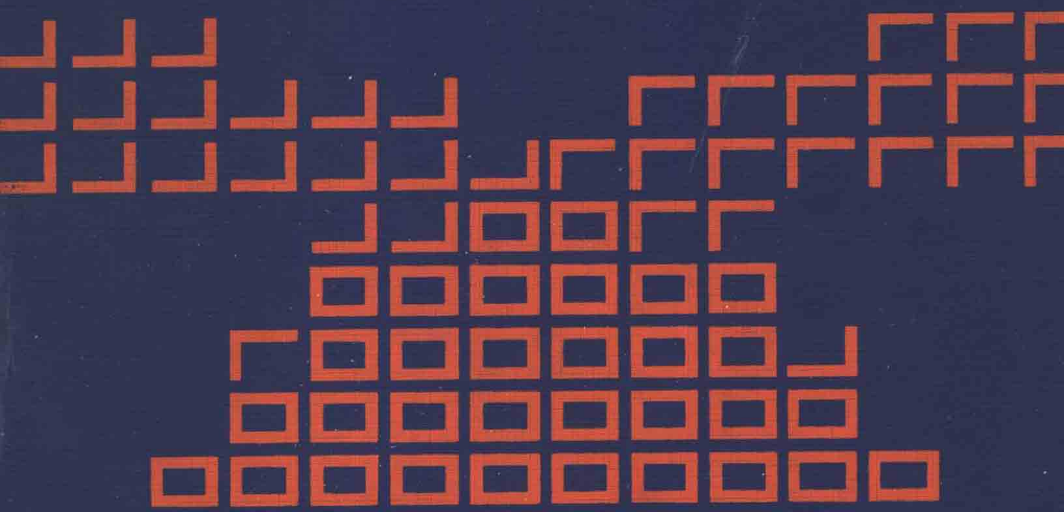
Multinational Enterprises in the West and East



Multinational Enterprises in the West and East

Dr. Leon Zurawicki
University of Warsaw

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Introduction

As a result of the analysis of key figures referring to the largest capitalist enterprises the following general conclusions may be drawn:

1. The international turnover and expansion of foreign markets plays a steadily increasing role in the activities of the above mentioned firms.
2. The share of dominant enterprises in their traditional home markets gradually declines. It should be emphasised that such an observation does not obviously result from our first remark. It is sufficient to assume that the growth rates of different markets are not equal and even if a given corporation promotes its expansion abroad, its oligopolistic position in the home market need not be weakened.[1]
3. Simultaneously the largest corporations become multibranch companies. And as we shall try to document in this book, both the branch and geographical diversification in the activities of the largest corporations reflect two sides of the same process: the extension of influence, the drive to improve stability, and consequently to increase profits.

The observations we have just made may be illustrated, and at the same time proven, by the phenomenon of the so-called "investments cross-hauling" to be seen in the geographical as well as — to a lesser extent — in the interbranch scope. These phenomena call for the modification of classical theories suggesting growth of domination of the strongest firms in "their" markets. The tendency is all the more amazing in that it refers in the same measure to the biggest corporation from not just one country, e.g. USA, but from various capitalist countries. Furthermore, it must be stressed that we witness here not only, and not even in the first instance, the expansion within foreign markets through exports and the purchases of already existing local firms. It is just the big oligopolies' direct investments abroad that come to the

fore. Consequently, it induces changes in the stream and character of international exchange and on the other hand creates new conditions and mechanisms of oligopolistic competition. At this moment we would like to draw the reader's attention to the evident feed-back effects. Namely, the general terms — including the political terms — of international exchange and the evolution of the world market exert a certain influence upon the mode of behaviour of the corporations, as do the varying intensity and new forms of competition.

The explanation of the process in question requires taking numerous factors into consideration, among which are the problem of risk-sharing in economic activity, the economies of scale, the scarcity of production factors or the limitations of particular national markets. Therefore, one of the aims of this work will be to examine which of the cited factors and in what way stimulate the large enterprises to adopt the international character more easily than is the case with even highly specialized medium-size or small firms.

At the same time, the fact that leading oligopolies from particular countries lose their share — which nonetheless still remains pretty high — of the home markets, ought to be interpreted in the proper way. The deconcentration of capital in the scale of particular countries does not mean at all that the greatest corporations see their power reduced. In order to give a full answer one should check first who benefits from the loss of the market share of the hitherto dominant firms in their domestic markets. It reveals in a majority of cases that the diminished shares of leading firms of one country are captured by the largest firms from other countries and vice versa. Thus, a specific exchange of markets takes place. In a situation in which different national markets are separated by various kinds of barriers, one might suppose that the biggest oligopolies would tend to first conquer their domestic markets, and only after achieving this aim expand into foreign markets. Historically, this trend is evident in the early development of the capitalist economy [65;66]. Nowadays it is of a much more complicated character. In the first place, due to their informal and inofficial mutual links, it is difficult to estimate the highest and most acceptable degree of sales concentration for the largest firms in specific markets. Thus, it may be concluded that neither can one determine accurately the moment when the domestic monopoly switches the bulk of its operations to foreign markets.

