Economic Impact of MNCs on Development of Developing Nations

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Abstract- Multinational corporations do not come into being from thin air; there must be a form, an organization, and a goal for them to be brought into existence. Many studies that have been carried out in Europe and the rest of developing nations have concentrated on the benefits of Multinational corporations but literature still remains very little when Africa and the rest of the developing nations are touched. This study sought to bridge the gap of MNC by adding more literature on factual findings from a developing country context such as Kenya. It was centered on principles of employment creation, poverty and dependency reduction and foreign direct investment. The study was geared towards the historical background of global investments while tracing their evolution from small businesses to their giant investments that today their massive capital is a real threat to the nation when issues of capital flight fall due. The study is important to policy makers in deciding whether to continue depending upon multinational corporations which result in eventual capital flight or to nurture the local companies for sustainable development. The research adopted descriptive research design. On the basis of facts presented in this study, the MNC has outlived the usefulness as a development agent. The role of MNCs should be redefined in the context of the LDCs in which they operate finally; LDCs should ensure stable political systems to ensure sound economic policies. The study also concludes that the government should take a prerogative role in supporting the operations of the MNCs since they have boosted the economic development of the developing countries with a drive towards full employment. However, the over-dependence on these MNCs should be avoided at all costs.

Index Terms- Multinational Corporations, Transfer Pricing, Poverty and dependency, Less Developed Countries

I. INTRODUCTION

Multinational corporations as we know do not come into being from thin air. There has to be some substance, some meaning and some objective for them to come into being. Historically, the evolution of multinational corporations date back to the 15th century. At that time, the organization of the production unit was wholly private ownership of the means of production. Using technology and simple division of labour, merchants could manufacture basic commodities, "In situ-without need to travel," (Louis, 1994).

Abdullah (1998) early multinational corporations took the form of alliances with the parent country's military or political powers in extending their activities to foreign areas. Contrary to the simplicity of production of the 15th century, modern complex structure of the world economy is the result of centuries of technological evolution and advancement. According to Clicker (1990) the dominant player in the modern world investment set up is the multinational corporations. According to Root (1994), an MNC is a parent company that engages in foreign production through its affiliates located in several countries, exercises direct control over the policies of its affiliates, and implements business strategies in production, marketing, finance and staffing that transcend national boundaries.

These are giant businesses which have expanded and crossed national frontiers, operate globally and whose organizational framework is complex. Robbok and Simmonds (1989) asserted that, the rise of the multinational corporations has confronted the nation state with challenges of the operations of the local jurisdiction. The nation state has had to grapple with national interests and how to protect them from being compromised by the multinational corporations whose focus is control and transfer of goods and money as they cross national borders.

Robbok and Simmonds (1989) as well trace the early investment. In 1851 an American (singer) invented the modern sewing machine. This gave way to a number of subsidiaries in different continents in two decades. After this pioneering invention, others followed and wanted to divorce themselves from the control of the parent country. Such group was the Otis brothers (also Americans) who invented the modern lift in 1859. In 1890 Alfred Nobel of Sweden invented dynamite and set up various subsidiaries in Germany and other European countries so as to transfer technology as crucial as handling explosives.

In the developing countries, the MNCs are no longer viewed with colonialism or protection from their countries. A new breed of dynamite and aggressive MNCs has emerged over the last three decades. They have cast the stigma of the past which long characterized their predecessors and have thrived on the ability to make more profits and contribute to economic development on their host countries. Nyong'o (1991) strongly contends that, nation-state building requires politically strong nationalistic local entrepreneurs.

The study took scope of the General motors' corporation company which is an American multinational automaker based in Detroit, Michigan and the world's second largest automaker with its global headquarters in Detroit; GM employs 209,000 people in every major region of the world and does business in some 157 countries. General motors' produce cars and trucks in 31 countries and sells and services these vehicles through the following divisions: Buick, Cadillac, Chevrolet, GMC, Opel, Vauxhall, and Holden. GM's oyster subsidiary provides vehicle safety, security and informational services. Unfortunately, for example in Kenya, the manufacturers are the MNC subsidiaries with global interests that often conflict with the national desire to build up local technological capacity and also the Asian businesses men without political clout to stop the imports that idle local factories The structural transformation of the world economy through internationalization of big businesses has become a real threat to the economic as well as political interdependence of the nation-state. Scientists and political economists have researched and written on this subject for decades. However, most of the writers have concentrated their prosperity in their investment exploits. Majority are preoccupied with the brighter side of the MNC almost to the total exclusion of the dark side of the giant businesses.

