Foreign Multinationals and the British Economy

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IMPACT AND POLICY

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It should be noted that Neil Hood's contribution
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Introduction: The Issues

The aim of this book is to provide a benchmark review of inward investment in Britain in the late 1980s. The timing is appropriate in a number of ways. The country has experienced nearly a decade of the Thatcher experiment, increasingly affecting inward investment through events such as the 'Big Bang',[1] and yet the UK economy has shown only limited improvement. It is pertinent to ask: 'what part, if any, can foreign multinationals play in the restoration of British competitiveness and the regeneration of the British economy?' The international business environment within which inward investment is taking place has, moreover, changed very radically. While subject to much hype, from industrialists themselves (witness the 'world car'[2]) as well as from journalists and academics, it is still true that competition has become increasingly international, even global in scale, and this process may extend to a wider range of manufacturing and service sectors in the years to come. The role of the subsidiaries of multinationals in Britain within this global competitive framework needs to be considered and questioned, as indeed does the relevance of 'national' industrial policy. Ten years ago, two of the present authors wrote that the failure of the government's attempt to rescue Chrysler UK was due to a 'lack of understanding of the operations of multinational enterprises';[3] is the suggestion still not true in relation to British MNE policies?

Because of such changes in international business and the international environment too, it may not, in fact, be meaningful in future to analyse inward investment as a separate component of business activities: inward and outward direct investment are interrelated, and inward investment (itself perhaps more footloose) is only one of a number of means of undertaking business across national frontiers alongside other contractual forms such as licensing.

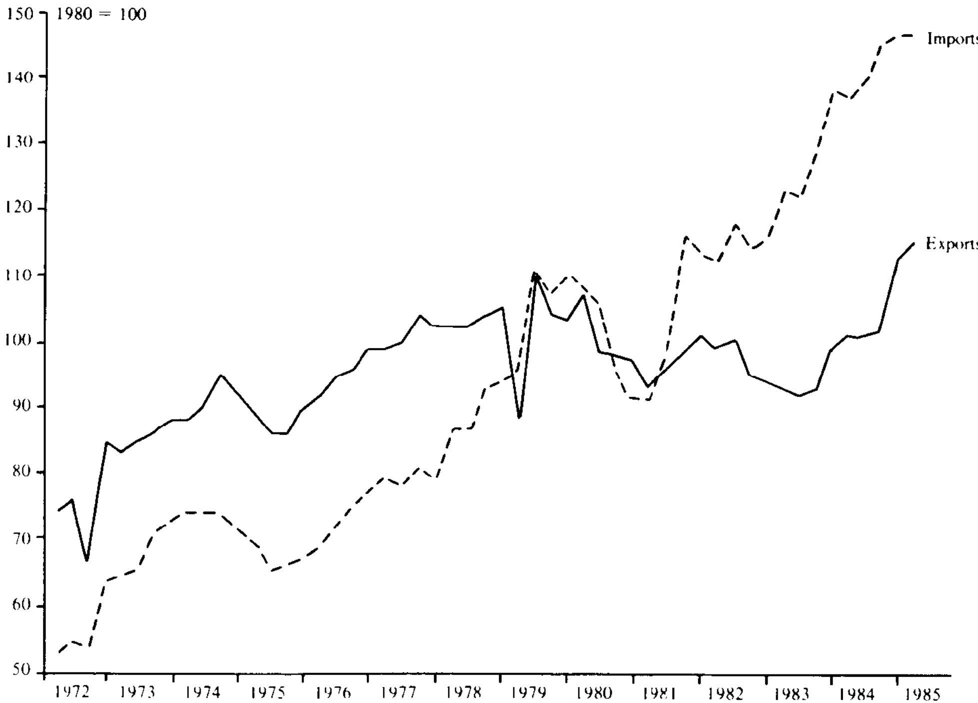
The role and impact of foreign MNEs in Britain has been the subject of a number of studies over the years. The work of Dunning, for example, has spanned nearly two decades, encompassing both the US direct investment phenomenon of the 1950s and 1960s and the Japanese investment issues of the 1980s.[4] Interest in the topic has ebbed and flowed: the optimistic findings of the report by Steuer and his colleagues for the Department of Trade and Industry in 1973 seemed to quieten the debate for some time;[5] but the reverberations associated with the oil price shock and the loss of competitiveness of some major American MNEs brought inward investment back closer to the centre of the stage, especially at the regional level in Britain. And in the 1980s there have been a succession of individual issues and controversies highlighted in the work of Brech and Sharp, Stopford and Turner and others.[6] The present volume aims to review the historical contribution of inward investment in Britain, and, from this to identify the major multinational issues of the present day and their link to Britain's competitive position in the world.

