Financial capital management in transnational corporations

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Abstract. Modern stage of modern economy development is characterized by progressing globalization, main forms of which are financial globalization, globalization of the activity of biggest transnational companies (TNC), intensification of world trade, regionalization of economic activity. TNC are driving force of globalization processes and the key stakeholder in it. Financial mechanism of the TNC management of and the role of TNC in the global capital turnover system are considered in the article. The authors consider the dynamics, structure and key indicators of international production of TNC. The scale of transnationalization of production and capital is analyzed on the base of FDI dynamics and the transnationality index. It was found that leading TNC of EAEC countries, in spite of intense development during last decades are still greatly inferior to TNC of developed countries by key parameters. It is emphasized that openness of the economies of EAEC countries creates favourable conditions for credit expansion of transnational capital effect of which is growth of external corporative debt. The article includes some recommendations how to form conditions that will attract big TNC not related to extracting sector of the economy of developing countries.

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Introduction

Today we see that the processes of financial globalization, integration of the countries into world financial system become irreversible [1]. The effect of it is that functioning of the world economy is influenced by TNC and this influence is constantly increasing. Global capital on the base of common production and the growth of transactions has turned world financial and goods markets into prioritized spheres of economic activity [2]. Because of that its institutional forms which have formed in the middle of XX century - banks, industrial corporations, groups of companies – must adapt themselves to the current changes. Main institutional forms of financial capital are TNC, TNB (transnational banks) and financial-industrial groups.

Using their financial and production power the biggest TNC directly influence the economy of developing countries and can dictate conditions not only to their competitors but to the governments as well establishing their own standards in many economic and social spheres. Current economic situation, which is characterized by high dynamics and uncertainty demands rational management of TNC financial capital.

TNC in modern interpretation are big companies (or conglomerates of the companies from different countries) which have a network of foreign officers, divisions more than in 2 countries functioning under centralized leadership and actively interacting with each other whose foreign operations give more than 25% of the company income.

Formation of TNC was related to formation of transnational capital [3]. In their financial activity TNC use the principles of tax, currency and customs regulation of those countries where their subsidiaries operate.

Manipulating by different financial conditions offered to them by the state TNC increase net cash flow [4].

Moreover, special financial conditions allow TNC to form their intercompany markets which are characterized by intercompany trade and transfer pricing. Transfer pricing is understood as establishing prices in international transactions between the connected to each other enterprises of one and the same TNC. It allows transferring the profits of TNC into those countries where the taxes are low or not levied at all: the effect of it is that corresponding country unjustly loses its tax income [5].

Financial mechanism of expansion of TNC activity in global economy is the system of company financial relations management performed through specific methods and tools of its activity which serve for the purpose of maximization of profit and expansion of its capital base. The main task of financial mechanism is formation of TNC capital, optimization of expenditures on its attraction, provision of cash for all spheres of TNC activity, assessment of their profitability, diversification of corporation activity. Financial levers are set of financial tools and indicators used by management system to influence economic activity of the company [6]. Such indicators include: cost efficiency, profitability, pricing, financial sanctions, dividends, interests, wages, taxes etc.

Financial globalization, integration of the countries into world financial system significantly increased since 1970 and since 1990 the increase was very big[7]. The number of TNC grew quickly. If in 1970 there were 7300 TNC in the world, in the early 90s their number reached 37 000. In 2012 there are 82 000 of TNC and the profit from the sales obtained by their foreign divisions amounted to 30 billion dollars. Most part of TNC are located in the USA (26,4%), China (14,6%), Japan (13,6%), France (6,4%), Germany (6,4%) and Great Britain (5,4%). Remained part of TNC (27,2%) are located in other countries. (Figure 1).