It is a fact that MNCs have devastating effects on their host countries; they are crafty in their dealings. More often not many who notice the negative effects including the host countries. The MNCs do more economic and political harm and perpetuate poverty in the LDCs. This indicates a situation really wanting where no research has been comprehensively carried out. A study conducted by Bicknell (1999) has shown that MNCs located in LDC countries do help LDC countries in creating better living standards for competitiveness across the globe after which he recommended for further research on the economic impact of MNC on the developing countries. Therefore this study sought to evaluate the economic impact of multinational corporations on the less developed countries.

The general objective of this study was to investigate the effects of multinational corporations on various aspects of development in developing countries with an emphasis on economic dominance, poverty, dependency, pollution and entrepreneurs with a view to providing necessary information for remedial action. The specific objectives of this study were; to evaluate the impact of MNCs on employment, to determine the impact of MNCs on the host state in foreign exchange loss through transfer pricing and to determine the impact of MNCs on perpetuating poverty in developing countries.

II. Literature Review

Simply put, multinational corporations refer to firms whose scope of investment in international or in countries outside their immediate origins or outside their national frontiers. Langdon (1981) posits that multinational corporations repatriate their profits and more large amounts of currencies across borders especially in the event of a relocation of plant for various reasons, this result in reduction in value of the host country's currency occasioning inflation hence making the value of imports rise ruining the economy of a developing country. This chapter explores around the three specific objectives of; (1) impact on employment creation (2), transfer pricing and (3) poverty and dependence

2.1 Impact on employment creation

A multinational corporation is a firm with productive capacity in a number of countries. The profit and income flows that they generate are part of the foreign capital flows moving between countries. As local markets throughout the world are being deregulated and liberalized foreign firms are looking to locate part of the production process in other countries where there are advantages. Although LDCs may present higher levels of risk they also present higher levels of returns in terms of profit. Many LDCs with growing economies and increasing incomes may provide future growth markets (Kotler, 1994)
Multinational corporations contribute to 65% of the non-governmental employment opportunities available at any given country of host (Reid, 2001). Schermerhorn (2002) argues the fact that for the case where many LDCs are often endowed with potentially large low wage labour forces and high levels of unemployment, this might be considered inappropriate technology and MNCs come in to equip the countries with intrinsic knowledge aimed at acquiring a skilled work force in the industry

Gerrefi (2003) maintains that the cycles of poverty will not be broken from within the domestic economy. The level of investment needed to raise productivity and incomes is not possible. Thus a foreign direct investment through multinational corporations is essential (Mulwa, 2000). By investing in areas and utilizing the factors of production where the LDCs have an absolute and comparative advantage MNCs will lead to a more efficient allocation of the world's resources (Gesso, 1999)

Schermerhorn (2001) defined ways to engage developing countries into development with the aid of the MNCs. They are sanctioned non-engagement, principled non-engagement, constructive engagement or unrestricted engagement. It is the responsibility of a developing nation to offer enough allocation opportunities to its people so that the society can provide skilled labour for the worldly market (Mundane, 2003). Langdon (2000) posits that Education is a contingency for paying employees a wage that is well above the poverty line in multinational company context. Marxism (1998) argues that it is the ethical obligation of MNCs to pay educated employees wages of the activities that are well above the poverty line.

