Subject	COMMERCE
Paper No and Title	**5 Business Environment**
Module No and Title	**29 Multinational Corporations**
Module Tag	**COM_P5_P29**

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1. Learning Outcomes

After studying this module, you would be able to

- Understand the meaning of multinational corporations.
- Learn the different forms of organization of MNCs.
- Evaluate MNCs.
- Know the impact of multinational corporations on international trade.

2. Introduction

In domestic business, commercial activities are conducted within the border of one country only. On the other hand, in international business commercial transactions take place between two or more regions, countries and nations. Today, international business has become an important economic force. The important form of conducting international business is multinational corporations. There has been phenomenal growth of multinational corporations due to economic liberalization across the world and breakup of USSR. There are nearly 82000 MNCs with over 8 lakhs affiliates according to the World Investment Report 2009. Multinational corporations account for a remarkable share of the World's investment, employment, production and trade.

3. Meaning of Multinational Corporation

Multinational Corporation is a corporation the headquarters of which is located in one country and which carries out operations in several countries. The country in which the headquarters are located is termed as "Home Country". The other country in which it carries on business is termed as "Host Country". For example: Coca-Cola is a company that has its headquarter in U.S.A. and it controls production and marketing facilities in several countries of the world.

In the words of Leonard Games, "A multinational corporation controls production facilities in more than one country, such facilities having been acquired through the process of direct foreign investment".

Thus, an MNC has its assets and other facilities in at least in one country other than its home country which are acquired through foreign direct investment. A company can't be termed as Multinational Corporation if it only exports its products to many countries as FDI is not involved.

There are few examples of foreign MNCs and their Indian subsidiaries or affiliates:

Foreign MNC	Indian Subsidiary
Cadbury	Cadbury India
Unilever	Hindustan Lever
Unisys	Tata Unisys
ABB	ABB India
Sony Corporation	Sony India

4. Features of Multinational Corporations

The salient features of multinationals can be described as follows:

1. **Giant Organizations-** MNCs are giant organizations as their assets and sales run into billions of dollars.
2. **International Operations-** The production, marketing and other facilities of the multinational corporations are spread in many countries. They operate through a network of branches and subsidiaries in host countries and a parent corporation in home country.

3. **Centralized Control**- The parent corporation exercises centralized control over all branches and subsidiaries in host countries. The policies laid down by the parent company are to be followed by the local management of branches and subsidiaries.
4. **Oligopolistic Power**- Due to their giant size, these corporations are oligopolistic in character and occupy a dominant position in the market. They gain huge economic power through the process of takeover and merger of other firms. For example: Tata Oil Mills is acquired by Hindustan Lever Limited.
5. **Advanced Technology**- MNCs use advanced technology and provide world class products and services. They employ capital intensive technology in various areas of business such as manufacturing, marketing etc.
6. **Collective Transfer of Resources**- MNCs facilitates multilateral transfer of resources like technical know-how, management expertise, machinery & equipment, raw material etc. for the operation of the subsidiaries in various countries.
7. **International Market**- MNCs has huge resources and superior marketing skills. This facilitates vast access to international markets. Therefore, MNCs are able to sell whatever they manufacture in different countries.

5. Forms of Multinational Corporations

Multinationals operate in the following forms:

