Edexcel

A Level

Business studies

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Unit 04-Section 10

Global industries and companies

35 The impact of MNCs

IMPACT OF MNCS ON THE LOCAL ECONOMY

The arrival of MNCs in local communities is generally welcomed. This is because a new factory is likely to create employment, provide work for businesses in the supply chain, give a boost to the local economy and provide an opportunity for people to learn new skills.

Local labour and job creation: One of the main impacts of MNCs on local economies is the creation of jobs. For many people, the opportunity to work in a full-time job with the possibility of training, a regular income, financial security and the opportunity to build a career is very appealing.

Wages and working conditions: Large businesses can increase local wages due to increased demand for workers and low unemployment rates. Modern, efficient MNCs with modern facilities and international standards of health and safety can create favorable working conditions. In 2017, Foxconn opened a new factory in Wisconsin, USA, offering an average annual salary of $53,875 plus benefits to attract workers locally and nationally.

Local businesses: MNCs can positively impact local businesses by creating jobs and increasing trade, revenues, and profit. They may also attract workers by offering better conditions or higher wages, or by providing products that compete with local products. However, when MNCs develop operations overseas, they may take trade away from local rivals, leading to job losses. Despite this, competition from MNCs may pressure local businesses to improve, potentially leading to more efficient and innovative enterprises. In summary, MNCs can have both positive and negative effects on local businesses.

The local community and environment: The people living in local communities are likely to welcome the location of MNCs in their area, but this is only if the benefits outweigh the drawbacks. In addition to employment opportunities and a boost to the local economy, MNCs might also provide the following benefits:

• Improvements in infrastructure. MNCs might invest some of their own money to help develop roads, electricity, water and gas supplies, schools, hospitals and other public amenities. They might do this to help build trust with the community.

• Contributions to local government taxes. In some countries, businesses have to pay local taxes to local authorities. Similar payments are likely to be paid by MNCs when they operate in other countries. This money can be used by local governments to help fund spending in the area.

• Help in local communities. Some MNCs make an effort to build strong links with the local community. They might participate in local cultural or sporting events. They may give money to local charities, organise fundraising events or give locals access to the company's facilities.

IMPACT OF MNCS ON THE NATIONAL ECONOMY

The overwhelming majority of governments around the world are in favour of MNCS setting up operations in their countries. This is because they are likely to generate income, employment, wealth and prosperity.

Economic growth: Foreign direct investment (FDI) boosts national income and employment in countries by establishing multinational corporations. This increases income and living standards, as local suppliers are likely to find work. FDI also creates jobs with higher wages, as seen in Hungary and Brazil, where foreign businesses offer wages between 4.5 and 6% higher than domestic employers.

FDI flows: When an overseas business locates a new facility in a foreign country, the amount of money spent on establishing that facility is classified as. Examples of specific benefits to the economy include the following.

• Increase in income. Generally, flows of FDI should result in higher levels of GDP for the host nation. The extra output and employment resulting from new FDI will increase economic growth and should help to raise the living standards for people in the host country.

• Increase in tax revenue. The profits made by MNCs are taxed by the host nation. This increases tax revenue for the government. This money can be spent on improving government services, such as healthcare, education, housing and transport networks.

• Increase in employment. The flow of FDI creates new jobs in the host nation.

• Reduce national debt. Some of the money received by the government from FDI might be used to reduce national debt. This has a positive impact on a country's finances. If a country can reduce its debt, it tells the world that it is more financially stable. As a result, interest payments might be reduced. The country should also find it easier to borrow in the future.

Balance of payments: MNC investment positively impacts the host nation's balance of payments, with a double impact. Initially, FDI flows into the host nation's account when a project is established, improving the balance of payments. Once the facility is open, foreign direct investment (FDI) boosts the host nation's balance of payments by boosting sales of goods overseas. Less-developed countries may experience even more significant impacts due to their difficulty in global market establishment. However, purchasing resources from overseas can negatively affect the host country's balance of payments.

Technology and skills transfer: MNC investment in foreign countries often means that new technologies and modern working practices are introduced into the host nation. This might result in the transfer of technologies and knowledge to local businesses. This transfer may be horizontal or vertical.

