

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 from 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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21 **Index terms**— Western firms, underdeveloped nations, political risk

1 Introduction

22 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.

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

24 ? Those arising from system instability.

25 ? Those arising from resentment of foreign investment.

26 ? 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 domestic business links.

27 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. 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.

1 INTRODUCTION

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

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

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

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

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

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

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

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

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

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

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

85 Twelfth, that once this sort of false patriotism holds among the ruling class of a country, the multinational
86 corporations can then manipulate the ruling class. They do this in many ways: By goading one ethnic nationality
87 against the other. The internal, regional and ethnic conflicts in the first republic is noteworthy.

88 By inducing witch-hunts against the true patriots of the country, stigmatizing them as communists, so as to
89 stop any agitation by the exploited masses. In 1953, Nnamdi Azikiwe's Eastern Nigerian Government passed a
90 law prohibiting "communists" from teaching in secondary schools in the East.

91 By making use of the university dons in the various disciplines especially the social sciences to spread false
92 theories aimed at defending the stance of multinationals and capitalism. Such theories are labelled "Scientific;
93 objective, detached and empirical". Some dons in the university are agents of foreign international agencies linked
94 with high espionage bodies, which may be unknown to these dons.

95 They use other institutions through which they manipulate the indigenes such as the professional associations,
96 news media, television, cultural attaches and so forth, to "sell" to the populace the idea that multinationalism is
97 good for the society, and that capitalist democracy is synonymous with progress and civilization. Secretly, they
98 arm the political parties of the bourgeoisie with money and trained secret and espionage agencies in order to
99 clamp down on the progressive forces of those that create the wealth of the nation, the working class and the
100 peasantry.

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

105 Lee Nehrt had carefully studied the ways the multinationals operate in LDC's before he stated that "the threat

106 of a revolutions, coup d'etat, or election that would result in a government with much more??.. nationalistic
107 tendencies is an element of political risk".

108 **2 II.**

109 **3 Background Literature**

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

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

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

121 **4 III.**

122 **5 Political Payoffs**

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

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

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

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

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

138 **6 IV.**

139 **7 Presentation**

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

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

144 **8 Political Risk Source Matrix**

145 **9 High**

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

154 **10 Low**

155 Medium High This explains the differences in executive beliefs regarding the political risk of Saudi Arabia vis-
156 á-vis Libya or Venezuela. Saudi Arabia would have shifted from 31 to 32 while the aforementioned two nations
157 would have shifted from 31 to 32 to 33. It is important to reiterate that this model deals with control of economic
158 decisionmaking not equity position, although in some cases they may be the same. This can be used to explain

13 RECOMMENDATION

159 off high political risk, while co-production agreements in Yugoslavia are viewed as being of relatively lower risk.
160 It is not the politics of the nation nor the governmental position regarding foreign ownership of equity which
161 results in political risk but in fact the government policies regarded control of economic decision-making.

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

171 This conceptualization has been supported by Ray Vernon;

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

175 11 a) Some Marginal Solutions to the Industrialization Impasse

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

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

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

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

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

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

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

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

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

202 12 VI.

203 13 Recommendation

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

207 Many scholars and observers of the international business scene will recollect episodes like the assassination of
208 president Allende of Chile when I. T. T. had its foot hold in the country, the kidnap in Venezuela of William Nei
209 House and so many others. The decision to pay bribe creates a major conflict between what is ethical and proper
210 and what is profitable and sometimes necessary to "business". Multinationals operating in foreign countries are
211 more politically vulnerable especially if their desire to control the economy of the host countries' conflict with the
212 host countries desire to control their economy. This is an area where all multinationals must watch very carefully
213 right from the onset of their investment proposals. Such strategic interests as politics and economy are their
214 inalienable rights which they cannot afford to lose to any foreign based multinational or its home government.

215 14 VII.

216 15 Conclusion



Figure 1:



Figure 2:



Figure 3: A

217 1



Figure 4:

11	12	13
Very Low	Low political	Medium
Political	Risks	Political
Risk		Risk
21 Low Political Risk	22 Medium Political Risk	23 High Political Risk
31 Medium Political Risk	32 High Political Risk	33 Very High Political Risk

Figure 5:

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