating discussion with Dr. F. Wilkinson of some of the central issues addressed in this paper. Both are at the ESRC Centre for Business Research, Cambridge University.
Research in economic geography, which represents a somewhat different way of thinking about the organisation of economic activity, has emphasised the advantages accruing to firms located in geographic proximity as the major factor explaining their location patterns. This research has shown that links among firms, institutions and infrastructures within a geographic area give rise to various forms of localised externalities that are external to individual firms but internal to the cluster, and are vital for the competitive success of the individual firms taking part in them. (Notable examples include Amin, 1994, Saxenian 1994, Scott, 1998, Storper, 1997). As local presence is often a prerequisite for gaining the benefits of these dynamics, the search for geographic proximity to such clusters is a major factor affecting the location choices of the firms concerned.

International business and management scholars have only recently discovered the potential merit in the ideas underlying the theories of economic geography for explaining the activities of firms, and have begun to examine the applicability of these ideas to their conceptualisations. Subsequently, the intracountry differences in terms of the abundance of the resources which provide the basis for the competitive advantages of firms (Porter, 1994, 1998, Ohmae, 1995, Enright, 1998), and the significance of agglomeration economies in explaining the patterns of FDI (Dunning, 1997, 1998) are acknowledged. The dynamics of the interaction of firms with other firms located in proximity are receiving increasing attention and agglomeration economies are being assigned considerable importance in affecting the competitive advantage of the participating firms (as well as of the regions and countries of which they are part).

In this paper I attempt to make some progress in this direction, by incorporating ideas from economic geography in TNC location theory. I seek to examine whether and to what extent such ideas facilitate our understanding of the factors affecting the location choices of TNCs and increase the explanatory power of the conventional location model of international business. In the next section I examine the applicability of ideas drawn from economic geography in explaining the behaviour of TNCs. Some arguments which emerge from this examination are put forward for empirical test, with reference to inward FDI in financial and professional services to the US. The paper concludes by drawing the implications of the introduction of ideas from economic geography for the conceptualisation of the forces that affect the location choices of TNCs and for FDI policy.

**ECONOMIC GEOGRAPHY AND THE LOCATION OF TNCs: SOME THEORETICAL CONSIDERATIONS**

Casual observation suggests that in some industries TNCs exhibit strong patterns of geographic concentration within countries (see Dunning, 1997a, fig. 3.1 for a description of the location of TNCs within the US; see also table 1 ahead). There is also some more systematic evidence which suggests that TNCs are attracted to clusters of economic activity in their own and in closely related industries and activities (Wheeler and Moody, 1992, Head et. al., 1995, 1999, Gong, 1995, Wei et. al., 1998). The concepts used to explain such concentration patterns were initially developed to explain the clustering of small and indigenous firms. As a consequence, their applicability to TNCs, that tend to be large and active in many countries and conti-