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Networked liabilities: Transnational authority in a world of transnational business

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Abstract

The proliferation of production networks and cross-border contracting is frequently cited as empowering globally active corporations to skirt, and shape, national regulations. While scholars often focus on the political gains from these new forms of business organization, we shift the conversation to the potential political costs of global firm reorganization. The spread of corporate subsidiaries and global supply-chain networks leave firms vulnerable to a host of jurisdictional claims, and by targeting a domestically rooted affiliate, states can bring the global practices of the multinational corporation in line with their interests. In other words, states can take advantage of the transnationalization of the firm to transnationalize their authority beyond traditional jurisdictional boundaries. We label this process "networked liabilities." Specifically, the combination of a firm's sunk costs and the country's jurisdictional substitutability determines the ability of governments to exert demands on multinational corporations. A key contribution of the article is to better specify the relationship between mobility and authority and to illustrate that networked liabilities can further empower a variety of states beyond traditional economic powers like the US or the European Union. We further highlight when firms may curtail the authority of great powers. The growing reach of the regulatory state domestically, coupled with the transnationalization of

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the firm, creates an increasing number of tools for certain governments to engage in economic statecraft beyond their borders. Our findings, then, contribute to debates on business–government relations in a globalized world, the changing nature of political risk, and the deterritorialization of state authority.

Keywords

Business–government, extraterritoriality, political risk, regulatory state, supply chains, transnational authority

Introduction

The transnationalization of business is a defining feature of globalization (Pauly and Reich, 1997; Sell, 2003; Vernon, 1971). Firms leverage economic openness to set up complex networks of affiliates and subsidiaries that span political jurisdictions. These multinational corporations (MNCs) build the backbone of global supply chains, often bringing with them both profits and cultural derision (Bartley, 2007; Dallas, 2015).[1]

Considerable research on the political consequences of globalization has focused on the ability of such companies to leverage this new-found mobility (Ahlquist, 2006; Culpepper and Reinke, 2014; Mosley, 2000; Rudra, 2002). For some, globalization opens up opportunities for firms to use the threat of exit to discipline public officials into adopting business-friendly policies. Proponents of this view often raise the specter of the regulatory race to the bottom, in which states must lower business regulations and taxes so as to prevent capital flight (Andrews, 1994). Others, by contrast, downplay this threat by highlighting the synergies between certain state institutions/policies and firm interests (Garrett, 1998). Regardless of where exactly authors cash out on this balance, most frame the debate as one of firm mobility, in which states must play defensively to minimize the potential threat of exit.

In this article, we shift the focus from the possible political advantages that firms gain from globalizing their operations to their potential costs. As firms create trails of affiliates and subsidiaries, they land in multiple political jurisdictions, generating sizable legal uncertainties. In some cases, this reorganization of the firm provides state actors with new levers to shape firm behavior that the state lacked in a pre-globalization era. In other words, the state can use the transnationalization of the firm to transnationalize its jurisdiction, reaching out from its borders through cross-national production systems to regulate the behavior of business based in other jurisdictions. We label this process *networked liabilities*. The extension of public authority through global corporate structures has important consequences for the behavior of specific powerful firms, which, in turn, can shape the stability of domestic regulatory bargains and, in some cases, have knock-on consequences for global governance more generally.

Clearly, not all jurisdictions have the ability to leverage networked liabilities and even those that do are not uniformly positioned to do so. The main goal of this article, then, is to identify the key boundary conditions for such a process. Bridging work on political risk and extraterritoriality, we argue that firm exposure to these networked liabilities is a product of two key dimensions: the level of jurisdictional substitutability; and the level of sunk costs. In short, companies are most likely to comply with the transnational demands of a state when their ability to wind down specific affiliates is constrained and costly. Key markets such as the US or the European Union are particularly well situated to exercise this form of authority as many global firms rely on these markets. That said, even in such large markets, we expect that our key variables will vary by sector and firm as the levels of substitutability and sunk costs change.

We explore this dynamic through three complementary cases: Nigeria's enforcement action against South African Telecom company MTN; China's intervention in the mining sector merger of Glencore and Xstrata; and the US effort to sanction the oil services company Schlumberger. We believe that the core logic underlying our argument is not limited to traditional regulatory leaders such as the US and the European Union. We, thus, chose the first two cases to highlight the ability of rising powers, which are still building their regulatory capacity, to exploit networked liabilities. Concurrently, our third case illustrates that even large developed economies may find limits in their ability to mobilize such authority. At the same time, we selected a range of sectors (telecommunications and natural resources), as well as domestic institutional tools (consumer protection, anti-trust, and sanctions), to demonstrate the generalizability of the argument. Our argument, then, serves as a corrective to more sweeping claims that equate market power with the aggregate size of the economy (e.g. Drezner, 2007). We identify both limits to the reach of traditional economic powers like the US or the European Union, and opportunities for rising powers to accomplish such economic statecraft through a growing regulatory toolkit (Bach et al., 2006; Newman and Posner, 2011; Nolke et al., 2015).

This article makes several important contributions to the literatures on globalization, interdependence, and state authority. First, it offers important insights on contradictory findings from the literature on globalization and the firm. By highlighting the political costs associated with affiliate and subsidiary networks, it suggests the conditions under which transnational business may generate new political risk. Second, it contributes to new research interested in the political ramifications of the global reorganization of the firm. While International Relations scholars have long recognized the importance of MNCs, relatively little work has examined the relationships between the changing internal organization of firms and possible transnational political repercussions.[2] Finally, the article adds to a growing body of work that attempts to better specify the extraterritorial authority of large markets. This research has identified a range of issue areas in which states are able to extend their authority outside of their territorial borders. Much of this work has focused on the US and the European Union. In this article, we develop a theoretical argument that provides boundary conditions for such authority and examine it in a set of rising powers in Africa and Asia as well.

