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REFLECTIONS ON THE INTERNATIONAL COMPANY AND ITS ROLE
IN THE DEVELOPMENT OF LATIN AMERICAN EXPORTS
OF MANUFACTURED PRODUCTS

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Working Paper

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Summary

1. The evolution of an international manufacturing company may be regarded as passing through three stages: export, international production, and multinational enterprise.
2. In entering the international production stage, manufacturers have generally started with licensing, but have then moved on to direct investment, avoiding contract supply arrangements for final products with local manufacturers. Ordinarily, the initial investment by a manufacturer in foreign production facilities marks a critical step in the evolution of an international enterprise because he commits substantial financial, managerial and technical resources that are exposed to many new risks.
3. A shift in management philosophy towards a global conception of the enterprise marks the beginning of the multinational enterprise stage. Top management starts to plan, organize and control the total activities of the company on a global scale that transcends the traditional distinction between domestic and foreign business.
4. Only a handful (perhaps a hundred or so) manufacturing companies in the United States and Europe have reached the multinational stage at the present time, but many more will do so in the decades ahead, including manufacturers in Japan. The great majority of international companies, however, will probably remain at the international production or exporting stages; there is no inevitable progression to the multinational stage. Despite their small numbers, the big multinational companies are likely to be the principal architects and builders of a world-wide pattern of international trade, production and investment in technologically intensive goods during the 1970s and subsequent decades of this country.
5. The international company at the multinational stage wants to make decisions in production, finance, marketing, procurement, research and development, and personnel without regard to political boundaries. And so the stage is set for a conflict between the nation-state and the multinational company. Relations between the multinational company and national governments in Latin America, Africa and Asia will be exacerbated by the fact that for the indefinite future multinational companies will be mainly North American,

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European and Japanese. The fundamental question may be posed as follows: How can the powerful economic energies of the multinational company be harnessed so as to benefit all the nations of the world and all the world's peoples?

6. The manufacturing enterprise first invests abroad in order to penetrate and develop foreign markets; marketing strategy is the main propulsive force although it is constrained by financial and production factors.

7. During the international production stage, a manufacturing enterprise is inclined to pursue a bilateral international marketing strategy; its management perceives foreign markets as separate national markets, ignoring interrelations among them.

8. At the multinational enterprise stage, the manufacturer abandons bilateral marketing strategy for multilateral marketing strategy. National markets are viewed as global market segments; managerial attention is focused on building up intra-enterprise transactions among national affiliate companies on regional or global levels. Multilateral marketing strategy can be a potent generator of international trade; it has a direct bearing on the role of international manufacturing companies in the creation of exports from developing countries.

9. To carry out a multilateral marketing strategy, the international company strives to integrate its policies and operations on a regional or world-wide scale. The basic form of integration is market integration which induces both international horizontal and vertical integration among manufacturing affiliates. The resulting intra-corporate transactions among enterprise affiliates will account for a rapidly growing share in world manufactures.

10. To develop market, horizontal and vertical integration on a world-wide scale, the parent company must exercise managerial control over its national affiliate companies. The question of managerial control leads to the ownership issue. Top managers of highly-integrated international companies are almost always insistent on 100 per cent ownership of affiliates; full ownership is viewed as an absolute prerequisite for efficient global operations. In contrast, international companies that have little horizontal or vertical integration are usually less concerned about full ownership and

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they may even actively search for joint venture partners. Probably the majority of international managers today consider ownership to be a pragmatic, business question rather than an ideological or political one.

11. Although international managers are reluctant to decide on foreign ownership arrangements for political reasons, they are very sensitive to political factors in reaching decisions on investments in specific foreign countries. The degree of political stability perceived by managers is probably the single most important determinant of a country's investment climate. What international managers fear most are sudden arbitrary changes in the "rules of the game".

12. There is ample evidence that governments and international companies disagree on which government policies are most favourable to foreign investment. Both parties have a responsibility to learn much more about the motivations and interests of each other.

13. Before an international manufacturing company actually invests in a country, it will have a broad choice of country locations, especially if its operations are world-wide in scope. Manufacturing is seldom resource-oriented; it is rather market-oriented, but even here lower trade barriers in the industrial areas of the world may make it economic to supply national markets from external production bases. In this regard, manufacturing companies differ sharply from extractive companies.

14. The locational mobility of international manufacturers gives them a strong negotiating power with respect to individual governments seeking to attract foreign investment.

15. Most foreign investment in manufacturing has occurred in North America and Western Europe, not in the developing areas of the world where markets are smaller and political risks are higher. The developing countries must find ways to encourage such investment or else forego its potential economic contributions.

16. Since the 1930s, international manufacturers have established plants in Latin America principally to maintain an export market that was threatened with extinction by import restrictions. Since local competition was weak, government import-substitution policies have tended to create monopolistic or semi-monopolistic foreign-controlled companies (alongside similarly

/created local

created local companies) that are primarily oriented to narrow local markets. From the standpoint of international management such investments are defensive. In contrast, international companies have pursued an aggressive strategy with respect to their investments in North America and Western Europe, responding to market opportunity and competition rather than to import restrictions. International affiliates in these two areas are now generating exports because their costs are competitive in world markets.

17. Manufacturing costs are higher in Latin America than in North America or Western Europe even for affiliates of the same international companies. High production costs constitute the single greatest obstacle facing Latin American companies in their efforts to expand exports of manufactured products. The outlook for a meaningful reduction of manufacturing costs in the smaller Latin American countries is bleak because their narrow domestic markets inhibit both economies of scale and competitive forces. In view of the slow pace of integration in Latin America, most of the future growth of manufactured exports will probably occur in Brazil, Mexico and Argentina.

18. Regional integration would allow international companies to rationalize their operations in Latin America. One consequence of this rationalization would be a pronounced increase in intra-regional trade in manufactured goods; another consequence would be a drastic reduction in the manufacturing costs of international affiliates mainly because of economies of specialization and scale. By lowering costs, regional integration would prepare international affiliates for export to North America and Western Europe.

19. Latin American governments should understand that any policies designed to limit the participation of international companies in regional common markets will also limit the creation by those companies of manufacturing bases for export to industrial markets outside the region.

20. Generally, international affiliate companies will be more responsive to efficient export promotion policies than national companies for at least three reasons: (1) external connexions with the parent company and its marketing organization, (2) concentration in newer and more technologically-advanced products, and (3) more competent and aggressive management.

21. Although international manufacturing affiliates as a group are probably more export-minded than national manufacturers, their exports remain only a /small fraction

small fraction of output. It is recommended that Latin American governments confer directly with international companies (first at the affiliate and then, if necessary, at the headquarters level) on the question of increasing affiliate exports. In the longer run, the host government will achieve greater export results through a screening of new investment proposals by international companies.

22. Latin American governments should now decide on the importance of export effects relative to other effects for new foreign investment proposals.

23. To make export effects the only criterion for the acceptability of foreign investment proposals would cause the rejection of most proposals. Latin American countries can hope to attract very few purely "export-base" projects that are entirely or primarily directed towards the export of advanced manufacturers to external markets. The principal motivation of international manufacturing companies to invest in Latin America will continue to be the penetration and development of markets in the region. To gain access to regional markets, some international companies should be willing to commit part of an affiliate's production for export to extra-regional markets.

24. The international company, especially at the multinational stage, has become a specialist in the transfer of products, technology, capital, and managerial enterprise among nations. In addition to its role as a transfer agent, the international company also functions as a change agent, creating new patterns of production, new technologies and new human skills in host economies and societies. The feature that distinguishes enterprise transfer from official transfers is not capital or technology but management.

25. Governments in Latin America cannot afford to ignore the international manufacturing company; rather they should learn to deal with it. It is necessary for them to find ways to exploit the resources of the international company while, at the same time, protecting the enduring interests of their own peoples in economic and social advancement.

