CHAPTER 1

Multinational Corporations - An Introduction

1. Multinational Corporations and the World Economy

One of the most important economic phenomena since the World War II era has been the emergence of multinational corporations (MNCs). The MNCs are the most important actors in the world economy. They are large companies that transcend national boundaries. Many large MNCs have annual sales which exceed the entire GNPs of the countries in which they operate. It has been estimated that in 1980 the largest 6 MNCs (Exxon, Mobil, General Motors, Texaco, Standard Oil and Ford), had annual sales which exceeded the GNPs of many developed countries including Australia, Canada, Belgium, Sweden, and Switzerland. In fact, the largest multinational Exxon, alone had annual sales in excess of $110 billion, surpassing the GNP of countries like Norway, Belgium and Switzerland. The data for 1985 show that the largest 50 MNCs had sales ranging between $13 billion and $97 billion (See Appendix - I). The largest 600 MNCs accounted for between one-fifth and one-fourth of the world output. The rate of growth of output of MNCs is currently expanding at a rate of more than 10% per annum, which is higher than the rates of growth of world output and world exports. Moreover, since the MNCs
are concentrated in technologically-advanced and fast growing industries, their share in the world output is likely to increase in the future. The predictions based on these trends indicate that by the end of the present century, the largest 200 or 300 MNCs will account for one half of the total world output.⁴

The role of MNCs as exporters and importers is no less significant. For instance, about 80 and 90% of the exports of both the United States and the United Kingdom is associated with the MNCs. The MNCs also play a major role in the international capital flows. Multinational banks and other non-financial companies account for the majority of international lending. And, more importantly, the MNCs account for the bulk of foreign direct investment (FDI), which is the most important manifestation of the process of multinationalisation.⁵ In fact, FDI is regarded as a good measure of investment abroad by the MNCs, and hence the terms FDI and MNCs are generally used synonymously in the literature. FDI, unlike commercial banks lending, provides finances as a part of a package of technology and management which can increase the productivity of capital. Thus, the financial value of FDI generally understates its overall benefits to the host countries.

2. Growth and Expansion of MNCs

Growth and expansion have been the key characteristics of
the MNCs. The MNCs have continued to expand in the period since 1960. The global stock of FDI, which is used as an approximate index of their expansion, increased in terms of current US dollars from $67.7 billion in 1960 to $713.5 billion in 1985. Table 1.1 presents the stocks of FDI abroad by major home country and region for the period 1960-1985.

Table 1.1 shows the declining importance of MNCs from the United States as foreign investors and increasing importance of MNCs from Western Europe and Japan. The United States, which accounted for almost half (47.1%) of the global stock of FDI in 1960 declined in importance to about one-third (35.1%) in 1985. By contrast, during the same period Japan, Canada and almost all the Western European countries increased their share in the global stock of FDI. The big gainers have been Japan and the Federal Republic of Germany. The MNCs from these two countries had relatively small amounts of FDI in 1960 as both countries were still recovering from the shocks of Second World War. Since then the MNCs from these countries have become increasingly important foreign investors. The emergence of Japan as a major exporter of capital can be attributed to its technological and industrial eminence and its dominant position as exporter of goods and services.

The MNCs from the developing countries have tended to
increase their small share of global stock of FDI from 1.0% in 1960 to 2.7% in 1985.

Table 1.1: Outward Stocks of Foreign Direct Investment, by Major Home Country and Region, 1960-1985.

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<tr>
<td>Developed Countries</td>
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<tr>
<td>United States</td>
<td>31.9</td>
<td>47.1</td>
<td>6.2</td>
<td>124.2</td>
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<tr>
<td>United Kingdom</td>
<td>12.4</td>
<td>18.3</td>
<td>17.4</td>
<td>87.0</td>
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<tr>
<td>Japan</td>
<td>0.5</td>
<td>0.7</td>
<td>11.1</td>
<td>15.9</td>
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<tr>
<td>Germany (FRG)</td>
<td>0.8</td>
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<td>11.1</td>
<td>18.9</td>
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<tr>
<td>Switzerland</td>
<td>2.3</td>
<td>3.4</td>
<td>26.9</td>
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<td>Netherlands</td>
<td>7.0</td>
<td>10.3</td>
<td>60.6</td>
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<tr>
<td>Canada</td>
<td>2.5</td>
<td>3.7</td>
<td>6.3</td>
<td>10.4</td>
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<tr>
<td>France</td>
<td>4.1</td>
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<td>Italy</td>
<td>1.1</td>
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<td>Sweden</td>
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<tr>
<td>Other</td>
<td>4.0</td>
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<td>3.1</td>
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<tr>
<td>Developing Countries</td>
<td>0.7</td>
<td>1.0</td>
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<td>6.6</td>
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<td>Centrally Planned Economies of Europe</td>
<td>-</td>
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<tr>
<td>Total</td>
<td>67.7</td>
<td>100.0</td>
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<td>282.0</td>
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As regards the MNCs from the socialist countries, no precise data are available. One rough estimate for 1983 places the value of stocks of FDI owned by the MNCs from these countries at $1 billion. Although the figure is likely to be an underestimation, yet it only accounts for less than 0.2% of the global stock of FDI.

