Multinational Corporations in Transnational Accountability

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Much of the national and transnational effort to develop accountability in the development and application of science and technology focuses on multinational corporations (MNCs) because they are one of the primary channels for transnational diffusion and use of new developments in applied science, new inventions, and new technologies or combinations of technologies around the world. Contemporary multinational corporations consist of a "parent company" incorporated in one country and its local branch offices or subsidiary companies incorporated or registered under the laws of the country where they operate but controlled by the parent through ownership of the stock and provision of the top management personnel.

Before the 19th century most businesses were family ventures, and firms with extensive cross-border transactions often sent family members or close associates abroad to look after the firm's interests. MNCs in their current form developed only after the modern idea of organizing businesses as corporations – entities with a legal status separate from the people owning them – was adopted in the 17th and 18th centuries. The great European monopoly trading companies – such as the Dutch East India Company, the British East India Company or the French North America Company – were proto-multinationals: they maintained trading offices to buy goods in Asia, ran their own shipping fleets (opening their ships to others' cargos when space was available), and sold goods to customers in Europe. However, their offices were not established as separate companies elsewhere because corporate form had not been adopted in other parts of the world. The MNCs familiar today first emerged in the early 19th century. British banks and insurance companies had branches in the USA and South America by 1825, Swiss firms set up textile factories in southern Germany in the 1830s, British gold mining companies owned mines in Brazil before 1820, and British and American railway pioneers owned separate railroad companies in Central and South America in the 1850s. By 1914, there were several thousand manufacturing multinationals and hundreds of mining or plantation multinationals. The links between multinational firms and European colonial empire became close after 1870 because many of the banking and mining multinationals operated in their home country's colonies. Manufacturing multinationals developed a very different pattern, preferring to locate factories in other relatively wealthy countries where there was sufficient customer base for their products. Thus, the German firm Siemens und Halske opened a factory in Russia in 1855, while the US-based Singer

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Sewing Machine Company set up European production in Scotland in 1867. In 1914, the assets owned by multinational corporations comprised approximately one-third of all foreign investment in the world; the other two-thirds was bank loans to foreign customers or investor purchases of bonds (also a form of loan) issued by companies or governments in another country.

19th century political conditions shaped the spread of multinationals in several ways. The idea of establishing state-owned factories was dormant at this time. The older royal arsenals and workshops of Europe were not the sources of industrial development, and British experience set up the model of privately owned firms leading the way. Direct colonial rule or indirect influence through the economic importance of European lenders and firms meant that the multinational corporation's home government could ensure favorable conditions for activity in most parts of the world. Manufacturers, who could have supplied foreign customers from their home country, often expanded to other relatively wealthy countries to get around tariffs by establishing factories that would count as "local producers." Critics of MNCs also arose in the late 19th and early 20th but, unlike today, focused on use of multinational operations to keep profits high through moves to low-wage areas rather than the impact of their day-to-day operations for people or the environment.[1]

The extent of multinational enterprise shrank between 1920 and 1945 under the impact of World Wars, which disrupted international trade and investment patterns, and the Great Depression, which reduced economic activity in general. Losses of foreign assets to the allies (for German companies) and to Soviet nationalizations (for Belgian and French companies) soured them on foreign investment. The Great Depression led to fracturing of the world into separate currency blocs which hindered international trade, and rising nationalism made foreign-owned companies targets in many countries. Companies still collaborated, but now preferred doing so through international cartels in which separate companies agree on pricing and division of markets among themselves rather than through direct ownership. Only in mining, where companies typically sought to integrate all phases of operation from initial extraction through processing, through sales of metals or materials to customers, did multinational organization persist at pre-1914 levels.

