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THE EFFECT OF FOREIGN REGULATIONS, SOCIAL TRENDS AND CORPORATE MANAGEMENT TECHNIQUES ON U.S. MULTINATIONAL CORPORATIONS

Elizabeth Humphreys

I. Introduction

Faced with changing regulatory restrictions, social attitudes and internal variables, U.S. based multinational firms occupy an increasingly fragile position in the world economy. Only a decade ago, prominent forecasters predicted that by the mid to late 1980's close to 70% of the world’s industrial output would be produced by the 300 largest multinationals. However, after 1978, predictions were less optimistic. In addition to slowing world economic growth, multinationals faced increasing hostility from host governments and new controlling and regulatory guidelines instituted by the U.S. and OECD (Dunning, p. 409). Such a shift from their recent prominence may cause related transformations in the American economy by affecting domestic corporations, their foreign subsidiaries and American investors. Because of this relationship between multinational enterprises and the domestic economy, careful monitoring and forecasting of their performance and operating environment could prove beneficial to individual firms and the U.S. economy as a whole.

U.S. corporations with majority owned subsidiaries operating in developed Western European countries have recently been accused of importing human resources while depleting local natural resources, thereby injuring local economies. Host countries desire the benefits of increased productivity provided by U.S. multinationals, but recognize that these benefits are accompanied by a decrease in control over resource allocation. Therefore, U.S. multinationals must strike a balance of control and cooperation with their European hosts or face
further restrictions on their operating decisions. In addition, recent data indicate a large number of U.S. multinationals are rearranging their structural organization in often futile attempts to cope with changes in their operating environments. These limitations may result in a shrinking marketplace and increased competition for U.S. companies from local European firms.

This paper examines the world environment within which the major U.S. international corporations operate. Particular attention will be focused on the regulatory policies influencing multinational corporations (MNCs), demographic shifts changing the environment they operate in, and internal factors (policy, planning, structure) changing the nature of multinational enterprise in general. Because of the current size of U.S. MNCs both here and abroad, these issues affect not only employees of the firms, but also their clients, customers and potential investors.

II. Regulatory Policies

Until the early 1960's the world wide economic environment actively encouraged foreign direct investment. The atmosphere was one of economic interdependence, particularly among the developed Western nations. Recently, this international economic order has fallen under suspicion. The prospect of increased U.S. direct investment no longer brings cheers of support abroad. Instead, it leads to a thorough evaluation of the proposed multinational in terms of the resulting political perceptions, economic costs and economic benefits to be derived from its establishment (OECD, p. 2). This appraisal of the consequences of increased foreign direct investment often results in the adoption of regulatory or restrictive policies by the governments of potential host countries.

Each nation has a set of long-term goals and values which it protects and encourages. The same is true for any multinational corporation. These potentially divergent goals may create an environment of conflict between the U.S. companies and their host countries abroad. The host countries are also aware of the potential benefits U.S. corporations may bring to the local economy in the form of increased capital, technology, and efficiency (Robuck, p. 207). This possible imbalance of costs and benefits makes the situation of appropriate regulation a delicate one. Each country must establish a framework through which the multinational corporation will be able to both pursue profits and further the goals of the countries it operates in.

The OECD Code of Liberalization of Capital Movements provides a logical framework for examining regulations and impediments of a general nature, restrictions placed on financing direct investment, and sectoral controls placed on inward direct investment. Following the OECD Code, the next paragraphs describe the situation in three countries with varying degrees of restrictions placed on MNCs operating within their borders. These countries (Great Britain, France and Australia) were chosen as typical examples along the spectrum from a relatively free investment environment to a highly regulated one.

Among the OECD member countries, the United Kingdom has one of the least restrictive environments for foreign direct investment. No authorization is required for investments by non-residents. However, the government does possess the authority to prohibit a proposed transfer of control of a centrally important manufacturing concern to a non-resident if this transfer is perceived as contrary to national interests. If this is the case, the property in question may be acquired by the government. Financing restrictions encountered by foreign investors parallel those placed on domestic investors (OECD, p. 6). Therefore, a U.S. multinational is at no financial disadvantage compared to local industries when establishing a subsidiary in the U.K.

Despite easy regulatory policies concerning general investment and financing, sectoral restrictions abound. Air transport, broadcasting, insurance, coal production and public monopolies are all subject to governmental regulation of foreign direct investment. Most of these regulations prohibit entry into the given industry for applicants who are not U.K. nationals or
for firms without headquarters in Great Britain (OECD, p. 9).

Alternatively, France provides a slightly more regulated environment for the foreign investor. General limitations include a requirement for prior authorization by the Ministry of Economics for inward direct investment (investment in the local economy through corporate expansion by foreign firms) by non-EEC (European Economic Community) member countries. Operations subject to declaration or foreign currency financing conditions also require similar approval (OECD, p. 6). These approvals are granted only after determining that the proposed investment will have no "exceptionally detrimental effect on the interests of France" and are conditional on results relating to local employment opportunities, regional development and exports (OECD, p. 7). Adherence to these conditions is then monitored by local authorities.