3. **Historical Evolution of MNCs**

The roots of present day MNCs lie deep in history. Banking has been conducted on international lines since the middle ages. Some authors trace the origins of international trading companies back to Mesopotamians. In England the corporate form of organisation was recognised as early as 12th century. In the early stages of the evolution of modern capitalism, the most important corporations were boroughs, guilds and other ecclesiastical bodies, which obtained royal charter for trading purposes.

The true forerunners of present-day MNCs however, were not the boroughs, guilds or other ecclesiastical bodies but the great trading companies of the 17th and the 18th centuries from the Great Britain, the United States and other European countries, like the East India Company the Hudson Bay Company, the Royal African Company, etc. Most of these colonial companies were essentially trading rather than manufacturing organisations (like East India Company). But gradually they started governing the lines
of their producers. Since they brought with them their own armies and religious missionaries, they also came to exercise control over the colonial territories.

The next phase in the development of MNCs began with the industrial revolution in the early 19th century. With the progress of industrial revolution and the immense shift from agriculture to industry in Europe and America, there was felt a need for a more effective way to form corporations than by special legislative charter. The industrial revolution required the flexibility of the corporation on a totally new scale. A new legal framework based on the concept of limited liability was needed to facilitate the development of the risky modern technological economy spawned by the industrial revolution. An important consequence of the industrial revolution was the emergence of industrial organisations. The pattern of production substantially increased the variety and the volume of manufactured goods coming out of factories, thereby widening the scope for employment and increased demand for goods. As the output from the factories increased rapidly, there arose a need for the development of exports. The outlet to exports already existed in the charters issued to the great trading companies mentioned above. These companies had trade establishments in several parts of the world and had some of the characteristics of modern MNCs.
The MNCs as they are understood today, came into being in the second half of the 19th century when businessmen in one country began to establish production facilities in other countries. They were motivated by the prospects of new markets, lower production and distribution costs, the need for raw materials, higher import duties, exploitation of patents and for reasons of competitive strategy.\textsuperscript{10} The improvement in transportation and communications through the development of steamship, railways and telegraph helped a great deal in this regard. Consequently, the forerunners of today’s MNCs began to expand beyond their home countries in significant numbers. Among the pioneers were, Friedrich Bayer, a German who took a share in an aniline plant in Albany in New York in 1865; Alfred Nobel the famous Swede, who set up an explosive plant in Hamburg in 1866, the US Singer Sewing Machine Company, which established its first overseas factory in Glasgow in 1867. According to Tugendhat\textsuperscript{11}, Singer Company has the strongest claim to be regarded as the first multinational corporation "because it was the first company to manufacture and to mass-market a product in basically the same form and bearing the same name across the world".

During the early 20th century, substantial multinational investment went into mining and petroleum industries. Large oil companies such as British Petroleum and Standard oil were the first multinationals in this area and other
mineral corporations, such as Anaconda Copper and International Nickel, followed quickly. Multinational investment got a boost following World War I, when protectionist policies of nation states spurred firms to jump the trade barrier raised by the nation states by replacing exports with foreign production. Gradually, manufacturing and merchandising multinationals much as Unilever/Lever Brothers, Nestle, Coca Cola, International Harvester, Singer, Phillips N.V., Woolworth, Imperial Chemical Industries, Ford Motor Company, Texas Instruments, etc. and other German Drug and Chemical firms, e.g. began operating on a world-wide basis. American multinational investment moved extensively to Canada, Europe and Central & South America, and to the Middle East for oil.

During the inter-war period, as the companies continued to expand their international interests, they soon colluded with one another, thereby giving rise to international cartels. Although cartels existed in many countries but in the inter-war period conditions were particularly ripe for their development on an international scale. Adam Smith, the Father of Economics, pointed out in the 18th century that the businessmen had an instinctive preference for curtailing competition rather than intensifying it. Such agreements, by restricting international competition, made it possible for the giant industries to grow in strength. One such cartel involved the British Imperial
Chemical Industries, the US Du Pont and Allied Chemicals and the German I.G. Farben. These cartels were, however, short-lived because they lacked a unifying structure within which to enforce the agreements among themselves. The World Wars’ damages in Europe also contributed to their demise. Despite all their weaknesses, such cartels were an important step in the evolution of modern MNCs. They imparted industrialists a training in international cooperation and also gave them an understanding of national differences and of the need to modify business practices. Instead of thinking primarily in terms of supplying their home markets and exporting surpluses, they became accustomed to approaching the problems of their industries on a world-wide basis. These lessons were of a great help in the changed conditions of the post-war world, especially to Americans.13

