

# [Should an mnc reduce its ethical standards?](https://assignbuster.com/should-an-mnc-reduce-its-ethical-standards/)

Ethical Standards are different for every country. Any business that goes international has to comply with the rules and regulation of that country in context to the norms of the business laws. This is where the need of ethics comes into picture where an MNC has to decide whether to follow its own ethics while continuing its business activities or to unethically compete with other business within the country. In order to arrive to a decision what a company should do we should first know the meanings of few terminologies as discussed below.

## What is the definition of MNC?

MNC is a company which has expanded internationally with a reason to grow. MNC is built to achieve maximum wealth for the share holders.

There are three key theories which justify existence of an MNC.

Comparative advantage:

Each country should use its comparative advantage to specialize in its production.

It should also rely on other countries to meet other needs.

Imperfect markets

MNC should make use of the resources in imperfect market to specialize in their products.

Imperfect markets make the factors of production immobile and it is the main cause of encouragement for the countries to specialize.

The Product cycle

Every MNC has a home country and the product cycle suggests that it should expand to foreign countries.

MNC will not have any problem it its management is tempted to achieve the goal of maximizing the wealth of share holders, not of their own.

## MNC and International Competence

International trade is the most common method by which firms conduct international business. Other methods are licensing, franchising, joint ventures, acquisitions of foreign firms, and formation of foreign subsidiaries. Each method has its margin of profit and needs little or more capital investment. For example, licensing and franchising require little capital investment but distribute some of the profit to other parties. While, acquisitions of foreign firms and formation of foreign subsidiaries require substantial capital investments but offer the potential for large returns.

## Ethical Standards and International Competence

An MNC should reduce its Ethical Standards to compete internationally. The main reason being every foreign country has a different ethical standards and an MNC which does not reduce its own Ethical Standard in that county, those activities and standards will be viewed in an unethical way. This is a biggest disadvantage to an MNC and it will not be able to compete in that country.

As discussed earlier, the MNCs expand internationally to grow, to maintain and earn profit, maximize wealth of the share holders. If it maintains a standard code of ethics according to the foreign country, it will be able to achieve these goals. If it is stuck to its own standard code of Ethics of the Home Country, then they will fail and diminish.

If an MNC reduces it Ethical standards, then this will help it in unfavorable economic conditions of a particular country. It will also help it to stay afloat when the cash flow is affected and returns are decreased.

The valuation model of the MNC shows that the MNC valuation is favorably affected when its foreign cash flows increase, the currencies dominating those cash inflows increase, or the MNC’s equivalent rate of return decreases. Certain political conditions, pressure from upper management affect the valuation of an MNC.

Below are other factors which play part for an MNC to grow internationally.

Problems due to malfunction in management

Exchange Rate movements

Risks of investments in foreign companies

Political Risks of a country

Centralized or De-centralized approach in decision making

Global Competition

Joint Venture restrictions and limitations

Impact of Global warming, terrorism and natural calamities

Uncertainties in the market

Let go deep down on each of the factors and find out how to reduce ethical standards in international competence.

## Agency Problems

The main goal of any MNC is to strengthen the wealth of Share holders. If managers start fulfilling their own interests instead of those share holders then the MNC will be in trouble. The Ethical Standard should be able to balance the growth of management and public.

## Exchange Rate Movements

A U. S. based firm operating in Asia and/or Europe has to balance its capital according to its sales and production in foreign country. The inflow and outflow of the cash and capital is affected by Exchange Rate decrease and increase. It is also a deciding factor for investment in the foreign countries. MNC should pay attention and be up to date with FOREX. Agency costs are larger for MNC than a domestic firm.

## Imperfect Markets

If perfect market exists, then wages, prices, and interest rates will be similar for the countries. There will not be any major competitive areas of products. But, the markets are imperfect and that tend to increase subsidiaries in the foreign countries.

## International Opportunities

Another factor of growth for an MNC is to buy foreign firms with similar interest, area and product. Licensing will also help grow the MNC. With a smaller investment or buying a stake in established company venture, gives opportunity to grow in foreign market.

## Internet

Now a day’s wide use of Internet is one of the major factors for any MNC to be recognized globally. Marketing, advertising, blogs and networking are the key usages of internet. Internet will result in more international business and MNC is touching the World Wide Web.

## Risks

There are various risks involved in investment, buying, licensing of foreign firms. Political risks also affect equally. Exchange rate movements, currency depreciation, stock market also affect the growth of the MNC. Every business has many types of risks, but overcoming them by finding alternatives in other areas is the way to go.

