

The Role of Multinational Companies

A simplified view of multinationals and a plea for their continued existence and expansion

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There are many definitions of a multinational, but all such definitions have one thing in common. A multinational is a business enterprise in one country which owns a separate business entity in another country. In other words, it has subsidiaries in other countries. This definition may be refined further by requiring that the parent company have at least four or so subsidiaries in other countries. Some of the definitions require that the subsidiary be a manufacturing subsidiary rather than a sales subsidiary. Ownership may be sole or may be shared with local shareholders or with other companies.

134

Aside from the trading companies of the 17th and 18th centuries, the first multinational appears to have been a Belgium company which set up a textile machinery plant in Prussia in 1815. The first American multinational was in 1852. The number of multinationals has increased steadily ever since.

During the 1950s and 1960s, multinational corporations based primarily in the United States, Europe and Japan moved to center stage in the world's economic theater, bringing an unprecedented flow of investment capital and technology across national borders. The multinationals almost without exception grew faster than purely national companies thus providing proportionately more jobs and paying proportionately more taxes to both home and host governments. By the 1970s, multinationals accounted for about 25% of the world's production of goods and services.

Unique

The multinational is unique in its capacity for generating massive flows of technology, both hardware and software, between countries. In a world where economic aid and technical assistance programs are shrinking daily, the multinational in all likelihood will increase in importance as the agent of technology transfer to developing countries.

In the 1960s during the burgeoning growth of U. S.-based multinationals, it frequently was perceived that

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virtually all multinationals were of American origin. In fact, even today the greatest number of multinationals are American. Yet the trend is for U. S.-based multinationals to be challenged by competition in profitable product lines from non-U. S. multinational competitors. Japan, for example, will account for \$80 billion in direct foreign investment by 1985. Compare this with the \$150 billion in direct foreign investment by U. S. multinationals today.

Multinational corporations tend to be high-technology businesses and it is this technology which makes them competitive in the world markets.

Today, there are over 170 American firms with subsidiary operations in at least 15 countries. Many of these are well-known. Examples are:

- Mobil with 71 subsidiaries.
- Pfizer with 58 subsidiaries.
- IBM World Trade with 76 subsidiaries.
- Goodyear with 44 subsidiaries.
- 3M with 42 subsidiaries.
- IT&T with 41 subsidiaries.
- Eastman Kodak with 49 subsidiaries.
- DuPont with 27 subsidiaries.
- General Electric with 30 subsidiaries.

Why and how do domestic business enterprises evolve into true multinationalists?

There are inherent business fears involved in investing abroad. Equally, businessmen have reservations about transferring technology to foreign soil. Such a transfer might make that technology more accessible to foreign competitors. Setting up shop abroad is a difficult chore because of cultural, linguistic and legal settings which are alien to home country thinking.

Foreign affiliates, far from being masters of their own fate, operate as separate entities under the laws, regulations and political whims of host governments. The assets of a manufacturing subsidiary consist mainly of fixed plant, equipment, and trained people who are citizens of the host country. These assets are not portable. They cannot be packed up and returned to the home country.

Long Haul

Once investment is made in another country, it is viewed as being for the long haul and under the control of the host government. The role of the parent is that of a shareholder who owns perhaps most of the assets but in no sense controls them completely. Therefore, many managements would prefer to serve their growing markets outside of their home country with exports from their home plants. Their business guidelines require strong and compelling reasons for expanding into multinational companies. Yet many larger corpo-

rations do in fact evolve into multinationals and they prosper in doing so.

Tariff and nontariff trade barriers often are cited as reasons for going multinational. They effectively bar many exports from the home country to foreign markets. For example, French tariffs on many American imports are 20%. In addition, France (and other European countries) impose an uplift (percentage increase in import price) of 12% or more. In West Germany, certain imports bear a duty of 25% and in Brazil and other Latin American countries duties often are more than 50%. All of these costs are in addition to the cost of transportation, insurance and credit as the products move to the foreign country.

With such costs as the added to the sales price of the product, it is apparent that to establish a new market or even maintain an existing market, some other means must be found to avoid tariff barriers.

