Managing International Political Risk: Arising Challenges for Multinationals in a Changing World

Editors:
Emin Akcaoglu, Harald J. Bolsinger & Rainer Wehner

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Foreword

Foreign direct investment (FDI) by multinational corporations (MNCs) is one of the major drivers of economic globalization. According to the data published by UNCTAD, the world FDI stock increased phenomenally from US$ 698 billion in 1980 to US$ 23 trillion in 2012. The growth in FDI flows has indeed outpaced the rate of growth in international trade. However, FDI flows have declined since the beginning of the global financial and economic crises in 2007. 2009 was the beginning of a recovery period for global FDI flows; but in 2011, a downward trend started and continued by 2015. After a significant improvement in 2015, the trend has been downward again. Though a modest recovery is expected at the moment, UNCTAD states that “elevated geopolitical risks and policy uncertainty for investors could have an impact on the scale and contours of the FDI recovery in 2017” (UNCTAD, World Investment Report 2017: p.2). Therefore, while the world has been going through a turbulent process, political risks and policy uncertainty currently seem as the major concerns of MNCs for their potential investments.

In many countries, the political agenda is rapidly changing, and the ever-diminishing stability is replaced by huge uncertainty and high dynamics. Uncertainties caused by unexpected political developments in various countries involve significant politics-induced financial risks for MNCs, and this situation is not limited only to developing and emerging countries.

Therefore, political risk management is a basic area especially for multinational companies to study particularly these days. In other words, in the current global environment of high political risks and policy uncertainty, it will certainly be valuable to examine the evolution of political risk perceptions of multinationals and also the tools and techniques they use to skilfully manage such risks. Analysing how investors perceive and deal with these risks will additionally contribute to a better understanding of the role of political risk insurance in the post-crisis investment landscape, and how it can help to multinationals’ direct investment activities in high risk regions or countries.

It is an imperative for companies, countries, business professionals and politicians, to get together for discussion about future developments and about options for securing global solidarity to the good of people and business in existing normative frameworks.

In this respect, Würzburg International Business Forum’s International Business Conference (24-25 May 2018) brought academics, professionals, business people and representatives of the public sector from the world together to analyse the current situation, trying to foresee
future developments regarding political risk management within the framework of foreign direct investment and all other activities of multinational corporations. The Conference provided an international forum for the exchange of information and experience regarding political risk management in different countries and the implications of these so far on countries’ economies and societies from a broader perspective. The Conference has explored both theoretical issues in the field and practical issues in formulating policy and strategy and it has also paid attention to the issue of employment and growth regarding multinationals and foreign direct investment.
Proceedings of Plenary Session I
Company-specific Reactions to Country Risk Changes: A Case Study from the Perspective of Austrian Subsidiaries in the Russian Federation

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Country risk is a term that is not only difficult to define but also difficult to assess. The following research project shows a company perspective of the understanding of country risk in the broader sense, considering country risk changes over time. Moreover, it examines ongoing operations of foreign subsidiaries after a successfully realized market entry. From the perspective of Austrian affiliates in the Russian Federation, the author will identify specific company strategic reactions to appeared changes of the Russian country risk ratings.

Motivation and research issue

Characteristic for the Russian Federation are not only the remarkable geographical conditions, but also the particular economic, political, legal and socio-cultural factors. Consequently, especially foreign investors face specific business conditions. Besides the well-known problems like extreme dependence on raw materials’ exports, lack of competitiveness of the manufacturing industry, a very high level of corruption, inefficient bureaucracy and a still continuing economic stagnation (Jänecke & Wehner, 2014), the European Union imposed economic sanctions based on the Crimea-conflict in March 2014 and, as a result, investment growth fell dramatically. A view of the state of the Austrian foreign direct investment (FDI) transactions into the Russian Federation reveals a persistent decline after 2013: In 2013 FDI amounted to €917 million, in 2014 fell to €247 million and in 2016 – to €-822 million (OeNB, 2017). Consequently, since 2014, the credit risk rating of the Russian Federation by Moody’s, S&P and Fitch deteriorated markedly while the outlook remained negative. This worrying ratings’ development has led to stress and confusion among foreign investors.

Internationally seen, according to several country-specific studies on FDI, country risk seems to be one important determinant of FDI (Blonigen, 2005, Vijayakumar et al., 2009, Goerzen et al., 2010, Demirbag et al., 2007). In post-soviet countries, for example, the economic transition and political instability have indeed had a negative impact on the investment behavior of foreign investors and, as a result, FDI flows into Eastern European reform countries and the Balkan countries have significantly decreased (Brada et al., 2006). The above examples show that every country or group of similar countries is unique and has its specific business environment. Therefore, investigating country risk requires specific analyses of individual countries.

As stated above, this case study focuses on the Russian Federation. Therefore, it should be first clarified how Austrian subsidiary companies with ongoing operations in a high risk country like the Russian Federation change their understanding of country risk, when it rises further due to a geopolitical conflict. Based on these observations, the main aim of this research project is to trace connections between the occurred increases of the country risk of the Russian Federation since 2014 and their influence on the strategies of Austrian companies with subsidiaries in the Russian market.

Theoretical frame and literature review

The literature review process consists of three steps. First, starting with the explanation of the term risk as measurable uncertainty (Knight, 1921), the specific form country risk should be described in its broader sense. The second step consists of a brief illustration of the internationalization process, focusing on that form with the strongest engagement, namely wholly owned subsidiaries. In the last part, the author directs the reader’s attention to the importance, perception and consequences of country risk not before the realization of a market entry but after a company has already been present on a foreign market for a certain time.

Country risk in the broader sense

Country risk can be, on the one hand, a “significant market barrier”, and, on the other hand, “an essential determinant of market and location attractiveness” (Levasier, 2003). Typically, country risk is associated with eventual negative external factors that affect companies’ activities abroad. They arise from the total economic,
political and socio-cultural situation of the host country (Meyer, 1987). In addition, the legal environment of the host country, potential global economic and environmental events are further aspects a country risk researcher should consider (Przybylski, 1993) as well as various internal and external political tensions with neighboring countries or unions.

The differentiation between country risk in the broader sense and country risk in the narrow sense of sovereign risk is also of key importance for this research project. The focus of the paper is on the overall risk of one specific country with all its risk aspects, i.e., “risks in connection with direct investments of international enterprises” (Przybylski, 1993). Furthermore, one should not mix up country risk with credit risk (Krayenbuehl, 1985). Moreover, with regard to the last clashes between the Russian Federation and the European Union, the political aspect of country risk is a strong one. At the same time, being aware of the fact that country risk includes more aspects than the political situation of a country, understanding both terms as synonyms would not be exact.

Different understandings of country risk result also in inconsistent country risk assessment concepts, most often based on quantifying risk components and presenting an overall country risk rating. The OECD country risk classification of Russia, for example, has worsened by one category at the beginning of 2015. Top ratings agencies like Moody’s, Standard and Poor’s and Fitch also lowered their sovereign risk appraisals of Russia as a reaction of the Crimea conflict once in spring 2014 and then again in the beginning of 2015, whereas the outlook remained negative even for the following year 2016.

Foreign market engagement in the form of wholly owned subsidiaries

Depending on the intensity of capital and management activities in the home country or, respectively, in the host country, forms of internationalization start with exporting and end with direct investments that can be expressed as cooperative (joint venture) or sole ownership enterprises (subsidiaries) (Meissner & Gerber, 1980, Johanson & Vahlne, 1990). Wholly owned subsidiaries are characterized by legal independence and liability of the invested capital abroad (Zentes, 2010). Additional distribution and production capacities are formed through the establishment of new or acquisition of existing subsidiaries (Jahrreiß, 1984).

Building a bridge between country risk and market engagement

When investing on a new risky market in the literature, country risk is important, on the one hand, on a macro (FDI) level and, on the other hand, on a micro (company) level. Empirical social research on the connection between country risk and FDI shows a positive correlation (Chakrabarti, 2001, Click, 2005, Hayakawa et al., 2013, Vijayakumar et al., 2009, Barbopoulus et al., 2013, Ledyaeva et al., 2013, etc.). However, this research project has its focus on reaction strategies of specific companies about their market engagement on foreign markets. A good recent example is the article of Gurkov & Saidov (2017), which shows specific strategic actions of Russian manufacturing subsidiaries of Western multinational corporations in various functional areas. In the case of the Russian Federation, a series of studies on companies with Russian subsidiaries examine the topics of strategy realization and strategy-as-practice perspective (Shekshnia, 1994, McCarthy & Puffer, 1997, Lorentz & Ghauri, 2010, Shekshnia, 1998, Koveshnikov et al., 2012, Salmi & Heikkilä, 2015, Fey & Shekshnia, 2011, Engelhard & Nägele, 2003, Gurkov, 2015, Gurkov, 2016, etc.).

Another decisive factor in determining the coherence between the above two terms is the time of looking at country risk. On the one hand, the assessment of country risk is crucial before the realization of the market entry and, on the other hand, it continues to exist after the successful foreign market establishment. Most of the literature examines country risk primarily related to entry mode choice claiming that multinational enterprises prefer equity joint ventures over wholly owned subsidiaries in foreign countries where the country risk (expressed also as external or institutional environment) is highly uncertain (Gatignon and Anderson, 1988, Agarwal, 1994, Agarwal and Ramaswami, 1992, Morschett et al., 2010, Kao and Kuo, 2017). However, the existing literature lacks of studies concentrating on market engagement strategies after a successful market entry. Especially such cases that face unexpected negative changes of the country risk represent the focus of the following research project.

Methodological approach

In order to answer the research question, methods of qualitative empirical research are used. Their aim is to explain a social phenomenon “from within” through analyzing certain experiences through documents or other means of proof (Flick, 2007). Often, qualitative research is being associated with a high degree of subjectivity in data interpretation, absence of basic theories, or even a lack of hypotheses to be tested (Holweg, 2012). However, in the course of an explorative case study, the generation of hypotheses happens rather in later stages of research with the aim of presenting a new perspective of a known topic (Eisenhardt, 1989). According to Yin (1994), using a case study as a research strategy supports a deep and detailed investigation of a certain phenomenon representing an identified research gap and has the aim to answer how and
why questions, like the current ones.

**Sampling**

First, the process of data collection requires a precise selection of the cases (Flick, 2007). The concrete subjects of this research investigation are Austrian companies with the strongest possible foreign representation in the Russian Federation, i.e. wholly owned subsidiaries with Austrian capital participation up to 100%. The main source of suitable companies was the homepage of the Vienna Stock Exchange because quoted companies have to publish their reports that provide a good data basis. The list has been also completed by own research work. Consequently, there has been selected six companies having at least one sales office or a production facility in the Russian Federation. In the next step, the researcher grouped the selected companies in three industry sectors: financial institutions, infrastructure and mechanical engineering.

**Research method**

Due to the small sample of relevant Austrian companies with direct investments in the Russian Federation and the intention to carry out an in-depth analysis of the selected companies, the best research method seems to be a case study method. This method requires a description and investigation of an individual case or a series of case studies (Flick, 2009). Usually, the main idea of such research method is to find one or more solutions for a certain problem that a company faces (Yin, 2003). A major advantage of the case study method is the fact that the case is not isolated from the context, in contrast to an experiment, but the analysis happens in its ordinary environment (Eisenhardt & Graebner, 2007). In this research work, a system of categories presents, on the one hand, the homogeneity (the similarities on which the groups of companies have been formed) and, on the other hand, the heterogeneity of cases (for example, the different industries in which the selected companies operate). In the first step, parallel within-case analyses for each of the six companies are planned; in the second step, cross case analyses within every of the three sector groups will follow.

There is a wide range of data collection and evaluation techniques in social sciences. In this sense, the choice of one or more suitable methods of investigation should occur very precisely. To ensure the expected result(s), combinations of different methods are often used. Among the different forms of triangulation, the so-called "methodological triangulation", i.e., a triangulation between different methods ("between-method") is the most widespread (Flick, 2007). To obtain valid results, the analysis implies a combination of, on the one hand, secondary data (company reports, press releases and additional corporate documents) and, on the other hand, supplementary primary data (expert interviews), if needed.

**Data collection**

Data collection distinguishes between two types of data depending on the survey methodology: secondary and primary data collection. For both types of data, the selection of available data followed in German and English as well as in Russian language.

Another important criterion for the data collection is to determine a time period of the upcoming investigation. In this thesis, the date of the official outbreak of the conflict between the Russian Federation and Ukraine, namely March 2014, served as a guideline for the timeframe. In order to be able to compare the business environment situation before and after 2014, the total investigation period consists of two separate periods (from 2011 to 2013 and from 2014 to 2016) or six years in total, which applies to both secondary and primary data.

**Secondary data** The secondary data include, on the one hand, statistical FDI data from the Austrian National Bank as well as from the Central Bank of the Russian Federation. On the other hand, also vital for the realization of this research project are country risk ratings provided by various international (Moody’s, Standard & Poor’s', Fitch) and national (Expert RA and NRA International) rating agencies. The second secondary source is online available company information like reports and press releases of the selected Austrian companies from 2011 – three years before to 2016 (published in 2017) – three years after the escalation of the conflict between the Russian Federation and Ukraine in March 2014. Relevant for the analysis are those documents and text passages among all available that contain information about the engagement on the Russian market.

**Primary data** Published company reports are easily accessible and available at any time. However, they have a few drawbacks as data material, a central one of which is the incompleteness of the necessary data, since they do not aim to answer the specific research question but give general information about a company's business activities (Bowen 2009). This results in the need for additional or more accurate information from other sources. Possible sources include specific market or sector studies, analyst reports, as well as interviews with company representatives (Schawel & Billing, 2014).

Based on the gained information from the insight into the company reports, there will be conducted expert interviews with the responsible persons for the business activities on the Russian market. There is evidence that personal interviews provide much flexibility in the process of both data collection and the following analysis (Yeung, 1995). This intention is planned to be realized both with
representatives in the Austrian headquarters and with the respective persons directly in the Russian Federation. Direct observers of occurring changes due to the volatile country risk give additional valuable, close to the market, information about the company performance in such a turbulent environment.

Data evaluation

As stated above, this research work represents a multiple case study. Both the company information available online (company reports and press releases) and the transcriptions of the planned narrative interviews represent different types of documents. For their evaluation, the best-suited method seems to be a document analysis (Bowen, 2009) conducted with the help of the software program for qualitative data analysis Atlas.ti.

Atlas.ti does not perform the data analysis itself but supports the whole analysis process (Friese, 2014). In the program, the first step is to form so-called hermeneutical units (abbreviated HUs). These units include the primary texts (the actual data (documents)) and secondary texts (memos, codes, code networks, etc.), which can subsequently be edited and managed in relation to each other. As this research project includes 1722 HUs so far, a precise description of the different documents helps with reaching completeness and efficiency of the subsequent analysis of each part of the examination objects.

An essential and a very creative part of the whole data evaluation is the coding process that assumes a very careful analyzing approach. There are many methods how coding can be processed. In this particular case, the data structure includes three steps (Costas, 2012). The first step consists of the building of first-order categories (coding “in vivo” data by searching for relevant words, phrases, and descriptions, and grouping them into first-order categories). The second step is about formulating of second-order themes (linking and collapsing the first-order categories into significant second-order themes). In the final stage, the researcher groups the second-order themes to a small number of aggregate theoretical dimensions. In the end, the author has to return to the respective text passages and interpret the results of the coding process in the context.

(Expected) Results

As the paper’s aim is to provide answers to two different research questions, the results represent important insights of two connected subjects: changes of the interpretation of country risk according to Austrian subsidiary companies in Russia and changes of their strategies as a reaction of increases of the Russian country risk since 2014.

Looking at the country risk as a term in company reports, it turns out that there are no definitions of it and especially the financial institutions mention country risk as a specific type of risk. Some of the selected companies analyze the business environment of countries they operate in on a frequent basis. Identified political, economic, legal, demographic, geographic and social-cultural aspects assemble the puzzle of the term country risk. In order to determine changes in the understanding of every single aspect of country risk, the author compared company document information three years before and three years after 2014. As expected, predominantly the political, but also many economic aspects provided new insights after the outbreak of the Russian-Ukrainian conflict. Even if many companies claimed that they did not experience unmanageable damage, still, profitability and even trust in the Russian market dropped remarkably and everyone hoped for a soon diplomatic solution.

However, many factors indicated a shrinkage of the economic performance of Russia. GDP decline, peak values of the inflation, drop of the prices because of a massive devaluation of the ruble, lower oil prices and a following significant stock price decrease were quite onerous occurrences after the imposing sanctions for the performance of the companies operating there. The companies registered that their customers also felt the negative effects of the destabilization of the macroeconomic situation of Russia: their creditworthiness declined which ended in a weaker demand and losses from bad loans. As investment climate has clouded, many companies issued a profit warning. Additionally, they warn against possible isolationist tendencies in Russia.

The interpretation of country risk from the perspective of Austrian subsidiaries in the Russian market actually changed after 2014. At first sight, it seems that mainly the political and economic aspects underwent changes. However, some legal and socio-cultural considerations were essential for further successful ongoing companies’ operations on the Russian market. In the following, the author will give exact examples of the reactions of Austrian subsidiary companies to changes of the Russian country risk.

Considering the above negative appearances of many aspects of the country risk of Russia, the reader expects, logically, also negative consequences for the companies’ performance. Financial losses, project postponements, staff cuts, closure of branches, etc. did indeed accompany the ongoing operations of the selected Austrian companies. Surprisingly, one can observe also not a few positive consequences for the business operations of the Austrian subsidiaries on the Russian market. These include spreading of the market coverage by opening additional branches in new regions of the Russian Federation and, consequently, hiring of new staff, as well as fulfillment of already approved projects irrespective of the increased country risk. These and other more concrete implications will be first
identified in the coding process and then grouped in overarching strategic actions of the Austrian subsidiaries on the Russian market in various functional areas like capital and asset management, operations management, human resource management, etc.

To conclude, the author wants to give an overview of positive and negative descriptions of the Russian market according to the selected Austrian companies. If before 2014 Russia was defined as a promising market, extremely interesting market, the most important, the most profitable one, full of potential, etc., after the conflict has erupted: The pearl was yesterday. Of course, even during the time between 2011 and 2013 the Russian market was not an easy market, much more difficult that assumed, Putin’s kingdom and even a big personal disappointment. Indeed, the negative tendency of the former promising market remained, but companies still describe it as a chance, core market, cash cow and important future market.

Summary

The main idea of this research project is to discover strategic reactions at company level to a worsening country risk. It makes an important and innovative contribution to the in-depth analysis of the effects of the changes of country risk ratings of one specific host country, the Russian Federation, on the performance of Austrian subsidiary companies there. This kind of – at first sight limited – research actually gives a very detailed and concrete practical information on effective strategies of doing business in difficult markets. Moreover, it shows ways how firms can deal with an unexpectedly occurred increase of country risks at a point of time when they have already established foreign entities.

References


Gurkov I. (2016): Against the Wind – New Factories of Russian Manufacturing Subsidiaries of Western Multinational Corporations. Eurasian Geography and
The ‘global migration crisis’ has triggered a call for businesses to partner with governments and NGOs to facilitate labor integration and ease social tensions in host countries. We propose that businesses can also play a role in reducing the push factors in origin countries that drive unmanaged migration flows. By engaging in socially responsible business practices that promote societal peace and stability, MNCs can help ameliorate the global migration crisis while also reducing political risk in their operating environments. We draw from the CSR, peace through commerce, and international management literatures to formulate a set of research propositions.

“Migration should be a choice, not a necessity”
(New York Declaration, September 2016)

The world is witnessing the migration of people on an unprecedented scale. More and more people live in countries that are not their native lands, with numbers swelling to 244 million in 2015 (New York Declaration, 2016). While many of these people migrate by choice, “pulled” for instance by education opportunities, more than 65 million people including refugees, asylum seekers and internally displaced persons have been “pushed” from their homes due to conflict, violence, persecution and human rights violations as of the end of 2016 (UNHCR, 2016). Millions of others flee their homes due to disasters, climate-induced droughts, poverty and hunger (Oxfam, 2018), interrelated phenomena that can both cause and be made worse by conflict. According to Eric Schwartz, president of Refugees International, an estimated 25 million people a year are displaced due to natural disasters that are exacerbated by the impacts of climate change, which in turn can aggravate the impacts of forced displacements as a result of conflict (KQED, 2018).

A ‘global migration crisis’ is thus unfolding, as many of those forced from homes seek new lives in foreign lands. These unmanaged migrants cross first into neighboring countries, with Syrian, Afghanistan, South Sudan and Somalia currently the largest source countries, and Turkey, Pakistan, Lebanon, and Iran among the top 10 migrant destinations. However, many hope to travel on to Europe or North America, and while some countries, like Germany, which also ranks among the top 10 migrant destinations, have opened their borders, many more have sought to restrict the inflow of migrants (UNHCR, 2016). As a result, the migration crisis has reverberated through the politics, economies, and social fabrics of countries across the world (PricewaterhouseCoopers, 2017). Given the stresses placed on public institutions and resources, the challenges posed to host countries are immense. Societies have become divided as they seek to manage the social and labor integration of migrants. A study by PricewaterhouseCoopers (2017) has highlighted the importance of collaboration between governments, NGOs and the private sector to develop solutions to manage the challenges faced by host country societies.

We propose that business can also play a role in reducing the push factors in origin countries that drive unmanaged migration and refugee flows. Origin countries are often afflicted with societal conflict and instability. By engaging in socially responsible business practices, we believe that MNCs, in collaboration with governments and NGOs, can help ameliorate the global migration crisis while also reducing political risk in their operating environments. Corporate social responsibility (CSR) activities are consistent with calls from the United Nations, including the UN Global Compact, the UN Principles for Responsible Management Education (PRME), and the UN Sustainable Development Goals (SDGs), for businesses to promote peace, stability and development in fragile and conflict-affected countries (Schouten & Miklian, 2018). This paper responds to calls in the international business literature for studies that examine how businesses can tackle the ‘grand challenges’ of our time, including migration (Buckley, Doh & Benischke, 2017). Our objective is to examine the relationship between unmanaged migration, push factors, MNCs and peace, and to develop a set of research propositions drawing on the CSR, peace through commerce, and international management literatures.

CSR and the Business-Peace Nexus

Corporate social responsibility (CSR) has been defined in a number of ways. It can generally be thought of a set of
practices through which companies integrate social and environmental concerns in their business operations and in their interactions with stakeholders (EU Commission, 2001). CSR thus embodies the notion of the ‘triple bottom line’ based on which companies take into consideration social and environmental sustainability in addition to sustainability of corporate profits (Dyllick & Hockerts, 2002; Waddock, Bodwell & Graves, 2002).

The United Nations Global Compact has provided businesses with a blueprint to further their CSR efforts in areas like employment, corruption, and poverty, and to become more engaged in sustainable development, particularly in countries affected by conflict. Through its Business for Peace (B4P) unit it encourages businesses to partner with governments and NGOs to work toward sustainable development that promotes societal peace and stability in fragile and conflict-affected countries. The linkage with CSR is made explicit, and Forbes is cited as recognizing that the promotion of peace is as an important component of future CSR efforts (UN Global Compact, 2015). Proponents of “business for peace“ argue that if companies pursue meaningful CSR opportunities in larger more demonstrable ways, CSR will become more central to an organization, “becoming the very DNA of the organization” (Ashgar, 2015).

Business for peace, or peace through commerce, is a relatively new concept (Fort, 2007) that has gained some momentum in the international business literature (e.g., Oetzel, Westermann-Behaylo, Koerber, Fort, & Rivera, 2010; Oetzel & Getz, 2011; Reade, 2015). It has been noted that the business for peace concept has grown out of the relative increase in the power and influence of MNCs compared to nation states, which have generally taken the lead role in peace building efforts (Schouten & Miklian, 2018). Businesses, in fact, have historically been associated more with conflict than with peace, as exemplified by the role of commerce in following the flag during periods of colonialism and mercantilism (Fort & Schipani, 2007). More recently it has been recognized that increased trade can help reduce conflict and that companies themselves most often benefit from the stability that comes with increased peace (Fort, 2007). The business-peace nexus brings to our attention that there are parallel activities of commercial and mercantile interests that nourish a sense of community” (Reade, 2015). This means engaging in egalitarian practices and participative decision making (Fort & Schipani, 2007; Reade, 2015). Responding to such social stresses can also include adopting practices that are culturally relevant and based on indigenous knowledge (Reade, 2015; Reade & McKenna, 2013). Firms might also pay attention to creating diverse teams to integrate organizational members in the case of ethnic conflict (Lee

Economic

Economic factors have been the most highly researched reason for unmanaged migration (Perry, 2012). A lack of economic development, with few jobs, high unemployment, and poverty, prompts people to look for opportunities elsewhere. Further, there is a strong link between underdevelopment and violence; resources are scarce, competition intensifies, and violence can erupt as people get desperate (Fort & Schipani, 2004).

MNCs can reduce economic push factors by providing jobs, creating safe working spaces, and engaging in economic development efforts. These might include training and resource transfer (Fort & Schipani, 2007). We therefore propose:

**Proposition 1:** When MNCs engage in job-creating investments and support local CSR initiatives, there will be greater societal peace and stability in their areas of operation and a decreased incidence of unmanaged migrant flows.

Societal

Societal push factors include concerns over religious freedom, personal safety and stable social conditions (Perry, 2012). Where these conditions are not met, societal tensions can escalate into ethnic conflict or other forms of identity-based conflict, such as conflicts based on religious affiliations or beliefs. Such conflicts between groups have been on the rise (HIK, 2014). People’s emotions, perceptions, and worldviews are tied to group identification and appear to be central to cycles of violence and conflict (Schirich, 2001).

To address such societal push factors, MNCs can “nourish a sense of community” within the company (Fort & Schipani, 2007). This means engaging in egalitarian practices and participative decision making (Fort & Schipani, 2007; Reade, 2015). Responding to such social stresses can also include adopting practices that are culturally relevant and based on indigenous knowledge (Reade, 2015; Reade & McKenna, 2013). Firms might also pay attention to creating diverse teams to integrate organizational members in the case of ethnic conflict (Lee

Migration Push Factors and MNC Engagement

Unmanaged population movements across borders are most often precipitated by “push” factors that involve some form of political conflict (UNHCR, 2016). Political conflicts can manifest as protests, strikes, riots, insurrections, terrorist attacks and war (HIK, 2014; Klomp & de Haan, 2009). There are a number of underlying systemic factors that drive political conflict which are, in their own right, “push” factors for unmanaged migration. They can be grouped into economic, societal, geopolitical and environmental push factors (Perry, 2012). The following details these push factors and proposes the role that MNCs can play in reducing them.

**Proposition 1**
& Reade, 2015). Therefore, we propose:

**Proposition 2:** When MNCs adopt equitable and transparent human resource management practices and support internally and externally the promotion of fundamental human rights, there will be greater societal peace and stability in their areas of operation and a decreased incidence of unmanaged migrant flows.

**Geopolitical**

Geopolitical push factors include weak or ineffective governance and fragile or corrupt state institutions, but can also be exacerbated by the presence of conflict in a neighboring state and by terrorism, often linked to cross-border and international networks. *Many internal conflicts around the world are concerned with either changing or preserving the current political or economic system (IIIK, 2014), while domestic and international terrorism creates instability for both societies and businesses* (IEP, 2016; 2017; Suder, 2006). The World Economic Forum (WEF) has determined that terrorism is one of the top risks for businesses whilst many of the refugees currently fleeing their countries do so because of terrorist threats.

MNCs can address these geopolitical factors by being responsible corporate citizens within their operating environments, advocating for responsive and effective governance, and engaging in supportive practices and actions to protect the safety and security of their employees (Bader, Reade & Froese, 2016; Bader & Schuster, 2015; Suder, Reade, Riviere, Birnik, & Nielsen, 2017). We therefore propose:

**Proposition 3:** When MNCs engage with governments and nongovernmental organizations as responsible corporate citizens, there will be greater societal peace and stability in their areas of operation and a decreased incidence of unmanaged migrant flows.

**Environmental**

Natural disasters and environmental degradation can lead to the displacement of people. Earthquakes, climate change-induced draught, and lack of potable water are some examples of how natural and manmade environmental disasters can increase social instability and push people to migrate. The effects of climate change can uproot people by destroying livelihoods, increasing food insecurity, and undermining social capital (UNFCC, 2018).

In the short term, businesses often have the capacity to respond to natural and manmade disasters more quickly and effectively than traditional aid providers (Balestros & Wry, 2017), contributing to social stability. In the medium term, business can help strengthen the resilience and adaptive capacity of societies facing environmental stress by engaging in ‘strong sustainability’ practices through CSR efforts (Malovics, Csigene, & Kraus, S., 2008). In the long-term, business can adopt and advocate for sustainable environmental practices that will limit the worst effects of climate change. Therefore, we propose:

**Proposition 4:** When MNCs engage in and advocate for environmentally sustainable practices within their areas of operation, there will be greater societal peace and stability and a decreased incidence of unmanaged migrant flows.

**Conclusion**

Rapid increases in recent years in the unmanaged movement of people across boarders has been described as a “global migration crisis”. The UN High Commission for Refugees has reported that as of the end of 2016 there were more than 65 million people worldwide who had been driven from their homes by conflict, poverty, and environmental disaster (UNHCR 2016; Oxfam 2018). While violence and conflict are the proximate cause when people decide to flee for safety, underlying economic, societal, geopolitical and environmental “push” factors are most often a contributing factor leading to the increased political instability and societal unrest that are the drivers of unmanaged migration.

Unmanaged migrants when internally displaced contribute to increased social stresses within countries of origin, and as they move across borders can exacerbate inter-group conflict and political instability in neighboring countries and along migration routes. When unmanaged migrants are able to reach destination countries, the result is often an increase in societal and political conflict as these countries seek to accommodate an increasing flow of refugees, asylum seekers, and undocumented migrants. In this context, attention has been drawn to the role business can and should play, in collaboration with governments and nongovernmental organizations, in facilitating host-country integration of unmanaged migrants (PwC, 2017).

We have proposed that MNCs also have a role to play in reducing the push factors in countries of origin that drive these unmanaged migration and refugee flows. Four research propositions have been presented for how business can engage in socially responsible business practices to ameliorate these push factors and thereby promote greater societal peace and stability in their areas of international operating environments. In this way, MNCs can contribute not only to the betterment of their own business but can help to address one of the ‘grand challenges’ of our time.

**References**


Why Chinese Firms Invest in Politically Risky Countries: Mapping the Cause

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This paper examines the concept of political risk and explores the causes of Chinese outward foreign direct investment (OFDI) in politically-risky countries. Empirical observations indicate that Chinese MNCs tend to invest in countries with a relatively high level of institutional hazards (political risk). Understanding the causes for this is of both theoretical and practical significance. This paper reviews literature of core journals in international business, examines the concept of political risk, describes and maps potential reasons for Chinese firms to invest in politically risky countries, particularly in Africa. Finally, we discuss the potential changes of Chinese firms’ investment behaviours based on the findings.

Political risk has increasingly become a major consideration in international business and foreign direct investment (FDI) due to the growing globalisation, rapid technology development, and social movement (Buckley, Chen, Clegg, & Voss, 2016a; Stevens, Xie, & Peng, 2016). Resource nationalism, tension between multinational enterprises (MNEs) and local communities (Klein, 2014), cyber-attack, and more recently revival of nationalism or “degloalisation” movement are becoming sources of political risk. It is widely reported in the literature that there is a negative relationship between the level of a country’s political risk and its inward FDI as MNEs tend to invest in low political risk countries to minimize its investment risk (Delios & Henisz, 2003) and that MNEs tend to avoid or reduce their investment in countries with high political risk (Giambona, Graham, & Harvey, 2017).

Nevertheless, several studies have reported that Chinese firms (most of them have not generated over 25% of their total revenue from international operations, thus cannot be considered as MNEs) have invested heavily in politically riskier countries (Buckley, Cross, Hui, Liu, & Voss, 2008b; Kolstad & Wiig, 2012; Ramasamy, Yeung, & Laforet, 2012). For example, Kang and Jiang (2012) found there is a positive association between Chinese outward FDI stock and political risk in their study on the location choice of Chinese firms in Southeast Asian countries. Similarly, a positive relationship was also reported by Lu, Huang and Muthiri (2017) in their study on Chinese outward FDI in African countries. Why Chinese firms display such idiosyncratic, or “perverse” (Buckley et al., 2018) investment behaviours, that are very different from those of Western MNEs (Buckley et al., 2008b), and even those from other developing countries? This raises an interesting question if the existing knowledge on FDI can adequately address important issues arisen from the increasing Chinese OFDI in this changing world.

Chinese outward FDI has rapidly increased since 2008 and become a leading source of global FDI. It reached $145.7 billion in 2015 (Ministry of Commerce, 2016) and was ranked as the second largest in the world, only trailing the USA (UNCTAD, 2016). By the end of 2015, the stock of Chinese outward FDI reached $1.1 trillion (Ministry of Commerce, 2016). A total of over 20,000 Chinese firms has invested in 188 countries and regions. (Ministry of Commerce, 2016). Moreover, Chinese firms have also invested substantially in politically-riskier countries, noticeably African countries over the last decade and accumulated FDI stock of over $34 billion in Africa by the end of 2015 (Ministry of Commerce, 2016). Such risky investment approach seems difficult to be fully explained by the main stream FDI theory, such as Dunning’s OLI model (Dunning, 2001) that was developed primarily for FDI from developed countries, and the Linkage-Leverage-Learning (LLL) model (Mathews, 2006) for FDI from developing countries. These main stream FDI theories primarily focus on the factors at the firm level, although the “location” of OLI model has considered the host country’s market size and the economic endowment (national resources and strategic assets). As concluded by Buckley et.al (2008) in their study on Chinese outward FDI that “Chinese ODI (outward FDI) is indeed distinctive with respects to a standard model of developing country ODI, which itself is distinctive with respect to industrialised country ODI” (p.717). However, little systematic research has been conducted on why such distinctiveness or differences in outward FDI behaviour exit between Chinese investors and their counterparts in developed and other developing countries.

This paper aims to explore why Chinese firms invest in politically riskier countries and map the causes of such investment. A small, but recently growing, literature has drawn theories from institutional and transaction cost theories (Buckley et al., 2008b), and more recently, political economy (Tuman & Shirali, 2017), and behavioural
decision theory (Buckley et al., 2016a; Maitland & Sammartino, 2015) to explain the investment behaviours of multinational enterprises (MNEs) into politically riskier countries. However, there has been little systematic integration of these theories to provide a comprehensive understanding of Chinese outward FDI in politically riskier countries.

This paper is organised as follows: We firstly review and analyse the concept of political risk. Next, we provide a comprehensive overview of the factors identified in the extant literature on outward FDI by Chinese firms. After this, we map these factors to identify their relationship. Finally, we discuss the main causes of risk-taking behaviour by Chinese firms and predict the future trend of their outward FDI behaviour in those politically-risky countries.

**Political risk: A conceptual framework**

Although political risk has long been a subject of study, there is no consensus on its definition (Fitzpatrick, 1983). The concept of political risk has been defined in many ways, with different scope and breadth. Early definition of political risk focused on the effects of *government actions* on the business. For example, Weston and Sorge (1972, p.60) defined political risks as they “arise from the actions of national governments which interfere with or prevent business transactions, or change the terms of agreements, or cause the confiscation of wholly or partially foreign owned business property”. These government interferences with private investment often generate “potential for significantly affecting the profit or other goals of a particular enterprise” (Robock, 1971, p.7) thus are sources of business risk for the firm (Kobrin, 1979).

Recent research on political risk has examined the causes of government actions in two streams; one focuses on the impact of political institutions on investors, such as quality of institutions, rules of laws, and corruption; another stream examines on the stability, or change, of political institutions or policies (Henisz, 2000). With regards to policy instability, or “political hazard” (Delios & Henisz, 2003), it refers to potential changes in government policy, or “policy creditability” (p.1155). In other words, it is concerned with the policy stability or how difficult to make changes in laws and regulations under the existing *institutional systems* (Delios & Henisz, 2003). Host country government policy change is a major source of political risk (Casson & da Silva Lopes, 2013). This specific aspect of political risk is often referred to “policy risk” (Bouchet, Clark, & Grosblamert, 2003; Buckley et al., 2016a). In summary, political risk can be considered as the product of the possibility of a political action and the magnitude of loss it may cause, although these two aspects have often been examined in the literature as two parallel streams.

More recently, the scope of political risk has been expanded as the global political, economic and social environment change over the past three decades. For example, Howell and Chaddick (1994, p.71) defined political risk as “the possibility that political decisions, events or conditions in a country, including those that might be referred to as social, will affect the business environment such that investors will lose money or have a reduced profit margin”. Similarly, Czinkota, Ronkainen and Moffett (2000, p.107) defined political risk as both “the actions of legitimate government authorities” and “events caused by factors outside the control of government”. These definitions added social risk to the realm of political risk.

Country risk is another term widely used in studying international business risk. Conceptually, it covers political risk. The concept of country risk can be defined as “additional risks not present in domestic transaction… (they) typically include risks arising from a variety of national differences in economic structures, policies, socio-political institutions, geography and currency” (Meldrum, 2000, p.33).

Casson and Lopes (2013) have proffered a typology of risks for foreign firms in host countries, and argue risks can be both subjective and objective from an epistemic perspective. The subjective risk is primarily caused by the investors’ unfamiliarity about the host country due to the lack of experience and thus can be alleviated through learning. They then classified the objective risks into two general groups (institutional and natural) and six specific categories. The institutional risks cover political, social, business, financial risks while natural risks include climatic and geological risks. Therefore, political risk can be considered as one specific institutional risk of country risk. Based on the discussion above, the conceptual framework of political risk can be depicted in Figure 1.

![Figure 1 The conceptual framework of political risk](Source.Casson & da Silva Lopes, 2013)
Political risk can be examined in multiple levels, and considered as a *relative* term to investing firms as its potential impact can vary with investing projects, firms, their industry, and their home country (Luo, 2001a) because the impact of host country government actions can be targeted at a specific level (Frynas & Mellahi, 2003). While the country-level risk can be termed as “macro political risks”, the other three levels (industry, firm, and project) of risks can be called as “micro” political risks (Robock, 1971). The relativity nature of political risk can be partly attributed to a variety of factors at the level of both host and home countries (Ramamurti, 2001), organisational level (Feinberg & Gupta, 2009), and individual level (Buckley et al., 2016a; George, Chattopadhyay, Sitkin, & Barden, 2006) due to the different perception by home country governments, focal firms, and their managers towards the nature of political risk (George et al., 2006; Hagigi & Sivakumar, 2009). Moreover, the impact of political risk is also related to home country’s institutions (Stevens et al., 2016). For example, the impact of corruption can have more severe impact on those foreign investors from countries where bribery is considered illegal by laws in home country, such as USA (Doh, Rodriguez, Uhlenbruck, Collins, & Eden, 2003).

In summary, the concept of political risk covers both the quality or impact of political institutions, and their stability. It can be objective or subjective, and has multiple levels.

**Why Chinese firms invest in political riskier countries?**

Research on outward FDI, particularly in the past two decades, has examined theories underpinning FDI from developing countries, including China. Several studies have found that Chinese OFDI tend to invest in politically risky countries as one of its distinctive features (Nuckley et al., 2018). For example, using the China’s outward FDI data from 1991 to 2005, Buckley et al., (2008b) found that Chinese firms invested heavily in countries that have high levels of political and economic risk, such as sub-Saharan Africa, Latin America and the Caribbean, and Southeast Asian regions. They also reviewed literature on developing country’s outward FDI to assess if Chinese outward FDI conforms to the general model of FDI and the special case of emerging country FDI. They pointed out that Chinese outward FDI conforms some aspects of developing country outward FDI models, such as home country embeddedness or special ownership advantages, and home government support for outward FDI. Nevertheless, Chinese outward FDI differs from their counterparts in other developing countries in several aspects. For example, the early Chinese outward FDI were made in developed, and culturally and geographically distinct countries, rather than developing and psychically close countries. Chinese firms also used both higher equity mode (wholly-owned subsidiaries) and international joint ventures (IJVs) at their early stage of internationalisation. They conclude that “Chinese ODI (outward FDI) is similar to, yet distinct from, the standard model of emerging country ODI…” (p.741). Table 1 shows the similarities and differences of OFDI between China and other developing countries.

| Table 1. Similarity and difference of outward FDI between China and other developing countries |
|-----------------------------------------------|-------------------------------------------------|
| **Standard model of developing country** | **Chinese outward FDI** |
| **outward FDI model** | **outward FDI** |
| **Home country embeddedness** | Similar as Chinese firms enjoy financial advantages especially |
| **Home government support** | Similar as Chinese government provides strong support for its domestic firms’ outward FDI, but can be different in forms and extent |
| **Early outward FDI occurs in other developing countries** | Different as early Chinese outward FDI was directed mostly to developed countries |
| **Outward FDI occurs in culturally and geographically close countries** | Different as early Chinese Outward FDI was directed to psychically and geographically distant countries |
| **Later outward FDI occurs in more advanced economies** | Different as both early and continued Chinese outward FDI occurs in more advanced economies |
| **IJVs are the main entry mode, especially in early outward FDI** | Different as both wholly-owned subsidiary and IJVs are used |

Source: adapted from Buckley et al., (2008).

Based on the findings in Table 1, all the differences of Chinese outward FDI from that of other developing countries lie in the high level of risk Chinese firms take in investing abroad, particularly in both of its investment path and entry mode. Rather than adopting an incremental approach to risk, Chinese firms invested in culturally and geographically distant countries with wholly-owned subsidiary as the dominant entry mode at the early stage of their internationalisation process. Moreover they also invested substantially in politically-riskier countries. All these suggest that such risk-taking behaviour is an important characteristic of Chinese outward FDI.
The risk-taking investment behaviour by Chinese firms can be observed in both developed and developing countries, as shown in Table 1. However, the type of risk taken by Chinese firms in developing countries is different from that in developed ones. While lack of ownership advantage and international experience is often the risk for Chinese firms to invest in developed countries, political risk is often the major risk for Chinese firms to invest in developing countries. This paper only focuses on Chinese outward FDI in developing countries with high levels of political risk.

A number of studies have explored the reasons why Chinese firms invest in politically-risky countries, particularly in Africa. Most of reasons or drivers are primarily based on both institutional and transactional approaches, and at both national and organisational levels. We reviewed literature from six core international journals (Journal of International Business Studies, Journal of World Business, Journal of International Management, Global Strategy Journal, Management Review International, and International Business Review) and seven other management journals supplemented by other articles published in key management journal and other relevant sources of information.

A variety of factors have been reported in the extant literature of political risk and Chinese OFDI. These factors can be grouped into three levels: country, organisational and individual levels.

**Influencing factors at the country level**

Several studies have reported the impact of home country embeddedness (Buckley et al., 2008b), or “home country conditions” (Luo & Wang, 2012) on risk-taking investment behaviour. These studies largely focus on home country institutions and economic environments.

**Institutional factors**

With regards to institutional factors, Buckley et al., (2008) suggested that the different or idiosyncratic outward FDI behaviour of Chinese firms can be attributed to the following reasons: 1) soft budget constraints as Chinese firms can access to cheap capital; 2) improved bilateral relations between Chinese and host country governments; 3) Chinese government’s political agenda as it directs outward FDI. Empirical studies have supported for these three factors at the home country level (for more details, see Buckley et al., 2018).

Short distance in institutional setting between China and other developing countries is another potential reason (Kolstad & Wiig, 2012; Morck, Yeung, & Zhoa, 2008). Although China has become the second largest economy since 2010, China is still a developing country judged by many intuitional and economic indicators, such as corruption and GDP per capita. Therefore, the institutional environment between China and other developing countries can be similar in many ways, such as poor legal enforcement, corruption, and labour relations. The importance of institutions to competitive advantage has been stressed in strategic literature (Peng, 2006). The short institutional distance also helps build internal legitimacy within Chinese firms (Child & Rodrigues, 2005).

