Transaction costs economics, knowledge transfer and universal ethical business norms in multinational enterprises

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Abstract: We use Transaction Costs Economics (TCE) theory to explain why ‘knowledge-intensive’ MNEs are more likely to employ universal ethical business norms in all countries where it operates. In TCE terms, transferring people and embedded ideas requires substantial asset-specific investments most efficiently governed in an MNE hierarchy. We extend TCE reasoning to show that: (a) when such transfers are frequent, they are likely to be governed in an MNE with standardised norms; and (b) when the host-country destination of such transfers is uncertain ex ante, they are likely to be governed with a standardised and proprietary MNE norms not necessarily consistent either with the MNE’s home or host country. We conjecture about the substance of such norms, including: (a) non-discrimination; (b) honesty and transparency; and (c) self-control and fairness. We integrate international business and ethics perspectives on business norms in MNEs reliant on adroit knowledge management to compete globally.

Keywords: multinational; knowledge transfer; ethics; transaction costs; governance.


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“You ask what the most valuable asset is. That’s easy: Our people and what they know and do together for clients around the world. You ask what rule or rules we follow in deciding how to treat people in our firm throughout their career? That’s also easy: One rule, no matter where you go in our firm. You can’t attach it to any one country or national culture, but it’s a single rule, like the Benedictines have. I think it’s why people stay and work so hard so well together”.

Excerpt from Interview with McKinsey & Co. Partner (Rennie, 1998)

1 Introduction

A fundamental issue in both International Business (IB) and International Business Ethics (IBE) research relates to whether and how Multinational Enterprises (MNEs) balance needs to be both respectful of different business norms around the world where they operate and consistent in the application of business norms across their operations. By ‘business norms’ we mean a behavioural description of standard operating procedures or routines (Cyert and March, 1963) explaining the way firms treat their employees, customers, competitors and other stakeholders: what a firm’s average employee wage and salary are; what a firm’s standards for customer treatment are; whether and how a firm responds to competitor price changes. In IB research, that fundamental issue of balance has attracted theoretical and empirical attention at least as far back as Stopford and Wells (1972), which delineated basic differences in the structure and routines of MNEs based on whether local (country) subsidiary or home office managers had more authority over the allocation of people and resources. Prahalad and Doz (1987) and other IB scholars (e.g. Bartlett and Ghoshal, 1989; Zaheer, 1995) described such authority allocation as part of the fundamental trade-off in MNEs between revenue-enhancing ‘responsiveness’ to local business norms and cost-reducing ‘efficiency’ from developing a single standard for doing business across MNE subsidiaries. IB research over the past two decades summarised by Peng (2008) and others (e.g. Ghemawat, 2007) has focused on where MNEs position themselves on that continuum, balance local with global norms and optimise returns.

IBE researchers (e.g. Donaldson, 1989; DeGeorge, 1994) have also addressed this issue, but as regards prescriptive ethical (not descriptive behavioural) norms of business – so-called ‘ought’ statements about aspirational routines reflecting firm values: what the firm ought to pay as an average employee wage or salary; what ought to be the firm’s standards for treating customers; whether and when the firm ought to match customer price changes. Again, this fundamental issue has attracted substantial research attention, with particular interest in when responses to these ethical business norms might vary in different parts of the world. Here, IBE researchers respond, perhaps, with less regard about difficulty in balancing local responsiveness with global efficiency. Business ethicists have highlighted alternative philosophical bases for MNEs to make decisions based on Kantian morality (Bowie, 1999), fundamental human rights (Donaldson, 1989), hyper-norms (Donaldson and Dunfee, 1994, 1999) and non-instrumental ethics (Quinn...
Transaction costs economics and Jones, 1995) that varies little, if at all, across the globe. Their justifications assume that respecting these ethical obligations by MNEs can improve strategic behaviour and economic performance. Acknowledging and acting on certain moral obligations, no matter where MNEs are doing business around the world, will lead them to undertake certain strategies, refrain from others and trust as a matter of logic, faith and/or experience that these norms of business are also efficient and effective in competition with other firms.

This view underplays, if not ignores completely, a set of competing arguments consistent with ethicists like Rorty (1985) or Werhane (1999), which might suggest that MNEs should show much more respect for host country norms of business. To do otherwise would ignore diversity in values and impose some form of ethical imperialism also imperiling local business prospects. What Beauchamp and Bowie (2008) describe as ethical relativism might be summarised by the familiar aphorism that ‘when in Rome, do as the Romans do’. Though it finds fewer proponents in IBE research, this alternative to standardisation of ethical business norms across all MNE operations is both plausible and, it would appear, desirable under certain foreseeable business conditions.

More recent empirical research crossing IB and IBE fields documents conditions when MNEs might standardise some but not necessarily all MNE functions in response to pressure from key stakeholders such as customers, competitors and employees. For example, Christmann (2004) documents the MNE tendencies to standardise policies related to communicating, overseeing and enforcing environmentally sensitive business practices in response to customer demands. Brammer et al. (2006) note pressure from competitors driving standardisation of MNE community relations policies as the MNE internationalises. Such studies connect the IB issue of centralising or decentralising MNE policy controls with the IBE issue of standardising or tailoring ethical business norms to local communities. Yet, their connections are still largely descriptive. They propose links between stakeholder interests and MNE policies, but provide no explanation about how and why particular stakeholder interests move from mere relevance to what Sharma (1997) and Mitchell et al. (1997) call ‘salience’ requiring MNE response, nor do they explain the performance implications of MNE response.

In sum, we see a substantial theoretical disconnect between IB and IBE research on how and why MNEs standardise or tailor to local circumstances business norms of conduct. We also see substantial lack of theoretical grounding for research crossing IB and IBE boundaries. These problems matter for IB and IBE research on MNEs, particularly research on how MNEs create, diffuse and exploit knowledge for competitive advantage.

The opening quotation suggests a response to these problems. Prominent MNEs like McKinsey rely for competitive advantage on the ability to get individuals and groups within the firm to develop and share knowledge with each other for different clients located around the world. Apparently, they do so under business norms largely invariant to office or client location. A standardised ‘rule’ for ‘Benedictines’ implies that these norms can be organisationally rather than geographically or (nationally) culturally defined. The Benedictines reference also implies a non-trivial ethical component to these norms. Efficient and effective knowledge sharing on the one hand, and consistent business norms, including ethical business norms, across the MNE may not be coincidental.

Our paper builds on this intuition. It is grounded in a well-defined Transaction Cost Economics (TCE) (Coase, 1937; Williamson, 1985; Teece, 1986) theoretical framework linking enhanced MNE efficiency and effectiveness to decisions about ethical business norms related to the treatment of a salient MNE stakeholder group: employees. The TCE framework explains conditions under which MNEs will give employee interests greater salience. It explains when, in response to those salient interests, MNEs may establish
what we call ‘universal’ ethical business norms. By universal, we mean a standardised set of proprietary (to the organisation) guides regarding the treatment of employees no matter where they are located geographically within the MNE.

Our framework contributes to IB and IBE research by explaining why such universal ethical business norms were adopted for reasons of efficiency and effectiveness rather than as a matter of adherence to fundamental duties or other moral imperatives. In doing so, our framework also contributes to MNE knowledge management research (Hymer, 1970; Teece, 1977; Kogut and Zander, 1993). Our TCE framework development leads to the conclusion that universal ethical business norms for MNE employees are most likely in so-called ‘knowledge-intensive’ (Starbuck, 1992) MNEs reliant on knowledge sharing for competitive advantage. In this way, we explain the strategic importance of ethical business norms for MNEs generally and highlight their importance in determining how and why certain types of MNEs locate at the extreme end of the centralisation-decentralisation policy continuum. They centralise authority and standardise as well as make proprietary ethical business norms of treatment for employees in order to facilitate the efficient and effective transfer of knowledge vital to the MNE success. IB and IBE research perspectives find reconciliation in this TCE logic.