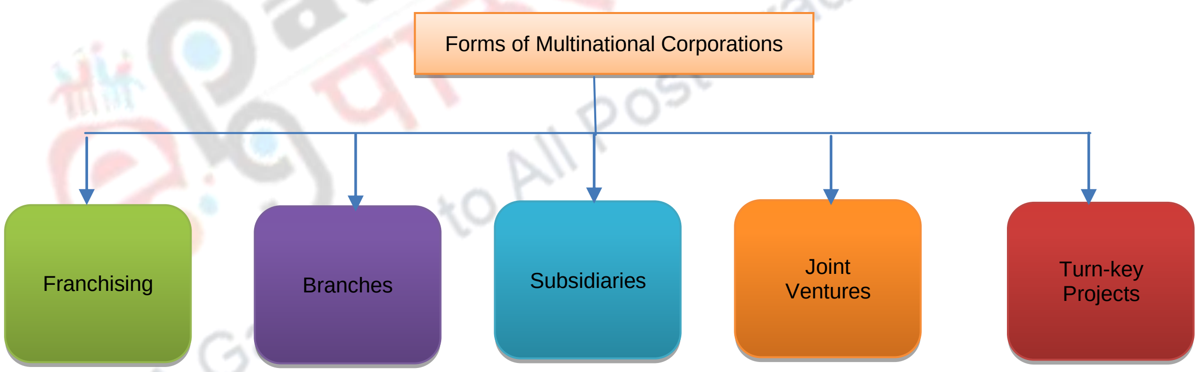

Figure 1: Forms of Multinational Corporations

1. **Franchising**- In this form, the firms in foreign countries purchase the right to use trademarks, patents, brand names, technology etc. of a multinational corporation. The firms getting the right or license is required to operate the business according to terms and conditions of the franchise agreement. A periodical royalty or license fee is paid by the firms to the multinational corporation. The license may be cancelled if the terms of the agreement are violated by the firm holding franchise. This form is popular for products having a good demand in host countries.
2. **Branches**- In this method, a multinational corporation can set up their branches in different countries. The working of these branches are controlled and managed by the head office situated in the home country. They are required to follow all the policies

guidelines laid down by their headquarters. The laws and regulations of the country in which branch is located, must be followed by it. It is very easier for multinationals to operate through branches.

3. **Subsidiaries-** In this system, a multinational firm set up wholly owned subsidiaries to operate in the foreign countries. In case of partly owned subsidiaries, shares are also owned by the people of the host country. The parent company laid down the policies and control the board of directors of the subsidiary company. The financial resources, managerial skills and international reputation of the parent company provide many benefits to their subsidiaries. By setting up subsidiaries all over the world, the business operations of the multinational can be expanded. This method is more profitable than franchising.
4. **Joint Ventures-** In this system, a multinational firm set up joint venture with a local firm in foreign country for manufacturing or marketing some product. The ownership and control of the business are jointly shared by the multinational and foreign firms. The multinational supplies the managerial expertise and technical knowhow and day to day management lies with local partner. For example: in Maruti Udyog, Suzuki provides advanced technology and day to day management lies with the persons nominated by the government of India.
5. **Turn-key Projects-** In this method, a multinational corporation undertakes a project from beginning to end in a foreign country. On completion of the project, it is handed over to the host country. There is no actively participation of the local client at various stages of construction. In a turnkey project, a multinational corporation agrees to handle every detail of the project for the client, including the training of the personnel in the operation of the plant. The quantity and quality of the production may be guaranteed by the multinational corporations. Underdeveloped countries use this form for the construction of certain projects which require high technical skill and experience. Multinationals are invited by the underdeveloped countries to construct huge projects as they possess technical and managerial expertise and huge financial resources.

6. Advantages of Multinational Corporations

MNCs play a very important role in economic development of the host countries. They make direct foreign investment in production activities of developing countries and thereby help in increasing production, import substitution and greater exports.

6.1 Benefits to Host Country

Multinational offer the following benefits to host countries:

1. **Foreign Capital-** Developing countries need capital for the process of rapid industrialization. Multinational corporations help these countries by facilitating transfer of capital from countries where it is abundant. Thus, these corporations help in increasing the level of investment and thereby speeding up the pace of economic development of the host country.
2. **Transfer of Advanced Technology-** MNCs serve as vehicles for the transfer of superior technology to developing economies that are technologically backward and cannot afford to invest in research and development. They help in improving the product quality and

cost reduction of developing countries by providing advanced technological know-how, improved skills and consultancy.