This paper explores the actual and potential contributions of the international company to the development of industrial exports by the countries of Latin America. To evaluate this role it is helpful to understand the structure and strategy of the international company from both historical and managerial perspectives. How did certain enterprises, for the most part headquartered in North America and Europe, become progressively more international in their business activities? What are the critical factors in the investment decisions of such enterprises? In what ways can multinational companies contribute to industrial growth in the developing countries, and, in particular, to the growth of their industrial exports? What strategy should Latin American governments exploit in dealing with multinational companies? These are some of the questions examined in this paper.

This paper is not a research report; it represents the thinking of this writer who has spent the past 15 years in university teaching and research on many aspects of the international company. For this reason, documentation is modest, and there is considerable reliance on the findings of the writer's own past research in the field. Some remarks are speculative in nature.

I. THE EVOLUTION OF THE INTERNATIONAL INDUSTRIAL ENTERPRISE

Most private manufacturing enterprises prefer to remain wholly domestic, staying out of foreign operations. Entrepreneurs grow up in the national market where they gain confidence in their ability to judge market risks and meet local competition. In contrast, international business appears complex, risky and somewhat mysterious; it requires that managers learn to deal with foreign governments and peoples who may behave in bewildering ways. In brief, international business managers must know how to overcome political, economic, social and cultural barriers that

/have few

have few counterparts at home. Is it any wonder, then, that most companies would prefer to remain safely at home?

How, then, do some companies become international? The actual historical experience of international companies in the United States suggests that the process of internationalization is most likely to be a gradual evolution that may be described in three stages.

The Export Stage

This first stage begins with the initial inquiry about a company's products from a domestic export intermediary or directly from a foreign buyer. If the manufacturer responds positively to this inquiry, the result may be a foreign sale that he judges to be profitable. As a consequence, the manufacturer follows up subsequent inquiries and makes sales to other foreign buyers, probably via domestic intermediaries. At some point, the manufacturer decides that his export business should be actively developed rather than depend simply on unsolicited inquiries. To that end, he is likely to appoint an export manager and provide him with a small staff or, alternatively, turn over his export business to an export agent in his own country.

If the manufacturer experiences a continuing expansion of export sales, the inadequacy of a "built-in" export department or his complete reliance on an outside agency will become increasingly evident. Consequently, the manufacturer next decides to establish a full export department at the same level as his domestic sales department. He also decides to circumvent the use of domestic intermediaries for his sales to some, if not all, foreign markets. Further growth of export sales may justify the establishment of foreign sales branches and even assembly operations if his products are disassembled to obtain a lower transportation cost to foreign markets.

The manufacturer has now evolved towards a systematic export programme that is supported by market research, intensive advertising, and other forms of promotion. He may be selling full product lines in scores of markets and his export sales may be 10 per cent or more of this total sales. But he still depends entirely on export operations (aside from modest foreign assembly operations in some instances) to penetrate foreign markets. This

/first phase

first phase in the evolution of an international manufacturing company ends when, for reasons to be examined, the manufacturer decides to penetrate foreign markets via foreign production under one or more arrangements.

The International Production Stage

Just as domestic manufacturers prefer to remain domestic, so do exporting manufacturers prefer to stay out of foreign production. Exports, however, are not always sufficient to achieve the manufacturer's international marketing objectives. He may seek foreign markets that cannot be penetrated from a production base that lies outside those markets, either absolutely or at an acceptable level of sales. The most common explanation of this situation is, of course, high import tariffs and other barriers imposed by governments, but it may also be that local competition within a foreign market becomes so intense that an outside manufacturer's products are effectively excluded. How, then, can the exporting manufacturer hope to penetrate such a market? Quite clearly, he must find a way to supply the foreign market from a production base located inside that market.

In principle, the exporting manufacturer may enter into foreign-base production in three basic ways: (1) licensing, (2) long-term contract arrangements with local producers, and (3) direct investment in manufacturing facilities. Which approach he chooses will depend on many factors, but generally U.S. manufacturers have started with licensing and have then increasingly shifted to direct investment, avoiding contract supply arrangements with local manufacturers.

Licensing is likely to be the first experience in foreign production for the exporting manufacturer because it appears so easy: it requires no capital investment and presents no substantial risks. The manufacturer simply licenses the use of his patents, know-how and/or trademarks to an independent foreign producer in return for royalty payments that are usually expressed as a percentage of production or sales. In this way, the manufacturer expects to participate in the growth of a foreign market that he cannot penetrate effectively via exports. A pure licensing arrangement means that the manufacturer has substituted an export of technology for the export of his products.

/The attractiveness

The attractiveness of licensing as a mode of entry into a foreign market is likely to diminish for the manufacturer as a result of his actual licensing experience. Commonly a licensee does not perform up to the expectations of the licensing manufacturer in sales and market development. As a result, the licensor becomes frustrated because he has no managerial control over the licensee's operations. Hence direct investment in foreign production may become progressively more attractive to the manufacturer as compared to licensing.

Ordinarily, the initial investment by the manufacturer in foreign production facilities marks a critical step in the evolution of an international business company. (However, this is not always the case. In particular, United States companies are inclined to view their plants in Canada as "domestic" rather than "foreign". For such companies their first investment outside Canada becomes the critical step.) For the first time the manufacturer commits substantial financial, managerial and technical resources to an international venture. He is now exposed to risks (such as expropriation) that run far beyond the risks associated with exporting or licensing, and he has many more assets exposed to those risks. Foreign direct investment, therefore, involves the top management of a company in international business decisions and operations to a far greater extent than exporting or licensing.

The first investment abroad prepares the ground for subsequent investment. Plants may be established in several countries to produce one or more of the manufacturer's product lines. At the same time, the manufacturer continues to export the output of his domestic plants to many markets, either directly or via his foreign manufacturing subsidiaries. He also continues to engage in licensing, but increasingly he enters licensing arrangements with his own subsidiaries rather than with independent foreign producers. (Today the bulk of the royalties received by American companies from Europe is paid by the European subsidiaries of these same companies.)

Towards the end of the international production stage in the evolution of an international company, the manufacturer will be penetrating markets throughout the world from several national production bases, supplemented

/by direct

by direct exporting from the parent company as well as by licensing arrangements. At the level of parent company, the management of these diverse operations becomes progressively more arduous; painful episodes signal the necessity to integrate the company's far-flung operations within a comprehensive global enterprise system in order to take full advantage of company resources. The shift in management philosophy towards a global conception of the enterprise marks the beginning of the third stage of evolution - the multinational enterprise.