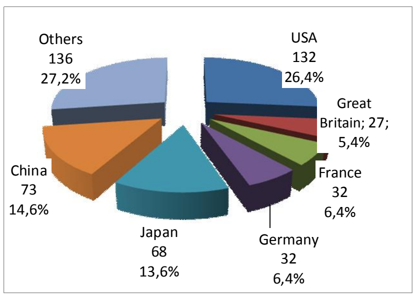

Figure 1. Share of countries in top-500 of non-financial TNC

Table 1. Indicators of international production of TNC

Indicator	1990	2005–2007 (average pre-crisis value)	2010	2011	2012
Profit from sales of foreign branches	5102	19 579	22 574	24 198	25 980
Added value (products manufactured by foreign branches)	1018	4124	5735	6260	6607
Aggregate assets of foreign branches	4599	43836	78631	83043	86574
Export of foreign branches	1498	5003	6320	7436	7439
The number of employees in foreign branches	21458	51795	63043	67852	71695

Globalization results in expansion and deepening of TNC activity. Since 1970 the aggregate assets of foreign branches have increased more than by 18 times and in 2012 were equal to 86574 billion dollars. They produced added value for more than 6,6 billion dollars which corresponds to 2,3% increment in global GDP. More than 71,7 million people work there and this is 3,3 times more than in 1990 (Table 1) [9].

Growth of international production of 100 leading TNC, mostly in developed countries has stopped in 2012. However 100 biggest TNC in developing countries and in the countries with transition economy have increased their foreign investments by 22% and continued the expansion of their international production networks. Numerous mergers resulted in appearance of new TNC of oligopolistic type which are characterized by small number of participators, prolonged relations of competition with the purpose to keep balance of forces, profit margin for main goods and the share of market.

Readiness of financial-industrial groups to combine competitiveness and cooperation proves their wish to minimize competition in conditions of oligopolistic markets. Because of that in some cases stagnation in TNC activity takes place: high management costs, bureaucratic structure of management and decision-making system. Besides that the studies show that organizational structures and the systems of coordination and control which have proved their efficiency in industrial TNC were less successful in the sphere of financial services of TNC, partly because of their big strategic complexity and partly because of the fact that requirements to efficient risk management create serious barriers hindering centralization [10].

Process of globalization is greatly facilitated by global production and investment decisions of TNC. The size of transnationalization of production and capital can be assessed by dynamics of FDI and TNI. The latter shows the ratio of the number of employees in foreign divisions of TNC, foreign assets and corporative sales to the corresponding aggregate indicators.

Today average TNI of 100 non-financial TNC of the world is 61,1% (Table 2). But TNI of American and Japan TNC is below the average, because they are oriented to internal markets where most part of assets, human resources and sales are concentrated.

The level of transnationality of developing countries and the countries with transition economy is much lower and amounts only to 37,9% [11]. TNI demonstrated that most transnationalized companies among developing countries are TNC of Argentina (74,4%), India (70,8%) and Malaysia (60,6%).

It should be mentioned that leading TNC of EEC, in spite of active development during last decades, are still significantly inferior not only to North-American, Western European and Japan TNC, but leading companies from developing economies. Only one Russian company Vympelcom was included into Top-100 of the leading non-financial TNC of the world.

Table 2. The level of transnationality of countries in 2012.

	Number of TNCs	Assets, million dollars		Sales, million dollars		Number of employees		TNI %
		Foreign	total	Foreign	total	Foreign	total	
Total in Top-100	*100*	*7698328*	*12841546*	*5661953*	*8726869*	*9845443*	*16875084*	*61,1%*
Including:								
USA	22	1731705	3295236	1322237	2440971	2644116	5224175	52,4%
Great Britain	14	1331854	1620817	972287	1348155	1042178	1544392	73,9%
Japan	8	678666	1183688	511457	976115	508743	1078886	52,3%
France	14	1002259	1699004	648309	969477	1355646	2192052	62,6%
Germany	10	871716	1557395	807977	1096817	1290476	2261421	62,2%
Italy	3	349457	520908	250384	380564	241600	366376	66,3%
Switzerland	5	378274	465568	267841	274623	622025	738236	87,7%
Belgium	1	115913	122621	36013	39758	109566	117632	92,8%
Spain	3	221917	385290	120098	199822	252043	333921	64,4%
Luxembourg	1	112239	114573	83996	84213	185319	244890	91,1%
Russia	1	33381	55360	13959	23061	33784	58184	59,6%
Brazil	1	45721	131478	38325,6	47694	15680	85305	44,5%
China	2	263140	741240	182248	245007	1056140	1810028	56,1%
Sweden	3	126004	172493	72077	85048	121284	162714	77,4%