It is the responsibility of MNCs to consider developing countries for their labour supply, because if executed property, it will create stockholder value (Kaburu 2005). Domar (1994) suggests that the level of investment is important in determining the level of economic growth and poverty reduction in LDCs. Multinational corporations provide employment. Although wages seem to be very low for us, people in developing countries often see this job as preferable to working as a subsistence farmer with even lower income (Kitche, 2001)

Langdon (1990) stresses that heavy advertisement on the part of MNCs distorts the structure of local demands and destroys indigenous industries which cannot afford the costs involved. According to Lall (2002) Informal employment is at record levels worldwide with severe consequences for poverty in poor countries

The financial crisis is throwing many people out of work and, in developing countries with no unemployment insurance but dependency on MNCs; they are forced to take informal jobs with low pay, no protection and high risk exposure. The study by Domar (1994) finds that 1.8 billion people, or more than half of the global labour force, are working without a formal labour contract and social security. Even during good times with robust growth rates, in many developing countries informal employment increased in some regions with the existence of MNCs," says Johannes (2008)

Jutting (2003) warns of the potential draw-backs of a further increase in informal employment: lower wages and incomes in poor countries that do not have the means to provide comprehensive safety nets. Women – who constitute the majority of workers in poor quality jobs – will be particularly affected, as will youth and the elderly.

The majority of the 1.4 billion poor people in the world depend exclusively on their labour for survival. Low pay, with no social benefits, increases the likelihood that the Millennium Development Goal of halving poverty world-wide by 2015 will not be met if the MNCs cannot be in the position of supporting the rapidly growing population, (Buckley P J Et al, 2008). 1.8 billion People work in MNCs compared to 1.2 billion who benefit from formal contracts and social security protection (Coughlin, 2006)

The share of informal employment tends to increase during economic turmoil. For example, during the Kenyan post election violence (2008), the country's economy shrank by almost one-fifth, while the share of informal employment expanded from 48% to 52% (Wangari, 2009)

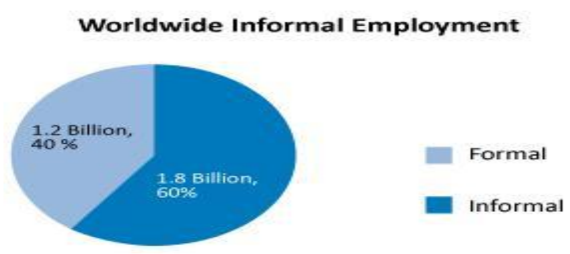

Figure 1

Source: OECD Development Centre "Is Informal Normal? (2009), based on Kenyan development trends, 2009

2.3 Transfer Pricing

MNC is likely to be diverse in terms of products and geographical markets. They have a range of different types of business in the form of subsidiary companies within a holding company structure or divisions within a multinational structure. Despite the MNCs being regarded as the principal agents by whom technological transfer occurs, it remains a fallacy or misplaced notion because MNCs scarcely have the appropriate to transfer.

MNCs engage in transfer pricing where they shift production between countries so as to benefit from lower tax arrangements in developing countries (Schermerhorn, 2000). Ake (2002) points out that, 'what passes as technology transfer occurs is not that the technology transferred is appropriate but that it is available. This is because it is produced in response to the needs of the environment that are quite different from those of host countries. The transferred technology is not integrated into the local center and system of production and so its ability to stimulate further technological development is severely limited.'

As it has been mentioned in the preceding sections, transfer pricing has adverse effects on the LCDs. It is a strategy aimed at lowering total taxes paid by the MNC to the host country. Intra corporate sales rates and purchase of goods and services are artificially invoiced so that the profits accrue to the branches located in low tax countries. The offices in high tax countries show little or no taxable profits in their books. This manipulation is common with intra firm trade though unrelated companies sometimes collude to transfer funds across boundaries (Lull, 1991)

MNCs pay for higher prices than other Kenyan firms. In 1984, a MNC quoted a price of US $115/KG of methyldopa drug to a licensed manufacturer though others sold it for US $ 68/kg. Another sold Diazepam drug at US $ 600/kg to a local licensee while the product was available for US $ 60/kg. These products are specialists produced in Kenya under licenses from big MNCs (Ake, 2002). The overpricing here could be due to transfer pricing or high production costs. According to Langdon (1981), MNCs repatriate their profits and move large amounts of currencies across borders especially in the event of a relocation of plant for various reasons.