Globalization and the transnationalization of business

Today, Wall Street's pride and joy, Apple Inc., exemplifies many of the current geopolitical and transnationalization trends. While Steve Jobs frequently boasted of the original Macintosh's American supply chain, the reinvigorated Apple no longer lives in its founder's garage. In 2012, the iPhone alone employed nearly 230,000 laborers in China, through the infamous FoxConn, who worked near 12-hour days, six days a week (Duhig and Bradsher, 2012). Apple has over 250 retail stores across 16 countries (Apple, 2016), and has contracts with production partners in over 21 jurisdictions (Tweney, 2013). It is the world's largest information technology (IT) company by assets and became the first US company to be valued at over US$700 billion (Kopytoff, 2015) — all while the majority of its revenue is routed through convoluted but ingenious legal schemes to ensure that they remain tax-exempt (Sheppard, 2013). Apple is far from alone — companies as diverse as Toyota, General Electric, Barclays, Siemens, and Shell have affiliate networks and supply chains that span across traditional political borders, opening up new room for both arbitrage and liability.

Since at least the 1970s, International Relations scholars have examined the role that transnational business plays in global politics. With respect to the relationship that such businesses have with the state, there are two dominant perspectives: one emphasizing the power of capital mobility; and another emphasizing the resilience of the state. On the one hand, increased capital mobility and the global expansion of the MNC after the Second World War brought with it a whole slew of scholarly work pronouncing the death of the nation-state. Vernon (1971) and Kindleberger (1969), for example, argued that multinationals restricted the sovereignty of states to a yet unforeseen degree. In particular, scholars argued that the propensity of MNCs to operate on a global level, combined with the territory-bound authority of national governments, created asymmetries of information and jurisdiction. According to the race-to-the-bottom theory, since capital is increasingly mobile, state power becomes restricted (Edwards, 1999; Goodman and Pauly, 1993; Rosecrance, 1999; Strange, 1996). Therefore, scholars argued that one needed to view international capital mobility as a structural variable that governed state behavior (Andrews, 1994) and that the attention should be focused on MNCs and government–MNC policy and bargaining interactions (Milner, 1988; Stopford and Strange, 1991). Some authors have therefore shown how firms gain power at the international level and can become involved in national policymaking (Abdelal, 2013; Avant et al., 2010; Doremus et al., 1998; Pauly and Reich, 1997; Sell, 2003). Others have focused on the conditions under which such mobility matters (Ahlquist, 2006; Culpepper and Reinke, 2014; Mosley, 2000; Rudra, 2002).

In response, a second strand of work emphasized the resilience of the state in the face of transnational capital. Garrett (1998: 789), refuting the idea that politics lags behind economics, argued that exactly because of market integration the state is asked to step in so as to "mitigate market dislocations by redistributing wealth and risk." Jensen (2006), on account of the fact that multinational investments are relatively liquid ex ante but much more illiquid ex post, similarly shows how political regimes matter for the investment decisions of MNCs.

However, when it comes to the direct relations between MNCs and governments, the latter research strand tends to focus on why firms find some institutional arrangements more attractive than others. In other words, states compete for foreign direct investment and some domestic or international institutional commitments assist the state in attracting firm dollars. Often, this works through some type of commitment or information mechanisms whereby institutions either signal the quality of domestic property rights or assure firms that they will not be targets of expropriation. Scholars have focused on domestic political institutions and regime type (Jensen, 2008; Li and Resnick, 2003; Oneal, 1994; Taylor, 2012), participation in international agreements (Büthe and Milner, 2008; Neumayer and Spess, 2005), welfare and taxation (Biglaiser and DeRouen, 2006; Jensen, 2006), or conflict (Jensen and Young, 2008) to explain which characteristics make states attractive to investors. Hence, the state is still a rather traditional actor trapped by its geographic borders while firms enjoy more of the benefits of mobility. In those cases where state institutions fit with firm interests, the state benefits. Otherwise, the state faces many of the same dilemmas as noted in the mobility literature.

Globalization and the transnationalization of authority

In contrast to arguments that emphasize firm mobility or state resilience, we focus on the ways in which state authority has transnationalized. Rather than viewing states as locked primarily within pre-globalization territorial units, we examine the ways in which mobility exposes firms to new channels of state authority (Farrell and Newman, 2014, 2015). Cross-jurisdictional commercial networks create liabilities, which states can then use to press changes to the broader MNC structure, bringing the latter into line with national prerogatives. In other words, firm mobility not only creates new opportunities, but also creates new political risks. This is not limited to expropriation risk and Vernon's infamous obsolescing bargain, but instead includes states using the local assets of an MNC to gain influence beyond territorial borders. In particular, we focus on the likelihood that firms adjust to such demands, leading them to change global strategy and business activity. Our argument, then, builds on emerging work identifying the role of extraterritoriality in global politics (Newman and Posner, 2011; Putnam, 2009; Raustiala, 2011). An additional contribution is to better specify the conditions under which states may produce changes in private actor behavior.

While early studies of globalization heralded a return to a laissez-faire government posture, the past four decades have instead been defined by a proliferation of rule-making (Abdelal, 2007). This is true not only at the global level, but at the domestic level as well, where scholars have argued that we now live in a world of regulatory capitalism (Braithwaite and Drahos, 2000; Büthe and Mattli, 2011; Levi-Faur, 2005; Vogel, 2008). Driven by state priorities, expert networks, and great power pressure, developed and developing economies have engaged in a process of re-regulation (Vogel, 1996), whereby liberalization efforts have seen the rise of new regulatory institutions. This process of re-regulation has occurred across sectors and issue areas, from competition laws and capital adequacy rules to emissions standards and child-worker protections.

A growing body of research suggests that such domestic law and regulation may have global consequences (Bach and Newman, 2007; Putnam, 2009; Raustiala, 2011). Consider the *effects doctrine* within anti-trust law (Putnam, 2016; Weintraub, 1991). The basic logic is that states may enforce domestic law on foreign firms, whose activity is located in foreign markets, if their behavior has a tangible and significant effect on the home market. More recently, states have started to make extraterritorial demands based on conditions of firm presence. That is to say, states may enforce their domestic law on foreign firms, whose activity is located in foreign markets, if those firms have significant assets in the state's home market. The US, for example, has used this logic to enforce its regulations on foreign bribery as well as sanctions (Kaczmarek and Newman, 2011).

