

# How firms become multinational enterprises



## **INTERNATIONAL BUSINESS ASSIGNMENT – II**

### **Introduction**

A significant shift is taking place in the world economy today; previously each nation had different and relatively isolated economies from each other by different barriers to cross border trade. But now we are drastically moving towards an independent global economic system in which different national economies are blending together which is referred as globalization.

Independent global economic system has brought effective involvement of numerous firms from various countries in the international market; the shift towards globalization has been accelerating currently, and it looks set to carry forward.

### **Multinational Enterprise**

An enterprise that operates and has its assets and facilities in more than one country excluding its home country is called as multinational enterprise, such firms has have offices, factories, outlets and etc., in different countries and usually have centralised head office where they co-ordinate global management.

The swiftly developing global economy creates many factors and opportunities for business worldwide. It creates opportunities for business to expand their resources, profit and market, this make many firms to become globalized for example Wal-mart , Coca-Cola, Exxon Mobil, Levi Strauss, and Royal Dutch Shell are some of the most successful multinational enterprise in the world. But still many significant differences exist between national markets along many relevant factors which need to be overcome to be successful globally.

## Why Firms become Multinational Enterprise?

As an enterprise operating in an International Business environment provides many new openings to a firm than operating in a domestic environment. A worldwide operation provides an enterprise access to new markets, resources and many other benefits, mainly it also widens the options of strategic moves of the firm against its rivals. Let's discuss the reasons for the firms becoming a Multinational corporation elaborately.

### **The Eclectic Paradigm**

An effective approach to the study of the internationalization of business was offered by John H. Dunning. The Eclectic paradigm was a dominant framework for explaining the reason for the existence of Multinational enterprises and the determinants of foreign direct investment.

Dunning stated three factors to the eclectic paradigm:

#### **i. Ownership-specific advantages**

The enterprise which invests in a foreign country has a competitive advantage and out-competes the firms that operate in the country where the investment is done. The multinational enterprise has advantages of Intangible assets like trade name, brand, and patents. The firm has benefits of reputation, technology and skills of management.

#### **ii. Location-specific advantages**

This advantage is based on the geographical position of the firm; according to this many positive factors like resources, cheap labour, host country's regulations and political stability are available for the multinational enterprises.

### **iii. Internationalization-specific advantages**

When a firm enlarge its operations in another country, by acquiring the property of the assets that are abroad its get this internationalization benefit. The firm gets a new market, reduces the production cost and can keep its skills and capabilities internal to the firm.

#### **The Product life cycle theory**

The product life cycle theory was framed by Raymond Vernon, this illustrate that in the beginning stage of the product life cycle the production and the rest of the operations of the product takes place in the home country. First the product will be serving the local market and then world market, when the product gains reputation the production gets relocated abroad to gain from lower labour cost and the other benefits available in host nation. At a point of time the country which invented the product becomes an importer of that product. The best example for this is the invention and production of personal computers by IBM. This is also an essential cause for firms to become a multinational enterprise.

#### **The Internationalization theory**

The market imperfections approach to Foergin direct Investment is typically referred to as internalization theory. The Internationalization theory was developed by Buckley and Casson. This theory states the main reasons for which the firms become a multinational enterprise due to market imperfection. Due to market imperfections, the monopolistic advantage of the firm can be used to widen worldwide to again competitive advantage. A firm overcomes market imperfections by creating its own market by the

means of internalisation through this the firms become a multinational enterprises.

### **Resource seeking**

The firms develop into a multinational enterprise to seek and secure natural resources like raw materials, minerals and human resource. This helps the firms to reduce the labor cost and production cost.

### **Market seeking**

The multinational enterprises emerge to identify and exploit new markets for their products. This approach is followed by the firms to overcome trade barrier and to reduce high transport cost.

### **Efficiency seeking**

The firms try to enlarge globally to obtain the efficiency benefits they obtain from the host country like cheap labour force, for example multinational enterprise obtain low cost but labour intensive manufacturing in many Asian countries.

### **Capabilities seeking**

The firms follow strategic operations by buying existing firms or assets abroad, this is an approach by the firm to seek adequacy in order to sustain and advance its competitive position globally. These are the major reasons for a firm to become a multinational enterprise.

### **How firms become multinational enterprise?**

Once a firm take on Foreign Direct Investment(FDI) it become a multinational enterprise, a multinational enterprises have substantial direct investment in foreign countries. FDI (Foreign Direct Investment) refers to the long term

participation like management, partnership, technology transfer and etc., between a foreign country and a host country. FDI has become a vital accept of global economy, many nations liberalized the regulations for FDI and numerous host economies has have reduced trade barriers for foreign nations to do business in their nation.

When a firm decides to enter foreign market and expand to become a multinational enterprise then mainly there are six different modes to enter.

### **Joint venture**

Establishing a joint venture with a foreign firm has been a feasible mode of enter to the world market. Setting up a firm that is jointly owned and operated by two or more firms is called as joint venture. A firm can gain advantage from a local partner's knowledge of the host country's competitive conditions, culture and political system. Through this joint venture a firm can gain by sharing development cost and high risk of entering a foreign market with the local partner.

### **Wholly Owned Subsidiaries**

When firm owns 100 percent of the stock then it is termed as wholly owned subsidiary. If a firm wants to compete based on its technology then this will be the most preferred entry mode. Many high-tech firms prefer this mode of entry for overseas expansion. Establishing a wholly owned subsidiary in a foreign market can be done by setting up a new operation in that country or by acquiring an established firm and using that firm to operate.

**Licensing**

Licensing is very attractive approach for the firms which lack capital to develop overseas operation. Licensing is an arrangement by a firm to grant the rights to intangible property to another entity for a period of time and in return a fee is charged by the licensor. The advantage of licensing is that the firm does not need to bear the set up cost and risk involved in opening a foreign market.

**Franchising**

Franchising is basically a specialized form of licensing in which franchiser sells the intangible property and provide business assistance to the franchisee. The best example for a firm using franchising strategy is McDonald's. By using this a firm can build up a global operation quickly at a low cost and risk.

**Exporting**

Most of the firms begin their internationalization as an exporter. Exporting reduces the costs of establishing manufacturing operation in the host country. By manufacturing the product in a centralised location and exporting it to world market; the firm may get the picture of substantial scale economies from its global sales volume.

**Turnkey Projects**

This is a means of exporting process technology to foreign countries. Under turnkey project, for a foreign client the contractor designs, construct the whole manufacturing unit and also train the operating personnel. After completing the contract, the contractor hands over the key to a plant that is ready for full operation hence this approach is called turnkey. Turnkey

projects are common in chemical, petroleum refining and metal refining industries, all of which require costly, complex production techniques.

### **Conclusion**

Abstaining national trade barriers and advancement in communication, information, and transportation technologies are the main factors which influence the trend towards internationalization. These changes have enabled firms to operate worldwide and emerged different nations market into a single global market. The advantages of the growing global economy should be utilised for the welfare of the people all over the world.

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