

**TRANSNATIONAL ENTERPRISES :
DEVELOPMENT OF A GLOBAL PERSPECTIVE**

**A Dissertation submitted to the University of Poona
In Partial Fulfilment of the Degree
MASTER OF PHILOSOPHY
IN
ECONOMICS**

**by
GAUTAM H. BAMBAWALE**

**Gokhale Institute of Politics and Economics
PUNE - 411,004.**

September 1981.

ACKNOWLEDGEMENTS

I am extremely grateful to Dr. S.V. Bokil for his guidance throughout the course of this study. My discussions with him and his incisive comments were extremely important in determining the final shape that this work has taken. The errors that remain are purely my own responsibility.

I thank the authorities of the Gokhale Institute for having awarded me a U.G.C. Junior Research Fellowship, without which this study could not have been completed.

I am grateful to Mr. A.L. Rao, who withstood my fastidiousness admirably well and typed the manuscript efficiently. In the final phase of this work he was not merely a collaborator but also a friend.

Finally, a big 'thank you' to Mr. G.M. Datar for his co-operation in doing the diagrams.

PUNE-4
September 1981.

(GAUTAM BAMBAWALE)

C O N T E N T S

<u>Chapter</u>		<u>Page</u>
I	INTRODUCTION	1 - 25
	1.1 General Introduction	1
	1.2 Problem of Definition	4
	1.3 Reasons for Investing Abroad	11
	1.4 Aims and Objectives	22
II	DIMENSIONS	26 - 51
	2.1 Size	26
	2.2 Spread	31
	2.3 Growth	42
III	ORGANISATION, OWNERSHIP AND CONTROL	52 - 85
	3.1 Organisation	52
	3.2 Ownership	69
	3.3 Control	79
IV	FINANCE	86 - 113
	4.1 Evolution of the Financial Function	86
	4.2 Financing Subsidiaries	94
	4.3 Withdrawing Funds from subsidiaries	103

Chapter

Page

V

CONCLUSION

114 - 122

5.1 Summing up

114

5.2 The Future

119

NOTES

123 - 126

BIBLIOGRAPHY

127 - 133

CHAPTER I

INTRODUCTION

1.1 General Introduction

The company which operates in a number of countries is called a transnational (or multinational) corporation. This is a phenomenon which has become widespread only during the latter half of the twentieth century. International financial institutions have existed since the seventeenth century, e.g., the Bank of Amsterdam. So too have international trading companies like the East India Companies of Holland, England and Spain. Many manufacturing companies too, had been operating in more than one country since the early 1900s. However, with the end of World War II, began a period in which foreign direct investment¹ increased tremendously. During this very period there seems to have occurred a vertical disintegration of production processes. Thus, production of a particular commodity was broken down into a number of discrete processes each of which could be located separately. This development must have been important in the post World War II direct investment boom, which resulted in the proliferation of transnational corporations² (TNCs).

TNCs are massive in size, whether measured in terms of assets, sales, employment, production or profits. They control a tremendous amount of resources-- physical, financial and human. Many of these large corporations are growing at rates greater than those achieved by many of the developed market economies. Further, TNCs as a group occupy an extremely important position in world production, world investment and world trade. Their actions are also of great consequence to international finance.

Although TNCs as a group seem to be important to the international economy, this recent phenomenon has not been adequately analysed and fully understood. Hence, differing opinions are held regarding the impact of TNCs on the world economy. The fact that TNCs operate across national frontiers and control large pools of resources makes them extremely important to the worldwide allocation of resources. Some visualise them as maximisers of world welfare, while others view their size as an indication of their ability to strengthen monopolistic tendencies. This belief is supported by the fact that most TNCs are to be found in industries which are oligopolistic in character.

Since TNC activities transcend national boundaries the objectives of these corporations could conflict with those of nation states and create tensions between these two entities. It is felt by a few that the rise and growth of the TNC signals the beginning of the decline of the nation state as a sovereign, political unit. TNC operations could as well lead to conflicts between countries.

Countries which are recipients of foreign direct investment --- referred to as host countries --- often welcome TNCs because they bring with them a package of resources including capital, technology and managerial skills. On the other hand host nations have been known to criticise TNCs, complaining about foreign domination and economic imperialism.

Countries which make direct investments abroad --- referred to as home countries --- criticise TNCs on the ground that continuous investment abroad implies a steady outflow of capital and hence has an adverse effect on the balance of payments. Another frequent objection to TNC operations abroad is the claim that employment opportunities in the home country dwindle due to the 'export of jobs'.

Thus we find that the TNC is a new institutional form which has become widespread only in very recent times. Its activities, operations and practices have an impact not only on existing institutions e.g., nation states, but also on social, economic and cultural developments the world over. In the words of the U.S. Tariff Commission --- "whatever one's views on the multinational corporation may be, it is beyond dispute that the spread of multinational business ranks with the development of the steam engine, electric power and the automobile as one of the major events of modern economic history."³

As such the TNC is an institution worthy of deep study. An understanding of the functioning and behaviour of TNCs and the motivations behind transnational business is essential to enable mankind to harness this institution in the cause of economic and social development.

1.2 Problem of Definition

Upto the point we have characterised a TNC as an enterprise, which operates in a number of countries. This is a very hazy definition. We, therefore, turn to the question --- what is a TNC?

The vast literature on the subject abounds with various definitions. This stems from the fact that different studies concentrate on different aspects of TNCs and accordingly different definitions have been employed.

One can classify the different possible definitions of a TNC into three categories :

- (a) those based on structural criteria
- (b) those based on criteria of performance
- (c) those based on behavioural criteria

(a) Structural Criteria

(i) Ownership : A corporation could be termed transnational if the ownership was diffused internationally, with persons of various nationalities owning the existing stock of the corporation. The problem with the use of this criterion is that one would have to specify the minimum number of nationalities that must be represented among the owners of a corporation, for it is to be classified as transnational.

(ii) Nationality of top management : If the 'top management' of a corporation or enterprise consisted of people of various nationalities it would be termed transnational.

The difficulty once again would be the specification of a minimum number of countries, which must be represented amongst the top management of the firm. A further problem would be that of defining 'top management'.

(iii) Minimum number of countries of operation :

This seems a more objective criterion than those mentioned previously and has been used quite frequently. Many writers have suggested that a TNC should be defined as a firm operating in two or more countries.⁴

(b) Performance Criteria

The criteria based on performance have to do with -

- (i) earnings
- (ii) sales
- (iii) assets
- (iv) employment.

It is suggested that a company should be classified as transnational depending on the extent of its foreign involvement. Thus, a firm with a certain minimum specified percentage of its earnings or sales originating abroad would be termed transnational. The foreign content of a firm, measured

in terms of assets or employment could similarly be used as criteria for defining TNCs.

In keeping with such a view the U.S. Tariff Commission suggested that the 'typical' TNC is one whose sales range from \$100 million to billions of dollars and direct foreign investment in manufacturing facilities would account for at least 15-20% of the company's total investment.⁵

(c) Behavioural Criteria

This includes the capacity of the firm's management to 'think internationally' or on a global scale. Of course, what one means by 'thinking internationally' remains to be elaborated.

Thus, we find Perlmutter distinguishing between three different types of TNCs on the basis of their orientation. Those, which are home country oriented he terms "ethnocentric", those which are host country oriented he calls "polycentric", and those which are world oriented as "geocentric".⁶

The problem of defining a TNC encompasses the question of the type of TNC operations which are to be included and those to be excluded from such a definition. A classification of TNCs according to type of operations

usually takes the following form :

- (i) Service Sector - which includes banks, insurance companies, airlines, accountants and consultants, hotels.
- (ii) Extractive Sector - includes mining smelting and oil companies.
- (iii) Manufacturing Sector - includes those companies primarily engaged in production of manufactured products.

Many studies limit their scope to those TNCs which operate manufacturing facilities only. Others concentrate on manufacturing and extractive TNCs, while some include TNCs from all three sectors.

The literature on TNCs also poses a problem of terminology. Some writers use the terms, 'international', 'transnational' and 'multinational' synonymously to describe these large enterprises which operate across national borders. Others differentiate between these terms and for them an 'international' firm has connotations quite different from those of a transnational firm.

In our study, a transnational corporation will be a firm which owns, controls and operates assets

in more than one country. Further, we do not restrict the scope of TNCs to manufacturing firms only, but also include those engaged in the extractive and service sectors. We accept that this is a very broad definition, but feel that it is appropriate for a study of the type we are making. We would also like cite the example of the United Nations, which has used a similar definition in most of the work they have undertaken on the subject.⁷

With regard to nomenclature, we agree with the Group of Eminent Persons who in their report to the United Nations recommended that the "word transnational would better convey the notion that these firms operate from their home bases across national borders".⁸ Since such firms need not necessarily be privately owned or incorporated, but could as easily be state owned we prefer to use the term enterprise rather than corporation. Therefore, hence onwards we will term these firms which own, control and operate assets in more than one country, transnational enterprises (TNEs).

We make a distinction between a TNE and an international enterprise.

The transnational enterprise is primarily a citizen of a particular country, but has foreign operations. The foreign content of the firm could range from a couple of percentage points to a majority share of its total operations. The enterprise would hire local executives and local directors. The securities of the company are issued in home country currency and any holdings of foreign exchange are firmly hedged.

The international enterprise has no home country to which it owes allegiance. It does not owe greater loyalty to any of the nations in which it operates. Cash holdings in any currency are viewed as being subject to exchange risk. Return on capital is equalised in every country of operation.

We will use the concept of an international firm, purely as a theoretical construct, against which we can compare any particular TNE or TNEs as a group. That is to say, that all existing firms operating in more than one country we classify as transnational. The concept of the international enterprise will be used as a measuring rod. What exactly we mean will become clearer as we proceed.

This would be an appropriate point to introduce some other terms, which we will use throughout the course of this study.

Parent company refers to the enterprise in the home country, which undertakes and controls foreign direct investment.

A foreign branch is part of the parent company which operates abroad. As opposed to this there exist foreign affiliates which are enterprises in their own right but are controlled by the parent company. A foreign affiliate is sometimes referred to as a subsidiary.

1.3 Reasons for Investing Abroad

We now ask ourselves the question --- why do firms invest abroad? Why don't they produce at home and service foreign markets through exports? Why don't they enter into licensing agreements with existing firms abroad?

To answer these questions we will closely examine 'the theory' of foreign direct investment. The argument runs as follows. Firms which operate abroad do so at a disadvantage vis-a-vis local, domestic firms. This is due to the inherent

difficulties encountered in operating in a foreign country. Cultural, social and political differences and variations in practices in different countries are just some of the problems faced by foreign firms. Since great distances could be involved barriers to effective communication could arise.

Thus, if firms are to invest abroad they must possess some advantages compared to local firms, which offset or more than offset the inherent difficulties of functioning abroad. If firms which undertake foreign direct investment must possess some distinct advantages with respect to national firms, there must exist some imperfections in either goods or factor markets or in both.⁹ Firms which invest abroad must possess some monopolistic advantages. In a world of perfect competition direct investment abroad cannot occur.

These advantages which a firm must possess if it has to invest abroad are termed ownership -- specific advantages because they are peculiar to a particular, individual firm. Ownership specific advantages are a necessary condition for foreign direct investment. A number of such advantages spring to mind.

(a) Capital : The foreign investor could have access to a larger amount of or cheaper capital as compared to domestic firms. This stems from the fact that TNEs control an enormous pool of resources, including capital, whereas domestic firms are likely to own very little. Moreover, TNEs have access to international capital markets which smaller, domestic firms are unlikely to possess. Finally, subsidiaries of TNEs are likely to obtain capital at lower interest rates even in local capital markets due to guarantees given by parent companies.

(b) Technology : The TNE usually possesses superior technology as compared to domestic national firms. By technology is meant the capability of using existing knowledge to manufacture new products or discover new processes. Since TNEs are essentially oligopolistic in nature technology includes the ability to differentiate products.

If, as is usually assumed in the literature, a high degree of correlation exists between the production of technology and research and development (R & D) expenditures, then one can comprehend the technological advantage possessed by TNEs. Usually a minimum level of R & D expenditure must be undertaken

for the net returns to be positive. It is more likely that a large TNE could finance this threshold level of R & D expenditures than a smaller local enterprise.

Further, taking out and defending patents internationally is very costly and may be beyond the capacity of a small or medium sized firm, but would usually be possible for a TNE.

Empirical evidence too shows R & D expenditures to be highly concentrated in the developed countries, especially the USA, which are the bases of most TNEs.¹⁰

(c) Exchange Risk : Aliber has attempted to explain the pattern of foreign direct investment as a currency area phenomenon, in which exchange risk plays an extremely important role.¹¹ In the international capital market a debt can be denominated in any one of a number of currencies. Since the currency in which a particular debt may be denominated, is subject to the risk of depreciation the rate of interest on such a debt reflects the expected depreciation of this particular currency. Further, there is uncertainty about the rate at which this currency will actually depreciate. Thus, investors will also demand a premium

for bearing this uncertainty. This premium for bearing exchange risk is termed a "currency premium". Obviously the currency premium will differ for different currencies, being smaller for harder currencies and larger for weaker currencies.

The next stage in the argument is that portfolio investors behave as though firms within a particular currency area invest in that particular currency area only. Therefore, even if a US firm invests in India portfolio investors behave as if these assets are denominated in dollars. Thus, the income of the US firm originating in India is not subject to the higher currency premium attached to the rupee. Therefore, US firms can borrow more cheaply than Indian firms in international capital markets. Also, US firms will capitalise the same stream of expected earnings at a higher rate than Indian firms.

To generalise, firms in the country whose currency is strongest have an advantage over local enterprises in foreign countries and can pay more than such enterprises for real assets in the host country.

(d) Management : It is recognised that TNEs possess superior managerial skills as compared to

local firms. This could be due to superior education, better training or could be a result of the organisations adopted by TNEs which might facilitate the spread of decision making.

(e) Marketing : This function includes the undertaking of market surveys to ascertain the nature of demand patterns and consumer preferences. An efficient distribution network so that the enterprises' products reach wholesale and retail outlets as quickly as possible is part of the marketing function. Most important to a firm operating under oligopolistic market conditions are advertising methods. It is quite likely that there exists a certain threshold level beyond which advertising outlays prove successful. If this is true, then a TNE would be at an advantage compared to a domestic firm since it could more easily undertake the minimum level of advertising.

It has been argued that superiority in marketing is one of the most important advantages possessed by TNEs.

(f) Access to raw materials : TNEs with their widespread networks of branches and subsidiaries are likely to have easier access to raw materials vis-a-vis

local firms. The access to raw materials could arise due to control over the production, processing or transportation of these resources. This control could arise because of historical, technological, financial or marketing factors.

(g) Economies of Scale : TNEs due to their large size are likely to have reaped economies of scale which smaller firms have not. This would be an important barrier to entry and could emphasise the dominance of TNEs in oligopolistic industries.

The possession of ownership specific advantages is a necessary but not a sufficient condition for foreign direct investment. The firm owning these advantages could easily hire them out through licensing. Therefore, by way of explanation, it has been suggested that markets in intermediate products could be imperfect. Thus, undertaking transactions of ownership -- specific advantages through the market mechanism could be costly and inefficient. Hence, there exists an incentive to bypass them by creating internal markets, through which these exchanges could be carried out more efficiently. The internationalisation of markets could also take place across national boundaries generating TNEs in the process.¹²

Other explanations rely on the existence of location-specific advantages which are peculiar to host countries or regions within countries. These include :

(a) Labour costs : Due to international differences in wage rates, TNEs could be attracted to those countries where labour is abundant and cheap. This seems to explain why TNEs invest in labour abundant LDCs. The urge to reduce labour costs in particular and costs of production in general explains much of the direct investment by foreign firms undertaken in countries like Taiwan, South Korea and Hong Kong.

(b) Government Policy : The existence of barriers to trade like tariffs and quantitative restrictions could induce firms to invest abroad. When export markets have been threatened by the erection of tariff barriers TNEs have been known to jump over such barriers by establishing production facilities in these countries and thus retaining such markets. Existence of crippling transport costs could be looked upon as a barrier to trade and could possibly be a reason for investing abroad.

Government policy with respect to the general investment climate in host countries is an important factor influencing foreign investment. Policies

regarding profit remittances, nationalisation and local participation affect the foreign investment decision of firms.

(c) Marketing : Factors like the size and growth of a market are important as far as direct investments abroad are concerned. Especially in markets comprising of high income buyers, who prefer differentiated products, firms are forced to produce locally so as to be able to satisfy consumer preferences. Local production becomes imperative for firms operating in industries characterized by rapid changes in models and designs.

The existence of a large but underdeveloped market consisting mainly of low income purchasers could attract TNMs by its sheer size.