2011 UNCTAD (United Nations confederation on Trade and Development) ranking of biggest non-financial TNC from developing countries and the states with transition economy includes only 8 Russian companies. The biggest are as follows: *Vympelcom, Lukoil, Gazprom, Evraz, Severstal* . By the amount of foreign assets they were on 9th, 11th, 28th, 55th and 57th positions accordingly. The TNC of the others independent EEC states were not included into the ranking.

Since the owners of financial capital are interested first of all in development of those branches where their capital can bring rather high profit, global investments are directed into industries characterized by high labour efficiency, technical equipping of production, high level of organization and production management, relatively low costs.

Inflow of international financial capital into national economies is carried out mainly in the form of FDI. FDI, in spite of cyclic fluctuations during 1995-2012, grew all the time. Foreign investments include FDI, foreign portfolio and credit investments.

Global inflow of FDI into world economy has reduced by 18% in 2012 in comparison with 2011 - from 1, 65 to 1,35 billion dollars.[12]. Economic instability and political uncertainty in a number of big countries made investors exercise caution. Besides that many TNC re-profiled their investments abroad through assets restructuring, disinvestments and relocation. If macroeconomic conditions in medium-term will be better investments of TNC can reach 1,6 billion in 2014 and 1,8 billion in 2015. However there are still high risks, including structural faults of global financial system, slowdown of economic growth in EU and great uncertainty in regard to the policy in the regions which play key role in investors' decisions.

Among the countries with developing economy Russia is on the second position by the amount of attracted investments, the country is inferior to Hong Kong (China) but superior to Brazil, China and India [13]. World ranking shows that the biggest recipients of FDI are experiencing the changes in the investments flows structure. For example, 5 biggest consumers in the world include 4 developing countries; and among top-20 of recipients there are 9 developing economies (Figure 2).

In 2012 the top-20 ranking by the amount of attracted investment side by side with Russia also included the Republic of Kazakhstan. Most part of FDI is in the spheres related to oil and gas: in 2012 about 3/4 of these flows were directed into these spheres. (It is expected that this ratio can be increased when in 2016-2017 the exploration of new big oil and gas deposits will begin). FDI deficit is observed in the basic industries, and in technological industries they are on zero level or close to zero.

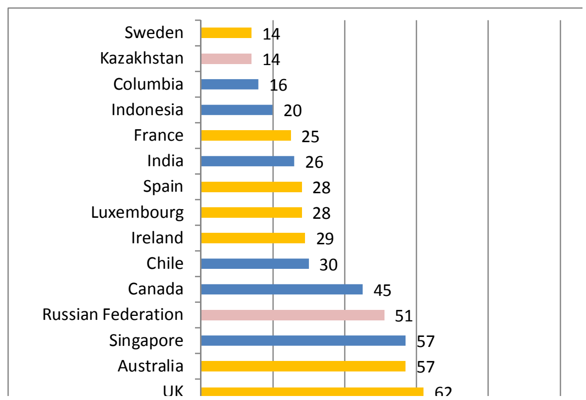

Figure 2. Top-20 countries in 2012, billion dollars.

During world financial crisis FDI reduced and at present moment the level of world investments has not reached pre-crisis levels while Kazakhstan for the last 4 years has attracted about 50% of gross FDI received by the country during all years of independence. In spite of negative dynamics of world flows in Kazakhstan the positive dynamics of gross FDI was kept. Since 1993 to 2012 summarized volume of FDI into Kazakhstan was 171,2 billion, and 81,6 of them were attracted during 2009-2012.