Despite these extraterritorial implications, dominant studies of business–government relations often analyze state power through a methodologically nationalist lens (Callahan, 2010). This further disregards the organization of today's *multinational* corporations (Bartley, 2007; Dallas, 2015). Scholars generally assume that governments interact with businesses primarily operating in their jurisdiction, but, increasingly, states have complex connections with foreign firms through MNC families. These networks can take a variety of forms, ranging from vertically integrated production networks to more modular, cooperative forms (Berger, 2005), but they share a fundamental reliance on corporate relationships that traverse political borders. Governments may use these relationships to reach through the affiliate or subsidiary structure into the business practices of the corporate group. As a result, domestic regulatory regimes can take on transnational importance. The central logic of the article is that the transnationalization of business, through affiliate structures and supply chains, exposes global companies to an increasing number of state claims based on "presence"-style arguments. We focus on the conditions under which states are able to successfully make such demands with implications for global firm strategy.

Much of the existing work on state power notes the importance of large markets for pressuring adjustment, focusing on the US and the European Union (Drezner, 2007; Simmons, 2001). Yet, we know from empirical examples that there is considerable variation in how successful great powers are when it comes to transnationalizing their rules. Take the example of the 2002 Sarbanes–Oxley reform in the US, which modernized the regulation of financial markets. It created a host of extraterritorial requirements for firms listing on US-based stock exchanges. In other words, these companies would be required to alter their home-country compliance practices so as to meet host-country demands, spreading compliance behavior across the MNC group. A significant number of firms decided as a result to delist from US-based exchanges rather than face the burden of such requirements (Hostak et al., 2013). In more generic terms, presence alone is insufficient for extraterritorial influence. Some firms will prefer to decouple their business rather than comply with the creeping global demands of the state.

We argue that the extent to which states can leverage networked liabilities to alter corporate strategy beyond their territory, and thereby transnationalize their authority, is determined by two key variables: sunk costs and jurisdictional substitutability. These two factors play a fundamental role in better defining the cost–benefit calculus that firms face when deciding whether to comply with the government demand or sever the relationship. The first factor comes from the literature on foreign direct investment, which identifies the extent of sunk costs as a key point of leverage in negotiations between global firms and states that may later seek to renegotiate the terms of such investments (Jensen, 2006, 2008).[3] We argue that a similar underlying logic applies not only to the renegotiation of contracts, but also to more common compliance demands by states. Importantly, these demands may not only focus on national investments, but also reach out into the broader corporate group.

As firms transnationalize, the extent of their relative presence can vary considerably. In some cases, firms create shell companies that entail little real sunk costs. In other cases, however, affiliates entail large investments with significant employment and infrastructure commitments, which cannot be easily redeployed globally. As states target affiliates for enforcement actions, firms can either absorb the penalty or engage in jurisdictional exit. Business responses will be conditioned by the extent of sunk costs as these determine a considerable amount of the price of dissolving the presence relationship with a particular jurisdiction.

The second factor — jurisdictional substitutability — relates to the ability of transnational firms to find an alternative jurisdiction that provides for a comparable business opportunity but does not make similar regulatory demands. A range of factors may influence jurisdictional substitutability, including market potential, the distribution of human capital, technical or physical resources, and the regulatory environment across jurisdictions. For example, jurisdictional substitutability differs in concentrated sectors like rare earth metals or aircraft production from distributed sectors like cement or rice. Similarly, firms that are heavily reliant on high-skill employees that, by definition, are scarce will inevitably need to be tied to a set of developed countries. In those areas, where firms may easily shift affiliates to alternative jurisdictions, they face fewer incentives to comply with demands that reach into the corporate group, and compliance with such demands should be lower. On the other hand, in those cases where firms have few outside options, global business operations may expose them to new state demands.

Based on the two dimensions of sunk costs and jurisdictional substitutability, one can construct a continuum through which to describe the potential and character of leverage that states may gain over firms as they transnationalize. The typology helps to understand both the boundary conditions of networked liability and the channels through which such political costs of transnationalization may be felt. Ultimately, we argue that this typology helps us to understand the likelihood of firms carrying out the demands of a host state. In other words, the transnationalization of authority can be operationalized by examining its effects on firm strategy and decision-making.

In cases where transnational firms have few sunk costs and there exists high levels of jurisdictional substitutability, states should be highly constrained in their ability to make transnational regulatory demands. In these instances, firms enjoy many of the advantages articulated in the capital mobility literature. However, as either sunk costs or jurisdictional substitutability shift up or to the left, firms face more difficult compliance environments. In those instances, when sunk costs are high but substitutability is low, compliance will be a function of the costs of the regulatory penalty versus the size of sunk costs. In some cases, firms may be willing to absorb relatively smaller regulatory penalties in exchange for continuing to operate globally. This contrasts with cases of low jurisdictional substitutability. Here, states hold considerable leverage even when firms have made few irrevocable investments. In these cases, the firm faces a regulatory choke point in which they have few exit options as they rely on the market for a core business function. States then have the option to use affiliate structures to hold the corporate group hostage. Finally, as transnational firms commit to large sunk costs and also face low jurisdictional substitutability, they face the most challenging compliance environment and are most likely to comply with regulatory demands that reach out into the corporate group.

This analytic mapping helps us derive the following empirical expectations:

> E1: When MNCs find themselves facing high sunk costs in jurisdictions of low substitutability, they will be forced to consider complying with most state demands even if they regulate the behavior of the corporate group.
>
> E2: When MNCs have low sunk costs in jurisdictions of low substitutability, companies face a choke point that leaves the firm with limited means to maneuver.
>
> E3: When MNCs have high sunk costs in jurisdictions of high substitutability, their decision to follow through with state demands will be driven by their ability to absorb penalties for non-compliance.