The period since the Second World War is that of a complete transformation from the situation prevailing between the wars. It has witnessed an explosive expansion of FDI led initially by Americans. In 1960, the global stock of FDI stood at $ 67.7 billion. This figure rose to $ 713.5 billion in 1985.14 This FDI by the MNCs is producing annually an output which is in excess of the GNP of all countries except the United States, and it is this output, growing at a rate of more than 10% per annum and faster than most national growth, that is revolutionizing
the world economy.\textsuperscript{15}

Thus, the phenomenon of multinational corporations is not new. What is relatively new, however, is the magnitude of the multinational corporations and the extent to which their international operations have become interwoven from technical, managerial, financial, accounting and personnel points of view. The modern multinational corporations are based not on just trading. They try to optimize their international production and marketing, generally by the use of trade marks and patents. This is one of the most significant structural changes in the history of international economic institutions and economic order.\textsuperscript{16}

4. Definition of MNCs

Generally, the term 'multinational corporation' is understood to mean a company or an enterprise operating in a number of countries and having production or service facilities outside the country of its origin. However, it is important to note that a firm that has some operation abroad is not necessarily a multinational corporation, but in essence we can say that a firm is a multinational if it has committed a substantial portion of its financial, human, marketing, technological, and productive resources to the activities abroad. According to Raymond Vernon\textsuperscript{17}, the term multinational corporation is confusing and imprecise, but that it always refers to cluster of corporations of diverse nationality joined by ties of
common ownership and responsive to common management strategy.

The term 'multinational corporation' was first used by David E. Lilienthal in a paper delivered before a symposium on 'Management and Corporations, 1985' at the Graduate School of Industrial Administration of the Carnegie Institute of Technology in April, 1960. He defined MNCs as, "corporations which have their home in one country but operate and live under the laws and customs of other countries as well". To Lilienthal, therefore, multinational simply meant a firm operating in more than one country. He hardly elaborated on the definition, or explained what types of operations should be included, or in how many countries a corporation should operate to qualify as multinational. He, however made it pretty clear that by operating he particularly meant industrial or commercial operations abroad which directly involve managerial responsibility.

Since then a number of definitions of MNCs have been given. These definitions are based on one or more of the following criteria: behaviour, structure or performance. The definitions on the behavioural criteria account for such features, whether the firm thinks internationally in terms of its investment decisions, considering the world as a large market. The definitions using the structural criteria are based on such factors as
the number of countries in which the firm is operating and the degree of ownership therein. The definitions on the performance criteria are based on some performance features like assets or sales.

The behavioural school of thought conceives a multinational firm as one whose 'top management' "thinks internationally". Thus, according to Peter Drucker\textsuperscript{21}, a multinational firm is one "whose corporate headquarters are in one country but organisation, business and scope are sufficiently world-wide ... Corporate top management is not concerned with any one region or territory ... an international business demands of its management people that they think and act as international businessmen in a world in which national passions are as strong as ever". A multinational firm, therefore, is a firm whose top management thinks internationally and weighs alternative investment possibilities on a world-wide basis.

Although the definition of a multinational corporation on the basis of a behavioural criterion has a strong intuitive appeal, yet it is beset with difficulties. Apart from defining "top management", it is almost impossible to ascertain what exactly do we mean by "thinking internationally" or "the world as a large market". The business world is so complex that very little is known about how decisions are made in big organisations, or what variables are taken into account, or what information
is available to the decision-makers.

According to the structural school as exemplified by David Lilienthal, "a multinational enterprise is an enterprise that is home-based in one country but exists and operates under the laws and customs of other countries as well."\(^2^2\) Another concept based on the structural considerations emphasizes the ownership and not the operations of a company. Oliver Giscard d'Estaing\(^2^3\) defines a multinational firm as "a firm owned by persons from many nations". For example, Unilever/Lever Brothers is a firm whose ownership is distributed over many countries. Unilever and other such firms not only have sale, manufacturing, R & D in many countries, but their managers and executives are also drawn from many countries without regard to nationality. Jack Behrman\(^2^4\) conceives the 'area of control and the integration of operations of the affiliates' as the significant features of a multinational enterprise. He stresses the fact that the essence of the multinational enterprise is that it attempts to treat various national markets as though they were one - to extent permitted by government atleast. George A. Steiner\(^2^5\) defines multinational corporation as a company which meets at least two criteria:

(i) that it does business in two or more countries in such volume that its well-being and growth rest in more than one country; and
(ii) that its management makes decisions on the basis of multinational alternatives.

