# Working Paper: October 10, 2016
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# Escape FDI and the Varieties of Capitalism: "A Hundred and One Ways to Leave Your Home Country"[1]

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***Abstract***: This paper is part of a series of papers exploring the concept of escape FDI using historical and other forms of analysis. In this paper, we argue that despite a long tradition of integrating historical insights and many recent calls for it, current IB theory remains thin in historical insight. We discuss why many of the recent calls for more historical analysis in IB studies may have underestimated the problems. Nevertheless, we make an argument for integrating that analysis using the concept of 'Escape FDI' as an example of the benefits of using historical insights to avoid oversimplification.

'Escape FDI' is cross-border investment motivated by a company's decision to transfer activities (or resources) from country A to country B in order to avoid negative circumstances in country A rather than because of business opportunities in country B. By introducing (or reintroducing) political and social considerations into international business (IB) theory, 'escape FDI' represents a useful point of departure for examining the role of historical arguments in management literature.

While prior research suggests a connection between escape FDI and an economy's degree of social coordination, we will argue that escape FDI is an issue that liberal and coordinated market economies alike have witnessed. Simple dichotomies between coordinated and liberal economies break down in the face of shifting social policies that are bound to very specific periods and national conflicts. We will argue that scholars have largely ignored fundamental findings of business historians and that lessons learned from different historical periods should be integrated into multinational theory. Quite consciously, the paper combines social science and historical issues and sources, in an effort to produce a synthesis that will benefit both approaches to understanding international business and its larger social context.

Keywords: History and Management; MNE-host government relations; Legal systems; Comparative analysis of institutions; Political risk; Regulation of MNCs; Varieties of capitalism.

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[1] This paper has benefited from helpful comments from Mira Wilkins, Geoffrey Jones, Krzysztof and Tomasz Obłōj, and Sevda Sparks, as well as. Errors remain our own.

## 1. INTRODUCTION

Over 10 years ago, Geoffrey Jones and Tarun Khanna prominently called for a (re-)integration of historical perspectives into international business in the pages of *JIBS* (Jones & Khanna, 2006). Jones and Khanna's contribution helped usher in a series of articles and books by historians and management theorists advocating applying historical study to a wide-range of management studies. (For IB see, Morck and Yeung, 2007; Buckley, 2009; Buckley, 2016; Buckley and Pérez, 2016) But despite Jones and Khanna's pleas for more interdisciplinary work, the integration of historical insights into general IB discussions is struggling. While the importance of history is regularly acknowledged among IB scholars for their work, calls for further integration have gone largely unheeded as much of the research in IB still relies on cross-sectional, empirical analyses with data stemming from rather short periods of time.

Against this background, we intend making a contribution to discussions about the use and abuse of history in IB. We will begin with a short history of efforts to bring history and IB closer together, highlighting the benefits and the many obstacles. We present evidence from IB journals of how little cross-fertilization has occurred in the recent past. Thereby, we suggest that calls for interdisciplinary work have failed to engender the desired result, in part because they underestimate methodological and value differences between history and social sciences. In fact, it seems that we may have less not more integration now than 20 years ago. Nevertheless, collaboration is both possible and desirable, as long as scholars on both sides of the divide better understand and respect the limits and potential insights of their disciplines. We will therefore confine ourselves to highlighting how historical knowledge could be used in IB. We will emphasize one potential benefit rarely evoked, providing counter examples.

In order to underline the necessity of a history perspective in IB, we will discuss the topic of 'escape FDI' from an historian's perspective as an example of just how historical knowledge might improve management theory, particularly IB theory. Scholars are taking more seriously corporate flight as an answer to institutional misalignments between home country and firm goals, but those interpretations of misalignments tend to be narrowly focused on differences between home and host countries, derived from only one period (Witt & Lewin, 2007). In order to buttress our general point, we argue that such discussions of 'escape FDI' ignore historical examples from other periods contradicting their results. Building specifically on Jones & Khanna (2006) as well as Witt & Lewin (2007), we argue that the business environment plays a much greater and varied role for 'escape FDI' than acknowledged in IB literature. Our analysis of 'escape FDI' is designed to highlight how IB theorists could profit from examining examples from earlier historical periods. We provide historical examples that indicate that current explanatory patterns of 'escape FDI' are not adequate as explanations of the political impetus to transfer activities outside of a company's home country. By presenting two examples drawn from a 50-year period during the 20th century, we illustrate the multifaceted motivations for escape.

The body of this paper is divided into two sections. The first discusses the role of history in IB theory. In this regard, we emphasize how the prevalence of a history perspective is in decline in this particular management discipline and why this presents an unfavorable development. In order to reinforce our position, the second part reviews the matter of 'escape FDI' as an example of scholarly work, which tends to rely heavily on dichotomies and insights drawn from our recent past. In this context, we also provide two counter examples to current explanatory patterns of 'escape FDI', which show that the current perspective neglects detailed insights from larger historical periods.

# 2. NECESSITY OF AN INTERDISCIPLINARY DIALOG BETWEEN HISTORY AND IB

## 2.1 Questionable Recognition of History in IB Research

There is nothing new about the idea of integrating history and international business theory. Like other social disciplines, IB has to rely on the past, as constructing future experiments is difficult, if not impossible. Some of the most important contributors to IB theory and other management disciplines have explicitly encouraged integration of history into business theory and are very conscious of the historical evolution of their work and multinationals (Casson, 1990; Dunning, 1993; Ingram, Rao, & Silverman, 2012; Üsdiken and Kipping, 2014).

