

# Benefits of multinational corporations in developing countries economics essay



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Low economic growth rates, obsolete technology, less capital, high unemployment rate and poor standard of living are the characteristics of developing countries. According to UNCTAD (2008), these countries usually invest 3 to 4 % of their GDP against estimated 7 to 9% annually in infrastructure which in results into gap in current volume of investments. This is where Multinational Corporations (MNC) maximizes their benefits by investing in host developing countries through their technological and other assets advantage. These corporations are usually large firms operating in imperfect market to open up new sources of information and knowledge and broaden the options of strategic moves which make the company competing with its home and global competitors.

In the 19th century, the newly emerged capitalist in developed Europe started to invest in less developed countries of the world including United States. This gave rise to Multinational enterprise in those countries particularly held by France, Germany, Britain and Holland. A multinational enterprise is an enterprise that engages in foreign direct investment and owns or, in some way, controls value-added activities in more than one country (Dunning & Lundan 2008). These firms have substantial direct investment in foreign countries and manage their operations both strategically and organizationally. Examples of MNCs include American Express, Wal-Mart, IBM, Hitachi and Unilever. About 85% of world's automobiles, 70% of computers and 65% of soft drinks are produced and marketed by MNCs. According to World Development Report, about 450 companies with annual revenues in excess of \$1billion account for over 80% of the total investment made by all companies outside their home countries.

One of the traditional motives for companies to invest abroad was the need to secure key supplies such as Standard Oil interested to open up new fields in the Middle East, Canada and Venezuela which turned out to be largest emerging MNCs of 19th century. Companies like Nestle, Ford and Bayer expanded internationally mainly in search of new market due to insufficient support from their small home markets compare to the technology and volume-intensive manufacturing process they pursue. In 1984, Nike shutdown it's last US factory and shifted company's total production to the cheap labour in Asia to have access to low-cost factors of production. Apart from labour, lower-cost capital also became a strong traditional cause for internationalization such as subsidies from host countries government. These driving traditional factors push companies mainly from the US & Europe to become Multinational Corporations. According to the World Investment Report 2002, the overall value-added of ExxonMobil in 2000 was \$63 billion and the value-added GDP of Chile was \$71 billion in 2000. According to Professor Vernon, companies developed a much richer foundation for their international operations as the global business environment became more complex and complicated.

As MNCs established international sales and production operations, their strategy became more integrated in global sense. The first new first emerging set of forces were the rising economies of scale, expanding R&D investments and shortening product life cycles which became necessary for firms to survive in those businesses. Global scanning and learning was the second factor that often became essential to a firm's global strategy to enhance their technological or marketing advantage. Lastly, it became

evident that firms started to bring competitive positioning as the third factor for internationalization by cross-subsidization of markets. This clearly evaluate firms were rarely driven by a single motivation factor.

According to Dunning's eclectic paradigm, multinational enterprises must meet three prerequisites for their existence. Firstly, foreign countries must offer certain location-specific advantages to motivate MNCs to invest there. Secondly, in order to counteract or match with some strategic capabilities with foreign markets, the company must provide a unique strategic competencies or ownership-specific advantages. Lastly, company must have some internalization advantages or organizational capabilities to earn good returns from leveraging its strategic strengths internally rather than externally through licenses or contracts. Companies like Wal-Mart entered in UK by buying supermarket chain ASDA with high-commitment-high-control mode of operating. Amazon. com, for example, uses same approach in Canada by managing its website control from the United States and securing reliable Canadian postal service for order fulfilment.

Dragon multinationals from developing countries like Asia Pacific succeed regardless of limited primary resources, skills and knowledge, and social capital. In the era of state-driven development, these firms often internationalized to avoid extreme regulation at their home countries. Their main driver was to search for new markets and technological innovation by using strategies of linkage, leverage and learning. According to World Investment Report 2004, few top Dragon multinationals from developing economies are Hutchison Whampoa (Hong Kong), Singtel (Singapore), Petronas (Malaysia) and Cemex (Mexico).

