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Multinational Risks

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Bolivia's decision last week to nationalize its gas industry provides a dramatic example of the hostile operating environment now facing multinational enterprises. And it's hardly a unique case. Even in the U.S. and Europe politicians have attacked -- and sometimes blocked -- corporate takeovers by foreign firms.

The message in all these cases is that the multinational corporation is again fair game for opportunistic politicians. But unlike in the 1970s, when expropriation was the great issue of the day, today's politicization of foreign direct investment takes the subtler form of "creeping nationalization."

Multinational managers brag that their operations create good jobs, generate tax revenues, transfer cutting-edge technology and bolster exports. They therefore assume that governments will welcome them with open arms -- as occurred in the 1990s, when countries in such regions as Latin America competed among themselves by offering generous incentive packages. To the extent that investment abroad poses political risks for the enterprise, managers believe these can be contained by writing complex contractual agreements with host countries and by purchasing costly political risk insurance when the government seems particularly unstable.

But recent events are proving the managers wrong, as governments are once again threatening firms either with outright nationalization or by placing all manner of conditions and restrictions on their license to operate. The reasons for this are certainly complex but in almost all cases can be traced to poor economic policies in host countries, despite the receipt of record amounts of foreign direct investment, which increased fivefold between 1990 and 1995 alone, reaching $100 billion by 1996.

Multinationals are becoming scapegoats for bad economic performance. Recall the words of German Labor Minister Franz Müntefering, who, before taking his current post, compared foreign investors to "locusts" that were stripping bare the nation's industrial base. It would seem to go without saying that Germany can hardly blame its economic woes on foreign firms; its problems are strictly homegrown. If foreigners are now loath to invest in German manufacturing plants, that's mostly because of the country's suffocating labor laws, not because multinational firms are rapacious. Without globalization, Germany would be in much deeper trouble than it is today -- and most politicians there, whether they'll admit it or not, know this is true.

Industrial-world governments hold no monopoly on economic folly. Consider South Africa's black economic empowerment (BEE) legislation that sets "targets" for multinational firms to achieve precise levels of black employment (including in managerial roles), equity ownership, supplier purchases and so forth by a certain date. Its monitoring rules have spawned an entire industry. Promoting the country's majority -- but long marginalized -- population is a laudable goal that every government has the duty to advance. Yet the intrusive BEE legislation raises concerns about "creeping nationalization."

But back to Bolivia. Its political and economic turmoil dates to the flawed coca eradication program in the 1990s, done partly under U.S. pressure. Coca farmers were inadequately compensated and protested their loss of income, leading to the recent election of populist President Evo Morales. Now a host of firms in the energy sector, including Spain's Repsol and Brazil's Petrobras, face significant losses on their operations in that country.

As usual with politicians, blame for the nation's economic plight has been pointed at greedy multinational firms rather than failed government policies. That's hardly new, and points to the fact that executives need to stay on top of domestic politics if their investments are to pay off.

Unfortunately, too many of them instead act as if an "enclave strategy," in which the firm operates at a safe distance from the domestic economy, will permit them to weather most storms. Like the captain of a vessel that strikes a shoal, however, the firm's owners should harshly judge the executive who misjudges a country's political environment, just as they would any other major strategic blunder.

Multinational firms must work actively to embed themselves in the local society and economy in order to win grassroots political support. This sort of "engagement strategy" requires a sophisticated understanding of domestic dynamics and a willingness to operate in a way that is widely appreciated as being "development-friendly."

One example is provided by the global mining giant Anglo-American, which could operate as an enclave but instead undertakes detailed "social assessments" where it operates, identifying issues where it could make a positive difference in the local community. The firm, for example, took the lead in providing HIV/AIDS medication to its workers in South Africa, and is now actively seeking to promote black management, which is a challenge given the technical qualifications required to become a mining engineer and the current shortage of blacks in that particular field. Anglo American undoubtedly questions certain aspects of Pretoria's BEE policy, but by deeply integrating its operations with the local economy it gains some political capital which could come in handy in the future.

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