



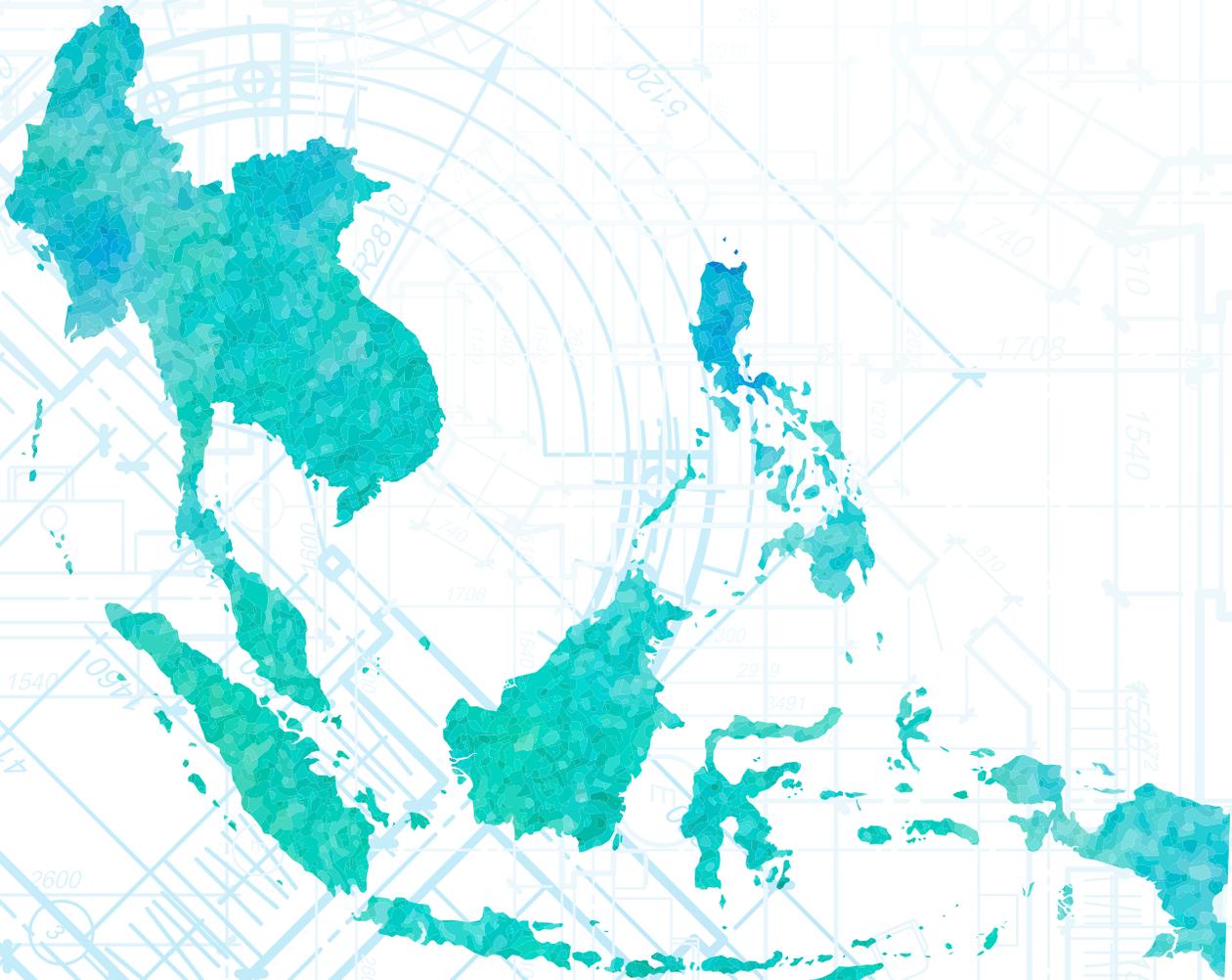
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