

Internationalization of TNCs from the extractive industries: a literature review

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The literature on the nature, shape and logic of internationalization of extractive industry TNCs is rather fragmented and poorly developed. This is a mounting problem since extractive industries are not only becoming increasingly important, but their operations have also become increasingly controversial. This article takes stock of three types of approaches towards internationalization. First traditional *intrinsic motives*, which represent an ‘international management’ angle and focuses on the resource-seeking, efficiency-seeking and strategic asset-seeking nature of extractive TNCs. Secondly, traditional *extrinsic motives*, which represents a more political economic angle towards extractive industries, and which builds on a bargaining perspective of internationalization. Thirdly, a modern extension of extrinsic motives to internationalization will be added, which considers the increasing role of Non-Governmental Organizations as factor in shaping the internationalization trajectories of extractive industries. This approach represents a ‘stakeholder’ approach to firm strategies. It considers the societal position of firms and considers the ‘license to operate’ or the normative position of transnational corporations. A correct understanding of the dynamics of internationalization of extractive industry TNCs requires an integrative approach of extrinsic as well as intrinsic motives. This article delineates the most important ingredients of such an approach.

1. Introduction: from intrinsic to extrinsic motives

The literature on the factors influencing the nature and degree of internationalization of transnational corporations (TNCs) from the extractive industries has been relatively modest and rather fragmented. Mainstream international business literature on the drivers of internationalization has primarily focused on the manufacturing and services industry and is not abundantly available for this sector. The extractive industries represent, firstly, a traditional case of (resource-based) internationalization. This has not stimulated much recent research due to the fact that most of the Western extractive industry firms started to internationalize long ago. Studying the entry motives of leading TNCs in these industries thus involves more historical than topical research.

Secondly, the extractive industries have always been a focal point for strong political controversy, which made studying them more the area of political economists than international business scholars – certainly after the international business community started to engage more in the study of the internal operations of TNCs (learning, affiliate autonomy and the like), further limiting attention for this branch. With the entry of a large number of extractive industries from developing countries (UNCTAD, 2006), there is growing controversy over access to natural resources as part of the growth models of both developed and developing countries; however, the internationalization patterns (and motives) of TNCs from the extractive industries are reemerging as a prime research area (UNCTAD, 2007). An overview of the literature serves to give an appropriate framework of reference for the debate on methods, theories and levels of analysis. This is the aim of the present contribution. In short, this requires a shift in research from the recent emphasis on intrinsic motives to (also) include extrinsic motives.

Firms in the extractive industries have in common their high-risk nature and capital intensity as well as the strong dependency of their business on world markets (Jones, 2005). Four types of TNC motives to internationalize are usually distinguished: market-seeking, efficiency-seeking, resource-seeking, and (strategic) asset-seeking. These can also be referred to as the “intrinsic motives” for internationalization (cf. van Tulder with van der Zwart, 2006: 48ff).

Depending on the phase in the value chain, each of these motives prevails in the extractive industries. For raw materials supply (upstream) the resource-seeking motive dominates, considerably limiting companies’ strategic manoeuvring room (Dunning and Narula, 2000; Nachum and Zaheer, 2005). Further down the value chain, internationalization of manufacturing and refining contains a resource-seeking component (e.g. the search for cheap labour), but efficiency-seeking investments do prevail in the attempt to exploit differences in factor endowments. Resource- and efficiency-seeking FDI can be subsumed under the term “vertical FDI” (Braconier et al., 2005). The supply and distribution of final products (downstream) are mainly led by market- and strategic asset-seeking motives (“horizontal FDI” in the sense of Braconier et al., 2005). Further, internationalization of parts of the value chain also depends on the type of resource, which has implications for e.g. transportability and pricing.¹ Finally, (strategic) asset-seeking FDI is

¹ Natural gas for example is considered more of a regional commodity (Foss, 2005), whereas for oil, due to its better transportability and consistent and global pricing in dollars (Gulen, 1999), a global market exists.

motivated by a desire to gain access to new reserves or markets, and – more often in the case of junior firms from developing countries – also to obtain access to firm-specific knowledge.