(d) Product cycle : The product cycle hypothesis stresses the importance of the position of a product in the cycle for the location of manufacturing facilities.¹³ Three stages in the product cycle are distinguished -- the new product, the maturing product and the standardised product.

New products are most likely to be invented and sold in high income countries (like USA). Production

will be undertaken in these high income countries themselves, because the new product is likely to be unstandardised as far as its inputs and processing are concerned. The final specifications of the good will cover a wide range. Therefore, producers will not generally be concerned with input costs but would be more interested in freedom to change inputs. Price elasticity of demand for output of individual firms is likely to be low, making cost differences relatively unimportant. Finally, there is a need for swift communication with customers and suppliers. These considerations lead to the concentration of production of the new product in the high income, innovating country (USA) itself.

The second stage in the product cycle, that of the maturing product, is characterised by increased demand and greater standardisation. Foreign markets will be captured and will become increasingly important. The maturing of the product decreases the need for flexibility in operations. Increasing standardisation opens up the possibility of mass production making the exploitation of scale economies possible. Hence, concern about production costs increase and those about product characteristics decrease. At this stage, the producer will take into consideration the cost of

production at various facilities, transport costs, tariffs and market share. It is likely that the producer will invest and produce abroad.¹⁴

In the final stage, when the product is standardised, production will take place in the LDCs. This would be because market knowledge and information would be less important at this stage. Products would be highly specified and competition would be primarily on price grounds. Therefore, low labour costs in LDCs would attract foreign capital.

Thus, the interaction between ownership --- specific advantages and location - specific advantages is advanced to explain the foreign direct investment phenomenon. We repeat that imperfections in goods and factor markets are necessary for explaining foreign direct investment. Thus, 'the theory' emphasises the oligopolistic nature of TNEs. That most TNEs are concentrated in highly oligopolistic, high technology industries characterised by advanced marketing and management techniques seems to lend credibility to 'the theory'.

Before concluding this section we would like to note other reasons, advanced by TNE managers, for investing abroad. The most important seems to be an

oligopolistic reaction or "bandwagon effect".¹⁵ If one of a number of firms in an oligopolistic industry invests in a foreign country, the others fearing a decline in their market share, immediately following the leader. This bandwagon effect has been cited by many firms as a reason for investing abroad.¹⁶

Firms were also motivated by much more aggressive strategies like the search for more profitable uses for capital and equipment. Proposals by foreign governments or foreign companies for the setting up of production facilities in their countries are also cited. Finally, pressure from one or more high ranking executives within the firm could also result in foreign investment.

1.4 Aims and Objectives

Earlier on we had distinguished between a transnational enterprise and an international enterprise. We had also observed that the concept of an international enterprise would be used purely as a theoretical construct.

Our hypothesis is that as a TNE increases in size and spread it evolves into an international enterprise. This process of evolution we term 'internationalisation'.

Thus, we believe that as a TNE increases in size and spread it no longer looks upon a particular country as the home nation, but becomes increasingly impartial between countries in which it operates. It develops a global perspective looking upon the entire world as its home. Its operations and policies are geared towards the optimization of an objective function for the enterprise system as a whole,¹⁷ even if this implies not achieving some of the objectives of the units of the system (affiliates). This is usually termed 'system optimisation'. The enterprise becomes aware of the risk of holding cash in any currency. Rate of profit is attempted to be equalised in every country in which the enterprise operates.

To prove this hypothesis, especially in the course of a study of this nature, seems to be somewhat ambitious. Therefore, the onus of providing a rigorous proof will not be taken in this particular study. However, we hope to substantiate our hypothesis by establishing that a process of 'internationalisation' of TNEs is taking place. This we attempt to do by concentrating on the transnational company itself and by showing,

--- that the organization of the TNE becomes increasingly complex as size and spread increase. These organisational changes facilitate the process of centralising decision making within the TNE

--- the strong preference for wholly owned or majority owned foreign affiliates on the part of TNEs, which indicates the preference for strong centralised control within the TNE.

We believe that the centralisation of decision making in the hands of executives at the apex of the TNE system is an important intermediary step in the 'internationalisation' process. Once this small coterie of executives, who make the important decisions in the system, develop in a national, global perspective, enterprise policy and behaviour will take on an international character. This small group of executives at the apex of the system are in a position to view the operations of the system in its entirety and hence are very likely to develop an international outlook with regard to enterprise operations and pursue a strategy of 'system optimisation.'

--- We also examine some of the financial practices of TNEs.

This, we believe, will be highly significant as far as the internationalisation of TNEs is concerned. Traditionally, finance has been a highly centralised function in most firms, especially in TNEs. The trend of financial practices followed by TNEs could provide us with a clue to the evolution of these firms.

We start, however, with a brief look at the dimensions of transnational enterprise activity.

CHAPTER II

DIMENSIONS2.1 Size

The most striking characteristic of TNEs is their size. A very rough idea of their size can be gleaned from the data on foreign direct investment. In 1975, the worldwide stock of foreign direct investment was \$258.9 billion. Of this the United States accounted for 47.8% (\$124.2 billion); the United Kingdom for 11.9% (\$30.8 billion); the Federal Republic of Germany, Japan, Switzerland, France and Canada accounting for 4 - 6.5 percent each (\$10 billion - \$16 billion). These, then, are the major countries of origin of foreign direct investment between them accounting for 86.9% of the total stock of foreign direct investment in 1975. We would, therefore, expect the majority of TNEs to be based in these countries.

Amongst recipients of this stock of direct investment abroad in 1975, the developed market economies accounted for 74% and the developing countries for 26%.¹ Thus, the very broad picture one gets of TNE operations is that they are mainly

based and operate in the developed market economies.

Direct investment abroad is concentrated amongst a few firms. In 1973, 250 - 300 firms accounted for 70% of US total foreign investment; 165 firms accounted for over 80% of UK direct investment abroad; 82 firms for over 70% of overseas direct investment of the FRG.² We believe that if this pattern has changed over time, it must have been towards a greater degree of concentration owing to the oligopolistic character of TNEs.

The total sales of foreign affiliates (excluding intra-firm sales) of all industrial TNEs was approximately \$670 billion in 1976. Of this total, industrial TNEs with consolidated sales of over \$1 billion each accounted for \$410 billion (61.2%).³

International production, defined as production subject to foreign control or decision and measured by the sales of foreign affiliates of TNEs was estimated to be \$330 billion in 1971. In the same year the value added by all TNEs was roughly \$500 billion, which was about one-fifth of world gross national product excluding the centrally planned economies. Amongst TNEs as a group, production

was concentrated amongst a few large firms, the value added by each of the top ten TNEs in 1971 being \$3 billion or more, which was greater than the GNP of over 80 countries.⁴

TNEs as a group are important in world trade. The US Tariff Commission found that in 1970, US-based TNEs accounted for one-fourth of world exports of all merchandise and one-fifth of world exports of manufactured goods.⁵

In 1970, private institutions in the international financial field (mainly TNEs headquartered in the US) as a group held \$268 billion in short term liquid assets. This was more than twice as great as the total of international reserves held by central banks and international monetary institutions all over the world.⁶ This gives us an inkling of the importance of the TNEs in the field of international finance.

Table 2.1 shows the size, measured in terms of consolidated sales, and foreign content of the ten largest TNEs in 1976.

It is obvious that they are gigantic and larger than many developed countries, measured by

TABLE 2.1 : Size^(a) and foreign content of major industrial corporations, end 1976

Rank ^(b)	Company	Country	Major industry	Total consolidated sales (\$ in billions)	No. ^(c) of subsidiary countries	Foreign sales as % of total consolidated sales.	Foreign assets as % of total assets
1.	Exxon	U.S.	Petroleum	48.6	25	72	54
2.	General Motors	U.S.	Motor Vehicles	17.2	21	24	12
3.	Royal Dutch/ Shell	Netherlands/ UK	Petroleum	36.1	43	62	50
4.	Ford Motors	U.S.	Motor Vehicles	28.8	30	31	40
5.	Texaco	U.S.	Petroleum	26.5	30	NA	54
6.	Mobil	U.S.	Petroleum	26.1	62	NA	49
7.	National Iranian Oil	Iran	Petroleum	19.7	NA	NA	NA
8.	Standard Oil (California)	U.S.	Petroleum	19.4	26	59	43
9.	British Petroleum	U.K.	Petroleum	19.1	52	83	NA
10.	Gulf Oil	U.S.	Petroleum	16.5	61	55	43

(a) Measured by Total consolidated sales

(b) Ranked in descending order of total consolidated sales

(c) 1973 NA : Not applicable

Note : GNP Figures for selected OECD countries in billions of dollars were USA 1706.5; Japan 552.9; FRG 437.0; France 304.3; UK 219.9; Turkey 41.1; Austria 39.6; Denmark 37.5; Finland 27.6; Norway 25.8; Greece 22.6; New Zealand 12.7; Portugal 12.0; Ireland 8.0; Luxembourg 2.0; Iceland 1.4; Data refer to 1976 except for Italy, Luxembourg, Norway, Portugal and Sweden for which figures are for 1975.

(Source : Hood and Young, 1979).

size of GNP. Table 2.1 not only shows us the size of the largest TNEs in the world but also confirms our earlier observation that most TNEs are based in developed countries.

We would like to point out that the five largest banks in the world ranked by size of total assets at the end of 1976, were all based in developed countries and had assets ranging from \$44 billion to \$72 billion. They operated in a very large number of countries both developed and developing. The transnationalisation of banks seems to have been an important development in the proliferation of manufacturing and extractive TNEs.

2.2 Spread

We have observed that most TNEs originate and operate in developed countries. A detailed breakdown of the major foreign investing countries in 1975 is shown in Table 2.2. A glance at the Table leads us to the inference that most TNEs would be based in the countries mentioned therein, with U.S. TNEs predominating. This seems to be substantiated by Table 2.1 which shows that amongst the ten largest TNEs in the world, seven are based in the US.

**TABLE 2.2 : Stock of direct investment abroad by
major country of origin, 1975.**

Country of origin	\$ in billions	Percentage
U.S.	124.2	47.8
U.K.	30.8	11.9
FRG	16.0	6.2
Japan	15.9	6.1
Switzerland	16.9	6.5
France	11.1	4.3
Canada	10.5	4.1
Netherlands	8.5	3.2
Sweden	4.4	1.7
Belgium-Luxemburg	3.2	1.2
Italy	3.3	1.3
Total above	243.8	94.3
All other (estimate)	15.1	5.7
Grand Total	258.9	100.0

(Source : UN, 1978, Table III - 32).

We have also seen the most important host countries are the developed market economies, which received 74% of the worldwide stock of foreign direct investment in 1975. Of these the major recipient countries were, Canada which received 15% of the total stock of foreign direct investments in 1975; the U.S. received 11%; the UK with 9% and the Federal Republic of Germany with 6%. Amongst the developing countries, which together received 26% of the worldwide stock of direct investment in 1975 the OPEC⁷ countries received 6%; the tax havens⁸ 3% and the remainder 17%⁹.

Table 2.3 which shows the distribution of foreign direct investment amongst LDCs, reveals that the more developed amongst them were preferred as host nations. Although investment in LDCs as a proportion of total direct investment abroad is small, TNEs operating in LDCs could control sizeable portions of particular sectors or industries. This is reflected in the complaints of LDCs regarding foreign domination of domestic industry.

Diversification of TNEs amongst countries varies quite a lot. The ten largest industrial corporations operated in 1973 in twenty one to sixty two countries each. (Table 2.1).

TABLE 2.3 : Direct investment stock in LDCs by host country or territory characteristics, 1975.

Host country, territory and group	Billions of dollars	Percentage
Total stock	68.2	100.0
OPEC countries of which :	15.6	22.9
Venezuela	4.0	5.9
Indonesia	3.5	5.1
Nigeria	2.9	4.3
Iran	1.2	1.8
Tax havens	8.9	13.0
All other LDCs & territories of which :	43.7	64.1
Brazil	9.1	13.3
Mexico	4.8	7.0
India	2.4	3.5
Malaysia	2.3	3.4
Argentina	2.0	2.9

(Source : UN, 1978, Table III - 47)

TABLE 2.4 : Firms with one or more foreign affiliates,
by the number of host countries, 1973.

No. of host countries	Number of firms based in				Total	
	EEC ^(a)	U.S.	Other countries	No.	Per- centage	
1	1807	1136	1312	4255	44.9	
2	783	334	383	1500	15.8	
3	454	206	197	857	9.0	
4	293	140	111	544	5.7	
5	232	95	82	409	4.3	
6	144	88	51	283	3.0	
7	128	75	31	234	2.5	
8	92	45	32	169	1.8	
9	78	56	29	163	1.7	
10	54	44	17	115	1.2	
11	45	37	22	104	1.1	
12	41	37	14	92	1.0	
13	34	22	12	68	0.7	
14	43	26	12	81	0.9	
15	29	25	11	65	0.7	
16	23	17	5	45	0.5	
17	20	14	8	42	0.4	
18	11	25	5	41	0.4	
19	26	14	5	45	0.5	
20	22	18	5	45	0.5	
More than 20	173	113	38	324	3.4	
Grand Total	4532	2567	2382	9481	100.0	
Percentage	(47.8)	(27.1)	(25.1)	(100.0)		

(a) Firms with one or more foreign affiliates, but not included in Table III-8.

Table 2.4 shows the number of host countries in which firms with one or more foreign affiliates operated during 1973.

Although the majority of TNEs operate in one or two host countries only, we should observe that over 20% of the TNEs in Table 2.4 operate in six or more countries. For US-based TNEs the corresponding figure is approximately 26% while it is only 12% for TNEs from 'other' countries.

What we find remarkable is that 3.4% of the firms (324) operate in twenty or more countries. These are obviously the biggest TNEs, as our perusal of Table 2.1 showed. We would also like to point out that the Harvard Multinational Enterprise Project found that of a sample of 391 enterprises approximately 77% of them operated in six or more countries. 18% of the sample firms operated in more than twenty countries. For U.S. firms the corresponding figure was 22%. The sample included 180 US-based TNEs drawn from the FORTUNE 500 list for 1967; 135 Europe-based and 61 Japan based TNEs selected from the FORTUNE 200 list for non-US companies for 1970 and 15 TNEs based elsewhere than US, Europe and Japan.¹⁰ This sample, therefore, included some of the largest TNEs in the world and we believe that the differences

in the figures for the sample above and those in Table 2.4 are significant.

As far as the sectorwise spread of TNEs is concerned we find that of the estimated stock of foreign investment in 1966 made by DAC countries,¹¹ 28.9% was in petroleum; 6.6% in mining; 40.5% in manufacturing; the remaining 24% being classified as 'other' including service sector. The distinction between developed and developing areas was important for the sectoral breakdown of foreign investment by DAC countries. Thus, of the total DAC direct investment in developed countries 23.6% was in petroleum; 5.2% in mining and 47.3% in manufacturing. For LDCs the corresponding figures were 39.7% in petroleum; 9.3% in mining and 26.9% in manufacturing.¹² Thus, LDCs were looked upon by TNEs primarily as sources of raw materials especially petroleum.

A good idea of the industries in which TNEs, are to be found can be obtained from Table 2.5, which shows the industry-wise composition of US foreign manufacturing investment in 1970.

Table 2.6 shows more or less the same information, but this time from the host countries point of view.

**TABLE 2.5 : Industrywise composition of US foreign
manufacturing investment in 1970.**

Industry	Value of investment (\$ million)	Percentage
Chemicals & allied products	6858	22.2
Transport equipment	5131	16.6
Non-electrical machinery	3798	12.3
Primary & Fabricated metals	2619	8.5
Electrical machinery	2613	8.5
Paper & allied products	2007	6.5
Food products	1853	6.0
Instruments	1345	4.4
Wood products	1296	4.2
Stone, clay and glass	1046	3.4
Rubber	974	3.1
Textiles & apparel	625	2.0
Printing and Publishing	138	0.4
Other	602	1.9
TOTAL :	30915	100.0

(Source : US Tariff Commission, 1973).

**TABLE 2.6 : Number of manufacturing subsidiaries of
TNEs in selected product lines in 4 developing countries, 1970.**

Product line	No. of subsidiaries			
	Brasil	Mexico	Colombia	India
Industrial inorganic chemicals	19	27	7	12
Agricultural chemicals	10	7	8	7
Miscellaneous chemical products	14	7	4	5
Drugs	23	28	14	22
Plastic materials & synthetics	15	19	8	16
Special industrial machinery	7	3	1	8
General industrial machinery	7	11	1	4
Office computing machines	5	6	2	2
Yarn & Thread mill	6	1	5	2
Electric distributing equipment	8	6	2	8
Miscellaneous electrical equipment	9	7	2	4
Metal cans	2	2	2	1

(Source : Vernon, 1977)

We find TNE activity to be concentrated in chemicals, machinery, electrical products and transport equipment. These industries are skill intensive in which R & D, product differentiation and marketing play a very important role. This is what we expected owing to the oligopolistic nature of TNEs.

