# Global Business in Local Culture: The Impact of Emdedded MNEs

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## Summary

In his book 'The Great Transformation,' published in 1944, Karl Polanyi warned about the dangers of unbridled market forces for locally embedded economic systems and democratic institutions. Many contemporary political scientists and economists concerned with human rights and social inequality in the age of globalisation regard this warning as visionary. They argue that the expansion of global trade has mainly benefited multinational enterprises (MNEs) at the expense of the local economy, culture and the environment.

The present book challenges the distinction between the 'desirable' local versus the 'undesirable' global. It draws on insights from economic sociology to illustrate how global business that is locally embedded can contribute to local economic empowerment and cultural renewal.

MNEs are free to choose where to invest, and they tend to pick locations where production costs are low. However, many of them are also aware that their investments do not take place in a vacuum. If MNEs only feel accountable to stakeholders abroad, they may eventually face a local legitimacy problem. In this context, a commitment to 'principled embeddedness' may help address external concerns about compliance with international sustainability standards as well as local concerns about inclusive growth. An MNE generates inclusive growth by embedding itself into the local economy and culture. This local engagement enables the company to gain trust in the form of social capital, which also serves its the long-term.

However, embedding a global company in local business is fraught with cultural misunderstandings as well as economic risk and uncertainty, especially in low income countries. It may also require a significant amount of investment in the upgrading of local skills, capacities, and infrastructure, as well as efforts to reconcile local cultural habits with the necessity to comply with the formal rules of global business. If the venture ultimately succeeds, foreign direct investment (FDI) does not just generate private profits, but also a considerable amount of external social benefits.

After all, embedded FDI does not just bring material goods into the country of destination but also knowledge and know-how as well as access to global networks and capital. These non-tangible resources are not just crucial for catch-up growth, but also an essential condition inclusive and sustainable change, a central objective of the Sustainable Development Goals (SDGs) of the United Nations (UN). Governments that are committed to the SDGs must therefore not just be regulators but also facilitators of change involving responsible and long-term oriented FDI in a national partnership for sustainable development.

A major obstacle to more sustainable economic integration is the defensive framing of sustainability in postmaterialist societies. It is expressed in the popular view that global economic growth undermines local sustainability. The UN Guiding Principles on Business and Human Rights (UNGP) implicitly embrace this view with its 'do no harm' requirement for MNEs. The result is a global compliance and due diligence bureaucracy that tends to discourage investments in local entrepreneurship and innovation in the Global South. This is however of little concern to anti-globalization activists who envision the restoration of something better that must have existed before capitalism. As media savvy 'epistemic brokers' their globally coordinated protest actions provide meaning and orientation by converting complex local stories of resistance into simplified and dramatic mythical accounts of 'big business' versus 'the people'. By doing so, they often misrepresent the demand for inclusive growth that has mobilized local people in the first place.

The arguments and policy recommendations in this book are based on insights from interdisciplinary social science and selected business case studies of MNEs operating in developing countries. They illustrate the contribution of embedded global business to the SDGs if supported by institutions in government and civil society that recognise the need to embark on a global partnership.

## 1. Introduction

Karl Polanyi calls the expansion of formal global markets in his seminal book 'The Great Transformation' (1944) a 'satanic mill'. This mill would feed upon local communities and their informal economies and eventually result in great social disruption. Polanyi's framing of economic history as a struggle of 'profit versus people' has gained renewed attention in the 21st century.

Robert Kuttner, an American journalist and social policy expert, argues in a recent essay in the New York Review of Books (Kuttner 2017) that austerity policies in Europe and the renewed push for deregulation in the United States would reaffirm what Polanyi criticised as "the utopian endeavour of economic liberalism to set up a self-regulating market system". This endeavour would crowd out local culture and citizenship; lead to extreme inequality, and eventually trigger a political counter-movement to restore human rights to ordinary people.