As a first plausibility probe of our argument, we examine three cases of transnational state demands exerted on MNCs. We analyze cases that demonstrate variation on our key independent variables — sunk costs and jurisdictional substitutability — that also vary on the dependent variable of compliance. Moreover, we chose these cases to illustrate the ability of our framework to explain empirical patterns that belie our current international political economy theories of MNC–government relations. While much research has illustrated that the US and the European Union have the ability to exercise some control over global firms, the current literature tends to ignore rising powers, or countries from the developing world more generally, often depicting them as policy-takers rather than policymakers (Drezner, 2007). We thus pick cases with both great powers and emerging markets as the primary state actor.

The transnationalization of authority through networked liabilities

Nigeria and MTN: Reaching through the affiliate to the corporate purse

MTN, based in South Africa, is one of the world's largest mobile phone operators with business operations in over 20 countries, from Afghanistan to Zambia, covering some 300 million customers. In late October 2015, Nigeria's National Communication Commission (NCC) levied the company with a record fine of US$5.2 billion for failing to comply with registration requirements for SIM cards used in mobile phones. According to the NCC, MTN had failed to heed the warning that the commission had issued more than 12 months prior regarding user registration (England and Wallis, 2015). While the NCC did not explicitly pressure MTN to change its business practices beyond abiding by the local SIM card registration rules, the huge fine imposed on the company reflected Nigeria's belief that the parent company is ultimately responsible, and that the latter should therefore pay the costs for the risky behavior of its affiliate. The fine represents half the company's global annual revenues (Giokos, 2015). With a multibillion dollar infrastructure investment in the country, which also represents the MNC's largest source of profits, the case is an example of a firm facing high sunk costs and low jurisdictional substitutability. This gives the host government of Nigeria considerable leverage as it reaches out past the local affiliate to extract regulatory demands from the corporate group.

		Jurisdictional substitutability: Low	Jurisdictional substitutability: High
Sunk costs	Large	Choke point and penalty	Penalty-driven
	Small	Choke point	Non-compliance

Figure 1. Paths toward networked liability.

The Nigerian government's justification for the regulatory action against MTN, which controls 43% of the country's telecommunications market, focused primarily on internal security issues. Anonymous or unregistered SIM cards can facilitate terrorism and crime. In particular, Nigeria's Boko Haram insurgency in the north-east of the country has been repeatedly cited as a concern by the Nigerian government. Given the fact that money transfers in developing countries frequently happen through mobile phone services, SIM card registration is a key tool to limit the financial flows of criminal and terrorist groups.

Unofficially, analysts suggest an additional economic motive as Nigeria needs to raise additional revenues. Over the last several years, Nigeria has become increasingly aggressive in going after international businesses, fining Shell US$3.9 billion in 2014 for environmental damages to the Bodo Community (Opeyemi, 2015). The same week that MTN was fined, the Nigerian affiliate of South African Standard Bank was also given a fine of US$5 million and told to fire a number of its directors for misstatements on financial accounts. According to some analysts, these fines represent Nigerian efforts to discipline foreign firms, while topping up their bottom line in the process. In the words of one analyst, the fine imposed on MTN is a "state-sanctioned mugging" (Shapshak, 2015). Regardless of the exact state motivation, the MTN–Nigeria dispute offers an important example of how governments can reach through affiliate networks into the overall assets of global corporations, whether these are physically held by the headquarters or not.

When the NCC announced the US$1000 penalty for each unregistered SIM card user, pressure to comply and pay the fine was high. MTN has been operating in the country since 2001 and derives huge profits from the "Giant of Africa." According to their shareholder reports, the company became the first global system for mobile communications (GSM) network in Nigeria in 2001, investing over the following years another US$1.8 billion (MTN, 2016). It also provides services in 223 Nigerian cities and towns and more than 10,000 villages. These represent substantial sunk costs, which make swiftly exiting the market extremely difficult.

As the most populous country in Africa, Nigeria also represents just over a third of MTN's total sales. While MTN has operations across 22 nations in Africa and the Middle East, Nigeria is its largest market, with a subscriber base of more than 60 million users.

Furthermore, in 2014, Nigeria overtook South Africa as the continent's largest economy, making it an important market well into the future (Shapshak, 2015). Combined, the high sunk costs associated with MTN's infrastructure investment, as well as its reliance on the Nigerian market for profits, afford the state considerable leverage in its compliance demands. MTN's Jyoti Desai dismissed any talk of MTN exiting Nigeria, saying that "the company has invested too substantially in the country's infrastructure and economy to even consider pulling out" (Tredger, 2016).

The fallout from Nigeria's regulatory action has also had broader implications for MTN's global operations. The news of the MTN case triggered investor panic and reservations about MTN's general operating procedure in Nigeria and beyond. Immediately following the fine, company shares dropped by more than 12% and continued to drop in the weeks following. The drop, and the way MTN handled the news of the fine, also triggered an investigation by the stock exchange — MTN had allegedly failed to officially alert shareholders to the fine for more than seven hours after the NCC had made its regulatory demands public (Allison, 2015). Moreover, the feud with the NCC raised questions about MTN's global business practices. MTN has faced a host of controversies in other countries, from corruption allegations in Iran (England and Wallis, 2015) to tax evasion in Uganda (Opeyemi, 2015). MTN's appetite for risk, which made them successful in the Nigerian market in the first place, became increasingly detrimental in the wake of the Nigerian fine. The Public Investment Corporation, South Africa's state-owned pension fund manager and MTN's largest shareholder, questioned how "risk and compliance function within MTN" (England, 2015).