• Horizontal transfers are when knowledge is transferred across the same industry.

• Vertical transfers may be forward or backward.

The transfer of technology and skills from an MNC to businesses in the host nation will improve efficiency and productivity. This will help to make domestic producers more competitive. It will generate sales both at home and abroad if the improvements are significant. In some cases, the copying of technologies, products and working practices can lead to the development of domestic producers. This poses a real threat to MNCs in their markets. Through a process called **reverse engineering**,

Consumers: Consumers are likely to benefit from the arrival of MNCs in their countries. This is because they will be free to buy some of the goods that they produce. Specific benefits to consumers include the following.

• More choice. The products supplied by MNCs will add to the choice already available in the host country However, not all MNCs produce consumer goods. Some make components or provide services for other businesses.

• Lower prices. The arrival of MNCs is likely to increase competition in the host country. The products made by MNCs may be cheaper because they use modern and efficient production techniques. Since their costs will be lower, they can offer products at lower prices. This competitive pressure may also force domestic producers to lower their prices.

• Improved quality. If MNCs use new technologies, modern materials and more efficient working practices, such as total quality management, the quality of products might also be improved. For example, they may be better designed, higher quality, more efficient and more attractive.

• Better living standards. In general, it is possible that many people in the host nation will enjoy better living standards if MNCs set up operations. They may benefit from employment opportunities and enjoy higher incomes.

Business culture: There is some evidence to suggest that MNCs can have an impact on the business culture in the countries where they set up operations. In some cases, people who are employed by MNCs may eventually leave their jobs and start their own businesses. This might happen because:

- individuals may have saved some money from employment, which can be used for start-up capital
- workers may have developed skills that they think could be put to better use working for themselves
- multinationals may encourage workers to set up businesses and become suppliers. If quality standards can be maintained, it provides MNCs with more flexibility.

Tax revenues: Multinationals pay taxes to national economies. Taxes can pay for government spending in areas such as health and education. However, MNCs are often accused of paying as little tax as possible, seeking locations where taxes are low. A common technique to avoid tax on profits is **transfer pricing**.

SUBJECT VOCABULARY

horizontal transfer the transfer of knowledge across the same industry
repatriated profit the return of the profit made by an MNC to the country where the MNC is based
reverse engineering a method of analysing a product's design by taking it apart
transfer pricing a system operated by MNCs. It is an attempt to avoid relatively high tax rates through the prices which one subsidiary charges to another for components and finished goods
vertical transfer the transfer of knowledge, backwards or forwards, along the chain of production in the same industry

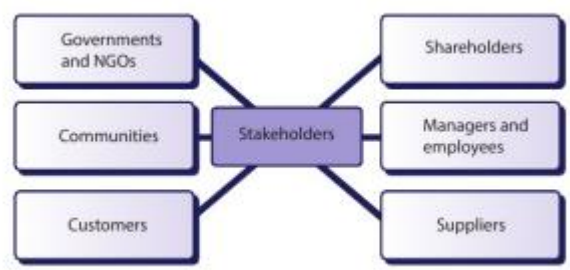
36 International business ethics

ETHICS

Ethics refers to the principles and acceptable norms that govern behaviour.. At the international level, ethics may or may not be expressed in a country's laws and regulations. If a firm establishes itself in a country, it will have to work within the **institutional framework** of both the home and the host country. This means a firm may be acting within the law of its home country but could be seen to be acting unethically in the other.

STAKEHOLDER CONFLICTS

Many people have a stake in the decisions that firms make. This means they have an interest in it or a right associated with it. As explored in Chapter 15, a stakeholder in a firm is an individual or a group that is affected by - and can affect - an organisation. The types of stakeholders in an international firm are listed in Figure 1.



▲ Figure 1 Types of stakeholders in an international firm

Stakeholder issues can arise in any area of a business, including the following.

Consumers:

- conflicts of interest (i.e. when one person or organisation has two roles and is unable to treat them both fairly at the same time), such as where an energy firm manipulates the markets. This results in consumers paying more than they would have if the situation was different.
- product safety, such as involving rotten meat that reaches consumers in the supply chain
- misleading advertising.

