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Analyzing the Cause of Political Risk Facing Multinational Corporations in Underdeveloped Nations

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Abstract - The most important consideration for Western firms doing business in underdeveloped nations is political risk. Experts argue that political risk is any threat to the long run profitability of the company's operations which grows not from the normal economic functioning of a society, but rather from nationalistic discriminatory actions of host countries. The pressure which might cause government to act in a manner adverse to the interest foreign investors in Africa may be viewed as falling into three categories namely; arising from system instability, those arising from resentment of foreign investment, those arising form conflict with perceptions of host country's national interests. Interference is not necessarily always the result of antagonism to foreign investment. Balance of payment, monetary and fiscal problems can at time bring about restrictive actions that affect foreign and domestic businesses alike. This paper is focused on analyzing the cause of political risks facing multinational corporations in under-developed nations.

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I. Introduction

The most important considerations for foreign firms doing business in under developed nation are political risks. Some experts in business argue that political risk is any threat to the long run profitability of the company's operations which grows not from the normal economic functioning of a society, but rather from nationalistic or discriminatory actions of host governments.

A study by Business International based upon foreign data offers the following list of government actions (reactions in most cases) which can affect the foreign investors:

- Important control
- Investment barriers
- Local equity requirements
- Local content requirements
- Borrowing restrictions
- Profit and royalty remittance
- Tax discriminations
- Incentives discrimination
- Demand for export
- Prevention of acquisitions
- Expropriation and nationalization

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The pressures which might cause governments to act in a manner in Africa in particular may be viewed as falling into three principals categories:

- Those arising from system instability.
- Those arising from resentment of foreign investment.
- Those arising from conflict with perceptions of host country's national interests.

Balance of payments, monetary and fiscal problems can at times, bring about restrictive action that affect foreign and domestics business links.

In some parts of the world where the United State of America has been the primary investor, anti-U. S. sentiments are often prevalent. Kindleberger cautions that "foreign investors in the past have often acted in underdeveloped nations as if they enjoy extra-territories rights, and this history of their considering themselves above the law corrupts and more nearly balances negotiations today source". (Vernon 1971). Fayer Weather observed that animosity toward foreign Investment is part of nationalistic traditional, which binds these people together.

a) Reasons for Conflicts Between Multinational Firms and Underdeveloped Nations: Paramount Causes of Political Risk

i. *The Nigerian Experience*

Many theories have been propounded about the dangers of multinational corporations and the dangers they pose to the continent of Africa and the third world in general terms. Most of these arguments can be summarized as follows:

First that they create economic problems and disadvantages for the development of the African economy, because, these foreign firms are subsidiaries or holdings of parent companies an corporations abroad, and as such, their basic interests cannot be readily identified with African's development.

Secondly, that they have, in Africa created a neocolonial economy. By so doing, many Africa countries have remained export-oriented economy whose industrial units are vertically integrated with the parent industries or sectors of the neo-colony itself.

Third, that their existence make it impossible to develop indigenous enterprises. By nature monopolistic, these multinational corporations swallow indigenous firms in the name of improving the efficiency production. The indigenization Decree is aimed at breaking part of this monopoly.

Fourth, that because of their advantageous position in the economy, they are capable of pushing the relatively helpless governments of the African nations to grant them such concession that lead to huge profits which are repatriated back to the metropolis. These concessions are embodied in five acts- the industrial development (income tax Relief) Act, 1958, the industrial Development (Import Duties Relief) Act 1957, the customs duties (Dumped and subsidized goods) Act 1958, the customs (Draw back) regulations 1959, and the income tax amendment Act, 1959.

Fifth, that they can shift quickly to mining, when it becomes more prosperous and by so doing can regulate industries and agriculture, thus distorting the patterns of economic development the giving country.

Sixth, that having held the neo-colonial economic to ransom, having fooled the politicians and the bureaucratic bourgeoies predisposed to the capitalist doctrines of multinational corporations, they may raise the false alarm that investment can be damaged if the current government pursues a progressive policy of re-examining its industrial and agricultural potentialities, and try to limit the power of the multinational corporations by nationalization. This sort of white mail is calculated to scare the progressive section of the masses into silence while the corporations will continue to rape the economy to their own advantage.

Seventh, that the multinational corporations help to create a parasitic class within the society, a class that is essentially committed to the doctrines of capitalism. Through the several ways listed above, they can use these means to ensure the preservation of such parasitism. The case against the ruling class, as presented above is a pointer to the danger facing Nigeria and the rest of Africa as a whole.

Eighth, that the multinational corporations, by so doing, create a class that is corrupt, and by so doing the multinational corporations export the sort of political corruption which we find in Britain, the United States, and other capitalist countries. That is how the indigenous politicians were corrupted during the first republic.

Ninth, that such a situation defames the democratic process. To allow such private power to rule in the name of individual liberty, national security is to thwart political democracy (Neghand 1975).

