European View of Multinationals

Examination of problem areas as seen in Europe, with comment on implications for transfer of technology to Europe

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In Europe today, if one speaks of the multinational corporations the impression is almost invariably created that we are talking about the American multinational corporations and not their European equivalents, despite the fact that there are quite a few worldwide names, such as Unilever, Phillips, B.P. and so on, which are clearly European. One would also get the idea that the whole multinational concept is an American concept, but if I, following a typical European tradition, refer back to my history books it seems to me that the Europeans have been in the multinational business for a long time. The old merchant venturers, who came from the Mediterranean to trade in the tin of my native West Country, through to the larger organizations, such as the East India and Hudson Bay companies, were all multinationals of a type. The major difference is a matter of scale in that, because of their limited communication systems and the dependence of all countries upon technological innovation and development, the opportunities for multinational development are that much greater.

Dr. Pearce

Many reports have been written and published by organizations of all sizes about multinational corporations, one of the more prestigious being the Report of the U.N. Group of Eminent Persons. The International Chamber of Commerce, which happens to be based in Paris, commented on this report and it made one point which intrigued me, and which I discussed with other Europeans who work for MNCs. This comment states that if the proposed commission on multinational corporations is set up, then that commission should include an adequate number of members drawn directly from the ranks of the multinational corporations, which by inference know just how MNCs work, and are not just theorizing. This seems sound common sense, but I would go further than that and suggest that not only should there be representation from the headquarters of such corporations, but also at least one representative from a subsidiary. There are understandably plenty of papers which can be consulted which have been written by members of the headquarters staff of MNCs, but surprisingly few which give the views of what in the U.K. are now popularly called the grass-roots people — those in the field, who by nature of their jobs are forced to see two sides to the question — that of the parent company and that of the host country.

To me, therefore, this is somewhat of a unique opportunity because I happen to work for one of the largest multinational corporations, and although I head a local affiliate I am not a member of the parent company top, or headquarters, management, and cannot speak for them. At the same time I am seen by my customers and local officials as one who is not quite a 100 percent member of the European business community because I have, quite rightly, to implement the broad policies and guidelines set for me by my parent company whose headquarters happen to be foreign-based.

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One has, however, to be practical in this world, and it would be naive to suggest that the attitude to multinationals in Europe is any different from that elsewhere, and is other than one of suspicion. Suspicion caused, I would suggest, by lack of knowledge, by the fear of size, and also I regret to say, in some cases, by plain envy of the apparent success of so many multinational corporations.

But is this suspicion justified and, if so, how can it be minimized? It is too much to suggest that it will be eliminated — too many writers, commentators and politicians have an interest in keeping the debate going — but actions can and have been taken which could minimize the suspicion, though I would not want to underestimate the size of the problem, or the time it will take to change some of the current views.

But what are people suspicious about? I suggest the following are the main ideas which give rise to the suspicion:

1. The apparent lack of information
   (a) about what the company does and how it operates;
   (b) about the size of corporate profits;
   (c) about the suggestion that multinational corporations can evade taxation, particularly in the host countries;
   (d) about the idea that profits can be transferred across national boundries by controlled transfer pricing of materials and technology;
   (e) about what may appear to be a technical bias towards the needs of parent companies' national location.

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2. The control by faceless non-nationals who are thought to have no responsibility to the host community.

I propose to comment on each of these ideas individually. There are other points, but I suggest these are the most significant.

Lack of Information

Let me start with the lack of information about what the company does and how it operates. Almost invariably, and for very good practical reasons, the majority of publications printed, such as annual reports, monthly magazines and policy statements, and the majority of speeches made by the multinational corporation executives, are made for consumption in the areas where they have the largest proportion of their shareholders, in those places where the majority of their shares are traded, and where their top executives happen to spend most of their time — in other words, where the headquarters are.

It is thus very easy for other nationalities to reach the conclusion that nearly all the company's efforts are directed towards that limited area and its interests, and little account being taken of the needs of others. To illustrate my point let me take just the question of R & D expenditures.

