Journal of World Business xxx (2013) xxx–xxx

Contents lists available at SciVerse ScienceDirect

Journal of World Business

journal homepage: www.elsevier.com/locate/jwb

The influence of political risk on the scope of internationalization of regulated companies: Insights from a Spanish sample

Alfredo Jiménez [a,*], Isabel Luis-Rico [b,1], Diana Benito-Osorio [c,2]

[a] University of Burgos, Department of Business Economy and Management, C/Parralillos s/n, 09001 Burgos, Spain
[b] University of Burgos, Department of Educational Sciences, C/ Villadiego s/n, 09001 Burgos, Spain
[c] Rey Juan Carlos University, Department of Management, Paseo de los Artilleros s/n, 28032 Madrid, Spain

ARTICLE INFO

Keywords:
Political risk
Multinational enterprise
Experience
Political capabilities
Foreign direct investment
Scope of internationalization

ABSTRACT

Political risk not only constitutes a threat for multinational enterprises but can also be a source of opportunities. Exposure to and accumulated experience dealing with political risk allows firms to better implement a wide set of political actions such as negotiation of entry conditions, lobbying, litigation, campaign contributions and coalition formation, leading to preferential conditions, reduced environmental uncertainty, reduced transaction costs and increased long-term sustainability to the firm. These advantages facilitate investments in countries with higher and more diverse levels of risk and make political risk to be positively associated with the firm's scope of internationalization. This effect is not homogeneous across firms. Drawing from a sample of 164 Spanish companies with investments in 119 countries, we find that the impact is greater for companies in industrial sectors that are the object of greater governmental regulation than it is for firms in non-regulated manufacturing or service sectors, with less frequent interactions with home and host-country institutions.

1. Introduction

In April 2012, Mrs. Cristina Fernández de Kirchner, president of Argentina, announced the expropriation of 51% of the YPF oil company, owned at the time by the Spanish firm, Repsol. A few days later, the president of Bolivia, Mr. Evo Morales, announced the nationalization of the local subsidiary of another Spanish multinational company, Red Eléctrica de España. Political risk frequently materialized in recent times in an indirect – though equally pernicious – way through forced renegotiation of previously agreed conditions.[3] Lately, however, some foreign governments have returned to direct measures in the form of nationalization or expropriation, highlighting the special relevance of political risk not only at the home country, but also in all host country locations where firms undertake Foreign Direct Investments (FDI).

Political risk has traditionally been understood as a threat to multinational enterprises (MNEs), due to an increased probability of opportunistic behaviour by the public sector (Henisz, 1998; Williamson, 1975, 1985; Zelner, 1999). Adopting a bargaining power approach (Kobrin, 1987; Vernon, 1971), several authors have pointed out that MNEs are vulnerable to expropriations, nationalizations, or unilateral modifications of the agreed conditions, when there is a shift in relative bargaining power from the firm to the government. This lower bargaining power can be caused as a consequence of technological obsolescence or the existence of high sunken costs. Conversely, the political institutions perspective (Henisz & Zelner, 2001) suggests that political risk is higher when authorities exercise greater political discretionality, due to the lack of restrictions on their behaviour.

Recently, it has been claimed that political risk is not exclusively an exogenous variable but – at least partially – an endogenous one. Therefore, MNEs can implement strategies targeting not only the market environment but also the non-market environment, with an increasing attention on the political context (Bonardi, Holburn, & Van den Bergh, 2006; Hillman & Hitt, 1999; Hillman, Keim, & Schuler, 2004; Holtbrügge, Berg, & Puck, 2007; Oliver & Holzinger, 2008). Building on the resource and capability-based view of the firm (Barney, 1991; Helfat & Peteraf, 2003; Helfat et al., 2007; Wernerfelt, 1984) and the non-market strategy literature (Doh, Lawton, & Rajwani, 2012; Hillman et al.,

* Corresponding author. Tel.: +34 947 25 89 73.
E-mail addresses: ajimenez@ubu.es (A. Jiménez), miluis@ubu.es (I. Luis-Rico), diana.benito@urjc.es (D. Benito-Osorio).
[1] Tel.: +34 947 25 90 19.
[2] Tel.: +34 91 488 77 94; fax: +34 91 488 79 49.
[3] A vice-president at Enron International claimed that governments tend to use indirect methods instead of direct expropriations: "*They are more likely to find ways to blame the Project sponsor, withhold or cancel key permits of approvals, and so forth, resulting in contract frustration rather than expropriation... The loss can even be worse than with (classical) expropriation, because it can be difficult or impossible for a project sponsor to obtain compensation for a contract frustration loss*" (Powers, 1998, pp. 127–128).

1090-9516/$ – see front matter © 2013 Elsevier Inc. All rights reserved.
http://dx.doi.org/10.1016/j.jwb.2013.06.001

2004), MNEs can develop political capabilities that allow them to interact with the authorities of the host country in more appropriate ways to achieve their strategic goals (Boddewyn & Brewer, 1994; Baron, 1995; Hillman & Hitt, 1999; Holburn, 2001; McWilliams, Fleet, & Cory, 2002; Wan, 2005; García-Canal & Guillén, 2008). There is empirical evidence of the proactive management of political risk by those companies with greater political capabilities in order to gain advantages in locations characterized by higher levels of risk or unpredictable policy contexts. This has been the case in the U.S. electricity sector (Holburn, 2001; Holburn & Zelner, 2010), the European air transport sector (Lawton & Rajwani, 2011; Lawton, Rajwani, & Doh, 2013), in Spanish MNEs (García-Canal & Guillén, 2008; Jiménez, 2010), and in FDI flows from the South of Europe towards the North of Africa and Eastern Europe (Jiménez, 2011). Consequently, we contextualize this paper within the international strategy of Spanish MNEs given the demonstrated relevance and positive impact of political risk in the location of companies in regulated industries across Latin America (García-Canal & Guillén, 2008), the scope of the international expansion of MNEs (Jiménez, 2010) and corporate performance (Jiménez & Delgado, 2012).

