A Study of the Status and Outlook of Multinational Enterprises in the Globalizing Economy with an Approach to Transaction Costs

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ABSTRACT

The present article tries to examine the status of multinational enterprises in the globalizing economy and its effect on technology transfer and development, and to study their outlook in shaping economic and political relations between countries. By examining the positive and negative views toward this phenomenon, this article analyzes the transaction costs in multinational enterprises as a distinctive factor than ensures their survival. This analysis allows us to identify when and where contractual alternatives to the multinational firm are likely to be viable, which depends on the nature of technology and the type of specialization (activity) of the enterprise as well as the characteristics of the markets of interest. Transaction cost analysis is done taking into consideration the relationship of the host country and multinational enterprises, and finally the optimal strategy is provided for local companies.

Key words: multinational enterprises, technology, technology transfer, transaction costs

Introduction

Trading technology products is very complicated and technology transfer influences long-term development in different respects [1]. That is why the developing countries are ready for technology transfer which is done in two major ways:

- Internalized
- Externalized

The internalized method is the same traditional foreign direct investment (FDI) and in this way the parent company is in charge of technology control and management as well as investment and supply of hardware, software, and all the activities from the beginning to production and marketing [2].

The increasing investment of multinational enterprises around the world has tremendously influenced the socioeconomic conditions of countries. FDI has many advantages for developing countries. In fact, this is the fastest and most efficient way to access new technologies and it enables the host countries to overcome the limitations related to investment, export, and technology. On the other hand, FDI prepares the ground for mastering the process of learning [3].

In order to come up with a plausible theory of foreign direct investment (FDI), [4] resorted to the oligopoly theory and proposed two major reasons for FDI (companies going beyond national borders):

1. To attenuate competition by buying it up or somehow displacing it

The Literature on Multinational Enterprises and Different Approaches:

At first economists did not consider multinational enterprises as a distinctive phenomenon. Multinational enterprises were merely arbitrageurs of capital which transferred equity from countries with low returns to places with higher returns and earned arbitrage profit, [4] introduced a plausible theory regarding multinational enterprises and foreign direct investment. He believed that the activity of these enterprises is not limited to capital transfer and involves the transfer of such advantages as efficiency, proper management, etc.

[4] believed that the capital arbitrage theory is at odds with the resource transfer activities of multinational businesses. These enterprises invest and borrow abroad; their activities center on industries such as automobile manufacturing, electronics, chemicals, and petroleum and less attention is given to textile, steel, and agriculture industries. Further, the capital transfer is from developed to developing countries and not the other way around [4].
Globalization Process:

The Condition of Multinational Enterprises in the Globalization Process:

Despite the innumerable criticisms of multinational enterprises, they are in effect considered as one of the most important elements of global economy and their development is sometimes regarded as synonymous to globalization process. Examining the condition of these enterprises verifies this issue. According to the statistics provided by the UN, the number of multinational enterprises has been reported to be more than 35000 in 1992 [8], and many of these enterprises are financially more powerful than the economy of many countries; further, they are more powerful and influential in political, economic, and social relations than the leaders of some countries. For instance, the sales of General Motors Company have been more than the GDP of such countries as Austria, Denmark, Nigeria, Norway, and Venezuela [9] In 2003, the number of multinational enterprises increased to 63000 with 700,000 branches in different countries, and they own almost two third of the export of products and services. In 2007, the income of Exxon Mobil Corporation which is one of the three international oil companies in the world has been equal to 390 billion dollars and it signifies the important role of such companies in global economy.

Today China ranks first in foreign direct investment in the world and by the end of 2003 about 7400 large Chinese businesses have been established in more than 160 countries whose investment value is about 33.2 billion dollars. Based on the statistics of UNCTAD, China ranks fifth among world investors after the US, Germany, England, and France [10].

In general, from an economic perspective, the performance of multinational enterprises in developing countries is important and considerable due to the following reasons:

1. Employment
2. Import of various new products
3. Entering new industries
4. Technology transfer, knowledge, and know-how
5. Improvement in the processes and structure of industries
6. Completion of the process of learning.

The Transaction Costs Perspective of Multinational Enterprises:

At one level the internalization school and the transactions cost approach are one in the same. Both see the firm as a response to market failure. Profit-seeking firms internalize operations when by so doing the costs of organizing and transacting business will thereby be lowered. According to this approach, a leading purpose of economic organization is to economize on the costs of business transactions over time.