## Joint Venture

Joint venture is a bigger factor of growth for an MNC. A major production company in one country can have a joint venture with a biggest supplier of the same or alike product in another country. Both of them can utilize the supply channels and monetary requirements and can grow together. A largest wine making company in U. S. can have a joint venture with a largest brewery in China. The U. S. company can leverage the brewery’s established channels and distribute wine in a big number throughout the country. It can utilize brewery of Chinese company, make wine and sell it locally. In addition, the U. S. company provides information to the brewery about the wine market of U. S. Thus, joint venture enables growth of MNC in international business and competence.

## Global Competition

An MNC having a standardized product in the market has to compete more internationally, because the product valuation, pricing, distribution and specifications are same all over the globe. That MNC should add more to its product categories or line of products to win the competition. It can also provide attractive benefits to firms and pricing or discounts to customers.

## Valuation of an MNC

All the factors we discussed above can affect either positively or negatively to the value of an MNC. A U. S. based MNC’s value can be declined due to political risk in the foreign country even though its cash flow is intact. Similarly, An Indian firm’s value will be increased due to demand and supply in the foreign country and exchange rate movements. In this case, its valuation depends on four factors:

Expected cash flows in Rupees:

This is the outward cash flows from the company to meet the needs of the foreign market’s demand.

It needs to flow the cash within itself to employ more people, buy more machinery for production and more logistics

Expected cash flows in Dollars that are ultimately converted into Rupees

This is inward cash flows as orders, profits and investments from the foreign country

This also includes selling of any part of the company to foreign buyers

The rate at which it can convert into Rupees

This is FOREX, currency remittances which will be fluctuating according to global market

It’s weighted average cost of capital

This includes acquisitions, mergers, sold-bought assets and stock values

Wise things can be done to increase the value of the MNC, to sustain in the international competition. One of them would be to sell of a part of the foreign venture which is riskier. Other would be to buy licensing of the foreign firm which has same or lesser risk.

MNC should be reducing its ethical standards on supply chain management as well. It can distribute its small amount of product or logistics thru a cheaper medium in foreign country rather than being responsible on itself. Markets with standardized currencies, like Euros, are a good choice in regards to this. A U. S. MNC can import a smaller amount of supply from a German company with lower rates in Euros and discontinue relations with U. S. supplier.

## Expansion in International Business

An MNC which manufactures auto parts at competitive rates and provides little lesser wages to its employees can guarantee job security to them. But, it should also think of expansion to cheap manufacturing foreign countries. Let us discuss some factors on why to expand:

The MNC should select the foreign country wisely, taking local competition in that country, production of the same auto parts in that country and general wages structure of that country. It is completely smart to expand in the country if there is not much competition in manufacturing parts and employing cheap labor. This is competitive advantage.

The MNC can leverage the imperfect market theory here. It cannot export the labor from its home country, but can establish a subsidiary in the foreign country and meet it needs.

With a strong establishment in the home country for the parts it manufactures, the MNC can easily expand and sustain in the foreign country. This is product cycle theory.

The MNC must choose the low currency country to expand as it can build a strong base in the foreign country. E. g. Dollar-Peso, Euro-Dollar, Dollar-Rs. It will be the best time to expand when the currency of the foreign country is weakened. This way it can exchange more amounts in foreign currency and invest more. This can also create an Exchange Rate movement risk.

The political risk is also involved in expansion as to how stable are the political conditions of the foreign country to grow with.

The MNC can hire a consultant to decide whether it should expand or not and the consultant will look into above major factors when trying to give them the answer.

## Time and Uncertainties

It has been observed that the US currency has weakened in the past few years with comparison to Australia, Mexico, etc. An MNC expanding its business in foreign countries can be affected by the foreign investors’ decisions because of these uncertainties.

For example, Google™ is expanding its services to China, African countries, Australia, etc. It has cash outflows associated with the creation, marketing, resources and administration of each of its services. It also generated cash inflows from selling space on its websites, advertising and media related applications. Each application has its own flow in different currency. Thus, the valuation of Google™ is based on its conversion of each country’s currency to the Dollars. And if the investors see that the Dollar is weakening day by day, they can change their mind to other application providers on the web. Valuation of the MNC is affected by these factors.

## Conclusion

An MNC has to reduce its ethical standards based on the above factors in various ways. This includes its employer-employee relationships, venture relationships, political and economical relationships and various local conditions of the home as well as the foreign country.

When a U. S. based MNC competes in some countries, it may encounter some business norms there that are not allowed in the United States. When competing with a Government contract, firms might provide payoffs to the government officials who will make the decision. Yet, in the United States, a firm will sometimes take a client on an expensive golf outing or provide skybox tickets to events. This is no different than a payoff. If the payoffs are bigger in some of the foreign countries, then MNC can compete by matching the payoff provided by its competitors. Thus, reducing ethical standards on major factors, the MNC can sustain in international competition.