The Multinational Enterprise Stage

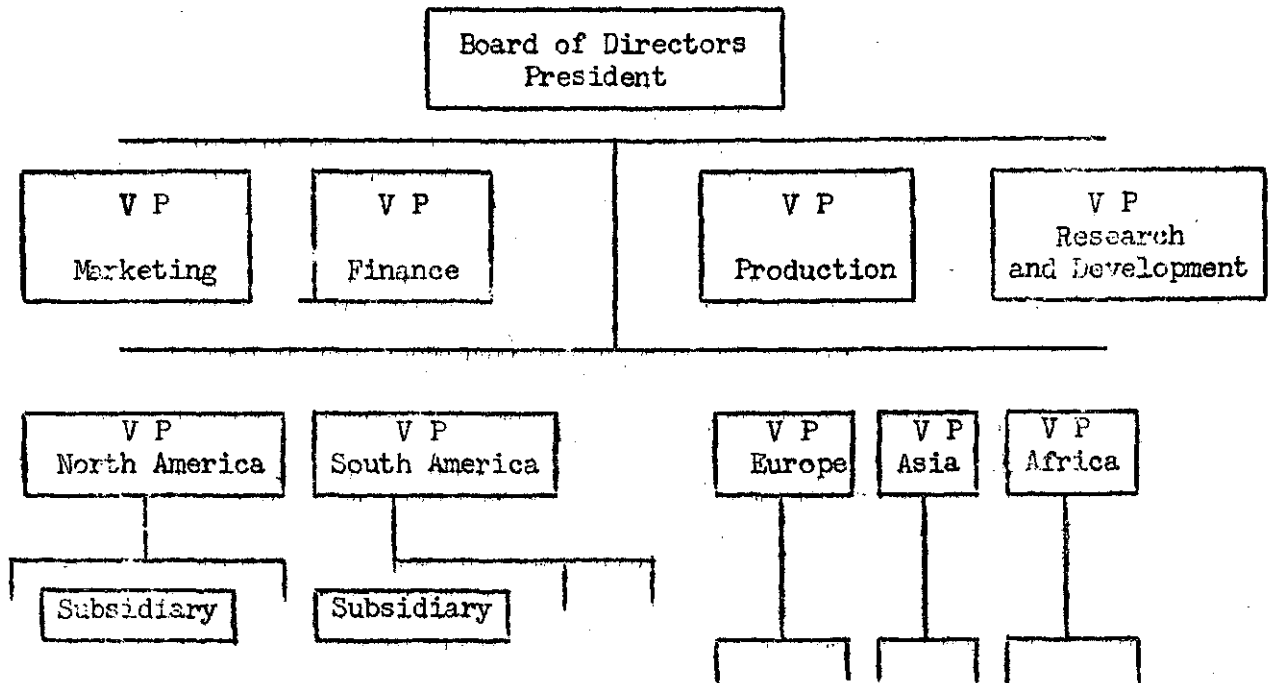
A company becomes a multinational enterprise when its top management begins to plan, organize and control its total activities on a global scale that transcends the usual distinction between domestic and foreign business. Such a company seeks answers to questions like these: Where in the world are our best markets? Where in the world should we produce our products for these markets? Where in the world should we undertake research and development activities to create new products for future markets? Where in the world should we recruit people to staff our organization? Where in the world should we obtain financing for our capital investments and our operations?

The transformation of an international production company into a multinational company does not happen quickly. It involves a substantial (and sometimes, drastic) reorganization of the company and the replacement of top managers who cannot develop a global outlook. Although more than one form of organization is available to the multinational company, one form in particular clearly reveals the significance of the global orientation to international business. It is depicted in Figure I.

Members of the Board of Directors, the President, and the corporate staff executives all have global responsibilities. For example, the Vice-President Marketing has the responsibility to provide advice, technical assistance and other staff support for all marketing operations of the enterprise throughout the world. Other corporate staff vice-presidents (only some of whom are shown) have similar responsibilities in their own functional areas.

Figure I

GEOGRAPHICAL ORGANIZATION OF A MULTINATIONAL COMPANY



/Line responsibility

Line responsibility at the operating level is organized by geographical regions. The Vice-President of South America, for instance, holds the responsibility (and commensurate line authority) for all the company's activities (production, finance, marketing, etc.) in South America. In particular, he has direct authority over the company's subsidiaries located in South American countries. Other line Vice-Presidents have a similar responsibility and authority for other regions of the world. It is noteworthy that no distinction between foreign and domestic operations appears in this organizational form: for a United States multinational company North America becomes just one of many world regions.

Some Observations on the Evolutionary Scheme

Only a handful of manufacturing companies in the United States and Europe have reached the multinational stage at the present time. All signs indicate, however, that far more manufacturers in the United States and Europe, as well as in Japan, will join the ranks of multinational companies, in the decades ahead. Nevertheless, the majority of international companies will probably remain at the international production or exporting stages. Most manufacturers in every country, of course, will remain wholly domestic in their orientation. There is, therefore, no inevitable progression to the multinational stage. Limitations of size and perhaps, more importantly, management philosophy will prevent many companies from becoming multinational, even among manufacturers who are presently exporting in substantial volume.

It would be a mistake, however, to judge the importance of multinational companies solely in terms of their relatively small number (probably not more than 100 at most). Most of these companies are extremely big, dominating not only their home markets but markets throughout the world. IBM, for example, has 70 per cent of the world market for computer equipment. Furthermore, they are concentrated in research-intensive, dynamic industries (electronics, nuclear energy equipment, transportation equipment, chemical specialties, petrochemicals, etc.) that will set the pace for economic growth and world trade in the years ahead.

/In brief

In brief, multinational companies are likely to be the principal architects and builders of a world-wide pattern of international trade, production, and investment in technologically-intensive manufactured goods during the 1970s and subsequent decades of this century.

A Note on the Multinational Company and the Nation-State System

The world is politically organized into nation-states, each possessing a national sovereignty that claims exclusive juridical control over the national territory and all activities (including, of course, economic and business activities) that cross national boundaries or take place within them. In particular, national governments resent outside control over their economies that, in their judgement, infringes on their effective sovereignty. This concern for national authority is commonly intensified by nationalistic attitudes that carry an emotional tone. In short, national governments want economic independence as well as political independence. The latter is, of course, a question of degree because few countries could afford the costs of complete economic independence, that is to say, economic self-sufficiency.

In contrast, the international company at the multinational stage seeks to function as if the world were a single global market. It wants to make decisions in production, finance marketing, procurement, research and development, and personnel without regard to political boundaries. Remarkable advances in communication and transportation technology form the physical basis for such a global strategy while the advantages of economic specialization and international factor mobility form its economic basis.

And so the stage is set for a conflict between the nation-state and the multinational company. Although this conflict will have manifestations that will vary from country to country and from company to company it is important to understand that the conflict is endemic and certainly not restricted to the developing countries (the "American Challenge" in Europe is a case in point). However, there is at least one important distinction between the developing countries and the industrial countries with regard to this conflict. For the indefinite

/future multinational

future multinational companies will be mainly North American, European and Japanese. This fact alone will exacerbate relations between the multinational company and national governments in Latin America, Africa and Asia while, at the same, it will tend to moderate (but not eliminate) them in the developed world.^{1/}

Some international business scholars believe that the multinational company is pointing the way towards an eventual supra-national organization of the world's peoples. They assert that the nation-state is archaic because it cannot cope on its own with twentieth-century technology; nor can it protect its people from a variety of threats ranging from pollution to nuclear warfare. Other scholars, while not going so far assert the necessity for institutional innovations if the nation-state and the multinational company are to reconcile their differences. Among these innovations may be cited the establishment of a United Nation corporate charter for international companies (possibly involving United Nations taxation) and the creation of a supra-national organization to prevent monopolistic abuses by global business enterprises. Suffice it to say at this point that the individual national government (including the United States Government) have only limited powers to deal with the big multinational company. The fundamental question may be posed as follows: How can the powerful economic energies of the international company be harnessed so as to benefit all the nations of the world and all the world's people? A creative response to this question can only come through co-operation among national governments and international agencies at the highest levels.

^{1/} As more European and Japanese companies become multinational (penetrating North American as well as other markets), one would expect some lessening of the resentment and concern now felt towards United States multinational companies in those areas.

II. WHY MANUFACTURING ENTERPRISES INVEST ABROAD

As the foregoing description of the evolution of an international company reveals, the manufacturing enterprise first invests abroad in order to penetrate and develop foreign markets, that, for one reason or another, cannot be effectively served from domestic export bases. This dominance of marketing strategy in the foreign investment decisions of manufacturers is fully brought out in a study by the National Industrial Conference Board entitled United States Production Abroad and the Balance of Payments. Of course, a proposed foreign investment must satisfy a company's financial criteria, such as return on investment and cash flow, before it is approved by management. But the main propulsive force behind an investment in foreign manufacturing facilities is a desire to establish or strengthen the company's position in foreign markets. Financial and production factors seldom act as initiating forces; they function more as constraints than motivations.

