

**GLOBAL SOURCING STRATEGY
BY FOREIGN MULTINATIONAL FIRMS
IN MALAYSIA: IMPACT OF LOCATION AND
PRODUCT FACTORS**

By

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TABLE OF CONTENTS

	Page
TITLE PAGE	i
ACKNOWLEDGEMENT	ii
TABLE OF CONTENTS	iii
LIST OF TABLES	vi
LIST OF FIGURES	ix
LIST OF APPENDICES	x
ABSTRAK	xii
ABSTRACT	xv
CHAPTER 1 INTRODUCTION	1
1.1 Background of the Study	1
1.2 Problem Statement	6
1.3 Research Objectives	8
1.4 Research Questions	8
1.5 Scope of Study	8
1.6 Significance of the Study	10
1.7 Definition and Description of Terminologies	11
1.8 Organization of the Remaining Chapters	12
CHAPTER 2 LITERATURE REVIEW	13
2.1 Introduction	13
2.2 Background of Global Sourcing Strategy	13
2.2.1 Definition of Global Sourcing Strategy	21
2.3 Theoretical Perspectives on Global Sourcing Strategy	22
2.3.1 Theory of MNE	22
2.3.2 Transaction Cost Theory	27
2.4 Antecedents of Global Sourcing Strategy	28
2.4.1 Location	30
2.4.2 Product	35
2.4.3 Sourcing-Related Factors	38
2.5 Conceptual Framework	42
2.6 Research Hypotheses	45
2.6.1 Location	47
2.6.2 Product	49
2.6.3 Sourcing-Related Factors	50
2.7 Summary	52
CHAPTER 3 METHODOLOGY	53
3.1 Introduction	53
3.2 Research and Sampling Design	53
3.3 Data Collection Procedure	56
3.4 Questionnaire Design	57
3.4.1 Variables and Measures	58
3.5 Statistical Analysis	58
3.5.1 Factor and Reliability Analyses	60

3.5.2	Descriptive Statistics	61
3.5.3	Correlation Analysis	61
3.5.4	Multiple and Hierarchical Regression	61
3.6	Summary	62
CHAPTER 4 FINDINGS AND ANALYSIS		64
4.1	Introduction	64
4.2	Profile of Respondents	64
4.3	Goodness of Measure	65
4.4	Factor Analyses	67
4.5	Re-stated Conceptual Framework and Hypotheses	73
4.6	Descriptive Statistics for Variables	75
4.7	Response Bias Analyses	76
4.8	Correlation Analysis	78
4.9	Hypotheses Testing	81
4.9.1	The Main Effects	81
4.9.2	Testing for Moderating Effects	84
4.10	Summary	128
CHAPTER 5 DISCUSSION AND CONCLUSION		130
5.1	Introduction	130
5.2	Recapitulations of the Study	130
5.3	Discussion of Findings	133
5.3.1	Main effect: trade barrier stability and global sourcing strategy	137
5.3.2	Main effect: product factors and global sourcing strategy	138
5.3.3	Moderator Factors	142
5.3.4	Moderating Effect: Supplier Dominance on the Relationship between the Predictors (trade barrier stability and product factors) and Global Sourcing Strategy	142
5.3.5	Moderating Effect: Competition Intensity on the Relationship between the Predictors (trade barrier stability and product factors) and Global Sourcing Strategy	146
5.3.4	Moderating Effect: Asset Specificity on the Relationship between the Predictors (trade barrier stability and product factors) and Global Sourcing Strategy	147
5.4	Implications of the study	149
5.4.1	Theoretical perspectives	150
5.4.2	Management	151
5.4.3	The Malaysian government	154
5.5	Limitations of the Study and Suggestions for Future Research	156

5.6 Conclusion	158
REFERENCES	161
APENDICES	170

LIST OF TABLES

Table No.	Title	Page
Table 3.1	Measurements for variables used in the study	59
Table 4.1	Description of Respondents	66
Table 4.2	Results of the principal component analysis with varimax rotation for product	69
Table 4.3	Results of the principal component analysis with varimax rotation for location	71
Table 4.4	Results of the principle component analysis with varimax rotation for sourcing related factors	72
Table 4.5	Re-stated Hypotheses	74
Table 4.6	Mean and standard deviation for variables used in the study	75
Table 4.7	Response bias on early versus late response using chi-square tests	76
Table 4.8	Responses bias using independent sample T-Tests on study variables	77
Table 4.9	Means, standard deviations, and intercorrelations of study variables	80
Table 4.10	The impact of trade barrier stability and product on global sourcing strategy	82
Table 4.11	Summary of the main effects	83
Table 4.12	The moderating effect of supplier dominance on the relationship between trade barrier stability, product factors and intra-domestic sourcing	87
Table 4.13	The moderating effect of supplier dominance on the relationship between trade barrier stability, product factors and intra-foreign sourcing	92

Table 4.14	The moderating effect of supplier dominance on the relationship between trade barrier stability, product factors and inter-domestic	96
Table 4.15	The moderating effect of supplier dominance on the relationship between trade barrier stability, product factors and inter-foreign sourcing	99
Table 4.16	Summary of findings of supplier dominance as a moderator	101
Table 4.17	The moderating effect of competition intensity on the relationship between trade barrier stability, product factors and intra-domestic sourcing	105
Table 4.18	The moderating effect of competition intensity on the relationship between trade barrier stability, product factors and intra-foreign sourcing	108
Table 4.19	The moderating effect of competition intensity on the relationship between trade barrier stability, product factors and inter-domestic sourcing	111
Table 4.20	The moderating effect of competition intensity on the relationship between trade barrier stability, product factors and inter-foreign	113
Table 4.21	Summary of findings for competitor intensity as a moderator	114
Table 4.22	The moderating effect of asset specificity on the relationship between location, product factors and intra-domestic sourcing	117
Table 4.23	The moderating effect of asset specificity on the relationship between trade barrier stability, product factors and intra-foreign sourcing	119
Table 4.24	The moderating effect of asset specificity on the relationship between trade barrier stability, product factors and inter-domestic sourcing	122

Table 4.25	The moderating effect of asset specificity on the relationship between trade barrier stability, product factors and inter-foreign sourcing	126
Table 4.26	Summary of findings for competitor intensity as a moderator	127
Table 5.1	Summary of Hypotheses	133
Table 5.2	Summary of moderator effect on the relationship between trade barrier stability, product factors and global sourcing strategy	136