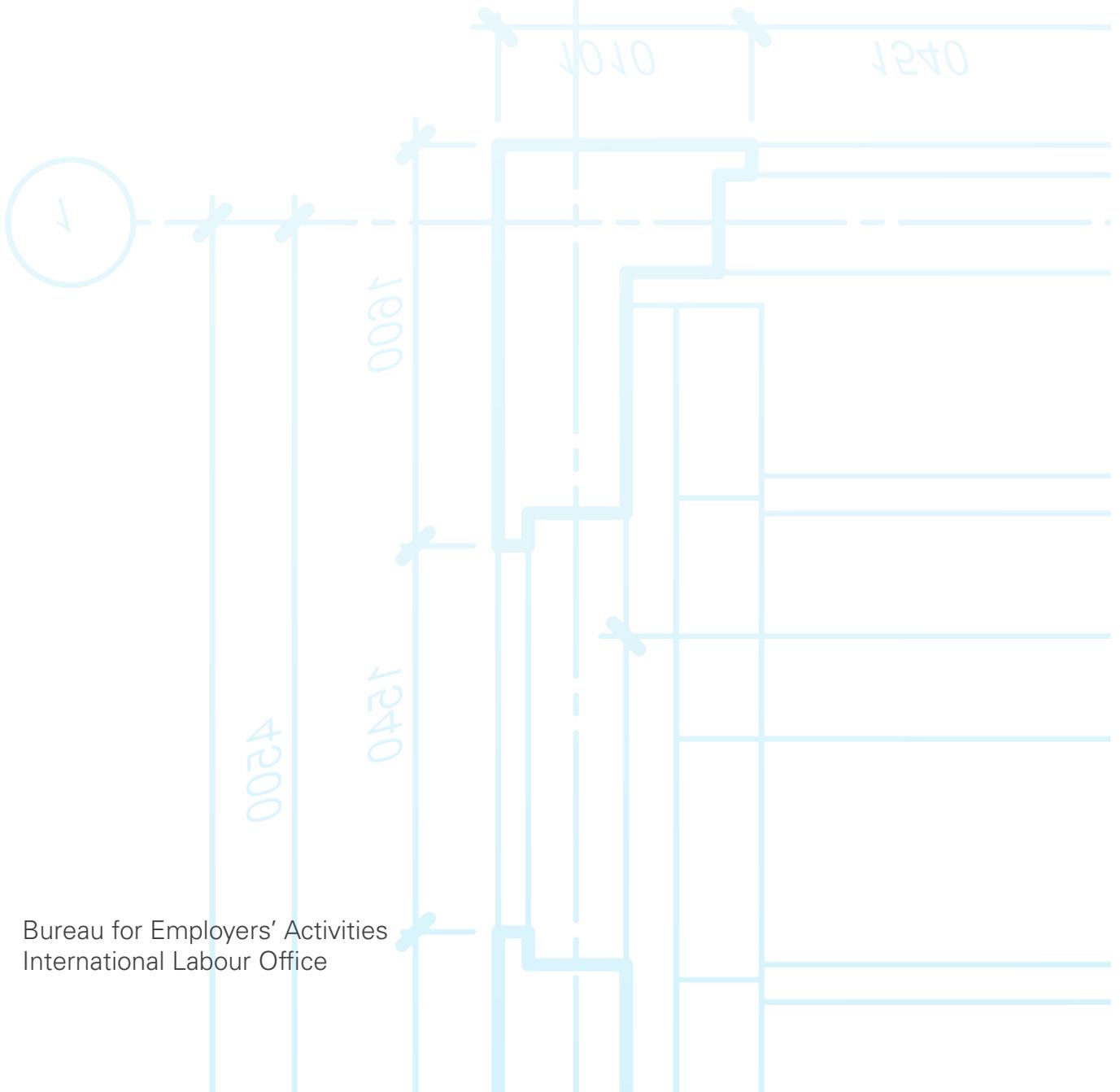
ACT/EMP
RESEARCH NOTE
JULY 2017