These international spillovers further narrowed MTN's options. Originally, the NCC gave MTN until 16 November to pay the fine (Vecchiatto, 2015). MTN then entered negotiations with the NCC to have the fine reduced. They disputed the fine, saying that the "manner of the imposition of the fine" as well as its size were "not in accordance with the NCC's powers under the Nigerian Communications Act" (Thomas, 2015). MTN argued that the fine represented about half the company's annual revenues (Giokos, 2015), and furthermore was the equivalent of paying US$1000 per unregistered user, when MTN's average revenue per user was about US$5 (Allison, 2015). After weeks of lobbying, the NCC agreed to a 25% reduction of the fee, bringing the total amount down to US$3.9 billion. In December 2015, MTN contested this amount as well, prompting another legal battle (Prinsloo, 2016b). Nevertheless, in February 2016, MTN agreed to withdraw the matter from the High Court in Lagos and announced the payment of US$250 million as an advance to a potential out-of-court settlement (Prinsloo, 2016). Given the excessively high penalty, the South African telecom company is trying its best to reduce it, but even the fact that it entertains the thought of paying the exorbitant sum, and that it has already made an advanced payment to that effect, is enough evidence of Nigeria's power in the feud. Indeed, according to a document seen by *Reuters* (2016), MTN offered to pay US$1.5 billion in March 2016 and negotiations are still under way. What is nevertheless clear is that MTN has no plans to pull out of Nigeria. In fact, it increased its capital expenditure target for 2016 in Nigeria from US$700 million to about US$1 billion (Kishan, 2016). The Chief Executive Officer (CEO) of MTN Nigeria, Ferdi Moolman, said that the company "is positioned for growth and investing in different things, especially broadband services" (Enejeta, 2016). While conventional theories often stress the structural power of business to threaten exit, the case demonstrates the power of networked liabilities, through which the Nigerian government successfully raided an MNC's coffers.

In addition to the fine, MTN announced a review of its global operations, and several executives resigned (including the chief executive of the Nigerian operations and the Nigeria head of regulatory and corporate affairs). Not least, the company created several new positions, including that of group chief operating officer, to strengthen operational oversight, governance, and compliance across all the 22 countries in Africa and the Middle East where it currently operates (CIO, 2015). Contra race-to-the-bottom-style arguments, the case shows how networked liabilities can intentionally, and unintentionally, reverberate into the regulatory practices of the corporate group.

China and Glencore: State-led reorganization

In 2015, Glencore PLC ranked 10th on the Fortune 500 (*Fortune*, 2015). The company operates and trades in 90 commodities markets, with footprints in over 50 countries, employing 190,000 people globally (Glencore, 2016). It serves as a quintessential example of the transnationalization of business often depicted in conventional theories concerned with global regulation and state power. Ivan Glasenberg, the company's charismatic and controversial CEO, has been at the center of the MNC's expansion over the past decade, implementing a ruthless mergers and acquisitions strategy to both stamp out competitors and reap the efficiency gains of global supply chain integration. In mid-2012, the year when the company's global revenue topped US$214 billion, Glasenberg announced Glencore's most audacious acquisition yet — the Swiss mining company Xstrata.

While competition authorities in the various jurisdictions where both firms operated were notified and, then, raised minor concerns, it was the Chinese anti-trust authorities who intervened. Although neither firm owned key assets in the country, China was and still is the world's largest buyer of natural resources. The Glencore case, then, with low sunk costs and low jurisdictional substitutability, fits the relationship that we describe in the bottom-left quadrant of Figure 1.

Chinese authorities requested a number of changes in order to receive merger approval, including the divestment from a recently acquired extraction site in Peru. Conventional theories might predict a Glencore exit from the Chinese market at this stage as it held no corporate assets in China. However, excluding oil and gas, the country is the largest buyer in every major commodity market, accounting for between 40% and 50% of all copper, aluminum, and zinc consumption globally (Ro, 2015). As per Bank of America, China was responsible for over 50% of commodities-related demand growth this past decade (Ro, 2015). The country's market power, a key component of jurisdictional substitutability, created a clear choke point.

At the time of the merger, Glencore was the prime player in the beginning and end of the commodity cycle while Xstrata, a company with substantial positions in coal and zinc, operating in 19 different jurisdictions, specialized in what constitutes the middle of the supply chain. Such an acquisition would produce sizable returns to scale, assuaging the fears of numerous shareholders who were already fretting about the commodity market bust that was soon to come. The deal would be worth US$41 billion, making it the fifth-largest natural resources merger in investment banking history (Blas, 2013; see also *The Street*, 2013).

Such a colossal transaction inevitably raised the heads of the world's key anti-trust agencies. Although the network effects of such a deal could be vast, Glencore and Xstrata tended to do their largest business in different commodities, arguably making any review process relatively smooth. Australia and the US were the first to give a green light while the European Union requested some minor divestments in the zinc market (Tivey, 2013). South Africa, where both firms employed a large army of workers, tried to hold back the deal given the inevitable downsizing that was set to ensue in the jurisdiction. However, given Glencore's diversified portfolio of mining properties, South Africa had little leverage. The largest roadblock came from a country where neither company had substantial physical operations — the People's Republic of China.

China's competition laws fall under the Ministry of Commerce, referred to as MOFCOM, and were only implemented in the past decade following pressure from some of the major Western economies (Faure and Zhang, 2013). As was noted earlier in the article, anti-trust has historically been a key tool in America's extraterritorial arsenal — something the Chinese have been happy to replicate. Their laws have an explicit extraterritorial clause, so any deal that might threaten Chinese national interests, independent of its territorial scope, can fall under the Republic's legal jurisdiction (Faure and Zhang, 2013). Specifically, when a deal involves companies with an aggregate global turnover that exceeds RMB10 billion (approximately US$14.9 billion), or an aggregate turnover within China that exceeds RMB2 billion (approximately US$2.99 billion), the deal requires MOFCOM approval (Gilbert + Tobin, 2013). In addition, if at least two of the merging parties each have a turnover of RMB400 million (approximately US$600 million) or more within China, MOFCOM authorization is required (Gilbert + Tobin, 2013). These turnover levels fall far below the mandates of the US Department of Justice (DOJ) or the European Commission, providing China with outsized influence on merger issues even compared to its traditional great power rivals. China's market power, coupled with the extraterritorial nature of the regulation, ensures that domestic authorities can, then, use affiliates to tap into the power resources of MNCs in order to accomplish the rising power's national priorities.