Secondly, it ought to be pointed out that numerous economic barriers separating the national markets gradually disappear and just in view of the process of economic integration the position of given enterprise should be evaluated on a broader, more global scale and not from the perspective of one market, even if it may be the most important one. Such a general approach helps to more realistically ascertain the rate of increase of power in the largest corporations, and consequently, to analyze the changes in the level of economic concentration on a global scale. In order to theoretically explain the tendencies mentioned above, it would be advisable to consider, whether and to what extent the activities of multinational enterprise represent a new phenomenon in light of actual knowledge about the aims and strategy of big corporations. It is our conviction, based on the definition of the multinational corporations used here, that expansion towards foreign markets results from the objectively conditioned evolution of the largest capitalist enterprises. The additional factor which accelerates this development is to be attributed to the character and forms of the oligopolistic competition in different markets. To illustrate this argument it may be observed that on the average the transition period before a national enterprise becomes a multinational is steadily becoming shorter. While the firms founded in 1870 required fifty years, the analogous period for the enterprises established in 1945 was only fifteen years. On the basis of the above-mentioned approach, Chapter I shall try to formulate, against the background of the theories of other authors, a unique concept of the multinational enterprise (MNE).

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Chapter 1

Theories of the MNE

The Definition of Multinational Enterprise

Before occupying ourselves with the main subject, it is necessary to limit the scope of our analysis, i.e. to give the definition of the MNE. In the literature this notion is interpreted in many ways. Whereas in purely theoretical dissertations more general formulations are to be found, in the studies undertaken for practical reasons by public institutions and organizations[2] more detailed specifications are given, which may prove helpful in determining the number of capitalist MNEs and their impact on the world economy. On the other hand for the purpose of particular research and analysis clear distinction of MNEs may supply scholars with a hint, how to filter statistical data and draw theoretical conclusions. Let us remember here that the rigorous criteria applied by the research team of Harvard University enabled them to label 187 firms from the list of largest American corporations as "multinationals." So far the studies on this sample of MNEs provide the widest evidence of their activities.

What is then the definition of the MNE? The fundamental criterion is the relation — expressed either in quantitative or monetary terms — of the foreign operations of a given enterprise to analogous indice of its activities in the home market, which is understood as the market of the state in which a company has its head office. An additional element to be taken into consideration is the degree of geographical diversification of its foreign activities, in other words the number of countries in which the products of a given firm are being sold. The requirements to be met are, according to different economists, more or less stringent. Thus we can find, for example, the multinational enterprise being defined as a firm which conducts its activities, marketing excluded, in more than one country [13, p. 1]. A similar definition was proposed

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by the group of experts of the UN Economic and Social Council, who see the MNE as an enterprise undertaking or controlling production or service activities in countries other than the one in which its head office is located.[3]

These are examples of very broad interpretation. More restrictive are the definitions, according to which the "multinationality" of given enterprise must be confirmed in at least several countries, while some additional criteria must be fulfilled. For example the US Federal Trade Commission classifies as multinational those enterprises which 1) realize a total turnover of at least 100 million dollars, 2) own subsidiaries in at least six countries, 3) have invested at least twenty percent of their capital abroad. It is, of course not only the value of production or sales abroad which might be useful in determining the international character of any given enterprise. There are other typical indices as well, e.g. its employment situation, profits earned, or the capital invested abroad. Obviously, the more stringent the criteria adopted, the less numerous are the corporations which satisfy them. When J. K. Bruck and F. A. Lees assumed that out of five basic indices (total turnover, profits, enployment, assets and production) the share of foreign activities represented by at least two of them had to exceed fifty percent in order to classify an enterprise as multinational, it proved that from the Fortune list of the 500 largest American firms in 1965 only eleven deserved this title. Among other artificially restrictive definitions mention should be made of the formula presented by the Centre for European Industrial Studies of the University of Bath, according to which the main feature of the MNE is the split of company stock between share-holders from two or more different states. If we overlook marginal participation there are not many enterprises of this kind originate as they do principally from not-so-frequent transnational mergers of enterprises of more or less equal power.

In this context it is reasonable to consider whether and in what respect the size of a firm — measured, for instance, by the value of sales — is significant when its multinational character is to be determined. Formally speaking, this attribute may be regarded as neutral, as some small enterprises undertake activities abroad while not all big corporations operate outside their domestic markets. Despite this appearance, however, the size of a firm is of great importance. A small company, even if it is highly specialized in one or another kind of production, plays only a minor role in the home or foreign markets, as its share in the total

supply remains modest. Such firms do not, therefore, practically exert any influence on the market situation, or more generally, on the world economy. For that reason they are not an interesting subject of research, neither from the point of view of the firm, nor the theory of international economic relations. In practice, however, it is not easy to take fully into consideration the size factor as it is difficult to determine the minimum dimensions of the MNE.

