BI Norwegian Business School is a leading Nordic research and teaching institution with campuses in the four largest Norwegian cities. Our activity is organized under eight departments covering the range of business research disciplines, and eight BI Research Centres concentrated around themes where we are especially strong.

Departments

- Accounting, auditing and business analytics
- Communication and culture
- Data Science and Analytics
- Economics
- Finance
- Law and Governance
- Leadership and Organizational Behaviour
- Marketing
- Strategy and Entrepreneurship

BI Research Centres

- Centre for Asset Pricing Research
- Centre for Construction Industry
- Centre for Corporate Governance
- Centre for Creative Industries
- Centre for Experimental Studies and Research
- Centre for Health Care Management
- Centre for Applied Macroeconomics and Commodity Prices
- Nordic Centre for Internet and Society

For an archive of all our PhD-dissertations/reports, please visit www.biopen.bi.no

BI Norwegian Business School
N-0442 Oslo
Phone: +47 46 41 00 00
www.bi.no

BI Norwegian Business School

Gilbert Kofi Adarkwah • Institutions, Policy Risk, and Firms Behavior

Institutions, Policy Risk, and Firms Behavior

Foreign Investments in High-Risk Countries

Gilbert Kofi Adarkwah

No. 9 – 2021
SERIES OF DISSERTATIONS

BI Norwegian Business School

Institutions, Policy Risk, and Firms Behavior

Foreign Investments in High-Risk Countries

by
Gilbert Kofi Adarkwah

A dissertation submitted to BI Norwegian Business School
for the degree of PhD

PhD specialisation: Strategic Management

Series of Dissertations 9/2021
BI Norwegian Business School

Gilbert Kofi Adarkwah
Institutions, Policy Risk, and Firms Behavior: Foreign Investments in High-Risk Countries

Series of Dissertations 9/2021

ISBN: 978-82-8247-168-8
ISSN: 1502-2099

BI Norwegian Business School
N-0442 Oslo
Phone +47 4641 0000
www.bi.no

SVANEMERKET
Trykkeri
2041 0731

TRYKT I NORGE
NO-598

Skipnes Kommunikasjon AS

To my Mother, Ernestina Armah

Acknowledgments

"Do not pray for your dreams to come true; pray that you live beyond your dreams. Because your dreams are limited to your imagination at a particular point in time."

Ernestina Armah (my mother)

My mother once told me that I should pray that I will live beyond my dreams because dreams are limited in scope by our imaginations. When growing up in Sefwi Elluokrom, a rural farming community in Ghana, doing a PhD was a dream beyond my imagination. Today, as I write the final chapter of my dissertation, I can look back and say that I have been very fortunate in my life. I have been lucky and met many incredible people who have supported me along the way to reach where I am now. Without these people, well, my imagination is limited, but this dissertation would not have happened. As such, I owe a great debt of gratitude to my family and friends for their support and encouragement over the years.

First, I would like to thank If P&C Insurance for financing the initial cost of this project. I began this PhD study as an industrial PhD student with generous support from my manager, Marianne Hartvig, colleagues, Hanne Cecilie Røed, Jørn Arne Nyborg, and the management team of If P&C Insurance. As the first-ever industrial PhD candidate sponsored by If P&C Insurance, the internal process of obtaining approval for the project and the external procedures of securing collaboration with the research council were challenging, to say the least. However, you supported me along the way. Thank you for not losing faith in me and for making my PhD dream come true.

Second, I would like to thank my advisors, Professor Birgitte Grøgaard and Associate Professor Sverre Tomassen. Thank you so much for allowing me to explore my research interests and for being supportive and patient with me over the years, even when you did not have to be. Since the day I enrolled in this program, you welcomed me with open minds and hearts. You have continued to invest an innumerable number of hours to mentor and advise me throughout this PhD process. I am very grateful. Thank you.

Third, I want to thank my dissertation committee members, Professors Randi Lunnan and Grazia Santangelo, for their valuable comments and suggestions for improving my proposal. These comments and suggestions shaped the final output of my dissertation. Thank you.

There is an African proverb that states, "It takes a village to raise a child." Besides my advisors and committee members, I have been privileged to receive mentorship from my colleagues at the Department of Strategy and Entrepreneurship. Special thanks go to Research Professor Gabriel R.G. Benito for his teaching, mentoring, discussions, and for co-authoring my first essay with me. To Thomas Hoholm, Anne Lenæs Zimarseth, and Kai Rune Mathisen, thank you for being an excellent department management team. To Helene Loe Colman, Amir Sasson, Pengfei Wang, Øystein Fjeldstad, Linda Rademaker, Vegard Kolbjørnsrud, Dovev Lavie, Marcus M. Larsen, Renate Kratochvil, Alessandra Luzzi, and Rolv Petter Amdam, thank you for your helpful comments on the brown bag presentations of my articles.

I would also like to thank Suzanne Fearnley McGowan for her invaluable support throughout this journey and for agreeing to be my partner in the journeys ahead.

Finally, I would like to share a message with my fellow Ph.D. students Tine Petersen Malonæs, Christopher Albert Sabel, Flladina Zilja, Sophie (Wenxin) Gao, Marius Andersson, Sverre Ubisch, Daniel Massie, Betina Riis Asplin, Keith Peavy, Corina Fehlner, Prakash Raj Paudel, and Marte Semb Aasmundsen. Since doing a Ph.D. can be a lonely process, I want to thank you for making my Ph.D. journey exciting.

Gilbert Kofi Adarkwah *Oslo 25.06.2021*

Abstract

This dissertation investigates the relationship between host country institution-related (policy) risks and firms' international investment strategies. The dissertation consists of four essays. **Essay 1** contributes to a fundamental discussion in the strategy and international business literature concerning why many firms continue to invest in countries with greater policy uncertainties by providing a more nuanced analysis of the strategies that MNEs use to handle and curb host country policy risks when investing abroad. **Essay 2** outlines how host countries' domestic and transnational institutional arrangements help firms dampen host country policy risks against their assets. **Essay 3** examines how the alignment of interests between firms' home and host countries affects the costs of doing business abroad and subsidiary-level investments. Finally, **Essay 4** demonstrates how firms contribute to institutionalization by examining investments by impact investing firms in high-risk developing countries. The essays provided in this dissertation incorporate several mechanisms to explain how firms respond to the institutional practices that affect them, thereby contributing to an important—but scarcely examined—aspect of institutionalization in the strategy and international business research.

Table of Contents

List of Tables

List of Figures

List of Appendices

1. Introduction

Institutions matter to firms' strategic choices. They do so because institutions create and regulate the marketplace in which firms compete (Cuervo-Cazurra et al., 2019; North, 1990a, 1991). In countries where market-supporting institutions are weak, host governments are predisposed to opportunistically alter processes and enact policies that could be detrimental to firms (Henisz, 2000b; Henisz & Zelner, 2006; Stevens et al., 2016). This increases institution-related risks for foreign firms (Blake & Moschieri, 2017; García-Canal & Guillén, 2008; Holburn & Zelner, 2010). In this dissertation, policy risk is defined as the proclivity for a host government to opportunistically alter the laws, regulations, or contracts governing an investment or fail to enforce them in a way that adversely affects the final returns on a foreign investor's assets (Holburn & Zelner, 2010). The nature and duration of foreign investments, as well as the unique uncertainties involved in investing abroad, make host countries' institution-related (policy) risks particularly important for multinational firms. For instance, a recent survey of over 1000 chief executive officers in 91 countries found that host country political uncertainties (a key source of policy risk) represents the most severe obstacles to doing business (PwC, 2020). Hence, policy risk is relevant in both theory and practice.

Unsurprisingly, many studies on foreign location choice (Coeurderoy & Murray, 2008; García-Canal & Guillén, 2008; Hoskisson et al., 2000; Meyer et al., 2009; Santangelo & Meyer, 2011), cross-border mergers and acquisitions (Bertrand et al., 2016; Hasija et al., 2020), alliances (Arikan et al., 2020), subsidiary investments (Delios & Henisz, 2000; Holburn & Zelner, 2010), and divestments (Blake & Moschieri, 2017; Kobrin, 1980) have examined how host country institution-related uncertainties affect the willingness of firms to invest in a country.

These earlier studies have undoubtedly generated valuable insights into the effect of institutions on firms' environments and how institutions influence firms' conformity to their environments. However, current knowledge on 1) the strategic behaviors that firms employ in response to institutional uncertainties that affect them and 2) firms' influence on the process of institutionalization in their environments remains limited in the strategy and international business literature (Buckley, 2016; Lawrence et al., 2011; Oliver, 1991). In addition, the majority of these studies have been criticized for offering little to no insights into the complexities of host country institution-related uncertainties and, therefore, less relevant to managers (Meyer & Estrin, 2014; Zhu & Sardana, 2020). Therefore, there is a need "to go

beyond such an approach" (Buckley, 2016, p. 79). In this dissertation, I seek to give nuances to the bi-directional relationship between host country institutions and firms' foreign strategy in the context of high-risk developing countries. Specifically, I seek to answer the following question: *How do host country institutional processes and practices interact with firms' international investment strategies?*

1.1 Institutions

In this dissertation, institutions are defined as "the humanly devised constraints that shape human interaction" (North, 1991, p. 97). Host country institutions may be informal (norms, customs, and values) or formal (laws, regulations, and policies). In this dissertation, I focus on formal institutions (e.g., government policies) enacted to control firms' conduct since these formal policies define what economic activities are permissible and profitable in a host country (North, 1991). Since a key focus of this dissertation is on host country policy risks and their effects on firms' international investment behavior, I primarily rely on the literature on political institutions (Henisz, 2000b; Henisz & Delios, 2001).

Earlier scholarship on institutionalization (North, 1990b, 1991; Scott, 1995) was concerned with how firms can secure their positions and legitimacy in an environment by conforming to the rules and norms of the institutional environment (Meyer & Rowan, 1977; Scott, 1995; Xu & Shenkar, 2002). These scholars have argued that in order to survive, firms must conform to the prevailing institutions in an environment (DiMaggio & Powell, 1983; Meyer & Rowan, 1977) because institutional isomorphism (DiMaggio & Powell, 1983) —both structural and procedural—will earn firms legitimacy and, ultimately, survival (Deephouse, 1996, 1999; Suchman, 1995). Thus, according to some earlier research on institutions, firms are passive actors *vis-à-vis* both home and host country institutions (Lawrence & Suddaby, 2006; Oliver, 1991). However, some strategy and international business scholars have argued that firms must actively participate in the process of institutionalization in order to gain favorable outcomes in uncertain institutional environments (Doh et al., 2012; Dorobantu et al., 2017; Funk & Hirschman, 2017; Mellahi et al., 2016; Zhu & Sardana, 2020). Through the essays included in this dissertation, I seek to contribute to this discussion by providing a nuanced understanding of how host country institutions interact with firms' international investment strategies. This dissertation argues that while domestic and transnational institutional safeguards help firms protect their assets in complex institutional environments, governments' behaviors determine the extent to which such institutional safeguards are adequate.

1.2 Host country policy risk

Host country policy risk has been a focal topic for strategy and the international business scholars interested in studying the development of market-supporting institutions in host countries (Henisz, 2000b; Henisz & Delios, 2001) and how such institutions, or the lack thereof, affect firms behavior (Henisz, 2000b; Henisz & Zelner, 2001; Meyer et al., 2009). It has been analyzed in the strategy and international business literature using a variety of approaches. These include the legitimacy-based approach (Darendeli & Hill, 2016; Hasija et al., 2020; Stevens et al., 2016), bargaining power approach (Kobrin, 1987; Ramamurti, 2001; Vernon, 1971, 1993), and political institutions approach (Henisz, 2000b; Henisz & Zelner, 2001). The legitimacy approach suggests that firms must establish legitimacy with host country stakeholders (Stevens et al., 2016) to improve their chances of success and, ultimately, their survival (Darendeli & Hill, 2016; Hasija et al., 2020). The bargaining power approach argues that firms with unique, firm-specific advantages (e.g., technological expertise, managerial superiority, or access to markets or export potential) relative to host governments have greater bargaining power over such governments (Kobrin, 1987; Ramamurti, 2001). However, as local institutions in the host country improve, such firms may gradually lose their bargaining power over host governments (Holburn & Zelner, 2010) and become vulnerable to *ex-post* opportunism behavior by the host government and other (local) stakeholders (Müllner & Puck, 2018).

On the other hand, the political-institutional approach examines the development of market-supporting institutions in host countries (Henisz, 2000b; Henisz & Delios, 2001) and how such institutions, or the lack thereof, affect firms behavior (Henisz, 2000b; Henisz & Zelner, 2001; Meyer et al., 2009). This approach posits that since host governments benefit from altering laws and policies to their advantage (e.g., transferring resources from private firms to national accounts), more political checks and balances that reduce a government's ability to change laws or enact new discriminatory laws will decrease the institution-related risks to firms (Henisz & Zelner, 2001; Stevens et al., 2016). This dissertation falls under the political-institutional approach emphasizing formal institutions (Bertrand et al., 2016; Henisz & Zelner, 2003).

Firms are likely to pursue different forms of behavior to safeguard their assets in various host environments due to heterogeneity in their perceptions of host country institution-related risks and their capabilities for managing such risks (Albino-Pimentel et al., 2018; Darendeli & Hill, 2016)). However, as discussed in **Essay 1**, firms do not only rely on their own capabilities to safeguard their assets in high-risk countries. Instead, they rely on a set of institutional

mechanisms that alleviate and offset the risks of investing in complex and volatile environments. As shown in **Essay 2**, such local and supranational institutional agreements provide strong protection for foreign firms' assets. Such agreements alleviate institution-related risks by allowing harmed foreign firms to call on external arbitration and even seize host government assets held abroad as compensation for losses due to a host government's negative behavior. As a result, some firms may continue to invest in countries with greater policy risks even when other firms are engaged in investment-related expropriation disputes with the same host country.

While institutions imply stability, as discussed in **Essay 3** and **Essay 4**, they may be subject to incremental and discontinuous change processes. As shown in **Essay 3**, firms adjust their investment behavior as institutions change, which allows them to absorb potential shocks that may stem from changes in the institutional environment. Additionally, **Essay 4** argues that some firms (i.e., impact investing firms) deliberately pursue investments in countries where they can change and/or create institutions (Demsetz, 1968; Lawrence & Suddaby, 2006). Thus, I posit that host country policy risk mitigation must not be limited to firms' passive compliance to government orders (North, 1990a, 1991) or good corporate behavior (Werner, 2015). Instead, firms must respond strategically and tactically to institutional forces in their environment to safeguard their assets and achieve favorable outcomes.

1.3 Description of the dissertation

This dissertation consists of four essays. For a summary, see **Figure 1.1**.

Essay 1: Dealing with high-risk environments: Multinational firms in developing countries

Essay 1 takes stock of the mechanisms available to MNEs to protect their investments in risky developing host countries. Existing strategy and international business research have highlighted the lack of investment in high-risk countries by showing a negative relationship between various forms of host country institution-related policy risk and foreign investments (Brunetti & Weder, 1998; Henisz, 2000b; Kobrin, 1978, 1979). At the same time, and in apparent contradiction, scholars have recently shown that many firms often invest in host countries with greater institution-related policy risks (Cuervo-Cazurra & Genc, 2008; Holburn & Zelner, 2010). These observations present an intriguing puzzle: *As evidenced by the increasing flow of foreign direct investment into high-risk developing countries*, *how do MNEs*

safeguard their investments in host countries characterized by severe policy uncertainties and a lack of market-supporting institutions? The first essay in this dissertation (**Essay 1**) answers this question by taking stock of the mechanisms available to MNEs to protect their investments in high-risk host countries. I argue that MNEs that expand into countries replete with institutional voids do so not only because they have an extraordinary appetite for risk or special capabilities against risks. Instead, these firms rely on a set of institutional mechanisms that alleviate and offset the risks of investing in high-risk host countries. Drawing on the political-institutional approaches to policy risk literature, I propose a framework of international investment protection.

Essay 2: Host government intervention and foreign direct investment inflow: An empirical investigation

Essay 2 examines the effect of host government interference in foreign firms' operations on foreign direct investments (FDI) inflows. Previous studies have argued that to attract more investments from multinational firms, governments—particularly those in developing countries—must demonstrate their willingness to abide by international norms of investment protection since investors are skeptical about the quality of domestic institutions in developing countries (Albino-Pimentel et al., 2018; Henisz, 2000a; Meyer et al., 2009). Consequently, many countries in the past decades have invested time and other scarce resources to negotiate, conclude, sign, and ratify international investment agreements (Elkins et al., 2006; Neumayer & Spess, 2005). International investment agreements generally contain provisions that allow aggrieved foreign investors to sue host governments in international courts (Dolzer & Schreuer, 2012). Moreover, the literature has argued that for host countries, the mere involvement in suits with foreign firms may signal increased policy risks and result in reduced foreign investment (Allee & Peinhardt, 2011; Wellhausen, 2015). Through **Essay 2**, this dissertation provides a comprehensive empirical assessment of this assertion by answering the following question: *Do expropriation disputes between multinational firms and host countries resulting from host government interference with firms' assets affect the host country's attractiveness as an FDI destination?* While host government interference with the assets of a few foreign investors does not deter FDI inflow, frequent interference that results in an increasing number of host state–foreign investor disputes reduce FDI inflow to a host country. The analysis also shows that when faced with increasing host country uncertainty, investors adopt a wait-and-see strategy. However, how long investors wait depends on the economic situation of the host country. For high-income countries, investors wait until approximately 10 disputes before reducing their

investment level in a host country. For low-income countries, this waiting period is a mere two disputes.

Essay 3: Changes in political affinity and firms' subsidiary investments

Essay 3 examines how changes in the bilateral political relationship between firms' home and host countries affect their investment decisions. Extant studies have argued that political affinity—i.e., the extent to which two countries have similar national interests in global affairs—influences firms' investment location choices (Arikan et al., 2020; Bertrand et al., 2016; Hasija et al., 2020; Li et al., 2018). However, it remains uncertain how periodic changes in political affinity affect subsidiary-level investments and FDI inflows in general. Therefore, as the third question for this dissertation, I ask and answer the following question: *How does the improvement or deterioration of political affinity affect firms' investment flows between two countries?* I argue that firms' decisions to adapt existing foreign subsidiary investments are influenced by the political risk embedded in the bilateral relationship between the home and subsidiary country. Thus, the improvement (deterioration) of political affinity is likely to decrease (increase) coordination costs, which subsequently leads to an increase (decrease) in firms' foreign subsidiary investments. Furthermore, since firms attribute greater coordination costs to environments with higher instability, the relevance of changes in political affinity on firms' subsidiary investments depends on the extent to which corruption in the environment fluctuates.

Essay 4: Host country policy risk and the foreign investments of social impact-seeking firms

Essay 4 examines the extent to which host country policy risk affects impact investing firms' foreign investment behavior and how these firms influence the institutional dynamics of their host countries. Despite a growing body of literature studying the effects of institutional environments on firms' investment behavior, impact investing firms—which make financial investments with the additional motive of generating a beneficial and measurable *social impact* (Hehenberger et al., 2019; Lee et al., 2020)—have sadly been neglected in this discussion (Lee et al., 2020). In this essay, I compare and contrast profit-seeking firms' and impact investing firms' foreign investment behavior to better understand the effects of host countries' policy risks on different firms. Additionally, the relationship between impact investing and host country institutionalization is explored to answer the following questions: *How does host country policy risk affect the choice of international investment location for impact-seeking firms? Do impact investing firms affect institutionalization in high-risk developing countries?* Impact investing

firms are essential to many countries' economic development as an important source of foreign capital (Carter et al., 2021; EDFI, 2020; Te Velde, 2011). Similar to private profit-seeking investments, impact investments involve providing resources for a return; however, unlike private profit-seeking firms, financial returns are not the sole objective for the investment (GIIN, 2018; Höchstädter & Scheck, 2015; Louche et al., 2012). Through a statistical analysis of European impact investing firms' investments in Africa, I find significant and robust evidence supporting the notion that the investment-deterring effect of host country policy risk is weaker for impact investing firms. Additionally, I find that impact investing firms contribute to institutionalization in their prioritized host countries. They achieve this through catalytic institutional work by leveraging their catalytic investment mandates to attract other investors that contribute to institutional development in countries with weaker institutions.

Figure 1.1 *Overview of the dissertation*

1.4 Research Design and Empirical Setting

Level of analysis and unit of observation

Earlier studies on market-supporting institutions and how such institutions—or lack thereof—affect firms' behavior have adopted various analytical foci at the individual level (Lawrence & Dover, 2015; Leung, 1993; Lounsbury & Glynn, 2001; Nichols et al., 2002), local community level (Arregle et al., 2016; Lee et al., 2016), firm-level (Blake & Moschieri, 2017; Bonardi et al., 2006; Henisz & Delios, 2001; Holburn & Zelner, 2010; Meyer et al., 2009), industry level (Brandl et al., 2019), national and public policy level (Li et al., 2018; Shapiro et al., 2018) and transnational level (Allee & Peinhardt, 2010; Wellhausen, 2015). One goal of this dissertation was to uncover the bi-directional relationship between institutions' and firms' strategies. To achieve this, I focus on both firm- and country-level analyses. Firm-level analyses are appropriate for examining the heterogeneity of preferences in firms, which also bring about different strategies (Klein et al., 1994). Country-level analyses are used when measuring the impact of government actions on variables that are aggregated to the country level—in this case, governments' actions on policy risk (Cieślik et al., 2018; Ganju et al., 2015).

Dissertation data sources

The dissertation combines multiple sources of data. **Essay 1** is a conceptual essay with illustrative cases drawn from various international investment arbitration forums, such as the International Centre for Settlement of Investment Disputes (ISCID), the North American Free Trade Agreement (NAFTA) tribunals, and the United Nations Commission on International Trade Law (UNCITRAL). **Essays 2**, **3**, and **4** are quantitative essays involving firm- and country-level data obtained from various sources, including LexisNexis Corporate Affiliations, firms' annual reports, and country-level information from The World Bank Group and United Nations (UN) databases. Where applicable, I provide a detailed description of the primary data sources and timeframe for analysis in each essay. **Table 1.1** provides a summary of the key variables and the sources.

Table 1.1 *Variables, Definitions, and Data Sources*

Variables	Measurements	Sources	Essays
Dependent variables			
foreign direct investment (FDI) inflows	Annual inflow of foreign direct investment	World Bank	2
Foreign subsidiary investment	Number of foreign subsidiaries in a given country and year (Oh & Oetzel, 2011)	LexisNexis Corporate Affiliations	3 & 4
Renewable energy	Total renewable electricity capacity and generation in GWh in 1000s	IRENA	4
Independent variables			
Host–investor dispute settle (HSDC)	Count number of disputes between the US and the host country	ICSID World Bank	2
Change in political affinity	The difference in voting affinity between the current (t) and previous year (t-1), divided by the value of voting affinity in the previous year (t-1)	Voeten et al. 2009 (UN General Assembly)	3
Host country risk	1 minus host country POLCON score (1 - Polcon) (Holburn & Zelner, 2010)	Henisz (2000a)	4
Control variables			
Various (see essays for more detail)			

Contributions

The essays in this dissertation provide important contributions to the international business and strategic management literature by providing nuance to the relationship between host country policy risk and firms' international investment strategies. In **Essay 1**, this dissertation sheds light on how domestic and supranational institutions help firms safeguard their assets in high-risk environments. In **Essay 2,** the dissertation contributes to a better understanding of how host countries' *ex-post* investment opportunistic behaviors affect firms' international investment strategies. Furthermore, **Essay 2** highlights how firms rely on supranational institutional agreements (i.e., international investment agreements) to call on external arbitration and claim compensation from host governments for economic losses arising from institutional uncertainties in host countries. Thus, I shed light on how institutions provide firms with credible protections in foreign countries and thus add to the literature on how firms mitigate risks when operating abroad (Buckley, 2016; Henisz et al., 2010; Henisz & Zelner, 2001; Kobrin, 1979).

Moreover, the findings of **Essay 3** contribute to a better understanding of how host country governments' policies and international relations affect existing subsidiary investments (García-Canal & Guillén, 2008; Oh & Oetzel, 2011). Specifically, I argue that government actions—or lack thereof—can affect firms' investment strategies abroad, thereby adding to the (political) institutional perspective on how firms manage their investments in high-risk environments (Bertrand et al., 2016; Duanmu, 2014). Finally, by showing how impact investing firms contribute to the development of renewable energy generation capacity in host countries and thus reflect the institutionalization of energy infrastructure (Holburn, 2012), **Essay 4** provides important contributions to the literature on institutional work (Lawrence et al., 2011; Lawrence & Suddaby, 2006; Lawrence et al., 2009) by identifying an underexplored actor that is advancing the improvement of institutions in high-risk countries. Notably, this introduces a new type of institutional work: catalytic institutional work.

1.5 References

Albino-Pimentel, J., Dussauge, P., & Shaver, J. M. (2018). Firm non-market capabilities and the effect of supranational institutional safeguards on the location choice of international investments. *Strategic Management Journal*, *39*(10), 2770-2793.

Allee, T., & Peinhardt, C. (2010). Delegating differences: Bilateral investment treaties and bargaining over dispute resolution provisions. *International Studies Quarterly*, *54*(1), 1-26.

Allee, T., & Peinhardt, C. (2011). Contingent credibility: The impact of investment treaty violations on foreign direct investment. *International organization*, *65*(3), 401-432.

Arikan, I., Arikan, A. M., & Shenkar, O. (2020). Nation-dyadic history and cross-border corporate deals: Role of conflict, trade, generational distance, and professional education. *Strategic Management Journal*, *41*(3), 422-466.

Arregle, J.-L., Miller, T. L., Hitt, M. A., & Beamish, P. W. (2016). How does regional institutional complexity affect MNE internationalization? *Journal of International Business Studies*, *47*(6), 697-722.

Bertrand, O., Betschinger, M. A., & Settles, A. (2016). The relevance of political affinity for the initial acquisition premium in cross-border acquisitions. *Strategic Management Journal*, *37*(10), 2071-2091.

Blake, D. J., & Moschieri, C. (2017). Policy risk, strategic decisions and contagion effects: Firm-specific considerations. *Strategic Management Journal*, *38*(3), 732-750.

Bonardi, J.-P., Holburn, G. L., & Vanden Bergh, R. G. (2006). Nonmarket strategy performance: Evidence from US electric utilities. *Academy of Management Journal*, *49*(6), 1209-1228.

Brandl, K., Darendeli, I., & Mudambi, R. (2019). Foreign actors and intellectual property protection regulations in developing countries. *Journal of International Business Studies*, *50*(5), 826-846.

Brunetti, A., & Weder, B. (1998). Investment and institutional uncertainty: A comparative study of different uncertainty measures. *Review of World Economics*, *134*(3), 513-533.

Buckley, P. J. (2016). The contribution of internalisation theory to international business: New realities and unanswered questions. *Journal of World Business*, *51*(1), 74-82.

Carter, P., Van de Sijpe, N., & Calel, R. (2021). The elusive quest for additionality. *World development*, *141*, 105393.

Cieślik, J., Kaciak, E., & van Stel, A. (2018). Country-level determinants and consequences of overconfidence in the ambitious entrepreneurship segment. *International Small Business Journal*, *36*(5), 473-499.

Coeurderoy, R., & Murray, G. (2008). Regulatory environments and the location decision: evidence from the early foreign market entries of new-technology-based firms. *Journal of International Business Studies*, *39*(4), 670-687.

Cuervo-Cazurra, A., Gaur, A., & Singh, D. (2019). Pro-market institutions and global strategy: The pendulum of pro-market reforms and reversals. *Journal of International Business Studies*, *50*(4), 598-632.

Cuervo-Cazurra, A., & Genc, M. (2008). Transforming disadvantages into advantages: developing-country MNEs in the least developed countries. *Journal of International Business Studies*, *39*(6), 957-979.

Darendeli, S. I., & Hill, T. L. (2016). Uncovering the complex relationships between political risk and MNE firm legitimacy: Insights from Libya. *Journal of International Business Studies*, *47*(1), 68-92.

Deephouse, D. L. (1996). Does isomorphism legitimate? *Academy of Management Journal*, *39*(4), 1024-1039.

Deephouse, D. L. (1999). To be different, or to be the same? It'sa question (and theory) of strategic balance. *Strategic Management Journal*, *20*(2), 147-166.

Delios, A., & Henisz, W. I. (2000). Japanese firms' investment strategies in emerging economies. *Academy of Management Journal*, *43*(3), 305-323.

Demsetz, H. (1968). Why regulate utilities? *The Journal of Law and Economics*, *11*(1), 55-65.

DiMaggio, P., & Powell, W. (1983). The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields. *American sociological review*, *48*(2), 147-160.

Doh, J. P., Lawton, T. C., & Rajwani, T. (2012). Advancing nonmarket strategy research: Institutional perspectives in a changing world. *Academy of Management Perspectives*, *26*(3), 22-39.

Dolzer, R., & Schreuer, C. (2012). *Principles of international investment law* (2nd ed.). Oxford University Press

Dorobantu, S., Kaul, A., & Zelner, B. (2017). Nonmarket strategy research through the lens of new institutional economics: An integrative review and future directions. *Strategic Management Journal*, *38*(1), 114-140.

Duanmu, J.-L. (2014). State-owned MNCs and host country expropriation risk: The role of home state soft power and economic gunboat diplomacy. *Journal of International Business Studies*, *45*(8), 1044-1060.

EDFI. (2020). *What is a DFI?* EDFI. Retrieved 11 May from https://www.edfi.eu/about-dfis/what-is-a-dfi/

Elkins, Z., Guzman, A. T., & Simmons, B. A. (2006). Competing for capital: The diffusion of bilateral investment treaties, 1960–2000. *International organization*, *60*(4), 811-846.

Funk, R. J., & Hirschman, D. (2017). Beyond nonmarket strategy: Market actions as corporate political activity. *Academy of management review*, *42*(1), 32-52.

Ganju, K. K., Pavlou, P. A., & Banker, R. D. (2015). Does information and communication technology lead to the well-being of nations? A country-level empirical investigation. *MIS Quarterly (Forthcoming)*, 15-072.

García-Canal, E., & Guillén, M. F. (2008). Risk and the strategy of foreign location choice in regulated industries. *Strategic Management Journal*, *29*(10), 1097-1115.
García-Canal, E., & Guillén, M. F. (2008). Risk and the strategy of foreign location choice in regulated industries. *Strategic Management Journal*, *29*(10), 1097-1115.
GIIN. (2018). *Global Sustainable Investment Review, GSIA Report, April*. http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf
Hasija, D., Liou, R. S., & Ellstrand, A. (2020). Navigating the new normal: Political affinity and multinationals' post-acquisition performance. *Journal of Management Studies*, *57*(3), 569-596.
Hehenberger, L., Mair, J., & Metz, A. (2019). The assembly of a field ideology: An idea-centric perspective on systemic power in impact investing. *Academy of Management Journal*, *62*(6), 1672-1704.
Henisz, W. J. (2000a). The institutional environment for economic growth. *Economics & Politics*, *12*(1), 1-31.
Henisz, W. J. (2000b). The institutional environment for multinational investment. *Journal of Law, Economics, and Organization*, *16*(2), 334-364.
Henisz, W. J., & Delios, A. (2001). Uncertainty, imitation, and plant location: Japanese multinational corporations, 1990-1996. *Administrative Science Quarterly*, *46*(3), 443-475.
Henisz, W. J., Mansfield, E. D., & Von Glinow, M. A. (2010). Conflict, security, and political risk: International business in challenging times. *Journal of International Business Studies* (41), 759–764.
Henisz, W. J., & Zelner, B. A. (2001). The institutional environment for telecommunications investment. *Journal of Economics & Management Strategy*, *10*(1), 123-147.
Henisz, W. J., & Zelner, B. A. (2003). Political risk management: A strategic perspective. In T. H. Moran (Ed.), *International Political Risk Management: The Brave New World* (pp. 154 -170). The World Bank Group.
Henisz, W. J., & Zelner, B. A. (2006). Interest groups, veto points, and electricity infrastructure deployment. *International organization*, 263-286.
Holburn, G. (2012). Assessing and managing regulatory risk in renewable energy: Contrasts between Canada and the United States. *Energy Policy*, *45*, 654-665.
Holburn, G., & Zelner, B. (2010). Political capabilities, policy risk, and international investment strategy: Evidence from the global electric power generation industry. *Strategic Management Journal*, *31*(12), 1290-1315.
Hoskisson, R. E., Eden, L., Lau, C. M., & Wright, M. (2000). Strategy in emerging economies. *Academy of Management Journal*, *43*(3), 249-267.
Höchstädter, A. K., & Scheck, B. (2015). What's in a name: An analysis of impact investing understandings by academics and practitioners. *Journal of Business Ethics*, *132*(2), 449-475.
Klein, K. J., Dansereau, F., & Hall, R. J. (1994). Levels Issues in Theory Development, Data Collection, and Analysis. *The Academy of Management Review*, *19*(2), 195-229.
Kobrin, S. J. (1978). When does political instability result in increased investment risk. *Columbia Journal of World Business*, *13*(3), 113-122.
Kobrin, S. J. (1979). Political risk: A review and reconsideration. *Journal of International Business Studies*, *10*(1), 67-80.
Kobrin, S. J. (1980). Foreign enterprise and forced divestment in LDCs. *International organization*, *34*(1), 65-88.
Kobrin, S. J. (1987). Testing the bargaining hypothesis in the manufacturing sector in developing countries. *International organization*, *41*(4), 609-638.

Lawrence, T., Suddaby, R., & Leca, B. (2011). Institutional work: Refocusing institutional studies of organization. *Journal of Management Inquiry*, *20*(1), 52-58.
Lawrence, T. B., & Dover, G. (2015). Place and institutional work: Creating housing for the hard-to-house. *Administrative Science Quarterly*, *60*(3), 371-410.
Lawrence, T. B., & Suddaby, R. (2006). Institutions and institutional work. In C. C. Hardy, T. B. Lawrence, & W. R. Nord (Eds.), *The Sage handbook of organization studies* (2nd ed., pp. 215-254). Sage.
Lawrence, T. B., Suddaby, R., & Leca, B. (2009). *Institutional work: Actors and agency in institutional studies of organizations*. Cambridge university press
Lee, I. H., Hong, E., & Makino, S. (2016). Location decisions of inward FDI in sub-national regions of a host country: Service versus manufacturing industries. *Asia Pacific Journal of Management*, *33*(2), 343-370.
Lee, M., Adbi, A., & Singh, J. (2020). Categorical cognition and outcome efficiency in impact investing decisions. *Strategic Management Journal*, *41*(1), 86-107.
Leung, C. K. (1993). Personal Contacts, Subcontracting Linkages, and Development in the Hong Kong-Zhujiang Delta Region. *Annals of the Association of American Geographers*, *83*(2), 272-302.
Li, J., Meyer, K. E., Zhang, H., & Ding, Y. (2018). Diplomatic and corporate networks: Bridges to foreign locations. *Journal of International Business Studies*, *49*(6), 659-683.
Louche, C., Arenas, D., & Van Cranenburgh, K. C. (2012). From preaching to investing: Attitudes of religious organisations towards responsible investment. *Journal of Business Ethics*, *110*(3), 301-320.
Lounsbury, M., & Glynn, M. A. (2001). Cultural entrepreneurship: stories, legitimacy, and the acquisition of resources. *Strategic Management Journal*, *22*(6-7), 545-564.
Mellahi, K., Frynas, J. G., Sun, P., & Siegel, D. (2016). A review of the nonmarket strategy literature: Toward a multi-theoretical integration. *Journal of Management*, *42*(1), 143-173.
Meyer, J. W., & Rowan, B. (1977). Institutionalized organizations: Formal structure as myth and ceremony. *American Journal of Sociology*, *83*(2), 340-363.
Meyer, K. E., & Estrin, S. (2014). Local Context and Global Strategy: Extending the Integration Responsiveness Framework to Subsidiary Strategy. *Global Strategy Journal*, *4*(1), 1-19.
Meyer, K. E., Estrin, S., Bhaumik, S. K., & Peng, M. W. (2009). Institutions, resources, and entry strategies in emerging economies. *Strategic Management Journal*, *30*(1), 61-80.
Müllner, J., & Puck, J. (2018). Towards a holistic framework of MNE–state bargaining: A formal model and case-based analysis. *Journal of World Business*, *53*(1), 15-26.
Neumayer, E., & Spess, L. (2005). Do bilateral investment treaties increase foreign direct investment to developing countries? *World development*, *33*(10), 1567-1585.
Nichols, T., Sugur, N., & Demir, E. (2002). Beyond cheap labour: trade unions and development in the Turkish metal industry. *The Sociological Review*, *50*(1), 23-47.
North, D. C. (1990a). *Institutions, institutional change and economic performance*. Cambridge University Press
North, D. C. (1990b). *Institutions, institutional change and economic performance (Political Economy of Institutions and Decisions)*. Cambridge: Cambridge University Press
North, D. C. (1991). Institutions. *Journal of Economic Perspectives*, *5*(1), 97-112.
Oh, C. H., & Oetzel, J. (2011). Multinationals' response to major disasters: how does subsidiary investment vary in response to the type of disaster and the quality of country governance? *Strategic Management Journal*, *32*(6), 658-681.
Oliver, C. (1991). Strategic responses to institutional processes. *Academy of management review*, *16*(1), 145-179.

Ramamurti, R. (2001). The obsolescing 'bargaining model'? MNC-host developing country relations revisited. *Journal of International Business Studies*, *32*(1), 23-39.

Santangelo, G. D., & Meyer, K. E. (2011). Extending the internationalization process model: Increases and decreases of MNE commitment in emerging economies. *Journal of International Business Studies*, *42*(7), 894-909.

Scott, W. R. (1995). Institutions and organizations. Foundations for organizational science. *London: A Sage Publication Series*.

Shapiro, D. M., Vecino, C., & Li, J. (2018). Exploring China's state-led FDI model: Evidence from the extractive sectors in Latin America. *Asia Pacific Journal of Management*, *35*(1), 11-37.

Stevens, C. E., Xie, E., & Peng, M. W. (2016). Toward a legitimacy-based view of political risk: The case of Google and Yahoo in China. *Strategic Management Journal*, *37*(5), 945-963.

Suchman, M. C. (1995). Managing legitimacy: Strategic and institutional approaches. *Academy of management review*, *20*(3), 571-610.

Te Velde, D. W. (2011). The role of development finance institutions in tackling global challenges. *London: ODI*.

Vernon, R. (1971). Sovereignty at bay: The multinational spread of US enterprises. *The International Executive*, *13*(4), 1-3.

Vernon, R. (1993). Sovereignty at bay: twenty years after. In *Multinationals in the Global Political Economy* (pp. 19-24). Springer.

Wellhausen, R. L. (2015). Investor–state disputes: when can governments break contracts? *Journal of Conflict Resolution*, *59*(2), 239-261.

Werner, T. (2015). Gaining access by doing good: The effect of sociopolitical reputation on firm participation in public policy making. *Management Science*, *61*(8), 1989-2011.

Xu, D., & Shenkar, O. (2002). Note: Institutional distance and the multinational enterprise. *Academy of management review*, *27*(4), 608-618.

Zhu, Y., & Sardana, D. (2020). Multinational enterprises' risk mitigation strategies in emerging markets: A political coalition perspective. *Journal of World Business*, *55*(2), 101044.

2. Dealing with High-Risk Environments

Multinational Firms in Developing Countries

Gilbert Kofi Adarkwah (BI) and Gabriel R. G. Benito (BI)

Earlier versions of this essay have been presented at the AIB Annual Meeting Copenhagen (Denmark, 2019), the 46th AIB-UKI (UK & Ireland Chapter) annual conference (Sussex, 2019), and the Journal of International Business Policy Paper Development Conference (CBS, 2019)

Abstract

We take stock of the mechanisms available to multinational enterprises (MNEs) to protect their investments in high-risk host countries. We argue that MNEs that expand into countries replete with institutional voids do so not only because they have an extraordinary appetite for risk or special capabilities against risks. Rather, these firms rely on a set of institutional mechanisms that alleviate and offset the risks of investing in high-risk host countries. Drawing on the political-institutional approaches to policy risk literature, we propose a framework of international investment protection. We contribute to international business research by introducing greater nuance into our understanding of the mechanisms that MNEs use to safeguard investments in high-risk host countries against policy risks.

Keywords: host country risk, investor-state dispute settlement, emerging markets/countries/economies, foreign direct investments policy

2.1 Introduction

What mechanisms do multinational enterprises (MNEs) use to safeguard their investments in high-risk developing countries replete with institutional voids? While risk management is considered an important component of the executive function (Figueira-de-Lemos et al., 2011; Gamso & Nelson, 2019; Miller, 1992; Zhu & Sardana, 2020), there is limited scholarly research on how firms explicitly protect their assets in high-risk countries, despite considerable research interest in host-country risks (García-Canal & Guillén, 2008; Goerzen et al., 2010; Holburn & Zelner, 2010b; Kobrin, 1980). Each year, a large number of MNEs fall victim to host government discrimination, sabotage, and expropriation (Cavusgil et al., 2020; Darendeli & Hill, 2016; Medina et al., 2019; Siegel, 2007; Sine & David, 2003). In 2020 alone, 2282 MNEs worldwide were involved in investor-host state disputes originating from purported discriminatory acts by governments (UNCTAD, 2021). The majority of host government discriminatory acts occur in developing countries due to the presence of institutional voids, understood as the absence of market-supporting institutions, specialized intermediaries, contract-enforcing mechanisms, and efficient transportation and communication networks (Khanna & Palepu, 2010). As a result, many studies in international business (Delios & Henisz, 2000; Giambona et al., 2017; Kobrin, 1979; Nguyen et al., 2018), economics (Brunetti & Weder, 1998), and political science (Jensen, 2003) have argued that MNEs are less likely to invest in developing countries due to the high-risk nature of the business environment.

At the same time, and in apparent contradiction, scholars have shown that firms often invest in host countries with greater institution-related policy risks (Cuervo-Cazurra & Genc, 2008; Holburn & Zelner, 2010a). In 2019, over half of all global foreign direct investment (FDI) went to developing countries (UNCTAD, 2020). For example, in sub-Saharan Africa, FDI inflows over the past two decades have increased from 2.8 to 59.2 billion dollars (UNCTAD, 2017). These observations present an intriguing puzzle: *As evidenced by the increasing flow of foreign direct investment into high-risk developing countries*, *how do MNEs safeguard their investments in host countries characterized by severe policy uncertainties and a lack of market-supporting institutions?*

Although host countries may present various levels of opportunity to MNEs, they hardly offer an environment that flawlessly guarantees the protection of MNEs' investments (Albino-Pimentel et al., 2018; Cavusgil et al., 2020). Building on this risks-opportunity framework, existing studies have highlighted the various strategies used by MNEs to mitigate host country policy risks when investing abroad (Figueira-de-Lemos et al., 2011; Henisz & Zelner, 2003;

Luo & Park, 2001; Miller, 1992), see **Table 2.1**. Although these studies have undoubtedly generated valuable insights into our understanding of how MNEs may manage risks in high-risk countries, the majority of these strategies have been criticized for being "passive and generic in nature" (Zhu & Sardana, 2020, p. 3), lacking contextualization and specificity, and therefore less relevant to managers (Meyer & Estrin, 2014; Zhu & Sardana, 2020). Therefore, there is a need "to go beyond such an approach" (Buckley, 2016, p. 79).

The purpose of this paper is to fill this gap in the literature by elucidating the key mechanisms that MNEs use to reduce risk when investing in high-risk countries. This is important because risk mitigation is a key concern of firms operating abroad, and therefore an essential part of managers' responsibilities (Cavusgil et al., 2020; Figueira-de-Lemos et al., 2011; Gamso & Nelson, 2019). For instance, a recent survey of over 1000 global executives in over 90 countries found that policy risk management represents the most pressing concern when doing business abroad (PwC, 2020). Hence, policy risk is relevant in both theory and practice.

Examining why many firms continue to invest in countries with greater policy uncertainties, our study contributes to the international business literature by providing a more nuanced analysis of the strategies that MNEs use to handle and curb host country policy risks when investing abroad. This is a major departure from previous studies that have mainly proposed generic risk mitigation strategies such as "avoidance," "cooperation," "imitation," and "flexibility" (see, for example, Miller,1992). By taking stock of the institutional mechanisms available to MNEs to protect their investments in high-risk host countries, this study contributes to an improved understanding of MNE-host country risk mitigation, thereby adding to an emerging stream of research that is building a foundation on the complex intersection of strategy, economics, and regulation in international business (Cavusgil et al., 2020; Gamso & Nelson, 2019; Miller, 1992; Zhu & Sardana, 2020).