LIST OF FIGURES

Figure No.	Title	Page
Figure 2.1	Theory of Multinational Enterprise	23
Figure 2.2	Conceptual framework of global sourcing strategy	46
Figure 4.1	Re-stated conceptual framework	73
Figure 4.2	The impact of supplier dominance on the relationship between trade barrier stability and intra-domestic global sourcing strategy	88
Figure 4.3	The impact of supplier dominance on the relationship between product delivery and intra-domestic global sourcing strategy	89
Figure 4.4	The impact of supplier dominance on the relationship between product delivery and intra-foreign global strategy	93
Figure 4.5	The impact of supplier dominance on the relationship between trade barrier stability and inter-foreign global sourcing strategy	100
Figure 4.6	The impact of competition intensity on the relationship between product delivery and intra-domestic global sourcing strategy	106
Figure 4.7	The impact of asset specificity on the relationship between product quality and inter-domestic global sourcing strategy	123
Figure 4.8	The impact of asset specificity on the relationship between product delivery and inter-domestic global sourcing strategy	124
Figure 5.1	Conceptual framework of Global Sourcing Strategy	131

LIST OF APPENDICES

APPENDIX	Title	Page
APPENDIX A	Questionnaire	170
APPENDIX B	Factor analysis: product factors dimension	182
APPENDIX C	Factor analysis: location dimension	187
APPENDIX D	Factor analysis: sourcing-related factors dimension	189
APPENDIX E	Reliability: value for money	194
APPENDIX F	Reliability: quality	196
APPENDIX G	Reliability: delivery	198
APPENDIX H	Reliability: trade barrier stability	200
APPENDIX I	Reliability: asset specificity	202
APPENDIX J	Reliability: competition intensity	204
APPENDIX K	Reliability: supplier dominance	206
APPENDIX L	Descriptive statistics: predictors and moderators	208
APPENDIX M	Response bias analysis on demographic	209
APPENDIX N	Response bias analysis on study variables	215
APPENDIX O	Correlation	217
APPENDIX P	Multiple Regression: Intra-domestic sourcing	219
APPENDIX Q	Multiple Regression: Intra-foreign sourcing	223
APPENDIX R	Multiple Regression: Inter-domestic sourcing	227
APPENDIX S	Multiple Regression: Inter-foreign sourcing	231
APPENDIX T1	Hierarchical Regression: Intra-domestic sourcing- supplier dominance	235
APPENDIX T2	Hierarchical Regression: Intra-domestic sourcing- competition intensity	242

APPENDIX T3	Hierarchical Regression: Intra-domestic sourcing- asset specificity	249
APPENDIX U1	Hierarchical Regression: Intra-foreign sourcing- supplier dominance	256
APPENDIX U2	Hierarchical Regression: Intra-foreign sourcing- competition intensity	263
APPENDIX U3	Hierarchical Regression: Intra-foreign sourcing- asset specificity	270
APPENDIX V1	Hierarchical Regression: Inter-domestic sourcing- supplier dominance	277
APPENDIX V2	Hierarchical Regression: Inter-domestic sourcing- competition intensity	284
APPENDIX V3	Hierarchical Regression: Inter-domestic sourcing- asset specificity	291
APPENDIX W1	Hierarchical Regression: Inter-foreign sourcing- supplier dominance	298
APPENDIX W2	Hierarchical Regression: Inter-foreign sourcing- competition intensity	305
APPENDIX W3	Hierarchical Regression: Inter-foreign sourcing- asset specificity	312

STRATEGI PEMBEKALAN GLOBAL OLEH SYARIKAT MULTINASIONAL DI MALAYSIA: IMPAK LOKASI DAN FAKTOR-FAKTOR PRODUK

ABSTRAK

Strategi pembekalan global adalah penelitian semula satu daripada beberapa strategi pembelian barangan keperluan syarikat berikutan wujudnya pembekalan dan permintaan secara global. Strategi ini akan memberi kesan kepada keadaan ekonomi keseluruhannya memandangkan bahawa lebih kurang 67% daripada kos barangan jualan sesebuah syarikat merupakan perbelanjaan pembelian barangan. Oleh itu, fahaman terhadap strategi pembekalan global ini adalah penting terutamanya bagi negara Malaysia kerana kedudukan sektor pembuatan sebagai sektor yang utama dan merupakan enjin pertumbuhan ekonomi dengan penglibatan signifikan oleh syarikat multinasional asing.

Strategi pembekalan global boleh dilihat dari dua sudut iaitu, faktor pemilikan (intra dan inter) dan faktor lokasi (domestik dan luar negara). Pada masa ini, kajian terhadap strategi pembekalan global dijalankan sama ada dengan hanya melihat dari sudut faktor pemilikan syarikat, atau hanya dari sudut faktor lokasi. Sebarang kajian untuk menghubungkan kedua-dua faktor ini hanyalah berbentuk konseptual dan secara kajian eksploratori sahaja. Memandangkan syarikat multinasional asing berkemungkinan melihat faktor lokasi sebagai satu faktor yang penting untuk strategi pembekalan global selain faktor produk, kajian ini telah mengkaji secara empirik, strategi pembekalan global dari sudut faktor pemilikan dan lokasi dan impaknya kepada faktor lokasi dan faktor produk. Pembolehubah pemoderat telah diambil kira dalam rangka kerja kajian ini untuk mengkaji impaknya ke atas hubungkait lokasi, produk, dan strategi pembekalan global.

Dengan menggunakan komponen sebagai unit analisis, syarikat multinasional asing yang mengguna-pakai tiga atau empat jenis strategi pembekalan global telah dikenalpasti. Empat jenis strategi pembekalan global tersebut adalah intra-domestik, intra-luar negara, inter-domestik, dan inter-luar negara. Responden dikehendaki menjawab tiga atau empat set soalselidik berkaitan dengan komponen strategi pembekalan masing-masing, yang dihantarkan kepada mereka melalui pos. Industri yang mengamalkan sekurang-kurangnya tiga atau empat jenis strategi pembekalan global adalah didapati dalam elektronik dan elektrik (E & E). Malah, penggunaan strategi pembekalan global adalah tertumpu dalam industri E & E.