For countries looking for investment, research and development expenditures are important because they may lead to the desired capital expenditures. In multinational corporations it is, however, quite common practice for the R & D expenditure to be controlled centrally and for economic reasons, for a high proportion of that expenditure to take place in the home country. If then in the annual report and the speeches made by the senior executives, most of the comments are directed towards the needs of the headquarters location, the simplest conclusion to reach is that the R & D is heavily biased in favor of the home location, and to the detriment of the countries which are hosts to the affiliates and who in some situations contribute towards the costs.

In many cases this is not the right conclusion, but the host countries are not ging to be convinced unless they too can see that quantified sums of R & D expenditure are being made in their interest, and desirably that there is some effort to quantify the value to the host country. Not easy to do, I readily admit, but killing suspicion is not an easy operation.

If companies are not prepared to release the R & D cost data, one of the alternates is to set up research labs in the country in which the subsidiary operates. This is, however, a limited option. For some research, particularly for large-scale process research involving heavy capital investment in pilot plants and other facilities, even the largest of companies would have considerable difficulty in justifying and paying for more than one such research facility. Assuming, however, this type of problem does not apply, then if an R & D operation is to be successful, and to last it has to be, there must first be an adequate supply of high-caliber personnel and a strong academic community with which they can confer. Getting both conditions is not always possible, but it is in most European countries, and I suggest that if multinational corporations want to continue to operate in Europe with reasonable local relationships, part of their R & D work is going to have to be decentralized to Europe. That it can be done has been shown by a number of companies, but probably the best example is that of I.B.M. That it can also be effective can be seen from the relationships which some MNCs have developed with the academic communities in Europe. They have access to an additional source of knowledge and expertise which is not available in the home country, and some of the opinion formers in the host country know what is going on and feel somewhat involved.

Inform People

Any program of informing people must be a continuing one, because people soon forget any benefits. Two examples of technological transfer affecting the U.K. oil industry, one old and one new, can be used to demonstrate my point on information.

In 1951, because of the transfer to the U.K. of the fluid catalytic cracking technology, which was developed in the U.S.A., the U.K. was able to give up wartime-quality gasoline and by improving the fuel quality allow the development of some very fine engines, as well as improving the balance of payments. This transfer of technology was well publicized and explained, and the balance of payments advantages quantified, and the oil industry gained considerable credit for some years after.

Today, the oil industry is transferring massive amounts of technological know-how — my guess is far more than in 1951 — for the development of the North Sea, but virtually nothing has been said in public about how much, or its value, and the result is that the majority of the British public who are not generally in favor of nationalization would be quite prepared to see the North Sea oil operations nationalized. The opinion polls show that the British public believes that American-controlled companies are going to step in and take away massive and excessive profits from the North Sea for little in the way of effort, and yet the amount and value of the technological transfer is enormous. I would suggest it has also been enormous in other producing areas of the world, but because little has been stated of the value, the suspicion remains that somehow the MNCs are getting away with something. Some companies, such as my own, are making more information available to both government and opinion leaders, but it is a fairly common characteristic for European governmental organizations to be suspicious of many forms of industry, and particularly large companies, and I feel it will take several years of continuous effort to get people to believe what is being said.

This point leads me on to the comment that the multinational corporations make extortionate profits.

Undoubtedly, multinational corporations do make very large sums of money as profits and the oil industry today is probably, because of all the recent publicity, the industry uppermost in people's minds, but are these profits excessive in relation to the investments and the risks involved? Return on investment comparisons show

not too surprisingly that the multinational corporations do not appear as the top companies on this basis, which would suggest that the profits, though large, are not excessive.

If we refer to the Fortune 500 for 1973, and look at the first 15 companies based on sales, all of which are multinational corporations, then on the basis of return on equity in 1973 the best ocmpany ranked 47th and the worst 402nd, and the average about 195th — hardly the most exciting of results!