But not only tariff barriers restrict direct sales abroad; many countries prohibit imports of certain goods entirely. These either must be manufactured within the country or not be available at all. One distinct advantage to the multinational form of doing business is that the parent company can have more of a say in the sale and distribution of goods from an owned subsidiary than it can from an independent distributor or retailer.

Servicing products once sold and having a base for such servicing often are necessary in sales to foreign countries. Also, local customs and government standards in foreign countries may dictate a major modification in the products. It then is necessary to establish an office where local personnel are available to handle such matters.

Benefits

There are legal and tax benefits available from the establishment of a business operation in a foreign country. For example, both the host country and the parent country may treat dividends and royalty in a manner which is more beneficial to the parent company than direct sales. Another legal reason for establishing a subsidiary in a foreign country is the increased isolation of the parent company from the legal processes of the host country, as with parent-subsidiary relationships in the home country.

Lower wages are usually not a prime factor in determining whether to establish a subsidiary. Wages come into the picture primarily in those instances where the competition is severe, such as in the automobile industry.

In the classic or simple case, how does establishment of a foreign subsidiary come about and how does this involve the transfer of intellectual property from the parent company to the subsidiary? In a typical growth pattern, first a sales representative appears on the foreign scene with little more than a brief case containing information and order blanks for a limited number of products. Then a sales subsidiary is set up when sales increase and the country is served wholly by exports from the parent company.

When this is done, there is a certain amount of intellectual property being transferred. The parent company may train the salesman in the foreign country. It may apply its sales and marketing techniques to

the new market. A distribution center may be set up with inventory and financial controls. These involve the expertise of the parent company which it passes on to the local personnel of the subsidiary. The resulting increased sales mean increased jobs for the local citizens.

Many subsidiaries are manned almost entirely by citizens of the host country, even top management.

Better Service

When the volume of business grows significantly, the question arises whether the host country may be serviced better and cheaper by setting up a manufacturing subsidiary, maybe not all products, but for certain products, and this is not brought about solely because of tariff and nontariff barriers, but for reasons of competition and servicing in the new market. When a larger plant is built, capital must be secured and such capital most often is obtained from the parent company, particularly in the developing countries whose supply of such capital is limited or nonexistent. Building a new plant may involve valuable proprietary know-how of the parent company in both design and operation. Local personnel must be trained in purchasing, engineering and manufacturing. As the new plant goes on stream, handling of both raw materials and product must be carried out in an efficient and experienced manner, all of which may be supplied from the expertise and proprietary knowledge of the parent company.

Again, this is an example of the transfer of proprietary intellectual property. As manufacturing expands, the plant must be maintained and it may be updated with new technology and manufacturing procedures. All of these require training local personnel by the parent. Much of the information utilized in the plant operation is of a trade secret nature and not necessarily patentable. It is still further example of the transfer of intellectual property.

If the legal and political climate is right, the success of the subsidiary may lead to establishment of a local research and development laboratory, again with the training of local personnel, financing by the parent company and utilization of basic technology of the parent.

Costs

But what about costs, profits and taxes? Typically, for every dollar of sales, it costs about 75 cents for raw materials, wages, utility expense, office supplies, etc. Most of this may be spent in the host country. If patents and trade secrets are involved, five cents may go to the patent and trade secret owner in return for the transfer and use of his proprietary intellectual property. As in this case where the parent company is the owner for the patents and trade secrets, the royalty is paid to the parent company for the same reason it is paid to any technology owner who is licensing his technology. That leaves 20 cents profit. Half of this goes to the host country in the form of taxes. The remaining 10 cents is divided into two parts, five cents for retention by the foreign subsidiary for the expansion of the business and the remaining five cents goes to the parent company as return on its risk investment for

building the plant and helping manage the subsidiary. Thus, out of every dollar of sales by the subsidiary, 90 cents often is retained in the host country and ten cents goes to the home country. Also don't forget the taxes by the host country on wages to the local employees and taxes by the home country on the dividends received by the parent company.