THE STATE OF BRITAIN AND BRITISH COMPETITIVENESS

It is almost unnecessarily trite to remark that since World War Two the British economy has witnessed a dramatic decline in relation to that of its principal competitors. Low productivity, low growth of *per capita* income and until the 1970s persistent balance of payments and exchange rate crises were characteristics of the British economy. The 1970s added frighteningly higher inflation, substantial intra-European industrial restructuring and severe unemployment to that list, while the unfavourable economic climate was a severe barrier to the growth of R & D and to innovation. Looking at the British economy in the mid to late 1980s, the fundamental problems still remained: in job terms especially the position had deteriorated further, with unemployment rising to historically high levels. On the other hand, inflation had been brought down to a rate below the OECD average, output was rising steadily and there was evidence of sharply improved productivity and corporate profitability, with even some signs of relative improvement *vis-à-vis* Britain's major competitors.[7]

Particularly worth emphasising because of the relationship to the multinational dimension is British trade performance. Traditionally the UK has been an importer of food and raw materials, but in 1983,

Figure 1.1: UK imports and exports of manufactures (by volume)



Source: House of Lords (1985), *Report from the Select Committee on Overseas Trade*, 238–I, Session 1984–5, HMSO, London, 30 July, Figure 2.2.

Table 1.1: Crude balance of trade (summary by class)

	Exports minus imports (£ millions)			Change in balance
	1978	1983	1984	1978–84
Class 21 Extraction and preparation of metalliferous ores	−619	−764	−801	−182
Class 22 Metal manufacturing	−236	−528	−181	55
Class 23 Extraction of minerals NES	−252	−269	−79	173
Class 24 Non-metallic mineral products	289	196	165	−124
Class 25 Chemical industry	1,192	1,582	1,682	490
Class 26 Man-made fibres production	82	54	73	−9
Class 31 Metal goods NES	259	−61	−153	−412
Class 32 Mechanical engineering	2,345	1,934	1,965	−380
Class 33 Office machinery and data processing equipment	−213	−947	−1,050	−837
Class 34 Electrical and electronic engineering	697	−1,036	−1,398	−2,095
Class 35 Motor vehicles and their parts	334	−2,535	−2,502	−2,836
Class 36 Other transport equipment	521	1,150	1,279	758
Class 37 Instrument engineering	−35	−185	−272	−237
Classes 41/42 Food, drink and tobacco	−1,947	−2,591	−3,301	−1,354
Class 43 Textile industry	−270	−1,056	−1,307	−1,037
Class 44 Leather and leather goods	−55	−97	−115	−60
Class 45 Footwear and clothing industries	−318	−1,018	−1,317	−999
Class 46 Timber and wooden furniture	−896	−1,668	−1,829	−933
Class 47 Paper, printing and publishing	−775	−1,497	−1,872	−1,097
Class 48 Rubber and plastics processing	159	−173	−274	−433
Class 49 Other manufacturing industries	−139	−444	−491	−352
Divns 2–4 Manufacturing industries (Rev definition)	124	−9,948	−11,765	−11,889

Source: House of Lords (1985), *Report from the Select Committee on Overseas Trade*, 238–I, Session 1984–5, HMSO, London, 30 July, Table 2.4.

as the culmination of a trend that had been evident for a number of years, the UK recorded its first ever peacetime deficit in manufactured trade. The pattern is shown in Figure 1.1; clearly the developments since 1972 which are highlighted have contributed towards the decline in manufacturing output (both in absolute and in relative terms) which took place during the period. The poor export performance and increasing import penetration occurred in most industrial sectors, and balances of trade deteriorated against nearly all geographical trading areas. It is, nevertheless, worth drawing attention to Table 1.1 on changes in crude trade balances by industry class: between 1978 and 1984, the trade balance in both electrical and electronic engineering (class 34) and motor vehicles (class 35) deteriorated by between £2 and 3 billion; these sectors are dominated by foreign owned companies both as regards investment in the UK and UK trade.

The position on manufacturing trade balances does not reveal the whole balance of payments picture. Nor is manufacturing output and productivity the only contributor to GDP. Yet, the service industries cannot substitute for manufacturing, given that many services are dependent on manufacturing and it has been suggested that only 20 per cent of services are tradeable abroad. With the oil account in deficit before the end of the century, and income from overseas investment and inward capital investment flows unlikely to compensate fully, clearly manufacturing is crucial.

The declining state of Britain is thus fundamentally attributal to the lack of competitiveness of manufacturing industry, since success in selling goods at home and abroad is dependent on the competitiveness of the products. Competitiveness has numerous aspects — price, quality, design and process, delivery, reliability, selling efficiency and so on, together necessary to produce sustained growth in output levels. Price competitiveness is affected by a number of short run and long run components, including labour costs, investment, productivity and the exchange rate; the relative contribution of each of these two changes in UK competitiveness has varied over time — in the 1980s the improvement in relative productivity was supported by sterling depreciation, but competitiveness eroded by labour costs. Because of the work of the National Economic Development Council (NEDC) and the Economic Development Committees (EDCs) there is now a greater awareness of the significance of non-price factors, particularly quality and quality control, design, delivery and after sales service, but much remains to be done in implementing improvements. Digging deeper to identify the underlying causes of