Nevertheless, led by the reactions to the oil industry in the U.S., there is now a feeling in some quarters in Europe that the multinational corporations make too high profits, and from this follows the view, which is very common in Europe, that not only are the profits too high, but the multinational corporations also avoid, or even evade, the payment of taxes in the host countries, and pay only a nominal amount in their home countries.

There is enough data, much of it inaccurate, which can be used by those so inclined to support this view, which is now held by politicians, civil servants, and also by some businessmen, that multinational corporations do not pay their fair share of taxes in the host countries. Some multinational corporations operate on a branch basis, and so do not need to declare publicly any profits or losses locally. Such lack of data is usually taken to mean there is something to hide — no news is good news for the critics. Where, however, annual accounts have been published, and oil industry results have been used to highlight this problem, there has rarely been any correlation between the subsidiaries' results and the parent company results. The subsidiaries' profits have generally appeared to be low relative to the parent company results. In addition, because the parent company has been investing heavily in the subsidiary then, under the normal tax laws of the country, no income tax has been paid. The massive taxes paid in the form of land taxes, local rates, employer taxes, etc., all are conveniently forgotten. My own company has recently been mentioned in this context of paying no income tax and yet in one area where we have a refinery, our local tax bill is about half of all taxes levied in that area.

The whole problem of international taxation is a complex one which needs an expert to describe it, but even to a layman in tax matters it is surprising how many variations there are between countries on such things as tax incentives, treatment of foreign earnings, and so on. The answer to these problems of where taxes are paid rests not with the MNCs, but with the governments, and how successful they are in agreeing a greater harmonization of national tax policies.

In Europe today, however, with all the social, and I may say socialistic, developments, the payment of a fair tax bill in the country of operations is being seen as a necessity for all industry, and multinational corporations are going to have to be seen to pay their share. This means reporting profits on a local basis and in accordance with all the local codes of practice, and unless this is done, and is seen to be done, then the multinational corporations will probably be taxed more heavily than they had expected. The application of this discriminatory principle might even be extended to international transactions where no multinational corporation is involved, but a company happens to operate internationally, and this I suggest is a most undesirable development.

In Europe today, where subsidiaries of MNCs are not seen to be paying local income taxes, the standard assumption is that this has been caused by the subsidiary being charged too high a price for its raw materials or its technology, with these prices being artificially inflated and not being fair arms-length or market prices.

The definition of a fair arms-length or market price for a raw material is becoming easier in most industries as the sophistication of the supplying countries and the number of competitors grows. Progressively, more and more information on raw material prices is being demanded of companies in Europe, both by the national governments and the EEC. The local managements know this only too well, and because of this they have to be sure that they are paying fair prices. So the freedom to distort results by adjusting transfer prices for raw materials is severely limited, and for the longer term, if adopted in Europe, it would be a very unwise policy. However, by contrast, it is very difficult to put a fair market price or value on technology and know-how, but I suggest that, with the increasing cost of technological development, one question is going to be raised increasingly. The question which says, what value do we get for the license fees, etc., paid, and are they fairly costed?

Question Cost

For some years, European countries have been questioning the cost of U.S. technological transfers on the basis that with U.S. rates of pay it must be more expensive technology than if the R & D had been done in Europe. The economics of scale have not been seen as so significant in R & D as they are in physical manufacturing, and when dealing with R & D one can never ignore the impact of the "not invented here" factor, which is not insignificant in Europe. Today, with the rapid inflation in Europe, this comparative technology cost comment is no longer so valid, but the question still not being answered today is whether the recipient country is getting its technology at either a fair or a competitive cost.

Because of inflationary pressures Europe, governments are applying price controls on finished products on the basis that price increases to the customer must be justified by increased costs — the systems are cost-oriented rather than market-oriented. Where the cost of technology is not a significant part of the final price,this creates no problem, but if the cost of technology does become important, then the multinational corporation is going to be asked to justify the cost of that technology.

