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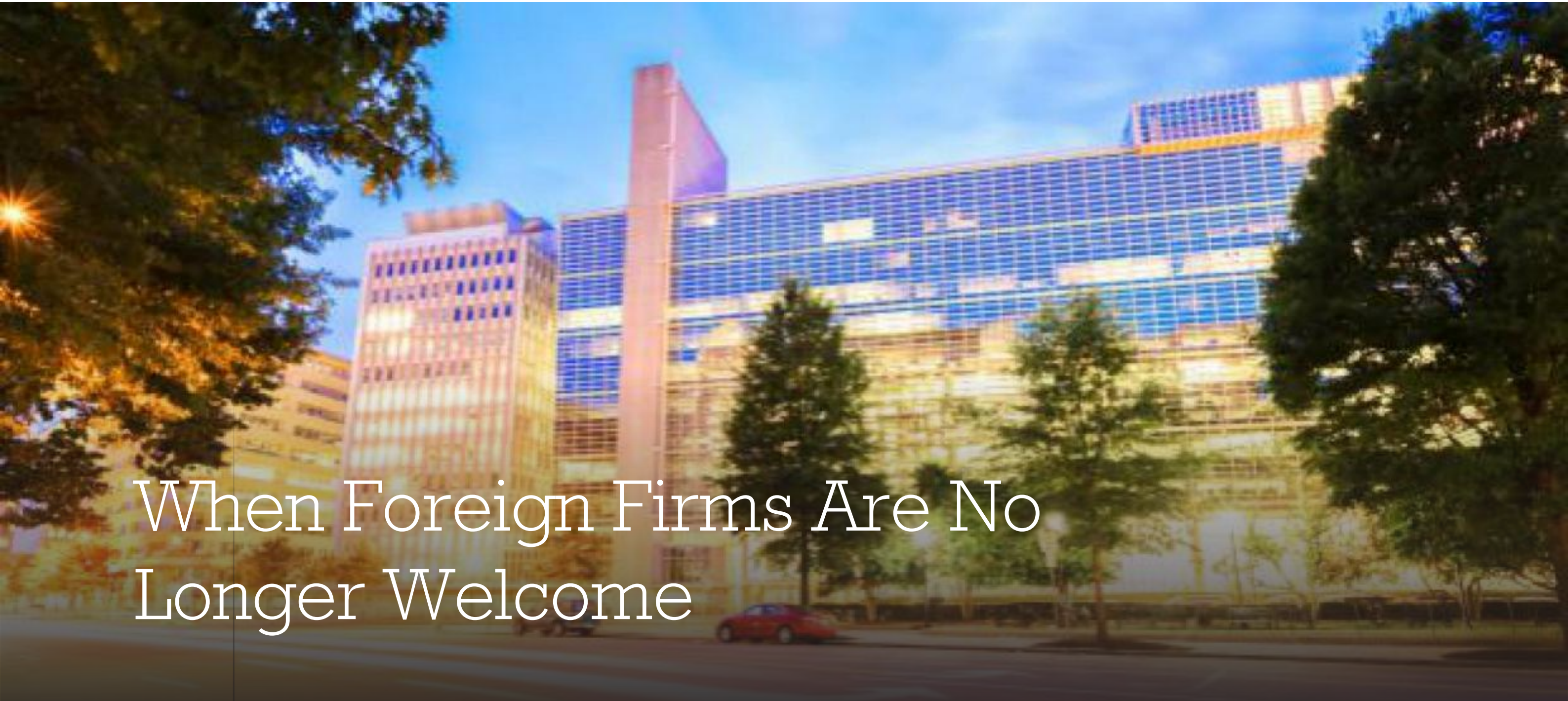

When Foreign Firms Are No Longer Welcome

Foreign firms are more likely to divest from a country when they experience a dispute with a host government.

Pulling out of a country is an expensive proposition for a multinational firm but it is sometimes required for the corporate bottom line. If the host country changes laws or even expropriates a subsidiary, it is often time to leave or divest.

Divestiture – pulling out assets or closing down part of a firm – is generally the result of either internal or external pressures. Internal pressures may be an issue with the parent company or unit-specific concerns. External pressures can come from the business or political environments. Multinational firms can also face pressures that are both external and company-specific, such as policy disputes with foreign host governments that push them to divest.

The World Bank's court

When multinational firms experience a dispute with a foreign government, they often seek a resolution via international arbitration. For example, Corn Products International (CPI) – an American company– ran into a dispute with the Mexican government in 2002. CPI produced High Fructose Corn Syrup (HFCS), a sweetener, in Mexico for the Mexican soft drinks industry. Most other sweeteners in these drinks were from locally produced cane sugar. An excise tax of 20 percent on drinks sweetened by products other than cane sugar was passed by the Mexican Congress. CPI and a handful of other U.S. producers of HFCS complained that the tax was unfairly directed at them, the primary producers of HFCS in the area. CPI challenged the tax before an international arbitration panel and was awarded **US$58M** in compensation.

CPI's case was heard at the World Bank's International Centre for the Settlement of Investment Disputes (ICSID). ICSID is the most prominent forum for the arbitration of international investment disputes. Firms can go to ICSID under two general conditions: the firm believes the host country has broken a contract, or it feels the host government has broken prior commitments to fair and non-discriminatory treatment made in international agreements or national law. Firms also require "access" to arbitration, which is often granted by a prior investment agreement between the host government and the company's home government, or arbitration clauses in the firm's investment contract with the host country.

International arbitration is not a panacea for firms. Taking a case to ICSID costs companies millions of dollars and they are not guaranteed to win. Furthermore, cases before ICSID can last for years, which is clearly sub-optimal for managers looking to deliver results on a quarterly or annual basis. Nevertheless, the number of firms who have challenged their treatment at the hands of foreign

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governments before ICSID has risen steadily for the last 20 years because arbitration offers firms a way to effectively challenge governments when corporate diplomacy and negotiation fail.

Disputes and Divestitures

In our recently published article in the *Strategic Management Journal*, **"Policy Risk, Strategic Decisions and Contagion Effects: Firm-specific Considerations"**, we collected data on ICSID cases to identify disputes between firms and governments with a view to studying their impact on companies' propensities to divest.

Our analysis revealed that companies that experience a dispute with a host country's government are approximately twice as likely to divest from that country than a firm that does not experience a dispute. We also found evidence that firms are more likely to divest from countries in the same region as the country where they experience a dispute. These findings, we believe, are evidence that managers view disputes as evidence of a lack of sufficient *political capabilities* to manage their political environment in the country where they experienced the dispute and in politically, economically and culturally similar locations.

Scavengers swooping in?

How do firms react when *others* experience disputes? One might expect firms to look at others' political problems and conclude they could be next. Our research suggests this is not the case. We find no evidence that the number of disputes a country has with other foreign firms makes non-disputing firms more likely to divest. Moreover, anecdotal evidence suggests that some firms may view the troubles of others as opportunities for themselves. For example, as Repsol was forced to retreat from Argentina following the nationalization of its YPF assets by the Kirchner government in 2012, Chevron elected to expand its presence.

Although managers appear to believe that "it will never happen to them", more divestitures may be on the horizon if a **retreat from globalisation** results in governments taking a more aggressive regulatory stance towards foreign firms. Such problems could be compounded by limited access to international arbitration. The ability to take a foreign government directly to court challenges conventional notions of sovereignty and remains highly controversial. This was evident in the vociferous objections to the Trans-Pacific Partnership's (TPP) provisions allowing firms to take foreign governments directly to arbitration from prominent politicians and academics including Senator Elizabeth Warren and Nobel laureate Joseph Stiglitz.

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