Despite only being an active anti-trust player for a handful of years, by the time of the Glencore deal, MOFCOM had already developed a controversial reputation with the world's elite corporations. Its review processes were frequently delayed, often focusing on aspects that most authorities deemed irrelevant, with little insight or justification as to how MOFCOM actually analyzed mergers. A number of analysts have gone as far as to say that the low standards and lengthy reviews were purely to give the Chinese access to Western companies' intellectual property. With the Chinese appetite for natural resources only increasing, Glencore had repeatedly stated its plans to increase its sales presence in China. They needed MOFCOM on their side. Despite low sunk costs, China's low substitutability gave Glencore and Xstrata no choice but to notify the authorities.

The review took over a year and a half to complete despite repeated promises by MOFCOM to finish within 180 days. Glencore was even forced to re-file the notification given frustrating early negotiation rounds. The final results did not disappoint, demonstrating a new level of Chinese interest in global merger outcomes. For the first time, MOFCOM released a lengthy account of its various decisions and calculations, focusing on how the merger would affect markets for copper, zinc, and lead concentrates. They argued that the market power of the merged entity could have adverse effects for China, from raising barriers to entry to diminishing consumer choice (DavisPolk, 2014). This was despite the fact that the two combined entities would, at most, only control 12.1% of the markets that the Chinese identified as concerns. Moreover, MOFCOM decided to hone in on the copper concentrate sector for the greatest reforms. As law firm DavisPolk (2014) noted:

> On a worldwide basis, the combined copper concentrate market share of the parties was 7.6% in production and 9.3% in supply, and only 12.1% in supply to China. In zinc concentrate, on a worldwide basis, the combined market share was 11.2%. … These are market shares that the U.S. antitrust authorities deem "unlikely to have adverse competitive effects and ordinarily require no further analysis." These shares are also well below the 25% combined share under which an absence of anticompetitive harm is presumed.

MOFCOM made a series of behavioral and structural requests that Glencore would have to abide by before the authority gave its approval. First off, Glencore would have to agree to sell a minimum of 900,000 tons of copper to Chinese clients per year for the next eight years, with 200,000 tons of these sales priced in accordance with the benchmark levels from pre-deal years (Ferreira-Marques, 2013). Second, and most controversially, MOFCOM sought to radically alter Glencore's global presence by requesting a series of otherwise lucrative divestitures. Specifically, Glencore would need to sell the Las Bambas greenfield copper mine in Peru where Xstrata had already invested US$2 billion. The mine is expected to produce 400,000 metric tons of copper between 2015 and 2019 with a total 6.9 million tons of copper in reserves (Whitfield, 2014). If Glencore were unable to find a buyer within six months, China would select a series of mines in the Philippines, Papua New Guinea, and Argentina that would need to be auctioned (Ferreira-Marques, 2013).

Despite having virtually no sunk costs in the country, China leveraged its market power as a way of altering Glencore's global business profile for the country's gain. MOFCOM was not hiding its cards. As it stated in its first public report on the deal:

> China is the world's major importing country for copper concentrate, with China's present demand accounting for about 50% of the total global demand. China's imports of copper concentrate in 2011 accounted for 68.5% of total domestic supply, and the trend shows an upward trajectory. In 2011, Glencore's and Xstrata's exports of copper concentrate to China accounted for 13.3% and 4.5% respectively of China's total imports, or 17.8% on a combined basis. The Chinese market is a major market for the undertakings concerned in the concentration. (Mayer Brown, 2013: 2)

As per our expectations, Chinese authority created a choke point for the company. Glencore had already invested huge sums into the deal and Glasenberg had put his reputation on the line. Both firms could not afford to lose the Chinese market, and, after a series of closed-door meetings, eventually began to execute MOFCOM's conditions.

Nonetheless, this was not direct, straightforward compliance. Instead, Glasenberg had room to move. A number of early reports noted that Glencore was keeping MOFCOM abreast of all the various bids that the company was receiving, going against general company conventions (Wilson and Hume, 2014). This puzzle soon resolved itself as analysts learned that subsidiaries of two different Chinese state-owned enterprises were, in effect, engaging in a bidding war, with Glasenberg and Glencore at the center (*Reuters*, 2013). While the company was forced to renege on a key copper mining asset, it eventually sold Las Bambas for nearly US$6 billion to MMG Ltd., a subsidiary of Chinese state-owned enterprise Chinamin Metals Corporation (Gough, 2014). The mine had only been valued at US$4 billion prior to the transaction.

Glencore was able to recoup its initial investments and, in turn, take on cash that it desperately needed to cover some of its debt-filled balance sheet. Glasenberg was further able to assuage shareholders who were starting to take a bearish outlook on commodities like copper by promising to boost their dividends (and his own given that he held 8% of the company's shares). As Paul Gait, analyst at Bernstein Research, noted, the general consensus was that Glasenberg was able to make the most out of a narrowing scope of options (Wilson and Hume, 2014).

China openly and capably utilized its market power to seriously shift the strategy of a poster child of global MNC power. In spite of limited sunk costs in the jurisdiction, the global integration of commodities markets that are beginning to resemble monopsony left Glencore liable. China created a choke point that provided Glencore with a mutually beneficial quid pro quo. A number of lawyers, Wall Street analysts, and MNC officers have noted that such behavior by China is becoming increasingly common, with unpredictable, self-serving, demands placed on foreign firms. However, as Catriona Hatton, partner at Baker Botts, has stated, "Companies are thinking about the cost of doing business in China. In some cases, it's a poison pill you have to swallow" (Michael, 2013).

The US and Schlumberger: Pay the penalty and move on

Schlumberger Limited is the nervous system that keeps the oil industry alive. The Netherlands & Antilles based oil services company does not own production facilities or land rights to drilling. Instead, the company specializes in extraction and drilling techniques that make it the go-to for private majors like Exxon Mobil and BP, and national oil companies from Brazil to Turkmenistan. At the peak of its powers in 2014, the company employed over 100,000 people across its oil and gas drilling stations located in 85 different jurisdictions (Ball and Davies, 2015; see also Schlumberger, 2016a). It took in more than US$48 billion, with a global valuation greater than US$116 billion (Ball and Davies, 2015). As *The Guardian* reported, it employed more people than Google, had a better turnover than Goldman Sachs, and was valued higher than McDonald's. While trading on five different international stock markets, it paid only US$1.9 billion in taxes (Schlumberger, 2016a). However, all this transnational activity had led the company to collide with the frictions of opposing national regulatory regimes.