Dengan menggunakan regresi berganda dan regresi hierarkikal, hasil penyelidikan yang diperolehi daripada mengkaji hipotesis menunjukkan yang E & E syarikat asing lebih cenderung mendapatkan pembekalan secara intra dan daripada pembekal domestik apabila kestabilan sekatan perdagangan adalah rendah. Adalah didapati juga bahawa syarikat asing tersebut sanggup memperolehi komponen yang bermutu tinggi secara inter daripada pembekal domestik, dan juga sanggup berbuat demikian sekiranya penghantaran itu tidak diperlu dengan segera. Kajian untuk menilai tahap kekesanan kesederhanaan ke atas dominasi pembekal, kesengitan persaingan, dan kekhususan aset, telah menunjukkan bahawa dominasi pembekal berperanan atau bertindak sebagai pemoderat di antara kestabilan sekatan dagangan dan strategi pembekalan global intra-domestik; dan di antara penghantaran produk dan strategi pembekalan global intra-domestik. Kesengitan persaingan berperanan sebagai pemoderat di antara penghantaran produk dan strategi pembekalan global intra-domestik. Kekhususan aset pula berperanan sebagai pemoderat di antara kualiti produk dan strategi pembekalan global inter-domestik, dan di antara

penghantaran produk dan strategi pembekalan global inter-domestik. Penemuan empirik ini boleh memberi manfaat kepada pegawai kerajaan dalam kementerian-kementerian tertentu, pembekal-pembekal serta syarikat-syarikat milik warganegara Malaysia yang berminat membuat pelaburan ke luar negara supaya memahami pola dan tren agar dapat merangka strategi yang tepat bagi kejayaan di masa hadapan.

GLOBAL SOURCING STRATEGY BY FOREIGN MULTINATIONAL FIRMS IN MALAYSIA: IMPACT OF LOCATION AND PRODUCT FACTORS

ABSTRACT

Global sourcing strategy is the reexamination of one of the many purchasing strategies for a company's purchased material as a result of global demand economics and global supply base. This strategy may have ripple effects to the economy as a whole since an estimate of 67% of the cost of goods of a company are tied up in purchase expenditure. The importance of understanding global sourcing strategy particularly in Malaysia is needed since the manufacturing sector is considered as the number one sector and the engine of growth for the economy with foreign multinational corporations playing a significant role in it.

Global sourcing strategy may be viewed from both ownership (intra and inter) and locational (foreign and domestic) factors. Currently the studies on global sourcing strategy are being examined either on ownership or locational factors. Any attempt to study global sourcing strategy on both factors was only made conceptually and in an exploratory study. Since foreign multinational corporations may view location as an important factor in their sourcing strategy besides product factors, this study had empirically examined global sourcing strategy on both, ownership and locational factors as well as addressing the impact of location and product factors on it. Moderating variables were also incorporated to the framework to examine its impact on the relationship between location, product factors and global sourcing strategy.

Using components as the unit of analysis, foreign multinational corporations that used three to four types of sourcing strategy were identified. These four types of sourcing strategies are intra-domestic, intra-foreign, inter-

domestic, and inter-foreign. Respondents had to answer four or three sets of questionnaires pertaining to their component sourcing strategy that was sent to them by mail. Industry that carried out at least three to four types of global sourcing strategy was found in the electrical and electronics (E&E). Furthermore, the utilization of these global sourcing strategies predominated in the E&E industry.

Using multiple and hierarchical regression, the findings generated from testing the hypothesis indicate that an E&E foreign MNCs is more likely to source internally and from domestic suppliers when trade barrier stability is low. It is also found that these MNCs are willing to source components with high quality externally from domestic suppliers, and are also willing to source externally from domestic suppliers when the delivery is not urgent. In testing the moderating effect of supplier dominance, competition intensity, and asset specificity it is found that supplier dominance behaves as a moderator between trade barrier and intra-domestic global sourcing strategy, and between product delivery and intra-domestic global sourcing strategy. Competition intensity behaves as a moderator between product delivery and intra-domestic global sourcing strategy. For asset specificity it behaves as a moderator between product quality and inter-domestic global sourcing strategy, and between product delivery and inter-domestic global sourcing strategy. The empirical findings may prove to be beneficial for government officers in relevant ministries as well as Malaysian owned suppliers and also Malaysian owned companies that are venturing abroad to understand the patterns, and trends in order to implement the right strategies for future success.

CHAPTER ONE

INTRODUCTION

This chapter introduces the background of study, explores the problem statement, identify the research questions and research objectives. It also provides the significance and scope of the study and offers definition and description of terminologies.

1.1 Background of study

Malaysia's remarkable economic development has seen it change from a country that depended entirely on primary commodities for its export earnings to a broad based export-oriented nation (Sieh, 2000). The manufacturing sector replaced agriculture as the number one sector in the economy with its main exports in semi-conductors, air-conditioners, and latex-dipped goods (Mohamad & Wheeler, 1994). This sector continues to be an engine of growth even after the 1997 financial crisis with its significant contribution to Gross Domestic Product (GDP) from 30 per cent in 1999 to 33.4 per cent in 2000 (Malaysia Industrial Digest, 2000). Although in 2001 there was a contraction of 5.9 per cent from the manufacturing sector and a downturn in the electrical and electronics (E&E) industry; the manufacturing sector continues to contribute 31.4% to GDP in 2005. It is forecasted that in 2010, this sector will contribute 32.4% to the GDP (Ninth Malaysia Plan, 2006-2010). The resilience of the sector underscores the multinational corporation's (MNCs) confidence in the Malaysia economy although China has emerged as a magnet of foreign direct investment (FDI) in the recent years.

In response to the global competitive environment, the manufacturing sector that played a leading role in the Malaysian recovery (Economic Report, 1999/2000) has to be innovative and proactive in responding to the current situation so as to achieve competitive advantage (Porter, 1985). One of the potential sources of achieving this competitive advantage at firm level is through the purchasing department (Monczka & Trent, 1991; Monczka, Trent, & Handfield, 2002). It has been found that two-thirds (2/3) of the cost of goods of a company is tied up in purchase expenditure (Chase & Aquilano, 1995). Hence, every dollar saved in purchasing could add to the corporate profit (Heinritz, Farrell, Guinipero, & Kolchin, 1991; Krajewski & Ritzman, 1993; Datta, 1999). This can be quoted from Dave Nelson, former Vice President of Purchasing at Honda of America in Leenders, Fearson, Flynn, and Johnson (2004) on his view of purchasing, that is:

“One of the reasons that Honda recognizes the importance of the purchased function is due to the fact that 80 percent of the cost of a car is purchased cost. So how goes purchasing is how goes Honda.”