Individual TNEs seldom operate in one product line only. The major TNEs have all diversified and often manufacture a whole range of products. We find instances of food companies entering chemical production, and chemical companies producing food products and engineering goods. Vertical integration of firms has strengthened this trend of product diversification. We find banks, insurance companies and advertising agencies diversifying into unrelated industries. Therefore, the traditional distinction between industries has become somewhat blurred. Table 2.7 shows that the average number of product lines for 180 US-based TNEs operating in LDCs was 1.68; for 135 UK and Europe-based TNEs 1.15; and for 76 other TNEs it was 1.32.

Table 2.7 reveals that the older the affiliate the more diversified it is. We would also like to point out that the table deals with affiliates

**TABLE 2.7 : Product lines of 2,845 manufacturing
affiliates of 391 TNEs in LDCs, 1975.**

Home country and date of entry	No. of affiliates	No. of product lines	Product lines per affiliate
<u>Affiliates of 180 US-based Corporations by date of entry</u>			
Before 1950	224	442	1.97
1950 - 1959	306	561	1.83
1960 - 1969	933	1448	1.55
TOTAL :	1463	2451	1.68

Affiliates of 135 UK & Europe based Corporations by date of entry

Before 1950	148	196	1.32
1950 - 1959	171	223	1.30
1960 - 1969	617	660	1.07
TOTAL :	936	1079	1.15

Affiliates of 76 other corporations by date of entry.

Before 1950	23	38	1.65
1950 - 1959	31	47	1.56
1960 - 1969	392	502	1.28
TOTAL :	446	587	1.32

(Source : UN, 1978, Table III - 23)

of TNEs in LDCs only. Since most TNE activity is concentrated in developed countries we expect product diversification to be greater among affiliates of TNEs operating in these countries.

To recapitulate, TNEs operate mainly in developed countries, with many having widespread networks covering a large number of countries. TNEs are concentrated in those industries which require large R & D expenditures, highly skilled labour and marketing expertise. Most TNEs produce a diversified range of products.

2.3 Growth

The total world-wide stock of foreign direct investment increased from \$105.3 billion in 1967, to \$158 billion in 1971 and further to \$287.2 billion in 1976. The increase was 172% for the period 1967-76 and 82% for 1971-76. We find that the direct investment stock grew at approximately the same rate as the combined GNP of DAC countries. This can be seen in Table 2.8.

A detailed breakdown of the increase in the total stock of direct investment abroad by major countries of origin is given in Table 2.9.

TABLE 2.8 : Comparison of increase in stock of direct investment and combined GNP of DAC Countries.

Item	1967	1971	1976	1967-71	1971-76
	Billions of current U.S. dollars			Average annual rate of increase Percentage	
A. GNP of DAC countries	1561	2213	4167	9.1	13.5
B. Direct investment stock	105	158	287	10.7	12.7

(Source : UN, 1978)

From Table 2.9, we can clearly see that although the US, the UK and France increased the amount they invested abroad, the rate of increase was less than that for Japan, Germany and Switzerland. Therefore, while the shares of US, UK and France in the total stock of foreign direct investment fell between 1967 and 1976, those of Japan, Switzerland and Germany increased. We would expect Japanese and German TNEs to have grown at faster rates than US and UK based TNEs.

TABLE 2.9 : Stock of direct investment abroad by
major country of origin, 1967-76.

Country of origin	Billions of dollars			Percentage distribution		
	1967	1971	1976	1967	1971	1976
U.S.	56.6	82.8	137.2	53.8	52.3	47.6
U.K.	17.5	23.7	32.1	16.6	15.0	11.2
F.R. Germany	3.0	7.3	19.9	2.8	4.6	6.9
Japan	1.5	4.4	19.4	1.4	2.8	6.7
Switzerland	5.0	9.5	18.6	4.8	6.0	6.5
France	6.0	7.3	11.9	5.7	4.6	4.1
Canada	3.7	6.5	11.1	3.5	4.1	3.9
Netherlands	2.2	4.0	9.7	2.1	2.5	3.4
Sweden	1.7	2.4	5.0	1.6	1.5	1.7
Belgium - Luxemburg	2.0	2.4	3.6	1.9	1.5	1.2
Italy	2.1	3.0	2.9	2.0	1.9	1.0
Total (above)	101.3	153.3	270.4	96.2	96.8	94.2
All other (estimated)	4.0	5.1	16.8	3.8	3.2	5.8
Grand Total	105.3	158.4	287.2	100.0	100.0	100.0

(Source : UN, 1978, Table III - 32)

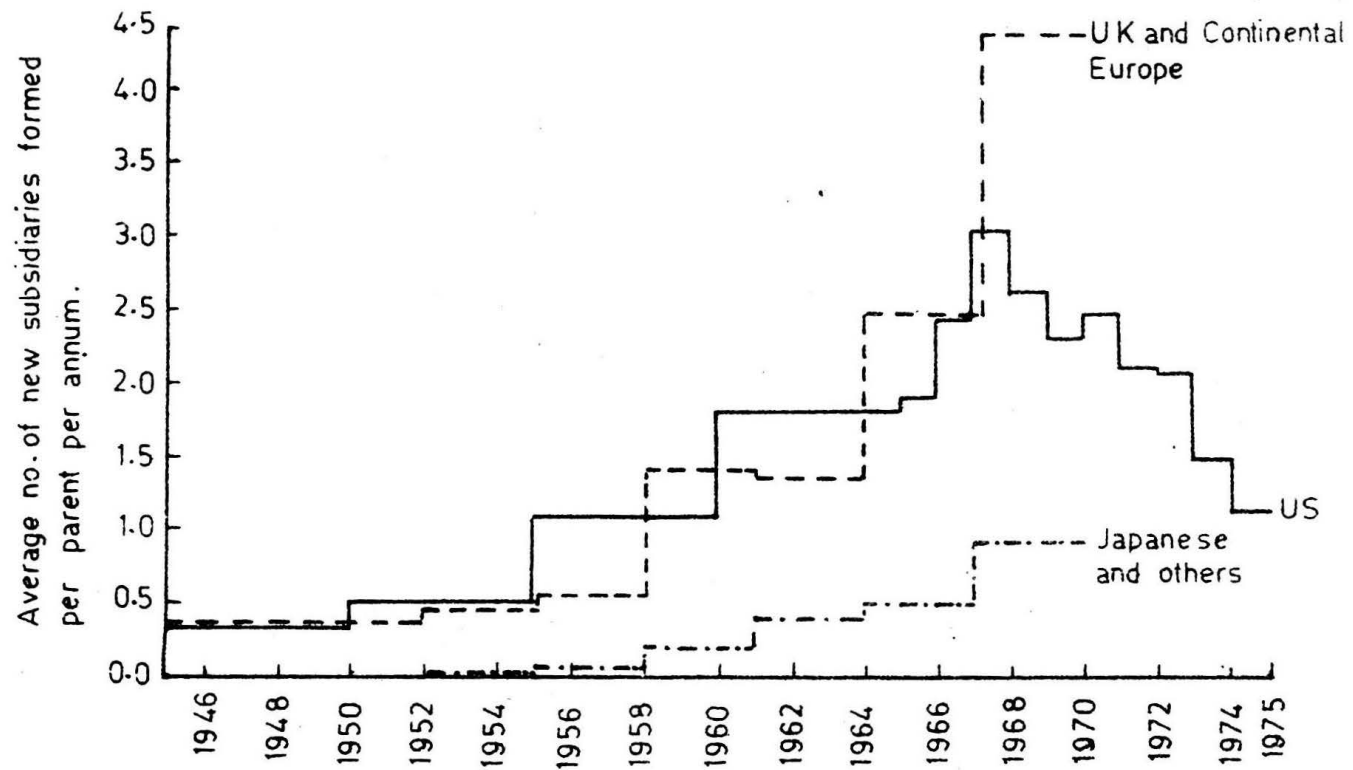


Fig. 2-1 Rate of new affiliate establishment per annum by a sample of US, European, Japanese and other TNEs

(Source : Hood and Young, 1979)

Figure 2.1 shows that in the early 70s European TNEs were growing more rapidly than US based enterprises. However, Japanese TNEs were growing less rapidly.

The relative expansion paths shown in Figure 2.1 must be taken as indicative only, since the samples of firms are not strictly comparable and the periods covered by the data are different. The number of new manufacturing subsidiaries formed by the sample of US-based TNEs peaked in 1968 when each TNE on an average established three new subsidiaries per annum. By 1975 this figure had fallen to nearly one. The take-off period for non-US TNEs was later than that for US TNEs. The main growth period for UK and continental European TNEs was the early and mid 60s, that for Japanese TNEs was the late 60s.

Now let us see if, and how, the distribution of the stock of foreign direct investment amongst host nations has changed over time. This is shown in Table 2.10.

The significant point emerging from the Table 2.10 is that, the share of the total stock of foreign direct investment of the developed countries has increased during the period 1967-1975, and that of the developing countries has decreased. The

TABLE 2.10 : Stock of direct investment abroad of developed market economies, by host country, 1967-1975.

Host country and country group	Percentage of total, end year		
	1967	1971	1975
Developed market economies	69	72	74
of which :			
Canada	18	17	15
U.S.A.	9	9	11
U.K.	8	9	9
West Germany	3	5	6
Other	30	32	33
Developing countries	31	28	26
of which :			
OPEC	9	7	6
Tax Havens	2	3	3
Other	20	18	17
TOTAL :	100	100	100
Total value of stock (\$ billion)	105	158	259

(Sources : UN, 1978. Table III - 33).

inference one could draw is that as developing host nations apply increasing pressure on TNEs to reduce their equity holdings in foreign affiliates based in such countries and attempt to control the activities of TNEs, these firms prefer to locate their plants in the developed nations.

A further interesting observation is that although the share of LDCs as a group in the worldwide stock of foreign direct investment has decreased during the period under consideration, the distribution of the direct investment stock amongst the developing countries itself has shifted. Thus, from Table 2.11, we find that the share, in the direct investment stock in LDCs, of the more developed of the developing nations like Indonesia, Brazil, Malaysia, Singapore and Hong Kong have increased at the expense of the poorer developing nations.

Table 2.12 shows the change in the proportion of sales of foreign affiliates in the Total consolidated sales of the world's 422 largest industrial corporations during 1971-76.

TABLE 2.11 : Direct investment stock in developing countries, by host country or territory characteristics (1967 - 1975)

Host countries	1967		1971		1975	
	\$ billion	%	\$ billion	%	\$ billion	%
Total stock	32.8	100.0	43.3	100.0	68.2	100.0
OPEC Countries of which :	9.1	27.7	11.6	26.8	15.6	22.9
Venezuela	3.5	10.6	3.7	8.5	4.0	5.9
Indonesia	0.2	0.6	1.0	2.3	3.5	5.1
Nigeria	1.1	3.3	1.7	3.9	2.9	4.3
Iran	0.7	2.1	0.9	2.1	1.2	1.8
Tax havens	2.3	7.0	3.9	9.0	8.9	13.0
All other LDCs of which :	21.4	65.3	27.8	64.2	43.7	64.1
Brazil	3.7	11.3	5.1	11.8	9.1	13.3
Mexico	1.8	5.5	2.4	5.5	4.8	7.0
India	1.3	4.0	1.6	3.7	2.4	3.5
Malaysia	0.7	2.1	0.9	2.1	2.3	3.4
Argentina	1.8	5.5	2.2	5.1	2.0	2.9
Singapore	0.2	0.6	0.4	0.9	1.7	2.5
Peru	0.8	2.4	0.9	2.1	1.7	2.5
Hong Kong	0.3	0.9	0.6	1.4	1.3	1.9
Phillipines	0.7	2.1	0.9	2.1	1.2	1.8
Trinidad & Tobago	0.7	2.1	1.0	2.3	1.2	1.8
Total of above 10 countries	12.0	36.5	16.0	37.0	27.7	40.6

(Source : UN, 1978, Table III - 47)

TABLE 2.12 : Change in the proportion of sales of foreign affiliates in total consolidated sales of world's 422 largest industrial corporations by country of origin, 1971-76. (No. of firms)

Change	US	Japan	UK	FRG	Other DCs	LDCs	Total
<u>Increase</u>							
Over 10% points	22	-	7	1	1	-	31
2 - 10% points	93	12	27	9	12	-	153
<u>Steady</u>	49	12	4	5	9	1	80
<u>Decrease</u>							
2 - 10% points	12	-	2	-	6	-	20
Over 10% points	1	-	-	-	1	-	2
Unknown	46	25	1	12	43	9	136
TOTAL :	223	49	41	27	72	10	422

(Source : UN, 1978).

Among firms for which the change in the proportion of sales was known only 8% registered a decrease, while 64% showed an increase of 2% or more. 11% of the firms showed an increase

of 10% points or more. The United Nations has observed that such evidence "indicates the strength of the trend towards greater internationalisation of large scale firms".¹³

Sales of foreign affiliates, of corporations with consolidated sales of more than \$1 billion each, increased 25% faster than the firms' total consolidated sales during 1971-76. While consolidated sales grew at an annual compound rate of 6.2%, sales of foreign affiliates grew at 11.1%.¹⁴

TNEs are becoming increasingly important in international trade. While world exports of all merchandise increased by 53% between 1966-70, TNE related exports grew by 69% and non-TNE exports by only 52%. Similarly while world exports of manufactured goods increased by 65%, TNE related exports of such goods rose by 73%.¹⁵

Thus, we find that TNEs are growing steadily, with the largest of them growing at much faster rates.

CHAPTER III

ORGANISATION, OWNERSHIP AND CONTROL

3.1 Organisation

In the first chapter we saw various factors which influence a firm's decision to invest abroad. We might have left the reader with a feeling that the decision to invest abroad is an overnight one. A national firm becomes transnational due to a snap decision by its directors. This is not true. A number of stages in the foreign activity of a firm can be distinguished.

A firm usually begins by exporting to a particular country where a market for its product exists. As this foreign market increases in size and as exports rise steadily, the parent company will generally establish a foreign branch in such a country. The branch would act as a service agency and would also undertake market surveys to determine whether the demand for the product is increasing. As demand increases, the firm will decide to begin assembly operations in the foreign country. Thus, components will be shipped to this country and the product will be assembled there. At this stage the quality of the product is extremely important for

building up goodwill and for persuading consumers to purchase this particular product. As the foreign market grows still larger, the firm finally decides to begin manufacturing in the foreign country itself. Once a new subsidiary has been set up it becomes yet another unit in the TNE system and will itself begin to grow.

As a TNE grows, its organisational structure also undergoes a change. The organisational structure which is adopted is an important factor in depicting the nature of relationships within the enterprise, in particular the relationship between the parent company and the subsidiaries. This is due to the necessity of changing the locus of decision making within the TNE as it expands. The evolution of the organisational structures of TNEs is closely linked to the strategies of expansion adopted by individual TNEs and could differ for TNEs of different nationalities.

It has been recognised that the evolution of the organisational patterns adopted by TNEs has taken place in fairly discrete stages. As a TNE increases in size, spread and diversity its organisational structure becomes increasingly complex. We concentrate on the set-up in the parent company, since subsidiaries tend to mirror the organisational pattern at the head

office.¹ Four different structures can be distinguished.
These are ---

- (1) Organisation based on central functions
- (2) Organisation based on geographical area
- (3) Organisation based on product groups
- (4) Organisation based on a mixture of
geographical area and product groups.

Organisation based on central functions

The central functions or services in a firm are --- production, marketing, finance, personnel etc. The TNE which is organised on the basis of these central services is usually small in size and spread. Foreign operations as a proportion of total operations are low. A TNE organised on these lines is usually a single product firm. This sort of organisational set up is depicted in Figure 3.1.