In 2009, as the US began to retool its approach to rogue states, the DOJ opened an investigation into the company's activities in Sudan and Iran. While MNCs can do business with sanctioned countries, the relationship between foreign and US-based affiliates always leaves room for liabilities. Schlumberger looked prime for the taking — evidence of wrongdoing was clear-cut and the company had massive sunk costs in the US, with two large research hubs located in Texas and Massachusetts (Schlumberger, 2016b). Key global strategy decisions were made in the former while the latter has been an important player in helping Schlumberger rack up some 35,000 patents — three times its infamous American peer Halliburton (Ball and Davies, 2015). However, such sunk costs and dependence need to be put in the broader diversification strategy that Schlumberger has employed. Its Massachusetts facility is only one of six nodes in a research network that spans some 125 different research centers. Again, its Texas office is also only one of its six major head offices. While the US market ranked in the top five revenue sources for the company during the six-year DOJ investigation (2009–2015), between 70% and 80% of its profits came from its non-American operations, with no single customer accounting for more than 10% of consolidated revenue (US Securities and Exchange Commission, 2013). Moreover, at the time investigations commenced, Schlumberger's largest source of revenue growth came from contracts with national oil companies (Hoyos, 2008). With all this in mind, Schlumberger had invested high sunk costs in a jurisdiction with relatively high substitutability, placing it in the top-right quadrant of Figure 1. In line with our theory, this resulted in Schlumberger taking a penalty-driven approach to its relations with the American state. The US was able to curb the firm's behavior and extract a precedent-setting settlement. Nonetheless, the MNC's diversification made such measures easily absorbable. The firm was quick to cut ties with Iran and Sudan, agreed to a criminal charge, and paid a US$232 million fine. However, rather than exiting the US, the company doubled down on its investments in the jurisdiction post-settlement and has not been afraid to risk doing business with newly sanctioned entities.

Between 2008 and 2015, the DOJ pursued a growing list of cases associated with financial misconduct in general, and sanctions evasion in particular (Brez and Casey, 2015). Rumors of the US taking on MNCs, rather than individuals or firms, within sanctioned countries to fully choke a regime were mounting and Schlumberger Ltd. was the first major oil and gas-related company to undergo such an investigation. In March 2015, the DOJ announced that American affiliate Schlumberger Oilfield Holdings Ltd. (SOHL), a wholly owned subsidiary of Schlumberger Ltd., had pled guilty to violating the International Emergency Economic Powers Act (IEEPA) by "facilitating" trade with Iran and Sudan. Schlumberger agreed to pay over US$232 million in fines and, unlike too-big-to-fail banks that have settled deferred prosecutions with the DOJ, pled guilty to *criminal* charges (US Department of Justice, 2015). An MNC that is not headquartered in the US has the legal right to operate in embargoed countries even if it has an affiliate on American soil. However, a firewall must exist between the MNC's constituent parts. Once an action is taken on US soil or by an employee of a US affiliate, the DOJ has the legal basis to pursue a global-scale prosecution. One of SOHL's Sugar Lands, Texas-based affiliates, Drilling & Management (D&M), had been in charge of overseeing the global capital expenditure process for the conglomerate. As the DOJ explains:

> The CAPEX [Capital Expenditure] process was a forecasting mechanism enabling oilfield locations to predict what tools and equipment they would need to meet anticipated demand for oilfield services. Oilfield personnel worldwide made requests through an automated system for the manufacture of new tools and for permission to spend money for certain purchases in order to support oilfield operations. (US Department of Justice, 2015)

Any final decision on capital allocation would still need to be approved by the US office, indirectly violating US law by, in the words of the DOJ, "facilitating" the business practices in Sudan and Iran (*Law360*, 2015).

While SOHL and D&M maintained that they had safeguards put in place to avoid its internal organizational processes resulting in sanctions violations, its global affiliates seemed to have disregarded the message. D&M affiliates actively labeled any requests related to Iran or Sudan as coming out of a warehouse in Jebel Ali (UAE) with the "BGM" code of the factory becoming notorious across the affiliate network. In email communications regarding the allocation requests, Iran was always referred to as a "Northern Gulf" country and Sudan as "Southern Egypt." In addition, a number of key business decisions for D&M's Sudanese and Iranian business arms were made directly out of the Texas office, knowingly in violation of the US sanctions regime (US Department of Justice, 2015). The network Schlumberger used to allocate its CAPEX left the Netherlands & Antilles-based holding company exposed to US law, while its foreign affiliates only added fuel to an already legally tenuous fire.

Last but certainly not least for our purposes, D&M American staff also violated sanctions by providing technical expertise to help fix equipment located in the embargoed jurisdictions. Similar to its CAPEX network, D&M uses an internal communication network that allows employees in its affiliates to request help in fixing any equipment that is in need of repair at one of its refining sites. If the problem is highly technical, the request gets routed back to the place where the piece of equipment was originally manufactured. Given that Sugar Lands still has substantial manufacturing facilities, this system led a number of US-based employees to consult affiliates based in Iran and Sudan, breaking the firewall needed to stay on the right side of US law (US Department of Justice, 2015).

With investigations ongoing in 2009, Schlumberger agreed to suspend all its operations in Iran and Sudan despite the large upfront costs of providing oil services in the countries. In spite of its limited reliance on the US for its profits or business operations, the high sunk costs in its American affiliates pushed the group to cave and pay the penalty. At the same time, SOHL was put under a three-year probation period where it has to make periodic reports to the DOJ on its parent company and, with it, their global affiliates' business practices. Last but certainly not least, Schlumberger has agreed to retain an independent consultant to monitor and review all of the parent companies' audits and every measure the company will henceforth take to maintain compliance with the sanction regime (US Department of Justice, 2015). Such increased monitoring capabilities ensures that the DOJ will have more cards to play against both Schlumberger and, likely, other oil and gas companies as the US continues to manipulate countries like North Korea and Iran.

