THE MULTINATIONAL COMPANIES AND THE EMERGING MARKETS

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The term of emerging markets defines the developing states that are an important source of cheap raw materials and labor force for the multinational companies, which are looking for competitive advantages. Consequently, the potential of these markets have determined important changes in the multinationals' actions that started, more and more, making foreign direct investments in developing states. But, relocating the activities outside the origin country, the firms are influenced and, meanwhile, are influencing the economical, political, social and cultural environment of the host states. Therefore, if the multinationals' decision of investing is taken only after a careful analysis of the opportunities and risks of the emerging markets, their activity may involve both benefits and costs for the local economy.

Key words: emerging markets, multinational companies, relocation of production, competitive advantages

Introduction

The emerging markets represent a great opportunity for multinational companies to grow and intensify the activities. The potential of these markets has already determined significant shifts in the multinationals' actions: if in 1992 the foreign direct investment (FDI) inflows to developing countries were only 18% from the total amount of FDI, in 1996 this percentage rose up to 33%, exceeding 100 billion dollars (UNCTAD, 1996). While these investments are widely interpreted as heralds of a major restructuring of the global economy, the emerging markets are considered to be a source of the future growth.

The term emerging market is used in order to define the developing states that are an important source of low-cost raw materials and labor force. Nowadays, the emerging markets' attractiveness has increased, fact that could be mainly explained through the implementation of some economic liberalization measures that have facilitated the entrance of the multinational companies on their territory. Moreover, the information technology made possible for the small and medium-sized multinationals to easily get in touch with business partners from the emerging markets; in the absence of these facilities, it would not warrant the time and cost of establishing traditional relationships.

Foreign Direct Investments on Emerging Markets: Opportunities and Risks for the Multinational Companies

Before the last decades of the XXth century, with a few notable exceptions, the multinationals' participation on the emerging markets was limited to establishing low-cost offshore production operations, accompanied in some cases by opportunistic exports. Nowadays, these companies are attracted by the revenue-generating potential of these markets and by the opportunity of growth offered by them. Therefore, apart from the advantage given by the possibility of establishing some production subsidiaries in order to produce low-cost goods that, later, will be exported to the developed countries at a much bigger price, the emerging markets are also attractive as secondary markets. This last advantage is exploited especially by the firms with products that have reached the maturity stage on the developed, oversaturated markets, and which now can be sold on the emerging ones. But, at an operational level, the multinationals may confront with some unfamiliar conditions and problems on the emerging markets. For example, what most companies that act on developed country would regard as basic marketing infrastructure, is largely absent in many emergent economies; also, here there is little or no market data, nonexistent or poorly developed distribution systems and, moreover, business regulations are frequently changing.

Another main category of challenges includes the decisions that multinationals have to take: which markets they enter and when, how the product life cycle and the market life cycle might evolve and how to structure the relationship with local partners. The problem that appears is that there is little guidance for corporate executives responsible for the firm's strategy across the emerging markets; so, the default option remains to use the same marketing frameworks applied in developed economies. Some interviews, conducted by A. K. Gupta and D. E. Westney and addressed to some multinational's managers, argue that, due to the differences in the level of development and in the growth possibilities, the strategies have to be reconceived before being implemented into the emerging markets (Gupta, Westney, 2003; p. 109-110). The risks that may frequently appear on these markets are the political, macroeconomic, monetary and informational ones. The most known political risks are expropriation – when the government takes over a foreign firm – and the political instability that might turn into an armed conflict or might foster corruption. The solutions, in order to avoid these challenges, are either having an important local company as a partner, or "inviting" the government to own part of the firm (Hooke, 2001; p. 50).