This book does not defend European austerity policies or the Trump administration fondness for deregulation of the domestic economy – while simultaneously rejecting multilateralism in the governance of the world trade system. It does also not deny the countless corporate scandals before and after the global financial crisis of 2007-2008 that ruined the lives of many ordinary people. Yet, it challenges the popular narrative of global business as a sort of zero-sum game that merely thrives at the expense of society and the environment. In a world characterised by a high degree of economic interdependence, social and geographical mobility and transboundary environmental and social challenges, global business cannot be regarded anymore as something external and alien that is unrelated to our personal lives and social networks. We are all directly or indirectly dependent on and also benefit from its products, services and innovations as local producers as well as local consumers. The global sustainability challenge of the 21st century is therefore not to get rid of global business but to better harness its potential to contribute to local sustainable development and inclusive growth.

Multinational Enterprises (MNEs) are the main players in global business and probably the most scrutinized ones. The belief that their global operations are completely detached from local cultural and social activities contradicts the fact that all economic relations, whether global or local, are always based on prior social relations. In other words, the local cultural dimension should not be pitched against the global economic dimension but must instead be seen as its foundation. There is, of course, corporate culture and there is local culture. However, these are not terms that describe a steady state but represent dynamic processes that thrive on exchange. Embedded foreign investments may contribute to a fruitful exchange by responding to local concerns and by creating new local economic opportunities through economic integration. If MNEs with a commitment to principled embeddedness succeed in becoming an accepted and respected player in the local economy and culture, these companies gain the necessary social capital to secure their long-term license to operate. In other words, corporate social responsibility (CSR) is built into the long-term interest of such firms. CSR thus ceases to be a separate section with a separate agenda within the MNE. Instead, it becomes an integral part of the business strategy.

The potential contribution of such MNEs to sustainable change in developing economies is seldom appreciated because it runs against the stereotype that MNEs merely privatise profits while socialising the costs in the regions where they invest.

The general view that companies do business at the expense of local cultural and economic activities remains firmly entrenched in the sustainability debate in affluent societies – often with the unintended consequence of encouraging cultural segregation rather than economic integration. Yet, the bipolar view of the 'bad' global and the 'good' local that underpins this static and defensive view of sustainability runs counter to the Sustainable Development Goals (SDGs) who call for inclusive growth (SDG 8) and a global partnership (SDG 17) to develop hybrid and tailor-made local solutions to the significant global challenges of the 21st century.

## 2. Karl Polanyi's influence in the globalization debate of the 21st century

Economic globalization is primarily associated with the growth of multinational enterprises (MNEs). They have their headquarters primarily in prosperous economies in North America, Europe, and Asia and focus increasingly on investing in developing countries where land and labor are still relatively cheap.

Economists and political scientists who represent the school of 'Embedded Liberalism' (Ruggie 1982, Hays 2009, Rodrik 2011) and scholars in the field of 'Corporate Social Responsibility' (CSR) (Scherer et al. 2006, Wettstein 2010) regard this trend as potentially disruptive for traditional communities and their locally embedded economic systems. Weak law enforcement capabilities in developing countries would be unable to ensure the protection of human rights of such communities and therefore public and private initiatives are required to compensate affected communities through a generous welfare state or global CSR initiatives respectively.

The view that the primary task of governments is to tame unfettered market forces is not necessarily wrong but incomplete and often accompanied by an ideological agenda and vested interests in preserving the status quo. On the left wing of the political spectrum, anti-globalisation activists demand additional regulation designed to minimise the social and environmental risks of global corporate investment. On the other side of the political spectrum, right-wing nationalists frame global economic integration and migration as threats to cultural identity and national sovereignty. The recent political successes of the far right in North America and Europe have been made possible because of the support of the 'distributional losers' of globalization and the sedentary middle class that is concerned about cultural and economic decline. These losers feel increasingly decoupled from global economic change and no more represented by the left wing politicians that have shifted their concerns from the domestic worker to 'vulnerable minorities' (Hopkin 2017, Pepinski 2017, Reckwitz 2018). They ask for simple explanations to complex problems and political entrepreneurs, who play the role of epistemic brokers, provide such explanations by using popular narratives of 'good' and 'evil' forces and by identifying plausible scapegoats (Aerni and Bernauer 2006).