The definitions based on the ownership concept of the structural criteria are also faced with difficulties. For example, it is a well-known fact that in large business corporations 'ownership' is not synonymous with 'control'. The analysis of the ownership of corporations gives us very little information about the distribution of power, authority, or decision-centers within the corporation.

The performance school defines a firm as multinational according to some performance characteristics, such as earnings, sales or assets and the number of employees. These characteristics are sometimes advocated as absolute and sometimes relative. The absolute measure will classify a corporation as multinational if it has committed a certain amount of resources to foreign operations. The relative measure asserts that a firm is multinational if it has committed a significant part of its financial, technological, and human resources to its activities abroad. Intuitively, the definition of performance on a relative basis is more appealing than the one based on absolute measure. Thus, based on the performance criteria, Bruck and Lees define a multinational corporation as, "any company having 50% of either sales, earnings, assets or employment from abroad".
According to Business International\textsuperscript{28}, "a firm is multinational when foreign operations account for at least 35\% of its total sales and profits". MacDonald and Parker\textsuperscript{29} consider a firm to be multinational if 20\% of its assets are overseas.

The definitions based on performance criteria suffer from conceptual as well as measurement difficulties. For example, what should be included in sales? How should earnings be measured?

Apart from the definitions based on the above criteria, certain authors have given classification of MNCs. For an interesting classification of the multinational corporation, we may refer to Howard V. Perlmutter\textsuperscript{30}, who identified three primary attitudes among international executives toward building a multinational corporation. He labelled such companies as ethnocentric (or home country-oriented), ploycentric (or host country-oriented) and geocentric (or world-oriented).

(i) An ethnocentric attitude is one in which anything domestic is considered the best in the world. This includes managerial personnel, techniques of management, and products.

(ii) A polycentric attitude is one that stresses the vast differences between the nationals of different countries due to the differences in culture, language, religion and
race. Because of these great differences, it is impossible for home country nationals to really understand the foreign environments. Local people know what is best for them, and the part of the firm which is located in the host country should be as 'local in identity' as possible.31

(iii) A goecentric attitude is one that is world-oriented, Managers, both at the headquarters and in the subsidiaries abroad, are in close communication with each other and are aware of the objectives of the entire enterprise. They do not equate superiority with nationality, and, within legal and political limits, seek the best men, regardless of nationality. Perlumutter argues that only these enterprises which fully integrate their global activities and have a goecentric outlook can be considered as truly multinational.

This classification, however, suffers from an oversimplification because the orientation test is not capable of application in the absence of data regarding the interests involved in corporate decision making.

Thus there is no general consensus over the definition of the term multinational corporation. Consequently, the multinational corporation means different things to different people, while different phenomena are called by the same name.32 The United Nations Secretariat33 defines MNCs broadly to cover "all enterprises which control
assets - factories, mines, sales offices and the like - in two or more countries. An important implication of the present definition is that the MNCs are responsible for bulk of FDI abroad. We shall adhere to this definition for our purposes. The terms 'corporation', 'firm' or 'enterprises' are generally used synonymously in the literature. We also make no specific distinction among them, though we would prefer the term 'multinational' to others. A foreign branch is a part of an enterprise that operates abroad. An affiliate is also a part of an enterprise that operates abroad, either in the form of a subsidiary with majority or sometimes as little as 25% control of the voting stock by the parent or in the form of an associate, in which case as little as 10% of voting stock may be judged adequate to satisfy the criterion.

Following Dunning, the activities of MNCs can be classified on the basis of three broad considerations: (a) Backward vertical operations, (b) Forward vertical operations and (c) Horizontal operations.

Backward vertical or cost oriented operations represent the extension of purchasing strategies of the investing firms. These are undertaken primarily to obtain unhindered, cheaper and more reliable supplies of raw materials or processed inputs for the investing company. The arrangements of this type are mainly present in firms engaged in extractive industries.
Forward vertical or market-oriented operations represent the extension of the sales strategies of the investing firms. The primary functions of these firms are to advance or protect their markets or supply points so as to ensure stable domestic production. Firms engaged in large export business are interested in evolving such strategies.

Horizontal operations largely comprise foreign manufacturing activities of MNCs which may or may not be harmonised with each other or with domestic activities. According to Dunning, it is the type of operation which is presently attracting the greatest attraction of both host and the home countries. Although these operations are variously defined, yet the most useful division is between high technology and intermediate technology investments.

5. Recent Trends in the Operations of MNCs

Some recent trends in the operations of MNCs may be noted here.