Discrimination by some developed countries may also contribute to the fact that Chinese firms invest in politically riskier countries. Accesses to the market and resources by emerging MNCs, including Chinese firms, to developed countries may be blocked by the host countries. Examples include the proposed acquisition of Unocal by CNOOC in the USA (Globerman & Shapiro, 2009) and Huawei’s bid for the National Broadband Network (NBN) project in Australia (Hedges, 2015). Such discrimination limits the choice of Chinese firms in their FDI decisions.

The strong strategic and financial support from Chinese government (Lu, Liu, Wright, & Filatotchev, 2014; Luo & Wang, 2012) has been identified as one of the important features of Chinese outward FDI (Buckley et al., 2008a). It is not a secrecy that Chinese government, particularly from both central and provincial levels, offers direct financial support to those Chinese firms investing abroad (Luo, Xue, & Han, 2010). Moreover, Chinese government plays a primary role in directly negotiating and bargaining with host country governments for entry conditions for Chinese natural resources firms (Li, Newenham-Kahindi, Shapiro, & Chen, 2013), often through bundling investment with low-interest loans, providing infrastructure (e.g., road, railway and port) and foreign aid (e.g., healthcare and education) that cannot be matched by Western MNCs due to its size and complexity. This “helps them (Chinese firms) mitigate the considerable political risks associated with these investments” (Li et al., 2013, p.301). In addition, Chinese government has also coordinated the investment activities of Chinese firms in FDI host countries to enhance their legitimacy there, which can help alleviate political risk (Stevens & Newenham-Kahindi, 2017).

**Economic factors (Transactional cost theory)**

Like MNEs from other developing countries, the fit of technology and products possessed by Chinese firms with the demand of developing countries can be another possible explanation for Chinese firms to invest into politically riskier countries. The costs for MNEs from developing countries to adapt their products and technologies for developing countries can be lower compared those for their counterparts in developed countries. Given the technology and products owned by emerging MNEs, expanding market in developing countries can be the only option for them if they aim to compete on their firm specific advantage (FSA) (Rugman, 2005). Anecdotal evidence shows that Chinese firms, such as Huawei, and ZTE, are able to adapt their products and technologies to developing countries due to
their “cheaper and more easily used products with technology” by users in those countries (Shen, 2012).

The large size of Chinese domestic market is probably an important factor that is not shared by most of firms in other developing countries. The large domestic market can help Chinese firms make OFDI due to the scale and scope of economy. This is a unique factor for Chinese firms and helps them invest in politically riskier countries. It is pointed out that Chinese firms can leverage their large domestic size, coordinate their domestic and international business and thus reap the benefits of scale of economy (Yeung & Liu, 2008). This is particularly helpful for those high volume Chinese manufacturing firms to compete with those technologically sophisticated and capital intensive MNEs in international market. The large domestic market size also benefits Chinese firms in terms of scope of economy in developing their business portfolio in both domestic and foreign markets.

Organisational factors

A raft of organisational factors has been identified in the literature. State ownership (Morck et al., 2008; Yeung & Liu, 2008) has been highlighted in the FDI literature, and is probably one of the most dominant factors at the organisational level that drives Chinese outward FDI into politically-riskier courtiers (Kolstad & Wiig, 2012). Although Chinese firms started making their FDI since early 1990s, Chinese privately owned enterprises (POEs) were only permitted to invest abroad since 2003 (Huang & Chi, 2014). Thus, it is not surprised that Chinese SOEs have been dominant for Chinese FDI, although Chinese POEs have been playing an increasingly important role, particularly since the GFC in 2009. SOEs are less sensitive to political risk (Ramasamy et al., 2012) due to their ownership from the agency perspective and their soft budget (Luo, 2001b; Tolentino, 2010).

A related factor is the strategic motive of Chinese outward FDI. One of the dominant motives for Chinese outward FDI is resource-seeking (Kolstad & Wiig, 2012) that is dominant in the FDI by Chinese SOEs. Due to its rapid economic development over the past three decades and the shortage of domestic supply of energy and minerals, China has relied heavily on international supply for its economic development. Therefore, China needs to secure resources from international markets to safeguard its economic future (Lu et al., 2017). Consequently, a substantial proportion of Chinese outward FDI has been made in the energy and minerals sector (Huang & Austin, 2011), primarily by Chinese SOEs. Although resource-seeking FDI is less subjective to political risk in the host countries (Kansal, 2015) as it depends on the availability of natural resources, Chinese firms, as latecomers in international markets (a point to be discussed below), have limited options (Stevens & Newenham-Kahindi, 2017). They can invest either in quality resources in politically-risky countries or second class of resources in developed countries where political risk is usually low. Moreover, the exploration and extraction of natural resources often involve an initial large scale capital investment, and a long period of gestation period (Asiedu & Lien, 2011). Often only large Chinese SOEs can afford such large scale of investment.

Latecomer in the global market is another reason why Chinese firms invest in politically riskier countries (Kolstad & Wiig, 2012). This well applies to Chinese firms, particularly SOEs, seeking natural resources. Established extractive companies, such as BHP Billion and Rio Tinto, had opportunities to explore and extract first-class natural resources globally, particularly in those host countries with low political risk, such as Australia and Canada. Thus, like other MNEs from emerging economies, Chinese firms have to invest either in second-class resource in developed countries like Australia, or first-class resources with relatively high political risk. As commented by an executive of a Chinese SOE on its decision to invest in a copper mine in Africa during our interview: “Our decision to acquire the mine was primarily based on its mineral quality as it contains about 2% of copper, which is much higher than 0.4% in our mines in Australia”.

Lack of international experience, particularly merger and acquisition (M&A) activities (such as due diligence and risk assessment) could be another factor contributing to the risk-taking behaviour by Chinese firms. An overwhelming majority of Chinese firms only started their international investment since 2001 when the Chinese government implemented its “going out” policy, and lifted its restriction on Chinese private firms to invest abroad (Huang & Chi, 2014). Given the complexity of political risk and its subjectivity in its assessment and evaluation, Chinese firms may be unable to assess the level of political risk satisfactorily (Yeung & Liu, 2008), and thus insensitive to political risk (Buckley, Yu, Liu, Munjal, & Tao, 2016b).

Chinese firms may also adopt different ways in political assessment compared with the Western MNEs. It has been pointed out by Brautigam (2009), a veteran research on Chinese engagement in Africa, that Chinese firms tend to assess the political risk at the project level, rather than the country level, suggesting different contextual factors and criteria are used by Chinese firms in evaluating political risk in host country.

Individual factors

Recently, several studies have explored the factors influencing the risk-taking investment behaviour at the individual level. Agency theory has been used in explaining FDI behaviours of top management in Chinese firms (Liu, Lu, & Chizema, 2014). Agency theory is an important characteristic of SOEs (Peng, Bruton, Stan, & Huang, 2016) and agency problem is perennial in Chinese SOEs due to state-ownership and weak corporate
governance (Tam & Yu, 2011). Senior managers in Chinese SOEs are often appointed politically, rather than based on their professional competences (Yeung & Liu, 2008). Anecdotal evidences showed that executives of Chinese SOEs may use outward FDI for empire building (Huang & Zhu, 2016) and benefit their family members, relatives and friends.

Lack of experience in international business and risk assessment at individual level could be another reason for Chinese firms to underestimate the level of political risk. Chinese entrepreneurs, particularly those from start-ups or small firms, were reported to use “guerrilla-style” outward FDI strategy because they lack managerial expertise and yet identify a new business opportunity in a host country (Yeung & Liu, 2008).

Finally, it is also reported that managers of Chinese firms use their personal relationship and networks as individual specific advantage (IFA) in making their investment decisions. This could be another reason for to invest in politically-riskier countries because such networking capabilities can “circumvent cumbersome rules and regulations… (and) help obtain privileged access to markets and resources (Yeung & Liu, 2008, p.77).

Based on the discussion above, we have mapped the factors that have been identified in the literature and driven Chinese firms to take risky behaviour in their FDI (Figure 2).

Discussion and cause-mapping

This paper focuses on the identification and integration of factors influencing Chinese firms’ investment in politically-riskier countries. Although Chinese firms were widely observed to display different patterns, particularly risk-taking, in their OFDI behaviour, extant literature explaining such idiosyncratic investment behaviour is still very scant and fragmented. We conducted a systematic literature review to identify factors underlining the risk-taking behaviour of Chinese firms in their OFDI, classify them into the levels of country, organisation and individual, and map them to understand their connections (Figure 2).

Compared with MNEs from other developing countries, Chinese firms also have shared with them several characteristics at both country and organizational levels, such as stage of technology and product development, short institutional distance to those in developing countries, financial support from home government, and latecomers in international markets. However, there are several distinctive factors that drive Chinese firms to take more risk in their outward FDI? Our map (Figure 2) indicates that there exist three major sources of distinctive factors that impact on such risk-taking behaviour: the China’s political system underpinned by its socialist ideology, the uniqueness of Chinese SOEs, and the large size and heterogeneity of Chinese domestic market and its rapid economic growth that accumulates large amount of capital for FDI financing.

Figure 2. Mapping factors that influences the risk-taking investment behavior by Chinese firms

China’s political system or regime (Shi, Hoskisson, & Zhang, 2016), particularly its institutions and political structure built on its political ideology, is one of key sources of the risk-taking investment behaviour of Chinese
firms for several reasons. The ideological differences and increasing competition between China and US with its Western alliances is a perennial phenomenon since 1949 and result in the grave concern by Chinese government about the security of its key mineral and energy supply from the global market for its economic development. For example, the resource-seeking motivation of Chinese outward FDI is primarily a national initiative to secure critical resources for Chinese economy. Although this is not different from those of Japanese MNEs in 1970’s and 1980’s, it is the China’s political ideology that concerns the political influence and control by developed countries on its international supply (e.g., oil and minerals), thereby making the international supply for China’s economic development more critical. Part of China’s “Belt and Road Initiative” is aimed to diversify these suppliers and their transportation for China’s national security (Cheng, 2016). Economic diplomacy by Chinese government is another outcome of this ideological competition. A point in this case is the diplomatic relationship between China and African countries. At the sixth Forum of China-Africa Cooperation (FOCAC) Summit and sixth Ministerial Conference in Dec 2015, President Xi Jinping announced China will offer African countries $60 billion of funding support from 2016 to 2018 (FOCAC, 2015). Part of such financial support is to help Chinese firms to invest in Africa among other initiatives (FOCAC, 2015). All these partly reflect the competition between China’s socialist ideology and the capitalist ideology of Western countries. The capital control by Chinese government and capital flight with Chinese private firms widely reported in media partly reflect the concern about this ideological difference at both levels of the Chinese government and firms (Weinland, 2017).

The second factor driving the risk-taking behaviour of Chinese firms is the role played by China’s SOEs that is very different from those from other countries. In general, SOEs are very different from private firms in terms of their objectives, financing and senior management appointments (Peng et al., 2016). However, Chinese SOE sector is massive. The total asset of Chinese SOEs at the end of 2016 was two trillion dollars and generated $700 billion of revenue (State-owned Assets Supervision and Administration Commission (SASAC), 2017). Moreover, Chinese governments are still heavily intervening with SEOs through multiple channels (Zhang & Freestone, 2013), including the appointment of senior management and boards of directors, approval of major investment decisions and financing, and even control of its SOEs’ production. Thus, the investment decisions at Chinese SOEs are often driven by its government’s political agenda and economic diplomacy. Agent problem is also a characteristic of Chinese SOEs due to their political appointment, coupled with their weak corporate governance (Tam & Yu, 2011). At the same time, the Chinese Government still has “little clear skill or experience” in managing political risk, unstable government and security threats in host countries (Shi, 2017).

The large domestic market size and its heterogeneity is also a unique factor influencing the risk-taking behaviour of Chinese investors as they can leverage their domestic operations for their international investment and business (Luo & Wang, 2012) in terms of scale of economy and investment portfolio. Chinese investors can reap substantial benefits from their domestic market size, making their products more competitive in international market (Buckley, et.al., 2018). The large domestic market size also enables them to take a risky approach in their FDI as such FDI may be more likely to be considered as “affordable loss” based on the effectuation theory in entrepreneurship discipline (Chandler, DeTienne, McKelvie, & Mumford, 2011). Those Chinese firms setting up their trading offices overseas can also benefit from China’s large domestic market and thus export their products at a lower price.

Will Chinese firms invest in politically-riskier countries in the future? The answer is yes as long as China is concerned with the competition of its political systems with those of Western countries, particularly the US. Its political agenda, such as its “Belt and Road” initiative, will play its part in driving Chinese firms, particularly its SOEs to invest in politically-riskier, often developing countries (Huang, 2016 #6). In addition, the large domestic market size will still help Chinese firms benefit from their scale of economy, enable them to take a risky approach in their outward FDI. Nevertheless, the amount for investing in politically riskier countries may be changed, especially in those countries with rich natural resources and poor institutions due to increasing awareness of the impact of political risk on commercial loss and staff security (Shi, 2017), coupled with the FDI made so far in the resources, partly alleviating the supply security of China’s key industries, such as energy and iron ore.

It is surprisingly that few studies have been devoted to studying the factors at individual level. In fact, no empirical research has been conducted so far, in our best knowledge, on how Chinese managers/owners perceive political risk at the individual level. Yeung and Liu (2008) suggested that Chinese managers take a risky approach in their outward FDI because they are flexible in management, and can skillfully leverage their personal relationship and network. As argued by Buckley et. al., (2016a), a manager’s risk propensity, that is, “an individual’s current tendency to take or avoid risk”, can play a substantial role in evaluating the nature of risk as it is subjective. How factors at the individual level influence the risk-taking behaviour could be an area with a huge potential for future research on Chinese outward FDI.
Conclusion

This paper attempts to identify factors that influence Chinese firms to invest in politically riskier countries and map their causes. In doing so, we reviewed literature of Chinese outward FDI in leading journals, and integrate and map the factors influencing Chinese firms’ investment in politically risky countries. Several conclusions can be made based on our findings in this study.

We have found that three root factors that underlie the risk-taking investment behaviour by Chinese firms: the Chinese political systems underlined by its ideology, the role of Chinese SOEs and their micro-management, and the existence of a large and heterogeneous domestic market. The Chinese political system is the most dominant factor that drives Chinese firms to take a risky approach in their investment in international markets. The differences, and thus competition in political systems between China and Western bloc lead by the USA is a major cause of concern for Chinese government to use investment as part of political agenda in serving its political needs. The ideological difference also concerns Chinese government for the international supply of natural resources for its rapid economic development, driving Chinese firms to “go out” to secure key natural resources (i.e., oil, gas, and minerals) though a variety of mechanism ranging from financial support to policy directions for its SOEs.

The second distinctive factor is China’s SOEs. Chinese SOEs plays a major role in China’s economic development domestically and economic diplomacy globally. Noticeably over the last two decades, Chinese SOEs have been dominant in making their FDI in securing international supply of natural resources and as major players for implementing China’s foreign aid projects. As latecomers in international markets, Chinese SOEs have invested heavily in quality resources that often are less explored in those countries due to the high level of political risk. At the organisational level, the agency problem arisen from the ownership and weak corporate governance, coupled with the political appointment of senior management and boards of directors, can make Chinese SOEs less sensitive to the financial performance outcomes and may use their outward FDI for the benefits of senior management.

The third factor that helps Chinese firms to make risky investment decision in their outward FDI is the large size and heterogeneity of domestic market and its rapid economic growth. A large domestic market can be leveraged by Chinese firms to reap the benefits of economies of scale and scope. Thus they can consider their investment in risky countries as “affordable loss” due to their large domestic business. Moreover, a heterogeneous and vibrant Chinese market also assists its small investors to invest abroad due to their ability to source products in their domestic market for different needs overseas. The consistent and rapid economic growth over the last three decades in Chinese economy has accumulated much capital in China which helped the financing Chinese firms easily secure financing for their OFDI and at the low costs.

References


Determinants of Political Risk in African Markets: A Nigerian Perspective

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The political risk determinants are significant for understanding how countries’ specific political risk indicators emerge that affects Multinational Corporations (MNCs) activities within African markets. The study investigates the determinants of political risk empirically by analysing data from MNCs operating in Nigeria using a mixed methods approach. The findings identified eight determinants and determined their relationships with some political risk. This paper contributes to the extant body of literature on political risk with some implications for practice in the conduct of PRA and management of political risk. It offers insight into what causes unexpected recurrent changes in most Africa’s political environments.

Keywords: political risk, multinational corporations, emerging markets, developing country, Nigeria, Africa

Introduction

Political risk is one of the most important influences upon the conduct of contemporary international business, particularly for multinational corporations (MNCs) operating in developing countries or emerging markets (Baek & Qian, 2011; Baldacci, Gupta, & Mati, 2011; Jiménez, Luis-Rico, & Benito-Osorio, 2014). A number of events have taken place, whose consequences have reshaped the international business environment and have influenced the types of strategy which multinational corporations adopt. These include the growth of transnational terrorism and conflicts in some part of the world (Bekker, Harvey, Lundblad, & Siegel, 2014; Sottilotta, 2015). Due to the consequences of some of these events for multinational corporations, it is prescient to investigate the determinants of political risk within the context of developing countries.

Political risk has been evolving over the past few decades, and different types have emerged during this period. At one time, the main risks facing businesses were nationalisation and expropriation. Subsequently, issues such as tax restrictions, license cancellation, delayed profit repatriation, changes in investment agreements, protectionism, have come to the fore (Baek & Qian, 2011; Jiménez, Luis-Rico, & Benito-Osorio, 2014; Sottilotta, 2015; World Bank, 2015).

The evolution of political risks has made them increasingly difficult to analyse. This has resulted in a range of consequences that have influenced some of the types of strategies which multinational corporations may adopt in emerging markets, due to differing country’s political risks (Kerner & Lawrence, 2014; Kesternich & Schnitzer, 2010). However, MNCs vary in terms of their types of ownership structure and entry mode. This suggests that they may perceive political risk in different ways and that this will influence their type of international involvement in developing countries (Agarwal & Feils, 2007; Kesternich & Schnitzer, 2010; Quer, Claver, & Rienda, 2012).

Each type of political risk has a number of interrelated determinants which lead to its existence in a particular country (Burmeister, 2000; Kobrin, 1982). They may affect multinational corporations in different ways. Likewise, it is the presence of these determinants which influences some of the political decisions or policies made by the government, which could further be attributed to the heterogeneity of political risk in most developing countries. Therefore, the purpose of this paper is to critically analyse the relationship between the determinants of political risk and the nature of political risks themselves – and to do so in an African context.

African markets are becoming important to the world economy with increasing rate of FDI by MNCs in their quest for growth and competitiveness (Bekaert et al., 2014; Hayakawa, Kimura, & Lee, 2013; Ramamurti, 2004; UNCTAD, 2016). However, most emerging markets in Africa tend to have evolving political climates, with unstable governments and frequent policy changes. In some African countries, terrorism and domestic insurgencies are particular issues (Asiedu, 2006; Baek & Qian, 2011; Jensen, 2008; Tarzi, 2005). This means that they have specific political risk factors that need to be taken into consideration in any calculus of political risk and political risk assessment (Baldacci, Gupta, & Mati, 2011; Bekaert et al., 2014; Quer et al., 2012).

Africa is not a homogenous entity; rather it is diverse and complex with considerable variations within as well as between some states. This diversity and pluralism relate to political, economic, socio-cultural and institutional systems (Amankwah-Amoah, 2016). Therefore, the consequences of
political risk for multinational corporations differ from one emerging market to another and likewise within individual parts of some of them (Brink, 2004). Nigeria is chosen as the emerging market to study since it has become one of the world’s major destinations for foreign direct investment (FDI) by multinational firms due to both its natural resources and its large domestic market (population 160 million). However, it has suffered from an unstable political environment caused by issues such as terrorism, inconsistent government policies, political violence, high rates of poverty, high rates of unemployment, religious intolerance, bad governance and poor management of resources (Bienen, 2013; Iarossi & Clarke, 2011). The paper is structured into six parts; the first is this introduction, the second part is a theoretical review and literature about political risk in Nigeria. The third part is about the methodology and analysis of findings adopted for the study, the fourth part discusses the findings, and the fifth part is about the study’s contributions, with the sixth a conclusion.

Literature Review

Political risk appeared as a distinct field of study in international business devoid of an accepted theory summarising the fundamental principles clarifying the responses of multinational firms towards host government policies regulating them either within the context of developed or emerging markets (Robock, 1971; Grosse & Behrman, 1992). Institutional theory is potentially a way forward in this context since the causes of political risk are often institutional. Previous studies have attempted to link political risk to institutional theory to explain what influences a firm’s decision to internationalise to a location (Dunning, 1998; Buckley et al., 2007; Busse & Hefeker, 2007; Jiménez et al., 2011, 2014; Osabutey & Okoro, 2015; Nathan, 2008; Quer et al., 2012; Witt & Lewin, 2007). The neo-institutional theory has a broad theoretical concept with accentuates on legitimacy, isomorphism and rational myths which focus more on resilient facets of social structure. In the context of this study, the legitimacy aspect of institutional theory posture will be considered due to the fact that multinational firms often attempt to attain legitimacy relative to the individual host country they are operating in (Meyer, 2008; Scott, 2004; Zucker, 1987). The legitimacy perspective of the neo-institutional theory construct can be used to explain how firms make decisions in responding to different institutional regulations as they move from either a developed economy to an emerging one or vice versa (Meyer, 2008; Peng, Wang, & Jiang, 2008; Quer et al., 2012). Therefore, these institutions could be “responsible” for the emergence of political risk in some markets.

Institutional theory is applicable to multinational firms particularly since they operate in different institutional contexts with different political risks. Institutional factors are a significant consideration for firms undertaking international business, especially in developing countries where there often serious institutional weaknesses (Francis & Zheng, 2009; Meyer, Estrin, Bhauumik, & Peng, 2009; Osabutey & Okoro, 2015). This is because both informal and formal rules influence whether a firm should enter a new market (Quer et al., 2012). Likewise, it is government institutions in a country who set up the rules and regulations which constitute how organisations should interact in both a formal and an informal setting (Meyer, 2008; Peng et al., 2008; Quer et al., 2012; Witold & Swaminathan, 2008). Consequently, the rules and regulations set by these government institutions are parameters which can determine the differences between a profitable investment and a non-profitable investment.

Political Risk

The definition of political risk is a challenge due to its association with concepts such as ‘political uncertainty’ and ‘political instability’ (Brink, 2004; Howell, 2002; Fitzpatrick, 1983). A number of researchers have tried to relate political risk to government interventions and political events. Howell (2002, p. 4) defines political risk “as the possibility that a political decision or events in a host country will alter the business environment in such a manner that an investor will run a loss or not gain as much as expected from the investment”. More generally, political risk may be understood in terms of its unfavourable consequences for multinational corporations operating in a political environment.

The unfavourable consequences of a political event depend on nature and conditions under which it occurs and the characteristics of the investment as well as the environment (Kobrin, 1979). For this reason, if political risk is seen as an event variable instead of a process variable, its conceptualization could be enhanced (Fitzpatrick, 1983). This implies that it is the probability of changes over time in the level of political risk which is its key driver even though there is the possibility of other factors, both in the event and process variables, that can change the level of political risk. Consequently, this study defines political risk as any changes in the political environment as a result of government decisions or any event/condition which affects the likelihood of a foreign investor achieving its business objectives in a host country. This suggests that political risk does not always originate from government political decisions because some features, causing political risk are not related to them or to political events but they are inherent in a political environment. Therefore, political risk is different from political instability and political uncertainty. Political uncertainty refers to changes due to government actions in a political
environment whereas political instability refers to unexpected changes in the political environment. However, political risk refers to the probability of the occurrence of risk. It is a more objective way of measuring the amount of doubt from political uncertainty and political instability than measures which capture the subjective elements of uncertainty and instability (Brink, 2004).

Political risk in an emerging market is driven by politics, history, religion, economics, culture and international relations (Brink, 2004, p. 21). The drivers of political risk are divergent and vary among countries; likewise their effects on multinational corporations (Burmester, 2000; Kobrin, 1982). Even in the same market, political risk types, costs, probabilities and the degree of their intensity can vary from one part to another; likewise, their consequences, which can be divided into micro and macro risks, vary in their impact (Brink, 2004; Howell, 2002). This can be attributed to differences in political environments, especially in developing countries with weak regulatory institutions, and where ideological, ethnic and religious cleavages are prominent (Busse & Hefeker, 2007; Gaft, 1988). The resultant inability of some multinational corporations to understand fully diverse political environments has resulted in across-the-board policies, which have dichotomized some developing countries as safe or unsafe (Fitzpatrick 1983, p. 251). Hence, there is the need for multinational corporations to have insights about the determinants of political risk in these different developing countries.

A particular political environment can lead to different types of political risk with a variety of consequences for multinational corporations (Uzonwanne, 2013). These consequences add to the cost of doing business, and the cost increases with an increasing probability of political risk, thereby creating different scenarios that corporations need to investigate critically (Brink, 2004; Qian & Baek, 2011). For this reason, multinational corporations use various means to assess each political environment so as to be able to manage and mitigate political risk.

### Classification of Political Risk

Political risk can be classified according to its source since not all risks are as a result of changes from host government decisions. Political risk can be categorised into three sources; namely host-government, host-society and neighbouring countries (Al Khattab, et al., 2011). However, this paper includes other types of political risk, such as investment agreement changes, licence cancellation, delayed in profit repatriation, price controls, and changes in rules and regulation which were not covered by Al Khattab, (2011), Table I.

<table>
<thead>
<tr>
<th>Serial</th>
<th>Host government</th>
<th>Host society</th>
<th>Neighbouring countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Taxation restrictions</td>
<td>Demonstrations/riots/strikes</td>
<td>Wars</td>
</tr>
<tr>
<td>2</td>
<td>Currency inconvertibility/devaluation</td>
<td>Revolutions</td>
<td>Sanction</td>
</tr>
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<td>3</td>
<td>Contract repudiation</td>
<td>Terrorism</td>
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<tr>
<td>4</td>
<td>Import or export restrictions</td>
<td>Coups d’état</td>
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<td>5</td>
<td>Ownership/personnel restrictions</td>
<td>Civil wars</td>
<td></td>
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<tr>
<td>6</td>
<td>Delayed profit repatriation</td>
<td>Hijacking</td>
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<td>7</td>
<td>License cancellation</td>
<td>Piracy</td>
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<td>8</td>
<td>Price controls</td>
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<tr>
<td>9</td>
<td>Expropriation/nationalisation</td>
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<tr>
<td>10</td>
<td>Investment agreements changes</td>
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<tr>
<td>11</td>
<td>Changes in rules and regulations</td>
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Source: Developed from Al Khattab et al. (2011)

### Political Risk in Nigeria

Since the amalgamation of the country in 1914, Nigeria has undergone a series of transformations that have shaped and reshaped its political landscape. After her independence in 1960, a number of political and economic reforms were introduced by both military and democratic governments which had consequences for multinational corporations (John, 1997; Umoren, 2001). Political instability started to emerge in the country after 1966 with the staging of a military coup, and then a civil war took place from 1967 to 1970. Then from 1972, the government introduced a succession of policies that led to the nationalisation of a number of multinational corporations, coupled with a number of military interventions in the government, as well as different political and religious crises (Bienen, 2003;
Onapajo, 2012; Orugbani, 2005). More recently, terrorism, high levels of corruption, high rates of unemployment, inadequate infrastructure, a poor legal system and the unstable situation in the oil-rich Niger Delta region have featured in the country (Aon, 2014; Wafure & Nurudeen, 2010). Nevertheless, Nigeria’s economy is growing and there is an increasing inflow of inward FDI (World Bank, 2015).

The country is divided along cultural, ethnic, linguistic and religious lines within her different geographical regions. Religion and ethnicity permeate the cultural, social and political, as well as the economic, the life of its citizens (Bienen, 2013; Onapajo, 2012). There are different regional ethnic militia groups, such as the Movement for the Emancipation of the Niger Delta (MEND) in the south, the Movement for the Actualisation of the Sovereign State of Biafra (MASSOB) in the east, the Odua People’s Congress (OPC) in the west and ‘Boko Haram’ in the north (Babawale, 2001). ‘Boko Haram’ is a terrorist group, whose actions have led to many deaths, and its activities have resulted in the declaration of a state of emergency in three northern states (Bienen, 2013; Danjibo, 2009). According to the Nigerian Bureau of Statistics, ‘despite the growth of the Nigerian economy, ironically, the percentage of Nigerians living in poverty is on the increase’ (NBS, 2012, p. 11). The report demonstrated that the percentage of the poverty rate of the population increased considerably during the period 1980 to 2010, with the northern part of the country having the highest percentage. In a study conducted by the World Bank on the Investment Climate Assessment Report, 2012, it was reported that in 26 states, investors in Nigeria lost 10 percent of their revenue due to poor infrastructure, crime, corruption and insecurity (Iarossi & Clarke, 2011). It also reported that 80 percent of firms offered bribes to government officials for one reason or another. Therefore, it is in this setting that the determinants of political risk in the emerging Nigerian market will be identified in order to assess their impact on multinational corporations.

**Features of Political Risk**

There are a number of contributory factors leading to the emergence and evolution of political risk in an emerging market. These are referred to as the determinants of political risk. One of the criteria for selecting these determinants is based on knowledge of the observed set of a political environment, which determines the emergence of political risk (Brink, 2004; Rarick, 2000). These determinants are associated with economic, socio-economic and social variables which can lead to events or conditions that cause unexpected changes in a political environment and/or changes in government actions. Most developing countries have ideological, ethnic and religious cleavages inherent in their political environments. These cleavages relate to religion, value systems, per capita income, ethnicity, bureaucratic quality, political structure, military intervention/government change and constitutional problems.

**Religion**

Religion has been a significant factor in the political evolution of most developing countries, especially in countries where there are several religions due to extremism or fundamentalism. Some countries’ laws are based on the religion of the state, with a resultant effect on certain businesses. Nigeria is a multi-religious country and religion permeates the cultural, social, political and economic life of its people, which causes divisions along religious lines (Kendhammer, 2013; Onapajo, 2012; Uzoma, 2004). The desire of a religious group to express its own identity prompts religious sentiment with some having extremist views, has been one of the most common sources of conflict in the country (Falola, 1998; Kukah, 1993). Indeed Nigeria has witnessed a number of religious conflicts especially in the northern part of the country (Agibbo, 2013; Bello & Fawole, 2011; Meagher, 2013; Salawu & Hassan, 2011).

**Value System**

A value system determines what is allowed and what is prescribed in a society. Every society presumes that the values it has enunciated for its members are eternal principles, which are immutable and timeless. A value system classifies certain acts and patterns of behaviour in a society, in accordance with its own ethical considerations. These classifications underpin the ethics and morals of a society. However, certain circumstances may lead to the breakdown of these classifications by society, due to poor leadership, corruption and poverty; these are issues which are all too common in Nigeria (Ikharehon & Omorie, 2015; Okigbo, 1993). The lack of values, such as integrity, honesty, hard work, moderation and humility, puts every other principle of conduct at risk in a country. It is for this reason that a high rate of corruption has been reported in Nigeria (Agibbo, 2013; Ayoola, 2013; Ogaboh, Agba, & Coker, 2010; Smith, 2010). Indeed the degeneration of these values is a systemic failure which has had a major effect on the operation of the business environment in the country due to lack of ethics (Bakare, 2011; Ochulo et al., 2011; Okigbo, 1987; Okoosi-Simbine, 2011).

**Ethnicity**

The existence of multiple ethnic groups in a country is a potential major source of political risk. The competing demands for state resources, as well as political power,
often create tension and agitation among them (Rarick, 2000). These situations are common in most developing countries, where the interests of some ethnic groups are prioritized over others. In Nigeria, there have been issues of inter-ethnic rivalry due to economic and political differences and interests (Nnoli, 1978). They have been responsible for some of the conflicts between the minority and majority ethnic groups which have been witnessed in the country (Ajayi, 2014; Oladiran, 2013; Salawu & Hassan, 2011).

**Per capita Income**

Per capita income is indicative of the living conditions of the average citizen in a given country. Per capita income can be high or low depending on the minimum wage, as well as the productivity of the economy and its impact on the average citizen of that country (Ake, 1985; John, 1997; Olaloku, 1979). A low per capita income indicates that most people are living in poverty, which often increases the crime rate in a country. Several studies on Nigeria have shown that there is a high poverty rate in the country due to the high rate of low per capita income among its population (NBS, 2012; Okoraofo & Nwaeeze, 2013). This is responsible for some of the social problems, crimes and political unrest which have been witnessed in the country (Okoraofo & Nwaeeze, 2013; Olofin et al., 2015).

**Bureaucratic Quality**

The quality of its bureaucracy determines the strength of a country’s institutions and the frequency of the revision of government policies, which is especially likely when there is a change in government or of leadership in any government organisations. There have been cases of political interference in bureaucratic decision making with consequences which have affected the quality of governance in Nigeria (Aluko & Adesopo, 2004). There are situations where excessive bureaucracy exists, creating a long process of doing business and other unethical practices that increase business costs (Lawal & Tobi, 2006; Okotoni, 2001). This often results in negative consequences for multinational corporations doing business in the country (Eme & Ugwu, 2011; Onyekwelu, Okpalibekwe, & Dike, 2015).

**Political Structure**

The political structure which may be spelt out in the constitution of a country covers a wide range of competing values, ideas, interests, persons and resources. This also translates into who gets what, when and how. Most developing countries still have political structures that are weak and defective, as well as which marginalise some groups (Amuwo, 1998; Falola & Heaton, 2008). A number of studies on Nigeria have shown that her political structure is one of the challenges of the country (Dudley, 2013; Joseph, 2014; Sklar, 1965). Some of the political instabilities which have been experienced in the country are because of her political structure. This has also resulted in the formation of different regional ethnic militia groups across the country such as MEND, MASSOB, OPC and Boko Haram (Bienen, 2013).

**Military Interventions / Unstable Government Change**

Government changes and military intervention in the affairs of governance, thereby creating political instability, are witnessed more in developing countries than in developed ones. The involvement of the military in politics is one of the elements of political risk in most developing countries. Changes in government have significant implications for the business environment due to policy changes which often accompany them (Sottilotta, 2015). The tendency for the military to intervene in the affairs of governance is a source of political risk in some developing countries, and there may be a history of military intervention. Nigeria witnessed military interventions and unstable government from 1966 to 1979 and from 1983 to 1999. This has contributed to the present state of Nigeria’s politics and its governance (Amuwo, 1998; Dudley, 1982; Ogaba Agbese, 1996; Orugbani, 2005).

**Constitutional Pitfalls**

The constitution of a country provides the foundation, as well as the mechanism, for the distribution of power, authority and incentives for citizenship. It also plays an important role in the political stability of a country (Tushnet, 2012). The failure of most developing countries to ensure that their constitutions and other statutory laws adapt to the realities of their circumstances is responsible for some of the conflicts which they have experienced. The provisions of Nigeria’s constitution have been decisive in how its citizens are governed and how the rule of law has been applied (Kalu, 2004, 2008; Obasanjo, 1989; Okigbo, 1993). Nigeria has experienced specific challenges as a result of her constitution, that was drafted mainly by preceding military governments before the democratic era (Ilesanmi, 2001; Kalu, 2004; Oviasuyi, Idada, & Isirajoie, 2010; Read, 1979). There have been agitations for a constitutional review in Nigeria, premised on the grounds that the present constitution was drafted by previous military governments and does not adequately address the aspirations of its citizens. Some of the contentious issues and conflicts which have been experienced in the country
have been attributed to constitutional pitfalls (Obasanjo, 1989; Ogowewo, 2000; Kalu, 2004).

**Hypothesis**

The features of political risk outlined above are likely to change over time, since the socio-economic and political situation of a country – in this case, Nigeria - may improve or deteriorate. If the determinants of political risk have various degrees of unfavourable consequences for firms, they will result in a negative impact on multinational corporations. These determinants of political risk create different types of political risk. This creates a rationale for identifying the relationship between the determinants and types of political risk in Nigeria. Therefore, there is the need to test whether as these determinants of political risk increases, the types of political of risk increases or vice versa.

H1 - There is a positive relationship between the determinants of and the types of political risk in Nigeria.

**Methodology, Data and Analysis of Results**

Multinational corporations operating in Nigeria were surveyed via the use of an on-line administered questionnaire to collect data to address the aim and test the hypothesis developed for this paper. Descriptive and inferential statistical analysis was used to equate the scores of the variables as well as examine the relationships between the independent and the dependent variables (Burns & Burns, 2008; Fields, 2013; Wetcher-Hendricks, 2011).

The databases of the Corporate Affairs Commission in Abuja and the Nigerian Stock Exchange in Lagos were used to identify 247 firms which were involved in international business in Nigeria. A further re-examination on a firm-by-firm basis during a pilot study clarified the identification process. Only 150 firms were finally identified as being involved in international business. Subsequently, 59 firms with international names and some form of foreign affiliations supporting their operations indicated that they were not involved in international business because they had been nationalised by the then Nigerian government in the 1970s. A total of 74 multinational corporations in Nigeria across different types of firms participated in an online survey, giving a participation rate of 81.3%.

**Reliability Test**

The scales used in the questionnaire were checked for internal consistency using Cronbach’s alpha coefficient to ensure that the research instrument provided an adequate and accurate measurement for the study. Values above 0.7 are considered acceptable; however, values above 0.8 are preferable (Pallant, 2010). A Cronbach’s alpha coefficient value of 0.86 was found (Table 2). Therefore, there is very good internal consistency associated with the scales used in the questionnaire.

<table>
<thead>
<tr>
<th>Characteristics of Multinational Firms</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
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<tbody>
<tr>
<td><strong>Type of Industry</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td>27</td>
<td>36.5</td>
</tr>
<tr>
<td>Petroleum &amp; Gas</td>
<td>24</td>
<td>32.4</td>
</tr>
<tr>
<td>Banking</td>
<td>12</td>
<td>16.2</td>
</tr>
<tr>
<td>Insurance</td>
<td>5</td>
<td>6.8</td>
</tr>
<tr>
<td>Construction</td>
<td>3</td>
<td>4.1</td>
</tr>
<tr>
<td>Communication</td>
<td>3</td>
<td>4.1</td>
</tr>
<tr>
<td><strong>Forms of International Business</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FDI</td>
<td>48</td>
<td>64.9</td>
</tr>
<tr>
<td>Export/Import</td>
<td>24</td>
<td>32.4</td>
</tr>
<tr>
<td>FPI</td>
<td>1</td>
<td>1.4</td>
</tr>
<tr>
<td>Others</td>
<td>1</td>
<td>1.4</td>
</tr>
</tbody>
</table>

Table 3. Description of Characteristics of Multinational Firms

Table 4 shows political and financial risks have a mean score of 4 (‘Very concerned’) while cultural risk has a

<table>
<thead>
<tr>
<th>Table 2. Reliability Statistics</th>
<th></th>
<th>Number of Items</th>
<th>Number of cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cronbach's Alpha</td>
<td>0.86</td>
<td>0.953</td>
<td>117</td>
</tr>
<tr>
<td>Cronbach's Alpha Based on Standardized Items</td>
<td>0.86</td>
<td></td>
<td>74</td>
</tr>
</tbody>
</table>

international business, 64.9% were internationalised by FDI and 32.4% by export/import. This indicates that most internationalised by FDI into petroleum & gas and manufacturing sectors mainly.
mean score of 2.8. This indicates that most of the participants are very concerned with political and financial risks than cultural risk in international business.

<table>
<thead>
<tr>
<th>Types of Risk</th>
<th>Mean</th>
<th>SEM</th>
<th>Median</th>
<th>Mode</th>
<th>SD</th>
<th>V</th>
<th>Min</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political risk</td>
<td>4.00</td>
<td>.092</td>
<td>4.00</td>
<td>4</td>
<td>.794</td>
<td>.630</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Financial risk</td>
<td>4.04</td>
<td>.091</td>
<td>4.00</td>
<td>4</td>
<td>.748</td>
<td>.615</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Cultural risk</td>
<td>2.84</td>
<td>.109</td>
<td>3.00</td>
<td>3</td>
<td>.937</td>
<td>.877</td>
<td>1</td>
<td>5</td>
</tr>
</tbody>
</table>

**Table 4. Types of Risk in International Business in Nigeria**

Table 5 indicates Mean scores ranging from 3.71 to 3.49, Mode scores ranging from 4 to 3 and SD scores ranging from 0.79 to 1.09, across all features of political risk. The results of the Mean, Mode and SD scores (‘3 moderately a feature’ ‘4 highly a feature’) indicate that most of the participants considered that these causes or features are major determinants of political risk in Nigeria. Among the causes or features of political risk poor value system, religious Intolerance, inter-ethnic rivalry and low per capita income had the highest mean scores.

**Table 5. Determinants of Political Risk in Nigeria**

<table>
<thead>
<tr>
<th>Determinants of Political Risk</th>
<th>Mean</th>
<th>Median</th>
<th>Mode</th>
<th>SD</th>
<th>V</th>
<th>Min</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poor Value System</td>
<td>3.71</td>
<td>4.00</td>
<td>4</td>
<td>.790</td>
<td>.624</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Religious Intolerance</td>
<td>3.72</td>
<td>4.00</td>
<td>4</td>
<td>.836</td>
<td>.699</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Inter-ethnic Rivalry</td>
<td>3.73</td>
<td>4.00</td>
<td>4</td>
<td>.746</td>
<td>.556</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Low Per Capital Income</td>
<td>3.61</td>
<td>4.00</td>
<td>4</td>
<td>.718</td>
<td>.516</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Unstable Gov. Change</td>
<td>3.21</td>
<td>3.00</td>
<td>4</td>
<td>1.092</td>
<td>1.193</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Constitutional Pitfalls</td>
<td>3.09</td>
<td>3.00</td>
<td>3</td>
<td>.939</td>
<td>.881</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Lengthy Bureaucratic Process</td>
<td>3.46</td>
<td>3.00</td>
<td>3</td>
<td>.831</td>
<td>.690</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Weak Political Structures</td>
<td>3.49</td>
<td>3.00</td>
<td>3</td>
<td>.848</td>
<td>.719</td>
<td>1</td>
<td>5</td>
</tr>
</tbody>
</table>

The outputs of the multiple regression results (Table 6) indicate that almost all the dependent variables (determinants) have a positive, but weak, relationship with the independent variable. Thus, it implies that as the determinants increase, political risks increase and vice versa. The R value = 0.463 discloses that a medium correlation exists between the determinants and political risk. This implies that an increase or a decrease in the determinants will not result inevitably in an increase or decrease in political risk. The value of R2 is 0.214 which indicates that 78.6% of the variation in the origin of political risk cannot be explained by the determinants only. Hence, it implies that there are other variables or factors which account for this difference in the origin of political risk. The F value is 2.145 which is significant at p<.05 with the value sig 0.440. Thus, it can be concluded that the regression model results significantly predict types of political risk. However, none of the independent variables makes a statistically significant unique contribution (significant at p<.05). This suggests that there is an overlap among them in making a unique contribution to the prediction of political risk.