Under such an organisational structure it is the manager in charge of a certain function e.g., finance, who is responsible for the proper discharge of that function in the parent company as well as in the subsidiaries. Thus, the line of reporting flows from the finance manager in the subsidiary who reports

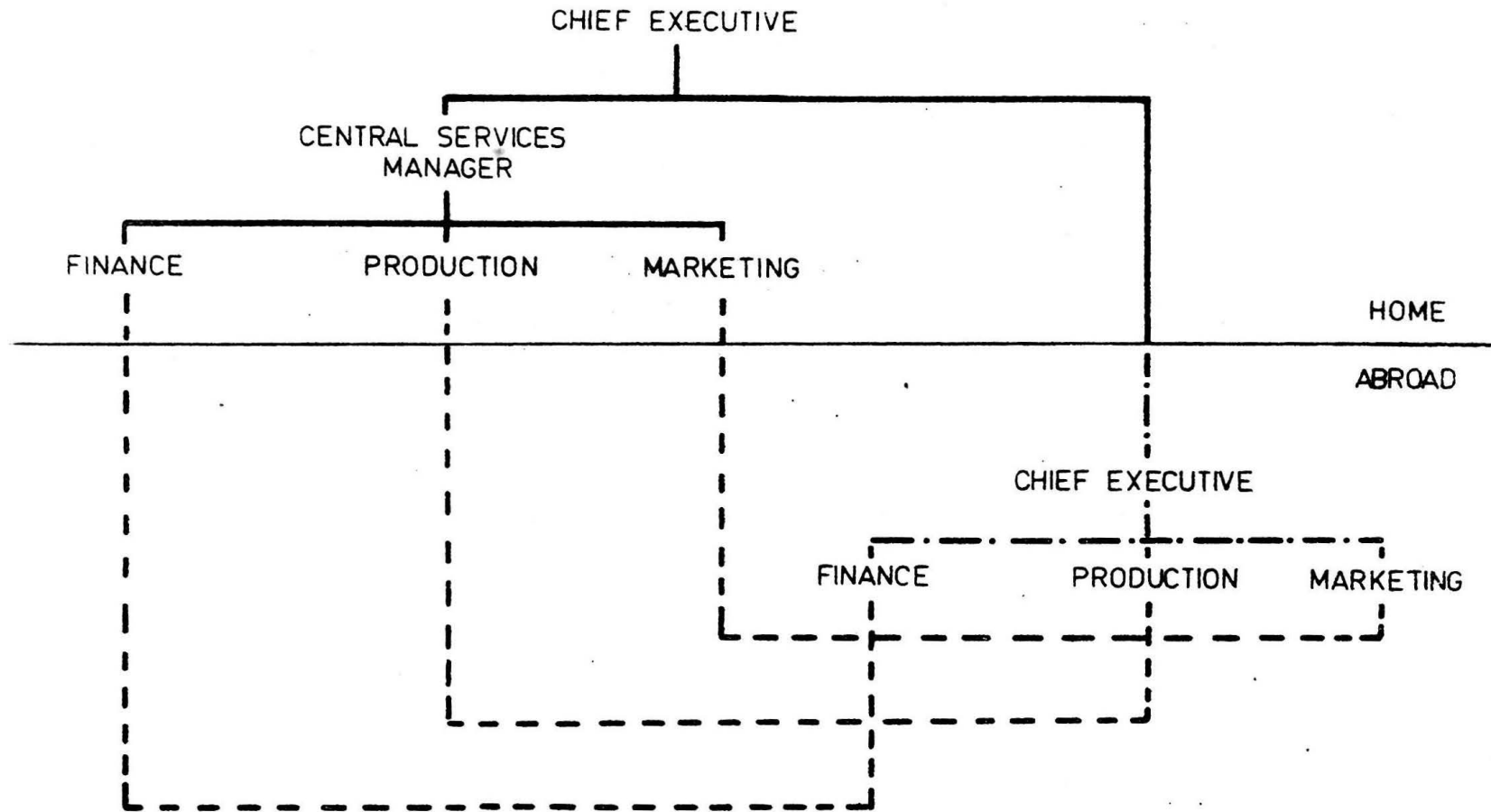


Fig. 3.1 Organisation based on central functions.
 (Source : Brooke and Remmers, 1970)

to the chief executive of the subsidiary and the finance manager at the head office. The finance manager at headquarters, in turn, reports to the chief executive of the TNE, who also confers with the chief executives of the subsidiaries.

This sort of organisation though convenient for small, single product TNEs which operate in very few overseas countries becomes increasingly inefficient as the TNE grows in size and spread. Therefore, this sort of organisational pattern usually gives way to the other types described below.

Organisation based on geographical area

Here the parent company is organised by product groups while the subsidiaries are organised according to geographical area. This organisational structure is a natural outcome for a company which begins by exporting abroad, then starts assembly operations overseas and finally begins to manufacture in the foreign country itself. When exports of the company increase and it decides to assemble its products abroad these operations remain under the control of the export department in the parent company. But when manufacturing is commenced abroad this leads to the creation of an international division which is

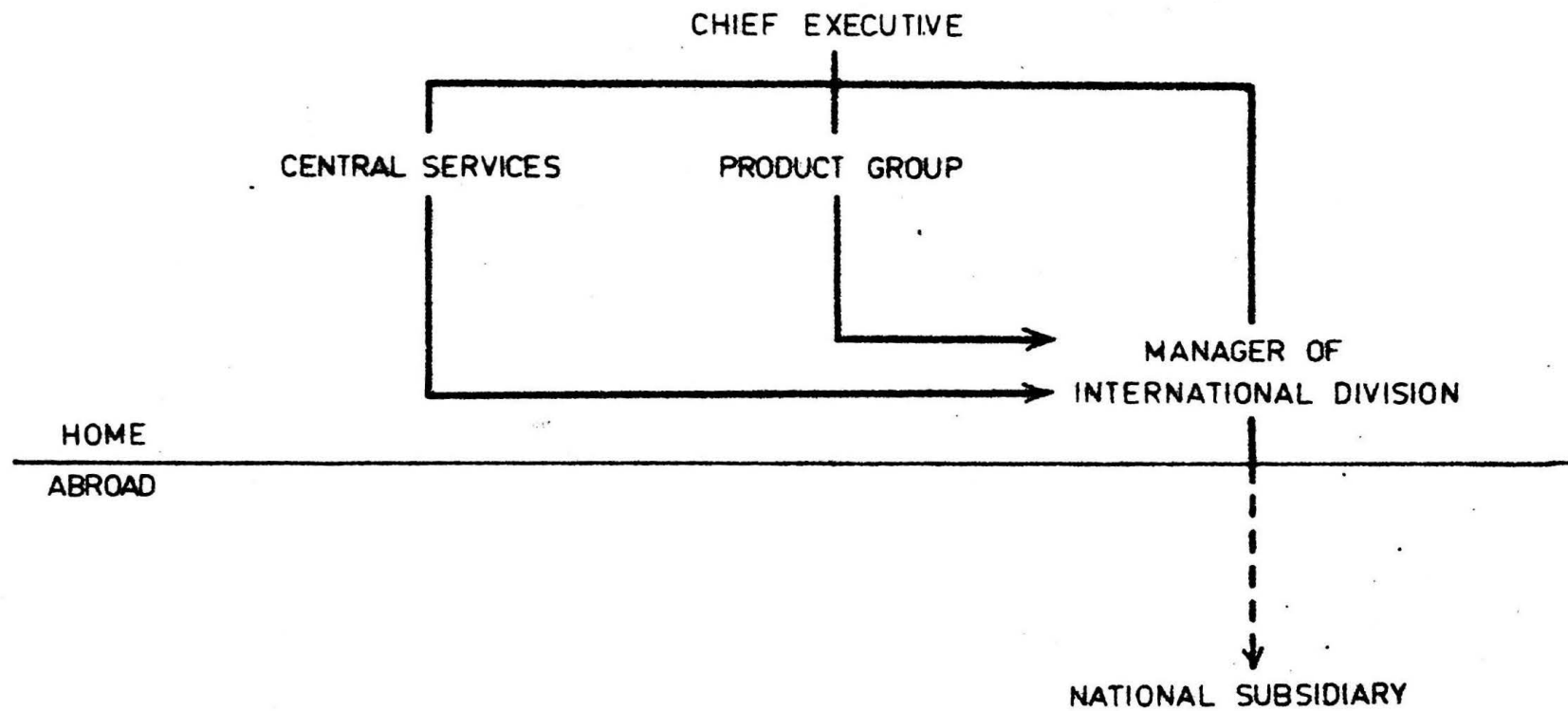


Fig . 3.2 Organisation based on geographical area
 (Source : Brooke and Remmers, 1970)

in charge of all operations abroad. This is shown in Figure 3.2. In this organisational set up the international division is concerned solely with the operations of the foreign subsidiaries. The international division manager is therefore likely to exercise considerable control over the operations of the foreign affiliates. This is due to the fact that his worth to the organisation would be evaluated on the basis of the performance of the subsidiaries. So too with the other executives in the international division in the parent company. Thus, decision making is likely to be more centralised under such an organisational structure than under an organisation based on central functions.

The difficulty faced in such an organisation is that tremendous communication problems generally arise at headquarters. This is because the international division is concerned solely about overseas operations, while the product group divisions in the parent company are bothered only with activities in the home country. There is likely to be much prejudice against the international division and indifference towards problems faced abroad.

Organisation based on product groups

This sort of enterprise is organised according to product groups not only at home but abroad too. When the firm, which is organised along product groups, begins the manufacture of a particular product abroad it remains the responsibility of the product group. This sort of organisation is usually more complex than one based on geographical area. There could exist sub-product divisions which directly control foreign operations.

The line of reporting could be quite complex as Figure 3.3 reveals. A production manager in a foreign subsidiary would have to report to the chief executive of the national subsidiary, who in turn would report to the manager in charge of the sub-product group at the head office and so on up the hierarchy. The existence of several levels of management executives between local operators and the top management of the TNE is likely to lead to greater centralisation in decision making.

The problems faced under such a set up are the difficulties in communication between the foreign subsidiary and the parent company. Thus, there are likely to be standard policies and procedures

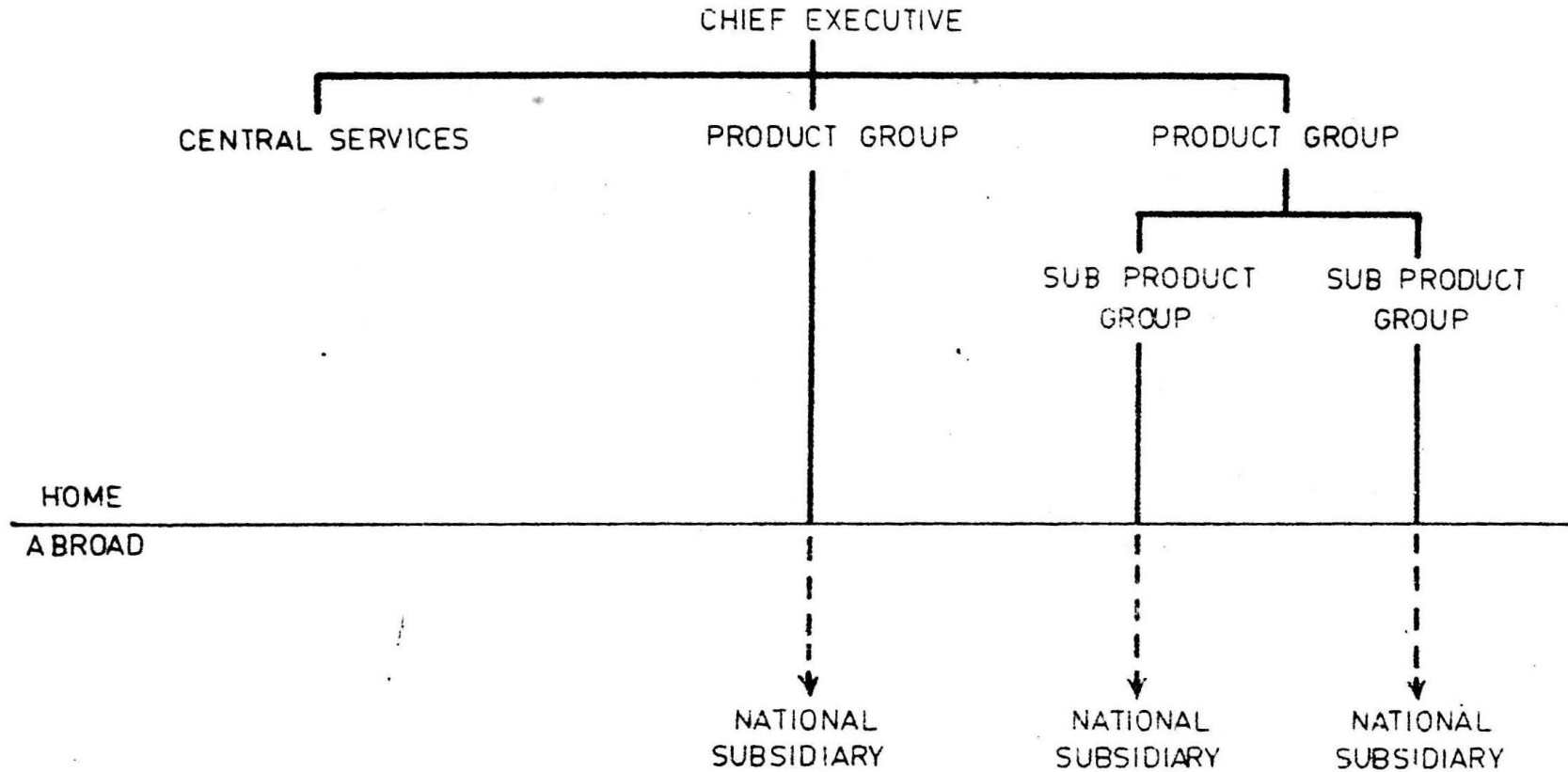


Fig. 3-3 Organisation based on product groups

(Source : Brooke and Remmers, 1970)

formulated by the parent company which the subsidiaries would have to follow.

Another difficulty is that if there exist operations in a particular foreign country, which have to do with two or more product groups there would be a waste of resources involved due to the necessity of setting up more than one organisation in the foreign country.

Organisation based on mixture of geographical area and product groups

We have seen that organizations based on either geographical area or product groups each have problems unique to themselves. The effort to overcome these difficulties has led to the evolution of a structure which combines the two.

We can differentiate between two structures here --

- (a) where the geographical organisation has priority
- (b) where the product group organisation has priority

(a) Under such an organisation the subsidiary is set up by the international division after consultations

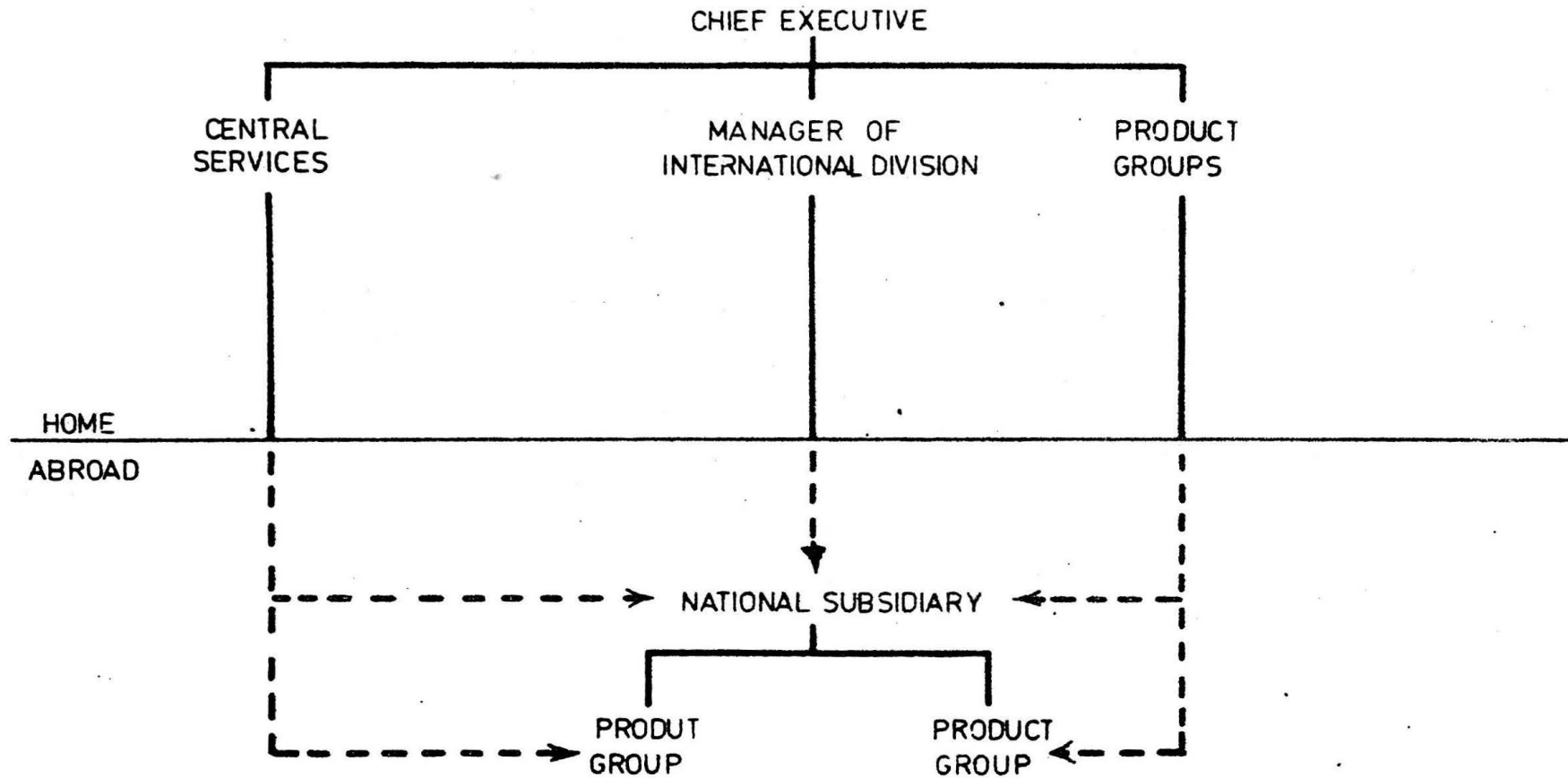


Fig. 3-4 Mixed organisation where geographical organisation has priority .
 (Source: Brooke and Remmers, 1970)

with the product group managers. All reporting is done to the international division manager, while the product group divisions are held responsible for the technical aspects of foreign operations. The international division would constantly prod the product group management not to neglect foreign subsidiaries.