(A) Growth of non-equity arrangements:- The slowdown in the growth of FDI in the developing countries since the mid-1970s can be explained by the expansion of the use of a variety of non-equity arrangements by the MNCs, which assume many of the characteristics of FDI.¹⁶ Non-equity arrangements include a broad, heterogeneous range of business operations where MNCs supply goods and services for investment projects or enterprises in host countries.
In contrast to FDI, the MNC is not the sole or majority owner of the project or enterprise, and in fact, may make no equity contribution. Sometimes referred to as 'new forms of foreign participation', these non-equity forms of arrangements include joint ventures, licensing, management contracts, franchising, turnkey operations, international subcontracting and a number of other contractual arrangements. Joint ventures, which generally involve two or more parties contributing to the equity and other assets of an enterprise, are an increasingly important alternative means of association with foreign enterprises, particularly in the developing countries. Although they usually call for equity participation, they are frequently included in the discussion of non-equity arrangements. The other forms of non-equity arrangements are more akin to sales transaction than to investment, since they usually do not involve a long-term ownership interest by one entity in another.

The deteriorating economic conditions and greater instability of most developing countries have had an important impact on the strategy of the MNCs. Many MNCs feel they can earn lucarative returns from certain tangible or intangible assets which they can supply to the investment projects without either financing or owning these projects. By supplying essential assets via non-equity arrangements, they can still benefit from the leverage that those assets confer, even when local
Partners or international lenders absorb start up costs and provide working capital. More importantly, these arrangements often mean reduced exposure to the commercial and political risks that are generally associated with FDI.

(B) The Growing Importance of Services: A major change during the recent years has been a substantial shift in the composition of both the stock and flows of FDI towards services. FDI during the 1950s was primarily concentrated in raw materials, other primary products and resource-based manufacturing. Today, it is mainly in technology-intensive manufacturing and services. By the mid-1980s, about 40% of the global stock of FDI was in services, compared to about one-quarter in early 1970s and less than one-fifth in early 1950s. The data for the annual flows of FDI show that during the first half of 1980s, more than half of the flows were in services. The most important sectors were finance and trade-related services although FDI in other services such as accounting, advertising and transportation, was also substantial. Overall, the importance of services is on the increase.

The growth of FDI in services has been particularly marked in the developed countries, turning the United States into the largest host country for FDI during the early 1980s. The recent data on FDI flows show that the developing countries are now participating to an almost equal degree
in the international expansion of service industries. However, a large part of FDI flows to the developing countries represents investments in offshore financial centers, especially in the Bahamas, Bermuda, the Cayman Islands, the Netherland Antilles and Panama.

(C) MNCs from the Developing Countries:— Another recent trend in the operations of the MNCs is the emergence of MNCs from the developing countries. While they are the recipients of large volume of FDI, the developing countries are a source of only a small part of the global stock of FDI, amounting to 2.7% in 1985. This shows a marked increase over 1% recorded in 1960. The real rise of these MNCs did not occur till the late 1960s and since early 1970s the rise has been rather rapid. By 1980, they numbered 968 with 1964 subsidiaries and were spread over 125 countries around the world.

The MNCs from the developing countries come primarily from the more industrialized developing countries of South and South East Asia and Latin America, the so called 'Newly Industrializing Countries' (NICs). The notable among them being Hong Kong, Brazil, Mexico, and the Republic of Korea. However, in recent years a handful of OPEC countries and other countries of Latin America and Asia are other major sources of ownership. Among the South Asian countries, India has emerged as a great exporter of capital. By 1982, Indian joint ventures abroad (JVAs) were
operating in 40 countries throughout the world.\textsuperscript{42}

Manufacturing constitutes the main sector where the MNCs from the developing countries have placed their investment in other developing countries. Over 55\% of their investment is in this sector, followed by 30\% in services and finance, although there are structural variations in individual countries. For example, manufacturing accounts for as high as 80\% in case of Taiwan and as low as 10\% in case of the Republic of Korea.

The MNCs from the developing countries tend to invest in other developing countries, though a handful of investment also goes to the developed world, mainly in service activities such as export marketing, banking, restaurants, etc. Most of the Indian JVAs are concentrated in a few countries like Kenya, Nigeria, Thailand, Singapore, Commonwealth of Independent States (CIS countries), Indonesia and Malaysia.\textsuperscript{43}

One important point in favour of these MNCs from the developing countries is that they transfer technologies better adapted to the relative factors costs in developing countries, and thus, offer certain advantages to other developing countries.

In general, one can regard this phenomenon of the emergence of MNCs from the developing countries as a form of south-south economic relations. In this context, they
are being considered as promising instruments for promoting economic and technical co-operation for achieving common developmental goals.44

(D) Enterprises from the Socialist Countries:— Another trend has been the emergence of a number of enterprises from the socialist countries as an important form of economic and industrial co-operation since 1970s. These enterprises operate mostly in the developed market economies through inter-governmental agreements. The recent data show that by 1985 these enterprises had established some 590 branches, subsidiaries and affiliates abroad. Of these, 418 were in developed countries and 172 in the developing countries.45

The geographical distribution of equity ventures of these countries is closely linked to the geographical distribution of their exports. Among the developed countries, the countries constituting European Economic Community (EEC) dominate the scene. Africa accounts for nearly two-fifths of the total in the developing countries.