Employees:

- employee safety, ensuring healthy and safe conditions, and avoiding failings that might lead to injury or death.

- employee redundancies. A company may need to reduce staff numbers to regain profitability or they may choose to outsource some work for cheaper returns pay and conditions.

Shareholders:

- conflicts of interest between the management and the shareholders
- short-term versus long-term returns on shares. Shareholders invest for dividends, with businesses deciding on annual profit retention and dividend return. They prioritize long-term growth, investing in new equipment or branch expansion. Reinvesting profits is the cheapest way to finance growth, persuading shareholders that future profits are in their long-term interests.

Countries or communities:

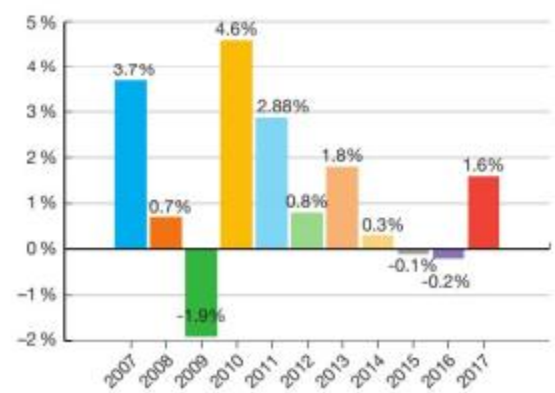
- safety, where people's wellbeing is compromised.
- environmental concerns, where the activities of the business pollute or damage the environment.
- resource depletion (i.e. using so much of something that there is very little left), where a company's extraction objectives are not good for the future for that country.

ENVIRONMENTAL CONSIDERATIONS

Companies are becoming increasingly concerned about the impact their activities have on the environment. They are under pressure from many stakeholders to stop or minimise any damage that their activities might inflict on the environment.

Emissions: Emissions of carbon rose by 1.6 per cent in 2017 after stabilising in the previous three years. Figure 2 shows the annual growth in global carbon emissions between 2007 and 2017.

There is strict legislation in many countries governing the environmental output of a business. This includes climate change legislation that requires companies to report on their greenhouse gas emissions. However, this legislation does not always exist in developing nations where many MNCs base their manufacturing industry. As they are creating employment within the developing country, environmental protection may not be a key priority.



▲ Figure 2 Annual growth in carbon emissions between 2007–17

Waste disposal: Many governments enforce legislation regarding how companies dispose of waste, as they do with air emissions. This legislation is often missing or not enforced in LEDCs (less economically developed countries). There are many barriers to effective waste disposal in LEDCs, such as the lack of a proper infrastructure to allow for efficient waste removal.

Sustainability: In business and economics, the term 'sustainability' has a specific meaning. A sustainable business is one that operates without negatively affecting the ability of future generations to meet their needs. This means that businesses should implement policies that preserve the environment so that it can support human life in the future. This might mean that businesses should adopt production methods that:

- avoid the use of large quantities of non-renewable resources
- make more use of recycled materials

- reduce or eliminate waste and pollution
- have a positive impact on the environment, such as encouraging employees to cycle to work instead of driving.

Environmental sustainability forces businesses to look beyond making short-term gains. They need to look at the long-term impact they are having on the environment. Businesses need to emphasise their **'green credentials'** and be more sustainable.

SUPPLY CHAIN CONSIDERATIONS

Global businesses face ethical issues in global sourcing and logistics, including human rights abuses in mines in the Democratic Republic of the Congo. The Organisation for Economic Co-operation and Development (OECD) has developed guidelines to minimize the use of conflict minerals, such as rarest minerals, by addressing these complex issues.

Some of the key supply chain issues are outlined below.

Pay and working conditions: Business ethics are challenged by global supply chain complexities and employee working conditions. While many countries have laws covering pay, conditions, holiday entitlement, health, safety, discrimination, and bullying, clear guidance on dismissal procedures is lacking.