Some scholars have been more explicit about how to integrate a historical perspective into IB theory. Jones & Khanna argued in the pages of *JIBS* that history can complement IB theory by reminding us of what is new and commonplace in international investment, and by highlighting what resources and path dependencies contribute to or hinder successful cross-border investment. They emphasize that many of the most interesting causal questions in international business are best addressed with rigorous long-term analysis that supplement quantitative techniques (Jones & Khanna, 2006). Although IB theorists generally acknowledge the importance of history to their work, social scientists and historians have not yet found a sturdy bridge with which to cross their methodological divide. With a few notable exceptions – such as the views of A. Chandler in strategy and general management, and M. Wilkins and G. Jones in IB – important insights drawn by professional business historians about different periods rarely find their way into business theory.

The lack of recognition is also manifested in the applied research methodologies of influential IB journals. In order to examine the recognition of history in IB, we took a closer look at the published articles in the two most notable IB journals, *Journal of International*

*Business Studies* (*JIBS)* and *Journal of World Business* (*JWB)*, from 2006 to 2015. Much of IB theory rests on statistical analysis of aggregate data collected over a relatively short period of time and contains little or no contextualization. The survey of *JIBS* articles included 509 articles, of which 117 we consider as longitudinal. (The others were conceptual studies, 35 or cross-sectional, 357.) Only three of the longitudinal studies were based on data from periods before 1980. Of those that mentioned the timeframe of data, 22 refer to periods shorter than five years. Even though the long-term validity of insights derived from data of short and recent periods seems like an issue worth discussing, none of the theoretical discussions in these pieces do.[2] Eighty-five percent of the articles during the ten years studied restricted their analysis to 20 years of data, approximately 50% to ten or fewer years. Only 10% contained data from more than 25 years. Of the 117 articles that can be classified as longitudinal, only 17 tried to exam the historical context of the data they were using. Even these efforts at contextualization were thin at best.

A closer examination of publications in *JWB* yielded similar results. Here our survey examined 463 articles, of which 31 are identified to be longitudinal (the others were conceptual studies, 82 or cross-sectional, 350). Ninety-four percent of the articles during the ten years studied restricted their analysis to 20 years of data, approximately 60% to ten or fewer years. Only one article contained data from more than 25 years. Of the 31 articles that can be classified as longitudinal, only seven tried to exam the historical context of the data they were using. These numbers illustrate how little historical contextualization seems to be valued by IB-researchers despite the popular calls for more and better integration.

To be sure, business historians may contribute to these intellectual walls by ignoring IB insights or by relying too heavily on a few business historians who occupy a position between the fields, rather than going directly to IB literature for the contexts that might help avoid writing sterile chronicles. But for the example we have chosen, in contrast, 'escape

[2] Analysis performed by authors, May-June 2015.

FDI,' there are many vivid historical narratives, which, as we will discuss, have been ignored by those formulating theory.

### 2.2 Dearth of an Interdisciplinary Dialog

The path for historians to acceptance by social scientists is rocky for many reasons. Even the best business history broad generalizations have been shown to be dubious. Most business historians today acknowledge that many of the generalizations about American and European business development in Chandler's work could not survive careful scrutiny and seem to have been formulated in hopes of bringing history closer to the social sciences. Moreover, social scientists still tend to choose very selectively from the rich assortment of historical experience, those examples that support their theory. (Kobrak and Schneider, 2011) Nevertheless, many of the best articles advocating the use of history in management studies emphasize a long list of potential contributions, while shying away from one of its most obvious functions, providing counter examples to generalization. They emphasize many very useful contributions of historical study, such as challenging sources, illuminating contexts and path dependencies, and identifying fads, but not the more limiting outcome for theory of identifying examples not covered by a generalization. (Lamoreaux, Raff, Temin, 2007; O'Sullivan and Graham, 2010)

Regretting the dearth of interdisciplinary dialog, recently many business historians have offered a series of solutions, mostly, but not exclusively, addressed to business historians. In some cases adopting the language of management theory, they bemoan historians' reticence to discuss their own "theory" and methodology, to address specific management theories, and to produce higher level generalizations, like their social science colleagues. Intended to gain recognition for business historians among social scientists, these discussions tend to gloss over how many differences in research agendas and methodological orientations make management theorists impatient with the historian's craft (Rowlinson, Hassard, & Decker, 2014; Fear, 2014). A group of serious business historians and social scientists have dedicated themselves to help their history colleagues write more business history that appeals to their social science counterparts. (Bucheli and Wadhwani, 2014)

Unfortunately, some of these efforts are marred by insufficient recognition of not only the methodological differences between management studies and history but also their divergent agendas and conception of social phenomena. As Bucheli and Wadhwani note themselves in their preface, "universal and predictive laws" as well as "grand objective synthesis" have largely been rejected by historians, because historical research's emphasis on temporal contingency. Social scientists are hired and promoted by their ability to overcome temporal constraints. Research methods, agendas and concept of action are not completely independent of one another. The differences are profound and hard to reconcile without abandoning fundamental aspects of scholars' intellectual orientations. (Leblebici, 2014) High levels of generalization are desirable outcomes for social scientists; for historians they tend to be suspect, propositions to be examined against detailed analysis of primary and secondary sources. Although even some historians look to history to prove an economic or political theory, many historians learn their craft by finding counter examples to some of the theories of great minds from Adam Smith through Marx to Milton Friedman.

Like many of our colleagues, we have not given up hope that academics will see the benefits of historical analysis and narrative to management study, but more for its use in stimulating imagination by providing a broader range of examples, in providing counter examples, rather than building theory, and most importantly by showing the degree of change in business. But we believe that the complexity of the past, professionally recounted, tends to limit the breadth of social generalization, frustrating attempts of both historians and theorists to find common ground.

