ISSN: 2395-7639

International Journal of Multidisciplinary Research in Science, Engineering, Technology & Management (IJMRSETM)

(A Monthly, Peer Reviewed Online Journal)

Visit: www.ijmrsetm.com

Volume 6, Issue 6, June 2019

Multinational Corporations and Their Impact on the Economics of Underdeveloped Countries with Particular Reference to India

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ABSTRACT: Multinational Corporations (MNCs) or Transnational Corporation (TNC), or Multinational Enterprise (MNE) is a business unit which operates simultaneously in different countries of the world. In some cases the manufacturing unit may be in one country, while the marketing and investment may be in other country. In other cases all the business operations are carried out in different countries, with the strategic head quarters in any part the world. The MNCs are huge business organisations which extend their business operations beyond the country of origin through a network of industries and marketing operations.

They are multi-process and multi-product enterprises. The few examples of MNCs, are, Sony of Japan, IBM of USA, Siemens of Germany, Videocon and ITC of India, etc. There are over 40,000 MNCs with over 2, 50,000 overseas affiliates. The top 300 MNCs control over 25 percent of the world economy.

KEYWORDS: multinational corporations, organizations, business, marketing, underdeveloped, India

I. INTRODUCTION

Previously American based multinationals ruled the world, but today, many Japanese, Korean, European and Indian multinational companies have spread their wings in many parts of the world. Before entering into any country, at the headquarters of MNCs, experts from various fields such as political science, economics, commerce international trade and diplomacy are analysing the business environment of a country and advising the top management. MNCs will always look out for opportunities. They carry out risk analysis, and send their personnel to learn and understand the business climate. They develop expertise understanding the culture, politics, economy and legal aspects of the country that they are planning to enter.[1,2]

The essential element that distinguishes the true multinational is its commitment to manufacturing, marketing, developing R&D, and financing opportunities throughout the world, rather than just thinking of the domestic situation.

Some of characteristics of MNCs are:
(i) Mode of Transfer:
The MNC has considerable freedom in selecting the financial channel through which funds or profits or both are moved, e.g., patents and trademarks can be sold outright or transferred in return through contractual binding on royalty payments.

Similarly, the MNC can move profits and cash from one unit to another by adjusting transfer prices on intercompany sales and purchases of goods and services. MNCs can use these various channels, singly or in combination, to transfer funds internationally, depending on the specific circumstances encountered.

(ii) Value for Money:
By shifting profits from high-tax to low-tax nations, MNCs can reduce their global tax payments. In addition, they can transfer funds among their various units, which allow them to circumvents currency controls and other regulations and to tap previously inaccessible investment and financing opportunities.

(iii) Flexibility:
Some to the internationally generated claims require a fixed payment schedule; other can be accelerated or delayed. MNCs can extend trade credit to their other subsidiaries through open account terms, say from 90 to 180 days. This give a major leverage to financial status. In addition, the timing for payment of fees and royalties may be modified when all parties to the agreement are related.[3,4]

To run a new and potentially profitable project, a good understanding of multinational strategies is necessary.

The three broad categories of multinationals and their associated strategies are explained below:
A. Innovation Based Multinationals:
Companies such as IBM, Philips and Sony create barriers to entry for others, by continually introducing new products and differentiating existing ones. Both domestically and international companies in this category spend large amounts on R&D and have a high ratio of technical to factory personnel. Their products are typically designed to fill a need perceived locally that often exists abroad as well.

B. The Mature Multinationals:
The primary approach in such companies is the presence of economies of scale. It exists whenever there is an increase in the scale of production, marketing and distribution costs could be increased in order to retain the existing position or more aggressive.

The existence of economics of scale means there are inherent costs advantages of being large. The more significant these economies of scale are, the greater will be the costs disadvantage faced by a new entrant in the same field in a given market.