There are a number of initiatives and organisations that are working to ensure fair working practices for all. Some are concerned with the employment practices of multinationals and may address the following issues:

- employment is freely chosen
- freedom of association and collective bargaining is freely chosen
- working conditions are safe and hygienic
- child labour is not used
- living wages are paid
- working hours are not excessive
- no discrimination is practised
- regular employment is provided
- no harsh or inhumane treatment is allowed.

Exploitation of labour: Labor exploitation is widespread worldwide, with the International Labour Organisation (ILO) estimating 24.9 million people were exploited in 2016. Bonded labour, where employees are forced to repay recruiters and employers, is prevalent in industries like the seafood industry in Thailand. Businesses are working to prevent exploitation by implementing guidelines banning bonded labour and setting minimum working conditions in their supply chains.

Child labour: Outsourcing businesses often rely on local suppliers who may not follow local regulations, leading to ethical dilemmas like child labour. This issue is common in local businesses and farms, where young children are often put to work. Implementing new sanctions must include protection for young workers, as seen in Bangladesh's case where 7,000 young girls were forced to work in exploitative situations. Convention 138 and 182 have changed the issue, potentially damaging families.

MARKETING CONSIDERATIONS

Misleading product labelling: Businesses should ensure that the labels on their products are not misleading. This is so that consumers can make a fully informed choice as to whether to buy their products and how to use them once bought. In many countries, legislation exists that states exactly what businesses should include in their labelling.

Inappropriate marketing activities: Product and business marketing activities, including advertising, publicity, and direct marketing, can be considered inappropriate if they are illegal or offensive. In 2013, the Chinese government accused GlaxoSmithKline of engaging in 'illegal marketing activities', including generous entertainment and gift giving. However, businesses recognize the cultural aspects of guanxi, a traditional Chinese business practice, in a global environment.

SUBJECT VOCABULARY

child labour the illegal employment of young children by a business
code of conduct a set of rules outlining the proper practices of an organisation that contribute to the welfare of key stakeholders and respect the rights of all affected by its operations
embezzlement the theft of money or other belongings from a business by an employee who has control over such resources
green credentials commitment to practices that do not damage the environment
institutional framework the system of formal laws, regulations and procedures, and informal conventions customs and norms that shape activity and behaviour

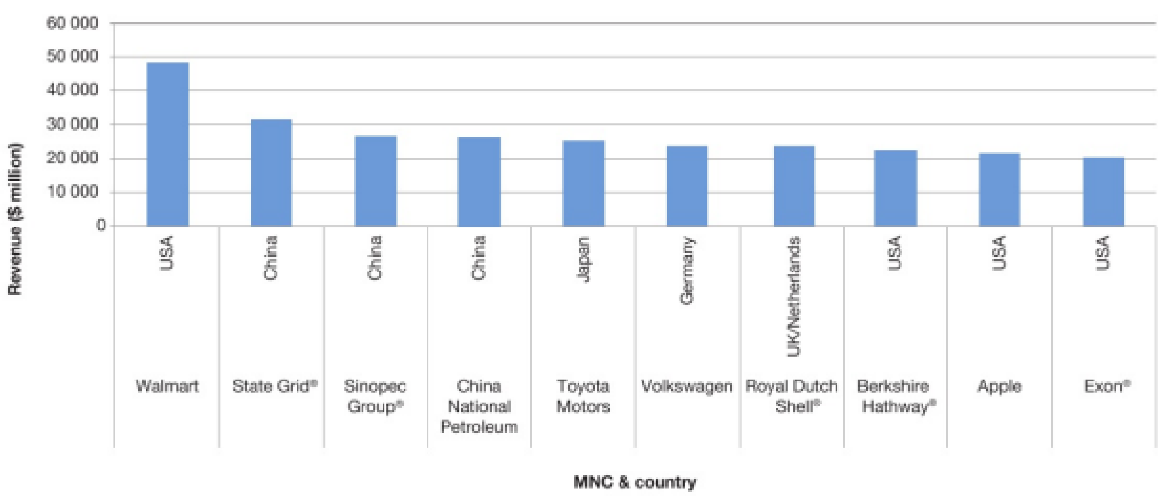
37 Controlling MNCs

THE POWER OF MNCs

MNCs are powerful organizations that contribute significantly to global wealth and job creation, often providing inward investment for developing nations and building foreign currency reserves. They exploit economies of scale and produce goods and services more cheaply, benefiting consumers and utilizing resources effectively. However, they are often criticized for their power and potential exploitation of stakeholders, such as consumers and smaller firms. MNCs may use polluting practices or consume non-renewable resources, and some control revenues and profits through low-tax countries.