This article, firstly, reviews the three traditional intrinsic motives for internationalization that are most relevant for the extractive industries (section 2). But the paper will also consider what is known of so-called “extrinsic motives”, the relationship with external stakeholders, in particular with governments. The famous saying of Yergin (1991), namely that oil is 90% politics and 10% oil, also holds for other extractive industries. The bargaining relationship with governments can therefore be understood as part of the traditional international business literature – albeit much less researched in the last two decades – and will be discussed in section 3. Finally, a new generation of “extrinsic” motives can be found in the upcoming influence of non-governmental organizations (NGOs). Section 4 briefly addresses to what extent NGO strategies – according to the literature – might have an impact on the international expansion and structure of the industry.

2. Traditional intrinsic motives: the international management perspective

Traditional intrinsic motives refer to the efficiency gains to be won from “being a TNC” through: internalizing markets across borders in a global economy characterized by considerable market failures; exploring the resources where they are located and transferring them elsewhere; coordinating asset-specific advantages of particular locations that are normally unrelated; and gaining in efficiency through the integration of closed markets around the world, such as labour markets. In the OLI (Ownership, Location and Internalization) approach of Dunning (1993), the motives primarily belong to so-called “locational advantages”, whilst empirical research at the level of the company adopted an international management perspective.

a. Resource-seeking

The resource-seeking motive in the extractive industries is mainly represented by the worldwide search for cheap natural resources. Resource-seeking is the traditional motive for internationalization that is also most easily fitted into a neoclassical (comparative advantage) welfare-maximizing framework. For resource-seeking firms, two options exist to access raw materials: (1) spot purchases and/or long-term contracts; or (2) internalization of production (Jones, 2005; Ollinger, 1994). In the OLI paradigm, TNCs are considered to gain an

advantage through internalization and therefore try to avoid external market transactions and the uncertainties of operating in the free market (e.g. Dunning, 2000).

From a transaction cost point of view, firms in the extractive industries have on average more reason to try to circumvent the inadequacies of the international market via vertical integration (Williamson, 1990). Asset specificity, information asymmetry (e.g. about the quality of the raw materials), uncertain conditions (quality, amount of the resources available, and geopolitical changes), and the frequency of transactions determine the choice between these options (Caves, 1971; Hennart, 2000; Jones, 2005; Williamson, 1990). Asset specificity is of obvious and prime importance in most of the extractive industries.² Vertical integration reduces those transaction costs and ensures self-sufficiency and independence from raw material suppliers (Morse, 1999; Vernon, 1971). Once they are vertically integrated, firms are “bound” to their raw material sources and continuously need to secure access to cheap sources in order to be able to compete on price, leading to further internationalization (Vernon, 1971).

It was found for the oil industry that vertical (upward) integration into the refining industry can be associated with considerable benefits, but also with high organizational costs (Al-Obaidan et al., 1993). Accordingly, factors other than the transaction benefits must exist that justify the high number of vertically integrated TNCs in the extractive industries. For example, strategic objectives might contribute to our understanding of why firms vertically integrate (Jacobides and Billinger, 2006).

Ownership advantage in State-owned enterprises (SOEs) in the oil industry is mainly based on their control over national resources, whereas private companies’ ownership advantages are derived from their ability to gain access to and control over resource reserves and finance all over the world plus their superior abilities in coordinating the international value chain. Furthermore, they often possess the technologies to extract resources economically even from reserves that were deemed too costly only a few decades ago. A brief look at the share of upstream versus downstream activities of the State versus private oil majors supports this view: SOEs dominate in the upstream

² In the oil or aluminium industry for example, switching costs are extremely high because refineries and production plants are built according to the specifications of the raw material available and therefore constant supply needs to be ensured (Al-Obaidan and Scully, 1993; Stuckey, 1983).