Such a structure is depicted in Figure 3.4.

(b) Under such an organisational pattern once the international division has set up the foreign subsidiary the product group management takes over effective control. Here, the marketing manager in the foreign country reports the chief executive of the national subsidiary on matters regarding personnel, but to the product group manager at headquarters on matters concerning the handling of products.

This points to the fact that the degree of centralisation of decision making within the TNE varies from function to function. For instance, as far as personnel were concerned subsidiaries were autonomous to a considerable degree. This function too is slowly centralised as indicated by the increasing use worldwide of aptitude tests and attitudinal surveys which are suggested by headquarters. Production and R & D

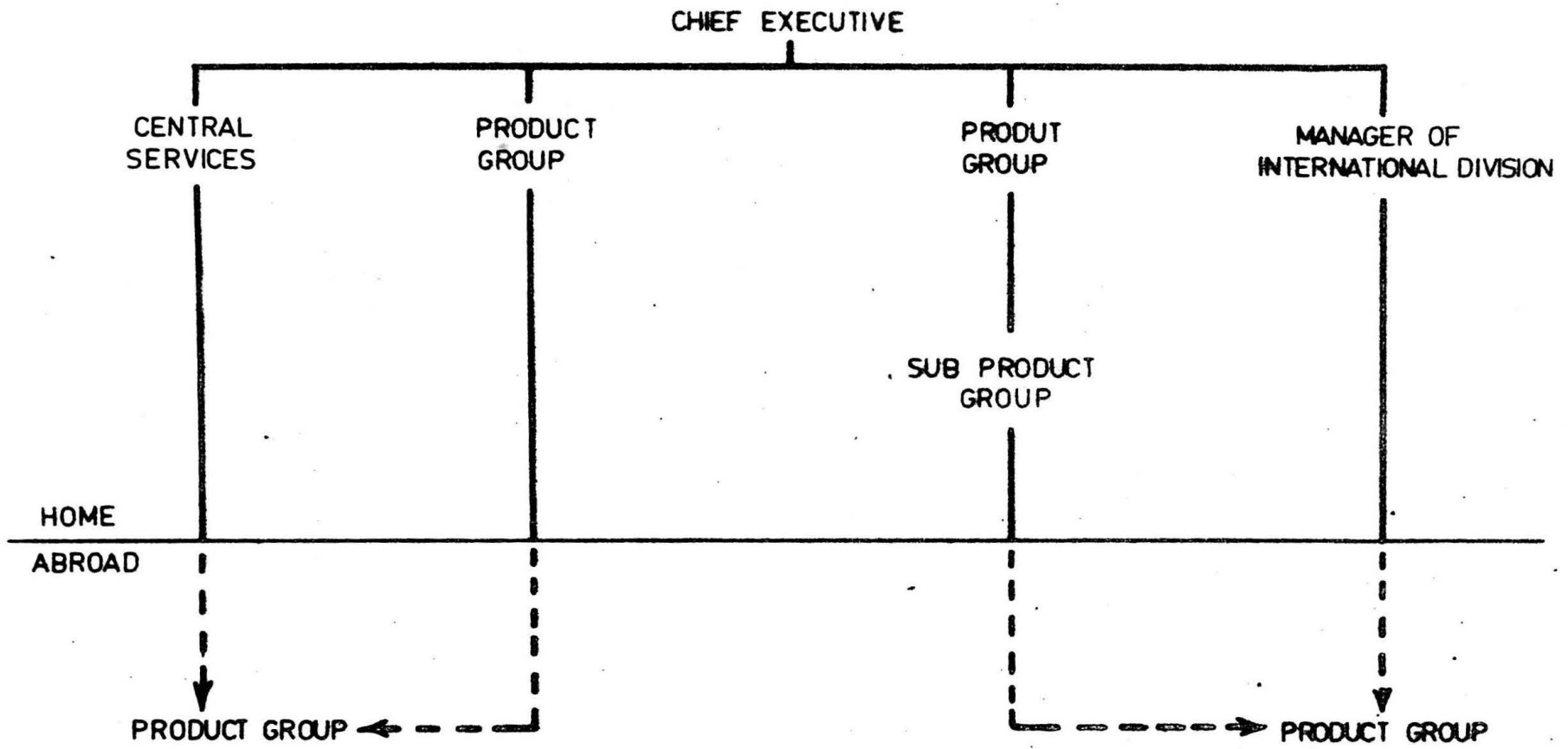


Fig. 3.5 Mixed organisation where product group organisation has priority
 (Source : Brooke and Remmers, 1970)

have traditionally been looked upon as functions, which need to be highly centralised. Marketing long considered to be unamenable to centralised control is increasingly becoming more centralised. This can be explained in the light of the fact that one of the major advantages possessed by TNEs over local firms is their advanced marketing techniques. It is the exploitation of these advanced techniques, which enable foreign subsidiaries of TNEs to compete with domestic firms. Thus, marketing expertise is transferred from the parent company to the subsidiaries and must therefore, be centrally controlled.

The organisational structure of the TNE where the product group organisation has priority is shown in Figure 3.5.

These, then, very broadly are the organisational structures that TNEs have been known to adopt. We do not mean to suggest that when a firm first invests abroad it has an organisation based on central functions and that as it grows larger it shifts to an organisation based on geographical area and so on down the line. What we want to point out is that the four structures we have very roughly outlined above seem to be correlated with size. The

smallest TNEs usually are organised according to central services. Larger TNEs are usually organised according to geographical area or product groups. The largest TNEs exhibit highly complex organisational patterns which comprise of a mixture of geographical area and product groups.

Thus the point we are making is that as TNEs grow larger in size and spread their organisational structures undergo a change and become increasingly complex.

Some of the largest TNEs have also developed regional centres whose objective is to coordinate the activities of subsidiaries in a group of countries. The regional centre is a unit of the head office which is physically closer to the foreign operations of the enterprise. It is run by executives from the parent company who have a good knowledge of the foreign activities of the enterprise. They are in close contact with the subsidiaries and can take over direct control of subsidiaries if and when necessary.

These developments serve to emphasise the increasing complexity of organisational patterns of TNEs. We believe that increasing complexity of organisational patterns are accompanied by a greater

centralisation of control within the TNE and the organisational changes facilitate this process. We observe that organisational changes bring about an increase in the number of stages between local operations and the top management of the enterprise. This development by itself is likely to lead to centralisation of decision making. Of course the increasing importance of foreign operations for the system as a whole, leads to the development of a global perspective by parent company management, which adds to the pressure for centralisation. Further, factors such as technological change, rate of technical progress and the development of global techniques and strategies regarding management, finance and marketing are also important to the process of centralising decision making.

There seems to be a little evidence on our belief that as a TNE increases in size and spread and adopts an increasingly complex organisational structure the level of centralisation within the system increases. Brooke and Remmers found such a pattern of increasingly complex organisational patterns for larger TNEs. Further, for a sample of 115 foreign owned or controlled subsidiaries based in the UK, they found 60% showing a tendency of increasing centralisation during the

period 1959 - 67. They also found this proportion to be greater for larger firms.²

The United Nations study on TNEs remarks that the reorganisation of a TNE is "accompanied by considerable changes in the attitudes of top managements : assumptions that business abroad is fundamentally different from business at home have been replaced by a global perspective and recognition of the need to integrate closely related domestic and foreign units".³

Thus, as TNEs grow larger in size and spread "the tendency, if we may generalise somewhat freely, is for TNEs to knit the structure of organisational power into tighter hierarchies with the most important decisions taken at the centre and the more routine ones left to the subsidiaries".⁴

Due to the oligopolistic nature of TNEs and the possibility of optimising returns to the system as a whole it seems "inevitable that such structural changes should occur, and that they should be accompanied by corresponding changes in corporate philosophy, attitudes of executives, group loyalty, and so on, which are psychologically necessary for their implementation".⁵

3.2 Ownership

As we have mentioned previously, an examination of the pattern of ownership of foreign affiliates of TNEs could give us a clue to the question of the locus of decision making within the TNE system. We realize that the pattern of ownership per se, would not be of much interest to us, but could be an important variable as far as control within the TNE system is concerned. The pattern of ownership could help us in deciding as to where in the system the really crucial decisions are taken.

Three separate types of ownership patterns are generally distinguished --- the wholly owned affiliate; the majority owned affiliate and the minority owned affiliate. There is no hard and fast rule as to what percentage of a firm's equity should be owned by the parent company for it to be classified as wholly owned, majority owned or minority owned. The usual convention is that if 95% or more of the equity is owned by the parent company the affiliate is classified as wholly owned; 50% or more makes it majority owned; 5-49% as minority owned, often termed a joint venture. Table 3.1 shows the pattern of ownership of 391 TNEs.

TABLE 3.1 : Foreign manufacturing subsidiaries of 391 TNEs classified by ownership pattern.

Country and ownership pattern	180 US-based enterprises		135 UK and Europe-based enterprises		61 Japan-based enterprises		All 391 enterprises in sample	
	No. of subsidiaries	%	No. of subsidiaries	%	No. of subsidiaries	%	No. of subsidiaries	%
1.	2.	3.	4.	5.	6.	7.	8.	9.
IN ALL COUNTRIES								
Total subsidiaries	5727	100.0	4661	100.0	562	100.0	9601	100.0
Wholly owned	3730	65.1	2278	48.9	34	6.0	4907	51.1
Majority owned	1223	21.4	1320	28.3	74	13.2	2177	22.7
Minority owned	723	12.6	712	15.3	431	76.7	1537	16.0
Unknown	51	0.9	351	7.5	23	4.1	980	10.2
IN INDUSTRIALISED COUNTRIES								
Total subsidiaries	3603	100.0	3207	100.0	46	100.0	6060	100.0
Wholly owned	2612	72.5	1788	55.7	6	13.0	3634	60.0

	1.	2.	3.	4.	5.	6.	7.	8.	9.
Majority owned		657	18.2	802	25.0	8	17.4	1260	20.8
Minority owned		302	8.4	404	12.6	30	65.2	626	10.3
Unknown		32	0.9	213	6.6	2	4.3	540	8.9
IN DEVELOPING COUNTRIES									
Total subsidiaries		2124	100.0	1454	100.0	516	100.0	3541	100.0
Wholly owned		1118	52.6	490	33.7	28	5.4	1273	36.0
Majority owned		566	26.6	518	35.6	66	12.8	917	25.9
Minority owned		421	19.8	308	21.2	401	77.7	911	25.7
Unknown		19	0.9	138	9.5	21	4.1	440	12.4

(Source : Vernon, 1977)

The data, as indicated in the table, is that of the Harvard Multinational Enterprise Project and represents some of the largest TNEs in the world. We have elaborated upon this sample of enterprises elsewhere. The data for US-based enterprises are provisional as of 1975, others are final as of 1970. The pattern of ownership emerging from a perusal of Table 3.1 is quite clear. For all 391 enterprises in the sample 51.1% of the foreign affiliates were wholly owned and 22.7% were majority owned. Therefore, 73.8% of the subsidiaries of the 391 enterprises were definitely fully controlled by the parent companies.

The differences amongst TNEs based in different countries seems to be extremely interesting. For the 180 US-based TNEs, we find that 86.5% of the affiliates were wholly or majority-owned; for UK and Europe-based TNEs the corresponding figure was 77.2%; while for Japan-based TNEs it was a mere 19.2%.

The distinction between developed and developing countries seems to be important to the type of ownership of the foreign affiliate. Thus, in the industrialised countries 60% of the foreign affiliates were wholly-owned and 20.8% were majority owned, together accounting for 80.8% of the affiliates. In the

developing countries only 36% of the subsidiaries were wholly-owned, a further 25.9% being majority-owned, together accounting for 61.9%.

The strong preference shown by the sample as a whole for majority and wholly owned foreign affiliates can be easily understood in the light of our earlier argument concerning the ownership specific advantages possessed by TNEs. A TNE possessing an advantage, say, in technology would want to reap the monopoly rents obtained from exploiting this advantage for itself and would be unwilling to share these profits with local shareholders. The existence of a large number of local shareholders, even if widely dispersed, could lead to the loss of the ownership-specific advantages possessed by a TNE through the seepage of knowledge. To protect against the loss of such advantages TNEs may be preferring majority and wholly owned subsidiaries. Further, local shareholders may prevent the TNE from pursuing the financial policies e.g., profit remittance, it desires. Local shareholders usually force the subsidiary to disclose information which it would not have done if the affiliate had been wholly owned.

We have seen that Japan-based TNEs preferred minority owned foreign affiliates. This pattern of behaviour can be explained by observing that the Japanese economy is wholly reliant on imported raw materials. Foreign affiliates of Japanese TNEs seem to be based mainly in extractive and primary industries, where technology of a not very advanced nature is required, whereas products requiring highly advanced technology are produced in Japan itself. Thus, cheap resources of raw materials being vital to support the strong Japanese exporting capacity of manufactured goods, the necessity of not being tied to a specific source of supply and at the same time gaining local acceptance seems to have determined the ownership policies of Japan-based TNEs vis-a-vis foreign affiliates.

The difference in ownership patterns between developed and developing countries can be explained in terms of pressures on TNEs by host governments. Developed countries usually being both host as well as home countries are unlikely to press TNEs to undertake joint ventures. LDCs are host countries only. Thus, they are likely to counteract TNE activity by pressing them to accept local shareholders within the ranks of the owners of foreign affiliates.

TNEs are more willing to share ownership of subsidiaries which are small and not critical to the enterprise system as a whole as they usually are in LDCs. Another reason for this willingness to share ownership of subsidiaries located in LDCs may be that the advantages possessed by TNEs may be being eroded. Take the example of a technological advantage due to which a TNE invests in a particular LDC. As this technology gets diffused, profits of the foreign affiliate could decrease. The TNE may want to reduce its equity holding of this foreign subsidiary and use the funds to finance R & D expenditures. The fact that most TNE investments in LDCs are in relatively low technology industries could explain the difference in the pattern of ownership of affiliates based in developed countries and those based in developing countries. TNEs also actively search for joint venture partners where knowledge of local practices and conditions is critical to the success of foreign operations. Such knowledge is likely to be necessary in LDCs where conditions are quite different from those obtaining in developed countries where most TNEs are based.

Further data on ownership patterns is presented in Table 3.2. It shows the distribution

of ownership pattern of foreign affiliates, of 391 TNEs, in LDCs by period of establishment. The number of wholly-and majority owned foreign affiliates declines, the later the period in which they were established. Thus, we find that in the period before 1951, 70.6% of the affiliates of the 180 US-based TNEs were either wholly or majority owned the corresponding figure for the period 1966-70 being 64%. For UK and Europe-based TNEs the figures were 54.5% and 35.3% respectively. For the remaining 76 TNEs in the sample (mainly Japanese) the corresponding figures were 35.6% and 14.3% respectively.

The reason for the emergence of such a pattern obviously is the increasing awareness of host governments of their power vis-a-vis TNEs. Host developing nations obviously want to share in the prosperity of foreign affiliates of TNEs. Hence, they press TNEs to accept joint ventures. This is especially true in the case of extractive and primary industries.

As the relationship between TNEs and host governments changes, new forms of ownership are coming into existence. Thus, we find 'fade-out' arrangements in which the TNE gradually reduces its equity holdings in the foreign affiliate, as the subsidiary becomes increasingly self reliant, finally relinquishing all its equity holdings to locals.

