Notes: Spelling has been Americanized, and MITSMR style applied. Hyperlinks will be used in the online version as they appeared in the original manuscript, but for production purposes they have been removed and a comment including the URL attached to the relevant text.

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As Globalization Retreats, MNEs Must Build Closer Ties

Multinationals would do well to cultivate local ties and communities in the countries where they operate to counterbalance increasingly powerful governments.

By Quy Nguyen Huy, Caterina Moschieri, and Davide Ravasi

Globalization is in retreat, and multinationals are on the defensive. Across the world, countries rich and poor have erected trade barriers and set up outright export bans to cope with the pandemic and, now, the war in Ukraine. In 2020, it was respirators, surgical gowns, medicines and other life-saving equipment that were hard to come by?. Two years later, it's wheat, palm oil, beef and other food products — and that's not including sanctions nations have imposed on Russia.

Citing national interest, governments have reclaimed much of the power multinationals had acquired over decades of almost unfettered globalization. The tilt in the balance of power can be traced back to the 2008 global financial crisis, when banks and corporations had to be bailed out by governments with taxpayers' money. In the years since, world trade growth has faltered as China turned inwards and the United States embraced an "America First" policy. The pandemic and Russia's war in Ukraine, neither of which were thought probable, have added momentum to deglobalization — and government fiat.

As a result, multinational corporations (MNCs), whose very rise was premised on free movement of goods and labor, are at a disadvantage. Used to friendly governments and easy access to overseas markets, they have not cultivated the sophisticated political judgment to manage government and public expectations.

Alibaba founder Jack Ma, for one, openly criticized financial regulations in China in October 2020, crossing a line that led to Chinese authorities scuppering his fintech conglomerate's IPO and launching a crackdown on the country's Big Tech companies. Last year, India's commerce minister publicly took the country's largest conglomerate to task for similar intransigence, after Tata Group griped about tough new e-commerce rules.

If conditions for MNCs in their home countries are now less cosy, spare a thought for their operations in foreign countries. Relationships between MNCs and host governments may deteriorate over time, along with the bargaining power that MNCs initially enjoyed on entry. Yet little is known of what makes some MNCs better able than others to deal with host hostility.

To find out, we studied eight MNCs involved in disputes with foreign governments in South America between 2001 and 2012: Cemex in Venezuela; Telefonica, Repsol, Vivendi and Endesa in Argentina; Telecom Italia in Bolivia; Shell in Nicaragua; and Iberdrola in Guatemala. As history seems to repeat with regularity, the wave of globalization led to widespread use of local partnerships by many expanding multinationals, who believed it was the fastest and arguably most successful way to internationalize. Then as globalization receded, its retreat revealed the drawbacks of local partnership, and former advantages became debilitating weaknesses. Our research shows this fatal side effect.

Our findings, published in the *Journal of Management Studies*, show that reliance on local partners could inadvertently create what we call *liability of insidership*. Local partners, whom MNCs often collaborate with in the form of joint ventures, isolate foreign investors from local stakeholders. This precludes the multinationals from developing direct contacts, nurturing local ties and building local reputation – all of which, our study shows, can make a significant difference to the MNCs' capacity to react and adapt to the sudden hostility of local governments.

Liability of insiders

To compare across cases, we focused on sectors including construction, energy and mining in which high sunk costs reduce bargaining power and can make exits difficult and costly. We also zoomed in on disputes that occurred in countries with similar institutional systems. All the firms analyzed had filed expropriation claims before the International Centre for Settlement of Investment Disputes (ICSID) of the World Bank, the leading entity for settling investment disputes between foreign firms and host governments.

We conducted 63 semi-structured interviews with 43 MNC executives; managers of peer firms; government officers and representatives of political associations; and diplomacy and political economics experts as well as labor union experts. We also examined analyst reports, newspaper articles, as well as corporate, legal, and government documents.

Anticipation, escalation, expropriation

We charted three phases of increasing hostility from political authorities: anticipation, escalation, and expropriation. Four of the cases we studied underestimated the expropriation threat at the first sign of trouble. They took remedial action only after the government hostility became evident, and ultimately failed to secure local and international support. Most of these firms exited their host countries and received minimal or no compensation for their losses.

A second group of firms picked up early warning signals and mobilized promptly to gather information, disseminate their own narratives and strengthen local and international support. Three of them maintained operations in the country even after the expropriation and/or received compensation from the host government.

Anticipation

The disputes typically began with symbolic, ambiguous actions that hint at the government's intention to intervene in an industry or the economy, usually in the name of protecting the people's interests. The actions might include setting price ceilings, increasing corporate taxes or using trade unions to pressure MNCs through public protests or strikes.

