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Global Business and International Trade

Multinational corporations

Outline of today’s seminar

1) Multinational corporations
2) Small case study

Brand value

- How can you measure the value of a brand?
- What are the most valuable brands?

Brand value

- http://www.millwardbrown.com/brandz/Top_100_Global_Brands.aspx
- Valuation process:
  - Ability to appeal to relevant customers and potential customers
  - Brands that succeed in creating the greatest attraction power are those that are:
    - **Meaningful** (meet the individual’s expectations and needs)
    - **Different** (unique in a positive way and “set the trends”)
    - **Salient** (come spontaneously to mind as the brand of choice for key needs)

Brand value

- Value of the intangible asset of the brand itself that exists in the minds of consumers
- That means the ability of brand associations in consumers' minds to deliver sales by predisposing consumers to choose the brand or pay more for it

Question

- What can be the definition of a multinational corporation?

Definition of an MNC

- There is no formal definition, but several of them using different criteria

1) MNC is a firm that is structured so that business is conducted or ownership is held across a number of countries or organized into global product divisions
2) MNC is a firm that has a specific ratio of foreign business activities or assets to total firm activities or assets
3) Based on the perspective of the corporation, that is, its behavior and its thinking (if managers think that company they run is multinational, then it is)

Definition of an MNC

- Howard Perlmutter differentiates (based on the attitude held by the decision makers of an organization) among 3 types:
  1) Ethnocentric
  2) Polycentric
  3) Geocentric

Definition of an MNC

- *Ethnocentric* organizations focus on home or domestic environment, which excludes the possibility to characterize them as MNCs
- *Polycentric* organizations have investment, operations or markets in several countries, but do not integrate the management of these international functions