business (in 2001 with 42% of all known oil reserves and 25% of world oil production in the hands of Saudi Aramco, Petroleos de Venezuela, Iran's NIOC and Mexico's Pemex), whereas private TNCs prevail in the downstream sector (Energy Intelligence Group, 2003). A recent report even argues that less than 10% of the world's known oil and gas reserves is controlled by Western international oil companies, with the share of resources controlled by national oil companies (NOCs) at 77% and still rising (James A. Baker III Institute for Public Policy, 2007). However, SOEs are increasingly changing from being "resource-holders" into active resource-seekers, as evident, for example, in CNPC's (China) push forward to secure international oil reserves (Hoyos, 2007), thus posing a new threat to established international oil companies and their resource-seeking strategies.³

b. Efficiency-seeking

Efficiency-seeking FDI in the extractive industries is mainly undertaken in the refining and manufacturing stages of the value chain, where economies of scale are essential and TNCs try to exploit differences in factor endowments of countries by spreading their value chain internationally.

Locational determinants vary throughout the steps in the value chain. For production, it is the geological potential, quality, accessibility and risks associated with production of the resource (which may include reputation risks and costs caused when projects have to be abandoned due to political instability or conflicts). Refining requires other locational factors. Here, the costs of transportation and distribution, i.e. access to markets and maximizing the scale of production, have to be balanced against each other (Tavares et al., 2006). In addition, access to the resources needed in the refining process plays a major role. For example, in the aluminium industry, cheap energy is highly valuable, and locations that offer opportunities for energy generation (e.g. rivers) are preferred for refining plants. The need for cheap energy is also a source of horizontal integration into the energy business in this industry (Stuckey, 1983; Whiteway, 1996).⁴

³ The announcements that China's biggest coal producer, Shenhua, intends to diversify into mining of other mineral resources and acquire more assets abroad shows that this tendency is also present in the mining sector, where it is even easier for SOEs to invest in foreign assets and buy up foreign companies because negotiations are less politicized (Oster, 2007).

⁴ The role of a steady power supply for investment decisions has also been noted for other industries (Morphy, 2005) and underscores the importance of infrastructure provision in developing countries wishing to attract foreign investors.

Recently, the “classic” variables that determine the location of resource-seeking TNCs’ foreign activities (availability, price and quality of the natural resource; infrastructure; and governmental factors) have been complemented by the availability of local opportunities to upgrade the resource and the chance to collaborate with local firms in knowledge- and/or capital-intensive exploitation (Beamish et al., 2003). Thus, more importance is attached to factors that are less based in the comparative advantage of the respective country but more grounded in the creation of competitive advantage, especially in industry clusters (Porter, 1998). This growing importance of so-called created assets in the last decades (e.g. Dunning and Narula, 1996) renders investments abroad more selective, especially those that do not directly depend on the presence of a natural resource.

However, most developing countries targeted by resource-seeking firms are usually in the early stages of their investment development path. They have not much to offer to the investing firm other than their natural resources and are therefore less likely to benefit from the presence of foreign firms that are likely to undertake efficiency-seeking investments elsewhere (Dunning et al., 2000). Here, Government policy is especially important. Industrial or regional policies, together with the foundation of relevant institutions, can trigger the development of related and supporting industries. In this case, the TNC presence helps upgrade locational advantages that can also help in the future to attract more beneficial forms of FDI (Dunning and Narula, 1997; Dunning et al., 2000).