The historian's craft – as practitioners tried to free it from religious, political, and nationalistic pressures – was built on explaining social phenomenon by integrating critical examination of particular primary sources with general knowledge of their context. To be sure, each generation of historians re-writes history and what they expect from history, but the profession thrived in the 19th century by developing a methodology that at least *strives* (our italics) to free itself from "higher purposes" (the passions of the day) about what to find from the past. This involves questioning the authenticity, motivation, and consistency of documents in order to build plausible narratives and explanations of social phenomena. Some first class historians and social theorists have made broad generalizations about social phenomena, but even those who make the broadest generalizations allow for contextualization, an understanding of the social context of the time in which the phenomena occur. (Stern, 1956; Carr, 1961; Hughes, 1964; Bloch, 1971; Barzun, 1974) Although historians should integrate the questions of the day, including management issues, into research questions, but not as propositions to be tested in service of other disciplines, but rather as aids to help connect events in narratives. Considering the disciplines beginnings, there would be a certain irony in the discipline turning to another "management science" purpose for redemption in the 21st century.

Consider Marx, who searched for social laws and saw economics behind human events. Even Marx highlighted the technological and social background that led to the creation of a bourgeoisie and proletariat. Other historians have aggregated data, but professional historians concentrate on the context and particularities of the data they use, and how both change over time. Historians may generalize about events and institutions, but in contrast with their social science colleagues, they spend much more time and effort on distinguishing between and discussing what is unique and commonplace in those events and institutions. And the greater the uniqueness in social action, the harder to generalize.

Consider another problem in developing theory, as intended by social scientists. Of course, 'theory' can mean view, idea, or presupposition, but for the social sciences it has a different sense. It entails a systematic organization of knowledge applicable to a wide variety of circumstances with a system of assumptions, accepted principles, and rules of procedure devised to analyze, predict, or otherwise explain the nature or behavior of a specialized set of phenomena. But historians' view of social action makes high level generalization difficult, if not impossible.

For historians, consciousness, knowledge, and attitudes help shape institutions, organizations, and action, thereby limiting the scope of generalization. As an Oxford philosopher recognized decades ago, unlike physical phenomena, human actions reflect a process of integrating into private and public conscious new information, gathered over successive time periods, and by definition unpredictable. (Berlin, 1947) (If the information were known at time t, it would not be new at time t+1) Some of that information is technical; some scientific; some perhaps philosophical, and some even historical, about what has happened in past periods. One of the many reasons that we cannot just apply the lessons of 1931 to 2008, for example, is that many living in 2008 know what happened in 1931 and have integrated that knowledge into their actions and expectations.

Some management theory and corporations are beginning to recognize the use of corporate memory – a very useful approach to the past but one that it is in its infancy – to improving management. But the very fact that the knowledge of the past may improve decision making in the present implies that those making the decisions will think and behave differently because of what they think about the past. Indeed, if those of us who teach at business schools are doing our job, the next generation of business leaders should think and act differently than their predecessors – hopefully making better decisions, but this is probably too much to expect.

Despite the interest of some young scholars in pursuing interdisciplinary work and some recruiting of historians for business school faculties, promotion and publication criteria still hinder scholarly work that amalgamates more than cursory insights from management theory and historical research.

The historian's craft is to determine what is unique and commonplace in the present, to give us a perspective beyond the present, which works against statistical generalization. Historians strive to compare and contrast periods and the actors working within those periods. In contrast to many social scientists, for historians, significant social change is the essence of their métier. Indeed, many historians look at their work as the study of social change over time. Although those who study business, especially international business, recognize that the changing contours of the multinational's environment are essential elements of firms' decision processes (Jones, 2005), changing contexts call into question the validity of applying quantitative techniques on large amounts of data.

## 2.3 Why History Should Matter More in IB

In the next section, we discuss some examples of 'escape FDI' that suggest that the currently prevailing vision of its causes need to be corrected or at least expanded. The narratives provide specific examples of how history can lead to better theory by providing counter instances, simply avoiding plain error or better yet, increasing the range of phenomena covered. Our historical section, therefore, discusses various phases of German FDI during and around the interwar period and American banking investment after World War II. Using a different periods than Witt & Lewin highlights the limits of drawing general theory from just one period. Our example serves as an illustration of the importance and complexity of environmental factors in explaining foreign investment decisions and in expanding the discussion of escape as a factor in producing those decisions. Not only does it illustrate the multifaceted nature of environmental determinants, the example also suggests that the breakdown of countries into coordinated and liberal market economies, used in many discussions of 'escape FDI,' and the relative importance of the breakdown for investment decisions lose some of their predictive value as they are drawn from rather short-term perceptions of corporate behavior.

# 3. HOW HISTORY CAN WORK AGAINST MISLEADING CONCLUSIONS: THE EXAMPLE OF ESCAPE FDI

## 3.1 What is Escape FDI?

Until recently, FDI theories, even those that followed a more political orientation, often applied a very strict behaviorist and economic approach, considering primarily product markets and resource advantages (important contributions have been made by Dunning (Eclectic Theory or OLI Framework), Vernon (Product-Life-Cycle theory) and Hymer (Theory of Monopolistic Firm Specific Advantages)). In fact, IB studies regularly seemed to show symptoms of an overvaluation of *direct* 'value creation factors' as drivers of FDIs. The respective theories and approaches, dedicated to researching the underlying motivations of FDI, made at least implicitly clear that its drivers are connected to value creation. It is no exaggeration to say that intrinsic economic motives were the predominant explanations for FDI in classical IB literature.

Most research de-emphasized external, institutional environments as explanations for internalization and FDI motives. Among the exceptions, Ajami & Ricks (1981) explored the motives for U.S. bound FDI of non-American firms. But like most IB researchers at the time, the authors identified primarily market reasons and (technological) resource advantages as salient motives. The significance of institutional factors, such as political and regulatory factors, is for the most part left out of their explanation. The authors' ranking and discussion of the "average reported importance of motives" (see Table 1 in Other Paper) is indicative. Although they included four institutional factors among the top 15 motives, these institutional factors played little or no further role in the conclusions of the authors (regarding the importance of various FDI drivers).