Multinational enterprise investment in conflict-affected zones in South-East Asia



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Acronyms

EBMOs	Employers' and Business Membership Organizations
CAZs	Conflict-affected zones
ILO	International Labour Organization
MNE	Multinational enterprise
UN	United Nations

Acknowledgments

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Background and methodology

This research note examines the decision-making practices related to risk management of multinational enterprises (MNEs) from across various sectors in conflict-affected zones (CAZs) in South-East Asia. The research project encompassed two main goals: The first was to explore and provide analysis of the decision-making processes of MNEs in CAZs in terms of their initial decision to invest in a given region and expand operations, or their decision to end their investment and depart. The second objective was to explore current or potential roles that employers' and business membership organizations (EBMOs)¹ could play in providing services to MNEs.

In the initial phase, the research team conducted extensive secondary research to understand, in broad terms, the MNE risk and investment decision-making process as well as EBMO capabilities in CAZs. The team applied the four types of international business risk – cross-cultural risk, country risk, commercial risk and currency risk – to structure their approach. The secondary research provided a foundation to assist in selecting countries where existing conflicts could impact MNE decision-making and that exemplified a range of situations that could apply to the rest of the region. Subsequently, three countries at different stages of economic development – Myanmar, the Philippines and Thailand – were selected for in-depth fieldwork.

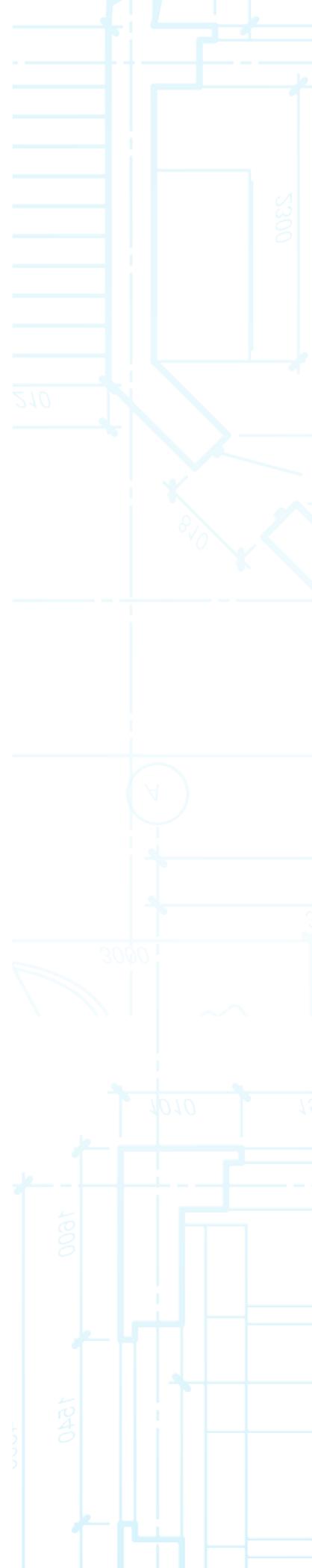
The primary research involved interviews conducted both in the United States, mainly with academics, public sector representatives and consultants, and in Myanmar, the Philippines and Thailand with MNEs, local and international EBMOs and representatives from the ILO and other UN agencies. Interviews were also conducted at the 16th Annual ILO Asia and the Pacific Regional Meeting held in Indonesia (December 2016) to gain the perspective of business leaders from across the region. In total, 67 individual interviews were conducted consisting of 19 US-based and 48 in-country interviews.²

Although companies in extractive industries often have the most to gain from operating in CAZs, they were not included within the scope of the primary research due to the fact that these enterprises generate few local employment opportunities.

The findings, primarily derived from the in-country research and covering both MNEs and EBMOs, were substantially different from initial expectations. The initial hypothesis about MNE decision-making – that MNEs consider reputational risk as a very significant barrier to doing business in CAZs – proved not to be correct.

¹ EBMOs are defined as any representative organization (member-based) of the private sector, namely employers' organizations (national, regional or provincial); chambers of commerce (national, regional or provincial); sectoral associations (representing enterprises in a specific sector of the economy); or any other formal established network of businesses that have come together to work for the collective interest.

² Interviews were conducted between October 2016 and February 2017.