The sectoral distribution of equity ventures from these socialist countries suggests a different pattern for developed and developing countries. In developed countries, a majority of these equity ventures are in the service sector, especially marketing. In fact, the trading
firms are the single largest group of affiliates in the developed countries which help in establishing a foreign marketing infrastructure to promote the exports of goods and services produced in the socialist countries. In developing countries the equity ventures are more evenly distributed between production and services.

The trade-supporting character of most of these equity ventures from socialist countries can be explained by a special institutional factor. In all these countries, foreign trade organizations (FTOs) have been established which are the only firms permitted to engage in foreign trade and, hence, in the bulk of economic activities abroad.46

6. Multinational Corporations and the Underdeveloped Countries

Economic growth in the present century has been to a large extent the result of the technological explosion, the development of management systems which permit increasingly effective mobilization and utilization of human and other resources and of new skills of marketing and world-wide distribution. Constantly developing technology, management systems, and distribution skills are the major assets of MNCs. It is therefore understandable that developing countries turn to MNCs for some of the inputs needed for accelerated economic growth. Many underdeveloped countries have offered special
inducements to attract MNCs in the form of tax holidays, protective tariffs or export and other subsidies. Although underdeveloped countries have received about a quarter of the estimated book value of the global stock of FDI, yet the presence of foreign MNCs in these economies is generally of much greater significance relative to the size of their economies.

While the importance of MNCs in economic development is acknowledged by most underdeveloped countries, it is equally recognized that their role in the development process is usually a limited one. In fact the role of the MNCs in underdeveloped countries has become the most fiercely debated issue in recent years. There is, at present, hardly any subject in the literature on MNCs which arouses so much controversy and such a variety of interpretation. The analysis of the phenomenon of FDI through the MNCs has been undertaken by schools which represent every shade of political and economic belief.47 The 'pro-foreign investment group' includes the Business School (Robbins and Stobaugh), the Traditional Economic School (Kindleberger and Vernon) and the Neo-traditionalist School (Goldberger, Behrman and Bannock). These schools recognize the moral and practical virtues of the free enterprise system and conclude unequivocally that FDI has positive significant impact on economic development of the host underdeveloped countries. The main
arguments of these schools are summarised as follows:

(i) the capital funds brought in by the MNCs bridge the foreign exchange gap and also contribute to filling up a resource gap between locally available savings and the desired investment;

(ii) the technology is very poorly developed in the underdeveloped countries which acts as a constraint in their economic development. In this context, the MNCs are recognized as the most effective instrument for diffusion of technology to the host UDCs;

(iii) by establishing their production facilities in the host UDCs the MNCs are said to generate not only additional employment but also train personnel both at the technical and the managerial levels through their better technical and managerial skills;

(iv) the MNCs tend to substitute imports and act as effective instruments of foreign exchange earnings by way of exports; and

(v) the MNCs benefit consumers by making available cheap and better quality products.

In the 'anti-foreign investment group' are included the Nationalist School (Streeten and Lall), the Dependence School (Dos Santos, Sunkel, Hymer) and the Marxist School (Baran, Sweezy, Magdoff). These schools strongly condemn
the MNCs for their deleterious impact on the economies of the host UDCs, such as suppression of domestic entrepreneurship, the import of unsuitable technology, the extension of oligopolistic practices (which includes unnecessary product differentiation, heavy advertising or excess profit taking) and the worsening of income distribution by a self perpetuating process which simultaneously reinforces high-income elites and provides them with expensive consumer goods. These schools (particularly the Marxist School) regard the emergence of the MNCs in UDCs as a revival of colonialism in a new guise viz. 'neo-colonialism', and a potential threat to the national sovereignty. These Schools, therefore, emphasize the need for rigorous controls on the activities of the MNCs. The views of these schools have been corroborated by the findings of the 'Group of Eminent Persons' appointed by the United Nations to study the impact of MNCs on the development process and on international relations. The Group submitted its report in 1974 alongwith its recommendations. It recognises the ability of the MNCs to tap financial, physical and human resources around the world and to combine them in economically feasible and commercially profitable activities, together with their capacity to develop and apply new technology and skills, to translate resources into output and to integrate product and financial markets throughout the world. However, the findings of the
Group reveal that their activities are not per se geared to the goals of development. Therefore, the Group observes, that the limitations as well as the capabilities of the MNCs in meeting development objectives need to be clearly understood.