During the 1920-1945 period political conditions were also far less favorable to multinational firms. Governments sought to deal with the Great Depression through currency controls and higher tariffs, which made trade and investment difficult. Revolutionary governments in Mexico and Russia took over foreign-owned assets in mining, oil, railways, and (in Russia) manufacturing to make them into state-owned enterprises. The Mexican program of having state ownership of leading sectors foreshadowed many of the post-World War II policies in Western Europe and the Third World, and in rejecting investor claims to compensation for their property sounded theme of redress for prior exploitation by foreign-owned business that would be raised again in the 1950s and 1960s as the governments of as newly-independent former colonies in Africa, the Middle East, and Asia sought to escape foreign economic influence and direct their country's economy towards industrialization in their own way. However, Lenin and Stalin's program in Russia/the USSR attracted the most attention in the 1920s and 1930s because it was part of an effort to entirely replace private ownership and price-setting in markets with state ownership and central planning.

[1] Reformist and revolutionary Marxist forms of this argument appeared in John Hobson, *Imperialism* (1902) and V.I. Lenin, *Imperialism: The Highest Stage of Capitalism* (1917) respectively.

After a slow post-World War II start, the sustained growth of North American, Japanese, and Western European economies in the 1950s and 1960s created new opportunities for business. The governments of the leading Western industrial countries moved decisively to establish open international markets by dismantling most of the protectionist measures adopted during the interwar period. This reduced the tariff-based motivations for MNC operations, but many companies still wanted to have production sites close to their customers. The combination of renewed MNC activity in industrial states and the reduction of MNC activity in developing states as many of the governments there nationalized the foreign mining, plantation, and railway firms established in the colonial era meant that in 1980 nearly two-thirds of total foreign direct investment was concentrated in the USA, Canada, and Western Europe.[2] Meanwhile, the Soviet government sought to develop a distinct socialist bloc economy through the Council for Mutual Economic Cooperation while the communists' 1949 victory in China closed another large part of the world to foreign companies.

The oil crisis-induced recessions of the early 1970s and early 1980s slowed economic activity, and with it MNC growth. Yet, some of the roots of later expansion of MNC activity were laid in this period. The American pattern of tighter coordination and global planning between parent company and subsidiaries was adopted by Western European and other MNCs. MNCs also became more willing to enter into joint ventures (co-owned firms) with governments or local investors, and many governments of developing countries became more willing to have manufacturing MNCs come into the country. The contrasting development performance of East Asian economies, with their government-encouraged policies of competing on global markets, over Latin American economies, with their continuing emphasis on replacing imports with locally made goods induced a broad rethinking of development strategy. This rethinking was reinforced as more data about Soviet and Chinese economic performance became available and indicated that central planners in both countries were finding it difficult to cope with the economic ramifications of the computer age.

Though the volume of international trade as a percentage of global production returned to 1914 levels by the mid 1970s, the value of all direct foreign investment did not reach its 1914 level of 9% of the value of annual world production until the late 1990s.[3] Only with the end of the Cold war and the opening of all parts of the world to foreign trade and investment did the level of MNC investment get back to what it had been. Yet, the distribution of activities was very different; MNCs were far more active in manufacturing and service industries than they had been in 1914, and less active in raw materials and provision of transportation or public utilities. The home countries of MNCs also became more diverse. In the mid-1960s, US firms made more than 80% of direct foreign investments.[4] More European companies took up multinational activity in the 1970s. In the 1980s Japanese manufacturers joined the older general trading companies in direct foreign investment, either to get closer to customers or to take advantage of lower cost labor in Southeast Asia. The more successful developing countries also became home to multinational firms of their own.

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[2] Dunning

[3] In 1992, the total equaled 8.5% of that year's world production. Jones 1996

[4] M. Wilkins. 1974. *The Maturing of Multinational Enterprise* (Cambridge, MA: Harvard University Press).