The statement reflects how important purchasing is in terms of dollars and cents to a company. At task for purchasing managers is the issue to make or to buy the materials needed, the choice of suppliers, the quantity to order, the price to pay for the materials, the quality of the materials, and the delivery of the materials to name a few (Leenders, et al., 2004).

Since purchasing is the eyes and ears of the organization in the suppliers' marketplace (Krajewski & Ritzman, 1993), decisions made by purchasing professionals may have a ripple effect throughout the entire economy. It may either deepen a recession by reduced reorder levels during

economic slowdown or fuel an upswing by optimistic activity (Scheuing, 1989). One of the many strategies that a purchasing department may pursue is sourcing strategies (Scheuing, 1989) or worldwide sourcing (Monczka & Trent, 1991; Monczka et al., 2002).

Global or worldwide sourcing is the reexamination of purchasing strategies for the majority of a company's purchased material to determine whether sourcing should change in the light of global supply economics and global supply base. Its goal is to seek out suppliers worldwide on the basis of price, quality, technology, and delivery reliability (McGowan, 1997:84). It is an approach that requires purchasing to view the entire world as a potential source for components, services and finished goods (Monczka et al., 2002). A.T. Kearney, Inc. a Chicago-based management consultant found that in China, an efficient global sourcing effort contributes an extra \$150 million to the bottom line for every \$1 billion of purchases (McGowan, 1997). KPMG UK industries in their website (2003) had claimed that their global sourcing strategy has vastly reduced its printing machinery purchasing costs of key components as much as 80% savings for its slider pivot shaft, 76% for its gear shaft, 89% for drive shaft, and 81% for its mounting block. The company has acquired overseas subsidiaries in order to reach or gain access into new market and provides consistent service to their global customers. The potential savings of using global sourcing is further confirmed by Trent and Monczka (2003) study. The study stated that companies that successfully implement global sourcing strategies on average achieve material cost saving between 15 to 30 per cent. Monczka and Trent (1992) believe that as firms operate in a dynamic environment, the need to search for capable suppliers worldwide would become a requirement rather an option. Owing to

this, global sourcing has become a central issue for many manufacturing multinational firms (Kotabe, 1992). Global sourcing however is multi-dimensional and includes factors such as production location, phases of production, internal versus external component sourcing, and internal versus external assembly (Rao & Witt, 1994). It addresses both ownership and locational perspective of sourcing. From the ownership perspective, it is viewed as company sourcing within their corporate system (intra) and sourcing from independent suppliers (inter) (Kotabe, 1998; Kotabe, Murray & Javalgi, 1998; and Kotabe & Murray, 2004). On the hand, locational perspective is viewed as sourcing from domestic and/or foreign suppliers (Swamidass and Kotabe, 1993, and Kotabe & Murray, 2004).

Researchers in the purchasing literature found the reasons behind international or global sourcing for MNCs as being price, quality, and delivery (Monczka & Giunipero, 1984; Min & Galle, 1991; Birou & Fawcett, 1993; Scully & Fawcett, 1994; and Alguire, Frear, & Metcalf, 1994). Birou and Fawcett (1993) further ranked the benefits from sourcing internationally, beginning with access to lower priced goods, followed by enhanced competitive position, access to higher quality goods, access to worldwide technology, better delivery performance, better customer service, increased number of suppliers, and helps meet counter-trade obligations. These researchers however did not identify whether global sourcing is being carried out within the corporate structure (intra-firm), or through independent supplier (inter-firm); and whether these suppliers are foreign-based or domestic-based. Besides identifying the company's benefits from international sourcing, Birou and Fawcett (1993) also ranked the challenges that a company will face when venturing into international sourcing. These are just-

in-time (JIT) sourcing requirements, finding qualified foreign sources, logistics support for longer supply lines, culture and language differences, duty and customs regulations, fluctuation in currency exchange rates, knowledge of foreign business practices, nationalistic attitudes and behaviour, and understanding the political environment

Those in the international business area have gone further by establishing the relationship between global sourcing strategy and market performance (Kotabe & Omura, 1989; Kotabe & Murray, 1990; and Murray & Kotabe, 1995). Their findings were similar, in that market performance (relative market share, sales growth rate, and pre tax profitability) is positively related with intra-firm or internal component sourcing. These researchers did not identify the reasons or motive for company implementing global sourcing strategy.

According to Dunning (1981), multinational enterprises (MNEs) will only invest in a foreign country that offers location-specific advantages (LSAs) such as facilities and resources. This is confirmed in Swamidass & Kotabe (1993) exploratory study examining whether locational factors have any influence on sourcing choices. It was found that plant location and global sourcing strategy is strongly related. However there is limited empirical evidence on this relationship. This nature of research is in line with Buckley's (2002) view, that the way to proceed forward is to look back by identifying the key empirical factors in the global economy. Furthermore, he suggests that location should be one of the issues to look into from 2000 onwards.

Documented empirical evidence on global sourcing strategy of foreign manufacturing MNCs in Malaysia is limited. Sieh and Yew (1997), and Sieh (2000) traced Malaysian foreign manufacturing MNCs sourcing pattern from

the aspect of intra- and inter-firm sourcing only, while research by Jantan, Ramayah, and Khaw (2000) investigated the relationship between global sourcing strategy and supplies performance of electronic and electrical companies in Penang, Malaysia. Empirical evidence of location and product factors on global sourcing strategy to date is unavailable.

1.2 Problem Statement

Malaysia's reliance on the manufacturing sector for its growth cannot be denied with the acknowledgement of it being the engine of growth for the country. This manufacturing sector in turn was found to have two-thirds of its cost of goods tied up in purchasing. This places purchasing as an important or critical department in monitoring and reducing cost of a company. As a global company adds another international plant, it creates the need for sourcing of components and other semi-processed goods to and from the new plant to existing plant (Kotabe & Murray, 2004). Therefore, the issues of global sourcing strategy would be; where do these companies get their supply? Is the supply from more than one country? Are these suppliers from local or foreign sources or both? Are these suppliers from within the internal structure of the company or external to the company?

Furthermore as purchasing department is particular about the price, quality and delivery of its supplies, would these criteria have impact on the global sourcing strategy of the company? It has been found that companies especially the MNEs when investing in foreign countries will examine the location advantages of the country. Does this location advantages have impact on global sourcing strategy?

