Multinational corporations.

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Recent advances in information technology, coupled with deregulation and market liberalization worldwide, have fueled an unprecedented surge in the growth of multinational corporations (MNCs). While some regard them as ruthless exploiters, others view them as benign engines of prosperity. But today's multinationals bear little resemblance to their forebears. They are reinventing themselves in diverse ways that confound the assumptions of critics and advocates alike.

Globalization Has Made MNCs More "Footloose" Than Ever

Partly true. There is a widespread perception that multinational corporations will rush to relocate in response to changing economic conditions. Yet there are compelling reasons for many MNCS tO stay put or, at the very least, to shift the location of their operations at a gradual pace. Some multinationals often find themselves "locked" into emerging hot-spot "clusters" of related assets and specialized infrastructure-such as Silicon Valley for microprocessors, Tsukuba City for miniaturization, and London for foreign exchange. Increasingly, such clusters can even be found in developing countries such as India, where Bangalore has become a hub for the software industry. These immobile resources are comprised of a dense network of specialized, often small, independent enterprises that supply crucial inputs and are difficult to replicate elsewhere. Leading MNCS must interact with these clusters if they are to gain and retain access to the latest thinking.

Another reason why MNCs are reluctant to uproot their operations is that they depend upon the skills of specialized teams of local workers. Volkswagen, for example, is using its Resende plant in Brazil as a lead site for experimenting with ways to change the assembly process. Multinationals that have become dependent on such "intelligent systems" can continue to attract investors by maintaining and strengthening these human assets, not by walking away.

MNCs Are, First and Foremost, Creatures of Their Home Countries

Not always. Most people assume that the home country always gets first priority whenever MNCS have to make hard choices: If faced with a downturn in the market, multinationals will close facilities abroad to protect those at home. Yet Japanese MNCS have strived to remain competitive by developing lower-cost capacity in facilities abroad. In doing so, corporate executives have played a role in "hollowing out" Japan's economy and have broken with generations of tradition that put national interest above all else.

Moreover, corporations now place higher priority on the innovation process - regardless of where that process is centered - than on outdated notions of home country. Some MNCS have developed world product mandates that farm out management authority and research-and-development leadership to foreign units. Tokyo is "home" to IBM's personal computers, while Taiwan is "home" to Philips' computer monitors.

Indeed, there is now widespread unease that MNCs are becoming truly "stateless," acting in the interests of shareholders who are themselves becoming globally dispersed. These concerns are amplified by the growing trend among major corporations to promote foreign nationals to top management positions. Some French and German companies even use English as the lingua franca for their management communications globally. [See Joshua Fishman's article on page 26.]

All Multinationals Are Large Corporations

No. It is easy to get that impression, since giant MNCs dominate the news. The top 100 multinationals own nearly $2 trillion of assets outside their home countries, a quarter of the world's stock of all foreign direct investment (FDI). And the recent wave of megamergers has made many large multinationals even larger. But a closer look at the marketplace reveals that the surge in MNC growth is also being driven by myriad newcomers, many of whom are actually quite small. Most of the estimated 45,000 firms that operate internationally employ fewer than 250 people. It is commonplace to find service companies that maintain fewer than 100 employees operating across more than 15 countries.

For years the traditional wisdom among multinational corporations was that bigger is better. Large MNCs could lower their production costs by producing massive volumes to serve global markets. By achieving such "economies of scale," they gained a crucial advantage over their competitors. In today's turbulent markets, however, size does not always matter. Big banks have been merging across borders to make themselves even bigger, but their success rates have been dismal. In the oil and gas industry, traditional leaders such as Exxon and Shell now face serious challenges from smaller upstarts that have carved out industry niches in exploration or lubricants. The success of Enron in transforming itself from a sleepy, domestic-pipeline operator in Texas to an international force in gas and power generation shows how potent this new challenge can be.

New competitors are emphasizing the power of intangible resources such as intellectual property and a flexible organizational structure that allows firms to respond better to their customers' diverse needs. These emerging multinationals are beginning to develop and link together expert teams within the corporation in ways that resemble the activities of the hot-spot clusters that lie outside the corporation. In contrast to traditional economic models of competition, these companies have found that economies of scale can best be achieved at the corporate level rather than the production level.

The message is clear to the major incumbents: transform or die. At a time when size and market shares are growing in importance for some MNCs, for others the value of incumbency has never been less.

MNC Markets Are Impenetrable to Rival Companies

No. Multinational leaders such as General Electric and Shell took many years to build their empires, helping create the impression that growth is slow and dependent on physical assets (such as sprawling factories) to erect high barriers to the entry of new competitors. But what about Microsoft (software), Cisco (computers), Fresenius (dialysis treatment), Enron (energy), Ispat Steel, and many other firms that have built billion-dollar international businesses in just a few years? They have relied on human skills to promote growth and remain competitive. These multinationals possess organizational hierarchies that are ideally suited to the creation and deployment of human resources and intangible assets such as patents or brands. By combining these attributes with a reputation for reliability, these new specialists have taken business away from much larger incumbents.