Yet, the claim that an unfettered global economy is disrupting the local economies in an unprecedented way does not correspond to today's reality of mixed economies with their subsidies and policy interventions to protect the domestic economy from world trade (Rogers 2017). Such protectionist policies, especially when combined with non-tariff trade barriers, are often justified by the almost unquestioned chauvinistic assumption that everything produced domestically is automatically more sustainable and of better quality than substitutes produced abroad. Such protectionist policies based on non-tariff trade barriers often favour potent incumbents in domestic business. These incumbents primarily aim at preserving the status quo by arguing in favour of protecting the 'embedded' national economy, understood as a highly regulated economic system that protects the local business against disruptive economic change driven by entrepreneurship and innovation. For outsiders, within and without the domestic economy, who do not benefit from the social network and the political connections of the resulting corporatist system, such an 'embedded' economy is primarily characterised by nepotism (Schluep and Aerni 2016). It stifles their economic opportunities. Therefore, entrepreneurial outsiders see economic globalisation not just as a threat but also an opportunity to weaken the dominant position of incumbents in domestic economies and make space for more economic freedom. The chances of such outsiders to find ways around established networks and create new and scalable markets has increased with the digital revolution and the rise of the global knowledge economy (Naam 2013). Public resentment against such agents of change persists, especially when they become successful and grow big.

## 3. The bipolar mindset in academia, civil society and government

The changing context in the global knowledge economy of the 21st century requires a critical re-evaluation of Polanyi's dualist worldview that guided his interpretation of economic history in the first half of the 20th century.

The re-evaluation of Polanyi takes place in the second, third and fourth chapter, as well as chapter 7.3 of the present book. It builds upon existing research in economic history (Braudel 1982, North 1977, Stehr 2008, Romer 2010, Bang 2016), economic sociology (Granovetter 1985, Zafirovski 2002, Beckert 2007), and industrial policy (Uzzi 1996, Meyer et l. 2011). This empirical research challenges the implicit baseline assumption of the school of 'embedded liberalism' based on Polanyi's argument that the global expansion of the formal market system poses an exclusive threat to locally embedded economic systems and human rights. The claim of Polanyi's contemporary disciples that the World Trade Organisation (WTO) merely represents the interests of the global actors at the expense of local interests is shown to be misguided in Chapter 2. After all, the WTO is a product of compromise. It reflects the wish of its member states to participate in a rule-based economy with ample policy space to take into account local concerns other than rent seeking protectionism. This policy space, incorporated in the different WTO Agreements, is especially significant for member states that belong to the category of Least Developed Countries. Some global activists would object by pointing out that many interests groups were underrepresented in the negotiations of the WTO Agreements. Indigenous people, for example, would feel threatened in their cultural identity by the expansion of global business encouraged by the WTO. Chapter 4.3 contradicts this view by pointing out that the local interests of indigenous people are often misrepresented by the global civil society organisations that claim to represent them on the global stage. After all, Article 21 of United Nations Declaration on the Rights of Indigenous Peoples from 2007 clearly demands respect for the economic rights of indigenous people (right to ownership, right to self-determination and economic development, equality before justice, freedom from discrimination). It indicates that indigenous people are as much interested in fair economic and cultural exchange as they are in cultural preservation. They are aware that their indigenous culture only remains attractive to the next generation if there is cultural renewal supported by selective economic integration.

Despite the lack of empirical evidence, the belief that the expansion of the formal global economy goes at the expense of local people who defend their local culture and natural environment has become very popular in contemporary affluent societies because it chimes well with postmaterial values. Even though mythical accounts of 'local people versus global profit' spread via social media by well-known anti-globalisation activists, such as Vandana Shiva, sound simple, plausible and therefore meaningful, they are highly misleading. After all, no real economy activity (profit) is detached from individuals (people) and their social networks (communities), as economic sociologists point out.

The embeddedness in social networks is especially crucial when a company invests abroad. It must gain social capital in the region of investment by contributing to the resolution of three major coordination problems: the problem of value, the problem of competition and the problem of cooperation. Chapter 5 points out that such a foreign investor may only be able to secure its long-term license to operate in the host country if these coordination problems are adequately addressed in collaboration with the local stakeholders.

Chapter 6 looks at contemporary economic and development policies that are still guided by the social science theories developed during the Cold War. Structuralist and neomarxist theories, that were very popular in Human Geography and Postcolonial Studies, implied for example that international trade must be a zero-sum game that benefits the rich at the expense of the poor. In turn, neoclassical economics, also a theory developed during the Cold War period, only focuses on the relatively modest efficiency gains from global trade while ignoring the welfare effects generated through the introduction of new goods and services (Romer 1994). As a result, welfare economics, a branch of neoclassical economics, has an exclusive focus on internalising the negative externalities caused by private sector activities. The positive external effects on society resulting from private sector investment in innovation are largely ignored.

