

Geo Factsheet



Number 49

Transnational Corporations - the problem or the solution?

A transnational corporation (TNC) is simply a large business organisation which operates and has ownership of assets in more than one country. A TNC could therefore operate in just two countries. Sometimes the term transnational corporation is used interchangeably with multinational corporation (MNC) but the latter really implies that the organisation is operating in more than two countries. Most TNCs:

- Operate in only a few countries.
- Are now involved in manufacturing and services (Table 1).
- Have their Head Offices in developed countries e.g. the USA and Japan However, most developing countries now have their own TNCs.

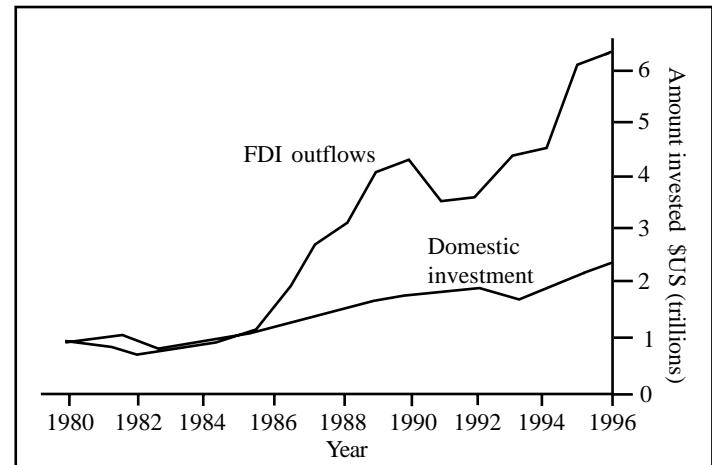
TNCs are responsible for a large percentage of total world employment, production and trade and are therefore the major contributor to Foreign Direct Investment (FDI) - plants, equipment and property, which is owned by businesses outside their home country.

Table 1. Top 15 TNCs by foreign assets, 1995

Company	Industry	Foreign assets as % of total	Foreign sales as % of total	Foreign employment as % of total
Royal Dutch/Shell	Energy	67.8	73.3	77.9
Ford	Automotive	29.0	30.6	29.8
General Electric	Electronics	30.4	24.4	32.4
Exxon	Energy	73.1	79.6	53.7
General Motors	Automotive	24.9	29.2	33.9
Volkswagen	Automotive	84.8	60.8	44.4
IBM	Computers	51.9	62.7	50.1
Toyota	Automotive	30.5	45.1	23.0
Nestlé	Food	86.9	98.2	97.0
Bayer	Chemicals	89.8	63.3	54.6
ABB	Electrical equipment	84.7	87.2	93.9
Nissan	Automotive	42.7	44.2	43.5
Elf Aquitaine	Energy	54.5	65.4	47.5
Mobil	Energy	61.8	65.9	52.2
Daimler-Benz	Automotive	39.2	63.2	22.2

In 1996, FDI totalled \$6 trillion and has been growing three times as fast as world domestic investment (Fig 1).

Fig 1. World domestic and foreign direct investment



TNCs therefore wield huge economic, financial and political power and their activities affect the entire society of a particular country. The supporters of TNCs suggest that they are responsible for fuelling development and bringing prosperity to millions. Their critics suggest that they wield far too much economic, political and social power, that they may carelessly exploit workers and that they introduce values and desires which, in non-western countries in particular, have harmful social and moral effects.

Why do TNCs exist?

Global markets exist for many products and services and those organisations with sufficient capital and expertise have established branches or affiliates in new countries. TNCs usually establish overseas branches in order to:

- Gain access to new markets
- Extend existing markets to match competitors
- Provide export platforms
- Avoid trade barriers
- Diversify production
- Reduce production costs e.g. by gaining access to cheaper labour
- Exploit economies of scale in order to out-compete smaller national, regional and local manufacturers

All of this has been hugely accelerated by cheap and efficient global communication networks which have allowed organisations to control the activities of dozens of affiliates via one head office - usually in a developed country - where management, marketing and research and development expertise is concentrated. TNCs have achieved **vertical integration** - where a business buys its suppliers or customers in order to increase control over them. When any particular organisation's customers or suppliers are in another country, then this organisation will automatically become a TNC.

Exam Hint - Many candidates produce simplistic responses. Many seem to believe that all TNCs are huge, harmful and operate mainly in developing countries.

Which countries do TNCs choose?

Between 1950 and 1970, the number of TNCs increased rapidly and it was usually the existence of a valuable natural resource which attracted their attentions. However, besides the general reasons listed on Page 1, one of the most important reasons why a TNC will become established in a new country is the level of incentives offered by the home government.

