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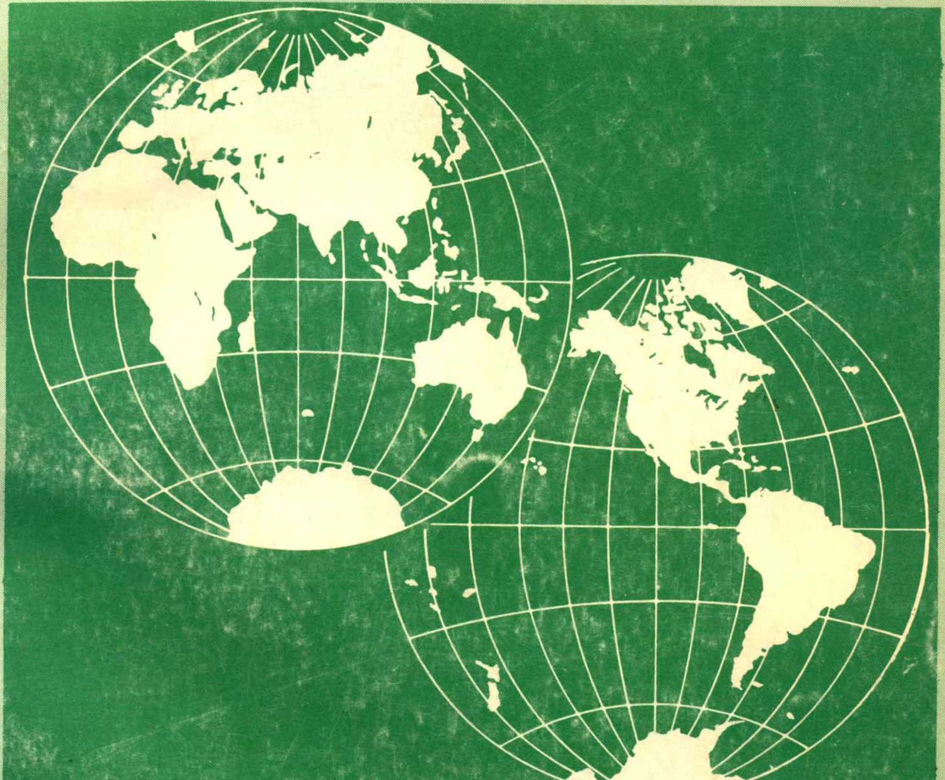
THE MULTINATIONAL CORPORATION

STUDIES ON U.S. FOREIGN INVESTMENT
Volume 2



U.S. DEPARTMENT OF COMMERCE

Domestic and International Business Administration

THE MULTINATIONAL CORPORATION

U.S. DEPARTMENT OF COMMERCE
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Volume 2

April 1973

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FOREWORD

This volume presents the fourth in a series of Department of Commerce staff studies on the multinational corporation. The first three studies were presented in The Multinational Corporation: Studies on U.S. Foreign Investment, Volume I, published in March 1972.

The purpose of these staff studies is to develop better and more comprehensive information on, and analysis of, the effects of U.S. foreign investment on the United States and the world economy. Volume II is intended to contribute to this objective by examining the factors that have motivated U.S. business to establish production facilities abroad.

Substantial work has been undertaken in the Department of Commerce and in other public and private organizations for the purpose of quantifying and analyzing in aggregate terms the effects of U.S. international investment on U.S. employment, trade and over-all economic performance. However, there is presently a paucity of information on why individual companies have decided to make overseas investment. This study is intended to help fill that gap. It does so by assaying the factors that motivated 76 U.S. companies in 15 industrial categories to undertake investments outside the United States.

The study was prepared for the Department of Commerce by The Conference Board under the supervision of J. Frank Gaston, Director of Special International Studies for the Conference Board. The conclusions and observations presented in this study do not necessarily reflect those of the Department of Commerce.

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Alexander B. Trowbridge
President

THE CONFERENCE BOARD

The Honorable Frederick B. Dent
Secretary of Commerce
Department of Commerce
Washington, D. C.

Dear Mr. Secretary:

I am pleased to transmit the accompanying report analyzing the motives of American business executives for investing abroad.