**Table 6. The Determinants of and Types of Political Risk**

<table>
<thead>
<tr>
<th>Independent Variables</th>
<th>Correlation</th>
<th>R</th>
<th>R²</th>
<th>Adjusted R²</th>
<th>F</th>
<th>Sig.</th>
<th>Unstandardized Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant) political risk</td>
<td>.463</td>
<td>.214</td>
<td>.114</td>
<td>2.14</td>
<td>.044</td>
<td>.000</td>
<td>2.141</td>
</tr>
<tr>
<td>Constitutional pitfalls</td>
<td>.386</td>
<td>.220</td>
<td>.196</td>
<td>.158</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Poor value system</td>
<td>.374</td>
<td>.616</td>
<td>.126</td>
<td>.250</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Religious intolerance</td>
<td>.310</td>
<td>.856</td>
<td>.073</td>
<td>.402</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inter-ethnic rivalry</td>
<td>.347</td>
<td>.672</td>
<td>.188</td>
<td>.441</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low per capita income</td>
<td>.361</td>
<td>.194</td>
<td>.273</td>
<td>.208</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bureaucratic process</td>
<td>.332</td>
<td>.813</td>
<td>.047</td>
<td>.199</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unstable government changes</td>
<td>.293</td>
<td>.902</td>
<td>-.016</td>
<td>.129</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Weak political structure</td>
<td>.244</td>
<td>.368</td>
<td>-.148</td>
<td>.163</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Thus, the output of the multiple regression results in Table 6 validates H1 that there is a positive relationship between the determinants of political risk and types of political risk.

Discussion

The features of political risks referred to as determinants were selected based on knowledge of the observed set of a political environment, in which its features contribute to the emergence of political risk. These features are associated with socio-economic and political factors, and they undergo changes intermittently in a political environment. These determinants have consequences in a political environment if they are not considered, checked, rectified, controlled, balanced or improved. The possible resultant effects of these determinants are that they may lead to events or conditions that cause unexpected changes and/or changes from government actions in a political environment. There are a number of explanations, which are supported by the findings of other studies, of these causes or features of the determinants of political risk.

The lack of values, such as integrity, honesty, hard work, survival of the fittest, moderation, and humility, puts every other principle of conduct at risk in Nigeria (Ayoola, 2013; Agbiboa, 2013b; Smith, 2010; Uma & Eboh, 2013). These acts and patterns of behaviours arise from the ethics and morals of its society. However, poor leadership, corruption and poverty (among others) can lead to the degeneration of value systems in a country. The degeneration of these values has created an impact on the operations of firms in Nigeria. Religion has been a significant factor in the political considerations of the country and permeates the cultural, social, political and economic life of most people. Anything that undermines religious practices has led to instability, especially in the northern part of the country. Equally, however, a mixture of religion and politics is used for economic and political gain in Nigeria (Agbiboa, 2013; Kendhammer, 2013; Meagher, 2013; Onapajo, 2012).

Competing demands for state resources and political power often creates tension between ethnic groups, which has, in turn, generated conflict between the minority and majority ethnic groups in Nigeria. The presence of multiple ethnic groups in the country, along with different ethnic militia groups, reflects issues of inter-ethnic rivalry (Ajayi, 2014; Oladiran, 2013; Ebegulem, 2011; Salawu & Hassan, 2011). Inequitable distribution of resources and political power is another of the determinants of political risk in Nigeria (Anyanwu, 2010; Olofin et al., 2015; Okroafor & Nwaere, 2013; Uma et al., 2013). Per capita income is an indication of the living conditions of an average citizen in Nigeria. A report by the Nigerian National Bureau of Statistics showed that, based on this measure, the relative poverty rate in the Nigerian population increased to 65% in 2011 (NBC, 2012b, p.11).

The failure to not ensure that the constitution and other statutory laws adapt to the realities of the circumstances is responsible for some of the conflicts experienced in Nigeria (Oviasuyi et al., 2010; Ogowewo, 2000; Kalu, 2008; Read, 1979). A major constitutional pitfall, if not resolved, makes a country prone to political instability and uncertainty; the consequences of which can have an impact on multinational corporations. PRS Group (2015) also argue that frequent changes in government have significant implications for the business environment due to policy changes that often accompany them. Indeed the tendency for the military to intervene in the affairs of government exacerbates this problem as well as being a threat to democracy in Nigeria (Orugbani, 2005). A perceived structural defect and institutional deformity affect the collective identity of the Nigerian people (Dudley, 2013; Joseph, 2014; Kalu, 2008). Likewise, Lawal & Tobi (2006) and Okotini (2001) pointed out that the quality of bureaucracy determines the strength of the institutions and the frequency of changes in a country in terms of revisions to policies. A weak political structure and poor bureaucratic quality are contributing features that make political risk manifest in Nigeria.

The research findings establish that political risk determinants make varying relative contributions to the prediction of political risk in Nigeria. Ideological, ethnic and religious cleavages are central to the political environment of Nigeria. These cleavages contribute to political risk. Likewise, it is the presence of these determinants of political risk that influence some of the political decisions and policies made by the Nigerian government, which could be attributed to the emergence of some of the heterogeneity of political risk in the country. It is only when these determinants of political risk are identified in the context of a specific country that country-specific risk variables and indicators can be determined. These determinants are significant in the understanding of how risk variables and indicators emerge and how political risk exists in different forms.

The acceptance of H1, which confirmed a positive relationship between the determinants of political risk and types of political risk, has validated these determinants of political risk in Nigeria. An implication of this is that if the determinants of political risk make political risk manifest, a positive relationship should exist between these determinants of political risk. The multiple regression analysis revealed that determinants such as religious intolerance, bureaucratic process, unstable government change and weak political structure showed a stronger unique contribution to political risk in Nigeria than the other factors. However, it has been found that an increase in just one of the determinants of political risk will not spontaneously result in an increase in a type of political risk.
since other overlapping contributory features were identified to be among the determinants of the prediction of political risk. Consequently, each determinant of political risk which impacts on multinational corporations can be influenced by the consequences of other determinants.

Contributions

This research has identified eight determinants which contribute to the emergence of political risk in the Nigerian context. These determinants are - constitutional pitfalls, poor value system, religious intolerance, inter-ethnic rivalry and low per capita income. Other determinants include unstable government change, lengthy bureaucratic process and weak political structures. While Ascher & Overholt (1983), Bjelland (2012), Brink (2004), Howell & Chaddick (1994) and Kobrin (1982), have investigated indicators of political risk, this study contributes to the understanding of political risk by suggesting these determinants are key drivers of political risk. These determinants are significant in understanding how they could contribute to the emergence of political risk and how it could cause unexpected changes in government decisions and/or changes in a country itself. It can be suggested that some of these determinants of political risk are part of the challenges that accompany the evolution of most developing nations.

These determinants of political risk could contribute to how multinational firms conduct their PRA in the sense that they provide knowledge for those operating in similar developing countries about how they could improve their conduct of PRA, especially in Africa. The inclusion of these determinants when using different PRA techniques or methodologies would improve the quality of the results they obtain for better understanding and operating in a political environment. This will, in turn, influence the type of strategies, in relation to modes of market entry, for example, which multinational firms adopt.

This study has shown that changes accompanying these aforementioned determinants could influence political decisions made by a government and that its resultant interrelated effects can be attributed to the emergence of different types of political risk in Nigeria. Therefore, these determinants are significant in understanding how risk variables and indicators emerge and how they contribute to the emergence of some political risks. This knowledge could improve how multinational firms conduct their PRA in similar developing countries in Africa.

Conclusion

The paper has investigated the determinants of political risk empirically by analysing data from 74 multinational corporations operating in Nigeria. The literature review identified eight determinants that contribute towards the emergence of political risk in the context of the emerging Nigerian market. These are constitutional pitfalls, poor value system, religious intolerance, inter-ethnic rivalry, low per capita income, unstable governments, lengthy bureaucratic processes and weak political structures. They were selected based on knowledge of the observed setting of the political environment and their interrelationships with socio-economic and political factors in contributing to the emergence of political risk. These concepts were augmented by ideas gathered from several other studies on Nigeria (Ayoola, 2013; Agbiboa, 2013b; Kendhammer, 2013; Meagher, 2013; Ajayi, 2014; Oladiran, 2013; Olofin et al., 2015; Uma et al., 2013).

The findings suggest that these determinants and their subsequent consequences cause various types of political risk to manifest themselves in the Nigerian business environment. They are significant in understanding how political risk variables and indicators have emerged, which have in turn caused different forms of political risk to existing. The validation of H1 that there is a positive relationship between the determinants of political risk and political risk itself has confirmed that these determinants can make political risk manifest. Some of the determinants are more prominent than others in contributing to political risk, due to their interrelationship in the political environment.

The evidence from this study suggests that it has been the changes accompanying these determinants which have influenced some of the political decisions or policies made by governments in Nigeria. Likewise, their resultant effects could be attributed to the emergence of different types of political risk in Nigeria. Thus, with their identification, a political environment can be assessed more accurately. An implication of this is the possibility that each type of political risk has a number of interrelated determinants that prompt its existence. Therefore, based on this finding, how specific political risks emerge which differentiate one emerging market from another can be better explained. In conclusion, this paper has provided insight from an African perspective about what causes frequent unexpected changes in governments’ political decisions or policies and which may affect multinational corporations.

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The Role of Foreign Direct Investments in Social Economy Development

Stukalo Nataliia, Oles Honchar Dnipro National University, Ukraine
Simakhova Anastasiia, Oles Honchar Dnipro National University, Ukraine

Social development of any country is based on an economic system that provides for it financially. Among the sources of financing of the social sphere, external sources, some of which include foreign direct investments (FDI), occupy a very important place. However, in scientific literature, not enough attention is paid to the problem of FDI potential for the development of social economy of a country. With this in mind, the purpose of this study is to explore the role and the place of direct foreign investments in the development of social economy.

JEL classification: F 21, B 55

Keywords: foreign direct investments, social economy, group of economies, Ukraine, development

FDI are essential for the economic growth of any country. The studies, conducted by different authors, proved the reliability of this statement. Thus, in particular, the influence and significance of FDI for the economic growth of various countries were studied by Asheghian, P (2016), Sothan, S (2017), Kumar, A. B., (2012), Kok, R, Ersoy, B. A., (2009), Cambazoglu, B. Karaalp, H. C. (2014), He, X, and X. Yao (2017). The authors have shown that FDI have especially significant impact on economic growth of developing countries. Thanks to the inflow of FDI, new jobs are created, trade is developing, new technologies are brought into these countries, which also implicitly influences social development of a country. The social effect of FDI was examined in the research of Scaperlanda, A. (1998) and the experts of OECD (2008). In the given papers, it was noted that multinational companies that invest FDI in developing countries, promote the development of social responsibility, cooperation and solidarity in these countries. Moreover, FDI are aimed at creation of well-paid jobs and effective management.

Certain authors raise the question of the influence of FDI on differentiation of incomes of the population, in particular, Wong, M.Y. H (2016) and Franco, C. and Gerussi, C (2013). Thus, the scientist Wong, M.Y. H (2016) proves that FDI contributes to differentiation of incomes of the population by the creation of a small sector of highly paid workers on the labour market. In contrast to these results, the study of researchers Franco, C. and Gerussi, E. (2013) shows that FDI do not contribute to differentiation of incomes of the population for countries with transitive economy.

Despite certain achievements in studying social aspects of FDI, the problem of the role of FDI in the development of social economy has not been considered yet. All developed countries of the world today have the developed social economy. In the countries with transitive economy, there takes place the transformation of the social component (Stukalo, Simakhova, 2018), which requires additional financial resources, which FDI could potentially become. Developing countries face the problems of social development, social economy is not developed, which requires significant capital investments and investment funds (Proshare, 2014). Socio-economic impact of FDI on the example of Nigeria showed a significant social effect of foreign investment for developing countries. Thus, the main positive channels of FDI for the social sphere of a developing country include (Proshare, 2014): employment sphere (an increase in the employment level, wages, and development of skills of workers), gender equality (enhancing of a social the status of women), the environment (contribution to solving ecological problems), internal business (an increase in its profitability), the sphere of state finances (an increase in taxation incomes). Thus, FDI will enhance social capabilities of a country and influence its social development.

Given the development of social economy, one of its key characteristics is the entrepreneurial initiative, the ability of the population to self-sufficiency of realization of the own potential of citizens (Simakhova, 2017). No doubt, development of entrepreneurship in the country is affected by attraction of foreign investments. Moreover, FDI is one of the channels of savings for the population due to an increase in wages and profits from business activity in companies with foreign capital.

A positive effect of FDI is manifested in the fact that they provide access to modern technologies and management. In the national economy they fuel the markets of goods and services, promote the expansion of the range of consumer products and improve their quality. FDI also influence competitiveness of companies that receive them. From the macroeconomic point of view, FDI contribute to socio-economic stabilization, improvement of social and economic policy that allow solving social problems in a
country.

Under conditions of effective actions, aimed to attract FDI in the economy of a country, they can play an important role not only in stabilizing the economic stability of a country, but also contribute to the solution of the problem of enhancing the life of the population by improving labor productivity. That is, the chain is as follows: FDI – increasing labor productivity – increasing competitiveness – economic stabilization – enhancement of life quality. Under such conditions, developing countries should be the major recipients of FDI. If we pay attention to the world statistics as for FDI dynamics, such situation was observed in 2014, when the share of the developing countries was the highest in terms of attracting FDI and made 53.2%, but up to 2016, the inflow of FDI to developing countries considerably decreased, specifically, by USD 58 bln. Compared with 2014, their share made up only 37 % (Table 1).

Table 1. FDI inflows by group of economies in 2014-2016 (billions of dollars and per cent)

<table>
<thead>
<tr>
<th>Group of economies</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Bln. dol.</td>
<td>%</td>
<td>Bln. dol.</td>
</tr>
<tr>
<td>World</td>
<td>1324</td>
<td>100</td>
<td>1774</td>
</tr>
<tr>
<td>Developed economies</td>
<td>563</td>
<td>42.6</td>
<td>984</td>
</tr>
<tr>
<td>Developing economies</td>
<td>704</td>
<td>53.2</td>
<td>752</td>
</tr>
<tr>
<td>Transition economies</td>
<td>57</td>
<td>4.3</td>
<td>38</td>
</tr>
<tr>
<td>Structurally weak, vulnerable and small economies</td>
<td>68</td>
<td>5.1</td>
<td>64</td>
</tr>
</tbody>
</table>

Source: Unctad World Investment Report, 2017

According to data from Table 1, 2014-2016 saw the changes in the share of groups of the countries in terms of attracting FDI, thus, the share of developed countries increased from 42.6% in 2014 to 59.1% in 2016. The share of the countries with transitive economy decreased from 4.3% to 3.9%, and that of the countries with small economies decreased from 5.1% to 3.3%. These trends are associated with allocation of the investment funds of developed countries to the countries of the same group of developed economies, since the share of the developed countries in provision of FDI increased from 56.5% in 2014 to 71.9% in 2016, or by USD 336 bln (Table 2). Thus, financing social economies at the expense of FDI takes place in the developed countries of the world. The redistribution of investment funds from developed countries to developing countries and countries with transitive economy has not taken place lately.

Table 2. FDI outflows by group of economies in 2014-2016 (billions of dollars and per cent)

<table>
<thead>
<tr>
<th>Group of economies</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Bln. dol.</td>
<td>%</td>
<td>Bln. dol.</td>
</tr>
<tr>
<td>World</td>
<td>1253</td>
<td>100</td>
<td>1594</td>
</tr>
<tr>
<td>Developed economies</td>
<td>708</td>
<td>56.5</td>
<td>1173</td>
</tr>
<tr>
<td>Developing economies</td>
<td>473</td>
<td>37.7</td>
<td>389</td>
</tr>
<tr>
<td>Transition economies</td>
<td>73</td>
<td>5.8</td>
<td>32</td>
</tr>
<tr>
<td>Structurally weak, vulnerable and small economies</td>
<td>26</td>
<td>2.1</td>
<td>14</td>
</tr>
</tbody>
</table>

Source: Unctad World Investment Report, 2017

The data of Table 2 show a decrease in the investment potential of developing countries and the countries of transitive economy. Thus, within 2014-2016, FDI, provided to developing country decreased by USD 90 bln, to the countries with transitive economy – by USD 48 bln. It indicates a shortage of foreign investments for financing social development and integrated social actions in these countries. Therefore, an increase in attraction of FDI in the future in developing countries and in transitive countries will promote a gradual development of social economy in them.

To explore the situation in the countries with transitive economy, take the example of Ukraine. Thus, within 2000-2016, FDI in the economy of Ukraine were increasing (Fig. 1).
The performed calculations of the ratio of FDI to GDP show that, despite the growth in absolute volume of FDI, in 2014-2016, there was a decrease in the ration of FDI to GDP. This indicates insufficiency of the FDI volume for providing social development in the country.

For a more detailed study of FDI influence on the social economy, it is necessary to perform a correlation-regression analysis of FDI influence on the main social indicators. One of the results of the social economy is provision of high welfare of the population (Sharpe, 1999; Simakhova, 2017). In turn, the welfare of the population can be estimated through the dynamics of average monthly wages (Karpuškiene, 2015; Quarter, Mook, Armstrong, 2009) and through GDP per capita (Iter, 2016; Simakhova, 2016; Harvie, Slater, Philp, 2009; Dipietro, Anoruo, 2006).

In Ukraine, the dynamics of the FDI growth within 2005-2016 coincides with an increase in average monthly wages (Table 3).

Table 3. FDI dynamics and average monthly wages in Ukraine within 2005-2016.

<table>
<thead>
<tr>
<th>Year</th>
<th>Direct foreign investments, mln UAH</th>
<th>Average monthly wages</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>21040</td>
<td>230</td>
</tr>
<tr>
<td>2001</td>
<td>24460</td>
<td>311</td>
</tr>
<tr>
<td>2002</td>
<td>29160</td>
<td>376</td>
</tr>
<tr>
<td>2003</td>
<td>36210</td>
<td>462</td>
</tr>
<tr>
<td>2004</td>
<td>48130</td>
<td>590</td>
</tr>
<tr>
<td>2005</td>
<td>86480</td>
<td>806</td>
</tr>
<tr>
<td>2006</td>
<td>109120</td>
<td>1041</td>
</tr>
<tr>
<td>2007</td>
<td>149190</td>
<td>1351</td>
</tr>
<tr>
<td>2008</td>
<td>187700</td>
<td>1806</td>
</tr>
<tr>
<td>2009</td>
<td>311800</td>
<td>1906</td>
</tr>
<tr>
<td>2010</td>
<td>357664</td>
<td>2239</td>
</tr>
<tr>
<td>2011</td>
<td>389962</td>
<td>2633</td>
</tr>
<tr>
<td>2012</td>
<td>435209</td>
<td>3026</td>
</tr>
<tr>
<td>2013</td>
<td>442374</td>
<td>3265</td>
</tr>
<tr>
<td>2014</td>
<td>677830</td>
<td>3480</td>
</tr>
<tr>
<td>2015</td>
<td>789614</td>
<td>4195</td>
</tr>
<tr>
<td>2016</td>
<td>903732</td>
<td>5183</td>
</tr>
</tbody>
</table>


The calculation of the correlation-regression model of dependence of average monthly wages in Ukraine on FDI within 2005-2016 gave the following results:

The equations of dependence of average monthly wages in Ukraine on FDI takes the form:

\[ Y= 0.006X, \]

where \( Y \) is the average monthly wages in Ukraine; \( X \) is the FDI in Ukraine.

R-square is 0.977

A high value of R-square indicates that there is close relationship between average monthly wages in Ukraine and the FDI volume. However, verification of adequacy of the model with the help of approximation coefficient, which made up 19% in calculation, showed that the model is not significant and reliable for further analysis and research.

To compare the obtained results of dependence of average monthly wages on FDI for Ukraine, we will calculate the correlation-regression model of dependence of average wages on FDI for Poland as a country with transitive economy and for such highly developed countries like Germany (with the corporative social model) and Great Britain (with the liberal social model) (Esping-Andersen, 1990).

Table 4. Dynamics of FDI and average monthly wages in Poland within 2005-2016.

<table>
<thead>
<tr>
<th>Year</th>
<th>Direct foreign investments, mln USD</th>
<th>Average monthly wages, USD</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>8207</td>
<td>812</td>
</tr>
<tr>
<td>2006</td>
<td>14576</td>
<td>841.1</td>
</tr>
<tr>
<td>2007</td>
<td>19855</td>
<td>987.3</td>
</tr>
<tr>
<td>2008</td>
<td>12279</td>
<td>1240.2</td>
</tr>
<tr>
<td>2009</td>
<td>10043</td>
<td>980.3</td>
</tr>
<tr>
<td>2010</td>
<td>12800</td>
<td>1124</td>
</tr>
<tr>
<td>2011</td>
<td>15925</td>
<td>1200.6</td>
</tr>
<tr>
<td>2012</td>
<td>12424</td>
<td>1117.4</td>
</tr>
<tr>
<td>2013</td>
<td>3625</td>
<td>1169.4</td>
</tr>
<tr>
<td>2014</td>
<td>14269</td>
<td>1194.3</td>
</tr>
<tr>
<td>2015</td>
<td>13472</td>
<td>1021</td>
</tr>
<tr>
<td>2016</td>
<td>11358</td>
<td>1012.8</td>
</tr>
</tbody>
</table>


According to the data of Table 4, FDI in Poland within 2005-2016 had a variety of trends of development, the growth was preceded by a decrease in volumes. Average monthly wages in Poland, with the exception of 2009, had a tendency to grow.

The calculation of the correlation-regression model of dependence of average wages in Poland on FDI within 2005-2016, gave the following results:

The equation of dependence of average wages in Germany on FDI takes the form:

\[ Y= 0,078 X, \]

(2)
where Y is the average wages in Poland;
X is the FDI in Poland.
R-square is 0.897

Therefore, it is possible to observe the similar tendency of relationship of FDI in Poland with average monthly wages like in Ukraine with a high value of R-square for the equation of dependence of average wages in Poland on FDI. However, approximation coefficient in the calculation appeared to be equal to 23.5%, which indicates insignificance of the model.

We will consider the dependence of average wages on FDI for highly developed European countries with social models of economic development.

Table 5. Dynamics of FDI and average monthly wages in Germany within 2005-2016

<table>
<thead>
<tr>
<th>Direct foreign investments, mln USD</th>
<th>Average annual wages, USD</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>47421</td>
</tr>
<tr>
<td>2006</td>
<td>55686</td>
</tr>
<tr>
<td>2007</td>
<td>80227</td>
</tr>
<tr>
<td>2008</td>
<td>8114</td>
</tr>
<tr>
<td>2009</td>
<td>23807</td>
</tr>
<tr>
<td>2010</td>
<td>65646</td>
</tr>
<tr>
<td>2011</td>
<td>67514</td>
</tr>
<tr>
<td>2012</td>
<td>28181</td>
</tr>
<tr>
<td>2013</td>
<td>15573</td>
</tr>
<tr>
<td>2014</td>
<td>3954</td>
</tr>
<tr>
<td>2015</td>
<td>33312</td>
</tr>
<tr>
<td>2016</td>
<td>9528</td>
</tr>
</tbody>
</table>


According to the data of Table 5, it is possible to notice the differences in the trends of development of investment activity and an increase in wages. Thus, within 2005-2016, wages in Germany continually had a tendency to increase and increased. As for the volume of FDI, they were increasing within 2005-2007, decreased in 2008, increased in 2009-2011, decreased in 2012-2014, increased in 2015 and decreased in 2016. Thus, in comparison with Ukraine, where within 2005-2016 FDI increased, it decreased in Germany over the same period. Therefore, we can preliminary conclude that in Germany, unlike Ukraine, FDI is not a significant factor that affects an increase in wages in the country.

The calculation of the correlation-regression model of dependence of average wages in Germany on FDI within 2005-2016 gave the following results:

The equation of dependence of average wages in Germany on FDI takes the form:

\[ Y = 0.798 \times X \]  

where Y is the average wages in Germany;
X is the FDI in Germany.
R-square is 0.66

Compared with Ukraine, a low value of R-square for the equation of dependence of average wages in Germany on FDI shows medium density of the indicators. Approximation coefficient in the calculation appeared to be 49.6%, indicating insignificance and inaccuracy of the model.

As far as Great Britain is concerned, within 2005-2016, the tendencies of development of foreign investment also has a variable character.

Table 6. Dynamics of FDI and average monthly wages in Great Britain within 2005-2016

<table>
<thead>
<tr>
<th>Direct foreign investments, mln USD</th>
<th>Average annual wages, USD</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>182894</td>
</tr>
<tr>
<td>2006</td>
<td>147396</td>
</tr>
<tr>
<td>2007</td>
<td>176864</td>
</tr>
<tr>
<td>2008</td>
<td>91798</td>
</tr>
<tr>
<td>2009</td>
<td>89796</td>
</tr>
<tr>
<td>2010</td>
<td>58180</td>
</tr>
<tr>
<td>2011</td>
<td>42200</td>
</tr>
<tr>
<td>2012</td>
<td>55446</td>
</tr>
<tr>
<td>2013</td>
<td>51676</td>
</tr>
<tr>
<td>2014</td>
<td>44821</td>
</tr>
<tr>
<td>2015</td>
<td>33003</td>
</tr>
<tr>
<td>2016</td>
<td>253826</td>
</tr>
</tbody>
</table>


According to the data of Table 5, it is possible to notice the differences in the trends of development of investment activity and an increase in wages. Thus, within 2005-2016, wages in Germany continually had a tendency to increase and increased. As for the volume of FDI, they were increasing within 2005-2007, decreased in 2008, increased in 2009-2011, decreased in 2012-2014, increased in 2015 and decreased in 2016. Thus, in comparison with Ukraine, where within 2005-2016 FDI increased, it decreased in Germany over the same period. Therefore, we can preliminary conclude that in Germany, unlike Ukraine, FDI is not a significant factor that affects an increase in wages in the country.

The calculation of the correlation-regression model of dependence of average wages in Great Britain on FDI within 2005-2016 gave the following results:

The equation of dependence of average wages in Great Britain on FDI takes the form:

\[ Y = 0.028 \times X \]  

where Y is the average wages in Great Britain;
X is the FDI in Great Britain.
R-square is 0.68

A low value of R-square for the equation of dependence of average monthly wages on FDI in the UK shows a similar situation with Germany, where this value was 0.66. Approximation coefficient during calculation also appeared
high and made up 50.5%, which indicates insignificance and inaccuracy of the model.

Thus, the average monthly wages in Ukraine and Poland depends on FDI, but they are not the major and important factor in formation of wages. As for the UK and Germany, average wages in the countries with developed economies, in spite of various models of social economy, do not correlate with the FDI volume in a sufficient degree.

We will verify the following hypothesis about the impact of FDI on the volume of GDP per capita for the above countries.

Within 2005-2016, GDP per capita in Ukraine as well as the volume of FDI constantly grew (Table 7).

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP per capita, UAH</th>
<th>Direct foreign investments, UAH, mln</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>9709</td>
<td>86480</td>
</tr>
<tr>
<td>2006</td>
<td>11630</td>
<td>109120</td>
</tr>
<tr>
<td>2007</td>
<td>15496</td>
<td>149190</td>
</tr>
<tr>
<td>2008</td>
<td>20534</td>
<td>187700</td>
</tr>
<tr>
<td>2009</td>
<td>19862</td>
<td>311800</td>
</tr>
<tr>
<td>2010</td>
<td>24429</td>
<td>357664</td>
</tr>
<tr>
<td>2011</td>
<td>29519</td>
<td>389962</td>
</tr>
<tr>
<td>2012</td>
<td>32002</td>
<td>435209</td>
</tr>
<tr>
<td>2013</td>
<td>33473</td>
<td>442374</td>
</tr>
<tr>
<td>2014</td>
<td>36904</td>
<td>677830</td>
</tr>
<tr>
<td>2015</td>
<td>46413</td>
<td>789614</td>
</tr>
<tr>
<td>2016</td>
<td>55848</td>
<td>903732</td>
</tr>
</tbody>
</table>


The calculation of the correlation-regression model of dependence of GDP per capita in Ukraine on FDI within 2005-2016 gave the following results:

The equation of dependence of GDP per capita in Ukraine on FDI has the following form:

\[ Y = 0.064X \]  

where \( Y \) is the GDP per capita in Ukraine;  
\( X \) is the FDI in Ukraine.  
R-square is 0.976

A high value of R-square indicates that there is a close relationship between GDP per capita in Ukraine and FDI volume. However, verification of the adequacy of the model using approximation coefficient, which in calculation was 20.3%, showed that the model is valid and reliable for further analysis and research. Like in the case with the average monthly wages in Ukraine, it is possible to argue that FDI influences the social development of Ukraine, however, they are not a direct factor of influence on the social economy.

As far as Poland is concerned, GDP per capita has been constantly increasing since 2006 (Table 8).

Table 8. Dynamics of GDP per capita in Poland and FDI within 2005-2016

<table>
<thead>
<tr>
<th>Year</th>
<th>Direct foreign investments, USD, mln</th>
<th>GDP per capita, USD</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>8207</td>
<td>16054</td>
</tr>
<tr>
<td>2006</td>
<td>14576</td>
<td>14655</td>
</tr>
<tr>
<td>2007</td>
<td>19855</td>
<td>15656</td>
</tr>
<tr>
<td>2008</td>
<td>12279</td>
<td>16459</td>
</tr>
<tr>
<td>2009</td>
<td>10043</td>
<td>16707</td>
</tr>
<tr>
<td>2010</td>
<td>12800</td>
<td>20076</td>
</tr>
<tr>
<td>2011</td>
<td>15925</td>
<td>21078</td>
</tr>
<tr>
<td>2012</td>
<td>12424</td>
<td>21412</td>
</tr>
<tr>
<td>2013</td>
<td>3625</td>
<td>21728</td>
</tr>
<tr>
<td>2014</td>
<td>14269</td>
<td>22452</td>
</tr>
<tr>
<td>2015</td>
<td>13472</td>
<td>23332</td>
</tr>
<tr>
<td>2016</td>
<td>11358</td>
<td>23975</td>
</tr>
</tbody>
</table>


The calculation of the correlation-regression model of dependence of GDP per capita in Poland on FDI within 2005-2016 gave the following results:

The equation of dependence of GDP per capita in Poland on FDI has the following form:

\[ Y = 1.418X \]  

where \( Y \) is the GDP per capita in Poland;  
\( X \) is the FDI in Poland.  
R-square is 0.872.

A high value of R-square for the equation of dependence of GDP per capita in Poland on FDI shows high density of indicators. Approximation coefficient in calculation appeared equal to 28.4%, which proves insignificance and inaccuracy of the model.  
As far as Germany is concerned, GDP per capita within 2005-2016 was constantly increasing (Table 9).
Table 9. Dynamics of GDP per capita in Germany and FDI within 2005-2016

<table>
<thead>
<tr>
<th></th>
<th>Direct foreign investments, USD, mln</th>
<th>GDP per capita, USD</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>47421</td>
<td>31366</td>
</tr>
<tr>
<td>2006</td>
<td>55686</td>
<td>32397</td>
</tr>
<tr>
<td>2007</td>
<td>80227</td>
<td>33237</td>
</tr>
<tr>
<td>2008</td>
<td>8114</td>
<td>33714</td>
</tr>
<tr>
<td>2009</td>
<td>23807</td>
<td>32147</td>
</tr>
<tr>
<td>2010</td>
<td>65646</td>
<td>37072</td>
</tr>
<tr>
<td>2011</td>
<td>67514</td>
<td>38433</td>
</tr>
<tr>
<td>2012</td>
<td>28181</td>
<td>38550</td>
</tr>
<tr>
<td>2013</td>
<td>15573</td>
<td>38633</td>
</tr>
<tr>
<td>2014</td>
<td>3954</td>
<td>39086</td>
</tr>
<tr>
<td>2015</td>
<td>33312</td>
<td>39416</td>
</tr>
<tr>
<td>2016</td>
<td>9528</td>
<td>39641</td>
</tr>
</tbody>
</table>


The calculation of the correlation-regression model of dependence of GDP per capita in Germany on FDI within 2005-2016 gave the following results:

The equation of dependence of GDP per capita in Germany on FDI has the following form

\[ Y = 0.66X, \]  
where \( Y \) is the GDP per capita in Germany; 
\( X \) is the FDI in Germany.

R-square is 0.65.

A low value of R-square for the equation of dependence of GDP per capita in Germany on FDI, like in Germany, shows medium density of indicators. A high approximation coefficient of 51.1% indicates insignificance and inaccuracy of the model.

Thus, for Germany and Great Britain, as for countries with highly developed economy, FDI do not affect the volume of GDP per capita.

It is possible to make a conclusion that FDI do not influence directly the welfare of the population through formation of its high income, however, they have an indirect influence through creation of new jobs, promotion of social stability in the country and other channels of influence (Fig. 2).

![Fig. 2. Indirect influence of FDI on social economy](image)

Source: authors’ elaboration

A more significant impact of FDI on formation of the income of population can be noticed in the countries with transitive economies. Thus, FDI can act as a potential source of financing of the social sphere for countries with transitive economy. Moreover, development of directions in terms of increasing the FDI inflow to the country is important in this respect.
In our opinion, the following potential measures can include:
- Improvement of the investment image and attractiveness of countries for investors;
- Transparency of investment legislation;
- Stimulation of investment activity of national corporative sector of economy;
- Creation of an effective system of management of investment processes;
- Involvement of FDI in social projects, initiatives and social sector of a country.

References


Kumar, A. B. (2012) Impact of Foreign Direct Investment, Trade Openness, Domestic Demand, and Exchange Rate on the Export Performance of Bangladesh: A VEC Approach, Economics Research International – Available at: http://dx.doi.org/10.1155/2012/463856


Exploring the Importance and Satisfaction of the Key Services in Gasoline Stations: A Study on Chinese Petroleum and Chemical Corporation (CPC) and Formosa Petrochemical Corporation (FPC)

Keng-Hsiang Cheng, Chinese Culture University, Taiwan
Oumarou Zougmore, Chinese Culture University, Taiwan

This study attempts to examine the core competence of gas stations through the foremost energy enterprise in Taiwan, which is Chinese Petroleum and Chemical Corporation (CPC).

In order to build up CPC’s Management Opportunity Grid (MOG), six major dimensions were identified and thirty-nine attributes items/service attributes were developed and analyzed. Furthermore, a Competitive Matrix (CM), based on the Simultaneous Importance-Performance Analysis (SIPA), was established in order to compare CPC and FPC competitiveness. We conducted a survey through a questionnaire among CPC’s customers, particularly owners of cars and motorcycles in the northern part of Taiwan. The data gathered focuses on the importance score and the degree of satisfaction of these groups of customers on the services of gas stations.

Besides revealing the core competencies that gas stations could hold; our findings identified the top ten service attributes that score high importance degree, yet low degree of satisfaction.

Therefore, our research concluded that CPC, by prioritizing these service attributes, could enhance its service quality and customer satisfaction as well as allow the firm's management to attain competitive advantage.

1. Introduction

The energy industry is the totality of all of the industries involved in the production and sale of energy, including fuel extraction, manufacturing, refining and distribution. Modern society consumes large amounts of fuel, and the energy industry is a crucial part of the infrastructure and maintenance of society in almost all countries (Sherman, 2013). Nowadays, we are faced with an overall serious energy problem. It appears almost certain that the oil industry was and is one of the most needed in term of demands. Thus, excluding countries that produce crude oil, energy enterprises are always found. In Taiwan, Chinese Petroleum and Chemical Corporation (CPC) had a monopoly on petroleum products until June 1996.

However, since January 1st 2002, the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu formally became the 144th Member of the WTO (WTO, 2017). Afterwards, the Ministry of Economic Affairs began promoting the liberalization of the domestic oil market. Thus, CPC began to face up new competitors. Li, Hsu and Lin (2004) conducted a study on the market liberalization in Taiwan’s petroleum refinery Industry in order to evaluate the impact on Taiwan macro-economy. Chang (2011) analyzed the structure of the oil market based on Taiwan government regulations and the behavior of Petroleum firms. Wang (2009) also mentioned the great pressure of price competition among Taiwan’s gas stations. All those studies revealed that the foremost energy enterprise in Taiwan (CPC Corporation) has had to deal with several new factors such as its competitors and customers’ satisfactions, etc. To obtain a controllable and stable oil supply, CPC has engaged in sole-risk operations with foreign governments and cooperative explorations with other state-owned petroleum companies or large international oil companies. These exploratory operations have continued for many years, covering the Americas, the Asia-Pacific region and Africa (CPC, 2015). Despite this, how is CPC is perceived in the Taiwan oil supply market? Are its customers satisfied with its services?

According to information provided on CPC’s website, their vision for information management is focused on the customer – and hence on security, accuracy, user-friendliness, convenience and universal access. Thus, realizing this vision and working towards strategic operational targets and competitiveness in the market requires integration of corporate information systems, provision of timely management and decision-making information, integration of virtual and physical channels to expand the industrial value chain, establishing customer relations management (CRM) systems and the promotion of knowledge management (CPC, 2015).

In addition, CPC, engaged in the exploration, production, refining, storage, transportation, and the sale of
oil and oil products in Taiwan. They have had to deal with many local competitors, especially Exxon Mobil Corporation, Formosa Plastics Corporation and Royal Dutch Shell plc.

Although many studies have been devoted to CPC customers’ satisfactions (Liu, 2003) and many tools have been used to conduct these researches (Liu, 2011). This study differs from existing literature in many ways. Based on the importance of the services provided and the satisfaction of its customers, the approach of this study is to compare CPC Corporation and its main opponents. A management opportunity grid (MOG) will be established and a competitive matrix will be developed. Furthermore, it is inferred that this information will allow CPC Corporation to improve its exploitation and activities.

This research aims to analyze the Taiwan oil market through a thorough examination of how CPC can increase the quality of its services and respond to the needs of its clients. This will increase the satisfaction of each client and improve client loyalty. This study clearly defines a management opportunity grid and competitive matrix in order to assist CPC in its marketing thus helping this firm to increase its customers' satisfaction regarding each service provided and make an individual difference with its competitors.

The research attempts to explore the following:
1. Examine the core competency and the key service items fossil fuels companies are required to hold.
2. Understand whether currently CPC Corporation's customers get great satisfaction from its services.
3. Lead to CPC Corporation’s main competitor analysis, discuss the degree of awareness and the real satisfaction that customers have regarding the services provided by the competitor of CPC Corporation.
4. Through MOG tool, concretely present how CPC Corporation could improve and reinforce the priorities order and recommendations of each service provided within a situation where resources are limited.
5. Through CM management tool, analysis of the main competitor, understand the difference between CPC Corporation services and its competitors and concretely present methods by which CPC Corporation can improve and reinforce its services items in order to surpass its competitors, within a situation where resources are limited.

This study attempts to answer the above questions and according to CPC’s core competency. A sustainable framework of competitive advantage will be established, which can be used in the future.

2. Literature Review

2.1 Core competencies

The core competencies are the specific competencies that organizations identify as contributing most to achieving strategic outcomes. Consequently, core competencies warrant an important place in the performance management process to ensure that the workforce is held accountable for behavior as well as results (University of California, Berkeley, 2012).

Similarly, core competence implies the aggregate capabilities, technologies and/or knowledge of a company, which are unique to it and are acknowledged to its members. The core competence has led the company to where it is and will lead it in the future with an adequate modification or with an addition of another competence (Lee, 1999).

Furthermore, Core competence is related to resource allocation, capabilities, knowledge, skills, and expertise along with value chain. It needs three elements: skills, resources and processes (Torkkeli, Tuominen and Markku, 2002), and it is communication, involvement, and a deep commitment to working organizational boundaries (Franklin and Peter, 1996).

Therefore, Core competency thinking is a powerful and widely promoted approach to focus and mobilize an organization’s resources (Uysal, 2007). Hence, a core competency is defined as an area of specialized expertise that is the result of harmonizing complex streams of technology and work activity (Gallon, Mark, Harold, Stillman and Coates, 1995).

Thus, regarding these few concepts of core competence (Prahalad and Hamel, 1990). Mwailu and Mercer (1983), Wesnerfelt (1984); Rumelt (1984), Penrose (1959) also inherited Resource-Based view; which they defined as a basis for the competitive advantage of a firm lies primarily in the application of a bundle of valuable tangible or intangible resources at the firm's disposal. Then to extended it concisely to core competence concept. Followed up the same idea, Prahalad and Hamel (1990) suggested three tests, which could be applied in order to identify core competencies in a company. First, a core competence provides potential access to a wide variety of markets. Second, a core competence should make a significant contribution to the perceived customer benefits of the end product. Finally, a core competence should be difficult for competitors to imitate. This difficulty will occur as a result of a complex harmonization of individual technologies that comprise the core competence, however it could be find as a more or less comprehensive pattern of internal coordination and learning.

Thus, Prahalad and Hamel (1990) also mentioned that not all competencies are relevant as core competencies, since core competencies cannot be assets (or things) such as patents, brands, production facilities and raw materials. However, asset management is a valid core competence. Prahalad and Hamel (1994) described core competences as "...a bundle of skills and technologies...". Then induced three dimensions according to firms’ activities, which are market-access, product-integration and functionality.
Markides and Williamson (1994) define core competences as a pool of experience, knowledge, and systems that together can act as catalysts that create and accumulate new strategic assets. There are nearly as many definitions of the associated concepts as there are scholars in the strategy domain. While this dilemma has been acknowledged by scholars (Hafsi and Thomas, 2005).

Resources are the inputs into the organization’s value chain. Barney (1991) categorized resources into three groups: physical resources such as plant, equipment, location and assets; human resources such as manpower, management team, training and experience; and organizational resources such as culture and reputation. Some resources are tangible and physical such as plant and equipment and others are intangible like brand name.

Each corporation has a bundle of resources, but not every firm can put its resources into best use. Companies vary in how they leverage their resources. Capabilities refer to the corporation’s ability to exploit its resources. A competency, the third level in the hierarchy, is a cross-functional integration and co-ordination of capabilities. Core competencies, the highest level in the hierarchy, cross Strategic Business Unit (SBU) boundaries (Burns, 1986).

2.2 Conceptual definition of Customer satisfaction

Customer satisfaction is a key factor in formation of customer desires for future purchase (Mittal, 2001). Furthermore, the satisfied customers will probably communicate with others about their positive experiences (Mosahad, 2010). Several studies and scholars also defined it closely.

In the old past year, Hoppe (1930) and Lewin (1936) put forward a definition which states that satisfaction is a psychological state, that is the post-purchase evaluation of experience of consumption. Satisfaction comes from the comparison between expectations and perceptions.

Aquilani, Serpico, Silvestri and Ruggieri (2014) presented a perfect overview of the definition of customer satisfaction since the first theoretical studies of (Hoppe, 1930) and (Lewin, 1936). Aquilani et al. (2014) also mentioned that all of these definitions of satisfaction could be classified in three different theoretical approaches: an emotional-cognitive response, a response related to a particular aspect and a response that occurs at a particular time.

As mentioned earlier, all of these definitions are close and focus on some major terms such as product and/or service, need and expectation. This study is also based on customer satisfaction through the service quality of CPC. Do their services meet customer needs and exceed customer expectations?

2.3 Management Opportunity Grid and Competitive Matrix analysis

Martilla and James (1977) formulated Importance-Performance Analysis (IPA). Blake, Schrader and James (1978) dubbed it to Action Grid Analysis (AGA). It is not just an analysis methodology but is implicitly a theory of behavior. It was introduced as a way of understanding clients’ needs and desires so as to make good management decisions about how to respond to them (Huan and Beanman, 2005). Thus, IPA examines two facets of expectations in parallel: the importance and performance of particular attributes (Hollenhorst, Olson and Fortney, 1992) and IPA identifies which product or service attributes a firm should focus on to enhance customer satisfaction (Matzler, Bailom, Hinterhuber, Renzl and Pichler, 2004). In other words, The Importance-Performance Analysis conceptually rests on multi-attribute models. The IPA technique identifies strengths and weaknesses by comparing the two criteria that consumers use in making a choice: the relative importance of attributes and consumers’ evaluation of the offering in terms of those attributes (Chu and Choi, 2000).

Typically, data from customer satisfaction surveys or service quality surveys (using SERVPERF model) (江國良, 2003) with pre-consuming measurement of service attribute importance are utilized to construct a two-dimensional matrix. In this matrix, service attribute importance is depicted along the Y-axis and service attribute performance (satisfaction or service quality) is depicted along the X-axis (Smith and Costello, 2009). Service attribute importance is measured using some form of self-stated importance (e.g., rating scales, constant sum scales, etc.) or implicitly derived importance (e.g., multiple regression weights, structural equation modeling weights or partial correlation weights). The means of performance and importance, commonly utilized in practice, divide the matrix into four quadrants.