In South East Asia, for example, host countries developed **export processing zones** (EPZs) within which goods were imported cheaply, infrastructure was provided and the normal restrictions concerning foreign ownership of national assets was waived. Similarly, many US TNCs have established themselves in the border industrial zone in Mexico to take advantage of cheap labour, lack of import duties and their proximity to the home country.

Two firm trends have emerged since the early 1980s. Firstly, there has generally been an increase in **cross investment** i.e. an increasing tendency for those countries which have their own TNCs to also be the destination country (host country) for other countries' TNCs. Table 2 lists the number of parent corporations in the eleven countries which are home to the most TNCs.

Table 2. Top eleven countries containing parent corporations

Country	Parent Corporations Based in Country
Germany	7560
Japan	3640
Sweden	3529
Switzerland	3000
United States	2972
France	2218
Netherlands	1608
United Kingdom	1467
Canada	1396
Finland	1300
Republic of Korea	1049

The second general trend is the increasing number of foreign TNCs which use the United States as a host country. The US remains the single largest recipient of foreign direct investment (FDI) in the world.

Case study: TNCs in China

After the United States, China is the second largest recipient of FDI in the world and the largest recipient among the developing world. Initially, TNCs attracted to China concentrated on labour intensive manufacturing industries, but in recent years TNCs such as Mitsui, Siemens, Coca Cola Co., IBM, Volkswagen and AT&T, have all begun to concentrate an increasing percentage of their investment on capital intensive and technological intensive industries, the service sector and on infrastructure projects.

Pros and Cons for the host country

Pros

1. Multiplier effect

Transnationals may set up in a new country and this may rapidly attract many more businesses into the area. This is the theory of **cumulative causation**. If the TNC is made to use indigenous supplies or components, and particularly if these materials or components have to be of high quality or precision, then both the level and quality of output of home industry may simultaneously increase. Such industries may become more competitive internationally and indigenous staff may also leave the TNC or their old home employers to set up business themselves. Thus, the TNC can be said to stimulate home based entrepreneurs.

Case study: TNCs in Bangladesh

TNCs such as Daewoo (Republic of Korea) have been attracted to Bangladesh because of:

1. Low wage rates compared to other Asian countries.
2. 'Spare' quotas to supply ready-made clothes to the European Union and to the US.

In 1980, Daewoo signed an agreement with a medium sized Bangladeshi garment firm (Desh Garment Company). Since then garment exports have increased dramatically and by 1992, accounted for 46% of Bangladesh's total export earnings. Daewoo provided training programmes, start-up capital and international marketing expertise.

Within the EPZs in Bangladesh, other Korean TNCs have invested heavily in food processing, electrical machinery and chemical industries.

2. Income

TNCs may bring huge inflows of capital, either directly, or from taxes and this may significantly improve a country's balance of payments. In developing countries, TNCs tend to export more than their indigenous counterparts. This is not surprising since many TNCs have specifically set up as export platforms. However, TNCs in developed countries usually end up with a higher corresponding level of imports than indigenous firms.

Increasingly, host governments, particularly of developing nations, are insisting that a certain proportion of a TNC's profits are reinvested in the host country.

3. Spread of Technology

TNCs have been responsible for the introduction of new technology to both developed and developing countries. This can take the form of management expertise, technological processes or simply of machinery. This geographical transfer of technology and knowledge can be a huge advantage for the receiving host country. Such technology can be copied and therefore become economically useful throughout the country.

The skill level of the local population may also rise. In practice, this has been most effective when host countries have insisted that the TNC introduces both manufacturing and research and development plants. This helps to ensure that the host country receives not only 'know how' but 'know why'. Some of the technologies which have been introduced to developing countries by TNCs - fertilisers, wood processing technology, pharmaceuticals etc. - have played an important part in raising the standards of living and improving the health of significant parts of the host country's population.

4. Employment

Huge numbers of relatively well paid jobs may be created. Despite many claims of exploitation, particularly in developing countries, TNCs often pay their employees above the average local rate. This is an important point because 'cheap' labour does not always mean exploited labour. It may just be cheap in comparison to rates in the home country.

In developing countries, most jobs are production jobs and, particularly in EPZs, these are often low skilled roles filled by women. In developed countries TNCs often geographically separate different types of production. In the UK, for example, higher order employment opportunities are often concentrated in and around London, whereas low order employment opportunities are often in plants in Wales, North England and Scotland.

Cons**1. Local companies become less competitive.**

Local firms may become financially unattractive to host country lenders and may, therefore, find it difficult to borrow money for the establishment of new manufacturing plants or for modernisation purposes. Furthermore, some TNCs do not rely upon the host country's manufacturers to supply materials and there is then little multiplier effect.

