Why do companies become multinational corporations

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Let us now take a look at what factors would motivate the companies to expand overseas. These motivations could arise due to a number of factors. Every company has its own reasons for establishing a base abroad. The analysis of the various factors involved in direct investment in a particular country is performed before the investment is considered and the weakness and strengths of stepping into that region are identified. Only if this analysis provides the numbers which appear to be in the favour of the investing company will the venture be given the go ahead and further steps would be taken.

Most corporations like to reduce costs wherever possible. This can mostly be done at the production or the supply stage. Most countries in the third world have very low labour costs involved in the production process. This opportunity can be exploited by moving the production plant to the third world country. Production costs are now reduced and the company gains more profits by achieving the same sales figure. Another key motivator is the need to secure key supplies. The oil companies want to open up new fields in Canada, Middle East and Venezuela (Christopher A. Bartlett et al, 2006).

Other companies would like to expand their markets in other parts of the world. If they feel they are producing more number of products than there are sales opportunities in the home country, they would want to expand their business into markets of other countries in order to obtain more sales.

According to Professor Raymond Vernon (Raymond Vernon, May 1966) the product cycle theory describes how these motives push companies to become MNCs. In the product cycle theory there are three stages. The initial

push is given by an innovation that a company creates in the home country let us say that it is an English company. This stage is called the development stage and at this point in time the company would benefit by establishing production plants in the home country so that research and production could be kept under close supervision. This also helps them keep a close eye on the home market sales figure. This innovation can also be in demand in other developed countries like the USA with similar market trends. Thus the company can start an export process and gain a small amount of market share in the USA (Raymond Vernon, May 1966).

The second stage is when the product matures and the company has a sizeable chunk of the home market and by now the export process has also become a major source of income rather than just a meager part of the sales figure. The competitors also view this exporting process as a major gain of revenue and hence start their own export ventures. Thus the company which came up with the innovative product establishes a production plant in the importing country. This gives the company a strong foothold in the market in the host country and hence it becomes a MNC rather than just exporting the goods abroad.

The third and final stage is when there are a huge number of competitors and the market price for the product goes down as everyone is trying to make it cheaper and hence gain more customers. The demand below the market price becomes inelastic and hence the companies cannot afford to slash the sale price continuously (David Begg and Damian Ward, 2007). This will motivate the companies to reduce costs in the production process. This is when they decide to establish their production base in the third world

countries with cheap labour. Thus the company becomes a true Multinational Corporation (David Begg and Damian Ward, 2007).

How can companies become Multinational Corporations?

There are various methods by which a company can have operations overseas. Each company has to first identify the type of expansion they require whether they want a market seeking opportunity or securing key supplies or production cost reduction. Based on these choices a company can decide how it wants to establish a base in a foreign country.

As suggested by Pehrsson, Anders (Feb 2008) the main modes of entry into foreign markets are:

Indirect Export.

Franchising.

Export through agent or distributor.

Joint venture with local partner.

Wholly owned subsidiary.

There are three major conditions as suggested by (Christopher A. Bartlett et al 2006), which have to be met for the company to choose a particular region to invest in. First, the foreign country must offer some sort of location-specific advantage. Second, the country should have a strategic advantage which helps the company to counteract the disadvantage they have in the local market. Third, it must also have organizational capabilities so that the

company can run at lower costs when the operations are maintained internally rather than licensing or franchising (Christopher A. Bartlett et al 2006).

Jan Johanson and Jan-Erik Vahlne (1977) developed the most well-known model called the Uppsala model for internationalization. According to this model, the whole process of internationalization was viewed as a learning process. The host country market is totally new to the investing company. Thus by providing investment and establishing a base in the host country, the company gains knowledge about the market, its customers and its competitors. With the help of this knowledge gained the company can now decide how much it can commit to the local market and will that commitment be worthwhile. New opportunities for investments like buying out a local distributor or starting a joint venture with a local company can also be identified. This enables the company to gain further knowledge in the local market. Eventually, through multiple learning cycles the company would have gained a lot of knowledge about the local market and hence would have become a fierce competitor in the host country.

The Uppsala model acts as a guideline for the companies to follow when they decide to become MNCs. But a lot of companies choose not to follow the Uppsala model. They look for shortcuts through which they can gain the knowledge of the local market faster and without investing much of their resources into the process.

Companies like Wal-Mart entered the United Kingdom by buying the super market chain Asda (Christopher A. Bartlett et al., 2006). This enabled them

to gain a lot of the local market knowledge by investing at a relatively lower rate as compared to building their own stores in the United Kingdom.