MULTINATIONALS

INTRODUCTION

In the previous section, we focused on the growth of firms – how growth was measured, how firms grew and the effects of growth. In this lesson we will select one particular type of business which demonstrates tremendous growth.

You may have noticed in your country or from television advertisements that some firms around us are really foreign firms, that is, they are branches of firms which are based in the United Kingdom (UK) or the United States of America (USA) or some other country. These branches are sometimes called subsidiaries while the main branch in the USA or the UK is called the headquarters or head office or parent company. The country in which the branch or subsidiary is located is called the host country. Firms which have branches or subsidiaries in two or more countries are called multinational corporations (or multinational enterprises) (Multinational Corporations). Sometimes, they are called transnational corporations. The following diagram depicts the overall structure of a multinational corporation. British Petroleum (BP) is used as the example.

MULTINATIONAL CORPORATION: BRITISH PETROLEUM

[Diagram showing the structure of British Petroleum's multinational operations with headquarters in London, branches in Canada, the U.S.A., Trinidad & Tobago, Brazil, Mozambique, China, and Australia, each indicated as host countries.]
British Petroleum has some 29,200 service stations with some 15,000 in the USA and over 14,000 in the rest of the world. This company has refineries either fully owned or partly owned in 24 countries. It carries out other productive activities (exploration) in over 22 countries. This is indeed a very large MNC. Here are some other examples of MNCs.

<table>
<thead>
<tr>
<th>MNC</th>
<th>Headquarters</th>
<th>Main Activity</th>
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<tbody>
<tr>
<td>General Motors</td>
<td>USA</td>
<td>Vehicles</td>
</tr>
<tr>
<td>Exxon</td>
<td>USA</td>
<td>Oil</td>
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<tr>
<td>Toyota</td>
<td>Japan</td>
<td>Vehicles</td>
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<td>IBM</td>
<td>USA</td>
<td>Computers</td>
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<tr>
<td>Unilever</td>
<td>Netherlands/USA</td>
<td>Food products, Detergents</td>
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<td>Nestlé</td>
<td>Switzerland</td>
<td>Food products</td>
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<td>Renault</td>
<td>France</td>
<td>Vehicles</td>
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<td>Philips</td>
<td>Netherlands</td>
<td>Electrical/Electronics</td>
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These companies have numerous branches worldwide. Now you can relate this type of growth to what you have learnt about the growth of firms. We must now focus on the reasons for such growth. These companies would have started as small businesses and then expanded to the extent that their operations crossed borders and moved to other countries.

Multinational Corporations grow essentially because there are opportunities for them to increase their profitability by taking advantage of all the possible economies of scale. In addition, some host countries encourage them by offering certain incentives and hoping in exchange to get gains in areas of employment, technology and revenue. Let us now focus on these. First, you can review the benefits of growth, that is, the Internal Economies of scale. Here are some immediate economies these firms acquire as they expand to other countries.

1. Multinational Corporations benefit from risk spreading. Since these companies have branches in other countries, downturns in economic activity or any other factor which might lead to losses in one country can be compensated for in other economies where the firm is making profits. Additionally, risks can be spread by the firm engaging in producing different types of products and so reducing the chances of failure.

2. Multinational Corporations also enjoy financial economies since as they grow, lenders are more likely to offer them loans at interest rates which are generally lower than what other firms can access.

3. With such huge operations, Multinational Corporations are also able to access raw materials very cheaply from countries where these are available. It becomes possible for them to provide such materials to all their branches.

4. Gains also become possible in the area of research and development as the MNC, operating on such a large scale, can have its own Research and Development (R&D) Department. Multinational Corporations have also grown globally and within the Caribbean because of incentives offered by host countries.

5. Some host countries offer Multinational Corporations huge tax concessions, that is, tax free holidays or low tax rates to encourage them to come. This of course helps to increase the profitability of the Multinational Corporations.