In keeping with the original intention of this project, as developed through discussions between the U. S. Department of Commerce and The Conference Board, the report focuses on obtaining from businessmen their views on why they invested in foreign countries. The testimony of business participants in the investment process, it was thought, would be a vital factor in understanding the substantial growth in U. S. direct foreign investment since 1966.

This subject is of critical importance today because of the threatened international economic position in which we find ourselves. Against this background of important change, the growth of our direct foreign investments assumes greater significance as it affects our balance of payments, and the growth of output, investment, and employment in the United States.

I know of the importance that you attach to the controversy over the effects of direct foreign investments by American companies and the possibility of Congressional action restricting such investments. I know that you are also aware of the need for a careful accumulation of information from many sources before good public policy can be formulated. Until fairly recently, the importance and impact of direct foreign investment had not been sufficiently studied. Thanks to the efforts of the Department of Commerce and other organizations, a body of substantial data and analysis is being developed. We hope that our research contribution to the analysis of direct foreign investment, in conjunction with several of yours and those of other organizations, will provide the factual basis that is needed to arrive at intelligent public policy.

This report was prepared under the direction of J. Frank Gaston, Director, Special International Studies. Essential assistance in carrying out the interviews was provided by other members of the staff: James Greene, Director, International Center; John Hein, Director, International Economics; and Frederick F. Randall, Specialist, International Management Research. Zoe Campbell, Associate Economist, supervised the preparation of the statistical tables. The whole project could not have been carried out, of course, were it not for the willing cooperation of the executives in the 76 corporations that were interviewed in order to gather the primary data.

Sincerely,

A. B. Trowbridge

A. B. Trowbridge

ABT:MG
Enclosure

Why Industry Invests Abroad

Summary of Findings

Report to the
Office of International Finance and Investment
Bureau of International Commerce
U.S. Department of Commerce

Prepared by
J. Frank Gaston, Director
Special International Studies
The Conference Board
April 1973

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I. Background and Methodology

The Department of Commerce has had a long-standing interest in the development of data on the balance of payments of the United States. In keeping with this position, it has undertaken over the years to develop statistical data on a continuing basis to record the operations of companies with direct investments abroad. These have appeared either as the basis of separate articles in the monthly Survey of Current Business of the Department of Commerce on the plant and equipment expenditures of foreign affiliates of U.S. corporations, or as part of the regular compilation of the balance of payments of the United States, of which direct investment flows of capital and earnings are becoming an increasingly important part.

The recent growing interest in the United States in the subject of multinational corporations prompted the Department of Commerce to enlarge its data collection and analysis activities in this area. It did this in a number of ways. It developed two monographs of its own, one entitled "Policy Aspects of Foreign Investment of U.S. Multinational Corporations" and the other, "Trends in Direct Investments Abroad by U.S. Multinational Corporations - 1960 to 1970". It also commissioned the Graduate School of Business of Harvard University to undertake a series of case studies of foreign direct investments by U.S. corporations. This study was published under the title, "U.S. Multinational Enterprises and the U.S. Economy".1/

In addition, the Department of Commerce undertook to collect comprehensive statistical data to enlarge its regular collection of relevant data as described above and to update part of its 1966 census of direct foreign investment of U.S. corporations. This "mini-census" has provided a solid body of statistical data for the year 1970 and a basis for a comparison of changes since 1966.

The Department also felt a need to go beyond the collection of basic statistical data and to examine the motives for foreign investment by American businessmen. Such an analysis, it was felt, could be better carried out by an outside organization.

The Department of Commerce contracted with The Conference Board to carry out such a study. This study was sponsored by the Department of Commerce as a separate, independent but supplemental project to the one that it is engaged in to collect and analyze comprehensive statistical data on the magnitude of foreign operations of American companies and their interactions with domestic operations.

It is separate and independent in that The Conference Board had the responsibility for carrying out the project once the scope and character

1/ All three separate studies have been incorporated in "The Multinational Corporation, Studies on U.S. Foreign Investment", Volume I, U.S. Department of Commerce, Washington, D. C., 1972.

had been agreed upon. The selection of the specific companies to be interviewed, the manner of carrying out the research, and the writing of the final report were the responsibilities of The Conference Board. This report and the larger study undertaken by the Department of Commerce are complementary in that they attempt to examine the same phenomena through the use of different approaches.