Thus, just as the MNCs can be effective agents of development they can, at the same time, act as potential sources of exploitation, conflict and tension. Fundamental new problems have arisen as a direct result of the growing internationalization of production as carried out by the MNCs. However, the solution lies in not doing away with the MNCs altogether, because the MNCs possess enormous resources—financial, technical and managerial—which the underdeveloped countries are in dire need of for accelerating their process of development. Therefore, there is need to regulate the activities of the MNCs in these countries. But generally the underdeveloped countries feel that their bargaining position in dealing with MNCs is weak. Various attempts have been made to control the activities of the MNCs at the national as well as regional levels, such as the Foreign Exchange Regulating Act (FERA), 1973 and the Companies Act, 1956 in case of India and the ‘Andean Pact’ in case of Latin American Countries. There is also an urgent need to evolve a code of conduct for the MNCs at the international level. In this context some permanent machinery within the United Nations is necessary. This will not only enhance
the bargaining power of the underdeveloped countries but also help them in securing the cooperation of the MNCs on far better terms. The activities of the MNCs, if properly controlled, can go a long way in accelerating the process of economic development of the host underdeveloped countries.

7. Aims and Objectives of the Study

The growing disparity between the developed and the developing countries has once again aroused interest in the debate about the relative importance of international financial flows whereby the developed countries can help the developing countries in both achieving a reasonable and self-sustained growth and also from preventing the widening gap between the North and the South from widening further. The renewed interest in the debate was the focus of attention at the International Meeting on Cooperation and Development, also known as the North-South Dialogue, held at Cancun, Mexico in 1981. There the developing countries claimed that a massive inflow of foreign aid from the North was needed to stimulate more rapid economic development and eradicate widespread poverty in the South. Some advanced countries, especially the United States, rejected this claim and argued that massive increase in foreign aid was neither practical nor the best means of ensuring continuing and reasonable growth in the developing countries. Rather the emphasis should be on
self-help and well-functioning market mechanisms and on the inflows of foreign direct investment (FDI). In recent years, the virtual collapse of other forms of international financial flows such as aid and credit, has meant a renewal of attention on FDI as a channel of international transfer of resources. According to the first World Investment Report brought out by the UN Centre for Transnational Corporations, the FDI has emerged as the single most important international flow in recent years, increasing far more rapidly than world trade and world output. Behind this new development, of course, lie more fundamental questions, for example, what should be the role of multinational corporations (MNCs) in the developing countries as they constitute the main source of FDI? Can the transfer of technology and the inflow of investment by the MNCs help reduce the economic gap between the developed and the developing countries? These questions are of fundamental importance and have far-reaching implications, not only for the economic questions under consideration, but also for the social and political well-being of the developing countries, or for that matter, the world at large. In this study, we wish to address ourselves to these fundamental questions, though with reference to a large developing country like India. Broadly speaking, the present study aims at evaluating the impact of the MNCs on the economies of the underdeveloped
countries with particular reference to India. By the term 'impact' we shall mean effect on growth. In other words, given the controversial role of foreign investment in the development process, the present study seeks to examine in detail what role the MNCs are playing in these countries in increasing their rates of growth so as to bring them on the path of self-sustained growth, of course, with reference to a large developing country like India. As has already been stated in the beginning of this chapter, we shall treat MNCs and FDI as synonymous. A great merit of FDI is that it not only brings capital but also technology. It is this FDI which, by bridging the dual gap of saving and investment and foreign exchange, can act as a potential source of economic development in India. It is against this background that we wish to undertake this study.

The present study is essentially a time series study, using data for a 25-year period, from 1955-56 to 1979-80. The choice of the time period is quite in line with the availability of data. In contrast to the 'project level approach', which aims at appraising the contribution of individual investment proposals to the aims of economic policy, the present study, on the impact of FDI, makes use of what is called 'aggregate overall approach' within the framework of a macroeconomic model. The latter approach is useful for a more general appraisal of the FDI on the economies of underdeveloped countries. More precisely,
following the approach of Kraska and Taira (1974), the present study proposes to examine empirically:

(i) the impact of FDI on the Indian economy through its effect on the macroeconomic indicators of development like the growth rate of GNP and the saving rate. For this purpose, the study seeks to specify and estimate a simultaneous equations model in which growth and savings are jointly determined.

(ii) the determinants of FDI in the Indian economy. The available empirical studies on the determinants of FDI in the developing countries show that FDI is determined simultaneously by economic as well as political variables. For this purpose, the study seeks to specify and estimate a single equation politico-economic model involving a complex set of economic and political variables which influence the flow of FDI in an economy.

For purposes of the estimation of the models, the study will make use of such econometric techniques as Ordinary Least Squares (OLS) and Two-stage Least Squares (2SLS).

