THE MULTI-NATIONAL[1] FIRM AS AN INSTRUMENT OF DEVELOPMENT

by **Lawrence E. McKibbin***

It is difficult to believe that mankind is really so stupid and stubborn as to fail to make more effective use of its natural, technological, and human resources than it is now doing. World per capita income is pitifully low, especially in the underdeveloped regions; the gaps between rich countries and poor countries are enormous; the gap between rich and poor within underdeveloped countries is often shocking. Suppose for a moment that I were given the task of improving the economic lot of a given country or region, say Ruritania[2]. How would I go about it? What would be my strategy for development?

First, I would have to evaluate Ruritania's resources. What can be produced? What raw materials are available? What capital do we have? Do we have trained manpower? Educational institutions? Etc...... For most of these questions the answers will be discouraging, for Ruritania, like most underdeveloped countries (it's more polite to say "developing", but I prefer to be honest), is poor. As Gunnar Myrdal points out in his monumental study *The Asian Drama*[3] countries are poor because they are poor. They are caught in the vicious cycle of having to live a day-to-day existence; they cannot save, therefore they cannot invest, therefore they cannot improve their rate of output; meanwhile the population keeps increasing; per capita production keeps going down instead of up. They stay poor. There seems no way out of the vicious cycle short of central government control coupled with massive foreign aid. Still, Ruritania must have *something*. It does: *people*. Millions of them. Mostly uneducated, illiterate, an unproductive lot, to be sure, but nonetheless human beings, with many of the attributes of people everywhere, whether in London, New York, Bangkok, or wherever.

These people are the greatest resource Ruritania has.[4] How can this resource be exploited? Now the word "exploited" is a loaded one. Exploitation connotes unfairness, advantage

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[1] The word multi-national is used to distinguish those firms who have capital investments in manufacturing in a number of different countries, as distinct from the international firm, which may be engaged only in trading.

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[2] A fictional country.

[3] Gunnar Myrdal, *The Asian Drama* (New York: Pantheon, 1968), p. 1870.

[4] For a discussion of low-cost labour as a resource, see Murray D. Bryce, *Policies and Methods for Industrial Development* (New York: McGraw-Hill, 1965), p. 26.

being taken by one person or group over another. But exploitation also refers to the act of taking advantage of an opportunity. One ***should,*** after all, exploit opportunities. And any population anywhere presents opportunity to those who can serve their needs, educate them, provide them means to realize their potential as human beings. Ruritania's population is no exception. They are an untapped, undeveloped market for an infinite variety of goods and services. Their needs are greater than those of the people in the advanced countries, precisely because they are underdeveloped.

In the language of business, the underdeveloped world represents the greatest untapped *market,* because the population of the underdeveloped world is far less saturated with goods than is the developed world. It is not easy to sell a refrigerator to a person who already has one in good working order. Relatively few people in the United States are without a refrigerator; in Ruritania, hardly anybody has one. The people of Ruritania would love to have refrigerators and a host of other things. How will those goods and services be provided? I believe the leading candidate to do the job of development required in Ruritania or anywhere else is the multi-national firm. As general manager of Ruritania, I would try to get our organization (country) moving by attracting selected multi-national firms to come in to develop and exploit the latent opportunities which exist because we have millions of people who have needs, wants, and desires which are not being met by existing institutions.

Economists will immediately point out that while there are needs, wants and desires, the people of Ruritania have no *income,* therefore there is no *effective* demand, therefore there is no *market.* Again, people are poor because they are poor and there's little that can be done about it, if conventional wisdom is followed. But conventional wisdom seldom solves the world's major problems. The Ruritanias of the world are in crisis. Crises sometimes force unconventional wisdom which bring forth new ideas which work. The multi-national firm of the future just may depart from traditional modes of operation in ways which will turn Ruritanias around.

The Argument for the Multi-National Firm

Why do I think international business will do the job of economic development better than other kinds of organizations? The international firm wins by default. Who else is there? The government? That's a possibility and, of course, government must play a key role, but the evidence to date suggests that a major aim of development--the increase in consumer choice and in levels of consumption--is not effectively met by government. When it comes to the capacity to produce efficiently many of the things the consumer wants, the entrepreneurial model still appears quite effective.

How about local entrepreneurs? There is little evidence to suggest that an economy will lift itself by its own economic bootstraps, as it were, through local businessmen. This is not to denigrate the role of local businessmen; they are a critical element in the development process.