The US was certainly successful in utilizing Schlumberger's American subsidiaries to curb the MNC's global behavior for the country's advantage. Once again, on the surface, this appears to be an all-out win for the DOJ, but Schlumberger's diversification and stateless identity has allowed it to take a cost–benefit decision calculus regarding sanctions. While the US$232 million may seem substantial, the company earned US$208 million in 2012 from Iran alone (Ball and Davies, 2015). As Barclays oil services and equipment analyst David Anderson aptly summarized:

> Everyone's known the company, Schlumberger, because its sort of dual-citizenship … has allowed them to operate in certain areas, which has given them an advantage over certain companies and areas, and Iran was one of them. … They operated in the country and they paid the fine. (Ball and Davies, 2015)

Conclusion

A large literature stresses the ways in which globalization has restructured the nature of the firm (Bartley, 2007; Dallas, 2015; Vernon, 1971). From complex supply chains to intricate affiliate structures, global companies have used economic openness to diversify production and smooth consumption. In this article, we argue that the transnationalization of business also creates new legal liabilities for these MNCs. As firms globalize, they expose themselves to new jurisdictional claims. These legal liabilities generate considerable leverage for the state as it seeks to exert its interests — financial, security, or other — not only on the affiliate, but also the entire corporate group. The transnationalization of business, then, generates new state authority, which we term "networked liabilities," as governments can extend their grasp through complex business relationships.

In many ways, this article offers a transnational complement to existing research on the political risk of foreign direct investment. This work has found that multinational firms may find their investments subject to the political whims of domestic politics (Jensen, 2006, 2008, 2014). Much of this work, though, keeps the locus of analysis within a particular sovereign state, for example: "Under what conditions do governments expropriate?" Our argument, then, further complicates the relationship, allowing state authority to transnationalize as well. By decoupling state jurisdiction from territory, our article completes the logic of globalization in which both markets and authority span geographical borders (Farrell and Newman, 2015; Newman and Posner, 2011).

In addition to introducing the concept of networked liabilities, a central contribution of the article is to better specify its boundary conditions. As with research on political risk, we find that sunk costs play a key role in state leverage. MTN's infrastructure investment limited the company's response and enhanced the Nigerian government's hand. At the same time, however, we also emphasize the importance of jurisdictional substitutability. In other words, how credible is a firm's outside option? In the case of Glencore, the company had little sunk costs in China but fell victim to the government's transnational demands because of China's irreplaceable market for raw material imports. A key next step in the research agenda is to explore the generalizability of the findings. Recent work by Wellhausen (2014) illustrates that the number of firms from the same home state that operate in a host jurisdiction heavily conditions government contract breach and, thus, hints at another important variable that could act as a limit to transnational state authority. In a similar vein, an MNC could leverage the threat of depriving a host country of key, future innovations as a means to reduce domestic regulatory actions, blurring the lines between penalty absorption and exit.[4]

Given recent headlines concerning regulatory actions against global companies ranging from Apple, Google, and Deutsche Bank to Uber, it is clear that our argument has the potential to explain business–government relations across a host of sectors and jurisdictions. There is also mounting evidence that the transnationalization of authority through networked liabilities is not limited to purely economic regulatory issues. Corporations increasingly find themselves under the spotlight for the behavior of their affiliates with regard to human rights, the environment, and labor practices (Bartley, 2007). NGOs, then, have used legal standing in developed countries to go after the corporate group, regardless of the location of the particular regulatory infringement. As legal and regulatory institutions diffuse globally (Brake and Katzenstein, 2013), future work should consider how these diffusion patterns may affect a state's long-term ability to exploit networked liabilities across these different regulatory domains. Ultimately, the spread of regulatory capitalism across countries and sectors may reduce jurisdictional substitutability.

More generally, the manuscript makes a number of key interventions in International Relations. First, it highlights the importance of moving to firm-level analysis. Considerable work on extraterritoriality and market power has focused on the unit of the state. A key contribution of the article is to demonstrate the variation of such authority across firms, states, and sectors. While both the US and China have large markets and considerable aggregate market power, China is better positioned vis-a-vis Glencore than the US is vis-a-vis Schlumberger because of the firm–sector–state relationship. While aggregate market size is clearly an important factor contributing to jurisdictional substitutability, our evidence suggests that it is not the sole determinant. Future work should consider how the internal organization of the firm, such as vertically versus horizontally integrated MNCs, alters bargaining and power dynamics between the firm and the state.

Second, the article underscores the deterritorialization of state authority. Much of the work on globalization has emphasized the deterritorialization of business but has largely continued to lock the state into discrete physical units. Work on interdependence, extraterritoriality, hierarchy, and multi-level governance (Farrell and Newman, 2014; Lake, 2009; Putnam, 2009; Sabel and Zeitlin, 2008), however, all point to the limits of this approach. Our argument, then, highlights the particular way in which global business interacts with transnational authority.

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Notes

1. We define an MNC as a company that conducts business operations in one or more jurisdictions outside its home market. There are a number of distinctions within the MNC category, including vertically versus horizontally integrated firms, or international versus global versus transnational companies, that aim to better specify authority and interdependence within the firm. For analytic purposes, we group these distinctions and analyze the MNC writ large. For definitive work discussing the key typologies of MNC organization, see Harzing (2000).
2. For some recent exceptions, see Jensen, Quinn and Weymouth (2015) and Johns and Wellhausen (2016).
3. In contrast to obsolescent bargaining models, we are not focusing here on expropriation demands or the renegotiation of investment contracts. Rather, we are interested in the state's ability to enforce its regulatory rule book against global companies.
4. We thank one of our anonymous reviewers for this point.

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