While our framework explains when and why knowledge-intensive MNEs are likely to adopt universal ethical business norms, it says little, if anything, about the substantive nature of such norms. Here, we add to our TCE foundation IBE theories for conjectural guidance. We define and briefly discuss three substantive ethical business norms and their implications for knowledge-intensive MNEs. We again contribute to research on knowledge governance in the MNE with exploration of substantive commitments consistent with the aim of facilitating the efficient and effective flow of knowledge among individual employees and groups located throughout the MNE. Thus, our paper provides theoretical grounding for understanding how universal ethical business norms arise in the MNE as a matter of TCE considerations and which substantive ethical business norms might be universalised.

To elaborate on these points, we divide the remainder of our paper into three parts. In Section 2 immediately below, we first elaborate on key terms in our framework, including knowledge, knowledge-based assets and knowledge-intensive MNEs. We show how these terms fit into a broader IB and TCE logic explaining the emergence and prudential management of international transactions. Then, using TCE-based logic and graphics, we develop our theoretical framework explaining conditions when, as a matter of transaction cost minimising, an MNE is more likely to adopt universal ethical business norms related to the transfer of people around MNE operations. When such transfers are central to exploitation of idiosyncratic (asset-specific) knowledge-based advantages, when such transfers are frequent and when the final destination of such transfers is not easily predictable (uncertainty), then a standard set of proprietary ethical business norms guiding the treatment of people involved in such transfers is likely. As we shall see, knowledge-intensive MNEs like McKinsey fit this description well.

In Section 3, we draw on TCE principles again for conjectural guidance on the substantive nature of such universal ethical business norms. We propose three: (a) employee non-discrimination; (b) honesty and transparency with employees and (c) self-control and fairness in maintaining basic norms even when conditions supporting their importance change. We conclude the paper in Section 4 with a review of key points from analyses, with discussion of implications for research and practice related to MNE strategy and ethics, and with suggestions for future empirical research to investigate evidence related to propositions derived from our theoretical framework.
2 A TCE framework for understanding when standardised ethical business norms will emerge

2.1 Foundational concepts and theories

2.1.1 Knowledge and knowledge-based assets

The concepts of knowledge and knowledge-based assets are foundational to our framework development. We follow Winter (1987) in distinguishing between tangible assets like plant, property and equipment and intangible ideas found in individuals and groups within the firm. We focus here on these intangible ideas. We call them knowledge, which strategy researchers have characterised as valuable, rare and/or difficult to transfer resources (Barney, 1991; Mosakowski, 1993), capabilities (Teece et al., 1997) and/or competencies (PraHALad and HamEL, 1990). We are less concerned about subtle differences among resources, capabilities and competencies. All three terms could describe intangible, knowledge-based assets useful in competition.

Nelson and Winter (1982) emphasise the importance of knowledge-based assets in the routinised activities of individuals and teams within a firm. Knowledge-based assets may be related to a particular product, such as a patent medicine, or to a particular service, such as a routine for pricing and assigning rental cars, airline seats or hotel lodgings. Other knowledge-assets inform the design and implementation of strategies for whole product and service departments, strategic business units, divisional business groups or the entire MNE network of operations. PraHALad and HamEL (1990), for example, note how Canon Corporation uses knowledge about the imaging field to develop an entire line of copying products and services for corporate customers worldwide. Bartlett and Ghoshal (1989) describe Ericsson’s ability to transfer expertise in telecommunications switching technologies across a range of related product and geographic markets.

While knowledge at Canon and Ericsson might be instrumental to the development of new product lines and divisions, know-how may be used as an end in itself. Consider here, for instance, the way in which professional firms in law, accounting, finance and management consulting turn to certain individuals and/or teams for the production and dissemination of advice to other professionals and clients globally. International professional service firms like McKinsey regularly shift individuals and practice teams across operations worldwide to develop and disseminate specialised, sometimes quite esoteric knowledge valuable to clients. In this way, individual knowledge flows become corporate knowledge stocks that, in turn, reinforce corporate-wide routines from an evolutionary perspective (Nelson and Winter, 1982).

2.1.2 Knowledge-intensive firms

Starbuck (1992) describes reliance on such specialised knowledge disseminated corporate-wide as indications of a ‘knowledge-intensive’ firm strategy. Knowledge-intensive firms are not necessarily information intensive. They are not mere data custodians or routine data manipulators as, say, credit card processing firms might be. The esoteric nature of knowledge created, its difficulty in articulating simply, the professional, often academic research training required to develop and disseminate knowledge to firm stakeholders all determine the degree of knowledge intensity. For Starbuck, professional service companies in law and management consulting describe
knowledge-intensive firms with top-tier law firms like New York City’s Wachtell, Lipton, Rosen & Katz as the exemplar. But other firms dependent on the creation and dissemination of technology innovations developed in labs, proving grounds and ‘skunk-works’ led by teams of scientists also fit in the knowledge-intensive category. Indeed, a growing number of firms operating in industries with high research and development (R&D) expenditures as a percentage of sales are candidates for inclusion in the knowledge-intensive category. Vaaler and McNamara (2010) document more than 10,000 firms operating in 30 knowledge-intensive industries in the USA with R&D expenditure-to-sales ratios more than one standard above the economy-wide mean. These industries include: biotech, information technology hardware and software, aerospace and defence, pharmaceuticals and medical testing equipment, communications and media, and related consulting services. Evans and Schmalensee (2002) and others (e.g. Posner, 2001) note that such firms depend primarily on the creation and company-wide exploitation of knowledge rather than physical assets for survival and success.

2.1.3 Knowledge, internal expansion and MNEs

How and why knowledge-intensive MNEs arise are familiar questions in IB research, particularly IB research grounded in TCE theory? Indeed, answers to these questions are as old as the IB field. As Teece (1986) points out, prior to the 1960s, economists did not consider the MNE to be a distinct phenomenon. It was simply an arbitrageur of capital, moving investment funds from countries where returns were low, such as the USA and the UK, to those countries where returns were higher, such as India or Brazil. The MNE earned arbitrage profits while serving the world-wide re-allocation of capital.

Hymer (1970) changed this view and observed that patterns of asset movement defied the arbitrage hypothesis. Instead, transfers took place between more developed economies rather than from developed to developing economies. A more plausible theory of internationalisation argued that firms went abroad to exploit certain special advantages developed internally. MNEs could try to export assets comprising these advantages or it could try to produce them through cooperative agreements with foreign firms. Internal expansion abroad would be a preferred strategy where costly negotiations with and misappropriation of assets by foreign firms was likely. MNEs emerged as an alternative to problematic international trade involving assets that have characteristics not unlike knowledge assets.

Analysis of the benefits and costs of internalised production and expansion through MNEs built on Hymer’s (1970) insights and emerged as a dominant logic in IB research of the 1970s and 1980s. ‘Internalisation’ researchers from Buckley and Casson (1976) to Rugman (1981) and Hennart (1982) developed Hymer’s (1970) basic logic, and promoted a stream of work that Henisz (2003) highlights for its continued importance in the 2000s. This IB research parallels a stream of work in strategic management explaining internal expansion through multi-business corporations more generally. For example, the so-called ‘resource-based’ view of firm articulated since Wernerfelt (1984), Barney (1986) and others, and reviewed by Mahoney (2005) emphasises that valuable but difficult-to-trade assets within the firm are often exploited internally in multi-business corporations rather than sold to other firms. Costs of discovering and credibly conveying value in negotiations can be substantial. So too can be the possibility of misappropriation by would-be purchasers. Internally developed and exploited resources provide a basis for explaining the emergence of multi-business corporations as well as their performance differences over time.
While we can conceive of many types of assets within firms prompting internationalisation through MNEs, perhaps the strongest case for such internal expansion arises when assets are knowledge-based. This insight reaches at least as far back as the 1970s and the work of Buckley and Casson (1976). Knowledge-based assets are most vulnerable to erosion in value due to costly negotiation with and/or misappropriation by firms abroad. Such assets may be difficult to value or transfer efficiently. Know-how in the form of a licence may be costly, if not impossible, to negotiate if there is no well-developed legal regime to assure the selling licensor and buying licensee that they have enforceable contract rights. Advances in Intellectual Property (IP) regimes since the 1980s may have lessened such concerns for patentable technologies and licensable trademarks and business processes such that cross-border sales might work satisfactorily. But certain valuable know-how controlled by firms may still be only weakly appropriable if at all. IP legal scholars like Gruner et al. (2006) note substantial variation in legal appropriation regimes persisting in the 2000s, even in countries with similar industrial economic and political structures. Cross-country differences undermine cross-border sales of know-how. Some types of knowledge may also be difficult to trade internationally given consistently weak appropriation regimes worldwide. Petruzzi et al. (1988) told us more than 20 years ago and Makadok (1998) repeated a decade later that many types of financial products, processes and routines of firms in banking, insurance and real estate were difficult to protect meaningfully through patents and copyrights.