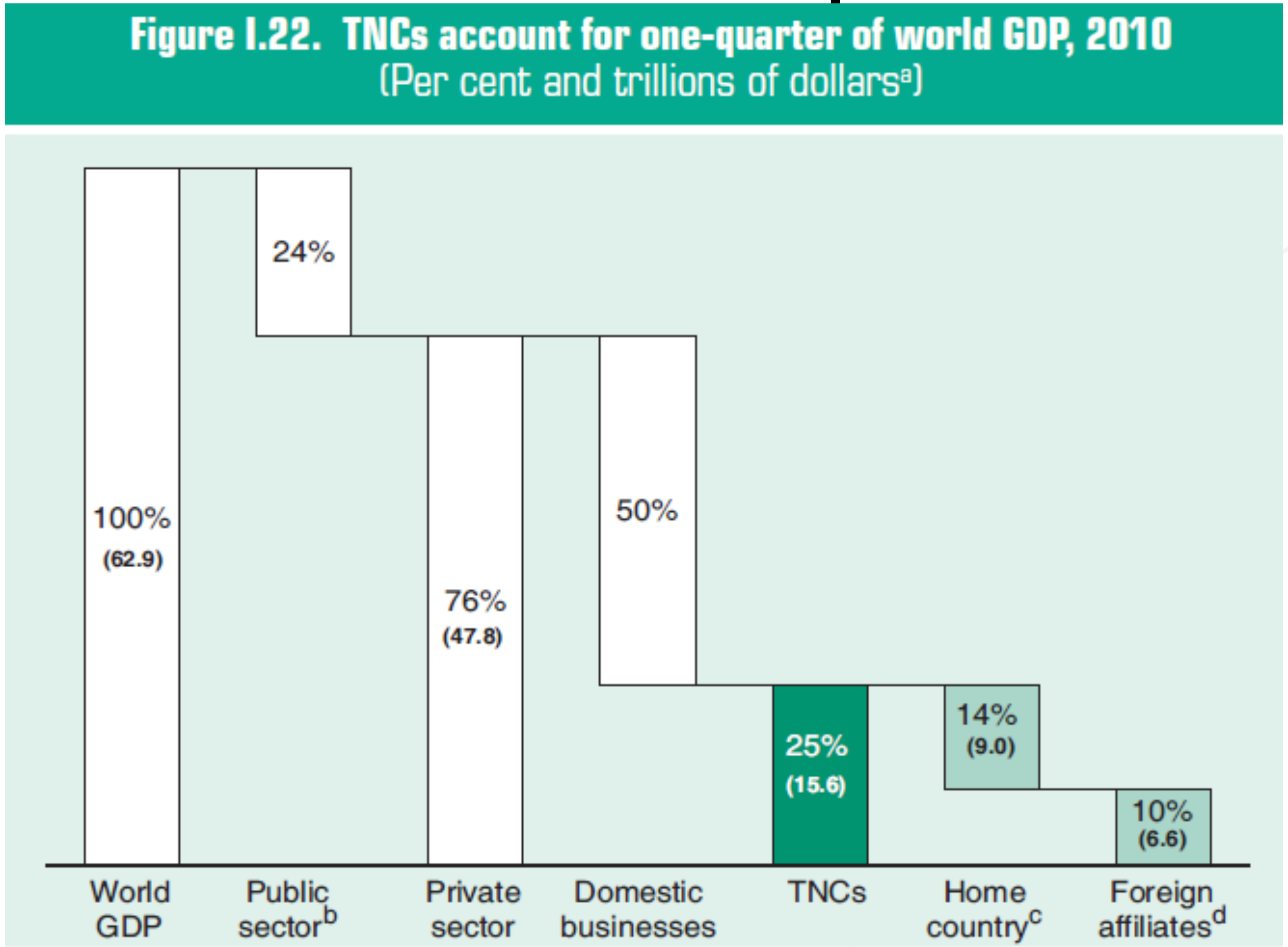
Definition of an MNC

- *Geocentric* organizations are integrated and have a world perspective regarding the breadth and reach of possible organizational operations
- UN calls such organizations not multinational, but transnational corporations, but both terms describe the same

Multinational corporations

- They began to flourish in the decade following WW2, primarily in the United States
- It was spurred by reconstruction efforts in Europe and an inflow of USD geared to take advantage of new opportunities, as countries of the ravaged continent attempted to rebuild their economies
- Since the 1970s USA has lost its dominance in this field

Multinational corporations



Task

- Try to find out in teams at least 5 advantages and 5 disadvantages of the working of a MNC based on an example of two companies described in the text

Multinational corporations

- Advantages and disadvantages
  - Arise from the fact that operations are not only domestically oriented
  - The international success of MNCs is primarily because of their ability to overcome the disadvantages and capitalize on the advantages
  - Depend to a large extent on the nature of individual corporations themselves and types of businesses

Multinational corporations
Advantages

- Advanced technical know-how
  - One of the most important advantages, enables MNC to compete internationally
  - Can be either developed or acquired by the corporation
  - **In most cases technology is patented (additional revenue)**
  - Gives the MNC the advantage in the areas of production, management, services or processes

Multinational corporations Advantages

- Large size and economies of scale
  - Most MNCs tend to be large (some of them have larger sales or revenues than the GDP of many countries)
  - This confers the advantage of significant economies of scale
  - The high volume of production lowers per-unit fixed costs for the company‘s products, which are reflected in lower final costs
  - This is especially important in industries that are capital-intensive (steel, cars, chemicals), in which fixed costs form a substantial proportion of total costs

Multinational corporations Advantages

- Lower input costs
  - Lower input costs can be achieved again due to larger size
  - Large production levels necessitate the purchase of inputs in large volumes
  - This enables MNCs to **bargain for lower input costs** (or volume discounts), which makes the final production also cheaper (and thus more price competitive)
  - System of purchase can be also more efficient due to effective **inventory control**

Multinational corporations
Advantages

- Ability to access raw materials in other regions
  - This may lower input and production costs
  - In many cases, MNCs also supply the needed technology, which may give them monopolistic control over the raw materials, because they often supply technology only in exchange for such a control

Multinational corporations
Advantages

- Ability to shift production to other locations
  - One of the most important advantages
  - MNCs can relocate their production facilities and thus take advantage of lower costs for labor, raw materials (or other inputs), and sometimes they even utilize **incentives** offered by host countries
  - This all raises international competitiveness of MNCs (they can export lower-cost goods to other markets) and gives them a distinct edge over purely domestic corporations