Bilateral and Multilateral Marketing Strategies

During the international production stage, a manufacturing enterprise is inclined to pursue a bilateral international marketing strategy, that is to say, its management perceives foreign markets as separate national markets and ignores potential inter-relations among those markets and among its subsidiaries located in them. Putting the matter somewhat differently, the international production company invests in country X in order to supply a market in country X - not to supply markets in countries Y and Z or in the home country. Such a bilateral strategy is encouraged by government import restrictions that isolate a national market from other national markets. Until the end of the 1950s it was the dominant strategy of even big international manufacturers.

At the multinational stage, however, the manufacturer abandons this bilateral strategy for a multilateral strategy. As observed earlier, managers now perceive a world-wide market that even includes the domestic market. National markets are viewed as global market segments. As a consequence, managerial attention becomes focused on building up intra-enterprise transactions (flows of products, technology, capital,

/and management)

and management) among national affiliate companies on regional or global levels in order to capitalize on economies of scale in all functions of the enterprise (R and D, production, marketing, finance, and management) and on the advantages of international specialization.

It follows that a multilateral marketing strategy can be a potent generator of international trade. Manufacturing facilities are established in country X not only (or even mainly) to supply that market but to penetrate other national markets via exports. Or facilities are established in country X to supply inputs for plants of the international company located in third countries. Multilateral marketing strategy, therefore, has a direct bearing on the role of the international manufacturing enterprise in the development of exports from developing countries. Such a company strategy is encouraged by regional integration (such as the EEC) and by a general liberalization of international trade barriers through GATT.

The emergence of this strategy in an era of generally low import barriers for manufactured goods in the industrial world, intensified by European integration, is hardly fortuitous.

Forms of integration by the Multinational Company

To carry out a multilateral marketing strategy, the international company strives to integrate its policies and operations on a regional or world-wide scale. The basic form of integration is market integration for the company's product lines and marketing programmes. Managers search for similarities among market variables in different countries, trying to answer questions such as the following: In which markets can we sell the same products and product lines? In which markets can we use the same channel, price and promotional policies and programmes?

This multimarket approach offers enormous advantages to a company. On the cost side, international standardization of products makes possible economies of scale in research and development, production, and logistics. International standardization of marketing policies and programmes also offers economies of scale of many kinds. For example, the costs of designing an advertising programme, such as ESSO's "Tiger in your Tank", may now be spread over a hundred national markets. On the demand side, market standardization promotes the creation of positive international images

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that stimulate awareness of, and preferences for, the company's products. In this way, the company takes advantage of communication links among consumers and industrial buyers in different countries.

International market integration induces both international horizontal and vertical integration among the manufacturing facilities associated with the international enterprise.

Horizontal integration occurs at the final product stage. Rather than have each of its national plants produce full product lines, the international enterprise creates a pattern of specialization among them, taking into account the scale of operations and the mix of factor services available in each of its country locations, including logistical factors of storage, handling and transportation. The movement of finished products among its national production bases allows the international company to offer full product lines in each national market at lower costs and/or higher quality levels than would be possible if those lines were entirely produced by each production base. Only some of the products entering the product line of the international company in country X are now produced there; the remaining products come from manufacturing plants located in other countries, including the home country. Indeed, country X, itself may be the home country of the enterprise. (For many years, for instance, United States automobile companies have been importing automobiles from their production plants in Western Europe to broaden product lines in North America.)

Vertical integration is a second form of co-operation among the manufacturing affiliates of the international company. Domestic vertical integration occurs when a manufacturing company decides to produce at least some of the inputs required in the manufacture of its final products. At the extreme, vertical integration can extend backwards to raw material extraction, but for most manufacturers outside heavy industries (such as basic steel and other metals, heavy chemicals, and oil refining) it is likely to go no further than the production of components and parts that are assembled into final products.

Vertical integration becomes international in scope when a company manufactures components and parts in one or more countries for use by its plant or plants located elsewhere. Thus one international company manufactures refrigerators in Europe by producing the mechanical elements in its German plant and the structural components in its French plant while final assembly occurs in its Italian plant. Another recent example is the decision of Ford to obtain the engine for its next small American car from Opel, its German subsidiary. Of greater interest to Latin America is the IBM plant in Argentina that supplies specialized computer equipment to other IBM plants in Latin America.

Market integration, horizontal integration and vertical integration are all aspects of an international enterprise system that seeks to take full advantage of the economies of specialization and scale. The result is a linkage of the different national entities belonging to the enterprise (the parent company and its affiliates) through network flows of products, technology, capital and management. These flows, of course, enter the balance of payments of individual nations. (It is estimated that one-quarter of United States exports now represent intra-corporate transactions between United States parent companies and their foreign affiliates.) It is to be expected that such intra-corporate transactions will account for a rapidly growing share of world trade in manufactures.

The Need for Managerial Control at the Headquarters Level

To pursue market, horizontal and vertical integration on a world-wide scale, the parent company must exercise managerial control over its national affiliate companies. At the policy level, it must decide which manufacturing affiliates will supply which markets and which strategies and policies will guide affiliate marketing programmes (market integration); which affiliates will produce which final products (horizontal integration); and which affiliates will be used as sources of specific components and other inputs for affiliates producing final products (vertical integration). Moreover, the parent company must have a control system that signals variances between the actual performance and expected performance of its affiliates and it must have the means to correct such variances. As transactions among

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affiliates (and between them and the parent company) become more numerous and complex, the need for headquarters control becomes ever more pressing. Failure on the part of one affiliate to deliver inputs on time, in sufficient quantity, or in conformity with tight product specifications may cause disruptions that spread throughout the entire international enterprise system.

This requirement for managerial control at headquarters should not be interpreted to mean that headquarters tries to manage everything at the affiliate level. To the contrary. Headquarters management ordinarily grants considerable operating autonomy to affiliate managers, frequently establishing the affiliates as profit centres. Furthermore, parent companies may invite the participation of affiliate managers in the formulation of enterprise strategies and policies. What centralized control does mean is that headquarters is responsible for global enterprise strategy and policies, the co-ordination of operations among all units of the enterprise, and the monitoring of affiliate operations to insure they conform to plans.

Headquarters also shapes the future structure of the enterprise through its investment decisions. It decides the kinds of new products the company should produce, the production capacity necessary for enterprise growth, and the location of new manufacturing plants to provide that capacity. The criteria that guide headquarters management in its determination of country locations for new manufacturing facilities is the subject of a later section in this report.

The Issue of Ownership

The ownership of foreign affiliates by international companies has provoked much unfavourable response in Latin America, especially in extractive industries but in manufacturing industries as well. Many governments in Latin America now compel or strongly urge international companies to form joint ventures with local business partners. The motivations behind such policies are a mix of economic and political considerations of which two are most prominent: (1) the belief that joint ventures will stimulate the growth of local business enterprise (and consequently the economy as a whole) more effectively than local affiliates fully owned by international companies, and (2) the rejection

/of foreign

of foreign ownership per se as a threat to national sovereignty. It is fitting, therefore to consider briefly the ownership issue from the standpoint of international enterprise management.

The top managers of international enterprises that have achieved, or are striving to achieve, high levels of horizontal and vertical integration among foreign affiliates are almost always strongly insistent on 100 per cent ownership. These managers identify ownership with control, and since they must exercise control over their affiliates in order to build a global enterprise system, full ownership appears to be an absolute prerequisite for efficient operations.^{2/}

General Motors, Ford and IBM illustrate this managerial position; all have integrated production, logistical and marketing operations at the international level. These companies push for full ownership of their affiliates and are likely to stay out of countries where this is not possible. (General Motors has refused to invest in India because of the ownership issue.) IBM entered Japan only after the host government granted permission for 100 per cent-owned subsidiary, a remarkable concession in light of the strong Japanese policy on joint ventures.