Attributes located in Quadrant I (performance is low and importance is high) require immediate attention for improvement and are major weaknesses. The management scheme for this quadrant is “concentrate here.” Attributes located in Quadrant II (both performance and importance are high) indicate opportunities for achieving or maintaining competitive advantage and are major strengths. The management scheme for this quadrant is “keep up the good work.” Attributes in Quadrant III (performance and importance are low) are minor weaknesses and do not require additional effort. The management scheme for this quadrant is “low priority.” Attributes located in Quadrant IV (performance is high and importance is low) indicate that business resources committed to these attributes would be overkill and should be deployed elsewhere. These attributes are minor strengths. The management scheme for this quadrant is “possible overkill.”

The inability to identify these attributes can threaten a firm’s place in the market and typically results in low consumer satisfaction.
A variant of IPA is the Management Opportunity Grid (MOG) (Chakravarty, Widdows and Feinberg, 1996). Similar to IPA, the MOG is also a four-quadrant grid, but it uses each attribute's possible impact on loyalty as the importance score on the vertical axis (Y-axis) and customer satisfaction to represent the performance on the horizontal axis (X-axis). The four suggested strategies of the MOG are: (1) doing well—maintain and monitor (high impact/ high satisfaction); (2) high potential opportunity (high impact/low satisfaction); (3) do something if you have time (low impact/low satisfaction); and (4) no problem (low impact/high satisfaction) (Bei and Shang, 2006).

However, the MOG model does not take into account the performance relative to competitors. In addition, the competitive strategy was not clearly defined and therefore, Burns (1986) has suggested a useful way of thinking about this by using the simultaneous importance-performance analysis (SIPA) and added “performance of competitors” as the third dimension in order to take competitor related performance into consideration and follow suggestions made by IPA on managerial decision-making. The three (3) concepts in SIPA, which are “attribute importance, company performance and competitor performance”, are either in the high or low category. By taking the importance of the quality attributes and the performance of the company and competitors, quality attributes can be classified into eight (8) scenarios.

Our study, after establishing the MOG of CPC, is based on (Burns, 1986)’ SIPA model to analyze all of the key services provided (service attribute) at its gas stations. The attribute importance and the overall satisfaction of its customers in order to distinguish the eight scenarios mentioned through the performance of these two companies was simultaneously considered. Moreover, after differentiating each scenario and having a clear-cut determination of their core competencies, a proposition of sustainable framework of competition strategy was made regarding each scenario.

3. Research Methodology

3.1 Research Design

The research method used is the research quantitative through a questionnaire. Since quantitative research attempts precise measurement of something, in business research, quantitative research methodologies usually measure consumer behavior, knowledge, opinions, or attitudes (Donald R.Cooper, 2014). By choosing this method of research, our choice was motivated by the extra huge data that we were faced up. Besides, we would like to have a better view of customers’ satisfaction of these two local gas companies.

The aim was to understand deeply how these two local firms, CPC Corporation and Formosa Petrochemical Corporation, compete with each other in this new idea of globalization where things change every single second, and get a clear idea about how CPC Corporation(Taiwan) perceive a given competitor through competitive advantage. Thus, using a quantitative method allowed building a competitive matrix.

The questionnaire designed for this study followed four crucial stages. The first stage consisted of meetings and exchanges with the department responsible for the gas stations of CPC Corporation. We discussed their main services provided, particularly the automobile and motorcycle owners. After these discussions, information on 45 major services provided to this group of customers was collected. The second stage was devoted to gathering additional resources related to the oil market, core competence in petroleum industry and customers satisfaction. The third stage referred to some related academic documents and research content. The final stage was devoted to a recapitulation of the important core competence services provided after comparing all of the gathered data form expects in oil field.

The development of this questionnaire took four (4) months. The content is divided in four primary parts. The first part measures the degree of importance of the services provided by CPC and Formosa Petrochemical Corporation. For each question, the five-point Likert-scale was used from very unimportant to very important (1=very unimportant, 2=unimportant, 3=common, 4=important, 5=very important). The second part of the questionnaire measures the degree of satisfaction for the overall services provided by each company(CPC and Formosa Petrochemical Corporation) using the five-point Likert scale, from very unsatisfied to very satisfied( 1=very unsatisfied, 2=unsatisfied, 3=common, 4=satisfied, 5=very satisfied). The third part of our questionnaire seeks the opinion of their customers (respondents) and the last part is a brief summary of the respondent’s basic information.

3.2 Data Collection

Since quantitative research was being conducted through the use of a questionnaire, and in order to meet the criteria of reliability and validity of our questionnaire, it was found necessary to conduct a pre-test by asking 10 employees of the department responsible for gas stations to fill out a questionnaire during our second interview. Hence, 39 important and competitive items were identified.

The data has been gathered from many sources. Most of them have been extracted from special energy websites such as Organization of the Petroleum Exporting Countries (OPEC) and the ABI/INFORM Trade & Industry database. In addition, information has been collected via special reviews and statistical reviews of world energy. Some crucial information has been extracted specially from each firm’s annual reports and magazines.
Nevertheless, given the special character of our research (i.e. a deep exploration of CPC’s services and core competence) each statement of our questionnaire could be concretely answered either by CPC’s or Formosa Petrochemical Corporation's customers; however our focal firm is still CPC. Thus, our sample population is its customers, particularly, automobile and motorcycle owners.

The research was focused on the northern part of Taiwan, especially in Taipei and New Taipei City, where we have randomly chosen ten (10) gas stations to conduct our survey. In average, thirty customers from each gas station were willing to answer the survey. In total, over three hundred (300) questionnaires were distributed to customers in three months (2016/04-2016/06).

3.3 Items of the measurement of the core competence

Here some primary variables and items concerning gas stations services core competence will be explained and listed. The related information on core competence has been gathered, not only, by referring to local academic and research papers (Her, 2009) as basic source, but also diverse interviews with some experts and scholars.

Therefore, in order to achieve accurate results, in addition to the definition of the core competence in the Chapter 2, the operating philosophy of CPC was also considered. Six(6) major dimensions were determined, which are "reliable", "cordial", "efficiency", "innovation", "rational pricing" and then Environmental facilities and security settings.

- Reliable—is the ability to perform the promised service dependably and accurately (Parasuraman, Zeithaml, and Berry, 1988).
- Cordial—here also refers to empathy, which Parasuraman et al. (1988) defines as caring, individualized attention the firm provides its customers.
- Efficiency—is the ability to avoid wasting materials, energy, efforts, money, and time in doing something or in producing a desired result. In a more general sense, it is the ability to do things well, successfully, and without waste (Robinson, Lakso, and Ren, 1991) (Wikipedia, 2017).
- Innovation—this term can be defined as something original and more effective and, as a consequence, new, that "breaks into" the market or society (Frankelius, 2009).
- Rational pricing—in our case, is defined as rational decisions and thoughts based on reason rather than on emotion, regarding the rate pricing of firm’s services. The definition is definitely different with the financial theory of rational pricing, which defines as a theory that contends that the market prices of assets will represent the arbitrage-free pricing level for those assets (Investopedia, 2017).
- Environmental facilities and security settings—by environment facilities, we refers to external conditions or surroundings, where people work and means or equipment facilitating the performance of the action in the gas stations. Then, by security settings, this research refers to something given or pledged to secure the fulfilment of a promise or obligation.

Through several exchanges and discussions with CPC’s sales office and the staff of gas station, 39 major items/ service attributes were determined. Which allow developing the final step of our questionnaire design and the measurement of gasoline stations’ dimensions of core competencies. The Appendix A shows the major items of gasoline stations in CPC and FPC’s gas stations.

4. Results

4.1 Descriptive statistics and Sample characteristics

For our research, a written questionnaire survey was distributed at 10 gasoline stations in Taipei and New Taipei City. In addition, we went to one Car Wash and valeting in the Xinzhuang district. In addition, the students of Chinese Culture University's and Taxi drivers filled out almost 60 questionnaires. Finally, due to the aspect of impartiality, some respondents were chosen randomly in the street in order to get accurate answers for both companies i.e. CPC and Formosa Corporation.

We distributed 300 questionnaires from April 2016 to June 2016 and 279 were returned completed. Only 267 questionnaires were usable, bringing the respondent rate to 89%.

We used Microsoft Excel 2013 and SPSS statistical software to analyze the collected data. As the results show, most of the customers refuse at least once per week, representing 44.6% of the respondents. Over a quarter of the customers have been using CPC's services for over 10 years, that being 28.1%. Only 13.5% of respondents refuse at Formosa gas stations. However, those customers who have been using those two gasoline companies up to 6 months, Formosa gas station comes in front of CPC with 22.8% against 5.6% of the respondents. Therefore, Formosa gas stations are making new customers and CPC has been keeping some loyal clients at the same period. Regarding the gender of the respondents, 63.3% of them were male. Then regarding the respondent age between 18 to 24 years old scored higher than the overall, i.e. 52.8%, follow by those age between 35 to 54 years old with 19.9%.

Based on the education level of the respondents, those with Bachelor's degrees scored higher (54.3%) than the overall and regarding the occupation of the respondents, 48.3% are students while specialists, managers and employees scored respectively 16.1% and 22.1%. Finally, respondents who earned less than 240.000 New Taiwan Dollars per year scored higher than the overall average.
4.2 CPC's MOG (Both, automobile and Motorcycle)

**Quadrant I: “Concentrate here”**

This quadrant is the most important because it is where customers perceive an importance of services provided. Unfortunately, they are dissatisfied about the same category of services. Therefore, for the management of these attributes, CPC has room for improvement. These attributes included:

4. The speed and attitude of reactions of employees towards customer’s complaints and suggestions
8. Staff is very active and take initiatives; they are able to warn and provide concrete suggestions (employees use proper protocols such as turning off car engine while refueling etc.)
29. Reasonable price of oil

Based on our previous mention of the chosen dimensions that we have made, we can classify them into reliable, cordial and rational pricing. These three major dimensions refer to CPC’s core competency. Customers feel that the speed and attitudes of employees’ reactions, towards customers’ complaints and suggestions, are quite slow, making most of them dissatisfied. During our questionnaire distribution, we had particularly noticed the fact that there was a lack of employees in some gas stations as well as a long process of request treatment by the hierarchy of CPC. In addition, employees are busy to serve customers without really focusing their mind on customers. Finally, as already mentioned, oil price is still a matter for all categories of respondents.

**Quadrant II “Keep up the good work”**

This second quadrant captured attributes with high importance and high satisfaction. Our findings show that the following attributes are located in

1. Company’s integrity and its reliability cause people (customers) to feel confident.
2. In order to be able to solve problems, employees should have oil related professional knowledge
3. The speed and attitude of reaction in unforeseen circumstances
6. Customers feel safe about the gas station (Safety issues such as fire “conflagration” or traffic flow)
7. Customers feel respected by gas station attendant’s warm and polite
10. Gas station provides washrooms for automobile and motorbike owners
14. There are more gasoline stations throughout the country. (gas stations density)
15. Gas station offers an easy and simple serving procedure (rapid process of payment, changing points to lagniappes)
16. Reduction of time waiting for services (flexibility of the waiting line)
17. 24/7 Operation, convenience of refueling any time.
22. Station increases the number of self-service equipment for customers who are in a hurry therefore enhancing convenience.
27. Method of payment, using easy card, stored-value card, one card, happycash, credit card, refuel vouchers, check, and money transfer.
32. Enjoy membership card, VIP card preferential prices.
33. Clear indications of entrance and exit
34. Clarity of the gas station’s signs and description, easy to find a fuel (oil) pump
35. Location of the gas station
36. Environment of the gas station is in order and shipshape
38. Gas station is equipped with safety equipment (fire extinguisher, monitor, security system).

In this quadrant, attributes [10. Gas station provides washrooms for automobile and motorbike owners.] is obviously the one which received the highest degree of satisfaction and importance, showing that the third group of research population is very satisfied with the performance of CPC in that field. In other terms, the mean of attributes 10, which is (4.0441, 4.4853), compared with the global mean of attributes (3.7255, 4.0939) shows a high gap which is relatively good.

However, attribute [32. Enjoy membership card, VIP card preferential prices.], referring to our graph, is nearly located on the abscissa line. Thus, CPC has to keep improving the said service. Our findings also show that this group of customers uses every service provided by CPC’s gas stations the most and could be willing to subscribe for membership or VIP cards, preferential prices as well as use simple maintenance services. Therefore, CPC has to use that great opportunity. Finally, for this quadrant “keep up the good work”, some attributes located in have the same degree of satisfaction, but in terms of importance, automobilists and motorcyclists appreciate these attributes items differently. Those are: 

- 1>34
- 13<22
- 17<6
- 27<33<7

**Quadrant III : “Low priority”**

Attributes located in this third quadrant are those with low degree of importance and meanwhile customers are less satisfied about the said attributes. In our study, this quadrant captured:

- Participation in public benefit activities (For instance, showing care for disadvantaged social groups)
- Service staff actively promote new developing businesses and activities
- Gas station has WI-FI for its customers, allowing customers to use internet and access online information at any time.
- Gas station supplies innovative service method, and integrates domestic industries. (ex: honey, household care products)
- Station offers customized service based on the individual station in order to fulfil customers’ requirements.
- Station provides a convenient and fast network platform for consulting, communication and interaction.
- Station Sells items for cars (auto parts and accessories store)
- Stations have installed automatic engine oil services pumps in public places (parking lots, department stores).
- Stations have provided Gogoro engine battery changing services.
- Stations provide adding water to the radiator and tire inflation services
- E-tag stored-value system
- The station is equipped with a vacuum oil extractor.
- Car wash and valeting services
- Parking lots
- Provide Automated Teller Machine (ATM) services.
- A public telephone is provided.

In this quadrant, we have noticed that attribute [12. Gas station has WI-FI for its customers, allowing customers to use internet and access online information at any time.], recorded the lowest degree of importance as well as the lowest satisfaction degree regarding respondents’ views. It is easily to understand the majority of the respondents’ views because people who live in the northern parts of Taiwan usually have data plans on their phones and do not rely on public connections.

Our findings show interesting results for attributes [23. Stations have installed automatic engine oil services pumps in public places (parking lots, department stores).], [37. Provide Automated Teller Machine (ATM) services.], which got the

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1 Comparison obtained based on their mean and position on the graph.
same degree of importance and satisfaction (3.5882, 3.9265). Most of our respondents think that it will be more convenient for customers to use these services if they are available and near to them.

Finally, in this quadrant, it also appeared that some attributes have the same degree of satisfaction, but with different degrees of importance. Which are: 「20<28」, 「12<19」, 「24<31<9」.

**Quadrant IV “Possible overkill”**

As defined previously, attributes located into this quadrant show that customer satisfaction is high, but for the same group of customers, the importance of services provided is low. This quadrant captured two attributes:

[11. Gas station has a convenience store, which can be helpful for car owners to purchase essential paraphernalia],

[13. Gas station provides total services such as glasses washing, polishing and simple maintenance of cars.]

Customers who use cars and motorcycles are very satisfied about these two attributes but do not place much importance on them. This might be a result of the fact that in some areas CPC’s shops do not provide the items or products they need. In addition, it is rare to encounter a situation where employees help customers to wash clients’ car glasses.

**4.3. FPC’s MOG (Both, automobile and Motorcycle)**

**Quadrant I: “Concentrate here”**

Service attributes located in this quadrant are important in regards to customers’ perception of FPC; meanwhile they do not find satisfaction concerning these service attributes. This quadrant captured:

27. Method of payment, using easy card, stored-value card, one card, happy cash, credit card, refuel vouchers, check, and money transfer.

29. Reasonable price of oil

As mentioned earlier in the MOG of Motorcyclists Error! Reference source not found., the respondents who own car and motorcycle as engine are also unsatisfied with the performance of FPC in delivery of these service attributes. Therefore, FPC has a room for improvement for these same services attributes.
**Quadrant II : « Keep up the good work »**

This quadrant captured attributes with high degree of importance and high degree of satisfaction; which are:

1. Company’s integrity and its reliability cause people (customers) to feel confident.
2. In order to be able to solve problems, employees should have oil related professional knowledge.
3. The speed and attitude of reaction in unforeseen circumstances.
4. The speed and attitude of reactions of employees towards customer’s complaints and suggestions.
5. Customers feel safe about the gas station (Safety issues such as fire “conflagration” or traffic flow).
6. Customers feel respected by gas station attendant’s warm and polite attitude.
7. Staff is very active and take initiative; they are able to warn and provide concrete suggestions (employees use proper protocol such as turning off car engine while refueling etc.)
8. Gas station provides washrooms for automobile and motorbike owners.
9. There are more gasoline stations throughout the country. (Gas stations density)
10. Gas station offers an easy and simple serving procedure (rapid process of payment, changing points to lagniappes).
11. Reduction of time waiting for services (flexibility of the waiting line).
12. 24/7 Operation, convenience of refueling any time.
13. Station increases the number of self-service equipment for customers who are in a hurry therefore enhancing convenience.
14. Enjoy membership card, VIP card preferential prices.
15. Clear indications of entrance and exit.
16. Clarity of the gas station’s signs and description, easy to find a fuel (oil) pump.
17. Location of the gas station.
18. Environment of the gas station is in order and shipshape.
19. Gas station is equipped with safety equipment (fire extinguisher, monitor, security).

Our research showed that service attribute [10. Gas station provides washrooms for automobile and motorbike owners] scored the highest degree of importance and the highest degree of satisfaction. As CPC’s MOG of Automobilists and motorcyclists, FPC’s MOG for this category of customers had the same attention for this service attribute. Both firms could innovate and offer cleaner washrooms to their customers.

Our research also found out that several service attributes in this quadrant scored the same degree of satisfaction. By grouping, we got this: (1; 8), (2; 4; 14), (7; 34), (22; 35).

**Quadrant III: “Low priority”**

This quadrant captured service attributes with low degree of importance and low degree of satisfaction.

11. Gas station has a convenience store, which can be helpful for car owners to purchase essential paraphernalia.
12. Gas station has WI-FI for its customers, allowing customers to use internet and access online information at any time.
13. Gas station supplies innovative service method, and integrates domestic industries. (eg: honey, household care products).
14. Station offers customized service based on the individual station in order to fulfil customers’ requirements.
15. Station provides a convenient and fast network platform for consulting, communication and interaction.
16. Station Sells items for cars (auto parts and accessories store).
17. Stations have installed automatic engine oil services pumps in public places (parking lots, department stores).
18. Stations have provided Gogoro engine battery changing services.
19. Stations provide adding water to the radiator and tire inflation services.
20. E-tag stored-value system.
21. The station is equipped with a vacuum oil extractor.
22. Parking lots.
23. Provide Automated Teller Machine (ATM) services.
24. A public telephone is provided.
This third quadrant also registers service attributes that scored similar ratings. By grouping these service attributes, we got (20, 23, 24), (18, 19), (26,37) scored the same degree of satisfaction, respectively (3.0441), (3.1324), (31912).

Besides, service attribute [12. Gas stations has Wi-Fi for its customers, allowing customers to use internet and access online information at any time] scored lowest, this is quite easy to explain. Basically, Customers of gas stations find this service attribute less important as well as less vital, because they do not usually stay longer than five(5) minutes while filling their tanks; except those come in the station for simple maintenance and washing of their cars and motorcycles. Therefore, FPC has the choice to inject fewer resources regarding the improvement of this service.

**Quadrant IV : « Possible overkill »**

Customers perceive service attributes located in this quadrant as unimportant service attributes, but they are highly satisfied with the performance of FPC. This fourth quadrant captured three service attributes:

5. Participation in public benefit activities (For instance, showing care for disadvantaged social groups)
9. Service staff actively promote new developing businesses and activities
30. Car wash and valeting services

Service attributes 5. & 9. well-nigh scored the same degree of satisfaction and almost the same degree of importance (3.2206, 3.9265)/ (3.2206, 3.9118). Although these two attributes fell into the same quadrant, they do not belong to the same dimension; reliability and cordiality. Therefore, theoretically speaking, FPC could invest less effort in this aspect.

**4.4 Competitive Matrix (CM) Analysis of CPC and FPC**

To build the Competitive matrix, this research used the cut-off point of the degree of importance, 4.0464 the global average (mean) of the service attributes, which are also known as key services of both companies. Besides, 3.6245 and 3.1438 were considered respectively as CPC and FPC key service’s global average of the degree of satisfaction.

The empirical result is represented through Error! Reference source not found., in which eight (8) scenarios of market opportunity were determined and the corresponding competitive strategic analysis of each scenario/area.

<p>| Table 1. Competitive Matrix (CM) of CPC and FPC |</p>
<table>
<thead>
<tr>
<th>Attribute Importance</th>
<th>Degree of Satisfaction</th>
<th>Competitive Strategy</th>
<th>Services Attributes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objective Data</td>
<td>CPC Performance</td>
<td>FPC Performance</td>
<td>Simultaneous Result</td>
</tr>
<tr>
<td>High</td>
<td>Good</td>
<td>Good</td>
<td>(1) Head-to-Head Competition</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>6; 10; 3; 38; 16; 17;</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>35; 4; 14; 33; 1; 7; 34;</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>36; 15; 27; 22; 2</td>
</tr>
<tr>
<td></td>
<td>Good</td>
<td>Poor</td>
<td>(2) Competitive Advantage</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>25</td>
</tr>
<tr>
<td></td>
<td>Poor</td>
<td>Good</td>
<td>(3) Competitive Disadvantage</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>Poor</td>
<td>(4) Neglected Opportunity</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>29</td>
</tr>
<tr>
<td>Low</td>
<td>Good</td>
<td>Good</td>
<td>(5) False Competition</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Nil</td>
</tr>
<tr>
<td></td>
<td>Good</td>
<td>Poor</td>
<td>(6) False Advantage</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Nil</td>
</tr>
<tr>
<td></td>
<td>Good</td>
<td>(7) False Alarm</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>32; 30; 5</td>
</tr>
<tr>
<td></td>
<td>Poor</td>
<td>(8) Null opportunity</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>13; 26; 37; 11; 31; 23; 24; 9; 20; 39; 28; 19; 12; 18; 21</td>
</tr>
</tbody>
</table>
(1) Head to head competition (High, Good, Good): The importance of this service attribute is high and company performance is equal to its competitor, meaning the company should at least maintain strategies (Lee and Hsieh, 2011).

We further learned that CPC in many aspects performs better than FPC. Especially for service attributes like [10. Gas stations provide washrooms for automobile and motorbike owners] and [6. Customers feel safe about the gas station (Safety issues such as fire “Conflagration” or traffic flow)]. The degree of satisfaction is significant and higher than FPC’s. In terms of location, CPC’s gas stations are spread all around Taiwan. In any gas station, a washroom is a likely fit out and employees work diligently to keep them clean.

(2) Competitive advantage (High, Good, Poor): The importance of the service attributes is high and the company performs better than its competitor does, and successfully differentiating the company from others in the market (Lee and Hsieh, 2011).

Besides, service attributes of the core competencies of CPC located in this area reveal that CPC is performing better than FPC. For service attributes [25. Gas stations provide adding water to the radiator and tire inflation services], it is obvious that customers, who do some simple maintenance in CPC gas stations, are quite satisfied with this service attribute. FPC should therefore work to enhance its services in this field.

(3) Competitive disadvantage (High, Poor, Good): The importance of this service attribute is high, but the company is inferior to its competitor, which is a drawback and it requires improvement.

CPC has to pay more attention to the cordiality of its employees because FPC takes advantage of this field. CPC should not neglect service attribute [8. Staff is very active and take initiative; they are able to warm and provide concrete suggestions (employees use proper protocol such as turning off car engine while refueling etc.)].

Nowadays, customers expect more regarding the employees of gas stations’ attitudes. If CPC wants to win customers loyalty, gas managers have to take in consideration the active attitude of its employees.

(4) Neglected opportunity (High, Poor, Poor): The importance of this service attribute is high, but neither the company nor its competitor meets the satisfaction level expected by customers (Lee and Hsieh, 2011).

Service attribute in this area is [29. Reasonable price of oil]. Although the pricing of the other services attributes in its core competency are perceived by customers as rational, automobilists and motorcyclists are not satisfied with the pricing of gasoline in these two main local petroleum companies; which is an opportunity for both to take over the opponent.

Therefore, if CPC or FPC can implement effective quality planning and improvements in this field, it can achieve customer satisfaction with its service performance and gain an advantage in this aspect.

(5) False competition (Low, Good, Good): Although the company and competitors have positive evaluations from customers, the attitude does not affect purchasing decisions (Lee and Hsieh, 2011).

That is to say, service attributes located in this area, based on customers’ perceptions, are those service attributes with low degree of importance but scored high degree of satisfaction. Furthermore, even CPC & FPC do not invest much effort in these service attributes; it could always get positive reactions from its customers for this category of service attributes. Error! Reference source not found. shows that both firms are using their resources efficiently because no service attribute dropped into.

(6) False advantage (Low, Good, Poor): Though the company performs better, the importance of the service attribute is low. This implies the company might be placing too much effort or resources into this attribute (Lee and Hsieh, 2011).

Our research shows that no service attribute is considered as false advantage item. Therefore, we conclude that customers degree of perception is low in this case, meanwhile CPC performance is higher the global average, which is not the case with FPC.

(7) False alarm (Low, Poor, Good): Though the competitor performs better than the company does, this does not affect customer brand preference or purchases (Lee and Hsieh, 2011).

Basically, service attributes located in this area do not affect CPC brand awareness. These service attributes are [32. Enjoy membership card, VIP card preferential prices.], [30. Car wash and valeting services] and [5. Participation in public benefit activities (For instance, showing care for disadvantaged social groups)].

(8) Null opportunity (Low, Poor, Poor): Even though the company and competitors, both deliver adequate quality services from the standpoint of customers, service attributes located in this area do not affect competition.

In other words, services located in this area scored a low degree of importance as well as CPC and FPC degree of satisfaction. Several service attributes are located into.

5. Conclusion

5.1 Research Finding

The purpose of this study was first to examine the core competency and the key attribute items fossil fuels companies require to hold in its gasoline stations. In addition, the purpose was also to analyze the Taiwan oil market through a thorough examination of how CPC can increase the quality of its services and respond to the needs of its clients. More specifically, this study was clearly designed to define an MOG and Competitive Matrix.
towards each group of customers for CPC gas stations. This section gradually answered our research problems.

Our research, based on customers’ perception, identified six major dimensions and third-nine service attributes. The dimensions include: "reliable", "cordial", "efficiency", "innovation", "rational pricing", and "environmental facilities and security settings". After analyzing, our findings have shown the following attribute items/services provided as the ten (10) top attribute items.

Table 2. Top 10 service attributes of importance.

<table>
<thead>
<tr>
<th>Rank</th>
<th>Attributes Items</th>
<th>Importance score</th>
<th>Core competency dimensions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>6. Customers feel safe about the gas station (Safety issues such as fire “conflagration” or traffic flow)</td>
<td>4.4869</td>
<td>Reliable</td>
</tr>
<tr>
<td>2</td>
<td>29. Reasonable price of oil</td>
<td>4.4569</td>
<td>Rational pricing</td>
</tr>
<tr>
<td>3</td>
<td>10. Gas station provides washrooms for automobile and motorbike owners</td>
<td>4.4457</td>
<td>Cordial</td>
</tr>
<tr>
<td>4</td>
<td>3. The speed and attitude of reaction in unforeseen circumstances</td>
<td>4.4382</td>
<td>Reliable</td>
</tr>
<tr>
<td>5</td>
<td>38. Gas station is equipped with safety equipment (fire extinguisher, monitor, security system).</td>
<td>4.4195</td>
<td>Environment facilities and security setting</td>
</tr>
<tr>
<td>6</td>
<td>16. Reduction of time waiting for services (flexibility of the waiting line)</td>
<td>4.4157</td>
<td>Efficiency</td>
</tr>
<tr>
<td>7</td>
<td>17. 24/7 Operation, convenience of refueling any time.</td>
<td>4.3521</td>
<td>Efficiency</td>
</tr>
<tr>
<td>8</td>
<td>35. Location of the gas station</td>
<td>4.3408</td>
<td>Environment facilities and security setting</td>
</tr>
<tr>
<td>9</td>
<td>4. The speed and attitude of reactions of employees towards customer’s complaints and suggestions</td>
<td>4.3296</td>
<td>Reliable</td>
</tr>
<tr>
<td>10</td>
<td>14. There are more gasoline stations throughout the country. (gas stations density)</td>
<td>4.3296</td>
<td>Efficiency</td>
</tr>
</tbody>
</table>

Referring to Error! Reference source not found., our analysis reveals that gas stations core competencies can be summarized and classified as follows: Reliable, Rational pricing, Cordiality, Environment facilities & security settings, and Efficiency. The results show that customers care more about some basic aspects such as safety and speed of reactions of the gasoline companies. This is likely different from the core values/competencies mentioned and orderly ranked by CPC on its website, which are Integrity, Innovation, Talent development, Safety, Security, Caring for the environment, and Social responsibility (CPC, 2017).

By summary, [Reliable] dimension registers three (3) services attributes. The very first one is [6. Customers feel safe about the gas station (Safety issues such as fire “conflagration” or traffic flow)]. Gas stations that are able to make customers feel safe, enhance and improve the image that customers have regarding the gasoline company indeed. Besides, [3. The speed and attitude of reaction in unforeseen circumstances] and [4. The speed and attitude of reactions of employees towards customer’s complaints and suggestions] can have significant impact on customers’ satisfaction, perception, and loyalty.

Secondly, [Rational Pricing] dimension has one (1) service attribute and it is relative to the [29. The reasonable price of oil] at pump. Gas stations should consider again their offer rate of pricing to its customers. Thirdly, [Cordial] dimension also registers one (1) service attribute. Gas stations, by providing [10...washrooms for automobile and motorbike owners] increase customers’ degree of satisfaction, somehow. Therefore, Gas stations should invest more efforts on this related service, because dirty and smelly washrooms could disrepute the image of the gas stations, which could affect the brand of the gasoline company.

Fourthly, [Environment facilities and security settings] have two (2) service attributes; [38. Gas station is equipped with safety equipment (fire extinguisher, monitor, security system)] and [35. Location of the gas station]. Customers expect convenience and security from gas stations. Thus, gas stations should consider the exits and entrances, the refueling lines, as well as the position and visibility of signs and nameplates. Customers perceive all these aspects and details as crucial.

Lastly, [Efficiency] dimension has three (3) service attributes: [16. Reduction of time waiting for services (flexibility of the waiting line)], [17. 24/7 Operation, convenience of refueling any time], and [14. There are more gasoline stations throughout the country (gas stations density)]. Reducing the time of waiting by increasing the number of employees during pick-times could solve the long waiting time, which is a net gain in terms of customer satisfaction. In addition, operating 24/7 and having more gasoline stations throughout the country reduces the painful
time of searching for the nearest gas station. The more gas stations are available and close to customers, the more customers are satisfied.

Exception, our research shows that customers of gas stations do not see the [Innovation] dimension of the core competencies as important dimension as scholars mentioned. Even Innovation is seen as important factor in a firm survivor and could help organizations to defeat competition and win new customers (Urbancová, 2013). Schumpeter (1942) pointed out the fundamental role that innovation plays for the survival of firms competing in the market. However, customers of gas stations expect more about the Reliability, Cordiality, Rational pricing, Environment facilities & security and the efficiency of gas stations. Our research suggests that CPC and FPC take in consideration these aspects, moreover some crucial aspects such as the speed of reaction, the cordial attitude while innovating its products and services. Innovation is not only costly for a firm; it could also be insignificant for customers when a firm do not focus on its core competencies. Therefore, gasoline companies should focus on the above five most important core competencies.

5.2 Theoretical and practical implications

6. Theoretical implications

This study focused on customers’ perception on gas stations’ services provided and identified the core competencies and key services attributes, then discussed the degree of importance and the degree of satisfaction. As a result of resources-based concepts, MOG tool, and CM model; as well as through our literature review and after analysis of the data gathered. We put forward concrete and substantial dimensions of competitive advantage, which every gasoline company could possess in order to hold a competitive position in the oil market.

Therefore, we specifically determined the core competencies of the gas stations based on resource-based view (Wesnerfelt, 1984) and the Core Competence of the Corporation (Prabhalad and Hamel, 1990). Those scholars mentioned and suggested a test to be applied in order to identify core competency in a company. Then, Barney (1991) categorized resources into three groups, (physical resources, human resources, and organizational resources). Then finally, a questionnaire was designed with questions that represent the key attribute items of gas stations, which is in line with the scientific methodology.

Secondly, previous researches also focused on customers’ satisfaction. The most specific definition was mentioned by Aquilani et al. (2014), hence showed a perfect overview of customers’ satisfaction definition. They mentioned that customers’ satisfaction definition could be classified in three different theoretical approaches, which are “emotional-cognitive response”, “response related to a particular aspect” and “response that occurs at a particular time”. Besides, following previous study on gas stations in Taiwan, which were mostly focused on customers’ satisfaction (汪澄仁, 2009) (Chen, 2013) (Yang, 2010).

Moreover, this study used the Management Opportunity Grid (MOG) tool (Chakravarity, Widdows and Feinberg, 1996) probing the degree of importance and the degree of satisfaction that customers perceive regarding gas stations’ services provided. Then considering the influence that CPC itself and its opponents/ competitors’ core competency have on customers’ satisfaction. After analyzing the data, an overall comparison between the two companies helped us to suggest feasible and concrete plans.

Finally, we established a competitive matrix (Burns, 1986), where eight (8) scenarios are determined, and corresponding suggestions and directives are mentioned in order to improve CPC and its opponent market strategies.

7. Practical implications

Wu (2009)’s study showed that, by strengthening and focusing on its employees training, gas stations could enhance its customer’s satisfaction and create customers loyalty in a long-term period. Our research has confirmed it and it is primordial that CPC & FPC reconsider this aspect in the politic of management. Besides, a good communication and a frequency of contact with customers could enhance customers’ satisfaction. CPC always faces high customers’ complaint requests; for instance the exit and entrance lines, oil prices, oil quality, speed of reactions, attitude while serving customers and so on. Therefore, the company should develop its marketing communication, which could arouse customer to develop positive attitude toward its gas stations services.

For automobilists who usually use parking lots, washing services and simple maintenance services... a reduction of waiting time is an aspect that all gas stations should pay close attention.

In addition, gas station customers are expecting more about the convenience of payment’s methods. 34.1% of our respondents find important and 44.9% of them think that it is very important that gas stations offer to customers other options of payment. Therefore, our research recommend that CPC and FPC should introduce [mobile technologies at the pump] online payment by using their smartphone. Furthermore, by having some ATM services in its gas stations, it would allow customers to withdraw cashes for minor purchases or in case of lack of cash on them to pay their fuel’s bills or fuel fares.

Moreover, regarding to the reasonable price of oil; like cigarettes, alcohol it is essential to mention that oil price is also subject to government regulations. In this field, FPC has a great policy. The oil prices in affiliate stations and wholesale price of oil are likely the same, thus getting in
advance on CPC, even with its status of public company. Unfortunately, several factors still influence the perception of the customer regarding the oil pricing in FPC such as the quality of the fuel, the frequency of refueling; briefly the degree of customer awareness.

Finally, oil companies have to work on the density and location of its gas stations. 47.6% of our respondents find very important that CPC and FPC increase the number of gas stations throughout the country. Therefore, we specially recommend CPC to keep the good work, meanwhile this aspect is also a great potential opportunity for FPC, if it plans to extend its market and enhance its competitiveness.

7.1 Limitations and Further research

Although this research has made some contributions to the theory and practice, there are some limitations of the research in its implementation:

- The questionnaire was in Chinese and research scope just took in consideration the motorcycle and car owners living in Taipei and New Taipei City as the survey population. Further researches could be as wide as by going forward in all cities of Taiwan.
- The study chose two major oil companies in Taiwan, a public company and a private company. Since there are several gasoline companies and an increasing number of gasoline stations in Taiwan’s oil market, future studies could take in consideration more than two oil companies.
- Due to the large number of gas stations in the country, especially in the North, the present research has been planning on to ask customers of 10 main gas stations located in Taipei and New Taipei City, however 7 gas stations of CPC were visited. Future studies could extend the number of visited gas stations.
- The present study focused on CPC customers and some passersby, future studies could distribute the questionnaire to both companies’ customers, CPC and Formosa gas stations, in order to have a symmetrical database.
- Our study encountered some difficulties regarding the patience and willingness of respondents. In fact, most of the respondents always spend 3 to 5 minutes to refuel their engine. In addition, the environment of the gas station could not allow us to have a long interaction with our respondents. Therefore, to solve this problem, we specially chose 10 specific gas stations where full services are offered, such as parking lots, car wash, valeting, and basic car services maintenance.
- Our study was focused on Taiwanese customer’s behavior regarding CPC and Formosa gas stations services, and due to the status of the researchers, we kindly recommend future international students to take in consideration foreign firms existing in the oil field, especially their own country’s firms.

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Proceedings of Plenary Session II
The Role of HR in Responding to Terrorist Threat: A Systemic Approach

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In this Extended Abstract, we introduce our systemic approach for the role of HR in responding to terrorist threat.

Research on terrorism and violent conflict, despite still a small field, is increasingly gaining momentum (e.g., Bader, 2015; Bader, Berg, & Holtbrügge, 2015; Reade, 2009; Czinkota, Knight, Liesch, & Steen, 2010; Harvey, Dabic, Kiessling, Maley, & Moeller, 2017). A number of research studies have been published in recent years dealing with the implications of terrorism for HRM-related issues (e.g., Bader, Froese, & Reade, 2017; Bader & Berg, 2013; 2014; Bader & Schuster, 2015; Beutell, O’Hare, Schneer, & Alstete, 2017; Paulus & Mühlfeld, 2017; Reade & Lee, 2012; 2016). These studies have mostly been at the individual level, utilizing different theoretical perspectives such as stress theory, social identity theory, and social support theory.

However, there is no comprehensive theoretical approach at the organizational level relevant to HRM. In our article, we address this shortcoming by examining extant literature on the influence of terrorism on HRM-related issues and introducing an MNC organization-wide systemic approach for HR response to terrorism as a basis for theory development.

Characteristics of Terrorism

Terrorism can be defined as “the threatened or actual use of illegal force and violence by a non-state actor to attain a political, economic, religious or social goal through fear, coercion, or intimidation” (Global Terrorism Index [GTI], 2016: 8). This definition takes into consideration both the physical act of terrorism as well as the psychological impact on people and society that is highly relevant for individual and HR responses to terrorism.

We differentiate between dimensions and levels of terrorism. The dimensions are international and domestic terrorism. International terrorism generally targets Western businesses and persons, whether located outside or inside their home country, while domestic terrorism accompanies various forms of ongoing sociopolitical violence, armed conflict or civil war (Hironaka, 2005; IEP, 2016; Reade & Lee, 2012) typically in developing and emerging economies.

The level of terrorism is an important consideration for MNCs and their employees. Objective measures of terrorism levels take into account frequency of terrorist incident, number of people killed or injured, and amount of property damaged. Countries with high levels of terrorism thus refer to those with a relatively high frequency of terrorist incidents, number of civilian casualties, and/or amount of terrorism-induced property damage (IEP, 2017).

These differentiations on terrorism are necessary to delineate our framework. To further delineate our systemic approach we include categories of the people in MNCs who are affected.

MNC Employees Affected

The HR function of the MNC has a global, organization-wide responsibility for staffing. While there are currently many different types of international assignments (Collings & Isichean, 2017), we consider for the purpose of our systematization two main categories of employees: expatriates and local employees. These categories include parent country nationals (PCNs), third country nationals (TCNs), and host country nationals (HCNs). All are crucial for the effective management of the MNC’s HR function (McNulty & De Cieri, 2011). Regarding the staffing of a given subsidiary, for example, an MNC needs to decide on the mix of local employees (HCNs), people from its home country (PCNs), or those from other units in the global network (TCNs). We know from previous research that employee and HR response to terrorism may be different for expatriates compared to local employees (Reade & Lee, 2012). Therefore, since PCNs and TCNs are generally considered to be expatriates, we categorize PCNs and TCNs together as expatriates, and categorize HCNs as local employees.

Terrorism-Response Grid

Based on this systematization, we derive a two by two matrix, clustering the respective HR responses to terrorist threat. On the x-axis, we differentiate between the
dimension of terrorism, i.e., domestic versus international. On the y-axis, we differentiate between the MNC employees affected, i.e., local employees versus expatriates. All four fields are additionally affected by the level of terrorism.

This allows us to derive four different, generic HR terrorism response strategies. The purely domestic response is appropriate when the dimension of terrorism is domestic and only local employees are affected. A coordinated domestic response should be chosen when domestic terrorism affects expatriates. A coordinated global response is appropriate when international terrorism affects local employees. And finally, a global response is required when international terrorism affects expatriates.

Conclusion

Our model integrates and extends several perspectives on how terrorism research has been conducted in IB and HR research. Doing so, we demonstrate how a variety of theoretical angles can be woven into a unifying framework at the organizational level. We consider this the foundation of an HR terrorism-response theory that awaits empirical testing. The four generic strategies of our model can be considered a guideline for MNCs to reconsider their terrorism-preparedness plans.

References


Europe’s Multimorision and Glocal Political Risk Analysis

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Turbulent local, regional and international politics pose challenges to European firms and their political risk management. In Europe, a process of multimorphosis is underway, with divergent trajectories between different regions and a re-selection of elites and institutions. Outside Europe, a triad of identity politics, resource politics and geopolitics in Asia, the Middle East and Africa is manifesting in assertive political actors, economic and cultural protectionism, and weak property rights. Political risk analysts for business will have to recalibrate their frameworks, giving attention to country-level risks but also tracing the diverse glocal forces and complex systems shaping regional and global interactions.

Introduction

European business is sailing in turbulent international seasapes. A process of multimorphosis and divergent trajectories in eastern, southern and western Europe is underway, while Britain’s exit from the EU or Brexit has further weakened underperforming EU institutions. Europe is also co-evolving with turbulent regional systems and assertive actors on its southern and eastern flanks. European business will continue to be active outside of Europe due to its export-focused economies, some limits to its own market, value chains, and the resources and markets it wants and needs. However, the continued high and often increasing impact of local, national, regional, and international politics on European business may also demand recalibrated frameworks of political risk management.

Multimorphosis and multipolarity

This paper proposes that trends and events in Europe point to a strong process of what could be termed multimorphosis (Matthee 2014). Sociopolitical multimorphosis is seen as a new reality in Europe with an impact on economies: institutional contestation, iteration and imperfect self-replication, partial slowdowns and breakdowns, selection and non-linear self-organization, emerging forces and bifurcation, trial and error.

They are attempts to provide new chances to achieve higher levels of fitness in the emerging and interactive landscape (Eidelson, 1997; Miller & Page 2007) and seascape. Landscape is used here as a metaphor for the relatively more structured and iterative processes and environment that co-constitute European actors and in which they participate. Seascape is used as a metaphor for those processes and environments that are more fluid and fickle, showing some patterns but presently beyond the control of or domestication by European actors.

European business will be shaped by multimorphosis in Europe and multipolarity in the international system. Multimorphosis was already visible before the UK’s Brexit referendum, and the new relations between the U.S. and a more powerful Asia will change Europe’s position. The political economies of a more assertive Russian-dominated region, the turbulent Middle East and North Africa (MENA), and those of Europe are envisaged here as a constellation of co-evolving complex adaptive systems.