Although most people think of giant firms like Exxon, Royal Dutch Shell, Nike, or Nestle when they hear the term “multinational corporation," any business firm operating simultaneously in more than one country through its own subsidiaries or branches qualifies as an MNC. These subsidiaries might run their own factories, like Toyota USA’s factory in California; they might operate retail stores, like London-based Body Shop’s stores in major US cities; they might be franchise operations, like the many MacDonald’s outside the USA, or they might be wholesalers abroad, like Coca-Cola’s bottling companies. Though the largest MNCs have annual sales exceeding the gross national products of most countries of the world, others are fairly small firms that link some or all of the various segments of production (product design, materials acquisition, fabrication) and distribution (shipping, delivery to wholesale or retail customers) across national borders.

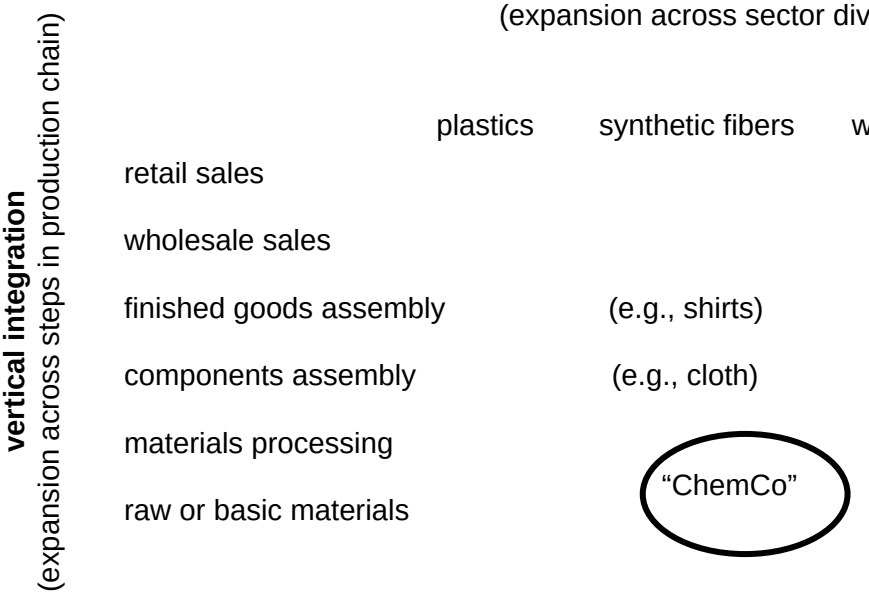
Though MNCs attract a lot of attention, it is important to remember that companies can engage in international trade and investment without becoming MNCs. Any company can buy materials or parts from suppliers in a different country, much as US bicycle makers buy derailleurs and other components from Shimano in Japan or Campagnolo in Italy. Any company can sell all or part of their production to wholesalers and retail customers in other countries or borrow money from a foreign bank. Yet, there is one pattern of trade between firms that seems to blur the distinction between MNCs and other firms. When the contracts between a firm and its suppliers include detailed specification of the type, design, and quality of goods to be produced, the line between dealing “at arm’s length” with a different independent company and dealing “in house” with another branch of the same company breaks down. When the buying company is well-known and its brands are put on the goods, environmental, labor and other activists concerned about practices in the suppliers’ factories often put pressure on the better known buyer to add stipulations about respect for labor rights or protection of the environment to the supply contracts.

MNCs (and business firms generally) want to operate in a cultural, social, economic, and political context that facilitates their activity and makes it easier (or at least no more difficult) for them to attain their goals. Whatever sort of good or service a company produces, its main goal is to earn profits by having an income from sales that exceeds its total expenses. This can lead to a narrow focus on the economic activity and the short to immediate term. Advocates of corporate social responsibility have urged companies to adopt a broader focus and a longer time horizon by adopting a “triple bottom line” concerned with people (respect for human rights and human dignity), planet (ecological sustainability), and profit (economic viability within the bounds of ethical conduct). Yet, profit remains the most important of the three for managers and investors because a company – whether behaving very ethically, very unethically, or somewhere in between – that does not earn more than it spends will not survive very long.