"MNCs have cast the stigma which characterizes their predecessors associated with colonialism," (Abdullah, 1997). Contrary to the expectation of most countries, the MNCs transfer of technology is of no economic significance to the host state. Ake (2002) points out that what passes as technology transfer occurs is not that the technology transferred is appropriate but that it is available. The technology so transferred is often obsolete, archaic, expensive and often unsuited to the application and demands of the host state. The MNC may transfer obsolete technology to developing countries such as expired pharmaceuticals, radioactive goods such as union carbides toxic products or the DDT. Hahlo et all (1997) establishes that an average MNC welds more economic power twice or thrice that of the nation state. Over two decades ago, the annual turnover of General motors' corporations was equal to the GNP of Switzerland, Pakistan and South Africa combined.

Overall incidences of absolute poverty were estimated at 52% based on welfare monitoring survey 3 of 1997. The number of the poor increased from 3.7 million (1972-1973) to 11.5 million in 1994 and now estimated to be 15 million (Gerrefi; 2002). Transfer pricing is common with intra company trade though unrelated companies sometimes collude to transfer funds across boundaries. This is a problem brought by MNCs and the effect on trade and development is disastrous, and (Lall, 1993) confirms this assertion.

Studies of the drug industries in several countries show that MNCs make huge profits at the home base by rising for materials supplied and services rendered to their subsidiary companies. Lall (1991) and Gerrefi (1993) concur on this statement. According to studies by Owino (1991), an examination of company invoices at CBK and suppliers quotation for 1983 and 1984 had evidence of this. Comparison revealed manipulation through over invoicing with MNCs paying higher than other companies. Desmond (2002) elaborates that today GM controls 90% of all exports to East and Central Africa. Transfer pricing is a problem in Kenya. A subsidiary of a large textile firm in Kenya purchased all inputs from the parent company until recently at much higher than competitive prices. Langdon (1991) and Coughlin (1996) also expose over pricing of imported inputs in the textile industry.

Silberztein (2008) posits that transfer pricing is a challenge for developing countries. A lot of debate about tax and developing countries nowadays tends to focus on how to reduce revenue leakage through offshore tax havens. But there is another hot issue called transfer pricing which developing countries have to be mindful of, particularly if they want to avoid the risk of losing out on tax revenue from cross-border transactions carried out by multinational enterprises. A large proportion of world trade is accounted for by cross-border trade taking place within multinational enterprises, where branches or subsidiaries of the same multinational enterprise exchange goods or services (Hahlo et al, 1997).

Brooks (2005) argues that one key difficulty in applying transfer pricing methods is to find open market transactions between independent enterprises that are comparable to the controlled transactions within a multinational enterprise. This is an issue for developed as well as developing countries, although it is magnified for developing ones due to the smaller size of their economies and smaller number of independent enterprises operating in their markets that can be looked to for comparisons.

2.4 Poverty and Dependency

Nyong'o (1998) strongly contends that nation-state building requires politically strong nationalistic local entrepreneurs. Unfortunately, for example in Kenya, the manufacturers are (1) either the MNC subsidiaries with global interests that often conflict with the national desire to build up local technological capacity, (2) or Asian businessmen without political clout to stop the imports that idle local factories. The structural transformation of the world economy through internalization of big businesses has become a real threat to the economic to the economic as well as political independence of the nation-state. In Kenya for example, despite various forms of interventions and economic policies the country continues to perform poorly. This continues to be despite the long regime of MNCs.

Eglin (1994) further points out that the artificial differentiation of products comes as a result of a single firm monopolizing the domestic market and wants to increase the sale of its products through advertising different brands names for basically the same product. This is true of firms making soap, soft drinks, paints, cosmetics, dry cells, food industries A sound economy facilitates employment by empowering the skilled and the less skilled. (Cowen, 1993) This view is true to a large extent since skills are the input to work and as work, so employment and therefore income and economic development.

A study to determine the MNCs perpetuation of poverty that was held at the cities of Kenya indicated the prevalence of poverty by regions. National percentage stood at 52%. Urban prevalence of absolute poverty is overwhelming despite the fact that MNCs operate in major urban centers. Kisumu has the highest percentage of absolute poverty, food poverty and hardcore poverty respectively. Urban food poverty stood at an average of 35% while overall poverty stood at 45%. (Muller, 2005)

Singh (1999) explains the social-cultural effect of a people's changed consumer taste is the desire to get what is beyond their reach. This breeds corruption, robbery and any measure that is sure to avail money, ethical and moral consideration notwithstanding. Almost half of the urban population lived below the absolute poverty line. The wealth of a nation and living standards are a direct reflection of the performance of the economy. The activities of the MNC directly affect the growth of the economies of the host states. Relocation of business has a sudden economic disorientation which affects economic performance. MNCs relocate operations without notice. However, Coughlin and Ikiara (1996) disagree by stating that MNCs assisted host countries economically and continue to do so. These authors disregard the exploitative nature of MNCs.