2.2 What do we know about host country policy risk?

Various types of host country risks can affect the economic value of MNEs' assets abroad, including cultural risk, currency risk, commercial risk, and policy/political risk, among others (Henisz, 2000b; Kobrin, 1982). Miller (1992) explained that when operating abroad, MNEs face three broad kinds of risks, namely, (1) general environmental, (2) industry, and (3) firm-specific risks. General risks are risks that affect all firms in a particular context or region across industries. They include political instability, policy instability, macroeconomic and social

uncertainties, etc. Industry risks are those that affect only firms in a particular industry, such as unexpected changes in consumer demand for an industry's output. Firm-level risks are those that are specific to a single firm, such as machine failures.

This paper is primarily concerned with risks emanating from a host country's policy environment, i.e., host country policy risks. We define host country policy risks as unexpected actions taken by political host country actors or events in the political system that alter a country's institutional environment in a manner that threatens the economic value of an investor's asset (Henisz & Zelner, 2014). This includes political instabilities, such as legislation changes, forced regime changes, societal unrest, terrorism, civil wars (Miller, 1993; Oh & Oetzel, 2011; Oh & Oetzel, 2017), and generally problematic host country political situations (Jensen, 2008). The nature of policy risk is very different from other types of international investment risk faced by MNEs; they are external, arising from actions taken by a host country government or entities representing a host country government (Wells, 1998). As such, while MNEs may have discretion over choices in managing other types of risks, they have limited control over host country policy risks. Such risks increase MNEs' operating costs and may negatively affect the economic value of their assets (Cuervo-Cazurra et al., 2018; Henisz & Zelner, 2004). Therefore, mitigation of host country policy risk has become one of the most salient concerns for MNEs (Gamso & Nelson, 2019).

Host-country policy risk has been analyzed in the international business literature using a variety of approaches. These include the legitimacy-based approach (Darendeli & Hill, 2016; Hasija et al., 2020; Stevens et al., 2016), bargaining power approach (Kobrin, 1987; Ramamurti, 2001; Vernon, 1971, 1993), and political-institutional approach (Henisz, 2000b; Henisz & Zelner, 2001). The legitimacy approach posits that MNEs must establish legitimacy with host country stakeholders to improve their chances of success (Darendeli & Hill, 2016; Hasija et al., 2020). The bargaining power approach argues that MNEs with unique, firm-specific advantages relative to host governments have greater bargaining power over such governments (Kobrin, 1987; Ramamurti, 2001). However, as local institutions in the host country improve, the MNEs may gradually lose their bargaining power over host governments (Holburn & Zelner, 2010a) and become vulnerable to host government opportunistic behaviors (Müllner & Puck, 2018). Finally, the political-institutional approach examines the development of formal institutions in host countries (Henisz, 2000b; Henisz & Delios, 2001) and how such institutions, or the lack thereof, affect firms' behavior (Henisz, 2000b; Henisz & Zelner, 2001; Meyer et al., 2009). This approach argues that since host governments benefit from altering laws and policies to

their advantage, more political checks and balances that reduce governments' ability to change laws or enact new discriminatory laws will decrease policy risks to firms (Henisz & Zelner, 2001; Stevens et al., 2016). In this paper, since we seek to introduce further nuance to the understanding of the mechanisms that firms use to safeguard their investments abroad against policy risks, we rely on the political-institutional approach (Bertrand et al., 2016; Henisz & Zelner, 2003). The strong emphasis on country-level formal institutions of the political-institutional approach (Bertrand et al., 2016; Henisz & Zelner, 2003) makes it the most appropriate approach for this study.

2.3 Host country policy risk mitigation in international business

MNEs are likely to adopt different strategies to safeguard their assets abroad due to heterogeneity in their perceptions of host country policy risks and differences in MNEs capabilities for managing such risks (Cavusgil et al., 2020). So far, however, the international business literature has only highlighted generic risk mitigation strategies that MNEs may adopt when investing abroad. Miller (1992), for instance, describes four possible generic strategies that firms can adopt to mitigate policy risks when operating abroad – avoidance, cooperation, imitation, and flexibility. However, such strategies have been criticized for lacking contextualization and specificity (Zhu & Sardana, 2020). Unfortunately, attempts to address these criticisms have mainly focused on MNEs own (nonmarket) capabilities. One such strategy centers on attempting to avoid risk by partnering with local firms, thereby becoming potentially less vulnerable to host country policy hazards (Bonardi et al., 2006; Henisz, 2000a; Henisz & Delios, 2001). Another strategy is to develop firm (nonmarket) capabilities, suggesting that firms with special capabilities may invest in risky host countries because these firms are less sensitive to the high uncertainties that emanate from volatile host government policies (Dorobantu et al., 2017; Holburn & Zelner, 2010b). When operating in high-risk countries, these MNEs supposedly rely on their nonmarket capabilities to protect their investments by exerting political influence on the host country government (Albino-Pimentel et al., 2018). Conversely, MNEs with weaker political capabilities are likely to avoid investing in countries where the risk of adverse policy change is higher (Holburn & Zelner, 2010b). Some of the notable theoretical and empirical studies on risk mitigation are summarized in **Table 2.1**.

Table 2.1 *Brief review of scholarship on risk mitigation*

Policy risk mitigation strategy	Examples	Key contributors
Partnership with other firms	Joint ventures with local firms	Zhu and Sardana (2020); Henisz (2000a); Delios and Henisz (2000); Bradley (1977); Bonardi et al. (2006)
Develop firm (nonmarket) capabilities	Hiring of former politicians, high-ranking government officials	Dorobantu et al. (2017); Albino-Pimentel et al. (2018); Holburn and Zelner (2010b); Barron (2011); Hillman and Hitt (1999); Hillman (2003)
Partnership with multilateral institutions	World bank or international finance Corporation	Gamso and Nelson (2019)
Coalition with key stakeholder groups	Coalition with unions, consumer groups, environmental and other public interest groups,	Iankova and Katz (2003) McCahery and Vermeulen (2000)

A primary concern of previous studies centered around firms' own capabilities is that they have neglected the fundamental institutional mechanisms used by MNEs to safeguard their investment in high-risk countries. This is a critical omission because, for instance, the reliance on firms' nonmarket capabilities – which firms acquire through close ties with government authorities, lobbying, campaign donations, or bribery (Barron, 2011; Hillman, 2003; Hillman & Hitt, 1999; Meznar & Nigh, 1995) – assumes that all government authorities in high-risk countries can be coerced or bribed. However, even if this were possible, the risks involved would not simply disappear. As a result, we argue that a viable strategy for MNEs is to use contractual safeguards, either directly with commercial and/or governing actors in a country (i.e., local authorities) or under the umbrella of bilateral host-home country arrangements. This strategy includes utilizing a wide range of international investment arrangements, such as bilateral investment treaties, foreign investment insurance, and portfolio investment guarantees, to protect their assets in high-risk countries.

2.4 Mechanisms for safeguarding foreign investments

Our main argument is that in addition to relying on MNEs' own capabilities, i.e., partnering with local firms (Bradley, 1977; Delios & Henisz, 2000), partnering with multilateral

institutions (Gamso & Nelson, 2019), or hiring former politicians or, high-ranking government officials (Albino-Pimentel et al., 2018; Dorobantu et al., 2017; Hillman & Hitt, 1999), MNEs rely on several institutional mechanisms to safeguard their investments in high-risk countries. We argue that such institutional mechanisms help MNEs that invest in high-risk countries replete with institutional voids to safeguard their assets. As discussed below, these mechanisms go beyond the MNEs' own nonmarket capabilities. These mechanisms include, bilateral international investment agreements (IIAs) negotiated between MNEs' home and host countries, international investment insurance (III), investment contracts (ICs), and portfolio investment guarantees (PIGs) to mitigate policy risk and ensure the preservation of favorable policy behavior toward the firm. We argue that host governments will hesitate to act opportunistically towards MNEs that safeguard their investments with the above mechanisms because MNEs can punish host governments for breaching such arrangements. We take stock and provide a detailed explanation of these mechanisms below and introduce greater levels of nuance than can be found in previous studies (Buckley, 2016; Miller, 1992).

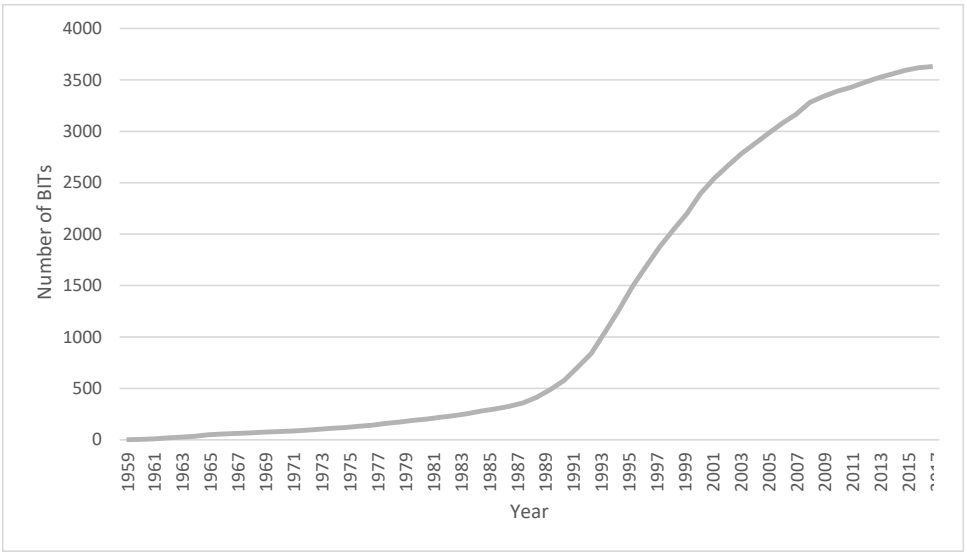
2.4.1 International Investment Treaties

When treaties exist between their home and host country, both advanced and emerging market firms expanding into developing countries with heightened levels of commercial and political risk rely on treaties as the first level of protection. Treaties are a cheaper alternative to lowering the level of risk MNEs face abroad than other instruments such as private insurance (Jandhyala & Weiner, 2014). Apart from being less costly than other private instruments (treaties can be regarded as public goods and are typically used free of charge), BITs and multilateral investment treaties (MITs) establish limits on the expropriation of assets and provide guidelines for adequate compensation in the case of expropriation of their assets (Neumayer & Spess, 2005). For example, most BITs provide for the transferability of investment-related funds in and out of a host country without delay and restrict the imposition of performance requirements (e.g., local content targets or export quotas). As a result, when choosing between two equally attractive investment destinations, MNEs are likely to choose the location where their home country has investment protection agreements with the host country (Blake & Moschieri, 2017; Jandhyala & Weiner, 2014; Salacuse & Sullivan, 2005). However, BITs and MITs can only be relied on post-hoc. They are also not available to all MNEs since they only protect investments from signatory countries.

Additionally, in some circumstances, host countries can set aside investor rights under a treaty with respect to a breach of treaty obligations for which no claim has been made if the treaty in

question is terminated before such rights are exercised by the foreign firm (Voon et al., 2014), which further highlights the need for additional levels of protection for foreign investments in risky host countries. The first BIT was signed between Germany and Pakistan in 1959 and came into force in 1962 (Egger & Pfaffermayr, 2004). Although not every country has a BIT with each other, globally, the number of BITs are on the rise (**Figure 2.1**). Notably, BITs and MITs protect investments but not trade. Thus, for investors to rely on BITs or MITs, their economic activity must be considered an investment by the host country.

Figure 2.1 *Development of BITs (1959–2018)*



Source: UNCTAD IIA database

To be able to rely on BITs to safeguard firms' assets, the presence of "qualified investments." For years, scholars have paid a great deal of attention to FDI (Buckley & Casson, 1976; Dunning, 1977; Hymer, 1960/1976). However, who qualifies as a foreign investor and what constitutes an investment is hardly ever defined and often taken axiomatically as a construct in the literature. In international business and economics, scholars assume that FDI involves (a) the transfer of funds, (b) a long-term project, (c) the purpose of regular income, (d) the participation of the subject transferring the funds in the management of the project to some extent, and (e) a business risk (Dolzer & Schreuer, 2012). To economists and international business scholars, these elements—especially the longevity of the project and participation in project management—distinguish FDI from portfolio investments.

However, both legally and in practice, the definition of FDI varies from country to country. Article 25 of the International Centre for Settlement of Investment Disputes (ICSID) Convention, which lays down the general parameters for the ICSID's activity, orients itself to the definition of investment as provided in individual BITs or MITs (Schreuer, 2009). As such, nearly all modern bilateral and multilateral treaties define "investment" in the context of that specific treaty. Thus, the definition of investment often varies from treaty to treaty. For instance, the United States' BIT model defines *investment* as "*assets that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk*" *(Dolzer & Schreuer, 2012).* It goes on to state that the forms an investment may take include: (i) an enterprise; (ii) shares, stock, and other forms of equity participation in an enterprise; (iii) bonds, debentures, other debt instruments, and loans, (iv) futures, options, and other derivatives; (v) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts; (vi) intellectual property rights; (vii) licenses, authorizations, permits, and similar rights conferred pursuant to domestic law; and (viii) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges. This definition covers both investments in physical assets such as manufacturing plants, factories, and stores as well as financial assets such as stocks, bonds, and—critically—contractual and rights conferred by law (Guzman, 1997). This implies that for a firm from the United States investing in a country where the United States has a rectified treaty, its investments are protected from expropriation and minor breaches of agreements (e.g., withdrawal of licenses) and other risks envisaged by international business and strategic management scholars in the early 1970s (Hymer, 1960/1976).

On the other hand, the Indian BIT model of 2008 defines investment as: "*an enterprise constituted, organized and operated in good faith by an investor in accordance with the law of the party in whose territory the investment is made, taken together with the assets of the enterprise, has the characteristics of an investment such as the commitment of capital or other resources, certain duration, the expectation of gain or profit, the assumption of risk and a significance for the development of the party in whose territory the investment is made.*" Under the Indian treaty, an enterprise may possess the following assets: (i) shares, stocks and other forms of equity instruments of the enterprise or in another enterprise, (ii) a debt instrument or security of another, enterprise, (iii) a loan to another enterprise, where the enterprise is an affiliate of the investor or the original maturity of the loan is at least 3 years, (iv) licenses, permits, authorizations or similar rights conferred in accordance with the law of a party, (v)

rights conferred by contracts of a long-term nature such as those to cultivate, extract or exploit natural resources in accordance with the law of a party, (vi) copyrights, know-how and intellectual property rights such as patents, trademarks, industrial designs, and trade names, to the extent they are recognized under the law of a party; (vii) movable or immovable property and related rights, and (viii) any other interests of the enterprise that involve substantial economic activity and out of which the enterprise derives significant financial value (Prabhash et al., 2018).

The definition of investment in the Indian treaty implies that only legally constituted enterprises in India can bring a claim under the treaties (Prabhash et al., 2018). Thus, foreign investors such as service providers without a legally constituted enterprise in India cannot bring a claim under India's BIT. This is fundamentally different from the United States treaties, under which one does not need to have an established enterprise in the host country. Our main point here is that FDI activities that might be considered an *investment* in one host country may not be a "*non-investment*" in another. Legally, for MNEs to claim legal rights for expropriation, their economic activity must meet four criteria that indicate the existence of an investment, which represent the so-called "Salini test": (1) A substantial commitment or contribution of money or assets; (2) a certain duration; (3) the assumption of an element of risk; (4) and a contribution to the economic development of the host country (Andreeva, 2008; Grabowski, 2014; Hwang, 2010). If MNEs activities in a host country do not meet these criteria, it is not legally considered an investment.[1]

International investment laws - those laws that give treaties their powers- are designed to promote and protect the activities of *foreign investors* (Dolzer & Schreuer, 2012). Thus, the nationality of investment determines its foreignness. To claim rights after expropriation

[1] The Salini criteria developed out of a case between two Italian companies, Salini Costruttori and Italstrade, and their dispute with the Moroccan government (ICSID Case No Arb/00/04) (Decision on Jurisdiction, 23 July 2001). Through a private company, the Moroccan government initiated a bidding process for the construction of a 50-kilometer highway in Morocco. Salini Costruttori and Italstrade jointly submitted a bid and won the contract for construction of the highway. However, the two companies did not complete the highway on time. Instead, they completed it 36 months later, going 4 months over the timetable laid out in their bid. The Moroccan government decided not to pay the full price because of the delay. After a series of domestic proceedings, the Italian companies submitted a dispute to ICSID arbitration under the Italy–Morocco BIT. The arbitration tribunal ruled that for the two companies to have made an investment in Morocco, there must be: (1) a contribution of money or assets; (2) a certain duration over which the project was to be implemented; (3) an element of risk; (4) a contribution to the host country's economy. The “Salini Test” has now become the main criteria for ICSID tribunals to determine whether an international activity is an investment or not. In a recent investment dispute case—Nova Scotia Power Incorporated v. Bolivarian Republic of Venezuela (II)—the Bolivarian Republic of Venezuela terminated Nova Scotia Power Incorporated’s right to receive up to 1.7 million metric tons of coal at fixed prices from the Paso Diablo coal mine in Venezuela. The tribunal relied on the “Salini Test” and ruled that Nova Scotia Power Incorporated had not made an “investment” in the Bolivarian Republic of Venezuela, thereby classifying their involvement as a portfolio activity.

(Kobrin, 1984; Medina et al., 2019), one must first and foremost be considered a foreign investor. Who qualifies as a foreign investor is determined by the nationality of the firm or the individual. As such, the nationality of investment determines which rights it may enjoy after expropriation. For instance, if an investor wishes to rely on a BIT or MIT, they must show that it is a national of one of the parties in the treaty (Guzman, 2008; Neumayer & Spess, 2005). If an MNE wishes to rely on a regional treaty such as NAFTA, the firm must show that it has the nationality of one of the countries that are part of the treaty (Abbott, 2000). Notably, investors can be individuals (natural persons) or firms (juridical persons). However, in the majority of cases, investors in international business are firms (Meyer, 2004).

For natural persons, investor foreignness is determined by national passports. For MNEs, the criteria for determining nationality again vary from country to country. In practice, the most commonly used criteria for identifying a firm's nationality is the place of incorporation or registered head office (Menz et al., 2015; Meyer & Benito, 2016). In fact, under international investment laws, even a majority shareholder cannot initiate a dispute with a host country when the majority shareholder is of a different nationality than the nationality of the MNE. This was the case of Barcelona Traction, Light and Power Company Limited when the International Court of Justice held that Belgium, the home country of the majority shareholders of a company incorporated in Canada, could not pursue a claim against Spain (the host country) for damages caused to the company (Briggs, 1971). Likewise, an individual with dual nationality may not be considered a foreign investor in any of the countries in which they hold nationality. For instance, if an Egyptian American with dual nationality for Egypt and the United States invests in Egypt, this investment will be considered a local investment under Egyptian treaties. That is, any person with the nationality of the host country is excluded from bringing a claim under international investment laws against their home nation. Our main point is that to enjoy the benefits under investment agreements, one must be considered foreign investor because international investment laws only protect *foreign investors* and their *investments.*

2.4.2 Investment contracts

Investments are long-term commitments, and many large-scale investment projects can last for decades. However, the general legislation of most host countries is seldom static (Peng et al., 2005). As such, in the absence of BITs and MITs, general legislation may not sufficiently address investors' concerns. Like those of other institutions, host government interests also change over time. For instance, suppose an MNE enters a high-risk developing country with large natural resource endowments but lacks the technology and competence to exploit such

resources. During the negotiation phase, the host government—which wants investors to create employment and bring foreign technology, etc.—may encourage investors to invest by offering various concessions. For example, the host government may offer tax advantages to the investor, agree to allow the unhindered repatriation of profits, and even waive certain restrictions. On the other hand, the investor—who aims to make the highest possible returns when investing in the country—may invest without hesitation. However, as noted by Vernon (1971), once the investment is made, a fundamental shift in power to the host government can occur. For example, the host government may no longer have incentives to keep the pre-investment promises, knowing that once the investment has been made, the investor cannot fully disinvest (Kerner, 2009). For instance, the host government can subsequently engage in hold-up (Woodhouse, 2005). The host government may increase taxes on the investment beyond the level that was agreed upon during the pre-investment stage. This commonly appears in long-term investment projects such as oil and gas exploration. Beyond the area of energy exploration and production, projects creating utilities and infrastructure have also been a target of indirect expropriation. As a result, MNEs rely on IC negotiated between the firm and host countries to lay out the rules for the venture with the host government and allocate rights and responsibilities for each party. ICs regulate the applicable law and define the mechanisms for disputes.

Moreover, most ICs contain stabilization clauses (Dolzer & Schreuer, 2012; Wells, 1977). These clauses "freeze" the provisions of the national system of law governing the IC to the date of the contract. This prevents the application of the contract to any future alterations, which essentially creates a legal framework that will last from the beginning to the end of the investment.

2.4.3 Private and public investment insurance

ICs (see Figure 2) allow investors to protect their investments in risky host countries through means that are separate from the general legal system of the host country. However, not all host governments are willing to sign contracts with foreign investors, even though they may acknowledge the importance of such contracts for investors. The terms required to attract MNEs are not the same as those required to retain them in a host country. Once firms have invested in a host country and the firm is visibly successful, any risk and uncertainty recognized by both the MNE and the host government before investment disappears. Some developing countries see this as an opportunity to renegotiate the terms of the investment. For instance, between 1952

and 1965, Republic Steel and all major foreign investors in Liberia were forced to renegotiate their IC with the government of Liberia, with the government significantly increasing taxes on the foreign firms each time (Wells, 1977).

Furthermore, after the Libyan coup of 1969, Colonel Muammar al-Gaddafi renegotiated the agreement with Occidental Oil Company in Libya. Colonel Gaddafi chose to renegotiate the agreement because he knew that Occidental Oil Company had invested huge sunk costs into its Libyan operations and that the company had no alternative crude sources outside of Libya that could feed the company's European refineries (Nygaard & Dahlstrom, 1992). Such risks inherent in major international investment projects have led to the evolution of a market for investment insurance schemes covering risks such as expropriation, the non-convertibility of currency, political violence, and losses due to wars, revolutions, insurrection, and civil strife. Notably, International investment insurance has been around since the 1950s. In its early years, investment insurance services were dominated by state-run insurance agencies that sought to promote their nations' outward foreign direct investment. For example, the United States offered III under the Marshall Plan to provide coverage for American firms investing abroad (Bishop et al., 2005). In 1971, investment insurance under the Marshall Plan was replaced by the Agency for International Development. Other countries, such as Germany, the United Kingdom, Norway, France, and Japan, have similar programs. The goal of this III was tied to the promotion of the national economy, with protection only being granted to national companies and projects in countries friendly to the issuing government (Dolzer & Schreuer, 2012). In effect, government insurance programs reflect the foreign policy goals of the MNEs home country regarding the eligibility of projects. For example, the international investment protection scheme of Germany only grants protections to investments in countries that have signed BITs with Germany (Moser et al., 2008). In the mid-1970s, private insurance companies entered the market, beginning with Lloyd's of London and American International Group. Moreover, the member states of the World Bank established the Multinational Investment Guarantee Agency (MIGA) to offer investment risk insurance and credit enhancement guarantees to protect FDI against political and non-commercial risks in high-risk countries (MIGA, 2018). At the regional level, the Islamic Development Bank was established to underwrite investment insurance for the Arab region (Shihata, 1972). Most international investment insurance programs include agreements with host countries that provide subrogation (Dolzer & Schreuer, 2012). In order words, investors' rights against host countries are assigned to the insurer upon payment of the insurance premium under the contract, which secures enforceable rights for investors in the case of expropriation by host governments. Unlike BITs and MITs, the terms of insurance cannot be

set aside. Although the maximum duration of such insurance is 15 years, it can be extended by 5 years before expiry. During the period of insurance coverage, an annual fee of between 0.3 and 1.75% of the invested sum is charged as an annual premium by the insurance company (Gianturco, 2001).

2.4.4 Guarantees

Notably, investment treaties and investment insurance cover investments but *not* trade. As a result, many countries provide other forms of protection for home country MNEs *trading* activities in developing countries to cover the typically hidden transaction costs that often reduce international trade from their home country. Government guarantees aim to mitigate frictions in international trade from the home country. The idea is that since the private market cannot provide adequate insurance for all risks associated with international trade, local firms' export activities are hampered in the absence of some form of government guarantee provision (Gianturco, 2001; Moser et al., 2008). Government guarantees have been hotly debated due to their potential to act as a subsidy, which gives home country investors an unfair advantage over host country firms. However, nearly all industrialized countries and an increasing number of emerging economies now have some form of government guarantee for foreign trade. The most common form of government guarantee is export credit guarantees (ECGs) (Gianturco, 2001). While ECGs are similar to III, the main difference is that they cover trading activities, not investments. Empirical evidence suggests that ECGs stimulate export from the home country (Moser et al., 2008).

ECGs work in two ways; the home country government may either grant individual firms credit to facilitate exports or, if a bank or other financial institution finances the exporting activity, the guarantee is given to the bank or financial institution to cover potential default risks. For example, in Germany, the government offers export credit guarantee programs that are integrated into the federal government accounts of the state. This implies that all premiums collected from exporters obtaining guarantees for their exports are transferred to the federal budget accounts (Moser et al., 2008). Thus, all disbursements associated with claim costs incurred during the lifespan of the guarantee are paid out from the federal government funds. To eliminate the distortions of competition, international agreements are put in place to regulate the activities of ECGs. For instance, the WTO Agreement on Subsidies and Countervailing Measures disciplines the use of export subsidies and provides countervailing measures to offset injuries caused by subsidized exports by member states (WTO, 1995). Firms prefer ECGs

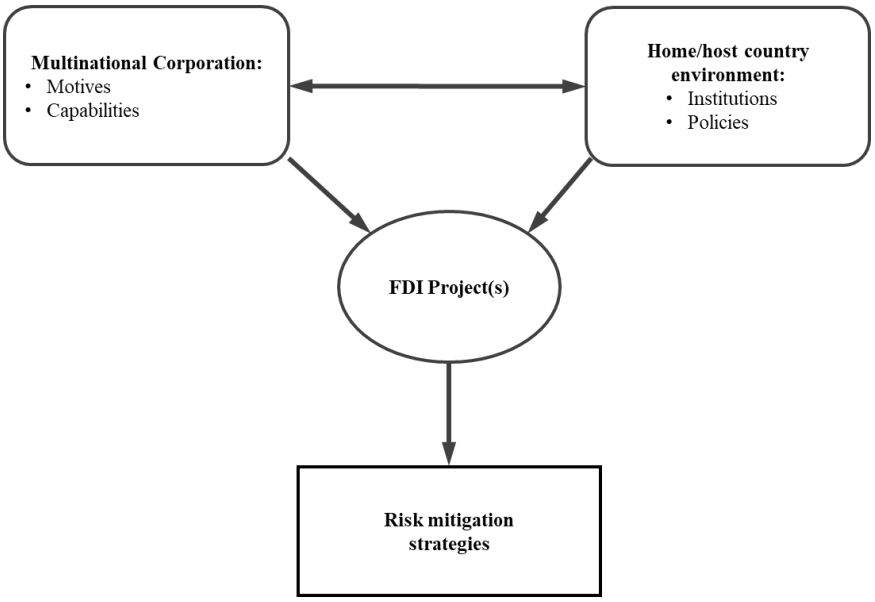
because they are less costly than traditional insurance. Additionally, as previously mentioned, investment treaties (BIT or MITs) and III schemes such as those offered by the MIGA of the World Bank Group only provide coverage for *investments,* while trading activities and firms not perceived as investors by the host country are not covered. As such, in the absence of investment treaties (BIT or MITs) and investment insurance, ECGs become the obvious choice for MNEs to protect their assets in developing countries.

2.5 A framework of international investment protection

Based on the mechanisms discussed above, and building on the efforts of previous scholars, such as (Miller, 1992), Gamso and Nelson (2019), Iankova and Katz (2003), Zhu and Sardana (2020), and Cavusgil et al. (2020), we propose a conceptual framework of international investment protection against host country policy risks that nuance the key mechanisms MNEs' use to protect their investment in high-risk countries (see **Figure 2.3**).

The set of mechanisms through which MNEs protect their investments in risky host countries are highly dependent on the nature of the economic activity or FDI project. As presented below, the investment type and destination country for such projects are influenced by MNEs' motives and capabilities (i.e., experience, resources, and political skills, and so on, among other factors) (Albino-Pimentel et al., 2018; Holburn & Zelner, 2010b; Kogut & Chang, 1996), as well as home and host country institutions and policies (Holburn & Zelner, 2010b; Jensen, 2003; Kobrin, 1978, 1979; Meyer et al., 2009). As **Figure 2.2** illustrates, a combination of motives and capabilities of MNEs, home and host country institutional characteristics, and policies affect the types of projects MNEs pursue, which in turn determines the possible risk mitigation mechanisms available to firms.

Figure 2.2 *Interaction between the MNEs, host and home country environments, investment projects, and risk mitigation strategies*

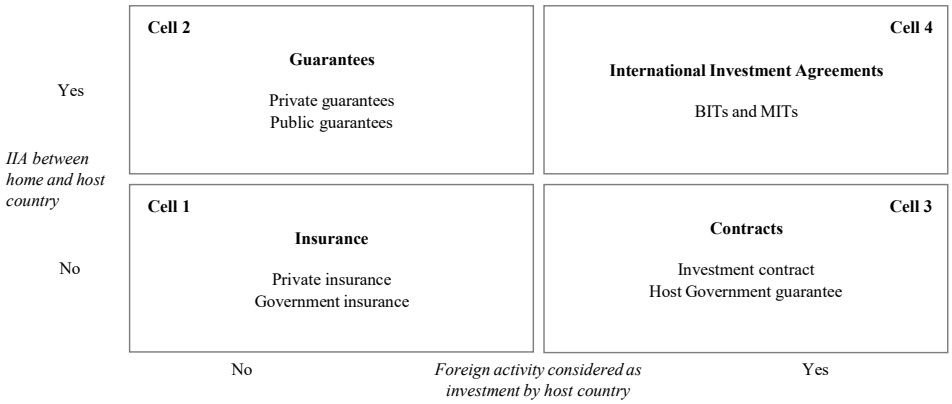


The framework of international investment protection against host country policy risks, depicted in **Figure 2.3,** rests on two critical assumptions. First, decision-makers in MNEs entering high-risk countries are presumed to be (bounded) rational actors. That is, given the option, boundedly rational decision-makers will choose to protect their investments against all identified protectable risks in developing host countries. Second, the model assumes that MNEs will not actively engage in treaty shopping (Weyzig, 2013) and thus divert FDI through conduit countries that have a more favorable treaty network. In other words, MNEs will not actively arbitrate between diverse sets of institutions because such acts are costly and come with risks to reputation, as evidenced by the recent high-profile media attention for the so-called "Double Irish, Dutch Sandwich" by American technology giants[2]. We acknowledge that international investment protection is done on a case by case basis, with the actual protection mechanism or a combination thereof being dependent on a firm's assessment of the nature of the risk they face in a host country, which ultimately depends on whether the economic activity in question is considered an *investment* by the host country. The choice also depends on the availability and

[2] In 2018, in investigation by the Dutch Chamber of Commerce revealed that Alphabet Inc., the parent company of Google moved 19.9 billion Euros ($22.7 billion) through a Dutch shell company to Bermuda in 2017, as part of an arrangement that allows it to reduce its foreign tax bill. After several media criticisms, google that tarnished the company's reputation, Google promised to end the practice after 2019.

cost of using a particular protection mechanism. We contend that BITs and MITs, which have become the central independent variable in recent strategic management and international business research, are not the only way to protect investments in high-risk host countries. Alternative mechanisms that MNEs rely on to protect their assets include III, ICs, and guarantees. **Figure 2.3** depicts this approach by presenting four alternative forms of investment protection available to MNEs investing in risky host countries.

Figure 2.3 *Protection of investment depending on IIA and FDI status*



We define IIAs as treaties between countries that are signed to reduce the likelihood of actions by host governments against MNEs based in signatory countries (Rangan & Sengul, 2009). Existing IIAs include BITs such as the Ghana-Switzerland BIT of 1991 or MITs such as the 1994 North American Free Trade Agreement (NAFTA) between Canada, the United States, and Mexico. Host country investor contracts are defined as agreements between MNEs and host governments (or an entity representing the host country, such as its trade department) to regulate a specific investment in the host country (Cotula, 2010). The main difference between host country investor contracts and IIAs is that IIAs such as BITs and MITs are signed between countries to regulate the establishment and treatment of *all* investments by the MNEs of signatory countries, while host country investor contracts regulate and govern a single investment by a single MNE in a single host country. Notably, host country investor contracts are the second level of protection mechanisms. We define investment insurance (II, also known as political risk insurance) as agreements among MNEs to protect FDI in risky host countries. II can cover risks from minor business disruption to outright expropriation by host governments. Finally, we define PIGs as protections provided by home governments for non-FDI international trade activities. Like II, PIGs are third-level protection mechanisms that occur among or between MNEs and their home country institutions.

2.6 Implications and future research directions

Through attempting to nuance the key institutional mechanisms that MNEs use to safeguard their investments in high-risk host countries, our analysis has identified several important implications for future research. MNEs entering developing countries can face regulations, workplace practices, and processes that vary significantly across countries. The international business literature has mainly focused on how MNEs adapt to these variations (George et al., 2016; Miller, 1992). However, the aspect of how firms can proactively protect their assets in these countries has rarely been addressed (Zhu & Sardana, 2020). To the best of our knowledge, this study represents the first attempt to systematically synthesize a diverse but scattered body of literature on the mechanisms that—apart from firms' own capabilities—enable MNEs to operate and thrive in high-risk developing countries. By drawing on research from various disciplines, including international business, political science, and law, this analysis serves as an initial step in answering the question of the mechanisms MNEs use to safeguard their investments in high-risk host countries, and consequently, why cross-border FDI activity continues to expand in developing countries despite high political due to heightened levels of national conflict, wars, terrorism, corruption, and fraught political regimes.

With the current trend of increasing geopolitical concerns and policy uncertainties among business leaders, this study opens up a number of research possibilities. First, a rational decision-making perspective suggests that the choice of a foreign market should be based on a trade-off between risks and returns, yet MNEs that choose to rely on ICs place their trust in host governments in developing countries. In light of recent heightened levels of national conflict, wars, terrorism, corruption, and fraught political regimes, how can MNEs ensure that host governments keep to their end of IC? Second, over the last 15 years, expropriations—particularly in the natural resource sector—have considerably increased worldwide (UNCTAD, 2019). Under what circumstances should a host government not be trusted to respect an IC? Finally, although developing countries are desperate for investment, they are also eager to govern. This was emphasized by the director-general of the WTO in a speech to trade ministers of least-developed countries (Moore, 1999). This is also the root of a deep ongoing discussion among countries in the G77 + China group at the United Nations. In its 2018 World Investments Report, the UN Conference on Trade and Development encouraged developing countries to adopt investment policy measures that are favorable to investors (UNCTAD, 2018). This raises the following questions: how should developing countries manage their relationship with

foreign MNEs to ensure that they attract more FDI while exercising their authority and right to regulate? Does being perceived as friendly for foreign MNEs lead to more FDI? With this article as the foundation, future research can help answer these pressing questions for business leaders, governments, and policymakers.

2.7 Conclusion

Our central argument is that as research continues to disentangle the difficulties that MNEs encounter when operating in developing countries, we should not forget what are arguably the most important reasons why global cross-border business activity continues to increase despite high political and commercial risks: the existence of risk-reducing and offsetting mechanisms. Various underlying international investment protection mechanisms in the form of bilateral and multilateral treaties, state-backed and private insurance, government guarantees, and ICs, ensure that although there are constantly increasing levels of risk in developing countries, MNEs can be shielded to ensure favorable economic outcomes for their operations in developing countries. Our analysis provides a new perspective for understanding MNEs that invest in high-risk countries by highlighting that these firms do not have a special appetite for risk. Instead, they rely on the portfolio of available international investment protection instruments.

2.8 References

Abbott, F. M. (2000). NAFTA and the Legalization of World Politics: A Case Study. *International organization*, *54*(3), 519-547.

Albino-Pimentel, J., Dussauge, P., & Shaver, J. M. (2018). Firm non-market capabilities and the effect of supranational institutional safeguards on the location choice of international investments. *Strategic Management Journal*, *39*(10), 2770-2793.

Andreeva, Y. (2008). Salvaging or sinking the investment? MHS v. Malaysia revisited. *The Law & Practice of International Courts and Tribunals*, *7*(2), 161-175.

Barron, A. (2011). Exploring national culture's consequences on international business lobbying. *Journal of World Business*, *46*(3), 320-327.

Bertrand, O., Betschinger, M. A., & Settles, A. (2016). The relevance of political affinity for the initial acquisition premium in cross-border acquisitions. *Strategic Management Journal*, *37*(10), 2071-2091.

Bishop, R. D., Crawford, J., & Reisman, W. M. (2005). *Foreign investment disputes: Cases, materials, and commentary* (2nd ed.). Wolters Kluwer Law & Business

Blake, D. J., & Moschieri, C. (2017). Policy risk, strategic decisions and contagion effects: Firm-specific considerations. *Strategic Management Journal*, *38*(3), 732-750.

Bonardi, J.-P., Holburn, G. L., & Vanden Bergh, R. G. (2006). Nonmarket strategy performance: Evidence from US electric utilities. *Academy of Management Journal*, *49*(6), 1209-1228.

Bradley, D. G. (1977). Managing against expropriation. *Harvard business review*, *55*(4), 75-83.

Briggs, H. W. (1971). Barcelona Traction: The jus standi of Belgium. *American Journal of International Law*, *65*(2), 327-345.

Brunetti, A., & Weder, B. (1998). Investment and institutional uncertainty: A comparative study of different uncertainty measures. *Review of World Economics*, *134*(3), 513-533.

Buckley, P. J. (2016). The contribution of internalisation theory to international business: New realities and unanswered questions. *Journal of World Business*, *51*(1), 74-82.

Buckley, P. J., & Casson, M. (1976). *Future of the multinational enterprise*. Palgrave MacMillan

Cavusgil, S. T., Deligonul, S., Ghauri, P. N., Bamiatzi, V., Park, B. I., & Mellahi, K. (2020). Risk in international business and its mitigation. *Journal of World Business*, *55*(2), 101078.

Cotula, L. (2010). *Investment contracts and sustainable development: How to make contracts for fairer and more sustainable natural resource investments*. International Institute for Environment and Development

Cuervo-Cazurra, A., Ciravegna, L., Melgarejo, M., & Lopez, L. (2018). Home country uncertainty and the internationalization-performance relationship: Building an uncertainty management capability. *Journal of World Business*, *53*(2), 209-221.

Cuervo-Cazurra, A., & Genc, M. (2008). Transforming disadvantages into advantages: developing-country MNEs in the least developed countries. *Journal of International Business Studies*, *39*(6), 957-979.

Darendeli, S. I., & Hill, T. L. (2016). Uncovering the complex relationships between political risk and MNE firm legitimacy: Insights from Libya. *Journal of International Business Studies*, *47*(1), 68-92.

Delios, A., & Henisz, W. I. (2000). Japanese firms' investment strategies in emerging economies. *Academy of Management Journal*, *43*(3), 305-323.

Dolzer, R., & Schreuer, C. (2012). *Principles of international investment law* (2nd ed.). Oxford University Press

Dorobantu, S., Kaul, A., & Zelner, B. (2017). Nonmarket strategy research through the lens of new institutional economics: An integrative review and future directions. *Strategic Management Journal*, *38*(1), 114-140.

Dunning, J. (1977). Trade, location of economic activity and the MNE: A search for an eclectic approach. In B. Ohlin, P.-O. Hesselborn, & P. M. Wijkman (Eds.), *The international allocation of economic activity* (pp. 395-418). Palgrave Macmillan.

Egger, P., & Pfaffermayr, M. (2004). The impact of bilateral investment treaties on foreign direct investment. *Journal of comparative economics*, *32*(4), 788-804.

Figueira-de-Lemos, F., Johanson, J., & Vahlne, J.-E. (2011). Risk management in the internationalization process of the firm: A note on the Uppsala model. *Journal of World Business*, *46*(2), 143-153.

Gamso, J., & Nelson, R. C. (2019). Does partnering with the World Bank shield investors from political risks in less developed countries? *Journal of World Business*, *54*(5), 100997.

García-Canal, E., & Guillén, M. F. (2008). Risk and the strategy of foreign location choice in regulated industries. *Strategic Management Journal*, *29*(10), 1097-1115.

George, G., Corbishley, C., Khayesi, J. N., Haas, M. R., & Tihanyi, L. (2016). Bringing Africa in: Promising directions for management research. *Academy of Management Journal*, *59*(2), 377-393.

Giambona, E., Graham, J. R., & Harvey, C. R. (2017). The management of political risk. *Journal of International Business Studies*, *48*(4), 523-533.
Gianturco, D. E. (2001). *Export credit agencies: The unsung giants of international trade and finance*. Greenwood Publishing Group
Goerzen, A., Sapp, S., & Delios, A. (2010). Investor response to environmental risk in foreign direct investment. *Management International Review*, *50*(6), 683-708.
Grabowski, A. (2014). The definition of investment under the ICSID Convention: A defense of Salini. *Chicago Journal of International Law*, *15*, 287- 309.
Guzman, A. T. (1997). Why LDCs sign treaties that hurt them: Explaining the popularity of bilateral investment treaties. *Virginia Journal of International Law*, *38*, 639 - 688.
Guzman, A. T. (2008). *How international law works: A rational choice theory*. Oxford University Press
Hasija, D., Liou, R. S., & Ellstrand, A. (2020). Navigating the new normal: Political affinity and multinationals' post-acquisition performance. *Journal of Management Studies*, *57*(3), 569-596.
Henisz, W. J. (2000a). The institutional environment for multinational investment. *The Journal of Law, Economics, and Organization*, *16*(2), 334-364.
Henisz, W. J. (2000b). The institutional environment for multinational investment. *Journal of Law, Economics, and Organization*, *16*(2), 334-364.
Henisz, W. J., & Delios, A. (2001). Uncertainty, imitation, and plant location: Japanese multinational corporations, 1990-1996. *Administrative Science Quarterly*, *46*(3), 443-475.
Henisz, W. J., & Zelner, B. A. (2001). The institutional environment for telecommunications investment. *Journal of Economics & Management Strategy*, *10*(1), 123-147.
Henisz, W. J., & Zelner, B. A. (2003). Political risk management: A strategic perspective. In T. H. Moran (Ed.), *International Political Risk Management: The Brave New World* (pp. 154 -170). The World Bank Group.
Henisz, W. J., & Zelner, B. A. (2004). Explicating political hazards and safeguards: a transaction cost politics approach. *Industrial and Corporate Change*, *13*(6), 901-915.
Henisz, W. J., & Zelner, B. A. (2014). The hidden risks in emerging markets. *Ieee Engineering Management Review*, *2*(42), 27-34.
Hillman, A. J. (2003). Determinants of Political Strategies in U.S. Multinationals. *Business & Society*, *42*(4), 455-484.
Hillman, A. J., & Hitt, M. A. (1999). Corporate political strategy formulation: A model of approach, participation, and strategy decisions. *Academy of management review*, *24*(4), 825-842.
Holburn, G., & Zelner, B. (2010a). Political capabilities, policy risk, and international investment strategy: Evidence from the global electric power generation industry. *Strategic Management Journal*, *31*(12), 1290-1315.
Holburn, G. L., & Zelner, B. A. (2010b). Political capabilities, policy risk, and international investment strategy: Evidence from the global electric power generation industry. *Strategic Management Journal*, *31*(12), 1290-1315.
Hwang, M. (2010). Recent developments in defining "investment". *ICSID Review*, *25*(1), 21-25.
Hymer, S. (1960/1976). *The international operations of national firms: a study of direct foreign investment*. MIT Press
Iankova, E., & Katz, J. (2003). Strategies for political risk mediation by international firms in transition economies: the case of Bulgaria. *Journal of World Business*, *38*(3), 182-203.
Jandhyala, S., & Weiner, R. J. (2014). Institutions sans frontières: International agreements and foreign investment. *Journal of International Business Studies*, *45*(6), 649-669.