The Conference Board survey is a qualitative one developed primarily through discussions with businessmen responsible for the international operations of their companies. This type of approach, it was felt, would provide a needed supplement to the mini-census that the Department of Commerce conducted for 1970. Statistical data, which form the core of the Commerce project, cannot provide the participants' view of the business and economic setting of the 1966-70 period and the reaction of businessmen to that setting. What was needed, it was thought, was an account of the interpretation by businessmen of their position in world-wide trade and investment and how they felt they could best operate and expand their operations.

Methodology

To develop such information, it was decided that the most fruitful approach was to conduct a series of interviews with the chief executives in charge of international operations of a sample of U.S. manufacturing companies. A target of 75 companies was decided upon, all in manufacturing industries in the United States covering most of the principal manufacturing industries in this country. The completed sample of interviewed companies numbered 76, and their distribution by major manufacturing industries is shown in Table 1, below.

Table 1. Industry Classification of Manufacturing Companies Interviewed

S.I.C. Number	Industry	Number of Companies
20	Food and Kindred Products	9
26	Paper and Allied Products	3
283,4	Drugs, Cleaners and Toilet Goods	6
28 ex. 283,4	Other Chemicals	7
29	Petroleum Refining	3
30	Rubber and Miscellaneous Plastic Products	2
32	Stone, Clay, Glass and Concrete Products	6
33	Primary Metal Industries	2
34	Fabricated Metal Products	6
357	Office and Computing Machines	4
35 ex. 357	Other Machinery, Except Electrical	7
365-7	Radio, Television and Communication Equipment and Parts	5
36 ex. 365-7	Other Electrical Machinery	4
37	Transportation Equipment	6
38	Professional, Scientific and Controlling Instruments	6
	Total	76

It was also decided that the survey should be limited to those companies with existing investments overseas. The limitations of time and funds made it impossible to cover other companies whose experience might also throw light on the motivation for foreign investment. For example, since no company was included without foreign investments currently, there was no probing of the reasoning of companies that may have considered going abroad in this period but decided against it. Similarly, there is no examination of those companies that might have had manufacturing operations abroad in the early part of the 1966-70 period but withdrew them so that at the end of the period they had no investments outside the United States. The geographic distribution of their foreign operations is shown in Statistical Table S-1.

The procedure used in selecting companies was to examine the Fortune 500 list and then make selections from that list by reference to the existence of foreign operations of the company. This information was obtained from a variety of sources. Two of the principal ones were Moody's Industrials and "Foreign Investment, Capital Controls, and the Balance of Payments", by N.K. Bruck and F. A. Lees, New York University, Institute of Finance Bulletin, No. 48-49, April 1968.

A larger number of companies was selected than the target of 75 that was sought. This was done to allow for the loss of companies that were unwilling to participate in the survey for one reason or another. The typical operating procedure was to send a letter to the selected company describing the survey and the manner in which it was to be conducted. This letter was followed by a telephone call in which a date for an interview was sought. The summary of the companies from whom interviews were sought and the resulting experience is shown below:

Number of companies selected to whom letters were sent	97
Completed interviews	76
Remainder	21

For interviewing, an outline of approximately nine pages was prepared, the main headings of which were:

A. Origin of Company's Foreign Operations
B. Extent and Nature of Current Overseas Operations
C. Overseas Investment
D. Sales and Related Information
E. Imports into the United States
F. Technology: Development and Transfer
G. Changes in Employment - Foreign Affiliate
H. Business Reaction to Government Policy and Proposed Legislation

Under each of the main headings, a series of questions was developed that were to be used as a guide by the interviewer. The purpose was not to seek detailed answers and tallies to specific questions, but to use as a guide to ensure that adequate coverage was made of the subject under consideration. The usual procedure employed by the interviewers was to open up the subject matter in broad terms and normally to let the interviewee respond as he saw fit. If the subject was completely covered by the volunteered comments, there was no need to probe further. If not, the detailed topics under each broad heading could be used to elicit further comments.

The actual interviews began in December, 1971, and extended through the first week of April, 1972, with the bulk being conducted in January-February. The average time of the interviews was about two hours. Some were conducted in as little as an hour and a half, and others went to two and a half hours or more.