Furthermore, integrated enterprises try to gain full ownership of affiliates in which, for historical reasons, they have only a partial ownership. In 1960, for example, Ford bought out the rest of Ford U.K. for \$ 350 million despite a protest by the U.S. Government which was worried about the balance of payments effects of such a large capital outflow coming at the end of the year. In the 1950s General Motors acquired the remainder of Holden, its Australian subsidiary, from local interests. Another example is Westinghouse. For many years this company carried on international manufacturing via licensing arrangements with independent foreign producers. But now Westinghouse, in trying to create an international enterprise system, is abandoning licensing in favour of full ownership of foreign manufacturing facilities.

^{2/} We are speaking here only of parent company ownership of foreign affiliates; the ownership of the parent company itself is another matter.

As noted earlier, economic and technological forces will encourage more international companies to reach towards higher levels of integration in the future. These companies will not easily abandon their determination to have full ownership of foreign affiliates even in the face of resistance by host governments.

In contrast, international companies that have little horizontal or vertical integration are usually less concerned about 100 per cent ownership and they may even actively search for joint venture partners. Scott Paper, a large manufacturer of paper tissue products, actually prefers to conduct its international business in developing countries through joint ventures in which it holds only a minority interest. Each of these joint ventures functions independently of the others, producing and marketing its products in the local market. In brief, a management following a bilateral marketing strategy is inclined to be more open on the question of local participation in its foreign affiliates because headquarters control is less vital.

Other considerations also influence managerial attitudes towards ownership of affiliates. Aside from the issue of control, the parent company may want to invest its abundant capital to the fullest extent in its own business. Why earn only a fraction of an affiliate's profits when the parent company has capital to own the entire affiliate? Associated with this attitude may be the conviction by management that local partners can contribute very little to the affiliate in terms of technology, production, marketing or general management. Some companies may also be unwilling to share their "technological secrets" with local partners. Finally, there are those managers who want to have full ownership of affiliates because this is the way the company has always operated at home and abroad.

In view of the many factors that may shape attitudes towards ownership, it is not surprising that international companies do not agree on the question of joint ventures. In a study of over 100 big United States international companies, the writer found that some 45 per cent favoured joint ventures while 55 per cent opposed them.^{3/} Those companies that

^{3/} Franklin R. Root, "United States Business Abroad and the Political Risks", Business Topics, Winter 1968.

favoured joint ventures said they did so because of the contributions in capital, management, marketing knowledge, etc., that local partners are able to offer. On the other hand, these companies rejected the notion that joint ventures were desirable because they pleased host governments or mollified nationalistic forces.

This study also found that probably a majority of international managers view the question of ownership as a pragmatic, business question rather than one of ideology. To be sure, there are some managers who consider the ownership of foreign affiliates to be a right of international companies in the same way it is a right at home, but these managers would appear to represent only a small, declining majority. Most international managers today fully recognize that their companies have no a priori right to own foreign affiliates, that ownership rights are granted by host governments and may be withdrawn at the discretion of those governments.

For many international companies, then, the question of ownership resolves itself into a variety of costs and benefits that are related to the performance, growth and profitability of the affiliate in question. In some instances, management may conclude that the net economic benefits of a joint venture or licensing arrangement exceed the net economic benefits of a fully-owned affiliate. In other instances, the same management may conclude the opposite.

One final important point emerges from this study: international managers are unwilling to take into account the political benefits and costs of different ownership arrangements. More to the point, they will almost always consider business arguments for joint ventures but seldom if ever, political arguments.

Managerial Criteria for the Country Location of
Manufacturing Facilities

Although international managers are reluctant to decide a foreign ownership arrangement for political reasons, they are very sensitive to political factors in reaching decisions on investments in specific foreign countries. Indeed, their perception of political risks in a particular country powerfully shapes their perceptions of investment opportunity and profitability in the same country.

This last statement is supported by a study undertaken by this writer of managerial attitudes towards governments and investment opportunities in five countries - the United Kingdom, France, Mexico, Brazil and India.^{4/} International executives in over 100 big United States companies were asked to respond to semantic differential tests that measured their attitudes towards the governments and investment opportunities in those five countries. It was found that attitudes towards governments were highly correlated with attitudes towards investment opportunities. For example, if executives believed a government were unstable, they were also inclined to believe that investment opportunities in that country were unprofitable and risky. Indeed, the degree of political stability perceived by managers emerged as the single most important determinant of a country's investment climate. It is the main reason why Mexico was viewed by these international executives as having an excellent investment climate in sharp contrast to Brazil's.

Political stability is a key concern of international managers because in its absence planning business operations becomes a very chancy affair, menaced by political uncertainties. On the other hand, international companies are generally willing to make accommodations to strong government policies towards foreign investment if these companies believe there exists a fundamental political stability. What international companies fear most are sudden, arbitrary changes in the "rules of the game". When

^{4/} Franklin R. Root, "Attitudes of American Executives Towards Foreign Governments and Investment Opportunities", Economic and Business Bulletin, January 1968.

they believe the rules of the game will be maintained by a strong government, then they are often willing to play the game despite demanding rules. The case of Mexico clearly documents this observation.

For many manufacturing companies, political stability appears to be a necessary condition for investment in a particular country. But it is not a sufficient condition. A management must also perceive a real investment opportunity that will be profitable, to the company. The many economic factors that must be investigated to evaluate a proposed foreign investment have been widely discussed in the literature and there is no need to go into them here. Suffice it to say that the economic criteria used to evaluate a proposed investment in manufacturing facilities intended for the local market are likely to differ from the criteria used to evaluate manufacturing facilities intended for international markets (including intra-corporate transfers).

Many governments seek to attract private foreign investment with a variety of concessions (taxation, accelerated depreciation allowances, etc.) as well as the active promotion of investment opportunities through the press and other media in the advanced countries. However, there is abundant evidence that governments and international companies disagree on which government policies are most favourable to foreign investment. A study by Robinson found that foreign investors consider the five most favourable policies to be: (1) establishment and firm adherence to a national development programme, (2) favourable terms for the transfer of profits and capital repatriation, (3) non-discrimination versus foreign ownership and control, (4) equality of treatment with domestic enterprises, and (5) freedom from detailed or burdensome regulations on organization, ownership and management.^{5/}

In contrast, his research on twenty governments showed that governments consider the five most important investment incentives to be: (1) tax relief to new enterprises, (2) equality of treatment with domestic enterprises, (3) a progressive domestic climate, (4) the transfer of profits and capital repatriation, and (5) government-sponsored credit institutions.

^{5/} Harry J. Robinson, The Motivation and Flow of Private Foreign Investment (Menlo Park, California: Stanford Research Center, 1961).

When governments do not know which factors are important to foreign investors, official investment promotion policies will be less than successful. Furthermore, government negotiations with foreign enterprises will be hindered by a misunderstanding of managerial motivations and interests. Of course, international managers have an equal obligation to understand the motivations and interests of host governments. Too often the foreign investors look at his projects only in business terms, paying no attention to its implications for economic growth, the balance of payments, employment, and other consequences that are of primary concern to host governments. If communication between the two parties is to be effective, then, both have a responsibility to learn much more about each other. Only in this way can they hope to avoid disputes arising out of simple misunderstanding, and thereby focus all their efforts on the resolution of real disagreements. More positively, mutual understanding should help each party to adapt his respective position to the interests of the other without, at the same time, sacrificing his own true interests.

Before an international manufacturing company actually invests in a country, it will have a wide range of location options, especially if its operations are world-wide in scope. Manufacturers can be very flexible in the choice of country locations because manufacturing processes are not tied to natural resource locations.^{6/} Furthermore, advances in transportation technology are continually broadening location options for manufacturers. Japan demonstrates this fact in a remarkable fashion. That country has built a massive steel industry with no local sources of iron ore and ore and only meager local supplies of coking coal, and most of the raw material inputs for its other industries are also procured from foreign sources.