Jensen, N. (2008). Political risk, democratic institutions, and foreign direct investment. *The Journal of Politics*, *70*(4), 1040-1052.
Jensen, N. M. (2003). Democratic governance and multinational corporations: Political regimes and inflows of foreign direct investment. *International organization*, *57*(3), 587-616.
Kerner, A. (2009). Why should I believe you? The costs and consequences of bilateral investment treaties. *International Studies Quarterly*, *53*(1), 73-102.
Khanna, T., & Palepu, K. G. (2010). *Winning in emerging markets: A road map for strategy and execution*. Harvard Business Press
Kobrin, S. J. (1978). When does political instability result in increased investment risk. *Columbia Journal of World Business*, *13*(3), 113-122.
Kobrin, S. J. (1979). Political risk: A review and reconsideration. *Journal of International Business Studies*, *10*(1), 67-80.
Kobrin, S. J. (1980). Foreign enterprise and forced divestment in LDCs. *International organization*, *34*(1), 65-88.
Kobrin, S. J. (1982). *Managing political risk assessment: Strategic response to environmental change* (Vol. 8). Univ of California Press
Kobrin, S. J. (1984). Expropriation as an attempt to control foreign firms in LDCs: trends from 1960 to 1979. *International Studies Quarterly*, *28*(3), 329-348.
Kobrin, S. J. (1987). Testing the bargaining hypothesis in the manufacturing sector in developing countries. *International organization*, *41*(4), 609-638.
Kogut, B., & Chang, S. J. (1996). Platform investments and volatile exchange rates: Direct investment in the US by Japanese electronic companies. *The Review of Economics and Statistics*, 221-231.
Luo, Y., & Park, S. H. (2001). Strategic alignment and performance of market-seeking MNCs in China. *Strategic Management Journal*, *22*(2), 141-155.
McCahery, J. A., & Vermeulen, E. P. (2000). The evolution of closely held business forms in Europe. *J. Corp. L.*, *26*, 855.
Medina, L. F., Bucheli, M., & Kim, M. (2019). Good friends in high places: Politico-economic determinants of the expropriation and taxation of multinational firms. *Journal of International Business Policy*, *2*(2), 119-141.
Menz, M., Kunisch, S., & Collis, D. J. (2015). The corporate headquarters in the contemporary corporation: Advancing a multimarket firm perspective. *The Academy of Management Annals*, *9*(1), 633-714.
Meyer, K. E. (2004). Perspectives on multinational enterprises in emerging economies. *Journal of International Business Studies*, *35*(4), 259-276.
Meyer, K. E., & Benito, G. R. G. (2016). Where do MNEs locate their headquarters? at home! *Global Strategy Journal*, *6*(2), 149-159.
Meyer, K. E., & Estrin, S. (2014). Local Context and Global Strategy: Extending the Integration Responsiveness Framework to Subsidiary Strategy. *Global Strategy Journal*, *4*(1), 1-19.
Meyer, K. E., Estrin, S., Bhaumik, S. K., & Peng, M. W. (2009). Institutions, resources, and entry strategies in emerging economies. *Strategic Management Journal*, *30*(1), 61-80.
Meznar, M. B., & Nigh, D. (1995). Buffer or bridge? Environmental and organizational determinants of public affairs activities in American firms. *Academy of Management Journal*, *38*(4), 975-996.
MIGA. (2018). *History*. http://www.miga.org
Miller, K. D. (1992). A framework for integrated risk management in international business. *Journal of International Business Studies*, *23*(2), 311-331.
Miller, K. D. (1993). Industry and Country Effects on Managers' Perceptions of Environmental Uncertainties. *Journal of International Business Studies*, *24*(4), 693-714.

Moore, M. (1999). *The Seattle Ministerial Conference and LDCs: Market Access, Supply-Side Constraints and Poverty Alleviation* https://www.wto.org

Moser, C., Nestmann, T., & Wedow, M. (2008). Political risk and export promotion: evidence from Germany. *World Economy*, *31*(6), 781-803.

Müllner, J., & Puck, J. (2018). Towards a holistic framework of MNE–state bargaining: A formal model and case-based analysis. *Journal of World Business*, *53*(1), 15-26.

Neumayer, E., & Spess, L. (2005). Do bilateral investment treaties increase foreign direct investment to developing countries? *World development*, *33*(10), 1567-1585.

Nguyen, Q., Kim, T., & Papanastassiou, M. (2018). Policy uncertainty, derivatives use, and firm-level FDI. *Journal of International Business Studies*, *49*(1), 96-126.

Nygaard, A., & Dahlstrom, R. (1992). Multinational company strategy and host country policy. *Scandinavian Journal of Management*, *8*(1), 3-13.

Oh, C. H., & Oetzel, J. (2011). Multinationals' response to major disasters: how does subsidiary investment vary in response to the type of disaster and the quality of country governance. *Strategic Management Journal*, *32*(6), 658-681.

Oh, C. H., & Oetzel, J. (2017). Once bitten twice shy? Experience managing violent conflict risk and MNC subsidiary-level investment and expansion. *Strategic Management Journal*, *38*(3), 714-731.

Peng, M., Lee, S.-H., & Wang, D. (2005). What determines the scope of the firm over time? A focus on institutional relatedness. *Academy of management review*, *30*(3), 622-633.

Prabhash, R., Vardhana, S. H., Kevin, J., & Ramandeep, S. (2018). India's Model bilateral investment treaty: Is India too risk averse? *Brookings India IMPACT Series*, *082018*(August 2018).

Ramamurti, R. (2001). The obsolescing 'bargaining model'? MNC-host developing country relations revisited. *Journal of International Business Studies*, *32*(1), 23-39.

Rangan, S., & Sengul, M. (2009). The influence of macro structure on the foreign market performance of transnational firms: The value of IGO connections, export dependence, and immigration links. *Administrative Science Quarterly*, *54*(2), 229-267.

Salacuse, J. W., & Sullivan, N. P. (2005). Do BITs really work: An evaluation of bilateral investment treaties and their grand bargain. *Harvard International Law Journal*, *46*, 67.

Schreuer, C. H. (2009). *The ICSID Convention: A commentary*. Cambridge University Press

Shihata, I. F. I. (1972). Arab investment guarantee corporation. *Journal of World Trade*, *6*, 185 -202.

Siegel, J. (2007). Contingent political capital and international alliances: Evidence from South Korea. *Administrative Science Quarterly*, *52*(4), 621-666.

Sine, W. D., & David, R. J. (2003). Environmental jolts, institutional change, and the creation of entrepreneurial opportunity in the US electric power industry. *Research Policy*, *32*(2), 185-207.

Stevens, C. E., Xie, E., & Peng, M. W. (2016). Toward a legitimacy-based view of political risk: The case of Google and Yahoo in China. *Strategic Management Journal*, *37*(5), 945-963.

UNCTAD. (2017). Investor-State Dispute Settlement: Review of Developments in 2017.

UNCTAD. (2018). *World investment report*. http://worldinvestmentreport.unctad.org/

UNCTAD. (2019). *Investment Dispute Settlement Navigator* https://investmentpolicyhub.unctad.org/ISDS

UNCTAD. (2020). *UNCTAD Investment Trends Monitor* https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=2274

UNCTAD. (2021). *UNCTAD releases data on over 1,000 investor-state arbitration cases* https://unctad.org/news/unctad-releases-data-over-1000-investor-state-arbitration-cases

Vernon, R. (1971). Sovereignty at bay: The multinational spread of US enterprises. *The International Executive*, *13*(4), 1-3.
Vernon, R. (1993). Sovereignty at bay: twenty years after. In *Multinationals in the Global Political Economy* (pp. 19-24). Springer.
Voon, T., Mitchell, A., & Munro, J. (2014). Parting ways: The impact of mutual termination of investment treaties on investor rights. *ICSID Review*, *29*(2), 451-473.
Wells, L. T. (1977). Negotiating with third world governments. *Harvard business review*(55(1)), 72-80.
Wells, L. T. (1998). Multinationals and the developing countries. *Journal of International Business Studies*, *29*(1), 101-114.
Weyzig, F. (2013). Tax treaty shopping: structural determinants of foreign firect investment routed through the Netherlands. *International Tax and Public Finance*, *20*(6), 910-937.
Woodhouse, E. J. (2005). The obsolescing bargain redux-foreign investment in the electric power sector in developing countries. *New York University Journal of International Law and Politics*, *38*, 121-219.
[Record #1107 is using a reference type undefined in this output style.]
Zhu, Y., & Sardana, D. (2020). Multinational enterprises' risk mitigation strategies in emerging markets: A political coalition perspective. *Journal of World Business*, *55*(2), 101044.

3. Host Governments-Foreign Firms Disputes

Host Government Intervention and FDI Inflow: An Empirical Investigation

Gilbert Kofi Adarkwah (BI)

Earlier versions of this essay have been presented at AIB annual conference (online 2020), the 45th EIBA Annual Conference (Leeds, 2019), and published as: **Adarkwah, G.** (2021). "Host Government Intervention and Foreign direct investments Inflow: An Empirical Investigation." International Business and Multi-layered Institutional Change (***Progress in International Business Research, Vol. 15***) – Forthcoming. Editors: Alain Verbeke, Rob van Tulder, Elizabeth L. Rose, Yingqi Wei

Abstract

This study examines the effect of host government interference in foreign investors' assets on foreign direct investment (FDI) inflow. I hypothesize that the relationship between host government interference and FDI inflow takes the form of an inverted U-shape. I tested this hypothesis using data from the International Centre for Settlement of Investment Disputes between 1996 and 2017. The results support the aforementioned hypothesis. While host government interference in the assets of a few foreign investors may not deter FDI inflow, frequent interferences that result in an increasing number of host state–foreign investor disputes reduce FDI inflow to a host country. The analysis also shows that investors adopt a wait-and-see strategy when faced with increasing host country uncertainty. However, how long investors wait depends on the economic situation of the host country. For high-income countries, investors wait until approximately 10 disputes before reducing their investment level in a host country, while this waiting period is a mere 2 disputes for low-income countries. The findings of this study suggest that countries seeking to attract more foreign investment should not interfere with the activities of foreign investors. However, if they do, disputes should be settled within that country and not in international arbitration courts, since frequently doing so may poison the host county investment environment and deter other foreign investors from investing.

Keywords: host country institutional risk; investment treaties; foreign investments; investor-state dispute settlement; supranational institutions; sovereignty

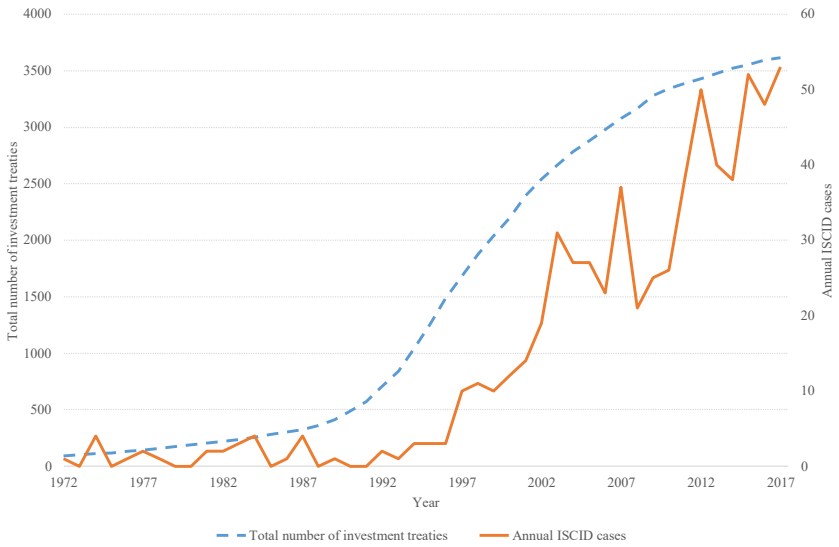
3.1 Introduction

How do disputes between host governments and foreign investors affect the attractiveness of a host country as a destination for foreign direct investment (FDI)? Do host governments that often are sued in international arbitration forums for interference with foreign investors' private property rights receive less FDI than countries that do not get sued? Host government interference, which is understood as acts stemming from host governments (or their representatives) that are designed to precipitate a change in the behavior of foreign investors in a direction compatible with host the government's objectives (Kobrin, 1980, 1984; Makhija, 1993), have been at the core of international business (IB) research since its early years (Kobrin, 1982, 1984; Minor, 1994; Root, 1968). From classic transaction cost theorists (Williamson, 1967) to the traditional bargaining literature (Ramamurti, 2001; Vernon, 1971), all have recognized the potential costs that host governments can impose on investors. The most severe breakdown a foreign investor can experience is in its relations with a host government because this can lead to the host government interfering with or holding up business transactions, changing the terms of agreements, or even wholly or partially confiscating the foreign investor's assets (Duanmu, 2014; Medina et al., 2019). Such actions can significantly affect investment performance because revenues lost due to host government interference can run into the billions of dollars. As such, the management of host country relationships has become a particularly important function for foreign investors (Makhija, 1993; Stevens et al., 2016).

There is anecdotal evidence suggesting that host governments that interfere in foreign investors' assets poison the investment climate of their countries and ultimately receive less FDI. Host governments, particularly those of developing countries, are advised not to interfere in the private properties of foreign investors in their territories (UNCTAD, 2018) since investors only invest and remain in host countries that treat them well. To attract more FDI and the related spillover to their economies, many governments invest time and other scarce resources to negotiate, conclude, sign, and ratify international investment agreements (IIAs) to alleviate foreign investors' concerns (Büthe & Milner, 2008; Elkins et al., 2006; Neumayer & Spess, 2005). Typically, IIAs include provisions of national treatment, most favored nations, the possibility to repatriate profits, and appropriate compensation in the event of expropriation. Most importantly, they also include provisions that permit aggrieved investors to challenge host government policies that violate IIA commitments via international investor-host state arbitration (i.e., host country dispute settlements (HCDSs) (Allee & Peinhardt, 2010, 2011; Dolzer & Schreuer, 2012). Many foreign investors rely on IIAs as a mechanism for

safeguarding their investments (Allee & Peinhardt, 2010, 2011; Jandhyala & Weiner, 2014). Although investment arbitration has proven to be an effective means of deterring host governments from arbitrary interference in foreign investors' assets (Jandhyala & Weiner, 2014), recent evidence has shown that host governments are increasingly doing so, and even expropriating those assets in some cases. This has led to an increasing number of investor-state confrontations and dispute settlements. As shown in **Figure 3.1**, since the early 1970s, the number of investor-state disputes settled at the International Center for the Settlement of Investment Disputes (ICSID) has increased markedly, reflecting the increasing level of hostility between foreign investors and host governments.

Figure 3.1 *Growth of investment agreements and ICSID cases (1972–2017)*



Source: UNCTAD Investment Policy Hub and IIA Database (2018)

Interestingly, although foreign investors rely on IIAs to protect their investments and even invest more in countries where there are IIAs (Albino-Pimentel et al., 2018; Neumayer & Spess, 2005), the IB literature and strategies used by firms and individual investors have paid very little attention to the effect of HCDSs on FDI inflow. Notably, the present study seeks to fill this gap in the literature. To achieve this, I used data from the ICSID—an international arbitration institution established by the United Nations under the World Bank in 1966 for legal dispute resolution and conciliation between foreign investors and host countries—to examine

the effect of HCDSs on FDI inflows. The results indicate that the relationship between host government interference in foreign investors' assets and FDI inflow takes the form of an inverted U-shaped curve. When there are only a few initial interferences, the resultant disputes in international arbitration courts do not deter FDI; however, as the number of interferences increases, foreign investors begin to reduce their investment levels in the host country. It appears that when faced with an uncertain business environment originating from host government actions, investors adopt a “wait-and-see” strategy. However, how long investors wait depends on the economic situation of the host country. For high-income countries, investors wait until approximately nine disputes before reducing investments level in a host country, while this waiting period is a mere two disputes for low-income countries.

Overall, this study makes three contributions. First, while earlier studies have focused on the *ex-ante* (before a dispute has occurred) effect of IIAs on FDI inflow (Albino-Pimentel et al., 2018; Jandhyala & Weiner, 2014; Neumayer & Spess, 2005), the present study highlights the *ex-post* and unexpectedly "bad behavior" of host governments after signing and rectifying IIAs. IIAs provide a mechanism for countries to credibly commit to treating foreign investors fairly because it allows harmed foreign investors to call upon external arbitration and seize host government assets held outside the host country. Thus, knowing that they can punish host governments for poor behavior and noncompliance to their treaty obligations, investors invest more in host countries that their home country has IIAs with (Albino-Pimentel et al., 2018; Neumayer & Spess, 2005). However, this *ex-ante* account of the effect of IIAs hinges on the assumption that signatory states will not renege on their IIA commitments in the future (Allee & Peinhardt, 2011).

Nevertheless, as evidenced in Figure 1 and Table 2, many host governments take (*ex-post)* actions and interfere with foreign investors' assets after entering into IIAs that contravene host governments' IIA obligations. This study enriches the political risk and IB literature by examining the effect of such host country *ex-post* behavior on FDI inflow. Second, contrary to earlier studies that focus on the role of host country domestic institutions (Khanna & Palepu, 1997; Meyer et al., 2009; North, 1990; Peng & Heath, 1996), the present study highlights the role of international institutions (operationalized as IIAs) on FDI inflow. The strategy and IB literature on international institutions tend to focus on issues such as corruption mitigation (Cuervo-Cazurra & Genc, 2008; Rodriguez et al., 2005) and the coercive pressure of transnational agencies (Henisz et al., 2005). The present study broadens these discussions by examining investor-host state disputes arising from host government interference in foreign

investors' assets, thereby responding to the call from Sun et al. (2010) for more exploration into "how firms mitigate potential rent misappropriation" by host governments. Third, by considering investor-host government disputes from a global perspective, this study extends the geographic scope of the empirical research on FDI inflow. The findings of this study suggest that host governments seeking to attract more FDI may fail to do so if the measures taken while exercising their right to regulate, govern, and deliver public services affect the economic interests of foreign investors.

3.2 Theory and Hypothesis

Host government interference in foreign firms' operations

Host government interference in foreign investors' assets was at the center of scholarly debates during the 1960s and 1970s, when many developing countries expropriated foreign investors' assets, particularly in the natural resources and extractive sectors (Fagre & Wells, 1982; Kobrin, 1979, 1984). However, by the late 1980s and early 1990s, many countries seeking to attract more FDI adopted investor-friendly policies and entered into IIAs (Grosse, 2007; Minor, 1994), leading some scholars to argue that host government interference has lost its relevance in the contemporary global economy (Li, 2009; Minor, 1994). Notably, host government interference can be direct or indirect. While direct interference may include outright nationalization or the confiscation of assets from foreign-owned businesses, indirect interference (i.e., "de facto," "disguised," "constructive," or "creeping" interference) occurs when a host government takes effective control of—or otherwise interferes with—foreigners' investments, which depreciate their economic value. This includes formal takings sanctioned by parliament or the executive branch of government, extra-legal interventions (or lack thereof), forced sales of equity, and divestment resulting from the renegotiation of contracts, etc. Thus, host government interference relates to any form of unilateral action taken by a host government that is official in nature and requires a certain level of compliance by investors.

Suppose a host government's actions (or those of its representatives) negatively affect the economic value of an investor's asset. In that case, the investor can revert to the host government's IIA commitments and initiate a legal dispute settlement in the form of international arbitration (Dolzer & Schreuer, 2012; Kobrin, 1980, 1984; Newcombe, 1999). Provisions that permit and guide the settlement of disputes between foreign investors and host governments are contained in IIAs, such as bilateral investment treaties (BITs) and multilateral

investment treaties (MITs). IIAs are legally binding supranational arrangements signed between countries to govern and stimulate investments (Rangan & Sengul, 2009). An example of a BIT is the Ghana-Switzerland BIT of 1991. MITs are investment agreements between several countries. An example of an MIT is the 2019 free trade agreement known as the United States–Mexico–Canada Agreement (USMCA). Today, there are over 3000 active IIAs globally (UNCTAD, 2017b). While countries sign IIAs to attract more FDI (Büthe & Milner, 2009), investors rely on IIAs to protect their assets in host countries (Allee & Peinhardt, 2010, 2011). By signing and ratifying IIAs, host governments reassure foreign investors that they are genuinely committed to refraining from interference with their assets. Host governments that violate IIA commitments and are sued by investors through international arbitration suffer the direct financial costs of contesting the litigation, the reputational damage associated with being a defendant, and the payment of a potentially sizable arbitration judgment award (Dolzer & Schreuer, 2012; Salacuse & Sullivan, 2005). As a result, scholars have argued that investments in host countries where the host government has signed and rectified an IIA are less likely to be interfered with (Albino-Pimentel et al., 2018; Allee & Peinhardt, 2010, 2011). However, as shown in **Figure 3.1**, host government interference is rather widespread.

The international investment dispute settlement process

Investors have responded to host government interference by either doing nothing, exiting/de-internationalizing from the host country (Benito & Welch, 1997; Dai et al., 2017) or suing the host government to challenge their decision in international arbitration courts (i.e., HCDS relying on IIAs). Notably, only foreign investors can sue host governments under IIAs for interference in their assets because states (home and host states) are the parties to the IIAs, and only states can be held liable to pay damages for the breach of treaty commitments. However, local investors can submit grievances to local courts. Foreign investors that decide to challenge a host government's noncompliance with IIA commitments by way of an HCDS begin by submitting a request for a consultation with the host government.[3] If the dispute is not settled after consultations, then the investor has the option to pursue international arbitration via a body such as the ICSID (Dolzer & Schreuer, 2012). The possibility to settle disputes in international arbitration courts affects investors' investment decisions in host countries since IIAs provide

[3] See Article 14 of Norway's bilateral investment treaty (BIT) model for an example how IIAs regulate dispute settlements between MNEs and host governments. Available at https://www.regjeringen.no/contentassets/e47326b61f424d4c9c3d470896492623/draft-model-agreement-english.pdf retrieved 02.05.2019.

investors with a certain level of comfort regarding potential host country interference (Albino-Pimentel et al., 2018; Jandhyala & Weiner, 2014).

The effect of host government interference on FDI decisions

Previous studies have analyzed the political and economic factors that prompt host government interference in foreign-owned assets. According to the traditional bargaining logic, after an investor has invested in a country, the investor loses bargaining power with the host government and becomes subject to policy changes and increasing interference in their operations by the host government (Fagre & Wells, 1982; Vernon, 1971). Nathan and Leonard (2004) observe those host governments that depend more on natural resources for their economy are more likely to interfere with foreign investors' assets. Similarly, Kobrin (1980) finds that specific factors, such as the sector of investment and the percentage owned by a parent company, also influence the likelihood of host government interference. Regarding the form of governance, Henisz (2000b) and Jensen (2003) find that both liberal democracies and non-democracies interfere with foreign investors' assets; however, interference is more likely to occur in non-democratic countries. Notably, host governments interfere with investors' assets because it benefits them (Henisz, 2000b). Host governments can perform the confiscation of wholly or partially foreign-owned businesses and transfer foreign-owned property rights to domestic ownership. As a result, host governments do not interfere with the assets of all investors in a specific industry or sector; instead, they do so selectively (Boddewyn, 2005; Kobrin, 1984).

In assessing investments abroad, a specialized branch of the literature on international investment decisions—known as the hysteresis hypothesis—contends that when faced with host country uncertainty, the best strategy for foreign investors is to wait and see (Baldwin & Krugman, 1989; Dixit, 1989, 1992). According to the hysteresis hypothesis, defined as the failure of an effect to reverse itself as its underlying cause is reversed (Baldwin & Krugman, 1989; Dixit, 1989, 1992), when host country uncertainty increases. Thus, investors do not immediately reduce their investment levels in a host country; instead, they wait and see. Similarly, the literature on IIAs argues that when host governments enter into IIAs, they signal their overall willingness to uphold and abide by international norms of investment protection, thus making the country an attractive location for foreign investors (Albino-Pimentel et al., 2018; Jandhyala & Weiner, 2014). Additionally, since assets committed in foreign markets are mostly irreversible and rebuilding an investment position in a previously abridged market may be costly and time-consuming for foreign investors (Belderbos & Zou, 2009; Folta et al., 2006),

they may hesitate to withdraw their investments from a host country. However, as host governments begin to renege on their commitments under IIAs and the number of interferences increases, investors may reduce investment levels in the host country over time. Foreign investors lose strategic bargaining power whenever specific assets are deployed in a foreign sovereign territory (Vernon, 1966). When confronted with the prospect of continued host government interference, investors seek opportunities elsewhere and reduce the investment level in the host country over time. Therefore, it is expected that the relationship between host government interference and FDI inflows will be an inverted parabola. Therefore, I put forth the following hypothesis:

Hypothesis: *There is an inverted U-shaped relationship between host government interference and FDI inflow.*

3.3 Method

Dependent variable

The main dependent variable is FDI inflow. Consistent with previous studies (Globerman & Shapiro, 2003; Kimino et al., 2007; Li & Vashchilko, 2010; Neumayer & Spess, 2005), I collected FDI data from the United Nations Conference on Trade and Development's (UNCTAD) foreign direct investment statistics. I used the absolute FDI inflow into host countries as the main dependent variable to capture direct changes in FDI inflows. If I were to use FDI inflow as a percentage of host countries' GDP, this measurement would capture changes in the relative importance of FDI to the host country but would not directly measure changes in inflows (Neumayer & Spess, 2005). According to an exclusive report by The Economist (2013), the world has 50–60 tax havens serving as domiciles for more than 2 million paper companies. It is estimated that between 10 and 30% of global FDI is channeled through such tax havens (Haberly & Wójcik, 2014). As some scholars have already acknowledged (Beugelsdijk et al., 2010), countries that position themselves as tax havens receive large FDI inflows. However, these FDIs do not necessarily generate value-adding activities in the focal country. Notably, investors send a large amount of FDI to tax haven countries to avoid paying taxes on them (Hines & Rice, 1994; Lipsey, 2007). To control for the use of holding companies and chain ownership to reduce tax burdens on firms without necessarily generating value-adding activities in the host country, I excluded tax haven countries from the dataset. Consistent with previous studies (Akamah et al., 2018), the present study relies on the definition of tax

havens provided by Dyreng and Lindsey (2009)[4]. Our overall sample contained data on 142 countries for a 22-year period (1996–2017). **Table 3.1** provides detailed information on the variables used in this study as well as their sources.

Table 3.1 *Variables, definitions, and data sources*

Variables	**Measurements**	**Sources**
Dependent variable		
FDI inflow	Annual inflow of foreign direct investment	UNCTAD
Independent variable		
Host government interference	Known investor-host country disputes under international arbitration at the ICSID and ICC	UNCTAD
Market size	Natural logarithm of host country population	World Bank
GDP per capita	Natural logarithm of host country GDP per capita	World Bank
Inflation	Inverse hyperbolic sine of inflation	World Bank
Natural resource endowments	Natural logarithm of host country natural resources	World Bank
POLCON	Host country POLCON score (Holburn & Zelner, 2010)	Henisz (2000a)
Investment agreements	Dummy variable equal to 1 if the country has a treaty for the investment, and 0 otherwise (Albino-Pimentel et al., 2018)	UNCTAD

Independent variable: The ICSID as a source of host government interference

The main independent variable is the existence of host-investor dispute settlement (HCDS) proceedings at an international arbitration tribunal. I used the absolute number of host country-investor arbitration cases registered with the ICSID as the main explanatory variable. International arbitration data was used because arbitration is the last resort for foreign firms in the case of host government interference in their operations (Dolzer & Schreuer, 2012). I collected HCDS data from the UNCTAD investment policy database (https://investmentpolicyhub.unctad.org/ISDS). The investment policy database is a

[4] I excluded Andorra, Anguilla, Antigua and Barbuda, Aruba, Bahamas, Bahrain, Barbados, Belize, Bermuda, the British Virgin Islands, Brunei, Cape Verde, the Cayman Islands, the Cook Islands, Costa Rica, Cyprus, Dominica, Gibraltar, Grenada, Guernsey and Alderney, Hong Kong, Ireland, the Isle of Man, Jersey, Kitts and Nevis, Latvia, Lebanon, Liberia, Liechtenstein, Luxembourg, Macau, Maldives, Malta, the Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, Netherlands Antilles (or Dutch Antilles), Niue, Palau, Panama, Samoa, San Marino, Seychelles, Singapore, St. Lucia, St. Vincent and The Grenadines, Switzerland, the US Virgin Islands, Uruguay, and Vanuatu from the dataset.

comprehensive database that contains HCDS cases decided on by the ICSID and the International Chamber of Commerce (ICC) (UNCTAD, 2017a). It contains extensive information on HCDSs and includes their specific dates of initiation, the names of the respondent countries, and the BITs or MITs upon which the dispute settlement was initiated. I used the respondent country as the identifier of the host country. IIAs typically specify multiple venues through which aggrieved investors or host governments may pursue their grievances (Dolzer & Schreuer, 2012). However, studies show that the ICSID is the most important and most commonly used arbitral venue. The ICSID is used far more than all of the other options combined (Allee & Peinhardt, 2010). Due to its establishment by an international convention in 1966 and close ties with the World Bank, investors have turned to the ICSID to contest host governments' interference eight times as frequently as they turned to all other institutionalized arbitration bodies combined (Allee & Peinhardt, 2011). Notably, a secretary-general empowered to disregard frivolous cases aids the ICSID's functioning. Thus, only legally valid claims are permitted by the secretary-general to proceed to arbitration. Its rulings are legally binding on the parties and in the domestic courts of all ICSID member states. Today, the ICSID has 161 signatory member countries, making the enforcement of ICSID rulings almost universal. Between 1996 and 2017, there were a total of 904 known treaty based HCDSs. Overall, 580 were concluded, 314 were pending, and 10 had an unknown outcome. Argentina had the most lawsuits, with 60 registered cases. This was followed by Venezuela, Spain, and the Czech Republic, with 44, 43, and 35 cases, respectively. **Table 3.2** provides an overview of the countries with the highest number of investor arbitration cases.

Table 3.2 *Countries with the most frequent number of HCDS cases*

Country	**Cases (as of 2017)**	**Country**	**Cases (as of 2017)**
Argentina	60	Cyprus	4
Spain	48	Armenia	4
Venezuela	46	Iraq	4
Czech Republic	40	Estonia	4
Egypt	32	China	4
Mexico	29	Belize	3
Poland	29	Sri Lanka	3
Canada	28	Slovenia	3
India	27	Mozambique	3
Ukraine	26	Australia	3
Russia	24	Thailand	3
Ecuador	23	Senegal	3
Hungary	18	Ethiopia	3
Kazakhstan	18	Germany	3
USA	16	Congo	3
Croatia	16	Zimbabwe	3

Peru	14	Yemen	3
Bolivia	14	Belgium	3
Georgia	13	Nicaragua	3
Libya	13	Korea	3
Romania	13	Oman	3
Slovakia	13	El Salvador	3
Kyrgyzstan	13	Paraguay	3
Turkmenistan	11	Burundi	3
Latvia	11	The Gambia	3
Italy	11	Bahrain	2
Moldova	11	Kuwait	2
Algeria	10	Benin	2
Panama	9	Ghana	2
Jordan	9	Honduras	2
Serbia	9	Azerbaijan	2
Uzbekistan	9	Mauritius	2
Costa Rica	9	Lesotho	2
Pakistan	9	Malaysia	2
Turkey	8	Morocco	2
Vietnam	8	Gabon	2
Bulgaria	8	Grenada	1
Chile	7	Nigeria	1
Indonesia	7	Barbados	1
Madagascar	6	Syria	1
Albania	6	France	1
Colombia	6	Tajikistan	1
Montenegro	6	Guyana	1
Saudi Arabia	5	Myanmar	1
Bosnia and Herzegovina	5	Sudan	1
Greece	5	Iran	1
Laos	5	Kenya	1
Philippines	5	Trinidad & Tobago	1
Lebanon	5	Bangladesh	1
Uruguay	5	Tunisia	1
Lithuania	5	Cape Verde	1
Guatemala	5	Cameroon	1
Macedonia	5	South Africa	1
Dominican Republic	5	Austria	1
Tanzania	4	Equatorial Guinea	1
United Arab Emirates	4	Uganda	1
Mongolia	4	UK	1

Source: UNCTAD Investment Policy Hub and IIA Database (2018)

Control variables

Several control variables found to be of importance in previous studies on host country determinants of FDI inflows were added to the model (see Chakrabarti (2001) or Blonigen (2005) for a review). The main control variables included market size, GDP per capita inflation, natural resource endowment, political uncertainties in the host state, and investment agreements.

Market size, GDP per capita, inflation. Consistent with previous studies on FDI inflows (Büthe & Milner, 2008; Dunning, 1998), I controlled for host country-specific demographic and economic factors. I also controlled for the host country's market size, GDP per capita, and inflation levels. Population was used as a proxy for market size.

Natural resource endowment. This study employed a measure of natural resource endowment to control for the fact that, all other things being equal, host countries with vast natural resources are more likely to attract more FDI (Dunning, 1988; Ramasamy et al., 2012). I adopted a measure equal to the sum of natural resource endowment as a percentage of GDP for each country, as reported by the World Bank (2019).

Policy uncertainty. I controlled for the level of policy uncertainty stemming from host country political constraints in our robustness test. This was operationalized through the political constraints (POLCON) index developed by Henisz (2000a). The POLCON index makes use of the government structure in a given host country and the political views represented by different levels of that government to measure the level of political constraints on policy changes in a specific host country in a particular year using a 0 to 1 scale.

Investment agreements. Several studies have shown that investment agreements (e.g., BITs and MITs) influence the location choice of foreign investors (Albino-Pimentel et al., 2018; Neumayer & Spess, 2005). Notably, countries that sign investment agreements are more likely to receive more FDI than those without investment agreements. For these reasons, I also controlled for the number of investment agreements (i.e., BITs and MITs) that host countries have signed and ratified.

Estimation technique

I used FDI inflows as the unit of analysis for this study. Consistent with existing literature (Neumayer & Spess, 2005), I took the natural log of FDI inflow for this analysis to reduce the skewness of the distribution of the dependent variable. The overall global increase in FDI may be a major cause of the increasing trend in overall investor-host country disputes. To mitigate for potential reverse causality problems of increasing FDI affecting the number of investor-host state disputes FDI inflow was lagged by one period. To mitigate this potential endogeneity problem more robustly, I adopted instrumental variable regression by running a two-stage least squares (2SLS) regression model using the *ivregress* command in Stata (version 16).

Notably, the institutional fabric of a host country influences the willingness of foreign investors to invest in it (Aguilera & Grøgaard, 2019; Meyer et al., 2009). Thus, I collected relevant data on host country political environments from the World Bank worldwide governance indicators (Kaufmann et al., 2011) and used them as instruments for institutions in the estimation model. In line with previous studies (Chen et al., 2017; Meyer et al., 2009), and as suggested by the theoretical considerations for this study, the concept of an institution is focused on institutions that support foreign investors' access to fair treatment in a host country. R*ule of law, regulatory quality, and government effectiveness* were used as instruments. Rule of law measures the extent to which agents have confidence in and abide by the rules of society, particularly the quality of contract enforcement, property rights, the police, and the courts. Regulatory quality captures a host government's ability to formulate and implement sound policies and regulations that permit and promote private sector development. Government effectiveness measures the quality of policy formulation and implementation as well as the credibility of a government's commitment to such policies (Kaufmann et al., 2011). Endogeneity may cause a generalized least squares estimates problem in a model, leading to a non-zero correlation between the error terms of the equations (Sayrs, 1989). Using the *estat firststage* command, I performed a postestimation analysis to check the strength of the instrument by estimating the first-stage regression statistics. The partial $R^2 = 0.9689$, F = 37254.9, and P-value = 0.0000 rejected the H_0 hypothesis that the instruments are weak. These results indicate that the study has good instruments. Thus, it is appropriate to adopt the 2SLS model, which has increasingly been used and recommended by IB and strategy scholars (Hitt et al., 1998).

3.4 Results

Tables 3.3 and **3.4** reports the descriptive statistics and correlations of the variables used in this analysis. This includes the means, standard deviations, and correlation coefficients.

Table 3.3 *Descriptive statistics and correlations*

	N	Mean	S.D.	1	2	3	4	5	6	7	8	9
1 FDI inflow	2,895	20.51	2.59	1								
2 HCDS	3,150	0.27	0.95	0.179***	1							
3 Market Size	3,150	42.78	144.33	0.300***	0.0840***	1						
4 GDP per Capita	3,150	9.18	14.57	0.487***	0.0334*	-0.0309*	1					
5 Institutions	3,150	- 0.15	0.95	0.554***	0.0241	0.0126	0.735***	1				
6 Inflation	2,763	1.59	1.18	-0.193***	0.0283	0.0274	-0.348***	-0.424***	1			
7 Resources Rents	3,150	8.42	12.04	-0.100***	-0.0433**	-0.0637***	-0.102***	-0.332***	0.324***	1		
8 POLCON	2,908	0.30	0.21	0.297***	0.0720***	0.00976	0.299***	0.496***	-0.246***	-0.304***	1	
9 Investment Agreements	3,003	31.75	28.91	0.583***	0.216***	0.351***	0.319***	0.390***	-0.206***	-0.144***	0.185***	1

$^{*}p < 0.05$, $^{**}p < 0.01$, $^{***}p < 0.001$

Table 3.4 presents the results of the regression analysis. In Model 1, the theoretically known determinants of FDI and the instrument are regressed on the dependent variable. Most variables in the model were tested in accordance with the following theoretical expectations: larger countries receive more FDI; richer countries receive more FDI; countries with natural resource endowment receive more FDI; investment agreements have a positive effect on FDI inflow. Unsurprisingly, while the inflation level in a country does not have an impact on FDI, the regression coefficient of inflation is statistically insignificant. In Model 2, I included the main explanatory variable, HCDS, in the specification. To directly test the hypothesis, I introduced the square term of host country dispute (HCDS^2) in Model 3 (Aiken et al., 1991). The regression coefficient was statistically significant ($\beta = -0.0192,\ p =< 0.01$). The regression coefficient was statistically significant ($\beta = -0.0192,\ p =< 0.01$). Notably, Models 2 and 3 confirmed the hypothesis. From a risk and reward standpoint, it seems evident that the argument "increasing risk, less FDI" contained a hypothesis that needs little detailed qualification. Models 2 and 3 suggest that while HCDS does not have an immediate negative impact on FDI inflows, there must be a limit beyond which foreign investors will continue to invest in a host country in the face of persistent interference by government officials. As shown in this study, this relationship is an inverse parabola. By maintaining the square term of host country dispute (i.e., HCDS^2) in the equation for Model 4, I tested the interaction effect of HCDS and market size (HCDS * *Market Size*) while controlling for the ability of host governments to make credible commitments to existing policy regimes based on the POLCON index (Henisz, 2000a) and its interaction with the corruption levels in a host country. The results suggest that the interaction of HCDS and market size has a negative and significant effect on the likelihood for investors to exit a host country, which further supports the hypothesis that persistent host country interference may lead to decreased FDI in a host country. With interaction terms included in the models, one cannot interpret the coefficients on the individual components in the conventional manner (Braumoeller, 2004). Instead, the results of HCDS in a model with a significant interaction term (*Treaties * HCDS*) represent the effect of investment agreements on FDI flow when the HCDS variable is zero (Braumoeller, 2004; Neumayer & Spess, 2005). These results from Model 4 confirm a widely known finding in the literature that host country institutions (which are operationalized as the number of investment agreements) are important in attracting FDI (Meyer et al., 2009; Peng, 2002). It also confirms the findings of Neumayer and Spess (2005) and Albino-Pimentel et al. (2018), which suggest that the existence of investment agreements has a substantial impact on firms' FDI location decisions while controlling for traditional determinants of foreign investment location choice and other host country variables.

Table 3.4 *Results of 2SLS regression of host government intervention and FDI inflow*

Variables	(1) Model 1	(2) Model 2	(3) Model 3	(4) Model 4
Institutions	0.700***	0.696***	0.696***	0.700***
	(0.0710)	(0.0757)	(0.0756)	(0.0753)
Market size	0.00303***	0.00302***	0.00301***	0.00331***
	(0.000239)	(0.000218)	(0.000220)	(0.000272)
GDP per capita	0.0337***	0.0345***	0.0349***	0.0340***
	(0.00398)	(0.00468)	(0.00467)	(0.00464)
Inflation	0.0513	0.0517	0.0528	0.0526
	(0.0338)	(0.0335)	(0.0334)	(0.0335)
Natural resource endowment	0.0144***	0.0143***	0.0143***	0.0144***
	(0.00351)	(0.00407)	(0.00406)	(0.00406)
POLCON	0.553***	0.517**	0.515**	0.545**
	(0.203)	(0.220)	(0.219)	(0.218)
Investment agreements	0.0293***	0.0280***	0.0274***	0.0294***
	(0.00138)	(0.00134)	(0.00134)	(0.00140)
HCDS		0.173***	0.350***	0.722***
		(0.0409)	(0.0449)	(0.0774)
HCDS^2			-0.0192***	-0.0130***
			(0.00311)	(0.00450)
HCDS * Market Size				-0.000841**
				(0.000380)
Treaties * HCDS				-0.00680***
				(0.00106)
Constant	19.00***	19.00***	18.98***	18.90***
	(0.115)	(0.123)	(0.123)	(0.124)
Observations	2,405	2,405	2,405	2,405
R-squared	0.507	0.512	0.515	0.522
2SLS	YES	YES	YES	YES

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Although necessary, a significant coefficient alone is not enough to establish a quadratic relationship (Haans et al., 2016; Lind & Mehlum, 2010). For this, I followed the three-step procedure proposed by Lind and Mehlum (2010) and recommended by Haans et al. (2016). Lind and Mehlum (2010) outlined the requirements for properly testing for the presence of a quadratic relationship: (1) The coefficient must be significant and of the expected sign ($\beta = -0.0192,\ p =< 0.01$). An inverted U-shaped relationship exists if the dependent variable first increases with the independent variable at a decreasing rate to reach a maximum, after which the dependent variable decreases at an increasing rate (Aiken et al., 1991; Haans et al., 2016). (2) The slope must be sufficiently steep; (3) The turning point must be located well within the

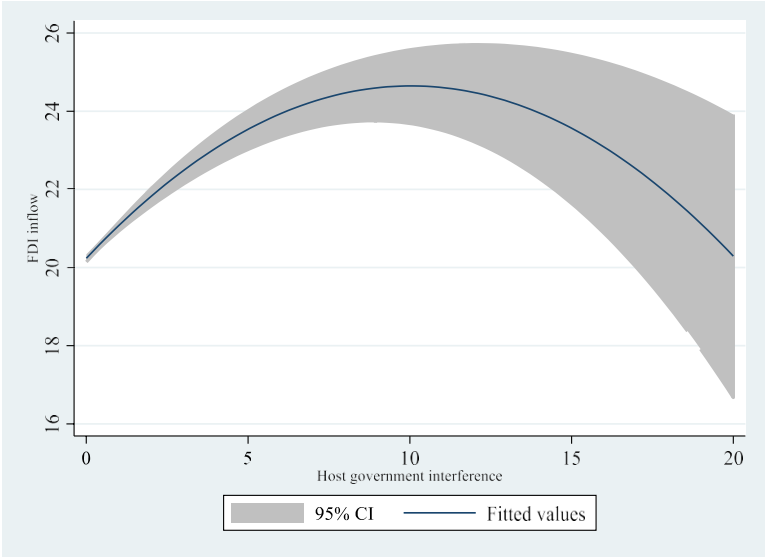
data range. Following Haans et al. (2016) recommendation to report the "turning point" due to its economic and statistical importance, I conduct a partial derivation of the regression function to explore the hypothesized relationship further: $\text{FDI inflow} = -0.0192\ \text{HCDS}\hat{}2 + 0.350$ reaches its maximum when $\frac{\partial \text{FDI inflow}}{\partial \text{HCDS}} = -0.6384\ \text{HCDS} + 0.350 = 0$, which occurs when $\text{HCDS} = \frac{0.350}{-0.0192} \cong -9.11$. This suggests that investors may generally continue to invest in a host country where the host government has interfered in their operations (or the operations of their peers and competitors) up to approximately nine interferences, at which point further host government interference begins to deter investors from investing in that country. This further supports the hypothesis that the relationship between host country interference and FDI may well be an inverse parabola[5]. However, it is essential to note that this does not explain exit or disinvestment as investors vary in their response to host government interference and host country risk management (Holburn & Zelner, 2010). FDI continues to increase until nine host government interferences before it begins to decrease. This raises the question of why this occurs. Notably, the answer lies with IIAs. Host governments that sign investment agreements send positive signals to investors, while the accumulation of numerous treaties demonstrates a more substantial commitment to protecting investors and promoting a healthy investment climate for all foreign investors (Allee & Peinhardt, 2011). Since FDI decisions are *ex-ante* to host government interventions (Büthe & Milner, 2009)) and ICSID cases tend to be lengthy,[6] firms are likely to continue to invest in a host country with investment agreements, even in the presence of pending investor-state arbitration disputes. However, as the number of interferences and related disputes increases, investors become wary and begin to reduce their level of investment in the host country. An example of this is the case of a German investor that was contracted by the Government of Thailand to construct a new major toll road in 1990. However, Wellhausen (2015) notes that immediately after its completion in 1998, the government of Thailand signed a similar contract with a competing investor from Hong Kong and refused to allocate land for exit ramps and restricted toll adjustments by the German investor. Despite this, the German investor did not immediately remove their investments from Thailand and continued investing until 2005, when it ultimately exited the country and initiated the ICSID

[5] While nine cases may sound very high to some readers, a detailed examination of the ICSID data revealed that this is not unusual. When host governments interfere in one sector, many firms in the sector seek dispute settlements in "batches". For instance, when Argentina suspended the tariff adjustment formula for gas transportation in 2003, 20 gas-producing companies instituted separate arbitration proceedings against Argentina. In 2015, after its revocation of the incentives for companies to use renewable energy sources, 19 aggrieved investors initiated HCDS proceedings against Spain in that same year.