In contrast, economic historians, political scientists, and researchers of business taxation have placed a much larger importance on institutional motives for firm internationalization via FDI in comparison to past IB research approaches. Institutional motives are deduced from the favorability of the institutional 'foreign investment regime' (Jodice, 1980: 177). "The national regime for FDI is the set of rules, regulations, and behavioral norms under which foreign enterprises are expected to operate" (ibid.). Notably, political (political stability, rule of law i.e.) as well as regulatory (strict or relaxed industry regulations i.e.) and fiscal causes (tax incentives, subsidies, i.e.) play a major role in the decision making process of MNEs with regard to foreign direct investments.

The internationalization process of firms is not exclusively driven by 'value creation'. Environmental, external motives, which are based on institutional surroundings, are also important parameters in the decision making process of multinational corporations. This reasoning is additionally substantiated by the World Bank, which published its 'World Development Report' (World Bank, 1997) in 1997, investigating the positive connection between the institutional environment ("good governance") and the attractiveness for investments. Furthermore, the implications of governance infrastructure on FDI have been thoroughly analyzed by Globerman & Shapiro (2003: 37), who concluded that "the political governance contributes in a very important way to attracting inward FDI from the United States". Yet, despite these unambiguous indications, institutional motives were still not sufficiently integrated into IB theories.

### 3.2 Escape FDI as a Consequence of the Varieties of Capitalism?

The concept of ‘escape FDI’, a term that was introduced by John Dunning (1996), which will be at the center of this article, has been at the center of recent attempts to correct this imbalance. Escape FDIs are the consequence of ‘restrictive legislation or macro-organizational policies by home governments’ (Dunning & Lundan, 2008: 74). A recent contribution of Witt & Lewin (2007) to the Journal of International Business Studies plays a pivotal role in the escape FDI literature because it correctly describes the phenomenon of escape FDI as a response of a firm to an institutional misalignment between the country of origin and the corporate goals. Unlike many prior contributions, the authors acknowledged the importance of institutions as a potential FDI driver. Their approach is compelling, in part, because the authors provided a quantitative-empirical basis to support their arguments. Subsequently, further scholars dedicated themselves to the influence of the institutional environment on FDI motivation (Ang & Michailova, 2008; Jackson & Deeg, 2008; Witt & Redding, 2008; Cantwell, Dunning, & Lundan, 2010). These papers connect international business activity with an institutional misalignment, similarly to the argument behind the concept of escape FDI.

Although Witt & Lewin played a key role in establishing ‘escape FDI’ as one explanation for outward FDI and by showing how institutional theory can contribute to understanding of escape FDIs, their groundbreaking innovation contains significant argumentative weaknesses.

Witt & Lewin base their argumentation on a distinction between liberal market economies (LME) and coordinated market economies (CME) – similarly to the terminology introduced by Hall & Soskice (2001) in their influential introduction to their edited book ‘Varieties of Capitalism’. Their principal argument is that escape FDIs rise with the degree of institutional misalignment which a firm faces at home, a very convincing and plausible argument to which we fully agree. However, Witt & Lewin further assume that the degree of institutional misalignment rises with the extent of societal coordination in the political economy. This is based on the assumption that the institutional decision making process in highly coordinated market economies involves more actors than similar processes in LMEs. As a result, the former are ‘institutionally sluggish’. Therefore, societies with high degrees of societal coordination must go hand in hand with slow rates of institutional adjustment, leaving the market participants eventually in a ‘deadlocked’ situation. Highly liberal economies, on the other hand, are characterized by minimal governmental interference in the market. Therefore, companies have the opportunity to act proactively upon environmental changes without paying importance to the decisions of other institutional actors. Hence, it is Witt’s & Lewin’s conclusion that coordinated market economies are more prone to institutional misalignments and outward FDI. Their argument is based on statistical correlations a ‘societal coordination index’ (Hall & Gingerich, 2004), both of which we address in our other paper. In this paper, we will for the most part confine ourselves to discussing some examples from the middle of the 20th century, which suggest that their dichotomy and explanation are oversimplified. But even a look at the period from which they draw their data reveals anomalies in their theory.

Although Witt & Lewin’s explanation accounts for some of the FDI during the 13 years of their study, even in that period several individual examples of politically motivated investment run counter to their theory. They involve escape but not from economies that could reasonably be considered controlled to ones that are generally less controlled. They involve specific regulation, not general regulatory frameworks.

U.S. companies, for example, created new or added to old foreign investment to avoid U.S. taxation or liability litigation, not because host countries were in general more liberal than the United States, but rather because those host countries offered specific regulatory or fiscal advantages in those narrow areas. Consider the example of American investment in Ireland during the period Witt & Lewin use. From 1990 to 2003, U.S. FDI grew from $5 to $70 billion. During roughly the same period, affiliate sales and profits grew five- and sevenfold respectively, while employment merely doubled.[3] Although operational business factors played a role in these decisions and estimates of the precise hierarchy of motivations are methodologically complicated to say the least, no one who studies business has any doubt that avoidance of U.S. taxes was among the most important reasons. Some companies have even changed their ultimate tax domicile (inversion). Escape was clearly a motivation, but not because the United States should be considered a coordinated and Ireland a liberal economy, but rather in this specific aspect of regulation and between these two countries, the combined regulatory terms of cross-border investment from the United States to Ireland created advantages for nimble American multinationals.

Fiscal researchers find ever more indicators that other taxes, such as property taxes, sales taxes, labor taxes, and VAT, for example, are having important effects on FDI location decisions (Buettner & Wamser, 2009; Egger, Radulescu, & Strecker, 2013). MNEs build up intra-organizational networks of international subsidiaries and flows in order to reduce tax expenditures.