**TABLE 3.2 : Distribution of ownership patterns of
1,276 manufacturing affiliates of 391 TNEs
established in LDCs, by period of establishment,
1951-1975.**

Home country & type of ownership	Number established as percentage of total				
	Before 1951	1951-60	1961-65	1966-70	1971-75
<u>Affiliates of 180 US-based Corporations</u>					
Total	100.0	100.0	100.0	100.0	100.0
Wholly owned	58.4	44.5	37.4	46.2	43.7
Majority owned	12.2	21.4	19.2	17.8	17.3
Co-owned ^(a)	5.6	7.9	11.4	11.2	10.4
Minority owned	11.2	18.8	21.7	21.5	28.1
Unknown	12.6	7.4	10.3	3.3	0.4
<u>Affiliates of 135 UK and Europe-based Corporations</u>					
Total	100.0	100.0	100.0	100.0	--
Wholly owned	39.1	31.6	20.9	18.9	--
Majority owned	15.4	20.1	15.6	16.4	--
Co-owned	5.3	6.6	11.1	6.6	--
Minority owned	9.8	27.9	35.8	42.1	--
Unknown	30.5	13.9	16.6	16.0	--

Home country & type of ownership	Number established as percentage of total				
	Before 1951	1951-60	1961-65	1966-70	1971-75
<u>Affiliates of 76-other TNEs</u>					
Total	100.0	100.0	100.0	100.0	--
Wholly owned	27.4	16.7	10.7	6.1	--
Majority owned	8.2	26.2	12.6	8.2	--
Co-owned	12.3	7.1	6.3	7.5	--
Minority owned	16.4	42.9	66.7	74.2	--
Unknown	35.6	7.1	3.8	3.9	--

(a) A 50-50 distribution of equity is termed as co-owned

(Source : UN, 1978. Table III-25).

Also existent are management contracts, in which the TNE supplies only managerial skills in return for a specified payment. This is an example of how the traditional direct investment 'package' of resources can be 'de-packaged'. TNEs are also involved in the establishment of turnkey projects in socialist countries and LDCs.

In conclusion, we would like to stress the marked preference of TNEs for wholly and majority - owned foreign affiliates. We realise that in modern day corporations minority ownership could be compatible with control and many a firm is controlled by groups holding a small percentage of the firm's total equity. This is true, but for our purposes the fact that TNEs generally own a majority share of their subsidiaries must be stressed. Majority ownership implies control of subsidiaries and the pattern of ownership preferred by TNEs leads us to infer that they prefer to maintain tight control over their foreign affiliates.

3.3 Control

In this section we examine the means through which the activities of the TNE system are coordinated and controlled by the parent company. Broadly, one can distinguish between formal methods of control, which are mainly financial in nature and include plans, forecasts, reports and budgets and information methods such as personal contacts and consultations between executives at different levels in the TNE system. Not much information is available about the nature and importance of informal methods as a means of controlling operations of foreign affiliates and here we shall concentrate on the formal channels.

The evaluation of subsidiary performance is an integral part of the controlling activities of headquarters. Depending upon the way subsidiaries are performing, the top management of the TNE can take steps towards continuing certain policies, discontinuing others and introducing new ones. Thus such evaluation serves two purposes, first it determines the future allocation of resources within the system, and second it facilitates the co-ordination and scheduling of a group of interdependent activities. The essential nature of the control process, therefore, has to do with the evaluation of whether planned targets are being achieved and if not, to reschedule activities so that such targets are fulfilled.

Basically, there are two ways of measuring the performance of a subsidiary ---

- (1) rate of return
- (2) subsidiary's performance relative to its budget.

When calculating the rate of return for a particular subsidiary within the TNE system the first question faced is, return on what? Many TNEs calculate the return on sales, but primarily computations of return on investment are employed. Any calculation

of return on investment relates income to an investment base. Usually net income before taxes is employed in such calculations, but the use of net income after taxes and gross operating income is not unknown. The investment base is usually total assets after depreciation, but alternatively total assets after before depreciation or the equity of the subsidiary are used.

A traditional means of evaluating the performance of a subsidiary and exercising control over its operations has been the budget. A subsidiary which fulfils budgetary targets is thought of as having performed well. The annual budget of a subsidiary has two main components --- the operating budget, which contains the income statement, balance sheet and cash flow projections, and the capital budget which lists individual projects to be undertaken in the coming financial year and their profitability.

The operating budget of a subsidiary is usually drawn up by the top most management of the subsidiary, keeping within the framework and guidelines forwarded by the parent company. Participation in this process by managers at various levels in the head office has also been known. This trend, here, seems to be towards closer head office participation.⁶

Cash budgets seem to be of special importance at the highest management levels, owing to the importance of financial flows within the system.

In the capital budget a distinction is usually made between major investment projects, like expansion of an existing subsidiary, entering a new market or launching a new product, and routine requests for capital funds. Major projects entail a detailed investigation prior to a decision by the parent company. As far as the capital budget is concerned very tight control is exercised by the parent company. This is done by limiting the amount of capital expenditure that subsidiary management can make without reference to higher authority.

Thus, control over the operations of foreign affiliates is exercised mainly through the formulation and scrutiny of their budgets. Control further requires the feedback of information on a regular basis to the head office. Subsidiaries are, therefore, required to report to headquarters at the same time, with standard information, in some prescribed format. Such reports makes it possible for the top management of the TNE to compare the actual performance of an affiliate with its planned

performance as reflected in the budget, and take corrective action whenever necessary.

At this point it would be appropriate to mention, that TNEs could use prices on intra-enterprise transactions as a means for transferring funds within the system. In this way profits could be allocated within the system so as to minimise the global tax liability of the enterprise. More of this later, the importance here being that the recorded profitability of a particular subsidiary could undermine or enhance the actual performance of the subsidiary. The greater the use of such means to reallocate profits amongst the various units of the TNE system, the less representative would be computations like the rate of return with regard to the actual performance of a subsidiary. Therefore, TNEs have been known to adjust their financial accounts so as to get a clearer picture of the actual performance of affiliates. However, serious difficulties can be encountered in measuring and assigning the benefits of intra-company transactions amongst various units. Further abstractions to the proper measurement of actual subsidiary performance could be differences in rules, regulations and accounting principles.

It has been observed ⁷ that measures of evaluating subsidiary performance are informal in TNEs which are small in size. When they make rate of return calculations they do not take into account the costs and benefits to other units in the system. As TNEs increase in size, parent companies have been noticed to keep an increasingly closer watch on subsidiary activities. At first budgetary policies are relatively relaxed but as the size of TNEs increases still further the budget becomes an extremely important method of controlling the financial activities of affiliates. Methods of evaluation become formal and rigid. As TNEs grow larger in size they are likely to judge the performance of subsidiaries with a global perspective taking into account "the income and assets of the entire system on an integrated basis rather than on the basis of only the subsidiary's records as an independent entity". ⁸

Hence, there seems to be quite a lot of evidence to support the hypothesis that as TNEs increase in size and spread there is increasing centralisation of control accompanied by the subordination of "the interests of ^{the} subsidiary to those of the corporation as a whole". ⁹ It has also been

found that some of the largest TNEs in the world today, find that the system can be 'overmanaged' and do tend to loosen control slightly. We interpret this as a relatively recent stage in the 'internationalisation' of the TNE in which the top managers of the subsidiaries of TNEs are themselves developing a global perspective. Therefore subsidiary management itself is gearing subsidiary operations towards the optimisation of the objective function of the enterprise as a whole. They operate subsidiary activities so as to achieve 'system optimisation' even if this entails not achieving certain objectives of the subsidiary itself. Thus, the possibility of 'overmanaging' the system makes it necessary and the development of a global perspective by subsidiary management makes it increasingly possible, for the parent company to loosen control. We repeat that these are relatively recent developments and this stage in the 'internationalisation' process is just being reached by a few of the largest TNEs in the world today.

CHAPTER IV

FINANCE

4.1 Evolution of the Financial Function

Traditionally, finance has been one of the most centralised functions in a firm, either national or transnational. It has also been pointed out that "in a global context, the free movement of funds is the bloodstream of the corporation".¹ We believe that an examination of the financial policies and practices of TNEs, especially the changes in these as the TNE increases in size and spread, will be significant in indicating the trend in the evolution of the TNE as an institution.

One factor distinguishing transnational from domestic business is the necessity of operating in different currencies. Therefore, exchange risk is one of the important factors affecting the financial decisions of TNEs. Unexpected changes in exchange rates could lead to exchange losses for the TNE system. We would like to point out here, that the existing literature on exchange rate fluctuations is curiously biased. Biased because it concentrates heavily on the possibility of the unexpected changes

in exchange rates leading to exchange losses. However, it is just as possible that exchange rate changes could lead to exchange gains. Thus, we must bear in mind that unexpected changes in exchange rates could lead to either exchange losses or exchange gains. Two types of exchange losses or gains can be distinguished ---

- (i) conversion losses or gains
- (ii) translation losses or gains

Exchange losses that result when currencies have to be actually converted into other currencies are termed conversion losses. Suppose, the Indian subsidiary of an US-based TNE borrow \$100 from the parent company and exchanges it for ₹100.² If, while the loan is outstanding, the Indian rupee is devalued so that when repaying the principal the Indian subsidiary has to convert ₹200 into \$100,³ then a conversion loss of ₹ 100 has been suffered.

Translation losses do not involve the actual exchange of currencies, but result from the restatement of the subsidiary's worth in terms of the parent's currency, consequent upon a devaluation. To elaborate, suppose the Indian subsidiary of the US-based TNE holds ₹ 100 in cash. These holdings are

shown in the parent company's books as a cash holding of \$100.⁴ Consequent upon the devaluation, although the subsidiary still holds £ 100 in cash, the parent company's books will show against the subsidiary's name a cash holding of \$50.⁵ Thus a translation loss of \$50 has been suffered.

Another important consideration for firms operating in a number of countries is that interest rates would usually differ amongst nations. This enables the TNE to borrow where interest rates are low and employ these funds where the return on investment is highest. This enables the TNE to minimise interest payments on borrowed capital. Of course, sometimes a decision to borrow in local capital markets is made, even if interest rate is high, due to the weakness of the local currency or due to other business reasons.

Differences in tax rates, tax structures and taxation policies between countries is important in influencing the financial policies of TNEs. Thus, the desire to minimise the global tax liability of the system persuades TNE management to reallocate profits amongst the various units of the enterprise system. Such differences have a bearing on the structure of capitalisation created for a foreign subsidiary and also determine the form and extent of remittances

from subsidiaries to the parent.

The very fact of operating in different countries amongst which laws, practices, conventions, customs and codes differ, obviously influences the financial policies of TNEs. Thus, host country laws regarding remittances influence the repatriation of profits to the home country.

Thus, we find that exchange risk, inter-country differences in taxation policies and interest rates are important considerations for the financial policies of TNEs. However, one must not lose sight of the fact that a TNE like a national enterprise is basically a business firm, whose most important objectives are production, and the generation of profits. However, because the TNE operates in a number of countries it has to take into consideration the factors mentioned above, which do not affect the activities of a national firm. Thus, a TNE like any firm attempts to optimise some objective function, but by virtue of being transnational it can exploit national differences in interest rates and tax rates in the process. What we are emphasising is that although factors like exchange risk, differences in tax and interest rates are peculiar to transnational

business and certainly do affect TNE policy, they need not be the most important considerations governing the TNE financial policy. To illustrate, assume a US-based TNE operating under conditions where the US dollar is expected to depreciate. Although the TNE recognises the risk involved in holding dollars it may be forced to do so since it has to make, say, wage payments in this currency in the near future. Thus the convenience of holding dollars for affecting payments outweighs the possible exchange loss which could result if the dollar does depreciate. So, the TNE continues to hold dollars even though an exchange loss is expected since there are other factors which must be taken into account before arriving at the decision of whether to hold dollars.

Therefore, although exchange risk, differences amongst countries in tax and interest rates are features peculiar to transnational business and do affect TNE financial policy, other factors which are common to both national and transnational business are also involved and only after a complex decision making process involving all these factors is an optimal financial policy arrived at.

It has been found that the financial policies of the TNE are evolutionary in nature.⁶ Three

distinct phases have been distinguished, which correspond quite closely to the size of the enterprise. When the TNE is small in size and when its foreign content is low, there does not exist any close regulation and management of the financial operations of the subsidiaries by headquarters. Executives in the parent company have very little knowledge and experience of transnational business. Therefore, foreign affiliates tend to operate independently and attempt to improve their own performances even if it implies the non-achievement of objectives of the system as a whole. At this particular stage in the evolution of the financial function in TNEs, very little use is made of intra-enterprise financial links, especially from the point of minimising exchange losses or maximising profits of the entire system.

As TNEs grow larger in size and as financial managers in the parent company acquire experience of international financial management, closer and tighter control over the financial activities of the subsidiaries is exercised. It has been recognised that usually a traumatic event, like a devaluation or the write off of a capital project, precedes the tightening

up of financial control. In this phase of the financial evolution of TNEs the importance of intra-company transactions is realised and extensive use of these means are made to attain enterprise objectives. The most important characteristic of this phase, is the 'system optimisation' approach of executives at the head office. In other words, parent company managers develop what we have been calling a global perspective and attempt to optimise the objective function of the enterprise system as a whole. For example, financial operations within the system are scheduled so as to maximise the profits of the entire system or minimise the total tax liability. We had pointed out that the development of a global perspective by the top executives of the TNE is extremely important in the 'internationalisation' process. There clearly seems to be much evidence that the centralisation of control and the development of such a global perspective by parent company managers is closely and positively correlated to the size of the TNE, at least as far as the financial function is concerned.

The third phase in the evolution of the financial operations of TNEs is where these enterprises grow so large in size that headquarters is faced with a dilemma. On the one hand the importance of foreign

operations and the expertise with respect to international financial management at head office encourages further centralisation and on the other the increasing number of subsidiaries and the increasing amount of intra-enterprise transactions makes it impossible for headquarters to give its decision on every transaction. Thus, although the parent company wishes to keep tight control over financial activities of the system it becomes nearly impossible to do so. The dilemma is usually met by loosening financial control to a certain extent and allowing a little more independence to local finance managers. Of course, headquarters issue a great deal of guidelines and rules within which subsidiary management has to operate. Finance executives in the parent company concentrate on changing and renewing such rules as a means of controlling subsidiary activities. "However, make no mistake about it -- even though these large enterprises seemingly are decentralised, their worldwide network of units and intercompany links are in fact controlled indirectly by their rule books or "bibles" from headquarters".⁷ Thus, these gigantic TNEs though slightly decentralised actively pursue a policy of 'system optimisation' through the issue of rules within which subsidiary managers have some degree of

autonomy. This last phase is relatively new to TNEs and only a handful of firms have reached this stage. As we have pointed out elsewhere, we believe that such developments indicate that a global perspective seems to be filtering down to the managers lower down in the TNE hierarchy. Thus, the top subsidiary management seem to be developing such a global attitude, enabling the parent company to loosen control to a small extent. The issue of rule books indicates that top management is not very sure if such a global attitude has truly taken root amongst subsidiary managers. It signifies caution on the part of top TNE management. We also emphasise the fact that the slight decentralisation of financial control amongst a few of the largest TNEs does not mean that 'system optimisation' is no longer pursued. It is very much the major objective of such TNEs, with subsidiary management also making a contribution through subordinating subsidiary objectives to those of the entire system. Of course since this is a relatively new stage in the evolution of TNEs, they have not yet adapted completely to such changes.

4.2 Financing Subsidiaries

Subsidiaries of TNEs require finance not only at the time they are set up but also at other points

in their lives. We now turn to the methods of financing foreign affiliates which TNEs have been known to employ.

There are a number of sources of finance which subsidiaries could tap whenever necessary. These can, very broadly be classified as

- (a) sources of finance internal to the TNE system
- (b) sources of finance external to the TNE system

Internal Finance : At the time of establishing the new subsidiary, the parent company obviously has to sink in some funds. Most TNEs start by investing very small sums on new affiliates hoping, of course, for a large pay off later on. So investment by the parent company in the new affiliate is absolutely essential during its gestation period. The parent has a choice so far as the division of this initial investment between debt and equity is concerned. For ownership, the parent must necessarily invest in the equity of the new subsidiary, but the head office retains the choice of the method of ownership, in different cases holding differing amounts of the affiliate's stock of equity. TNEs have been known to provide newly set up affiliates

with machinery, technical know-how or patented processes in exchange for part of the stock of the affiliate. The ratio between debt and equity is extremely important and there are a number of factors influencing the division between the two when the parent company initially invests in a new subsidiary. Dividend payments and profit remittances are usually very closely and strictly controlled by government regulations, whereas policies regarding interest payments are not so severe. Thus, many TNEs prefer to make loans to new subsidiaries rather than invest in its equity. This is done primarily as a means of enabling the parent to conveniently withdraw funds from the subsidiary at later dates. TNEs are especially cautious of their equity commitments in subsidiaries based in countries whose currency is weak and is liable to be devalued. The relative ease of converting a loan into equity acts as a spur to such behaviour.