POLITICAL INFLUENCE

State-owned enterprises (SOEs) in countries like China control over 120 companies across various sectors, allowing political influence to create, manage, and end businesses. This extensive control can lead to commercial and ethical issues, as seen in China.



▲ Figure 2 The Top 10 MNCs in 2017 by revenue

However, state ownership or control is not very efficient, and so the drawbacks often outweigh the benefits.

• Corruption can be a problem as SOEs might be favoured by powerful politicians.

• State-owned operations may take the capital that other firms might better employ. This is because politicians or regulators, rather than the market, decide where funding should go. This means inefficient businesses may be given more money than they need while also not being subjected to the competitive forces that would otherwise reduce prices and improve efficiency.

• Shareholders' and other investors' rights may be reduced or ignored because they are not the true beneficiaries of the business. The actual beneficiaries (as may be the case with Petrobras) may be the politicians themselves. However, some state enterprises benefit the population as a whole.

• Investment expenditure, especially on research and development, may be ignored. There is likely to be less competitive pressure from other firms with state ownership. This means there will be less incentive to undertake expensive research to create new or better products or services.

Even where a firm is not owned or controlled by the state, political influence may still be important. There could be national strategic priorities, such as energy independence or the development and preservation of key industries. Governments may want to boost employment or regulate financial institutions.

Privately owned businesses can be controlled using a number of political initiatives.

• Tariffs, quotas, regulations and local content requirements can be used to protect domestic businesses from international competitors.

• Many countries even place direct or indirect ownership restrictions on businesses that they consider to be critical.

• Countries can also support domestic industries through subsidies or tax breaks. Subsidies can be designed to help create factories to produce and distribute goods. They can also help consumers to buy products and assist domestic firms in exporting their goods and services.

There are many other forms of political influence that can serve to direct the behaviour of businesses, including the following.

• Lobbying by politicians to influence the decisions of businesses. For example, a politician may wish to prevent the foreign direct investment of a competitor, as this could threaten jobs in his or her electorate.

• Politicians 'retiring' to seats on the boards of plcs. It is not clear whether having former politicians on a board adds value because of their knowledge, or their influence and connections. However, many businesses hire politicians as soon as they leave office.

Some benefits and drawbacks of using political influence to control MNCs are shown in Table 1

Benefits	Drawbacks
Can create, manage and end a business.	Helps to facilitate corruption.
Helps elected officials to challenge the power of private business and to address issues of concern (e.g. ethics and the environment).	Can add to inefficiencies, such as the misallocation of capital and lack of research and development.

▲ Table 1 Benefits and drawbacks of using political influence to control MNCs

LEGAL CONTROL

One of the best ways of controlling large international businesses is through regulation, competition laws and taxation policies.

Competition policy: Competition policy exists to promote competition and ensure that markets operate as efficiently as possible. In many countries, there are specialised agencies set up by the government to protect producers and consumers from unfair or anti- competitive practices.

In 2017, Google's **parent company** AlphabetR was fined €2.4 billion by the EU because it abused its dominance in the search engine market.

Taxation policy: Governments use taxation policies to raise the revenue to run their countries. However, these policies can also be employed to help control the activities of MNCs.

There are concerns that many big companies can use countries' differing systems to avoid tax. Tax avoidance involves using legal methods to reduce the amount of tax that a company pays. This differs from tax evasion, which is the illegal avoidance of tax.

Legislation: The government plays a crucial role in creating a legal framework for businesses, ensuring protection for at-risk groups. However, it must strike a balance between excessive intervention, which can discourage enterprise and foreign investment, and insufficient intervention, which may neglect stakeholder interests. Countries like China have implemented legislation to penalize companies for environmental damage, employee exploitation, and anti-competitive practices.