With fewer and fewer restrictions on cross-border direct invest, the past 20 years are full of other examples of what might be called regulatory arbitrage that go beyond Witt & Lewin's simple dichotomy between liberal and controlled economies. The escape motives may involve very specific forms of control. As with taxes, avoiding strict pollution regulations cannot be viewed in isolation from other reasons for investment, but there is evidence suggesting that they at least play a role in the choice of country. Once again, in so far as companies try to escape increasing environmental restrictions in the developed

[3] WWW.amcham.ie/download/FDI 2013.pdf, Economic Relationship 2013, Joseph P. Quinlan, American Chamber of Commerce (Ireland), Accessed February 24, 2015.

countries, they are not leaving countries with generally controlled economies to ones that can be characterized as less controlled. Although aggregate statistics do not have a large effect on aggregate investment flows, there is much evidence that there is "ample empirical evince that resource and pollution intensive industries do have a location preference for, and an influence in creating, areas of low environmental standards." China, hardly a generally liberal state, alone represents 40% of these investments. (Mabey and McNally, 1999: 3) The degree of importance of pollution havens to investment decisions, however, may be affected by how liberal or controlled the home country of investing firms are. (Dean, Lovely, and Wang, 2004)

### 3.3 Escape FDI from a Historian's Perspective: Two Historical Examples

Moreover, we contend that any robust general theory should be derived from data from more than one period. Business people make the decision to invest internationally in widely different political and social contexts. These contexts help shape the direction, form, and content of investment as much as microeconomic imperatives. Neither the macro- nor the micro-motivations can be fully understood without reference to each other. That changing mixture is a very complex story that has not been adequately described in the literature. This lack of a longer historical perspective helps explain some misrepresentations of some cultures and a certain bias toward liberal versus controlled economies (Hall & Soskice, 2001), underestimating the utility of coordination of economies in some periods and some countries.

History can help understand the various ways institutional environments can shape business strategies, and how both the environments and the strategies evolve over time in an ever changing dialectic. In some sense, this article is intended to highlight with historical examples what may have been an unintended offshoot by theorists. If we might borrow or paraphrase an insight from Karl Marx, while men make history, they structure businesses within historically framed sets of opportunities and constraints.

Our two historical examples are indeed special, but robust theories need to account for special cases. To be sure, the two periods and the banking sector have unique aspects, but so too did the past 20 years and manufacturing, which are more actively studied. The interwar period, for example, is usually characterized as one in which politics played an unusually large role in investment decisions for all countries, especially Germany. But this can be said of other periods too and may once again become a major factor in FDI decisions, as investment in resource rich countries increases and political risk once again rears its ugly head. Moreover, U.S. tax law has not had a static effect on investment decisions across time and sectors. Our second example comes from a sector, financial services, which tends to be less studied by IB theorists. A discussion of this highly regulated, but fragmented sector of the U.S. economy highlights the limits of using rigid dichotomies between economies, especially with little or no reference to how those economies change over time.

### 3.3.1 Germany and the "Great Disorder."

Contrary to the Witt & Lewin perspective, neither the form nor the direction of German foreign investment during much of the interwar period, for example, was determined by the extent of home country or host country coordination of their economies. Other externalities were decisive. German firms directed much of their investment toward a country that had just demonstrated an astonishing lack of commitment to property rights. Not only did German companies invest in the United States, they used funds raised to fund some of their domestic activities and foreign investment in other economies that were still open to them. The structure of much of this investment came in the form of complicated holding companies, designed to shelter the companies from the illiberalism of both their home and host countries.

As Mira Wilkins has pointed out about investment in general in the United States during the interwar period, the roughly 20 years covered by our discussion is more like several periods rather than one, with a changing array of German motivations for FDI (Wilkins, 2004a). The environmental motivations included political risk, taxes, diversification of business and foreign exchange risk, as well as anomalies macroeconomic imbalances. Little of this conforms neatly to businesses from controlled investing in less-controlled economies. This relatively small chunk of time illustrates, a larger truth about many periods: the past is messy.

For much of the 20$^{th}$ century, Germany was the second largest economy in the world. Before World War I, German companies were among the first movers of international direct investment. Until World War I, what we now call the problem of "foreignness" played little role for German firms. World War I was particularly disruptive for them. It created new opportunities and risks for companies investing into Germany too (Kobrak, Hansen, & Kopper, 2004). German companies, such as Bayer and Hoechst, had large manufacturing operations in the United States and other countries (Hayes, 1987). Whereas in 1913 over one-third of all electrical production and nearly half of world trade in electrical goods involved German companies, by 1918, Germany had lost much of that dominance in global markets to new competition from other countries (Feldenkirchen, 2004). The "Great War" led to many other reversals. It changed the flow and nature of foreign direct investment. Whereas the United States had been a net importer of direct and portfolio investment, during the war net flows began to shift from west to east. Germany went from a major creditor to debtor nation.

Nevertheless, from 1919 to 1929, foreign direct investment into the United States grew from $7 to $17 billion, but portfolio investment grew even faster, though the distinction between the two became more blurred (Jones, 2005). This growth is explained in part by the many new complicated structures that were created to facilitate round-tripping funds, dollar loans to Germany, for example, which ended up funding investment in the United States.

Although this section deals with German investment abroad and German politics were at the hub of many political risk issues, some of the difficulties encountered by German companies were also important aspects of the new political environment for companies from other nations (Wilkins, 2004b: 25).

More importantly for German firms, virtually all German property in the United States was seized by the U.S. government in 1917. The seizure amounted to approximately $500 million, (Wilkins, 2004a) roughly 1% of U.S. GDP (if an expropriation of that scale happened today, the figure would be roughly $170 billion.). Some of the assets were sold off to American companies; some was returned to their German owners in the late 1920s, providing a windfall that helped finance external and home-country (German) investment. The firms that tended to come out of the expropriation best or avoid totally were ones that had been associated with companies in family networks, such as Merck, and those that used holding company or other complex structures to keep the assets outside of German (Kobrak, 2002; Wilkins, 2004a). This was a lesson that was not lost on German businessmen. While the risks reduced the overall amount of German investment, they also distorted patterns of German foreign investment and FDI statistics (Jones, 2005; Wilkins, 2004a; Kobrak & Wüstenhagen, 2006).