c. Strategic asset-seeking

International business literature on the strategic asset-seeking behaviour of extractive industries is scarce as well – certainly when investment in developing countries is considered. High initial investments to set up operations in the extractive industries create a need for large economies of scale (Vernon, 1971) which in turn has resulted in an oligopolistic industry structure. Under oligopolistic conditions, firms are likely to enter foreign markets strategically in order to erect entry barriers or curb competitors’ benefits in their home market or foreign locations (Caves, 1971; Vernon, 1971). The importance of longer-term contracts in the extractive industries, combined with the fact that these contracts often contain exclusivity rights for particular resources, makes the resource a (strategic) asset as well. In terms of entry strategies, in the extractive industries there exist clear “first-mover” (locational)

advantages (Frynas, 2000; Stuckey, 1983). Furthermore, firms merge with local firms or acquire them in order to gain access to their strategic position in the market and national resource reserves. For example, the merger of Exxon with Mobil enhanced the position of the newly formed company in Asia (Gilley, 1998).

Strategic asset-seeking in the sense of acquiring knowledge internationally is of particular importance for the latest generation of extractive TNCs from developing nations. Given the limited availability of technical know-how in their home countries, resource-seeking TNCs from newly industrializing countries such as India and China (see UNCTAD, 2006) are likely to also engage in high levels of strategic asset-seeking FDI, thereby aiming to accelerate their development into transnational players via the acquisition of technology and know-how instead of own development (Dunning et al., 1996). Cross-border mergers and acquisitions (M&As) of upstream extractive corporations make up the bulk of FDI, especially to developing countries (Brakman et al., 2006). Waves of M&As occurred in oil and gas (e.g. ExxonMobil, ConocoPhillips, BP Amoco) as well as in the mining industry (BHP Billiton, Rio Tinto). M&As are often faster and cheaper than building up foreign assets through greenfield investments and are therefore chosen by companies aiming for rapid expansion of their international operations (OECD, 2001; Oster, 2007). Likewise, M&As serve strategic political objectives, especially in the oil industry, i.e. when SOEs bid on foreign firms in order to secure future oil supply (Gardiner, 2006; Zweig and Bi, 2005).⁵

Two different perspectives on cross-border M&As can be distinguished. The first sees acquisitions as a way for firms to spread and make use of their competitive (ownership) advantages, whereas more recently, a second view has been developed emphasizing a “pull” from the host country location triggering M&As (Anand et al., 2005). There is most likely interplay between the competitive advantages of the acquiring firm and the local assets possessed by the acquired firm in the host country. The ability to successfully engage in knowledge diffusion between the two firms (internalization) then determines the success of the M&A transaction (Anand et al., 2005).

⁵ A recent report for the upstream oil business showed that national oil companies (NOCs) are playing an increasingly important role in the competition with international oil companies as major buyers of assets (John S. Herold Inc., 2006).

3. Traditional extrinsic motives: the international political economy perspective

The location-specific advantages of the host country are of no use to firms as long as they are not granted authorization by host governments to explore them. Natural resource laws and policies in the host country create a more or less favourable frame for FDI that influences the interaction of ownership advantages with location advantages (e.g. when local firms are favoured with beneficial regulations or countries introduce tax benefits and the like to attract foreign investors). Traditional theories of FDI largely neglect the influence politics can have on the actual value of a reserve (including political factors, as compared to the pure value the reserve might have) to a foreign investor (Etemad and Salmasi, 2003b).

Mineral policies reflect Government interests and are mainly influenced by the importance of the investment and industry for the national economy (Moline, 2001). Government involvement and power (bargaining) relationships are of special importance in the extractive industries, with oil being the most politicized natural resource of all due to its central role for the world economy (Morse, 1999). Most resource-rich countries (developed and developing alike) rely heavily on exports of oil and other natural resources to keep their economies running. Consequently, governments are highly sensitive to foreign control over these resources (Ghemawat, 2001; Penrose, 1968). The increasing use of production-sharing agreements instead of concessions in the oil and gas industry supports the notion that governments want to be involved as far as possible in the management of their resources (Pongsiri, 2004). The degree of internationalization in the extractive industries is therefore influenced by the sources of bargaining power of (1) governments, (2) TNCs and (3) the degree to which these sources change over time. This section discusses the application of the classical obsolescing bargain model of Vernon (1971) to the extractive industries and considers in which direction it has been updated and extended.