Tenth, that multinational corporations, because they desire to maximize their profits, do everything in their power to give false information to any government about their real income and economic activities, turnovers, profits and so on. They do this by taking into account that the countries concerned do not have the men trained in the most sophisticated manner who might successfully probe the intricacies of the economic maneuvers of the long-standing organizations.

Eleventh, that once the multinational corporations get a grip on the nationals of the country, they induce them through social interactions to legislate against trade unions, on the argument that their industrial productivity would decline and that this decline would harm the national economy, as if these metropolitan capitalists were indeed interested in the affairs of the country.

In fact, a neo-colonial economy is prone to induce false patriotism because the rulers who are capitalist in their thinking and action, and having been corrupted by those monstrous unethical foreign institutions might mistake foreign interest for the interest of their own country. The Federal Government of Nigeria and its agencies would be wise to review all labour edicts in the spirit of the loftiest patriotism for the country.

Twelfth, that once this sort of false patriotism holds among the ruling class of a country, the multinational corporations can then manipulate the ruling class. They do this in many ways:

- By goading one ethnic nationality against the other. The internal, regional and ethnic conflicts in the first republic is noteworthy.
- By inducing witch-hunts against the true patriots of the country, stigmatizing them as communists, so as to stop any agitation by the exploited masses. In 1953, Nnamdi Azikiwe's Eastern Nigerian Government passed a law prohibiting "communists" from teaching in secondary schools in the East.
- By making use of the university dons in the various disciplines especially the social sciences to spread false theories aimed at defending the stance of multinationals and capitalism. Such theories are labelled "Scientific; objective, detached and empirical". Some dons in the university are agents of foreign international agencies linked with high espionage bodies, which may be unknown to these dons.
- They use other institutions through which they manipulate the indigenes such as the professional associations, news media, television, cultural attaches and so forth, to "sell" to the populace the idea that multinationalism is good for the society, and that capitalist democracy is synonymous with progress and civilization. Secretly, they arm the political parties of the bourgeoisie with money and trained secret and espionage agencies in order to clamp down on the progressive forces of those that create the wealth of the nation, the working class and the peasantry.

The dangers of multinationals in Africa and the third world are endless. The way a country has felt them depends on the degree of involvement of these octopuses in the county. As a result of these practices by the multinationals, host governments tend to insulate themselves against further interference in their national affairs by the foreign firms.

Lee Nehrt had carefully studied the ways the multinationals operate in LDC's before he stated that "the threat of a revolutions, coup d'etat, or election that would result in a government with much more…….. nationalistic tendencies is an element of political risk".

II. Background Literature

Political risk relates to the problems of war or revolution, confiscation, expropriation, domestication and controls. Import restrictions, price controls and labour policy are other areas of deadly political risk. Confiscation, expropriation, domestication and nationalization of foreign investments are terms frequently used and incorrectly defined in the literature on political vulnerability.

Confiscation occurs when a foreign investment is taken over by a government without any reimbursement. Expropriation occurs when a foreign investment is taken over by a government with some form of reimbursement made. The reimbursement may not be the full value of the investment from the view point of the company being expropriated, but nonetheless some attempt to reimburse foreign investment is made.

While confiscation and expropriation deal with the taking of property, nationalization technically refers to ownership by the government. Confiscation or expropriation of foreign business are probably the most frequently used and most critical politically induced risks of foreign business.

III. Political Payoffs

One approach taken in dealing with political vulnerability the political pay-off. This involves attempting to lessen political risks by paying those in power to intervene on behalf of the multination company.

Political payoff or bribery has been used to lessen the negative effects of a variety of problems. Paying heads of state avoid confiscatory taxes or expulsions, paying fees to agents insure the acceptance of sales contract, and providing monetary encouragement to an assortment of people whose action can affect the effectiveness of a company's programmes are decisions which frequently confront multinational managers and raise ethic questions.

The decision to pay a bribe creates a major conflict between what is ethical and proper and what is profitable and sometime necessary for business. International payoffs are perceived by those involved as a means of accomplishing business goals.

Let us consider U. S. businesses at this juncture. Bribery became a national issue during the mid 70s with public disclosure of political payoffs to foreign recipients by U. S. firms. Amounts pay were as high as $70 million and included such companies as Lockheed Aircraft.

A definition of bribery can range from the relatively innocuous payment of a few cents to a minor official or business manager so that it will not take four hours to get papers processed or product loaded abroad trucks, to the extreme of paying millions of dollars to head of state to insure your company preferential treatment.

IV. Presentation

Stated most succinctly, the control theory of political risk states that political risk is the result of the conflict between the foreign firm and the government regarding control of the economic decision making of the subsidiary.

The following matrix depicts the levels of political risk resulting from the control conflict.