3. **Employment Generation-** MNCs help in generation of employment opportunities by establishing their manufacturing units in host countries. They use cheap labour in these countries in order to reduce cost of production and increasing their profits.
4. **New Products for Consumers-** Consumers are able to have the benefit of all the amenities and accessories of life when MNCs are permit to operate in their countries. They get superior products and services at affordable prices. This helps in increasing the standard of living in host countries.
5. **Managerial Revolution-** MNCs help to promote professionalization management and thus kindle a managerial revolution in the host countries. They use sophisticated management techniques and trained managers. These corporations have evolved various concept and techniques like management by objectives, corporate planning and job enrichment. Multinationals help in human resource development by building up 'Knowledge Base' in host countries. They serve as conveyor of knowledge and experience.
6. **Foreign Exchange-** Multinational corporations help in improving the balance of payment position of host countries through increasing their exports and decrease their dependence on imports.
7. **Boost to Ancillary Industries-** MNC helps domestic suppliers and ancillary units to provide support to their operations. Thus encourages the growth of ancillary industries in host countries.
8. **Healthy Competition-** MNCs help in breaking the domestic monopolies by increasing competition in host countries. They force domestic firms to increase their efficiency level or withdraw from the market.
9. **Research and Development-** Multinational Corporations have an efficient research and development system because of its enormous resources. Thus, it serve as a source of innovations and inventions.
10. **World Economy-** Multinationals encourage international brotherhood and cultural exchanges through integrating national economies into a world economy.

6.2 Benefits to Home country

The following benefits are availed by the home country i.e. the country of origin of an MNC:

1. **Cost Reduction-** Home country can obtain cheaper raw materials and labour from other countries. This results in reduction of cost of production.
2. **Job Creation-** they help in generating employment opportunities for its nationals in foreign countries due to their higher scale of operations.
3. **Managerial Expertise-** they can obtain technical and managerial expertise available in other countries.
4. **Higher Earnings-** they earn huge incomes in the form of licensing fee, dividend, royalty etc

7. Disadvantages of Multinational Corporations

Multinational corporations are a mixed blessing. Various problems are faced by host nations because of them. The main disadvantages of multinationals are:

1. **Disregard of National Goals-** MNCs do not invest in underdeveloped strategic sectors and backward regions of host countries. They invest in most profitable sectors e.g. consumer goods and use capital intensive technology. As a result, few jobs are created and the two chronic problems- unemployment and poverty of host nations remain unsolved.
2. **Threat to National Sovereignty-** Multinationals pose a threat to national sovereignty of the host countries. They influence internal and external policies of the host countries by interfering in their political affairs. For example: ITI are criticized for overthrowing government in countries like Chile.
3. **Dwindling of Natural Resources-** MNCs ignore the economic welfare of the host country as they have an interest in their profit. Some of the non-renewable natural resources are overexploited by MNCs and this leads to fast depletion of these resources.
4. **Obsolete Technology-** MNCs often transfer obsolete and defective technology to their collaborators in host countries. This adversely affect the employment, income and growth of indigenous technology of these countries. Sometimes, imported machinery was locally available or it remained idle for the want of repairs and maintenance facilities.
5. **Growth of Monopolies-** In host countries, big business houses are eager to enter into an understanding with the MNCs. This lead to growth of monopolies and concentration of economic power. Indigenous enterprises are killed by the MNCs through strategic advantages like patents, resources, foreign exchange and so on. This helps big business houses to diversify and expand.
6. **Restrictive Clauses-** In collaboration agreement, MNCs generally introduce restrictive clauses as they have a strong bargaining power. For example: technology cannot be moved to third parties, export from host country are restricted, the managerial post are filled by the parent company etc.
7. **Failure to Develop Local Skills-** In order to exploit cheap labour, MNCs set up their factories in developing economies. They are not interested to diffuse skills and advanced technical know- how among the workers of the host countries. As a result, local skills and talents cannot be developed.
8. **Excessive Repatriating of Profits-** MNCs take away maximum payment in the form of royalty, dividend, technical fee etc. from their subsidiaries and collaborators. Host countries face foreign exchange crisis and balance of payment problem due to repatriation of profits by MNCs.
9. **Threat to Home Industries-** MNCs have killed local industries of the host countries by putting restrictive clauses and strong competition before them. The home industries are not able to enjoy a level playing field with MNCs that are in a position to spend heavily on advertisement and to sell products of superior quality at cheaper rates. As a result, they are forced to close down their business or are even acquired by the MNCs.
10. **Impose their Culture-** Multinational corporations impose their culture on developing countries to sell their products. This spoil the cultural heritage of local people. For example: the consumption of soft drinks, synthetic food etc. have encouraged by the MNCs in India.
11. **Consumer Goods for Higher Income Groups-** MNCs produce consumer goods like soft drinks, chocolates, toothpastes, cosmetics, V.C.R etc. for higher income groups of the society. These products are not affordable by the lower income groups of the society.