In addition to the survey data, information from annual reports of the companies and replies received by The Conference Board from previous surveys of a related nature were considered.

Description of Sample

As already mentioned, 76 companies were interviewed, all of which are primarily engaged in manufacturing in the United States. The specific manufacturing industries into which they are classified are shown in Table 1. This table is made up primarily of two-digit Standard Industrial Classification categories although, in a number of instances, it was possible to make a finer classification.

As in all cases where the industrial classification of the company is made by reference to the major part of its activities, the great underlying variety of activities is hidden. As one example, a number of these companies engage in mining and extractive operations both here and abroad, which a classification by two-digit industries cannot reveal. This is true even outside so well known a case as the petroleum companies. Secondly, the classification of these companies into manufacturing categories does not reveal the large amount of service activities performed both here and abroad. In most instances, these activities are connected with marketing and servicing the principal products manufactured by the company. In others, however, the connection is only slight.

The process of selection and the constraints of ensuring that companies with foreign operations are included confined the sample to large companies, in the main. As shown in the table below based upon statistical data submitted by 44 companies, only 16% of these had assets under half a billion dollars. Approximately 59% of the companies had assets in excess of one billion dollars. The data submitted tend to overstate assets because of the usually unconsolidated nature of the reports; but unquestionably these companies are among the giants in the U.S. corporate structure.

Table 2. Size of Companies Interviewed

Asset Size	Number of Corporations
Under $500 million	7
$ 500 - $ 999	11
1,000 - 1,499	8
1,500 - 1,999	4
2,000 - 2,999	5
3,000 - 4,999	4
5,000 and over	5
All corporations	44

All manufacturing corporations in the United States with assets of $250 million and more totalled 294 in 1969.2/ These constituted 15/1,000 of all manufacturing corporations in the United States. It is clear, consequently, that the sample of companies included in this study are not representative of the size distribution of all manufacturing corporations.

This selection was intentional in order to obtain the greatest coverage of foreign investments with minimum effort. It is believed that the major part by far of direct foreign investments is made by large corporations. "Actually, the degree of concentration is quite substantial: About 250-300 U.S.-based multinational corporations account for over 70% of all foreign direct investments. If the Fortune list of the 500 largest U.S. companies is used for comparison, almost the entire direct investment universe would be included."3/

As already noted, all the companies had to have manufacturing facilities overseas in order to be included in the sample. On the average, slightly more than one quarter of their assets in 1970 were located in foreign countries. The distribution of assets between foreign and domestic is shown in Statistical Table S-4. When the companies are classified on the basis of the number of foreign to total employees, foreign operations shows a higher percentage, approximately 35% in 1970. Since wages and salaries are generally lower, however, payrolls to foreign employees constitutes only about 20% of their total.

The overseas operations of these companies are sizable and widespread geographically. As can be seen in Statistical Table S-2, the companies on the average are located in approximately 16 different countries.

2/ See U.S. Treasury Department, Internal Revenue Service, Statistics of Income Preliminary 1969, Corporation Income Tax Returns, Washington, D. C., October 1971, page 24.

3/ See "Trends in Direct Investments Abroad by U.S. Multinational Corporations, 1960 to 1970", Staff Study, U.S. Department of Commerce, Washington, D. C., February 1972, page 3.

These countries are located in all the continents of the world. They are in less developed countries as well as developed ones. There is in the aggregate a decided preference, however, when going overseas to locate in developed nations. When locating operations in less developed parts of the world, such as in Latin America or the Far East, there is a decided preference for placing the manufacturing facilities in countries that are on the verge of being classifiable as developed.

II. Summary - Investment Motives of Multinational Corporation Managers

The principal reasons for making investments in foreign countries, according to the businessmen interviewed in 76 companies, are shown below in order of importance (see Statistical Table S-3 for tally of reasons by industry). The importance of the reasons is measured by the frequency of mention by the individual business executives.