One of the few studies that analyze the advantages of the first companies that enter the emerging markets – called "the first-mover advantages" – concludes that most of these markets' conditions "appear to inhibit rather than enhance first-mover advantages, raising the possibility that no firm should attempt to pioneer in such a market" (Nakata, Sivakumar, 1995; p. 31). This study argues that the lack of the enabling conditions for rapid commercialization impedes the convertibility to profit of early investments and temporary product advantages. Such an approach clearly supports the argument for delaying the entry on an emerging market. The analysis made by A. K. Gupta and D.E. Westney fights against this judgment, arguing that the early entrants in emerging markets may have additional sources of advantages, including favorable government relations, pent-up demand, marketing productivity, marketing resources and consequent learning (Gupta, Westney, 2003; p. 113).

National governments are far more influential in emerging markets than in developed-country systems. This reflects the recent history of many developing states as command economies, with closed markets, the desire of many host governments to build local business as the economy grows and FDI increase and the importance of the government-led infrastructure projects in the early stages of development. The establishment of relationships between the multinationals and the governments may have tangible benefits for the first ones, such as granting one of a limited number of licenses or permits. Moreover, many governments from the emerging markets are still establishing new regulations in order to stimulate the business environment and the multinationals that have already invested in these markets will be favorably positioned to influence the regulation of the market regarding the price control or the opening of communications media.

There may be a substantial latent demand for the Western brands, previously unavailable but known in emerging markets, offering higher sales levels than many of the first-entered firms assume. The advantage of the low-cost factors of production from the emerging markets is considered by the multinationals not only in establishing the location of production, but also in timing of market entry. In this case the comparison is not only with global costs but also with future costs. Low advertising rates per capita in emerging markets enable firms to launch brands and build brand awareness very economically.

Although the number of the managers with both emerging market and international experience is growing, it remains a constraint and thus a potential advantage to multinationals that have entered multiple emerging markets and have developed a pool of experienced managers. Often, the developing countries provide opportunities for innovation in marketing or in production process and the consequent learning can be transferred to other markets. The ability of companies to leverage leading-edge ideas and best practices across operating subsidiaries can be a critical source of competitive advantage (Keegan, 1995). For example, due to the lack of developed distribution infrastructure in many emerging markets, multinationals have created innovative distribution processes or product packaging that is transferable to developed markets.

The Influence of Multinational Companies on Emerging Markets

Multinational firms, relocating their operations beyond the boundaries of their home country, influence and are influenced by the political, economical, social and cultural environment of the host state. These impacts may be both positive and negative ones. It can be observed that the multinationals may have a positive contribution to the trade balance of the host developing country by producing goods that used to be imported (import substitution) and which can ever be exported (reversal of the direction of trade). Thanks to their experience and advanced technology, the multinationals are likely to be more productive then their local counterparts and this is why they can offer higher incomes to the employees (Lipsey, 2002). Some studies have analyzed the way in which the advantages given by the high salaries and by the increased productivity may influence the efficiency and the incomes of the local firms. They concluded that the multinationals have a positive influence not only on the national markets, raising up the average level of the salaries, but also on the other national firms, determining them either to implement modern methods and technologies, or to attract the labor force that previously had been trained in the multinationals (Malchow-Moller, N., Markusen, 2007; p. 3-5). An example regarding the positive impact of the multinationals from emerging markets on the local firms is the Chinese appliance-maker Haier. Nowadays, it is exporting to developed countries, a step that was inconceivable before massive FDI flows into

China have changed the work practices and standards there. Indeed, the foreign direct investments are fostering the innovation and the development of new information that may be dispersed and used on multiple levels of the local economy. But, the extent to which local firms can take advantage of this depends on some specific factors of host country, such as the local infrastructure and government policies.