(i) Reduction in Promotion Costs:
Some companies like Coca-Cola and Proctor and Gamble take advantage of the facts that potential entrants are wary of the high costs involved in advertising and marketing a new product. Such firms are able to exploit the premium associated with their strong brand names. MNCs can use single campaign and visual aspects in all the countries simultaneously with different languages like Nestle’s Nescafe.

(ii) Cost Advantage through Multiple Activities:
Other companies take advantage of economics of scope. Economies of scope exists whenever the some investment can support multi-profitable activities, which are less expensive.

Examples abound of the cost advantages of producing and selling multiple products related to common technology, production facilities and distribution network. For example, Honda has increased its investment in small engine technology in the automobile, motorcycle, marine engine, and generator business.[5,6]

C. The Senescent Multinationals:
There are some product lines where the competitive advantage is very fast.

II. DISCUSSION

The strategies followed in such cases are given below:

1. One possibility is to enter new markets where little competition currently exists. For example Crown Cork & Seal, the Philadelphia-based maker of bottle tops and cans, reacted to the slowing of growth and heightened competition in business in the United States by expanding overseas, its set up subsidiaries in such countries as Thailand, Malaysia, and Peru, estimating correctly that in these developing and urbanizing societies, people would eventually switch from home grown produce to food in cans and drinks in bottles.

2. Another strategy often followed when senescence sets in is to use the firm's global scanning capability to seek out lower cost production sites. Costs can then be minimized by integration of the firm's manufacturing facilities worldwide. Many electronics and textile firm in the United States (US) shifted their production facilities to Asian locations such as Taiwan and Hong-Kong to take advantage of the lower labour costs.[7,8]

Reasons for the Growth of MNCs:
(i) Non-Transferable Knowledge:
It is often possible for an MNC to sell its knowledge in the form of patent rights and to licence foreign producer. This relieves the MNC of the need to make foreign direct investment.

However, sometimes an MNC that has a Production Process or Product Patent can make a larger profit by carrying out the production in a foreign country itself. The reason for this is that some kinds of knowledge cannot be sold and which are the result of years of experience.

(ii) Exploiting Reputations:
In some situation, MNCs invest to exploit their reputation rather than protect their reputation. This motive is of particular importance in the case of foreign direct investment by banks because in the banking business an international reputation can attract deposits.

If the goodwill is established the bank can expand and build a strong customer base. Quality service to a large number of customers is bound to ensure success. This probably explains the tremendous growth of foreign banks such as Citibank, Grind-lays and Standard Chartered in India.

(iii) Protecting Reputations:
Normally, products, develop a good or bad name, which transcends international boundaries. It would be very difficult for an MNC to protect in reputation if a foreign licensee does an inferior job. Therefore, MNCs prefer to invest in a country rather than licensing and transfer expertise, to ensure the maintenance of their good name.[9,10]

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(iv) Protecting Secrecy:
MNCs prefer direct investment, rather than granting a license to a foreign company if protecting the secrecy of the product is important. While it may be true that a license will take precautions to protect patent rights, it is equally true that it may be less conscientious than the original owner of the patent.

(v) Availability of Capital:
The fact that MNCs have access to capital markets has been advocated as another reason why firms themselves moved abroad. A firm operating in only one country does not have the same access to cheaper funds as a larger firm. However, this argument, which has been put forward for the growth of MNCs has been rejected by many critics.

(vi) Product Life Cycle Hypothesis:
It has been argued that opportunities for further gains at home eventually dry up. To maintain the growth of profits, a corporation must venture abroad where markets are not so well penetrated and where there is perhaps less competition.

This hypothesis perfectly explains the growth of American MNCs in other countries where they can fully exploit all the stages of the life cycle of a product. A prime example would be Gillette, which has revolutionized the shaving systems industry.