Felin and others criticize the limits of a landscape metaphor in evolutionary economics, which assumes a search for a knowable list of opportunities. “Not only do we not know what will happen, we typically do not know what can happen” (Felin, Kaufman, Kolle & Longo, 2014, p. 12). There are sets of still-empty possibilities that may be turned, within enabling constraints, into value propositions by entrepreneurship and innovation. Assuming this is the case, it is proposed here that for European business, the metaphor of an emergent seascape interacting with a landscape would be sufficient to encompass this different focus. This paper will discuss dimensions of the emergent seascape.

Europe trapped on local fitness peaks?

Current EU institutions have now stumbled or failed in short succession, regarding four major issues. One issue has been the Euro crisis since 2008, alongside the related Greece crisis, with Portugal, Spain and Italy still presenting potential flashpoints. The recession brought forward by decades the point to 2030 when the health, pension and education costs of the baby boomer generation will become unsupportable (Kaletsky, 2010). Previously successful adaptations have possibly trapped many European Union member states on local fitness peaks from which the higher peaks are not directly accessible (Davenport, Leibold & Voelpel, 2007).

Two foreign policy crises have indicated the limits to
European policy responses, cohesion and power: what was known as the Arab Spring, which led to major instabilities in Libya, Syria, and Europe’s southern neighborhood, as well as Russia’s activities since 2014 in Ukraine and in Europe’s eastern neighborhood. In past years, and especially in 2015, several national governments and EU institutions were also largely unable to achieve policy objectives and maintain EU rules regarding external frontiers, internal freedom of movement and migration in the face of unprecedented flows of asylum-seekers, refugees, and economic migrants (Matthee, 2015; De Wijk, 2016).

Another issue has been the growing mistrust of electorates of EU and media institutions, reflected in results of referendums and elections of the European Parliament (Mudde, 2012). This state of affairs partly reflects the shift from the EU’s initial focus on breaking down internal market barriers toward also emphasizing a more hegemonic Europe-wide harmonization of rules. Although incremental change has pushed the system toward possible bifurcation at the critical point of issues, a slight majority of British voters chose to support the Brexit option. The EU institutions, whose limited responsiveness to UK concerns and proposals for more subsidiarity also played a role, thereby lost a member that constituted its second largest economic power and its largest military power (Jensen and Snaith, 2016).

Post-Brexit recalibration

As a result of the UK’s withdrawal, the EU itself has been confirmed as a limited middle power. The EU’s impact on foreign policy in the UN will also decrease, and its global economic, political and military influence will be diminished. EU institutions will retain capabilities that are not negligible, but they will have to reduce their ambitions and rhetorical claims (Hobolt, 2016).

Brexit, combined with other events like the increased economic and nationalist protectionism under President Trump in the U.S. and pressures from Europe’s southern and eastern flanks, will be one milestone on the way to a re-selection of political elites, institutions, and dominant discourses in Europe. It will sometimes entail emergent novelties that political and economic actors may use for innovation and entrepreneurship. Often, however, these novelties will force companies to give more attention and resources to political risk management.

Pushing for trade liberalization was one of Britain’s main contributions to the EU, and the Brexit event could increase the strength of potentially protectionist member states. Brexit would also alter the European Parliament’s party landscape and ideological composition. Possible policy implications would therefore affect an increased regulatory burden on EU businesses, weaker copyright protection in the EU, a stronger push for tax harmonization, and higher taxation of financial transactions (Hix, 2016).

An EU of different speeds

The combined activities of European Union member states make the dynamics of innovation increasingly complex. Pockets of stability remain. However, uneven political support for the EU institutions will continue. Brexit also represents a qualitative change in the nature of EU membership. Other countries with preferences that are too divergent to be easily accommodated might more readily consider opting out of the core of European integration, instead preferring membership in the European Economic Area or a free trade agreement.

Since 2008, there has been a renewed emphasis in member states on subsidiarity and regaining more decision-making competences from the EU institutions. Most demands relate to more competences for the governments of states (Schmidt and Wood, 2017). Member state competences will remain especially important in the EU. This will also be true for energy policy, which remains closely allied to foreign and security policy. Internal energy path dependencies, forces, and interactions in the EU are not aligned and are not likely to be aligned well soon (European Parliament, 2017). When renewables form an important source of European countries’ energy, geopolitical interdependencies may then shrink to the size of the grid that connects producer, transit, and consumer countries. One implication would be that countries with certain capacities would become more influential, changing the patterns of influence and power in Europe. For example, better-placed countries would be those with considerable storage capability, high reserve capacity, the ability to produce renewable electricity at times of high demand, or large interconnector capacity that allows the balancing of outputs of different areas (Scholten and Bosman, 2016).

However, there are also continuing demands for more competences and even autonomy for nations within plurinational states. There are an estimated 87 cultural groups in greater Europe, of which 33 dominate nation states. The remaining 54 differ in their efforts to pursue claims regarding language rights and non-territorial cultural councils (Pan and Piehl, 2006; Smith, 2014). The expansion of impersonal markets and associated norms and discourses at the expense of other forms of integration in southern and eastern Europe are often seen as forms of material and symbolic dispossession (Hann and Hart, 2011). Different socio-economic trajectories in southern, eastern and northwestern Europe persist.

Continued autonomy campaigns, sometimes also involving disputes about resource transfers within a country, are visible in Catalonia, Scotland and northern Italy, and to some extent, in Flanders, too. In the case of Catalonia, it has resulted in a political crisis which the Spanish government tried to resolve since 2017 by resorting
to legalistic, re-centralizing and sometimes strong-arm tactics. As a result, Catalanian trust in the relatively young tradition of rule of law in modern Spain has been damaged and the crisis has not been resolved. (Martinovich, 2017) While Catalonia as a brand has become established, for better or worse, indigenous business and European multinationals in Catalonia continue to be affected.

Many coordination issues will reinforce the value of the EU institutions. They range from moderating potentially clashing group and state interests to ensuring a single market and dealing with transnational challenges. However, after Brexit, the above forces and different levels of competences reinforce an EU of different poles and speeds. New combinations of individualist, communitarian, cosmopolitan, and environmentalist ideas and actors will arise and shape business contexts.

Cities as sociopolitical sites

Failed and failing cities outside Europe will constitute a key driver of future change, in addition to reinforcing migrant streams to Europe. Technological developments will allow migrants to maintain close links with their home communities and to transfer issues from the home country into the host country (Heinsohn, 2003; Rinke & Schwägerl, 2012). Some of them will be economically successful in Europe, with resulting social tensions, informal economies, transnational dimensions and sometimes violent interactions with others who may not be as successful. European cities rather than nation states may also become new sites of migrant identity.

This situation is reshaping the local environment of European business, generating costs and benefits, as well as new market segments, rules of the game, and models of coexistence. Market re-segmentation, for example, Islamic consumerism and age, gender or family lifestyles, boycotts and buycotts related to MENA causes, competitiveness to become accepted partners, and brand development, will become part of the abovementioned processes in Europe (Boubekeur, 2012).

Social ecosystems between some cities and smaller towns and more distant regions may diverge more. Persistent poverty, neglected constituencies in post-industrial heartlands, youth unemployment, concerns of the elderly, and an internally diverse underclass in many cities will be features in the future, too (Reincke, 2015; Börsch-Supan, 2015). A decreasing sense of security and control over events, sometimes more mediatized than real, is likely too. Architecture and spatial planning focused on optimal combinations of status, connectivity and quality of life, security, and perhaps greater self-sufficiency will become in demand among higher-income groups.

A positive feature for European business is that smaller emergent actors of various kinds pursuing their own fitness peaks constitute a new economic reality in Europe. They include some cities, such as the virtual city-states of greater Paris and London. Regions such as Bavaria, Catalonia, Flanders, South Tyrol, and northern Italy are also among these actors. Also included are mega-regions such as the Italian one from Milan through Rome to Turin and the cross-national one spanning Amsterdam-Rotterdam-Ruhr-Cologne, Brussels-Antwerp and Lille, and northwestern, southern, and eastern European political-cultural axes (Florida, Gulden & Melander, 2008). European cities with historical and locational advantages and specializations will also become more prominent in international commercial diplomacy.

Populist forces and political re-selection

A realignment within political elites, bureaucracies, and electorates is underway in Europe. Assertive actors and diverse pressures from outside Europe, in a world where Europe’s influence is past its apex, are reinforcing this process of re-selection among political elites, institutions, and dominant discourses. Anti-establishment or populist parties with economic, national, or cultural protectionist demands are also among the drivers of this realignment. Their growth indicates that segments of the electorate have lost their trust in the responsiveness of mainstream parties to their concerns and the adequacy of mainstream frameworks to give meaning to their experiences or to ensure appropriate policies (Albertazzi and McDonnell, 2015; Inglehart and Norris, 2016).

In many countries of Europe, the higher support for these opposition forces means that the political options of centrist mainstream parties have shrunk. Coalitions with more parties are necessary in proportional systems, and sometimes, such coalitions or policy choices will become stuck unless there is some form of accommodation with anti-establishment parties. In addition, smaller political niche entrepreneurs can enter or grow in proportional systems, reinforcing fragmentation and policy complexity.

Many mainstream parties in Germany, Austria, Denmark, the Netherlands, the pre-Brexit UK, and France have shifted to incorporate some of the views and potential constituencies of the anti-establishment parties (Balfour, 2016). Even if the anti-establishment parties gain influence and occasional power, the complexity of socio-economic challenges will often be beyond their current reach. Various backlashes by incumbent political actors and iterations of dominant discourses may also occur. Nevertheless, the total effect has been one of a partially transformed metapolitics and politics, in which challenges to the status quo are more likely.

Europe’s southern and eastern flanks

Conducting international business in diverse socio-
One hundred years ago, European actors constituted a much larger and powerful component of the world population and world economy. In the case of commercial or related political disputes with non-European actors, certain rules of the game and incentives operated, negotiations often occurred from a position of relative strength, and the forms and costs of compliance differed.

Today, Europe’s relative global power has weakened and is weakening further. There are key dependencies on outside actors regarding energy and rare minerals (De Ridder, 2013). At the same time, major parts of European countries and societies still have competitive advantages that will carry-over. Co-evolution in the new environment will occur. Under certain circumstances, Europe’s relative position in some sectors may turn out to be competitive or allow for creative forms of coopetition.

Socio-political disruption of polities and the crumbling regional order in the Middle East and North Africa (MENA) is reshaping the context of European business there. The authoritarian bargains in many MENA countries, consisting of governments providing services and government jobs for quiescence by citizens and communities, have eroded. New socio-political orders are in formation, sometimes violently. Population growth and insecurities regarding water, food, and jobs are exhausting bloated bureaucracies and budgets and will continue to fuel instability (Cammack, Dunne, Hamzawy, Lynch, Muasher, Sayigh, & Yahya, 2017). In some areas, new social contracts with local actors will be required to gain or keep a license to operate.

The contagious impact of regional instability was already visible during the Arab, Amazigh, and Kurdish rebellions in the region since 2011. The close intertwining of economics and politics and the strong involvement of the political and military apparatus in the economy will continue to shape the environment and options of European business. However, these systems do not operate in the same way. Partiality in the distribution of rent income, rising bureaucratic brokerage, and institutionalised interpersonal modes of access differ (Redman, 2014). This state of affairs will increase the complexity for European business and occasionally, its opportunities. Meanwhile, the growth of anti-Israeli statements and boycott campaigns in Europe signal a trend that will constitute new challenges to some European businesses (World Council of Churches, 2016).

Iran will constitute one relatively stable regime in the region. However, different US and EU interests and projection power will continue to affect European business in Iran. The Joint Comprehensive Plan of Action (JCPOA) nuclear accord between Iran, the EU, Germany and five permanent members of the UN Security Council in 2015, and the resulting termination of UN and some EU sanctions, has opened up new opportunities to European business, actively supported by many European national and regional governments. However, remaining and possible re-imposed U.S. sanctions by the Trump government and also non-complementary business systems in Iran have already slowed down the process and could even close the current window of opportunity for European multinationals. (Motevalli, 2017). Even such a development would not necessarily affect the increased opportunities for smaller European businesses absent from U.S. markets and able to gain finance.

The interactive triad of identity politics, national politics, and geopolitics will continue to shape the southern and eastern flanks of Europe. Already, different frameworks of identity politics are emerging or dominant in Russia, the Visegrad countries and perhaps Austria. The decline or re-emergence of Russia as a regional power will be an important driver of change in Europe’s eastern neighbourhood, and in the western Balkans, Central Asia, and the South Caucasus. If Russia eventually declines demographically and economically, the emerging vacuum may persuade eastern European alliances to adopt a more assertive policy to the east (Friedman, 2010). The balance of power in Europe may in time move slightly eastwards, with eastern Europe relying on U.S. support and becoming more important as the demographic weaknesses of Germany and France have effect.

**Contesting frameworks of political risk analysis**

The metapolitical and political contests between Europe’s actors will also reshape risk management paradigms and their specialized companies. The existing worldviews of bigger European business actors are highly path-dependent. They are rooted in symbolic discourses and socio-political settlements that became dominant during previous eras with specific characteristics: largely stable bipolarity or uni-polarity in the international sphere, Atlanticist alliances, discourses about universal and disembodied liberal capitalism, relative regional peace and economic prosperity, and expanding institutions at the EU level.

Dominant discourses can act to “protect” a political order from the inputs of external reality. However, this internal model is a truly effective mechanism only if the learned preferences and constructed intentions allow actors and institutions to execute appropriate responses as the environment changes (Witt, 2013). An interactive triad of identity politics, national politics and geopolitics within and outside Europe – as well as chance events and policy responses - have exposed the partial adaptation and blind spots of dominant west European discourses. In the past few years, many policy analysts and media pundits,
particularly in western Europe, have regularly made wrong assessments on EU abilities to influence the Arab Spring or the Eurozone crisis, migration pressures, an assertive Russia and Turkey, Islamist terrorism, and urban underclasses. Their record has included a marked underestimation of the victories of the Brexit camp and the Trump presidential campaign (Jennings and Wright, 2016), as well as direct or indirect populist successes in Austria, Germany, France and the Netherlands.

Dislocation events, structural changes and learning by key actors mean that many of these frameworks have now lost the ability to give meaning to new experiences or to comply with criteria of adaptation (Glynos and Howarth, 2007). A contestation of dominant frameworks of analysis and related institutional struggles will mark European academia and media in the next decade. Many major companies providing political risk management services are rooted in certain class and urban constellations in Britain, the US or France. Their dominant paradigms may clash or result in tense interactions with the paradigms of important SME clients or even smaller providers of political risk management in different countries of Europe. Based on the recent record, political risk analysts need to give renewed attention to their frameworks’ ability to assess accurately, to generate fruitful options or to assist actors sufficiently in instituting appropriate measures.

New frameworks - also in the internal models of policy-makers and risk analysts - are emerging around five interactive themes: security, socio-economic systems, identity politics, civil rights, and a new period in geopolitics. The view of globalization as an inevitable process of borderless and disembodied capitalism will possibly be of little use to European business in the next decade. Glocalization will often be a better framework of analysis and predictor of trends. Here, the term is more widely redefined as the shaping of political economies by global connections and interests but also by very particular local sociopolitical forces and formations.

Emerging new frameworks

Elements of the dominant frameworks will undergo iterations and will also change as a result of new sociopolitical constellations and chance events. Time-bound learning processes will also form a part thereof (North 1990). New frameworks dealing with international business need to give attention to cooperation and interdependence but also to economic protectionism, competition, and coopetition. They may re-emphasize the embodied forces, sociopolitical formations, and glocal dimensions shaping connectivity involved in sea lanes, energy pipelines, railway tracks, airports, internet cables, tunnels, and various chokepoints of global supply chains, rather than the too disembodied versions discussed in Khanna (2016).

More particularist but also internally contested, Asian, Islamic, and African and Latin American cosmopolitanisms will become more prominent among new middle classes outside Europe. These actors will also generate business discourses and practices that will recast the international order to the advantage of actors outside Europe. Innovations by European business firms will be subject to different selective mechanisms in diverse landscapes (Hölzl, 2005), including techno-nationalism or techno-identity politics. In such cases, research and innovation are driven by sentiments and ambitions to service the greater good, already visible in great powers such as China, Russia, India, Iran, and other countries (Cunha, 2015). It will also shape strategic competition by economic, security and political actors, the willingness to infringe on intellectual and other property rights, and policies ranging from industrial espionage to selective protectionism.

Even before the Trump presidency and its assertive protectionist statements in the U.S., the WTO noticed a rise in protectionism among G20 members (World Trade Organization, 2016). The turn towards more protectionism is likely to be visible in European government policies and reshape economic priorities and investment, entrepreneurial and consumer behavior, and market actors and incentive systems.

Europe’s public and private security sector

European business will, in any case, experience the strong influence of both government and non-state political actors on their business operations in Asia, Latin America, the MENA countries, and Africa. European business will face the risk of becoming targets of more or less sophisticated forms of scapegoating and extortion if the political authorities do not perform or experience popular pressure (Oprach, 2012).

European business operating internationally will have a changing and weaker security umbrella. Brexit has reinforced this trend and Russia’s growing influence in the Middle East has underlined the limits of the security umbrella. These developments may create not only new redundancies but also new incentives for innovation in the European defense industries. These industries will remain largely national in character, but industry interdependence between the UK, France and Germany will continue. The renegotiation of the pro-Atlanticist political and economic relationships between European states and the U.S. will be important.

Growing and new actors and market segments related to diverse private security goods and services will be important, as well as in cybersecurity. Private security providers will in some contexts also become part of their government’s foreign policy projects, or even of those of other governments. Major Western providers of political
risk management services are servicing major Chinese companies in Africa, the Middle East and in China itself. New rules of the game are already emerging.

An important and related new economic reality is that the international and regional rules of the game are changing on the seas, in the air, and less noticeable, in outer space. The change in the maritime order is especially significant for the export-oriented economies of Europe, for whom secure and open sea lanes are important. The potential security guarantor role of the U.S. navy will be more important for European business, but less self-evident. Russia has also shifted to a more assertive naval posture, so that the Eastern Mediterranean again is a contested area. When European powers perceive that international commerce is under threat, they may delegate the protection function to internationally sanctioned maritime coalitions or to private security firms (De Nevers, 2015). The increased importance of navies and the maritime sector for those European countries that have one will be a new economic reality.

The impact of political authorities

A process of institutional selection and variation in countries and regions outside Europe will shape and constrain the international reach of European state models and European business (Lange, 2017). It will also challenge European business schools and thinkers to renew their approaches in preparing business for new political economic realities.

One of the important effector tools encompass state-linked corporations or privately-owned national corporate champions, well-positioned as potential competitors of European business. For example, in many states worldwide, states or state-linked corporations dominate the energy sector, whether in oil, gas, or renewable energies. These companies often form part of the government’s foreign policy and operate in accordance with both strategic and economic imperatives. More than 80% of the world’s oil and gas reserves are now controlled by national energy companies (Bremmer, 2010). However, especially outside the OECD countries, this dynamic is often also visible in other sectors, such as banking, infrastructure, electricity, telecommunications, aviation, shipping, and the space sector.

In many locales in Africa, Asia, Latin America and the Middle East, different political actors, sources of legitimacy, claims and understandings of public authority, and resources co-exist in multiple spaces of authority within the public sphere. Diffused authority or the mediated state may be some terms to express this reality (Menkhaus, 2008; Boege, 2009). For European business, it remains often challenging to identify or correctly assess the meaning of informal political shifts and to reconfigure their stakeholder management. Involvement with one faction may also preclude opportunities linked to another faction or losses after political struggles. Competitors from other powers with different frameworks and fewer scruples or strings attached to operations may win out.

Diverse property regimes and political risks

European business will continue to encounter different business discourses and property regimes in different parts of the world. Property rules are universally significant in restraining and shaping production and consumption (Hann and Hart, 2011). Franz von Benda-Beckman refers to a property regime, which is constituted by four factors. One factor comprises cultural or ideological discourses, which contain the ideals of a person and collectivity, imposing a reality check on hyper-commodification. Another factor is political and legal regulation, a plurality of registers, which specify forms in which it can be kept, ownership and entitlement. Social relations and the way land use are tied to forms of kinship, which constitute the third factor. The fourth factor encompasses practices that change or reinforce the other three factors. Incentives are aligned between the exercise of the means or ownership of production and performance (Hann, 2005).

European business will periodically encounter authorities worldwide that weaken their self-defined property rights and reshape the relational contracts of property regimes. This will occur in sectors ranging from agriculture and construction to energy and mining. Since 1990, over 75 emerging economy governments have nationalized foreign investments or have been sued for unlawfully devaluing foreign holdings (Wellhausen, 2011). In several non-OECD countries, a form of “double movement” is constituting a new economic reality. The scope of property is continuously modified, both from above, through the regulations of states and other authorities, and from below, through the actions of citizens, consumers, and communities. (Bremmer and Keat, 2009).

The presence of non-European guarantors in other regions may encourage actors in these regions to renegotiate or break previous commitments, both economic and political. The non-renewal of bilateral trade treaties with some European states by the government in South Africa, while retaining those treaties with Russia and China, is one example. As the political and business leaders of many emerging powers see that the power gap between them and European powers narrow, some will be even more motivated to turn the balance of power in their favor or to gain politically-useful benefits. European business will have to contend with higher risks that politicians will try to avoid opposition or gain support from important power bases by rewriting the terms of a deal. This will not only be
the case outside Europe. Spain retroactively reduced subsidies for solar power producers, and Norway changed the regulations for income from oil pipelines just after raising funds from investors. The ability to assess and manage political risks and opportunities will be a key competitive advantage for European business in the future.

Conclusions

All in all, in the next ten or fifteen years, European business will operate with less influence in an external environment and with more complexity. Randomness and determinism will often co-exist, and change will sometimes be abrupt and discontinuous. There will be a selective mechanism at work for those with higher risk tolerance to explore chances for innovation and entrepreneurship within enabling constraints. The same will apply to those who have the ability to engage with political actors in economies outside Europe. However, the correct calculation of affordable losses will also become more important. Projects and enterprises should often be structured in such a modular way that at least some components could survive serious setbacks.

In Europe itself, political, social and economic institutions, and organizations will be subject to morphosis and punctuated equilibrium. Due to high and diverse social expectations but limited state capabilities, the need for public-private-NGO partnerships in Europe will strengthen. Co-evolution will occur with regional systems in North America, the MENA region, and east of Europe. The metapolitical and political changes may also fuel contestation between risk management paradigms and European providers of political risk management services.

References


State Capture, Political Risks and International Business: Evidence from Ukraine under Yanukovych*

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Merging approaches from Political Science and International Business Studies, this paper develops an innovative approach to political risk factors connected to state capture (in the post-Soviet space). The empirical part focuses on their impact on European enterprises in Ukraine under Yanukovych, and their coping strategies.

Introduction

Ideally, states provide security for doing business by a legal-institutional framework, enterprises can rely on. State institutions work in a legal-rational, predictable and effective manner. Relations between officials and private actors are formal and impersonal. In the OECD-area, this is a constellation often taken for granted. In many countries worldwide, however, the reality looks different. Private actors seize public institutions and processes to realize their particularistic interests of accumulating power and private wealth. For this purpose, they systematically “abuse, side-step, ignore or even tailor” formal institutions to their own needs in order to accumulate power and ever more wealth (Amundsen, 1999, p. 3). Such forms of “state capture” are associated with weak state institutions, legal uncertainty, rampant corruption and the detrimental behaviour of ruling elites, fostering their own business interests (“favourtism”) while harming independent enterprises. These are specific “political risks”, international businesses are confronted with, when operating in affected countries.

There is a lack of clarity about the term “political risk” as such. In international business studies, there is no universally accepted definition, let alone any universal concept of political risks. However, despite the heterogeneity, there is at least a shared notion of political risk. Drawing on a literature review, Leitner (2017) defines Political Risks as “any occurrence in the international business context where public actions or non-state actors that are active in the host country of the international activities interfere with private international businesses and adversely impact the performance of the international operation.” (Leitner, 2017, p. 29) As Leitner (2017) further reveals, state capture as a source of political risks has not yet been systematically operationalised.

In the search for an approach leading to a deeper understanding of political risks associated with state capture, this paper draws on the political science concept of “neopatrimonialism”. The concept delivers insights into how specific factors of political risks are embedded in a political system. This focus has not yet gained much attention in the literature on neopatrimonialism. Research has so far dealt with political and, to a substantially lesser degree, with economic consequences of this specific mode of organisation. International business aspects, however, have been widely neglected. In international business studies, the concept of neopatrimonialism has not been considered likewise. The lack of related studies is first of all due to a general lack of interdisciplinary approaches between political science and business studies.

From the empirical point of view, this paper focuses on political risk factors to European businesses, along with coping strategies which they developed under the rule of Yanukovych. According to Fisun (2003), the characteristic features of the system Yanukovych were the ‘wide strata of neopatrimonial rent-seeking actors, acting together with/or in place of governmental institutions via clientelistic networks of patronage and pork barrel rewards’, as well as a high level of competition. Fisun therefore characterises the system as ‘oligarchic neopatrimonialism’ (Fisun, 2003, p. 6; cf. also Franke et al., 2009, p. 80). However, the system was not only dominated by oligarchs, as regional politicians of networks, entrepreneurs and ‘wealthy businesspeople’ all turned out to be major players as well.
(cf. Pleines 2012, p. 128). The central broker in the whole configuration is the president. He maintains ‘a system of personal ties, (…) based first and foremost on regional (…) unity, as well as on present-day rent-seeking interests.’ He maintains power by capturing state resources and redistributing them to his own clientelistic network (Fisun, 2012, p. 3). Menon and Rumer (2015) provide an in-depth analysis of the inner workings of this system under Yanukovych, including its large-scale corruption schemes, centred on the president’s network. As the authors highlight, such practices were treated as ‘no secret’ by president Yanukovych (Menon et al., 2015, p. 48). Marples (2015) describes this system as ‘a Donetsk-based regime of apparatchiks and gangsters with their own private mansions and assets abroad’ (Marples, 2015, pp. 15).

In order to conceptualize political risk factors related to state capture, section two introduces the political science concept of neopatrimonialism. It derives three factors, in particular institutional ambiguity, systemic corruption and systematic favouritism. The empirical part of this chapter focuses on the impact of these three factors on European enterprises in Ukraine under Yanukovych (section four), and, finally, their coping strategies (section five). In this regard, section three gives a brief overview of the data collection process and the analysis method applied.

The internationalisation is usually associated with an increased risk. The risks arise from the fact that the company is entering a new market that may differ culturally, socially, economically, legally, politically-institutionally as well as structurally – ie in the constellation of the competition and local market preferences. Above all, the transformational economies in the post-Soviet region incur a heightened risk portfolio (Hoskisson et al, 2000; Meschi, 2005; Alcantara & Mitsushashi, 2013). In addition to socio-economic and market risks, there are also specific political risk factors that have a significant influence on international business activities (Leitner & Meissner, 2017). In this context, risk refers above all to the possible negative consequences for the company’s business activity and profitability in the respective foreign market due to unforeseen changes in the business environment (March and Shapira, 1987; Al Khattab et al., 2007). The business environment refers to all variables that define the framework for entrepreneurial activity in a particular market, and includes both microeconomic and macroeconomic indicators, as well as those found in the political and institutional context (van Wyk, 2010).

Three areas are specifically relevant to identifying risk factors that can have a negative impact on business: these are company-specific factors, the sectors and, as a third area, the general environment of the company in the foreign market (Miller, 1992; Müller, 1993; Werner et al.; 1996). While the sector and company-specific variables have been well studied, the general environment in particular often remains underexposed, even though it subsumes two key factors which can have a tremendous impact on the business, namely the political and institutional framework of a market (Lawton & Rajwani, 2015; Grosse, 2011). This non-market environment describes all those influencing variables not subsumed in an economic context, ie. that do not follow market logic, but instead find themselves in a social and political context. In order to make this very broad field manageable for companies, we refer to the literature on political risks, a strand in international business administration, dedicated specifically to the risk factors of the political environment (Sottilotta, 2017). This environment includes factors such as bureaucratic quality, judicial independence and the rule of law, transparency in public tenders, or the importance and influence of informal networks. The more transparent and predictable the political and institutional environment, the better a company can adapt to general conditions and optimise processes in order to work as efficiently as possible.

Political risk refers to all acts or decisions of public institutions and / or non-state players that are present in this foreign market and have an influence on the business activities of the international company and a negative effect on its performance (Leitner, 2017, p. 29).

Political risks can be identified at three different levels of analysis: the geopolitical level, the macro level - whereby further differentiations can be made between internal and external factors - and the micro level. At the geopolitical level, factors such as global terror, geopolitical power strategies from different countries, or even global conflicts are examined more closely and their possible effects on the company examined. The micro level deals selectively with those market risk factors specifically relevant to a single company or project. The macro level, on the other hand, deals with the political risk factors that arise in a country due to domestic and foreign policy dynamics, but also due to specific regime typology (Robock, 1971; Alon & Martin, 1998; de la Torre & Neckar, 1988).

Political risk refers to all acts or decisions of public institutions and / or non-governmental players present in this foreign market and who have an influence on the business activities of the international company and a negative effect on its performance (Leitner 2017, p. 29).

At the macro level, external political risks include factors such as regional or bilateral conflicts or the quality of diplomatic relations. Of equal importance may also be the basic ideology and agenda in comparison with international companies in a particular foreign market. The more hostile the political attitude towards international companies, the higher the political risk (Kobrin, 1979). The external factors refer to all those risk factors arising from the foreign policy dynamics of a country, factors resulting from the domestic political constellation. This includes, for example, political stability, which
comprises factors such as insurrections or strikes, but also to what extent a state can exercise its monopoly of power throughout the state territory, or how regulated regime change takes place in a state (Miller, 1992). The question of the specific political risks of differently structured democracy constellations is also discussed in this area (Jensen, 2008; Jensen et al., 2013).

Table 1. Analysis Levels for Political Risks

<table>
<thead>
<tr>
<th>Geopolitical Risk Factors (MIGA 2015)</th>
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<tr>
<td>Macropolitical Risk Factors (Robock, 1971; Alon &amp; Martin, 1998)</td>
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<tr>
<td>Internal (de la Torre et al 1988)</td>
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<td>External (de la Torre et al 1988)</td>
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<td>Political stability (Miller 1992)</td>
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<tr>
<td>Regional, Bilateral Conflicts and Diplomatic Ties (Alon &amp; Martin 1998)</td>
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<td>Systemic Corruption (Meissner 2017)</td>
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<td>Systemic Favouritism (Meissner 2017)</td>
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<td>Host country’s attitude towards international companies (Kobrin 1980)</td>
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<td>Institutional Ambiguity (Meissner 2017)</td>
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<td>Micropolitical Risk Factors (Robock 1971, Alon &amp; Martin 1998)</td>
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State Capture and Political Risks: Insights from the Concept of Neopatrimonialism

The roots of the concept of Neopatrimonialism go back to the studies of Max Weber, who drew a distinction between two “ideal types,” in particular patrimonial systems of rule and modern ones (cf. O’Neil, 2007, p. 2). As pointed out by Erdmann (2012), neopatrimonialism refers to a system in which two forms of logic and institutional patterns exist side by side: the patrimonial system of personal rule, clientelism and patronage and the legal-rational system of modern statehood (Erdmann, 2012). At the same time, the two spheres overlap. ‘The patrimonial system (of personal rule) penetrates the legal-rational system, twists its logic, functions and output (...), as formal and informal institutions and behaviour are intimately linked to each other in various ways and to varying degrees and this mixture becomes institutionalised’ (Erdmann, 2012, pp. 47). In this respect, neopatrimonialism differs from ‘patrimonialism,’ under which all power relations between ruler and ruled, political as well as administrative relations, constitute personal relations (Erdmann et al. 2007, p. 105).

Neopatrimonialism does not stand for a particular institutional, social or economic system as such. It rather describes ‘a social and political order of conflicting modes of organisation and their legitimization’ (Robinson, 2013, p. 137). It is a mode of organisation in which ‘the public and the private, the political and the economic, the individual and the collective, the “old” and the “new” all overlap. In this context, certain groups of individuals dominate the system. Formally, they rule “within the framework of, and with the claim to, legal-rational bureaucracy or “modern stateness.”’ (Erdmann et al., 2007, p. 105) In fact, however, they appropriate gains, privatise public resources and use them for private consumption (Sindzingre, 2010, p. 4). In other words, formal state bureaucracies are infused with the particularistic politics of the rulers (Soest et al. 2011, p. 4). Regarding the relations between neopatrimonialism and
regime types, it is noteworthy that authoritarian regimes provide an appropriate basis for neopatrimonial rule and vice versa. This is mainly, though not only, due to the specific structure of institutions and power relations in authoritarian states. The preservation of power due to the absence of free and fair elections, top-down processes due to vertically-organised structures in state and society, the lack of rule of law, and the dominance of the executive, altogether serve as a breeding ground for clientelism and patronage. Yet, as Soest (2010) stresses with regards to authoritarian regimes, they are not necessarily dominated by neopatrimonialism (Soest, 2010, p. 6). However, such conclusions are merely theoretical in nature, given a lack of research in this field.

Patrimonial systems provide for security according to their own logic. The system is dominated by a patron who appoints the administrative apparatus, which is, in turn, responsible for reporting back to this strongman. The ruler delegates jurisdiction to deputies who maintain a certain degree of discretionary power. Actions taken tend to be arbitrary. They are based on subjective reasoning and follow ad hoc procedures. At the same time, operations are mostly informal or off the record. Important orders are often given orally. They draw on historical memory, based on local traditions. In official procurement and sales, verbal agreements are used. As administration is a means of clientelistic politics, benefits are the reward for personal connections with political leaders. In other words, rules are applied with partiality (Brinkerhoff et al. 2002, pp. 6) Under such conditions, security depends on and is secured best through personal connections and/or professed loyalty to the leader.

Neopatrimonial environments are not automatically associated with insecurity. ‘Within this system, people have a certain degree of choice as to which logic they wish to employ to achieve their goals and to best realise their interests’ (Erdmann, 2012, p. 48). In other words, they can either draw on the formal legal-rational system of modern statehood or on the informal system of patrimonial rule. However, the mixture of formal and informal patterns characteristic of neopatrimonial systems is, at the same time, associated with specific factors of systemic insecurity.

One of those factors is institutional ambiguity. Ambiguity can appear both between formal and informal institutions and among formal institutions. Concerning the first case, Robinson (2013) points out that under neopatrimonialism, formal and informal rules are not mutually supportive but rather work against one another (Robinson 2013: 138). This results in insecurity about which rules are to be enforced (O’Neil, 2007, p. 3). As Erdmann (2012) puts it, all actors are confronted with insecurity ‘about which rules or which relationships are best applied or mobilised in any particular situation in order to achieve a specific goal – either the legal-rational (formal) or the patrimonial (informal)’ one (Erdmann, 2012, p. 48). A classic example of the insecurity inherent to institutional ambiguity is found in the practice of bribing. According to informal rules, bribing might be rational in certain situations and constellations. However, corruption may also entail legal prosecution. In the worst case, it might even provide grounds for blackmailing. In other words, under such conditions, the ‘legitimate rules of the game’ are unclear (O’Neil, 2007, p. 3). Actions of state institutions and officials are not (fully) calculable (Erdmann et. al, 2007, p. 19). International companies are particularly prone to this form of insecurity, since they are aliens with regards to local patrimonial systems and thus lack decisive insights into the whole logic of the process. At the same time, no general code exists which prescribes how to behave under such conditions, since each and every neopatrimonial system stands unique. In fact, praxis shows that there is a fluent transition between the two poles of legal-rational and patrimonial rule. In other words, the share of patrimonial vs. legal-rational domination invariably differs from country to country.

Ambiguity of formal institutions furthermore, entails that procedures, regulations and laws are unclear or even contradictory. In such cases, it is due to the fact that ruling elites tailor them to fit their particularistic interests. This form of arbitrariness is strongly associated with legal insecurity. While the legal/constitutional framework provides for legal certainty in theory, legal decisions in practise frequently make little or even no reference at all to abstract, general and non-retroactive laws. The result is that international companies have to deal with a lack of security and predictability, both of which in terms of the environment they are acting in. In this context, political-judicial trials are a popular strategy for harming or even getting rid of competitors. As Robinson (2013) highlights, in such constellations, foreign investment is impeded by weak property rights and high transaction costs. At the same time, property and contract rights are secured best through personal connections. However, the development of such measures proves to be highly costly to ‘outsiders’ (Robinson, 2013, p. 138).

This leads to another political risk factor which European businesses are confronted with, and that is systematic favouritism. In the present case, it involves private actors systematically using public office to foster the business interests of the ruler himself or the ruler’s clientele, while impeding initiatives by actors who are not part of the ruler’s network. According to this understanding, systematic favouritism is a non-monetary form of corruption. In this context, rulers distribute licenses, contracts and public projects to their own business networks. As a result, political elites accumulate more and more wealth. They often control significant shares of the national economy (Robinson, 2013, p. 138). Systematic favouritism thus poses major risks to European businesses as certain markets are freely accessible only at first sight.
Businesses of the ruling elite are favoured while international companies suffer from difficulties in gaining any (sustainable) access to such networks. However, once they have succeeded in connecting with local networks, they can gain major benefits. Such relationships are most likely in such cases when the ruling elite and European businesses benefit from win-win constellations. Such relationships are, however prone to insecurity at the same time. If (international) actors tread on the logic of the respective patrimonial system, and/or if the cooperation loses attractiveness, they may well lose their position at any time. As the rule of law is weak, this might lead in the worst case, to expropriation without compensation.

Another factor of systemic insecurity which European businesses are confronted with lies in corruption in monetary form. As Bratton and Van de Walle’s (1997, pp. 63-68) point out, corruption constitutes an integral part of neopatrimonial orders, going hand in hand with the (informal) concentration of power and systematic clientelism (Soest et al., 2011, p. 7). Systemic corruption involves members of the ruling elite (both politicians and bureaucrats) utilizing their authority to sustain their status and wealth by systematically extracting bribes. A result thereof is that corruption becomes an integrated part of the public system and is therein systemic. In such environments, international companies are confronted with demands for entrance fees, kickbacks as well as payments necessary to ward off unjustified claims by tax authorities, the security service or the customs authority (etc.). In this context, corruption is always associated with a significant degree of arbitrariness and a lack of predictability, even if certain ‘going rates’ apply. In that vein, corruption taints a major risk to Western companies in particular, since such practises conflict with their compliance standards.

This section introduced three political risk factors associated with state capture, in particular, institutional ambiguity, systematic favouritism and systemic corruption. As neopatrimonialism is the prevalent form of organisation in non-OECD countries (Soest, 2010, p. 2), the factors are universal, hence not only characteristic of post-Soviet Ukraine. The empirical focus of this chapter hones in on the case of Ukraine however, to illustrate this phenomenon. To that end, the following section introduces the process of data collection and analysis.

How do organizations perceive risks in a certain market and how do they adapt their entry strategies? Departing from a broader perspective, Figueira-de-Lemos and Amjad Hadjikhani (2014) investigate internationalization strategies in relation to the perceived stability or instability of the target market. What this study brings into the discussion of political risk is the subjective construction of uncertainty. Knowledge and experience are concepts that were introduced by Johanson and Vahine (1977) into the internationalization literature as the foundation of their incremental internationalization theory. Their theory predicts that firms would expand their operations in relation to their learning experience. With the degree of knowledge or experience a firm acquired in their internationalization endeavors; the more risk can be taken in subsequent expansions. Perceived uncertainty rises with the increasing dynamic of the environment because it might reduce the availability of knowledge or experience which fits to respond to the new environment. The gap between the available knowledge/experience in relation to the environmental challenges results in uncertainty for the organization. Consequently, what might be perceived as risky or uncertain in the eyes of one organization, might be perceived as irrelevant or at least not threatening for another organization which believes it has the necessary knowledge/experience to cope with these risks. An organization perceiving the environmental changes as risky and the expected risk level exceeds the organization’s threshold of risk acceptance, has two options available. It either (i) accumulates knowledge which prepares the company to respond to the new uncertain situation, or (ii) the company reduces its commitment in the respective market. Five reaction-modes are discerned by the authors to adjust the company’s commitment to the perceived uncertainty levels (Figueira-de-Lemos & Amjad Hadjikhani 2014, p. 337):

1. Increase Learning Commitment is recommended in a situation where the company combines a low level of commitment in a market with a moderate to high level of perceived risks.
2. Increase Investment Commitment in markets, where the firm is confronted with low to moderate risk levels and low to moderate commitment.
3. Decrease Investment Commitment in markets with either moderate or high levels of risk in combination with moderate to high levels of commitment. An important prerequisite for this option is that the firm has the knowledge available to evaluate the results of the environmental dynamics and knows which assets must be divested. A sub-strategy here would be to Wait and See in extreme cases of high risk and high market commitment because the firm would not have the required knowledge to react accordingly to environmental changes.
4. Wait and See with Increasing Learning Commitment seems to be the right answer to environments with moderate to high risk levels and moderate to high investment commitments.
5. Leaving the market is advised if the company is present in a market with low to moderate investments but moderate to high risks because the companies do not have the possibilities to acquire the necessary knowledge to cope with increasing risk levels.

Prior learning opportunities for an organization would improve forecast results of political dynamics and would help design according mitigation strategies which leaves the organization much better prepared for politically hazardous
markets. Their empirical analysis among Japanese firms that expanded overseas supported the assumption that those firms that follow the incremental model of internationalization, i.e., they gained experience with operating in politically risky markets, show less objections for entering politically uncertain markets (Delios & Henisz 2003, pp. 1161).

Notwithstanding these results, Jimenez (2010) argues that companies do not necessarily see political risk as a barrier, but could exploit advantages through entering politically risky markets if they assume that they could manage such markets better than their competitors. Drawing on a sample of Spanish multinational enterprises (MNEs) and their scope of internationalization, i.e., the number of countries which they cover, he shows that only a part of the organizations follow the path as predicted through the incremental internationalization model. In contrast, some MNEs move directly to high risk markets without following the expected learning curve. The explanation is that organizations with higher political capabilities profit from a competitive advantage in politically risky markets (Jimenez, 2010, p. 627). Jimenez and Delegado-Garcia (2012) show that Spanish MNEs' performance is better in high risk countries. These findings confirm the argument that obviously Spanish MNEs view political risk not as a threat to their business but as an opportunity and try to actively exploit advantages that emerge through political risks. Yet another study (Jimenez et al. 2014) digs deeper into the question whether political risk might be conceived as an opportunity rather than a threat for organizations. Previous exposure to risky markets allows the organization for accumulating experience in dealing with politically risky environments and learning how to apply political strategies such as lobbying, litigation, campaigning, and coalition formation helps reduce the perceived uncertainty, transaction costs and improve sustainability (Jimenez et al., 2014, p. 301). The value of political strategies has recently been shown by a number of authors (Schuler et al., 2002; Rajwani & Liedong, 2015; Nell et al., 2015; Puck et al., 2013; Darendeli & Hill 2016). The effect was stronger for companies in highly regulated industries (e.g., telecommunications, electricity, energy, banking and finance, air transport and infrastructure projects) as compared to firms from less regulated industries (e.g., textile, pharmaceuticals, food, tobacco, steel, electronics, chemicals, machinery, etc.). The explanation is that companies from highly regulated areas were more exposed to previous interactions with public authorities either in foreign markets or in their domestic markets, which provided them with more learning opportunities. (Jimenez et al., 2014, p. 309)

Brouthers (1995) found that market entry modes depend on the perceived level of risks in the target country. Managers tend to opt for more independent entry strategies (licensing, franchising) in case they perceive a relatively high level of risk and tend to trust in high commitment and high control entry strategies (wholly owned subsidiaries) if a relatively low level of risk is thought to affect the operation in the host country. The findings of Datta et al. (2015) confirm the previous results that managers opt for entry strategies which convey less risks for the company in uncertain political environments. This piece of research examined under which circumstances managers with equity ownership opt either for greenfield investments or for acquisitions when internationalizing their business. They found that political risk has a moderating effect and is highly relevant for managers with significant equity ownership. When entering politically risky markets, these managers prefer acquisitions to greenfield investments because they allow for quicker and relatively safer returns than greenfield investments (Datta et al., 2015, p. 608).