Although literature on global sourcing to date is dominated by research conducted in the developed countries, studies on the relationship between

location, product factors, and global sourcing strategy are limited. The existing studies on the relationship of location factors and global sourcing strategy are an exploratory research (Swamidass and Kotabe, 1993), and conceptual papers (Kotabe, 1998, Fraering & Prasad, 1999, Kotabe and Murray, 2004). The relationship of product factors on global sourcing strategy was empirically addressed from the perspective of internal factors of purchasing such as price, quality and delivery on the ownership strategy (Kotabe & Murray, 1990; Murray & Kotabe, 1995; Sieh & Yiew, 1997; Sieh, 2000; and Jantan et al., 2000). Other empirical research was on determinants of global sourcing strategy (Monczka & Giunipero, 1984; Min & Galle, 1991; Birou & Fawcett, 1993; Scully & Fawcett, 1994; Alguire, Frear, & Metcalf, 1994; and Trent & Monczka, 2003). However, these studies was carried out without identifying ownership, and locational aspects of global sourcing strategy. To date few researchers have attempted to focus on the impact of location and product factors on global sourcing strategy in a single study. Since global sourcing strategy of foreign MNCs cannot take place without their presence in a host country, this raises the issues of:

To what extent does the factors that attracted foreign manufacturing MNCs to invest in the host country, influence its global sourcing strategy?

To what extent does product influences global sourcing strategy of foreign manufacturing MNCs?

Would the relationship between location, product factors, and global sourcing strategy be affected by sourcing-related factors?

1.3 Research Objectives

This research hopes to achieve the following objectives:

1. To identify and examine whether location and product factors have any influence on the sourcing strategy of foreign multinational firms;
2. To investigate whether sourcing-related factors (bargaining power of suppliers and asset specificity) moderate the relationship between location, product factors, and global sourcing strategy.

1.4 Research Questions

1. What is the relationship between location, product factors, and global sourcing strategy?
2. Does bargaining power of suppliers and asset specificity moderate the impact of location and product factors on global sourcing strategy?

1.5 Scope of Study

This study focuses on the locational and ownership aspect of global sourcing strategy and whether location and product factors have any impact on global sourcing strategy. To capture a complete understanding of issues related to sourcing strategy, moderator variables are also included. Locational aspect of global sourcing strategy includes domestic and foreign suppliers while ownership aspect of global sourcing strategy includes internal (intra) and external (inter) sourcing (Swamidass and Kotabe, 1993; Kotabe, 1998; Kotabe, et al., 1998; and Kotabe & Murray, 2004). The dimensions for location factors in this study are trade barriers and exchange rate stability

(Swamidass and Kotabe, 1993; Kotabe, 1998; Fraering & Prasad, 1999; and Kotabe and Murray, 2004). These dimensions are important in order to understand the impact of global company having another plant in Malaysia on its global sourcing strategy. The dimensions for product factors are material cost, delivery and quality. These three dimensions are consistently the more important dimensions for product when it comes to suppliers' selection (Monczka & Giunipero, 1984; Min & Galle, 1991; Birou & Fawcett, 1993; Scully & Fawcett, 1994; and Alguire et al., 1994). The moderator factors identified for this study are bargaining power of suppliers and asset specificity similar to that in Murray and Kotabe's (1995) and Jantan et al., (2000) research. This is to empirically prove whether these variables will modify the form and/or strength of the relationship between the independent and dependent variables (Sharma et al., 1981).

The study focuses on foreign MNCs in the Malaysia. MNCs are defined as having investment or financial operations in more than one country (Butler, 2000:1), and a corporation that engages in production or service activities through its own affiliates in several countries, maintains control over the policies of these affiliates, and manages from a global perspective (Deresky, 2006:483). Foreign MNCs are of particular interest because of their intense level of competition (Morrison, 1990) that frequently utilises cross-border flows of components (Lee, 1996). Furthermore, MNCs that constitute an important segment of the Malaysian economy are considered engines of globalisation (Sieh, 2000) that managed the international trade (Kotabe, 1998), and may improve the export capability of the host country (Igram & Dunn, Jr., 1993). Their strategies are likely to be

influenced more by global as opposed to local or national considerations (Murray & Kotabe, 1995; and Kotabe & Murray, 2004).

1.6 Significance of the Study

Since previous research is exploratory and conceptual in nature, it is hoped that this study shall provide an empirical evidence and insight into the relationship between location, product factors, and global sourcing strategies from the perspective of MNCs operating in an emerging economy. Secondly, it is hoped to improve on existing literature by investigating the moderating effects on the above relationship. Furthermore, the impact of current events has created new uncertainties that may require a re-examination of established facts (Buckley, 2002) such as the 1997 financial crisis, September 11, 2001, and ASEAN Free Trade Area (AFTA).

It is also hoped that the results of this research will contribute to practical significance and use, by providing a framework that may assist decision-makers in the manufacturing companies pertaining to issues that may influence their global sourcing strategy. Furthermore, global sourcing strategy will support the companies' strategy to be dominant and competitive players in the global economy. The Malaysian government officials on the other hand, in formulating policies to enhance active investment from foreign MNCs, and increase participation from local business in the economy, may use this research information as guide. Patterns, trends, and issues emerging from the preference of sourcing may indirectly address the participation of local companies as supplies to foreign MNCs. With China's increasing importance as a destination for foreign direct investment, this study may provide further understanding as to foreign MNCs strategy in sourcing in

Malaysia, which may be a catalyst in the formulation of policies in strengthening Malaysia's position in investment and trade.

1.7 Definition and Description of Terminologies

Global would include firms that carry out international, transnational, and multinational activities (Kotabe, 1992).

Global sourcing strategy is the procurement of components from more than one country that are used for further processing regardless whether the import source is internal or external to the company (Kotabe & Murray, 1990, Murray et al., 1995).

Locational aspect of global sourcing refers to domestic versus foreign suppliers (Kotabe et al., 1998).

Ownership aspect of global sourcing refers to internal versus external sourcing (Kotabe et al., 1998).

Internal sourcing or intra-firm sourcing is procuring from a firm that is more than 50 per cent owned by the parent company (Murray et al., 1995).

External sourcing or inter-firm sourcing involves procurement from independent suppliers on a contractual basis (Kotabe & Murray, 1990, Murray et al., 1995).

Multinational Corporation (MNC) is defined as having investment or financial operations in more than one country (Butler, 2000:1).

Tariff is defined as tax imposed by a government on goods entering at its border (Cateora & Graham, 1994:4).

A non-tariff barrier is any government policy, other than tariffs, which reduces imports but does not restrict domestic production of import substitutes (Ingram & Dunn, Jr., 1993).