8. Chapter Scheme

The whole of the study is divided into seven chapters. Besides this introductory chapter, which contains a brief introduction to MNCs, their definition, historical perspective, their role in underdeveloped countries and
aims and objectives of our study, there are six other chapters. Chapters 2 focuses on the role of FDI in the developing countries, its stocks and flows in these countries and its sources and the pattern of its sectoral distribution. Chapter 3 is concerned with the MNCs and the Indian economy. Besides touching upon briefly on role of FDI in the pre-independence period, it will critically examine Indian Government’s approach to FDI in the post-independence era, the salient features of FDI in India, the nature and pattern of FDI in India and industry-wise distribution of Branches and Foreign controlled rupee companies (FCRCs) of MNCs. Chapter 4 contains review of literature of our study. Chapter 5 discusses the methodology of our study and the empirical estimation of the simultaneous equations model relating to the impact of foreign capital on economic growth in India. It also contains the results of our study. Chapter 6 is devoted to the discussion of the determinants of FDI in developing countries. Besides discussing the theories of FDI in developing countries, it also contains the empirical estimation of a single equation politico-economic model of the determinants of FDI in India. Finally, Chapter 7 contains the summary and conclusions and the policy implications emanating from our study.

9. Data Source

Most of the data used in the present study has been taken
from the Central Statistical Organisation (Economic Surveys), the Statistical Abstract of India and the Department of Company Affairs, Government of India. The data on the inflow of FDI has been taken from the various issues of Reserve Bank of India Bulletin. A number of UN studies, especially those of the UN Centre for Transnational Corporations (UNCTC) and the OECD Development Co-operation reports, were also consulted.
Notes and References


4. Generally foreign private investment takes place in two ways: (i) direct investment, and (ii) portfolio investment. The direct investment is made up of investment by branches and subsidiaries of foreign companies. The portfolio investment, on the other hand consists of shareholdings through the mechanism of capital markets by foreign investors (individual or institutions) in companies aboard. The main feature of direct investment is that the investor retains control over the investment capital. In other words, direct investment and management go together. Whereas, with portfolio investment, no such control is exercised. The investor simply lends his capital in order to get a return on it, but he has no control over the use of that capital. It is direct investment which is intimately associated with MNCs. See, e.g.

5. Since 1980s the United States has emerged as the largest recipient of FDI from its position as the leading source of FDI in 1960. See U.N. (1988) op. cit, p. 25.


13. Tugendhat, Christopher, op. cit., p 44


19. Ibid.


22. See Lilienthal, David E., op. cit.


26. See Ahroni, Yair, op. cit, p. 10.


31. Ibid., p.38

32. In the literature, various expressions like Multinational Company, Multinational Enterprise, Transnational Company, International Firm, Supra National Firm, Global Corporation Global Company, Cosmocorp, etc. have been used interchangeably and are like synonyms to describe the same entity.


34. However, a distinction must be made between a study of FDI and a study of MNCs because the activities of MNCs are not limited to and in some cases are even
independent of financial flows. The activities of MNCs encompass a host of other activities also, such as the transfer of technology as well as goods, the provision of managerial services and entrepreneurship and related business practices, including cooperative arrangements, marketing restrictions and transfer pricing.


36. This is the reason why the current data on FDI do not fully reflect the significance and scope of the activities of MNCs. See Paul, Samuel, op. cit. p 748 and United Nations Centre on Transnational Corporations, Transnational Corporations in World Development - Third Survey, New York, 1983, p.4

37. See UN (1988), op. cit, p. 67

38. Ibid., p.370

39. Ibid., p.378

40. See UN (1988) op. cit. p.24

41. Lall, R. B., Multinationals from the Third World: Indian Firms Investing Abroad, Delhi, Oxford University Press, 1986, pp. 2-4.

42. See Morris, Sebastian, "Foreign Direct Investments from India: 1964-83" Export-Import Bank of India
Occasional paper no. 13, May 1991, p. 2. Latest data show that till 31 December, 1991 there were 161 JVAs and another 84 were under implementation. Total equity invested by Indian companies in these JVAs is around Rs.150 crore. Of the total 245 JVAs, 130 were in Asia, 58 in Europe, 37 in Africa and 12 in U.S.A. See, e.g. Economic Survey 1992–93, Government of India, p. 111

43. Ibid.
44. Ibid., p. 3
45. See UN (1988), op. cit., p. 39
46. Ibid.
47. For more details about these schools, see Lall, Sanjaya, "Theories of Direct Private Foreign Investment and Multinational Behaviour", Economic and Political Weekly, Special no., August 1976, pp. 1331–43.
is a first substantial attempt by the UNCTC to examine the global structure of FDI and the policy implications that flow therefrom. It focuses on the role of the Triad (defined as the United States, the European Community and Japan) in the global pattern of FDI during the 1980s. According to the report, since 1983, FDI outflows have increased at the unprecedented rate of growth of 29 percent a year, three times faster than that of the growth of exports and four times that of the growth of world output. Also see Ghosh, Jayati, "Foreign Private Investment without Illusions", Economic and Political Weekly, No. 42, October 19, 1991, pp. 2392-93.