The expansion of the global economy after the Cold War has however significantly benefited previously developing nations, such as China, that have undergone institutional reforms to embark on catch-up growth. In this context, China was not focused on merely capturing efficiency gains from trade but on taking full advantage of the economic opportunities resulting from the rise of the global knowledge economy.

The global knowledge economy is strongly linked to the ongoing digital revolution that made the nonrival resource 'knowledge' more widely available. Yet, access to codified knowledge on the internet is only one part. The more important part is investment in human capital to create the necessary tacit knowledge (know-how) to make commercial use of codified knowledge. It is Foreign Direct Investment (FDI) that combines knowledge with know-how transfer into the local economy. These essential ingredients of endogenous development increase the likelihood that imported physical goods will eventually be substituted by locally produced goods. Being a non-tangible resource, knowledge in the form of instructions, recipes, protocols makes it possible to create a local good that is otherwise too costly to import - provided that the country has invested in the business infrastructure and the human skills and know-how of its people to take advantage of the new opportunities.

In this context, the effectiveness of Official Development Assistance (DA), which was also invented during the Cold War to win over non-aligned developing countries, is increasingly questioned because it is stuck in the classic view that development aid must protect rather than economically empower the poor (Easterly 2007, Deaton 2015). As such, it tends to preserve unsustainable local structures in low income countries rather than enable the highly needed structural change to create new economic opportunities for the large and increasingly educated younger generations in the developing world.

## 4. Acknowledging the value of companies committed to 'principled embeddedness'

Chapter 7 and 8 argue that effective DA needs to build upon the principle of cooperation, especially with the private sector, if its goal is to enable sustainable change that reduces poverty through more economic opportunities and, simultaneously, improves the environment through sustainable intensification. Producing more with less by making effective use of new platform technologies such as information technology, nanotechnology, and biotechnology, is vital given population growth and increasing affluence in the 21st century. In this context, the focus in public policy and CSR needs to shift from merely regulating and avoiding the risks of FDI to harnessing its benefits for the poor and the environment. It must be based on the insight that investments of MNEs do not just cause external costs for the local environment and society but may also generate external social and environmental benefits, especially if the MNE is committed to 'principled embeddedness'. An MNE that abides by its internal code of conduct while taking an effort to locally embed its economic activities so that it contributes to the upgrading and expansion of the local economy has a substantial potential to contribute to inclusive growth while improving its environmental stewardship in collaboration with local stakeholders.

In this context, Chapter 7 points out that the UN Guiding Principles on Business and Human Rights (UNGP) as well as various other international CSR guidelines developed by the Organisation for Economic Cooperation and Development (OECD) and the International Organisation for Standardisation (ISO), should recognise that corporate responsibility cannot be merely limited to the requirement of doing 'no harm'. After all, companies do not create value by merely avoiding risks but taking the risk to invest in a new market. MNEs that benefit the region in which they operate should also be rewarded for doing 'good,' not because they want to be good corporate citizens but because doing so is in their long-term interest.

A possible reason for the omission of the importance of corporate embeddedness in current CSR strategies may be the influence of global retailers on the design of sustainability standards in the food and agricultural sectors. Rather than informing consumers about the efforts of the supplying global agribusiness companies to make agriculture in developing countries more sustainable, they prefer to portray themselves as the most sustainable companies in the global food value chain. They do so by informing consumers about their collaboration with reputation-enhancing environmental organisations, such as WWF. In their marketing campaigns, they primarily aim at making consumers feel good about themselves by feeling confident that their retailer is a selfless defender of nature and small-scale farming against the forces of industrial agriculture (Miller 2012, Aerni 2013a). The essential pillars of this wellness sustainability are 'organic' or 'fair trade' premium products portrayed as natural, healthy and fair and therefore as the more ethical alternative to industrial agriculture.

