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

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

BY

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ABSTRACT

The growing attractiveness of government intervention in the economy of the developing countries has increased the political risks that multinational firms have historically been subjected to. These risks seem to exert different impact on financial management practices in these countries. Various environmental constraints, ranging from conflict in tax laws and youth restiveness to political risk, inhibit the success of multinational firms in developing countries. We recommend that government in developing countries should try to take the peculiar socio/economic situation into consideration while formulating operating rules for the multinational corporations (MNCS) to ensure a conducive operating environment for the successful financial management practices.

INTRODUCTION

International business involves an institutional 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 (MNCs) epitomize these firms. 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 subjected to. These risks take the form of currency controls, expropriation, change in tax law, and requirements for additional local production. These risks affect the value of the 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 of political, social and economic risks. In developing societies, the greatest risk inhibiting the operations of multinational corporations are the environmental influences characterized by conflicting demands of government in form of taxes and the immediate community’s demand for social services. In this paper we present the result of empirical investigation of financial management practices of multinational corporations in developing economies using multinational oil firms operating in Nigeria as a case study.

**CONCEPTUAL FRAMEWORK**

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

Multinational corporations have been variously defined (Okwandu 1992, Gilpin 1987, Ellicman and stone hill, 1973). As corporations that own and manage economic units in two or more countries. They enjoy worldwide access 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 of different products and exerting control on its industry in the country concerned to provide the firm 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 channels 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 of goods 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 of dividends.

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 nations 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.

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(b) Financial market arbitrage is the transfer of funds among units. This process allows MNCS to circumvent exchange controls, earn higher risk-adjusted yields on excess funds and tap previously unavailable capital sources.

(c) Regulatory system arbitrage occurs where subsidiary profits are a function of government regulations (Where a government agency sets allowable prices on the firms goods) or union pressure, rather than 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 of credit 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, earn 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 flagrant display of wealth by the staff of such companies more often attract the envy and anger of the host communities who often react with bitter hostilities, giving rise to youth restiveness, and disruption of the company's operation. (Ekpo, 1998). The issue of how 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 1973, Shapiro. 1986, Zenoff and Robbins 1968).

But empirical investigation on the success or failure of these approaches in developing economies that are saddled with contradictory laws characterized by conflicting demands of the government and that of the 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 communities make extra demands for the provision of social 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. This study therefore presents the results of empirical investigation of the environmental constraints confronting financial management practices of multinational corporations in developing countries with Nigeria 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 constraints in developing countries?

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

\[ H_0_1: \] There is no significant relationship between regulatory system arbitrage of the MNCs and the local laws in their operating environments.

\[ H_0_2: \] There is no significant relationship between the success of financial management practices of the MNCs and the environmental constraints in developing countries.

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. We also identified community leaders in the areas of operations of these companies. Copies of questionnaires were administered on 20 principal officers of these companies. 20 copies of questionnaire were also administered on the leaders of 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 influence of inhibitive nature of operating laws in Nigeria to the success of regulatory system arbitrage of multinational corporations in Nigeria. It also relates the possible successes of financial management practices of the multinational corporations to the environmental constraints in Nigeria.

The respondents were required to rate the success of regulatory system arbitrage. Their responses 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 percent 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 use 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 with 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 of 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 respondents 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 of 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 of 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 financial 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 MCs operating in Nigeria. MCs in Nigeria are expected to contribute significantly to the socioeconomic 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 Nigeria. 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.

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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 area of operation to give the host communities a sense of belonging. This will ensure an environment conducive for their smooth operations. Government in developing countries should try to take the local communities into confidence while formulating 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, ablist encourage the existing ones to carry out their operations successfully, in order to impact positive on economic growth and development of the economy.

REFERENCES


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# APPENDIX

Table I(a)

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

<table>
<thead>
<tr>
<th>No of Respondents</th>
<th>Rating of Regulatory System Arbitrage</th>
<th>Percentage of the Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>32</td>
<td>10%</td>
<td>80%</td>
</tr>
<tr>
<td>8</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>-</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Table I(b)

<table>
<thead>
<tr>
<th>No of Respondents</th>
<th>Rating of the Inhibiting nature of operating laws in Nigeria</th>
<th>Percentage of the respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>29</td>
<td>80%</td>
<td>73%</td>
</tr>
<tr>
<td>11</td>
<td>60%</td>
<td>27%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>-</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

*Source: Field Survey, 2002*

Table 2(a)


<table>
<thead>
<tr>
<th>No of Respondents</th>
<th>Rating of the Success of the Financial Management Practices</th>
<th>Percentage of the Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>20</td>
<td>80%</td>
<td>50%</td>
</tr>
<tr>
<td>20</td>
<td>70%</td>
<td>50%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>-</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

*Source: Field Survey, 2002*

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### Table 2(b)

<table>
<thead>
<tr>
<th>No of Respondents</th>
<th>Rating of the Environmental Constraints in Nigeria</th>
<th>Percentage of the Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>35</td>
<td>80%</td>
<td>88%</td>
</tr>
<tr>
<td>5</td>
<td>70%</td>
<td>12%</td>
</tr>
<tr>
<td>Total</td>
<td>40</td>
<td>100%</td>
</tr>
</tbody>
</table>

*SOURCE: FIELD SURVEY. 2002*

### Table 1a

**Pearson Correlation Analysis Results**

<table>
<thead>
<tr>
<th>Variables</th>
<th>X</th>
<th>Y</th>
<th>Simple Correlation</th>
<th>Nature</th>
<th>Significance at 0.05</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory System arbitrage</td>
<td>1.000</td>
<td>-0.112</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(V)</td>
<td>-0.112</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating laws in Nigeria</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</table>

### Table 3b

<table>
<thead>
<tr>
<th>Variables</th>
<th>X</th>
<th>Y</th>
<th>Simple Correlation</th>
<th>Nature</th>
<th>Significance at 0.05</th>
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</thead>
<tbody>
<tr>
<td>Success of Financial Management Practice</td>
<td>1.000</td>
<td>0.3360</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(V)</td>
<td>-0.112</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Environmental Constraints</td>
<td>0.360</td>
<td>1.00</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

*No of respondents (n)=40*

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