MNCS & FDI

What are multinational companies?
A multinational company is a large business which operates in at least two different countries. They sell goods and services into global markets and have production plants and other operating facilities all over the world. MNCs contribute about 10% to world GDP and about two-thirds to global exports. Examples include, McDonald's, Toyota, Microsoft and Coca-Cola.

What are some of the key features of MNCs?
- **huge assets (land, building, plant, machinery, money etc) and revenue:** MNCs are extremely well-resourced and often afford to take on large-scale contracts and projects that many other firms could not cope with
- **highly qualified and experienced professional executives & managers:** can afford to higher the best from anywhere in the world
- **powerful advertising and marketing capability:** can outcompete smaller rivals by investing huge amounts of money in impressive advertising campaigns
- **highly advanced and up-to-date technology:** can afford to keep up to date with technological developments and as a result have the most efficient factories, machinery and equipment that can help lower costs
- **highly influential both economically and politically:** can be very powerful and even influence government decision-making
- **very efficient since they can exploit huge economies of scale:** they are large which this allows them to reduce their costs significantly - they can buy huge quantities of raw materials more cheaply, for example.
- **ownership and control are centred in the home country:** profits always returned to the home country (where the company was first established).

What is foreign direct investment (FDI)?
Foreign direct investment or inward investment, consists of flows of private capital between countries, often to fund business ventures. In other words, it's when a company makes an investment in a foreign country. Another part of FDI is the purchase of shares in a foreign business (10% or more). Most of the FDI comes from MNCs.

Reasons for the Emergence of MNCs/ FDI

Economies of Scale
In some industries, firms that exploit economies of scale can reduce costs. MNCs will be in a better position to exploit economies of scale because they are so large. Firms that sell to global markets will produce more than those who just sell to domestic markets. Such firms are so powerful they can place a lot of pressure on suppliers to lower their prices. One of the main reasons why MNC have emerged is because as companies get bigger and bigger, their costs get lower and lower - provided they avoid diseconomies of scale.

Access to Natural Resources/ Cheap Materials

Many large companies are happy to invest overseas because they need to buy huge quantities of resources. A significant proportion of FDI is targeted at the mining industry. Many African states have attracted FDI because they have large reserves of valuable resources. Many countries import significant quantities of food from overseas. This is because in some countries the food needs of the population are not met by domestic producers.

*Reserves: amount of something valuable, such as oil, gas or metal ore

Lower Transport and Communication Costs

- Developments in transport and communications have helped to drive the growth in MNC/ FDI activity. Transportation costs have come down and the speed with which goods can be delivered has gone up. This makes distribution in overseas markets much more attractive. Air travel is now relatively cheap with the number of destinations growing. This means that managers and other stuff can travel around the world more easily to discuss and organise business activity.
- Recent advances in communications technology have been particularly rapid. People can transmit a wide range of different information, such as text, drawings, video clips, photographs and financial documents, instantly using electronic devices. Both individuals and groups can talk face-to-face even though they might be so apart from each other. Improved and cheaper communication links have made global business much more efficient.

Access to Customers in Different Regions

One of the main reasons why MNCs have developed successfully is because they can sell far more goods and services in global markets than they can in domestic markets. Companies can make considerably more profit selling to the 7000 million people worldwide than they can sell into perhaps 50 million people at home. As the global economy continues to grow, more and more companies are likely to target overseas markets to help increase revenues, profits and returns to shareholders.

What are some ways that governments actively seek FDI?

- offering tax breaks, subsidies, grants and low interest loans
- lifting restrictions and relaxing regulations to make it easier for foreign firms to invest
- investing in their own infrastructure
- investing in education so that people can get jobs with foreign companies

<u>Advantages of MNCs/ FDI</u>

Job Creation

One of the main benefits of FDI is the employment created when MNCs arrive and establish factories, warehouses, shops and other business facilities. When MNCs set up operations overseas, income in those countries rises. Local suppliers are also likely to get work when a multinational arrives. Workers get wages, leading to an increase in living standard and those with new employment will spend some of their income with local businesses. This increases demand and, in turn, creates more jobs. There is a positive local multiplier effect. Also, there is more output in the economy so GDP will rise, increasing economic growth and raising living standards. In addition, MNCs have the resources to offer higher wages so workers benefit from this.

Investment in Infrastructure
Countries with poor infrastructure often struggle to attract FDI. If a country has inadequate road networks, ports, railway networks, bridges, power distribution, airports, telecommunications, industrial parks and other facilities, it is more difficult to do business in that country. Consequently, owing to the attractiveness of MNCs/ FDI, governments are more likely to invest in infrastructure in order to attract the attention of investors. If this investment is forthcoming, everyone will benefit (such as the existing business). Also, sometimes foreign investors contribute to a nations infrastructure, such as building a new road, if it is allowed to develop a specific business interest.

Developing Skills
MNCs provide training and work experience for workers when they locate operations in foreign countries. Also, governments in less developed countries often spend more on education to help attract MNCs. Some businesses offer financial support for workers or their children to fund their education. The arrival of MNCs may also encourage local people set up businesses. MNCs often bring new technologies, techniques, methods, working practises and skills. This new work practices and technology help the host country to become more competitive and grow. MNCs may have provided the skills and motivation needed for enterprise. For example, a new MNC may encourage locals to supply services, such as transport, accommodation, maintenance, cleaning and leisure activities.

Developing Capital
The arrival of MNCs will help to boost the stock of capital in host countries. One reason is because when a business sets up a new facility, such as a factory, it is likely to install up-to-date technology. The arrival of MNCs might also encourage local suppliers and other businesses to invest in new capital project. This will help them win orders to supply the MNC, for example.

Contributing to Taxes
The profits made by MNCs are taxed by the host nation. This increases tax revenue for the government that can be used to improve government services (e.g. to improve education or provide vaccinations). Increased employment and wages should also lead to an increased tax base and government revenue.

Other Advantages:
- Exports or replacing imports can improve the current account.
- MNCs can bring cleaner technology and raise environmental awareness.

<u>Disadvantages of MNCs/ FDI</u>
Tax Avoidance (practise of trying to pay less tax in legal ways)
Evidence shows that MNCs are guilty of tax avoidance, exploiting the generosity of their host country by not giving back. If MNCs can avoid paying taxes in countries

with well-developed legal systems, it may suggest that less-developed nations have little chance of getting their 'fair share' of taxes from MNCs.

Environmental Damage
MNCs are often heavily involved in the extraction industries such as coal, oil and gold mining, they also transport their products over long distances; these activities are all damaging to the environment. They can lead to air and noise pollution.

Moving Profits Abroad
MNC headquarters are often based in developed countries and MNC profits made are often repatriated (i.e. returned to the country where the MNC is based). As a result, the host country loses out. This suggests that MNCs bring more benefits to developed countries than to less developed countries.

*Repatriation (of profit): where a multinational returns the profits from an overseas venture to the country where it is based, typically from a developing country to a developed country