Another reason for financing subsidiaries by means of loans rather than equity is the possibility of reducing the global tax burden of the ~~entire~~ entire enterprise. Usually dividend payments made by the subsidiary are not tax deductible, whereas interest payments are. Thus the greater the debt and the lower the equity of the subsidiary, the lesser the tax

liability of the subsidiary. Of course, this does not mean that the subsidiary can have any arbitrary debt equity ratio. Usually governments specify certain limits for the debt equity ratio of registered companies. Further the receipt by the parent company of the principal amount of a loan is not subject to tax whereas retirement of subsidiary stock is. It should be realised that the parent can provide the subsidiary with credit not only by making loans but also by means of trade credit, that is by extending credit for goods and services provided by the parent to the subsidiary. The use of such intra-enterprise accounts have certain advantages over loans. They make for greater flexibility in the provision of credit, since the amount of credit can be increased or decreased merely by lengthening or shortening the term of credit. Loans do not possess such flexibility. When the time for repayment of the debt arises, governments are less likely to interfere if the debt is in the form of intra-enterprise accounts than if they are in the form of loans.

Thus far, we have concentrated on the transfer of funds from the parent company to a subsidiary. It is also possible for one subsidiary in

the system to borrow from the other subsidiaries therein. This could possibly be a considerable source of finance if tapped. Yet, it seems, that this source has been used very sparingly by most TNEs. One reason could be that local financial institutions are reluctant to accept such practices. Another could be that when there are a large number of subsidiaries in the system it is possible for inter-subsidiary financial links to become so intricate that headquarters is in danger of losing track of these. Instead parents prefer not to use such links at all, or use them sparingly.

The aim of most parent companies seems to be to get subsidiaries to 'stand on their own feet'. Thus, once the initial period of establishing the subsidiary has been passed, most TNEs do not wish to extend much financial help. Hence, subsidiaries have to use undistributed profits and depreciation allowances as their major sources of finance. As we shall see later this is a quite considerable source of finance to most subsidiaries.

External Finance : One can distinguish three categories here. Finance obtained locally in the host country, finance obtained from institutions in the home country and finally, finance raised in other countries.

Local borrowing is generally an important source of finance to the foreign affiliates of TNEs. There are two important reasons for such a preference. First, local borrowing is an automatic method of protecting against the devaluation of the local currency. Since the assets of the subsidiary are denominated in local currency it is preferable that the liabilities of the subsidiary also be denominated in local currency. In the event of a devaluation of the local currency both the assets and the liabilities of the subsidiary will be affected symmetrically. Thus, the greater the proportion of the liabilities of the subsidiary which are denominated in local currency the greater the protection against exchange risk.

Secondly, funds in the host country could be available at lower cost than elsewhere. In such a circumstance it would only be rational for the subsidiary to borrow substantially in the local market. Funds borrowed locally could be used in other units of the system. At times parent company management believes that local debt is essential to impress upon subsidiary managers the cost of capital and is, therefore, important to subsidiary performance. When the debt of the subsidiary does not appear in the consolidated

statement of the TNE, local borrowing by the subsidiary does not affect the overall borrowing capacity of the TNE. In such cases, headquarters encourage subsidiaries to borrow locally. Some countries like Japan, limit the amount of funds which foreigners can bring into the country. Thus, there may be no alternative to local borrowing.

Debt contracted by subsidiaries could be either long term or short term. It seems that foreign affiliates of TNEs have very limited resort to long term credit from local financial institutions. They seem to be discriminated against by local financial institutions who fear the export of capital by subsidiaries, which could lead to problems for the country's balance of payments. Further, most subsidiaries are unknown to local authorities, who therefore demand the parent company to guarantee repayment of such loans. Most parents are unwilling to make such guarantees. In many countries, especially LDCs, there is a paucity of long term funds. In developing countries most long term funds are corralled by government agencies for development purposes. This could explain the observation that subsidiaries of TNEs do not obtain much long term finance locally.

Local short term borrowing is very extensive for almost all foreign affiliates. As we have seen this is because TNEs view such means as crucial in hedging against exchange risk. It has been noted that where short term debt is concerned subsidiaries are not discriminated against. As long as they provide collateral short term loans are extended to them.

Trade credit from local companies is a further source of finance. As the subsidiary's production increases, trade credit is likely to increase more or less proportionally.

The parent could finance its subsidiaries by raising loans in the home country. The use of such sources depends upon the cost and availability of local debt and also upon the parent's perception of exchange risk. Capital markets in other countries could also be tapped. Thus we find US-based TNEs financing many subsidiaries by borrowing in the Eurodollar market. Floating of shares by the parent company, either in the home country or in other countries, could be an additional means of financing subsidiary operations, although very unlikely. Such methods have been employed as signified by the development of the Eurobond market.

**TABLE 4.1 : Sources of Funds, MOFA's of 313 US
Foreign Direct Investors primarily engaged in Manu-
facturing 1969.**

	Percentage
From within the TNE	60
Internally generated by affiliate	46
Depreciation	29
Retained earnings	17
From parent	14
Equity	9
Loans	5
From outside TNE	40
Loans	39
Equity	1

TOTAL :	100

=====

(Source : Robbins and Stobaugh, 1974).

Table 4.1 gives a broad idea of the proportions in which these different sources are combined to finance subsidiary operations.

We find from the table that 60% of the funds are raised within the TNE system of which 46% being accounted for by depreciation allowances and retained earnings, and only 14% accounted for by finances from the parent company. 40% of finances were raised from sources external to the TNE mainly from loans.

4.3 Withdrawing Funds from Subsidiaries

In this section we examine the methods employed by TNEs to withdraw funds from subsidiaries located abroad. In particular, we shall concentrate on policies regarding (1) Dividends (2) Royalties and Management fees (3) Transfer pricing.

A fourth method used by TNEs for transferring funds from a subsidiary to the parent is interest payments on loans made to the subsidiary. Since, we have already observed the working of interest payments as a means of withdrawing funds in the previous section we shall not go into it again here.

Dividends : One would expect that when a subsidiary has just been set up dividend payments would be minimal since the affiliate would be 'getting on its own feet'. During this gestation period subsidiaries have a phenomenal need for finance and this necessity would dictate dividend policies in the early years of the subsidiaries existence. Once the subsidiary becomes reasonably profitable, dividend payments would increase. Such a pattern has been observed with respect to the subsidiaries of many TNEs.

Other subsidiaries, however, have been noticed to pay out a stable dividend year after year. The reason for this is host country pressure against the withdrawal of funds from local subsidiaries. As a means of countering such pressure TNEs make dividend payments right from the start of the subsidiary's operations, the payment usually bearing a stable relationship to expected long term profits.

Dividend policies are affected by a host of other factors. The fact that tax rates and taxation policies differ amongst countries affects dividend policies of subsidiaries. Thus, TNEs which aim at minimising the total tax burden on the system

as a whole are led to adopting different dividend policies for subsidiaries based in different countries. To illustrate, in some countries dividends are taxed at higher rates than other types of payment. There exists an incentive to substitute dividends by royalties or management fees, which are usually tax deductible locally. Differences in tax rates between host and home countries affect dividend payments. In home countries e.g., USA, TNEs get a tax credit on income earned abroad and which has already been taxed by the host government. Many TNEs manipulate their dividend payments in such a way that the total tax liability of the system is minimised.

TNEs have also been known to route their dividend payments through tax-haven countries where foreign dividend income is either totally or partially exempted from domestic taxation, or is subject to reduced rates.

Attitudes of management towards exchange risk and the economic condition of the host country are important considerations as far as dividend policy is concerned. It has been observed that firms of different size have different attitudes towards exchange risk.⁸ Smaller TNEs find it less necessary to protect against exchange risk than larger TNEs.

This is because the scope and content of foreign operations is small in smaller TNEs. As firms increase in size and as the proportion of foreign activities in the total operations increases, they become more concerned in protecting against exchange risks and actively pursue policies to attain this objective. Medium sized TNEs commonly use the forward market for fulfilling such aims, while the biggest TNEs control their subsidiaries by submitting to them rules of thumb in protecting against exchange risk. Thus, we find that when management is averse to taking risk, they do not allow subsidiaries to accumulate surplus cash and direct them to pay out most of their earnings each year. Other ways of protecting against exchange risk are the matching of assets and liabilities denominated in local currency, provision of intra-enterprise loans instead of equity and not capitalising reinvested earnings. We shall see later how the transfer price mechanism can also be used to good effect for this purpose.

The subsidiary's requirements for funds and the parent's necessity for these have to be kept in mind when deciding dividend policy for the subsidiary. If the subsidiary's need is urgent then no dividend might be paid at all and most of its

earnings could be reinvested. If the parent company's requirement for funds are great then quite a large dividend payment would be made.

Finally, the existence of local shareholders among the subsidiary's owners and their extent have an important bearing on dividend policies. The larger the equity holdings of local shareholders the the greater the pressure on the subsidiary to pay out a large and stable dividend year after year. Most minority owned foreign affiliates of TNEs have been known to follow such a policy.

Thus, the use of dividends as a means of withdrawing funds from a subsidiary is subject to a number of influencing factors. The actual policy followed by a TNE in the case of particular subsidiaries depends on the weights attached by the TNE to each of these factors.

Royalties and Management Fees : Royalties are paid for the use of trade names and patents. Thus, the parent company allows its subsidiaries to use trade names or some patented processes which it owns in return for which it might get some payment. These payments are termed royalties.

Management fees are paid for management services provided by the parent company.

When the subsidiary is young its payment of royalties and management fees usually exceeds its dividend payments. Once the affiliate has become reasonably profitable dividend payments increase and usually exceed royalties and management fees.

However, this is a relatively rigid tool for the withdrawal of funds since such payments are made in accordance with contracts drawn up at an earlier stage. As we have seen earlier, this tool could be used very frequently as a substitute for dividends especially where differences in tax rates and taxation policies amongst nations enables the TNE to minimise its global tax liability. Very often host governments limit the amount of payments that can be made by foreign affiliates in such manner. Often the financial condition of the subsidiary itself is such as to prevent the payment of royalties and management fees.

Transfer Pricing : We have, throughout this study, been viewing a TNE as a system comprising a number of units which are spread across the globe. We have also observed that there exist a large number of transactions which take place between

between different units in the system. The prices between different units in the system. The prices at which such intra-enterprise transactions are carried out are generally referred to as transfer-prices. The TNE has a certain degree of freedom in setting these transfer prices since the transactions are between units of one system. To facilitate comparison reference is usually made to 'arm's length' prices, which are the prices at which transactions between unrelated and independent firms are or would be carried out. The freedom which TNEs possess in setting transfer prices results in their being greater than or less than the corresponding 'arm's length' prices. Thus, transfer pricing is an extremely useful as well as flexible tool for transferring funds within the TNE system. TNEs seem to use this tool quite liberally in achieving objectives like the maximisation of global profits or the minimisation of exchange risk.

Of immediate concern to us, here, is the use of transfer-pricing for withdrawing funds from foreign affiliates. Thus, if the host country government has laid down quantitative restrictions on the remittance of profits, the TNE could overprice the sale of goods and services to this particular subsidiary, from which it wants to withdraw funds, from the parent and from

other subsidiaries and underprice the sales of goods and services by this subsidiary to other units in the system. Such use of the transfer price mechanism could also be made to increase the parent company's share of profits at the expense of local shareholders.

Use of transfer pricing by TNEs has been made to reallocate profits within the system as so as to minimise the tax burden and maximise profits. Thus, if there was a loss in one centre of operation, the head office could use transfer pricing to remit profits to the centre where the loss had been suffered so as to minimise the tax burden of the system as a whole. We have already noted that the existence of international differences in tax rates, tariffs and taxation policies has led TNEs to use transfer pricing to reallocate profits, amongst various units and maximise global profits. This is an example of the 'system optimisation' approach we have spoken of earlier.

When a particular currency is under the threat of devaluation the TNE usually orders its units in such a country to speed up payments to other units of the system, which are based in other countries, and orders these other units to slow down payments to

subsidiaries in the country facing imminent devaluation. Such action is carried out in order to reduce exchange risk, and locate cash holdings of the system in stronger currencies.

Further, we must note that political pressure from host government against withdrawal of profits from subsidiaries and the threat of nationalisation have led TNEs to make increasing use of this tool.

However, there are certain limits to the use of transfer pricing. These limits are both internal and external to the TNE. Factors internal to the TNE are the communication of requisite knowledge to the parent company and the capacity of the parent to process such information and arrive at a determinate set of transfer prices. Even if subsidiaries can provide headquarters with the necessary information, the head office may not have sufficient resources to handle this information properly. Thus, in the gigantic TNEs, which have a large number of subsidiaries in a large number of countries the processing of such information is bound to become extremely difficult.

A further limitation on the use of transfer

pricing seems to be wholly psychological - i.e., of persuading subsidiary management to show losses or low profits. However, our belief is that as TNEs continue to increase in size and spread, subsidiary management too will develop a global perspective and will be willing to use transfer pricing on an increasing scale.

Their limitations on the use of transfer pricing which are external to TNEs are the pressures of host governments and international agencies. There is a trend towards increasing detection and monitoring of transfer pricing by national government as well as by international institutions. Host governments are motivated primarily by the loss of tax revenue implied by the use of transfer pricing to reallocate profits amongst different countries.

The extent to which transfer pricing has been used seems to be quite great. Lall⁹ shows that in 1970, one-third of total US manufactured trade was intra-enterprise. The trend seems to be one of increasing magnitude of intra-firm transactions. More interesting to us is the finding that intra-company transactions seem to be highly concentrated amongst a few large enterprises. In 1970, eighteen

firms accounted for 65% of intra-enterprise exports. It is likely that the degree of concentration has increased. Robbins and Stobaugh found that smaller TNEs are not in a position to use transfer pricing very widely. As TNEs increase in size they make increasing use of this tool for achieving their objectives.

Thus, transfer pricing seems to be widely used especially by the bigger TNEs.

CHAPTER V

CONCLUSION5.1 Summing up

We began by distinguishing between a transnational and an international enterprise. All existing firms which own, control and operate assets in more than one country we termed 'transnational'. The concept of an international enterprise we used as a distant objective, in the direction of which a transnational progresses as it increases in size and spread. This evolutionary process we termed 'internationalisation'. It is characterised by the increasingly global outlook adopted by the enterprise, whose objective gradually becomes one of 'system optimisation' i.e., the optimisation of an objective function pertaining to the enterprise system as a whole. We had also stated our belief that the centralisation of decision making in the hands of executives at the apex of the TNE system is an important intermediary step in the 'internationalisation' process.¹

Going on to examine some of the dimensions of TNEs we found their major characteristic to be

their large size.² Very broadly, we found a positive correlation between the size of the TNE and its spread, measured by the number of countries and product lines in which the TNE operates. Thus, the larger TNEs had greater foreign content measured either in terms of sales or assets. Our belief is that as the TNE increases in size and spread, and in its foreign content, overseas operations become increasingly important to the enterprise system as a whole. Executives in the parents company, who are in a position to view the enterprises activity in its entirety, can no longer afford to take a partisan view and instead develop a global outlook with respect to the TNE's operations and aim at 'system optimisation'. At this stage the centralisation of control in the hands of parent company executives is important for enforcing decisions on subsidiaries which may conflict with subsidiary interests but are necessary for 'system optimisation'.

To substantiate our hypothesis we concentrated on the TNE itself. We observed that as the TNE increases in size and spread its organisational structure becomes increasingly complex.³ Thus, we noticed a shift from an organisation based on central functions to one based either on geographical area or on product groups, as the TNE expanded and

diversified. As the TNE grew still bigger it adopted an organisational set up which was essentially a mixture of those based on geographical area and product groups. These changes in organisational structure are such as to facilitate the centralisation of decision making. The fact that as TNEs expand in size and spread they feel pressures which lead them to adopt organisational structures which facilitate the centralisation of control, leads us to believe that parent company executives are developing a global perspectives.

As far as patterns of ownership of foreign affiliates is concerned we saw the strong preference which TNEs exhibited for wholly or majority-owned subsidiaries.³ The reason for such a preference is obviously to capture as large a portion of the monopoly profits accumulated by foreign affiliates arising from the ownership specific advantages possessed by TNEs. However, the point important to us is that a majority ownership of the equity of a subsidiary enables the parent company to exercise full control over the affiliate's activities. Thus TNE's preference for wholly and majority-owned foreign affiliates indicates a desire to closely monitor and control the operations of subsidiaries. We have marshalled a satisfactory

amount of evidence to support the hypothesis that as TNEs increase in size and spread there is a tendency of increasing centralisation of decision making.