Exchange rate is defined as the price of one's country's currency in units of another currency or commodity (Eiteman et al., 2001:22).

Materials is generally accepted as referring to supplies acquired from outside upon which a manufacturing business operates to produce the finished product which passes to the consumer (Osborn, 1987:4).

Bargaining power of supplier focused on the number of suppliers available in supplying the required components or materials. The smaller the number, the higher is the bargaining power of supplier (Porter, 1980).

Asset Specificity is the degree to which materials are made only to fill the order of the buyer (Murray, Kotabe, & Wildt, 1995). A supplier and a buyer are 'locked into' the transaction when assets are specialized to that transaction (Williamson, 1979).

1.8 Organization of the Remaining Chapters

This study is organized into five chapters. The chapter two on literature review includes the overview of the history of global sourcing strategy, followed by the theoretical perspectives used for this study. A review of previous studies and its gap is also identified which formed the basis for the conceptual framework of this study. Hypotheses were formulated at the end of this chapter. Chapter three is the research design and methodology that includes research approach, sampling design, data analysis, questionnaire development and administration. Chapter four is the findings and analysis of the result and finally Chapter five is the discussion and conclusion of the study.

CHAPTER TWO

LITERATURE REVIEW

2.1 *Introduction*

The literature review in this study will discuss the background of purchasing and its function with emphasis on global sourcing strategy, and the impact of location and product factors on global sourcing strategy. It will also discuss the sourcing-related factors that may influence location and product factors on global sourcing strategy. Theoretical perspectives, theoretical framework, and hypotheses are also presented.

2.2 *Background of Global Sourcing Strategy*

There are two parallel streams of research pertaining to global sourcing strategy. One of the streams is in the operations management domain and the other in the international business domain. Under the operations management domain the research leaned towards understanding purchasing and procurement. The term procurement is used to describe the activities concerned with the operative and tactical planning and organization supply. The purchase function is a small part of procurement concerned with the 'buying-processes' itself. The important role of purchasing was demonstrated by the world event that took place. Supply was less than demand during the World War I, II, and Middle East oil embargo in 1973, and these phenomena continued until today shown by the intense competitiveness in the world market. Issues of reducing cost became a constant issue in order to have a competitive pricing. With the entire flow of information, materials, and services from raw materials suppliers through factories and warehouses to the end-customer; purchasing became one of

the major determinants at the early stage of operations or transformation process that deserves management attention. It has proven in the manufacturing sector as compared to service sector, material dollars typically account for half of the sales dollar (Leenders et al., 2004).

The common statement pertaining to the objectives of purchasing function is about getting the right materials, at the right quantity, delivered at the right time, and at the right place, from the right source, with the right service and at the right price. Overall the success of the purchasing department depends on its skill in locating or developing suppliers, analyzing their capabilities, selecting the appropriate supplier, and then working with that supplier to obtain continuous improvements. Purchasing should be the expert in knowing, and/ or determining which supplier has the capability to provide the needed products or services (Leenders, et al., 2004). Meeting quality, delivery, quantity, cost, flexibility, profitably and competitiveness are few of the main criteria that purchasing managers look for in a supplier (Carter & Narasimhan, 1990; Das & Handfield, 1997; Quayle, 2001).

Purchasing manager may decide whether to acquire materials from one single source or from multiple sources. The reason acquiring from one source are influenced by the company's findings with regards to quality, service, price, and cost benefits. From the research findings sole sourcing are being implemented because the company purchase high value product, require expensive tooling, and at times because the supplier holds the design rights of the item, whereas for multiple sourcing these products are more standard and can be easily acquired from many suppliers (Quayle, 2001). Sourcing may also take place through imposed sourcing, intermediated sourcing, and direct sourcing (Nassimbeni & Sartor, 2007). According to

these researchers, imposed sourcing is when the list of suppliers are given by the client and the host's government to the MNCs when the contract is about to sign. While intermediated sourcing is the use of an intermediary to negotiate and monitor the execution of technical specifications for the buyer as well as the supplier. Finally, direct sourcing is when the buyer directly deals with the supplier.

The progression from just buying from domestic buyer to coordinating and integrating purchasing on a worldwide basis is due to company wanting to achieve greater performance gains as competitive pressure intensifies (Monczka & Trent, 1992). Worldwide sourcing or global sourcing strategy is one of purchasing many strategies that include total quality management at supplier, longer-term supplier relationships, cross-functional teams, early supplier design involvement, supplier development and buyer/seller consulting teams, supply-base optimization, and total cost of ownership (Monczka & Trent, 1991b). These strategies are being implemented by purchasing in order to continuously strive to improve the quality, time, and technology of a form since it is directly responsible for 70 per cent of a manufacturing cost of goods (Monczka & Trent, 1991b; Chase & Aquilino, 1995). This has shifted purchasing responsibility from being just an administrative function or tactical purchasing to a function that is critical in achieving strategic objectives or strategic sourcing management of a firm (Monczka & Trent, 1991b; Monczka et al., 2002). Monczka and Trent (1991b) studied the evolution of purchasing strategy of companies operating in multinational market in America and found that in the 1980's purchasing role was just to provide operational support to the buying firm. As firms continue to strive to improve quality and service while reducing cost and enhancing

value, purchasing role became crucial in sustaining the firm's competitiveness and ensuring the firm's performance objectives in the intense worldwide competition. The study also found that supplier importance had moved up the rank from a ranking of number 13 and below out of 20 to the first top ten respectively from 1980's to 1990's respectively.

Research in operations management has generally leaned towards understanding how materials are purchased, and selection of suppliers to name a few while research in international business is more concerned of the buying of inputs from all over the world. With companies having subsidiaries throughout the world, and the search for a country to expand production continues, global sourcing strategy remained to have an impact on performance, exchange rate, location, technology, research and development, to name a few (Kotabe & Murray, 2004). Both operations management and international business have contributed substantially to current understanding of how and why of purchasing and sourcing of materials or components. This study will concentrate on global sourcing strategy from the perspective of international business and operations management addressing global sourcing strategy and factors pertinent to purchasing such as price, quality and delivery that literature have indicated to have an impact on global sourcing strategy.