a. Government bargaining power

In her less well-known work on the international petroleum industry, Edith Penrose – already in the 1960s – argued that the bargaining power of host governments in relation to resource-seeking TNCs depends heavily on the relevance of operations in the respective country for the firm and the presence of alternative locations for resource exploitation (Penrose, 1968). Legislation and the threat of nationalization are sources

of host country government bargaining power, which is further enhanced if the TNC operates in a competitive industry (Fagre and Wells, 1982). General economic conditions and world market commodity prices affect the distribution of bargaining power between firms and governments and are reflected in legislation and contracts (Etemad and Salmasi, 2003a).

Extractive industry legislation is one way for governments to ensure that they receive a share of the benefits generated by resource exploitation, e.g. in the form of taxes paid on raw products traded within the firm (Makhija, 1993; Penrose, 1968). There are pronounced quality differences in countries' legal frameworks regarding natural resource extraction (Bougrine, 2006; Kimel'man and Andriushin, 2005), confronting TNCs with a "jurisdictional asymmetry" (Jones, 2005, p. 201). In less developed host countries, legal systems are often developed "on the go", as Government officials gain more experience with the resource industry.⁶ This adds another dimension of complexity and uncertainty for the TNC manager and another source of transaction costs (Meyer, 2001).

Regulatory differences between countries strongly influence decision-making on foreign investments. It has been shown that, besides the overall profitability of a project and the mineral potential of the country, a favourable fiscal regime is the third decisive factor for the direction of FDI (Etemad et al., 2003b). This provokes "regulatory bargaining" between host governments and firms (Reed, 2002) and might end in a race to the bottom when governments try to compete for FDI (van Tulder and van der Zwart, 2006).⁷

The threat of nationalization of foreign firms' assets has been considered one of the major risk factors in the natural resource industry after the wave of expropriations of the 1960s and 1970s in the oil industry of the Middle East (Bradley, 1977). At the same time, nationalization in the mining sector took place in South America (Bolivia, Chile) and

⁶ For examples of the development of the Kazakh and Russian petroleum legislation, see Brothers, 1997; Lynch-Bell, 1994.

⁷ The mineral development agreement between the Government of Liberia and Mittal Steel (now ArcelorMittal) is a good example of how TNCs use their bargaining power to negotiate beneficial conditions for their operations. Amongst other things, the agreement forbids the application of newly introduced laws to the company and its operations, frees Mittal from tax obligations for at least five years, puts corporate land interests and rights above those of local communities, and transfers important public infrastructure into company ownership (Global Witness, 2006). The Liberian Government's manoeuvring room to influence corporate conduct is severely restricted by the agreement and conflicts can be anticipated. It seems unlikely that developed country governments would accept equal conditions.

Africa (Zaire, Ghana, Guyana, Zaire), affecting negatively the levels of FDI in the sector (Etemad et al., 2003a; Hilson and Yakovleva, 2007). Nationalizations at the time were driven by the wish to break free from colonial ties and to gain control over strategically important resources (Jones, 2005). Advances in administrative skills in the resource-rich countries and the availability of operational knowledge on the market were the enablers, making the creation of State-owned enterprises in the extractive industries possible (Makhija, 1993; Vernon, 1971). However, the need for capital, latest technology and innovations, and the lack of experience in managing the (considerable) market risks made some governments open up again to foreign investment after the first enthusiasm faded (Morse, 1999). In addition, efforts to copy the strategies of the leading TNCs by integrating downstream (vertical integration) into developed market economies turned out to be extremely costly for the nationalized TNCs from resource-rich countries.