International Production and Multinational Enterprises:

In order to apply transactions cost economics to MNEs, we divide them into two groups:

1. Horizontally integrated MNEs
2. Vertically integrated MNEs.

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<th>Type of MNE</th>
<th>Description</th>
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<tr>
<td>Vertically integrated MNEs</td>
<td>为企业提供完整的生产链服务，从原材料采购到商品销售均由企业自身承担。</td>
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| Horizontally integrated MNEs |主要从事某一方面的业务，如生产、销售或其他增值服务。

2. To employ abroad the firm's special advantages, advantages such as skills, entrepreneurship, or access to capital.

Of course the company can export the commodity or license it to a foreign enterprise, but it prefers to use FDI to avoid technology misappropriation and prevent the costly haggling between the licensor and the licensee. Hymer came to the conclusion that underdeveloped countries need to devote a major share of their scarce resources to establishing multinational enterprises [5].

Multinational enterprises start their activities wherever they deem favorable for investment and these companies and businesses, based on their technological and financial capabilities, dominate the management, technical knowledge, and know-how of the markets. The more these enterprises progress in the global economy, the more they are faced with resistance. Especially in some countries this phenomenon is faced with Marxists and nationalists and these oppositions occurs due to their fear of the domination of enterprises in the developing countries. According to this view, multinational enterprises are exploitative, opportunistic, and even imperialistic, and one of the new ways of imperialism and domination over the developing countries is to access and despoil their resources and mines. Researchers such as Raymond Vernon (in his book “The Storm over the Multinationals”) or Howard Prellmutter were among those who believed that the disadvantages of multinational enterprises surpass their advantages. In contrast, people such as Galbraith, Schuster, and Burger were proponents of the multinationals due to their advantages, and believed that these enterprises are one of the most important factors in production development, wealth, and technology transfer because of their high efficiency [6].

There were also theorists like Vernon who stepped further and considered multinational enterprises as the source of innovation, welfare, and prosperity, but these days the attitude toward these enterprises has become more reasonable and it has been shown that they have advantages and disadvantages. The empirical evidence suggests that the positive aspects of multinational actions are more than the negative consequences. By making new laws, the United Nations has attempted to control the negative aspects of these enterprises so that developing countries can exploit their resources and facilities for the sake of their development and progress [7]
Horizontally integrated MNEs are businesses that produce the same product in different locations, but vertical MNEs produces output in some of its plants which serve as inputs in other located elsewhere. Horizontal and vertical integration can both exist within a single firm. Regardless of whether the product is controlled by domestic companies or multinational enterprises, if the production techniques and knowledge are uniformly distributed internationally, the choice of production location will merely depend on factors such as differences in production costs, tariffs, taxes, transportation costs, and the size of markets [11].

The theory of comparative advantage indicates how differences between countries in comparative costs lead to international specialization of production and trade. Economies of scale promote the level of specialization and may turn a country into the sole producer and supplier of a specific product in the world.

The above figure shows that for production of goods in the U.S. and exportation to England, enterprises must undergo production costs as well as other costs such as taxes and tariffs, and this will lead to increased marginal production cost [12]. It is thus more economical for the manufacturing enterprise to produce the goods in the host country through FDI than to produce in the U.S. and export to England.

**The Transaction Costs of MNEs (David J. Teece):**

**A. The transaction cost properties of horizontally integrated multinationals:**

Assume a company with special production activities and with sole proprietorship which is in a position that production abroad (in the host country) is an easier way to access foreign markets than exporting the final product, and assume that its competitive advantage is technological know-how. First, it must identify with whom (what company) to transact (transfer technology) so as to negotiate the terms of transaction, sign necessary agreements, and make necessary inspections to ensure that the terms and conditions of the agreement are met and that in case of violation these terms will be enforced (the law of the host country is the supporter). Thus, in case of early disclosure in the process of technology transfer the rights of the transferor will be supported [13]. Moreover, in transaction it must be clarified for both parties that the value of the information corresponds to the claims of the seller. Further, in technology transfer there should be symmetry between the transferor and the transferee in technological capability, otherwise the transaction may fail.

Although technology can easily be transferred through codification (formulae for chemical compounds or codes of software applications), but often know-how cannot be codified, for it always has a tacit component; even if it is codified it will not always be understood by the receiver and knowledge transfer will not be feasible without sufficient training and support [14,15]. This must also be taken into consideration within the agreement so as to help the receiver in absorbing technology.