Yet other forms of know-how related to unprotected and perhaps unprotectable regimes lead to total breakdown in negotiations and almost compel internalisation as the only means of effective and efficient exploitation. Consider, for example, the daunting challenges of ‘licensing’ the Wachtell, Lipton approach to defending against hostile acquisitions, or McKinsey & Company’s approach to identifying market segments in emerging technology industries. If such processes could be articulated in the first place, then knowledge ‘sellers’ would still be hard-pressed to convey the means of effective knowledge transfer without substantial cost and/or lost value. Revealing details about these processes in negotiations might actually convey the essence of their value to would-be buyers also decreasing the value of any final sale. In these and other contexts described above, knowledge-intensive firms, including MNEs, have advantages in exploiting valuable know-how by means other than inter-firm trade. Knowledge-intensive firms seeking to internationalise tend to expand abroad internally, through establishment of foreign subsidiaries governed by MNEs.

2.1.4 TCE theory and the MNE

TCE-based research in the social sciences substantially predates MNE internalisation research, but the two theories share common assumptions about the nature of individuals and organisations engaged in valuable exchange over time. Indeed, TCE theory may benefit from greater developmental attention than internalisation theory when it comes to understanding motivations for using alternative regimes to expand economic activity by firms, including MNEs of central interest in this paper. As we will see below, TCE theory uncovers conditions when MNEs are more likely to develop a standardised set of ethical business norms across their operations as a matter of economic efficiency.
Recent reviews of TCE research by Mahoney (2005), Foss (2005) and Bucheli et al. (2010) provide the basis for our summary of this perspective. TCE theory runs back at least as far as Coase’s (1937) descriptive analysis and then through various refinements primarily by Williamson (1975, 1985, 1996a). Consistent with these analyses, we define transaction costs as the costs of producing and overseeing the exchange of goods and services over time. By TCE theory, we mean an analytical perspective for evaluating alternative regimes for effecting transactions based on their prospective costs. Alternative regimes for transactions are often described in polar terms: at one pole is a ‘market’ regime using contract and price negotiation for parties to arrive at terms of exchange; at the other pole is a ‘hierarchy’ regime using bureaucracy and fiat for parties to arrive at terms of exchange. Williamson (1996a) and others have also described ‘hybrid’ regimes including both market and hierarchy regime components. TCE assumes that parties seek a regime that minimises transaction costs. Indeed, transaction cost minimisation becomes the essence of strategic management (Williamson, 1999).

In deciding the appropriate transaction regime, TCE theory assumes that parties are ‘boundedly rational’ (Simon, 1947), that is they seek a comprehensive understanding of transaction costs under alternative regimes, but have only limited capabilities to do so. TCE theory also assumes parties act self-interestedly to the point of withholding or distorting information critical to any exchange of goods or services if it serves the firm. The impact of bonded rationality and opportunism is especially important for choosing regimes in the context of few prospective exchange parties, what Williamson (1975) termed as the small-numbers bargaining problem. Other important TCE factors include the uncertainty surrounding transactions, the frequency of such transactions and the extent to which individuals or firms in a transaction must invest in specialised goods and services – what Williamson (1985) called asset specificity.

The descriptive aim of TCE theory is to compare the costs of producing and exchanging goods and services over time between individuals in a market versus alternative regimes where individuals ‘internalise’ aspects of transactions by employing rather than contracting with individuals, by merging rather than selling at arm’s length to firms and by otherwise replacing markets with bureaucratic hierarchies. The primary normative aim of this perspective is to define the circumstances when internalisation would be more cost-efficient than leaving transactions in the market. Thirty years of empirical research highlights the prime importance of asset specificity but also frequency and uncertainty as relevant TCE factors affecting the choice between market-based and hierarchy-based regimes. Where, in particular, there is high asset specificity for one party involved in a transaction, there is a greater likelihood that transaction costs will be lower within a hierarchical bureaucracy rather than in the market regime where parties can contract freely. The impact of transaction frequency and uncertainty on this choice is less determined either theoretically or empirically, and is thought to be contingent on specific transaction circumstances.

Notice how TCE reasoning closely tracks and expands on the basic logic of internalisation applied to MNEs. In both, the focus is on how firms establish optimal boundaries for purposes of optimising exchange relationships. In both, the default approach is rather limited boundaries given the inherently greater efficiency of inter-firm exchanges governed by contracts and markets rather than by fiat within the organisation. In both, however, there are exceptional circumstances, often involving knowledge-based assets, where concerns of misappropriation within a market setting will cause one party or the other to seek a transaction’s internalisation. An individual contractor becomes a
firm employee. A firm supplying a component is acquired and becomes a division. In these and similar circumstances where transactions cross political borders, we can see how a firm with expanding business can become an MNE with wholly owned subsidiary operations abroad. What TCE adds to this analysis is greater detail and rigour regarding explanations for such transaction decisions.

2.2 Framework development

We make this point through development of our TCE framework in three steps. We will show that the transaction cost minimising set of institutions and mechanisms for the knowledge-intensive firm include: (a) internalised expansion to exploit knowledge assets in MNE subsidiaries; (b) standardised terms covering the exchange of these knowledge assets among MNE subsidiaries and (c) proprietary (to the MNE) terms covering the exchange no matter which host countries where MNE subsidiaries are located. This result follows from applying Williamson’s (1975, 1985) three principal factors influencing the choice of exchange governance mode under TCE: transaction asset specificity, frequency and uncertainty. As we develop each of these points regarding the appropriate transaction regime for transferring people with valuable knowledge, we also gain insight on appropriate ethical business norms to guide such transfers. Under certain conditions, that insight leads to adoption of universal ethical business norms.

2.2.1 High asset specificity and internalised exchange

From the TCE perspective, the first and perhaps most important attribute for assessing a transaction and identifying the appropriate governance structure is the degree to which individuals involved in the transaction must invest in what Klein et al. (1978) called dedicated assets. Their value in a given transaction is significantly higher than in their next best use. For example, a professional consultant may pursue an academic or professional qualification in order to complete a project for a client. A supplier may invest in equipment to fabricate specialised components in order to win a contract from a manufacturer. Williamson (1985) thought transactions with ‘high asset specificity’ followed from the need to create dedicated investments.

Market-based arrangements are often sufficient to safeguard buyers and sellers in transactions which do not involve high asset specificity. Perhaps the consultant’s academic or professional training can be easily redeployed if her project is suddenly cancelled by the client. The supplier of specialised components may suspect that her client-manufacturer is near bankruptcy; yet this supplier also has in mind a second manufacturer with substantially the same needs. The second manufacturer can also use the remaining inventory of components if the first distressed manufacturer fails. Of course, assets that are highly specified to a particular type of transaction may be expensive to redeploy. If so, then parties to an exchange can become subject to a hold-up problem. In this situation, some parties – say the client obtaining consulting services or the manufacturer benefiting from specialised components fabrication – can take advantage of their counterparts who are no longer able to opt out of an arrangement except at considerable cost. Again, Williamson (1985) supplies an apt description. Opportunism is self-interest seeking with guile, meaning that parties have incentives to withhold key information about a prospective exchange and to reveal and exploit that information to renegotiate terms favourably later. Prospective parties to a transaction
involving high asset specificity may anticipate some opportunistic behaviours and negotiate additional incentives or penalties before exchange ensues. Foresight is limited as are mechanisms to implement incentives or penalties. Incomplete information and mechanism availability make the choice of governance mode crucial.