By 1929, many of the Germany companies had rebuild their international businesses, but with some new forms. German managers realized that acquiring and keeping sources of financing required much more complex international structures. Long before the collapse of liberal democracy in Germany in the early 1930s, companies established subsidiaries abroad, some of which could hold dollars and other currencies (Jones & Lubinski, 2012).

In the late 1920s, Germany's largest company and the world's fourth, IG Farben, the product of the 1925 merger of Hoechst, Bayer, BASF, and other German chemical companies maintained limited international production, even after its American property had been returned. Its limited international organization remained decentralized, but part of IG Chemical, Farben's Swiss holding and financing arm for international operations (Hayes, 1987). Other companies established international subsidiaries, where they once operated through agencies. Under German accounting rules, subsidiaries were not fully consolidated into German parent accounts. German companies could keep the proceeds of American financial settlements "offshore." Schering, for example, won a huge suit against Kodak in the late 20s. The funds remained in the United States and were used to guarantee dollar loans in Germany. They were not repatriated to Germany until the mid-1930s, as part of schemes to make money off discounted German debt and win foreign exchange concessions from the German authorities (Kobrak, 2002).

Some German companies actually transferred ownership and nation of incorporation outside of Germany. Stinnes, one of Germany's largest concerns, provides a striking example. In 1926, on the verge of collapse, the Stinnes family, which inherited the concern after its founder's death in 1924, transferred the ownership of most of its huge Europe oil, coal, and coking holdings, mostly located in Germany, to the United States. In order to secure dollar financing, it founded several American subsidiaries, with 50% of shares in the hands of the German investors, 50% in American hands. The companies were used to secure a $25 million debenture, the payment of which relied on funds that came out of Europe and which became blocked in the 1930s (Hugo Stinnes Corporation, 1957).

To be sure, the attraction of the huge, prosperous and capital-rich U.S. market played a large role in this investment, but understanding the evolution of the form of business activity requires referencing the political and economic environment in which German companies operated and was not just a function of the U.S.'s reputation as a liberal economy, which the Germans in particular had much reason to doubt.

German politics did, however, influence how the investments were made. As political and economic conditions in Germany and other countries deteriorated during the depression, German firms developed even more complex international strategies. Cloaking the identity of their companies in many foreign markets had multiple advantages. The practice of camouflaging ownership had multiple effects on foreign investments, making normal business more complicated. (Kobrak & Wüstenhagen, 2006). Although this strategy ultimately failed, it was based on the reasonable judgment that the United States would not enter World War II and British fears of alienating its large, potential ally by interfering with business coming out of the United States would allow German companies to operate internationally from the United States. Despite German efforts to cloak ownership, American authorities reported in 1946 that they had taken $400 million in German properties from 200 German companies, such IG Farben, Bosch, and Schering AG (Wilkins, 2004a). Unlike the post-World War I period, virtually all the property was lost.

In addition to investment from German to the United Sates, the interwar and war periods witnessed disruption in inward German foreign. During the hyperinflation and the recession brought on by monetary stabilization in the early 1920s, American firms took advantage of bargain basement German asset prices to make portfolio and direct investments, most of which were very lucrative for the parents. But even before World War II, some of these FDI investments created huge management problems and embroiled the multinationals in conflicts between parent and subsidiary (Feldman, 1989; Heide, 2004; Turner, 2005).

In general, during the 20s and 30s, investments became more political and often were driven by escape motives, but not always from controlled to liberal economies. Companies had to take into consideration the interests of their governments. German companies were expected to integrate German foreign policy into their investment decisions; even American companies were hauled in front of congressional committees to explain their dealings with foreign companies (Kobrak, 2002).

### 3.3.2 "Escape from New York"

Examples of escape from home countries can be found even among countries generally classified as open and liberal in recent studies. Not only did the United States expropriate private property during World War I, as discussed above, for much of its history, America has provided a relatively hostile environment to banks. Until very recently, America's banking system was highly regulated but fragmented. Joint-stock banks could only operate in the states in which they were based and in some states without any branches. For most of the 19th century, the United States had no central bank, to coordinate the banking system and serve as banker of last resort. Many of the functions of a central bank and larger national banks were performed by private banks, such as the House of Morgan or Kuhn Loeb, who were less regulated. For much of American history, too, foreign banks were not allowed to have branches in New York, the country's greatest financial center and domestic banks had severe restrictions on their foreign activities. Borrowing and lending was controlled in many ways, and after the 1930s, banks had to choose between commercial and investment banking activities (Sylla, 2007). In contrast to most countries, banking was and still is to some extent regulated by states, not the national government. Even before the recent Dodd-Frank Reform, banking, therefore, passes through several layers of regulation, state examiners, the Federal Reserve, and the U.S. treasury and securities administrations.

America's leading role in multinational banking is a relatively new phenomenon. Prior to World War I, American banks had very few foreign subsidiaries compared to their English, German, and French counterparts. Hemmed in the many national and state banking restrictions, in 1913, only a few state, trust, and arguably private banks had foreign operations. Until the creation of the FED, American national banks were not allowed to do business outside the United States. State banks lacked the economies of scale. As in many areas, trusts fell between the regulatory cracks and entered foreign markets. Nevertheless, the advance of American banks into the world proceeded at a snail's pace until national banks were permitted foreign branches, World War I reversed the flow of foreign investment, and other statutes led to the creation of special purpose vehicles for foreign activities. Even before the banking and securities acts of the 1930s American banks were chomping at the bit to find new expansion opportunities.