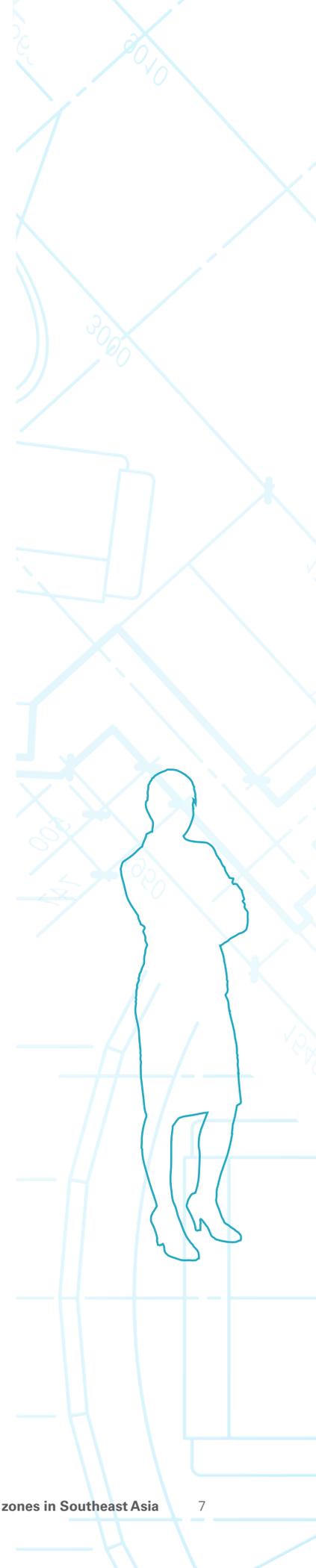
The approach to risk assessment

The procedures used by MNEs to assess risks vary, depending on the amount of internal versus external resources a company dedicates to the function. At the most sophisticated end of the spectrum, MNEs maintain their own information networks and can even operate their own command centres. At the most limited end, MNEs outsource most functions and rely primarily on third-party information sources that classify certain threat levels. The research uncovered two different potential setups and protocols for MNE risk assessment and management, although it is important to note that common among them is the reliance on third-party organizations. EBMOs in the countries under review currently play a very limited role in providing information to MNEs with regards to risk assessment decisions.

Generally, the risk assessment process for expansion into a potentially difficult or dangerous environment is embedded in an overall analysis of the benefits and risks of operating in a new area. The MNE's security team will determine the necessary security protocols and assess the associated costs on the basis of the specific business goals established for a region, the resources the business will have in terms of facilities and staff and those needed for infrastructure and supply chains. An assessment involves the collection of data from a wide variety of sources both on the ground and in the form of secondary third-party sources. As part of this process, the MNE will conduct regular intelligence collection, coordinating with local embassies, police forces and the media while monitoring threats as they arise.

In general, MNE risk assessment teams endeavour to be risk neutral, objectively presenting risks while outlining the security costs associated with undertaking a project. Some advanced organizations maintain 24-hour security centres intended to monitor and interpret threats in real time. However, these companies also rely on the analysis of third-party risk assessment entities³ that classify regions with different perceived threat levels and provide information monitoring systems by maintaining networks and analysts dedicated to interpreting threats. In this way, smaller MNEs or those that have less of an asset presence on the ground can outsource their security needs. This represents the other end of the spectrum wherein an MNE provides very few of its own services and instead relies almost exclusively on external assessments.

³ Examples of these companies include iJET and Control Risk who offer a range of services to help firms determine and combat security and political risk in emerging markets. They are commonly used by firms seeking baseline assessments of risks in a certain area as well as updated reports on developing security threats and conditions. The security centres are not necessarily on the ground and may in fact be based in other countries close to their markets, in Europe and the US (<https://www.controlrisks.com>; <https://www.ijet.com>)



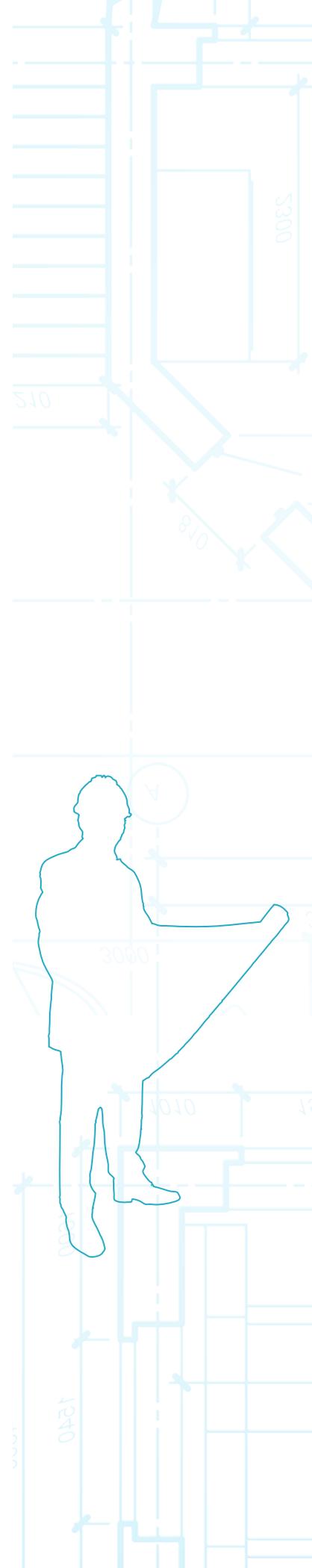
Decision-making framework

The initial hypothesis for this research project centred on the idea that MNEs were chiefly concerned with reputational risk in CAZs, along with the more explicit risk of violence against employees and property. Through interviews and by investigating current MNE risk mitigation strategies, it was found that the decision-making process is much more complicated, with varying tiers of risk. In addition, non-market strategies – a framework to analyse forces outside of a competitive market system – play an important role in the MNE decision-making process.⁴