Nationalization basically breaks up the vertical integration between upstream and downstream operations where inputs and outputs can be balanced within the firm (Morse, 1999). Industries differ in their risk profile for expropriations depending on the bargaining power of actors, which in turn is largely determined by the possibilities for substitution and the number of competing sources. For example, the aluminium industry is less prone to nationalization than the copper industry. Bauxite – the main aluminium ore – can be found in a range of locations, whereas high-quality copper reserves are located in only a very few select places which provides the governments with much greater bargaining power (Vernon, 1971). Oil is found in a large number of locations, but the biggest and easiest to extract reserves are nevertheless concentrated in a few countries. This, combined with its high strategic relevance for the world economy, made it a prime target for nationalizations (and counter-nationalizations). Governments follow different objectives across industries (Makhija, 1993).

Has the risk of nationalization lost its relevance for bargaining relationships in extractive industries? Current events in South America (e.g. Bolivia and Ecuador nationalizing their hydrocarbon industries in 2006) show that the risk of expropriation is not a hypothetical one. Also in Venezuela, foreign oil and gas operators had to hand over their projects to the local PDVSA without knowledge about potential compensation by the Government (Hays, 2007). With all production already nationalized, in May 2009 the Venezuelan Congress passed a new law that further extended the influence of the Government to all activities related to the petroleum industry, resulting in nationalization of oil service companies. Also in Nigeria, the Government plans to

restructure its national oil industry and award more oil and gas blocks to the new National Petroleum Corporation of Nigeria (replacing the current NNPC) (Izundu, 2007).

These examples point clearly to a general trend of developing country governments aiming to reduce foreign control in their extractive industries. The argument that expropriations often occur in “waves” when neighbouring countries copy the behaviour that proved successful in another country (Bradley, 1977) underscores the importance for managers to be (still) aware of that risk. Although advocated frequently, joint ventures with the local government or indigenous firms are not a magic bullet against expropriation (Bradley, 1977). Besides losing assets through direct expropriation, there is also the possibility of “creeping expropriation”, when the Government introduces measures (tariffs, regulations etc.) that ultimately make doing business in the respective country impossible for the corporation (Moline, 2001). The fear of losing assets through expropriation – even in case this event does not occur – impacts firm behaviour: it leads to strong exploitation of existing deposits but inhibits the firm’s desire to explore new reserves (where chances are high that they will be lost in the near future). This strategy can have a negative economic impact on the host economy, because high levels of production often reduce the total amount of resources that can be extracted from a reserve (Peterson, 1976).

In the oil industry, the power balance has now clearly shifted towards the SOEs of countries such as Saudi Arabia, Venezuela, China, the Islamic Republic of Iran, and the Russian Federation and seems unlikely to change in the future (Hoyos, 2007; Vikas and Essworth, 2007). However, most governments that own their national petroleum industry fail to reinvest enough money in the industry to maintain its competitiveness in the long run. As a result, the role of international oil firms might change into one where they partner up with the national oil companies, bringing their technical expertise and managerial skills to the bargain (Hoyos, 2007). There is little literature on the nationalization of mining ventures, which is an indicator for the lower political relevance of the mining industry for state governments (and also the fact that there are more local mining firms operating in the respective countries).

b. An obsolescing bargain over time?

Extractive industry TNCs derive bargaining power primarily from their technological capabilities (Fagre et al., 1982; Pongsiri, 2004) and their control over the international value chain. Host countries often do not have access to the newest technology possessed by foreign

TNCs with their large R&D expenditures. Constant progress in the development of production technology enables TNCs to produce and refine natural resources more efficiently, reducing the bargaining power of countries that rely on the cheap availability of their resources even further (Morse, 1999). Additionally, TNCs are often supported in their international ventures by their home governments (Bougrine, 2006).⁸ Bilateral investment treaties (BITs) and their clauses on the protection and promotion of FDI are a way for home country governments to try to reduce the political risk for their TNCs associated with operating in (developing) foreign countries (Fortanier and van Tulder, 2007). However, with scarce resources justifying even entry into unstable countries, BITs are more important for attracting non-resource-seeking FDI, e.g. refining and manufacturing. It has been argued that the increased use of BITs reduces the bargaining power of host governments because they do not gain an advantage over other countries (that can also negotiate a BIT) but are bound to the clauses of the treaty in relation to the incoming firms (Fortanier et al., 2007).