Importance of Reasons for Foreign Investment

		Mentioned by Number of Companies
1.	Maintain or increase market share locally.......	33
2.	Unable to reach market from U.S. because of tariffs, transportation costs, or nationalistic purchasing policies......................	25
3.	To meet competition...........................	20
4.	To meet local content requirements and host government pressure............................	18
5.	Faster sales growth than in the United States...	15
6.	To obtain or use local raw materials or components....................................	13
7.	Low wage costs.................................	13
8.	Greater profit prospects abroad..................	11
9	To follow major customers.......................	10
10.	Inducements connected with host government investment promotion programs..................	8

These descriptions present a view of the business world as seen by the principal participants at the time decisions were taken to make foreign investments. They reflect a state of mind and an evaluation of what is considered important and what is considered unimportant in enhancing the wellbeing of the individual company.

In any environment, business investment in fixed plant and equipment is often undertaken for many reasons, which cannot always be sharply distinguished from one another. Sometimes they are reinforcing and sometimes they are in opposition to one another. At times they are partly duplicating and at other times they can be effective only if they exist at the same time. Sometimes long-term considerations predominate and sometimes short-term ones. At times the reasons represent "offensive" action and at other times, "defensive" action. Sometimes investment is made in response to attractions of locating an operation in a particular area and sometimes they are made in order to avoid the disadvantages of previously located facilities.

When crossing international borders, all the problems exist that would be involved in considering investment within one country, plus the additional complications that arise because the foreign country may be unfamiliar, different laws apply, and nationals may have different customs and different behavior patterns. The fact that an investment must be made in the currency of the host country means that a problem of transfer is involved both in making the investment and in the return of income from that investment. To one extent or another, all these factors are present in the replies provided by the business executives interviewed.

Composite of Reasons for Foreign Investment

If one were to attempt to develop a composite that would reflect these 76 companies, it would be somewhat as described below. The composite picture, of course, cannot be taken to apply precisely to each industry but inso far as an "average" can be representative of the individual observations, the composite provides a reasonable and accurate picture of the general motivations of those business executives interviewed in making foreign investments.

Of most importance to the companies interviewed in making foreign investments were market factors. This was expressed in a variety of ways when businessmen were queried as to what spurred them to go overseas. *The existence of growing markets*, *faster sales growth* abroad than in the United States, the need to maintain market shares, and related reasons were most frequently offered. Closely allied to such considerations was that investment was made to protect the company from competitors. This competition took a number of forms. In some cases it represented other companies in the United States moving to establish facilities in foreign countries, and, consequently, compelling the respondent to do likewise. If he did not, he risked the loss of that market. In other cases, of course, the competition took the form of international companies from other countries or from local foreign producers. Underlying the concern over competition was the feeling that such competition could not be met by exports from the United States because of the disadvantages of transportation costs and the higher costs that would result from tariffs and other barriers to trade. The only workable alternative then would be to locate in the foreign country.

For some, pressure was experienced from local governments to have products made locally. This pressure was exerted by the government generally to bolster the economy and to provide employment to its working force. At times this pressure extended to have the company not only manufacture in the foreign country but to export in order to help ease the foreign exchange problem that the country was facing. The pressure that was felt took the form of a threat to cut off exports from the outside. The company was faced on one hand with a loss of export markets and, on the other hand, with an insulated market if it established local production facilities because the local government would normally raise import barriers once a local source of supply was assured.

A variant of this situation was experienced by companies manufacturing a product in the drug or pharmaceutical field or one in which the government was a prime purchaser. In the first instance, requirements of labeling, of adherence to standards, and of inspection of production facilities made it mandatory for the company to have manufacturing facilities in the country. In the other case, the government, as a major consumer, specifically favored local producers. Bids for jobs by companies without a local presence would automatically receive a low priority. In still other variants, the need for a local presence was found in industries where the nature of the product and service requires that they be close at hand. In some instances - for example, companies that supply parts to the automobile industry - there was pressure exerted by the automobile manufacturers to have a source of local supply in each country to as large an extent as possible. This desire on the part of the automobile manufacturers stemmed partly from their efforts to keep costs low and partly from the desire to maintain a source of components and parts that would be quickly responsive to needs. It also reflected the pressure exerted by host governments on the automobile industry to buy locally. In other lines, such as computers, not only must the computer and its equipment be installed, but there is a continuing problem of ensuring that it is maintained in operating condition. The growing importance of software also makes it imperative that the user be supplied with the necessary programs and technical advice to ensure that he derives the greatest benefit from the installed equipment. In still other industries, such as suppliers to building contractors, there is a need for a local presence in order to continue finishing and maintenance operations on parts and components that go into the construction of buildings. For manufacturers of such items as elevators, a similar consideration exists in that the service and maintenance activities following the installation of the elevator are extremely important. Local facilities are needed then to manufacture and stock parts as well as to provide maintenance and repair services.