Any company – whether an MNC operating in several countries around the world or a locally-oriented firm – looking for ways to make additional money can look in three directions. It can continue with the same lines of business but expand their volume of production (“scale up”) by adding new factories, hiring additional workers, and buying more materials and parts if there appears to be unsatisfied demand for the goods or services it currently provides. If there is not much additional demand, it can search “horizontally” or “vertically” for opportunities to earn more by integrating new activities into firm operations. Horizontal integration involves taking up opportunities in related lines of business. Thus, a chemical company initially producing plastics might decide that it can also produce synthetic fibers, or a beer brewer owning a large enough spring might decide to add bottled water to its product line. Vertical integration involves looking for opportunities along the production and distribution chain from acquisition of materials through sales to final users. Thus, a clothing company that initially bought cloth from textile manufacturers, made clothes, and

then sold the clothes to wholesalers might decide to acquire its own textile factory, its own retail stores, or both. Whether and how far a company will go in vertical or horizontal expansion depends on its calculations of the net benefit. If it would cost a lot to extend activity to other products because the equipment is expensive or properly trained workers hard to hire and retain, or continuing in arm's length relations with suppliers and wholesalers looks more profitable than bringing those operations in-house, the company will keep to its current industry or place in the production and distribution chain. If however, activities in a related business or in a different part of the supply chain appear likely to enhance the firm's overall prospects, it will expand vertically or horizontally. The possibilities are outlined using a hypothetical chemical company in Figure 1.

Figure 1. Integration possibilities for hypothetical firm "ChemCo" currently producing synthetic fibers sold to textile makers



The relative benefits of expanding or contracting company activity change over time, giving actual MNC decisions a dynamic easily missed by those who believe that business always regards "bigger as better." In the 1980s, management experts who advised focusing on "core competencies" were claiming that companies would profit most if they limited their activity to the particular goods or services they could produce most profitably and sold off parts of the business doing other things. In biotechnology in the 1990s and 2000s, in contrast, many firms were busy expanding, either through buying other companies or

entering into long-term contracts. There were so many mergers that one analyst predicted approximately half a dozen "food clusters" would dominate world processed food production within a few decades.[5]

Businesses do not operate in a vacuum. Managers know that they face and must to some extent address the concerns of both internal and external stakeholders. "Internal" stakeholders are those inside the firm – owners (shareholders), managers, and workers. Until recently, particularly in the "Anglo-American" model of "shareholder capitalism," they received the most attention. Managers run the company as agents for the owners, and deal with workers as a distinct group – sometimes through labor unions and collective bargaining, sometimes not, but always in a context of laws and regulations on workplace safety, wages, hours, and related matters. "External" stakeholders are those outside the firm. For many, particularly advocates of the German "social market" model, the external stakeholders are residents of the communities in which the firm operates. They are certainly important as they will feel the effects of pollution or pollution-mitigation, firm hiring or firm layoffs, and the opening or closing of major production or distribution facilities employing large numbers of people. However, external stakeholders also include a firm's suppliers and customers, and the local, subnational and national governments of the countries where they operate. They, too, are affected by firm success or failure. As "corporate social responsibility" has become a more prominent concern, thinking about the needs of these various stakeholders has become more explicit.

Companies operate in societies where other members also want favorable conditions for their own activity and some protection from the impact of companies' activities on their own lives. Government regulation is a fact of social life, but it can protect as well as limit companies. Companies need secure rights of ownership and use over their property, access to materials and supplies, access to customers, and assistance in enforcing contracts and settling disputes. Yet, the kinds of regulation a particular company will accept – or even ask for – depends on the type of activity it undertakes. Fishing companies running factory ships on the world's oceans do not need exclusive rights to operate in a particular part of the ocean; what they want is permission to look for fish all around the ocean and clear property rights to their ships and the fish they catch. Oil and gas companies, in contrast, want exclusive rights to operate in a particular location because the pool of oil stays in one place and they have to build expensive equipment to get to the oil. If another company comes along and drills a well too close to the first, it could take away enough oil to keep the first from paying off its investment in the equipment; thus oil companies want protection against others setting up in the same place. Companies that have to spend a lot of money on product research and development want strong patent systems and other protection of intellectual property so they can sell enough of whatever they develop to recover their R&D costs as well as their production costs. In contrast, patents giving exclusive right to develop products from an invention are less important than the trademarks and brands that distinguish one company's goods from another's for companies using well-known technologies to produce everyday goods like towels, tennis balls, or hammers.