If the MNE as such is to be attributed a distinct character it cannot be just a loose combination of subsidiaries widely spread among various countries. The MNE distinguishes itself by an appropriate organizational structure, assuring the concerted action of all the parts of the system. This aspect is particularly stressed by the French economist M. Byé. The definition of "foreign activities" is by no means a trivial task. We must be aware of the fact that many enterprises, because of their very character, e.g. international carriers or expeditors, have a global reach. Would that mean that for the sake of the purity of classification the term MNE ought to be reserved exclusively to productive enterprises? And if so is it only direct production abroad which should be taken into account? Many economists express such an opinion.

The author's view is, however, different. The competition "from outside", e.g. by means of exports, does not at all mean that the competitive power of a foreign enterprise is reduced, nor that the importance of exports is less for a given enterprise than the sales of a local subsidiary. To the contrary, it may be shown in many cases — see further "the theory of product-cycle" [59] — that the trade expansion is usually followed by direct investments of foreign firms in the export markets. Thus, in our opinion, the ownership of productive facilities abroad is not a prerequisite of being multinational. Attention should rather be drawn to the fact that MNEs realize the strategy on a global scale, whereas their tactics may be quite differentiated [10, p. 11; 3, p. 90]. The result thereof is that we identify the MNE with the world oligopoly. Potentially, it is any large corporation. Of course, one can make further distinctions and introduce more detailed classifications of MNEs based on the field of their activities or on the spread of their geographical orientation. Analysis of this kind does not, however, sound very promising.[4] In the case of many MNEs, capital is by far the most "malleable" element, and production factors reveal substantial mobility.

Therefore, the classifications as mentioned above are not only conventional, but also temporary. It is often more advisable to look

carefully at the country of origin of a given enterprise, as its "citizenship" may provoke political repercussions. From the notion "world oligopoly" it may be derived, that we are dealing with an enterprise which occupies one of the dominant positions in several national markets. This is typical for largest MNEs, and considering multinational enterprise as comprising the world oligopoly, we may try to present a more general theoretical explanation of the phenomenon of their expansion.

Theories of the Multinational Enterprise

The theory of MNE, if judged by the generalizations met in the literature on the subject, appeared as a point of intersection of two branches of economy: the theory of the firm, the theory of international economic relations. It means that in the case of MNEs the theory of the firm is being applied when the enterprise operates in a strongly diversified and quickly changing international environment.

One of the main theoretical currents, represented by such authors as R. Z. Aliber, J. Behrman, H. V. Perlmutter, suggests that it is the differences between the economies of various countries plus the barriers in the international trade (customs tariffs, etc.) which give rise to the expansion of MNEs. According to the view of the above-mentioned authors the MNEs try to take full advantage of the diversity of the opportunities with which they are confronted on the international stage as far as production costs and sales possibilities are concerned. This opinion is quite obviously and certainly correct, although too general and insufficient to explain the whole complexity of the phenomenon. Aliber's concept [5; 6] is of distinct character insofar as it analyses the international activities of productive enterprises, and more exactly their direct investments abroad, in the same way as their indirect portfolio investments are treated, Aliber chooses as his point of departure the division of the world into different currency zones, and relying upon the differences in the rate of interest, but even to a larger extent on the fact that some currencies, e.g. the US dollar, are more preferred than others, comes to the conclusion that the above mentioned circumstances determine the stock market price of any company active in given area. Consequently, according to Aliber, the fact that the cash flow of a particular enterprise is earned from production in preferred currency more evidently raises the stock prices than if equal earnings were gained from exports to the same

area. Furthermore, in this way characteristic capital flow is generated. The enterprises from the privileged currency area may establish subsidiaries or purchase the shares of already operating firms in other countries more easily, whereas the companies from the other currency areas attempt to establish themselves, at least partially, within the zone of privileged currency. Thus, the export of capital would be closely correlated with the level of and changes in the interest and exchange rates in different countries, and the resulting movements of capital would become an instrument of offsetting these differences. It seems that whereas the thesis of Aliber rightly accentuates the unity of the world capital market, it nonetheless abstracts completely from the specific character of direct investments in productive capacities, the difficulties arising at the moment of attempted withdrawal of invested funds and the question of self-financing of large enterprises. Moreover, Aliber's concept can be challenged also for the reason that the strong depreciation of pound sterling or US dollar witnessed in the 1970s has by no means slowed down the rate of foreign investments from the USA or Great Britain. So this theory still waits for its confirmation in practice.[5] The representatives of another approach, such as E. Penrose, S. Hirsch, R. Caves or R. Vernon assume that the dynamic expansion of a firm in the domestic market must sooner or later saturate the demand of local consumers and consequently the excess supply forces the producers, especially when operating in the situation of oligopoly, to look for the possibilities of sales increases in the foreign markets, even by way of exports. This concept helps to explain among others why the MNEs from small countries emerged relatively early.