The obsolescing bargain model suggested that with time and increasing resource commitment into fixed assets, bargaining power shifts from the hands of the multinational managers into the hands of the host country government officials, leading to an obsolescing bargain that is likely to be renegotiated at the initiative of the host government (Vernon, 1971). The model is based on the assumption of high sunk costs that are present in the extractive industries that are characterized by (a) asset specificity of the investments, (b) transaction costs, (c) remoteness of the reserves, and (d) price-cost instability (Barham et al., 1998). High investments weaken the stance of the foreign firm towards the local authorities. Likewise, Government perception of the fairness of rent distribution changes over time towards a perceived unfairness of the distribution of resource rents that does not consider the risk and high initial investments associated with resource exploration (Vernon, 1971).

Additionally, after the initial phase in the bargaining process, the host country government becomes less dependent on the TNC when infrastructure is built and returns from resource exploration flow in and contribute to development (Penrose, 1968; Vernon, 1971). Furthermore, political calculus and the wish to distance the Government from the TNC in the sense of showing Government independence from foreign firms may reduce the appreciation of TNC presence in the country (Vernon,

⁸ This factor has been incorporated in more recent elaborations of Vernon's original bargaining model (see Ramamurti, 2001 below).

1971). Because of the high political and strategic relevance of oil, the effects of the obsolescing bargain model are most pronounced in the oil industry rather than in mining. More recent studies have revealed a positive long-term influence of technology intensity of the venture and size of the investment undertaken by the TNC on the long-term stability of the bargain (Vachani, 1995).

However, the obsolescing bargain model has been criticized for overestimating the power of local governments to dictate policy and for underestimating the ability of TNCs to put pressure on governments in response (Jenkins, 1986). Firstly, even for a developed-country Government (such as that of Canada), there seem to be notable obstacles to the realization of actions inhibiting TNC conduct (*ibid.*). A two-tier bargaining model extending the work of Vernon to incorporate bargaining between national governments and/or financial institutions and the host country (e.g. the formation of bilateral agreements, imposing of liberalization by the IMF) that precedes and shapes the conditions for the actual bargaining process between the individual TNC and host government has been proposed by Ramamurti (2001). He concludes that as a result of the tier-one negotiations, the position of host governments in the tier-two direct negotiations with TNCs has been weakened.

Secondly, the role of international organizations and the influence of globalization have been underrated in the original obsolescing bargaining model. Market liberalization requirements in particular imposed on developing countries by the Bretton Woods institutions have increased the competition between developing countries to encourage FDI as part of their economic development plans (Portelli, 2004). Eden (2004) argues that the desire of host governments to attract FDI, combined with more cooperative relations between governments and TNCs (Dunning, 1993; Luo, 2001), makes the model less applicable today. Thirdly, organizational legitimacy or the wish to create and maintain corporate reputation (or credibility) has become an increasingly important variable that is not accounted for in the original obsolescing bargain model (Eden et al., 2004). Legitimacy, the extent to which the organization is accepted by its environment (Kostova and Zaheer, 1999), has the potential to enhance the TNCs' bargaining position and to prevent the bargain from becoming obsolete (Eden et al., 2004).

4. Modern extrinsic factors: the role of NGOs

In the past, the horizontal integration or diversification of oil companies into completely unrelated industries such as computers

boomed in the 1970s and was mainly part of a market-seeking strategy (spreading risks and investing in anti-cyclical industries; cf. van Tulder and Junne, 1988). These strategies often proved unsuccessful and forced companies to refocus due to a lack of internal resources (Ollinger, 1994). The experience also shows the relatively high “exit barriers” that exist in oligopolistic industries. More recently, European oil TNCs in particular have started to diversify into more related industries, such as the renewable energy sector. This move can be interpreted as safeguarding future markets, but has also been influenced by the growing pressure by critical NGOs to become more “sustainable” and position themselves as good corporate citizens (Frynas, 2003).