Multinational corporations
Advantages

- Scale economies in shipment, distribution and promotion
  - Scale economies allow MNCs to achieve lower costs in shipping – large volumes of freight permit them to negotiate lower rates
  - Some very large corporations (oil industry) purchase (or lease) their own ships, which is even more effective
  - **Distribution and promotion costs** are also lower due to high volumes of production
  - More importantly, MNCs are often able **to standardize a promotional message** and use it in different countries (global communication strategy)

Multinational corporations
Advantages

- Brand image and goodwill advantages
  - Many of the MNCs possess product lines that have established a good reputation for quality, performance, value and service
  - This can be used to differentiate from others by introduction of new products
  - It can lead to cost reduction for communication of new products (or products in new markets), because <u>part of the message is being told by the known brand</u>

Multinational corporations
Advantages

- Access to low-cost financing
  - MNCs require large amounts of financing and generally they are excellent credit risks (they are favored customers of financial institutions, which lend them at best rates)
  - They also have access to different financial markets, which allows them to find the best offer (then funds are transferred internally to required locations)

Multinational corporations Advantages

- Financial flexibility
  - MNCs can manipulate their profits and shift them to lower-tax locations
  - The manipulation of profits to save taxes is generally accomplished through **transfer pricing** or other financial mechanism
  - This greater financial leverage can be used to artificially lower prices to enter new markets or to increase market shares in existing ones

Multinational corporations Advantages

- Information advantages
  - MNCs have a global market view and are able to collect, process, analyze and exploit their knowledge of worldwide markets
  - It is an advantage not only in marketing, but also in all other aspects of operations
  - Access to this information provides MNCs with the opportunity to position themselves appropriately to respond to contingencies and exploit opportunities

Multinational corporations
Advantages

- Managerial experience and expertise
  - MNCs are able to assimilate a wealth of valuable managerial experience
  - They acquire expertise in different ways of approaching business problems and can effectively apply this knowledge to multiple locations

Multinational corporations
Advantages

- Diversification of risks
  - Simultaneous presence in different countries allows MNCs to more effectively bear the risk of cyclic economic declines, which are not the same in different countries
  - Thus, losses in one country can be offset by gains in other countries
  - It allows diversification of political, economic and other risks

Multinational corporations Disadvantages

- Business risks
  - Several risks are not borne by companies whose operations are purely domestic in nature
  - MNCs have to deal with **currencies** of other countries, which renders them vulnerable to fluctuations in exchange rates
  - This can wipe out the entire profit of a particular business activity (and expenses to eliminate such a negative development over the long run are often very high)
  - Over the short run, several hedging mechanisms exists

Multinational corporations Disadvantages

- Host-country regulations
  - MNCs are often subject to regulations that vary from country to country and it can be quite expensive to get familiar with these regulations and modify operations to ensure not overstepping them
  - These regulations very often change, which makes it even more difficult to adapt
  - <u>Bans on imports, exports, availability of credits, necessity of government approval</u>

Multinational corporations Disadvantages

- Different legal systems
  - MNCs must operate under the different legal systems of different countries
  - In some countries the legislative and judicial processes are extremely cumbersome and contain many nuances that are not easily understood by non-natives
  - Some legislation can also prohibit the type of business activity regarded by MNC as normal

Multinational corporations
Disadvantages

- Political risks
  - MNCs can‘t do much if a host country decides to take action that is not fully in the interest of the corporation
  - They increase in countries whose government tend to be unstable or change frequently

Multinational corporations Disadvantages

- Operational difficulties
  - These can be created by working in a wide variety of business environments
  - Unwritten business practice and market conventions often prevail (then lack of familiarity with them causes difficulties to conduct business in accordance with them)
  - Often the normal methods of operation of an MNC can be quite contrary to a country‘s business practices

Multinational corporations Disadvantages

- Cultural differences
  - Can lead to major problems
  - Employees are sometimes not able to adjust to the local culture (personally or professionally), which reduces their optimal performance
  - Manager often have troubles in dealing with local offices because of culturally based communication problems
  - Inability to understand and respond appropriately to local cultures has often led MNCs products to fail, to problems with local customers, business partners, governments or own employees