Research in the area of global sourcing began since the past two decades. Being one of purchasing many strategies, global sourcing's goal is to identify good suppliers worldwide on the basis of price, quality, technology, and delivery reliability (McGowan, 1997). Hefler (1981) offered the concept of global sourcing in the 1980s for survival and growth of American manufacturing companies that were confronted with competition from East

Europe, Asia, and South America. Empirical research were later carried out by other researchers in establishing the relationship between global sourcing strategy and market performance (Kotabe & Omura, 1989; Kotabe & Murray, 1990; Murray & Kotabe, 1995), identifying the factors behind international or global sourcing strategy (Monczka & Giunipero, 1984; Min & Galle, 1991; Biro & Fawcett, 1993; Scully & Fawcett, 1994; Aguire, Frear, & Metcalf, 1994), and the influence of locational factors on sourcing choices (Swamidass & Kotabe, 1993). Conceptual paper were also written on global sourcing practices of manufacturing multinational companies (MMC) in United States (U.S.), in particular American and Japanese MNCs (Kotabe, 1998, Kotabe & Murray, 2004), and the development of global sourcing (Monczka & Trent, 1991a). These represents a profound attempt in understanding the need for global sourcing strategy, differences between MNCs from different countries, the influence of locational factors on it, and its impact on market performance of manufacturing companies in developed countries. Furthermore, as global company adds another international plant, it creates the need for sourcing of components and other semi-processes goods to and from the new plant to existing plant (Kotabe & Murray, 2004).

Global sourcing is multi-dimensional and includes factors such as production location, phases of production, internal versus external component sourcing, and internal versus external assembly (Rao & Witt, 1994). It addresses not only the locational perspective of sourcing, but also the ownership aspect of sourcing. Ownership is viewed as intra or inter, and locational is viewed as domestic or foreign. Companies that carried out intra-sourcing or internal sourcing procure components within their own corporate system by having trade between a parent company and its subsidiaries

abroad or / and also between foreign subsidiaries across national boundaries (Kotabe, 1998; Kotabe, Murray & Javalgi, 1998; and Kotabe & Murray, 2004). The intra-sourcing allows the ability of the company to exploit technologies and expertise within itself especially when technology is specific to its use or a novelty in the marketplace. This eliminates the unnecessary sharing of information with potential competitor (Kotabe & Murray, 2004). On the other hand inter-sourcing or external sourcing is the procurement from independent suppliers that often crosses the national boundaries (Kotabe et al., 1998; Kotabe & Murray, 2004). The reliance on independent external sources of supply of major components, however, places the important value-creating activities and assurance of component quality on independent companies that may create a potential loss of orders to competitors, and losing sight of emerging technologies and expertise in the long-term (Kotabe & Murray, 2004).

Handfield (1994) found that majority of the critical suppliers to North American firms are foreign-based. These are firms manufacturing computer, electronics, automotive, pharmaceutical, and chemical. Rajagopal and Bernard (1994) found that similar findings in their study in United Kingdom (U.K.) of American companies based in U.K.. These companies sourced their goods from foreign companies if they are unable to source from their own companies. Nassimbeni (2006) also reported for the year 2001, the Italian firms have made 30 per cent of all purchases abroad. Oumlil, Sekely, and Yates (1994), further confirmed previous findings when they found 83 per cent of U.S. firms surveyed in U.S. sourced products from foreign suppliers, and it increases as the size of the firm increases. They further found that 11.5 per cent sourced from U.S. suppliers located outside U.S., and 8.3 per cent

from company's subsidiary outside U.S.. Insights as to why the preferences for foreign-based suppliers were not given. In contrast to the above findings, Murray, Wildt, and Kotabe (1995) reported that 74 per cent of the total value of all product components of firms in America was purchased domestically, that is, the respondents for this study purchased product components from local suppliers of which 33 per cent of the total value of all components was procured internally. Overall the respondents considered domestic component sourcing more important to market performance than foreign component sourcing and external component sourcing more important than internal component sourcing from local supplier.

In Malaysia, Sieh and Yew (1997) found that MNCs from Europe, Japan, and U.S. source majority of their inputs through intra-firms channels or within their company's system. This they suggested was due to the production process that was split up into stages across national borders and the controlled purchasing by international or regional purchasing officer. However, they found that MNCs from new industrialized economics (NIE), such as Hong Kong, Korea, Taiwan, and Singapore relied heavily on local vendor. Sieh and Yew further identified three patterns of MNCs in Malaysia. First, Malaysia's manufactured exports have high import content. Secondly, Japanese E&E and automotive industries source majority of their input from home country, and finally, European automotive MNCs reduce their dependency on home-country sourcing and source from third countries or locally. In food industries, Sieh (2000) found that the industry do not depend on their parent companies in home countries for supply of raw materials, but instead purchase locally from competitive suppliers. However, reasons as to why such trends existed were not identified. Both the empirical research of

Sieh and Yew (1997), and Sieh (2000) did not identify whether intra-firm and inter-firm suppliers are from abroad or local.

Researchers in the purchasing literature found price, quality, and delivery as the main reasons for global or international sourcing of MNCs (Monczka & Guinipero, 1984; Galle, 1991; Birou & Fawcett, 1993; Scully & Fawcett, 1994; and Alguire, Frear, & Metcalf, 1994). The vigorous research in establishing the factors behind global sourcing failed to distinguish whether sourcing is carried out within the company's structure (intra), or from an independent company (inter), and whether these suppliers are foreign or domestic. It also did not address whether sourcing was carried out as a result of a need to internalize procurement from scattered multinational facilities of MNEs. However, Jantan, Ramayah, and Khaw (2000) study on electronics and electrical (E&E) MNCs in Penang, Malaysia on whether sourcing strategy (inter-firm or intra-firm) will lead to better supplies' quality, delivery or cost found that companies prefer to source from intra-firm than inter-firm when issues of quality, delivery or cost is pertinent to the company. This data for the study was collected at components level. Although the main study did not include locational aspect of sourcing strategy, it did highlight under its sourcing profiles that 37 out of 82 companies from a sample size of 150 indicated that components sourced from intra-firm are from both local and abroad while 63 companies had similar response for inter-firm sourcing. For this study, global sourcing strategy is viewed from the perspective of internal and external sourcing (ownership), and domestic and foreign suppliers (locational).