A different approach to the market entry process into politically risky markets is opted for when researching internationalization into markets that are characterized by high levels of informality and/or corruption. Both factors are part of the political risk array as has been pointed out previously in this chapter. The empirical work of Uhlenbruck et al. (2006) looks at how host country corruption impacts on entry strategies. Corruption is analyzed along two dimensions, (i) pervasiveness, which refers to the likelihood that a firm is confronted with corruption in its normal interaction with public authorities; and (ii) arbitrariness, which is the ambiguity associated with corrupt actions. Ambiguity means that the firm does not know if the corrupt act will lead to the intended outcome. The results of their investigation suggest that MNEs do not restrain from entering corrupt markets, but adapt their strategy. They tend to enter countries with higher pervasiveness via nonequity modes, i.e., all strategies where the entering firm does not assume any ownership in the target market. A nonequity entry allows the company for exploiting the business opportunity while avoiding partly the associated risks of corruption. The level of arbitrariness, however, seems to play a crucial role in the evaluation of the overall risk level as arbitrariness adds ambiguity to the pervasiveness of corruption. Therefore, companies that opt for an equity entry strategy prefer joint ventures over wholly owned subsidiaries in markets with high arbitrariness. (Uhlenbruck et al., 2006, pp. 410) The results of the impact of political risk on the entry strategy options are questioned by Meschi (2005) who found in his study on the survival rate of international joint ventures no statistically supported effect of political risk variables on the survival rate. He argues that the decision to form joint ventures is rather a response to economic uncertainty in the target market (Meschi, 2005, p. 150). Nevertheless, these results are methodologically not as convincing as the results generated by Uhlenbruck et al. (2006) as they refer to a more fuzzy variable of overall political risk (Meschi 2005, p. 147) in comparison to the narrowly defined and clearly
operationalized concept of corruption. Slangen and van Rob J.M., Tulder (2009) reiterated that MNEs prefer joint ventures over wholly owned subsidiaries when entering markets with higher environmental uncertainty. Straub (2008, p. 259) again confirms the effect of political risk in shaping the MNEs market entry approach through a cross-country panel analysis.

**Data Collection and Analysis**

The empirical study draws on 30 qualitative interviews in total, carried out by Competence Center for Black Sea Region Studies. The interviews were conducted with business representatives from companies of varying sizes, operating in different sectors, such as, chemical distribution, automotive trade, insurance services, pharmaceutics, trade of basic materials, construction, real estate, logistics, trade of paper and packaging material as well as law, business and tax consulting. All these companies were connected to the chamber of commerce in Vienna. However, not all of them were Austrian companies, as there were also European multinational companies among them. For this reason, this chapter refers to European companies. The business representatives were of Austrian, German and Ukrainian nationality. 14 of these interviews were carried out in Kyiv in February/March 2013, seven in Vienna between July 2012 and February 2013 and one in Bratislava in March 2013. In addition, nine out of 30 interviews were carried out with local academics in Kyiv in February/March 2013. These interviewees were all well-educated, of different ages and held a fundamentally critical attitude towards the political situation in their country. Among them were two journalists and at least one political scientist. They worked in local research institutes, think tanks and Non-Governmental Organisations (NGOs). One of them was a member of the State Committee for the Fight against Organised Crime and Corruption. They were tracked down by internet, based on research from local country experts.

The interviews were semi-structured, taking between 1 and 1.5 hours each. Those conducted with business representatives mainly focused on experiences and coping strategies applied in terms of institutional ambiguity, systematic favouritism and systemic corruption. In the case of the interviews with local academics, the exchanges were merely directed at gaining broader background information on the country, the specific form of state capture, along with the three factors of systemic insecurity, including its roots and changes over the course of time. The data analysis was done hermeneutically, establishing categories inductively. Moreover, most interviews were embedded in broader overall discussions on political, economic and social matters of contemporary Ukraine.

**Political Risks in Ukraine under Yanukovych**

All interview partners were well informed about the fact that Yanukovych misused his public position for private business purposes. Such issues received comparably high public attention in Ukraine under Yanukovych, not least since people were confronted with its consequences in daily live. However, in terms of the concrete constellation of state capture and its consequences, several representatives of European companies emphasised that they only learned about it after the market entry. As an international business representative put it, 'for us from the West, the state structure of Ukraine looks strange. It is a mixture of oligopoly and clan-networks' (Interview Partner XXI, 2013). This raises the question then of how exactly were European businesses confronted with Political risks related to state capture in their daily operations?

Answers are found in an array of details. First and foremost, systematic favouritism constituted a core feature of this system of state capture. As the senior researcher of a Kyiv based research institute put it, ‘the entire economic sphere is based on interpersonal connections.’ It is a system in which ‘property and power are interconnected. Using power to obtain property is not a crime in this line of thinking. The ones who are linked to the rulers get privileges’ (Interview Partner XXVIII, 2013). Similarly, the head of a local think tank stressed that ‘everybody tries to capitalise on their social contacts. Gaining political influence means you will get preferential treatment, particularly when you have access to the president’ (Interview Partner XIX, 2013). As a member of the ‘State Committee for the Fight against Organized Crime and Corruption’ highlighted, the state has systematically been privatized for the purpose of generating privileges. ‘They’ developed ‘a scheme’ in order ‘to place their people inside government agencies’. Now ‘they run the system.’ They ‘influence public procurement,’ ‘develop policies’ and ‘make regulations’ (…) ‘according to their particularistic needs’ (Interview Partner XXX, 2013).

In the context of privatization of state enterprises, 2) the refund of tax paid in export business, 3), state subventions, particularly in the field of coal mining, and 4), ‘unfriendly takeovers’ of companies (Interview Partner XXI, 2013). In all these areas, politically well-connected people proved to
be the beneficiaries. However, other interview partners stated that favouritism was rooted in the field of public procurement (Interview Partners XVII, XIX & XXIX, 2013). A Kyiv based investigative journalist reported regular cases in which members of the Yanukovych-network used state tenders to strengthen their businesses, while independent enterprises faced no chance of winning the tender (Interview Partner XV, 2013).

Furthermore, systematic favouritism means that independent businesses are categorically disfavoured, insofar as they are prevented from obtaining access to the sectors dominated by oligarchs and the ruling family. As the manager of a local subsidiary of an Austrian supplier for construction components emphasized, he has ‘no friends and contacts’ in government which he would however need in order to receive a public contract. ‘In this field, the game is too complicated and allowed for a certain group of people only. This is not only a barrier, but also a border you cannot cross’ (Interview Partner XI, 2013). At the same time, independent companies are often confronted with regulatory barriers (Interview Partners VI & XXX, 2013).

The country manager of an international pharmaceutical company complained about laws in the fields of product registration, fees and patent protection against international standards: ‘they were made because there is a very strong connection between political forces in this country and those who do business in this sector’ (Interview Partner IX, 2013). Likewise, a country representative of an International Bank expressed how he felt ‘disappointed about the few illusions his institute initially had’ concerning the market entry in Ukraine. A key reason is that the state and the economy are ‘controlled by a few people’ (Interview Partner VI, 2013).

State power was also strategically and deliberately applied to cause damage to competitors. According to a member of the ‘State Committee for the Fight against Organized Crime and Corruption,’ there were regular cases, where the state fiscal service, the police and the security service were used ‘to develop the business of the family’ (Interview Partner XXX, 2013). Though difficult to verify, several business representatives reported second-hand stories of how the secret service SBU, the police and tax agencies (Interview Partners II & IV, 2013), the national bank (Interview Partners III & VI, 2013) and the judiciary (Interview Partner VII, 2013) had been systematically employed to put pressure on independent businesses. A Western investor in real estate unveiled the case of an $55 million investment project in Southern Ukraine that came under serious pressure, when a unit of the ministry of interior against organised and economic crime visited the construction site in order to demand protection money in the amount of $300,000. When they refused to pay, a public prosecutor initiated inquiries against the company. The conflict was finally solved by paying local intermediaries ‘a sum less than $300,000’. (Interview Partner VII, 2013) The country manager of an international car manufacturer reported a case wherein drugs were planted in his cars. He was able to solve the problem by paying a bribe of $1,000 in order to avoid the initiation of inquiries by a state prosecutor. ‘You have to stop such things in the very beginning. As soon as it proceeds by way of formal action, you are trapped. Then it will get really expensive or even, the game is over’ (Interview Partner IV, 2013).

Yet, the overall view was that big international companies were still less prone to such risks than local ones (Interview Partners IV, VII, XIX & XX, 2013). The situation for international companies was however sufficiently poor that the representative of an international insurance company emphasized that he had been fighting with ‘oligarchic structures’ for more than six years, as he experienced ‘extreme pressure from all sides of politics to sell his business’ (Interview Partner V, 2013). The country representative of an international company from the transport sector reported, furthermore, that his company had had to struggle with the withdrawal of an important licence when they sold their shares in another company to a consortium rather than to an oligarch who was among the bidders (Interview Partner I, 2013). Likewise, an international construction company was first awarded a contract by the city of Kyiv to reconstruct a historical building. However, they were later confronted with the allegation their licences were insufficient for doing business: ‘in my opinion, they tried to push us out as hard as they could.’ This took place not only by ‘verbal threats’ but also by actions aimed at undermining the company’s position as a general contractor vis-à-vis subcontractors (Interview Partner XVI, 2013). The country manager of an international car manufacturer concluded that ‘in this country, it is not merely about doing and developing business’. In fact, ‘keeping the company alive, resisting the pressure of judicial and tax authorities, is already a huge success’ in and of itself (Interview Partner IV, 2013).

As the aforementioned cases reveal, a strong connection is at hand between favouritism and legal insecurity. Given this backdrop, an international lawyer stated that Ukraine suffered from ‘massive problems in terms of property rights’ (Interview Partner XXVI, 2012). Likewise, a company representative complained that ‘investments of foreign companies are not safe.’ The problem is that ‘profitable companies can be attacked by people in power,’ relying on ‘very well educated lawyers’, using ‘exits in Ukrainian regulations’ (Interview Partner XXIII, 2012).

The latter statement indicates that ‘systematic favouritism’ and legal insecurity are in turn connected to the ambiguity attached to formal institutions. In fact, under Yanukovych, Ukraine featured a well-established system, with legislators constantly implementing new, contradictory or unclear laws. ‘There are no clear rules and people try to take advantage of that,’ commented one interviewee...
(Interview Partner XXIII, 2012). Laws ‘are so underdetermined that they can interpret them how they need. They are full of gaps. (…) This was done on purpose’ (Interview Partner IV, 2013). This phenomenon applied to all areas of trade, economic and tax law, as well as to administrative regulations. Nevertheless, the interview partners often pointed to deficient tax and fire regulations, in particular (Interview Partner XXV, 2012; Interview Partners III, V, VI, VII, VIII, IX & XII, 2013).

Such strategies were not only used to harm independent businesses. They were rather part of an omnipresent corruption system, affecting virtually every sphere of public life. A common strategy was to establish bureaucratic hurdles and to provoke law violations in order to extract money (Interview Partner II, VII, XII, XXII & XXX, 2013): ‘the idea behind [it] is that the more bureaucratic the system, the easier it is to collect bribes. This is why the bureaucracy of this country shows incredible things’ (Interview Partner II, 2013). In this context, it was particularly popular to use tax audits and fire inspections as a front for conjuring up unjustified fees and fines (Interview Partner II, IV, V, VI, VII, XI, XII & XXII, 2013). Businesses not accepting this ran the risk of getting seriously impeded in their operations. In the worst case, local authorities would halt production altogether until the company paid up (Interview Partner XXIV, 2012). Corruption schemes also applied in the fields of licensing and registration. The construction and real-estate sectors were particularly prone to such methods. As an international tax advisor concluded, ‘foreign investors have to fight a constant battle against the bureaucracy, tax and cartel authorities. They regard them as cash cows’ (Interview Partner XIV, 2013).

At the same time, the judiciary was highly affected by corruption. ‘There is little sense going to court, because corruption prevails’ (Interview Partner I, 2013). Likewise, the country representative of an international insurance company revealed that as soon as a case ends-up at court, his company writes off the disputed amount of money. ‘You cannot win. We have lost a lot of money this way’ (Interview Partner XX, 2013). The general perception was that verdicts could be purchased (Interview Partners I, IV, VI, VII, IX, XVI, XVIII, XX & XXX, 2013). Though difficult to verify, a company representative stated that verdicts cost between $20,000 and $40,000 (Interview Partner VII, 2013). However, another interview partner noted that, despite such schemes, foreign businesses had no chance of winning when members of the ruling elite were involved in legal disputes (Interview Partner VII, 2013).

Yet, under specific circumstances, there was still at least the possibility of winning public tenders if one acquiesced to paying bribes. A local anticorruption activist stated that in public procurement, ‘going rates’ of between 30 and 50 percent of the contract value applied (Interview Partner XVII, 2013). The country representative of an international construction company commented, for example, that they withdrew from the contractor when they received the signal to pay between 15 and 17 percent of the project value in cash (Interview Partner XVI, 2013). In other cases, foreign companies were asked to invest in social projects and infrastructure, thereby using local companies as contractors (Interview Partner XXII, 2013).

Many interview partners regarded corruption as a political phenomenon, rooted in all levels of government (Interview Partner XXIII, 2012; Interview Partners I & III, 2013). There was also a widespread view that corruption was controlled centrally (Interview Partners III, IV & XII, 2013) or even represented a part of a pyramid system with the Yanukovych family and close allies as final beneficiaries at the top (Interview Partners II, VII, X, XIII, XIX, XXII & XXX, 2013). Others confirmed this, but stressed that the true picture would probably be more complex (Interview Partners X & XV, 2015). In fact, the structure of the informal system is difficult to determine, as it is a black box. However, the general view on this seems to be influenced by Soviet memory and pre-Soviet memory to a large extent. This became evident in background conversations with interviewees, who regularly pointed to the fact that the system of centralised corruption and the misuse of public office for patronage and clientelism (“state capture”) dates back to Soviet and pre-Soviet times. Such practices are perceived as widespread phenomena throughout the entire post-Soviet space. Irrespective of the details, European businesses perceived corruption as a financial burden and a high risk (Interview Partner XXVII, 2012; Interview Partners IV & XVI, 2013).

**Coping Strategies of International Businesses**

European businesses responded to such political risks in different ways. Some big companies/MNCs were in the middle of preparing to leave the country or taking this step into consideration at the time of the interview. However, most companies denied having such plans in the short- and mid-term. One smaller enterprise professed to be tied to their investments and therefore not able to leave the country (Interview Partner VII, 2013). Still others declared to be reasonably satisfied with their business operations in Ukraine, having found ways of coping with political risks. However, in terms of additional investment, most companies proved to be reluctant (Interview Partners V, XXIII & XXIX). At the same time, the representative of an international consulting company specialised in Ukraine...
mentioned that his company would also be a beneficiary of this difficult political and economic constellation (Interview Partner III, 2013).

One coping mechanism was found in “systematic favouritism” and all its consequences, insofar as doing business with independent “private” partners. The aim is to interfere with politics as little as possible (Interview Partner VI, 2013). As the representative of an Austrian construction company admitted, they had decided not to take part in public tenders anymore. However, independent tenders were rare and hardly predictable. For that reason, the local office was equipped with the absolute minimum managerial staff necessary to maintain basic operations. In case the company won a tender, they sent expats and sub-contracted workers for a limited period of time (Interview Partner XII, 2013). Nevertheless, doing business with private partners does not mean companies can entirely circumvent systemic corruption. As the company representative further stated, “you still need your building permit. They have the militia, their inspectors. They will all come to your construction site and ask for bribes” (Interview Partner XII, 2013).

Some rosier areas could be pinpointed however. Western companies offering high-tech products needed by local companies were in a comparably good position (Interview XXXI). The same held true in case of win-win constellations: “Western investors are tolerated when they fit into the business model of the nomenklatura or when they complement their interests” (Interview Partner XVI, 2013). However, as the country manager of an international bank pointed out, in terms of reliable business cooperations, there were also enormous differences between the individual oligarchs. While Akhmetov would be a good business partner relying on Western standards, the bank refused to do any business with Kolomoyskyi or Firtash (Interview Partner XIII, 2013).

In light of these conditions, some companies decided to shift their business activities into such areas which are less affected by systematic favouritism. Eventually, businesses relying on high-tech and specific know-how managed to establish themselves in a comparably safe position. This held particularly true for IT-companies, as well as for the consulting industry (Interview Partners III & XXXII, 2013). A case to point out is a smaller enterprise tied to the Ukrainian market due to high investments done, which shifted their activities from real estate investments to consulting and facility management (Interview Partner VII, 2013).

An approach for coping with the risk of expropriation is to make reference to property. Some companies avoided concentrating assets in the country (Interview Partners I & IV, 2013). (cf. Leitner et al., 2014): “my office is rented, also the building for the call centre. We have not built any facility. This was a conscious decision. We do not work like this in other countries” (Interview Partner I, 2013). Another related strategy is to set up a local branch instead of establishing a fully operating local subsidiary. Subsequently, the core processes are left with the parent company in the home country (Interview Partners I & IX, 2013) (Leitner et al., 2015).

Other companies preferred to outsource activities to local business partners. Such cooperations were particularly frequent in the field of sales and distribution. In this context, local business partners often act as redistributors, drawing on their local business networks (Interview Partners XI & XVI, 2013). In addition, they also provide for security, as they know which rules and which relationships are best applied or mobilised, particularly in case of ambiguity between formal and informal institutions (Interview Partners XX & XXV, 2013). At the same time, they can handle corruption claims, which keeps “your company clean from [the] inside at least” (Interview Partner XXV, 2013). As the country manager of an international car manufacturer put it, “you need a local partner dealing with the issues you do not want to know about. (…) You know he has to do things, not compatible with your norms and values” (Interview Partner IV, 2013). At the same time, some company representatives emphasised that establishing joint ventures with local partners is again a risky undertaking, as there is “no basis of trust” (Interview Partner IV, 2013), and moreover, no legal system to rely on in case of conflicts or fraud (Interview Partners IV and VII, 2013).

There is the alternative of approaching local “consulting companies” or “lobbyists” for assistance in these matters (Interview Partners II, IV, V, VI, VII, XIII, XX, XXIV, XXVII & XXXI, 2013). Such “companies” are in fact one-man enterprises, operated by locals with personal contacts to high-ranked officials. They act as brokers or intermediaries. Many of them used to be state officials or managers of state enterprises themselves (Interview partners II, VI, XXVII, XXXI & XXXII, 2013), some of them dating back to Soviet times. These persons can “open the door” and connect people to the highest level of the neopatrimonial order, which is, in the local context, also referred to as “Krysha” (Interview Partners VII, XIII & XXX, 2013). By doing so, they can provide protection. They defend attacks by officials, judges and local businessmen: “you do not have any networks. You do not know how this culture of bribing works. And you do not know where to go. So basically what you need, you need somebody, who provides you with these services” (Interview Partner XXXII, 2013). However, such practises entail a high risk of fraud (Interview Partner XIII, 2013). Moreover, informal networks are prone to instability (Interview Partners XII & XVIII, 2013). As an international company representative put it, when a new president comes into power, your informal network will break away. As a result of that, companies not only face the challenge of rebuilding their networks, but they also have to cope with hostilities and attacks by the new people in power, who
regard them as a friend of their enemy (Interview Partner II, 2013).

Such brokers are also there to handle corruption claims. In this regard, one can speak of a strategy of outsourcing corruption: “Western companies pay consulting companies for paying illegal money. By doing so, they can avoid having ‘unofficial fees’ show up in their reports. This way they keep clean” (Interview Partner XIII, 2013). Likewise, an international company representative declared they would not pay “big sums” of bribery themselves, as this is “dangerous and criminal.” They only pay “operational money” up to 20,000 Euro, as in the case of manipulated fire inspections. One interview explained: “when things become too big, we engage our lawyer, telling him we do not want to hear and know anything about it” (Interview Partner IV, 2013). Another case in point is found with an international construction company, having engaged a “customs broker. We do not need to worry, who will ask for money. He knows everything and he will pay. In the end, we will only get a hefty bill” (Interview XIII, 2013).

Yet despite its rampant practice in everyday business, most companies surveyed nevertheless denied paying bribes. Some of them argued it would not be possible due to their compliance laws and due to audits (Interviews XI, XXIII, XXVII & XXVIII, 2013). Others feared losing their reputation (Interview VIII). Another argument was that there is an element of insecurity inherent to corrupt dealings. As the company representative of an international construction company put it, it is a vicious circle leading to additional claims and, as such, an incalculable financial risk (Interview Partner XVIII, 2013, also Interview Partners IXXII, XXVII & XXV, 2013). Others stressed that bribing might entail legal prosecution or might even give grounds for blackmailing (Interview Partners II & XXII, 2013), though you can again pay your way out of it (Interview Partner III, 2013). Yet others argued that they are transparent and compliant with local law and, as a result of that, do not offer any basis for corruption claims (Interview Partners XIII & XIV, 2013). Another company representative declared that they would be the subcontractor, and as such not exposed to corruption claims, which does not however hold true for the main contractor (Interview Partner XII, 2013). Yet others argued they could refuse paying any bribes, as they rather hold their weight through the high quality of their services and/or products (Interview Partners IX, XI & XII, 2013). In contrast, others stressed that corruption is part of the system and as such impossible to avoid (Interview Partners II, XXI, XVIII & XXIX, 2013): “recently, a German expat from the pharmaceutical industry told me they would never bribe. I can only smile about this. The one who brings ethics into play, should not go to Ukraine” (Interview Partner VII, 2013).

Yet another coping strategy is found in attracting as little attention as possible. This can be done by keeping operations on a smaller scale (Interview Partner, XIII, 2013), by not advertising publicly and not giving any interviews to the media (Interview Partner, II, 2013). The strategy of attracting no attention also applies vis-à-vis the tax administration. This entails neither declaring high profits, nor losses (Interview Partner, XII and XIII, 2013). What’s more, the amount of money in Ukrainian bank accounts should not exceed day-to-day needs (Interview Partner, IV, 2013). This represents, however, no guarantee that the tax administration will not start any manipulative attack proceedings. As some company representatives expressed, in such cases, they fight against the attack with all judicial instances available. The goal is to tire out the opponent, which makes future attacks less likely (Interview Partner, XIII, XIV & XXIV, 2013). Yet, apart from this specific case, International companies rather avoid going to court in Ukraine. Some MNCs circumvented having trials under Ukrainian law by choosing a third country as the place of jurisdiction (Interview Partner, XVIII, 2013).

Concerning systematic favouritism, institutional ambiguity and systemic corruption, Western companies not only turned to local agents, but to international agencies as well (Leitner et al., 2015). As several company representatives noted, political pressure through embassies, national chambers of commerce, European Union institutions or high level home government officials regularly turns out to be effective. Such institutions prepare lists of companies facing specific threats. They then address the problem at the highest diplomatic level (Interview Partners I, II, III, IV, IX, XIV, XXI, XXVII & XXXII, 2013).

Finally, the recruitment strategy plays a major role when coping with political risks (cf. Leitner et al., 2015). In Ukraine, a company’s most critical organisational departments are accounting and legal services (Interview Partners II, III, VII & XX, 2013): “you need a reliable accounting department; people that are well versed, as this is an area full of traps” (Interview Partner II, 2013). Another interviewee offered: “the accounting department is in position two in terms of significance to a company” (Interview Partner III, 2013). As the country representative of an international bank explained, for accounting purposes, he would employ three times as many people as in Austria (Interview Partner XX, 2013).

In all these areas, international companies mostly employ locals, although they simultaneously aim at maintaining full control over organisational processes by expats (Interview Partner II, III & IX, 2013). In this context again, the reason is that only locals know which rules and which relationships are best applied or mobilised in any given situation (Interview Partner II, III, IX & XIII, 2013). As a company representative highlighted, only locals know the necessary networks and how to avoid or handle attacks by government authorities: “you need local personnel for all that. People who know how all these machinations work.
Conclusions

The way a firm could be affected through political risks is a combination of two dimensions. The one dimension refers to the probability of the potential event. The second dimension relates to the impact the event might have for the organization. Consequently we can derive four squares through this 2x2 matrix if we divide probability and impact into low and high respectively. According to this matrix, we find events that might occur quite rarely with only a minor expected impact on the organization. Also, we can define a square that describes events which do happen quite often but still have little impact. Moving on to the north-west in the matrix we see the square which describes events that are expected to happen rarely, but will have an enormous impact for the organization. And, finally, in the north-east of the matrix we find those political risks which are highly probable and at the same time are supposed to have a high impact on the company. (McKellar, 2010) When prioritizing the respective risk factors with regards to the resources that should be deployed to manage them, the north-east quadrant should be of highest priority since its impact will be very severe.

If an organization has to formulate strategies on how to react or manage a certain political risk factor, four generic strategies are available, which range from acceptance, via mitigation and transfer, to avoidance. The acceptance strategy implies that the company accepts the associated political risks, and starts the operation. The mitigation strategy aims at either reducing the probability of a certain risk coming true or reducing the potential negative impact of the risk event. This could be done for instance through adapting the market entry strategy, through political strategies, stakeholder management and other risk mitigating activities. Another option is that the company transfers the risk to a third party which is willing to bear the risk in exchange for compensation. An example is a risk insurance firm which covers your risks for a certain premium. Sometimes, risky activities in the business process are outsourced to partners who are willing to take the risk, such as selling the products to local agents who are then responsible for delivering the goods to the final customer. In some countries, especially if public authorities are involved, this step in the business process might be highly exposed to corruption claims and therefore poses a political risk. Finally, if the company evaluates that a business opportunity simply is associated with too high political risks, than the decision would be to not follow this opportunity and avoid the business.

This paper examined the relation between state capture and political risks. For this purpose, the chapter drew on Max Weber’s differentiation between modern and traditional forms of rule. Ideally, states provide security by a legal-institutional framework, which citizenry can rely on. Under patrimonialism, however, rules are applied informally and with partiality. Security depends on personal connections to the leader. Neopatrimonial states are, in turn, characterised by a mixture of modern and patrimonial systems, since formal institutions are seized in place by clientelistic networks. As the mixture becomes institutionalised, international businesses have a certain degree of choice. In order to gain security, they can either draw on the formal legal-rational system of modern statehood or on the informal system of patrimonial rule. At the same time, this mixture of formal and informal patterns is associated with specific risks. They are systemic corruption, systematic favouritism and institutional ambiguity.

The empirical part of this chapter first provided evidence to that effect, depicting the characteristics of these risks under the reign of Yanukovych. It also revealed that European businesses were heavily affected by these factors. It then examined their coping strategies. Coping strategies entail methods of minimising the insecurity in the business environment. In this respect, the empirical data revealed three basic options. The first possibility lies in minimising the exposure to political risk factors inherent to the local neopatrimonial system. This can be done by doing business with independent “private” partners, creating win-win constellations, shifting business activities into safer business areas, avoiding concentrating assets in the country, setting up a local branch instead of establishing a fully operating local subsidiary and/or attracting as little attention as possible. The second option is to rely on local partners who know which rules and which relationships are best applied or mobilised in the local neopatrimonial context. Related strategies aim at outsourcing activities to local business partners, employing locals and/or employing brokers or intermediaries. The latter particularly provide for security by connecting businesses to the highest level of the neopatrimonial order, which is, in the local context, also referred to as “Krysha.” The third option is to mobilise external agents in order to enforce the legal-rational system of modern states, according to international standards. In this regard, international businesses regularly rely on embassies, national chambers of commerce, European Union institutions and/or high level home government officials.
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Further Literature


Strategic Responses of Trade-Dependent firms to rising Trade Protectionism

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In the face of the major economic shifts in activity in recent years, rising skepticism on the merits of trade and globalization has become a political reality across several key developed countries. This poses challenges for trade-dependent firms and requires new strategic responses. In this paper, we draw on existing research to propose a framework of corporate Non-Market Strategies – through both Corporate Political Activity and Corporate Social Responsibility - to address trade protectionism.

In recent years high unemployment and/or underemployment in developed countries, together with the shift in economic importance towards emerging countries, has encouraged the growth of anti-globalization sentiment in the developed world. Existing liberal trade policy prescriptions are often considered to have failed a large segment of the population and this has fostered profound disillusion with both the 'elite' and their global vision (Kobrin, 2017; Morgan, 2016).

In this context, the legitimacy of standard business models is being questioned. In particular, the idea that it is legitimate for companies to distribute their production systems globally, at will, is widely debated and the trade policies which facilitated these global production networks are being criticized. Some governments are actively revising their stance on trade, posing challenges for trade-dependent companies. This paper explores this challenge of rising trade-skepticism and protectionism for trade-dependent companies and highlights potential non-market strategic responses which they could adopt. It reports initial findings from preliminary interviews with trade associations.

Shifts in government and consumer attitudes to trade and globalization have their roots in a wide range of socio-economic factors (Kobrin, 2017; Mansfield and Mutz, 2013; Mansfield et al., 2015). They thus require corporate action on several levels, through coordinated market and non-market strategies (NMS) (Baron, 1995). In this paper, we draw on existing research, especially on corporate NMS, international economics and international political economy, to develop a framework of potential corporate strategies to address rising trade skepticism. Specifically, we address the question of what non-market strategies can be mobilized by multinational companies faced with rising negative sentiment on international trade?

In relation to CPA, three key findings emerge from the limited literature that looks at CPA by trade-dependent firms. Firstly, the way that issues are framed and their salience for voters are both vital to success in public policy debates. (Destler, Odell and Elliot 1987; Farrand, 2015). In this context, it is crucial for trade dependent firms to be vocal in defending trade and highlighting the costs of protection (Destler et al., 1987). Secondly, timing is important. When faced with anti-trade advocacy, early counter-organisation is vital. Thirdly, lobbying against protectionism is more effective when undertaken with grass roots networks and NGOs and within broad coalitions, including transnational networks (Destler et al. 1987; Schnietz and Nieman, 1999; Brook 2005; Kolk and Curran, 2017; Curran and Eckhardt, 2017; Eckhardt and De Bievre, 2015).

In the CSR domain, existing corporate activity could be leveraged to counter anti-globalization rhetoric and policy. However, there is little evidence that such linkages are being mobilized. Scholars increasingly refer to the concept of political CSR (PCSR), which "suggests an extended model of governance with business firms contributing to global regulation and providing public goods." (Scherer and Palazzo,2011: 901). In this context, companies are, of necessity, taking greater responsibility along their supply chains, including for public goods, which are usually provided by states. Such PCSR activities could help to mitigate the potential negative effects of trade on vulnerable developing countries and their people. However, there is little discussion in the literature, or evidence from company activism, of leveraging such activities in his way.

Although PCSR, almost by definition, brings companies’ CSR activities closer to their CPA activities, scholars have recently noted a surprising lack of coordination between the two (Anastasiadis, 2013; den Hond et al, 2014; Lock and Seele, 2016). Companies thus seem to be failing to capitalize on an important potential political resource – its links to civil society - which could potentially be leveraged to build broader coalition in support of wider political objectives (Dahan, 2005).

Building on the literature above, we propose an integrated framework for trade dependent corporate NMS to address trade protectionism, summarised in Figure 1.
threats to their business models. This paper has highlighted some potential strategies for trade dependent companies and reported some initial findings from exploratory interviews. However, further empirical research at firm and industry level is needed to illuminate the extent to which different strategies are mobilized in different circumstances, as well as the crucial question of their effectiveness.

References


The Effect of Herd Behavior on Stock Markets during the Election Times: Evidence from Borsa Istanbul

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The main purpose of this study is to examine the evidence of herd behavior during the general, local and referendum election times in Borsa Istanbul (BIST) between the periods 1997 to 2017. The second aim of this study is to investigate whether the pattern of herd behavior changes based on the uncertainty level of these election periods. Based on the regression results, it is found that there is no evidence of herd behavior in Borsa Istanbul. These results may be interpreted as investors did not intend to imitate others’ financial decisions during election times in Turkey.

The main argument of behavioral finance is that investors are not behaving rationally always. In contrast to the major classical finance theories such as Efficient Market Hypothesis and Modern Portfolio Theory, behavioral finance does not assume investors as rational while making important economic decisions, and it argues that information is not available to everyone. As a result of the irrationality of the investors, stock anomalies, speculative market bubbles, and crashes are more likely to occur (Ricciardi and Simon, 2000). Behavioral finance argues that investors make financial decisions with mental shortcuts and these may cause some biases. Mental shortcuts are called as heuristics, and some examples are overconfidence, representativeness, and availability heuristics. Herd behavior is one of them and it is the focus of this study. Basically, herd behavior is defined as imitating others’ decisions regardless of one’s own private information (Bikhchandani and Sharma, 2000, pp. 281).

Many researchers conducted studies about the evidence of herd behavior in developed (such as USA and England) and developing (such as Turkey and Brazil) countries’ markets. The literature mostly intends to find evidence of herd behavior in various markets by using different types of measurement and time intervals (i.e. Choe, Kho and Stulz (1998), Altay (2008) and Demirer, Kutan and Chen (2010)). However, recently some studies focused on some special events or periods. For example, Galariotis, Rong and Spyrou (2014) examined herd behavior in the U.S. and U.K. during the periods of crucial macroeconomic announcements. Their study based on the announcement dates of macroeconomic events such as changes in the U.S. federal funds rate or changes in the Bank of England base rate. Consequently, they found significant evidence of herd behavior during these times. Another example is the study of Gavriliidis, Kallinterakis and Tsalauoutos (2015) where they investigated herd behavior in Ramadan. Their starting point was that during Ramadan, investors have positive mood so there can be higher tendency for herd behavior during these days. Their analyses were based on the seven majority Muslim countries and they found significant evidence of herd behavior during Ramadan in most of sample markets.

Besides, there are several studies that investigate the effect of unexpected events on investor psychology. One of these studies was conducted by Peterson (2002) and it is analyzed that how the investor psychology and security pricing are affected when there are anticipated events such as earnings reports, national elections or Federal Reserve Board announcements. It is concluded that security prices generally decrease when the outcome of an event is equal or better than “expectations”. A similar study was conducted...
by Mehdian, Nas and Perry (2007) in Turkey, and they examined the reactions of investors to the unexpected political and economic information. They found that investors systematically set security prices below their fundamental values during these times, and this situation makes the equity market riskier. Therefore, it is obvious that security prices are related with the anticipated events and investor psychology. Moreover, in the literature there are many studies that suggest that there is an effect of political risk on stock returns (such as Diamonte, Liew and Stevens (1996), and Kim and Mei (2001)).

Gokceler (2010) stated that, there are two main properties of political risk which are called as political uncertainty and instability, the examples that cause these properties can be given as elections, wars and collective actions. In these situations, the outcome and the probability of its occurring are both uncertain. As argued by Gokceler (2010), in a democratic system a major uncertainty is national elections, and it presents uncertainty to both domestic and foreign investors. Also, she pointed out that in emerging markets there is more political uncertainty. Moreover, as indicated by Pantzalis, Stangeland and Turtle (1999, pp.1576) there are many political events that affect market participants, but political elections are particularly important for three reasons: (1) With elections investors can influence the medium and long-term economic policies of a country. (2) With elections information is disseminated into the financial markets since the elections attract the attention of media, pollsters, and political and financial analysts who are the mediators that filter information between politicians and the public. (3) Investors change their previous probability distributions of policies when the election outcomes become more certain.

The effect of national elections on stock returns has been researched by several studies. One of the primary studies that were conducted by Foerster and Schmitz (1997) examined the effect of United States (U.S.) election cycle in an international context. They observed exchange rates of 18 countries during the period 1957 to 1996, and they found that U.S. election cycle helps to predict both U.S. and international stock returns. Similarly, Pantzalis, Stangeland and Turtle (1999) examined the stock market indices of 33 different countries during the political election time periods between 1974 and 1995, using event study methodology. Their results indicate that two weeks before the elections there is a positive abnormal return, and these are strongest for elections with the highest degrees of uncertainty. They argued that especially the countries with low political, economic and press freedom are exposed to abnormal returns more than other countries. Moreover, Kapopoulos (2007) analyzed the movements of stock prices on the Athens stock exchange based on the changes in political environment. One of the crucial results that they reached was that when the election times get closer, the stock market volatility increases explicitly.

Furthermore, there are few studies that analyzed the effects of election periods on stock returns in Turkey. Mandaci (2003) examined the effect of general elections (1991, 1995, 1999 and 2002 elections) in Turkey on the BIST-100 index returns. The main argument is that before the elections, if there is an uncertainty about the results it is expected that there will be stagnation and withdrawals from the market. But if the election results can be predicted before, this time it is expected there will be a recovery in the market and with these positive effects investors will tend to purchase more stocks immediately before that period to obtain high (abnormal) profit. She used the event study to analyze the returns 15 days before and after the election days, because in emerging markets such as Turkey, the effects of elections are assumed to be short-term. As a result, she found that in the determined period abnormal returns are experienced in certain days such as third day before and second day after the 1999 elections.

As shown in the literature above; elections cause uncertainty both in the social and economic environment of the country. Parker and Prechter (2012) emphasized that based on the socioeconomic theory, when there is uncertainty; people tend to imitate others due to evolutionary reasons. The underlying reason is that people think unconsciously that “sometimes others actually do know”, so according to them under uncertainty following others or showing herd behavior increases the overall chance of survival (Parker and Prechter, pp.5). Therefore, under uncertainty it is probable that investors also tend to herd while making crucial investment decisions.

Methodology

In this section firstly, the elections during the indicated period is summarized; secondly, the aims and the hypotheses of the study are clarified; thirdly, the data and the sample are defined; and lastly methodology was explained in detail.

Elections in Turkey

Totally, during these years there are thirteen election periods in Turkey. Between the periods 1997 and 2017, six general elections were realized:
- 18 April 1999: As a result of this early general elections the coalition government was established that composed of Democratic Left Party (DSP), Nationalist Movement Party (MHP) and Motherland Party (ANAP).
- 3 November 2002: The results of the elections indicate that the Justice and Development Party (AKP) won the election with nearly two-thirds of the seats in the parliament, and hence government has changed.
- 22 July 2007: AKP again won the election, and the one-party government continued. Moreover, as a result of the election some crucial political changes emerged such as the
alliances of Kurdish nationalist and socialist parties entered the parliament with 22 seats.
- 12 June 2011: The government was still AKP. Therefore, it can be concluded that during these times AKP was the sole government, and there was stability. So, it can also be said that during these periods there was not much uncertainty in the political environment.
- 7 June 2015: The election resulted in an unclear parliament and AKP lost its majority in Tukey's Grand National Assembly. A new government could only be formed through a coalition between different parties, but since they could not agree on forming coalition this election was redone on 1 November 2015.
- 1 November 2015: The AKP has won this election. However, since these last two elections were repeated, it could be stated that they have uncertain environment relative to the previous ones.

Between the given periods, there were also four local elections. The first one was held on 18.04.1999, the second one was held on 28.03.2004, the third one was held on 29.03.2009, and the latest one was held on 30.03.2014. Since local elections are held in all regions of Turkey, their results are more uncertain relative to general elections.

Lastly, there were three constitutional referendums in this period. One was held on 21.10.2007, other one was held on 12.09.2010, and the last one was held on 16.04.2017. The constitutional changes were accepted in all elections by the public. However, this may also contain uncertainty and political risk because of the changes in the constitution.

**Aims and Hypotheses**

In the light of the above explanations, a gap in the finance literature about the effects of herd behavior in the stock markets during the election periods is determined. For this reason, the main aim of this study is to investigate the relationship between the election periods and herd behavior in the stock market, namely Borsa Istanbul. The results of the elections can be both certain and uncertain based on the situation of the country. When the structure of general elections is analyzed, it could be seen that after 2002 there is stability about the government, and it seems the political environment is relatively certain. However, the 1999 early general elections, 2015 elections, all local and referendum elections have more uncertain structures. Therefore, the second aim of this study is to indicate whether pattern of herd behavior changes based on the uncertainty among these election periods.

Based on these aims the following four hypotheses are tested:

H1: There is no herd behavior on BIST on the general election periods (except 1999 and 2015 elections).
H2: There is herd behavior on BIST on the local election periods.
H3: There is herd behavior on BIST on the referendum periods.
H4: There is herd behavior on BIST on the 18.04.1999, 07.06.2015 and 01.11.2015 general elections.

To test the four hypotheses by following Chang, Cheng and Khorana (2000); non-linear regression analysis method was used.

**The Data and The Sample**

Sample includes all the stocks available on day t at BIST between the periods 1997-2017. The event study was applied in the beginning of the analyses and the periods were separated by using dummies for each period. Mandaci (2003) stated that in emerging markets such as Turkey, the effects of elections are assumed to be short-term, and that is why she had taken into consideration 15 days before and after the election days. Based on this study the event window for the analysis is 15 days before (dummy 1) and after (dummy 2) election dates. There are thirteen election periods in this study. As a market indicator BIST-All index daily closing prices was used. To calculate the dispersions, daily returns of the stocks and of the BIST-All index were calculated. The data was collected from Finnet Analyse database (www.finnet.gen.tr). The data was organized in the Microsoft Excel and then the regression analyses were applied in the E-views software.

**Methodology**

In this study, to investigate herd behavior on BIST, the non-linear multiple regression was used following Chang, Cheng and Khorana (2000). Basically, the expectation is that when there is herd behavior in the market, the dispersion will be relatively low. They measured dispersion by cross-sectional absolute deviation (CSAD) in period t as:

\[
CSAD_t = \frac{\sum_{i=1}^{N} |R_{i,t} - R_{m,t}|}{N} \tag{1}
\]

In Equation (1), \(R_{i,t}\) is the return of stock i in period t, \(R_{m,t}\) is the return of BIST-All index in period t, and N is the number of stocks.

As emphasized by Demirer, Lee and Lien (2014) based on the Capital Asset Pricing Model (CAPM), which assumes investors are rational, the return dispersion increases with the absolute value of market return. The reason is the sensitivity of each asset in the portfolio is different from each other, so each reacts differently to the market shocks. In contrast, as pointed out by Chang, Cheng and Khorana (2000) when the investors behave in a similar way in the market, asset returns will gather around the overall market return. Also, they suggest that linear models can be insufficient to detect herd behavior; therefore, the non-linear model gives more accurate results. The non-linear regression equation is:

\[
CSAD_t = \alpha + \gamma_1 |R_{m,t}| + \gamma_2 R^2_{m,t} + \varepsilon_t \tag{2}
\]
In Equation (2), the statistically significant negative $\gamma_2$ coefficient provides an evidence of herd behavior and non-linearity. The positive $\gamma_1$ shows that there is an increase at a decreasing rate in dispersion with an increase in the market return. As stated by Caporale, Economou and Philippas (2008), the reason why the absolute values are used is that the focus is on the size of the return, not on its sign. Note that this model is called as non-linear model because of the relationship between dependent and independent variable. However, it is linear with respect to the model parameters $\gamma_1$, because the parameter exponents are equal to 1.

**Results**

Before implementing the regression analysis, the preliminary assumptions were checked for each period. There were some outliers in the dataset, but they were not excluded, because CSAD is not affected from the outliers too much as indicated by Christie and Huang (1995) and Chang, Cheng and Khorana (2000). Therefore, these outliers were kept in the dataset to hold the observations in the periods stable. Moreover, based on Jarque-Bera normality test it seems residuals are normally distributed for the all periods.

The second assumption that should be checked is linearity. However, because the regression model that is used is a curvilinear (or quadratic) model, the linearity assumption could not be provided for it. As linear regression assumes linearity for the relationship, curvilinear regression assumes appropriate kind of curve for the data. Thus, for the quadratic function the assumption is the data are quadratic; therefore, it seems there is no linearity problem in the model. The third assumption that should be checked is autocorrelation, and it was tested by using Breusch-Godfrey Serial Correlation LM Test. It is found that for the all periods it seems there is no autocorrelation problem for this dataset.