When considering the financing of direct investment in France, authorization depends upon conditions relating to the current balance-of-payments situation (OECD, p. 13). Again, as in the U.K., there are many sectoral restrictions. These encompass transportation, agriculture, insurance, defense, casinos and public monopolies, as well as various other regulated activities (mostly service industries). The sectoral provisions in France place strict limitations on potential U.S. investment. Most of the industries mentioned above are open only to authorized investment of EEC nationals (OECD, p. 14). However, if authorized, a U.S. firm may establish an agricultural venture or enter a service industry as long as a reciprocal opportunity is established for a French firm in the U.S.

As we move along the spectrum toward more and tighter restrictions, it can be seen that Australia strictly limits investment opportunities for foreigners. Each direct investment proposal requires examination of its potential economic benefits (including employment opportunities), level of Australian equity participation, and possible effect on general economic and social policies (OECD, p. 5). Furthermore, foreign interests are prohibited from engaging in speculative real estate investments for passive income.

Financing a direct investment in Australia is quite an adventure. The initial establishment of a multinational corporation in Australia forbids the enterprise to raise funds locally—all capital must be imported. However, once the investment is established it is considered a local concern and is encouraged to raise funds by increasing local equity through new share issues (OECD, p. 8).

Finally, Australia's sectoral restrictions appear lenient when compared to the other regulations faced by the foreign direct investor as detailed in the preceding paragraph. Only public monopolies (mostly public utilities), banking and a small number of private monopolies remain strictly "off limits" to foreign investors (OECD, p. 12). Otherwise, each proposal is evaluated by the government to ascertain the net economic benefits to the related industry and to the economy as a whole. Generally, the proposal must evidence substantial benefits to obtain approval.

Given the very broad range of investment environments illustrated by the examples above, a U.S. based firm contemplating foreign expansion must carefully examine sectoral limitations, financial restrictions, market potential and tax treaties (as well as the multitude of general investment impediments) in the determination of the most beneficial site for a new subsidiary. Firm management then engages in a complex cost-benefit analysis, often paying particular attention to the target country's relationships with the major European markets. Frequently, (particularly in the case of advantageous tax treaties) the subsidiary will be established in what appears to be an unlikely host country in order to take advantage of neighboring markets while enjoying favorable tax treatment (McLachlan, p. 6). The degree of regulatory influence varies considerably depending upon where the U.S. corporation plans to invest, as evidenced by the examples above. Consequently, careful investigation of the restrictions and local industries is necessary. In addition, these restrictions are often accompanied by a growing distaste on the
part of host countries for American corporate expansion abroad.

III. Social Influences

Public acceptance of U.S. direct investment abroad has shifted dramatically since the 1950's. Both in Europe and here at home, the desirability of foreign investment over foreign trade is being debated. The period between the 1950's and the mid 1960's saw Western Europe recovering from World War II and in need of capital, knowledge, and human skills. U.S. firms recognized this as an opportunity to expand and develop America's position as the most technologically advanced nation in the world. In addition, increasing domestic institutional constraints restricted expansion by merger in the U.S., so many firms sought expansion abroad (Dunning, p. 413). This imbalance of foreign and domestic growth remained acceptable until recently. Now, both host country and U.S. citizens and business groups are expressing concern for the potential damaging effects of the influential position U.S. industry holds abroad.

One domestic group expressing specific dissatisfaction with current U.S. direct investment policy is the AFL-CIO. The leaders contend that U.S. direct investment abroad negatively affects the domestic economy by favoring foreign investment over foreign trade and production in the U.S. (Howenstein, p. 36). Furthermore, they claim that it leads to the exportation of jobs instead of goods, and impairs domestic economic development by sending capital abroad instead of using it at home. This negative sentiment expressed by labor has become a growing concern for management and policymakers in MNCs. As a result, management has often had to appease the labor leaders by demonstrating that the firm is fully utilizing available local workers and resources before considering foreign expansion. The worker needs to be shown direct economic benefit, usually in the form of increased pay or jobs (Spero, p. 112).

Another issue, both in the U.S. and in host countries, is the size of the MNCs' operations abroad. In spite of the legal obstacles outlined in the previous section, there has been recent growth of U.S. multinational corporate participation in foreign economies as opposed to rapid growth in U.S. domestic production and exports (Spero, p. 112). In 1977, the dollar market value of majority owned foreign subsidiary (MOFA) production was roughly equivalent to 88% of the total dollar value of U.S. exports for that year (Predicasts Forecasts). Because export markets have not become friendlier, the growth of MOFA production has averaged 10–12% annually—two times the growth rate in world output (Dunning, p. 3).