(vii) Avoiding Tariffs and Quotas:
MNCs prefer to invest directly in a country in order to avoid import tariffs and quotas that the firm may have to face if it produces the goods at home and ship them. For example, a number of foreign automobile and truck producers opened plants in the US to avoid restrictions on-selling foreign made cars. Automobile giants like. Fiat, Volkswagen, Honda and Mazda are entering different countries not with the products but with technology and money.[11,12]

(viii) Strategic FDI:
The strategic motive for making investments has been advocated as another reason for the growth of MNCs. MNCs enters foreign markets to protect their market share when this is being threatened by the potential entry of indigenous firms or multinationals from other countries.

(ix) Symbiotic Relationships:
Some firms have followed clients who have made direct investment. This is especially true in the case of accountancy and consulting firms. Large US accounting firms, which know the parent companies special needs and practices have opened offices in countries where their clients have opened subsidiaries.

These US accounting firms have an advantage over local firms because of their knowledge of the parent company and because the client may prefer to engage only one firm in order to reduce the number of people with access to sensitive information. Templeton, Goldman Sachs and Earnest and Young are moving with their clients even to small countries like Sri Lanka, Panama and Mauritius.

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III. RESULTS

When making over direct investment it is necessary to allow for risk due to investments being made in a foreign country. Country risk is one of the special issues faced by MNCs when investing abroad. In involves the possibility of losses due to country-specific economic, political and social events.[13,14]

Among the country risks that are faced by MNCs are those related to the local economy, those due to the possibility of confiscation i.e. Government take over without any compensation, and those due to expropriation i.e., Government takeover with compensation which at times can be generous. In addition there are the political/social risks of wars, revolutions and insurrections. Even though none of these latter events are specifically directed towards on MNC by the foreign government, they can damage or destroy an investment. There are also risks of currency non-convertibility and restriction the repatriation of income. International magazines like Euro Money and the Economist regularly conduct country risk evaluations in order to facilitate MNCs.

Methods of Reducing Country Risk and Control:
1. Controlling Crucial Elements of Corporate Operations:
Most of the MNCs try to prevent operations in developing countries by other local entities without their cooperation. This can be achieved if the company maintains control of an element of operations.

For example, food and soft drink manufacturers keep their special ingredients secret. Automobile companies may produce vital parts such as engines in some other country and refuse to supply these parts if their operations are seized.[15,16]

2. Programmed Stages of Planned Disinvestment:
There is an alternative technique to handover ownership and control to local people in future. This is sometimes a requirement of the host government. There is a calculated move to involve themselves in stages.

3. Joint Ventures:
Instead of promising shared ownership in future, an alternative technique for reducing the risk of expropriation is to share ownership with private or official partners in the host country from the very beginning.

Such shared ownerships, known as joint ventures rely on the reluctance of local partners, if private, to accept the interference of their own Government as a means of reducing expropriation.

When the partner is the government itself, the disincentive to expropriation is concerned over the loss of future investments. Multiple joint ventures in different countries reduce the risk of expropriation, even if there is no local participation. If the government of one country does expropriate the business, it faces the risk of being isolated simultaneously by numerous foreign powers.

Problems from the Growth of MNCs:
Much of the concern about MNCs stems from their size, which can be formidable. MNCs may impose on their host governments to the advantages of their own shareholders and the disadvantages of citizens and shareholders in the country of shareholders in the past.

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It can be difficult to manage economics in which MNCs have extensive investments. Since MNCs often have ready access to external sources of finance, they can blunt local monetary policy. When the Government wishes to constrain any economic activity, MNCs may nevertheless expand through foreign borrowing.

Similarly, efforts at economic expansion may be frustrated if MNCs move funds abroad in search of advantages elsewhere. Although it is true that any firm can frustrate plans for economic expansion due to integrated financial markets, MNCs are likely to take advantage of any opportunity to gain profits.[17,18]

As we have seen, MNCs can also shift profits to reduce their total 'tax burden by showing larger profits in countries with lower tax rates citizens and shareholders in the country of shareholders in the past.