The presence of a TNC in either a developed or a developing country may lead to a reduction in the number of small or medium sized home companies or it may suppress the establishment of new small firms. This is because:-

- The economies of scale which TNCs can achieve mean that the unit cost of production is much less than that which medium or small firms can achieve.
- TNCs usually benefit from superior management and marketing skills, particularly when they are planning to exploit overseas markets.
- Financial resources may allow them to buy smaller competing firms or to outlast competition in price wars.
- Paying workers above the local rate may encourage workers to leave their home employers, creating local hostility and possibly threatening the survival of local firms. TNCs have been accused of putting little importance on factors such as local trust and community responsibility.

Exam Hint - The question 'What effects might a TNC have on local employment?' often proves an excellent discriminator. The weakest candidates will respond that jobs will increase. Better candidates realise that factors such as direct and indirect employment effects, the type of employment created, its stability and wage levels are all important considerations. Only the most able candidates however will appreciate that, due to displacement or suppression of local industry, employment opportunities may actually fall and that any consequences may affect different types of worker selectively.

2. Loss of autonomy and suppression of technical development

There is a risk that a small country may lose some of its autonomy - its ability to self govern - if it becomes too heavily dependent upon the TNC. Once a TNC has become established in a particular country it can be very difficult for the government of that country to control the behaviour of the TNC, which may operate in 20 countries and have its decision makers in a head office thousands of miles away. The aims of a TNC are unlikely to be the same as those of a host government and it has been argued that a TNC might deliberately prevent technological advance of such a country so that this dependency is maintained. Many critics have suggested that US TNCs have wielded too much influence in Canada, for example, resulting in Canada remaining 'industrially backward'.

The spread of new technological processes and skills from the TNC may be very limited. This may be because the TNC does not establish working links with other factories or because it refuses to share or demonstrate its technology. The technology may in fact be jealously guarded. Even more importantly, few TNCs locate many of their creative and/or development plants - where new ideas and processes are developed - away from their home country. This prevents the host country developing its own ideas and knowledge.

A dominant TNC may result in a large proportion of the workforce in the city, region or even country becoming overspecialised or economically dependant upon one form of production. This is extremely risky since transnational TNCs may close plants even when these plants are profitable, if greater profits can be made elsewhere.

Finally, the government of a poor country, heavily dependent upon one or more TNCs, may be tempted to relax worker safety regulations or environmental protection regulations in order to accommodate the TNC. This may have disastrous social or environmental consequences.

3. Transfer pricing

The TNC will inevitably return earnings and profits back to the home country and these may exceed the initial inflow of capital. TNCs can hide the true profit which they make by overpricing or underpricing. For example, the TNC will purchase components in order to manufacture its own product. A pharmaceutical company may have to purchase hundreds of different chemicals in order to make its own products. These component chemicals may be purchased - at a highly inflated price - from one of its own subsidiaries i.e. a different company within the TNC. This will increase costs, decrease profits and hence decrease taxes payable to the host country. Conversely, the TNC may underprice its own products which are destined for export to one of its own subsidiaries. Again, this decreases profits and tax payable to the host country. The deliberate manipulation of pricing to reduce taxes to the host country is known as **transfer pricing** and is a major problem for all host countries irrespective of their level of development.

TNCs have therefore changed the way in which trade operates. An increasing percentage of world trade is now intra-TNC rather than international i.e. it is between different branches of the same TNC. It has been estimated, for example, that more than 50% of the total trade of Japan (imports and exports) occurs within TNCs.

4. Financial cost to host

It often costs the host country huge sums of money to attract the TNC. In developing countries, costs may include the development of new infrastructure such as roads, railways, docks, EPZs etc. Developed countries may also have to offer financial incentives in order to attract TNCs to economically weaker areas. The UK Government offered Siemens several £million to reduce capital costs to help construct its semiconductor plant in North Tyneside.

Government incentives to tempt TNCs may mean that other sectors of the economy - for example agriculture - are neglected.

Case Study - Siemens - Inward investment into Britain

Siemens, the German engineering and electrical giant, first announced its intention to build a £1.1 billion semiconductor plant in North Tyneside in 1995. After having received a British government grant of several £million, the factory opened in 1997, creating nearly 800 jobs.

The TNC started to face difficulty shortly after production began at the plant. The price of computer memory chips fell dramatically by 85%, forcing the company to reconsider plans to expand the site in North Tyneside. Despite the fact that the plant was profitable, Siemens have recently announced that they are going to close the plant citing the pressures of world markets, combined with the strength of the British pound. The geography of the semiconductor industry will be the focus of a future Factsheet.

5. Inappropriate Goods

The goods the TNC produces may be inappropriate to the needs of the host country. (The production of luxury cars, for example, which are expensive for all but a tiny minority of the population and which are unsuitable for local conditions). Other products - such as beef burgers or Coca Cola - have been criticised because they exert a westernising influence and this may encourage the poor to spend less on healthier, basic foodstuffs.