This is the saga of intellectual property transfer from the parent company in one country to a subsidiary company in another country.

What then are the benefits to the multinational as a result of, in effect, losing some of its control and transferring intellectual property as above described to a foreign country subject to unfamiliar laws and politics? These benefits include new markets for established products with new sales and new profits, and expanding the current market with better or lower pricing.

The parent company also finds in the host country a new source of technical and management personnel who when trained may then rise in the ranks of the subsidiary or in some cases be transferred to the home office or another subsidiary. There is another basic benefit to the multinational which is the same as in the case of conducting business in the home country. That is the establishment of a plant or subsidiary close to the raw material source or to the marketplace, which reduces the cost of transportation. The parent company also has increased its sensitivity to the needs of the host country, and therefore can do a better job of selling and supplying a more competitive product.

Equally important, are the benefits to the host country. The subsidiary is a new source of jobs and a new source of tax revenue for the host government. It puts money into the hands of the local people which is passed along in the local economy. After the parent company brings into the affiliate many of the benefits it provides its home employees, such as health insurance, disability insurance, pension plans and stock options. Often, it raises the education level of the employees. The result is a higher standard of living and lifestyle of the host country.

Manufacturing Subsidiary

A manufacturing subsidiary offers even greater benefits because the parent company provides a source of capital investment that perhaps was not available in the local area or in the host country, as well as valuable know-how, without which no business at all could have been started. It decreases imports to the host country and in many ways increases exports, thus greatly improving the balance of payments so troublesome to many countries. When manufacturing and laboratory facilities are established, it provided technical training to host country people employed, by again raising the level of skill of the host country people.

Not all benefits can be measured with numbers, however. When, for example, a plant is established in an economically-depressed area or a developing country, some of the local unemployed may be hired. For example, a former coal miner may be hired in the docking area of the plant. He soon becomes a factory worker and later a foreman. Finally he raises in the

ranks to a company manager. All of this enables him to buy a home, have a car and even send his children to college. He is an example of many whose lives are changed as a result of the multinational presence. How can you measure that, or how can you measure the effects of the payroll dollars magnified many times as they travel through the community?

In a world of 4 billion people, the need for world economic development is imperative. Some 500 million people are undernourished. About 800 million adults cannot read or write. Some 1.5 billion people do not have medical care. Over 1 billion human beings have inadequate housing and 1.3 billion have incomes less than \$90/year. The magnitude of the economic problems of the world are such that even if all the personal income in the U.S. in 1979 were redistributed to the rest of the world each person outside of the U.S. in the world would receive only \$421. The solution, therefore, cannot be limited to more equal distribution of existing resources. More wealth must be created and one way to create wealth while improving the welfare of the underprivileged of the world, is through the multinational.

Self-Sufficiency

Today, no country is completely self-sufficient, nor will any be tomorrow. The multinationals relate to the lack of national self-sufficiency because they achieve access to markets, raw materials, and supplies the world over. As time passes, multinationals undoubtedly will relate in more meaningful fashion to the needs of the developing countries.

The multinational is perhaps the only organization that will be capable of generating massive flows of technology and capital to the developing countries in a world which is becoming more and more interdependent. The multinational will, in all likelihood, be the main source of technology transfer to developing nations because only the multinational can afford today's high cost of development of product and know-how, marketing and large-scale distribution, and understanding and meeting governmental regulations worldwide, all of which are intellectual property. Is it reasonable to expect individuals, small businesses or even governments to afford such high cost, even if they had the manpower and experience?

In light of all this, it is difficult to understand why many potential host countries erect artificial barriers to this type of intellectual property transfer. For example, such barriers as majority local ownership being required, trade secrets not being protected after a short term, royalties not being permitted, and dividends having to be retained in the host country.

Even though some countries grant tax incentives, these are normally of minor benefit to the multinational because without tax credit the tax is paid to the home country. Perhaps this is the result of suspicion and misunderstanding due to differences in religious and cultural background. But reason must prevail if there is to be any chance for the poor and underprivileged of the developing world to share in the wealth of the developed world and to create wealth and technology on their own.