[6] For instance, a claim initiated by ABCI Investments Limited against the Republic of Tunisia in 2004 for the alleged expropriation of its assets in Tunisia is still pending, 15 years after the initial submission.

procedure for compensation. This suggests that all other things being equal, other investors may continue to invest in a destination country—even in the face of host government intervention in the operations of their competitors and peers—until reaching a tipping point, after which they divert capital in response to host government interference. As the results of the present analysis show, this tipping point is nine interferences. This result suggests that investors do not necessarily view host government interference in the assets of their peers and competitors as an immediate reason to reduce their commitments in a host country; instead, they wait and see. To guide the assessment on whether an inverted U-shaped relationship exists between FDI inflow and host government interference, I plot this relationship in **Figure 3.2**. The results further provide supporting evidence of an inverted U-shaped relationship between host country interference and FDI inflow (Haans et al., 2016).

Figure 3.2 *Inverted U-shaped relationship between host government interference and FDI*



Income groups

Recent studies have shown that there is rapid growth in FDI, particularly in developing countries (Buckley et al., 2010; George et al., 2016; Kolstad & Wiig, 2012). However, the greatest challenge to investors in developing countries is the persistence of host government interference due to institutional voids, which are understood as the absence of market-supporting institutions, specialized intermediaries, contract-enforcing mechanisms, and efficient transportation and communication networks (George et al., 2016; Khanna & Palepu,

2010). Consistent with previous studies (Asiedu, 2002; Guzman, 1997), the present study also tested the effect of host government interference on FDI inflow to different groups of countries. The World Bank (2019b) classifies countries into four groups: *low-income countries*, *lower-middle-income countries*, *upper-middle-income countries*, *and high-income countries.* To test our hypothesis on different income groups, I relied on the World Bank classification of countries and split the countries accordingly. **Table 3.5** presents the analysis with different income groups. Model 1 contains the results for low-income countries only. Model 2 contains results for lower-middle-income countries only. Models 3 and 4 contain results for upper-middle-income and high-income countries, respectively. As presented in **Table 3.5**, the results were consistent across all four groups of countries, further supporting the hypothesis presented in this study. The quadratic term (HCDS^2) is negative and significant for low-income countries ($\beta = -0.325,\ p =< 0.01$), lower-middle-income countries ($\beta = -0.082,\ p =< 0.01$), upper-middle-income countries ($\beta = -0.0663, p =< 0.01$) and high-income countries ($\beta = -0.0112, p =< 0.01$). A partial derivation of the regression function for low-income countries, $\text{FDI inflow}_{\text{low income}} = -0.325\text{HCDS}\text{^}2 + 1.654$, reaches its maximum when $\frac{\partial \text{FDI inflow}_{\text{low-income}}}{\partial \text{HCDS}} = -0.65 + 1.654 = 0$, which occurs when $\text{HCDS} = \frac{1.654}{-0.65} \cong -2.5$ This suggests that, for low-income countries, a mere two interferences result in a negative response from investors (i.e., FDI decreases). For lower-middle-income countries, $\text{FDI inflow}_{\text{lower middle income}} = -0.0663\text{HCDS}\text{^}2 + 0.458$ reaches its maximum when $\frac{\partial \text{FDI inflow}_{\text{lower middle income}}}{\partial \text{HCDS}} = -0.1326 + 0.458 = 0$, which occurs when $\text{HCDS} = \frac{0.458}{-0.1326} \cong -3.45$. For upper middle income countries, $\text{FDI inflow}_{\text{Upper middle income}} = -0.082\ \text{HCDS}\text{^}2 + 0.672$ reaches its maximum when $\frac{\partial \text{FDI inflow}_{\text{Upper middle income}}}{\partial \text{HCDS}} = -0.164 + 0.672 = 0$, which occurs when $\text{HCDS} = \frac{0.672}{-0.164} \cong -4.09$. For high-income countries, $\text{FDI inflow}_{\text{High income}} = -0.0112\text{HCDS}\text{^}2 + 0.235$ reaches its maximum when $\frac{\partial \text{FDI inflow}_{\text{High income}}}{\partial \text{HCDS}} = -0.0244 + 0.235 = 0$, which occurs when $\text{HCDS} = \frac{0.235}{-0.0224} \cong 10.49$.

Suggests that investors' hysteria in response to host country interference depends on the economic status of the host country. These relationships are depicted in **Figure 3.3**. For high-income countries, investors are more likely to continue investing in a destination country until approximately 10 investor-state dispute cases before FDI begins to decrease. However, for low-income countries, FDI decreases after just two investor-state disputes. For low-income

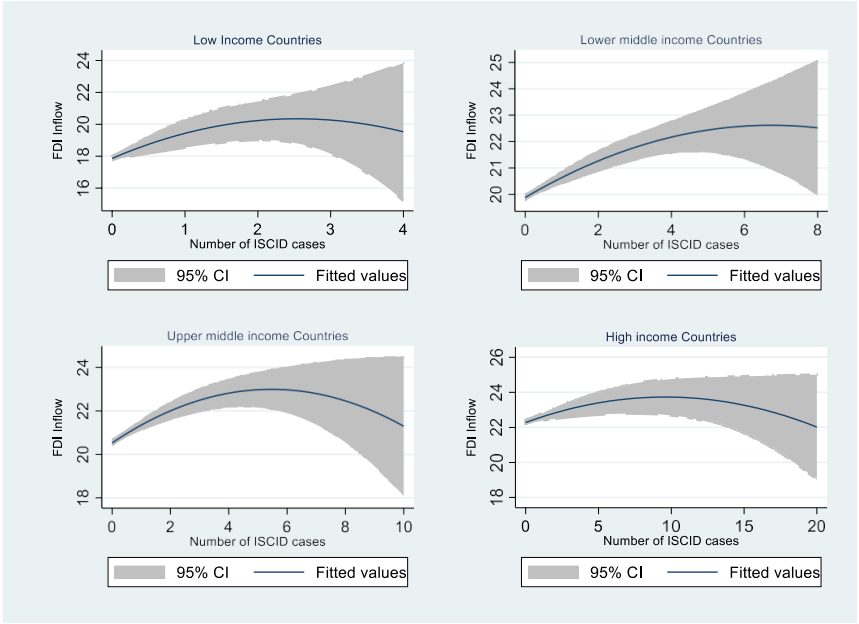
countries, the slightest confrontations between governments and foreign investors may wreak havoc and lead to lower FDI inflow.

Table 3.5 *Results of 2SLS regression of host government intervention and FDI inflow*

	(1)	(2)	(3)	(4)
Variables	Model 1	Model 2	Model 3	Model 4
Institutions	1.157***	-0.443***	0.494***	0.407***
	(0.179)	(0.137)	(0.167)	(0.0985)
ICSID	1.654***	0.458***	0.672***	0.235***
	(0.462)	(0.112)	(0.0977)	(0.0591)
Market size	0.0522***	0.00484***	0.00578***	0.0186***
	(0.00421)	(0.000333)	(0.000273)	(0.00192)
GDP per capita	3.598***	0.856***	0.266***	0.0207***
	(0.328)	(0.0646)	(0.0280)	(0.00488)
Inflation	-0.173	-0.00858	0.438***	0.227
	(0.156)	(0.0837)	(0.114)	(0.159)
Natural resource endowment	-0.0129	0.0123**	0.0243***	-0.0203**
	(0.0129)	(0.00564)	(0.00577)	(0.00939)
POLCON	-1.556*	-1.496**	3.826***	1.468*
	(0.809)	(0.628)	(0.752)	(0.763)
HCDS^2	-0.325***	-0.0663***	-0.0820***	-0.0112***
	(0.119)	(0.0172)	(0.0160)	(0.00325)
HCDS * Market size	-0.0260***	-0.00112***	-0.00146***	-0.00589***
	(0.00861)	(0.000372)	(0.000560)	(0.00191)
Inflation * POLCON	0.848*	0.538*	-0.788***	-0.799**
	(0.448)	(0.288)	(0.280)	(0.353)
Constant	17.06***	18.49***	17.66***	20.54***
	(0.360)	(0.234)	(0.357)	(0.373)
Observations	475	648	752	672
R-squared	0.402	0.414	0.455	0.399
Income group	Low income	Lower middle income	Upper middle income	High income

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Figure 3.3 *Inverted U-shaped relationship between host government interference and FDI by income group*



Robustness tests

To evaluate the robustness of the findings of this study several additional analyses were conducted. First, although the use of lagged dependent variables minimizes the risk of omitted variables and mitigates simultaneity bias as well as potential reverse causality problems (Feinberg & Gupta, 2004; Veugelers, 1997; Witte et al., 2016), the lag length of one period is somewhat arbitrary. As a robustness check, I investigated the robustness of the model using different lag periods. I found that the present results were consistent for two, three, and four lagged periods. Additionally, I examined whether the effect of HCDS on FDI inflow varies between democratic and non-democratic countries. To achieve this, I replaced POLCON with *polity* scores obtained by the polity project (Marshall & Jaggers, 2017) in Models 4, 5, and 6. The *polity* indicators are widely used in IB studies. The *polity* indicators are widely used in studies of international business (Dow & Karunaratna, 2006) to account for autocracy and democracy in host countries. *Polity* scores vary from 10 (for full democracies) to -10 (for full dictatorships). Notably, the results were consistent with those of the previous estimation. Consistent with the first estimation, HCDS did not deter FDI inflow. *Polity* was positive and significant for the lagged period of two years. This suggests that democratic countries attract

more FDI, which is consistent with previous research (Jensen, 2003), albeit not for three- and four-year lag periods. **Tables 3.6** and **3.7** reports the results of the different lag periods and the alternative estimation controlling for democratic and non-democratic governance.

3.5 Discussion and Conclusion

Motivated by the increasing level of investor-host state confrontations over the past two decades, this study has provided theoretical arguments and empirical evidence to demonstrate how complete or partial interference by host governments in foreign investors' assets affects the general attractiveness of host states as FDI destinations. The findings of this study suggest that host country policy risks arising from government interference in foreign investors' assets do not immediately deter FDI in a host country. However, there is a certain tipping point at which further interference begins to deter FDI inflow to a host country. On the other hand, the non-market capabilities literature has advised foreign investors to acquire superior bargaining power when confronted by host government interference. Notably, investors that control unique technologies have capital resources or possess some strategic advantage can engage in maneuvering to prevent a host government from interfering with their assets or, at least, minimize the effect of such interferences (Albino-Pimentel et al., 2018). However, foreign investors' *ex-ante* strategic bargaining power largely disappears as soon as specific assets are deployed in a foreign sovereign territory (Vernon, 1966). When confronted with the prospect of continued host government interference, investors will seek opportunities elsewhere and reduce their investment in the focal country over time. This is consistent with Holburn and Zelner (2010), suggesting that host country policy risk may not immediately deter FDI. At first glance, one might find it intriguing that host government interference does not poison the host country's investment environment and deter firms from investing in a host country. While this might arguably be the case, FDI decisions are long-term commitments with high initial sunk costs that cannot easily be recouped. This suggests that investors may remain in a host country, even in the face of increasing uncertainties. This, I argue, is an example of economic hysteresis, which is the tendency for effects such as FDI in a host country to persist well after the cause that brought them about (an FDI-friendly government at one point in time) has disappeared (Dixit, 1989, 1992; Parsley & Wei, 1994). Investors may continue to invest in a host country for an extended period, even as uncertainty levels in the host country increase, due to the expectation that the host environment will improve (Axarloglou & Kouvelis, 2007). I speculate that investors interpret host governments' interference in the operations of peers' and

competitors' assets as a unique problem for their peers and competitors and thus not universal to the host environment. Thus, investors will be reluctant to immediately reduce investments or de-internationalize from a host country even if changes in the host country's investment environment adversely affect the economic value of their assets in that country. This "hysteresis" occurs because investors perceive foreign investments in distant countries as a platform for future expansion into that country or other regions near that host country (Kogut & Chang, 1996; Yamawaki, 1991). Investment in a volatile host country provides an opportunity to reduce the "liability of foreignness" by learning about the host country environment, developing critical relationships with the local network of suppliers, distributors, customers, and government officials, and adapting products and business processes to local circumstances (Chang, 1995; Song, 2002). Should an opportunity for expansion materialize in the future due to the host country's investment environment uncertainties being resolved, a platform investment can facilitate more rapid expansion (Belderbos & Zou, 2009). The statistical analysis of FDI location choices in the sample consists of nearly the entire population of host countries from 1996 to 2017 and provides robust empirical support for our assertion that host country-investor disputes do not poison their host environment. With decades of host country interference and subsequent international investment cases, perhaps firms are beginning to understand that host governments' have divergent expectations from foreign investors. While investors may be interested in maximizing returns, host governments have more complex preferences for governance and development; thus, periodic tensions with host country officials will not merely disappear (Makhija, 1993; Stevens et al., 2016). Therefore, some level of host government interference is expected and seen as a normal part of IB, leading investors to choose a wait-and-see strategy as the optimal response in the face of increasing uncertainties stemming from host government actions.

From a host government perspective, the findings of the present study confirm a widely held notion that a country's economic performance over time is primarily determined by its political, institutional, and legal environment. The results suggest that host governments aiming to attract more FDI to create employment, bring in foreign technology, etc., must avoid interfering with investors' assets. Although membership in external institutions such as the ICSID provides avenues to reduce investor concern over host government-related risk, host governments should respect their IIA commitments in full to avoid international confrontations with foreign firms. A deeper analysis of the results from the present study shows that investors are particularly sensitive to interference by the host governments of lower-income countries since a mere two

interferences lead to a decrease in FDI, compared to nine interferences by high-income countries. Therefore, the message to developing countries is that avoiding disputes with foreign investors has the desired benefit of higher FDI inflows.

Naturally, the present analysis has certain limitations. First, I drew on data from a single international arbitration body (i.e., the ICSID) and did not include disputes between foreign investors and host states from other arbitration institutions. This may have created selection bias if some countries only relied on arbitration tribunals other than the ICSID or the World Bank Group. Unfortunately, there is a lack of data to address the possibility of such bias econometrically. Most arbitration tribunals do not make arbitration disputes public (Buys, 2003; Lynch & Lynch, 2003), while others, such as the Swedish Arbitration Institute, only report aggregate numbers, which makes it challenging to identify the countries involved. The ICSID publicizes information through its website and various other publications (e.g., the UNCTAD investment policy hub) regarding the nature, timing, and outcomes of proceedings and awards, which makes it possible to collect essential details about the cases and parties involved. Second, some firms may decide against arbitration with host governments for fear of losing access to resources if they upset their host government. Notably, such disputes will not appear in our data. Finally, international arbitration is a last-resort remedy for foreign firms. In the event of host government interference, IIAs require foreign firms to first and foremost pursue local remedies before international arbitration (Dolzer & Schreuer, 2012; Whittinghill, 2003). Thus, arbitration cases are not representative of all potential interference and disputes with host governments. Thus, one can assume that local remedies put in place by host governments to resolve disputes with foreign investors are effective.

Table 3.6 *Results of 2SLS regression of host government intervention and FDI inflow*

Variables	(1) Model 1	(2) Model 2	(3) Model 3	(4) Model 4	(5) Model 5	(6) Model 6
Institutions	0.811***	0.780***	0.684***	0.792***	0.774***	0.682***
	(0.0822)	(0.0867)	(0.0891)	(0.0866)	(0.0911)	(0.0933)
HCDS	0.629***	0.612***	0.548***	0.566***	0.560***	0.502***
	(0.0534)	(0.0517)	(0.0526)	(0.0521)	(0.0509)	(0.0513)
Market size	0.00525***	0.00514***	0.00486***	0.00504***	0.00492***	0.00465***
	(0.000339)	(0.000336)	(0.000317)	(0.000320)	(0.000316)	(0.000297)
GDP per capita	0.0461***	0.0451***	0.0481***	0.0513***	0.0499***	0.0531***
	(0.00478)	(0.00484)	(0.00490)	(0.00497)	(0.00508)	(0.00502)
Inflation	0.117	0.118	0.131	0.0545	0.0488	0.0750
	(0.0735)	(0.0805)	(0.0814)	(0.0559)	(0.0620)	(0.0617)
Natural resource endowment	0.00943**	0.00615	-0.00235	0.00520	0.00147	-0.00767*
	(0.00426)	(0.00452)	(0.00454)	(0.00425)	(0.00449)	(0.00457)
POLCON	1.079**	1.008**	0.792*			
	(0.432)	(0.429)	(0.440)			
HCDS^2	-0.0310***	-0.0280***	-0.0231***	-0.0276***	-0.0252***	-0.0206***
	(0.00421)	(0.00440)	(0.00464)	(0.00390)	(0.00412)	(0.00439)
HCDS * Market size	-0.00172***	-0.00165***	-0.00133***	-0.00148***	-0.00142***	-0.00112**
	(0.000506)	(0.000513)	(0.000507)	(0.000481)	(0.000487)	(0.000479)
Inflation * POLCON	-0.296	-0.295	-0.337	-0.124	-0.100	-0.169
	(0.194)	(0.204)	(0.208)	(0.135)	(0.145)	(0.147)
Polity				0.0202*	0.0131	0.00585
				(0.0106)	(0.0107)	(0.0110)
Constant	19.39***	19.42***	19.53***	19.76***	19.80***	19.86***
	(0.178)	(0.181)	(0.187)	(0.104)	(0.108)	(0.113)
Observations	2,427	2,415	2,411	2,383	2,372	2,371
R-squared	0.397	0.374	0.345	0.422	0.395	0.364
Lagged period	2 years	3 years	4 years	2 years	3 years	4 years

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

3.6 References

Aguilera, R. V., & Grøgaard, B. (2019). The dubious role of institutions in international business: A road forward. *Journal of International Business Studies*, 1-16.

Aiken, L. S., West, S. G., & Reno, R. R. (1991). *Multiple regression: Testing and interpreting interactions*. Sage

Akamah, H., Hope, O.-K., & Thomas, W. B. (2018). Tax havens and disclosure aggregation. *Journal of International Business Studies*, *49*(1), 49-69.

Albino-Pimentel, J., Dussauge, P., & Shaver, J. M. (2018). Firm non-market capabilities and the effect of supranational institutional safeguards on the location choice of international investments. *Strategic Management Journal*, *39*(10), 2770-2793.

Allee, T., & Peinhardt, C. (2010). Delegating differences: Bilateral investment treaties and bargaining over dispute resolution provisions. *International Studies Quarterly*, *54*(1), 1-26.

Allee, T., & Peinhardt, C. (2011). Contingent credibility: The impact of investment treaty violations on foreign direct investment. *International organization*, *65*(3), 401-432.

Asiedu, E. (2002). On the determinants of foreign direct investment to developing countries: is Africa different? *World development*, *30*(1), 107-119.

Axarloglou, K., & Kouvelis, P. (2007). Hysteresis in adjusting the ownership structure of foreign subsidiaries. *International Business Review*, *16*(4), 494-506.

Baldwin, R., & Krugman, P. (1989). Persistent trade effects of large exchange rate shocks. *The Quarterly Journal of Economics*, *104*(4), 635-654.

Belderbos, R., & Zou, J. (2009). Real options and foreign affiliate divestments: A portfolio perspective. *Journal of International Business Studies*, *40*(4), 600-620.

Benito, G. R., & Welch, L. S. (1997). De-internationalization. *Mir: Management International Review*, 7-25.

Beugelsdijk, S., Hennart, J.-F., Slangen, A., & Smeets, R. (2010). Why and how FDI stocks are a biased measure of MNE affiliate activity. *Journal of International Business Studies*, *41*(9), 1444-1459.

Blonigen, B. A. (2005). A review of the empirical literature on FDI determinants. *Atlantic Economic Journal*, *33*(4), 383-403.

Boddewyn, J. (2005). Early US business-school literature (1960–1975) on international business–government relations: Its twenty-first-century relevance. In G. Robert (Ed.), *International Business and Government Relations in the Twenty-First Century* (pp. 25-48). Cambridge University Press.

Braumoeller, B. F. (2004). Hypothesis testing and multiplicative interaction terms. *International organization*, *58*(4), 807-820.

Buckley, P. J., Clegg, L. J., Cross, A., Liu, X., Voss, H., & Zheng, P. (2010). The determinants of Chinese outward foreign direct investment. In *Foreign Direct Investment, China and the World Economy* (pp. 81-118). Springer.

Buys, C. G. (2003). The tensions between confidentiality and transparency in international arbitration. *American Review of International Arbitration*, *14*(121).

Büthe, T., & Milner, H. V. (2008). The politics of foreign direct investment into developing countries: increasing FDI through international trade agreements? *American Journal of Political Science*, *52*(4), 741-762.

Büthe, T., & Milner, H. V. (2009). Bilateral Investment Treaties and Foreign Direct Investment: A Political Analysis. In K. P. Sauvant & L. E. Sachs (Eds.), *The effect of treaties on foreign direct investment: Bilateral investment treaties, double taxation treaties, and investment flows* (pp. 171-224). Oxford University Press.

Chakrabarti, A. (2001). The determinants of foreign direct investments: Sensitivity analyses of cross-country regressions. *kyklos*, *54*(1), 89-114.

Chang, S. J. (1995). International expansion strategy of Japanese firms: Capability building through sequential entry. *Academy of Management Journal*, *38*(2), 383-407.

Chen, R., Cui, L., Li, S., & Rolfe, R. (2017). Acquisition or greenfield entry into Africa? Responding to institutional dynamics in an emerging continent. *Global Strategy Journal*, *7*(2), 212-230.

Cuervo-Cazurra, A., & Genc, M. (2008). Transforming disadvantages into advantages: developing-country MNEs in the least developed countries. *Journal of International Business Studies*, *39*(6), 957-979.

Dai, L., Eden, L., & Beamish, P. W. (2017). Caught in the crossfire: Dimensions of vulnerability and foreign multinationals' exit from war-afflicted countries. *Strategic Management Journal*, *38*(7), 1478-1498.

Dixit, A. (1989). Entry and exit decisions under uncertainty. *Journal of Political Economy*, *97*(3), 620-638.

Dixit, A. (1992). Investment and hysteresis. *Journal of Economic Perspectives*, *6*(1), 107-132.

Dolzer, R., & Schreuer, C. (2012). *Principles of international investment law* (2nd ed.). Oxford University Press

Dow, D., & Karunaratna, A. (2006). Developing a multidimensional instrument to measure psychic distance stimuli. *Journal of International Business Studies*, *37*(5), 578-602.

Duanmu, J.-L. (2014). State-owned MNCs and host country expropriation risk: The role of home state soft power and economic gunboat diplomacy. *Journal of International Business Studies*, *45*(8), 1044-1060.

Dunning, J. (1988). The Eclectic Paradigm of International Production: A Restatement and Some Possible Extensions. *Journal of International Business Studies*, *19*(1), 1-31.

Dunning, J. (1998). Location and the multinational enterprise: a neglected factor? *Journal of International Business Studies*, *29*(1), 45-66.

Dyreng, S. D., & Lindsey, B. P. (2009). Using financial accounting data to examine the effect of foreign operations located in tax havens and other countries on US multinational firms' tax rates. *Journal of Accounting Research*, *47*(5), 1283-1316.

Elkins, Z., Guzman, A. T., & Simmons, B. A. (2006). Competing for capital: The diffusion of bilateral investment treaties, 1960–2000. *International organization*, *60*(4), 811-846.

Fagre, N., & Wells, L. T. (1982). Bargaining power of multinationals and host governments. *Journal of International Business Studies*, *13*(2), 9-23.

Feinberg, S. E., & Gupta, A. K. (2004). Knowledge spillovers and the assignment of R&D responsibilities to foreign subsidiaries. *Strategic Management Journal*, *25*(8-9), 823-845.

Folta, T. B., Johnson, D. R., & O'Brien, J. (2006). Uncertainty, irreversibility, and the likelihood of entry: An empirical assessment of the option to defer. *Journal of Economic Behavior & Organization*, *61*(3), 432-452.

George, G., Corbishley, C., Khayesi, J. N., Haas, M. R., & Tihanyi, L. (2016). Bringing Africa in: Promising directions for management research. *Academy of Management Journal*, *59*(2), 377-393.

Globerman, S., & Shapiro, D. (2003). Governance infrastructure and US foreign direct investment. *Journal of International Business Studies*, *34*(1), 19-39.

Grosse, R. (2007). Introduction: can Latin American firms compete? In *Can Latin American Firms Compete?* Oxford University Press.

Guzman, A. T. (1997). Why LDCs sign treaties that hurt them: Explaining the popularity of bilateral investment treaties. *Virginia Journal of International Law*, *38*, 639 - 688.

Haans, R. F., Pieters, C., & He, Z. L. (2016). Thinking about U: Theorizing and testing U-and inverted U-shaped relationships in strategy research. *Strategic Management Journal*, *37*(7), 1177-1195.

Haberly, D., & Wójcik, D. (2014). Tax havens and the production of offshore FDI: an empirical analysis. *Journal of Economic Geography*, *15*(1), 75-101.

Henisz, W. J. (2000a). The institutional environment for economic growth. *Economics & Politics*, *12*(1), 1-31.

Henisz, W. J. (2000b). The institutional environment for multinational investment. *Journal of Law, Economics, and Organization*, *16*(2), 334-364.

Henisz, W. J., Zelner, B. A., & Guillén, M. F. (2005). The worldwide diffusion of market-oriented infrastructure reform, 1977–1999. *American sociological review*, *70*(6), 871-897.

Hines, J. R., & Rice, E. M. (1994). Fiscal paradise: Foreign tax havens and American business. *The Quarterly Journal of Economics*, *109*(1), 149-182.

Hitt, M. A., Gimeno, J., & Hoskisson, R. E. (1998). Current and future research methods in strategic management. *Organizational Research Methods*, *1*(1), 6-44.

Holburn, G. L., & Zelner, B. A. (2010). Political capabilities, policy risk, and international investment strategy: Evidence from the global electric power generation industry. *Strategic Management Journal*, *31*(12), 1290-1315.

Jandhyala, S., & Weiner, R. J. (2014). Institutions sans frontières: International agreements and foreign investment. *Journal of International Business Studies*, *45*(6), 649-669.

Jensen, N. M. (2003). Democratic governance and multinational corporations: Political regimes and inflows of foreign direct investment. *International Organization*, *57*(3), 587-616.

Kaufmann, D., Kraay, A., & Mastruzzi, M. (2011). The worldwide governance indicators: methodology and analytical issues. *Hague Journal on the Rule of Law*, *3*(2), 220-246.

Khanna, T., & Palepu, K. G. (1997). Why focused strategies may be wrong for emerging markets. *Harvard business review*, *75*(4), 41–51.

Khanna, T., & Palepu, K. G. (2010). *Winning in emerging markets: A road map for strategy and execution*. Harvard Business Press

Kimino, S., Saal, D. S., & Driffield, N. (2007). Macro determinants of FDI inflows to Japan: an analysis of source country characteristics. *World Economy*, *30*(3), 446-469.

Kobrin, S. J. (1979). Political risk: A review and reconsideration. *Journal of International Business Studies*, *10*(1), 67-80.

Kobrin, S. J. (1980). Foreign enterprise and forced divestment in LDCs. *International organization*, *34*(1), 65-88.

Kobrin, S. J. (1982). *Managing political risk assessment: Strategic response to environmental change* (Vol. 8). Univ of California Press

Kobrin, S. J. (1984). Expropriation as an attempt to control foreign firms in LDCs: trends from 1960 to 1979. *International Studies Quarterly*, *28*(3), 329-348.

Kogut, B., & Chang, S. J. (1996). Platform investments and volatile exchange rates: Direct investment in the US by Japanese electronic companies. *The Review of Economics and Statistics*, 221-231.

Kolstad, I., & Wiig, A. (2012). What determines Chinese outward FDI? *Journal of World Business*, *47*(1), 26-34.

Li, Q. (2009). Democracy, autocracy, and expropriation of foreign direct investment. *Comparative Political Studies*, *42*(8), 1098-1127.

Li, Q., & Vashchilko, T. (2010). Dyadic military conflict, security alliances, and bilateral FDI flows. *Journal of International Business Studies*, *41*(5), 765-782.

Lind, J. T., & Mehlum, H. (2010). With or without U? The appropriate test for a U-shaped relationship. *Oxford Bulletin of Economics and Statistics*, *72*(1), 109-118.

Lipsey, R. E. (2007). *Defining and measuring the location of FDI output*.
Lynch, K., & Lynch, K. L. (2003). *The forces of economic globalization: Challenges to the regime of international commercial arbitration*. Kluwer Law International BV
Makhija, M. V. (1993). Government intervention in the Venezuelan petroleum industry: An empirical investigation of political risk. *Journal of International Business Studies*, *24*(3), 531-555.
Marshall, M. G., & Jaggers, K. (2017). Polity IV Project, Political Regime Characteristics and Transitions, 1800-2017.
Medina, L. F., Bucheli, M., & Kim, M. (2019). Good friends in high places: Politico-economic determinants of the expropriation and taxation of multinational firms. *Journal of International Business Policy*.
Meyer, K. E., Estrin, S., Bhaumik, S. K., & Peng, M. W. (2009). Institutions, resources, and entry strategies in emerging economies. *Strategic Management Journal*, *30*(1), 61-80.
Minor, M. S. (1994). The demise of expropriation as an instrument of LDC policy 1980–1992. *Journal of International Business Studies*, *25*(1), 177-188.
Nathan, J., & Leonard, W. (2004). Resource wealth and political regimes in Africa. *Comparative Political Studies*, *37*(7), 816-841.
Neumayer, E., & Spess, L. (2005). Do bilateral investment treaties increase foreign direct investment to developing countries? *World development*, *33*(10), 1567-1585.
Newcombe, A. P. (1999). *Regulatory Expropriation, Investment Protection and International Law: When Is Government Regulation Expropriatory and When Should Compensation Be Paid?* University of Toronto
North, D. C. (1990). *Institutions, institutional change and economic performance (Political Economy of Institutions and Decisions)*. Cambridge: Cambridge University Press
Parsley, D. C., & Wei, S.-J. (1994). *Insignificant and Inconsequential Hysteresis: The Case of the US Bilateral Trade*.
Peng, M. W. (2002). Towards an institution-based view of business strategy. *Asia Pacific Journal of Management*, *19*(2-3), 251-267.
Peng, M. W., & Heath, P. S. (1996). The growth of the firm in planned economies in transition: Institutions, organizations, and strategic choice. *Academy of management review*, *21*(2), 492-528.
Ramamurti, R. (2001). The obsolescing 'bargaining model'? MNC-host developing country relations revisited. *Journal of International Business Studies*, *32*(1), 23-39.
Ramasamy, B., Yeung, M., & Laforet, S. (2012). China's outward foreign direct investment: Location choice and firm ownership. *Journal of World Business*, *47*(1), 17-25.
Rangan, S., & Sengul, M. (2009). The influence of macro structure on the foreign market performance of transnational firms: The value of IGO connections, export dependence, and immigration links. *Administrative Science Quarterly*, *54*(2), 229-267.
Rodriguez, P., Uhlenbruck, K., & Eden, L. (2005). Government corruption and the entry strategies of multinationals. *Academy of management review*, *30*(2), 383-396.
Root, F. R. (1968). The expropriation experience of American companies: What happened to 38 companies. *Business Horizons*, *11*(2), 69-74.
Salacuse, J. W., & Sullivan, N. P. (2005). Do BITs really work: An evaluation of bilateral investment treaties and their grand bargain. *Harvard International Law Journal*, *46*, 67.
Sayrs, L. W. (1989). *Pooled time series analysis*. Sage
Song, J. (2002). Firm capabilities and technology ladders: Sequential foreign direct investments of Japanese electronics firms in East Asia. *Strategic Management Journal*, *23*(3), 191-210.

Stevens, C. E., Xie, E., & Peng, M. W. (2016). Toward a legitimacy-based view of political risk: The case of Google and Yahoo in China. *Strategic Management Journal*, *37*(5), 945-963.
Sun, P., Mellahi, K., & Thun, E. (2010). The dynamic value of MNE political embeddedness: The case of the Chinese automobile industry. *Journal of International Business Studies*, *41*(7), 1161-1182.
The Economist. (2013, 16 February). Special report: Offshore finance. *The Economist*.
UNCTAD. (2017a). Investor-State Dispute Settlement: Review of Developments in 2017.
UNCTAD. (2017b). *World investment report: Reforming international investment governance*.
UNCTAD. (2018). *World investment report*. http://worldinvestmentreport.unctad.org/
Vernon, R. (1966). 1966" International investment and international trade in the product cycle". Quarterly Journal of Economics 80: 190-207.
Vernon, R. (1971). Sovereignty at bay: The multinational spread of US enterprises. *The International Executive*, *13*(4), 1-3.
Veugelers, R. (1997). Internal R & D expenditures and external technology sourcing. *Research Policy*, *26*(3), 303-315.
Wellhausen, R. L. (2015). Investor–state disputes: when can governments break contracts? *Journal of Conflict Resolution*, *59*(2), 239-261.
Whittinghill, C. L. (2003). The Role and Regulation of International Commercial Arbitration in Argentina. *Texas International Law Journal*, *38*, 795.
Williamson, O. E. (1967). Hierarchical control and optimum firm size. *Journal of Political Economy*, *75*(2), 123-138.
Witte, C. T., Burger, M. J., Ianchovichina, E. I., & Pennings, E. (2016). *Dodging bullets: The heterogeneous effect of political violence on greenfield FDI*. The World Bank
World Bank. (2019). *Total natural resources rents (% of GDP)*
Yamawaki, H. (1991). Exports, and foreign distributional activities: evidence on Japanese firms in the United States. *The Review of Economics and Statistics*, 294-300.

4. Political Affinity and Subsidiary Investments

Changes in Political Affinity and Firms' Subsidiary Investments

Gilbert Kofi Adarkwah (BI), Christopher Albert Sabel (BI) and Flladina Zilja (CBS)

Earlier versions of this essay have been presented at the 41st SMS Annual Conference (virtual, 2021), the AOM 81ST Annual Conference (Virtual, 2021), and the AIB Annual Meeting (virtual, 2021).

Abstract

We investigate the effect of changes in countries' bilateral political affinity on multinational firms' foreign subsidiary investments. We argue that firms' decisions to adapt existing foreign subsidiary investments are influenced by the political risk embedded in the bilateral relationship between the home and subsidiary country. Thus, an improvement (deterioration) of political affinity is likely to decrease (increase) coordination costs, which subsequently leads to an increase (decrease) in firms' foreign subsidiary investments. Further, as firms attribute greater coordination costs to environments with higher instability, the relevance of changes in political affinity on firms' subsidiary investments depends on the extent to which the corruptive environment fluctuates. Analyzing 1,606 US firms and their ties to 142 subsidiary countries from 2000 to 2015, we find strong support for our hypotheses.

Keywords: foreign subsidiary investments, multinational corporations, nonmarket strategies, political affinity, political risk

4.1 Introduction

When firms invest abroad, the success of their foreign investments depends in part on the bilateral political relations between the firm's home country and the destination country of the investment (Bertrand et al., 2016; Duanmu, 2014; Holburn & Zelner, 2010; Li et al., 2018). Studies on cross-border M&A (Bertrand et al., 2016; Hasija et al., 2020), alliances (Arikan et al., 2020), and subsidiary investments (Holburn & Zelner, 2010; Li et al., 2018) show that political affinity between two countries influences the occurrence and performance of cross-border investments.

However, extant literature examining the impact of political affinity has mainly focused on its effects on firms' pre-investment decisions and not on post-investment consequences of changes in political affinity. As a result, we know much about how political risk embedded in countries' diplomatic relations influences location choices and performance of new investments (Albino-Pimentel et al., 2018; Duanmu, 2014; Hasija et al., 2020; Holburn & Zelner, 2010). However, we know little about how firms react to the post-investment consequences of changes in bilateral political relationships between their home and subsidiary countries. This is important because firms recalibrate investment decisions after foreign entry based on new factors that change their initial economic reasoning for investing in a foreign country (Bertrand & Capron, 2015). Although studies have examined changes in firms' subsidiary investments due to country-specific political risks, such as violent conflicts (Oh & Oetzel, 2011, 2017) and investor-state disputes (Blake & Moschieri, 2017), they do not look at the changes in bilateral political relationships between countries. However, such changes can impose challenges on the foreign investments of multinational firms. For instance, the rising tensions between China and Australia's political relations have left Chinese firms worrying about gaining clearance for cross-border acquisitions. As a result, investments by Chinese firms in Australia fell by more than 30% in 2018[7].

The purpose of this study is to shed light on the effect of changes in intercountry bilateral political relationships on multinational firms' foreign subsidiary investments. Specifically, we hypothesize that a positive (negative) change in political affinity between a firm's home and subsidiary countries will increase (decrease) foreign subsidiary investments. To that end, we extend research on the effects of political risk on firms' behavior (Bertrand et al., 2016; Holburn & Zelner, 2010) by examining how changes in intercountry political affinity – understood as

[7] Smyth, J. (2020). 'Business feels the fear in Australia-China trade dispute. Financial Times'. URL: https://www.ft.com/content/d3ebba4d-3a1a-4bc0-88a0-ff49945fe2f9

the similarity of national interests in global affairs (Gartzke, 1998; Li et al., 2018) – affect multinational firms' existing foreign subsidiary investments. We argue that changes in political affinity, captured as changes in United Nations General Assembly voting similarity (Bertrand et al., 2016; Duanmu, 2014), affect political risk (Bertrand et al., 2016), which in turn influences coordination costs (Reuer & Tong, 2005). An improvement (deterioration) of political affinity is likely to decrease (increase) coordination costs, which increase with the complexity of managing foreign subsidiaries (Gulati & Singh, 1998). We posit that firms actively manage their foreign subsidiary investments in response to changes in the political environment, preempting potential increases in the cost of doing business by altering investments according to changes in political affinity. Moreover, we argue that the effect of political affinity changes is moderated by the stability of the corruptive environment in the foreign location. A stable level of corruption (high or low) in the subsidiary country offers predictability to manage the environment (Malesky & Samphantharak, 2008), whereas instability leads to increased risk. Hence, firms increase (reduce) investments more in stable (unstable) foreign locations.

We test our hypothesis on a sample of 1,606 US firms and their ties to 142 subsidiary countries from 2000 to 2015. We find robust empirical evidence that firms react to post-market entry changes in political affinity by increasing (reducing) the number of subsidiaries in countries for which political affinity improves (deteriorates). We further find evidence that reduced political stability – measured as a change in corruption – in the subsidiary country moderates this relationship so that more (less) political instability decreases (increases) investments. Our results remain robust when accounting for endogenous changes of political affinity with instrumental variable methods.

Our study makes three main theoretical contributions. First, we show that changes in political affinity between multinational firms' home country and subsidiary country represent an important foundation for firms' assessment of political risk in investment decisions. This adds a nonmarket perspective (Bertrand et al., 2016; Duanmu, 2014) to the view that firms revise cross-border investment decisions post-market entry after learning about the foreign market (Bertrand & Capron, 2015). Second, we enable a better understanding of how foreign country governments and international relations affect existing subsidiary investments (García-Canal & Guillén, 2008; Oh & Oetzel, 2011). Specifically, we show how government actions, or the lack thereof, can stimulate or hinder foreign investment through international political relations. Third, although previous studies have argued that governments may use coercive powers such as expropriations to induce divestment of subsidiaries by foreign firms from hostile states

(Bertrand et al., 2016; Kobrin, 1980), we show that firms also react in anticipation to potential changes in political risk in subsidiary countries. Taken together, our findings advance the understanding of how firms respond to fluctuations in the subsidiary country's institutional environment. Our findings complement the emerging stream of research seeking to narrow the micro-macro divide in understanding firms' strategic behaviors regarding foreign investments (Blake & Moschieri, 2017; Holburn & Zelner, 2010).

4.2 Theory

Political Risk and Foreign Investment

Prior studies argue that multinational firms avoid or decrease investments in foreign countries with high political risk: the risk that government actions will directly or indirectly harm firms' economic interests in the country (Holburn & Zelner, 2010; Kobrin, 1980). Through political processes, governments may opportunistically alter policy outcomes in ways that are unfavorable to firms' interests, creating uncertainty and heightened costs of doing business (Bonardi et al., 2006; Henisz & Zelner, 2005). Firms manage this kind of risk by relying on their political resources and by avoiding or safeguarding against sunk investments as outcomes of policymaking (Henisz, 2003).

Political risk does not only rest on national political developments. Bilateral diplomatic relations between countries influence the political risk of multinational firms' investments abroad (Bertrand et al., 2016; Duanmu, 2014; Li et al., 2018). Political affinity between countries – defined as the alignment of national interests in global affairs (Gartzke, 1998) – develops over time and can be cooperative or conflictual (Li et al., 2018). Higher political affinity leads countries to cooperate more and interfere less in each other's interests (Gartzke, 2000). Cooperative behaviors are to some extent driven by historical ties and military action (Arikan et al., 2020) and political affinity equally leads to government actions that affect firms' economic interests. For instance, Bertrand et al. (2016) show that foreign acquirers need to provide higher initial acquisition premiums if political affinity between the acquirer's home country and the investment country is low. This is because target firms can leverage potential government intervention more easily if bilateral relations are unfavorable. Likewise, state-owned enterprises invest in countries too risky for private firms when political affinity is high, as state entities can leverage political relations between countries to a greater extent (Duanmu, 2014). Consequently, there is a price attributable to countries' political affinity as part of

political risk. Consistent with these arguments, recent literature that looks at political affinity and the location choice of foreign investments finds that firms are more likely to choose locations with high political affinity, avoiding this source of political risk (Li et al., 2018).

To date, previous studies have mainly focused on political affinity as a pre-investment evaluation criterion for market entry through subsidiaries (Duanmu, 2014; Holburn & Zelner, 2010), market entry through alliances or acquisitions (Arikan et al., 2020), and the location choice for market entry (Albino-Pimentel et al., 2018; Li et al., 2018). Exceptions are studies by Bertrand et al. (2016), who look at political affinity as an antecedent of foreign acquisition costs, and Hasija et al. (2020), who study post-acquisition performance. These studies show that foreign acquirers from countries with greater political affinity obtain better post-acquisition performance and attribute this to reduced legitimacy concerns that foreign firms face during the integration phase (Hasija et al., 2020). A commonality among these studies is that they investigate political affinity at the level before investment and the final commitment of resources by firms. Hence, two important elements are overlooked: firms' portfolio of foreign investments and the adaptation of investments in response to post-investment changes in political affinity. Thus, we know little about how changes in political affinity between countries affect firms' portfolio of existing foreign investments. This is important because firms significantly adjust their investment portfolios due to post-investment learning about the foreign environment (Bertrand & Capron, 2015; Oh & Oetzel, 2017).