Consider how this choice would apply to a firm as it examines the costs of transferring the asset abroad by means of the market, that is by exporting it through sale to a foreign firm, by licensing its use abroad, or by jointly producing it with a foreign firm. The firm also examines the costs of transferring the asset abroad by means of internal expansion, that is by establishing an MNE subsidiary in the foreign market. As asset specificity increases, the costs of expanding abroad by means of market structures increase faster than the costs of governance through firm structures. Eventually, the total costs of a given asset exchange using the market and inter-firm trading exceed those of using internalised production and international expansion by the MNE.

This relationship between asset specificity and the total costs of asset exchange in the MNE follows Williamson’s (1985) description of the same relationship in firms more generally, and is graphically represented following Williamson’s (1985) lead in Figure 1 below.

**Figure 1** Asset specificity and MNE exchange

A certain output is assumed and the horizontal axis refers to the extent of asset specificity, $A$, while the vertical axis measures costs to the MNE. The curve $\Delta Q$ denotes the difference in production cost between internalised and non-internalised production. It is positive everywhere, indicating a production cost disadvantage in internalisation that approaches zero for extreme values of $A$. 
The curve $\Delta P$ denotes the difference in governance costs between market and internal transacting. When $A$ is zero or small, internalisation of transactions is more costly compared to market-based exchanges. But as $A$ increases, internalisation saves on transaction costs relative to use of markets. This follows primarily from the steeply declining curvilinear slope of $\Delta P$. This slope suggests that governance costs quickly erode advantages and then produce governance cost disadvantages from use of the market at moderate values of $A$.

At $A_0$, integration is efficient since it economises on net production and governance costs denoted by the straight line, $\Delta P + \Delta Q$. At all points to the right of $A_0$, the MNE will find internal expansion abroad to be more efficient than trading with a foreign enterprise. At $A_0$, for example, the net savings from internalised production will be equal to the distance $A_0W$. To the left of $A_0$, say $A_1$, the net loss from internalised production will be equal to the distance $0Y$, which represents production costs, and $OZ$, which represents the transaction costs associated with this approach. The intuition behind Figure 1 is straightforward. Transactions with high asset specificity tend to be internalised by the MNE, largely because of increasing governance (not production) costs. Demonstrating that point graphically takes us part of the way towards showing that the knowledge intensive MNE will often find it economically attractive to set up universal norms of ethical practice.

An example enables us to illustrate the results shown graphically. Consider a management consulting firm currently operating in a single country but considering how it might increase its profits by accessing markets abroad. The basis for this firm’s advantage resides in tacit and team-embedded consulting know-how – perhaps it is know-how related to commercialising new products effectively or to implementing pay-for-performance incentive plans. Our graphical illustration above suggests that the management consulting firm has two sets of choices. The first set of choices involves various market-based mechanisms for ‘exporting’ the firm’s know-how. It may export by means of ‘renting out’ consultant teams to management firms in other countries. It may licence a firm overseas to confer occasionally with these teams, or set up some sort of joint venture involving the sale of equity to the foreign affiliate. The other set of choices involves internal expansion abroad through various subsidiary modes. A wholly owned subsidiary abroad means the transfer of team skills will be accomplished through bureaucratic rather than market modes. While market-based mechanisms may be a more efficient mode of producing consulting services abroad relative to bureaucratic mechanisms, the governance costs of monitoring market-based transactions may swamp any of its production advantages. Because we expect rather high monitoring costs associated with exporting this tacit and team-based know-how, we also expect to see the management consulting firm to opt for a wholly owned subsidiary mode of expansion. Indeed, management consulting companies like McKinsey or law firms like Wachtell, Lipton rely on this mode for expansion into foreign markets.

2.2.2 High frequency and standardised norms governing exchange

Why should the MNE develop its own standardised approach to the exchange of knowledge assets across operations? Put another way, why not simply let managers in each of host-country MNE subsidiaries negotiate their own terms for the exchange of individuals or teams with valuable know-how? The existence of a standard operating procedure for transfers may seem like a constraint on the subsidiary manager seeking to
structure the right transfer terms for a particular employee or team of employees. On the other hand, standardised norms of exchange, viewed from the perspective of the whole network of MNE operations, may provide for greater efficiency. As members of the MNE, they commit to observing certain corporate-wide operating procedures. Terms of transfer are substantially known in advance by concerned employees and less time and fewer resources are spent negotiating and implementing exchanges. Prominent MNEs like Colgate-Palmolive, for instance, promote international assignment policies with standard rules setting in advance the costs of orientation, moving and settling, income equalisation, children’s education and home leave for managers and their families (Rosenzweig, 1994).

The transaction efficiencies of standardised terms throughout the MNE are largely driven by the frequency with which the exchanges take place. The cost of establishing an MNE standard – developing the standard, educating managers about it and enforcing it in the breach – will be easier to recover if, when transactions are frequent, its contracts are standardised. Look again at a graphical illustration of this point given in Figure 2 below.

**Figure 2  Frequency and MNE exchange**

The figure compares changes in the overall costs of standardised versus non-standardised ad hoc agreements governing the intra-MNE exchanges of increasing frequency. Again, a certain output is assumed as in Figure 1. The horizontal axis in Figure 2, however, refers to the extent of exchange frequency, $B$, while the vertical axis measures costs to the MNE. The curve $\Delta Q$ denotes the difference in exchange cost between standardised and non-standardised exchange. It is positive everywhere indicating an exchange cost disadvantage in standardisation – left alone; MNE country managers would be able to tailor agreements to swap individual employees and teams of employees with greater
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precision and efficiency than managers back at the corporate headquarters. Its shape, however, shows that this disadvantage declines as $B$ increases, and in the limit it approaches zero.

The curve $\Delta P$ denotes the difference in governance costs between transacting with standardised MNE terms and transacting based on non-standardised terms. When $B$ is zero or small, standardisation of transaction terms is more costly to govern compared with non-standardised market-based exchanges. But $\Delta P$ declines rapidly so that advantages from tailoring rather than standardising agreement terms disappear and then become governance cost disadvantages. At $B_0$, standardisation is efficient since it economises on net exchange and governance costs denoted by the straight line, $\Delta P + \Delta Q$. At all points to the right of $B_0$, the MNE will find the development of uniform policies of intra-firm trade in ‘assets’ to be more efficient than giving the country managers discretion to set all of the terms of exchange. At $B_2$, for example, the net savings from standardised norms will be equal to the distance $B_2W$. To the left of $B_0$, say $B_1$, the net loss from uniformity will be equal to the distance $0Y$, which represents costs of transfer, and $OZ$, which represents the total transaction costs associated with this approach. As frequency of transacting within the MNE increases, standardised ethical business norms of exchange will be easier to justify on efficiency grounds.

Our fictional consulting firm may again serve as an example of the trend illustrated graphically above. If the management consulting firm has few consulting contracts abroad, then may be it would be most efficient to let those managers handling foreign projects to decide on what terms (implying what ethical business norms) to apply. But as the number of consulting projects increases, it may become necessary to establish some standardisation regarding exchanges of personnel from different offices, compensation to different office managers for such transfers and the ultimate staffing arrangements for such engagements abroad as a matter of overall corporate effectiveness and efficiency.

2.2.3 High uncertainty and proprietary norms governing exchange

We have shown that high asset specificity prompts internalisation of firm exchanges abroad, while high frequency engenders the development of standardised terms for such exchange. Yet, the standardised terms could take the following form: ethical business norms for the transfer for individuals or teams moving from one of the MNE’s country operations to another should follow from norms prevailing in the destination country. If employees are moving to Stockholm, then transfer terms related to pay, perquisites and project opportunities follow Swedish standards. If employees are moving to Doha, then pay, perquisites and project opportunities follow local Qatari standards. The standardised terms could take just the opposite form. Ethical business norms for the transfer could follow from practices prevailing in the headquarters country. Whether going to Stockholm or Doha, the standard set of terms invoke ethical business norms prevailing in the USA, UK, Japan, Singapore or wherever else the MNE may be headquartered. Individuals and teams in such an MNE would become ‘bilateral’ knowledge-transfer specialists. They move between the USA and Sweden or between the USA and Qatar exclusively. In this context, standardisation based on ethical business norms of the home or host countries is supportable.

