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The transnational company after globalisation

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ABSTRACT

International capital market integration has facilitated the rise of a new kind of 'financially enhanced' transnational. The mode of operation of the financially enhanced transnational corporation is compared with that of the more traditional production-orientated multinational company. The paper discusses the breakdown of globalisation into a new regionalisation in the international financial system, and the spreading macroeconomic crisis in the major industrialised economies. It argues that new financing constraints will freeze the current structure of international business. The crisis reveals finance as the key enabler and feature of international business.

1. Introduction

The inflation of capital markets in the world's main financial centres, and the growing integration of capital markets since the 1980s have given rise to a new kind of transnational company. This is the 'financially enhanced' transnational, whose rapid growth has less to do with the dynamism of their productive and commercial activities, and more to do with the ability of companies to expand their balance sheets rapidly in inflating capital markets. When those balance sheets expand across the borders of sovereign states, multinational companies may extend cross-border activities through financial transactions, rather than decisions about how and where to produce abroad.

The circumstances in the financial markets that have fed this rapid growth have now come to an end, with the largest capital markets in the U.S. depressed by the financial crisis and the refinancing needs of the banking sector, a new international regionalism emerging out of the concentration of global foreign currency reserves in Asia, and the proliferation of bilateral swap arrangements between central banks in particular regions. This will leave the 'financially enhanced' transnational company still in a dominant position in international trade and production, but weakened by the increased illiquidity of its balance sheet.

The paper is structured as follows. The first section explores the distinctive mode of operation of the 'financially enhanced' transnational and its dependence on capital market inflation and international capital market integration. The second section examines the consequences for the 'financially enhanced' transnational of the current financial crisis. The third section outlines a key factor that will influence the progress of transnational companies in future, namely the emergence of a new regionalism in the international financial system. A final section remarks on some conclusions that may be drawn from this analysis for international business.

2. The 'financially enhanced' transnational

This section argues that the key factors in the evolution of transnational companies in recent years have not been the commercial dynamism of the advanced industrial countries or the emerging markets of Brazil, Russia, India and East Asia, but

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changes in the capital markets. For readers with a historical perspective, this should come as no surprise. After all, changes in capital financing and banking have always played a crucial part in the evolution of international business: The emergence of capital markets in North America and Europe, following legislation to facilitate the routine establishment of companies with limited liability in the 1860s, played a key part in the transition from the first generation of multinational companies to the second [1].

The first generation of multinational companies, dating back to the late middle ages, had been established as trading companies by sovereign princes as a way of promoting trade, but also of generating income for the Crown. Commercial legislation in the second half of the nineteenth century that facilitated the setting up of joint stock companies incubated a new generation of multinational companies that now were able to engage in production as well as trade. As capital controls were eased following the break-up of the Bretton Woods system at the start of the 1970s, this gave rise to the main *problématique* of late twentieth century international business theory, namely the management 'choice' of whether to produce at home or abroad, and the consequences of such strategies (see [2]).

However, the facilitation of foreign direct investment by multinational companies was by no means the most important outcome of the lifting of capital controls. This aspect of globalisation combined with a new key trend that emerged at the end of the 1970s, namely the inflation of capital markets by the systematic inauguration of funded pension schemes. The shift from old-style pay-as-you-go pension schemes, in which those currently in employment paid the pensions of those currently retired, to schemes in which contributions were invested in various financial and other asset markets, to generate a return out of which future pensions would be paid, resulted in major inflows into capital markets ([3], Part 2). The impact on securities prices was not equal: bonds and other instruments with fixed maturity (repayment) values obviously had little scope to inflate, unless the bonds had a long time to maturity. The inflationary impact in capital markets was therefore concentrated on equity values, which have no assured repayment in the future. This process I have elsewhere called 'capital market inflation' ([3], Part 1). Its symptom was the boom in equity markets that gathered pace in the 1980s and continued through into the 21st century. Its chief areas of concentration were the United States and the United Kingdom. This was not, as many proponents of capital market inflation argued at the time (see for example [4]), because of the inherent superiority of those countries' capital markets. Rather, the boom in the equity markets in those countries occurred because they had the largest shift towards funded pension schemes.

The effect of capital market inflation was an equity boom for companies, leading to the over-capitalisation of the largest companies. An over-capitalised company has more capital than it requires to conduct its non-financial business. The excess capital may be held as liquid assets, or used to conduct merger and takeover activity [5]. In the past, over-capitalisation was considered contrary to shareholders' interests because it involved 'watering down' the profits of a company, i.e., distributing a given profit generated from commercial activity over a greater amount of shares, or reducing earnings-per-share. But with anti-inflationary fervour maintaining high short-term interest rates, over-capitalisation virtually paid for itself because of returns on liquid assets. Additional profits could be generated from buying and selling companies.

In the 1980s, therefore, there emerged a new type of multinational company, the financially enhanced and, this time, genuinely transnational company: previous multinational companies had their ownership concentrated in one country; the new transnational, through its operations in capital markets around the world, has its ownership dispersed around those markets. The financial enhancement came in two forms. The first was through over-capitalisation, which improves the financial stability of a company by allowing it to hold more liquid assets without having to save these up out of its retained profits. The second financial enhancement was through access to capital markets around the world, as capital controls in Europe and North America, and then emerging markets (with the significant exception India and China) were eased. Companies could now raise additional capital in many other countries. Transnational companies like Siemens have their shares quoted in markets in the key countries in which they operate. Their ownership is, in theory at least, truly global, if we overlook the fact that in most markets only locally incorporated companies may have their shares listed. More importantly, relatively minor companies from developing countries could turn themselves into transnational companies simply through their ability to raise capital in the more open capital markets.

The promotion of emerging market companies such as Cimex and Mittal to transnational status did not, however, mean that the perfect capital market, that state of entrepreneurial democracy in which capital is available to anyone with a sound business idea, had arrived or was imminent. The opening up of capital markets usually meant allowing foreign residents to hold shares listed on a given market, rather than allowing foreign companies to raise capital in that market. This eased in a new kind of foreign direct investment. The old kind, dating back to the 19th century, involved the export of capital equipment, in which a company buys and installs such equipment in a foreign country. Increasingly, since the 1980s, foreign direct investment has been of the financial kind, in which no equipment crosses borders, but ownership of companies crosses borders. With the growing trend to privatisation, more and more state companies were sold to foreign companies, and holding companies divesting themselves of subsidiaries sold them to foreign purchasers.

The financially enhanced transnational company is distinctive because it grows by means of international mergers and acquisitions, rather than by means of expanding production abroad. Its strategic management is less concerned with decisions to set up production plants in foreign parts, but more and more with buying and selling companies in foreign parts: a lucrative business as long as capital market inflation allowed subsidiaries to be sold at a profit. It also means that, for a given volume of foreign direct investment there was now less actual investment in fixed capital and infrastructure [6]. In other words, the apparently more efficient capital market was in fact becoming less efficient at delivering productive investment: more financial transactions accompanied a given amount of such investment.