Innovations in strategy are at the heart of today's rapid internationalization. For example, it took India's Ispat Steel only 10 years to become one of the top 10 steel makers in the world. Ispat Steel challenged the old business model - based on achieving economies of scale through giant production units - by building a global network of small-scale steel plants. Along the way, it replaced trade with local production. Ispat added further corporate-level strength by transferring across borders lessons learned in any one plant about promoting greater efficiency.

In other industries, new technology is transforming supply possibilities. Mass customization allows a customer to get precisely what he or she wants, anywhere in the world. A person can walk into a bicycle shop in the United States, specify the preferred design and components, have the bicycle built to order overseas, and ride it home from the shop within weeks. Similarly, British women have been experimenting with computer-assisted equipment that allows them to specify the perfect fit for their jeans, which are cut and sewn in Latin America. Creating the necessary flexibility in the supply chain to achieve these new performance demands is a challenge that many incumbent MNCS are finding difficult to meet.

Competition is no longer solely about richly endowed firms battling against poorer ones: It is also a contest to develop strategies and learn new skills. Competition now needs to be thought of in terms of the intensity of managers' imagination. The message of today's competitive environment is that David can beat Goliath and does so with increasing frequency.

Only Some Industries Are Going Global

Not anymore. A few years ago, the conventional wisdom held that many industries were impervious to globalization, particularly those in the service sector. Yet today we find MNCs in office cleaning (International Service Systems in Denmark), dialysis treatment clinics (Fresenius in Germany), and fresh-food retailing (Sainsburys in the United Kingdom). There are international operators in real estate, law, and even simple services such as taxis and hairdressing. In the absence of protective regulations, no sector in any country can be confident that it will never be confronted by foreign competitors.

None of these developments suggest that all firms must go global. But to survive even local businesses can (and must) adopt global standards. A firm can be world-class in behavior without being global in its asset disposition, provided it has a global perspective, a global information base, and the necessary imagination to strive for continuous improvement and adapt to shifting circumstances. For example, there are many fast-growing businesses in India - such as the luggage company VIP - that have achieved world-class status in operational efficiency and technical proficiency and that are run by entrepreneurs who relentlessly travel the world in search of fresh inspiration. These firms may well be some of tomorrow's MNCs, leveraging the advantages that they have already created at home. In many industries, the greatest challenge to purely local businesses comes from their immediate neighbors, firms that have been faster to seize the opportunities afforded by the information revolution and liberalization.

MNCs Are Bigger Than Their Assets

True. The reach and influence of multinationals, large and small, is far greater than the official statistics suggest. Policymakers can, therefore, seriously underestimate the extent to which national economies have become intertwined with others. There are at least two sources for this misconception: the way in which cross-border investments are estimated and the manner in which the "boundary" of a firm is defined.

The official figures for the flow of FDI - the historical cost-accounting basis for the asset base of multinational corporations - show an annual flow of nearly $400 billion. The United Nations, however, has recently begun to question these figures and has estimated that if one includes the

capital mobilized by local borrowings and the equity shares of partners, the "real" figure is closer to $1.4 trillion per year. In other words, a corporation's "presence" in a country goes beyond the assets that it chooses to locate there.

The influence of a multinational can also be gauged by its effect on local suppliers as it creates new demand and sets new standards of quality. All these elements are part of a world where the local production of MNCs in overseas markets now greatly exceeds the sum of world trade. The resulting deep integration of national economies is growing so fast that any suggestion in developed economies that the domestic-policy agenda can be isolated from the global economy seems antediluvian.

Perhaps even more seriously, the explosion of strategic alliances among firms is transforming the competitive landscape. One estimate is that more than 20,000 alliances have been formed within the last two years alone. How, then, should one now think about where economic power is located? As one executive observed some years ago: "The electronics business in Europe is not the same as the European electronics business." Competition is no longer defined solely by the ownership of assets; it is also a matter of who is in league with whom. The airline industry in its post-deregulation phase, for example, is coalescing around several global alliances: One such partnership is the Star Alliance, with Lufthansa and United Airlines as central players. These groups hope to gain advantages from shared ticketing, loyalty programs (such as frequent flyer miles), and even the occasional use of shared equipment. [See Ellis Juan's "Aviation: The Politics and Economics of a Boom," FOREIGN POLICY, Winter 1997-98.]

Public policy has yet to come to grips with the salient issue that ownership is not the same as control, and that the real power of the MNCs lies in their ability to exert control far beyond their legal "boundaries." New rules are needed, probably on an international basis, to ensure that this new "group-to-group" competition is adequately supervised to avoid abuses of power.