The sustained oligopolistic nature of most extractive industries has made many leading Western firms prone to become “icons” or “worst-practice” cases for critical NGOs, in particular in their home markets. De Beers became an icon for the “blood diamonds” campaign; Shell for the environmental (Brent Spar) and human rights movement (Nigeria); Rio Tinto (mining) for the environmental movement and the indigenous peoples movement (in Papua New Guinea); or Total and other resource firms for human rights organizations owing to their involvement in Myanmar.

International NGOs represent a relatively new force influencing the internationalization of firms but are of great importance in the extractive industries where especially upstream operations abroad – and in developing countries – are subject to close public scrutiny (MMSD, 2002). Extractive industry firms often have a considerable impact on the social and physical environment in which they operate in making legitimacy, gaining a “license to operate”, and avoiding negative labels such as “enemies of the country” (Zinkin, 2004, p. 69) preconditions for successful operations. For the individual firm, lack of legitimacy can be an entry barrier but is also important once the market has been entered (Kostova et al., 1999). Engaging in corporate social responsibility (CSR) and entering local partnerships are ways for TNCs to enhance their organizational legitimacy in order to strengthen their bargaining power (Eden et al., 2004).

So far, the role of NGOs as important actors in the bargaining process between TNCs and host governments has only received scant attention in models of the bargaining process (Ramamurti, 2001), especially with respect to the resource-extracting industries. However, the increasing importance of NGOs as players in the political debate has been widely recognized (Kobrin, 2005; Ramamurti, 2004; Rugman

and Verbeke, 1998; Teegen et al., 2004). Due to the reduced ability of governments to define and act on their own national economic policies, transnational NGOs have become important players in helping them shape these policies (Smith, 2005). Owing to the lack of success of traditional government strategies that were beneficial for foreign TNCs and some host country governments, mineral policies in developing countries recently changed to also incorporate the interests of groups other than the Government (e.g. local communities, artisanal and small-scale miners, environmentalists) (Mtegha et al., 2006). National and transnational NGOs often support such groups and are increasingly gaining bargaining positions as third party players that are able to aid host governments but also work with TNCs wishing to improve their track record.

Recently, the relative “distance” between home and host country’s CSR regimes has been identified as a factor influencing both the internationalization and the CSR strategies of TNCs (van Tulder with van der Zwart, 2006, chapter 13). It is proposed in this framework that cultural distance as a factor affecting the bargaining relationships with societal stakeholders in the home and host context should be complemented by “institutional distance” and “development distance”. Translated to the extractive industries, this implies that the higher the involvement of developed-country TNCs in developing countries that are unstable due to low-quality governance (boiling down to a high institutional and development distance), the higher the risk of reputational damage in the home market. There seems to be a risk that international oil companies with an increasing need to obey certain rules of conduct in developing countries are disadvantaged when competing with State-owned firms from developing or newly industrialized countries (NICs).

A recent example is the huge investment of the Chinese CNPC in Sudan’s oil industry when concerns about human rights issues made international oil companies reluctant to invest (Hoyos, 2007). The foreign investment policies of – especially Chinese and Indian – SOEs have “[...] complicated international efforts to create a more effective architecture to address rights crises, conflict management over energy resources and environmental stewardship” (James Baker III Institute, 2007, p. 16). It is obvious that international efforts to marginalize countries as a result of their human rights abuses are losing their force when firms from countries that are aggressively pushing to secure new resource reserves invest despite those issues (Zweig et al., 2005). With its investments in Myanmar and Sudan, for example China “[...] is challenging the United States’ moral hegemony and its ability to check states whose records it abhors” (Zweig et al., 2005, p. 5).

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