Pros and Cons for the home country

Many American labour organisations have argued that American TNCs which establish overseas plants cause home unemployment. However, other economists argue the exact opposite, that overall, overseas investment by TNC's actually creates jobs in the home country. The overall **net employment effect** of overseas investment on the **home** economy can be summarised as:

$$\text{NE} = (\text{EJ} + \text{HJ} + \text{SJ}) - \text{DJ}$$

Where:

NE = Net employment effect

EJ = Number of jobs created in the home country by companies who are exporting solely as a consequence of the activities of the TNC in the host country

HJ = The number of extra jobs created at the TNC's home head office because of the increased overseas activity

SJ = The number of extra jobs created in domestic (home) firms because of the extra jobs in the TNC's head office and its increased overseas activity

DJ = The number of jobs or potential jobs lost as a result of the TNCs investment abroad rather than in the home country (without the TNC overseas markets might have stimulated the establishment of factories in the home country)

The overall (net) effect can be very difficult to calculate. Numerous studies have shown that the establishment of an overseas TNC will have both positive and negative employment effects in the home country. Jobs will be created in some geographical areas and lost in others. Some types of employment will be created and some lost and such changes will not affect everyone equally. Some kind of workers, often women or those from minorities, may well be affected the most. This is often because the displaced jobs in home firms would have been production line jobs, whilst those created in head office are likely to be managerial.

Exam Hint - Most candidates limit their responses to the costs and benefits to the host country, but very few candidates discuss the advantages and disadvantages to the home nation.

Conclusion

Clearly, there is no definite answer to the question 'Are TNCs the problem or the solution?'. With every TNC there is the potential for both positive and negative effects on both the home and host nation. The true impact of a TNC's activity cannot be evaluated unless we can be sure of what would have happened **without** the TNC. For example, if a particular TNC had not established in country x the question is "Would that market niche have remained unfilled?" or would another TNC or 'home' company have become established. Arguments which are based on "What if...." scenarios are known as **counter factual** arguments.

What is more certain, is that it is extremely difficult to imagine a country being able to opt out of international trade altogether. TNCs therefore seem likely to increase their already large share of world trade and perhaps effective guidelines or international regulations on the activities of TNCs are now what is needed.

The existing guidelines - from bodies such as the OECD, the International Labour Organisation and the United Nations - are all voluntary. Clearly, with so much influence, TNCs must also be forced to take a responsible approach to world trade.

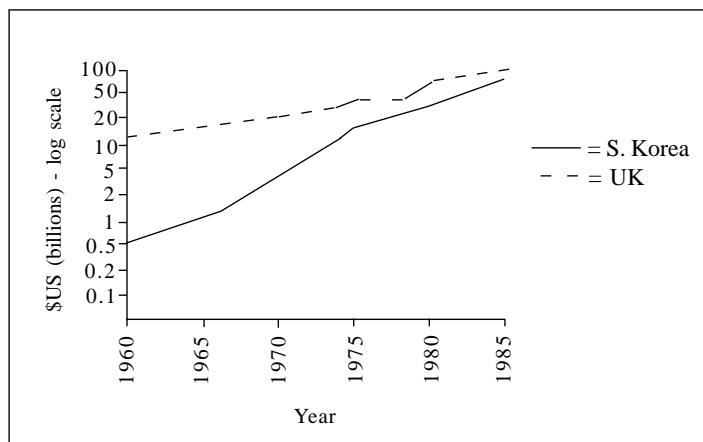
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Practice Questions

1. The graph below shows the rate of change of inward investment made by TNCs based in the UK and South Korea.



- (a) Summarise the trends shown for the periods;

- (i) 1960 to 1975 (2 marks)
(ii) 1975 to 1985 (2 marks)

2. (a) Define and give an example of a transnational corporation (TNC). (2 marks)

- (b) What evidence could be used to demonstrate the impact of TNCs on a country? (4 marks)

Answers

Marking points are shown by semicolons

- (a) (i) During 1960-1975 there is a more rapid rate of change in South Korea;
there is a more uniform rate of change in the UK;
in South Korea there is a twentyfold increase;
and in the UK there is a twofold increase;

(ii) During 1975-1985 there is a more rapid rate of growth in South Korea;
but from 1978 to 1980 the UK's growth rate is faster;
the UK's rate varies more than South Korea's;
and there is a period of decline in the UK from 1975 to 1977;
- (a) A business which operates in two or more countries;
(e.g. Exxon/Shell etc.).

(b) Credit reference to:
physical environment;
e.g. air/soil/water quality;
built environment;
e.g. roads/railways/docks/airports/EPZs;
economic factors;
e.g. GNP/employment/balance of payments;