MNCs Are Inherently Exploitative

Yes and no. Advocacy groups often portray multinationals as globetrotting sweatshop operators, indifferent polluters, and systematic tax evaders. But for many industries, labor costs are not the determining factor in deciding where to locate. Remember the debate over the North American Free Trade Agreement and presidential candidate Ross Perot's warning of a "giant sucking sound?" If low wages were the primary criteria, then U.S. businesses would have leapfrogged over Mexico and relocated in Haiti. Labor costs in many segments of consumer electronics are less than 5 percent of the total cost (although in other segments and industries, such as textiles, wage rate differentials can be significant). Overall, wages are only one part of the productivity and quality equation.

That said, exploitation remains a problem. But how much of this is a function of business in general, rather than MNCs in particular? Smaller, local firms often can be much more exploitative than foreigners. Multinationals typically pay at or above the going wage and provide superior training. But even if most MNCS are well intentioned, they suffer from a credibility gap. The very fact that they can, and sometimes do, leave the host country contradicts their implicit commitment to provide economic security through "good" employment. Many management teams underestimate this reality. Perhaps unwittingly, MNCS can fuel public concern by being culturally insensitive, not honoring promises made by their predecessors, and being inconsistent in other aspects of their "social contract" with local society.

With regard to the environment, international big business is both the creator of pollution and the only resource available for its cleanup. The MNCs' record on pollution pales in comparison with those of many local businesses and state-owned enterprises: Look at the environmental damage in the former Soviet Union and Eastern Europe, not to mention today's mess in China.

By whose standards should performance be judged? Should local businesses in Eastern Europe adhere to local standards while MNCS operating there are held to more stringent international standards? Who is really going to be able to implement the Kyoto Protocol on Climate Change - local governments faced with strong domestic opposition or MNCs that can be held accountable through international regulations? It should not be forgotten that the Montreal Protocol on Substances that Deplete the Ozone Layer owes much of its success to the active participation of MNCS that possessed both the incentive to write workable regulations and the technical expertise to define what was possible. But multinationals also need to accept their obligation, as Shell has recently done, to engage much more extensively in the public debate about environmental-policy options.

The issue of tax evasion continues to generate acrimonious debate, despite guidelines produced by the Organisation for Economic Cooperation and Development. Multinational corporations protest that they pay their taxes responsibly. For example, the U.S. Chamber of Commerce in Bangkok claimed a few years ago that MNCs paid 70 percent of Thailand's corporate taxes, implying considerable tax evasion by the locals. But even this seemingly simple claim was clouded by the intricate workings of the local tax code.

Some state governments in the United States, such as California's, have sought to tax MNCs based on a proportion of their worldwide income, regardless of the profitability of their local operations. The underlying motive of such legislation is to preempt possible tax evasion through transfer price practices - whereby multinationals overprice and underprice components shipped among various affiliates in an attempt to shift income from high- to low-tax venues. Corporate reaction to broad taxation has been predictably negative. What is the benchmark for fairness? The debate will most likely continue as an arcane technical subject, leaving public opinion unaltered in its negative perception.

Investments by MNCs Are Good, Investments by International Money Managers Are Bad

Not necessarily. Foreign direct investment by multinational corporations has a long-term effect and is not always mobile. Foreign portfolio investment (FPI) is mostly volatile money that can go away overnight - and often does, as demonstrated by the 1998 panic over emerging markets. Although spending plans for FDI are being cut back, few firms are rushing to the exit. Therefore, FDI might be more stable than FPI, but there have been periods of volatility. In the 1970s, when Malaysia announced plans for highly discriminatory ethnic controls as part of that country's New Economic Policy, many MNCs concluded that the government had abandoned its favorable investment climate. Accordingly, they cut back on capital spending, closed some plants, and moved money offshore. Such instances, however, have become rare: Most governments want to welcome foreigners, not scare them away.

Another popular misconception is that, since foreign direct investment and foreign portfolio investment have both boomed in the 1990s [see chart on next page], they are somehow related. The drivers behind them, however, are different. Foreign portfolio investment is a story of deregulation and the changing attitudes of investors. There are new opportunities to invest in emerging markets that used to be closed. Moreover, the perceived risk of investing abroad has declined as better information has become available.

Whereas the principal objective of FPI is to maximize the return to the investor, FDI has a more complex set of motivations. One such motivation is resource seeking - gaining access either to natural resources (an oil field or copper mine) or man-made resources (skilled labor or the technologies within a cluster). There are also marker-seeking investors who hope to gain a foothold in an expanding local market. And there are efficiency-seeking investors who believe that a series of investments linked across borders can lower total system costs below what could be achieved in one territory alone. These objectives cannot be attained overnight and the costs of quitting are usually high. Consequently, most FDI activity has been concentrated in relatively few

countries, leaving the poorest countries unable to benefit from the MNCS' resources and abilities to create new industries.