Drawing on the contributions of these authors, the objective of this paper is to analyze whether political risk has a diverse impact on internationalization strategy dependent on the particular industry to which the company belongs. Specifically, we propose that the overall impact of political risk on a firm's scope of internationalization will be positive, with regard to both the absolute level of risk of the different locations and the diversity of risks of the firm's FDI portfolio. We expect that this impact will be greater on those companies in regulated industries, given the superior development of their political capabilities in comparison with other companies. This is because the state plays a very active role in the regulation of these industries. This increases uncertainty and the unpredictability of the policy context and means that MNEs have to react and interact much more frequently with governments both from the home and from the host countries (Doh & Pearce, 2004; Lawton et al., 2013). This broader experience and exposure allows firms to achieve a more accurate assessment of political risk, enhance negotiation, litigation and lobbying skills, choose better campaign contributions, form coalitions and political networks that facilitate access to information, resources and opportunities an even take advantage of corrupt systems. This, in turn, can provide preferential conditions when entering a country, reduced environmental uncertainty, lower transaction costs and increased long-term sustainability to the firm (Hillman, Zarkhoody, & Bierman, 1999). In contrast, political capabilities are relatively underdeveloped in companies from non-regulated industries, in which the state plays a much less relevant role, because interaction with the political institutions of the home and host countries is not as frequent.

Combining the institutional approach with the resource-based view of the firm and the non-market strategy literature, this paper contributes to the literature on institutional environment and its impact on business management. Drawing from a sample of 164 Spanish companies with investments in 119 countries, we find that exposure to and previous experience dealing with political risk and political capabilities play a key role in international strategy. However, the influence varies across industries, being greater for companies in industrial sectors that are the object of greater governmental regulation than it is for firms in non-regulated manufacturing or service sectors, with less frequent interactions with home and host-country institutions. In addition, a second contribution lies in the supplementary empirical evidence we have gathered, to demonstrate that the firm should consider political risk and political environment as an opportunity rather than solely as a set of constraints or a source of potential threats (Oliver & Holzinger, 2008). In fact, companies can take advantage of opportunities arising both from the particular risk level of the locations and from the management of a diversified location portfolio.

The remainder of the paper is structured as follows: in Section 2, we review the literature focused on political risk and political capabilities and we develop our hypotheses. Section 3 describes the sample, model, dependent, independent and control variables, and the collinearity diagnosis. Section 4 shows the results and the robustness tests. Finally, Section 5 presents the main conclusions, managerial contributions, limitations and future lines of research.

2. Literature review and hypotheses

2.1. Political risk, political capabilities and scope of internationalization

Despite the existence of several possible definitions, political risk may be broadly defined as the probability of a government using its monopoly over legal coercion to refrain from fulfilling existing agreements with an MNE, in order to affect the redistribution of rents between the public and private sector (Holburn, 2001). Building on the bargaining power approach, most papers focused on political risk have argued that MNEs enjoy their most advantageous position when negotiating the entry conditions with the host government before making their investment. Once the investment is made, however, there is a crucial shift in the relative bargaining power between the MNE and the government due to the existence of sunken costs (Vernon, 1971). In addition, the bargaining power of the MNE may also decrease as any technological and managerial advantage becomes obsolete or the gap between the MNE and domestic companies is narrowed. Eventually, a point can be reached where the host government may consider the advantages of appropriating the rents that the MNE generates. Nevertheless, this approach has been criticized, because it considers MNE-government relations as a zero-sum game, without taking into account the possibilities of mutual benefits (Luo, 2001).

Recognizing that markets operate in a political, administrative, judicial, and social context, a new approach based on the analysis of political institutions has been employed to predict the level of risk as a function of the existence of constraints on the discretional behaviour of the authorities (Henisz, 2000; Henisz & Zelner, 2001). This perspective, which belongs to the institutional economics literature (North, 1981, 1990), acknowledges that the institutional context in which the firm operates affects its behaviour.

Generally, MNEs tend to avoid investments in locations where authorities can easily and unilaterally modify the agreed conditions governing the firm's entrepreneurial activity. This has been confirmed by several studies analyzing political discretionality (Henisz, 2000; Henisz & Zelner, 2001, 2002), economic freedom and protection of property rights (Bengoa & Sánchez-Robles, 2003; Kapuria-Foreman, 2007) and corruption (Cuervo-Cazurra, 2006, 2008; Habib & Zurawicki, 2002; Wei, 2000).

Literature has shown that enterprises sometimes behave differently and tend to invest in locations characterized by higher levels of political risk (García-Canal & Guillén, 2008; Holburn & Zelner, 2010; Holburn, 2001; Jiménez, 2010, 2011). Drawing on the resource and capability-based view of the firm (Barney, 1991; Helfat & Peteraf, 2003; Helfat et al., 2007; Wernerfelt, 1984) and on the corporate political activity and non-market strategy literature (Bonardi et al., 2006; Doh et al., 2012; Hillman & Hitt, 1999; Hillman et al., 2004; Holtbrügge et al., 2007; Oliver & Holzinger, 2008), this behaviour can be explained by the development of capabilities of a political nature that allow firms to obtain competitive advantages. These capabilities guarantee success