The decision-making framework presented below was developed to provide a more comprehensive and sophisticated process for evaluating the risk of operating in CAZs.

- 1. Economic risk:** The prime risk to operating in CAZs that MNEs identified was economic risk. This category includes, at its most basic level, a tenable business case for expanding operations to the region in question. Beyond basic profit and loss considerations, MNEs also look at issues such as access to local finance, tax rates, stability of local and global equity markets, tariffs, exchange rates and the constraints related to moving money across borders.
- 2. Infrastructure risk:** The second greatest risk identified by MNEs is infrastructure risk. This is defined as the risk of unstable roads, railways, ports and electricity networks, or the risk of poor maintenance of existing networks. This risk is most highest for extractive or export manufacturing industries in CAZs.
- 3. Institutional risk:** The third greatest risk to doing business in CAZs was identified as institutional risk. This risk includes a multitude of issues such as independence of the local judiciary, corruption, investment policies, risk of expropriation and political stability. Land ownership laws and documentation are especially important.
- 4. Reputational risk:** The fourth major risk area was reputational risk, whereby forced labour, child labour and other issues that violate fundamental human rights have a negative impact on the MNE. Several business leaders and academics who were interviewed felt that reputational risk ranked relatively low on the list of concerns because many MNEs feel adequately protected as long as their first tier of sub-suppliers are compliant with prevailing social, environmental and safety standards.
- 5. Explicit conflict risk:** The final risk area is explicit conflict risk, which is the risk of facilities or employees being harmed through direct violent action, including kidnappings and bombings. This is not limited to traditional warfare and includes guerrilla tactics, insurgencies and terrorism.

⁴ David Bach and David Bruce Allen. 2010. "What Every CEO Needs to Know About Nonmarket Strategy" in *MIT Sloan Management Review*. Spring edition.



All five of the risk types identified above were developed into a risk rating framework (Figure 1). Contrary to the initial hypothesis that the risks posed by conflict would be best organized on a geographical basis, it was found that generalizations are more easily applicable across sectors (i.e., manufacturing, business services, agriculture). The risk rating framework allows better identification of risks and therefore suggests the best risk mitigation strategies for MNEs in various industries considering operating in CAZs across South-East Asia.

It is important to note that this framework is based on the assumption that an MNE has a business case for entering a CAZ. This includes availability of natural resources, a favourable cost structure or access to regional markets.



Figure 1. Risk rating framework



Economic risk rating: Economic risk implicitly involves some of the reasoning behind a business case for entering a CAZ. Therefore, the risk rating is based on how much an industry would be impacted by economic volatility or even an economic collapse in the host country. Economic risk is lowest for agriculture, oil and gas and forestry and mining due to the availability of natural resources.



Infrastructure risk rating: The infrastructure risk generally varies based on the need to export goods. Manufacturing, which includes textiles, food and beverage processing and other consumer goods, receives a high infrastructure risk rating due to the commonality of MNE exports. Oil and gas has a low rating since companies in this sector are willing to cover the costs of building infrastructure in the region. Business services, which includes business process outsourcing (BPO) and call centres, is in a unique position. Although there is less of a requirement for access to ports, there may be a need for access to cities for a large labour force and there is certainly a need for reliable internet services and utilities.



Institutional risk rating: Although agriculture, oil and gas and forestry and mining benefit from a low economic risk rating due to the availability of natural resources, these industries most likely face high institutional risk. CAZs with natural resources are likely to face challenges surrounding government oversight and land ownership disputes. Manufacturing is more nuanced. MNEs seeking to build large manufacturing plants could face the same land ownership issues, but some of these enterprises have the option of locating to industrial parks. Because business services typically employ locals, this sector has a low institutional risk rating.