By overall count, several reasons for foreign investment - source of raw materials, lower wage costs abroad and greater profit prospects abroad - were mentioned by nearly the same number of companies. This nearly equal importance must be qualified, however.

For some companies, the need to obtain a source of raw materials was an important factor prodding them to establish production facilities abroad. The petroleum companies in this survey went abroad almost solely for this reason. To a large extent, this is also true of the primary metal industries. The same reason is given by companies in other industries as well.

Lower wage costs abroad were mentioned by a moderate number of companies as playing a part in the overall process of considering foreign investment. Almost invariably, though, it was regarded by business executives as not being decisive. Greater importance almost without exception was attached to scme other reason for investment.

Profits or the hope of profits was offered by a moderate number of companies as being a reason of importance in investing overseas. The comparatively few replies identifying prospective profitability probably understates the importance of this reason. For one thing, it must be assumed that profit calculations play a part when a company goes overseas in response to what it describes as market potential or threat of lost markets. Secondly, almost all companies mentioned that they used the measuring rod of a rate-of-return when comparing U.S. investment projects with foreign ones. Very frequently the point was made that foreign investments were regarded as more risky than domestic ones; consequently, it was necessary to have foreign projects earn a higher rate of return before investment would be made overseas.

Such factors as market considerations, costs, poor business activity at home might all play a part in the decision to go overseas but, of course, could be subsumed under the reason "greater profit prospects abroad". The business executive may emphasize market considerations or whatever seems to be the immediate goal, but in the end, he probably also has the hope of either short or long-term profits. It appears that higher margins (net income to net sales) was not a factor inducing business to go abroad in this period. Such margins as well as profitability (net income to net worth) were actually higher in the United States in 1966 for the reporting companies in general. By 1970, the situation was reversed with margins and profitability higher abroad, according to the financial data supplied by the respondents.

Only three companies said that they went abroad in order to export to the United States. These companies maintained that they were unable to hold on to markets in the United States because of the growing competition that they were facing from foreign manufacturers exporting to this country. They had to move overseas to make components or finished products in order to export to the United States and thereby hold on to the markets they previously served from this country. Had they not made this move, they would have lost the market entirely to foreign competitors.

III. Industry Looks at Foreign Investment

The following section contains a summary of the discussions conducted with business executives that forms the core of this report. The methodology utilized in obtaining this information is described in Section I. Though the bulk of the responses come from personal interviews, resort was made in some instances to replies to previous surveys by The Conference Board for amplification or for clarification. As noted in the section on methodology, all the companies interviewed are large ones and in all cases have some foreign investments. The average size of the companies in the survey is approximately two billion dollars. The importance of their foreign operations is shown in Statistical Table S-4. For all companies combined, slightly more than one quarter of their assets in 1970 were in foreign countries. The geographic distribution of their foreign operations is shown in Statistical Table S-1.

The responses obtained from the business executives are arranged by the two-digit classes of the Standard Industrial Classification. Some exceptions exist to this general statement. Included in the food industry is one tobacco and one textile company. This combining was done in order to ensure that the individual companies could not be identified. The chemical industry is separated into two parts. One group consists of those companies predominantly engaged in the manufacture of drugs, cleaners, and toilet goods and the other group consists of all other chemical companies. Similarly, the electrical machinery group is separated into two components. One consists of companies classified under the heading of radio, television, and communication equipment and parts. The second group is labeled "other electrical machinery". The nonelectrical machinery manufacturers are separated into office and computing machines and other machinery, except electrical.

The summaries presented in the following pages are meant to be a composite of all the responses in that industry. Insofar as possible, each is designed to present what seems to be the most common point of view. Some details, of necessity, are omitted but not anything of consequence. As a result of being a composite, it cannot represent in detail each of the companies included in the individual industries. Some individual companies, consequently, may find that they do not subscribe to all aspects of the industry composite presented.