Having high levels of efficiency, the multinational companies increase the quality of goods produced and consumed locally; in this way they raise the satisfaction of the national consumers and ensure a convergence of the global clients' tastes. This may be regarded as an advantage in bringing different cultures closer and in reducing the marketing costs of the multinationals. The investments made by multinational companies in new plants and factories may create new jobs in the emerging markets. Moreover, these firms pay taxes, in the benefit of local economy that may use them to improve the educational system, the transports, or other services. Yet, sometimes multinationals may have a negative impact on local firms. It is the case when they receive favorable discriminatory treatments from the host governments, such as lower taxation rate or tax break. Consequently, local discriminated firms will be less competitive, suffering shrinkage of the market share, layoffs or profit reduction. Such negative effects were felt in Nigeria, the sixth largest producer in the world, when the competitive giants Shell (Anglo-Dutch), Chevron (U.S.) and Texaco (U.S.) have started operating there. Local firms, such as the Nigerian National Petroleum Corporation (NNPC), had to yield the leader market position to those multinationals. In response, the local enterprises decided to increase their competitiveness and power allying with other local firms or with the multinationals. In this situation, whether or not local governments protect individual local firms through regulation depends on analyzing the gains and the losses arising from this protection. In China, it seems that the protection of the national industries played an important role since the government tried to equalize such fiscal and political treatments to all firms, starting with 2001.

The technology transfer, in the form of technological know-how, of managerial skills and market techniques, can also have positive local effects, allowing the developing countries to catch up with the economic development of industrialized states. This was particularly important in the rapid development of the economies of Taiwan, South Korea and Hong Kong, which are now classified as ones of the fastest-growing newly industrialized countries with huge export capacity. But, in some cases, the technology transfer made by multinationals may be ill-suited to the needs of the host country. For example, production methods based on modern and sophisticated technology (for which the host country may not have suitably qualified manpower and supporting industries) may require a capital-intensive production system which may not create as many jobs as the host government had hoped. An important implication of the transfer of modern technology is that the multinational may end up dominating the industry by using its technological advantage as an effective barrier, for other domestic or international firms, to entry the market.

The multinational companies bring with them, on the emerging markets, the capital needed for the economic modernization, increasing, through the reform of the financial services and institutions, the productivity of the capital. But, as the local economy becomes more dependent on the economic health of the multinational company, the financial fortunes of the firm take on increasing significance. When a retrenchment of a multinational is accompanied by layoffs, cutbacks or a total shutdown of local operations, the effects can be devastating to the host economy.

A potential entry of a multinational company on an emerging market often prods the host government into liberalizing the trade and investment policies by lowering or removing barriers to free trade and investment; this will enhance the economic prosperity.

One of the most effective ways to reduce the monopoly power of indigenous firms, to stimulate the domestic competition and to encourage the growth of entrepreneurship is to attract multinational companies into the country (but, in the case they enter through merges and acquisitions, the effects might be opposite). Actually, this is one of the basic ideas behind the privatization and deregulation programs undertaken by governments worldwide.

Often, the multinationals may have an important political impact on a national and international level, their size offering them a tremendous power in each country they operate. It is possible that this power is misused and, for this reason, their presence is sometimes regarded as a threat to the sovereignty of the host country. It is considered that, especially in the emerging markets that are vulnerable in front of the power and influence of multinationals, the economic development programs are often dominated by the conditions formulated by these firms for the inflows of FDI. The multinationals' subsidiaries are usually implementing the decisions taken by the parent company that may not correspond to the needs and aspirations of the host country.

The question of industrial dominance is particularly relevant in the case of those multinationals that use their unique ownership advantages to obtain concessions from the host government. For example, in the early stages of development of the computer industry, computer firms would often insist on exclusive rights to produce or supply only their own brands. They also insisted on products being serviced only by their own authorized technicians, excluding local supplying firms. One major concern about this dominance is that multinationals may use their power and influence to interfere in the host government's economic and political policies for their own interest (Harrison, Dalkiran, Elsey, 2000; p. 47-50).

The cultural impact of the multinational companies is a much discussed topic, raising a national indignation about the practices adopted by these firms in the host states. Introducing new technologies and work practices and challenging management philosophies, multinationals transmit cultural change in the host country. For example, when McDonald's entered in Russia, at the beginnings of the '90s, it heralded a completely new concept in the food industry that significantly altered the eating habits of the population. Of course, this raised deep resentments of the cultural intrusion of McDonald's, especially on the part of the old generation.