World War II shifted finance even further in favor of the United States. Of the largest 20 banks in the world in 1950, 15 were in the United States. American banks had easier access to dollar reserves, the currency in which trade transactions were dominated and which served as the anchor of the Bretton Woods System. In the advantageous environment, U.S. companies prospered and expanded abroad. With comparative technological and managerial advantages, and the blessings of the U.S. and, at least at the early stages, non-U.S. governments, they took advantage of the reduction of impediments to trade and investment, which increased demand for banking services outside of the United States. But before U.S. banks could profit from the expansion of their clients and attain new economies of scale, they had to break free of many archaic U.S. banking statutes built up over decades, which reflected peculiar American attitudes and path dependencies about finance and federalism. Chief among these were state banking laws that forbade interstate banking and the Glass-Steagall Act, which forbade banks to provide commercial and investment banking services. State banking prevented even U.S. money-center banks from acquiring the domestic economies of scale and diversification, commonplace for French and British banks, which would have corresponded to America's vast size. The largest U.S. banks, such as Bank of America and Chase, were large because they were located in large states – California and New York. None of the largest banks acquired more than a 3% share of the U.S. banking market. Some of the largest banks were restricted to one city, some to just one office. Glass-Steagall prevented them from competing on an equal footing with French and German universal banks. American regulators forbade U.S. banks from paying interest on checking accounts and set ceilings on other accounts (Sylla, 2002).

For these banks, Europe was the Promised Land. In many respects, European banking regulations were far less draconian, especially for American banks. The British especially welcomed the Americans as a way of restoring London's financial clout. By the 1970s, many large American banks were doing approximately half of their business outside of the United States. At first the Exodus was enhanced by further American restrictions on American banks, such as controls on capital outflows. Within a decade these provisions were deemed ineffectual and they were relaxed. The Exodus allowed the banks to expand their services in many ways. They developed term loans tailored to clients' needs, a form of financing that was not secured to assets. But U.S. banks were losing business to their large and less regulated American clients, who could bypass them and go directly to capital markets, for both investment and borrowing. The banks were losing their deposit and lending base, leading to efforts to become larger by domestic mergers, use of more Fed borrowing, and foreign investment. Between 1950 and 1970, U.S. measures to keep interest rates low artificially encouraged U.S. borrowing, especially short-term borrowing, leading to further dollar flows to other countries. More and more dollars were building up abroad, which led to U.S. government efforts to stop the build-up of dollars, such as the 1963 interest rate equalization tax, a tax on foreign borrowing in the United States. Having foreign branches helped U.S. banks avoid many of the new lending restrictions and encourage more U.S. banks to establish foreign entities especially in London. Restrictions placed on U.S. companies in 1965 on capital exports further increased U.S. companies' dependence on their banks' ability to give them foreign financing (Sylla, 2002).

The American banks saw the nascent Eurocurrency as an opportunity. The growth of U.S. financial FDI is impossible to understand without reference to the growth and nature of Eurocurrency. Although Eurocurrency or Euromarkets (bonds, deposits, loans) refer to any funds held in banks in a currency other than the currency of the country in which they are located, the bulk of the deposits in the 1950s and 60s were in dollars and the deposits originated in the United States. Ultimately, one of the banks involved had an account with a bank in the United States. The bank that issues the dollar deposit in London is in effect creating a liability that is matched by an asset with an American bank. A London bank, if it wanted to avoid huge foreign exchange speculation, would have to have a correspondent bank in the United States, its own affiliate (and there were few), or have its parent there. This gave the American banks an advantage in creating Eurodollar accounts. These non-U.S. accounts are not strictly regulated by either the U.S. authorities or the countries in which they are located. The development of the Euromarkets both enabled and was enhanced by the American invasion. Even though in 1977, the Eurobond market was still dominated by non-U.S. banks, American banks kept an advantage in holding the deposits used to purchase the bonds. From 1964 through 1975, Eurocurrency's gross market size climbed from $20 to $480 billion, a staggering 24-fold increase in 11 years (Battilossi, 2002). By the mid-1970, this amounted to roughly one-third the U.S. GDP.

The American invasion along with the development of Euromarkets, both of which were brought on by a paradoxical mixture of heavy and light regulation, as well as the collapse of the Bretton Woods System collectively contributed to the revolution in multinational banking. Fear of American political risk (see above section on U.S. expropriation) and heavy-handed financial regulation combined with greater abilities to get and keep funds offshore in lightly, but reliably regulated markets provided a highly seductive environment. With the dollar still the world's trading currency and with their large international network of branches and subsidiaries, American banks were well-positioned to take advantage of the explosion in foreign exchange trading (Sylla, 2002). From 1960 to 1973, American branches in Europe grew from 131 to 689 (Battisossi, 2002).

The invasion of American banks helped revolutionize banking and money centres. The presence of American competition created new competitive pressures for European banks. In several countries, American banks expanded the offerings to European retail customers, with innovative services or just more marketing of banking products (Sylla, 2002). Some data indicates the extent of the American financial invasion. It stimulated an increase of international flows and banking investment. From 1955 to 1970, the number of foreign banks in London grew from 69 to 148; in Paris 24 to 52; Frankfurt/Hamburg, 17 to 55, and in Zurich, from 7 to 22. From 1961 to 1970, the foreign assets held by domestic banks shot up in London from 17% to 25%, whereas they actually declined in the U.S. to one-third of their 1961 levels, reflecting a transfer of international activity from the United States to the United Kingdom. By the end of Bretton Woods, net overseas earnings by London based banks had tripled from the early 1960s. Euromarkets expanded currencies and locations (Schenk, 2002).

All this left European banks with a competitive challenge. The two world wars and interwar chaos reduced their relative size and international networks (Cassis, 2002). Not only did the American arrival threaten European banks' home market advantages and state control of the banking sector, a managerial and innovative challenge at home to say the least, it seemed to call for greater international investment. But their relative weakness and perception of political risks confronted the European banks with a daunting challenge. For many of the biggest European banks banding together seemed like the only reasonable option in the topsy-turvy world after the fall of Bretton Woods in 1971. Desperate to expand their foreign activities to respond to the new financial architecture and America's head start, by the late 1970s, most of the member banks pursued separate foreign investments even while the joint-ventures still survived (Ross, 2002).