Rather than being resource-oriented, manufacturing installations tend to be market-oriented. The powerful pull of markets in North America, Western Europe and Japan on foreign investors is a fact of international business. But the lowering of trade barriers, the emergence of common

^{6/} International extractive companies have fewer location options; they are limited to a certain number of countries that have the proper natural resources. Even here, however, no single country is likely to have a monopoly resource position.

markets and free trade areas, as well as transportation and communication improvements make it progressively more economic for manufacturers to supply national markets from external production bases. For example, although the United States manufacturer may be strongly compelled by reason of market opportunity (and competition) to invest in the European Common Market, he may choose among six countries for the location of his manufacturing facilities.

In brief, today's international manufacturing company enjoys a high degree of freedom in the selection of foreign locations for his production bases. Natural resource or market locations will seldom limit his freedom of choice at the country level. Even if one accepts the argument that manufacturing companies must invest abroad in order to survive (an unproven assertion), it does not follow that they must invest in a particular country or even in a particular region. In this regard, manufacturing companies differ sharply from extractive companies who are continually searching the world (soon to include the ocean bed) for commercially-exploitable minerals.

The locational mobility of international manufacturers gives them a strong negotiating power with respect to individual governments seeking to attract foreign investment.

This power would be somewhat weakened in the face of a common foreign investment policy supported by several governments, comprising a region, but the degree of weakening would also depend on the market opportunities offered by the region. Although the CACM countries can undoubtedly improve their bargaining position with foreign investors through a common policy, their position will remain generally weak because of the small size of even the entire CACM markets.

It is a fact that most of the foreign investment in manufacturing has occurred in North America and Western Europe - not in the developing regions. With a few exceptions, markets in the developing countries are smaller and less dynamic than markets in the advanced countries while, at the same time, political risks have been much higher. Is it any wonder, then, that most international manufacturers have concentrated their investments in the industrial countries? Far from having to beat back an avalanche of foreign manufacturing investments, Latin America and other developing areas must find ways to encourage such investment or else foresake its potential economic contributions.

III. THE INTERNATIONAL COMPANY AS AN EXPORTER OF MANUFACTURED PRODUCTS FROM LATIN AMERICA

This final section examines the traditional role of the international manufacturing company in Latin America: local market orientation induced by high import protection and high manufacturing costs. It then considers what Latin American governments can do to move international affiliate companies towards exports via economic integration, negotiations with international companies now in Latin America, and the application of screening criteria to new investment proposals. It closes with some brief remarks on the role of the international company as both a transfer and change agent.

International Manufacturing Companies in Latin America: Local Market Orientation

Since the 1930s, international manufacturers have established plants in Latin America principally to maintain an export market that was threatened with extinction by import restrictions.

Policies of import substitution adopted by Latin American governments have encouraged foreign investment in manufacturing facilities directed towards only the supply of the local market. Because of the limited size of the local market, the frequent lack of industrial infra-structure, the absence of supporting industries, and other well-known factors, the production cost of these facilities is higher (and often much higher) than similar facilities at home or in other advanced countries. Investment in those facilities is profitable only because international competition is excluded by tariffs and import quotas. Since local competition has been either absent or weak, import-substitution policies have tended to create, therefore, monopolistic or semi-monopolistic foreign-controlled companies (alongside similarly-created local enterprise) that are primarily oriented to narrow local markets. From the standpoint of international management such investments are defensive (the maintenance of export sales) rather than aggressive (the development of market positions).

/In contrast

In contrast to this defensive strategy in Latin America, international companies have pursued an aggressive strategy with respect to their investments in Western Europe and North America. American companies have set up plants in Europe mainly in response to dynamic markets and competition, and only partly, or not at all, in response to protectionist tariffs and other import barriers. Increasingly, European companies are investing in North America for the same reason. Sharp reductions in tariffs at successive GATT conferences, and a general abandonment of import quotas for manufactures goods in both Western Europe and United States have continually reduced the importance of defensive strategy induced by import protection.

As a consequence, American plants in Europe (and European plants in North America) are forced to compete not only with local plants but also with imported manufactured products. From the start, therefore, it is necessary that the costs of these plants be internationally competitive.

This is why American plants in Europe have adapted quickly to the evolution of the EEC and EFTA and why many are now exporting to the rest of the world, including North America. Even in the middle 1950s, United States companies in the United Kingdom were responsible for about one-third of all United Kingdom exports of newer industrial products and for two-fifths if automobiles are included in this export category.^{7/} The experience of American plants in Europe conclusively demonstrates that international companies can make an important contribution to the export of manufactures, especially in new, technology-intensive products. But for this to happen manufacturing costs must be low enough to meet international competition.

Manufacturing Costs in Latin America

Ten years ago a comparison was made between the domestic costs of United States international companies and the manufacturing costs of their own subsidiary companies in Western Europe and Latin America. For Western Europe it was found that some plant costs were higher and some were lower,

^{7/} See John H. Dunning, American Investment in British Manufacturing Industry (London, George Allen and Unwin) p. 293.

but on the whole plant costs were competitive with those in the United States. In the case of Latin America, however manufacturing costs in 69 per cent of the comparisons (the sample comprised 66 different products) were higher than in the United States.^{8/} The relevant table is shown below.

Unit Cost Comparisons of Subsidiary Plants in Latin America and Plants
in the United States of the Same International Companies

(Percentages of sample)

	Material	Plant Costs		Total	Sales	Other	Total Unit Cost
		Labour	Overhead				
Mexico -	13	73	53	28	56	56	31
+	86	27	47	72	44	44	69
Latin America -	7	57	7	7	27	18	14
Excluding Mexico, Brazil and Argentina +	93	43	93	93	72	82	85
Total -	14	68	35	26	56	30	31
Latin America +	86	32	65	75	44	71	69

+ Indicates costs equal to or higher than United States costs.

- Indicates costs lower than United States costs.

Looking at the entries for all Latin America it is noteworthy that material costs are usually higher than in the United States. Although unit labour costs are lower in Latin America in about 68 per cent of the comparisons, they are higher in the other comparisons despite much lower wage rates. It is not surprising that plant overhead in about two-thirds of the comparisons is higher in Latin America reflecting the generally smaller scale of outputs, frequently coupled with excess capacity. But observe that overhead costs in Mexico are lower in 53 per cent of the

^{8/} T.R.Gates and F. Linden, Costs and Competition (New York: The Conference Board, 1961).

comparisons because its large domestic market makes possible economies of scale. (The bearing of the size of the local market on unit overhead costs is clearly indicated by the fact that Argentina, Brazil and Mexico all have much lower unit overhead costs than the rest of Latin America which in 93 per cent of the comparisons had higher unit overhead costs than the United States.)

In addition to production and selling costs, business income taxes and interest rates also may influence the prices of manufactured products in Latin America.^{9/} Although the effect of business taxes on prices may be greater in the United States (certainly tax rates are higher), this effect is probably offset by higher interest rates in Latin America, particularly for working capital financing.

High production costs constitute the single greatest obstacle facing Latin American companies in their efforts to expand exports of manufactured products. This is true for both foreign-owned and national manufacturing companies. The countries best situated with respect to manufacturing costs are the big countries: Brazil, Mexico and Argentina. By producing for the sizeable internal markets in these countries some plants can achieve economies of scale that match those in North America and Europe. They are, therefore, much better prepared to enter international markets than plants in the smaller countries in Latin America. Competitive manufacturing costs, of course, are not the only factor in a company's export sales, but they do form an indispensable basis for any continuing export programme. Unless manufacturing costs can be lowered, the outlook for any broad expansion of manufactured exports by the smaller countries in Latin America can only be regarded as bleak. The foregoing table indicates that these countries showed higher total unit costs in 85 per cent of the comparisons. They are caught in a vicious circle: exports of manufactures are constrained because production costs are high and costs are high because the local market is small which, in turn, makes production costs high...