From Pre-Investment Anticipation to Post-Investment Management

We study the post-investment phase of international operations, which is the period after a firm has established a subsidiary in a foreign market. We focus on the varying nature of the bilateral political environment during this phase and capture subsidiary investments through the presence of a multinational firm's subsidiaries (e.g. Oh & Oetzel, 2017). Our starting point is that post entry, firms monitor subsidiary countries' political environments and subsequently decide whether to increase or decrease investments (Reuer & Tong, 2005). A firm's decision to exit a foreign market can be partially seen as the consequence of the firm's responses to pressures arising from both the subsidiary and home country environments (DiMaggio & Powell, 1983; Meyer & Rowan, 1977). Cuypers and Martin (2010) argue that it is advantageous to have fewer subsidiaries in countries when uncertainties are high because this allows firms to easily exit a market. Firms may reduce subsidiary investments in a country by shifting resources

to subsidiaries in other countries (Chung et al., 2010; Kogut & Kulatilaka, 1994) or by exiting the foreign market completely (Blake & Moschieri, 2017).

When firms establish foreign subsidiaries, the bilateral relations between governments affect the subsidiaries' success or failure (Holburn & Zelner, 2010). Governments may discriminate against and even sabotage the operations of subsidiaries owned by firms from countries with which they have strained relationships (Delios & Henisz, 2000; Sidki Darendeli & Hill, 2016). For instance, in 2020, India banned 59 Chinese IT firms due to national security concerns, including those that produce popular apps such as TikTok and WeChat[8]. The risk of such adverse events leads to higher preemptive subsidiary coordination costs, as potential political expropriation of profits and assets of the subsidiary by foreign governments must be managed (Delios & Henisz, 2003; Kobrin, 1980). As a result, when firms pursue subsidiary investment in foreign countries, they continually monitor the political environment for information on potential adverse changes that may affect their foreign operations (Lu et al., 2014) to mitigate negative outcomes. In this study, we consider that firms place a premium on flexibility and reduce (increase) foreign subsidiary investment when political risk increases (decreases) and extend these arguments to changes in political affinity.

Although there are no studies on the post-investment management of political affinity between countries and subsidiary investments, there is evidence for the management of political risk post-investment. It has been shown that firms are more likely to divest or exit a country due to country-specific factors (Berry, 2013; Henisz & Delios, 2004). In addition, Blake and Moschieri (2017) showed that when multinational firms engage in direct dispute with a state, they are more likely to divest from it. Along with such country-specific and firm-country dyadic factors, we hypothesize that changes in country-to-country dyadic factors such as affinity equally lead to the reevaluation of political risk, similar to outright conflicts. We argue that firms' decisions to increase or decrease subsidiary investments are significantly influenced by political risk embedded in the home and subsidiary countries' bilateral relationships. Given that governments can discriminate against foreign firms and do so under strained bilateral political relationships, we argue that a positive change in political affinity may lead to increased subsidiary investment and vice versa.

[8] Findlay, S. (2020). 'India bans dozens of Chinese mobile apps'. Financial Times.
URL: https://www.ft.com/content/08e15c26-48e0-4540-a040-1a8782e84f2e

Hypothesis 1 (H1): *A positive (negative) change in political affinity increases (decreases) firms' foreign subsidiary investment.*

Moderating Effect of Volatility in Corruption

The stability of institutions is an important factor that affects the relevance of diplomatic relations (Li et al., 2018). As mentioned, uncertainty around the stability of institutions increases political risk and, consequently, coordination and contingency costs (Reuer & Tong, 2005). A central argument in our theoretical framework is that because adverse changes in host country institutions increase the cost of doing business abroad, firms actively respond to changes in political affinity as part of the post-entry management of their investments.

Previous studies have shown that weak market-supporting institutions affect firms' willingness to invest in a country (Meyer et al., 2009). This is particularly so regarding corruption in foreign countries, understood as the abuse of public power for personal gain (Collins et al., 2009). Corruption in subsidiary countries discourages foreign investments (Cuervo-Cazurra, 2006; Rodriguez et al., 2005), as it increases coordination costs for foreign firms (Cuervo-Cazurra, 2006). For instance, firms offer bribes to win contracts and obtain market access privileges (Habib & Zurawicki, 2002). We extend the logic further and argue that once a firm has entered a foreign country, a stable environment of corruption (high or low) offers foreign firms predictability to manage the level of corruption (Malesky & Samphantharak, 2008). In a subsidiary country where corruption is pervasive, corrupt acts become part of the regular practice of business, and both businesses and government officials tend to take this for granted (Kwok & Tadesse, 2006). This provides predictability, similar to an environment with strong institutions and low corruption.

However, environments in which regulations and practices around corruption constantly change provide added uncertainty and risk. We argue that fluctuations in the regulatory environment increase the location-specific risk and, thus, coordination costs (Madhok, 1997). Consistent with this argument, Oh and Oetzel (2011) show that political instability (terrorism) negatively moderates the relationship between the host country risk and post-market entry subsidiary investments, as firms attribute greater coordination costs to environments with higher instability. We extend such arguments and hypothesize that the positive relationship between changes in political affinity and firms' foreign subsidiary investments is negatively moderated by changes in corruptive practices.

Hypothesis 2 (H2): *A volatile level of corruption in a host country negatively moderates the relationship between changes in political affinity and firms' foreign subsidiary investment.*

4.3 Method

Sample

We analyze multinational firms' strategic decisions related to foreign subsidiary investments using a sample of US public firms from 2000 to 2015. To construct the sample, we first obtained a list of all publicly traded US firms across industries for the relevant period from Standard & Poor's COMPUSTAT database. We complement this database with information on firms' foreign activity from the Nexis Lexis Corporate Affiliations Database. An advantage of this database is that it contains detailed information about firms' domestic and foreign subsidiaries across industries. This approach is similar to Lee and Song (2012) and Phene and Almeida (2008), who studied the foreign investments of multinational firms. Then, we deselect firms with no foreign subsidiary identified in the Nexis Lexis Corporate Affiliations Database throughout our timeframe, which is similar to prior studies (e.g. Li et al., 2018).

Second, to create firm-country dyads, we obtained country-level data on UN General Assembly voting between 2000 and 2015. We used the data on dyadic voting affinity provided by Voeten et al. (2009), which were updated in 2020 and are an extension of Gartzke's (1998) work. This database provided us with voting data on UN-member country dyads and has been used previously (Bertrand et al., 2016; Hasija et al., 2020). We supplemented this with country-level data through a variety of sources, such as the World Bank database for country-level information, the World Bank Governance Indicators for data on government indicators, the World Bank ICSID database for disputes between countries, the UNCTAD database for international investment treaties, the Uppsala database for armed conflicts, and the IMF grant databases. We deselect observations that have missing values for country-level indicators. This approach yields a panel dataset of 1,606 US multinational firms with subsidiaries in 142 countries between 2000 and 2015. Third, to create our final sample, we aggregate observations to the firm-country dyad level, which results in 7,857 firm-country dyads, in which each firm can only have one dyad per year in any foreign country.

Variables

Our main dependent variable is *foreign subsidiary investment*, which is a proxy for the total equity investments in the foreign country (Surdu et al., 2019). More specifically, foreign subsidiary investment is measured as the yearly *number of foreign subsidiaries* that a focal firm has in any individual foreign country. This measure is particularly suited for our setting, as it captures the relative increase (decrease) in foreign investment following an improvement (deterioration) in political affinity. Prior studies equally use the number of subsidiaries to study the investment levels of foreign multinationals specifically (Oh & Oetzel, 2011) and count measures of investments in relation to political affinity (Holburn & Zelner, 2010).

Our main independent variable is the *change in voting affinity (%),* which is calculated as the difference in absolute voting affinity between the current (t) and previous year (t-1), divided by the value of voting affinity in the previous year (t-1). Change in voting affinity measures the volatility of absolute voting affinity. Absolute voting affinity is extensively used in the international relations literature (Gartzke, 1998) and has been recently adopted in strategy research to capture foreign policy affinity between countries (Bertrand et al., 2016; Hasija et al., 2020; Holburn & Zelner, 2010). Prior studies capturing affinity between countries use their dyadic voting affinity, which is calculated as the voting similarity index between country 1 and country 2 in a given session, computed using three categories of vote data: 1 = "yes" or approval on an issue; 2 = abstain, and 3 = "no" or disapproval on an issue[9]. The underlying logic in the international relations literature is that those countries that vote the same are more likely to have a good relationship and act cooperatively, as they are similar in their views and understandings of key issues. On the contrary, countries that vote differently are expected to have a more conflictual relationship (Bertrand et al., 2016). We equally share this assertion. To limit reverse causality, we lag change in voting affinity by one year and re-estimate the regressions using a two-year lag.

Our moderator, *changes in the control of corruption*, is based on the control of corruption index that summarizes a wide range of published expert surveys. It captures perceptions of the extent to which public power is exercised for private gain, including both petty cash and larger schemes of corruption (Kaufmann et al., 1999; Kraay et al., 2010). The original estimate gives the country's aggregate score in units of standard normal distribution ranging from -2.5 (high

[9] Abstention is counted as half-agreement with a yes or no vote.

corruption) to 2.5 (low corruption). The measure is consistent with previous literature (Weitzel & Berns, 2006). Note that instead of absolute values, to capture the volatility of corruption, we focus on yearly changes:

$$change\ in\ corruption = (control_{of_{corruption}\ t} - control\ of\ corruption_{t-1})/control\ of\ corruption_{t-1}$$

We include control variables at the firm, country, and dyad levels. First, following literature on foreign investments (e.g. Blake & Moschieri, 2017; Oh & Oetzel, 2017), we control for firm-specific variations that could affect the firms' expansion or contraction of foreign subsidiaries. Specifically, we account for firm size using the natural *logarithm of firm assets*, firm profitability using the inverse hyperbolic sine of *EBITDA* and *ROA*[10], and firm debt using *leverage*. In addition, we include the domestic subsidiary count (*number US subsidiaries*) to account for firm investment within the US and domestic market concentration in the main industry the firm operates in based on its two-digit SIC code (*US subsidiary HHI*) computed as a Herfindal-Hirschmann Index. The underlying logic is that market concentration facilitates collusion; thus, in low concentration markets, the competition is more aggressive, thereby affecting chances of survival domestically (Mata & Portugal, 2002) and changing incentives for firms to seek expansion opportunities abroad.

Second, we control for the core dimensions of the subsidiary country that make it an attractive investment location. We include the absolute value of *UN political affinity* (Bertrand et al., 2016; Hasija et al., 2020), which is between 0 and +1, where 0 indicates that the countries voted opposite in a given year and +1 indicates identical voting patterns. Further, we control for the subsidiary country population, employing the natural logarithm of the population (*foreign population ln*), inflation (*foreign inflation ihs*)[4], *GDP growth (ihs)*[4], *GDP per capita (ln)*, *foreign country natural resources (ln)*, and *foreign country conflicts (ln)*. In addition, we include an *EU membership* dummy, as EU countries tend to vote similarly. We pay particular attention to account for those political and economic factors that shape countries' relations and could have a confounding effect on voting affinity. First, we control for disputes (*dispute count*) between US firms and their subsidiary countries. A high number of arguments point toward more hostile relations between countries (Blake & Moschieri, 2017). Second, to account for US-subsidiary country economic dependence (Albino-Pimentel et al., 2018), we include an

[10] We use the inverse hyperbolic sine transformation to approximate the natural logarithm. This method is recommended when dealing with large positive and negative values and is better suited for the case of zero-valued observations (Burbidge et al., 1988; Witte et al., 2017).

investment treaty dummy that equals one if the countries have a treaty regulating trade and zero otherwise. We further control for grant programs (*IMF GRAC* and *IMF PRGT*) under the IMF schemes. Last, to capture some of the unmeasured, time-invariant firm and country characteristics that may be relevant regarding firms' foreign commitment, we include firm-country fixed effects. In addition, we capture the effect of unobserved temporal shocks by including year dummies. The variables used in the analysis with a description of sources are shown in **Table 4.1.**

Table 4.1 *Variables, Definitions, and Data Source*

Variables	Measurement	Source
Dependent variable		
Foreign sub-investment	Number of foreign subsidiaries in a given country and year (Oh & Oetzel, 2011)	LexisNexis Corporate Affiliate
Independent variable		
Change in political affinity	The difference in voting affinity between the current (t) and previous year (t-1), divided by the value of voting affinity in the previous year (t-1)	Voeten et al. 2009 (UN General Assembly)
Moderators		
Change in control of corruption	Yearly percent changes in the control of corruption. Control of corruption estimate based on WGI aggregation methodology (Kraay, Kaufmann & Mastruzzi, 2010)	World Bank WGI Indicators
Control variables		
Political affinity	Dyadic affinity indicators between two countries I and j, measured as VA(i, j) = (#agree(i, j) − #disagree(i, j))/total mutual votes(i, j) (Gartzke, 1998)	Voeten et al. 2009 (UN General Assembly)
Total assets (ln)	Natural logarithm of total assets	Compustat Annual
Leverage	Total liabilities/Total assets	Compustat Annual
EBITDA (ihs)	EBITDA as defined in Compustat Database	Compustat Annual
ROA	Net income/Total assets	Compustat Annual
Number US subsidiaries	Total count of US subsidiaries	LexisNexis Corporate Affiliate
US subsidiary HHI (SIC)	Concentration in US subsidiaries' industry as Herfindal-Hirschmann Index	LexisNexis Corporate Affiliate
Host population (ln)	Natural logarithm of host country population	World Bank
Host inflation (ihs)	Inverse hyperbolic sine of inflation	World Bank
GDP growth (ihs)	Inverse hyperbolic sine of GDP growth	World Bank
GDP per capita (ln)	Natural logarithm of GDP per capita	World Bank
Host natural resources (ln)	Natural logarithm of Host natural resources	World Bank
Host conflicts (ln)	Natural logarithm of the number of host country conflicts	World Bank
IMF GRAC (ln)	Natural logarithm of the number of IMF country GRAC	IMF databases
IMF PRGT (ln)	Natural logarithm of the number of IMF country PRGT	IMF databases
EU membership dummy	Dummy variable equal to one if the country is a member of the EU	Manually coded
Dispute count	Count number of disputes between US and the host country	ICSID World Bank
Investment treaty dummy	Dummy variable equal to one if the country has a treaty with US	UNCTAD
Exports to Iran (ln)	Natural logarithm of Exports to Iran	UNCTAD

Empirical Strategy

Our dependent variable – each firm's number of subsidiaries per foreign country – is a count variable with positive integers as values. There is no overdispersion of zeros, and the variance is close to the mean. Therefore, Poisson models are preferred instead of negative binomial models (Wooldridge, 2010). Hence, we estimate a Poisson model, represented as:

$$\text{Subsidiary investment}_{ijt} = \alpha_0 + \alpha_1 \textit{ change in political affinity}_{jt-1} + \beta \text{ firm}_{it-1} + \delta \text{ country}_{jt-1} + \gamma \text{ year}_t + \omega \text{ dyad}_{ijt} + \varepsilon_{ijt}$$

where *foreign subsidiary investment* is the number of subsidiaries in a given country; *change in voting affinity* is the percent change in UN voting affinity yearly; *firm* is a vector of firm control variables; *country* is a vector of foreign country control variables; *year* is a vector of year fixed effects; *dyad* is a vector of firm-country fixed effects, and ε_{ijt} denotes the idiosyncratic error term. Subscripts *i*, *j*, and *t* represent firm, country, and, year respectively. All variables have been lagged one year to reduce reverse causality problems.

We estimate fixed-effects Poisson models, which drop dyads in which no change can be registered, as well as dyads with only one observation, as they do not contribute to a change in likelihood. We further estimate models that take the natural logarithm of our dependent variable, *foreign subsidiary investment*, and estimate OLS regressions to show that our results remain robust with different specifications. To address endogeneity concerns due to non-random voting, we estimate a nonlinear two-stage approach that incorporates the residuals of the first stage (OLS) as regressors into the second stage (Poisson) (Lin & Wooldridge, 2019). This follows similar two-stage selection approaches on foreign divestment decisions in nonlinear models (Berry, 2013; Oh & Oetzel, 2017). We include an exogenous instrument – *subsidiary countries' exports to Iran* – in the first stage. *Exports to Iran* captures the diplomatic relationship between subsidiary countries and Iran, which has an often contested, strained, and varying relationship with the United States. When the United States imposes sanctions on Iran, US allies – who may not themselves sanction Iran – often stop foreign trade with Iran due to the fear of US retaliation (Haidar, 2017). We consequently assert that exports to Iran affect the United States' subsidiary-country political relationship but do not directly affect the number of US foreign subsidiaries in a focal subsidiary country.

4.4 Result

Table 4.2 presents the descriptive statistics, and **Table 4.3** contains the correlation matrix. After carefully examining the explanatory variables for multicollinearity, we find that this seems to be of no concern because all explanatory variables are correlated below 0.2.

Table 4.2 *Descriptive statistics (7758 firm-country dyads)*

	VARIABLES	(1) N	(2) mean	(3) sd	(4) min	(5) max
1	Foreign sub investment	39,282	1.740	2.057	1	45
2	Foreign sub investment (ln)	39,282	0.316	0.564	0	3.807
3	Political affinity	39,282	0.489	0.167	0.110	0.952
4	Change in political affinity	39,282	0.023	0.158	-0.574	1.570
5	Total assets (ln)	39,282	5.947	2.531	0.001	12.89
6	Leverage	39,282	1.081	39.51	0	7,804
7	EBITDA (ihs)	39,282	3.374	3.684	-8.687	11.70
8	ROA	39,282	-2.516	40.70	-2,324	6.600
9	Number US subsidiaries	39,282	24.72	37.06	1	755
10	US subsidiary HHI (SIC)	39,282	0.204	0.263	0.001	1
11	Foreign population (ln)	39,282	17.33	1.438	12.52	21.04
12	Foreign inflation (ihs)	39,282	1.396	0.895	-4.796	4.823
13	GDP growth (ihs)	39,282	0.987	1.309	-3.412	3.874
14	GDP per capita (ln)	39,282	10.05	1.045	5.268	11.69
15	Foreign natural resources (ln)	39,282	0.834	0.864	0	4.083
16	Foreign conflicts (ln)	39,282	0.655	1.633	0	6.919
17	IMF GRAC (ln)	39,282	0.926	4.420	0	23.87
18	IMF PRGT (ln)	39,282	0.109	1.423	0	20.77
19	EU membership dummy	39,282	0.451	0.498	0	1
20	Dispute count	39,282	0.192	0.660	0	4
21	Investment treaty dummy	39,282	0.252	0.434	0	1
22	Exports to Iran (ln)	39,282	17.36	6.420	0	23.92
23	Change in control of corruption	37,254	-0.046	0.851	-47.77	11.59

***Table 4.3** Correlation matrix*

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22
1 Foreign sub investment	1																					
2 Foreign sub investment (ln)	0,86	1																				
3 Political affinity	0,13	0,15	1																			
4 Change in political affinity	-0,01	-0,02	0,16	1																		
5 Total assets (ln)	0,05	0,05	0,06	0	1																	
6 Leverage	0	0	0,01	0,01	-0,03	1																
7 EBITDA (ihs)	0,04	0,04	0,02	-0,02	0,74	-0,01	1															
8 ROA	-0,03	-0,03	-0,02	0,01	0,1	0	0,11	1														
9 Number US subsidiaries	0,37	0,36	-0,07	-0,04	0,08	0	0,07	0	1													
10 US subsidiary HHI (SIC)	-0,19	-0,25	0,09	0,06	0,01	0	-0,03	0	-0,42	1												
11 Foreign population (ln)	0,07	0,08	-0,15	0,01	0	0	-0,01	0,01	-0,07	0,09	1											
12 Foreign inflation (ihs)	-0,06	-0,08	-0,36	-0,05	-0,02	-0,01	0	0,02	0,03	-0,05	0,2	1										
13 GDP growth (ihs)	-0,02	-0,03	-0,32	-0,31	-0,02	-0,01	0,01	-0,01	0,03	-0,05	0,16	0,16	1									
14 GDP per capita (ln)	0,1	0,13	0,63	-0,01	0,04	0	0,02	-0,01	-0,09	0,09	-0,5	-0,46	-0,31	1								
15 Foreign natural resources (ln)	-0,04	-0,04	-0,32	0,03	-0,02	0	-0,01	0	0,05	-0,08	0,23	0,46	0,17	-0,48	1							
16 Foreign conflicts (ln)	-0,05	-0,07	-0,33	0,01	-0,01	0	-0,01	0,01	0,04	-0,04	0,41	0,35	0,15	-0,62	0,33	1						
17 IMF GRAC (ln)	-0,05	-0,06	-0,05	-0,04	-0,01	0	0,01	0	0,07	-0,06	-0,08	0,05	-0,01	-0,17	-0,02	0,09	1					
18 IMF PRGT (ln)	-0,02	-0,03	-0,09	0,01	-0,01	0	0	-0,01	0,03	-0,03	0	0,11	0,03	-0,21	0,08	0,06	0,07	1				
19 EU membership dummy	0,06	0,07	0,43	-0,01	0,01	0	0,01	0	-0,03	0,04	-0,14	-0,23	-0,25	0,41	-0,53	-0,34	0,02	-0,07	1			
20 Dispute count	0,07	0,09	0,26	0,05	0	0,02	-0,01	-0,01	-0,03	-0,01	0,01	-0,02	-0,01	0,1	0,19	-0,06	-0,04	-0,02	-0,25	1		
21 Investment treaty dummy	-0,05	-0,06	-0,22	0,08	-0,04	0,01	-0,01	0,01	0,02	-0,06	0,06	0,37	0,15	-0,39	0,47	0,37	0,09	0,08	-0,51	0,33	1	
22 Exports to Iran (ln)	-0,07	-0,07	-0,22	0,03	-0,01	0	0	0,01	0,01	-0,03	0,08	-0,1	0,05	-0,05	-0,05	-0,04	-0,01	-0,04	-0,17	0,04	0,02	1
23 Change in control of corruption	0,01	0,01	0,04	-0,07	0	0	0	0	0	0	-0,04	-0,05	0,02	0,04	-0,03	0	0,01	0	0,01	0,02	-0,08	-0,02

Table 4.4 *The effect of changes in political affinity on foreign subsidiary investments (main results)*

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Poisson			OLS			OLS 1st stage	Poisson 2nd stage	2SLS 2nd stage
Dependent variables	Foreign sub-investment			Foreign sub-investment (ln)			Δ affinity	F inv	F inv (ln)
Political affinity	0.304	-0.227		0.241	-0.020			-0.114	-0.020
	(0.082)	(0.198)		(0.063)	(0.111)			(0.239)	(0.065)
	[0.000]	[0.253]		[0.000]	[0.853]			[0.634]	[0.752]
Change in political affinity	0.024	**0.123**		0.016	**0.058**			**0.132**	**0.058**
	(0.026)	**(0.030)**		(0.013)	**(0.018)**			**(0.029)**	**(0.015)**
	[0.366]	**[0.000]**		[0.212]	**[0.001]**			**[0.000]**	**[0.000]**
Political affinity (%) *t-2*			-0.355			-0.154			
			(0.219)			(0.126)			
			[0.105]			[0.221]			
Change in political affinity (%) *t-2*			**0.119**			**0.062**			
			(0.042)			**(0.023)**			
			[0.004]			**[0.008]**			
Export to Iran / First stage residuals							**0.002**	**0.095**	
							(0.000)	**(0.044)**	
							[0.001]	**[0.033]**	
Full controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations (dyad-years)	39,282	37,829	30,141	39,282	39,282	31,195	39,282	37,829	37,829
Number of firm-country dyads	7,758	6,305	5,238	7,758	7,758	6,292	7,758	6,305	6,305
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm-Country FE	No	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes
Chi2 / F-value	7979	807.5	678.8	1455	29.35	24.09	2015	821.9	67.18
loglikelihood / Adj. R2	-53791	-33877	-26749	0.200	0.106	0.109	0.575	-34396	0.107

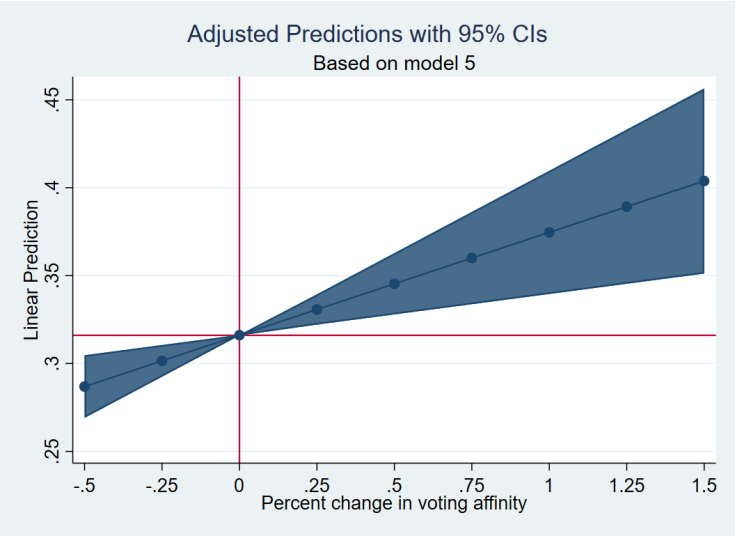
Robust standard errors in parentheses. P-values in brackets

Table 4.4 contains the results of the main regressions examining the effect of change in political affinity on foreign subsidiary investments. Model 1 estimates a random-effects Poisson regression without firm-country fixed effects, presenting a significant effect for *political affinity* (β=0.304, p<0.001), whereas *change in political affinity* is not significant (β=0.024, p=0.366). Testing the between variance of the panel such results can be expected, as the overall effect of political affinity subsumes small changes in the overall level. Our results that political affinity is positively related to subsidiary investment are in line with prior results indicating that lower overall political risk leads to more foreign investment (Holburn & Zelner, 2010) and that

positive UN voting affinity leads to market entry (Li et al., 2018). However, to make inferences on post-market entry changes, we must examine within-unit variances of the same firms over a time period. Thus, models 2 and 3 estimate the same model with firm-country fixed effects. Model 2 employs a one-year lag of the independent variables, and model 3 employs a two-year lag. Model 2 shows that the rather stable *political affinity* turns insignificant (β=-0.227, p=0.253), whereas *change in political affinity* turns significant and positively related to foreign subsidiary investments (β=0.123, p<0.001). The same applies to model 3 with a two-year lag for *political affinity* (β=-0.355, p=0.105) and *change in political affinity* (β=0.042, p=0.004). This indicates that whereas pre-market entry investments may be primarily affected by the overall values of political affinity, post-market entry adjustments may be affected by changes in political affinity, providing evidence for hypothesis 1.

To provide robustness to these assertions, we re-estimate the models as OLS regressions with the natural logarithm of the number of subsidiaries as the dependent variable. Models 4, 5, and 6 present the same pattern as 1, 2, and 3. Model 4 shows a significant effect for *political affinity* (β=0.241, p<0.001), whereas *change in political affinity* is not significant (β=0.016, p=0.212). Models 5 (one-year lag; *political affinity* [β=-0.02, p=0.853] and *change in political affinity* [β=0.058, p=0.001]) and 6 (two-year lag; *political affinity* [β=-0.154, p=0.221] and *change in political affinity* [β=0.062, p=0.008]) show dynamic post-market entry effects in the fixed effects regressions. This provides further evidence for our hypothesis. We plot the marginal effects in model 5 graphically in **Figure 4.1**, as marginal effects in linear models can be more easily understood. **Figure 4.1** underscores that a positive (negative) change in political affinity increases (decreases) firms' foreign subsidiary investment.

Figure 4.1 *Marginal effects of changes in political affinity*



In terms of magnitude (model 5), for every unit increase in *change in political affinity* (mean= 0.0226), subsidiaries increase by 5.97%[11]. Provided that firms, on average, do not increase or decrease the number of subsidiaries every year, such results are intuitive and show that the average effect is negligible. However, when looking at the standard deviation of *change in political affinity* (SD= 0.158), we can see that with only one standard deviation above (SD+1), firms start to establish (divest) 0.89 additional subsidiaries in a focal country[12]. Given that the average number of foreign subsidiaries is 1.74, this corresponds to an increase of 51% (=0.89/1.74=0.51). This indicates that a *change in political affinity* also has a substantial effect in magnitude for multinational firms once the volatility reaches a certain threshold.

To lessen endogeneity concerns, models 7 (first stage) and 8 (second stage) estimate a two-stage model with a first stage OLS and a second stage Poisson regression. We include the instrument *export to Iran* in the first stage. A Stock-Yogo instrument test shows sufficient instrument strength (F-value = 16.38) (Stock & Yogo, 2005). The instrument is also significant (β=0.002, p=0.001). Model 8 shows the second-stage Poisson regression with a one-year time lag of the independent variable. First stage residuals are significant (β=0.095, p=0.033), and coefficients for *change in political affinity* remain robust (β=0.132, p<0.001). We then perform a more conservative 2SLS regression with the natural logarithm of foreign subsidiary

[11] Calculated as (eβ -1) x100 = (e0.058-1) x 100

[12] Calculated as (eβ -1) x100 = (e0.058-1) x 100 x 0.158

investment as the dependent variable in the second stage, which arrives at similar results in strength and direction (model 9).

Table 4.5 *Changes in the control of corruption*

	(10) Poisson 2nd stage
Dependent variables	F inv
Change in political affinity	0.108
	(0.029)
	[0.000]
Change in control of corruption	0.005
	(0.003)
	[0.153]
Change in control of corruption x Change in political affinity	**-0.021**
	(0.007)
	[0.003]
Full controls	Yes
Observations (dyad-years)	35,848
Number of firm-country dyads	6,132
Year FE	Yes
Firm-Country FE	Yes
Chi2 / F-value	790
loglikelihood / Adj. R2	-32134
Robust standard errors in parentheses. P-values in brackets	

Table 4.5 shows results for *changes in control of corruption* as a moderator of the *changes in political affinity-subsidiary investment* relationship. Consistent with hypotheses 2 that states volatile levels in the control of corruption negatively moderate the relationship between changes in political affinity and firms' foreign subsidiary investment, we find evidence for a negative moderating effect of *change in control of corruption* (mean =-0.05) on the *change in voting affinity-subsidiary investment* relationship (β=-0.021, p=0.003). This further indicates that when affinity increases but government corruptive practices are less predictable (change), the firm will increase its foreign subsidiary commitment to a *lesser* extent. In our particular sample, because changes are on average negative, firms reduce their subsidiaries.

Table 4.6 *Controlling for strategic industries with industry FE*

	(11) Poisson model	(12) OLS 1st stage	(13) Poisson 2nd stage
Dependent variables	Foreign sub-investment	Δ affinity	Foreign sub-investment
Change in political affinity	**0.128**		**0.136**
	(0.052)		**(0.027)**
	[0.013]		**[0.000]**
Export to Iran / First stage residuals		0.002	0.087
		(0.000)	(0.042)
		[0.001]	[0.036]
Full controls	Yes	Yes	Yes
Observations (dyad-years)	37,829	39,282	37,829
Number of firm-country dyads	6,305	7,758	6,305
Year FE	Yes	Yes	Yes
Firm-Country FE	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes
Chi2 / F-value	1201	585.1	167683
loglikelihood / Adj. R2	-34337	0.574	-34336

Robust standard errors in parentheses. P-values in brackets.

Several industries are included in our cross-industry sample. Some industries may be more strategic to the state and, hence, more prone to government intervention in the case of changes in political affinity than others. For instance, strategic industries focusing on key resources (e.g., oil and gas) or national security interests (e.g., telecommunications and aerospace) are more likely to be affected by government intervention in the case of improvement (or deterioration) in diplomatic relations. To control for this, we include subsidiary-industry fixed effects in our model specifications (Arikan & Shenkar, 2013). **Table 4.6** contains these results. Models 11, 12, and 13 show the original estimation and first and second stage of the two-stage Poisson model, corroborating prior findings when accounting for industry specificities. *Change in political affinity* lagged by one year remains significant and similar in strength (model 13: β=0.136, $p<0.001$).

In the last step, we trim the sample at the 1% and 99% levels of the dependent variable (number of subsidiaries) to ensure that our results are not primarily driven by large firms with strong country footprints, which can quickly invest and divest subsidiaries, or by small firms with a precarious foothold, which are more likely to fail or expand aggressively. We re-estimate our regressions with this new sample and confirm that our results remain similar in direction, significance, and strength (Appendix 4.1). Taken together, our analyses show that multinational

firms adapt their subsidiary investment to changes in political affinity and react more strongly when the local political environment is less stable and more prone to intervention. This strengthens our claim that firms strategically manage their foreign subsidiary investment post-market entry in response to changes in the political affinity between their home and subsidiary countries.

4.5 Discussion and Conclusion

Research on political affinity shows that firms evaluate *pre-market entry* conditions to decide whether to invest in a country, which is partly based on political affinity (Duanmu, 2014; Li et al., 2018). We extend these studies by investigating whether *post-market entry* changes to political affinity equally affect multinational firms' foreign subsidiary investments. The study uses a large dataset of US public firms from 2000 to 2015 across industries and employs various techniques to address endogeneity and to limit alternative explanations. The study finds robust effects of changes in political affinity on foreign subsidiary investments. Firms increase (decrease) the number of their subsidiaries based on improving (deteriorating) political affinity. We extend the general notion that firms adapt their investment strategies by increasing (decreasing) subsidiaries when economic risk decreases or increases (Oh & Oetzel, 2011) and relate to prior work on political risk in general and political affinity in particular. Our results are consistent with prior theorizations on political risk, which posited that firms manage political risk (Holburn & Zelner, 2010) because coercion against foreign investment (DiMaggio & Powell, 1983) and increased coordination costs associated with political risk lead firms to avoid investing (Berry, 2013; Delios & Henisz, 2003).

We hypothesize that an increase (decrease) in political affinity increases (decreases) firms' foreign subsidiary investment. Whereas prior studies focused on the pre-market entry effects of political affinity, confirming that low political affinity leads to reduced investments (Holburn & Zelner, 2010; Li et al., 2018), we focus on the post-market entry changes in existing investments. In line with our hypothesis, our empirical analysis suggests that firms reduce subsidiary investments in countries with unfavorable changes in political affinity and increase subsidiary investments in countries with favorable changes. We also estimate models that examine the pre-market entry effects of political affinity and find evidence that confirms prior studies. We further substantiate our assertions and provide additional empirical support through three tests. First, we show that these effects remain robust when we account for the cross-industry structure of our sample. Second, we examine how the stability of the corruption

practices in the foreign country affects firms' tendency to change subsidiary investments. We show that negative changes in the control of corruption in concert with changes in affinity lead to decreased investments. This provides further evidence that firms actively assess political affinity as a proxy for government action against (or on behalf of) foreign actors. This follows prior assertions that more volatile political environments and uncertainty increase the cost of doing business in foreign investments (Bertrand et al., 2016; Cuervo-Cazurra, 2006; Henisz & Delios, 2004).

Taken together, our study makes several contributions to the growing literature on political affinity's effects on multinational firms' strategies. First, we expand the boundaries of previous research that mainly focused on the pre-market entry effects (Bertrand et al., 2016; Li et al., 2018) instead of post-market entry adjustments of political affinity on firms' investments. Although pre-market entry evaluations are important, firms equally must assess their ongoing investments according to political developments, which we show to be heterogeneous based on investing firms' countries of origin. Our empirical analysis suggests that although favorable political affinity between the firm's home country and the subsidiary country may open doors to opportunities, unfavorable political affinity may increase the cost of doing business and, in the worst case, lead to market exit. Second, our study contributes to strategy research. In the past decade, scholars have made substantial progress toward understanding the relationship between international politics and firms' strategies (Albino-Pimentel et al., 2018; Blake & Moschieri, 2017; García-Canal & Guillén, 2008). However, most extant research has focused on bilateral contractual relationships, such as investment treaties (Albino-Pimentel et al., 2018). Our study focuses on the dynamic evolution of bilateral relationships and their effect on firms' subsidiary investments. Finally, whereas extant research has suggested that firms exit subsidiary countries due to pressures from governments (DiMaggio & Powell, 1983; Kobrin, 1980; Meyer & Rowan, 1977), this study argues that firms may voluntarily exit countries due to an anticipated increase in policy risk.

Limitations

We recognize that this study has multiple limitations. First, although our results are consistent with the proposed hypothesis, we do not directly measure whether firms already planned to increase their subsidiary investments before the change in political affinity took place. By lagging our independent variables by one and two years, we try to address this econometrically. In the same vein, it is also not possible to examine whether firms divested subsidiaries

voluntarily or because of direct government action or pressure. Consequently, other more detailed mechanisms of political action due to changes in bilateral relationships might equally explain the empirical results. However, accounting for the main building blocks of the political risk literature, such as investment treaties, conflicts, national characteristics, and other supranational investment programs, we can assume that changes in political affinity have their distinct effect. Second, although we employ an extensive sampling approach and compile a representative sample across countries and continents, we rely on US firms only. Given that the economic power of the United States cannot be matched by most other countries, our results might very well be different for firms from emerging markets or smaller nations less embedded in the global political environment. Thus, we motivate scholars to study our assertions in different global contexts.

Conclusion

This study examines the post-market entry effects of changes in political affinity on foreign subsidiary investments. We show that changes in political affinity can lead to investments and divestments of multinational firms. Although subsidiaries proxy foreign direct investment, we think that this study opens avenues for further work that aims to understand how various facets of foreign direct investment are affected by changes in political affinity. Promising work could investigate existing contractual relationships such as alliances or other equity-based phenomena. New studies could also examine whether there are differences in single industries or between commodity industries and industries of national strategic importance. In summary, studying post-market entry changes in political affinity can open a fruitful avenue for understanding why firms adapt their foreign investments in anticipation of other political events.

4.6 References

Albino-Pimentel, J., Dussauge, P., & Shaver, J. M. (2018). Firm non-market capabilities and the effect of supranational institutional safeguards on the location choice of international investments. *Strategic Management Journal*, *39*(10), 2770-2793.

Arikan, I., Arikan, A. M., & Shenkar, O. (2020). Nation-dyadic history and cross-border corporate deals: Role of conflict, trade, generational distance, and professional education. *Strategic Management Journal*, *41*(3), 422-466.

Arikan, I., & Shenkar, O. (2013). National animosity and cross-border alliances. *Academy of Management Journal*, *56*(6), 1516-1544.

Berry, H. (2013). When Do Firms Divest Foreign Operations? *Organization Science*, *24*(1), 246-261.

Bertrand, O., Betschinger, M.-A., & Settles, A. (2016). The relevance of political affinity for the initial acquisition premium in cross-border acquisitions. *Strategic Management Journal*, *37*(10), 2071-2091.

Bertrand, O., & Capron, L. (2015). Productivity enhancement at home via cross-border acquisitions: The roles of learning and contemporaneous domestic investments. *Strategic Management Journal*, *36*(5), 640-658.

Blake, D. J., & Moschieri, C. (2017). Policy risk, strategic decisions and contagion effects: Firm-specific considerations. *Strategic Management Journal*, *38*(3), 732-750.

Bonardi, J.-P., Holburn, G., & Bergh, R. G. V. (2006). Nonmarket Strategy Performance: Evidence from U.S. Electric Utilities. *The Academy of Management Journal*, *49*(6), 1209-1228.

Burbidge, J., Magee, L., & Robb, A. (1988). Alternative Transformations to Handle Extreme Values of the Dependent Variable. *Journal of the American Statistical Association*, *83*(401), 123-127.

Chung, C. C., Lee, S.-H., Beamish, P. W., & Isobe, T. (2010). Subsidiary expansion/contraction during times of economic crisis. *Journal of International Business Studies*, *41*(3), 500-516.

Collins, J. D., Uhlenbruck, K., & Rodriguez, P. (2009). Why Firms Engage in Corruption: A Top Management Perspective. *Journal of Business Ethics*, *87*(1), 89-108.

Cuervo-Cazurra, A. (2006). Who cares about corruption? *Journal of International Business Studies*, *37*(6), 807-822.

Cuypers, I. R. P., & Martin, X. (2010). What makes and what does not make a real option? A study of equity shares in international joint ventures. *Journal of International Business Studies*, *41*(1), 47-69.

Delios, A., & Henisz, W. I. (2000). Japanese Firms' Investment Strategies in Emerging Economies. *Academy of Management Journal*, *43*(3), 305-323.

Delios, A., & Henisz, W. J. (2003). Political hazards, experience, and sequential entry strategies: the international expansion of Japanese firms, 1980–1998. *Strategic Management Journal*, *24*(11), 1153-1164.

DiMaggio, P. J., & Powell, W. W. (1983). The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields. *American Sociological Review*, *48*(2), 147-160.

Duanmu, J.-L. (2014). State-owned MNCs and host country expropriation risk: The role of home state soft power and economic gunboat diplomacy. *Journal of International Business Studies*, *45*(8), 1044-1060.

García-Canal, E., & Guillén, M. F. (2008). Risk and the strategy of foreign location choice in regulated industries. *Strategic Management Journal*, *29*(10), 1097-1115.

Gartzke, E. (1998). Kant We All Just get Along? Opportunity, Willingness, and the Origins of the Democratic Peace. *American Journal of Political Science*, *42*(1), 1-27.

Gartzke, E. (2000). Preferences and the democratic peace. *International Studies Quarterly*, *44*(2), 191-212.

Gulati, R., & Singh, H. (1998). The Architecture of Cooperation: Managing Coordination Costs and Appropriation Concerns in Strategic Alliances. *Administrative Science Quarterly*, *43*(4), 781-814.

Habib, M., & Zurawicki, L. (2002). Corruption and foreign direct investment. *Journal of International Business Studies*, *33*(2), 291-307.

Haidar, J. I. (2017). Sanctions and export deflection: evidence from Iran. *Economic Policy*, *32*(90), 319-355.

Hasija, D., Liou, R.-S., & Ellstrand, A. (2020). Navigating the New Normal: Political Affinity and Multinationals' Post-Acquisition Performance. *Journal of Management Studies*, *57*(3), 569-596.

Henisz, W. J. (2003). The power of the Buckley and Casson thesis: the ability to manage institutional idiosyncrasies. *Journal of International Business Studies*, *34*(2), 173-184.

Henisz, W. J., & Delios, A. (2004). Information or influence? The benefits of experience for managing political uncertainty. *Strategic Organization*, *2*(4), 389-421.

Henisz, W. J., & Zelner, B. A. (2005). Legitimacy, Interest Group Pressures, and Change in Emergent Institutions: The Case of Foreign Investors and Host Country Governments. *The Academy of Management Review*, *30*(2), 361-382.

Holburn, G., & Zelner, B. (2010). Political capabilities, policy risk, and international investment strategy: Evidence from the global electric power generation industry. *Strategic Management Journal*, *31*(12), 1290-1315.

Kaufmann, D., Kraay, A., & Zoido-Lobaton, P. (1999). *Governance matters*. https://EconPapers.repec.org/RePEc:wbk:wbrwps:2196

Kobrin, S. J. (1980). Foreign enterprise and forced divestment in LDCs. *International organization*, *34*(1), 65-88.

Kogut, B., & Kulatilaka, N. (1994). Operating flexibility, global manufacturing, and the option value of a multinational network. *Management Science*, *40*(1), 123-139.

Kraay, A., Kaufmann, D., & Mastruzzi, M. (2010). *The worldwide governance indicators : methodology and analytical issues* [doi:10.1596/1813-9450-5430]. The World Bank

Kwok, C. C. Y., & Tadesse, S. (2006). The MNC as an agent of change for host-country institutions: FDI and corruption. *Journal of International Business Studies*, *37*(6), 767-785.

Lee, S.-H., & Song, S. (2012). Host country uncertainty, intra-MNC production shifts, and subsidiary performance. *Strategic Management Journal*, *33*(11), 1331-1340.

Li, J., Meyer, K. E., Zhang, H., & Ding, Y. (2018). Diplomatic and corporate networks: Bridges to foreign locations. *Journal of International Business Studies*, *49*(6), 659-683.

Lin, W., & Wooldridge, J. M. (2019). Chapter 2 - Testing and Correcting for Endogeneity in Nonlinear Unobserved Effects Models. In M. Tsionas (Ed.), *Panel Data Econometrics* (pp. 21-43). Academic Press.

