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FINANCIAL MANAGEMENT PRACTICES OF MULTINATIONAL CORPORATIONS: CONSTRAINTS AND EXPERIENCES IN DEVELOPING ECONOMIES

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BY

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ABSTRACT

77,e growing attractiveness of government interventiou in the economy of the developing countries has increased the political risks thai multinational firms have historicalli been subjected 10. These risks seem to exert a different impact on financial management practices of mnltinational corporations in these countries. Various environmental constraints, ranging from conflictinv tax laws to youth restiveness lend 10 inhibit/he success a/financial management practices of MNCS in developing countries. We recommend that government in developing countries should try 10 lake the peculiar socio/economic ill developing situation of the Local communities into consideration while formulating operating rules for the MNCS, 10 enslire conducive operating environment for the successful financial management practices.

INTRODUCTION

International busines s involves an institutional of arrangement and practice, which facilitates the exchange of commodities. service technology and managerial information across national frontiers. When firms own and control income generating assets in more than one country. such firms are called international business. multinational corporations (M CS) epitomize these finns. they operate their business outfits in several countries of the world. The growing attractiveness of government intervention in the economy especially among developing countries has increased the political risks that multinational firms have historically been ubjected to. These risks take the orm of currency controls. expropriation. change. tax law. and requirements for additional local production expensive pollution control equipment.

The common denominator in all these risks is an uncertain government action (especially in developing economics) that affects the value of the firm (Shapiro. 1986:472). Financial management practices deal with investment and financing decisions of the firm. These involve in part, the highly coordinated international interchange of goods (material parts.subassemblies, and finished products).

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services (technology, management skills, trademarks, and patents), and capital (equity and debt). These activities are associated with benefits, cost and constraints that arise from these internal financial linkages. The host countries where these multinational corporations operate also impose certain risks on their activities. These could in form ofpolitical, social and economic risks. In developing societies, the greatest risk inhibiting the operations of multinational corporations are the environmental influences characterized by conflicting demands ofgovernment in form oftaxes and the immediate community's demand for social services. In this paper we present the result of empirical investigation of financial management practices ofmultinational corporations in developing economies using multinational oil firms operating in Nigeria as a case study.

COIICEPTUAL FRAMEWORK

Multinational corporations are of, 'arious types the Raw materials seekers, who aim at exploring the raw materials that could be f-und overseas, market seekers, who are archetype of the modem multinational firms that aim to go overseas to produce and to sell in foreign markets. And the cost minimizers who seek out to invest in lower-eost production sites overseas.

Multinational corporations have been variously defined (Okwandu 1992, Gilpin 1987, Eltcman and stone hill, 1973). As corporations that own and manage economic units in two or more countries. They enjoy worldwide assess to capital, depend on foreign income and are managed with a worldwide viewpoint MNCS usually adopt horizontal, vertical and conglomerate expansion strategies. A horizontal, expansion involves manufacturing the same products in the different countries. Vertical expansion involves locating different stages in the production or marking process in various countries. Conglomerate expansion on the other hand, involves a multinational company manufacturing internationally a range ofdifferent products and exerting control on its industry in the country concerned to provide the finn with economic and non-economic power.

One of the difficulties confronting independent firms in international business is how to transfer funds generated and profits made be between its affiliates and the parent company. The multinational corporations have to select financial channels through which funds and allocated profits are moved. The most popular channel are:

(i) By varying the price at which transactions occur.
(ii) By selling patents and trademarks.
(iii) By adjusting transfer price on intra-corporate sales and purchases ofgoods and service.
(iv) Investment could be undertaken by sending capital overseas as debt with at least some choice of interest rate, currency and repayment schedule or as equity with returns in the form ofdividends.

The ability to transfer funds and to reallocate profits internally presents multinationals with three different types of arbitrage opportunities (Lessard, 1979): these are:

(a) Tax arbitrage involves shifting profit from units located in high tax notions to those in lower-tax nations or from those in a tax paying position to those with tax losses. This arrangement enables MNCS to reduce their tax burden.

(b) Financial market arbitrage is the trnnsferoffunds among units. This processallows MNCS to circumvent exchangecontrols, earn higher risk-adj usted yields on excess funds and tap previously unavailable capital sources

(c) Regulatory system arbitra ge occurs where subsidiary profits are a function of government regulations (Where a government agency sets allowable prices on the firms goods) or union pressure. ratherthan the market place. The ability to disguise true profitability by reallocating profits among subsidiary units may provide the multinational firms with a negotiating advantage.