Langdon (1991) narrates that the effects of class formation leads to poverty. The erosion of nationalism among the educated elite leads to their association with MNCs to further narrow interests in the process of class formation. The effects of this are denial of a country of the input of her educated manpower that is expected to plough back to the economy what resources they were trained with.

Donna (2000) adds that the social cultural effects of a changed consumer taste leads to massive corruption and robbery which adversely affect the economy. They are 'indoctrinated to desire what desire they cannot afford.' The technology of MNCs is usually misplaced in LCDs while the small economies are integrated into those of MNCs in most strategic sectors rendering the small economies subsistence and incapability of self generation and growth.

Turner (2001) asserts that corporate managers of MNCs have the ultimate powers to shift and relocate capital (resulting in massive layoffs), develop or suppress technology. They defend brand loyalty and have the power to make daily decisions on what people should eat, live, wear and what sort of knowledge is to be taught in schools and universities. These decisions have some impact on the host government since they result to serious cases of poverty if altered and dependence upon the foreign MNCs which may decide to relocate themselves any time. Langdon (1991) stresses that heavy advertising distorts the structure of local demands and destroys indigenous industries which cannot afford the costs involved.

Majority of Kenya urban poor live in peri-urban and slum settlements that are characterized by low quality basic services such as water, schools and health. They have no regular job and no regular income. 25% of their little income is used on rent. (Corey et al., 2003). MNCs are a key factor in the large improvement in welfare that has occurred in developing countries over the last 40 years. In those countries (the LDC) where the presence of MNCs is negligible, severe poverty rates persist and show little sign of improvement (Lull, 1991).

Brooks (2005) argues that the main role of MNCs is underappreciated — they have provided developing countries with much needed capital, jobs, and environmentally friendly technologies. Ake (2002) posits that through free market initiatives, MNCs create wealth, which provides the income flow necessary for welfare improvements. If the desideratum of developing countries is to escape severe conditions of poverty, they need to privatize, deregulate, protect private property rights, and establish a rule of law — the MNCs will then provide the capital. Never accept statistics about global poverty at face value and always remember that each household behind the figures has its own human story to tell. Whatever the difference of opinion on the extent of global poverty, one thing is certain: a significant proportion of the world's population is excluded from our prevailing economic system of wealth creation. The symptoms of its inherent instability – recession, volatile food and fuel prices, and climate change - impact disproportionately on the poor. (Weitzman, 1999)

Extreme poverty strikes when household resources prove insufficient to secure the essentials of dignified living. The consequences of persistent poverty include insufficient food, children out of school, diminution of household back-up resources and exclusion from valuable social networks (Kaplinsky R, 2001). Expressing poverty as a percentage yields more favorable results due to rising population. For example, extreme poverty in sub-Saharan Africa fell slightly from 58% to 51% between 1990 and 2005. (Todaro, 2000)

III. Methodology

The researcher adopted both descriptive and analytical survey methods with an objective of finding out the impact of MNCs on development of their host countries. This is because these methods report the way things are in order to look closely to the statement of the problem and thus in line with the research objectives. This study targeted the universal set up of managers working with the General Motors Company with the procurement department, purchases and sales department and the publicity department. The reason behind the target population of managers was because managers are the ones the researcher opted could be having the required information to fill the research questionnaires. The company has 50 managers employed on both full time and part time basis but only a total of 30 successful respondents were found upon which the results of this study is based as shown below;

Table 3.1 target population

Population	Number of managers	Respondents per category
Procurement	15	50%
Sales and purchases	10	33.33%
Publicity	5	16.67%
Total	30	100%

