

# Free essay on multinational firms

[Business](#), [Company](#)



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## **Executive summary**

The global nature of multinational firms indicates that they must adopt proper managerial policies in order to ensure they cope with increased costs and competition levels that prevail in global markets. It is necessary for multinationals to evaluate their operational structures so that they achieve their goals and objectives. There are multinationals that aim at maximizing shareholder value as opposed to others that target maximizing stakeholder value. Most of the firms that aim at maximizing shareholder value appreciate the role of the shareholder as being central to their capital structures and hence a key stakeholder for realization of targets. Those that aim at maximizing stakeholder value appreciate the collective role that all stakeholders such as shareholders, employees, suppliers and the community play in the success of the multinational. The model that a multinational

adopts determines its strategies in investing in some corporate governance aspects such as corporate social responsibility.

## **Introduction**

Financial management normally deals with how various firms arrive at their financial decisions such as those regarding capital structure, working capital management, dividend policy and investment management. The decisions are vital for the attainment of set policies and objectives based on the strategy of each firm. The need for prudent financial management is a crucial aspect for multinational firms owing to the globalized and liberalization nature of modern business. This is because most consumption patterns around the world have been internationalized where a firm may be operating in one continent while its raw materials are being sourced from another continent. The business environment has today increasingly become globalized where major economic decisions such as consumption, investment and production are being conducted at an international level.

## **Features of financial management**

- Debt policy

Multinational firms adopt effective strategies aimed at increasing profitability so that most of revenues generated can be used in operations. The high corporate taxes that multinationals are exposed to make it worthwhile to finance most of the investments through debt. This is because the interest paid on these debts is deductible from profits realized by a firm so as to determine its tax burden. This tax induced benefit of debt is utilized by multinational firms in effectively financing their operations (Gunnar, Yves &

Bartlett, 2013).

However, multinationals have an added advantage because they can shift debts from their affiliates that are located on low tax regime countries to high tax regime countries. Eventually the tax savings from the deductions that are made in high-tax countries exceed the corresponding payments in tax that are made in low-tax countries. Such aspects of debt shifting have monumental impacts on the capital structures of various multinational firms especially those with operations in diverse regions of the world.

In order for multinational firms to effectively manage their debts and maximize shareholder value there is need to understand some of the distinguishing features between managing multinational firms and domestic ones. This is because multinationals are exposed to greater risks due to their widened operations. One of the main distinguishing features is foreign exchange risk. Multinational firms deal with different currencies when conducting their businesses as compared to domestic firms that only handle one currency. This exposes these multinational entities to risks that result from exchange rate volatility in foreign exchange rates. Variation in exchange rates has serious impacts on the profit levels that multinational firms make and may determine investment decisions made. It is therefore crucial for firms in the international scene to anticipate such volatility so that they can anticipate competitiveness in main areas such as imports or value addition for exports.

Political risks also have profound impact in financial management policies adopted by multinationals. These risks result from gains or losses that a company experiences due to unforeseen actions of government agencies or

other acts of political nature such as terrorism.

Multinationals also face increased opportunities due to their presence in global markets. They can utilize the benefits presented by their international presence to raise capital in countries or regions where costs for such capital are lowest. They also gain from larger economies of scale and networking opportunities presented by their international presence (Robinson & Stocken, 2013).

It is also evident that multinational firms are exposed to various market imperfections. This is due various differences between nations' laws on taxes, business systems and general trading environments. These imperfections that are prevalent in the international scene act as a barrier to the extent to which a multinational company can diversify its business portfolio. However, these market imperfections also act as a source of various leveraging opportunities that a multinational company can exploit.

- Dividend policy

Multinational firms adopt different dividend repatriation policies so as to maximize their shareholders' value and prevent capital flight. The dividend policies adopted by a multinational firm is based on the preferences for investors on whether to receive cash dividends in the present or reap increased benefits in the future through capital gains. Most multinationals prefer the variant mode of a stable dividend policy where external shareholders receive a stable but rising amount of dividend

## **Managerial ownership**

There are various proposals on the ownership and management of multinational firms. Multinational firms with origins in European countries like

United Kingdom, Germany, France and others usually prefer geocentric models where multinationals operate as fully fledged subsidiaries in countries where they are situated. They conduct most of their operations such as recruitment from these resident countries. However multinationals that originates from high context culture countries like Japan and China normally adopt ethnocentric models of managerial control where they prefer most of the managerial functions to be directed from their home countries. They forward key personnel from their home countries to various locations in the world where they have operations. Most of these businesses tend to be controlled through family ties.

### **Differences in financial management systems**

Most multinational firms design their financial management systems with a major priority of maximizing shareholder value. It means that most of the strategies that are adopted are geared towards maximizing the wealth of shareholders in the short and long term. This wealth is maximized mainly through receipt of dividends by these shareholders after every trading period and also through capital gains. Anglo-Saxon countries like the USA, Canada, Australia and the United Kingdom give priority to maximization of shareholder value. This is opposed to behaviors in multinationals from other countries such as Germany and France. This is because for multinationals based in Germany or France shareholders are considered as one group of stakeholders besides others like employees, suppliers, customers amongst others. Such companies aim at maximizing the welfare of all stakeholders with no particular preference to shareholders as is the practice in most US firms (Goergen, 2012).