In response to this first phase of government hostility, four of the firms — Telecom Italia, Vivendi, Iberdrola and Endesa — relied on local partners to gather additional information and to monitor the situation. What they got was filtered information that painted a partial and inaccurate picture of the situation that led them to delegate action as well.

"We were myopic," a director of Telecom Italia told us. "We delegated and we should have intervened in first person."

These four firms had adopted a networking strategy that we refer to as mediated embedding. This arms-length approach often stems from firms' narrow focus on profits. According to our interviewees, Telecom Italia saw the local investment as merely "a cash cow" while Iberdrola, a Spanish electricity utilities firm, did not think it necessary to invest in the local communities. Telecom Italia even incurred local anger by violating an agreement with a local trade union and firing workers.

Endesa, another of the MNCs that relied on a local partner to manage its relationship with the host government, built goodwill with the local people by giving aid to the underprivileged, providing training, etc. This may explain why the Spanish electricity firm managed to mobilize local support and to renegotiate tariffs with the host government in Argentina. It eventually stayed in the country for five more years.

In contrast, four other firms in our sample — Shell, Telefonica, Cemex and Repsol — sought information from local lobbyists, trade unions or other MNCs. This helped them to connect the dots of incipient government hostility and spurred them to early action.

These MNCs directly owned and managed their local investments, had built relationships with a broad range of local stakeholders, and liaised with the central government through lobbyists, "high-level contacts" or informal interactions with political authorities. We call their networking strategy *proximal embedding*.

Local stakeholders helped these firms detect subtle signals of targeted hostility. Managers at the Mexican building materials company Cemex and Spanish energy firm Repsol, for example, noticed that some contractors were delaying payments and some large clients had changed providers. The firms sprang into action. A Cemex executive recalled: "We collected evidence and documents. They [political authorities] were saying or doing something one day? We would take note of it and write it down. We had it documented. We never feared that we lacked arguments."

Escalation

In this phase, the MNCs began to face targeted government accusations of failing to fulfil their investment commitments or causing pollution. They also had to contend with demonstrations, fines, increased taxes, class action lawsuits and media criticism.

Managers of MNCs operating through local partners misjudged the situation even more. In the case of the French water services multinational Vivendi, managers maintained that the hostility they faced in Argentina was due to "unfortunate events" rather than a deliberate plan to seize their assets.

They also preferred to avoid direct confrontation, seeking instead to appease the authorities. As a Telecom Italia director lamented: “In Bolivia, my impression is now that the local partner knew [of the threat] but did not say…When there is no partnership, you have a better understanding of what happens.”

In contrast, managers of proximally embedded firms had already sensed danger, and actively sounded out local stakeholders to gauge if the latter shared the government’s hostility.

Cemex’s managers, for example, contacted suppliers to renegotiate the terms of their contracts. They met with clients who had stopped or delayed payments, and set up meetings with local employees to discuss rumors that senior executives were negligent. Cemex also reached out to friendly government contacts and mobilized lobbyists to gather information about the government’s motives.

Proactive managers of proximally embedded MNCs thus concluded that confrontation with the government was inevitable and began to plan accordingly. All four sought to highlight how their investments had contributed to local economic development, and that the actions proposed by the government would harm, not help, local communities. For example, Telefonica stressed how its “modern management technologies increased business efficiency and quality of services and goods offered to the community.” It asserted that the government did not have the capacity to finance the necessary investments in telecommunications. Repsol, meanwhile, warned that if MNCs were cast out it would have a chilling effect on foreign investment.

Expropriation

Threats and accusations finally gave way to formal cancellation or modification of concessions (Iberdrola and Endesa), expropriation of assets (Cemex, Repsol, Telefonica and Telecom Italia), or seizure of rent sources (Shell and Vivendi) without compensation.

Managers of firms operating through local partners (Vivendi, Iberdrola, Telecom Italia) now faced broad-based hostility from local stakeholders. These MNCs’ only recourse was to file complaints with ICSID, the World Bank arbitration entity, even while they prepared to exit their host countries.

In contrast, proximally embedded MNCs intensified efforts to mobilize local stakeholders and put pressure on host governments to settle disputes amicably, or at least not to cause further harm to their remaining assets.

Endesa, the only MNC to pursue a hybrid strategy, lost control of its board and was forced to sell its majority stake in its Argentinean subsidiary. But, with the help of local supporters, it was able to persuade the government to renegotiate tariffs and continue with its operations in the country.

Ties that bind

Our study reveals the importance of MNCs nurturing direct, local ties as well as investing in social initiatives that benefit local communities. Firms that operated in foreign countries through a joint venture with local firms tended to rely too much on their partners to relate to stakeholders. Often this created a “liability of insiderness” and caused them to be complacent and miss early warning signs. By comparison, MNCs that operated through directly controlled subsidiaries were more hands-on and more likely to gain the goodwill of locals, enabling them to react quickly to government hostilities.

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