Injecting uncertainty into such transactions changes things. As Williamson (1985) notes, the influence of uncertainty on the economic organisation of transactions is conditional. Increase in what individuals do not or cannot know may matter little for
transactions where assets supporting them are non-specific. Recall our example about a
components supplier of components with uncertainty about the future solvency of its
component manufacturer. If there are alternative potential customers for the components
then the supplier is less likely to be left holding worthless inventory in the event of a
manufacturer bankruptcy. Since new trading relations are easily arranged, continuity of
the relationship has little value and uncertainty is irrelevant. Uncertainty takes on
importance once asset specificity is observed. Now the manufacturer’s financial distress
can be a problem for the supplier whose components lose value the moment they have to
be redeployed to another potential client.

The role of uncertainty in MNE exchanges is also conditional on the existence of
asset-specific investments and frequency in transacting with those investments. We begin
with the assumption that the MNE is competing based on knowledge assets which are
best preserved by exploiting them abroad via internalisation. The uncertainty of such
transactions concerns the prospective destination of the MNE’s knowledge assets. Where
the individuals or teams transfer to and from only one particular node of the MNE
network of operations, there is relatively little uncertainty, and the norms of the host
country may be appropriate to govern the transfer terms. Norms of the host country are
less likely to result in any outcomes employees deem inequitable. Indeed, the MNE has
the opportunity to select in advance individuals and teams whose characteristics match
those of the local environment. Because their range of deployment is limited, the MNE
manager need not worry that the same qualities conducive to transfer and work in one
country subsidiary may not be conducive to transfer and work in a different country or
culture. The use of knowledge assets is limited to specific parts of the MNE subsidiary
network.

Where, on the other hand, the breadth of prospective country deployment for these
individuals is large, the MNE manager’s job becomes more complicated. Fit with one
culture or country may yet render the team of employees unfit to work effectively under
the different norms of another country. Think, for example, of a new product marketing
team which is made up primarily of women and which is sent first to a locale where
women make up a large portion of the MNE’s managerial workforce – say, Stockholm –
followed by deployment to another country operation where managerial opportunities for
women are less broad – say, Doha. This is because the team’s ability to operate in one of
the environments may be stifled if the MNE’s norms of practice follow the local culture.
In the case at hand, the female members of the team would have many project
opportunities, superior pay and perquisites in Stockholm, but perhaps fewer project
opportunities and related pay and perquisites where their competence is less highly
valued and respected in Doha. The overall value of certain members of the team is
diluted, and the incentives for female members to serve on such teams reduced. A policy
of following differing norms of practice creates dissonance about the extent to which the
MNE values the contribution of certain individuals and the teams in which they work.

The costs of maintaining the free flow of knowledge assets with deployments that are
varied and largely unknown in advance may require MNE managers to dispense with
ethical relativism and adopt standardised ethical business norms tailored to the MNE. It
is an interesting irony that, to preserve and exploit MNE know-how in a particular
country operation, the MNE may have to deviate from the country’s norms of conduct.

Again, the TCE reasoning for this shift from host country to universal MNE norms
can be graphically illustrated in Figure 3 below.
Figure 3  Uncertainty and MNE exchange

The figure compares changes in the overall costs of norms of exchange using universal MNE norms versus country-based norms. A certain output is once again assumed as in Figures 1 and 2. This time, however, the horizontal axis refers to the extent of ex ante exchange uncertainty, \( C \), while the vertical axis measures costs to the MNE. The curve \( \Delta Q \) denotes the difference in exchange cost between universal MNE-based norms and host country-based norms of exchange. It is positive everywhere, indicating an exchange cost disadvantage in using a single set of exchange norms for all transactions – at any one instance; MNE managers would find greater efficiency and effectiveness in having an individual whose background and skills fit local ethical norms closely. The shape of this curve, however, shows that the disadvantage declines as \( C \) increases, and in the limit it approaches zero.

The curve \( \Delta P \) once more denotes differences in governance costs, but this time between making transfers based on proprietary MNE norms and varying transfer terms based on home or host country norms. When \( C \) is zero or small, use of MNE-based norms is more costly compared to using country norms of exchange. But as \( C \) increases, cost advantages from using multiple sets of ethical standards tied to a particular country erode quickly. Again, \( \Delta P \) declines curvilinearly and soon yields negative governance cost advantages. At \( C_0 \), it is efficient to abandon country and adopt a proprietary (to the MNE) set of ethical business norms since it economises on net exchange and governance costs denoted by the straight line, \( \Delta P + \Delta Q \). At all points to the right of \( C_0 \), the MNE will find the development of its own proprietary ethical business norms. At \( C_2 \), for example, the net savings from proprietary MNE norms will be equal to the distance \( C_2W \). To the left of \( C_0 \), say \( C_1 \), the net loss from having a single proprietary set of norms tied to the MNE rather than to a given country will be equal to the distance \( 0Y \), which represents costs of transfer, and \( OZ \), which represents the total transaction costs associated with this
approach. As uncertainty about the destination of knowledge assets within the MNE increases, a single set of proprietary ethical business norms is likely to replace an approach based on ethical business norms where the MNE operates or is headquartered.

Our fictional management consulting firm again provides an example consistent with the graphical illustration described immediately above. Recall the marketing team led by women. Perhaps it would be prudent to consider reshuffling the team membership and leadership if it were to operate frequently abroad but almost always abroad in Doha. The first assumption behind this suggestion is that clients from Doha would not prefer to deal with women in a leadership role. A second assumption behind this suggestion is that the team would not be deployed by the consulting firm beyond this limited geographic scope. Women excluded from leading the marketing team in this limited ‘off-limits’ zone might still find substantial opportunity with other clients of the consulting firm. In this limited case, reference to host country norms in transferring individuals and teams may still make economic sense.

On the other hand, the marketing team’s engagements in Doha may constitute the first of many future engagements that will spread to other countries with different mores regarding the role of women in the workforce. Whoever leads the marketing team in Doha will likely teach and lead others as the practice expands. Women leading the team in Doha today are increasingly valuable for the know-how they can convey throughout the network of MNE subsidiary operations and not merely for what they convey in this instance in this locale. Indeed, women in this situation may have options to jump to another company with fewer qualms about what clients in one locale today think about culturally different approaches to leadership. Needs for efficient and effective transfer throughout the network become more important than who is in front of the client in Doha today. Thus, an increasing likelihood of deployment elsewhere raises uncertainty regarding which host (or home) country should serve as the referent for determining norms of ethical practice. Where the deployment possibilities are broad, it may be more efficient and effective from a TCE perspective for the consulting firm to adopt a proprietary set of norms that, presumably, do not discriminate against women leading this or any other team.

2.3 Mapping the TCE and ethical business norm position of knowledge-intensive MNEs

The TCE-based framework is now complete. It suggests that, as a matter of transaction cost efficiency and effectiveness, MNEs reliant on the frequent and flexible flow of knowledge embedded in individuals or teams are more likely to develop universal ethical business norms no matter where the MNEs operate. TCE concepts of asset specificity, frequency and uncertainty provide the key components leading to this conclusion about optimal knowledge governance and ethics central to IB and IBE research.1

Not all MNEs fall into the ‘universal’ category. Think, for example, of MNEs, which may have some hard-to-trade assets, but still rely more substantially on other sources to compete successfully. The other sources may be access to low-cost natural resources or to financial subsidies from local governments. Such MNEs are under less pressure to adopt universal ethical business norms to facilitate knowledge transfers that are less important to firm performance. Indeed, they may be obliged to develop ethical business norms based on some degree of ethical relativism. To ignore local norms in this situation might only magnify an intrinsic liability of foreignness that MNEs manage in any foreign
This alternative set of ethical business norms might fit more closely with MNEs emphasising Prahalad and Doz’s (1987) local ‘responsiveness’ instead of global efficiency. In this case, MNE operations are a set of loosely affiliated national subsidiaries pursuing what Porter (1986) described as simple *multi-domestic* strategies. Operational strategy is delegated largely to the country managers and they share few resources. Knowledge-intensive MNEs are, by contrast highly integrated and interdependent, what Bartlett and Ghoshal (1989) described as *transnational* firms.