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Multinational Corporations in India:
MNCs have been operating in India even prior to Independence, like Singer, Parry, Philips, Unit- Lever, Proctor and Gamble. They either operated in the form of subsidiaries or entered into collaboration with Indian companies involving sale of technology as well as use of foreign brand names for the final products. The entry of MNCs in India was controlled by existing industrial policy statements, MRTP Act, and FERA. In the pre-reform period the operations of MNCs in India were restricted.

New Industrial Policy 1991 and Multinational Corporations:
The New Industrial Policy 1991, removed the restrictions of entry to MNCs through various concessions. The amendment of FERA in 1993 provided further concession to MNCs in India.

At present MNCs in India can—
(i) Increase foreign equity up to 51 percent by remittances in foreign exchange in specified high priority areas. Subsequently MNCs are free to own a majority share in equity in most products.

(ii) Borrow money or accept deposit without the permission of Reserve Bank of India.

(iii) Transfer shares from one non-resident to another non-resident.[19,20]

(iv) Disinvest equity at market rates on stock exchanges.

(v) Go for 100 percent foreign equity through the automatic route in Specified sectors.

(vi) Deal in immovable properties in India.

(vii) Carry on in India any activity of trading, commercial or industrial except a very small negative list.

Thus, MNCs have been placed at par with Indian Companies and would not be subjected to any special restrictions under FERA.

Criticisms against MNCs in India:
The operations of MNCs in India have been opposed on the following grounds:
(i) They are interested more on mergers and acquisitions and not on fresh projects.

(ii) They have raised very large part of their financial resources from within the country.

(iii) They supply second hand plant and machinery declared obsolete in their country.

(i v) They are mainly profit oriented and have short term focus on quick profits. National interests and problems are generally ignored.

(v) They use expatriate management and personnel rather than competitive Indian Management.

(vi) Though they collect most of the capital from within the country, they have repatriated huge profits to their mother country.

(vii) They make no effort to adopt an appropriate technology suitable to the needs. Moreover, transfer of technology proves very costly.

(viii) Once an MNC gains foothold in a venture, it tries to increase its holding in order to become a majority shareholder.

(ix) Further, once financial liberalizations are in place and free movement is allowed, MNCs can estabilize the economy.

(x) They prefer to participate in the production of mass consumption and non-essential items.

IV. CONCLUSIONS

Sanjaya Lall in 1974 proposed a spectrum of scholarly analysis of multinational corporations, from the political right to the left. He put the business school how-to-do-it writers at the extreme right, followed by the liberal laissez-faire economists, and the neoliberals (they remain right of center but do allow for occasional mistakes of the marketplace such as externalities). Moving to the left side of the line are nationalists, who prioritize national interests over corporate profits, then the "dependencia" school in Latin America that focuses on the evils of imperialism, and on the far left the Marxists.[21,22] The range is so broad that scholarly consensus is hard to discern.

Anti-corporate advocates criticize multinational corporations for being without a basis in a national ethos, being ultimate without a specific nationhood, and that this lack of an ethos appears in their ways of operating as they enter into contracts with countries that have low human rights or environmental standards. In the world economy facilitated by multinational corporations, capital will increasingly be able to play workers, communities, and nations off against one another as they demand tax, regulation and wage concessions while threatening to move. In other words, increased mobility of multinational corporations benefits capital while workers and communities lose. Some negative outcomes generated by multinational corporations include increased inequality, unemployment, and wage stagnation. For the debate from a neo-liberal perspective see Raymond Vernon, Storm over the Multinationals (1977).[23,24]

The aggressive use of tax avoidance schemes, and multinational tax havens, allows multinational corporations to gain competitive advantages over small and medium-sized enterprises. Organizations such as the Tax Justice Network criticize governments for allowing multinational organizations to escape tax, particularly by using base erosion and profit shifting (BEPS) tax tools, since less money can be spent for public services.[25]

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ISSN: 2395-7639

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