Lu, J., Liu, X., Wright, M., & Filatotchev, I. (2014). International experience and FDI location choices of Chinese firms: The moderating effects of home country government support and host country institutions. *Journal of International Business Studies*, *45*(4), 428-449.

Madhok, A. (1997). Cost, Value and Foreign Market Entry Mode: The Transaction and the Firm. *Strategic Management Journal*, *18*(1), 39-61.

Malesky, E. J., & Samphantharak, K. (2008). Predictable Corruption and Firm Investment: Evidence from a Natural Experiment and Survey of Cambodian Entrepreneurs. *Quarterly Journal of Political Science*, *3*(3), 227-267.

Mata, J., & Portugal, P. (2002). The survival of new domestic and foreign-owned firms. *Strategic Management Journal*, *23*(4), 323-343.

Meyer, J. W., & Rowan, B. (1977). Institutionalized Organizations: Formal Structure as Myth and Ceremony. *American Journal of Sociology*, *83*(2), 340-363.

Meyer, K. E., Estrin, S., Bhaumik, S. K., & Peng, M. W. (2009). Institutions, resources, and entry strategies in emerging economies. *Strategic Management Journal*, *30*(1), 61-80.

Oh, C. H., & Oetzel, J. (2011). Multinationals' response to major disasters: how does subsidiary investment vary in response to the type of disaster and the quality of country governance? *Strategic Management Journal*, *32*(6), 658-681.

Oh, C. H., & Oetzel, J. (2017). Once bitten twice shy? Experience managing violent conflict risk and MNC subsidiary-level investment and expansion. *Strategic Management Journal*, *38*(3), 714-731.

Phene, A., & Almeida, P. (2008). Innovation in Multinational Subsidiaries: The Role of Knowledge Assimilation and Subsidiary Capabilities. *Journal of International Business Studies*, *39*(5), 901-919.

Reuer, J. J., & Tong, T. W. (2005). Real Options in International Joint Ventures. *Journal of Management*, *31*(3), 403-423.

Rodriguez, P., Uhlenbruck, K., & Eden, L. (2005). Government corruption and the entry strategies of multinationals. *Academy of management review*, *30*(2), 383-396.

Sidki Darendeli, I., & Hill, T. L. (2016). Uncovering the complex relationships between political risk and MNE firm legitimacy: Insights from Libya. *Journal of International Business Studies*, *47*(1), 68-92.

Stock, J. H., & Yogo, M. (2005). Testing for Weak Instruments in Linear IV Regression. In D. W. K. Andrews & J. H. Stock (Eds.), *Identification and Inference for Econometric Models: Essays in Honor of Thomas Rothenberg.* (pp. 80-108). Cambridge University Press.

Surdu, I., Mellahi, K., & Glaister, K. W. (2019). Once bitten, not necessarily shy? Determinants of foreign market re-entry commitment strategies. *Journal of International Business Studies*, *50*(3), 393-422.

Voeten, E., Strezhnev, A., & Bailey, M. (2009). *United Nations General Assembly Voting Data* Version V27) [roll-call data]. Harvard Dataverse. https://doi.org/doi:10.7910/DVN/LEJUQZ

Weitzel, U., & Berns, S. (2006). Cross-Border Takeovers, Corruption, and Related Aspects of Governance. *Journal of International Business Studies*, *37*(6), 786-806.

Witte, C. T., Burger, M. J., Ianchovichina, E. I., & Pennings, E. (2017). Dodging bullets: The heterogeneous effect of political violence on greenfield FDI. *Journal of International Business Studies*, *48*(7), 862-892.

Wooldridge, J. (2010). *Econometric analysis of cross section and panel data* (2nd ed.). MIT Press

4.7 Appendices

Appendix 1: *Main results with winsorized values of changes in political affinity*

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Poisson			OLS			OLS 1st stage	Poisson 2nd stage
Dependent variables	Foreign sub investment			Foreign sub investment (ln)			Δ affinity	F inv
Political affinity	0.309	-0.229		0.252	-0.008			-0.128
	(0.082)	(0.201)		(0.063)	(0.114)			(0.242)
	[0.000]	[0.255]		[0.000]	[0.943]			[0.595]
Change in political affinity	-0.014	**0.118**		0.003	**0.054**			**0.129**
	(0.031)	**(0.035)**		(0.015)	**(0.021)**			**(0.036)**
	[0.666]	**[0.001]**		[0.827]	**[0.010]**			**[0.000]**
Political affinity (%) *t-2*			-0.390			-0.165		
			(0.232)			(0.135)		
			[0.093]			[0.221]		
Change in political affinity (%) *t-2*			**0.103**			**0.054**		
			(0.049)			**(0.028)**		
			[0.035]			**[0.052]**		
Export to Iran / First stage residuals							**0.001**	**0.092**
							(0.000)	**(0.048)**
							[0.161]	**[0.055]**
Full controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations (dyad-years)	38,490	36,985	29,437	38,490	38,490	30,560	38,490	36,214
Number of firm-country dyads	7,735	6,230	5,131	7,735	7,735	6,254	7,731	6,108
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm-Country FE	No	Yes	Yes	No	Yes	Yes	Yes	Yes
Chi2 / F-value	8019	816.5	671.1	1459	29.28	23.73	2300	813.9
loglikelihood / Adj. R2	-53626	-33621	-27419	0.201	0.109	0.112	0.614	-32978

Robust standard errors in parentheses. P-values in brackets

Appendix 2: *Table 4.4 continued (all controls)*

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Poisson			OLS			OLS 1st stage	Poisson 2nd stage	2SLS 2nd stage
Dependent variables	Foreign commitment			Foreign commitment (ln)			Δ affinity	Commit.	F inv (ln)
Total assets (ln)	-0.008	-0.026	-0.011	-0.007	-0.011	-0.002	-0.001	-0.026	-0.011
	(0.004)	(0.010)	(0.011)	(0.003)	(0.006)	(0.006)	(0.001)	(0.010)	(0.003)
	[0.064]	[0.008]	[0.318]	[0.011]	[0.056]	[0.697]	[0.287]	[0.009]	[0.002]
Leverage	-0.000	-0.000	-0.000	-0.000	-0.000	0.000	-0.000	-0.000	-0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
	[0.163]	[0.638]	[0.360]	[0.752]	[0.865]	[0.502]	[0.372]	[0.648]	[0.841]
EBITDA (ihs)	0.006	0.007	0.007	0.005	0.005	0.005	0.000	0.007	0.005
	(0.002)	(0.002)	(0.002)	(0.001)	(0.001)	(0.001)	(0.000)	(0.002)	(0.001)
	[0.001]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.356]	[0.000]	[0.000]
ROA	-0.000	0.000	0.000	-0.000	-0.000	0.000	0.000	0.000	-0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
	[0.738]	[0.458]	[0.474]	[0.503]	[0.916]	[0.755]	[0.634]	[0.452]	[0.912]
Number US subsidiaries	0.005	0.002	0.002	0.003	0.002	0.002	-0.000	0.002	0.002
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.001]	[0.000]	[0.000]
US subsidiary HHI (SIC)	-0.529	-0.158	-0.139	-0.196	-0.093	-0.074	-0.007	-0.158	-0.093
	(0.024)	(0.028)	(0.029)	(0.013)	(0.018)	(0.020)	(0.006)	(0.028)	(0.012)
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.226]	[0.000]	[0.000]
Host population (ln)	0.144	-0.741	-0.573	0.072	-0.397	-0.321	-0.033	-0.735	-0.397
	(0.007)	(0.265)	(0.291)	(0.004)	(0.147)	(0.170)	(0.027)	(0.266)	(0.081)
	[0.000]	[0.005]	[0.049]	[0.000]	[0.007]	[0.059]	[0.210]	[0.006]	[0.000]
Host inflation (ihs)	0.014	0.005	0.009	0.003	-0.000	0.002	0.008	0.006	-0.000
	(0.007)	(0.007)	(0.007)	(0.004)	(0.004)	(0.004)	(0.001)	(0.007)	(0.003)
	[0.040]	[0.517]	[0.167]	[0.435]	[0.933]	[0.621]	[0.000]	[0.424]	[0.905]
GDP growth (ihs)	0.002	-0.004	-0.002	-0.003	-0.002	-0.001	-0.001	-0.004	-0.002
	(0.005)	(0.004)	(0.005)	(0.002)	(0.002)	(0.002)	(0.001)	(0.004)	(0.002)
	[0.606]	[0.320]	[0.692]	[0.157]	[0.413]	[0.756]	[0.099]	[0.293]	[0.355]
GDP per capita (ln)	0.203	-0.040	-0.062	0.083	-0.036	-0.051	-0.032	-0.038	-0.036
	(0.016)	(0.052)	(0.058)	(0.011)	(0.028)	(0.033)	(0.005)	(0.052)	(0.015)
	[0.000]	[0.442]	[0.289]	[0.000]	[0.198]	[0.120]	[0.000]	[0.468]	[0.019]

Host natural resources (ln)	0.020	-0.020	-0.029	0.004	-0.011	-0.009	-0.014	-0.014	-0.011
	(0.011)	(0.031)	(0.032)	(0.008)	(0.017)	(0.018)	(0.004)	(0.031)	(0.012)
	[0.069]	[0.531]	[0.360]	[0.579]	[0.511]	[0.621]	[0.001]	[0.644]	[0.336]
Host conflicts (ln)	-0.009	-0.007	-0.006	-0.007	-0.004	-0.003	0.002	-0.007	-0.004
	(0.005)	(0.007)	(0.008)	(0.004)	(0.005)	(0.005)	(0.001)	(0.007)	(0.003)
	[0.106]	[0.371]	[0.438]	[0.063]	[0.375]	[0.540]	[0.071]	[0.342]	[0.190]
IMF GRAC (ln)	-0.003	-0.002	-0.002	0.000	-0.001	-0.001	-0.001	-0.002	-0.001
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.000)	(0.001)	(0.000)
	[0.003]	[0.168]	[0.199]	[0.927]	[0.470]	[0.502]	[0.000]	[0.170]	[0.247]
IMF PRGT (ln)	0.006	0.001	0.001	0.001	0.001	0.001	-0.004	0.001	0.001
	(0.003)	(0.005)	(0.005)	(0.002)	(0.004)	(0.003)	(0.001)	(0.005)	(0.002)
	[0.054]	[0.774]	[0.783]	[0.791]	[0.858]	[0.811]	[0.010]	[0.812]	[0.769]
EU membership dummy	0.064	-0.101	-0.056	0.030	-0.054	-0.021	-0.034	-0.100	-0.054
	(0.024)	(0.053)	(0.096)	(0.015)	(0.047)	(0.072)	(0.031)	(0.053)	(0.056)
	[0.007]	[0.058]	[0.560]	[0.049]	[0.259]	[0.772]	[0.267]	[0.061]	[0.335]
Dispute count	0.004	-0.031	-0.010	-0.009	-0.018	-0.012	-0.025	-0.033	-0.018
	(0.011)	(0.009)	(0.005)	(0.004)	(0.004)	(0.004)	(0.002)	(0.009)	(0.005)
	[0.704]	[0.001]	[0.066]	[0.030]	[0.000]	[0.001]	[0.000]	[0.001]	[0.001]
Investment treaty dummy	0.102	0.051	0.039	0.037	0.024	0.018	-0.030	0.050	0.024
	(0.021)	(0.023)	(0.024)	(0.011)	(0.013)	(0.014)	(0.003)	(0.024)	(0.009)
	[0.000]	[0.030]	[0.104]	[0.001]	[0.061]	[0.205]	[0.000]	[0.034]	[0.007]
Constant				-1.899	7.358	6.897	-1.088		
				(0.145)	(2.509)	(2.742)	(0.418)		
				[0.000]	[0.003]	[0.012]	[0.009]		
Observations (dyad-years)	39,282	37,829	30,141	39,282	39,282	31,195	39,282	37,829	37,829
Number of firm-country dyads	7,758	6,305	5,238	7,758	7,758	6,292	7,758	6,305	6,305
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm-Country FE	No	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes
Chi2 / F-value	7979	807.5	678.8	1455	29.35	24.09	2015	821.9	67.18
loglikelihood / Adj. R2	-53791	-33877	-26749	0.200	0,106	0,109	0,575	-34396	0.107

Robust standard errors in parentheses. P-values in brackets

5. Institutionalizations in High Risk Developing Countries

Host country policy risk and the foreign investments of social impact-seeking firms

Gilbert Kofi Adarkwah (BI), Birgitte Grøgaard (BI) and Sverre Tomassen (BI)

Earlier versions of this essay have been presented at the 41st SMS Annual Conference (virtual, 2021) and the AIB Annual Meeting (virtual, 2021).

Abstract

We draw on the *institutional work* literature to examine the extent to which host country policy risks stemming from poor institutional quality affect the strategic investment decisions of impact investing firms. Based on statistical analyses of impact investing firms' investments in Africa, we find significant and robust evidence that the investment deterrent effect on host country policy risk is smaller for impact investing firms. We argue that this difference is due to impact investors´ motives to engage in institutional work to develop and build host country institutions. To support this claim, we also examine the relationship between impact investing and host country institutionalization. Our results suggest a positive relationship between impact investing and institutionalization in host countries. This study contributes to the literature on institutional work by identifying an underexplored actor that is advancing the improvement of institutions in high-risk countries and by introducing a new type of institutional work: catalytic institutional work.

Keywords: impact investing, social enterprise, foreign location choice; institutional work

5.1 Introduction

The strategy and international business (IB) literature has long considered host country institutional contexts essential in influencing firms' international investments (Buckley et al., 2007; Demirbag et al., 2007; Dorobantu et al., 2017; García-Canal & Guillén, 2008). Institutional context has been found to influence firms' internationalization (Delios & Henisz, 2003; Meyer et al., 2009), global strategies (Bonardi, 2004; Peng, 2012; Peng et al., 2009), location choices (Holburn & Zelner, 2010; Meyer et al., 2009; Xu & Shenkar, 2002), and entry mode strategies (Xu & Shenkar, 2002; Yiu & Makino, 2002). Host countries with weaker institutions are expected to receive less foreign investments due to higher policy risks (Henisz, 2000b; Henisz & Zelner, 2004; Kobrin, 1976). Host country policy risk is defined as the proclivity for a host government to opportunistically alter the laws, regulations, or contracts governing an investment or fail to enforce them in a way that adversely affects the final returns on a foreign investor's assets (Holburn & Zelner, 2010). Despite the growing body of research on host country hazards (Berry, 2014; Henisz & Zelner, 2004) and how firms can manage unfavorable policy environments (Holburn & Zelner, 2010; Oh & Oetzel, 2017), researchers so far have primarily focused on the effects of host country policy risk on profit-seeking firms.

However, firms may invest for reasons other than "classic" profit-driven motives (Cheng & Kwan, 2000; Hennart & Park, 1994; Luo, 2001). It remains unclear whether the institutional context has a similar impact on firms that also seek nonpecuniary outcomes (Höchstädter & Scheck, 2015; Lee et al., 2020). For example, a survey by Renneboog et al. (2008) found that impact investors—which make financial investments with the additional motive of creating a beneficial and measurable *social impact* (Hehenberger et al., 2019; Lee et al., 2020) —are likely to knowingly forego expected financial returns due to social or moral considerations.

Building on the institutional work literature (Lawrence et al., 2013; Lawrence & Suddaby, 2006; Yan et al., 2018), we compare and contrast profit-seeking firms' and impact investing firms' foreign investment behavior to better understand the effects of host countries' policy risks on different types of investors. We hypothesize that impact investing firms are less likely to be deterred by host country policy risks when investing abroad because their investment decisions are driven by nonpecuniary motives (Barber et al., 2020; Lee et al., 2020). Previous studies have examined the willingness to accept trade-offs between financial and social outcomes (Barber et al., 2020) as well as the outcome efficiency of impact investing firms (Lee et al., 2020). However, how countries' policy risks affect impact investing firms' willingness to invest and whether such investments have an impact remains unexplored. This is surprising since

impact investors explicitly claim that they "invest where others will not" (i.e., areas with greater policy risk) (Norfund, 2020). Notably, impact investing firms represent essential sources of foreign investment (Carter et al., 2021; EDFI, 2020). Each year, development finance institutions (DFIs)—which are the specific type of impact investors that we focus on in this study—invest over 90 billion dollars to support under-financed countries and projects worldwide (Carter et al., 2021; Runde & Milner, 2019). Through their investments, impact investors aim to build, improve, or disrupt prevailing institutional structures that are limiting the economic and social development of host countries with weak institutions (Carter et al., 2021; EDFI, 2020; Runde, 2014; Te Velde, 2011).

We test our hypotheses on a sample of European impact investing firms in Africa, using a unique dataset from 2000 to 2015. Contrary to their profit-seeking counterparts, we found evidence of the investment deterrence effect of policy risk being lower for impact investing firms. We also found evidence of strengthened institutions in the countries targeted by impact investing firms.

Our study makes three contributions to the literature: First, we contribute to the literature on institutional work by identifying an underexplored actor that is advancing the improvement of institutions in high-risk countries (Lawrence et al., 2013; Lawrence & Suddaby, 2006). Second, we advance the literature by introducing a new type of institutional work—catalytic institutional work—that impact investors employ to influence institutions in high-risk host countries. In contrast to direct advocacy and other identified forms of institutional work (Lawrence & Suddaby, 2006), impact investors act as catalysts to attract other investors that jointly contribute to institutional development in countries with weaker institutions. Finally, by comparing profit-seeking and impact investing firms, our study also adds to the literature on host policy risk by advancing the understanding of how policy risk in host countries' institutional environments affects different market actors (Cuervo-Cazurra & Genc, 2008; Delios & Henisz, 2003).

5.2 Theory

Host country institutional contexts and policy risks

The decision of where to allocate international investments is one of the most critical strategic choices that firms make (Jindra et al., 2016; Nielsen et al., 2017). Earlier studies have shown that an important determinant of the countries where firms make their investments is the quality of host country institutions (Cuervo-Cazurra & Genc, 2008; Gao et al., 2017; Lu et al., 2014; Meyer et al., 2009). Notably, institutions—understood as controls on the behaviors of individuals and firms—determine the local policies and frameworks (or the lack thereof) of an

economy (Scott et al., 1994). Moreover, institutions can be informal (i.e., norms, customs, and values) or formal (i.e., laws, regulations, and policies). In this paper, we focus on the formal dimension of institutions (e.g., government policies enacted to control firms' conduct) since formal policies define which economic activities are permissible and profitable in a host country (North, 1991). Research on foreign investment has particularly emphasized the importance of the stability, predictability, and transparency of formal institutions to protect investments (Cuervo-Cazurra et al., 2019; Meyer et al., 2009). It is argued that countries with weaker institutions are associated with heightened political rent-seeking by policymakers, which increases host country policy risk (Holburn & Zelner, 2010) and thereby affect firms' likelihood to invest (Blake & Moschieri, 2017; Jandhyala & Weiner, 2014). Thus, countries that pose greater policy risks are less likely to receive cross-border investments. However, the literature on host country policy risks is primarily based on studies of profit-seeking firms (Henisz & Delios, 2001; Holburn & Zelner, 2010; Kobrin, 1976, 1978). We argue that other important market actors invest in host countries with weaker institutions, with the specific aim of contributing to the strengthening of those institutions.

Institutional work theory

The early scholarship on institutional theory placed a strong emphasis on the constraining nature of institutions on the actions and behaviors of firms (DiMaggio & Powell, 1983; Meyer & Rowan, 1977; Scott, 1987, 2001; Selznick, 1949). However, recent scholarship on institutional theory (Lawrence et al., 2013; Lawrence et al., 2009) has focused on understanding how multiple types of agents can take purposeful actions to change, develop, and even create institutions. This process is referred to as "institutional work" (Lawrence & Suddaby, 2006). Institutional work theory draws on earlier works on agency in organization studies (Dimaggio, 1988; DiMaggio & Powell, 1983; Meyer & Rowan, 1977). However, it explicitly emphasizes the role of actors (collective and individuals) as agents that engage in activities to maintain, disrupt, or create institutions (Granqvist & Gustafsson, 2016; Zietsma & Lawrence, 2010). It argues that actors are not only shaped by institutions but can also reproduce or create institutions in the form of policies and standards (Slager et al., 2012). Thus, while institutions may set controls on firms' behavior and even affect their location strategies, firms can also challenge, affect, and even create or destroy the institutions of a host country (Lawrence et al., 2011; Lawrence & Suddaby, 2006).

The creation of new institutions involves extensive interactions between the engaging firm and its stakeholders (Lawrence & Phillips, 2019). This occurs through a process of consensus

among multiple stakeholders regarding a set of rules and norms governing market participants' actions (Garud et al., 2002). Firms engaging in institutional work argue that prevailing rules and norms are problematic and that new rules and norms will resolve existing problems (Greenwood et al., 2002; Suddaby & Greenwood, 2005). Thus, firms that engage in institutional work envision their actions as a means of advancing interests that are suppressed by prevailing institutions (Dimaggio, 1988; Waldron et al., 2015). Institutional work has been examined both at the individual and firm-level with the underlying assumption that firms promote their own self-interests (Alvarez et al., 2015; Lawrence et al., 2011; Lawrence & Dover, 2015; Lawrence et al., 2013). As a result, firms that seek to contribute to broader economic and social development, such as impact investing firms, have received scant attention. This is unfortunate because the purposive actions and practices of impact investing firms involve the deliberate pursuit of modifying or creating institutions through their investments (Demsetz, 1968; Lawrence & Suddaby, 2006). Notably, anecdotal evidence suggests that impact investing firms have been crucial for creating and maintaining institutions in developing countries. For instance, when Barclays Bank Plc decided to exit Africa[13] in 2017 after decades of operation, they left a massive vacuum in the continent's financial sector (Arnold & Jenkins, 2016). Four European impact investors[14] established *Arise Invest*, a South African-based purposeful bank investment company, to fill this gap and invest and stimulate growth across financial services within the African continent (Arise, 2021; O'Neill, 2017). This example illustrates how impact investment firms commit resources to sustain and improve the institutions of countries, which is exemplified in the present study by financial intermediaries.

5.3 Hypotheses

Host country policy risks and international investment location choice

Extant research suggests that firms pay substantial attention to host country characteristics (Dunning, 1998; Holburn & Zelner, 2010; Hoskisson et al., 2000; Nielsen et al., 2017). Accordingly, a country's institutional quality, or lack thereof, will influence firms' likelihood to invest (Delios & Henisz, 2000; Meyer et al., 2009). Host country institutions affect the predictability of firms' external context and can result in increased political hazards for foreign

[13] According to Chief Executive Jes Staley, the reason for exiting Africa is increasing policy risk: "As the situation worsened and African currencies became weaker, the argument to stay on the continent became less compelling." Source: https://www.bbc.com/news/business-35695601.
[14] The impact investors were four european development financial institutions: Norfund, NorFinance, Rabobank, and FMO.

firms (Henisz & Delios, 2004). Weak host country institutions threaten firms' ability to pursue innovation and subsidiary-level investments because the inadequate enforcement of laws creates uncertainty regarding the costs of doing business (Mudambi et al., 2013). Since one of the key challenges faced by firms when investing in foreign countries is the management of policy risks (Cuervo-Cazurra & Genc, 2008; Henisz, 2000b; Holburn & Zelner, 2010), firms are cautious with regard to where they locate their investments. We extend this line of work by positing that firms (both profit-seeking firms and impact investing firms) fear host country discrimination, sabotage, and expropriation. As such, they are less likely to invest in countries that pose greater policy-related risks to their investments, *ceteris paribus*. In this context, we put forth the following baseline hypothesis:

Hypothesis 1: *Greater host country policy risk discourages foreign investment.*

Host country policy risks and impact investing

Hypothesis 1 suggests that host country policy risks similarly affect all firms. However, we expect that impact investing firms' attitudes to host country policy risks may differ from those of purely profit-seeking firms due to the nonpecuniary motives of impact investing firms (Barber et al., 2020; Lee et al., 2020; Louche et al., 2012). Unlike purely profit-seeking firms, it has been claimed that impact investing firms optimize social outcomes before financial outcomes when investing (Hehenberger et al., 2019; Lee et al., 2020). Moreover, many impact investing firms are purposefully established to help develop sustainable businesses and industries in developing countries (Carter et al., 2021) and explicitly state their ambition to contribute to developing and maintaining host country institutions (Norfund, 2020). Impact investing firms use their investments as a form of institutional work (Lawrence, Suddaby, & Leca, 2011) by engaging in deliberate and purposeful practices to change the institutional environments where other investors lack confidence. Through their investments, impact investing firms stimulate more investments in the host countries (Carter et al., 2021; Runde, 2014; Te Velde, 2011) and help safeguard their investment environments (Agrawal & Hockerts, 2019; Yan et al., 2021). We posit that because of impact investing firms' broad investment mandates to maximize financial and social outcomes (Carter et al., 2021; EDFI, 2020; Lee et al., 2020), they are less likely to be deterred by greater host country policy risk when investing abroad. Formally, we hypothesize that:

Hypothesis 2: *In contrast to profit-seeking firms, the investment deterrent effect of host country policy risk is weaker for firms with nonpecuniary motives.*

Impact investing and institutional impact

Hypothesis 2 assumes that impact investing firms are less affected by host country policy risk due to their motives being aimed at influencing host country institutions. Therefore, we should expect to see the positive development of institutions in the host countries of impact investors. In recent years, impact investing firms' contributions toward societal and environmental sustainability have increased in importance (Lounsbury, 2001; Lounsbury et al., 2003; Sine & Lee, 2009). This is particularly evident in developing countries where governments are in dire need of more foreign capital to augment domestic savings (Carter et al., 2021; Ramamurti, 2004). This is unsurprising given that most developing countries lag behind developed countries in achieving the United Nations (UN) Sustainable Development Goals (SDGs) (Begashaw, 2019). In Africa, which serves as the context for the present study, a recent report by the UN revealed that most African countries had made little or no progress in creating the relevant infrastructure for achieving the SDGs (Begashaw, 2020). This is because these countries lack the capital, capabilities, and necessary infrastructure to achieve the SDGs. Thus, impact investing firms focus specifically on the SDGs and seek to positively affect sustainability outcomes in the countries they invest in (Carter et al., 2021; Scholtens & Sievänen, 2013). Following institutional work theory (Lawrence & Suddaby, 2006), and given that achieving the SDGs has become ubiquitous with addressing global "grand challenges" (Berry et al., 2021), we expect that when impact investing firms invest in countries where domestic resources are scarce but the need for sustainable economic and social growth are high, these firms take purposeful actions to support the creation of infrastructure aimed at realizing such needs. Formally, we hypothesize that:

Hypothesis 3: *Host countries prioritized by impact investing firms for investments are more likely to experience improved sustainable development outcomes.*

5.4 Method

Empirical setting and sample

To test our hypotheses, we focused on a subset of impact investors (i.e., DFIs) (Agrawal & Hockerts, 2019; Carter et al., 2021; Saltuk et al., 2013). DFIs invest in private sector projects in low and middle-income countries to promote job creation and sustainable economic growth (EDFI, 2020). They do this to serve as catalysts for attracting and mobilizing more foreign capital and other sources of private capital into the destination countries. As foreign investors,

DFIs' investment decisions are based on stringent criteria to safeguard financial sustainability, transparency, and environmental and social accountability (EDFI, 2020; Norfund, 2020). Specifically, in this paper, we focus on members of the Association of European Development Finance Institutions (EDFI). EFDI was founded in 1992. Its members consist of firms established in the European Union member states or member states of the European Free Trade Association that invest (or plan to invest) outside of the European Union (EDFI, 2020). Each year, DFIs annually invest over $90 billion in over 5000 projects across developing countries (Carter et al., 2021; EDFI, 2020). Thus, to promote job creation and sustainable economic growth, EDFIs invest in some of the world's most challenging sectors and countries where the private sector is weak and jobs are scarce (EDFI, 2020), which makes the EDFI a suitable example for testing our hypotheses.

In particular, we focus on the EDFI's investments in Africa. We do so for two reasons. First, Africa is beginning to capture the attention of entrepreneurs, corporate executives, and scholars as an emerging market for new growth opportunities (George et al., 2016; Mol et al., 2017). Over the past two decades, cutbacks in aid offered by advanced countries to African countries, combined with the liberalization of investment policies by emerging economies such as China, have led to considerable growth in foreign investments in Africa through unilateral actions and bilateral negotiations. Today, African countries represent a substantial portion of global foreign direct investment inflow (UNCTAD, 2018). Due to the rapid expansion of information and communication networks (specifically mobile technology), the number of foreign firms expected to invest in Africa should increase in the coming years (George et al., 2016; Mol et al., 2017). For example, McKinsey (2010) estimates that by 2025, over half of all people in Africa will have internet access, which will provide further opportunities for investments in health care, education, finance, retail, and government. As the world's second-largest continent—covering an area the size of China, India, the United States, and most of Europe combined and containing over 30% of the world's minerals, with the largest reserves of precious metals—the global economy is expected to look to Africa for resources to sustain its development in the near future (George et al., 2016). Second, Africa represents a challenging continent for most foreign investors. For example, market-related transactions are less efficient and riskier in African countries than in most developed nations (Mol et al., 2017; Wang et al., 2012). As a continent with vast ethnic and linguistic variations, African countries differ significantly with respect to their business regulations, government restrictions, and incentives for foreign investment. Since host governments' policies often serve as the basis

for foreign investment planning (Henisz, 2000b), variations in institutions are among the greatest challenges for firms in Africa. Additionally, African countries persistently lag behind their developed counterparts in achieving the SDGs due to a lack of capital, capabilities, and necessary infrastructure (Begashaw, 2019), which makes Africa the ideal context for our study.

Data sources

To generate the sample for this study, we collected rich data on foreign investment in Africa from the LexisNexis Corporate Affiliations database. This database contains information on all major companies worldwide. After an initial examination of the data, we found that this database provided limited or no information about certain impact investing firms and their investments. Therefore, we complemented this data with a hand-constructed database of investments by impact investing firms from 2000 to 2015. Specifically, we collected information on impact investing firms' investments in Africa from annual reports and company websites. We had two goals in mind when collecting data on the impact of investing firms. First, we assessed whether EDFI members reported their investment data publicly. Second, we determined whether the member had its investment focus in Africa. These goals led to the collection and analysis of data for seven DFIs from 2000 to 2015. The studied DFIs include the following: (1) The Norwegian Investment Fund for Developing Countries (Norfund); (2) The Swedish Development Finance Institution (Swedfund); (3) The Finnish Fund for Industrial Cooperation (Finnfund); (4) The Danish Investment Fund for Developing Countries (IFU); (5) the Commonwealth Development Corporation (CDC) of the United Kingdom; (6) the: Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden (FMO) of the Netherlands; (7) *Société de Promotion et de Participation pour la Coopération Economique* (Proparco) of France. Therefore, our sampled FDI exporting countries included Norway, Sweden, Denmark, Finland, the United Kingdom, the Netherlands, and France. For both DFIs and profit-seeking firms, we collected all relevant investment data, including the destination country, investment amount, number of employees, sales, and investment type. There was a total of **10,751** cross-border investments into Africa undertaken by firms in this dataset.

Dependent variables

Our dependent variable for Hypotheses 1 and 2 is firm equity investments in a host country. We operationalized this dependent variable, *investment*, as a count variable measuring the number of investments that a particular country receives from different companies over a specific time. Although one may argue that a count variable may be an imperfect indicator for representing the actual value of investments in foreign countries, foreign investment—as a count variable—is widely used as the main dependent variable in the strategy and IB literature (Almeida & Phene, 2004; Arregle et al., 2009; Oh & Oetzel, 2011, 2017). For our dependent variable for Hypothesis 3, *renewable energy infrastructure*, we used the total renewable electricity generation (in 1000 GWh) in a specific country per year (Becker & Fischer, 2013; Zhao et al., 2013). Renewable electricity generation capacity reflects the institutionalization of energy infrastructure in developing countries (Holburn, 2012). Access to electricity contributes to social and economic development since it supports individual households while also being necessary for key institutions such as hospitals and schools. Recent research has pointed to the provision of energy services as vital for social and economic growth in sub-Saharan Africa, a region currently overrepresented by countries with electricity deficits, with hundreds of millions of people lacking access (Brew-Hammond, 2010). Hence, we use changes in electricity capacity as a proxy for institutional changes since improving utility infrastructure—including renewable energy capacity—requires financial, legal, educational, and other types of institutional changes (Holburn, 2012; Holburn & Spiller, 2002; Levy & Spiller, 1994).

Independent variable

To test Hypotheses 1 and 2, we constructed the independent variable *country policy risk* based on the political constraint index (POLCON) (Henisz, 2000b). The POLCON index has been consistently used in the strategy and international business literature to measure host country policy risk (Blake & Moschieri, 2017; Choi et al., 2015; García-Canal & Guillén, 2008; Holburn & Zelner, 2010; Macher & Mayo, 2015). POLCON builds on structural modeling combining host country institutional and political analysis. It is derived using spatial modeling techniques from positive political theory and based on a scale of 0 to 1, where 0 reflects the absence of effective veto players in a host country's political system and the complete concentration of policymaking authority (Henisz, 2000a). Each additional host country institutional veto player (i.e., a government branch that is both constitutionally effective and controlled by a different party from the other branches) has a positive but diminishing effect on the POLCON value.

Thus, POLCON reflects the extent to which formal relationships among a country's branches of government (i.e., legislative, executive, and judicial) and the partisan composition of the individual actors inhabiting these branches constrain any one institutional actor from singlehandedly affecting a (negative) change in policy within the host country (Henisz, 2000a). In our specification—which is consistent with previous studies (Delios & Henisz, 2003; García-Canal & Guillén, 2008; Holburn & Zelner, 2010), —the policy risk for a given host country γ in time $_t$ is defined as $host\ country\ risk_{\gamma t} = 1 - \mathrm{POLCON}_{\gamma t}$.

Every year, DFIs prioritize which countries they wish to invest in, with some countries being given higher priority than others. For instance, in its strategy for 2019 to 2022, Norfund selected 29 core countries where capital is scarce, and international investments will have high impact potential[15] (Norfund, 2019). To test Hypothesis 3, which examines the effect of impact investing firms' investments on institutionalization (e.g., renewable energy capacity) in host countries, we constructed a binary variable that equals 1 if a host country has explicitly been selected as a priority country by a DFI, and 0 otherwise.

Control variables

We included several variables at the firm, country, and dyad levels to capture the relationships between home and host countries in our model. The control variables used in this study are also among the most consistent determinants for investments by firms in new markets (see Chakrabarti (2001) or Blonigen (2005) for a review). First, following prior literature on foreign investments (Blake & Moschieri, 2017; Zhong et al., 2019), we controlled for firm-specific variations that affect the willingness to invest abroad. Specifically, we accounted for firm size based on *total assets (in US dollars, logged)* and *the number of employees (logged).*

Second, we controlled for host country-specific dimensions that may affect a country's attractiveness as an investment destination. Moreover, we controlled for host country market size (*market size (host)*) using the natural logarithm of the host country's population (Chakrabarti, 2001) and per-capita gross domestic product (GDP per capita). We chose to include per-capita GDP instead of absolute GDP because, as Root and Ahmed (1979) noted, absolute GDP is a relatively poor indicator of firms' willingness to invest in a host country. This is particularly true for developing countries, which represent the context of this study. Inflation,

[15] All of the DFIs in our sample had an explicit list of priority countries for the years under study, with the exception of the FMO from the Netherlands. For more information, see https://www.fmo-im.nl/en/emerging-markets.

and especially erratic inflation, affects host country relative prices, thus making it riskier for firms to undertake long-term investments in such countries. Therefore, we also controlled for the inflation level in each host country by including the inflation rate as a proxy for macroeconomic stability. We also included the natural resource intensity (*host natural resource intensity*) of the host countries to control for the fact that, *ceteris paribus,* large natural resource endowments are a major attraction for foreign investors (Ramasamy et al., 2012). For each country, we adopted a measure equal to the sum of natural resource endowment as a percentage of GDP, as reported by the World Bank (2019). Previous studies have shown that improvement (deterioration) in a country's market-supporting institutions' affects firms' willingness to invest in that country (Meyer et al., 2009). Following these studies, we controlled for annual changes (i.e., improvement or deterioration) in the corporate governance of each country's foreign investments based on the developed by the World Bank governance indicators (WGI) (Kraay et al., 2010). These governance indicators are based on findings from a number of surveys on perceptions of good governance in each host country and cover six areas: regulatory quality, rule of law, control of corruption, government effectiveness, voice and accountability, and political stability and lack of violence. Our theoretical considerations suggest that our concept of institutions focuses on indicators that most closely reflect market efficiency (Cuervo-Cazurra et al., 2019). Therefore, we focused on changes in *regulatory quality*, *rule of law,* and *control of corruption*. Third, to account for home country economic conditions, we controlled for home country market size (*market size*) and *GDP per capita*.

Finally, to capture some of the unmeasured factors relevant to firm foreign investment, we included firm-host country dyadic effects. Dyadic effects allowed us to control for factors that may be important but specific to each firm-host country dyad, which we may have been unable to measure using the variables included in our model (Blake & Moschieri, 2017). Specifically, we include dyadic cultural ties *(colonial ties)* and the *geographic distance* between home and host countries using data from the Distances database published by the *Centre des Etudes Prospectives et d'Informations Internationales*. We operationalized colonial ties as a dyad and assigned a value of 1 if a colonial relationship existed between the home and host country and 0 otherwise. Geographic distance was operationalized as the natural logarithm of the number of kilometers between the home and host countries' capital cities (Clark et al., 2017). The variables used in the analysis and their sources are presented in **Table 5.1**.

Table 5.1 *Variable measurements and sources*

Variables	Measurements	Sources
Dependent variable		
Investment	Number of foreign investments made in a given country	LexisNexis Corporate Affiliations Impact investing firms' internal investment data
Renewable energy	Total renewable electricity capacity and generation (in 1000 GWh)	The International Renewable Energy Agency (IRENA)
Independent variable		
Host country risk	1 minus host country POLCON score (1 - POLCON) (Holburn & Zelner, 2010)	Henisz (2000a)
DFI priority country	Dummy variable equal to 1 if the country is a priority country in a given year, 0 otherwise	Impact investing firms' internal investment data
Treaties (dyad)	Dummy variable equal to 1 if the country has an investment treaty, and 0 otherwise (Albino-Pimentel et al., 2018)	UNCTAD
Control variables		
Total assets	Natural logarithm of total assets	LexisNexis Corporate Affiliations Impact investing firms' internal investment data
Number of employees	Total count of employees	LexisNexis Corporate Affiliations Impact investing firms' internal investment data
Experience	Total number of years that firms have been in operation	LexisNexis Corporate Affiliations Impact investing firms' internal investment data
Market size (host)	Natural logarithm of host country population	World Bank
GDP per capita (host)	Natural logarithm of host country GDP per capita	World Bank
Host inflation (host)	Inverse hyperbolic sine of inflation	World Bank
Host natural resources	Natural logarithm of host country natural resources	World Bank
Market Size (home)	Natural logarithm of home country population	World Bank
GDP per capita (home)	Natural logarithm of home country GDP per capita	World Bank
Host conflicts	Natural logarithm of the number of violent conflicts in a host country	PRIO/UCDP Armed Conflict database 20.1
Colonial ties (dyad)	Dyadic colonial relationship indicating past colonial ties between home and host countries	Centre des Etudes Prospectives et d'Informations Internationales

Geographic distance	Natural logarithm of the geographic distance between home and host countries	Centre des Etudes Prospectives et d'Informations Internationales
▲ Control of corruption	Annual % change in the control of corruption calculated using the WGI aggregation methodology detailed in Kraay, Kaufmann & Mastruzzi (2010)	World Bank WGI Indicators
▲ Rule of law	Annual % changes in the rule of law calculated using the WGI aggregation methodology detailed in Kraay, Kaufmann & Mastruzzi (2010)	World Bank WGI Indicators
▲ Regulatory quality	Annual % change in regulatory quality calculated using the WGI aggregation methodology detailed in Kraay, Kaufmann & Mastruzzi (2010)	World Bank WGI Indicators

Estimation technique

In testing hypotheses 1 and 2, since our unit of analysis was investments in specific host countries over a specific time and our outcome of interest was a count variable, the homoscedastic and normally distributed error term assumptions for linear regression were violated (Montgomery et al., 2012). Moreover, we followed prior research (Anderson & Sutherland, 2015; Arregle et al., 2016; Cuervo-Cazurra et al., 2017) and employed a Poisson model (pseudo-maximum likelihood with robust standard errors) (Blundell et al., 1995; Hausman et al., 1984). Thus, our empirical model can be represented as:

$$investment_{ijt} = \alpha_0 + \alpha_1\ country\ policy\ risk_{jt-1} + \beta\ firm_{it-1} + \delta\ host\ country_{jt-1} + \delta\ home\ country_{jt-1} + \omega\ dyad_{ijt} + \varepsilon_{ijt.}$$

where *investment* is the number of firms' equity investments in a given country, *host country risk* is computed as 1-POLCON (Holburn & Zelner, 2010), *firm* is a vector of firm control variables, *home country* is a vector of foreign country control variables, *host country* is a vector of foreign country control variables, the dyad is a vector of firm country variables, and ε_{ijt} denotes the error term. Subscripts *i*, *j*, and *t* represent firm, country, and year, respectively. In addition to the Poisson model, we log-transformed our dependent variable, *investments*, and estimated the ordinary least squares (OLS) regressions (Lin & Wooldridge, 2019). To test Hypothesis 3, we focused on one host country characteristic: institutionalization (Holburn, 2012; Holburn & Spiller, 2002). We aimed to demonstrate the difference in institutionalization (i.e., improvement in renewable energy capacity) between the countries prioritized by impact investors and non-prioritized countries. We estimated OLS regression models for *DFI*

investments on countries' renewable energy capacities. To reduce endogeneity concerns, all explanatory variables were lagged one year.

5.5 Results

Tables 2 and **3** report the descriptive statistics and correlation coefficients between our main variables. After carefully examining the explanatory variables for multicollinearity, we found that multicollinearity was not a concern in our data (highest variance inflation factor (VIF) = 5.06, associated with the DFI's home country GDP per capita (*GDP per capita (home)*), while mean VIF = 3.11) below the commonly used cut-off of 10 (Marcoulides & Raykov, 2019; Rogerson, 2001). Notably, all VIF values were below 6 (Chatterjee & Simonoff, 2013).