The Impact of FDI on the Development of Central and Eastern European Countries

It is difficult to estimate the specific FDI's contribution on the development of the Eastern and Central European countries. There is no doubt that an important contribution to increase the exports of these states has been made by the major Western multinationals in the oil, gas and automobiles industries. Other multinationals helped the reorganization of the local industries in food-processing, beverages, chemicals and electronics. These firms have stimulated the production of the goods able to satisfy the clients from the local markets, especially in countries such as Poland, Hungary or Czech Republic, where there is a sophisticated and diversified demand. In countries in which, before the '90s, consumers had to accept low quality goods, the same clients are now demanding high quality Western products, refusing to be "fobbed off" with substitutes. Consequently, it is the Western multinationals which must produce the proper goods, at the right prices, in order to satisfy the demand. Moreover, by doing so, Western firms can reestablish the equilibrium in the balance of payments of the countries of the region and also can achieve substantial import substitution.

John Howell, from Ernst and Young, being questioned if the FDI had an important contribution to the economies of the region, argues that what it matters is whether the FDI have generated cultural benefits, by producing changes in the mentality of the government, managers and workers (Howell, 1994; p. 116). He also notes that the real test is whether FDI helped the entrepreneurs create an expanding private sector that includes the small and medium enterprises, especially from the service sector. There were significant progresses in Poland and in Czech Republic, states that have achieved some major cultural changes and entrepreneurial advances, but in many other countries the FDI have a limited impact on the way in which firms act.

An important motivation for the Western multinationals to relocate the production in the Eastern and Central European countries was their desire to achieve competitive advantage over rival firms from the same industry. There is no doubt that the Central and Eastern European states offer a number of significant benefits, one of them being the low wage of the labor force. The benefits that the multinationals may accrue depend largely on the speed with which they take advantages of the opportunities offered by the emerging markets. After 1990, in the Eastern Europe, it seems to be a correlation between the opportunities for the Western investors and the speed of the privatization process. At the end of the last century, John Howell identified that the average size of an investment made in the region was about 10 million dollars, the total value of the investments made only in the automobiles industry being of over 100 million dollars (Howell, 1994; p. 119). Indeed, the car makers discovered unrivalled opportunities for investing in the motor vehicle industry in Eastern Europe. Initially, the Western multinationals like Volkswagen have made joint-venture agreements, but later, firms such as General Motors or Fiat have undertaken greenfield investments in order to exploit the competitive advantages of the emerging markets. The biggest investments were made in Poland and Czech Republic, states that became, especially after their adhesion to the European Union, the center of the Eastern European auto industry. Previously, these states had very few domestic car manufacturers – FSO and FSM in Poland, Skoda in Czechoslovakia.

Although the multinational companies were convinced that the increased investment and the reorganization of production can improve the local firms' efficiency, they were reluctant to perpetuate joint-ventures where the influence of the multinationals on the long term development of production remains limited. It was essential of the Western firms to adopt a long term strategy in order to benefit from the advantages offered by these markets; meanwhile, it was not enough to use only the excess of the production capacity of the national firms to obtain the Western designed cars. To increase the number of the cars, it was vital that, on long term, the Western investors abandoned the joint-ventures in favor of greenfield investments. The auto industry from Central and Eastern Europe have already had a highly qualified labor force, even if the productivity levels were lower then in the case of their Western counterparts. But, if the level of qualification is correlated to the low-cost labor force, the benefits of the competitive advantage become obvious. Moreover, the investors are confident that they can obtain high quality products, comparable to the Western standards, with the help of the Central and Eastern European labor force. But, if the present competitive advantage – of the low-cost labor force – disappears in future, then this might be compensate by the benefits of having established themselves in an expanding consumer market where the increased wages become translated into a higher demand for luxury goods.

Conclusions

Considering all the aspects mentioned above, we can say that if the multinationals have enough information about the risks they might confront with in the emerging markets and, meanwhile, they adopt measures to avoid, diminish or remove the effects of these risks, then they can profit by the opportunities of the low cost of production, transforming them into competitive advantages on the global market. Meanwhile, it is obvious that the multinational companies play a major role in helping the emerging economies catch up with the advanced levels of development of the industrialized economies.

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