Figure 4 summarises our TCE-grounded points about when MNEs are more likely to develop a universal ethical business norms as a response to challenges related to knowledge transfer and exploitation.

The figure maps MNEs according to their scores on each of three TCE dimensions we analysed above: asset specificity, frequency and uncertainty. A mapping assumption is that there is some low but sufficient level of asset specificity, frequency and uncertainty associated with the transfer of valuable knowledge meriting the emergence of an MNE. But given this emergence, not all MNEs map onto the knowledge-intensive MNE position where asset specificity, frequency and uncertainty regarding the geographic locale of knowledge transfer are all high.

Simple multi-domestic MNEs, for example, map near the origin of all three axes. Between these two extremes reside MNEs with some but not all of the characteristics leading to a standard set of ethical business norms. In broad middle space of Figure 4, MNEs may exhibit some mix of ethical business norms that remain constant or vary across geographic locales. Consider, for example, MNEs more dependent on knowledge-based assets and thus scoring high on the asset specificity dimension. Yet, the frequency and uncertainty of locale for transferring such knowledge is low. Here, again, we might not expect universal ethical business norms to emerge. These MNE managers have a
heightened awareness of the value derived from knowledge-based assets. Yet, that knowledge is largely locally sourced and infrequently shared, thus decreasing the need for the development of standard ethical business norms that are proprietary to the MNE.

Consider also the possibility of an MNE highly reliant on hard-to-trade knowledge assets (high asset specificity) and their frequent (high frequency) but not uncertain transfer – they move predictably between well-defined destination pairs (low uncertainty). Christmann (2004) may have been highlighting this sort of MNE when documenting tendencies for the MNE to standardise processes of communicating with stakeholders regarding environmental business norms, even if the underpinning ethical norms themselves varied with subsidiary location.

In only one of eight possible mapping positions in Figure 4 we expect that MNEs will adopt standardised ethical business norms based on proprietary MNE values: where transaction asset specificity, frequency and uncertainty are all high. Again, the paradigmatic MNE in this universal category may be a professional services firm substantially reliant on the frequent transfer of individuals and teams across a range of geographic destinations that are difficult to predict in advance. In these special circumstances, standardised norms tied to no one geographic locale – a Benedictine basis – are likely to dominate for reasons of transaction cost efficiency and effectiveness, not necessarily because of moral conviction.

3 Substantive ethics to universalise in the knowledge-intensive MNE

Thus far we have maintained that, as a matter of TCE efficiency and effectiveness, knowledge-intensive MNEs are likely to develop universal ethical business norms to transfer knowledge assets across their operations. This TCE-grounded argument has moral implications, but to this point they have been developed in a somewhat oblique manner. We now develop these implications more directly. Substantive moral beliefs and their consistency in some broader ethical system constitute an important part of an MNE’s knowledge and behavioural routines. These understandings and ways of doing business influence, in turn, firm culture, which Barney (1991) and others have identified as a key resource explaining organisational performance differences over time.

TCE theory and practice again provide guidance for our search for substantive ethical business norms. This may surprise some readers, since TCE theoretical assumes tendencies among exchange parties towards opportunism, a term Williamson (1975, p.26) described as ‘self-interest seeking with guile’. This assumption may seem amoral or even immoral nature. Indeed, it may explain why Ghoshal and Moran (1996) as unrealistic and prompted them to question the practicality of the TCE perspective for explaining behaviour in business transaction. In any case, a theory reliant on such an assumption may seem, at first, to be an inapposite guide to identifying substantive ethical business norms.

Williamson (1996b) responds to Ghoshal and Moran (1996) and to other TCE sceptics by indicating that opportunism is a rebuttable assumption in TCE theory. Without knowing more about the transaction parties, opportunism provides a realistic description of the way behaviours and motivations are likely to be received by all involved. But we often do, in practice, know more about the individuals with whom we do business. For example, we learn through repeated transactions with the same individuals and through behavioural cues individuals give during a given transaction.
And insofar as we know more about the ethical business norms of counterparties, we can identify ethical business norms that render in part the assumption of opportunism in a particular exchange less likely. We refer to such norms as comprising the ‘moral climate’ of the MNE.

In this section, we briefly highlight three ethical business norms comprising an MNE’s moral climate and thereby the likelihood of opportunistic behaviour increasing transaction costs. Since we are primarily concerned with knowledge-intensive MNEs, our first ethical business norm is organisational non-discrimination against its employees who are also agents of knowledge transfer. Our second and third norms for inclusion have more general application. The second ethical business norm is organisational honesty and transparency with employees so that these agents of knowledge transfer in MNEs can deal with each other in trust. The third ethical business norm is organisational ‘self-control’ to guard against radical changes in rules related to the transfer and treatment of employees if conditions change. This third norm does not prohibit adjustments to transfer rules in changed circumstances. It merely requires some changes be justified on some equitable basis for all concerned. Such ethical business norms support exploitation of knowledge-based assets in MNEs, particularly knowledge-intensive MNEs likely to adopt universal ethical business norms described earlier.

3.1 Moral climate and competitive advantage

In our overview of this section, we introduced the concept of moral climate with little explanation beyond a collection of ethical business norms followed by a firm. Victor and Cullen (1988) describe moral climate as the shared perceptions of prevailing organisational norms established for addressing ought questions we posed at the beginning of our paper. They are embodied in organisational members as well as in organisational routines and incentive structures. Moral climate constitutes a form of knowledge about how to proceed in the face of value-charged dilemmas. To the extent others observe this knowledge in action, an organisation’s moral climate becomes part of an organisation’s reputation and integrity.

Many MNEs hold that their distinctive moral climate conveys a favourable reputation for integrity and, therefore, competitive advantage in the marketplace. Reputation for organisational integrity is part of their ‘brand’ identity. MNEs like healthcare giant Johnson and Johnson not only espouse integrity in decision-making based on beliefs in fairness and honesty, but also actively promote such commitments in customer advertising and in communications to firm stakeholders. If valuable in competition then advertising and communication about moral climate needs something more. It must also be grounded in basic routines, and difficult to reverse if desired by top management. In this way, decisions about value-charged issues can become what Ghemawat (1991) might describe as organisational ‘commitments’ or components of Barney’s (1991) organisational culture, or organisationally dedicated assets from a TCE perspective (Williamson, 1985). No matter the nomenclature, decisions flowing from such beliefs can become valuable and can generate organisational performance differences over time.

Readers may note that we have not touched on ethical codes as sources of moral climate. Aguilera and Cuervo-Cazerra (2004) tell us that corporate codes of conduct hearken back at least to the late 1970s when the USA-based Business Roundtable prescribed ethical behaviours for top managers and directors in the wake of several corporate scandals. Written codes of ‘ethical conduct’ or ‘good governance’ have since
proliferated in US and foreign firms, particularly since the 1990s. But perhaps written codes are themselves worth little. In TCE terms, written codes are not specific to firms but more generalisable to the industry or broader economy in which several firms operate. If written codes are valuable assets, then they have rather low asset specificity. They can be easily adopted – a motion of the board of directors – amended and/or copied by others. Indeed, organisations developing codes of conduct seek their adoption across an industry or economy as in the case of the Business Roundtable in the late 1970s. Written codes have organisation-specific meaning, convey organisation-specific commitments and constitute organisation-specific value when paired with consistent beliefs and routines in organisational actions. Put another way, MNEs can have great written codes but awful moral climate if beliefs and behaviours are not aligned with what is written. Written codes of conduct at MNEs like the conglomerate Tyco and the energy trading and transportation giant Enron reflected the state of the art in the early 2000s.