A review of the history of transfers suggests that flexibility and adaptation in agreements results in reduced legal problems, better disclosure, easier agreement, better enforcement, and finally more efficient transfer. Considering the above explanations, it is not just knowledge and capital that provides companies with opportunities to internationalize their economic activities; rather failure of host markets contributes to the process and therefore companies engage in horizontal development. Hence, it is high transaction costs that lie behind horizontal FDI.

The figure assumes that locational factors indicate that a foreign production location minimizes production costs and the issue is whether it ought to be licensed or internalized (integrated). In the above figure, the horizontal axis denotes index of the complexity of know-how, \( G_C \) is the average governance cost for licensing, and \( G_I \) is the average governance cost for internalization. The above figures show the difference between governance costs for licensing and internalization.
B. The transaction cost properties of vertically integrated MNEs:

A large portion of FDI is sourcing abroad of raw materials such as oil, copper, and aluminum. The vertically integrated MNE sources inputs in one country for use in another country. Consider a smelter located in the home country. Assume that there are many different types and grades of ore and that to smelt the ore at the lowest cost the smelter needs to be designed to process particular grade of ore [16]. If this ore is found only in one or two locations abroad, then there may be re-contracting hazards associated with relying on long-term supply contracts with another enterprise. This is because once the investment in idiosyncratic smelting facilities has been made, the enterprise engaged in smelting will be extremely vulnerable to changes made by the ore supplier in the conditions of sale. The supplier of the ore may be blatantly opportunistic [17]. Despite contract specifications to the contrary, the supplier may simply raise prices or lower quality. Judicial redress may be weak; so to the extent that alternative suppliers are not available, the owner of the smelter will be obliged to go along with the new terms imposed by the supplier. Ex ante backward vertical integration can eliminate this risk.
Optimal Strategies for Facing Multinationals:

Along with globalization and the advent of multinational enterprises in local markets, local companies and organizations have no choice but to face them. The results of research studies show that most managers react to MNEs as follows:

1. Asking the government to pass laws in order to limit the activity of MNEs and support the organizations in order to compete and survive.
2. Merging or partnership with MNEs which depends on their capabilities.
3. Exiting the market.

The local companies react in one of the above ways if they have not been prepared for the advent of multinationals. In order to take necessary precautions, they must first accurately identify their own position in the market and then start assessing the capabilities and assets of the competition. Accordingly, they can adopt one of the following strategies in order to survive [18].

The requirement for staying in competition is to identify and quickly respond to market opportunities. Thus, more efficient methods must be used for monitoring the opportunities and threats; along with modifying their organizational structure, the companies must become very flexible.

First Condition:

If there is little pressure for globalization and domestic companies have no competitive advantage in global markets, it is better for them to adopt a defensive strategy. In this strategy the focus is on small markets which are of no particular interest to multinationals.

Second Condition:

If there is little pressure for globalization and domestic companies have competitive advantages in global markets, it is better for them to adopt the developer strategy, whereby they expand their domestic opportunities to a limited number of markets and in this way they must use their special advantages and their understanding of the market to compete with the reputation of their brand.

Third Condition:

If there is high pressure for globalization and domestic companies have no competitive advantages in global markets, it is better for them to adopt a partnership strategy instead of facing and competing with multinationals and to continue their activities as a subcontractor or through merger or licensing.

Conclusion:

Nowadays multinational enterprises start their activities in any country they deem favorable for investment, and whether vertically or horizontally, they proceed to achieve their predetermined goals through foreign direct investment. Regardless of the negative views regarding MNEs, FDI is a mutual advantage for the host country and the parent company, and the two parties benefit from the returns
of their agreement with respect to their capabilities which act as negotiating tools.

The host country benefits in the long-term if it plans wisely, for the most important advantage of the host country is access to new technology and using its spill-over in other industries. If that is realized, the benefits will be boundless [19]. If the host country acquires the technical knowledge, i.e. the knowledge and skills necessary for implementing a technology, and also the know-how of the technology, its objectives will be fully realized. An enterprise can become multinational if the following conditions are met:
1. Strategy (capital)
2. Location (host country)
3. Transaction costs (low marginal cost in the host country in comparison with the parent country).

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