[Note to instructors: The following section is to be used when cases deal with biotechnology]

The particular dynamics in Biotechnology

Applying current scientific advances in chemistry, biochemistry, genetics, and requires particularly large amounts of R&D work, and companies operating in those areas want very strong protection of patents and

[5] "A survey of agriculture and technology," *The Economist* 25 March 2000.

trade secrets. At the same time, members of the public want strong assurance that any products allowed on the market will be safe for humans and animals and non-disruptive to the natural environment. The tensions between competing concerns can be seen very well in the relation among firms developing genetically modified plant or animal organisms, potential customers and others in society, and the government. For instance, developers of genetically modified (GM) plants begin with an idea and initially work on it inside enclosed laboratories. At this stage, regulators worry primarily about the safety of laboratory conditions for those working inside and the precautions taken in lab facility design and operation to ensure that what is inside stays inside. GM organism developers cannot go directly from lab testing to distribution of a new seed or plant stock; they need to grow the plant through more than one generation to assess how the modification affects the plant over time. Some of these growth experiments can occur in labs, but others can only be completed in outdoor fields. The move outdoors shifts the regulators' attention to the more difficult task of ensuring the lowest risk of contamination to nearby areas. Once the GM plant is proven stable and able to perform as expected in resisting pests, blight, drought, or other unfavorable conditions, the developer will want to introduce it to farmers and, through their crops, into the animal or human food supply. This shifts the regulators' focus yet again, to the safety of consuming the new variety of food. Each shift in focus expands the circle of people directly affected.

The changes in the circle of people affected and the focus of regulations is summarized in this table:

Stage of GMO development	Circle of affected parties	Focus of Regulations
First – turning idea into invention	Lab workers, immediate neighbors	Risk management
Second – turning invention into useful product	Lab and field workers, persons, animals, plants in locations close enough to be affected by escape of seeds or plant parts from fields used for outdoor trials	Risk management
Third – allowing new product to be sold	Production workers, product handlers, buyers/users, neighbors of users, ultimate consumers of products containing GM organisms	Risk Management Product Safety Safety of Use Facilitation of commerce

However, debate about the safety of a potential new product begins well before a company seeks permission to offer it for sale. Growing awareness development begins long before a product comes to market has led members of the public, particularly environmental and other activists skeptical of GM technology, to pay attention much earlier in the process.

In the lab development and outdoor trials phases, regulations address risk management. Decisions reflect not only the state of scientific and technological knowledge but also the level of public trust or distrust of genetic modification techniques and/or the motives of those engaged in developing them. Genetic modification in the 2000s is in some ways the chemicals of the 1980s – not only an area of disagreement about the best approach to the products themselves but also one of the major fields of contention between advocates and critics of private enterprise, market economics, and corporate activities. In the 1980s, several major chemical spills focused public attention on chemical companies of all sorts, from the largest MNC to the smallest local garage workshop; and large segments of the public became convinced that chemical companies were ignoring hazards, failing to inform government agencies or neighbors adequately of risks and response measures, and generally carrying on without proper regard for the safety and health of employees and neighbors. Seeking to avoid what many regarded as the "close the gate after the horse has bolted" character of chemical regulation, activists began efforts to de-legitimate GM foods in the eyes of the public before any had moved from lab to field trial. These efforts were greatly assisted by a political climate that emphasized human rights more strongly and was marked by a proliferation of environmental NGOs and social movements deeply skeptical of individual large corporations, oligopolistic industries, and governments' ability or willingness to decree and enforce regulations industry opposes.