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In the light of the degree of commitment and risk involved, set against the level of control and closeness of market, there are range options available for firms looking to internationalise its operations. The firm can choose range as per their growth of experience and degree of commitment to operate globally. Exporting is the first stage where firms can enter international business. It involves selling goods or services from one country to another in two ways. Technic group a UK based tyre making company developed its overseas business by arranging exclusive distribution agreements in each country for the two brands it manufactured which is direct exporting. Flymo a medium-sized British lawnmower making company shifted its overseas business from a distribution to more direct control to think long term for its own export success. This is an example of indirect exporting.

Licensing is another stage where firms enter foreign market by providing license to a host countries firm to utilize or sell intellectual property in exchange for financial returns. A major potential drawback in any licensing is when the agreement between the two firms comes to an end; the licensor firm may stand up as a potential powerful competitor. In 1969, the French magazine Elle granted a license for a Japanese version to a local firm, Mag House to sell its magazine. But the Japanese version advanced beyond the original concept and the contract was void in 1988. Franchising is a phenomenal growing form of licensing for firms to internationalize their operations abroad. In UK, franchise accounts for 10% of retail sales with expected increase to 25-30% in coming years. Benetton is a good example whose shop grew from 0 to 650 in US in five years by providing franchisee to firms who can use company's marketing benefit as a well known trademark

against agreed payments and systems of control. But many problems are associated with franchising which revoke a franchise and end up being very costly. Due to failure of operating 14 outlets according to McDonald's standards, company had to withdraw the license of its largest franchisee in France.

In the post-war period, there has been substantial growth in joint venture activity which is the second stage strategies for firms operating internationally. The General Motors & Toyota's joint venture NUMMI is an equity joint venture with a separate legal personality which operates in US with an agreed life of 12 years in the initial agreement for long term commitments. Another type of business venture between firms where no separate legal personality is formed is described as contractual joint venture. Here firms will assist and share the risks and rewards of the collaboration in a clear specific ways. British Aerospace and Taiwan Aerospace in 1993 agreed to set up a joint venture for the manufacture of a regional jet aircraft. This enabled British Aerospace to shift some of its final assembly work to Taiwan to access lower labour costs. However, due to potential conflicts between partners can lead to the termination of the co-operation agreement such as operational disagreements or disagreements over use and requisition of profits.

Firms can also internationalize through other contractual forms of international business such as management contracts, turnkey operations, contract manufacturing and countertrade. According to Financial Times report (1992), Canada's Four Seasons Hotels will undertake management of five Japanese Regent International hotels under an agreement becoming <https://assignbuster.com/benefits-of-multinational-corporations-in-developing-countries-economics-essay/>

world's largest operator of luxury hotels. But one of the top stage strategies for firms becoming multinational enterprise is Foreign Direct Investment (FDI) where firm is seeking high growth of experience with high degree long-term commitment. FDI has been defined as the acquisition or establishment of profit-generating assets in a host country over which the investing firm has control. According to Financial Times report (1989), Bosch a company from West Germany decided to invest £100 million on a production facility in Miskin, north west Cardiff in order to produce high technology car alternators. The decision got finalized due to lower labour cost in Britain compared to Germany and availability of Welsh labour force who demonstrated its keenness and flexibility to adapt at Japanese transplants. But there limitations for FDI such as the security of fixed and liquid investments, the business unit's economic feasibility, and ability to move currency freely inside and outside of the host country. Despite these limitations, countries like US and UK had the largest stock of outward FDI in 1991 i. e. \$385 billion and \$226 billion respectively.

Due to the emergence and the growth of the MNCs, there have been massive changes in the world economy. The scopes of MNC's operations in the number of host countries and all kind of strategic alliances have expanded. Also, there have been remarkable changes in the relations with home and host governments as well as with international governmental and non-governmental organizations.