Although the story of American bank flight to Europe might be seen as confirmation of the “escape from coordinated-economies hypothesis,” American banks fled to both liberal and coordinated banking systems. To be sure, Eurocurrency markets offered in a sense the ultimate in liberal business environments, but the national systems, such as the domestic German, British and French, where they also opened offices, were not. They were highly regulated and well ordered. The very order of those markets posed opportunities and risks. American banks could appeal to customers tired of the staid, conservative banks. But those non-American banks soon demanded more access to U.S. markets, creating a competitive challenge to the once safe domestic banks and creating demands for changes in American banking regulation.

The story of American banking investment is in many respects a classic regulatory one, but not a simplistic account of moving from CMEs to LMEs. Although the U.S. investment at first relied on the openness of British banking, it soon morphed into more coordinated economies, such as Germany, France, and Switzerland. It was contingent on many political and regulatory factors. Indeed, American banking regulation illustrates the broader political and changing dimension of regulation. From its earliest days, the United States wrestled with the need for a strong banking system and a desire to keep banks small and local. This political, cultural preference still haunts American banking, despite major regulatory changes. Current debates not only illustrate how important deep-seated political and cultural preferences are, but also how these preferences adapt and shape specific regulatory changes, making broad generalizations over time and sectors about the degree of coordination in economies shaky at best.

## 4. DISCUSSION AND CONCLUSION

While some researchers, in particular Witt & Lewin, argue that CMEs are more prone to escape FDI, we present evidence for the view that this explanation is over simplified. Based on historical data in this piece and aggregate historical in another, we find that the dichotomy has very limited explanatory use. According to our statistical findings, CMEs are not only more prone to outward FDI than LMEs, but are surprisingly also more likely to attract inward FDI, suggesting at least that economic coordination is not a deterrent to investment. Indeed, the low correlations in both their regressions and ours indicate that heavy reliance on economic coordination as a predictor of FDI is unwarranted.

Our historical examples yield insights about the complex and changing institutional contexts that produce waves of FDI. Detailed analysis of the past casts doubt on using labels, such as LME and CME, which mask historical transformations. A business history perspective shows that coordinated or liberal orientations are 'not carved in stone' and that at various stages of development each creates opportunities and obstacles for foreign investment. This analysis suggests furthermore that aggregated data needs to be supplemented at least with detailed analysis of particular phenomena and their context. Marrying the two methodologies can produce fruitful results by helping to avoid static variables, such as societal coordination indices. The degree to which and velocity of FDI to both types of economies serve as a recent cautionary tale of using static aggregate data (Kramer, 1983).

With this in mind, we should note that what we recommend here as an integrated research agenda and methodology is not easy. There is another obstacle to the laudable goal of interdisciplinary work: mastering the literature in one discipline is hard enough. Bridging methodological differences and integrating disciplines requires creative, disciplined effort. As we have noted, even historians working on multinationals spend little time with the work of current leaders in IB, while business history is chock full of examples of 'escape FDI' that hardly finds its way into IB papers. Our effort here represents one alternative: co-authorship. Another is interdisciplinary conferences and university seminars to encourage contact between practitioners and opportunities to ask questions about each's work that could enrich both. Perhaps too, history departments and business schools should look to ways of institutionalizing linkages with joint post-docs and regular seminars, particularly important for young scholars. Lastly, and most importantly, journals need to "practice what they preach," as it were, and demand of authors the good practice that has made it into their own pages. Perhaps most importantly, social scientists must be willing to accept history's role in providing counter examples, a function that may go to the heart of some core methodological values, and historians should not be afraid on critical analysis of over-reaching theory.

Perhaps collaboration requires both self-criticism and self-confidence in what each can offer the other, including remembering the dangers of both too much history (historicism) and too little can be impediments to knowledge. (Popper, 1961) The overall aim of this paper is to help encourage a fusion between history and IB research and to broaden debates about the origins and motivations of FDI by analyzing recent theory and history. We present some conceptual and analytic evidence for this view that FDI theory could profit more from a broader and deeper appreciation of business history research, but to a large extent treat it as a given, without sufficient discussion of the obstacles and examples of its use.

Our interwar period case points to an additional motivation for foreign direct investment besides the frequently stated value creation motives. It is not always to exploit property and locational advantages by combining them with management, but rather to escape constraints imposed by firms' home countries, both liberal and coordinated ones can involve political risk. Political risk, even home-country political risk takes many forms. Our interwar German narrative highlights that escape FDI has broad, complex and changing motivations. Our U.S. banking example points to the complex nature of regulation and how it shapes investment decision. Not only does history offer many examples of how political risk needs to be added to maximizing technology and corporate advantages to explain international strategies and structures, but also that home country political risk has a broader impact than that of host countries (Tallman, 1988; Kobrak, Hansen, & Kopper, 2004; Newburry, 2012). The nature of that impact changes not only with the risks posed by home countries, but how that home country fits into the world. Both home and host country risk is relational. The one cannot be understood without the other, and is not confined to categories such as coordinated versus liberal regulatory environments.

For many reasons, environmental factors are still important determinants of FDI. Indeed, the increase in new significant emerging markets as recipients and sponsors of foreign investment as well as increasing resource dependencies produce more cultural clashes. During the period in from which Witt and Levin drew their data, several key environmental factors clearly influenced the flow of FDI. These include but are not limited to increased ease and incentives to use tax havens and the opening of new, emerging markets to western companies, markets that were more open in the 1990s than before, but hardly ones that could be described as liberal. Our examples are by no means a complete panorama of institutional influences on FDI. They do however illustrate the varied political and regulatory environments that have shaped international investment strategies and tactics.

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