Now, you will notice that so far we have outlined why Multinational Corporations have grown. These points outline the benefits which accrue to the MNC. Let us now explore the benefits which the host country can receive from MNC’s.
Benefits for the Host Country:

1. In many cases, host countries (especially developing countries) lack the necessary technology and expertise to exploit their natural resources. Multinational Corporations have helped these countries by providing such technology and expertise.
2. By setting up subsidiaries in host countries jobs are created, helping to reduce rising rates of unemployment.
3. Governments in host countries find opportunities to earn tax revenue (in many cases in the form of foreign exchange) to pursue their own domestic expansionary policies and social programmes.
4. Multinational Corporations have sound communication links worldwide and these help in the marketing of the output produced in host countries.
5. In a general way, host countries benefit from increased economic growth as greater output is produced with opportunities for increasing per capital income in these countries.

You will imagine though that there is another side to the coin. Multinational Corporations are not always viewed as ‘saviours’ or good businesses. In many countries, they receive hostile treatment especially from trade unions.

Let us now look at this aspect of Multinational Corporations.

Disadvantages of Multinationals: (for host countries)

1. A major argument against Multinational Corporations originates from the very structure of the organization. Branches in host countries are just that...! They represent one arm of the organization and not the organization itself. Branches operate for the existence of the organization so that as gains (profits) are made, these are siphoned back to the parent company or ‘nerve centre’. Such repatriation of profits means that the host country is denied the opportunity to benefit from serious re-investment of earnings to help create further output, employment and growth.

Look at the following diagram which demonstrates this.

![Diagram of Multinational Corporations]

Profits being repatriated.

2. Another problem host countries face comes about because of the system Multinational Corporations use to source certain inputs (raw materials and intermediate products). Multinational Corporations involved in secondary production (for example, manufacturing and construction) use inputs manufactured by their subsidiaries elsewhere. A very good example is the case of Multinational Corporations involved in the assembling of vehicles. This means that by sourcing inputs elsewhere, the import content of the final product tends to be very high resulting in a negative impact on the
host country’s balance of trade. Furthermore, by sourcing inputs elsewhere, it denies the host country the opportunity to develop its own linkage industries.

3. Closely linked to the problem of ‘sourcing’ are the opportunities created for ‘transfer pricing’. Multinational Corporations source inputs (for example, raw materials) and also source human resources (for example, consultants, engineers) from other branches to engage at times in a practice which helps them to artificially increase costs and so depress profits (artificially). They do this by paying exorbitant fees for such inputs or services and so transfer funds from countries where tax rates are high to countries which are tax havens. Now, you must remember that companies pay corporation tax on their profits. As such, if their books show small profits, their tax to be paid will be small. The MNC itself does not lose as an organization since the money is simply sent to another branch where the tax rate is small or non-existent. Look at the following diagram which depicts transfer pricing.

**EXAMPLE OF TRANSFER PRICING**

![Diagram of transfer pricing]

Branch ‘B’ therefore increases its costs and shows less profits and so with the high tax rate pays the host country less taxes than what it is supposed to pay.

Branch ‘A’ earns high profits but operates in a tax haven and so tax payments are minimal.

4. Another disadvantage which Multinational Corporations bring to host countries has to do with the type of technology used. This applies especially in cases where Multinational Corporations from developed countries set up subsidiaries in developing countries. You must remember that host countries hope to benefit from job creation. However, Multinational Corporations tend to use technology which is capital-intensive in economies which have surpluses of labour. The end result is ‘technological unemployment’ since the technology used cannot absorb the available labour.

Now that you have explored the operations of Multinational Corporations, attempt the activity on the following page.
THE IMPACT OF TRADE LIBERALISATION AND GLOBALISATION

INTRODUCTION

If you were to visit your village shop or a supermarket or even a large department store in your country, you will encounter many products which were not produced in the domestic economy. In fact, you will probably see some items which came from the United States (US), some from the United Kingdom (UK), some from Singapore and some from other Caribbean Islands. This is because there is trade existing between your country and these other countries.

Sometimes you may find that the range of commodities being imported is very wide while in other cases the range tends to be narrow. This has to do with the government’s position on trade with other countries. Some governments take measures to restrict trade while others might take a position of encouraging as much trade as possible with other countries.

Trade liberalization involves freeing up or removing the barriers to trade. These barriers include taxes on imports, import quotas, foreign exchange controls and bans. By removing these barriers, importers are allowed the freedom to access goods from all over the world while consumers benefit from greater variety and perhaps improvement in quality and lower prices.