The fourth assumption is the multicollinearity which is tested by correlations among independent variables, and it is found that there is also a multicollinearity problem for all periods. But it is very normal, because the second independent variable is just the square of first independent variable. So, multicollinearity had already been expected in this model. This is one of the limitations of the quadratic models. The last assumption that should be checked is homoscedasticity. It is found that there is no heteroscedasticity problem based on the White test for all the periods.

After those preliminary tests, multiple regressions were implemented to test each hypothesis. As exhibited in Table 1, according to the F-statistics the model is statistically significant and valid for all the periods in general elections. The adjusted R-square values range between 37-95% which means; that amount of the total variation of CSAD explained respectively by the regression model consisting of absolute value of return and square of return.

When the coefficients are evaluated, in the first sub-period of 3.11.2002 elections, and second sub-period of 12.06.2011 elections $\gamma_1$ is negative and this may imply that CSAD decreases when the absolute value of the market return increases, but they are not statistically significant. On the other hand, in the remaining periods $\gamma_1$ is positive and this may imply that CSAD increases when the absolute value of the market return increases, but they are not statistically significant. According to this model, $\gamma_2$ coefficient must be negative and statistically significant to point herd behavior in the market. However, $\gamma_2$ is positive for first two general elections, and for the last election $\gamma_2$ is negative. The negativity of this coefficient may reflect the higher degree of uncertainty level and the evidence of herd behavior for this pre-election period, but it is not statistically significant. Therefore, this shows there is no evidence of herd behavior on BIST. As a result, since it was hypothesized that “there is no herd behavior in BIST on the general election periods (except 1999 and 2015 elections)”, the first hypothesis cannot be rejected.

### Table 1. Regression Results for the General Elections

<table>
<thead>
<tr>
<th></th>
<th>F</th>
<th>Constant</th>
<th>$\gamma_1$</th>
<th>$\gamma_2$</th>
<th>Adj. R-Square</th>
<th>F-Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>11.11.2002</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>1</td>
<td>0.021*</td>
<td>-0.114</td>
<td>12.248*</td>
<td>0.946</td>
<td>124.616*</td>
</tr>
<tr>
<td>2</td>
<td>2</td>
<td>0.028*</td>
<td>0.19</td>
<td>2.296</td>
<td>0.893</td>
<td>59.270*</td>
</tr>
<tr>
<td><strong>30.03.2004</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>3</td>
<td>0.017*</td>
<td>0.344</td>
<td>11.407*</td>
<td>0.933</td>
<td>98.345*</td>
</tr>
<tr>
<td>2</td>
<td>4</td>
<td>0.017*</td>
<td>0.126</td>
<td>7.081</td>
<td>0.875</td>
<td>49.974*</td>
</tr>
<tr>
<td><strong>22.7.2007</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>5</td>
<td>0.015*</td>
<td>0.334</td>
<td>-1.352</td>
<td>0.364</td>
<td>5.014*</td>
</tr>
<tr>
<td>2</td>
<td>6</td>
<td>0.014*</td>
<td>-0.065</td>
<td>23.105</td>
<td>0.703</td>
<td>17.585*</td>
</tr>
</tbody>
</table>

The coefficient is significant at 5% level.

As exhibited in Table 2, according to the F-statistics except the first sub-period of 28.03.2004 and second sub-period of 30.03.2014 local elections, the model is statistically significant and valid. For the first sub-period of the 28.03.2004 elections and the second sub-period of the 30.03.2014 elections, according to the adjusted R-square values, adjusted R square is 16.9% and 18.8% respectively, and they are too low, but the models and the coefficients are statistically significant but positive. For the first period of 28.03.2004 elections although the $\gamma_2$ coefficient is negative, it is not statistically significant. Therefore, for the local election periods there is also no evidence of herd behavior in the market. As a result,
since it was hypothesized that “there is herd behavior in BIST on the local election periods”, the second hypothesis is rejected.

Table 2. Regression Results for Local Elections

<table>
<thead>
<tr>
<th>P</th>
<th>Constant</th>
<th>y1</th>
<th>y2</th>
<th>Adj. R-Square</th>
<th>F-Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.021*</td>
<td>0.34</td>
<td>-7.011</td>
<td>0.169</td>
<td>2.423</td>
</tr>
<tr>
<td></td>
<td>(0.931)</td>
<td>(0.962)</td>
<td>(-4.042)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>0.024*</td>
<td>-0.569</td>
<td>22.337*</td>
<td>0.575</td>
<td>10.444*</td>
</tr>
<tr>
<td></td>
<td>(12.434)</td>
<td>(-1.874)</td>
<td>(2.810)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*The coefficient is significant at 5% level.
†-statistic is reported in parentheses for the corresponding coefficient.

As exhibited in Table 3, according to the F-statistics except the second sub-period of 21.10.2007 and 16.04.2017 referendum elections, the model is statistically significant and valid. Among the statistically significant models, the adjusted R square values range between 68-85%. When the coefficients are evaluated, γ2 coefficients are not statistically significant. Only for the first sub-period of 16.04.2017 referendum elections, γ2 coefficient is statistically significant, however since the indication of herd behavior is the negative coefficient for the referendum election periods there is also no evidence of herd behavior in the market. As a result, since it was hypothesized that “there is herd behavior on BIST on the referendum election periods”, the third hypothesis is also rejected.

Table 3. Regression Results for Referendum Elections

<table>
<thead>
<tr>
<th>P</th>
<th>Constant</th>
<th>y1</th>
<th>y2</th>
<th>Adj. R-Square</th>
<th>F-Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.014*</td>
<td>0.296</td>
<td>7.932</td>
<td>0.7</td>
<td>17.35*</td>
</tr>
<tr>
<td></td>
<td>(8.281)</td>
<td>(0.663)</td>
<td>(0.640)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>0.014*</td>
<td>0.297</td>
<td>-3.231</td>
<td>0.288</td>
<td>3.835</td>
</tr>
<tr>
<td></td>
<td>(8.202)</td>
<td>(1.150)</td>
<td>(-0.419)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*The coefficient is significant at 5% level.
†-statistic is reported in parentheses for the corresponding coefficient.

Lastly, the early elections that was held on 18.04.1999 and the local elections that was held on the same date, 7.06.2015 and 11.11.2015 general elections were investigated. As exhibited in Table 4, according to the F-statistics the model is statistically significant and valid except in the 18.04.1999 second sub-period. The adjusted R square values range between 23-92%. When the coefficients are evaluated, it is observed that γ2 coefficients are not statistically significant. Therefore, there is no evidence of herd behavior during the 1999 and 2015 election periods, and the fourth hypothesis that was stated that “There is herd behavior on BIST on the 18.04.1999, 07.06.2015 and 01.11.2015 general elections” shall be rejected.

Table 4. Regression Results for 1999 and 2015 Elections

<table>
<thead>
<tr>
<th>P</th>
<th>Constant</th>
<th>y1</th>
<th>y2</th>
<th>Adj. R-Square</th>
<th>F-Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.029*</td>
<td>0.028</td>
<td>0.642</td>
<td>0.722</td>
<td>12.743*</td>
</tr>
<tr>
<td></td>
<td>(5.931)</td>
<td>(0.322)</td>
<td>(0.311)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>0.034*</td>
<td>0.117</td>
<td>2.049</td>
<td>0.614</td>
<td>4.188</td>
</tr>
<tr>
<td></td>
<td>(6.390)</td>
<td>(0.300)</td>
<td>(0.614)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*The coefficient is significant at 5% level.
†-statistic is reported in parentheses for the corresponding coefficient.

**Discussion and Conclusion**

The main argument of the behavioral finance is that investors are not behaving in a rational way always, and it argues that investors make financial decisions with mental shortcuts and these may cause some biases such as herd behavior. Basically, herd behavior is defined as imitating others’ decisions regardless of one’s own private information (Bikhchandani and Sharma, 2000: 281). This study has contributed to the literature in two ways. The main aim of this study was to examine the effect of general, local and referendum elections on herd behavior on BIST between the periods 1999 to 2018. The results of the elections can be both certain and uncertain based on the situation of the country. Parker and Prechter (2012) emphasized that under uncertainty it is probable that investors are also tending to herd while making crucial investment decisions. Thus, the second aim of this study was to indicate whether pattern of herd behavior changes based on the uncertainty among these election periods. BIST-All index was used as an indicator for the whole market, and the event study was applied. The periods were separated by using dummies for each period. Event window for the analysis was 15 days before (dummy 1) and after (dummy 2) election dates. To test the hypotheses Chang, Cheng and Khorana’s (2000) non-linear regression analysis method was used. and CSAD was used as dispersion measurement. After examining the descriptive statistics and test of assumptions of all variables, regression analyses were applied. Based on the regression results, the γ2 coefficients were not found to be statistically significant or negative. Therefore, based on these findings, it can be argued that not only there is no evidence of herd behavior in BIST, but also there is no evidence of non-linear
relationship between CSAD and mean return during these periods. Hence, the linearity result is consistent with the rational asset pricing models’ predictions. Moreover, since there is no evidence of herd behavior in the given periods, a change in the pattern of herd behavior based on the uncertainty among election periods cannot be determined.

There were some limitations in this study. First, since the model is quadratic, there is a high multicollinearity problem, and this may influence the results of the regression equation. The violation of this assumption may decrease the predictive power of the regression model and coefficients. But for these types of equations the second independent variable is just the square of first independent variable, so it could not be corrected. Secondly, although it seems the sample size provides the 5:1 rule, the included sample was too low for the financial dataset, because in general the herd behavior models are implemented to more than a thousand-sample size. Finally, there may be some other factors that may affect the herd behavior in the market such as country and firm specific factors, or some crucial political events, but these cannot be included in the model, so it is not possible to measure their effects.

Since the most common measurement method is cross sectional dispersion of stock returns method, this methodology was preferred in this study. However, against those deficiencies, to reach more accurate results about herd behavior on BIST, the recent methodology which is called as beta herding can be applied in further studies. Finally, presidential elections can also be a good predictor for the instability, because in every election presidents change and there is an uncertainty. Therefore, these periods can be compared in the further research.

From the results, as expected, investors tend to show herd behavior more commonly relative to certain periods, under uncertainty. These results may be interpreted as during these one-party periods political environment was stable not only in general elections, but also in local elections and referendum voting. Therefore, investors did not intend to imitate others’ financial decisions during these periods.

On the other hand, 1999 and 2015 elections were not resulted as one-party government, and even there is an uncertainty, still there is no evidence of herd behavior during these periods. These results may provide support for Can (2014) study which found long-term pattern of herd behavior in Turkish stock market. Can (2014) found evidence of herd behavior in monthly time intervals, but in this study daily data were used for a short-term evidence (15-days). Moreover, as stated by Döm (2003), institutional investors herd more than individual investors because they are able to reach more information about other investors and they affect stock market returns more than individual investors do. In line with this argument, it may be suggested that in Borsa Istanbul the number of institutional investors may be insufficient to affect the market. However, these results require further testing under the considerations that were mentioned above. As this study is one of the first under literature that considers herd behavior during elections times, the research methodology could be improved to include terms of econometric models and periods.

In conclusion, if the other factors that influence stock market are disregarded, from the findings it can be concluded that Turkish stock market is a good option to make an investment. Herd behavior may increase the volatility of the market. Hence, absence of herd behavior may be the indicator of stability in Borsa Istanbul. However, other factors as it is mentioned before should also be considered to make efficient investment decisions.

References


German FDI in Turkey: An Analysis under the Recent Developments

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Rainer Wehner, University of Applied Sciences Würzburg-Schweinfurt, Germany

Germany and Turkey historically have had very close relations since the World War I. Their relations have been strengthened since the beginning of the 1960s by the Turkish guest workers large-scale migration to Germany. Throughout the decades some of the German Turks have gained German citizenship, employer status and even also political power. With the help of such special connections, Germany has now been the largest trading partner of Turkey and also one of the largest foreign direct investors in the country. However, the relations between these countries have recently been negatively affected due to a number of political developments. In this respect, the aim of this paper is to analyze German direct investors’ perceptions regarding Turkey as a host country under such developments, and therefore to understand if there are significant concerns over political risks for further investment activities.

Germany is one of the biggest exporters as well as investors in the world. In fact, the export performance of Germany cannot be separately analyzed and understood from its performance as a foreign direct investor. OECD statistics on direct investments indicates that Germany has an investment stock of over $1.7 trillion.

German foreign direct investment is absolutely important for Turkey as well. Germany is the largest trading partner of Turkey, and there are more than 7 thousand German companies which have direct investments in Turkey. Recently, some political tensions have been raised between the German and Turkish governments and such events have caused a number of concerns in the business community as well regarding whether such issues may affect the German companies’ future operations in Turkey.

With this regard, this paper aims to investigate and analyze the German outward direct investments in Turkey in terms of the recent political developments’ effects on political risk perceptions of German multinationals. In other words, we will look at the German FDI in Turkey from a political risk management perspective and the importance of inter-governmental relations between the home and host countries.

To this end, we have undertaken a basic secondary data analysis over the financial press before having a number of interviews with managers from German companies as well as business associations in Turkey. Due to the interviewees’ concerns, we do not disclose their names or affiliations.

The paper will follow a very brief historical perspective and then the focus will be on trade and investment relations. This will be followed by the recent political developments before analyzing the effects of such events. Finally, a very short conclusion will be provided.

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Special Partners: Germany and Turkey

Though there was also fairly large interactions earlier, Turkey’s special relations with Germany first started during the Ottoman period when both countries were close allies in the World War I. Then, in the late 1930s and early 1940s some German academics escaping from the Hitler’s regime actively involved in the development of the Turkish university system as well as restructuring various public organizations and regulatory issues. After the World War II, due to the labor shortage in Germany, some Turkish guest workers went to the country in the 1960s for rebuilding the economy. This has created a closer psychic distance between the two societies. Also with the help of such interactions, both countries have significant economic and commercial relations throughout the time. Germany is currently the largest trading partner and the fifth largest direct investor for Turkey. In other words, since the Ottoman period, both countries have had significant historical, social, economic, and cultural ties.

Interestingly, the labor migration has constituted one of the most important and sensitive issues between these countries. Interestingly, some of the ‘recent political developments have also been directly related to the Turkish diaspora in Germany. There are different estimates about the so-called Turkish German population: One estimate is between 2.5-4 million; over 1.5 of them already holds German citizenship (Conradt, & Langenbacher, 2013). Another one is approximately 3 million, and nearly 1.2 million are German citizens and can vote in German elections. The very important point is that nearly 1.43
million of the Turkish Germans can also vote in Turkish elections (Zsabo, 2018). This is a huge political power and when there is a knife-edge balance in any election, it can be absolutely critical.

**German FDI in Turkey**

As of the end-2017, there were 7,111 German companies operating in Turkey (Turkish Ministry of Economy) with a total FDI inflow of over $9 billion (OECD Stats).

With this amount, Germany follows the Netherlands, US, Austria, and the UK in the largest direct investors list. (However, for instance, the Netherlands’ tax-related position should be separately analyzed. In many instances, foreign or even domestic investors use the Netherlands for corporate tax avoidance purposes. Therefore, some German companies may also have significant ‘pass-through FDI’ over the Netherlands to Turkey.)

Though there are also the cases for investments through acquisitions, German FDI in Turkey has largely been ‘greenfield’ since the 1960s when an import substitution policy was adopted by the then-government. Foreign investments played a significant role in the successful implementation of this policy. Some German investors of that period are still very active in the Turkish industry. Allianz, BASF, Bayer, Daimler-Chrysler, Deutsche Bank, Deutsche Messe, Dresdner Bank, Dr. Oetker, Henkel, MAN, Metro, Nordstern, Robert-Bosch, Siemens, Ströer, Volkswagen, and Westdeutsche Landesbank are some of these well-known German companies operating in Turkey for very long years. Turkey, with a population of about 80 million, has been a huge market for these companies, many of which have large production plants in the country. The estimated current value of such productive assets is around €9 billion and the total employment generated is about 140 thousand people. For instance, only clothing manufacturer Hugo Boss employs more than 3,800 people in its plant at the Izmir Free Trade Zone while BASF employs 800 at different production plants in six cities.

German FDI in Turkey has generally been in manufacturing and service industries. In manufacturing, German companies are mainly concentrated in machinery, vehicle parts, electrical-electronics, chemical products, food, and ready-to-wear production; in the services sector, they are in the trade, retailing, tourism, communication, banking and investment financing.

Therefore, a large part of German FDI has been either ‘market-seeking’ or ‘efficiency-seeking’. There are also ‘resources-seeking’ (i.e. mining or agricultural) German investments, but their importance is rather insignificant. Even ‘efficiency-seeking’ investments can be considered ‘market-seeking’ when manufacturing is organized partly locally for the low-end of value-added segments of the value chain depending on labor-costs or logistical advantages. In such cases, Turkey has been chosen as a manufacturing location either for its domestic market or as an export base for its locational proximity to the regional target markets. Bus-manufacturing could be a good example of this. In other words, the main motive of many German investors in Turkey has been building up of a sales and service network, and when necessary manufacturing.

In line with the Turkish industry’s structural locational distribution, the German companies also prefer Istanbul and the Marmara region as the major investment location. This area is followed by Izmir, Bursa, Antalya, Ankara, and Mugla.

**Trade between Germany and Turkey**

Another important indicator of bilateral economic relations between countries is how much they export to each other. Turkish-German foreign trade is historically in the favor of Germany due to the fact that German goods are widely sought-after worldwide and Germany is one of the biggest exporters in the world. For instance, according to the German National Statistics Office, in 2017 Germany exported goods worth $1.571 trillion and imported goods to the value of $1.270 trillion, and hence had a trade surplus of over $300 million. In the same year, Turkey sold only over $15.2 billion worth of goods to Germany and imported $21.3 billion of goods. When we compare the Turkish-German bilateral trade with Germany’s worldwide trade activity, it is just a tiny section.

In this framework, the trade balance has been constantly against Turkey. In other words, in the bilateral trade, Turkey has the "net importer" and Germany has the "net exporter" position. However, Germany has been the largest export market of Turkish goods for decades.

Turkish products that are exported to Germany are not limited to textile-apparel, and agricultural products. Turkey exports large-scale automotive, chemical, electrical, electronic, machinery, and iron and steel products to Germany as well. However, we should note that that some of the biggest Turkish exporters are in fact German companies’ subsidiaries such as Bosch (the 9th biggest exporter in 2016), Mercedes-Benz (the 11th), Ferrero (the 13th), Bosch-Siemens Household Appliances (the 14th). In other words, German multinationals’ subsidiaries have been at the top of the exporters’ list for decades.

Germany’s superior export performance has also ties to export financing schemes of the German government next to the German technology, quality and reliability. To support the German economy at difficult and risky markets, the Germany government supports its multinationals and exporters against economic and political risks of export transactions as well as political risks of foreign investments by providing export credit and investment guarantees. Such guarantees are also of significant importance for Turkish
imports from Germany.

**Turkish – German Business Council**

In 1996, the Turkish-German Business Council was formed with the aim of developing economic and commercial cooperation between the two countries as well as promoting Turkey as a favorable host country for German investments. The Business Council’s activities have been carried out in cooperation with the German-Turkish Chamber of Commerce and Industry (AHK) and the Turkish-German Chamber of Commerce and Industry (TD-IHK) located in Istanbul. AHK Turkey (the Germany Foreign Trade Office) is also tasked with supporting the bilateral trade relations. AHK Turkey has currently more than 860 members from all sectors.

**Political Background**

Germany’s approach to Turkey’s EU membership application has always been a crucial aspect of German-Turkish relations. The Turkish side knows that Germany’s role and influence are vital to shaping the EU policies towards Turkey. For decades, Germany has acknowledged Turkey as an important strategic partner that should not be isolated from Europe. However, since Mrs. Merkel’s appointment to the office, Germany has voiced a different perspective, called ‘privileged partnership’ instead of Turkey’s full membership. This has been formulated as an extension of the existing Customs Union between Turkey and the EU. The same approach was, in fact, earlier adopted during the former Chancellor Helmut Kohl’s period. Mr. Kohl wanted to keep Turkey anchored to the EU, and hence pushed the other European countries to enter into the Customs Union with Turkey. This experiment was the first in history as normally a non-member was not allowed to enter in the Customs Union before becoming a full member.

However, Mrs. Merkel’s standing brought a policy shift to Germany’s approach to Turkey. This was because between the two conservative governments, the Social Democrat-Green coalition was in power from 1998 to 2005. In this period, the-then Chancellor Gerhard Schröder and Foreign Minister Joschka Fischer were significantly supportive for Turkey’s EU candidacy. Subsequently, the EU started accession negotiations with Turkey in October 2005.

When the accession negotiations started, Mr. Erdogan’s Justice and Development Party was already in government in Turkey following a clear victory in the 2002 elections, and this party’s foreign policy then seemed substantially pro-European. This period for Turkey and Germany as well the EU was like a honeymoon year. Later, however, conditions started to change for all sides.

After her election in 2005, Mrs. Merkel carried on Germany’s earlier standing in the negotiations with Turkey though she was openly favoring a privileged partnership. With that regard while Germany did not block negotiations, Mrs. Merkel seemed to discourage Turkey by allowing the negotiations to be dragged out by some other member states. This started to cause resentment and disappointment in the Turkish government and also in the Turkish society in general. These events were also paving the way towards the current situation.

**Recent Developments**

There was a military coup attempt on 15 July 2016 in Turkey. Since then, there have been important political developments in the country. For example, just after the coup attempt, the state of emergency was declared; and then a referendum was held on 16 April 2017 to amend the country’s constitution to replace the existing parliament-based government with a presidential system. The state of emergency has not been ended since its first declaration. As a result, some European politicians started to voice their serious concerns whether Turkey was evolving into an authoritarian regime. As a reaction to such criticisms, the Turkish president accused those countries’ governments to support the opposition in Turkey. The high and erratic uncertainty caused by political developments like these was a harbinger of a new era when Germany and other European countries are not called anymore “close friends” or “partners”.

Following the failed Turkish coup attempt in July 2016, many arrests were made and hundreds of Turkish military officers asked for asylum in Germany. Mr. Erdogan has called Berlin to extradite these people. But the German government rejected these calls by alleging that rule of law and judiciary in Turkey is not strong.

Later, a Turkish-German journalist was arrested and jailed in Turkey in February 2017. This resulted in banning Turkish politicians from campaigning in Germany for the approval of the constitutional referendum of April 2017. As said earlier, nearly 1.43 million Turkish people living in Germany can vote in Turkish elections. These actions, in turn, led Mr. Erdogan to accuse Germany and Mrs. Merkel of using ‘Nazi methods’.

Then the German parliament, Bundestag voted to withdraw the German troops from the Incirlik base in Turkey and to redeploy them in Jordan. In July 2017, the Turkish government canceled a planned visit by a German parliamentary delegation to the NATO base in Konya while the Turkish government was accusing Berlin of providing asylum to coup plotters. As a result of all these developments, first the German officials warned German nationals against the risks of traveling to Turkey, and then Mrs. Merkel declared that Berlin would start considering economic sanctions against Turkey and hence reduce its
economic cooperation with Ankara. In this line, the German Foreign Minister also mentioned reviewing Hermes investment guarantees among the economic measures to be taken against Turkey. As these guaranteed are issued by the government to German companies for their investments in Turkey, this issue further enhanced concerns among the business community.

As a result of these entire process, both sides lost trust to the other party. In this beleaguer environment, a new event came to the agenda when the German newspaper Die Zeit reported in July 1917 that Turkey had provided the German authorities with a list of over 680 German firms on suspicion of supporting terrorism. This list was including such large multinationals as Daimler and BASF. Obviously, this particular development created substantial unrest among the German companies operating in Turkey. As a result of the reactions of the business community to this news, the Turkish government tried to assure the German investors. The Turkish Deputy Prime Minister, Mr. Bekir Bozdağ, said that there was a "communication error" with the mentioned list and there was no legal investigation into German companies.

In addition, the Turkish Prime Minister Mr. Binali Yıldırım also assured the German companies at a meeting with the senior representatives of some leading companies such as Bosch, Siemens, Mercedes, Metro Group, Frankfurt Messe and Thyssen Krupp. He stated that “I am very clear that we do not consider you German companies. We see you as the companies of this country.”

Also at the same meeting, the Turkish Minister for Economy, Mr. Nihat Zeybekci, requested the representatives of the German multinationals to have meetings at their headquarters in Germany to explain the Turkish government’s approach to their CEOs.

Interestingly, shortly after these developments, a business consortium comprising Germany’s Siemens was awarded a tender for the construction of a 1,000 MW power plant and wind turbines by beating out eight other bidders. Reuters (03.08.2017) commented on this by stating that “Turkey picked Germany’s Siemens as the winning bidder for a $1 billion wind power project on Thursday, a sign Ankara wants to keep business separate from the widening diplomatic row between the NATO allies.”

For instance, by referring to the mentioned list of companies which allegedly supporting terrorist activities, Kurt Bock, the chairman of BASF said to the German News Agency (DPA) that: ‘This was not an event that increases confidence to Turkey. Everyone knows that there is a need for basic stability for investments. The rule of law and recognition of laws is also a part of it.’ Similarly, German Industry Association Vice President Thomas Bauer worried about the developments in Turkey. Mr. Bauer, also heading Bauer Construction Company, said in his statement to the German Economy News Agency (DPA-AFX): "Of course, the question of what will happen tomorrow is being asked. This is because Turkey has a maverick regime. The possibility of imposing sanctions against Turkey or warning people to travel to the country are significant risks. Though we currently continue to do the existing business as usual, when viewed prospectively Turkey has lost her attractiveness. Now I would not buy a company in Turkey.”

Another German investor Heidelberg Cement, a construction materials manufacturing company, is also cautious about new investments in Turkey. Company’s chairman Bernd Scheifele said to the news agency Deutsche Welle that “Despite the good opportunities, the purchase of a new company is not planned.” Volker Treia, foreign trade officer at the German Chamber of Industry and Commerce (DIHK), is not optimistic either about the country. He said, “If the political situation does not change, it is not possible for German companies to think about making new investments” (Deutsche Welle, 20.09.2017). Martin Wansleben, CEO of the Association of German Chambers of Commerce and Industry (DIHK), the largest Germany business association told Anadolu Agency that “German firms with experience of operating in Turkey were investing for the long-term, despite the country’s current economic problems.”

Similarly, one of the interviewed company managers said that “There is huge market potential for their products in the energy sector due to growing energy needs of Turkey. With this regard, they want to enlarge their production capacity. But the head office in Germany is significantly concerned with the recent developments in the country. Therefore, they do not know how they can move forward by adopting which type of investment strategy.”

**German Multinationals’ Reactions**

All these recent political tensions between Turkey and Germany have naturally led to unrest in the business world. German multinational companies have been concerned that Turkey's political environment may also cause significant risks for their investments in the country although those representatives of the German companies represented at the prime minister’s meeting told journalists that they had agreed with Mr. Yıldırım that Turkey-German relations should continue "more silently”.

**Conclusion**

For foreign direct investment, one of the major concerns of multinationals is definitely the political risks faced in the host country. In this respect, the trust relations between the home and host countries are extremely important. In addition, multinationals are also concerned with the predictability of risk factors in connection with government policies. Furthermore, the predictability issue is directly related to the legal infrastructure of the host country, as well as formation and operation of the host
government. The recent developments regarding the Turkish and German governments interactions over a number of different areas together with the German multinational companies operations in Turkey may give interesting clues about these subject areas. Of course, all these should be explored and then analyzed in detail.

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Proceedings of Plenary Session III
Kia vs. the Government of Nuevo León: Lessons from an FDI Dispute at the State Level
Andreas M. Hartmann, Tecnologico de Monterrey, Mexico
Joohee Kim, Tecnologico de Monterrey, Mexico

This paper deals with the topic of MNCs’ subnational choices of location and relative political risk. A Korean car manufacturer set up a manufacturing plant in Mexico and found the state government to be reneging on a large part of its predecessor’s promises for investment subsidies and tax breaks. In comparison with other, similar cases, the main factors for this relative failure were a lack of experience and local connection on the MNCs’ side and the strength of local industry on the Mexican state’s side. Our conclusions focus on foreign investors’ relative bargaining strength at the subnational level.

This paper uses the case of a Korean car factory in Mexico to elucidate the power relationships between foreign investors and state-level governments. Mexico has become a major location for foreign-owned car manufacturing plants, due to its closeness and duty-free entry of Mexican-assembled cars to the North American market, with relatively low restrictions on local content. From the MNCs’ point of view, the choice of country is obvious but then, the selection of a specific location within one of Mexico’s thirty-two territorial entities can amount to a real challenge.

The case reported in this paper is unique, as it has led to a major conflict where similar investments in other Mexican states have run smoothly. We will show how choosing a Mexican state with a strong industrial base put the foreign investor in a weak position once the newly elected local government decided to go back on its predecessor’s generous promises of financial and infrastructure support. From the evidence shown, we will draw conclusions about power relations between foreign investors and state governments.

Our case study is entirely based on official documents and press reports from both Mexico and South Korea, as well as some third-country sources.

After this introduction, we present a brief literature review on FDI location choice. The following section deals with Mexico’s situation as an attractor of foreign investment. We then present a brief history of the MNC’s internationalization and site selection abroad. The empirical core of the centers on Kia’s entry into Mexico and the relationship with the Nuevo Leon state government. We then discuss the implications of the case and the lessons that can be derived from it. Finally, the paper offers a set of conclusions.

Literature Review

The location choices of foreign companies have been a recurrent topic in the international business literature (for a recent review, cf. Nielsen, Asmussen, & Weatherall, 2017). The great majority of studies focus on the country level, while within-country choices have focused mostly on the level of industrial clusters (Brenner & Mühlig, 2013; Nielsen, et al., 2017). However, two recent studies highlight the importance of local governments for foreign investors: Nicolini, Scarpa, and Valbonesi (2017) found that for member countries of the European Union, a federal structure has a significant positive effect on the granting of state aid to investors in the automotive industry. Li and Sun showed that in the Chinese context, “large foreign firms can receive favourable treatments from local institutions due to their contribution to local economy and employment” (2017: 561).

Power Relationships between Local Governments and Foreign Investors

Although the academic literature on the relations between host-country governments and foreign MNCs goes back at least to the 1960s (cf. Boddewyn, 2005), the theory most often referred to (cf. Kobrin, 2009) is Vernon’s (1971) “obsolescing bargain” model, which was meant as a warning to MNC managers that their companies could fall victim to expropriation and other abuses once they had made a substantial investment in the corresponding host countries. Since those times, many countries – including Mexico – have promulgated foreign investment laws that protect MNCs from such arbitrary decisions (cf. UNCTAD, 2016). For some countries, however, expropriation is still a perceived risk for foreign investors (cf. Jia & Mayer, 2017).

To adapt Vernon’s (1971) theoretical model to conditions below the expropriation threshold, Eden, Lenway, and Schuler (2005) have extended Vernon’s original two-phase concept into a “political bargaining model”, which presents an ongoing relationship between the foreign investor and the host country government, allowing for a partial compatibility of the parties’ interests. This model looks at both parties, goals,
resources, constraints, and outcomes, as well as the MNE’s strategies and the bargaining process as such.

Behrman and Grosse (1990, quoted in Grosse, 2005) have developed another framework that applies a stakeholder approach to MNC-Host government relationships: While MNCs have to take into account their competitors, other governments, suppliers, and customers, host governments need to respond to voters and other governments, as well as various pressure groups. We will use a combination of these two frameworks for analyzing the case of Kia in Mexico.

**Mexican States and FDI Attraction**

**The Macroeconomic Context: Automotive FDI in Mexico**

While in the 1960s, foreign carmakers had to negotiate their permits for producing in Mexico (cf. Bennett & Sharpe, 1979), the situation has completely changed since the 1990s: The implementation of the North American Free Trade Agreement (NAFTA) has transformed the country into a prime location for setting up car assembly plants, which produce mainly for tariff-free exportation to the US and Canada. Without any sizeable domestic manufacturer, Mexico has thus become number eight among the world’s car manufacturers in 2016 (OICA, 2017), although local content was often relatively low. For the Mexican state of San Luis Potosí, for example, “OEMs use an estimate of 50% to 55% local content, but Tier 1 companies only use 10% to 30% local content, with 30% being an exception” (Soto, 2016). All over Mexico, politicians and government officials are involved in efforts to increase both the size and the depth of automotive production. A fully developed car-assembly plant, with its host of suppliers, often provides tens of thousands of jobs and sizeable tax income.

**Qualifying conditions: Infrastructure, workforce, and security** Like most emerging economies, Mexico presents enormous regional differences in terms of internal development, which make specific locations more or less attractive for foreign investors. For medium-tech manufacturing operations with a strong export orientation such as the car industry, any potential site for setting up an assembly plant would need to meet a set of minimum criteria:

- A robust transportation network for receiving parts and shipping out finished cars. For example, Holl (2004) found that new motorways influenced the spatial distribution of manufacturing establishments in Spain. In an emerging economy like Mexico, with its vast territory, transport connection plays an even more important role.
- A dependable infrastructure in terms of electricity and water, which is not guaranteed in all Mexican states.
- A sufficient amount of both half-skilled workers as well as educated administrative and technical employees. For the country level, Noorbakhsh, Paloni, and Youssef (2001) have corroborated the importance of human capital for FDI influx.
- A sufficient level of security and crime control. In this respect, the empirical results are not unanimous: For example, Kinda (2009) found mixed results for the effects on crime on FDI in 77 developing nations, while Daniele and Marani (2011) could show that persistent crime deterred FDI in some regions of Italy. For the specific case of Mexico, Ashby and Ramos (2013) found the state-level murder rate to be positively correlated with FDI in some sectors and negatively with others, while there was no significant effect for the manufacturing industry. On the other hand, Pajunen (2008) was able to show that countries’ relative attractiveness for FDI not did result from specific individual institutional factors but from sets of characteristics that may be functionally equivalent.
- A stable and effective functioning of government. On a national level, Globerman and Shapiro (2002) found such “governance infrastructure” to be a significant predictor of FDI.

Clearly, not all regions of Mexico fulfill these conditions. The Mexican Southeast, for example, is lacking in both infrastructure and skilled workers, while several states on both coasts are plagued by violence. As a result, out of the thirty-one Mexican states plus one Federal District, only twelve host foreign car assembly plants.

**Within-country patterns of FDI in the Mexican car industry** According to traditional economic theory, one would expect FDI projects to cluster in specific areas for taking advantage of favorable factor conditions and agglomeration benefits, such as the proximity of specialized suppliers. Four Mexican states (Coahuila, Guanajuato, Mexico State, San Luis Potosí) contain assembly plants from several competing manufacturers, which seem to have given preference to such agglomeration advantages. For example, when Japanese car manufacturer Honda was looking for a second site in Mexico, it chose Guanajuato over Jalisco, where it had established its first plant. A company representative cited the unavailability of a sufficiently large plot and the connection to two railroad networks as motives for the different location and denied receiving special incentives from Guanajuato state authorities (Ramírez & Romo, 2011). In such a constellation, the state government will be inclined to favor foreign car makers and their suppliers in general, but would probably avoid giving preferential treatment to one company over the other, in order to avoid...
conflicts with individual firms and maintaining the doors open for future investment by current and potential industry participants.

However, the dominant pattern of spatial distribution is one car manufacturer per state (Aguascalientes, Baja California, Chihuahua, Jalisco, Morelos, Nuevo León, Puebla, Sonora, cf. Global Business Reports, 2016). The Volkswagen Group even preferred a relatively underdeveloped site within Puebla state for its new Audi plant, in order to remain within the same entity as the Volkswagen factory established in the 1960s. Two reasons for this behavior can be presumed: First, foreign car manufacturers avoid to co-locate in one state in order to prevent any competition for local semi-skilled and skilled workers, which could lead to wage increases and worker poaching. Sun, Tong, and Yu (2002) found some evidence of such crowding out for those Chinese provinces that have traditionally been most attractive for FDI. Second, being an important company at the state level should guarantee a special relation with the local government, which might be used for obtaining initial incentives and favorable treatment in the ongoing political bargaining process. For example, the German firm BMW supposedly received incentives worth MXN 3.5 billion (then approx. USD 237 million) for locating in San Luis Potosí state (Hernández López, 2014).

These two different within-country location strategies also have implications for carmakers’ supplier networks: When a company sets up shop within a state where competitors already operate, it will probably be able to plug into a part of the existing supplier structure, which is already operating and just needs to start making custom-made parts. In fact, many of the world’s most important tier-1 suppliers service a host of OEMs. On the other hand, those carmakers that choose to open up a location without competitors in the same industry often have to invite some of their key suppliers to install plants specifically for this customer. This constellation increases the carmakers’ bargaining power, but also their vulnerability to potential failures from the suppliers’ side. Additionally, setting up a whole OEM-supplier cluster might prolong the overall setup process and requires even more cooperation from the local authorities, which need to facilitate even more land and infrastructure.

Industry structure of Nuevo León state With a population of 5.1 million inhabitants, Nuevo León ranks eighth among Mexico’s thirty-three federative entities (INEGI, 2016) but third in per-capita income. Since the end of the XIX century, Nuevo León has been a major center of the manufacturing industry. Today, it hosts the headquarters of cement maker Cemex, beverage and retail giant Femsa, and the industrial conglomerate Grupo Alfa. Nuevo León is also the basis of the largest Mexican-owned bank Banorte and a host of second-level firms with family owner ship, which are not listed on the Mexican stock exchange even though they employ thousands of workers. Additionally, Nuevo León has a long history of attracting manufacturing investment from foreign firms from North America, Europe, and Asia, such as Carrier (air conditioners), Johnson Controls (auto parts), Lego (toys), LG (appliances), etc. Traditionally, Nuevo León’s governments have been industry-friendly, with several governors hail ing from the state’s leading industrial families.

Kia’s Internationalization

Hyundai Motor Group (HMG) with its two major brands Hyundai and Kia is South Korea’s largest auto manufacturer, reaching a total output of almost 5 million vehicles in 2016. Its internationalization was prompted by push factors such as saturation of the domestic market, necessity to increase the ratio of overseas production volume to limit currency risks, and a surge in labor costs escalated by militant unions after the 1997 Asian financial crisis. The same crisis forced Kia Motors into large-scale restructuring efforts, which led to its acquisition by Hyundai Motors in 1998. The consolidated group (HMG) then started expansion into overseas markets.

Before the crisis, key Korean automakers enjoyed their exclusive market position under the protection granted by the national government. With the hike of domestic sales by about 40% around the 1988 Seoul Olympics, the production volume increased from 100 thousand in 1980 to 1 million in 1988 (Cho, Kim, & Kim, 2014). However, in the 1990s, the industry’s rapid expansion caused market saturation and overinvestment. Hyundai Motors no longer sustained its monopoly position in the domestic market and turned to overseas market by building KD (knocked down) assembly plants in Asia and Europe.

Another factor behind international expansion was exchange rate volatility. With the devaluation of the Korean currency after the Asian crisis, HMC expanded the export volume with competitively lower prices and made foreign exchange gains of KRW 240.5 billion in 1997 and KRW 463.7 billion in 1998 (chosunBIZ, 2013, Feb. 13). In 2012, HMG achieved a sales record of 7.1 million units with 8.8% of global market shares, which made it the 5th global automaker (Schmitt, 2017). However, with the increase in won value of nearly 7.6% against the US dollar, the earnings of Hyundai and Kia dropped despite higher unit sales. It was 5.5 % year-on-year drop in net profit in 2012 when it had an 8% hike in sales (Panait, 2013). While limiting currency risks by expanding the global productions, HMC tried to keep in check price hikes by holding costs down through authoritative measures against militant unions.

In response, however, militant unionists organized frequent walkouts and stalled productivity improvements and implementation of new technology. As a result, in 2016, the productivity level per hour in the South Korean
plants was half of those in the United States (Korea Times 2017, March 3). Further, the company failed keeping surging labor costs down considering the fact that a plant level worker was paid an average annual income of KRW 96 million (USD 85,333).

**Kia’s Globalization and Site Selection Strategy**

The first phase of globalization of Hyundai Motors took place when it built a Canadian plant in Bromont in 1985. With over 400,000 cars, nearly three-fourths of its Canadian outputs in 1988, Hyundai was ranked fourth largest car exporter into the US (Sachwald, 2013: 228). Hyundai had not considered the U.S. for its first overseas plant mostly due to protectionist sentiments against foreign automakers in the U.S. (McDermott, 2014: 159). Further, the Canadian government offered generous incentives such as CAD 131 million dollars and a free site (McDermott, 2014: 159). However, this move turned out to be a bitter failure. The Bromont plant started its operation in 1985 with an installed capacity of 100,000 units, but was closed in 1993 due to its poor quality and decreasing sales (Chung, 2009). The major reason for this was due to its location where HMC was isolated from the main automobile industry (McDermott, 2014: 159) and suffered from insufficient supplies. When closing the plant, HMC had to pay back a part of the incentives, USD 50.1 million to the local government (Hankyong Daily, Sept. 12, 1996).


In the third phase, announced as “Hyundai 21st Century Business Strategy”, HMC turned away from the KD productions and targeted the wider consumer base in Turkey in 1997, India in 1998 and China in 2002. The Indian plant was considered a stepping-stone to access major global markets. After taking over KIA, HMG started looking into the Chinese market and built plants in 2002. Then, it again targeted the North American market in Alabama in 2005 and in Georgia in 2010. For the European market, plants were launched in Slovakia in 2007 and the Czech Republic in 2009. Finally, with the entry into Brazil in 2012 and Mexico in 2016, HMC had finally accessed most of the major auto markets in the world.

On the subnational level, HMG looked for location advantages such as access to skilled labor and raw materials, and availability of suppliers. In India, it chose Chennai due to the infrastructures such as ports, airports, public transportation, and water networks even though it was remoted from New Delhi, the most important market for motor vehicles. The Alabama plant lies some 280 km from the Port of Mobile on the Gulf of Mexico to ship vehicles to Latin America (Lyne, 2002). In Slovakia, a potential workforce of 450,000 lives within a fifty-kilometer radius from Kia (TheKoreaHerald, 2004, Mar. 3). In addition to the above conditions, HMG looked for locations that were union-free or dominated by docile unionism. In Turkey, Hyundai workers did not join the nationwide strike in 2015 (MKStock, 2015, May 18), while in the U.S., HMC ruled out those candidate states that did not have ‘right to work’ law. In India, among four candidate sites, Hyundai Motors was not in favor of Kolkata due to the communist state government. The Hyundai workers in Brazil joined a company-friendly union apart from the militant unionism based in Sao Paulo. Similarly, the union at the Mexican Kia plant was affiliated with a politically moderate official umbrella organization.

After the Canadian experience, access to a network of suppliers became an important consideration for HMG. For example, The Turkish plant is located 68 km from Honda Kocaeli. The Indian plant is located 27.2 km from the Ford plant, and in China, HMC built its plants 144 km from Toyota’s. In Alabama, Kia’s plant is located at the juncture of I-95 and I-16, along which several auto suppliers have lined up. Hyundai and Kia have also invited major suppliers to accompany them to new international sites in order to assure a constant supply and high quality of components (Park & Rhee, 2015). Furthermore, HMC chose the sites close enough to sibling plants to share the production platform and key parts such as engines, transmissions, and other components.

From its experience with the Bromont plant, HMC learned that generous incentives could cloud its judgment (McDermott, 2014: 159) and that incentives should be the last factor to be considered after all other requirements have been met. Having said that, being a strong and distinctive player in a region had its advantages of high negotiation power over the incentive deals. All of the hosting regions offered Kia incentives such as infrastructure improvements, free sites, tax breaks, and other benefits.