These claims are increasingly questioned based on insights gained from empirical research (Makita and Tsuruta 2017, Huybrechts et al. 2017, Dragusanu et al. 2017, Laufer 2014, Lott 2015, Ramone 2013, Gilbert 2012, Henderson 2008). Even from an ethical point of view, it is unclear whether these wellness premium products are the best choice for consumers. There is increasing evidence from field research, that 'fair trade' and 'organic' production in developing countries may help increase the income of the immediate beneficiaries (e.g., members of the respective farm cooperative) but discourage local entrepreneurship and innovation, the key ingredients for homegrown development. Moreover, 'fair trade' and 'organic' cooperatives in developing countries are controlled by retailers in developed countries. As such, they have become capital-intensive tropical food production sites subsidized by foreign consumers and states, but in most cases, utterly disembedded from local economic activities. As such, these niche markets for affluent consumers contribute very little to structural change.

Finally, it is unclear whether ethical concerns indeed motivate the consumer's decision to buy organic or fair trade, or whether it is instead about treating oneself to a premium product (Miller 2012). No one would probably be puzzled if the marketing slogan for these 'sustainable' products would be 'because I am worth it'.

## 5. When MNEs become part of the solution rather than part of the problem

Whether FDI is indeed capable of generating profits by empowering rather than exploiting people does not just depend on the awareness of the MNE that it does not operate in a vacuum but also on the respective domestic institutional setting. Governments that want to force foreign investors to comply with local content requirements may not be effective in achieving the desired outcome if they fail to "do their homework." This homework comprises domestic reforms and investments not just in the domestic human capital stock and an institutional environment that enables economic and technological change, but also in the physical and digital infrastructure (UNCTAD 2017a).

Creating these favourable framework conditions helps reduce the uncertainty for subsidiaries of MNEs to invest in the domestic economy.

The commitment in practice to 'principled embeddedness' is illustrated in this book using selected MNE case studies in chapter 7.4. Also, Chapter 8 uses concrete case studies in Africa to highlight the importance of state and non-state actors as intermediaries and catalysts who render local institutions and businesses more responsive to MNEs that are prepared to become more embedded in the local economy.

These case studies are not meant to praise the selected MNEs for their local business practices, but instead to point out that the long-term profit-motive may not necessarily conflict with social and environmental objectives. The potential for opportunism in large companies may be widespread despite increasing expenses on compliance and due diligence processes (Chen and Soltes 2018). However, the examples clearly show that globally active corporations may contribute to economic empowerment and sustainable change in the regions of investment through a strategy of principled embeddedness. This is particularly true for their presence in many developing countries where they often offer an alternative to a repressive traditional economic system in which social status and not individual merits determine one's chances to obtain a decent job in the formal economy (Martin 2012).

The ambitious young and educated majority in developing countries who are stuck in persistent feudalist structures tend to become outsiders in their society, especially if they are not connected to the country's political and economic elite. Lacking the necessary social connections to enter the formal economy as entrepreneurs, they often decide to migrate elsewhere in search for economic opportunities. In this context, the growing number of economic refugees is a symptom of failed domestic policies as well as misguided development assistance (DA) that avoids productive collaboration with the private sector to create economic opportunities for entrepreneurs in the formal domestic economy. The grievance of the neglected young entrepreneurs is identified as one of the main triggers of the Arab spring (Martin 2012).

It is not surprising that Karl Polanyi never addressed this downside of traditional economies in which land-owning insiders may officially portray themselves as custodians of the natural environment, traditional society, and local culture to strengthen the legitimacy of their privileged economic and political position in society. It would have conflicted with his binary thinking of the 'bad' global and the 'good' local. This binary thinking is however persistent because it offers a reduction of complexity in an ever more complex society (Luhmann 1993). As a result, the binary thinking continues to influence the funding priorities in development cooperation, academic research and CSR strategies, despite the growing empirical evidence that it aggravates rather than resolves the social and environmental sustainability challenges of the 21st century. After all, focusing only on the 'vulnerable', the presumably passive victims of change, and portraying the agents of change, understood as foreign direct investors and local entrepreneurs who strive to become their suppliers, as mere perpetrators, supports the incumbent elite. They benefit from the status quo at the expense of economic empowerment and inclusive growth.