^{9/} Under conditions of perfect competition, of course, business income taxes have no influence on prices. But competition in manufactures is hardly perfect either in North America or Latin America, although perhaps for different reasons.

/Clearly the

Clearly the smaller countries must find ways to break out of this vicious circle. One way is to introduce more competition into local markets by abandoning massive import-substitution policies for policies of selective import protection. Another way is through the encouragement of export-oriented production by both domestic and foreign companies. However, the most promising way lies through a regional integration of national markets. Not only would integration directly broaden markets and thereby permit economies of scale, it would also intensify local competition and provide the basic conditions necessary for an expansion of exports by both domestic and foreign companies.

In view of the slow pace of integration in Latin America, however, one can reasonably expect that most of the future growth of manufactured exports will occur mainly in Brazil, Mexico and Argentina.

Regional Integration and the International Company

Regional integration would allow international companies to rationalize their operations in Latin America. The present pattern of largely self-sufficient local affiliate plants would be replaced by a pattern of interdependent plants that would take advantage of specialization and economies of scale. Some of these plants would produce finished products for sale throughout the integrated region; others would specialize in the production of inputs for other plants. One consequence of this rationalization would be a pronounced increase in intra-regional trade in manufactured goods; another consequence would be a drastic reduction in manufacturing costs of international affiliates mainly (but not entirely) because of economies of specialization and scale.

There is no need to speculate about such a response by international companies to integration in Latin America because there is the example of United States companies in the EEC. From the beginning, these companies have regarded the EEC as one market and they have created EEC-wide production and marketing systems to service it. Earlier this paper discussed the movement of international companies towards multilateral marketing strategies on a global scale. Regional integration in Latin America would enlarge to a remarkable degree the opportunity for multilateral marketing strategy in that region, and international companies would be the first to take advantage of that opportunity.

/There is

There is a fear in some Latin American circles that international companies would enjoy most of the fruits of economic integration, to the disadvantage of national companies. The economic and political issues raised by this anxiety are too complex to be adequately discussed here. As we have noted, international companies are highly motivated to operate on regional or even global levels. Because this regional outlook is not shared by national companies (whose outlook is limited to the local market), it is to be expected that international companies will respond more quickly to regional market opportunities. But this does not mean that national companies will never respond, only that it will probably take some time. Again the example of the EEC is instructive. In the first half of the 1960s it was the United States international companies who took fullest advantage of the common market, but as the decade progressed, more and more European firms began to market, and even produce, their products on an EEC scale. It can be argued that the "demonstration effect" and competition of United States companies have stimulated European companies to participate actively in the common market.

If progress towards the creation of a common market in Latin America is measured by the growth of intra-regional trade and specialization (a yardstick commonly used for this purpose), then international companies will almost certainly contribute strongly to that end if given the opportunity. But that is not the whole story. Integration would also strengthen the capability of international affiliates in Latin America to export manufactures to North America and Western Europe by lowering production and marketing costs to competitive levels. Increasingly, these affiliates would be drawn into global multilateral marketing systems directed by the present companies. As indicated earlier, this has already happened to United States affiliate plants in Western Europe.

In sum, Latin American governments should understand that any policies designed to limit the participation of international companies in regional common markets will also limit the creation by these companies of manufacturing bases for export to the industrial markets outside the region. This is especially true for those countries that have only small internal

/markets. The

markets. The development of extra-regional exports of manufactures from those countries is inextricably linked to the development of intra-regional trade in the same products. This is true for both international and national companies.

Moving International Affiliate Companies Towards Exports

It was argued that regional integration (with all its implications) would be a powerful force moving international affiliates in Latin America towards an export orientation; at first intra-regionally but subsequently extra-regionally as well. But apart from integration, individual governments can take certain steps to stimulate affiliate exports, with varying degrees of success depending on the circumstances. Many of these steps, of course, will belong to a broader class of efforts directed at all manufacturers, whether national or international. Generally, international affiliate companies will be more responsive to official export promotion policies than national companies for at least three reasons.

First and foremost is the fact that affiliate company belongs to an international enterprise that has the experience and organization to penetrate export markets. Once a parent company decides to use its subsidiary in Latin America as a source of inputs or finished products, the export marketing problem is largely taken care of by the entry of the subsidiary into an enterprise marketing system. Even when a subsidiary is allowed to seek export markets on its own (which may be the case especially for its export sales within Latin America), it can call on the parent company for marketing assistance and advice.

Second, the affiliate company manufactures newer and more technologically advanced products than most national companies. Indeed, this is the major competitive advantage of foreign enterprise in Latin America. This product capability (which derives from access to the technology of the parent company) gives the foreign affiliate a comparative export advantage as well.

Third, the affiliate company has more competent and aggressive management (and therefore lower manufacturing costs) than most local companies.

One of the principal contribution of the parent company to its affiliate is "managerial technology" which is commonly transferred to nationals through executive development programmes.^{10/}

In view of these advantages one should expect to find that international manufacturing subsidiaries in Latin America are already more export-oriented than their local counterparts. Unfortunately, there is little data on this question, but Fajnzylber's study does indicate that this is the situation in Brazil.^{11/} He found that one out of four affiliates of international companies export and they account for one third of Brazil's exports of manufactured products. The technological content of these exports is significantly higher than the content of exports by national companies. Fajnzylber also indicated that for the great majority of firms who export manufactures, the activity is marginal and cyclical, but that this is less true of international affiliates than of national firms.

Although international affiliate manufacturers as a group are probably exporting a higher fraction of their output than national manufacturers in Latin America, this fraction remains very low for most of them. As discussed above, these affiliates were mostly established to supply local markets when exports to those markets were excluded by high import protection. How can national governments now turn these international affiliates towards exports markets?

Aside from the adoption of general policies favourable to the export of manufactures (realistic exchange rates, non-inflationary fiscal and monetary policies, etc.) and export promotion programmes designed to assist manufacturers in general, it is recommended that Latin American governments confer directly with international companies (first at the affiliate and then if necessary, at the headquarters level) on the question of export

^{10/} International companies are making increasing efforts to staff management posts in affiliate with nationals. Partly this is a response to nationalism; partly to cost pressures, and partly, to the demands of corporate executive development programmes.

^{11/} "Resumen de los principales resultados y conclusiones proporcionados por el informe: Estudio de algunos aspectos básicos para la formulación de una estrategia de exportación de productos manufacturados en Brasil", September 1969.

expansion. Government officials should prepare for such meetings by gathering data on each affiliate's past export performance (size rate of growth; destination, product mix, share of total production, etc.) and how it compares with other companies in the same industry.

The purpose of these conferences would be to explore the ways by which an affiliate can further increase (or initiate) export sales. Factors that limit such sales should be identified although this is not always a simple task. It is particularly important to ascertain which restraining factors are traceable to the operations of the affiliate (such as high manufacturing costs) and which are traceable to headquarters policies (such as export market limitations).

With regard to the first class of restraints, the government may be able to offer considerable assistance, especially when official policies and regulations themselves contribute to operational problems. To illustrate, a common complaint of international managers is that host governments frequently impose restrictions on imports of raw materials and other inputs that then cause production stoppages and higher costs.