Sometimes firms violate commitments once made. In the breach, we may learn more about moral climate than where written codes and real beliefs and routines prevent breach. To illustrate this point, consider the cases of Ashland Oil Company and Exxon-Mobil. Matthews et al. (1991) tell us that, when Ashland oil was involved in an oil spill in January of 1988, the Ashland CEO and other corporate officers quickly went to the location of the spill near Pittsburgh, admitted fault and directed the clean-up. This action turned out to be wise from an ethical as well as a business perspective. Ashland oil had its fines reduced and suffered less litigation as a result of its behaviour. They also gained respect as a ‘responsible’ company. In March of 1989, the Exxon-Valdez ran aground in Prince William Sound off the coast of Alaska, and dirtied its waters and shoreline with thousands of gallons of Alaskan crude. Exxon’s CEO did not rush to the scene, and only belatedly sent a taped message of apology. Exxon began a 20-year fight against claims of environmental degradation and economic losses by thousands of fishermen, canneries, local communities and environmental constituencies. In failing to settle these claims quickly, Exxon apparently learned nothing from the Ashland Oil incident. Twenty years of litigation in US federal courts, including the US Supreme Court later in 2007, has done little to enhance its reputation and the moral climate it reflects to so many observers. To date, US federal courts have awarded hundreds of million dollars for actual and punitive damages (StarTribune, 2007). Even in breach, moral climate constitutes a valuable asset tailored to the MNE’s specific circumstances.

3.2. Substantive ethical business norms and the moral climate of knowledge-intensive MNEs

3.2.1 Organisational non-discrimination

The justification for this ethical business norm in knowledge-intensive MNEs has already been partially developed in Section 2 where we discussed the role of transaction uncertainty. In knowledge-intensive MNEs, employees individually and in teams are agents of effective and efficient transfer across subsidiary operations. If it is reasonable to believe that the quality of the employees who possess this knowledge is not a function of race, religious belief, sex, ethnic origin or sexual preference, but rather is a function of ability and training, then discrimination does not make economic sense. To discriminate in knowledge-intensive MNEs is to demotivate these knowledge-transfer agents. Friedman (1962) wrote eloquently about the long-term economic inefficiency of discrimination,
particularly racial discrimination. When MNEs follow local custom and discriminate, they promote cognitive dissonance in their employees, a state of discomfort or tension from observing incompatible beliefs.

Suppose, for example, our knowledge-intensive multinational consulting firm allows women to lead consulting teams in Stockholm but not Doha, thereby honouring local ethical business norms in both regions. This policy could promote cognitive dissonance among female employees regarding the value of leadership assessed differently only because of factors irrelevant to the work to be completed. Women seeking to lead these teams are almost certainly conflicted both with respect to their own talents and with respect to their opinions of the MNE they work for. Their inner conflicts would demotivate them as agents of knowledge transfer. The value of their knowledge is diminished. For MNEs competing substantially on the efficient and effective exploitation of knowledge assets, such a strategy would seem counterproductive. It is more likely that knowledge-intensive MNEs will promote non-discrimination across all subsidiaries wherever they are located.

3.2.2 Organisational honesty and transparency

Bachman and Zaheer (2006) convey key findings from almost 20 years of strategy research documenting the value of shared values – trust – in reducing transaction costs between firms, and highlight the importance of trust within MNEs, particularly MNEs competing in knowledge-intensive technology industries. Mastery of a different sort of ‘knowledge’ – social knowledge about local customs and beliefs that can differ widely around the world – constitutes a distinctive challenge for MNEs. Consider the wide disparity in customs with respect to the exchange of gifts and the formality or lack of formality in negotiations and contracting between only two industrialised democracies, the USA and Japan. The greater these social differences, the greater the need for shared values to overcome inevitable gaps in understanding between executives. When people and know-how flow from the USA to Japan or elsewhere in knowledge-intensive MNEs trust is especially attractive as an aid to fair and equitable valuation and distribution of knowledge assets. Assets can have high specificity to the MNE generally as well as to particular subsidiaries of the MNE. Trust among different subsidiary managers helps to assure smoother flows within this proprietary network.

Shared values as trust go hand in hand with shared information – honesty. Indeed, honesty and trust are mutually reinforcing. Honesty among MNE stakeholders promotes trust and increasing trust reinforces honesty in a kind of virtuous circle. One question currently dividing research on the role of trust in business concerns its sources. Ouchi (1980) and Fukuyama (1995) both suggest that the success of Japanese MNEs in the USA, Europe and elsewhere prompted many to identify trust as a culturally based source of advantage available to all Japanese firms. Barney (1991) suggests that the concept of trust is tied primarily to a firm-specific culture rather than country-specific culture. No matter the source, less dissembling, gaming and/or opportunistic renegotiation in the context of knowledge transfers likely builds trust among stakeholders and decreases transaction costs to the benefit of MNEs.
3.2.3 Organisational self-control and fairness

Contracts provide the transactional bedrock for most market exchanges. Coase (1937) and Williamson (1975, 1985) tell us that exchange through bureaucratic means within the firm is exceptional. The default exchange mode is through markets mediated by contract. Indeed, firms may themselves have some of the transactional qualities we find in markets. When transactions involve the creation of dedicated assets by one or both parties, there will be tendencies to bring the transactions into the firm and govern them with bureaucratic approaches. But bureaucracies have their own rules of reason, if not internal ‘laws’ governing exchange of valuable resources. This aspect of bureaucracies may help explain why finance scholars like Jensen and Meckling (1976) describe a firm as a ‘nexus of contracts’. But as we have noted earlier, agreements governing exchanges are likely to be incomplete. They rarely cover every foreseeable contingency. A supplier of specialised components for a government defence system may wish to renegotiate for a price increase if a sudden military build-up increases demand for systems dramatically. Likewise, the government may wish to renegotiate for a price decrease when the military crisis passes and demand for systems drops off. Inescapable issues of contract incompleteness require some understanding – trust and honesty – among parties regarding how adjustments are likely to be made, which parties are best able to shoulder such adjustments and how disagreements about adjustment costs will be resolved so that parties continue to work together in good faith and for mutual benefit. Hart (2007) may summarise this point best when he refers to contracts as not merely statements of mutually undertaken obligations to perform for valuable consideration, but also as ‘reference points’ for renegotiation of these obligations and consideration as contingencies arise.

In this context, MNEs will benefit from developing norms consistent with flexibility to meet contingencies that arise under agreements, but also some self-regulation on the extent to which MNEs will opportunistically revise agreements. Self-regulation to forego the ‘last additional penny’ extractable from a disadvantaged (by contingency) counterparty yields benefits to MNEs in the longer run. It generates reciprocal behaviour when positions are reversed. In any case, it reduces ‘aggrievement costs’ (Hart, 2007), that is costs that a counterparty deems unfair to incur due to the combination of contingency and temporarily disadvantaged bargaining leverage. If forced to incur them by an excessively opportunistic party, the counterparty may respond by ‘working to rule’, that is doing the bare minimum required by the most restrictive interpretation of the agreement. The quality of performance is likely to suffer in these instances. This sort of agreement dysfunction almost certainly undermines efficient and effective transfer of tacit know-how embedded in individuals and teams moving about some network of MNE subsidiaries.

3.3 Adding substantive ethical business norms to our TCE framework

Consider again some of the substantive norms we highlight for inclusion in the moral climate of knowledge-intensive MNEs implementing universal ethical business norms across its operations globally: (a) non-discrimination; (b) honesty and transparency and (c) self-control and fairness. Together, they constitute key elements of a moral climate undergirding TCE-grounded tendencies in knowledge-intensive MNEs.
To work effectively, these substantive norms should not be selectively pursued in one subsidiary of the MNE and rejected or ignored in another. Dissonance produced by such a practice would likely undermine the free movement of individuals and teams and the know-how they transfer. As a matter of TCE efficiency and effectiveness, knowledge-intensive MNEs cannot have one set of substantive moral commitments at home country and other sets abroad. Employees and other key corporate stakeholders will not know which values, beliefs and behaviours represent the MNE’s moral climate. Governance of knowledge management would break down, and important corporate assets would diminish in value. On the other hand, promoting these norms as part of the broader moral climate will support TCE-grounded tendencies and protect valuable corporate assets.