V. Political Risk Source Matrix

Host Government Desire for Control of Economic Decision-Making

Firm Desire *for* control of Economic Decision-making	Low	Medium	High
Low	11 Very Low Political Risk	12 Low political Risks	13 Medium Political Risk
Medium	21 Low Political Risk	22 Medium Political Risk	23 High Political Risk
High	31 Medium Political Risk	32 High Political Risk	33 Very High Political Risk

This matrix can best be understood by considering several examples. First, in the case of a vertically integrated firm whose raw materials is extracted in foreign country, the firm must view the extract industry's subsidiary operation with a desire for a high level control. So long as the nations' desire for control of economic decision-making is low the political risk of the investment is relatively low, (the oil firms in Saudi Arabia prior to the last decade). When the country's desire for economic control shifts upwards (as with the formation of OPEC) the political risk of the subsidiary increases as well. The model even accommodates the differences among OPEC nations. Saudi Arabia has gone along with the OPEC nations regarding ownership but has been considerably more willing to allow a large amount of economic decision-making to remain in the hands of the firms via management contracts.

This explains the differences in executive beliefs regarding the political risk of Saudi Arabia vis-á-vis Libya or Venezuela. Saudi Arabia would have shifted from 31 to 32 while the aforementioned two nations would have shifted from 31 to 32 to 33. It is important to reiterate that this model deals with control of economic decision-making not equity position, although in some cases they may be the same. This can be used to explain off high political risk, while co-production agreements in Yugoslavia are viewed as being of relatively lower risk. It is not the politics of the nation nor the governmental position regarding foreign ownership of equity which results in political risk but in fact the government policies regarded control of economic decision-making.

Another point worth noting regarding the model is that it pertains to a particular investment. The host government may desire to control an extractive operation but not an assembly plant whose product is intended for export. They may desire control of investments which compete with the local industries but not other. They may desire control of capital intensive operations but not labour intensive, so forth. Further, this model also handles those situations in which the firm's desire for control is low. A low level of desire for control by the firm could result from either the investment being of minimal importance, currently and in the future, or because the operation would be relatively useless to the host government without the corporate expertise or the global corporate system. In essence, a firm can reduce the political risk of an investment, design and implementation of "built-in" control mechanisms.

This conceptualization has been supported by Ray Vernon;

This extraordinary spread of U.S enterprises into foreign countries in the last decades has produced its inevitable aftermath. So long as the political clash of interest remains unsolved, the constructive economic role of the enterprise will be accompanied by destructive tension" (Vernon 1971).

a) Some Marginal Solutions to the Industrialization Impasse

On the question of the ownership structure of the multinationals there are four basic alternate strategies which have been pursued in Africa and in most LDC's.

Most fallen short of nationalization, indeed because of this factor, it is often argued that these strategies adopted by the development countries still maximize the harmful consequences of this. In other words, the strategies are supposedly "pragmatic" and are designed to increase the long-run capacity of the country to sustain its own development, by first building up an infrastructure of material production and the requisite skills.

These strategies are namely; localization of senior management administrative staff (e.g. Africanization), requiring foreign firm to raise a substantial part of their capital requirements from the domestic capital market through the establishment of a national institution and also through the issuance of local equities and state participation at all levels of the economy.

Also favoured is the state participation in the ownership structure of foreign capitalistic firms through a majority-shared ownership.

Much state activities in all these countries have been directed towards publicizing and pressurizing multinational companies in to allowing nationals participate in the higher level of management.

Often, progress is measured simply in terms of the number of foreigners whose jobs have been taken over by local personnel. There are two weakness of this strategy.

The first weakness of the strategy is that it underestimates the social powers of these institutions and the degree of their "totality" in the control of the individuals. Local persons move into a particular institutional structure with their own ethos, values, life styles and ways of doing things — all of which are derived from the imperative of exploiting local resources for the benefit of the metropolitan capital.

These nationals, therefore, work in a situation where there are strong built-in pressure to conform to the values and the bahavioural patterns of the enterprise.

The second weakness in this strategy is the phenomenon of organizational substitution which has been made easy through the possibility of virtually instant communications. This process permits the companies to let nationals fill managerial positions nominally, and at the same time, empty these managerial positions of any decision-making significance, by simply referring back to the head.

VI. Recommendation

No amount of political payoffs can avert the attendant revolution and the instability, whose probabilities are so high under such conflicting situations. The state has the basic responsibility to control the behaviour of the national or multinational enterprises. Anything short of this I regarded as a potent source of political risk.

Many scholars and observers of the international business scene will recollect episodes like the assassination of president Allende of Chile when I. T. T. had its foot hold in the country, the kidnap in Venezuela of William Nei House and so many others.

The decision to pay bribe creates a major conflict between what is ethical and proper and what is profitable and sometimes necessary to "business".

VII. Conclusion

Multinationals operating in foreign countries are more politically vulnerable especially if their desire to control the economy of the host countries' conflict with the host countries desire to control their economy.

This is an area where all multinationals must watch very carefully right from the onset of their investment proposals. Such strategic interests as politics and economy are their inalienable rights which they cannot afford to lose to any foreign based multinational or its home government.

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