MNCs Are Creations of Wealthy Countries

Not anymore. Historically this has been the case, with the United Kingdom and United States in leading positions. But many of the newcomers are based in developing countries. For example, Taiwan is now home to many MNCs, such as computer companies Acer and Mitac, that have secured high world market shares in many niche products - most notably, handy scanners (96 percent) and the PC mouse (63 percent). Many developing-country firms that deal in natural resources, such as Petrobras in Brazil and Kuwait Oil, have expanded abroad to control more of the chain of supply and get closer to consumers. For instance, Petroleos de Venezuela owns Citgo, a leading chain of gas stations in the United States. Many new forms of multinationals are emerging - such as the family empires of the overseas Chinese - that add further variety to the stew of organizational forms now represented by the multinationals. Governments in some of the smaller countries now find that they must contend with both host-and home-country influences in their negotiations with MNCS.

MNCs Are Beyond Government Control

Absolutely not. The relationship between governments and multinationals is characterized by a complex distribution of benefits. Multinational corporations increasingly demand the "freedom" they need to optimize their operations across borders, with the goal of lowering their total costs and continuously upgrading quality. Their key bargaining chip in dealing with host governments is that they have the option not to invest. But once multinationals enter a country, they are, to some degree, locked in by the commitments that they have made to develop local operations and provide job training. Multinationals need access to local skills and other resources such as hot-spot clusters. Host governments need MNCS to act as agents in building competitiveness and trade.

Instead of engaging in adversarial bargaining about the distribution of wealth, both sides have a strong incentive to work on building partnerships that create wealth in the first place. The growth of "welcome-mat" investment incentives - tax breaks, investments grants, sometimes even preferential access to capital and guarantees of exclusive market rights - is one indicator of the sea change in government thinking. Governments would do well to employ officials who not only understand the economics of traditional market structures but also the managerial forces that change those structures. In addition, more vigorous intergovernmental collaboration is needed to strengthen institutions such as the World Trade Organization.

Policymakers urgently need a new mindset if they are to maintain a reasonable equity in the balance of power among states, firms, and consumers. Just as domestic banks require regulatory institutions that restrain their speculative instincts, MNCS require regulatory mechanisms that check their instincts to put profit above all else. The challenge is to maintain fairness without sabotaging the innovation engine that drives both new and old MNCS and creates new wealth. Consumers and governments can no longer rely exclusively on market mechanisms to rein in multinationals, nor can they blindly trust executives in the boardroom to do the "right thing."

WANT TO KNOW MORE?

Multinational corporations (MNCs) have been a source of controversy ever since the East India Company developed the British taste for tea and a Chinese taste for opium. Karl Marx's Das Kapital was written in part as an attack on international capitalism. In this century, many books - reflecting the popular fear that foreign MNCs destroy the fabric of local society and loot its resources - have argued for firmer state control. See, for example, Jean Jacques Servan-

Schreiber's Le Defi americain (London: Hamish Hamilton, 1968) and Richard Barnet and Ronald Mueller's Global Reach: The Power of the Multinational Corporations (New York: Simon and Schuster, 1974). Raymond Vernon provides a more sober assessment in Sovereignty at Bay (New York: Basic Books, 1971) and his later, slightly revisionist work, Storm over the Multinationals (Cambridge: Harvard University Press, 1977).

An essential reference for some of the best-available statistics and commentary on the growth of MNCS and the subsequent regulatory response is the United Nations Conference on Trade and Development's annual World Investment Report. For more detail on the changing international division of labor, see Peter Dicken's Global Shift: The Internationalization of Economic Activity (New York: Guilford Press, 1998).

Excellent assessments of the impact of MNCS on economic progress, especially in developing countries, can be found in Ted Moran, ed., Multinational Corporations: The Political Economy of Foreign Direct Investment (Lexington: Lexington Books, 1985). John Stopford and Susan Strange explore the possibility that nations and firms might form a partnership in fostering economic development in Rival States, Rival Firms (Cambridge: Cambridge University Press, 1991).

For an encyclopedic treatment of the many competing theories about what drives foreign direct investment and its impact on host economies, see John Dunning's Multinational Enterprises and the Global Economy (Wokingham: Addison-Wesley, 1993). Dunning, ed., Governments, Globalization and International Business (Oxford: Oxford University Press, 1997) offers country case studies that vividly illustrate how efforts to separate MNCs from the wider policy debate over the workings of the international financial and trade system are counterproductive. The rise of immobile assets in the globalizing economy is explored in G.M. Peter Swann, Martha Prevezer, and David Stout, eds. The Dynamics of Industrial Clustering (Oxford: Oxford University Press, 1998). A detailed explanation of corporate alliances can be found in Yves Doz and Gary Hamel's Alliance Advantage (Boston: HBS Press, 1998).

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