However, most local entrepreneurs cannot amass sufficient capital and do not have sufficient technical knowhow to tackle many desirable projects. The local enterprise ordinarily cannot afford to do much beyond searching for short-run profit-making opportunities, because it is in a constant battle for survival; it cannot afford research and experimentation to any appreciable extent, and it cannot wait very long for a return on its investments. Unless an investment proposal meets a three or four year (or less) payback standard, it will most likely have to be rejected.

The large international enterprise, on the other hand, can often afford to undertake marginal ventures which promise returns only after a number of years without appreciable payback. An example would be chemical fertilizers in countries like Thailand where a tremendous marketing effort will have to be undertaken over a long period (may be five to ten years) before the farmers will be convinced that fertilizers are worthwhile. (The farmers may be right in being skeptical --perhaps the specific product mix and the techniques of fertilizer application will have to be evolved over an extended period of time before optimum results are obtained). A Shell Oil Company or an Esso, or a consortium of international organizations could take the time and devote the resources to educate farmers, to grant them extended credit terms, to take losses[5] over a number of years before reaping their share of the increased yields resulting from the use of fertilizers. A small local company could not. The government theoretically could, but would it? Probably not--the government has its hands full doing other things, (such as fighting insurgents along its borders; providing education; building roads and dams; collecting revenues; etc.). The government would have difficulty amassing and focussing the knowledge which is the stock-in-trade of the large international firm.

Another example further illustrates the point. A group of four businessmen from a remote province in the Amazon jungle of Peru studied the feasibility of constructing a cement plant to exploit the only known lime-stone deposit in the region. The businessmen in this instance were enthusiastic, public-spirited, hardworking people who saw in the opportunity to build a cement plant not only profits for themselves but real civic achievement--they felt they could produce locally a product which was then imported from Venezuela or Europe and which was very costly (not only was the market price high, but scarce foreign exchange had to be used to buy it) because the cement had to be transported some two thousand miles up the Amazon river to the river port of Iquitos. Some three thousand people were scattered through a vast territory embracing the upper reaches of the Amazon and it's tributaries and some potentially valuable agricultural land on the Eastern slope of the Andes mountains. (The Andes is a very high range paralleling the West Coast of South America, effectively cutting off Eastern Peru from the more populous West along the coast).

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[5] "Losses" may be misleading. The kind of losses I have in mind are really additional invesments required to build a market. Accounting conventions, however, cause such invesments to be shown on Profit and Loss statements as costs or expenses during the year of their occurrence.

A careful assessment of the potential market, the probable costs of production, and the investment required showed that it might indeed have proved feasible to construct a small plant. "Small" by most standards in the cement industry means and investment of at least one million U.S. dollars to construct a plant capable of producing around 30,000 tons of cement a year. (There are enormous economies of scale in cement, therefore plants in most areas have capacities of more than 100,000 tons annually). A one-million-dollar investment is not enourmous from the point of view of most multi-national firms, but it is beyond the reach of most local entrepreneurs, especially those in remote regions where resources tend to be especially scarce. But suppose that our entrepreneurs could borrow sufficient capital to install a plant and begin production. How long would it be before a cash flow squeeze would force them into insolvency? There are long lead times in an operation of this kind, and while the plant may well prove feasible in the long run--after the market has an opportunity to grow--in the early years there is a very high probability that a small group of local entrepreneurs with meager resources would not be able to survive.

After carefully considering the risks, the Peruvian entrepreneurs decided they would have to abandon the project, even though they felt very strongly that the long-run potential for profits was there, and that such a plant was desperately needed if dreams of development for their community and their region were ever to be met.

If the assessment of long-run profit is correct, but if for a number of reasons local entrepreneurs cannot survive the early years of investment with no return, then who would ever undertake the project? Possibly the government could do it, but governments have not been known to be especially adept in the cement business. A much more likely possibility would be the mutinational firm, whose resources, both financial and technical, would enable it to make a strategic investment, betting on the long-run growth of the market. The multi-national firm can afford to bet on such a venture because if the gamble should fail it will not be totally ruinous--only a small part of the resources of the firm would be devoted to such marginal projects.