In addition to the domestic concerns of the AFL-CIO, foreign economies have raised issues regarding the strength of U.S. corporate operations abroad. For example, since most U.S. MNCs operating abroad are oligopolies and because of their size often provide a significant share of host country national product, they are frequently accused of decreasing competition and limiting total potential production. Host country officials and business leaders contend that the presence of large U.S. firms leads to maintenance of artificially high prices and a resulting decline in foreign market efficiency through the reduction in competition (Dunning, p. 413). These factors combine to hinder indigenous (foreign) national growth by absorbing local capital (through local investment in the U.S. firm) rather than increasing total capital available and employing expatriate, rather than indigenous, management and policymakers (Spero, p. 109).

Not surprisingly, the trend of increasing U.S. participation in local economies has not been popular in host countries. As a result, European fear of technological dependence on the U.S. (especially in research intensive industries) has grown dramatically in recent years. There has also been increasing tension due to the threat of U.S. intervention in subsidiary host country governments—in other words, the threat of application of U.S. laws beyond U.S. borders (Spero, p. 115). U.S. tax and incorporation laws often apply to U.S. companies operating abroad. Consequently, this may indirectly subject the host country to typically
American policies as they affect U.S. firms operating abroad. This is especially true in countries heavily reliant on local U.S. production and technology.

Finally, host countries realize that U.S. multinationals are motivated by private interests. They employ a highly efficient and powerful concentration of financial and managerial resources in their pursuit of private profits. These goals are not always seen as desirable in the host countries which has led to a “schizophrenic” attitude toward U.S. multinationals abroad. “The foreign investment is wanted, but not the foreign investor.” (Dunning, p. 389) Foreign countries are also increasingly less likely to blindly accept resource allocation decisions made by MNCs. Instead, most host country governments establish regulations regarding multinational corporate behavior as previously discussed. Some countries try to negotiate contracts insuring that domestic interests will be satisfied and provide renegotiation options after a designated period (Dunning, p. 413).

These changes in social trends and operating environments may force U.S. multinational corporations to carefully consider the domestic implications of their production policies in the future. How these corporate subsidiaries are viewed will have direct impact on their operating freedom. Therefore, U.S. based multinationals must concentrate more on improving how they are perceived in their operating environments. It is the people they work and live with that largely determine the policies and regulations affecting the corporation.

IV. Internal Factors

Finally, internal factors (strategy, structure, planning) also influence the potential of U.S. multinational corporations. Because of their interrelationship, these variables will be discussed as a group.

Management scientists generally accept that there must be a “fit” between the policy governing a corporation, the environment it operates in, and the corporate structure. This is particularly true when discussing multinationals, which operate in a diversity of environments. A corporation’s environment is subject to its strategy through the policies and decisions that influence investors, lawmakers and resource utilization. Thus, its strategy should be reflective of the most crucial elements in that environment. In order to efficiently utilize available resources (capital, human, natural), corporate strategy and operating environments must blend together and communicate. To do this, management must have reliable data on political trends, the local economy and pending legislative matters that may affect the firm. This information is analyzed and a strategy then formed to maximize the benefits (or at least minimize the costs) to the firm from the anticipated trends (Egelhoff, p. 435).

Corporate structure strongly influences a multinational firm’s strategy choice. The more rigid and inflexible corporate structures require greater strategic adaptability (Egelhoff, p. 453). This strategic flexibility is necessary in order to effectively relate to local supply and demand elements, demographics, and regulatory changes. As the corporate structure becomes more flexible (through structural decentralization and establishment of multiple divisions) the strategic plans must become more standardized to insure achievement of corporate goals.

Corporations organized into functional divisions face the greatest number of required “fits” between strategy and structure. In order to operate efficiently, the firm must restrict its product line, limit the number of foreign subsidiaries, maintain minimal outside ownership and acquire relatively few foreign firms. This is necessary to maintain a streamlined structure (Egelhoff, p. 453). However, these organizations are also able to be more heavily reliant on the product-related and technological strengths of the U.S. parent.

With managerial and organizational capabilities centrally located, the need for duplication of these services in other areas of the firm is eliminated. This centralization, barring any resulting loss in firm-wide communication, should provide the least-cost structure for multinationals that are heavily product integrated
(subsidiaries’ products coordinated on a regional or local basis) (Egelhoff, p. 453).

In order to be effective under these circumstances, the corporation must develop an information processing system to facilitate interaction between operating and production units and the U.S. parent. The costs of establishing such an elaborate system are usually far exceeded by the benefits derived from the resulting improvement in operating environment and communication. The information processing system enables the firm, through interrelation of the parent and subsidiaries, to operate in a relatively homogenous environment which makes managerial decisions easier and more globally applicable (Egelhoff, p. 453).