One case in which the cost of the basic technology is being challenged is already proceeding through the British legal system, and we can expect more. But to answer the question of arms-length charging for technology is not going to be easy, and the R & D groups are going to have to be progressively more and more concerned about not only their level of costs, but also where they allocate them. The costs are going to have to be justified in the same way as raw material costs, manpower costs, etc., and to do this the multinational corporations are going to be required to release R & D expenditure data

which, in the past, has been kept very confidential. When competitive data is available the difficulties are reduced, but with a new product or concept, it is easy to see how many problems can arise. In Europe the pharmaceutical industry knows only too well how much time and effort is needed to answer the questions which are raised.

Allocating Costs

Just to mention one other very obvious difficulty — the question of how to allocate the costs of R & D, which unfortunately has to be stopped because it is not producing the results. No country is going to be very happy to accept such charges, and yet from a business viewpoint these costs must eventually be recovered from the customer if the company is to survive. Research is an expensive operation today, and becoming more so. With the increasing complexity of technology and the limitations placed on developments by environmental and social requirements, it is quite possible that the failure rate in R & D will increase, and who pays the bill for those failures will have to be determined. Today, this question of who pays for unproductive research is one that keeps being deferred, but with the increasing state intervention in Europe and elsewhere, this problem has got to be faced and the multinational corporations are likely to be the first in the firing line. The multinational corporations do, however, have one card to play and that is to demonstrate just how much technology and technological information gets transferred at nil or very low costs. One of the great advantages of being a member of a multinational corporation is that if I, or one of my executives, has a problem, we can call on people in almost any part of the world to help us. In most cases all that is needed is just one telephone conversation, and we have access to a knowledge base which will help us solve our problem. We can also visit plants and operations in a multitude of countries and get from them ideas which have succeeded and thoughts about those that have not. We can compare our operations with the most efficient in any part of the world, and we have a knowledge base to draw on that no national company can hope to equal. The value of this type of technology transfer is enormous and no license fees are charged. Some countries in Europe vaguely recognize this important contribution of the multi-national corporations, but to date I have seen few attempts to quantify the value, and so the impact on governmental views is minimal. There is here, however, a very important flow of technical information for which no direct fees are charged and there has been little incentive to quantify this cost. Some interest was evident in the U.K. in the early 1960s of the value of international comparative data in assessing company and industry performance, but didn't get very far. There are some indications that this interest is reviving.

Certainly, international Trade Unionism is interested in comparative data, but for very different reasons, and as the participative management trend develops in Europe our managements are going to have to be just as well infomed as the trade unions, or hand over their responsibilities to the trade unions. It is not at all surprising, therefore, that trade unions in Europe are anti-multinational corporations, because today they are one of the few types of organizations with communications systems that can equal those of organized labor.

The next area of criticism of the multinational corporation has been that of technological bias. By this I mean that if the major proportion of the R&D expenditure takes place in the home country, then it is easy to assume that the major part of the expenditure will be to meet the technological needs of the home country, and although the subsidiaries, and hence their customers, are paying a share, the end product is not necessarily directed toward their needs. An example of this occurred in the late 1950s. Europe was then seeing a very rapid rise in the demand for fuel oil and because the crude oil supply was mainly high-sulphur Middle East crude, a need was developing for sulphur reduction processes for fuel oil. A major proportion of the oil industry process research was being done in the U.S., and contributed to by some European subsidiaries, but because there was no market pressure for lower sulphur fuels in the U.S., and little hope of recovering the additional costs in Europe, then very little work was being done on fuel oil desulphurization. Fortunately, the production of low-sulphur crudes from Libya in 1962 alleviated the problem for Europe. Then, however, the environmental lobby became increasingly more important in the U.S., and the U.S. started asking for low-sulphur fuel, and the R&D accent changed rapidly to the development of processes for fuel oil desulphurization. Today the processes are available to the world, but primarily because of the U.S. demand impetus.