There exists a set of investment opportunities which will begin to show profits only after a number of years of nurturing the market. The organizations capable of investing in such opportunities must be able and willing to wait out the early years before reaping their rewards. Not only must they be willing to wait, but they must be capable of pouring in additional resources to rescue projects which succumb to the almost inevitable forces of "Murphy's Law", i.e. that if something can go wrong on a project it will. Despite the most expert feasibility studies, investment projects often do not work out as planned, even in developed countries.[6] In the Ruritanias of the world, uncertainty is that much greater. The staying power of the multi-national firm will enable it to survive in many situations were local entrepreneurs would be doomed to failure.

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[6] For a fascinating discussion of the innovative capacity of organizations to rescue projects that do not go according to plan, see Albert O. Hirschman, *Development Projects Observed* (Washington, D.C.: The Brookings Institution, 1967), especially Chapter 1, "The Principle of the Hiding Hand", pp. 9-34.

Barriers to Multi-National Investments

While touting the capabilities of the multi-national firm, I have to admit that international business has not yet provided the entire solution for the growth needs of the developing countries. I believe international business is terribly under-committed in the developing countries. New investments should be expanding at a faster rate. What is holding organizations back?

There are, of course, he obvious problems of governmental red tape, legal restrictions, fear of political upheaval and general uncertainty about the stability of the economic environment (e.g., no one in his right mind would be likely to rush in to invest in Cambodia and Laos at the moment). But the constraints preventing new investment often lie within the firm itself. Managerial attitudes are significant. Two of the major problems deterring investments are: 1) managers have become over-fond of quantitative decision-rules; and 2) many managers in large organizations have not developed, or have lost, a sense of mission--they have a commitment to little beyond keeping their jobs.

Decision-making tools

Perhaps International Business (especially American Business) has fallen victim to its own sophistication. An impressive array of decision-making tools and techniques has evolved to replace the old seat-of-the pants methods, but perhaps one unanticipated side-effect is a built-in propensity to avoid some risks which should be undertaken. This is not to say that quantitative decision-making models are inherently inadequate. Perhaps we have not yet become sophisticated enough to quantify a variable such as "a sense of mission", not so much because it is absolutely unquantifiable but because we haven't yet done enough research to measure it.

The budgeting process in many large organizations is essentially built from the bottom-up in piecemeal fashion, rather than from the top down. The bottom-up approach has the virtue of involving lower levels in the organization and thus securing a greater likelihood of their commitment to the success of the various projects; however, it has the disadvantage of being subject to arbitrary quantitative decision rules which may impede the attainment of long-range strategic goals. Perhaps worse, the decision rules themselves can become so constraining that the process of strategy formulation is impaired.[7] Organizations have developed very sophisticated control mechanisms; however, an enterprise can become so preoccupied with control and efficiency that it neglects to look at where it is going and why it is going there.

Decision-making rules can stifle many new projects, especially in underdeveloped countries. Since risks are higher in these areas (or at least they are perceived as being higher) the rejection point for a new venture proposed by a manager in Ruritania will ordinarily be higher than it

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[7] For a discussion of the inadequacies of standard budgeting methods, see Seymour Tilles, "Strategies for Allocating Funds", *Harvard Bussiness Review*, (January, February, 1966), pp. 8-16.

would be in the United States or Europe. A firm ordinarily ranks capital investment proposals according to the potential return on investment. The more sophisticated approaches use discounted-cash-flow, a method measuring the present value of future cash flows anticipated for the project. If the present value of future flow is higher than the amount of the investment, the firm will invest; if not, the project will be rejected. A critical element in the formula used to calculate present value is the discount rate acceptable to the firm. Theoretically, all projects for which a return is higher than the marginal cost of capital should be undertaken; in practice, a considerable cushion is built-in to compensate for perceived risk. In Ruritania, where uncertainties abound, the return on the investment would have to be much higher than the cost of the capital (whether equity or borrowed) before a project would be undertaken.

Here is where stultifying decision-rules often enter the picture. The typical firm may simply reject all investments which promise a return lower than some arbitrary cutoff point. Or still simpler rules might be involved, e.g. a payback criterion, where no projects are undertaken unless the capital is "paid back" by the project within a given number of years, often as low as two or three. It is this kind of rule which prevents the establishment of cement plants in the Amazon jungle. Certain investment projects will always be rejected by ordinary financial decision-rules, because the early years do not meet payback standards, and because earnings in future years are discounted at too high a rate.

This is not to say that decision-rules are not useful or that they should not be invoked However, quantitative tools must be recognized for what they are : tools, not objectives.