Thus, it can be said that although it is true that MNCs provide many benefits to both host and home country, but there are some problems as well. MNCs are not an unmixed blessing as they have both positive and negative roles.

8. MNCs and International Trade

The international trade is increasing day by day. A MNC strongly influence the local and world economy and also plays a positive role in international trade.

According to Peter Drucker, multinationalism and enlarging world trade are two sides of the same coin. The period in which multinationals were rapidly growing i.e. fifties and sixties- was the period of most rapid growth of multinational trade. During this period, the world trading economy increased at an annual rate of 15 percent.

The export intensity (i.e % of exports to total sales) of the foreign subsidiaries or affiliates of MNCs has significantly increased. One third of the global exports is done by the foreign affiliates of MNCs. For example, export intensity of foreign subsidiaries of MNCs of US has increased from less than 20% in the mid-sixties to over 40% in early 1990s for all economies, from 20% to 40% for developed economies, from 6 to 22% for Latin America and from 23 to 64% for developing Asia. The export intensity of India has very low. The export contribution of foreign affiliates of MNC account for nearly more than 40% of the total exports in China.

Between ¼ and 1/3 of manufactured goods now moving in world trade are intra- company shipments i.e. goods are being shipped from one branch to another of multinational corporations. Apart from trade in commodities, other transactions such as licensing of technology, granting of loans, provision of services etc. also take place between the different parts of these enterprises. A transfer price is settled for all such transactions which is different from the price which is settled between independent parties operating at arm’s length. The legitimate concerns of the company is reflected by such differences but it can be used for shifting the profits from high to low tax countries or to get around exchange or price controls or custom duties. Multinationals use artificial transfer prices to manipulate financial flows which is a matter of concern to governments. The cooperation of inter-government is necessary for the effective monitoring and control of transfer prices. This is required to make effective tax law covering transfer prices which exist in many countries. In intra-firm trade, corporations can impose restrictive business practices within their own organizations, limit the exports of their affiliates, allot their markets between nations or put the limit on their technology by their affiliates. Although such practices are followed for the best business interest of the companies, but it conflict with the national interests and developmental objectives of the host countries.

9. Summary

- A multinational corporation is a corporation which carries out operations in several countries.

- Giant organizations, international operations, oligopolistic power, centralized control, advanced technology, collective transfer of resources, international market are the main features of multinational corporations.
- Multinationals operate in different forms such as franchising, branches, subsidiaries, joint ventures, turnkey projects etc.
- Multinationals provide gains to host countries through foreign capital, transfer of advanced technology, employment generation, new products, foreign exchange, managerial revolution, research and development etc.
- Multinationals cause harm to host countries through disregard of national goals, threat to national sovereignty, dwindling of natural resources, obsolete technology, growth of monopolies, restrictive clauses, threat to home industries etc.
- A MNC strongly influence the local and world economy and also plays a positive role in international trade.