Vernon's concept of product cycle [59] deserves more attention in this context. It is based upon the fact that different enterprises do not have at their disposal the same possibilities of application of the technical know-how, even if access to such knowledge is equal. It results therefrom that the enterprise performing the role of innovator finds itself in a more advantageous position in comparison to others. New products are, in the first place, oriented to the largest and most developed market in the world — the USA — and are manufactured right there. After the successful introduction of the product to this market, the sales expansion — by way of exports — to other developed countries follows, if only the latter's standard of living encourages such a move. It may be observed, by the way, that as the time goes by the innovator's premium diminishes as the product becomes more popular and the imitators

follow. The next phase is marked by replacing exports with local production, i.e. manufactured in the importer's country. This is not only due to the calculus of production and transportation costs, but also the benefits of direct contact with a given market are taken into consideration. Finally, the production may be shifted to the Third World countries, partly to supply their markets, however, mainly in order to substitute with cheaper imports the more expensive production of actual manufacturers in other countries. As can be noticed, as the product gradually reaches greater maturity its production is moved to new areas, which proves very important when international production specialization and the division of labour are discussed. The phenomenon in question was carefully analyzed also by the Hungarian economist G. Adam [1;2]. Of course, according to Vernon, the actual product cycle need not follow the same pattern in every case and the whole concept need not be confirmed in each branch of industry. Certainly, the development of electronics or chemical industries supplied appropriate arguments. Furthermore, the model of "product cycle" fit well the specific character of American firms at the time when the technology gap between the US and other countries was quite apparent. At the same time this concept was oriented towards labour-saving products and technologies, which by no means incidentally appeared first in the USA, as the cost of labour was pretty high there if compared with other countries. It soon revealed, however, that the product-cycle theory cannot be applied universally, which Vernon later admitted himself [61, p. 107]. It was not because the concept could not be extended to the non-American MNEs. After all, one can show that many corporations first introduce a new product in the domestic market before they start expansion abroad. Moreover, what now seems to be more clear than ten years ago, is that in some branches of production the technological leadership may not always be attributed to the American MNEs. The product-cycle model might have been also modified in a way that it allows for the fact that many enterprises, non-American included, start innovations in the American market, even if it is not their principal market. However, in no matter what direction the attempts to improve Vernon's model are oriented, be it the assumption of the decisive role of the US (Western European) market for the largest capitalist enterprises, or be it the assumption that the expansion abroad of a given enterprise is always preceded by the achievement of a stable position in its national market, it seems evident that the

product cycle cannot be identified with the life-cycle of the enterprise. The model described above may therefore help explain how the national firms transformed into multinationals. It is nevertheless not very useful for the interpretation of already existing MNEs simultaneously operating in different markets. After all, one should remember that the majority of the largest MNEs have already been present at the global stage for very many years. In general terms they are not so much concerned about launching and spreading a recently invented type of production all over the world, as about the constant management of their activities on an international scale.

Let us also note here the concept of the MNE presented by Hirsch. His approach is based upon two assumptions. Firstly, Hirsch maintains that the cost of marketing is higher for the exporter than for the local producer, which naturally stimulates direct investment abroad. Secondly, in a similar way to Vernon, Hirsch assumes that the monopoly access to certain know-how induces the expansion abroad. The relative weights of these two factors, which always distinguish a given branch of industry, determine whether such a branch is prone to direct investments abroad or not [26, pp. 266–67]. Practically, this thesis would be confirmed by the mere list of industrial branches with investments abroad. At the same time Hirsch loyally admits that the example of the aircraft industry denies such general tendency.

The author does not refute the concept of Hirsch. It does not seem, however, very convincing as he does not supply us with the key to understanding to what extent each of the two factors, the cost of marketing, and the monopoly with respect to know-how, stimulates expansion abroad by means of direct investments. It is also worthwhile to emphasise that foreign investments are representative for such important, and at the same time varied, industries as the pharmaceutical industry, production of foodstuffs, and electronics. In addition to that, there is another feature common to all the above-mentioned (and other) branches. They are, namely, highly concentrated, which certainly leaves its impact on the foreign activities of particular corporations.

The views summarized here encourage one important reservation. Although one cannot oversimplify the problem and consider every MNE to be a model, it is, on the other hand, certainly erroneous to assume that each actual or potential MNE has some technological advantage if compared with other firms. To recog-

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