(d) Finally. the ability to permit an affiliate to negate the effect ofcredit restraint or controls in its country of operations. It also provides an arbitrage advantage. If a government limits access to additional borrowing locally. the firm with the ability to draw on external sources of funds can not only achieve greater short term profits but may also be able to attain a more powerful market position on the long run.

The last two-arbitrage opportunities are of great interest to multinational corporations in developing countries. For example. in Nigeria, multinational corporations in oil and construction business are known to have taken advantage of the weak currency situation in the country to circumvent exchange controls, cam higher-risk-adjusted yields on excess fund with the collaboration of corrupt government officials. Disguise true profitability by reallocating profits among their various units.

The impact of these profits, manifest. in from of higher pay and better conditions of service to their staff. The l1agrant display of wealth by thc staff of such companies more often attract thc envy and anger of the host communities who often react with biter hostilities, giving rise to youth restiveness, and disruption ofthe company's operation. (Ekpo, I998). The issue ofhow multinational corporations use tax arbitrage, financial market arbitrage and regulatory system arbitrage in their financial management practices have dominated discussions in finance in the recent past (Lessard 1979, Robbins and Stobaugh I973, Shapiro. 1986. Zenoff and Robbins 1968).

But empirical investigation on the success or failure of thcse approaches in developing economies that are saddled with contradictory laws characterized by conflicting demands of the government and that ofthe immediate community has not been given the necessary attention. Instances abound in these countries where the central governments set the operational guidelines yet, the immediate host cornmunities make extra demands for the provision ofsocial amenities as they believe rightly that exploitation of their natural resources should attract some benefits to them.

If the government could not provide the basic necessities of life, then the companies that exploit these resource should be held accountable. Th is study therefore presents the results of empirical investigation ofthe environmental con traints confronting financial management practices of multinational corporations in developing countries with igeria as a case study.

METHODOLOGY

This study tried to find answers the following questions:

(i) Is there any relationship between regulatory system arbitrage of the MNCs and the local laws in developing countries?

(ii) Is there any relationship between the success of financial management practices of the MNCs and the environmental consttaints in developing countries?

Two null hypotheses were formulated and tested as a guide to answering our research questions. Therc are.-

Ho₁: There is no significant relationship between regulatory system arbitrage of the MNCS and the local laws in their operating environments.

Ho₂: There is no significant relationship between the success of financial managernent practices of the MNCS and the environment constraints in developing country.

We identified 5 major multinational corporations involved in oil exploration and marketing in Nigeria. These companies include: Shell Petroleum Development Corporation (SPDC), Agip, Exxon Mobil. Total Elf Finna. and Texaco Chevron. Wc also identified community leaders in the areas of operations of these companies copies of Questionnaire. were administered on 20 principal officers of these companies. 20 copies of questionnaire were also administered on the leaders or these communities. Responses from these respondents were used for the analysis.

DATA ANALYSIS

The method of analysis employed in the study enable us relate the intluence of inhibitive nature of operating laws in Nigeria to the success of regulatory system arbitrage of muhinational corporations in igeria. It also relates the possible successes of financial management practices of the multinational corporations to the envirorunental constrains *in* Nigeria

The respondents were required to rate the success of regulatory system arbitrage. Thcir Reponses are summarized table (I a). A cursory look at the table shows that 32 out of 40 or 80 percent of the respondents are of the view that the chances of success fusing regulatory system arbitrage by Multinational Corporation is only 10 percent. 8 out of 40 or 20% of the respondents are of the view that the chances of success are 30 percent. On their rating of the nature of inhibitive nature of operating laws in Nigeria, 29 out of 40 or 73 percent of the respondents are of the view that the inhibitive laws working against the usc of regulatory system arbitrage is as high as 80 percent, while 11 out of 40 or 27 percent of the respondents are of the view that the inhibitive laws are as high as 60 percent.

In order to establish if a relationship exist between the success of regulatory system arbitrage and inhibitive nature of operating law in Nigeria. a Pearson Correlation analysis was conducted (see tables 3 & 4). The 'result of the analysis show that there exists a negative but insignificant relationship between the success of regulatory system arbitrage by Multinational Corporations and inhibitive nature of operating laws in Nigeria. To ascertain the success of financial management practices the multinational corporations in an environment where constraints such as youth restiveness, double taxation, high currency depreciation and lack of' infrastructures exist, the respondents were required to rate the success of financial management practices of their various corporations and also the environmental constraints in their areas of operation. Their responses are summarized in table 2 (a and b).