2.2.1 Definitions of Global Sourcing Strategy

Sourcing strategy can be viewed from two perspectives, global or world-wide and international sourcing. According to Kotabe and Murray (1990), international sourcing is the acquisition of raw materials, components, and sub-assemblies from international sources for use in fabrication, assembly or for resale regardless of whether the import is internal or external to the company. This is in contrast to Monczka and Trent's (1991a) definition in that they defined international sourcing as buyers buying from suppliers outside the firm's country of manufacture. On the other hand, global sourcing strategy according to McGowan (1997) refers to the re-examination of purchasing strategies for the majority of a company's purchased material to identify whether sourcing needs to change in relation to that global supply economics and global supply base. Its goal is to identify good suppliers worldwide on the basis of price, quality, technology, and delivery reliability. Kotabe (1992) meanwhile refers global sourcing strategy as the management of the interfaces among research and development, manufacturing, and marketing on a global basis, and of logistics identifying which production units will serve which particular markets. It also addresses how components will be supplied for production such that the firm can exploit both its own competitive advantages and the comparative advantages of various countries. While Murray et al. (1995) offer a simple definition on global sourcing, that is, the procurement of components from more than one country that was used for further processing or assembly into finished product. In addition to this, Kotabe and Murray (2004) state that sourcing strategy relates to the use of imports, assembly, or production within the country to serve a foreign market, and another the decision to use internal or external supplies of components

or finished goods. The present study will define sourcing strategy from the global perspective to capture the dynamic movement of sourcing between and within country. Therefore the definition of global sourcing strategy for this study is the procurement of components from more than one country that are used for further processing regardless whether the import source is internal or external to the company, outside and within the country.

2.3 *Theoretical Perspectives on Global Sourcing Strategy*

There are many overlapping theories in explaining international sourcing or import sourcing due to its multi-disciplinary nature, and lack of a commonly accepted research paradigm (Swamidass, 1993). Theories that were used in explaining sourcing include international product life cycle theory, internalization theory, eclectic theory, internationalization theory, contingency theory, transaction theory, competitive advantage, comparative advantage, and foreign direct investment (FDI) theories to name a few (Lawrence & Lorsch, 1967; Vernon, 1974; Buckley & Casson, 1976; Dunning, 1977; Williamson, 1979; Rugman, 1980; Porter, 1980). In the development of theories, Buckley (1992) has acknowledged Theory of Multinational Enterprise (MNE) as an established theory to be used for International Business phenomenon. This concurs with Casson's (1987) statement that "the theory of the MNE is an example of an economic theory which is not merely plausible, but actually 'works' ". These theories offer explicit explanation as to why global sourcing takes place.

2.3.1 *Theory of MNE*

Theory of MNE is a synthesis of internalization theory, the theory of location, and competitive dynamism (refer to figure 2.1). Each theory offers its explanation in understanding how firms manage to be competitive in an

imperfect market, to own and control factor availability, minimise government intervention, and concern for the growth of the firm.

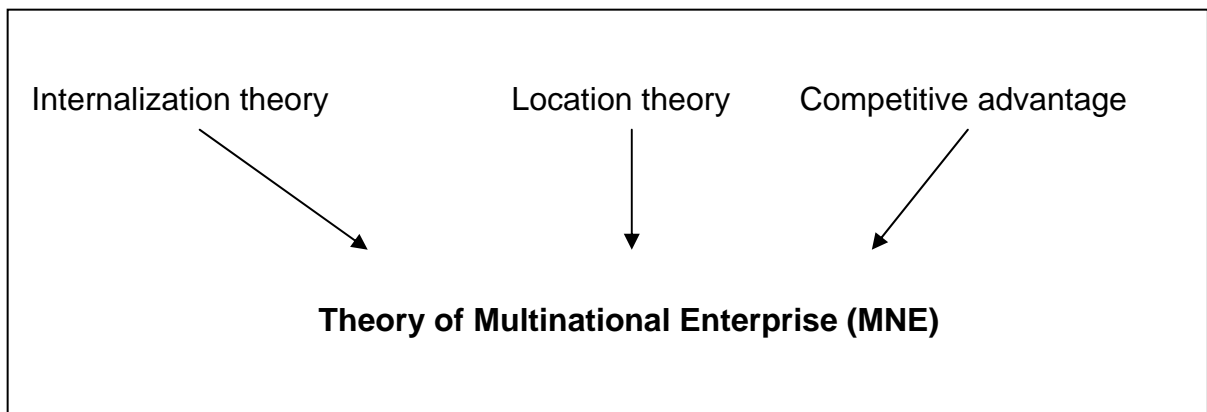


Figure 2.1
Theory of Multinational Enterprise

2.3.1.1 Internalization Theory

Buckley and Casson (1976) establish the theory of internalization for MNE by basing it on three simple postulates. One, firms maximize profit in a world of imperfect market. Two, when markets in intermediate products are imperfect, there is an incentive to bypass them by creating an internal market. This would bring about common ownership and control of activities that are linked by the market. Third, internalization of markets across national boundaries generates MNEs. This is due to the vertical integration of production since different stages of production are carried out in different countries that require different combination of factors, and the law of comparative advantage. This view compliments that of Rugman's (1986) internalization theory of FDI. Rugman postulates that multinational production is the result of the need to internalize monopolistic and oligopolistic advantages across nations by multinational firms. This encourages internal procurement of intermediate products from within scattered multinational facilities of MNEs. MNEs prefer to internalize rather than externalize when it

is more beneficial for the company to internalize the advantages (Rugman, 1980). Rugman and Verbek (1992) reasons for internalization are market imperfection that is similar to Buckley and Casson (1976), and government-imposed market imperfections. Thus, internalization theory encourages internal procurement of intermediate products from within scattered multinational facilities of MNEs (Rugman, 1986). When a transaction is internalized the administrative aspect of it would be the use of authority rather than the voluntary bargaining between people in the market (McGuinness, 1987). Buckley and Casson (1976), however, caution of the difficulty in measuring empirically the concept of internalization. This has been proven otherwise by the empirical findings of Kotabe and Omura (1989), and Swamidass and Kotabe (1993).

2.3.1.2 Location Theory

Buckley (1985) includes location theory as a viable explanation of the growth, pattern, and operations or sourcing policies of inputs and market sourcing policies. The critical connection between location factors and internalization of MNEs is that internalization will affect location in two ways. One, the MNEs shall have an incentive to minimise government intervention through transfer pricing. Secondly, increased communication flows in an internal market may bias high communication cost activities towards the source country where critical activities are focused at head office.

Dunning (1973) states that location theory is concerned both supply and demand oriented variables that influence the spatial distribution of production processes, research and development, and administrative of firms. An MNE may be faced with the same type of cost decisions as a local firm on the supply side, but however differ on the structure of competition,