In other countries like Japan, various related businesses operate through groups known as keiretsu. Examples of such businesses include firms like Mitsubishi and Mitsui that resulted from consolidation of various family owned businesses to become leading global enterprises. In these Japanese multinationals, the prosperity and growth of the various business groups i. e. keiretsu is accorded priority over shareholder interests. The main focus therefore becomes increasing the market share of the business rather than maximizing rewards and returns to shareholders.

## **Corporate governance**

Corporate governance refers to policies and strategies that are used to exert control and direction of firms. It defines how rights and responsibilities are shared and executed in a firm. Multinational firms have different models upon which they base their corporate governance principles. The Anglo-American model of corporate governance is widely practiced in countries like the USA and United Kingdom. It emphasizes the maximization of shareholder value. This model advocates for a single tiered board of directors that is mainly composed on non executive directors. These non executive directors are elected by shareholders after defined periods of service. The elections are conducted during annual general meetings of the company shareholders. Managers and boards of directors make strategic decisions that ensure the shareholder gets a return on his investment in the company both in the short and long term. However, there is a difference between the application of the model in the USA and UK. This is because in the USA, the chief executive also serves as the chairman to the board of directors while in the UK; the chief executive has no dual roles.

However this is contrasted by corporate governance models that are adopted by countries in continental Europe such as Germany, Netherlands, Italy, Austria and others. They adopt a two tiered board of directors i. e. a supervisory board and the executive board of directors. The executive board of directors run the day to day operations of the company and consists mainly of company managers. The supervisory board is mandated to hire and fire members of the executive board and represents the interests of various stakeholders in a firm such as shareholders and employees. This is done through their role of reviewing all major business decisions before implementation. The supervisory board is also tasked with determining the remuneration of the members of the executive board.

In the Indian model, corporate governance lays emphasis on adherence to ethical attributes such as honesty and integrity for managers (Masdoor, 2011). This is because they view the shareholders as the actual owners of the organizations. The managers in these firms are considered as the custodians or trustees of the interests of the shareholders and decisions made should guarantee wealth maximization to the shareholders.

In the area of corporate social responsibility, most of the countries in continental Europe such as Germany and countries like Japan adopt the constituency model of corporate social responsibility. They acknowledge the community where their multinational firms operate as key stakeholders in the success of their business strategy. They must therefore demonstrate a balance between shareholder and non shareholder interests. There is greater commitment to corporate social responsibility efforts such as sustainable environment, education improvement and proper disposal of hazardous



wastes as vital in their business success. They also recognize policies that improve the relationships between the company and the communities in where it operates. They regard such moves as a way of achieving a social license to operate in their jurisdictions. This is because proper relationships are vital in cultivating an environment of customer loyalty and responsibility.

However, this is contradicted by multinationals in countries where maximization of shareholder value is the main aim. Such firms adopt the sustainability model of corporate social responsibility. They aim at maximizing shareholder value by reducing unwarranted expenditure that reduces profits. Multinationals such as those with origins in the United Kingdom view commitment to increased corporate social responsibility as negating this commitment. This is because it reduces the levels of profitability for firms thereby reducing amounts that could have accrued to those shareholders as dividends. They therefore implement policies that are mainly aimed at complying with the general applicable laws in areas such environmental sustainability but no further efforts are evident.

In the area of ethics, various multinationals demonstrate varying behaviors all aimed at ensuring successful implementation of their strategies. Culture plays a significant role in determining the nature of ethical attributes that take prominence in an organization. Indian multinationals have greater appreciation of values such as trusteeship as enumerated in the teachings of Mahatma Gandhi. The same applies for multinationals based in high context culture countries such as Japan, South Korea and China. Western-based multinationals lay more emphasis on establishing rigid ethical principles

enumerated in codes of conduct and ethical codes. Most of the countries from Europe establish actual offices that enhance ethical adherence by all organizational stakeholders. They establish offices such as ethical compliance officer.

## **Conclusion and recommendations**

Multinational firms play a crucial role in the process of globalization due to their potential in generating income and creation of wealth in national economies. These companies must address the various challenges that exist in form of risks due to their exposure to the international market.

Formulation of clear corporate governance principles places these firms at an advantage. It enhances their global appeal and maximizes returns to various stakeholders such as shareholders and communities where the organizations operate. Firms must clearly formulate ethical codes that serve as reference points for any stakeholder that wants to engage with them. They must also endeavor to embrace corporate social responsibility as a strategic tool in nurturing proper relationships between them and the diverse communities where they operate. It demonstrates appreciation and recognition of the vital role corporate social responsibility plays in increasing the visibility of the firm in the community. Such efforts must be done in recognition of culture and beliefs of local communities.

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