A cursory look at the table shows that 20 out or 50 percent of the respondents are of the view that financial management practices of Multinational Corporations is 80 percent successful in Nigeria. 20 out of 40 or 50 percent of the responds also opined that the success of financial management practices of Multinational Corporations in Nigeria is 70 percent success. On the ratings of environmental constraints to the success of financial management practices. 35 out 01'40 or 88 percent of the respondents are of the view that the constraints can affect the success of financial management practices of Multinational Corporations to the level 01'80 percent. While only 5 out of 40 or percent are of the view that it could measure up to 70 percent level. In order to establish if a relationship exist, between the success of finaneial management practices of the MNCS and the environment constraints, a person correlation analysis was constructed. (table 4). The result shows that there is a negative and significant relationship between the success of financial management practices of multinational corporations and environmental constraints in Nigeria, which implies that the higher the environmental constraints. the lower the success of financial management practices of multinational corporations in Nigeria.

CONCLUDING REMARKS

Based on the finding of this study. we conclude that multinational corporation in Nigeria operate under a very harsh social environment. The duplication of taxes by all tiers of government imposed a very high cost of operation on the M CS operating in Nigeria. M CS in Nigeria are expected to contribute significantly to the socia/economic lives of their host communities tax addition to the payment of all the imposed taxes. Lack of orderly tax system in Nigeria prevents MNCS from taking advantage of regulatory system arbitrage in their financial management practices in igeria. The operating environments of the multinational companies are rendered un-conducive because of pressures from host communities for the provision of social infrastructures that have long been neglected by the government at all tiers. Multinational corporations in Nigeria can carry out successful financial management practices if the operating environment is conducive.

RECOMMENDATIONS

Based on the findings of this study, we recommend that government of developing countries should endeavor to harmonize their tax systems among the various tiers of government to reduce high cost of operations by multinational corporations.

Specific taxes should be spell out for the MNCS in every of the country and there should be concerted effort by government to protect the MNCS against unauthorized taxes and levies by any tier of government Multinational corporations should exercise high sense of responsibility in addressing the social problems of their host communities especially as they impact negatively on their activities such as pollution, land degradation and moral decadence of some of the officials. In so doing, the restiveness of the youths in host communities could be curtailed and contained.

MNCS in developing countries should employ qualified youths in their earsof operation to give the host communities a sense of be longing. This will ensure an environment conducive for their smooth operations. Government in developing countries should try to take the local communities into confidence while fonnulating guiding rules and regulations affecting the operations of multinational corporations in order to provide a conducive environment as an incentive to attract these companies to the country, ablest encourage the existing ones to carry out their operations successfully, in order to impact positive on economic growth and development of the economy.

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APPENDIX

Table I(a)

Rating of the Success of Regulatory System Arbitrage and Inhibitive Nature of Operating Laws in Nigeria

	No of Respondents	Rating of **Regulatory System** Arbitrage	Percentage of the Respondents
	32	10%	80%
	8	30%	20%
Total	*4f1*	-	*100%*

. Table I(b)

	No of Respondents	Rating of the inhibiting nature of operating **laws in Nigeria.** ...	Percentage of the respondents
	29	80%	73%
	I I	60%	27%
Ttltol	*4IJ*	-	*J()O%*

SOURCE: FIELD SURVEY, 2002

Table 2(a)

Ratings of the Success of Financial Management Practices of the MNCS and the Environmental Constraints in Nigeria.

	No of Respondents	Rating of the Success of the Financial Management **Practices**	Percentage of the Respondents
	20	80%	50%
	20	70%	50%
Totol	*40*	-	*J()O%*

SOURCE: FIELD SURVEY. 2002

Table 2(b)

	No of **Respondents**	Rating of **the** Environmental Constraints in **Nigeria**	Percentage of the Respondents
	35	80%	88%
	5	70%	12%
Total	**40**	-	100%

SOURCE: FIELD SURVEY. 2002

Table Ja

Pearson Correlation Analysis Results

Variables	X	Y	Simple Correlation	**Nature**	Significance at 0.05
Regulatory System arbitrage	1.000	-0.112			
			-0.112	Negative	Insufficient
(V)	-0.112	1.000			
Operating laws in Nigeria					

J. No of respondent (II) 40

2. "J' Dole from table 2(0)

Table 3b

Variables	X	Y	Simple Correlation	**Nature**	Significance at 0.05
Success of Financial Management Practices	1.000	0.3360 -0.360		"Negative	I Insufficient
(V)		-0.112			
Environmental Constraints	0.360	1.00			

No of respondents (n)=40

SOURCE: COMPUTER PRINTOUT USING DATA FROM TABLE (2B)