Figure 1.2: Requirements for manufacturing competitiveness in Britain

	Macro	Micro
Hardware	1. Government fiscal and monetary policies and industrial policies – Macro policies favouring manufacturing and trade – Exchange rate stability – Low interest rates, especially for SMEs – Taxes and rates to favour manufacturing industry and investment – Supportive and integrated industrial policy – Support for innovation and export	2. Production capability – Level and quality of investment – Utilisation of investment – Creation of new technology
Software	3. Socio-economic environments – National attitudes – Educational system: attitudes, orientation, responsiveness, levels of expenditure – Regulation and deregulation	4. Corporate management[a] – Quality of management: in turn relating to range of managerial issues from corporate strategy to labour relations – Non-price-competitiveness factors, including quality, design, market research, delivery, after sales service – Import substitution and local sourcing – Export promotion

Note: a. Some of these factors may also be amenable to government policy intervention.
Sources: The matrix is derived from W.J. Abernathy, K.B. Clark, and A.M. Kantrow (1981), 'The new industrial competition', *Harvard Business Review*, September–October. The items within the matrix are drawn from House of Lords (1985), *Report from the Select Committee on Overseas Trade*, 236–I, Session 1984–5, HMSO, London, 30 July.

deteriorating competitiveness leads the observer first to the company and corporate management, and questions both of corporate strategy and specific matters such as the encouragement of marketing, the provision of finance, innovation and R & D, maker/user relationships and manpower and training; and thereafter to education, cultural and attitudinal factors. The fact that there is no panacea and that Britain's competitiveness problems are ubiquitous are perhaps the most important lessons learned in recent years.

A House of Lords Select Committee, appointed to consider the causes and implications of the deficit in the UK's balance of trade in manufactures reviewed many of the issues discussed above.[8] The conclusions have been summarised in Figure 1.2, distinguishing crudely between 'macro' and 'micro' issues, and 'hardware' (plant and equipment) and 'software' (people, corporate management). There is no question that stable and supportive fiscal and monetary policies provide an important framework within which firms compete. Nevertheless the key requirements for manufacturing competitiveness are associated with quadrants two and four, and these in turn are believed to be dependent upon attitudinal changes at all levels, an educational system which is responsive to the needs of industry and the revival of entrepreneurship (but it has to be asked whether some of these are real problems or not: for example, some foreign companies find their British workers as responsive and productive as anywhere in the world). The same problem areas could be analysed differently to distinguish between short run factors (North Sea oil and government financial and exchange rate policies); medium term factors such as demand considerations; and the long run variables of poor rates of investment and culture and attitudes.

It is within the theme of the restoration of British competitiveness that the position of inward investment and foreign multinationals needs to be considered. The broad issues associated with multinationality and the internationalisation of business are discussed in the next section. Before turning to this topic, it is interesting to look at the conclusions of the Select Committee on inward investment, competitiveness and the balance of payments. Essentially, four main points emerged:[9]

Inward investment flows and the balance of payments. To quote: 'there remains the theory that flows of inward capital investment could enable the country to sustain a permanent deficit in manufacturing, but . . . there is no reason to suppose that investment in the United Kingdom will appeal to overseas investors on the scale that would be required. And over-reliance on inward investment is not desirable so long as development of strategies and innovation continue to be based overseas' (para. 95).

Operating characteristics of foreign firms. 'The Committee felt that many British firms had much to learn from foreign practices in the drive to be competitive . . . The factors are well known: attention to quality, good marketing, paying attention to the consumers' requirements, labour force motivation and cooperation, effective training, sufficient investment in R & D and up to date technology such as flexible manufacturing systems, etc. Many of these factors are transferable' (para. 124).

Sourcing policies of multinationals. Criticism was made of the import content of the manufactures of MNEs, especially in the motor and IT industries. It was accepted, nevertheless, that decisions on importing, as opposed to sourcing locally, were made because of high costs and poor industrial relations historically in the motor industry, and because of the failure of indigenous suppliers in the IT sector.

Government policy and MNEs. It was advised that pressure be brought to bear on MNEs to source more manufacturing in the UK. And in the case of new investors, 'Government should be less beguiled by the immediate employment opportunities they create and more concerned with the level of manufacturing and value added. They should be careful too in their encouragement of the import of foreign R & D to the detriment of development of new technologies by indigenous British firms. Britain's technical independence must not inadvertently be weakened' (para. 219).

The items above relate chiefly to quadrants two and four — the micro dimensions — in Figure 1.2. As the statements show, MNEs may make a positive contribution to Britain's competitiveness across these dimensions. On the other hand, the multinationals themselves may be hampered (as in local sourcing) by adverse features of the British economy deriving from quadrants one and three; the latter may also retard the transferability of superior management practices into the indigenous sector. Finally, centralised R & D at headquarters level within the MNEs is an offsetting negative factor in quadrant two. Already then some of the problems and contradictions associated with foreign multinationals can be seen.

MULTINATIONALS: THE GLOBAL ISSUES

Multinationals both react to and are a major driving force within the