

6. Explain Vernon's product life-cycle theory of FDI. What are the strengths and weaknesses of the theory?
7. Why do you think the host country tends to resist cross-border acquisitions rather than greenfield investments?
8. How would you incorporate political risk into the capital budgeting process of foreign investment projects?
9. Explain and compare forward versus backward internalization.
10. What could be the reason for the negative synergistic gains for British acquisitions of U.S. firms?
11. Define *country risk*. How is it different from political risk?
12. What are the advantages and disadvantages of FDI as compared to a licensing agreement with a foreign partner?
13. What operational and financial measures can an MNC take to minimize the political risk associated with a foreign investment project?
14. Study the experience of Enron in India and discuss what we can learn from it for the management of political risk.
15. Discuss the different ways political events in a host country may affect local operations of an MNC.
16. What factors would you consider in evaluating the political risk associated with making FDI in a foreign country?
17. Daimler, a German carmaker, acquired Chrysler, the third largest U.S. automaker, for \$40.5 billion in 1998. But after years of declining profit and labor problems, Daimler sold off Chrysler to the U.S. private equity firm Cerberus for \$7.4 billion in 2007. Study the DaimlerChrysler saga and identify the main factors for the failure of this cross-border merger.
18. Lured by extremely low labor costs in Bangladesh, many MNCs in the so-called fast-fashion business, including H&M, Inditex (parent of the popular Zara brand), Marks&Spencer, and Gap, are heavily outsourcing to Bangladesh. As a result, the garment industry has become a major source of employment and income for Bangladesh. However, the industry has recently suffered a spate of disasters. In September 2012, about 110 workers died in a blaze at the Tazeen Fashions factory outside Dhaka, the capital city. What's worse, in April 2013, more than 1,100 workers perished in the collapse of the Rena Plaz building in Dhaka. In your opinion, (i) what are the root causes of the disasters? (ii) What should be done to prevent future disasters?

**INTERNET EXERCISES**



You are hired as a political consultant for General Motors Company, which is considering building automobile plants in three countries: Brazil, China, and Poland. Choose a country and analyze the political risk of investing in that country. In doing so, utilize websites such as [www.cia.gov/library/publications/the-world-factbook](http://www.cia.gov/library/publications/the-world-factbook) or any other relevant Internet resources. You may prepare a final report to GM using a format similar to Exhibit 16.10.

**MINI CASE**

**Enron versus Bombay Politicians**

On August 3, 1995, the Maharashtra state government of India, dominated by the nationalist, right-wing Bharatiya Janata Party (BJP), abruptly canceled Enron's \$2.9 billion power project in Dabhol, located south of Bombay, the industrial heartland of India. This came as a huge blow to Rebecca P. Mark, the chairman and chief executive of Enron's international power unit, who spearheaded the Houston-based energy giant's international investment drive. Upon the news release, Enron's share price fell immediately by about 10 percent to



\$33.50. Mark sprang to action to resuscitate the deal with the Maharashtra state, promising concessions. This effort, however, was met with scorn from BJP politicians. Enron's Dabhol debacle cast a serious doubt on the company's aggressive global expansion strategy, involving some \$10 billion in projects in power plants and pipelines spanning across Asia, South America, and the Middle East.

Enron became involved in the project in 1992 when the new reformist government of the Congress Party (I), led by Prime Minister Narasimha Rao, was keen on attracting foreign investment in infrastructure. After meeting with the Indian government officials visiting Houston in May, Enron dispatched executives to India to hammer out a "memorandum of understanding" in just 10 days to build a massive 2,015-megawatt Dabhol power complex. New Delhi placed the project on a fast track and awarded it to Enron without competitive bidding. Subsequently, the Maharashtra State Electricity Board (MSEB) agreed to buy 90 percent of the power Dabhol produces. Two other U.S. companies, General Electric (GE) and Bechtel Group, agreed to join Enron as partners for the Dabhol project.

In the process of structuring the deal, Enron made a profound political miscalculation: It did not seriously take into consideration a rising backlash against foreign investments by an opposition coalition led by the BJP. During the state election campaign in early 1995,

the BJP called for a reevaluation of the Enron project. Jay Dubashi, the BJP's economic advisor, said that the BJP would review all foreign investments already in India, and "If it turns out that we have to ask them to go, then we'll ask them to go." Instead of waiting for the election results, Enron rushed to close the deal and began construction, apparently believing that a new government would find it difficult to unwind the deal when construction was already under way. Enron was not very concerned with local political sentiments. Enron fought to keep the contract details confidential, but a successful lawsuit by a Bombay consumer group forced the company to reveal the details: Enron would receive 7.4 cents per kilowatt-hour from MSEB and Enron's rate of return would be 23 percent, far higher than 16 percent over the capital cost that the Indian government guaranteed to others. Critics cited the disclosure as proof that Enron had exaggerated project costs to begin with and that the deal might have involved corruption.

The BJP won the 1995 election in Maharashtra state and fulfilled its promise. Manohar Joshi, the newly elected chief minister of Maharashtra, who campaigned on a pledge to "drive Enron into the sea," promptly canceled the project, citing inflated project costs and too-high electricity rates. This pledge played well with Indian voters, many of whom had a visceral distrust of foreign companies since the British colonial era. (It helps to recall that India was first colonized by a foreign company, the British East India Company.) By the time the project was canceled, Enron already had invested some \$300 million. Officials of the Congress Party who championed the Dabhol project in the first place did not come to the rescue of the project. The BJP criticized the Congress Party, rightly or wrongly, for being too corrupt to reform the economy and too cozy with business interests. In an effort to pressure Maharashtra to reverse its decision, Enron "pushed like hell" the U.S. Energy Department to make a statement in June 1995 to the effect that canceling the Enron deal could adversely affect other power projects. The statement only compounded the situation. The BJP politicians immediately criticized the statement as an attempt by Washington to bully India.

After months of nasty exchanges and lawsuits, Enron and Maharashtra negotiators agreed to revive the Dabhol project. The new deal required that Enron cut the project's cost from \$2.9 billion to \$2.5 billion, lower the proposed electricity rates, and make a state-owned utility a 30 percent partner in the project. A satisfied Joshi, the chief minister, stated: "Maharashtra has gained tremendously by this decision." Enron needed to make a major concession to demonstrate that its global power projects were still on track. The new deal led Enron to withdraw a lawsuit seeking \$500 million in damages from Maharashtra for the cancellation of the Dabhol project.

### Discussion Points

1. Discuss the chief mistakes that Enron made in India.
2. Discuss what Enron might have done differently to avoid its predicament in India.

### REFERENCES & SUGGESTED READINGS

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