4 Concluding discussion

4.1 Reviewing key framework points and innovations

At the outset of this paper, we promised development of a framework for understanding the emergence of universal ethical business norms related to transfer within MNEs. Perhaps the most important innovation in the resulting framework relates to its primary basis in (transaction) economic rather than ethical theory. TCE-grounded factors including asset specificity, frequency and uncertainty lead knowledge-intensive MNEs to standardise a set of proprietary norms of ethical conduct regarding the transfer of people and know-how across subsidiary operations located around the world. In this way, we have informed a fundamental issue in IBE research with TCE theory and practice familiar to IB research. Secondly, we used TCE and related ethics research perspectives for identifying some (but by no means all) prominent substantive ethical business norms for inclusion in that standardised set. Again, we claim some progress in
integrating these perspectives for deeper understanding of how and why developing a moral climate based on non-discrimination, trust and honesty, and self-control as well as fairness enhances the ability to exploit assets fully in the intensive MNE.

Our framework development strategy differs with others steeped primarily in ethical reasoning based on Kantian morality (Bowie, 1999), fundamental duties (Donaldson, 1989), hyper norms (Donaldson and Dunfee, 1999) and/or non-instrumental ethics (Quinn and Jones, 1995). Our primary reliance on TCE assumptions also means that our framework may be more narrowly drawn. Our TCE framework suggests the appropriateness of a standardised set of proprietary ethical business norms to govern knowledge transfer in the limited case of a specific type of MNE. As we noted earlier, many other types of MNEs compete based on advantages quite unrelated to frequent and ex ante uncertain transfer of human capital. They are less likely to exhibit the universal ethical business norms appropriate to knowledge-intensive MNEs. These other MNE types might benefit from an approach more closely related to the ethical relativism or ethical ethnocentric perspectives noted earlier. Thus, we see innovation in both the economic basis and in the narrowly drawn and contingent logic our framework represents.

4.2 Implications for research and practice

We have already noted some of the research implications following from development of this framework. Most importantly, our framework integrates IB and IBE perspectives to suggest several non-intuitive questions for future empirical research. Our framework suggests, for example, that universal ethical business norms related to the transfer of employees will develop in MNEs only under conditions where MNEs compete based on frequent and flexible knowledge transfer. Alternatively, our framework suggests that standardised, though not necessarily proprietary, norms are likely in MNEs dependent on frequent transfer but to destinations that are largely predictable in advance. Our framework suggests yet a third configuration of norms associated with MNEs dependent on know-how to compete internationally but know-how that need not move frequently nor flexibly over time. Future empirical research would investigate evidence related to the distinctiveness of these different MNE types through interviews with MNE executives, review of MNE transfer policies and agreements, and assessment of MNE subsidiary and MNE-wide performance.

Our framework also has practical implications for MNE managers. We noted several points about how to promote a moral climate conducive to knowledge transfer in MNEs. We also noted at least one example typically not improving moral climate, that is adoption of written ethical codes. We think MNE managers would do well to review the usefulness of establishing written codes prior to substantial training in ethics, ethical issues and ethical decision-making at individual-, group- and MNE-wide levels. Once adopted, written codes then require reinforcement through additional training and appropriate incentives to employ that training. Without these other investments, written codes can become meaningless words rather than powerful statements about norms to guide conduct.

Yet another framework implication relates to the scope of MNE operations under universal ethical business norms. What happens when local ethical business norms vary substantially from those of the MNE? For example, a management consulting firm doing business in Doha may insist that their project teams be led by women but the client in Doha may insist otherwise. Now the MNE faces a dilemma. The MNE can accommodate the local client and deny women project leadership opportunities in this locale or drop the local client and deny the MNE a local market growth opportunity. Based on our
framework, the knowledge-intensive MNE just might drop the local client or, at least, bid less aggressively for his business. Our analysis suggests that such a strategy may be justified to the extent that it envalues the rest of the MNE’s operations around the world. It reinforces ethical norms of non-discrimination and opportunity based on merit. It will make it easier for MNEs to transfer people and teams across the remaining subsidiary network, thus supporting the critical knowledge transfer process. It can be justified as a rational trade-off between the costs of tailoring ethical business norms to local conditions and the costs of preserving consistency in ethical business norms across the entire MNE.

We find examples of MNEs making the same trade-offs in related circumstances. Beauchamp and Bowie (2008) have noted that the garment manufacturer, Levi Strauss, does not manufacture in military-ruled Myanmar in part because it might compromise the MNEs universal commitment to human rights and non-discrimination important to Levi Strauss employees and customers. Similarly, McKinsey did not do business in India for several years in the 1970s and early 1980s due to local corruption and bribery issues involving local government officials. Again, a key factor leading to this decision was preservation of basic ethical business principles – those unchanging Benedictine norms – important to McKinsey partners, managers, consultants and analysts across all offices of the MNE. Adoption of universal ethical business norms does not eliminate the possibility of local conflicts and costs associated with international business transactions. It does, however, provide a guide for responding to such conflicts and costs, and in extreme cases deciding when to forgo certain transactions and trim back the scope of MNE operations to decrease conflicts and costs globally.

4.3 Concluding points

We end this paper where we began by thinking about how discussions between IB and IBE scholars might be enhanced. We think our framework represents a genuinely new and helpful way to advance those discussions, at least with regard to how MNEs manage knowledge transfers. But other frameworks steeped primarily in business ethics continue to matter. Donaldson (1989), for example, might conclude that MNEs ought to adopt universal norms of ethical conduct in contradiction to ethical relativism and the ‘when in Rome do as the Romans do’ maxim. Donaldson (1989) would base this conclusion on a moral conviction that all firms must adhere to a minimum set of imperatives, which would require substantive ethics proscribing discrimination, lying and excessively opportunistic behaviour. Of course, the idea of universal moral minima goes back much further. The 18th century German philosopher, Immanuel Kant (1785), for example, held that individual moral obligations derived from the dignity of a ‘wider community’ of people from around the globe rather than from any one locality.

We share this cosmopolitan perspective on the nature of rights and obligations but would enrich arguments for its application to the MNE with theorising and evidence from outside the traditional confines of business ethics. We chose TCE theorising and evidence, and find both not only valid but also exciting to develop in the case of MNEs and the governance of knowledge transfer. We highlight a different approach to thinking about the system of beliefs and values supporting strategy and structure in MNEs. At the same time we advance discussion and debate among applied philosophers and other scholars working in the broad fields of strategic management and international business. This type of wide-ranging discussion and debate can only improve our understanding of MNEs as it underscores the continued importance of studying the logic and worth of MNE values and beliefs.
References


Note

1 Kogut and Zander (1992, 1993, 1995, 1996, 2003) contend that opportunistic behaviour closely associated with opportunistic misappropriation of asset specific investments is either a ‘second-order’ or perhaps even an unnecessary assumption for a workable theory of knowledge creation and transfer within MNEs. Inescapable uncertainty in external markets about the value of tacit knowledge generated by firms may be sufficient without assuming opportunistic behaviour by foreign counterparties to explain why certain firms find it both efficient and effective to internationalise their operations via the MNE form. On the other hand, Mahoney (2001), Foss (1996a, 1996b, 2005), Nickerson and Zenger (2004) contest Kogut and Zander’s ‘evolutionary’ view of knowledge transfer in favour of retaining all TCE framework assumptions. Not surprisingly, our own view is closer to Mahoney, Foss and Nickerson and Zenger. As we will discuss in more detail below, some degree of moderate (but not excessive) opportunism among firms to a transaction involving dedicated assets is both realistic and desirable. When conditions supporting an exchange relationship over time change substantially, one or more parties are likely to seek favourable renegotiation of terms to reflect new realities and incentives to carry on for mutual benefit. In any case, our framework draws on the full menu of TCE concepts including asset specificity and opportunism as well as concepts of exchange frequency and uncertainty to understand when standardised ethical business norms will arise in MNEs.