In the same time, in spite of positive dynamics of investments inflow they are still not diversified. Thus, analysis of industrial structure of top-100 Kazakhstan companies-investors (by the sales volume) testifies that most part of money is still invested into oil and gas sector of the economy. Today almost all biggest oil and gas companies from USA, Russia, China and European countries operate in Kazakhstan Activity of investors in fuel and energy/mineral sectors is much higher than in real sector of Kazakhstan economy.

Openness of the economy of EEC countries creates favourable conditions for credit expansion of transnational capital which in turn leads to accumulation of national debt. For example, external corporative debt of Russia in January of 2013 was 564 billion dollars, from this sum the debts of commercial banks amount to 208 billion, and debts of other enterprises and organizations - 356 billion dollars. During 2011-2012 corporative debt of Russia increased by 122 billion dollars. The key debtors are biggest state TNC. The external debt of *Rosneft* in 2011 was over 20 billion dollars, it greatly increased in 2012 and is still increasing with the purchase of *TNK-BP*. Net debt of *Gasprom* in October of 2012 was 37,5 billion dollars and it is also increasing due to approved investment program and construction of the pipeline *South Stream* system. Other big companies - *RZHD*, *Russian aluminum, Lukoil, Severstal, VTB, RusHydro and the Sberbank of Russia* also have big external debts. Officially the state is not responsible for liabilities of its enterprises and organizations but in fact in critical situations it helps them to pay the debts, for example, during last crisis the state pumped them with money in forms of short-terms and long term credits. *Sberbank, VTB, Gazprombank* also gave billions of dollars to *Gazprom* and *Rosneft*. That is why external debts of state enterprises are called quasi-state debts because the risks are shared by the state as well.

Even for not so big economy of Kazakhstan gross external debt in 2012 was 13,1 billion or almost 60% of GDP. Most part of it is so-called intracompany debt, the credits of TNC in oil sector to their Kazakhstan subsidiaries. Kazakhstan opened the economy for attracting direct and portfolio investments and this accelerated growth of debt in corporative sector. Transnational capital deliberately hinders development of industry of such countries as Kazakhstan, Russia, Afghanistan, the countries of Persian Gulf and others which have rich natural resources in order to perform credit expansion and establish control over oil and gas market.

State supports economic growth with the aid of National Bank and financial institutes but the tools of monetary and fiscal policy are not enough, this happened in the USA, EU where QE measures resulted in outflow of capital and do not enter the real sector of economy. For example, outflow of capital from Russia in 2008 was 133,7 billion dollars, in 2009 - 56,1 billion, in 2010 - 34,4 billion, in 2011 - 80,5 billion and in 2012 - 56,8 billion dollars. Total outflow was more than 360 billion. National banks of most EEC countries can not satisfy the needs of enterprises and organizations, especially big ones, for borrowed and investment money. This is determined by particularities of bank system whose liabilities and assets are formed by short-term money because there are no investment banks.

Developing countries (especially those which must increase competitiveness of non-resource economy from the scratch) must create conditions for attracting biggest TNC not engaged into production of raw materials. These countries must accumulate reserve funds, restrict credit expansion in oil and gas sector of economy by means of strict fiscal policy and using monetary tools.

In order to attract financial capital of leading world players into development of non-resource industries developing countries must do the following:

- To improve investment climate of their countries constantly. Fair court system, low level of corruption of regulating and supervision bodies, competitive (non-monopolized, non-contract) economic environment, balanced regulatory framework.
- To reduce risks. For example, put option must be provided for all welcome investors (leading TNC). Put option will enable the investors to leave Kazakhstan project with fixed sum of losses. The most cautious investors will see that they can`t loose all their investments and they will participate in the project.
- To form co-investment funds where world leaders will participate in national projects. Availability of co-investor represented by the state will make the TNC's task of attraction money easier, and allow TNC to share the risks of investments. This must increase attractiveness of potential projects at the territory of Kazakhstan

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