The concept of vulnerability treats the target population as passive victims who need to be saved by 'therapeutic entrepreneurs' supported by DA (Ecclestone 2017). These therapeutic entrepreneurs are assumed to be better educated and therefore to know better what the vulnerable need. In most cases, these external stakeholders are not aware that their interpretation of the local circumstances is in most cases not informed by the local people and their concerns, but somewhat static stereotypes and mythical stories that prevail in donor countries about the situation of the poor in recipient countries. An issue that is extensively discussed in Chapter 4 as well as the concluding remarks in Chapter 9.

The view that entrepreneurs who try to take advantage of economic opportunities are mere perpetrators who do not need any assistance proves to be one of the most widespread myths in affluent societies. Why? Because, worldwide, the self-employed, in most cases survival entrepreneurs, live in a much more precarious state than those with formal employment. Moreover, this is not just true for daily laborers without any formal education or training but also university graduates in developing countries that do not have the opportunity to enter into a family business and failed to obtain a well-paid job with a foreign NGO, an MNE or the government after graduation (Aerni 2015b).

Since the human rights movement emerged from the labour rights movement, the grievances of these entrepreneurs are just not on the radar screen of human rights activists (Aerni 2015b). Yet, survival entrepreneurs, especially if endowed with a good education and business training, may be of great interest to foreign companies which care about motivated and qualified local partners and employees. More than anyone else, these companies give entrepreneurs in precarious situations a chance by investing in their skills or the upgrade of their business. As such, MNEs may significantly contribute to social mobility in traditional societies and the economic empowerment of outsiders.

MNEs in affluent societies are however hardly ever associated with economic empowerment in developing economies. Instead, they are perceived as selfish actors that care about shareholder value, competitive off-shore employment, tax evasion schemes and monopoly power. This may be true for MNEs involved in corporate crimes and malpractices. Hollywood movies and the media widely cover these cases. However, empirical research indicates that the vast majority of MNEs do not correspond to the negative stereotype of 'Big Business'. The claim, for example, that small businesses would account for a higher share of decent employment, be more innovative and contribute more to the tax base of society has mostly be rebutted (WTO 2016, Atkinson and Lind 2018).

Moreover, even though 'big business' may spend more on political lobbying, they seem to be less effective in achieving their goals than small businesses, who generally pay less taxes and obtain much more government assistance (Atkinson and Lind 2018). The reason for this outcome is that public opinion loves 'small' and hates 'big' business, and politicians who care about re-elections are careful about not being associated with the 'hated' ones. Alas, by asking for more regulation of innovation-driven industries, the same politicians may inadvertently strengthen the market position of large firms that, unlike start-up companies, have the means to comply with additional costly regulation (Aerni 2015b). The rather artificial divide between small 'good' firms and bad 'large' firms leads to short-termism in politics that is unable to address the long-term challenges of sustainable development in a collaborative way. After all, small companies must become part of a business ecosystem that also involves large companies if they want to succeed. Moreover, big companies are probably the largest investors in innovative small companies (Atkinson and Lind 2018).

Given the urgency to move away from the unproductive binary mindset in academia, civil society, and politics and to learn from the past when addressing the global sustainability challenges of the 21st century, chapter 9 concludes by calling for a paradigm shift in the theory and practice of international sustainable development. This paradigm shift is reflected in SDG 8 on 'Decent work and Economic Growth' of the United Nations Sustainable Development Goals. The United Nations Development Program (UNDP) considers this goal key for achieving the remaining 16 Sustainable Development Goals because improved incomes lift people out of poverty and automatically improve access to essential human rights (e.g., the right to food, right to water, right to decent shelter, gender equality). As such, SDG 8 represents the priority of poor people in developing countries who have not obtained formal employment in the private sector and are therefore forced to make a living as survival entrepreneurs. To understand why the poor people value foreign direct investment if embedded in the local economy, one has to listen directly to the poor in these countries rather than to the anti-globalisation activists who claim to talk on behalf of their interests. The concluding illustrate using a concrete example of good investigative journalism, how the voice of the locals can be heard and induce a change in thinking about sustainable development in the particular local context. The example shows that, for the poor, it is obvious, that poverty has no cause. It is merely the absence of prosperity. People in affluent societies, see prosperity as the cause of poverty elsewhere. It is important they realize that economic exchange, unlike war, is not a zero-sum game.

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