It appears that some of the largest TNEs find the system to be 'overmanaged' and hence loosen control slightly. This we have interpreted as a further step in the 'internationalisation' process. We have noted previously that one important intermediary step in such a process is the centralisation of control in the hands of parent company executives. Such centralisation is necessary because the parent company managers develop a global perspective whereas subsidiary managers have not. Thus, the parent company manipulates the activities of subsidiaries so as to optimise the objective function of the entire system. As TNEs grow larger still, we believe that, subsidiary managers themselves develop a global perspective and willingly subordinate the objectives of the subsidiary to those of the enterprise system as a whole. This makes it possible for the parent company to decentralise decision making to a small extent.

Finally, we turned to the financial policies and practices of TNEs⁴ hoping that these would provide further evidence of the 'internationalisation' process. Financial practices of TNEs display an evolutionary

nature. As a TNE increases in size and spread the parent company exercises increasing control over the finances of the entire system and manipulates⁵ these to attain the objective of 'system optimisation'. Again, we observed that a few of the largest TNEs were forced by their sheer size to decentralise slightly. We repeat that sheer size is a necessary condition for decentralisation of control --- the development of a global perspective by subsidiary management makes it possible to do so without compromising the objective of 'system optimisation'.

An examination of the methods of financing subsidiary operations revealed that the TNE's awareness of exchange risk increases with the size of the firm, leading to greater reliance on funds generated within affiliates themselves. The positive correlation between the size and spread of TNEs on the one hand, and the awareness of exchange risk and measures taken to protect against them on the other, points to the fact that the larger the TNE the less willing it is to accept exchange losses and the non-optimisation of the system's objective function.

As TNEs increase in size they are more likely to exploit national differences in tax rates and interest rates to minimise the tax liability and maximise profits of the entire system. TNEs also show an

awareness of transfer-pricing for attaining the aims and objectives of the system.

Thus, we firmly believe that TNEs are developing a global perspective and their executives are beginning to 'think internationally'. This is reflected by the gearing of TNE operations towards 'system optimisation'. A process of 'internationalisation' of TNEs definitely seems to be taking place.

5.2 The Future

We have seen that a transnational enterprise, which is primarily a citizen of a particular country, evolves into an international one as it expands in size and spread, possessing no home country to which it owes loyalty. In the course of this evolutionary process the enterprise develops an a-national, global outlook with respect to its operations. It looks upon the world as a whole as its sphere of operation, exploiting national differences in the pursuit of the optimisation of the system's objective function.

As TNEs evolve in this manner they will increasingly come into conflict with nation states. This is evident, even today, in the policies being adopted by both home and host countries, vis-a-vis

TNEs. We find many host countries, especially LDCs, barring entry of TNEs into certain strategic sectors of the economy e.g., defence, communications etc. Further, takeovers by TNEs in certain key industries like iron and steel, cement are restricted. The desire for national ownership on the part of developing host nations has led to their insistence for joint ventures only. Many host countries have set up government agencies to screen foreign direct investment and to specify the conditions of entry.

Home countries are usually host countries too and their policies regarding TNEs are influenced by this dual role. Most home nations encourage TNEs but also safeguard against takeover of domestic firms by foreignbased TNEs. A large amount of legislation has been passed regarding the outflow of capital and technology from home countries. Incentives to invest in LDCs have been provided in the form of insurance to investors against non-commercial risks, risk of expropriation without compensation etc. Home nations attempt to remove the uncertainty of investment climate in LDCs through bilateral investment agreements.

International action to monitor and control the activities of TNEs is being undertaken on an

ever-increasing scale. Thus, we find that the United Nations has set up a centre for TNEs which collects and disseminates information regarding these institutions. It also initiates and publishes the result of various research programmes undertaken. A commission for TNEs has also been established which investigates conflicts between a TNE and any particular nation state. Typical of such an international action is the search for a code of conduct for TNEs.

An attempt at harmonising the policies of various countries regarding TNEs has been attempted, but the differences amongst nations seems to be too great to be bridged. Thus the harmonisation of policies of various countries as an attempt to regulate TNE activity seems to be an ideal which is nearly impossible to reach.

The point which is important here is that the future will be characterised by increasing conflict between TNEs and host countries. Conflicts between the two will lead to bargaining between them and finally to some compromise. The outcome of the bargaining process depends on the relative bargaining powers of the opposing parties. The host country will have greater bargaining power when its market is large and is growing fast, when it owns scarce and highly

valuable resources and if a larger number of options are open to the host nation compared to those open to the TNE. Conversely, the TNE will be at an advantage vis-a-vis the host nation, in the bargaining process, if the value of the package of resources it offers is great and if the options open to the company are large while those open to the host country are few.

Thus, the future development of the TNE depends on the relative strengths of the TNE on the one hand and the nation state on the other. As the relative strengths of the two entities change, the balance of power between them shifts and will lead to new developments of the TNE. Thus, in the future TNEs will have to display great flexibility in adapting their operations to changing conditions which result from national and international action.

NOTESChapter I

1. A distinction is usually made between direct investment and portfolio investment. Though both are essentially a long term movement of capital between countries, portfolio investment is motivated by interest rate differentials and the investor does not retain control over the investment. Direct investment entails the retention of control by the investor. Hence, direct investment is accompanied by varying amounts of management and technology.
2. We would like to point out that all foreign direct investment need not be undertaken by TNCs. Conversely, all TNE investment abroad does not imply a movement of capital between countries.
3. US Tariff Commission, 1973, p. 78.
4. See Brooke and Remmers, 1970. Also Dunning, 1971, Ch. I.
5. US Tariff Commission, 1973. Although it makes such a suggestion the US Tariff Commission defined a transnational corporation as being a manufacturing firm which engaged in foreign direct investment.
6. Perlmutter, 1969.
7. See UN, 1973 and UN, 1978.
8. UN, 1974, p. 25.
9. Kindleberger, 1969.
10. For example, see UN, 1973, Table 39, p. 189.

11. Aliber, 1970.
12. Buckley and Casson, 1976.
13. Vernon, 1966.
14. Abroad meant Western Europe. At the time the product cycle hypothesis was first advanced Western Europe, although relatively well developed, had labour costs which were significantly lower than those in the USA.
15. See Knickerbocker, 1973 and Aharoni, 1966.
16. In later versions of the product cycle model it was exactly this type of oligopolistic behaviour that was stressed. See Vernon, 1974.
17. We do not specify any particular objective function. For a review of possible objective functions see Horst, 1974.

Chapter II

1. UN, 1978
2. UN, 1973
3. UN, 1978
4. UN, 1973
5. US Tariff Commission, 1973.
6. Ibid.
7. Algeria, Equador, Gabon, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates and Venezuela.

8. Bahamas, Barbados, Bermuda, Cayman Islands, Netherland Antilles and Panama.
9. UN, 1978.
10. Vernon, 1977.
11. Development Assistance Committee of the Organisation for Economic Co-operation and Development.
12. UN, 1973.
13. UN, 1978, p. 38.
14. Ibid
15. US Tariff Commission, 1973.

Chapter III

1. Brooke and Remmers, 1970.
2. Ibid.
3. UN, 1973, p. 32.
4. Lall and Streeten, 1977, p. 40.
5. Ibid.
6. Brooke and Remmers, 1970.
7. Robbins and Stobaugh, 1974.
8. Ibid, p. 150.

9. UN, 1973, p. 33.

Chapter IV

1. UN, 1973, p. 40.
2. The exchange rate is Rs.1 = \$1
3. The new exchange rate is Rs 2 = \$1
4. Rs. 1 = \$1
5. Rs 2 = \$1
6. Robbins and Stobaugh, 1974
7. Ibid, p.43.
8. Robbins and Stobaugh, 1974.
9. Lall, 1973.

Chapter V

1. See Chapter I
2. Chapter II
3. Chapter III
4. Chapter IV

BIBLIOGRAPHY

- Aharoni, Y., The Foreign Investment Decision Process, Boston : Harvard U.P., 1966.
- Aharoni, Y., 'On the Definition of a Multinational Corporation', Quarterly Review of Economics and Business, Vol. II, Autumn, 1971, pp ; reprinted in Kapoor, A. and Grub, P.D. (eds.), The Multinational Enterprise in Transition, Princeton : Darwin Press, 1972.
- Aliber, R.Z., 'A Theory of direct foreign investment', in Kindleberger, C.P. (ed.), The International Corporation, Cambridge, Mass. : MIT Press, 1970.
- Brooke, M.Z. and Remmers, H.L., The Strategy of Multinational Enterprise, London : Longman, 1970.
- Brooke, M.Z. and Remmers, H.L., The Multinational Company in Europe, London : Longman, 1972.
- Buckley, P.J. and Casson, M., The Future of the Multinational Enterprise, London : Macmillan, 1976.
- Caves, R.E., 'International Corporations : The Industrial Economics of foreign investment', Economica, 38, 1971, pp.1-27; reprinted in Dunning, J.H. (ed.), International Investment, Harmondsworth: Penguin Books, 1972.
- Corden, W.M., 'The Theory of International Trade', in Dunning, J.H. (ed.), Economic Analysis and the Multinational Enterprise, London : George Allen & Unwin, 1974, pp.184-210.

- Dunning, J.H., Studies in International Investment,
London : George Allen & Unwin, 1970.
- Dunning, J.H., (ed.), The Multinational Enterprise,
London : George Allen & Unwin, 1971.
- Dunning, J.H. (ed.), International Investment,
Harmondsworth: Panguin Bliks, 1972.
- Dunning, J.H., 'The determinants of international
Production', Oxford Economic Papers,
25, No.3, 1973, pp. 289-336.
- Dunning, J.H., Economic Analysis and the Multinational
Enterprise, London : George Allen &
Unwin, 1974.
- Grubel, H.G., 'Internationally diversified portfolios:
Welfare gains and capital flows',
American Economic Review, 58, 1968,
pp.1299-1314; reprinted in Dunning,
J.H. (ed.), International Investment,
Harmondsworth: Penguin Books, 1972,
pp.201-19.
- Gruber, W.D., Mehta, D. and Vernon, R., 'The R & D
Factor in International trade and inter-
national investment' of US industry',
Journal of Political Economy, 75,
1967, pp.20-37.
- Hirsch, S., 'An international trade and investment
theory of the firm', Oxford Economic
Papers, 28, 1976, pp. 258-70.
- Hirschleifer, J., 'On the economics of transfer
pricing', Journal of Business, July 1956.
- Hood, N. and Young, S., The Economics of Multinational
Enterprise, London : Longman, 1979.

- Horst, T., 'The Theory of the firm', in Dunning, J.H. (ed.), Economic Analysis and the Multinational Enterprise, London: George Allen & Unwin, 1974.
- Hymer, S., 'The Multinational Corporation and the law of uneven development', in Redice, H. (ed.), International Firms and Modern Imperialism, Harmondsworth: Penguin Books, 1975, pp.37-62.
- Hymer, S. and Rowthorn, R., 'Multinational Corporations and international oligopoly: the non-American Challenge', in Kindleberger, C.P., (ed.), The International Corporation, Cambridge, Mass.: MIT Press, 1970.
- Jacoby, N.H., 'The Multinational Corporation', in Kapoor, A. and Grub, P.D. (eds.), The Multinational Enterprise in Transition, Princeton: Darwin Press, 1972.
- Jasay, A.B., 'The social choice between home and Overseas investment', Economic Journal, 70, 1960, pp. 105-13; reprinted in Dunning, J.H. (ed.), International Investment, Harmondsworth: Penguin Books, 1972, pp.117-28.
- Johnson, H.G., 'The efficiency and welfare implications of the international corporation', in Kindleberger, C.P., (ed.), The International Corporation, Cambridge, Mass.: MIT Press, 1970, reprinted in Dunning, J.H. (ed.), International Investment, Harmondsworth, Penguin Books, 1972.
- Kapoor, A. and Grub, P.D. (eds.), The Multinational Enterprise in Transition, Princeton: Darwin Press, 1972.

- Kemp, M.C., 'The benefits and costs of private investment from abroad : comment', Economic Record, 38, 1962, pp.108-10; reprinted in Dunning, J.H. (ed.), International Investment, Harmondsworth: Penguin Books, 1972, pp.159-162.
- Kidron, M., Foreign Investment in India, London : Oxford U.P., 1965.
- Kindleberger, C.P., American Business Abroad : Six Lectures on Direct Investment, New Haven, Conn.: Yale U.P., 1969.
- Kindleberger, C.P. (ed.), The International Corporation, Cambridge, Mass. : MIT Press, 1970.
- Kindleberger, C.P., International Economics, Homewood, Illinois : Irwin, 1973.
- Krickerbocker, F.T., Oligopolistic Reaction and the Multinational Enterprise, Boston : Harvard U.P., 1973.
- Lall, S., 'Transfer pricing by multinational manufacturing firms', Oxford Bulletin of Economics and Statistics, 35, 1973,
- Lall, S. and Streeten, P., Foreign Investment, Transnationals and Developing Countries, London : Macmillan, 1977.
- Mac Dougall, G.D.A., 'The benefits and costs of private investments from abroad : a theoretical approach', Economic Record, 36, 1960 pp.13-35; reprinted in Dunning, J.H. (ed.), International Investment, Harmondsworth: Penguin Books, 1972, pp.129-58.
- Manfield, E., 'Technology and Technological Change', in Dunning, J.H. (ed.), Economic Analysis and the Multinational Enterprise, London: George Allen & Unwin, 1974, pp.147-83.

Penrose, E.T., 'The Theory of the Growth of the Firm,
Oxford : Blackwell, 1959.

Perlmutter, H.V., 'The Tortuous Evolution of the
Multinational Corporation', Columbia
Journal of World Business, Vol.4, 1969;
reprinted in Kapoor, A. and Grub, P.D.
(eds.), The Multinational Enterprise
in Transition, Princeton: Darwin Press, 1972.

Radice, H., International Firms and Modern Imperialism,
Harmondsworth: Penguin Books, 1975.

Robbins, S.M. and Stobaugh, R.B., Money in the Multi-
national Enterprise : A Study in Financial
Policy, New York : Basic Books, 1974.

Robertson, D., 'The Multinational Enterprise : trade
flows and trade policy', in Dunning, J.H.
(ed), International Investment,
Harmondsworth : Penguin Books, 1972,
pp. 326-56.

Sodersten, B., International Economics, London,
Macmillan, 1971.

Solomon, L.D., Multinational Corporations and the
Emerging World Order, London :
Kennikat, 1978.

Stevens, G.V.O., 'The determinants of investment', in
Dunning, J.H. (ed.), Economic Analysis
and the Multinational Enterprise, London:
George Allan & Unwin, 1974

Streeten, P., 'Costs and benefits of Multinational
enterprises in less developed countries',
in Dunning, J.H.(ed.), The Multinational
Enterprise, London: George Allan &
Unwin, 1971.

- Streeten, P., 'The Theory of development policy', in Dunning, J.H. (ed.), Economic Analysis and the Multinational Enterprise, London: George Allen & Unwin, 1974, pp.252-79.
- United Nations Centre on Transnational Corporations, Survey of Research on Transnational Corporations, E.77.II.A.16, New York: UN, 1977.
- United Nations Economic and Social Council, The Impact of Multinational Corporations on Development and International Relations : Report of the Group of Eminent Persons, E/5500/ADD1, New York : UN, 1974.
- United Nations Economic and Social Council, Transnational Corporations in World Development : A Re-examination, Commission on Transnational Corporations, 4th Session, E/C, 10/38, New York : UN, 1978.
- United Nations Secretariat, Department of Economic and Social Affairs, Multinational Corporations in World Development, ST/ECA/190, New York : UN, 1973.
- United States Tariff Commission, Implications of Multinational Firms for World Trade and Investment and for US Trade and Labour, Report to the Committee of the US Senate and its sub-committee on International Trade, 93rd Congress, 1st Session, Washington: US Government Printing Office, 1973.
- Vernon, R., 'International investment and international trade in the product cycle', Quarterly Journal of Economics, 80, 1966, pp.190-207; reprinted in Dunning, J.H. (ed.), International Investment, Harmondsworth, Penguin Books, 1972, pp. 305-25.

- Vernon, R., 'The location of economic activity' in
Dunning, J.H. (ed.), Economic Analysis
and the Multinational Enterprise,
London : George Allen & Unwin, 1974,
pp.69-114.
- Vernon, R., Storm over the Multinationals : The Red
Issues, London : Macmillan, 1977.
- Willey, H.D., 'Direct investment controls and the
balance of payments', in Kindleberger,
C.P. (ed.), The International Corporation,
Cambridge, Mass. : MIT Press, 1970.