Among the academic and government scientists in Europe this happens to be quite a wellknown example, which is used to argue the case of technical bias, and to justify the need to spend R&D money in Europe and so minimize the need for technological transfer. Many of the arguments can be refuted, but the fact is the thought is still there

"We are Different"

Another more recent case which is indicative of governmental thinking was that of the choice of nuclear reactors for British power generation. After discounting the "not invented here" factor, one could hear and read all too frequently the view that the U.S. reactors were really designed for very different environmental and sociological conditions than existed in the U.K. and hence were not suitable. The concept that "we are different" is still very strong in both Europe and its individual countries, and probably becoming stonger, and is not something which can be ignored in the business of international exchange of technology

At the same time, there are examples in virtually all industries where the central research is used to develop something specific for a host country. One has only to look at the North Sea work to see how much technology is being developed centrally just for that operation, and the cost far exceeds what is being paid for it. European industry has benefitted considerably from developments in the fields of computers, elastomers, petroleum and chemical processing, machine tools, vehicles, etc., as a result of central research. Unfortunately, European governments have not been convinced that the cost ought not to be lower.

The final criticism which applies to all aspects of the multinational corporation business is that the control rests with a group of faceless nonnationals who have no responsibility to the host community and are outside its influence and control. Such a criticism is, I suggest, made by those who know little of what makes a business run, or who just want to make political points. If the multinational corporations had as their prime objective short-term profits and then getting out of the business, then the criticism would be justified. If, however, one looks at the record of the multinational corporations, there are very few cases of this happening. Usually they have been around a very long time, and in the majority of cases have continued to invest over many years — this to me is no short-term opportunism. Esso is supposed to be the classic multinational corporation, and yet we are the oldest oil company operating in the British Isles.

It is true that multinational corporations can decide to invest in one country rather than another, and if one analyzes the situation in which a company has decided to put more or new money into a particular country rather than another, the economic arguments have been overwhelming, and this comment applies equally to European MNCs as to any other nationality. Once, however, an investment has been made, then the company is very much under the influence of the local community who now have the power of their own laws and organizations. It has, therefore, been the exception where a MNC has pulled out and in those few exceptional cases it is almost invariably a national government sponsored company which has taken over and operated the company on a subsidized basis.

Sociological Arguments

There are, I appreciate, sociological arguments which could be used to balance the economic arguments of where investments are made, but whose responsibility are they? Most multinational corporations take their social responsibilities very seriously. In my experience in the U.K., the MNCs take their social responsibility quite often more seriously than the national companies. Because of the bias against them, they have to — it is enlightened self-preservation if you like. But is this social problem their prime responsibility, or does that rest with the government?

In Europe, as elsewhere, there is a lot of criticism and suspicion of multinational corporations. Most of the criticism is directed against the American multinational corporations because they are usually bigger and more obvious. Many European firms which are multinational corporations in their own right are not seen by the general European public as multinational corporations at all, and this emphasizes the American problem. Industry and business, and their objectives of making a profit, are not seen as very socially acceptable and therefore fair targets for criticism. The general socialistic trend throughout Europe, and the struggle for power between the bureaucrats of Brussels, the local governments, and the Trade Union movement, will both tend to emphasize and increase the criticism of the multinational corporations. Most of the criticism is, however, I suggest, due to ignorance — ignorance of what the multinational corporations do and how they do it. If the multinational corporations are going to destroy this ignorance and suspicion, particularly amongst the general public, then they are going to have to be freer and more open with information both to governments and the general public. Some companies are doing this more and more, but some are not. The suspicions in Europe are, however, quite deeply rooted and my concern is that some of the multinational corporations may have recognized their problems too late and be forced into actions which will benefit neither the multinational corporations nor Europe. Important bodies like the U.N. and the EEC and the national governments, need to develop policies which will allow multinational corporations to function, but in developing these policies I do hope that they will follow the advice of the International Chamber of Commerce and involve some people who really know how the multinational corporations work.