Table 5.2 *Descriptive statistics*

	Variables	N	Mean	SD	Min	Max
1	Investment (count)	10,751	110.5	144.0	1	549
2	Investment (ln)	10,751	3.755	1.504	0	6.308
3	DFI investments	6,748	9.665	9.481	1	41
4	DFI priority country	10,751	0.354	0.478	0	1
5	Host country risk	2,887	0.719	0.165	0.321	1
6	Treaties (dyad)	10,751	0.757	0.429	0	1
7	Market size (host)	10,750	17.12	1.107	11.30	19.01
8	GDP per capita (host)	10,740	7.619	1.038	4.718	9.986
9	Host inflation (host)	9,186	1.625	0.856	-3.305	4.587
10	Host natural resources	10,740	1.781	1.236	-6.746	4.231
11	Market size (home)	10,750	17.21	1.003	15.32	18.01
12	GDP per capita (home)	10,750	10.65	0.305	10.02	11.54
13	Total assets	8,148	13.11	1.986	4.167	16.06
14	Number of employees	9,967	5.118	0.649	1.099	6.620
15	Colonial ties (dyad)	10,751	0.498	0.500	0	1
16	Geographic distance	10,670	8.748	0.518	7.201	9.258
17	Host conflicts	4,336	49.35	100.8	1	552
18	▲ Regulatory quality	8,865	-0.306	4.285	-70.57	33.85
19	▲ Rule of law	8,870	0.128	34.17	-76.96	2,257
20	▲ Control of corruption	8,865	-0.466	3.076	-30.28	167.6

Table 5.3 *Correlation matrix*

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
1) Investment (count)	1																			
2) Investment (ln)	0.927	1																		
3) DFI investments	0.632	0.583	1																	
4) DFI priority country	-0.117	-0.118	0.177	1																
5) Host country risk	-0.159	-0.211	-0.069	-0.093	1															
6) Treaties (dyad)	0.081	0.104	-0.047	-0.134	0.078	1														
7) Market size (host)	0.002	-0.003	-0.005	0.057	-0.099	-0.033	1													
8) GDP per capita (host)	0.114	0.086	0.114	-0.118	0.067	0.122	0.125	1												
9) Host inflation (host)	-0.065	-0.070	0.013	0.031	-0.045	-0.102	0.247	-0.137	1											
10) Host natural resources	-0.123	-0.120	-0.011	-0.011	0.021	-0.063	0.164	-0.132	0.194	1										
11) Market size (home)	0.011	-0.012	0.063	0.014	0.036	0.564	-0.066	0.124	-0.097	-0.029	1									
12) GDP per capita (home)	0.074	0.032	0.239	-0.191	-0.076	-0.366	0.046	0.156	0.155	0.124	-0.441	1								
13) Total assets	0.144	0.066	0.445	0.003	0.365	-0.037	0.015	0.057	0.078	0.068	0.020	0.097	1							
14) Number of employees	0.024	0.018	0.311	0.188	-0.190	-0.013	-0.037	0.067	0.007	0.015	0.017	0.296	-0.004	1						
15) Colonial ties (dyad)	-0.116	-0.127	0.007	0.152	-0.065	0.292	0.096	0.133	0.116	-0.032	0.612	-0.214	-0.070	0.076	1					
16) Geographic distance	-0.169	-0.189	0.295	0.501	-0.258	-0.251	0.065	-0.114	0.146	0.023	-0.099	0.073	0.273	0.427	0.134	1				
17) Host conflicts	0.246	0.122	0.310	0.165	-0.331	-0.084	0.069	-0.048	0.116	0.012	-0.040	0.136	0.072	-0.009	0.002	0.349	1			
18) ▲ Regulatory quality	0.438	0.359	0.597	0.341	-0.100	-0.033	-0.022	0.021	-0.033	-0.090	0.034	0.078	0.288	0.566	0.051	0.427	0.204	1		
19) ▲ Rule of law	0.004	-0.075	0.305	0.192	-0.338	-0.306	0.058	-0.056	0.084	-0.020	-0.024	0.082	0.046	0.052	0.113	0.562	0.541	0.205	1	
20)▲ Control of corruption	-0.124	-0.230	-0.008	0.148	0.185	-0.270	0.041	0.044	0.053	0.023	0.039	0.041	0.159	-0.185	0.040	0.085	0.105	-0.022	0.483	1

Table 5.4 Poisson estimation of investments (firm-year dyadic effects)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
	Poisson						OLS			Poisson				
Dependent variables	Investment						Investment (ln)			Investment				
Host country risk	-1.345	-0.416	-1.503	**-0.643**	**-0.499**	**-0.632**	-1.467	**-0.984**	**-1.229**	-1.010	-0.430	-0.648	-5.018	-1.769
	(0.022)	(0.049)	(0.025)	**(0.040)**	**(0.069)**	**(0.053)**	(0.101)	**(0.258)**	**(0.122)**	(0.024)	(0.069)	(0.053)	(0.181)	(0.143)
	[0.000]	[0.000]	[0.000]	**[0.000]**	**[0.000]**	**[0.000]**	[0.000]	**[0.000]**	**[0.000]**	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Treaties (dyad)										**0.489**	**0.350**	**0.272**		
										(0.008)	**(0.024)**	**(0.021)**		
										[0.000]	**[0.000]**	**[0.000]**		
Treaties (dyad) * Host country risk													**5.546**	**1.226**
													(0.197)	**(0.145)**
													[0.000]	**[0.000]**
Observations	2,887	774	2,113	1,715	628	1,087	2,887	628	1,087	2,887	628	1,087	628	1,087
Firm-country-year dummies	No	No	No	Yes	Yes	Yes	No	No	No	Yes	Yes	Yes	Yes	Yes
Full controls	No	No	No	Yes	Yes	Yes	No	Yes	Yes	No	Yes	Yes	Yes	Yes
Chi2 / F-val	3947	74.21	3734	11339	4212	7782	209.7	13.71	32.33	20711	4425	7953	5354	8029
loglikelihood / Adj. R2	-28439	-8305	-19876	-9680	-3877	-5474	0.0674	0.221	0.288	-20057	-3771	-5388	-3306	-5351
Impact investors		Yes			Yes			Yes			Yes		Yes	
Profit-seeking firms			Yes			Yes			Yes			Yes		Yes

Robust standard errors in parentheses. P-values in brackets.

Table 5.4 presents the analyses for testing Hypotheses 1 and 2. Model 1 estimates a random-effects Poisson regression with our explanatory variable and no control variables. Models 2 and 3 estimate the same model as Model 1, but for only impact investing firms and profit-seeking firms, respectively. The results from Models 1, 2 and 3 suggest a significant negative effect of *host country risk* on *investment* (*all firms*: **β = -1.345, p<0.001**; *impact investing firms*: **β = -0.416, p<0.001**; *profit-seeking firms*: **β = -1.503, p<0.001**). Model 4 was similar to Model 1, except it had firm-, host country-, home country-, and dyad-level control variables. The results from Model 4 further confirm the significant effect of *host country risk* on *investment*, thereby supporting Hypothesis 1 (*all firms*: **β = -0.643, p<0.001**). The result indicating that host country policy risk is negatively related to subsidiary investment is in line with prior results suggesting that greater political hazards slow foreign investment (Delios & Henisz, 2003; Holburn & Zelner, 2010).

To test Hypothesis 2, we split the sample into two categories: profit-seeking firms and impact investing firms. By splitting the sample, we could compare impact investing firms' behaviors with those of profit-seeking firms while allowing all independent variables to vary across different firm groups (Clogg et al., 1995). Model 5 estimates the results for impact investing firms, while Model 6 represents profit-seeking firms. Moreover, Models 4, 5, and 6 include firm-country dyad effects. The results from Model 5 indicate that host country policy risk also has a negative effect on investments by impact investing firms; however, this effect is smaller than on profit-seeking firms (*impact investing firms:* **β= -0.499, p<0.001**; *profit-seeking firms*: **β= -0.632, p<0.001**). To provide additional robustness to these results, we also performed a t-test to compare the sample means of the two groups of firms. The t-test confirmed a significant difference between the two groups (t-value = **-22.7468, p = 0.0000**; two-sided t-test). Additionally, we measured the intra-group correlation coefficient (r) of host country policy risk and investments by impact investing firms versus profit-seeking firms (Ellis, 2010). The results showed that although host country policy risk has a significant negative effect on both impact investing firms and profit-seeking firms, these effects are significantly different (*profit-seeking firms*: **r = -0.3182**; *impact investing firms*: **r = -0.0766**). The effect size of host country policy risk on investment is more than four times greater for profit-seeking firms than for impact investing firms (Ellis, 2010). These results provide support for Hypothesis 2, which posits that the investment deterrent effect of host country policy risk on impact investing firms is weaker than for profit-seeking firms due to impact investing firms' nonpecuniary investment motives. Thus, impact investing firms from the United Kingdom, France, the Netherlands, Norway,

Sweden, Denmark, and Finland are more likely to invest in countries with higher policy risk levels than their profit-seeking counterparts.

To provide further nuance to the results from Models 3 and 4, we re-estimated these models as OLS regressions with the dependent variable's natural logarithm, *investment (ln)*. Notably, Models 7, 8, and 9 presented the same pattern as Models 1 to 6. When accounting for the log transformation of both dependent and independent variables, a 1% increase in policy risk decreases investments in the next year by **0.984%** for impact investing firms and **1.229%** for profit-seeking firms. Given that foreign investments are a critical source of private external finance for developing countries, this result is extremely important and intuitively appealing. To achieve SGDs, African countries require foreign investments to supplement domestic savings. However, firms are risk-averse (Delios & Henisz, 2003) and reduce foreign investments in response to increased policy risk. This is also true for impact investing firms that intentionally forego financial returns in exchange for social or moral considerations (Barber et al., 2020; Lee et al., 2020). We also included control variables in the present study. Most of the control variables were tested in accordance with the theoretical expectations of this study: larger countries receive more investment; richer countries receive more investments; past colonial ties have a positive effect on investments.

Furthermore, we graphically plotted the marginal effects in Models 8 and 9 (see **Figure 5.1**) since marginal effects in linear models are easier to understand. In **Figure 5.1**, the vertical axis shows the marginal effect of firms' investments in host countries, while the horizontal axis shows the level of host country policy risk. **Figure 5.1** underscores that host country policy risk abridges the willingness of firms to invest in particular countries. The confidence intervals show that firms (both profit-seeking firms and impact investing firms) are hesitant to invest in host countries with a greater policy risk, although the effect of policy risk is stronger on profit-seeking firms than on impact investing firms.

Figure 5.1 *Marginal effect of host country policy risk on investment*

Previous studies argue that to attract foreign capital, governments must demonstrate their willingness to abide by international norms of investment protection because investors are skeptical about the quality of domestic institutions (Albino-Pimentel et al., 2018; Jandhyala & Weiner, 2014). In response, many developing countries have invested time and other scarce resources to negotiate, conclude, sign, and ratify international investment protection agreements with FDI exporting countries alleviate prospective investors' concerns. Such supranational agreements generally contain provisions that allow aggrieved foreign investors to sue host states in international arbitration forums (Dolzer & Schreuer, 2012), with the arbitration awards enforceable under the universal Convention on the Recognition and Enforcement of Foreign Arbitral Awards. It is argued that this enforcement mechanism signals governments' preparedness to abide by international norms of investment protection, thereby making their countries attractive to foreign firms. In Models 10, 11, and 12, we followed similar research

methods (Albino-Pimentel et al., 2018; Blake & Moschieri, 2017; Jandhyala & Weiner, 2014) and included *treaties* to account for supranational investment protection agreements. The results depicted in Model 10 (**β = - 1.010, p < 0.001**), Model 11 (**β = -0.430, p < 0.001**), and Model 12 (**β = -0.648, p < 0.001**) provide additional support for Hypotheses 1 and 2. Additionally, these results confirm that the existence of supranational investment agreements between a firm's home and host countries positively and significantly affects the firm's likelihood of investing in that specific host country. In Models 13 and 14, we test the interaction effect of *treaties* and policy risk (*treaties (dyad) * host country risk*). Again, the results suggest that the interaction of *treaties* with *host country risk positively affects* investments by impact investing firms **(β = 5.546 p < 0.001**) and profit-seeking firms **(β = 1.226; p > 0.100**). We interpret this result as an indication that impact investing firms that aim to invest in private sector projects to promote job creation and sustainable economic growth may prefer countries that have (or have had some historical) economic relations with their home country.[16] Notably, the interaction effect did not affect the original results for Hypotheses 1 and 2.

Additional analyses

Furthermore, we conducted an additional analysis by estimating a series of alternative specifications (see **Table 5.5**). The literature on host country risk suggests that the effect of host country risk on investments is contingent upon firms' interpretations of this risk (Miller, 1992; Oetzel & Oh, 2014; Witte et al., 2016). Building on previous literature (Miller, 1992; Oetzel & Oh, 2014), we used an alternative measure for the main independent variable *host country risk* and recomputed our estimation from using 1-POLCON (Holburn & Zelner, 2010) to using host country armed violent conflict (*host conflicts*). We measured armed violent conflict using the indicator of civil conflict incidence from the PRIO/UCDP Armed Conflict Database 20.1

[16] With interaction terms included in the models, one cannot interpret the coefficients on the individual components in the conventional manner. Instead, the results for host country risk in Models 11 and 12 represent the effects of treaties on investments when host country risk is zero.

(Pettersson & Öberg, 2020). PRIO/UCDP gathers armed conflict data using information from a selection of publicly available sources, including journals, news agencies, nongovernmental organizations report, and government statements. Sadly, violent conflicts and wars are not rare occurrences in developing and emerging economies (Pettersson et al., 2019; Witte et al., 2016). Notably, 40% of the most conflict-affected countries in terms of fatalities were developing countries (Pettersson & Öberg, 2020), which made this factor appropriate for the present study. Thus, we substituted host country policy risk with the alternative measure of armed conflict (*host conflicts*). This alternative measure of host country risk was represented in Model 15 and confirmed the robustness of the results for our main hypothesis (**β = -0.250, p < 0.001**). In Model 16, we also accounted for the effect of *treaties using* the new specification. However, the effect of host country policy risk on investment was still significantly negative.

Table 5.5 *Robustness tests*

	(15)	(16)	(17)	(18)	(17)	(18)
	Poisson					
Dependent variables	Investment					
Host conflicts	**-0.250** **(0.001)** **[0.000]**					**-0.094** **(0.002)** **[0.000]**
Host country risk (1-POLCON)		**-0.222** **(0.051)** **[0.000]**	**-1.759** **(0.088)** **[0.000]**	**-0.983** **(0.396)** **[0.013]**	**-3.033** **(0.128)** **[0.000]**	
Treaties (dyad)		**1.744** **(0.070)** [0.000]	0.064 (0.026) [0.014]	1.186 (0.293) [0.000]	-1.489 (0.109) [0.000]	0.431 (0.011) [0.000]
Treaties (dyad) * Host conflicts				**0.765** **(0.395)** **[0.052]**	**2.418** **(0.166)** **[0.000]**	
Observations	4,336	1,013	484	1,013	484	2,413
Firm-country-year dummies	No	Yes	Yes	Yes	Yes	Yes
Full controls	No	Yes	Yes	Yes	Yes	Yes
Chi2	48972	7679	3242	7683	3468	123855
loglikelihood	-129984	-5206	-2476	-5204	-2363	-18987
Impact investors		Yes	Yes	Yes	Yes	
Cluster		EU	Nordic	EU	Nordic	

Robust standard errors in parentheses. P-values in brackets.

Table 5.6 *Poisson estimation of investments (firm-year dyadic fixed effects)*

	(19)	(20)	(21)
		OLS	
Dependent variables	Renewable Energy capacity in 1000 GWh		
# DFI investments	0.659	**0.718**	**2.183**
	(0.074)	**(0.074)**	**(0.103)**
	[0.000]	**[0.000]**	**[0.000]**
Priority Countries		19.260	**16.220**
		(1.568)	**(1.570)**
		[0.000]	**[0.000]**
Observations	6,602	6,602	4,712
Firm-Country-year dummies	Yes	Yes	Yes
Full controls	No	No	Yes
Chi2 / F-val	78.62	115.7	316.7
loglikelihood / Adj. R2	0.0116	0.0336	0.652

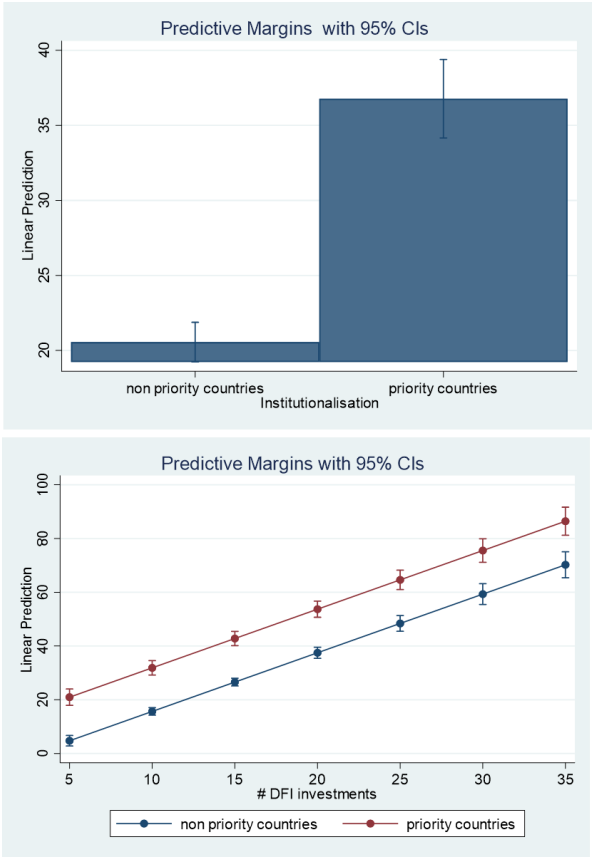
Robust standard errors in parentheses. P-values in brackets

In addition to the alternative measure of host country policy risk, we also paid specific attention to the fact that firms' national origin may impact where they invest (Hennart & Larimo, 1998; Meyer et al., 2009). Therefore, apart from controlling for home country market size and GDP, we also controlled for cultural differences between home countries via a cluster approach proposed by Ronen and Shenkar (1985) that has widely been used in the strategy literature (e.g., Meyer et al., 2009). We developed two firm-home country dyadic clusters based on the impact investing firms. Of the sampled impact investments, 31% were made by impact investing firms from Nordic countries (i.e., Norway, Sweden, Denmark, and Finland), while 69% were from the United Kingdom, Netherlands, and France combined. The results presented for Models 15 (*EU cluster*: **$\beta = -0.222, p < 0.005$**) and 3 (*Nordic cluster*: **$\beta = -1.759, p < 0.001$**) provide robustness support for Hypothesis 1. In **Models 18** and **19**, we introduced the interaction term *(treaties (dyad) * host conflicts)*. The results remained consistent, with host country policy risk negatively affecting impact investing firms' willingness to invest in a country.

To test Hypothesis 3, we split the sample into two categories: (1) profit-seeking firms and impact investing firms; (2) estimated OLS regression for *DFI investments* on countries'

institutionalization (**Table 5.6**). In Model 19, we tested the direct effect of FDI on renewable energy capacity (in 1000 GWh) without including firm, home country, or host country control variables. The results indicate that investments by impact investing firms (i.e., DFIs) do indeed have a positive effect on institutionalization (i.e., renewable energy generation capacity in host countries) (**β = 0.659, p < 0.001**). In Model 20, we included country prioritization (priority countries vs. non-priority countries) and found that the effect of *priority countries* was significant and positive (**β = 19.260, p < 0.001**). In Model 21, we included all of the firm-, country-, and dyad-level control variables used in Hypotheses 1 and 2. The results were consistent (**β = 2.183, p < 0.001**), suggesting that priority countries experience improved sustainable development outcomes from impact investing. **Figure 5.2** graphically depicts the marginal effects of Model 21. Notably, the positive effect of investments from impact investing was stronger in priority countries than in non-priority countries.

Figure 5.2 *Marginal effect of impact investments on institutionalization*



5.6 Discussion and conclusion

To date, host country policy risk research has focused on profit-seeking firms' abilities to manage risks (Albino-Pimentel et al., 2018; Bonardi et al., 2006; Doh et al., 2012; Dorobantu et al., 2017; Henisz & Zelner, 2003; Kobrin, 1979; Rajwani & Liedong, 2015) and how they avoid investing in countries with greater policy risk (Blake & Moschieri, 2017; Holburn & Vanden Bergh, 2004; Reuer et al., 2004). We extend such studies in the context of impact investing firms (Lee et al., 2020) by employing a novel dataset to examine whether host country policy risks stemming from poor institutional quality affect profit-seeking firms and impact-seeking investing firms differently.

In line with our hypotheses, our empirical analysis suggests that host country policy risk affects the likelihood of both investor groups to invest in a country; however, this effect was smaller for impact investing firms. We argue that this difference is based on impact investors´ engagement in institutional work. To support this claim, we provided empirical evidence of improved institutions in the host countries of impact investors.

Our study makes three important theoretical contributions. First, we extend the research on host country policy risks by examining whether host country policy risks affect profit-seeking firms and impact-seeking investing firms differently. Our study provides compelling evidence suggesting that countries' ability to demonstrate a credible commitment to safeguarding foreign investors' assets is of substantial interest to firms' international investment decisions. Even for social impact-seeking investing firms motivated by nonpecuniary purposes, host country policy predictability seems to be a key determinant of investment location. This is an important addition to the research on host country policy risk, which has traditionally paid scant attention to firms that simultaneously pursue financial and social goals. Moreover, this study has addressed the call for more research exploring how impact investing firms balance the tradeoff between the desire to recoup investments in their firm-specific assets and prosocial motives (Alon et al., 2020; McMullen & Bergman Jr, 2017).

Second, we identify important but underexplored institutional work actors: impact investors. Although host country policy risks negatively affect investment from both types of investors, impact investors are less deterred by host country policy risk than profit-seeking firms. We argue that these differences are due to impact investors´ engagement in institutional work. We empirically illustrate a positive relationship between institutionalization and impact investments that contribute to the development of critical host country institutions (Brew-Hammond, 2010). Although governments are responsible and accountable for improving their

institutional environment by credibly committing to the SDGs, impact investing firms may reduce institutional-related hazards through their investments. Institutional work is often described as being performed by insider experts who "skillfully manipulate their institutional environment" (Lawrence et al., 2013, p. 1029). The results of our study indicate that this traditional conceptualization of institutional work may underestimate the vital role of actors with nonpecuniary motives that contribute to improving institutions.

Third, we identify an additional form of institutional work: catalytic institutional work (Lawrence et al., 2013). This adds an important nuance to the institutional work literature by incorporating new forms of "work" that involve efforts to shape facets of institutions by actors that are not directly associated with the institutions (Lawrence et al., 2013). Impact investing firms often influence institutions indirectly through investments in critically important institutions. Our analysis shows that the catalytic effects of impact investing firms are recognizable in countries with high policy risks.

Despite its numerous contributions to the relevant literature, we recognize that our study also has certain limitations. For example, there is a potential sample selection bias associated with the selection of impact investing firms. First, our focus on DFIs, which are mainly state-owned (EDFI, 2020), may have their investment decisions affected by their owners' non-economic objectives (Goldeng et al., 2008). However, although home governments influence the investment decisions of DFIs, we believe that disentangling DFIs' priority countries from non-priority countries and controlling for formal relationships between the countries (i.e., colonial ties and formal economic agreements) allowed us to eliminate this potential bias empirically. Another potential limitation of our study is that our data and the estimation technique employed did not allow us to directly measure whether firms increased or decreased their investment levels due to policy risks. However, we believe that we have addressed this limitation econometrically by lagging all explanatory variables to ensure that the coefficient of investments and the other independent variables are truly independent of the previous value of investments.

Finally, we note the broader implications of our study for policymakers. Although we found statistically significant differences between the two types of firms, *both* impact-seeking investing firms and profit-seeking firms are negatively affected by policy risks. Thus, while impact investing firms empathize nonpecuniary motives, they remain—first and foremost—*investors* that are also affected by host country risks (Barber et al., 2020).). Impact investors are sophisticated investors that seek to achieve the most efficient investment outcomes with

multiple motives (Lee et al., 2020). Weak host country market-supporting institutions may increase impact investing firms' concerns (Duanmu, 2014; Kobrin, 1979), thereby slowing further investments or discouraging them entirely. The nonpecuniary motives of impact investing firms may thus serve as a double-edged sword by nudging impact investing firms to optimally allocate investments to achieve attractive financial returns by prioritizing investments in countries with manageable policy risks.

5.7 References

Agrawal, A., & Hockerts, K. (2019). Impact investing: review and research agenda. *Journal of Small Business & Entrepreneurship*, 1-29.

Albino-Pimentel, J., Dussauge, P., & Shaver, J. M. (2018). Firm non-market capabilities and the effect of supranational institutional safeguards on the location choice of international investments. *Strategic Management Journal*, *39*(10), 2770-2793.

Almeida, P., & Phene, A. (2004). Subsidiaries and knowledge creation: The influence of the MNC and host country on innovation. *Strategic Management Journal*, *25*(8-9), 847-864.

Alon, I., Mersland, R., Musteen, M., & Randøy, T. (2020). The research frontier on internationalization of social enterprises. *Journal of World Business*, *55*(5), 101091.

Alvarez, S. A., Young, S. L., & Woolley, J. L. (2015). Opportunities and institutions: A co-creation story of the king crab industry. *Journal of Business Venturing*, *30*(1), 95-112.

Anderson, J., & Sutherland, D. (2015). Developed economy investment promotion agencies and emerging market foreign direct investment: The case of Chinese FDI in Canada. *Journal of World Business*, *50*(4), 815-825.

Arise. (2021). *Investment Mandate*. https://ariseinvest.com/investment-mandate/

Arnold, M., & Jenkins, P. (2016). Barclays set to exit African business. *Financial Times*. https://www.ft.com/content/01d64502-dca4-11e5-827d-4dfbe0213e07

Arregle, J.-L., Beamish, P. W., & Hébert, L. (2009). The regional dimension of MNEs' foreign subsidiary localization. *Journal of International Business Studies*, *40*(1), 86-107.

Arregle, J.-L., Miller, T. L., Hitt, M. A., & Beamish, P. W. (2016). How does regional institutional complexity affect MNE internationalization? *Journal of International Business Studies*, *47*(6), 697-722.

Barber, B. M., Morse, A., & Yasuda, A. (2020). Impact Investing. *Journal of Financial Economics*.

Becker, B., & Fischer, D. (2013). Promoting renewable electricity generation in emerging economies. *Energy Policy*, *56*, 446-455.

Begashaw, B. (2019). *Africa and the Sustainable Development Goals: A long way to go*. Brookings

Begashaw, B. (2020). Strategies to deliver on the Sustainable Development Goals in Africa. *Caulibaly, B, Foresight Africa. Africa Growth Initiative at Brookings*.

Berry, H. (2014). Global integration and innovation: Multicountry knowledge generation within MNCs. *Strategic Management Journal*, *35*(6), 869-890.

Berry, H., Kaul, A., & Lee, N. (2021). FOLLOW THE SMOKE: THE POLLUTION HAVEN EFFECT ON GLOBAL SOURCING. *Strategic Management Journal*.

Blake, D. J., & Moschieri, C. (2017). Policy risk, strategic decisions and contagion effects: Firm-specific considerations. *Strategic Management Journal*, *38*(3), 732-750.

Blonigen, B. A. (2005). A review of the empirical literature on FDI determinants. *Atlantic Economic Journal*, *33*(4), 383-403.

Blundell, R., Griffith, R., & Reenen, J. V. (1995). Dynamic count data models of technological innovation. *The Economic Journal*, *105*(429), 333-344.

Bonardi, J.-P., Holburn, G. L., & Vanden Bergh, R. G. (2006). Nonmarket strategy performance: Evidence from US electric utilities. *Academy of Management Journal*, *49*(6), 1209-1228.

Bonardi, J. P. (2004). Global and political strategies in deregulated industries: The asymmetric behaviors of former monopolies. *Strategic Management Journal*, *25*(2), 101-120.

Brew-Hammond, A. (2010). Energy access in Africa: Challenges ahead. *Energy Policy*, *38*(5), 2291-2301.

Buckley, P. J., Clegg, L. J., Cross, A. R., Liu, X., Voss, H., & Zheng, P. (2007). The determinants of Chinese outward foreign direct investment. *Journal of International Business Studies*, *38*(4), 499-518.

Carter, P., Van de Sijpe, N., & Calel, R. (2021). The elusive quest for additionality. *World development*, *141*, 105393.

Chakrabarti, A. (2001). The determinants of foreign direct investments: Sensitivity analyses of cross-country regressions. *kyklos*, *54*(1), 89-114.

Chatterjee, S., & Simonoff, J. S. (2013). *Handbook of regression analysis* (Vol. 5). John Wiley & Sons

Cheng, L. K., & Kwan, Y. K. (2000). What are the determinants of the location of foreign direct investment? The Chinese experience. *Journal of International Economics*, *51*(2), 379-400.

Choi, S.-J., Jia, N., & Lu, J. (2015). The structure of political institutions and effectiveness of corporate political lobbying. *Organization science*, *26*(1), 158-179.

Clark, D. R., Li, D., & Shepherd, D. A. (2017). Country familiarity in the initial stage of foreign market selection. *Journal of International Business Studies*.

Clogg, C. C., Petkova, E., & Haritou, A. (1995). Statistical methods for comparing regression coefficients between models. *American Journal of Sociology*, *100*(5), 1261-1293.

Cuervo-Cazurra, A., Gaur, A., & Singh, D. (2019). Pro-market institutions and global strategy: The pendulum of pro-market reforms and reversals. *Journal of International Business Studies*, *50*(4), 598-632.

Cuervo-Cazurra, A., & Genc, M. (2008). Transforming disadvantages into advantages: developing-country MNEs in the least developed countries. *Journal of International Business Studies*, *39*(6), 957-979.

Cuervo-Cazurra, A., Mudambi, R., Pedersen, T., & Piscitello, L. (2017). Research Methodology in Global Strategy Research. *Global Strategy Journal*, *7*(3), 233-240.

Cuervo-Cazurra, A., Mudambi, R., & Pedersen, T. (2019). Clarifying the relationships between institutions and global strategy. *Global Strategy Journal*, *9*(2), 151-175.

Delios, A., & Henisz, W. I. (2000). Japanese firms' investment strategies in emerging economies. *Academy of Management Journal*, *43*(3), 305-323.

Delios, A., & Henisz, W. J. (2003). Political hazards, experience, and sequential entry strategies: The international expansion of Japanese firms, 1980–1998. *Strategic Management Journal*, *24*(11), 1153-1164.

Demirbag, M., Glaister, K. W., & Tatoglu, E. (2007). Institutional and transaction cost influences on MNEs' ownership strategies of their affiliates: Evidence from an emerging market. *Journal of World Business*, *42*(4), 418-434.

Demsetz, H. (1968). Why regulate utilities? *The Journal of Law and Economics*, *11*(1), 55-65.

Dimaggio, P. (1988). Interest and agency in institutional theory. In L. G. Zucker (Ed.), *Research on Institutional Patterns: Environment and Culture* (pp. 3-22). Ballinger Publishing Co.

DiMaggio, P., & Powell, W. (1983). The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields. *American sociological review*, *48*(2), 147-160.

Doh, J. P., Lawton, T. C., & Rajwani, T. (2012). Advancing nonmarket strategy research: Institutional perspectives in a changing world. *Academy of Management Perspectives*, *26*(3), 22-39.

Dolzer, R., & Schreuer, C. (2012). *Principles of international investment law* (2nd ed.). Oxford University Press

Dorobantu, S., Kaul, A., & Zelner, B. (2017). Nonmarket strategy research through the lens of new institutional economics: An integrative review and future directions. *Strategic Management Journal*, *38*(1), 114-140.

Duanmu, J.-L. (2014). State-owned MNCs and host country expropriation risk: The role of home state soft power and economic gunboat diplomacy. *Journal of International Business Studies*, *45*(8), 1044-1060.

Dunning, J. H. (1998). Location and the multinational enterprise: a neglected factor? *Journal of International Business Studies*, *29*(1), 45-66.

EDFI. (2020). *What is a DFI?* EDFI. Retrieved 11 May from https://www.edfi.eu/about-dfis/what-is-a-dfi/

Ellis, P. D. (2010). *The essential guide to effect sizes: Statistical power, meta-analysis, and the interpretation of research results*. Cambridge University Press

Gao, C., Zuzul, T., Jones, G., & Khanna, T. (2017). Overcoming Institutional Voids: A Reputation-Based View of Long-Run Survival. *Strategic Management Journal*, *38*(11), 2147-2167.

García-Canal, E., & Guillén, M. F. (2008). Risk and the strategy of foreign location choice in regulated industries. *Strategic Management Journal*, *29*(10), 1097-1115.

Garud, R., Jain, S., & Kumaraswamy, A. (2002). Institutional entrepreneurship in the sponsorship of common technological standards: The case of Sun Microsystems and Java. *Academy of Management Journal*, *45*(1), 196-214.

George, G., Corbishley, C., Khayesi, J. N., Haas, M. R., & Tihanyi, L. (2016). Bringing Africa in: Promising directions for management research. *Academy of Management Journal*, *59*(2), 377-393.

Goldeng, E., Grünfeld, L. A., & Benito, G. R. (2008). The performance differential between private and state owned enterprises: The roles of ownership, management and market structure. *Journal of Management Studies*, *45*(7), 1244-1273.

Granqvist, N., & Gustafsson, R. (2016). Temporal institutional work. *Academy of Management Journal*, *59*(3), 1009-1035.

Greenwood, R., Suddaby, R., & Hinings, C. R. (2002). Theorizing change: The role of professional associations in the transformation of institutionalized fields. *Academy of Management Journal*, *45*(1), 58-80.

Hausman, J. A., Hall, B. H., & Griliches, Z. (1984). *Econometric models for count data with an application to the patents-R&D relationship* (0898-2937).

Hehenberger, L., Mair, J., & Metz, A. (2019). The assembly of a field ideology: An idea-centric perspective on systemic power in impact investing. *Academy of Management Journal*, *62*(6), 1672-1704.

Henisz, W. J. (2000a). The institutional environment for economic growth. *Economics & Politics*, *12*(1), 1-31.

Henisz, W. J. (2000b). The institutional environment for multinational investment. *Journal of Law, Economics, and Organization*, *16*(2), 334-364.

Henisz, W. J., & Delios, A. (2001). Uncertainty, imitation, and plant location: Japanese multinational corporations, 1990-1996. *Administrative Science Quarterly*, *46*(3), 443-475.

Henisz, W. J., & Delios, A. (2004). Information or influence? The benefits of experience for managing political uncertainty. *Strategic Organization*, *2*(4), 389-421.

Henisz, W. J., & Zelner, B. A. (2003). Political risk management: A strategic perspective. In T. H. Moran (Ed.), *International Political Risk Management: The Brave New World* (pp. 154 -170). The World Bank Group.

Henisz, W. J., & Zelner, B. A. (2004). Explicating political hazards and safeguards: a transaction cost politics approach. *Industrial and Corporate Change*, *13*(6), 901-915.

Hennart, J.-F., & Larimo, J. (1998). The impact of culture on the strategy of multinational enterprises: does national origin affect ownership decisions? *Journal of International Business Studies*, *29*(3), 515-538.

Hennart, J. F., & Park, Y. R. (1994). Location, governance, and strategic determinants of Japanese manufacturing investment in the United States. *Strategic Management Journal*, *15*(6), 419-436.

Holburn, G. (2012). Assessing and managing regulatory risk in renewable energy: Contrasts between Canada and the United States. *Energy Policy*, *45*, 654-665.

Holburn, G. L., & Spiller, P. (2002). Institutional or structural: lessons from international electricity sector reforms. *The Economics of Contracts: Theories and Applications, Cambridge University*.

Holburn, G. L., & Vanden Bergh, R. (2004). Influencing agencies through pivotal political institutions. *Journal of Law, Economics, and Organization*, *20*(2), 458-483.

Holburn, G. L., & Zelner, B. A. (2010). Political capabilities, policy risk, and international investment strategy: Evidence from the global electric power generation industry. *Strategic Management Journal*, *31*(12), 1290-1315.

Hoskisson, R. E., Eden, L., Lau, C. M., & Wright, M. (2000). Strategy in emerging economies. *Academy of Management Journal*, *43*(3), 249-267.

Höchstädter, A. K., & Scheck, B. (2015). What's in a name: An analysis of impact investing understandings by academics and practitioners. *Journal of Business Ethics*, *132*(2), 449-475.

Jandhyala, S., & Weiner, R. J. (2014). Institutions sans frontières: International agreements and foreign investment. *Journal of International Business Studies*, *45*(6), 649-669.

Jindra, B., Hassan, S. S., & Cantner, U. (2016). What does location choice reveal about knowledge-seeking strategies of emerging market multinationals in the EU? *International Business Review*, *25*(1, Part A), 204-220.

Kobrin, S. J. (1976). The environmental determinants of foreign direct manufacturing investment: an ex post empirical analysis. *Journal of International Business Studies*, *7*(2), 29-42.

Kobrin, S. J. (1978). When does political instability result in increased investment risk. *Columbia Journal of World Business*, *13*(3), 113-122.

Kobrin, S. J. (1979). Political risk: A review and reconsideration. *Journal of International Business Studies*, *10*(1), 67-80.

Kraay, A., Kaufmann, D., & Mastruzzi, M. (2010). *The worldwide governance indicators: methodology and analytical issues*. The World Bank

Lawrence, T., Suddaby, R., & Leca, B. (2011). Institutional work: Refocusing institutional studies of organization. *Journal of Management Inquiry*, *20*(1), 52-58.

Lawrence, T. B., & Dover, G. (2015). Place and institutional work: Creating housing for the hard-to-house. *Administrative Science Quarterly*, *60*(3), 371-410.

Lawrence, T. B., Leca, B., & Zilber, T. B. (2013). Institutional work: Current research, new directions and overlooked issues. *Organization Studies*, *34*(8), 1023-1033.

Lawrence, T. B., & Phillips, N. (2019). *Constructing organizational life: How social-symbolic work shapes selves, organizations, and institutions*. Oxford University Press

Lawrence, T. B., & Suddaby, R. (2006). Institutions and institutional work. In C. C. Hardy, T. B. Lawrence, & W. R. Nord (Eds.), *The Sage handbook of organization studies* (2nd ed., pp. 215-254). Sage.

Lawrence, T. B., Suddaby, R., & Leca, B. (2009). *Institutional work: Actors and agency in institutional studies of organizations*. Cambridge university press

Lee, M., Adbi, A., & Singh, J. (2020). Categorical cognition and outcome efficiency in impact investing decisions. *Strategic Management Journal*, *41*(1), 86-107.

Levy, B., & Spiller, P. T. (1994). The institutional foundations of regulatory commitment: a comparative analysis of telecommunications regulation. *The Journal of Law, Economics, and Organization*, *10*(2), 201-246.

Lin, W., & Wooldridge, J. M. (2019). Chapter 2 - Testing and Correcting for Endogeneity in Nonlinear Unobserved Effects Models. In M. Tsionas (Ed.), *Panel Data Econometrics* (pp. 21-43). Academic Press.

Louche, C., Arenas, D., & Van Cranenburgh, K. C. (2012). From preaching to investing: Attitudes of religious organisations towards responsible investment. *Journal of Business Ethics*, *110*(3), 301-320.

Lounsbury, M. (2001). Institutional sources of practice variation: Staffing college and university recycling programs. *Administrative Science Quarterly*, *46*(1), 29-56.

Lounsbury, M., Ventresca, M., & Hirsch, P. M. (2003). Social movements, field frames and industry emergence: a cultural–political perspective on US recycling. *Socio-economic review*, *1*(1), 71-104.

Lu, J., Liu, X., Wright, M., & Filatotchev, I. (2014). International experience and FDI location choices of Chinese firms: The moderating effects of home country government support and host country institutions. *Journal of International Business Studies*, *45*(4), 428-449.

Luo, Y. (2001). Determinants of entry in an emerging economy: A multilevel approach. *Journal of Management Studies*, *38*(3), 443-472.

Macher, J. T., & Mayo, J. W. (2015). Influencing public policymaking: Firm-, industry-, and country-level determinants. *Strategic Management Journal*, *36*(13), 2021-2038.

Marcoulides, K. M., & Raykov, T. (2019). Evaluation of variance inflation factors in regression models using latent variable modeling methods. *Educational and Psychological Measurement*, *79*(5), 874-882.

McMullen, J. S., & Bergman Jr, B. J. (2017). Social entrepreneurship and the development paradox of prosocial motivation: A cautionary tale. *Strategic Entrepreneurship Journal*, *11*(3), 243-270.

Meyer, J. W., & Rowan, B. (1977). Institutionalized organizations: Formal structure as myth and ceremony. *American Journal of Sociology*, *83*(2), 340-363.

Meyer, K. E., Estrin, S., Bhaumik, S. K., & Peng, M. W. (2009). Institutions, resources, and entry strategies in emerging economies. *Strategic Management Journal*, *30*(1), 61-80.

Miller, K. D. (1992). A framework for integrated risk management in international business. *Journal of International Business Studies*, *23*(2), 311-331.

Mol, M. J., Stadler, C., & Ariño, A. (2017). Africa: The new frontier for global strategy scholars. *Global Strategy Journal*, *7*(1), 3-9.

Montgomery, D. C., Peck, E. A., & Vining, G. G. (2012). *Introduction to linear regression analysis* (Vol. 821). John Wiley & Sons

Mudambi, R., Navarra, P., & Delios, A. (2013). Government regulation, corruption, and FDI. *Asia Pacific Journal of Management*, *30*(2), 487-511.

Nielsen, B. B., Asmussen, C. G., & Weatherall, C. D. (2017). The location choice of foreign direct investments: Empirical evidence and methodological challenges. *Journal of World Business*, *52*(1), 62-82.
Norfund. (2019). *STRATEGY 2019 – 2022*. https://www.norfund.no/about-norfund/strategy/
Norfund. (2020). *About Norfund*. Norfund. Retrieved 26.08 from https://www.norfund.no/about-norfund/
North, D. C. (1991). Institutions. *Journal of Economic Perspectives*, *5*(1), 97-112.
O'Neill, D. (2017). African banks grasp the global retreat. *Euromoney*. https://www.euromoney.com/article/b150zgrdjcc8bk/african-banks-grasp-the-global-retreat
Oetzel, J. M., & Oh, C. H. (2014). Learning to carry the cat by the tail: Firm experience, disasters, and multinational subsidiary entry and expansion. *Organization science*, *25*(3), 732-756.
Oh, C. H., & Oetzel, J. (2011). Multinationals' response to major disasters: how does subsidiary investment vary in response to the type of disaster and the quality of country governance? *Strategic Management Journal*, *32*(6), 658-681.
Oh, C. H., & Oetzel, J. (2017). Once bitten twice shy? Experience managing violent conflict risk and MNC subsidiary-level investment and expansion. *Strategic Management Journal*, *38*(3), 714-731.
Peng, M. W. (2012). The global strategy of emerging multinationals from China. *Global Strategy Journal*, *2*(2), 97-107.
Peng, M. W., Sun, S. L., Pinkham, B., & Chen, H. (2009). The institution-based view as a third leg for a strategy tripod. *Academy of Management Perspectives*, *23*(3), 63-81.
Pettersson, T., Högbladh, S., & Öberg, M. (2019). Organized violence, 1989–2018 and peace agreements. *Journal of Peace Research*, *56*(4), 589-603.
Pettersson, T., & Öberg, M. (2020). Organized violence, 1989–2019. *Journal of Peace Research*, *57*(4), 597-613.
Rajwani, T., & Liedong, T. A. (2015). Political activity and firm performance within nonmarket research: A review and international comparative assessment. *Journal of World Business*, *50*(2), 273-283.
Ramamurti, R. (2004). Developing countries and MNEs: extending and enriching the research agenda. *Journal of International Business Studies*, *35*(4), 277-283.
Ramasamy, B., Yeung, M., & Laforet, S. (2012). China's outward foreign direct investment: Location choice and firm ownership. *Journal of World Business*, *47*(1), 17-25.
Renneboog, L., Ter Horst, J., & Zhang, C. (2008). Socially responsible investments: Institutional aspects, performance, and investor behavior. *Journal of Banking & Finance*, *32*(9), 1723-1742.
Reuer, J. J., Shenkar, O., & Ragozzino, R. (2004). Mitigating risk in international mergers and acquisitions: the role of contingent payouts. *Journal of International Business Studies*, *35*(1), 19-32.
Rogerson, P. A. (2001). *Data reduction: factor analysis and cluster analysis*. SAGE Publications
Runde, D. (2014). Development Finance Institutions Come of Age. *Forbes*. https://www.forbes.com/sites/danielrunde/2014/10/17/development-finance-institutions-come-of-age-dfi/#3b52d5535c2c
Runde, D. F., & Milner, A. (2019). Development finance institutions: plateaued growth, increasing need. *Center for Strategic and International Studies, February*, *13*.
Saltuk, Y., Bouri, A., Mudaliar, A., & Pease, M. (2013). Perspectives on progress: The impact investor survey. *Global Social Finance, JP Morgan and the Global Impact Investing Network, London, January*, *7*.