If the corporate manager would play his entrepreneurial role to the hilt he would undertake all possible opportunities which offered a fighting chance of being successful. Legend has it that Tom Watson of IBM simply wouldn't take no for an answer from his subordinates when it came to pushing his personal pet ideas. He would typically instruct his engineers to "build me a machine that will......".[8] If current decision-making tools had been rigidly applied to IBM's ventures over the years, many very successful projects might never have been started.

Uncritical application of decision rules throughout a multi-national organization can lead to avoidance of almost all risks to the point where the firm is missing many potentially profitable opportunities. In part this is because managers are judged on performance in the short run, and failure of individual projects may prejudice an individual manager's career in an organization. It is much easier for a manager to depend upon a universal corporate decision-rule than to fight for a risky project, especially one which will not pay off for several years.

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[8] William Rogers, *Think: A Biography of the Watsons and IBM* (New York: New American Library, 1969), p. 188.

In their preoccupation with control and safety, many organizations are not serving the basic purposes of the private sector as well as they should. Since risks are inherent in the process of private entrepreneurship, some failures are to be expected. A group of prominent management authors comments "...... a high-risk strategy that has failed was not necessarily a mistake, so long as the risk was anticipated and the consequences of failure carefully calculated. In fact, a planning problem confronting a number of diversified companies today is how to encourage their divisions to undertake projects where failure can be afforded but where success, if it comes, will be attended by high profits not available in run-of-the-mill low-risk activities."[9]

It is possible that some of the strongest firms, ones which could readily absorb lossses from failures, as precisely the ones which become highly preoccupied with sophisticated mathematical models and decision-rules which could prevent their engaging in many activities in underdeveloped countries.

A Sense of Mission

This leads me to suggest that there are some ventures which *should* be undertaken simply because management thinks they *ought* to be undertaken, and because management *wants* them to be done. A computer manufacturer could conceivably decide to develop a teaching-machine to combat illiteracy in countries where there are not enough teachers, not only as a profit-making venture, but because management thinks it is something that ought to be done. I hasten to add that this does not imply a "dogooder" approach. No private company should undertake a commercial project which promises no economic return whatsoever. The point is, knowing what ought to be done and wanting to do what ought to be done will lead organizations to *search*[10] for profit-making opportunities in those areas, and then to devote extraordinary efforts to accomplish what they set out to do.

Such things as religious convictions, political ideologies, humanitarian ideals, etc . may provide causes which could drive organizations beyond their ordinary capabilities. For example, are all investments in Israel motivated by profit considerations alone? Obviously not. Patriotism, excitement, glory, adventure, even curiosity have all provided strong motives for organizations in the past. When one looks into the history of firms which came to Southeast Asia over a century ago, one cannot but be impressed by the daring, audacity, and the risk-taking which went into such ventures. Profit-seekers they were, to be sure, but there was more, *much more*, to the game. Corporations, like individuals, need the stimulus of a sense of mission to drive them beyond levels

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[9] Edmund P. Learned, et. al., *Business Policy: Text and Cases* (Homewood, Illinois: Richard D. Irwin, Inc., 1969), p. 25.

[10] Research shows that even large firms tend to have limited, ineffective methods to search, or scan the environment for new opportunities. See Francis Joseph Aguilar, *Scanning the Business Environment* (New York: MacMillan, 1967), esp. Chapter III.

of ordinary performance. Profit-making is essential; but it is not enough. If profits were the paramount motivator, more of us would be involved with the Mafia. Moreover, a sense of mission is by no means incompatible with maximizing the present value of future profits. Quite the contrary.

Conclusion

If top managers in major multi-national corporations would see Development as a mission to which their organizations should be dedicated, the process of Development would undoubtedly be hastened. How many firms can say that they have searched the environment for new opportunities in the underdeveloped world as thoroughly as they have in the advanced areas? And how many enterprises are really utilizing effectively all their resources, both real and potential? If one looks at the top five hundred corporations in the world, how many would have to turn down a new investment proposal because they could not find the funds? Often cited is the shortage of management talent. Is this "shortage" real? Have multi-national firms given fair opportunities for local managers to develop their capacities? The chances are there is a great deal of slack in most organizations.

Conscientious, systematic effort should be made to induce investment in the developing world, partly because to leave it to languish in the economic doldrums would rest heavily on the consciences of advanced peoples everywhere, and partly because many profitable opportunities of the future lie there.

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