In contrast, as the corporate structure diversifies into separate international divisions, fewer “fit” variables require matches for efficient operation. As long as foreign operations are relatively small and have only a moderate number of subsidiaries, the entity faces few structural restrictions (Egelhoff, p. 454).

This strong relationship between strategy and structure has prompted a recent surge of reorganizations among U.S. MNCs. Searching for an organizational structure which would provide a lasting solution to the problems of constantly changing environments, multinationals have built multiple functional divisions to handle the diversity of problems encountered when operating in several environments simultaneously. Unfortunately, the frenzy of frequent organizational adjustments has proved more costly than beneficial. Corporate management has spent more time rearranging the rules than playing the game. Consequently, the majority of these large multinationals have ended up with increasingly complex divisional structures without clear lines of communication (Bartlet, p. 139).

The most successful multinational corporations spent time developing a complex decision making process rather than rearranging the corporate structure to deal with current problems. Diagonal, as well as vertical and horizontal, lines of communication were established as a means to provide management with more complete and comprehensive information concerning production and operating environments. This provided the companies with flexibility to meet current demands without having to reorganize. Most of these corporations maintained the simple structure of international divisions discussed earlier. This basic structure, coupled with a highly developed decision making process, allowed these MNCs to remain successful in a time of increasing restriction and change (Bartlet, p. 138).

The key to the success of these elaborate decision making systems is the numerous communication channels established throughout both the parent and foreign subsidiaries. Special emphasis is placed on diagonal and horizontal communication between managers and staff of different divisions. In addition, corporate goals are well established and published to facilitate cohesion among the subsidiaries, and forecasting (both internal and environmental factors) is employed to alert management to the cyclical patterns many multinationals face (Bartlet, p. 140).

Thus, multinational forecasting is especially complex because of the wide variety of variables that can affect the operations of a multinational corporation. The forecasts must focus on the international environment and how the U.S. corporations relate to it. Political, economic and social trends are of particular importance. Unfortunately for forecasters, these will differ significantly all over the world. This requires that a broad range of forecasts be supplied to the home office in order to help formulate long range plans for subsidiaries all over the world.

Both foreign and domestic political cycles (especially their relationship with economic developments) are particularly important to multinationals because they have the potential to be exposed to so many of them. Here, the forecasters must not only recognize the cycles, but also look beneath them to find their causes and eventual influences.

Once these detailed forecasts are compiled, they are analyzed by management, both at home and abroad, in determining long range goals and plans. Trends necessitating revision of managerial efforts and policy should be given top priority. These include regulatory changes
and political cycles. Then, in order to remain in a favorable light, the forecasts should be used to coordinate public relations and maintain local interest in the success of the U.S. foreign subsidiary (Hutzel, p. 5).

The U.S. government also plays a large role in the operation of U.S. companies abroad. The effects of government policy changes at home must be assessed as to their influence on operations in Europe. However, U.S. policy changes may go beyond just influencing U.S. corporate behavior. They may also change the way foreigners view U.S. multinationals operating in their country (Hutzel, p. 9). It is especially important for U.S. MNCs to maintain a healthy image abroad and good relations with foreign press in order to assure continued operations.

V. Conclusion

Because of their general fall from favor abroad, U.S. multinational corporations face an uncertain future. Regulatory restrictions abound, and governments and foreign businessmen now question the economic benefits to be derived from any new U.S. inward direct investment. Furthermore, the increasingly elaborate structures adopted by some corporations complicate communication and strategic decision making. How should U.S. international industry handle the discouraging news from abroad in order to remain active and profitable in European business ventures?

First, U.S. MNCs must recognize the importance of maintaining good public relations abroad. A positive attitude toward U.S. inward direct investment on the part of European governments and businesses is an essential ingredient for the continued prosperity of U.S. multinationals. The local community must feel that it has a personal interest (such as jobs or improved lifestyle through corporate sponsored community programs) in the productivity of any U.S. firms with subsidiaries nearby. In other words, the community must feel that the economic and social benefits of the inward direct investment exceed the related costs. Aggressively friendly public relations and involvement in civic activities of local importance may help U.S. firms polish their tarnishing image abroad. Maintaining harmony with local governments and policymakers may also help alleviate some regulatory restrictions on American corporations operating abroad. At the very least it could prevent additional constraints on U.S. corporations’ foreign operations.

U.S. multinationals must also look critically at their current organizational structures and corporate policies. Are they operating efficiently? Is decision making flexible, yet complex enough to adapt to changing economic and political environments abroad? The versatile, simply organized firms have proven to be the most successful in recent years. They adapt quickly to forecasts of economic and political trends in their relevant environments.

Focusing more attention and energy on improving public image and maintaining a simple, flexible organizational structure thus appear essential for continued profitability of U.S. multinational corporations abroad.

References