These efforts were most successful in Europe, where industry disarray combined with stronger countervailing influences from Green Parties and others led to adoption of a process focused regulatory approach based on stricter readings of the precautionary principle. As European realized the different balance of pressures in the USA was allowing industry more influence, European activists sought to promote wider adoption of similar views among US environmental and social activists. They and local GM skeptics had some success, but not enough to prevent adoption of a more end product oriented regulatory approach in the USA. This more permissive climate for initial experimenting and field trials then influenced the European arguments as European firms, now more united in their preferences and better organized for discussions with officials as policy is being developed, argued that the EU's process oriented approach to regulation was leaving it at a competitive disadvantage with US and Asian firms.

If and when a GM plant or animal is permitted into general agriculture, regulation must also address product safety, safe usage, and facilitation of commerce. While product developers have the primary responsibility for product safety, even a safe product can pose hazards if used incorrectly, so users must be informed about safe uses, warned against hazardous ones, and informed of measures they can take should dangers develop. These, like risk management, address potential problems and avoidance of harm. Like risk reduction rules, these tend to be enforced through liability law and regarded by companies as a potential burden. Regulations facilitating commerce, such as creation and enforcement of intellectual property rights in GM organisms, and the range of market regulation measures that provide a stable context for taking out loans, securing insurance, and buying or selling, are regarded by companies as facilitators. Left to themselves (as guided by their need to make some profit so they can cover costs, repay lenders and provide returns for investors), most companies want regulations that facilitate commerce while leaving them wide latitude of discretion on risk management. Consumers also want a stable commercial climate, but insist increasingly on good risk management and consideration of the long-term environmental impact of GM products.

Thus the content and extent of government regulation regarding development and introduction of GM organisms depends on the balance between various social groups. Industry typically has several

advantages in the political contest: the relatively large size of the benefits or losses they will experience from different types of regulation motivates them to get involved in the issue and the relatively small number of companies (typically in the hundreds if all firms are considered; less than 100 if only the big firms are considered) makes is relatively easy for them to organize industry associations for joint political activity. They typically prefer what political scientists call “insider strategies” for gaining influence – making presentations to individual legislators or other officials (“lobbying”) or supporting preferred candidates with campaign contributions. Segments of the public, whether focused on themselves as consumers, environmentalists, or some other group, usually have greater difficulty organizing because they are more numerous and typically enjoy relatively small gains or losses from different regulations. These barriers can be overcome through mass membership organizations and/or activist campaigns. Mass membership consumer or environmental organizations often engage in lobbying and encourage their members to support particular candidates. Activist campaigns, whether run by mass membership organizations or other groups, sometimes engage in “outsider strategies” as well as, seeking to influence political decisions through stirring up public controversy sufficient to make politicians and regulators pay attention and accommodate the concerns expressed.

Debates over GM organisms combine arguments about the application of a technology and the environmental impact of human activities. In both areas, appeals to scientific evidence are a typical part of the policy debate. Companies seeking permission to develop and then sell GM organisms and groups opposing development or sale (whether of all GM organisms or of a particular one) all appeal to laboratory and field studies of the safety and effects of GM organisms. Yet, none fully shares the commitment to rigorous methodologies, consciously seeking to prevent initial hypotheses and other beliefs from so dominating analysis that contrary observational data is ignored, and openness to correction that characterize the best scientific research. Many participants in the GM organisms debate let their prior assumptions about safety or danger of GM organisms color interpretation of data or selection of the particular studies to highlight and engage in a good deal of personal attack against those not sharing their views. Scientific expertise can be used to challenge the most exaggerated arguments for or against, and perhaps limit the impact of the personal attacks, but policy decisions will be driven mainly by social and economic concerns rather than science.

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