Scholtens, B., & Sievänen, R. (2013). Drivers of Socially Responsible Investing: A Case Study of Four Nordic Countries. *Journal of Business Ethics*, *115*(3), 605-616.
Scott, R. W., Scott, W. R., & Meyer, J. W. (1994). *Institutional environments and organizations: Structural complexity and individualism*. Sage
Scott, W. R. (1987). The adolescence of institutional theory. *Administrative Science Quarterly*, 493-511.
Scott, W. R. (2001). *Institutions and organizations* (3 ed.). SAGE Publications.
Selznick, P. (1949). *TVA and the grass roots: A study in the sociology of formal organization* (Vol. 3). University of California Press.
Sine, W. D., & Lee, B. H. (2009). Tilting at windmills? The environmental movement and the emergence of the US wind energy sector. *Administrative Science Quarterly*, *54*(1), 123-155.
Slager, R., Gond, J.-P., & Moon, J. (2012). Standardization as institutional work: The regulatory power of a responsible investment standard. *Organization Studies*, *33*(5-6), 763-790.
Suddaby, R., & Greenwood, R. (2005). Rhetorical strategies of legitimacy. *Administrative Science Quarterly*, *50*(1), 35-67.
Te Velde, D. W. (2011). The role of development finance institutions in tackling global challenges. *London: ODI*.
UNCTAD. (2018). *World investment report*. http://worldinvestmentreport.unctad.org/
Waldron, T. L., Fisher, G., & Navis, C. (2015). Institutional entrepreneurs' social mobility in organizational fields. *Journal of Business Venturing*, *30*(1), 131-149.
Wang, C., Hong, J., Kafouros, M., & Wright, M. (2012). Exploring the role of government involvement in outward FDI from emerging economies. *Journal of International Business Studies*, *43*(7), 655-676.
Witte, C. T., Burger, M. J., Ianchovichina, E. I., & Pennings, E. (2016). *Dodging bullets: The heterogeneous effect of political violence on greenfield FDI*. The World Bank
World Bank. (2019). *Total natural resources rents (% of GDP)*
Xu, D., & Shenkar, O. (2002). Note: Institutional distance and the multinational enterprise. *Academy of management review*, *27*(4), 608-618.
Yan, S., Almandoz, J. J., & Ferraro, F. (2021). The Impact of Logic (In) Compatibility: Green Investing, State Policy, and Corporate Environmental Performance. *Administrative Science Quarterly*.
Yan, Z. J., Zhu, J. C., Fan, D., & Kalfadellis, P. (2018). An institutional work view toward the internationalization of emerging market firms. *Journal of World Business*, *53*(5), 682-694.
Yiu, D., & Makino, S. (2002). The choice between joint venture and wholly owned subsidiary: An institutional perspective. *Organization science*, *13*(6), 667-683.
Zhao, Y., Tang, K. K., & Wang, L.-l. (2013). Do renewable electricity policies promote renewable electricity generation? Evidence from panel data. *Energy Policy*, *62*, 887-897.
Zhong, W., Lin, Y., Gao, D., & Yang, H. (2019). Does politician turnover affect foreign subsidiary performance? Evidence in China. *Journal of international business studies*, *50*(7), 1184-1212.
Zietsma, C., & Lawrence, T. B. (2010). Institutional work in the transformation of an organizational field: The interplay of boundary work and practice work. *Administrative Science Quarterly*, *55*(2), 189-221.

5.8 Appendices

Appendix 3: *Table 5.4 continued (all controls)*

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
	Poisson						OLS			Poisson				
Dependent variables	Investment						Investment (ln)			Investment				
Market size (host)				0.005	0.027	-0.005		0.036	0.037		0.017	-0.007	0.007	-0.005
				(0.004)	(0.007)	(0.005)		(0.030)	(0.016)		(0.007)	(0.005)	(0.007)	(0.005)
				[0.228]	[0.000]	[0.305]		[0.219]	[0.022]		[0.024]	[0.157]	[0.381]	[0.297]
GDP per capita (host)				0.025	0.003	0.036		0.020	0.031		-0.000	0.032	-0.019	0.031
				(0.005)	(0.008)	(0.006)		(0.031)	(0.018)		(0.008)	(0.006)	(0.008)	(0.006)
				[0.000]	[0.708]	[0.000]		[0.525]	[0.078]		[0.986]	[0.000]	[0.017]	[0.000]
Host inflation (host)				0.031	0.025	0.032		0.002	0.010		0.021	0.029	0.009	0.026
				(0.005)	(0.009)	(0.007)		(0.036)	(0.021)		(0.009)	(0.007)	(0.009)	(0.007)
				[0.000]	[0.004]	[0.000]		[0.949]	[0.648]		[0.018]	[0.000]	[0.292]	[0.000]
Host natural resources				-0.009	-0.005	-0.012		-0.014	-0.040		-0.007	-0.009	-0.005	-0.010
				(0.004)	(0.006)	(0.005)		(0.023)	(0.016)		(0.006)	(0.005)	(0.006)	(0.005)
				[0.020]	[0.404]	[0.019]		[0.537]	[0.014]		[0.252]	[0.060]	[0.393]	[0.046]
Market size (home)				0.050	0.009	0.078		0.025	0.003		-0.009	0.046	-0.037	0.051
				(0.007)	(0.013)	(0.010)		(0.049)	(0.026)		(0.013)	(0.011)	(0.013)	(0.011)
				[0.000]	[0.494]	[0.000]		[0.608]	[0.900]		[0.490]	[0.000]	[0.004]	[0.000]
GDP per capita (home)				0.041	-0.105	0.399		-0.226	-0.199		0.255	0.563	0.048	0.586
				(0.027)	(0.038)	(0.053)		(0.133)	(0.090)		(0.046)	(0.055)	(0.048)	(0.055)

				[0.134]	[0.005]	[0.000]		[0.089]	[0.028]		[0.000]	[0.000]	[0.310]	[0.000]
Total assets				-0.012	-0.065	0.007		0.058	0.028		-0.079	0.005	-0.107	0.002
				(0.003)	(0.008)	(0.003)		(0.021)	(0.007)		(0.008)	(0.003)	(0.009)	(0.003)
				[0.000]	[0.000]	[0.038]		[0.005]	[0.000]		[0.000]	[0.144]	[0.000]	[0.574]
Number of employees				0.104	-0.119	0.212		-0.163	0.193		-0.152	0.200	-0.000	0.180
				(0.016)	(0.028)	(0.021)		(0.075)	(0.052)		(0.029)	(0.021)	(0.031)	(0.021)
				[0.000]	[0.000]	[0.000]		[0.030]	[0.000]		[0.000]	[0.000]	[0.991]	[0.000]
Colonial ties (dyad)				-0.164	-0.066	-0.213		-0.072	-0.201		-0.034	-0.211	0.019	-0.211
				(0.011)	(0.024)	(0.013)		(0.101)	(0.042)		(0.024)	(0.013)	(0.024)	(0.013)
				[0.000]	[0.005]	[0.000]		[0.475]	[0.000]		[0.154]	[0.000]	[0.424]	[0.000]
Geographic distance				-0.253	-0.141	-0.272		-0.163	-0.577		-0.032	-0.238	0.144	-0.223
				(0.015)	(0.029)	(0.019)		(0.113)	(0.048)		(0.030)	(0.019)	(0.032)	(0.019)
				[0.000]	[0.000]	[0.000]		[0.149]	[0.000]		[0.289]	[0.000]	[0.000]	[0.000]
▲ Regulatory quality				0.069	0.107	0.051		0.143	0.120		0.101	0.051	0.081	0.051
				(0.002)	(0.004)	(0.003)		(0.014)	(0.009)		(0.004)	(0.003)	(0.004)	(0.003)
				[0.000]	[0.000]	[0.000]		[0.000]	[0.000]		[0.000]	[0.000]	[0.000]	[0.000]
▲ Rule of law				0.021	0.025	0.031		0.012	0.086		0.026	0.039	0.022	0.041
				(0.002)	(0.002)	(0.011)		(0.006)	(0.033)		(0.002)	(0.011)	(0.002)	(0.011)
				[0.000]	[0.000]	[0.006]		[0.049]	[0.009]		[0.000]	[0.001]	[0.000]	[0.000]
▲ Control of corruption				-0.003	-0.026	-0.003		-0.005	-0.009		-0.024	0.002	-0.000	0.010
				(0.002)	(0.004)	(0.002)		(0.015)	(0.006)		(0.005)	(0.003)	(0.005)	(0.003)
				[0.113]	[0.000]	[0.275]		[0.749]	[0.131]		[0.000]	[0.479]	[0.988]	[0.000]
Constant	4.351	3.815	4.438	4.350	7.007	-0.268	4.122	6.885	9.250	3.512	2.856	-1.751	6.463	-1.379

	(0.015)	(0.032)	(0.018)	(0.405)	(0.627)	(0.682)	(0.075)	(2.352)	(1.327)	(0.025)	(0.703)	(0.696)	(0.723)	(0.704)
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.694]	[0.000]	[0.004]	[0.000]	[0.000]	[0.000]	[0.012]	[0.000]	[0.050]
Observations	2,887	774	2,113	1,715	628	1,087	2,887	628	1,087	2,887	628	1,087	628	1,087
Firm-country-year dummies	No	No	No	Yes	Yes	Yes	No	No	No	Yes	Yes	Yes	Yes	Yes
Full controls	No	No	No	Yes	Yes	Yes	No	Yes	Yes	No	Yes	Yes	Yes	Yes
Chi2 / F-val	3947	74.21	3734	11339	4212	7782	209.7	13.71	32.33	20711	4425	7953	5354	8029
loglikelihood / Adj. R2	-28439	-8305	-19876	-9680	-3877	-5474	0.0674	0.221	0.288	-20057	-3771	-5388	-3306	-5351
Impact investors		Yes			Yes			Yes			Yes		Yes	
Profit-seeking firms			Yes			Yes			Yes			Yes		Yes

Robust standard errors in parentheses. P-values in brackets.

Appendix 4: *Table 5.5 continued (all controls)*

	(15)	(16)	(17)	(18)	(17)	(18)
		Poisson				
Dependent variables		Investment				
Market size (host)		0.002	-0.015	0.003	-0.009	-0.006
		(0.005)	(0.009)	(0.005)	(0.009)	(0.003)
		[0.624]	[0.097]	[0.602]	[0.299]	[0.025]
GDP per capita (host)		0.016	-0.001	0.015	-0.012	0.009
		(0.006)	(0.010)	(0.006)	(0.010)	(0.003)
		[0.010]	[0.935]	[0.010]	[0.227]	[0.001]
Host inflation (host)		0.020	0.036	0.020	0.030	-0.006
		(0.007)	(0.012)	(0.007)	(0.012)	(0.003)
		[0.002]	[0.002]	[0.003]	[0.012]	[0.075]
Host natural resources		-0.010	0.002	-0.010	-0.002	0.005
		(0.005)	(0.007)	(0.005)	(0.007)	(0.003)
		[0.032]	[0.753]	[0.030]	[0.808]	[0.040]
Market size (home)		0.183	0.038	0.183	-0.043	0.012
		(0.016)	(0.036)	(0.016)	(0.037)	(0.004)
		[0.000]	[0.297]	[0.000]	[0.247]	[0.005]
GDP per capita (home)		0.904	-0.022	0.900	-0.081	0.094
		(0.088)	(0.044)	(0.088)	(0.044)	(0.021)
		[0.000]	[0.608]	[0.000]	[0.067]	[0.000]
Total assets		-0.027	0.013	-0.028	-0.015	-0.022
		(0.004)	(0.007)	(0.004)	(0.007)	(0.003)
		[0.000]	[0.062]	[0.000]	[0.029]	[0.000]
Number of employees		0.029	0.053	0.024	0.114	0.226
		(0.022)	(0.035)	(0.022)	(0.036)	(0.007)
		[0.182]	[0.130]	[0.266]	[0.002]	[0.000]
Colonial ties (dyad)		-0.216		-0.215		0.001
		(0.013)		(0.013)		(0.007)
		[0.000]		[0.000]		[0.885]
Geographic distance		-0.063	-0.615	-0.062	-0.469	0.861
		(0.019)	(0.041)	(0.019)	(0.043)	(0.011)
		[0.001]	[0.000]	[0.001]	[0.000]	[0.000]
▲ Regulatory quality		0.059	0.086	0.059	0.072	0.024
		(0.003)	(0.005)	(0.003)	(0.005)	(0.001)
		[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
▲ Rule of law		0.022	0.023	0.022	0.020	-0.125
		(0.003)	(0.003)	(0.003)	(0.003)	(0.003)
		[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
▲ Control of corruption		0.015	0.005	0.018	0.020	-0.049
		(0.003)	(0.004)	(0.003)	(0.004)	(0.002)
		[0.000]	[0.199]	[0.000]	[0.000]	[0.000]
Constant	4.575	-9.737	9.500	-9.117	10.840	-5.404
	(0.003)	(1.096)	(1.033)	(1.141)	(1.043)	(0.276)
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Observations	4,336	1,013	484	1,013	484	2,413
Firm-country FE	No	Yes	Yes	Yes	Yes	Yes
Full controls	No	Yes	Yes	Yes	Yes	Yes
Chi2	48972	7679	3242	7683	3468	123855
loglikelihood	-129984	-5206	-2476	-5204	-2363	-18987
Impact Investors		Yes	Yes	Yes	Yes	
Cluster		EU	Nordic	EU	Nordic	

Robust standard errors in parentheses. P-values in brackets.

Appendix 5: *Table 5.7 continued (all controls)*

	(19)	(20)	(21)
			Poisson
Dependent variables			Investment
Market size (host)			-0.321
			(0.609)
			[0.598]
GDP per capita (host)			1.055
			(0.664)
			[0.112]
Host inflation (host)			0.895
			(0.814)
			[0.272]
Host natural resources			0.331
			(0.553)
			[0.550]
Market size (home)			-1.000
			(1.062)
			[0.347]
GDP per capita (home)			-10.623
			(6.091)
			[0.081]
Total assets			3.846
			(0.466)
			[0.000]
Number of employees			-11.932
			(1.716)
			[0.000]
Colonial ties (dyad)			-0.591
			(1.498)
			[0.693]
Geographic distance			-7.023
			(1.641)
			[0.000]
▲ Regulatory quality			-3.443
			(0.303)
			[0.000]
▲ Rule of law			0.028
			(0.230)
			[0.904]
▲ Control of corruption			-1.299
			(0.412)
			[0.002]
Constant	12.508	6.624	195.960
	(1.014)	(1.111)	(77.669)
	[0.000]	[0.000]	[0.012]
Observations	6,602	6,602	4,712
Firm-country-year dummies	Yes	Yes	Yes
Full controls	No	No	Yes
Chi2 / F-val	78.62	115.7	316.7
loglikelihood / Adj. R2	0.0116	0.0336	0.652

Robust standard errors in parentheses. P-values in brackets.

6. Summary and Conclusion

This dissertation has provided nuance to our understanding of the relationship between host country institution-related (policy) risks and firms' international investment strategies. More specifically, I have shown how firms safeguard their investments in complex institutional environments. I also examined how (impact investing) firms contribute to the process of institutionalization in their environments. While earlier studies have examined how institution-related uncertainties affect the willingness of firms to invest (Delios & Henisz, 2000; Holburn & Zelner, 2010) and how institutions influence firms' conformity to their environments (Cuervo-Cazurra et al., 2019; North, 1990, 1991), they have paid scant attention to the strategic behaviors that firms employ in response to the institutional uncertainties that affect them or how firms influence institutionalization in their environments (Lawrence et al., 2011; Oliver, 1991). By taken stock and provide a detailed explanation of key safeguarding mechanisms that firms use to reduce risks and protect investments in high-risk environments (**Essay 1**), this dissertation introducing greater nuance into our understanding of the mechanisms that MNEs use to safeguard investments abroad against policy risks (Buckley, 2016; Miller, 1992).

Additionally, by showing how host countries' domestic and transnational institutional arrangements help firms dampen policy-related risk (**Essay 2**), this dissertation provides an important nuance to how institutions matter when protecting firms' foreign investments. Finally, by demonstrating how political affinity between firms' host and home markets affect the cost of doing business abroad and subsidiary level investments (**Essay 3**), as well as how firms contribute to institutionalization (**Essay 4**), this dissertation sheds more light on how governments' international relations affect policy risks and how firms may contribute to the improvement of institutions in high-risk countries. These are non-trivial additions to the strategy and international business literature because policy risk affects all firms—even for firms operating in developed markets where market-supporting institutions are strong.

6.1 Research Implications of the Dissertation

The findings of this dissertation have important implications for research. As previously noted, most extant strategy and international business studies on institutions have conceptualized firms as passive actors *vis-à-vis* institutional pressures (Lawrence et al., 2013; Lawrence & Suddaby, 2006). However, as shown in this dissertation, the relationship between firms and host country institutional uncertainties must go beyond passive compliance by firms (North, 1990, 1991) or

good corporate behavior (Werner, 2015). The relations between host country institutions and firms must be seen as bi-directional. Although **Essay 1** is a conceptual paper that does not provide an empirical test of the mechanisms, the evidence discussed in this essay nonetheless suggests a bi-directional relationship between institutions and firms' foreign investment behaviors. Countries rely on transnational institutional arrangements to signal their willingness to adequately protect the investments of foreign firms. However, the same institutional arrangements also permit firms to initiate dispute settlement processes against host countries and, in some cases, even confiscate host country assets in third countries in exchange for economic damages caused by the host government (Albino-Pimentel et al., 2018).). Thus, such institutions may be conceptualized as a double-edged sword that can support and/or hinder firms' relationships with host governments. Finally, this dissertation highlights that firms are less tolerant of institutional uncertainties, particularly in developing countries. In these countries, firms are more likely to reduce investment due to increased policy risks (see **Essays 2**, **3**, and **4**).

6.2 Implications for Management

This dissertation has several managerial implications. **Essay 1** elucidates the various tools that managers can use to safeguard their investments against aggressive host government interference, particularly in high-risk countries. It suggests that firms do not necessarily need to have extraordinary appetites for risk or special capabilities against risks before investing in high-risk countries. Instead, they can reduce risk by relying on a set of institutional mechanisms that alleviate and offset the risks of investing in high-risk host countries. These mechanisms include bilateral international investment agreements (IIAs) negotiated between MNEs' home and host countries, international investment insurance (III), investment contracts (ICs), and portfolio investment guarantees (PIGs). The findings of **Essay 3** posit that firms must not only pay attention to host country domestic institutions but must also consider host and home countries' stances in global affairs and how these assert pressures on firms' behavior through increased coordination costs. Finally, **Essay 4** shows that firms can improve host country institutions and sustainable development through their investment behavior by catalyzing greater institutional work.

6.3 Implications for Governments and Policymakers

The essays in this dissertation also have implications for government officials and policymakers. The findings of **Essay 2** suggest that although governments have the right to regulate the institutional environments of their jurisdictions, the abuse of sovereignty rights may hinder development—especially foreign capital inflows. Therefore, policymakers must consider the potential adverse effects of regulatory actions on their country's attractiveness as an FDI destination. Specifically, host countries seeking to attract more foreign investment should not interfere with foreign firms' operations. However, if they do, disputes should be settled at home and not in international arbitration courts. This is because engaging in international arbitration forums signals increased policy risk, which consequently "poisons" the host country's attractiveness as an FDI destination.

The findings of **Essay 4,** which suggest a positive relationship between investments by impact investing firms and institutionalization, also have implications for governments and policymakers—particularly those in developing countries**.** These results provide compelling evidence suggesting that a country's ability to demonstrate a credible commitment to safeguarding investors' assets is of substantial interest to firms' when they make international investment decisions. This is even true for social impact-seeking investing firms, which are motivated by nonpecuniary outcomes. Thus, governments seeking to attract more foreign capital must improve their market-supporting institutions by demonstrating a willingness to abide by international norms of investment protection since firms are skeptical of countries with greater policy risk.

6.4 Limitations and Directions for Future Research

While this dissertation makes substantial research contributions and provides a managerial understanding of the relationship between institutions and firms' foreign strategic choices, I recognize that the essays constituting this dissertation's theoretical and empirical frameworks could undoubtedly be refined and extended. For example, **Essay 1** is conceptual, providing no empirical test of the tools and mechanisms discussed. Thus, future empirical work could explore the rigor of the mechanisms discussed in this essay. Moreover, while **Essays 2**, **3**, and **4** are based on empirical data and quantitative methods, my initial presentation of the results to established firms, managers, and investors has left me with unanswered questions about how firms' investment motives affect their attitudes to policy risk. For instance, although **Essay 4** finds that (impact investing) firms play an important role in the process of institutionalization in their chosen countries, how exactly they decide which countries to invest in is not entirely

clear. As a result, future research should investigate the decision-making processes and day-to-day practices that (impact investing) firms engage in when deciding on where to invest.

Additionally, while **Essay 3** argues that firms' decisions to adapt existing foreign subsidiary investments are influenced by their home and host countries' political affinity, our measure of political affinity is based on cues from voting similarities in the UN General Assembly (Bertrand et al., 2016; Duanmu, 2014). I recognize that there are other cues, such as confrontations on social and traditional media platforms or outright wars between countries. Thus, future studies should include political affinity cues from these new avenues of political discourse (e.g., Twitter, Facebook, TikTok, etc.) and examine how such "crowd affinity" affects firms' foreign investment strategies.

6.5 References

Albino-Pimentel, J., Dussauge, P., & Shaver, J. M. (2018). Firm non-market capabilities and the effect of supranational institutional safeguards on the location choice of international investments. *Strategic Management Journal*, *39*(10), 2770-2793.

Buckley, P. J. (2016). The contribution of internalisation theory to international business: New realities and unanswered questions. *Journal of World Business*, *51*(1), 74-82.

Cuervo-Cazurra, A., Gaur, A., & Singh, D. (2019). Pro-market institutions and global strategy: The pendulum of pro-market reforms and reversals. *Journal of International Business Studies*, *50*(4), 598-632.

Delios, A., & Henisz, W. I. (2000). Japanese firms' investment strategies in emerging economies. *Academy of Management Journal*, *43*(3), 305-323.

Holburn, G., & Zelner, B. (2010). Political capabilities, policy risk, and international investment strategy: Evidence from the global electric power generation industry. *Strategic Management Journal*, *31*(12), 1290-1315.

Lawrence, T., Suddaby, R., & Leca, B. (2011). Institutional work: Refocusing institutional studies of organization. *Journal of Management Inquiry*, *20*(1), 52-58.

Lawrence, T. B., Leca, B., & Zilber, T. B. (2013). Institutional Work: Current Research, New Directions and Overlooked Issues. *Organization Studies*, *34*(8), 1023-1033.

Lawrence, T. B., & Suddaby, R. (2006). Institutions and institutional work. In C. C. Hardy, T. B. Lawrence, & W. R. Nord (Eds.), *The Sage handbook of organization studies* (2nd ed., pp. 215-254). Sage.

Miller, K. D. (1992). A framework for integrated risk management in international business. *Journal of International Business Studies*, *23*(2), 311-331.

North, D. C. (1990). *Institutions, institutional change and economic performance*. Cambridge University Press

North, D. C. (1991). Institutions. *Journal of Economic Perspectives*, *5*(1), 97-112.

Oliver, C. (1991). Strategic responses to institutional processes. *Academy of management review*, *16*(1), 145-179.

Werner, T. (2015). Gaining access by doing good: The effect of sociopolitical reputation on firm participation in public policy making. *Management Science*, *61*(8), 1989-2011.

Series of Dissertations

2021

9/2021 *Gilbert Kofi Adarkwah*
Institutions, Policy Risk, and Firms Behavior: Foreign Investments in High-Risk Countries

8/2021 *Ilka Verena Ohlmer*
The Social Side of Employee Pay: Exploring social-psychological outcomes and the explatory mechanisms of employee pay standing from the social-effects perspective on pay

7/2021 *Emanuela Stagno*
Some Consequences of Vulnerability in Consumers' Life

6/2021 *Christopher Albert Sabel*
Spinouts, Sharks, and Genealogy: Established Firms as Resource Acquisition Channel for Startups

5/2021 *Njål Andersen*
No article is an island entire of itself: Extending bibliometric science mapping in the field of management with social network analysis

4/2021 *Julia Zhulanova*
Macroeconomic Dynamics, Commodity Prices and Expectations

3/2021 *Magnus Våge Knutsen*
Essays on reputation

2/2021 *Even Comfort Hvinden*
CRUDE GAMES: Essays on strategic competition in oil markets

1/2021 *Namhee Matheson*
Theory and Evidence on the Effect of Disagreement on Asset Prices

2020

7/2020 *Rasmus Bøgh Holmen*
Productivity and Mobility

6/2020 *Arne Fredrik Lyshol*
Essays in labor and housing search

5/2020 *Irena Kustec*
Three essays on family firms

4/2020 *Kateryna Maltseva*
Digital Self-Tracking: Psychological and Behaviroal Implications

3/2020 *Flladina Zilja*
The role of CEOs in international strategy

2/2020 *Vedrana Jez*
Managerial Attention and Cognitive Flexibility in Strategic Decision Making

1/2020 *Ling Tak Douglas Chung*
Three Essays on Retail Trading

2019

7/2019 *Adeline Holmedahl Hvidsten*
The role of incompleteness in co-designing collaborative service delivery: A case study of electronic coordination in Norwegian health care

6/2019 *Delphine Caruelle*
The Interplay between Time and Customer Emotion during Service Encounters

5/2019 *Chi Hoang*
How the Human Schema Guides Consumer Behavior

4/2019 *Wah Yip Chu*
Essays in Empirical Asset Pricing and Investment

3/2019 *Olga Mikhailova*
Medical technological innovation processes: The role of inter-relatedness at the global and local levels for the case Transcatheter of Aortic Valve Implantation

2/2019 *Jo Albertsen Saakvitne*
Essays on Market Microstructure

1/2019 *Per-Magnus Moe Thompson*
All you need is love?: Investigating leadership from leaders' attachment experiences in close relationships

2018

15/2018 *Stefania Sardo*
Questioning normality: A study of obduracy and innovation in the O&G industry

14/2018 *Ingvild Müller Seljeseth*
The Inevitable Thucydides's Trap?: How Hierarchical Instability and Threat Influences Leaders' Openness to Inputs from Others

13/2018 *Daniela Carmen Cristian*
The Utility of Hedonics Beyond Pleasure: Positive Outcomes of Hedonic Consumption

12/2018 *Daniel Øgård Kinn*
Essays in Econometrics

11/2018 *Ragnar Enger Juelsrud*
Essays in Macro-Finance

10/2018 *Bisrat Agegnehu Misganaw*
On entrepreneurial teams and their formation in science-based industries

9/2018 *Martin Blomhoff Holm*
Consumption

8/2018 *Helene Lie Røhr*
Essays on decision making dynamics in politics and consumer choice

7/2018 *Hoang Ho*
Are Human Resource Management (HRM) Systems Good or Bad for Employee Well-Being?: An Investigation of the Well-being Paradox from the Mutual Gains and Critical Perspectives

6/2018 *Rannveig Røste*
Innovation in Public Services: Wicked Problems and Multi-layered Solutions

5/2018 *Mathias Hansson*
The Complex Simplicity of Patterns of Action: Organizational Routines as Source of Adaptation and Performance

4/2018 *Mariia Koval*
Antecedents and Consequences of Unplanned Alliance Terminations

3/2018 *Maximilian Rohrer*
Three Essays in Financial Economics

2/2018 *Viacheslav Iurkov*
The role of alliance networks for firms' geographic scope and performance: A structural embeddedness perspective

1/2018 *Huy-Vu Nguyen*
Wealth Inequality

2017

14/2017 *Mirha Suangic*
Aspirations and Daring Confrontations: Investigating the Relationship between Employees' Aspirational Role-Identities and Problem-Oriented Voice

13/2017 *Beniamino Callegari*
A heterodox theoretical interpretation

12/2017 *Sepideh Khayati Zahiri*
Essays on Predictive Ability of Macroeconomic Variables and Commodity Prices

11/2017 *Tonje Hungnes*
Reorganizing healthcare services: Sensemaking and organizing innovation

10/2017 *Eileen Fugelsnes*
From backstage to consensus: A study of the Norwegian pension reform process

9/2017 *Knut-Eric Neset Joslin*
Experimental Markets with Frictions

8/2017 *Sumaya AlBalooshi*
Switching between Resources: Psychosocial Resources as Moderators of the Impact of Powerlessness on Cognition and Behavior

7/2017 *Zongwei Lu*
Three essays on auction theory and contest theory

6/2017 *Frode Martin Nordvik*
Oil Extraction and The Macroeconomy

5/2017 *Elizabeth Solberg*
Adapting to Changing Job Demands**:** A Broadcast Approach to Understanding Self-Regulated Adaptive Performance and Cultivating it in Situated Work Settings

4/2017 *Natalia Bodrug*
Essays on economic choices and cultural values

3/2017 *Vegard Høghaug Larsen*
Drivers of the business cycle: Oil, news and uncertainty

2/2017 *Nikolay Georgiev*
Use of Word Categories with Psychological Relevance Predicts Prominence in Online Social Networks

1/2017 *Sigmund Valaker*
Breakdown of Team Cognition and Team Performance: Examining the influence of media and overconfidence on mutual understanding, shared situation awareness and contextualization

2016

12/2016 *Xiaobei Wang*
Strategizing in Logistics Networks: The role of Logistics Service Providers as mediators and network facilitators

11/2016 *Prosper Ameh Kwei-Narh*
A mid-range theory of monitoring behaviors, shared task mental models, and team performance within dynamic settings

10/2016 *Anton Diachenko*
Ownership type, performance, and context: Study of institutional and industrial owners

9/2016 *Ranvir S. Rai*
Innovation in Practice: A Practice-Theoretical Exploration of Discontinuous Service Innovations

8/2016 *Gordana Abramovic*
Effective Diversity Management on the Line - Who and How? On the role of line managers in organisations with a diverse workforce

7/2016 *Mohammad Ejaz*
Why do some service innovations succeed while others fail? A comparative case study of managing innovation processes of two internet-based aggregation financial services at Finn.no (Penger.no)

6/2016 *Asmund Rygh*
Corporate governance and international business: Essays on multinational enterprises, ownership, finance and institutions

5/2016 *Chen Qu*
Three Essays on Game Theory and Patent-Pool Formation

4/2016 *Arash Aloosh*
Three Essays in International Finance

3/2016 *John-Erik Mathisen*
Elaborating and Implemental Mindsets in Business-related Behavior: An Investigation of the Interface between Cognition and Action. How goals and plans emerge and relate to cognition and action in business.

2/2016 *Øyvind Nilsen Aas*
Essays in industrial organization and search theory

1/2016 *Dominque Kost*
Understanding Transactive Memory Systems in Virtual Teams: The role of integration and differentiation, task dependencies and routines

2015

8/2015 *Andreea Mitrache*
Macroeconomic Factors and Asset Prices – An Empirical Investigation

7/2015 *Lene Pettersen*
Working in Tandem: A Longitudinal Study of the Interplay of Working Practices and Social Enterprise Platforms in the Multinational Workplace

6/2015 *Di Cui*
Three Essays on Investor Recognition and Mergers & Acquisitions

5/2015 *Katja Maria Hydle*
Cross border practices: Transnational Practices in Professional Service Firms

4/2015 *Ieva Martinkenaitė-Pujanauskienė*
Evolutionary and power perspectives on headquarters-subsidiary knowledge transfer: The role of disseminative and absorptive capacities

3/2015 *Tarje Gaustad*
The Perils of Self-Brand Connections: Consumer Response to Changes in Brand Image

2/2015 *Jakob Utgård*
Organizational form, local market structure and corporate social performance in retail

1/2015 *Drago Bergholt*
Shocks and Transmission Channels in Multi-Sector Small Open Economies

2014

13/2014 *Nam Huong Dau*
Asset Pricing with Heterogeneous Beliefs and Portfolio Constraints

12/2014 *Vegard Kolbjørnsrud*
On governance in collaborative communities

11/2014 *Ignacio García de Olalla López*
Essays in Corporate Finance

10/2014 *Sebastiano Lombardo*
Client-consultant interaction practices: Sources of ingenuity, value creation and strategizing

9/2014 *Leif Anders Thorsrud*
International business cycles and oil market dynamics

8/2014 *Ide Katrine Birkeland*
Fire Walk with Me: Exploring the Role of Harmonious and Obsessive Passion in Well-being and Performance at Work

7/2014 *Sinem Acar-Burkay*
Essays on relational outcomes in mixed-motive situations

6/2014 *Susanne H.G. Poulsson*
On Experiences as Economic Offerings

5/2014 *Eric Lawrence Wiik*
Functional Method as a Heuristic and Research Perspective: A Study in Systems Theory

4/2014 *Christian Enger Gimsø*
Narcissus and Leadership Potential - The measurement and implications of narcissism in leadership selection processes

3/2014 *Mehrad Moeini-Jazani*
When Power Has Its Pants Down: Social Power Increases Sensitivity to Internal Desires

2/2014 *Yuriy Zhovtobryukh*
The role of technology, ownership and origin in M&A performance

1/2014 *Siv Staubo*
Regulation and Corporate Board Composition

2013

9/2013 *Bjørn Tallak Bakken*
Intuition and analysis in decision making: On the relationships between cognitive style, cognitive processing, decision behaviour, and task performance in a simulated crisis management context

8/2013 *Karl Joachim Breunig*
Realizing Reticulation: A Comparative Study of Capability Dynamics in two International Professional Service Firms over 10 years

7/2013 *Junhua Zhong*
Three Essays on Empirical Asset Pricing

6/2013 *Ren Lu*
Cluster Networks and Cluster Innovations: An Empirical Study of Norwegian Centres of Expertise

5/2013 *Therese Dille*
Inter-institutional projects in time: a conceptual framework and empirical investigation

4/2013 *Thai Binh Phan*
Network Service Innovations: Users' Benefits from Improving Network Structure

3/2013 *Terje Gaustad*
Creating the Image: A Transaction Cost Analysis of Joint Value Creation in the Motion Picture Industry

2/2013 *Anna Swärd*
Trust processes in fixed-duration alliances: A multi-level, multi-dimensional, and temporal view on trust

1/2013 *Sut I Wong Humborstad*
Congruence in empowerment expectations: On subordinates' responses to disconfirmed experiences and to leaders' unawareness of their empowerment expectations

2012

9/2012 *Robert Buch*
Interdependent Social Exchange Relationships: Exploring the socially embedded nature of social exchange relationships in organizations

8/2012 *Ali Faraji-Rad*
When the message feels right: Investigating how source similarity enhances message persuasiveness

7/2012 *Marit Anti*
Commercial friendship from a customer perspective: Exploring social norm of altruism in consumer relationships and self-interest-seeking behavior

6/2012 *Birgit Helene Jevnaker*
Vestiges of Design-Creation: An inquiry into the advent of designer and enterprise relations

5/2012 *Erik Aadland*
Status decoupling and signaling boundaries: Rival market category emergence in the Norwegian advertising field, 2000-2010

4/2012 *Ulaş Burkay*
The Rise of Mediating Firms: The Adoption of Digital Mediating Technologies and the Consequent Re-organization of Industries

3/2012 *Tale Skjølsvik*
Beyond the 'trusted advisor': The impact of client-professional relationships on the client's selection of professional service firms

2/2012 *Karoline Hofslett Kopperud*
Well-Being at Work: On concepts, measurement, and leadership influence

1/2012 *Christina G. L. Nerstad*
In Pursuit of Success at Work: An Empirical Examination of the Perceived Motivational Climate, Its Outcomes and Antecedents

2011

12/2011 *Kjell Jørgensen*
Three Articles on Market Microstructure at the Oslo Stock Exchange (OSE)

11/2011 *Siri Valseth*
Essays on the information content in bond market order flow

10/2011 *Elisabet Sørfjorddal Hauge*
How do metal musicians become entrepreneurial? A phenomenological investigation on opportunity recognition

9/2011 *Sturla Lyngnes Fjesme*
Initial Public Offering Allocations

8/2011 *Gard Paulsen*
Betwixt and between: Software in telecommunications and the programming language Chill, 1974-1999

7/2011 *Morten G. Josefsen*
Three essays on corporate control

6/2011 *Christopher Wales*
Demands, designs and decisions about evaluation: On the evaluation of postgraduate programmes for school leadership development in Norway and England

5/2011 *Limei Che*
Investors' performance and trading behavior on the Norwegian stock market

4/2011 *Caroline D Ditlev-Simonsen*
Five Perspectives on Corporate Social Responsibility (CSR): Aan empirical analysis

3/2011 *Atle Raa*
Fra instrumentell rasjonalitet til tvetydighet: En analyse av utviklingen av Statskonsults tilnærming til standarden Mål- og resultatstyring (MRS) 1987-2004

2/2011 *Anne Louise Koefoed*
Hydrogen in the making - how an energy company organises under uncertainty

1/2011 *Lars Erling Olsen*
Broad vs. Narrow Brand Strategies: The Effects of Association Accessibility on Brand Performance

2010

8/2010 *Anne Berit Swanberg*
Learning with Style: The relationships among approaches to learning, personality, group climate and academic performance

7/2010 *Asle Fagerstrøm*
Implications of motivating operations for understanding the point-of-online-purchase: Using functional analysis to predict and control consumer purchasing behavior

6/2010 *Carl J. Hatteland*
Ports as Actors in Industrial Networks

5/2010 *Radu-Mihai Dimitriu*
Extending where? How consumers' perception of the extension category affects brand extension evaluation

4/2010 *Svanhild E. Haugnes*
Consumers in Industrial Networks: a study of the Norwegian-Portuguese bacalhau network

3/2010 *Stine Ludvigsen*
State Ownership and Corporate Governance: Empirical Evidence from Norway and Sweden

2/2010 *Anders Dysvik*
An inside story – is self-determination the key? Intrinsic motivation as mediator and moderator between work and individual motivational sources and employee outcomes. Four essays

1/2010 *Etty Ragnhild Nilsen*
Opportunities for learning and knowledge creation in practice

2009

8/2009 *Erna Senkina Engebrethsen*
Transportation Mode Selection in Supply Chain Planning

7/2009 *Stein Bjørnstad*
Shipshaped: Kongsberg industry and innovations in deepwater technology, 1975-2007

6/2009 *Thomas Hoholm*
The Contrary Forces of Innovation*:* An Ethnography of Innovation Processes *in the Food Industry.*

5/2009 *Christian Heyerdahl-Larsen*
Asset Pricing with Multiple Assets and Goods

4/2009 *Leif-Magnus Jensen*
The Role of Intermediaries in Evolving Distribution Contexts: A Study of Car Distribution

3/2009 *Andreas Brekke*
A Bumper? An Empirical Investigation of the Relationship between the Economy and the Environment

2/2009 *Monica Skjøld Johansen*
Mellom profesjon og reform: Om fremveksten og implementeringen av enhetlig ledelse i norsk sykehusvesen

1/2009 *Mona Kristin Solvoll*
Televised sport: Exploring the structuration of producing change and stability in a public service institution

2008

7/2008 *Helene Loe Colman*
Organizational Identity and Value Creation in Post-Acquisition Integration: The Spiralling Interaction of the Target's Contributive and the Acquirer's Absorptive Capacities

6/2008 *Fahad Awaleh*
Interacting Strategically within Dyadic Business Relationships: A case study from the Norwegian Electronics Industry

5/2008 *Dijana Tiplic*
Managing Organizational Change during Institutional Upheaval: Bosnia-Herzegovina's Higher Education in Transition

4/2008 *Jan Merok Paulsen*
Managing Adaptive Learning from the Middle

3/2008 *Pingying Zhang Wenstøp*
Effective Board Task Performance. Searching for Understanding into Board Failure and Success

2/2008 *Gunhild J. Ecklund*
Creating a new role for an old central bank: The Bank of Norway 1945-1954

1/2008 *Øystein Strøm*
Three essays on corporate boards

2007

6/2007 *Martha Kold Bakkevig*
The Capability to Commercialize Network Products in Telecommunication

5/2007 *Siw Marita Fosstenløkken*
Enhancing Intangible Resources in Professional Service Firms. A Comparative Study of How Competence Development Takes Place in Four Firms

4/2007 *Gro Alteren*
Does Cultural Sensitivity Matter to the Maintaining of Business Relationships in the Export Markets? An empirical investigation in the Norwegian seafood industry

3/2007 *Lars C. Monkerud*
Organizing Local Democracy: The Norwegian Experience

2/2007 *Siv Marina Flø Karlsen*
The Born Global – Redefined. On the Determinants of SMEs Pace of Internationalization

1/2007 *Per Engelseth*
The Role of the Package as an Information Resource in the Supply Chain. A case study of distributing fresh foods to retailers in Norway

2006

10/2006 *Anne Live Vaagaasar*
From Tool to Actor - How a project came to orchestrate its own life and that of others

9/2006 *Kjell Brynjulf Hjertø*
The Relationship Between Intragroup Conflict, Group Size and Work Effectiveness

8/2006 *Taran Thune*
Formation of research collaborations between universities and firms: Towards an integrated framework of tie formation motives, processes and experiences

7/2006 *Lena E. Bygballe*
Learning Across Firm Boundaries. The Role of Organisational Routines

6/2006 *Hans Solli-Sæther*
Transplants' role stress and work performance in IT outsourcing relationships

5/2006 *Bjørn Hansen*
Facility based competition in telecommunications – Three essays on two-way access and one essay on three-way access

4/2006 *Knut Boge*
Votes Count but the Number of Seats Decides: A comparative historical case study of 20th century Danish, Swedish and Norwegian road policy

3/2006 *Birgitte Grøgaard*
Strategy, structure and the environment. Essays on international strategies and subsidiary roles

2/2006 *Sverre A. Christensen*
Switching Relations - The rise and fall of the Norwegian telecom industry

1/2006 *Nina Veflen Olsen*
Incremental Product Development. Four essays on activities, resources, and actors

2005

6/2005 *Jon Erland Bonde Lervik*
Managing Matters:Transferring Organizational Practices within Multinational Companies

5/2005 *Tore Mysen*
Balancing Controls When Governing Agents in Established Relationships: The Influence of Performance Ambiguity

4/2005 *Anne Flagstad*
How Reforms Influence Organisational Practices: The Cases of Public Roads and Electricity Supply Organisations in Norway

3/2005 *Erlend Kvaal*
Topics in accounting for impairment of fixed asset

2/2005 *Amir Sasson*
On Mediation and Affiliation. A Study of Information Mediated Network Effects in The Banking Industry

1/2005 *Elin Kubberød*
Not just a Matter of Taste – Disgust in the Food Domain

2004

10/2004 *Sverre Tomassen*
The Effects of Transaction Costs on the Performance of Foreign Direct Investments - An empirical investigation

9/2004 *Catherine Børve Monsen:*
Regulation, Ownership and Company Strategies. The Case of European Incumbent Telecommunications Operators

8/2004 *Johannes A. Skjeltorp*
Trading in Equity Markets: A study of Individual, Institutional and Corporate Trading Decision.

7/2004 *Frank Elter*
Strategizing in Complex Contexts

6/2004 *Qinglei Dai*
Essays on International Banking and Tax-Motivated Trading

5/2004 *Arne Morten Ulvnes*
Communication Strategies and the Costs of Adapting to Opportunism in an Interfirm Marketing System

4/2004 *Gisle Henden*
Intuition and its Role in Strategic Thinking

3/2004 *Haakon O. Aa. Solheim*
Essays on volatility in the foreign exchange market

2/2004 *Xiaoling Yao*
From Village Election to National Democratisation. An Economic-Political Microcosm Approach to Chinese Transformation

1/2004 *Ragnhild Silkoset*
Collective Market Orientation in Co-producing Networks

2003

2/2003 *Egil Marstein*
The influence of stakeholder groups on organizational decision-making in public hospitals

1/2003 *Joyce Hartog McHenry*
Management of Knowledge in Practice. Learning to visualise competence

2002

6/2002 *Gay Bjercke*
Business Landscapes and Mindscapes in People's Republic of China. A Study of a Sino-Scandinavian Joint Venture

5/2002 *Thorvald Hærem*
Task Complexity and Expertise as Determinants of Task Perceptions and Performance: Why Technology-Structure Research has been unreliable and inconclusive

4/2002 *Norman T. Sheehan*
Reputation as a Driver in Knowledge-Intensive Service Firms:
An exploratory study of the relationship between reputation and value creation in petroleum exploration units

3/2002 *Line Lervik Olsen*
Modeling Equity, Satisfaction and Loyalty in Business-to-Consumer Markets

2/2002 *Fred H. Strønen*
Strategy Formation from a Loosely Coupled System Perspective. The Case of Fjordland

1/2002 *Terje I. Våland*
Emergence of conflicts in complex projects. The role of informal versus formal governance mechanisms in understanding interorganizational conflicts in the oil industry

2001

6/2001 *Kenneth H. Wathne*
Relationship Governance in a Vertical Network Context

5/2001 *Ming Li*
Value-Focused Data Envelopment Analysis

4/2001 *Lin Jiang*
An Integrated Methodology for Environmental Policy Analysis

3/2001 *Geir Høidal Bjønnes*
Four Essays on the Market Microstructure of Financial Markets

2/2001 *Dagfinn Rime*
Trading in Foreign Exchange Markets. Four Essays on the Microstructure of Foreign Exchange

1/2001 *Ragnhild Kvålshaugen*
The Antecedents of Management Competence. The Role of Educational Background and Type of Work Experience

2000

1/2000 *Per Ingvar Olsen*
Transforming Economies. The Case of the Norwegian Electricity Market Reform