Benefits	Drawbacks
Can be used to improve competition in the domestic market.	It is difficult to achieve consistent legal practice between countries, so businesses have an incentive to find the friendliest legal environment, where the laws and tax policies are the best for them.
Helps to check corporate power.	It is easy for big international firms to move to friendly environments and avoid treatment that they consider to be unfavourable to their business.
Facilitates consumer protection.	Even where there is agreement over laws, policies and standards, they are often not easy to enforce.

▲ Table 2 Benefits and drawbacks of using laws to control MNCs

CONSUMER PRESSURE

Consumer pressure can influence MNCs to change their behavior, such as canceling marketing events or avoiding products in ethnically and culturally diverse regions. Chinese consumers and the government have the power to influence companies' behavior. Companies are forced to consider social, political, and historical sensitivities when marketing products in diverse regions. For example, Nestlé removed artificial colors and flavors from its products in the US, MarsR considered phasing out artificial food dyes, and McDonald's stopped using antibiotic-raised chickens due to'superbugs'.

PRESSURE GROUPS

Pressure groups, voluntary organizations operating at all levels of society, can publicize bad company behavior and threaten to damage the firm's image, aiming to change political or commercial decision-making.

For example, organisations like Corporate Watch investigate such areas of concern as tax avoidance and **payday lending**. They attempt to provide information on the unethical practices of corporations.

Pressure groups have several methods that they can use to control MNCs.

- **Boycotting**. Business ethics can be promoted through boycotting. This involves withdrawing from commercial or social relations as a form of protest.

- **Media criticism.** Starbucks, Google, and Amazon have faced criticism for alleged tax avoidance schemes, while DeBeers was accused of contributing to conflict diamonds and financing civil wars in Africa.

- **Direct action.** Direct action is the use of demonstrations, protests, strikes or even sabotage to achieve a political or social goal.

- **Lobbying**. This is the taking of issues directly to government in an effort to influence change. Organisations such as Amnesty International and the World Development Movement often lobby governments on human rights and development issues.

Benefits	Drawbacks
It enlists committed people, including volunteers.	Campaigns may be ill-informed or misguided.
Particularly where social media is involved, activists can be enlisted incredibly quickly to engage in information gathering or protest.	Information going viral (i.e. when an image, video or link spreads rapidly through a population by people sharing it electronically with friends and colleagues) may mean it is impossible for a pressure group to influence the message that is ultimately communicated.
It raises issues that may otherwise not become public knowledge.	Direct action can lead to violence or miscarriages of justice.
It alerts politicians and authorities to issues of concern to the public.	Direct action can be very disruptive which may be counterproductive.

▲ Table 3 Benefits and drawbacks of using pressure groups and social media to control MNCs

SOCIAL MEDIA

Social media can be defined as an interaction between electronic and mobile devices, applications and people, that allows users to create content.

As well as being a tool for the promotion of a business's objectives, social media can act as a means of controlling its behaviour, by:

- making the collection of information from a variety of sources easier
- increasing social awareness through communication
- ensuring greater transparency
- bringing together people in order to create a kind of social authority to challenge the power of large companies.

SELF-REGULATION

Self-regulation also involves **self-policing**. This means that the businesses who are signed up to an agreement monitor their own activities. They might do this by measuring emissions, recording consumer complaints and listening to employees' issues. Some of the advantages of self-regulation are outlined below.

- Government regulation might be avoided. This is likely to be more rigorous and expensive. Compliance costs can be a burden when the government imposes rules and regulations.
- The needs of business stakeholders might be better served. This is because members signed up to an agreement will be more aware of the practices in a particular industry than an outside agency. The reputation and image of businesses might be improved if consumers and employees see a genuine attempt to safeguard their interests.
- It may be easier for businesses to encourage its employees to adopt ethical behaviour and principles. This is because the rules are based on social norms and accepted practices. They are not forced upon them from above.
- Self-regulation can also benefit the taxpayer. The cost of setting up government agencies to make rules, monitor business activity and enforce rules can be very expensive.