This move to encourage free trade is one dimension of the globalization process. You can probably see trade liberalization as a subset of globalization. It is one of the ways by which people from different parts of the world become connected. Let us now examine the issue of globalization.

The fact that countries have been trading with each other for a long time and that people from different parts of the world have been in contact and have made links with others elsewhere, suggest to us that globalization is nothing new. What has happened in recent times is that changing technologies, in particular, have allowed a more rapid rate of globalization. Links and inter-connections between countries and between peoples have accelerated.

If you were to check on the work you covered in the previous sections, you will see the topic of multinationals. Notice how multinationals have connections in several countries. These companies represent one of the significant actors on the globalization scene as they have production plants, raw material sources, distribution centres in different countries, making the production process cover a wide area, that is, in several different countries. (By now, you must be getting the picture of what globalization entails).

Consider your own community, your own village perhaps, where people meet and interact at different levels. Imagine that each individual comes from a different country; each business is from a different country. Yet, communication takes place, production takes place, marketing takes place, ideas are exchanged. If this village or community is seen as the entire world, it would give the perfect idea of what globalization involves.

Globalization makes the entire world reduce itself into one village such that the lives of people from different countries become inter-connected. Trade liberalization encourages this; Internet links facilitate this; Media networks and the telephone system facilitate this; Fax machines facilitate this; Multinationals encourage this.

A global market emerges but we must note that not only goods, services and ideas are exchanged but cultural patterns and habits are also influenced. The effects of globalization are felt on several groups: businesses, consumers, the government and the economy in general.
These arrows inside represent the links between countries emerging because of trade liberalization, multinational corporations, the Internet, fax machines, media networks, for example, cable television.

THE IMPACT ON BUSINESS

1. You would have noticed that as the world becomes one global market, one village, it allows for greater competition among firms. This can cause marginal firms to collapse or be taken over by large companies.
2. Businesses will now have access to the improved technologies being developed elsewhere. This can go a long way in improving productivity and quality.
3. As businesses grow, opportunities for establishing plants elsewhere will present themselves. This leads to increasing economies of scale and so lower average costs.
4. The world becomes the market now and a wider market provides the opportunity for businesses to grow and enjoy the benefits of growth.
The Impact of Trade Liberalisation and Globalisation

5. The Internet becomes a tool to access raw materials, intermediate products and final products. In the same way it provides opportunities for businesses to market their own products.

THE IMPACT ON CONSUMERS

1. Consumers will now be able to access goods which were not available to them previously. A greater variety of goods becomes available.
2. Internet purchases become possible.
3. Increased competition encourages lower prices for consumers.
4. Consumer habits and demand patterns are likely to be affected by the influence of print and electronic media together with products marketed via the Internet.

THE IMPACT OF THE ECONOMY

1. The possibility for growth in the economy is there. Increased trade, increased foreign exchange earnings can fuel economic growth.
2. Unemployment can result for several reasons. Some businesses can collapse up because of the increasing competition. Then again there is less need for the unskilled since special skills are required in an integrated global labour market. Greater labour mobility becomes possible and there is less protection for those without necessary skills.
3. Small economies in particular are very vulnerable to external events since such economies tend to be highly ‘open’. Changes in demand or adverse movements in price can have disastrous effects on such economies.
4. Increasing world demand can lead to rapid depletion of some natural resources which can have major impacts on future growth.
5. The economy can face high external costs of increasing crime rates (facilitated by the Internet) in the form of illicit trade in drugs and money laundering.

THE IMPACT OF THE GOVERNMENT

1. There is the potential loss of power and governance to large multinationals which can easily become tied into the politics of the country.
2. The sovereignty of the state can be threatened by international organizations making rules and laws for a large part of the participants in the global market. The World Trade Organization (WTO) is one such example.
3. Government must find resources and develop policies to deal with the negative impacts on the economy which can come with globalization. These include increasing crime; a widening gap between rich and poor countries since the profits of international trade tend to be shared disproportionately; environmental degradation; threats to the survival of small businesses.