Reputational risk rating: For oil and gas and forestry and mining, reputational risk is high due to past human rights violations. Local governments and citizens are likely to be very sensitive to the entrance of these firms. However, it is important to note that this risk is likely to be of limited concern to MNEs if there are large economic incentives, i.e. rich natural resources. Agriculture has a low rating for this risk, but for companies seeking fair trade agricultural products or a broader image of corporate social responsibility, reputation can be an incentive.



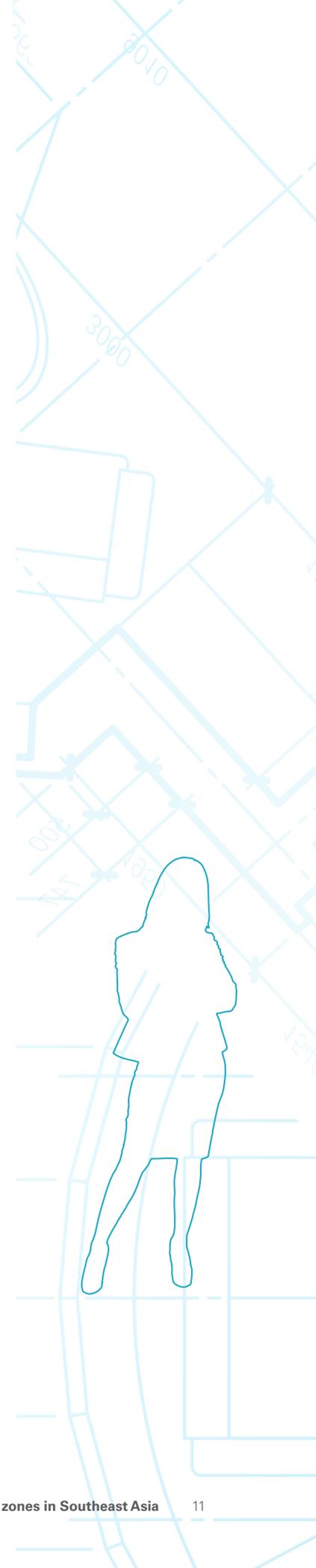
Explicit conflict risk rating: While explicit conflict risk is likely to shift in CAZs as active conflict arises, the agriculture, oil and gas and forestry and mining sectors are rated higher for this risk than other industries. Operations in these sectors are often located far from city centres and are therefore removed from central government and military influence, making them more vulnerable to explicit conflict.

From an ILO perspective, mandate and programmatic interest, it is important to balance this risk rating framework with the potential employment effect. For example, oil and gas operations, despite historically generating high returns for governments, are typically insulated from local communities and therefore do not create opportunities for local employment. Conversely, manufacturing generates high local employment despite being more susceptible to some of the risks in the proposed framework. The employment effect matrix (Figure 2) uses the risk rating framework and outlines the employment impact per sector for each component of risk.

Figure 2. Employment effect matrix

Industry	Manufacturing	Business services	Agriculture	Forestry and mining	Oil and gas
 Employment Effect	●	●	●	●	●
 Economic	●	●	●	●	●
 Infrastructure	●	●	●	●	●
 Institutional	●	●	●	●	●
 Reputational	●	●	●	●	●
 Explicit Conflict	●	●	●	●	●