Export restraints that result from headquarters policy towards an affiliate are a proper subject for negotiations between the host government and headquarters management. In these negotiations public officials should impress on headquarters management the key importance to the host government of higher affiliate exports, pointing out how headquarters policies now constrain them. The outcome of these negotiations will depend on the circumstances of each case, including the relative bargaining power of the two parties. However, headquarters management will be in a weaker bargaining position than otherwise if it cannot justify its policies towards affiliate management in terms of factors beyond its control. When the factors are under its control (such as administrative market limitations or an export pricing formula imposed on the affiliate), then headquarters will have a flexibility for making concessions to the host government. The fact that the affiliate is already operating in the host country also adds to the bargaining power of governments officials.

/Although direct

Although direct talks with both affiliate and headquarters management will have mixed results, they are well worth the effort in the opinion of this writer. In the longer run, however, the host government will achieve greater export results through a screening of new investment proposals by international companies.

Screening new foreign investment proposals for their export potential

Unless a government adopts a laissez-faire policy towards investments by international companies, it is compelled to decide on the merits of each investment proposal. To be rational this decision process should utilize screening criteria that reflect the interest priorities of the host government. When these criteria are not explicitly defined and ordered in degrees of importance, then the government runs the risk of letting in investments that do not promote its interests or keeping out investments that do.

The variety of interests that a government may have in foreign investments frequently makes it difficult to achieve a consistent set of screening criteria, as much for political reasons as for economic. Since the Second World War Latin American governments have placed major emphasis on the import-substitution effects of a proposed foreign investment in manufacturing facilities while other criteria - balance of payments effects, employment effects, and economic development effects - have been rarely decisive. In more recent years, ownership effects and technology effects have gained in importance. Only now, however, is attention turning towards the export effects of foreign investments in manufacturing.

Latin American governments should now decide on the importance of export effects relative to other effects; they should determine the acceptable "trade-offs" among the different effects because no single investment can maximize all of them. Furthermore, host governments should let international companies know their investment preferences so that these companies can design proposals that are optimal in terms of those preferences while still protecting their own interests. When international companies are unclear as to the preference structure of a host government, they may expend

/considerable time

considerable time and money in the development of proposals that are later rejected or substantially modified in painful negotiations, or they may simply avoid investment in that country.

Even if it were politically feasible to make export effects the only criteria for the acceptability of foreign investment proposals, such a course of action would be unwise for Latin American governments. The reason is simple: an exclusive export criterion would screen out most investment proposals by international companies, many of which might be desirable because of other effects. Latin American countries can hope to attract very few purely "export base" projects that are entirely directed towards the export of advanced manufactures to external markets.^{12/}

A quick review of the requirements for export-base projects will indicate why this is so.

Export-base foreign investments may be classified in two main categories: (1) affiliate manufacturing facilities in Country A to supply finished products to markets in Countries B, C, D, ... and (2) affiliate manufacturing facilities in Country A to supply parts, components, sub-assemblies, and other inputs to sister affiliates in Countries B, C, D ...

The first category demands that Country A have advantageous access to the other countries via low or zero trade barriers (membership in a free trade area or customs union is the clearest example) and/or via low transportation costs (including ease of communications), and that these advantages be not offset by high manufacturing costs. For the most part, Latin American countries do not offer these advantages (with the exception of Mexico and some Caribbean countries), and, furthermore, manufacturing costs are often high. This situation would change, of course, if countries in Latin America abolished restrictions on intra-regional trade. Then export-base investments might be drawn to those countries that offer favourable conditions for access to other countries in the region, as is frequently the case for the Netherlands and Belgium in the EEC. Preferential

^{12/} We exclude from "advanced manufactures" the processing of raw materials.

tariff treatment by the industrial countries of manufactures goods from the developing countries would also favour this kind of export-base investment in Latin America, but probably only for a few countries.

The second category of export-base foreign investment places high emphasis on low manufacturing cost and political stability in Country A. The products in question ordinarily have a high unit value so that transportation costs play only a minimal role. The developing countries that have been most successful in attracting this investment are Taiwan, South Korea, Singapore, Hong Kong, Mexico, and some Caribbean countries. These countries offer low-wage labour that can be quickly trained to a semi-skilled level (often the labour is female) plus a stable political environment. A common example of this category of export-base investment is the sourcing by United States companies of electronic sub-assemblies in affiliate plants in (say) Taiwan for the manufacture of final products in United States plants. Because the parent company has locational mobility with respect to this type of investment, it can make comparisons of manufacturing cost on a global rather than on a merely regional level. Costs in a Latin American country are compared against costs in an Asian country and (possibly) a Southern European country. Costs, therefore, must be at minimal levels to attract this kind of investments. Political stability is also key factor because any disruption of the affiliate's production would force painful adjustments on other company affiliates who depend on that production to support their own. On both counts - low manufacturing costs and high political stability - most countries in Latin America cannot compete for international sourcing investments in manufacturing.

The principal motivation of international manufacturing companies to invest in Latin America will continue to be, therefore, the penetration and development of markets in the region. To gain access to regional markets, some international companies should be willing to commit part of an affiliate's production for export to extra-regional markets. (As previously observed, there should be no difficulty in gaining export commitments for regional markets that are opened up by government agreements.)

/It is

It is a question of negotiations: What do both parties give up with an export commitment? A broad opportunity for trade-offs among different investment effects enhances the probability of an eventual agreement between the international company and the host government. Is the government willing to give up its insistence on (say) a minority joint venture for an export commitment? Is the company willing to enter an export commitment (and possibly a lower return on its investment) in exchange for the right to have a majority share of a joint venture or even full ownership? For some investment proposals economic factors will undoubtedly rule out any export commitment by the international company but for others there will be some economic flexibility that will allow fruitful negotiations if the host government is also willing to make concessions or commitments.

Some Brief Remarks on the International Company as a Transfer and Change Agent

It is fitting to make some closing remarks with regard to the role of the international company in the world economy as both a transfer and change agent.

The international company, especially at the multinational stage, has become a specialist in the transfer of products, technology, capital and managerial enterprise among nations. The traditional theory of trade assumed away any international mobility of factors of production; in effect, the international company has stood this theory on its head. The distinguishing feature of the advanced international company lies precisely in its capacity to move factors of production from one nation to the next; it is no longer confined to the export and import of products. This capacity greatly enhances its actual and potential contributions to the international economy via a better allocation of resources among nations and via growth and development effects.

The international company introduces a dynamic force into the comparative cost structures of nations by transferring capital, technology and management to countries and then combining them with local factors to produce new products in new ways both for domestic consumption and

/for export.

for export. In this way the international company functions as a change agent, creating new patterns of production, new technologies and new human skills in host economies and societies.

All this is to say that the international company is a potent economic engine for the transmission of productive factors and technology among nations. This economic role is underrated by economists and others whose attention is focused on the governmental level. Its significance is suggested by an OECD study that found that international companies are responsible for the transfer of more technical assistance to the developing countries than official technical assistance programmes. Capital transferred by international companies to the developing countries also compares favourably with official capital transfers. But the feature that distinguishes enterprise transfers from official transfers is not capital or technology but management. International companies not only transfer capital and technology to host countries (as do official aid programmes) but also combine them with local factors of production to produce and market commercial products (something which official aid programmes do not do).

Some development economists argue that the international company does too much leaving nothing for local enterprise. This issue is too complex to go into here. But this argument does make questionable assumptions about the small backward linkage effects of foreign investments as well as their demoralizing effects on local enterprise, especially in the case of manufacturing investments.

Governments in Latin America cannot afford to ignore the international manufacturing company; rather they should learn to deal with it. International companies have the technology, managerial skills, organization and market connexions that Latin America needs and which are available from no other source. Certainly no government or official agency can do what IBM, and other multinational companies can do on a global scale.

/Governments in

Governments in Latin America (as well as governments elsewhere) should find ways to exploit the resources of the international company while, at the same protecting the enduring interests of their peoples in economic and social advancement. It is not suggested that an accomodation between the national interest and the international company will be an easy task. But the potential rewards justify the effort.