Some information was also obtained from the webpage of ministry of planning and vision 2030, Kenya on how GM has been contributing towards the development of Kenya as a developing nation. A total of 11 managers from procurement, 5 from purchases and sales and 4 from publicity were picked at random. The researcher used the simple random sampling method to group the sample population into a manageable sample of 20 respondents that represented 66.67% of the population which is above the average as shown below;

Table3.2 sampling procedure

Population category	Estimated number of managers	Units per sample	% per category
Procurement	15	11	36.67%
Purchases and sales	10	5	16.67%
Publicity	5	4	13.67%
Total	30	20	66.67%

The research was conducted through administration of closed ended questionnaires to respondents who shall fill and return them for analysis. Both primary and secondary data was viable for this study. The primary data was collected through use of structured questionnaires from the respondents which will form the main data instrument. The questionnaires were administered through telephone and face to face interviews with the respondents. After data had been assembled, descriptive statistics such as measures of central tendency and dispersion and seasonal patterns (use of trends) were employed in the final analysis.

IV. Findings and Conclusion

This chapter reviewed the general context of MNCs and their pros and cons in the developing countries where many of them are hosted. It looked keenly unto the three objectives of the researcher i.e. employment creation, transfer pricing and poverty and dependence reduction. The researcher found that the MNCs do create rigorous employment opportunities in the country, have fostered towards the reduction of poverty and dependency although much of the gains are again lost through transfer pricing to the main branches of this MNCs in the developed countries.

The research also found out that many of these MNCs do have a multiplier effect towards poverty reduction through their contribution to relevant schemes like the Red Cross scheme and other social corporate responsibilities. Many managers in the General Motors Corporation are satisfied with their employment benefits in the procurement, sales and publicity departments. The employment criteria is based primarily on both academic qualification in which case many managers are employed with the post university qualifications and also experience as a benchmarking qualification to employment. The corporation has substantially reduced the poverty levels mainly by the creation of employment opportunities to the locals and also substantially by their schemes of contribution to the poor that they reveal is ideal and active.

On the basis of facts presented in this study, the MNC has outlived the usefulness as a development agent. The role of MNCs should be redefined in the context of the LDCs in which they operate finally; LDCs should ensure stable political systems to ensure sound economic policies. The study also concludes that the government should take a prerogative role in supporting the operations of the MNCs since they have boosted the economic development of the developing countries with a drive towards full employment. However, the over-dependence on these MNCs should be avoided at all costs.

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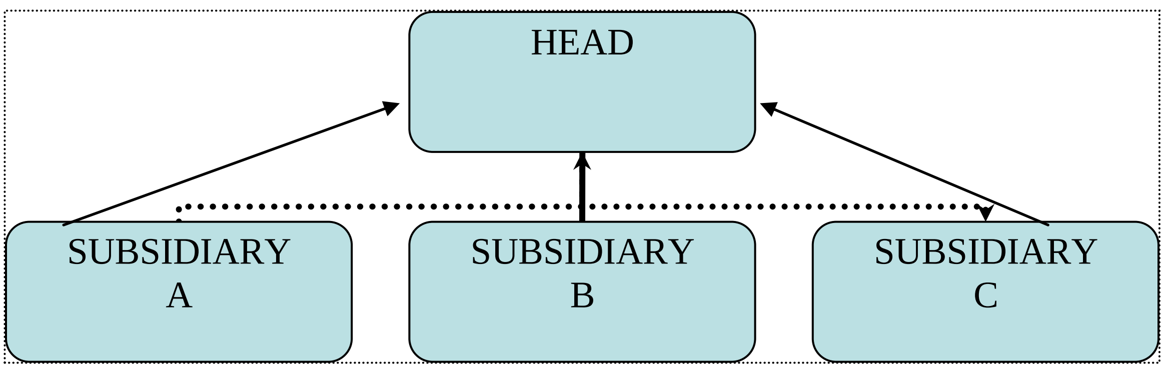
THEORETICAL FRAMEWORK

This is the foundation upon which the whole research study is based. The nature depends on the type of the study. It can be called elaborate network of association among the identified variables

CONCEPTUAL FRAMEWORK OF MNC COHESIVE CONTROL



………………….transmission of policies to Subsidiaries or Affiliates

---------------------feedback to HQ (head company) in parent company