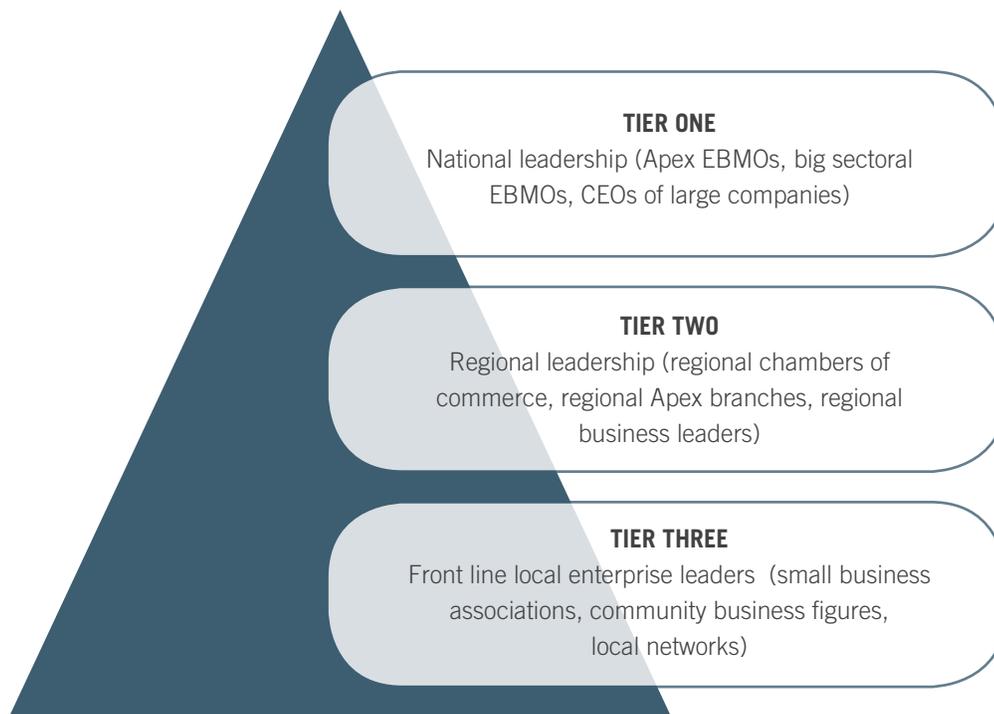
● High risk
 ● Medium risk
 ● Low risk



Business representation infrastructure

Enterprises are represented through a myriad of different associations and networks. These can range from quite formal structures to looser networks and can represent business from certain geographical regions or by industry or sector of commercial activity. Membership can overlap and enterprises (particularly larger ones) can be members of multiple associations and networks. Figure 3 outlines the main elements of the domestic private sector through its formal and informal networks and associations.

Figure 3. Formal and informal networks in the domestic private sector



Source: Adapted from Lederach, 1997

EBMOs are mostly (but not always) multi-ethnic/religious/cultural, and have credibility and a connecting ability across society that other groups can lack. This gives them a neutral status. In general terms there are four main advantages or potential advantages that EBMOs possess:

- 1. Inclusivity:** They are embedded in their communities with a variety of linkages to different social and political actors and they (can) cut across cultural, ethnic or religious lines.
- 2. Influence:** Business owners have an inherent interest in stability as a point of fundamental importance to business growth. Acting collectively they present a key pressure point.



3. **Scalability:** Their representative nature and functioning as a trusted network provides large potential for a wider footprint.
4. **Partnerships:** Historical and deep partnerships with other stakeholders can be pivotal for exerting joint pressure for a particular course of action or political direction.

The capacity of EBMOs can vary widely in real terms. Some EBMOs with specific functions or mandates can provide specific and valued services. Others have a limited capacity to undertake even basic services. A wide spectrum exists.



Recommendations

The research study found that decision-making by MNEs regarding investment in a CAZ follows a clear framework, with different weightings given to different risk criteria. The decision is made primarily, however, on economic grounds.

The research found potential opportunities for EBMOs to provide targeted services to these MNEs to both facilitate the initial decision to invest in a location and additionally to assist the ongoing minimization and management of risk in the specific area. There would clearly be a need to work with a range of partners, notably investment agencies, so that efforts can be coordinated and maximized.

The following recommendations are proposed to enable EBMOs to develop sustainable and demand-driven services that could be used by MNEs.

1. Develop a package of economic information services for EBMOs tailored to MNE investors

There is a high level of demand for services such as increased knowledge of the local operating environment, supply chain information and data and access to skilled labour, all of which would reduce market entry risks. A generic package of services and tools could be developed that could be modified for individual geographical and sectorial interests. This package could be developed utilizing the MNE decision-making framework as a useful reference. The framework itself could be developed further in operational terms and widely disseminated to EBMOs.

2. Increase awareness of the policy leverage of EBMOs

Sub-national EBMOs based in CAZs can use local influence to insist on better land use policies and lobby for infrastructure investment and sound legal and judicial procedures, etc. A support package could be created to help EBMOs promote and maximize their political and policy objectives that addresses infrastructure risk and institutional risk. Existing ILO tools could be tailored to address these needs.

3. Promote the value of EBMOs as facilitation entry partners for MNE investors

Sub-national EBMOs in CAZs are uniquely well positioned to advise MNEs on political conditions and cultural sensitivities. Sharing information about the local cultural climate is a low-cost, high-impact way in which EBMOs can assist prospective MNE investors. Since foreign MNEs may not have the network or knowledge to succeed in this area, EBMOs could fill this gap.





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