**Kia’s Entry into Mexico**

On the surface, selecting Nuevo León as a production site within the NAFTA area made a lot of sense for Kia: Mexico is the second largest car market in Latin America after Brazil. Kia’s plant has a planned capacity of 30 thousand units, of which it plans to export 60% to North America, 20% to South America, and the remaining 20% to the domestic market. Most importantly, Kia’s site in Nuevo León is located only 200 kilometers from the U.S. border, the second largest market in the world. On the supply side, Nuevo León state has an automotive industry
that accounts for 20% of national output, 23% of exports, and employs over 600 thousand people, ranking third for auto parts production in the country. The city where Kia is located, Pesquería, has immediate access to an international airport and railroad line to the US.

It took Kia three years to make an investment decision in Mexico due to quality issues at other plants. Kia was a third-ranked automaker by number of vehicle recalls in the U.S., 3.3 million in 2013. Therefore, Kia stopped its aggressive expansion plans worried that its suppliers would be unable to keep up the pace. However, it became difficult to squeeze additional capacity from the existing plants. The U.S. plants reached up to 125-130% of utilization rate on a two-shifts-a-day basis in 2014 (Automotive News, 2014, Feb. 10). With an additional plant in Mexico, Kia could increase overseas production rate from 49% to 55%, which would alleviate the capacity problem (Meail Business News, 2016, Sep. 8) and reduce vulnerability to fluctuating exchange rates. Since the state of Nuevo León met the basic conditions for a new site, the state’s incentive package offer was a relatively minor factor to be considered.

Meanwhile, the Nuevo León state had a strong interest in attracting Kia. Kia would be the final consumer of its auto part manufacturers and would strengthen the state’s economic position. A local university even prepared a 74-page report on the economic and social impact of the investment (Instituto para el Desarrollo Regional, 2016). Kia Group itself took care to explain its positive impact on the local economy, including direct and indirect employment, an increase of property value, and CSR efforts in the rather poor municipality of Pesquería, including a refurbishing of the local school (Kia Motors México, 2015).

History of the Conflict between Kia and the Government of Nuevo León

In June 2015, a new governor was elected in Nuevo León, and matters turned complicated for Kia. While the plant was already halfway completed, the governor demanded renegotiation claiming the reversal of the incentive deals reached by the previous administration. Amidst the conflict, the contents of the confidential contract were released to the public. The contract seemed disadvantageous for the citizens of the state by creating a major fiscal burden including the exemption from the payroll tax for 20 years.

In March 2016, when the plant was 98% completed (Yonhap News, 2016, March 29), the state stalled the implementation of the infrastructure components of the agreement, such as a natural gas pipeline, drainage lines, water treatment facilities, and a rail spur connecting the Kia lot to the main line. In response, Kia alluded to the possibility of taking the case to the International Center for Settlement of Investment Disputes at the World Bank (Asia Economics News, 2016, Feb. 16). However, such a step would have been Kia’s last resort since it would have further delayed the start of operations.

In April 2016, the state Secretary of Economics claimed that there were 31 illegal provisions in the contract and denounced Kia for excessive incentives amounting to nearly 28% of the total investment, compared to 6% of incentives that other companies had received previously. Kia argued the deal was reached through a transparent bidding process and even hinted at the possibility of withdrawing its investment. Then, the state subtly changed its stance toward Kia. The new governor said, “we have no differences with Kia, we have differences with the previous government.” Further, he pointed out that the state would fulfill the commitments that had legal validity according to the possibilities of state finances (La Silla Rota, 2016, Jan 19).

On April 4, 2016, Mexican president Enrique Pena Nieto said he would keep an eye on the deal when asked for mediation by South Korean president Park. The next day, the state governor announced he still would not comply with the agreement. Members of the lower house of the Mexican federal parliament adopted a statement urging the state to honor the agreement. In May 2016, the Mexican Secretary of the Economy urged both parties to reach a compromise saying Kia could relinquish up to USD $23 million in incentives. On June 8, 2016, both parties released a joint statement that the deal was reached with the reduction of the incentives from 28% to 10.5%. In the same month, an anti-corruption prosecutor accused the previous governor Medina of draining some MXN $195.87 million from state coffers.

Agreement with the Previous State Government

The major motive for the Nuevo León government to support Kia’s investment in the state was the prospect of creating a total of 70,000 jobs, out of which 14,000 would be employed directly by Kia and the rest by suppliers and associated businesses. In the first stage, the car assembly plant would offer direct employment for 4,000 workers. Kia would make an initial investment of USD 2.5 billion. The Nuevo León government committed to infrastructure measures and tax breaks costing around USD 700 million, equivalent to 28% of the private investment (Agencia el Universal, 2015, Dec 6). As was later revealed, these incentives included the state government paying federal taxes for the firm, as well as taking care of infrastructure investments, such as building a fire station, a million-gallon water tank, and a training center (Campos Garza, 2015). Additionally, the agreement included some special favors, such as paying for the inauguration party and condoning all future traffic fines for Kia employees (Flores, 2016).
The amount of incentives originally offered by the Nuevo León government was in line with the financial support offered to foreign car assemblers in the 1995-2000 period, when state and federal governments offered incentives equivalent to between 35% and 40% of foreign investment sums (Agencia el Universal, 2015, Dec 6). However, there was also a precedent in Guanajuato state, where the Japanese car maker Mazda had to accept a reduction of the originally promised incentives package. In the 2010’s, incentives given to car manufacturers varied between 0% and 27% of the sum invested (cf. Table 1). While the Guanajuato state with its multiple car companies offered incentives of up to 2%, single-investor States (San Luis Potosí, Puebla, Nuevo León) chipped in between 17% and 27% of the sum invested. The case of Aguascalientes with its Nissan-Daimler JV is exceptional, as the state government changed its policy from generous to no incentives at all (Arteaga, 2016), when Nissan was already captive due to inter-plant linkages.

### Table 1: Comparison of Incentives given to Car OEMs in Mexico in the 2010’s

<table>
<thead>
<tr>
<th>OEM</th>
<th>Mexican State</th>
<th>Year</th>
<th>Investment (millions of MXN)</th>
<th>Direct Employment</th>
<th>Incentives (millions of MXN)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nissan-Daimler</td>
<td>Aguascalientes</td>
<td>2015</td>
<td>1,240</td>
<td>3,700</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>Mazda</td>
<td>Guanajuato</td>
<td>2012</td>
<td>770</td>
<td>4,500</td>
<td>13.9</td>
<td>1.8%</td>
</tr>
<tr>
<td>Honda</td>
<td>Guanajuato</td>
<td>2012</td>
<td>1,270</td>
<td>1,200</td>
<td>25.4</td>
<td>2%</td>
</tr>
<tr>
<td>Nissan</td>
<td>Aguascalientes</td>
<td>2012</td>
<td>2,000</td>
<td>1,200</td>
<td>150</td>
<td>7.5%</td>
</tr>
<tr>
<td>BMW</td>
<td>San Luis Potosi</td>
<td>2014</td>
<td>1,000</td>
<td>1,500</td>
<td>170</td>
<td>17%</td>
</tr>
<tr>
<td>Audi</td>
<td>Puebla</td>
<td>2012</td>
<td>1,800</td>
<td>1,500</td>
<td>486</td>
<td>27%</td>
</tr>
<tr>
<td>Kia</td>
<td>Nuevo León</td>
<td>2014</td>
<td>2,482</td>
<td>8,900</td>
<td>670</td>
<td>27%</td>
</tr>
</tbody>
</table>

Source: Flores (2016), based on Nuevo León government data

Additionally, in 2007, Nuevo León had promulgated the Law on Promotion of Investment and Employment that limited state incentives to 5% of the invested sum (Agencia el Universal, 2015, Dec 6). Thus, the agreement signed on August 27, 2014 was technically illegal and also imposed an enormous burden on the local government’s budget. The Mexican federal government had already stepped in with a USD 190 million tax incentive.

### Impact of the Change of Government

In October 2015, a wave of discontent against governmental corruption swept into office a new, independent governor of Nuevo León, who promised to clean up the mess left behind by the previous administration. The Kia project had already been targeted, because the previous government had purchased the plot of land from one of the previous governor’s friends, at a much inflated price (Pulso, 2015), to be donated to Kia. One of the main problems left behind by the previous administration was the state’s excessive debt, which made it impossible to finance the storm drain system and the railroad spur that had been promised to Kia (Agencia el Universal, 2016, Jan 25). The new government also had to catch up on a six-month delay in other infrastructure work, which threatened to push back the beginning of production at the plant (Flores, 2015).

Therefore, the new government labeled the contract as “overreaching and not implementable”. Kia was more cautious and demanded legal certainty, although the possibility of a lawsuit for breach of confidentiality was mentioned (Pulso, 2015) after the Nuevo León authorities had published the original agreement on its Facebook account on November 29, 2015 (Manufactura, 2016). This step clearly contravened Kia’s understanding of the agreement, which contained a passage labelling the document as “highly confidential and commercially sensitive”, according to a local TV anchorman (Martínez, 2015). While Kia insisted on the validity of the contract, the new state government contested it.

On the national level, the Mexican federal government urged the parties to come to an agreement (CNNExpansión, 2015), while the Korean ambassador in Mexico stressed the future benefits of Kia’s installation in Nuevo León (Olvera, 2015). While Kia did not make any public statements, Nuevo León’s Secretary of Economic Development accused the firm of “extraordinary stubbornness” to insist on an “illegal” agreement and a “leonine contract”. He also voiced the suspicion that Kia would enlist the help of then president Park Geun-hye during her official visit to Mexico (Flores, 2016).

The new governor could not give too much credit to Kia since the economic benefits brought by the investment project had been a success of his predecessor. On the other hand, the state needed to bring in an auto assembler in order to participate in Mexico’s auto manufacturing boom. Kia presented itself as an innocent bystander since it did not want to put itself in the middle of the political disputes. Further, it did not want to make another withdrawal decision after the Canadian experience and to have open conflicts with any government. From the experience of its...
13-year long conflict with the Brazilian government at the arbitration court of the International Chamber of Commerce. Kia learned that confrontation with any state would hurt the future market opportunity. Even though Kia was awarded over USD $200 million and was relieved of a BRL 2 billion penalty levied by the Brazilian government, Kia still has been branded as an anti-Brazilian automaker, which made Kia rule out Brazil, the largest auto market in Latin region, from its potential site lists (YonhapNews, 2011, Oct 30).

After several months of intensive coverage in both the local and international press (e.g., Althaus, 2016), in June 2016, the conflict ended in a new agreement that substantially reduced both tax breaks and the infrastructure projects that had originally been promised (Agencia el Universal, 2016, Jun 8). The most important details of the incentives are listed in Table 2. Overall, State support was reduced from 28% to 10% of the sum invested and for the first time, Kia committed to contributing to the infrastructure developed and guaranteed an undisclosed amount of jobs and local purchases (González & Nava, 2016). On October 13, 2016, the Nuevo León State government, the Municipality of Pesquería, and Kia signed a new agreement with parallel text in Spanish and English. The government published the scanned text in full length (79 pages), including all clauses with both parties’ rights and obligations in the previous and modified agreement. As the government explained in an additional graph, the new agreement would lead to MXN 7 billion (approx. USD 368 million, as of Oct 13, 2016) in savings (Government of Nuevo León, 2016a). To further strengthen the state government’s position, the new agreement established verification visits, penalties for non-compliance by the investor, and a binding arbitration procedure according to ICC rules (Convenio de Colaboración/Collaboration Agreement, 2016). The Nuevo León government also published a graphic overview of Kia’s contractual obligations in the previous agreement (none for Kia and sixteen for Nuevo León) and the new text (thirteen for Kia and four for Nuevo León) (Government of Nuevo León, 2016b).

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Income tax exemption</td>
<td>100% over 20 years</td>
<td>95% over 5 years</td>
</tr>
<tr>
<td>Real property tax exemption</td>
<td>100% over 5 years</td>
<td>10% over 10 years</td>
</tr>
<tr>
<td>Exemption of value added tax on</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>real estate purchases</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exemption of motor vehicle tax</td>
<td>100%</td>
<td>None</td>
</tr>
<tr>
<td>for Kia employees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exemption of fee for environmental impact study</td>
<td>100%</td>
<td>None</td>
</tr>
</tbody>
</table>

Source: El Universal, 2016

Discussion

In a study of FDI in China, Luo (2001) had found personal relations between MNC managers and regional governments to have the most significant effect on several performance measures. Confirming these findings, the unfavorable outcome for Kia in this case may be partially imputed to the lack of the carmaker’s ties to the new state government, although the local Secretary of Economic Development was the owner of a car supplier (without known ties to Kia). The fact that the foreign investor did not go through with its threat to withdraw or reduce its investment is in line with another finding in the literature: For foreign investments by US-based MNCs, Wheeler and Mody found that “high-cost tournament play is unnecessary for countries with good infrastructure development, specialized input suppliers and an expanding domestic market” (1992: 57). Apparently, Kia found the infrastructure and suppliers to be sufficiently developed, while NAFTA provided domestic-equivalent conditions for access to the US market. Thus, the size of the local government’s incentives were not decisive.

Even if Kia and its parent company HMG have built an impressive international network over the last years, compared to other car companies, the Korean are relative newcomers to the game of influencing host country governments. A study comparing Toyota and Hyundai’s lobbying in Europe, for example, found the latter to be far less effective in influencing politics (Barron, Pereda, & Stacey, 2017). Johanson and Vahlne (2009) have defined the concept of “liability of outsidership” for MNCs, defined as the absence of a relevant network in the host country. Generally, it can be assumed that in a Latin America, Asian firms face a greater liability of outsidership than North American or European-based MNCs (cf. Chen, 2017). Applying Ghemawat’s (2001) CAGE framework, Korean firms face greater cultural, administrative, and geographic distance to Mexico than their European competitors. A
similar situation forced the Chinese automaker FAW to cancel the construction of a small-scale assembly operation in the state of Michoacán (cf. Cuervo-Cazurra & Montoya, 2014), even though FAW had a Mexican partner. That failure that might have warned Kia to tread more carefully in its Mexican investment.

**The concept of legitimate expectations** In conflicts between governments and foreign investors, the latter have often invoked the concept of legitimate expectations, including — among others — “[g]overnments’ written commitments to investors, e.g., contractual commitments beyond mere contractual expectations” [Sauvant & Ünüvar, 2016]. Clearly, the present case falls into this category, as the Nuevo León government had signed a binding agreement. However, things get complicated insofar as one could consider the agreement to be partially void, as it violated a local law promulgated prior to the contract signature. On the other hand, the concept of legitimate expectations could also be applied in the opposite direction, i.e., the investor’s committing to creating a sizeable number of jobs and including a concrete percentage of local content into its production process, instead of just assembling foreign-made parts. In the partially politicized and economically sensitive context of the present conflict, however, such legal considerations should not be considered necessarily as 100% enforceable; Mexico’s relatively weak rule of law (rank 88 worldwide, cf. World Justice Project, 2016) adds even more uncertainty.

**The role of national stereotypes in FDI-related negotiations** As measured by Håkanson and Ambos’ (2010) study on psychic distance, Korean managers qualified the difficulty of doing business in Mexico with a score of 67, compared to a minimum score of 21 (China) and a maximum score of 77 (Argentina). Thus, Kia probably expected its insertion into the Mexican context to be rather difficult. On the other hand, Koreans perceive contracts to be somewhat malleable (Lee, 2005; Movius, Matsuura, Yan, & Kim, 2006), which allowed Kia to deal with the situation in a flexible way.

Had the Korean firm insisted even stronger on the fulfillment of the original contract, the Mexican public might have viewed the firm as abusive, thus reinforcing or creating a negative country-of-origin effect (cf. Yu & Liu, 2016), which could have interfered both with its capacity to attract qualified workers and with its sales within Mexico. Since Kia began selling its vehicles in July 2015, the total volume of its sales accounted for 95,352 units in just under two years, making Kia the 5th largest vehicle brand in Mexico (Mexico News Daily, 2017, May 6). We can thus conclude that Kia’s cautious approach to the conflict at least helped it maintain a positive image in the eyes of the Mexican public.

**Relative bargaining power in an ongoing relationship** Although the major commitment for the FDI project was established through the construction of the assembly plant, the further development of the initial investment leaves multiple options for both parties to implement or withhold actions that could benefit or harm the other side’s interests. The state government could authorize and/or finance further infrastructure for the focal firm, its suppliers, and associated companies. The foreign company, on the other hand, could increase or decrease the rate of production at the plant and, above all, modify the depth of production either in-house or by inviting and qualifying supplier firms. Kia’s actual bargaining strength would depend on the flexibility and resilience of its global production network, as well as the degree of capacity utilization in its plants. If the Nuevo León government were seen as exerting too much pressure, the Korean firm could use the “option value” of its multinational production network (cf. Kogut & Kulatilaka, 1994) by shifting manufacturing out of Mexico.

What strengthened the local government’s position was its strategy of going public, knowing that public opinion expected the governor to make good on its promise to revise the agreement with Kia. The new government needed to “win” the negotiation and to make sure that the outcome would be all over the media. Kia, on the other hand, also tried to build up some local support through its CSR initiatives: Even amid the conflicts, the company donated MXN 1 million to public schools in the Pesquería municipality and initiated a professional career development program for university students. Kia participated in cultural events, reforestation, and recycling activities with citizens and provided training programs for its new employees with the support of the state government at Nuevo León.

**Conclusions**

Large foreign investment projects can bring many jobs and prosperity to a region or state. It is in the best interest of the local authorities to help the foreign investor, to the extent that a potential loss of the investment cannot be substituted by other national or foreign investors.

However, a state-level industry that is already well developed reduces the perceived attractiveness of any proposed foreign investment. Additionally, local incumbents might not view too favorably that a foreign firm receives preferential treatment, such as tax breaks, while the locals have to carry the full fiscal burden. Thus, the bargaining power of a foreign investor is reduced when local industry is strong and well connected to local authorities. In the current case, local firms never intervened publicly in the conflict, but their influence was felt through the preexisting law limiting incentives for foreign investors. The uniqueness of the situation in Nuevo León becomes evident when compared to other states, where similar levels
of state incentives were approved without any conflict reported in the press.

Finally, Kia’s situation as a latecomer to Mexico exacerbated its position as an outsider, without relevant political connections in Mexico. Contrary to the chaebol tradition of strong government protection in Korea, even asking for the Korean President’s support did not turn the situation to Kia’s favor.

This case demonstrates that even on the subnational level, the nonmarket aspects of location choice play a major role for foreign investors. A major limitation to this study lies in the nature of the issue: Only time will tell whether Kia can turn the adverse political situation into an economic success or whether the firm will choose to reduce its investment in Mexico in search for more favorable conditions elsewhere. When this paper was written (early 2018), the Kia operation was fully functional, although depth of production was rather limited, with powertrains and dashboard assemblies being imported as whole component sets. Within the context of NAFTA renegotiation, the probably increase of mandatory local content demanded by the US administration could possibly prompt another round in the ongoing bargaining process between Kia and the state of Nuevo León.

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Business Diplomacy: How to Ease Multinational Corporations’ Business Risk in Developing Countries and Conflict-prone Zones

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These days, multinational corporations (MNCs) are no longer ‘innocent’ business actors; they play an important role in international relations as well. The revenues and market value of many MNCs are higher than the GDPs of small countries. For many developing countries and conflict-prone regions, MNCs are attractive partners since they support economic growth. Entering markets and starting operations in developing countries or conflict-prone regions is attractive for MNCs since the margins are high and the potential for growth great. However, operating in developing countries and especially conflict-prone regions is also risky. Recent research has already contributed to this topic, for example by describing what kind of diplomatic actions had already been undertaken by so-called principled leaders in order to manage in conflict-prone regions. But the topic needs far more research to better understand how MNCs act in conflict-prone regions in order to survive. To fill the gap, this study investigated on a more explorative basis the question: “How do principled leaders manage their company’s business successfully by conducting business diplomacy in developing countries and conflict-prone zones?”

Grounded theory was used in this study as a basis for the methodology. Interviews were conducted with nine principled leaders from different MNCs operating in various sectors. The results showed that business diplomacy was conducted by every MNC to minimize the business risks and maximize the business opportunities, but to different degrees. Based on the data analysis, a conceptual Business Diplomacy Framework Matrix was developed to lay a theoretical foundation for understanding how MNCs can act when launching a new venture in a conflict-prone region.

Today, we talk about a globalized society in a world that is becoming more and more interconnected and economically interdependent. To put it differently, economic, social or political problems are getting too big for MNCs or for governments to figure out all by themselves (Westermann-Behaylo et al., 2015). In the 1990s, privatization and the power shift from the Western economy to the more developing economies compelled Western companies to leave the safety of familiar economies and expand to other parts of the world such as Brazil or China. These occurrences forced governments to pass their power of managing foreign policy goals and national tasks even more to MNCs (Westermann-Behaylo et al., 2015). In turn, this created a situation in which governments had to deal with a lack of vital resources such as experienced and well educated people to get the country’s business done. This is where diplomatically well-organized MNCs come into play. They expand their business by entering emerging markets while taking on a diplomatic role by managing multiple interactions between local stakeholders such as the government, NGOs, and communities.

New opportunities have also appeared for some of the countries that are active in the global market economy, but they have simultaneously created governance gaps for others within the last century. Unstable market situations giving rise to other types of conflict than the commonly known conflicts between states. An example of that is an intra-state conflict having a lasting effect on many groups within society as they mainly undermine human progress and economic development (Sidibe & Saner, n.d.). To provide some insights into the status quo, different sources have shown that today more than 60 conflicts are taking place and more than 15 peacekeeping operations are being undertaken by the United Nations in conflict zones (United Nations, 2016; Council Foreign Relations, 2016; Wikipedia, 2016; see Appendix: Table 1 & 2).

Macnamara (2012) and Nelson (2000) stressed that the field of commerce and diplomacy is no longer state-centric, nor confined to official governmental interactions, since a variety of MNCs have a standing in world politics by negotiating and compromising with foreign authorities to ease these complex circumstances. As shown by a study undertaken by the Edelman Trust Barometer (2016), MNCs are actually expected to go beyond serving their pure market demand and instead take responsibility to respond to social public demands. Around 80 percent of the respondents believed and trusted in the fact that MNCs are more likely to be in a position to improve profits, economic as well as social conditions in the society where they
operate compared to national governments (Edelman Trust Barometer, 2016; see Appendix: Figure 1 & 2; Nye, 2008).

Increased foreign direct investment in developing countries and conflict-prone zones is just another aspect clarifying why this study is of interest. The non-profit research and educational organization ‘The Fund for Peace’ gathered data from many countries with regard to their extent of fragility and came to the conclusion that of 178 listed countries, around 70.2 percent (125 countries) were characterized as “warning” and “alert” and could be considered so-called conflict zones (Fund for peace, 2015; see Appendix: Figure 3). Of these 125 conflict zones, 54.4 percent experienced an increase in FDI in the period from 2011 to 2015 (The World Bank Group, 2016). In summary, MNCs are investing and operating in more than half of the world’s conflict zones, and because of their diplomatic skills, they are expected to provide assistance at the same time as they are successfully exploring the business situation in these countries and regions (Nelson, 2000). Previous research has presented different concepts that match exactly what MNCs diplomatically practise to survive in emerging and conflict-prone economies. Scholars call these concepts corporate diplomacy, economic diplomacy, business diplomacy, etc. They are elaborated in detail in the next section. The recent literature has pointed out some pioneering businesses that successfully launched diplomatic actions. Tesco, a retailer originating from the UK, addressed the issue of labor grievances within the agricultural sector in South Africa in 2009 (Kotze, 2014). DHL, a worldwide logistics company operating in more than 220 countries, helped to re-establish the distribution of mail and parcels in Kosovo. In particular, it supported the country in establishing the necessary logistics for continued service (Bennett, 2001). Another example is given by the multinational construction company ABB, which has taken the diplomatic role and responsibility to encourage diversity and improve ethnic relations in the workplace by bringing Bosnians, Kosovars and Serbs together. It helped with rebuilding electricity infrastructures, which were damaged during the war that took place between 1992 and 1995 (Bennett, 2001).

Practical relevance

Practising business diplomacy by building relationships with foreign authorities contributes to the growth of developing countries and conflict-prone zones and grants access to foreign markets in terms of resources, labor, etc. Recent studies conducted by Melin (2016), Westermann-Behaylo et al. (2015), Ruël (2013), and Ruël and Zuideman (2012) have contributed to the exploration of what kind of diplomatic actions have already been accomplished by MNCs and were taken as the starting point for this study.

Finding out how successful business diplomats of pioneering MNCs behave and act to launch ventures in emerging and conflict markets is the goal of this study. Which stakeholders are important enough to stay in contact with? What preparations must be taken care of before entering a developing country or a conflict-prone zone? How do business diplomats behave towards foreign authorities? What actions can help to gain access to the relevant market? All of these questions are answered by this research, which in turn provides input for other companies which plan to launch a venture in such a complex business environment. In summary, this study dove deeper into the topic of business diplomacy by investigating how these MNCs developed and encouraged interpersonal links with relevant stakeholders in the unexplored context of developing countries and conflict-prone areas. It should encourage MNCs not to ignore complex situations in their area of operation, but instead to take responsibility and handle them properly since threats and other difficult situations affect not only the emerging market itself but also all other parties involved. As a final step, a “Business Diplomacy Framework Matrix” was created to put into perspective all dos and don’ts for business diplomats when planning to launch a new venture in a developing country or a conflict-prone zone.

The following section starts with a literature review and a theoretical framework to give an idea about what exactly is meant by the term business diplomacy and how it is related to MNCs operating in developing countries and conflict-prone zones. Then the qualitative methodology approach, used to analyze the semi-structured telephone interviews, is discussed. Sections 4-6 present the research findings of this study, a discussion about these findings in relation to previous studies on this topic, and finally concluding remarks derived from first-hand insights into how MNCs handle their business strategies with foreign stakeholders to establish a positive, long-term relationship.

Literature review and theoretical framework

This section provides an overview of the recent, relevant literature in an attempt to come up with a clear understanding of what business diplomacy is about. It aims to point out how the topics MNCs, business diplomacy, and developing countries and conflict-prone zones are connected to come up with an appropriate research question.

Different facets of diplomacy

Several scholars have conducted research about international companies that developed so-called business competencies, helping them to build bridges between their company and a foreign and multifaceted political setting. In 2000, for example, business diplomacy was supposed to “influence economic and social actors to create and seize
new business opportunities; working with rule-making international bodies whose decisions affect international business; forestalling potential conflicts with stakeholders and minimizing political risks; using international media channels to safeguard corporate image and reputation” (Saner et al., 2000, p. 13). About three years later Steger (2003) came up with a new concept of what international companies were urged to apply due to globalization, and entitled it corporate diplomacy. In his eyes, it was a systematic and professional endeavor of international companies to obtain a license to operate and to manage the business setting to guarantee that business is done smoothly (Steger, 2003, p.67). This is supported by what Heinz (2014) stated in his study. He clearly emphasized that advancing the corporate interest by negotiating and creating alliances with key authorities such as governments, analysts, the media and NGOs is the most important aspect to focus on when it comes to business survival in a fast-changing environment. Another facet of diplomacy is public diplomacy, which can be understood as a two-way street characterized by an exchange of information in terms of listening and talking. Credibility is important for this type of diplomacy since the outcome of the negotiation depends on what values international companies share with the respective foreign authorities and how the latter perceive the international companies’ messages and adapt to them accordingly. Others have made a more detailed differentiation of the concept as international companies can make use of business diplomacy on the one hand and commercial diplomacy on the other. Commercial diplomacy is then popularly understood as making policy in terms of working within a network of public and private actors who manage commercial relations using diplomatic channels and processes, and business support in terms of granting access to new markets (Ruël, 2013). It is represented as a two-dimensional concept, meaning that it is practised by heads of state and embassies as well as by international companies. The kind of diplomacy that is exercised by multinationals is also termed business diplomacy, where the focus lies on its stakeholder management (Sidi & Saner, n.d.). In this case, managers negotiate, re-negotiate, compromise and set up long-term, positive relationships with local authorities to establish a license to operate and increase the business’ power as well as its legitimacy (Ruël, 2013).

Most recent studies have switched to the term corporate diplomacy again and extended already existing research on this topic by adding aspects from research areas such as political corporate social responsibility, international relations, and peace studies (Westermann-Behaylo et al., 2015). For the purpose of this study, the term business diplomacy was chosen as the most appropriate facet, since its focus lies on stakeholder management by international companies.

The use of business diplomacy to gain power and legitimacy

International companies need approval from the local government and other foreign authorities in possession of legitimate power. They can make use of power and legitimacy as two independent tools or in combination to build authority in such a strategically important market environment. Power is generally understood as the capability of someone to determine the other participant’s way of thinking, which in turn leads to the desired result of a discussion or an event (Nye, 2008). For international companies, power seems to be an effective way to extend their control in terms of achieving the status of institutions within society (Ordeix-Rigo & Duarte, 2009). There are different modes of power that can be employed by international companies such as soft power, hard power and smart power (Hedetoft et al., n.d.; Ordeix-Rigo & Duarte, 2009). Soft power can be distinguished in three sub-types: coercive power that makes use of physical resources of forces, violence, or restraint; utilitarian power that is based on exchange of material or of financial resources; and symbolic power that rests on normative and social symbols such as prestige, esteem, love and acceptance. Hard power is best known as military power or economic pressures that are used to control others to act accordingly. Smart power represents the most effective and efficient way, namely the balanced combination of soft and hard power aligned to the respective situation. Legitimacy inevitably plays an important role, too. This study works with the definition provided by Ordeix-Rigo and Duarte (2009). It states that a company’s performance should give other authorities the impression that it is desirable, appropriate within the given society, and accepted in the host country’s constructed system of norms, values, and beliefs. To increase both power and legitimacy, international companies have the possibility to make use of what recent research calls business diplomacy.

Tools of business diplomacy

Along with power and legitimacy, research has revealed certain tools that business diplomats use while working abroad. An antecedent of all the following tools is “having a positive corporate diplomatic history” as a company (Nelson, 2000). Of course, this takes some time to develop and depends on previous actions by the respective company in the home market. Presuming that a MNC had a strategy for dealing with stakeholders in the past, it seems conceivable that it might face problems with foreign authorities, particularly in developing countries and conflict-prone zones, since circumstances are already heating up.

Another commonly known tool is having a “good reputation” as a company, as a positive picture of a business partner makes every step easier to negotiate (Ordeix-Rigo
& Duarte, 2009). Since diplomacy is all about storytelling and seeking compromises among all stakeholders regarding a certain issue, the fact of “being truly interested” in doing some good for the foreign society in the short or long run helps in achieving the company’s business goals. Next, being “aware of who is who” in developing countries and conflict-prone zones is a very valuable tool of business diplomacy (Nelson, 2000). Pulling the right strings by involving the relevant stakeholders makes it easier for companies to succeed, also financially. Finally, the “usage of media channels” in developing countries and conflict-prone zones is related to other tools and can influence the chance of success with a business in either a positive or a negative way.

The ambition of business diplomacy

Given these popular tools of business diplomacy, the question of “when is business diplomacy carried out successfully?” still remains unanswered. Research done by London (1999) has pointed this out very clearly. Business diplomacy is successful when two main goals are achieved, namely process goals and outcome goals. Under process goals, London (1999) understood that companies are closely cooperating with all relevant stakeholders during the process, and coercion, threats and other negative interactions have been avoided. Communication among all participating parties should remain flexible as well as open to new ideas. Outcome goals are achieved when negotiations have positive consequences realised either unanimously or in a consensus. The agreements achieved should bring some stability to the negotiations by lasting for a certain time. Continuously striving to improve interpersonal competencies as well as establishing a group identity with a certain common interest is also necessary for continuing, positive, long-term relationships that will withstand future deals and disagreements. In general, maintaining respect for all involved stakeholders and a diplomatic stance as well as being approachable to fellow negotiating parties pays off for companies.

MNCs in developing countries and conflict-prone zones

Globalization of trade and investment has changed the nature of relations between states and brought new players to the stage regarding the market economy, namely MNCs (Banfield et al., 2003). In developing countries and conflict-prone zones especially, there are inherent difficult characteristics to handle, such as major foreign investment, weak legal frameworks and governance structures, which confront foreign investment firms with inevitable grievances when planning to launch a new venture there (Valente & Crane, 2010). Those characteristics differ in intensity, since they are highly contextual, industry- and company-specific (Banfield et al., 2005; Macnamara, 2012). Therefore, this study is based on the understanding of developing countries and conflict-prone zones as countries or regions that are already at risk or obviously becoming subject to non-violent and violent conflicts in terms of civil wars or on a more localized stage (Banfield et al., 2003). Recently, light has been shed on new types of conflicts, moving away from the idea that conflicts happen between states towards more intra-state or internal conflicts (Sidibe & Sane, n.d.). MNCs offer valuable aspects such as credibility, neutrality, resources, and legitimacy and have an extensive reach that makes them receptive to taking on a role connecting them to issues of peace and security, traditionally the preserve of state sovereignty as well as national identity these days (Banfield et al., 2003; Tripathi and Gündüz, 2008). As the former Secretary General Kofi Annan once stated, “At a time when more than 1 billion people are denied the very minimum requirements of human dignity, business cannot afford to be seen as the problem” (Valente and Crane, 2010). This quote once again makes clear that MNCs must take on a new role that not only includes the idea of following their own business goals but goes beyond that to consider other stakeholders’ positions and needs and to take responsibility for their actions in the foreign context.

There are two ways that MNCs can act in foreign contexts. On the micro-level, they are responsible for all impacts derived from their corporate operations and their relationships with foreign authorities and society. A negative example is the exploitation of natural resources in poor regions. Investment in such a valuable resource leads to grievances within a certain region rather than promoting development for all stakeholders. This situation is also related to the “Dutch Disease”.

When looking at the macro-level, international companies focus on including the foreign contexts’ economic and natural environments as well as political impacts and their own business performance but in collaboration with relevant stakeholders in the region. An illustrative example for the macro-level is the provision of resources in combination with the support of MNCs to build a medical center in a developing country or conflict-prone zone rather than just donating money to the society. Such actions go beyond traditional philanthropy and corporate social responsibility and hence place MNCs in quasi-governmental roles in cooperation with other stakeholders, taking major decisions about public welfare and social provision (Valente and Crane, 2010).

Recent research took a closer look at the different relationships MNCs have with different foreign authorities when doing business abroad (Banfield et al., 2003). The present study added results about the relationship between MNCs and the local security services in the respective foreign context. This type of relationship is one of the most important ones when it comes to generating soft power. To
strengthen the ties between MNCs and the foreign authorities, MNCs can attend joint trainings of their security service, grant assistance programs, or involuntarily assist repressive governments by providing them and the security service with certain supplies. Knowledge about military psychological operations is important to influence foreign authorities’ behavior. In other words, MNCs have to interpret deception or disinformation-related issues in the right way to uphold a good relationship with the local security services. The local security services may also try to apply wartime tactics in situations that seem ambiguous. As a result, potential danger may evolve when actions are interpreted in the wrong way. A wide array of grievances may also arise when the company management and the local security services must work together. In many cases, MNCs are not allowed to choose their own security services and are compelled to contract security services from the government. The governments of many developing countries are rather repressive, and their politics may not be democratic. This can have a spillover effect on the security services provided, resulting in violations of the rights of local citizens while protecting the international company. In summary, this study aims to conflate business diplomacy and MNCs in foreign conflict-prone contexts. Business diplomacy is a vital instrument used by MNCs to master the micro- and macro-level challenges they may face in developing countries and conflict-prone zones. Research has found evidence of principled leaders of MNCs who acted as diplomatic actors, but has not addressed what processes they went through (Melin, 2016). Therefore, the present study focuses on exploring how international companies take on their new role to achieve their business goals without contributing to local tensions. The main research question then reads:

“How do principled leaders manage their company’s business successfully by conducting business diplomacy in developing countries and conflict-prone zones?” as illustrated by Figure 4. It is proposed that MNCs have a certain stakeholder management strategy, which represents actions and tools of business diplomacy and hence has an impact on the business performance in the foreign context. The next sections draw on the theoretical background just discussed and points out what relevant choices are made to transform the theory into practice.

**Research methodology**

**Research Method**

Choosing the right research design leads the way to translating the theoretical part into practice. Nowadays, MNCs have to explore possibilities for meeting their policy goals as well as business targets in developing countries and conflict-prone zones because most developing economies are still situated within weak regulatory, institutional and governmental frameworks that hamper MNCs. For that reason, this study used grounded theory,
which was invented by Glaser and Strauss in 1967 and basically means discovering theory from data (Babbie & Mouton, 2001, Glaser & Strauss, 2009). In other words, it is a “general methodology for developing theory that is grounded in data systematically gathered and analyzed” (Strauss & Corbin, 1994). Through actual research, meaning a continuous interplay between analysis and data collection, the researcher is able to derive a theory (Strauss & Corbin, 1994). To justify this choice of using grounded theory, two aspects need to be clarified. For one thing, this methodology is appropriate regarding the present study because the research into MNCs conducting business diplomacy in the context of developing countries and conflict-prone zones is still in the early stage of development. Second, grounded theory supports the goal of this study, which is to come up with a theory on how principled leaders manage their companies’ business by behaving diplomatically in an unstable foreign environment. There are also two weaknesses of grounded theory that must be considered. First, the theory that will be generated might be overly complex since research on this topic is still new.

Second, results from a later analysis might be too narrow and represent a rather idiosyncratic setting (Eisenhardt, 1989). The qualitative analysis process was conducted as follows. Data were collected by means of nine semi-structured telephone interviews, since there is not much coherent theory about how exactly principled leaders manage their stakeholder’s interests to pursue successful business in developing countries and conflict-prone zones. The interviews allowed the researcher to get in touch with a sufficient number of principled leaders spread around the world in different foreign contexts. Such a qualitative approach offered the chance to observe the phenomenon under study substantially and to create a deeper understanding of it (Babbie, 2001). It also improved the validity in comparison to any kind of survey and led to rich, in-depth insights. Semi-structured interviews offered an initial direction due to some pre-determined questions but then left each interviewee the opportunity to provide additional relevant and valuable information. In this way, all the different categories that make up the concept of business diplomacy discussed in the previous section could be reflected much more accurately. The semi-structured interviews in general took around 30 to 60 minutes, and a transcribed version was checked by each respective interviewee afterwards.

**Research sample**

The research sample for this study was drawn from nine semi-structured telephone interviews conducted between October 2016 and April 2017. All selected MNCs met the following criteria: (1) being an internationally oriented company, and (2) operating in a developing country or a conflict-prone zone.

A wide range of developing countries and conflict-prone zones were covered by this research, namely the Niger Delta area, Nigeria, South Africa, Kenya, Honduras, Senegal, Moldova, Guatemala, Colombia, Bukavu (Central Africa), Congo, Sierra Leone, Rwanda, Russia, Ukraine, Belarus, Moldova. This allowed us to interpret and draw conclusions over a wide range, which does not imply that the research findings can be generalized. The selected MNCs operated within the following six sectors: machinery, oil and energy, farming, public policy, banking, and oil and gas. For the sake of all interviewees, it was decided to keep their name as well as their company anonymous.

Then a theoretical case selection with regard to the interviewees was made. The researcher looked for those employees in the position of principled leaders, who are also called business diplomats, since they were the ones who made difficult decisions, resolved conflicts, and negotiated deals on behalf on their MNC. The unit of analysis remained the MNC, since principled leaders acted on behalf of the MNC they were working for. To select potentially interesting MNCs, this study started by screening trade mission documents as well as stock exchange lists from the Netherlands and Germany.

Additionally, the world’s largest professional network, LinkedIn, provided a great opportunity to contact those international company representatives from companies doing business in developing countries and conflict-prone zones.

Once the conduct of semi-structured telephone interviews was complete, the raw interview data needed to be organized, coded and analysed. The present study turned the raw data into meaningful data by assigning every interview transcript to two people who analyzed them independently of each other. This process effectively avoided the possibility of researcher bias. The conceptual model from section two was used here. Every concept was coded by a different color. Everything said by an interviewee that was related to the category of a company’s general situation in the foreign context was marked blue. The category of main stakeholders was highlighted yellow; main challenges a MNC faced in a foreign context were colored red; business diplomacy on the organizational level was shaded purple; tools of business diplomacy were marked green; and finally business diplomacy on the employee level was shaded orange. An overview of this in combination with the main interview questions can be found in the appendix (see Table 4). Once the categories were classified, the theory was built by means of connecting and interrelating data.

All cases were compared on the basis of each color code (each representing one concept of interest), making it possible to look for similarities and differences between the interviews. It was decided to grant all interviewees privacy
through total anonymization, since more than half of the interviewees did not want to disclose any names. With prepared and managed interview data, the researcher was then allowed to start interpreting it, creating explanatory accounts as well as providing meaning for the main research question.

The following section gives an overview of the results from the analysis regarding the nine semi-structured telephone interviews conducted with relevant business diplomats from MNCs that were present in developing countries and conflict-prone zones.

**Research findings and discussion**

Results were taken from nine semi-structured telephone interviews conducted in the period between October 2016 and April 2017. All selected MNCs met the following criteria: (1) an internationally oriented company, and (2) operating in a developing country or a conflict-prone zone. A wide range of developing countries and conflict-prone zones were covered by this research, namely the Niger Delta area, Nigeria, South Africa, Kenya, Honduras, Senegal, Moldova, Guatemala, Colombia, Bukavu (Central Africa), Congo, Sierra Leone, Rwanda, Russia, Ukraine, Belarus, Moldova. This allowed us to interpret and draw conclusions over a wide range, which does not imply that the research findings could be generalized. The nine MNCs operated within the following different six sectors: machinery, oil and energy, farming, public policy, banking, and oil and gas. For the sake of all interviewees, it was decided to keep their name as well as their company anonymous.

This section starts with the information interviewees gave about their company’s general situation in the respective foreign context. The next part outlines the most important stakeholders that MNCs must consider while doing business in a developing country or a conflict-prone region. The third part discusses the main challenges these MNCs encountered in the past. Subsequent parts consider business diplomacy from different perspectives. The last part examines advice given by interviewed business diplomats to others who plan to launch a new venture in developing countries and conflict-prone zones.

**MNCs in developing countries and conflict-prone zones**

Interviewees described the situation of their company while working in developing countries or conflict-prone zones. There were many different foreign contexts mentioned during the interviews. In this way, the first step for other companies was provided as they can get an idea of what a successful business looks like in such environments. Most of the interviewees had practised business diplomacy for a long time on behalf of their companies, making them good role models for other businesses that want to launch a new venture in an exciting and difficult context.

Recalling sub-question one, “What are the general situations of successful business diplomats and their companies in developing countries and conflict-prone zones?”, it can be answered as follows. As stated by one of the interviewees, companies did not play a crucial role in the past when it came to mitigating and solving conflicts. This has now changed. In many developing countries and conflict-prone zones, the companies’ clients did not possess the knowledge and experience in implementing projects according to international standards. This along with weak governance structures in those areas were the main reasons why most of the MNCs focused their investments and business goals on developing countries and conflict-prone zones.

The degree to which business diplomats and employees conducted business diplomacy depended greatly on the type of industry and the goal of the respective company. To give an example, back in 1995 a brewery in Bukavu, the Democratic Republic of the Congo, somehow always continued working, even in an environment characterized by violence and expulsion. It was not known whether and to what extent the brewery was involved in humanitarian aid situations, but for some reason the company was able to operate despite the problematic circumstances in that area. The best explanation was that all actors in Bukavu had an interest in being provided with beer. We can conclude that fulfilling special interests allows companies to operate even in difficult conflict-prone situations as long as they are needed and this is communicated properly among all stakeholders.

Another interviewed business diplomat emphasized that many aspects of business diplomacy need to be studied, prepared for and planned before the actual launch of a new venture. In other words, only after proper preparation and analysis were employees supposed to take action on foreign grounds on behalf of their companies. This was supported by the fact that companies very often failed to deliver their business, their product and their services even if their products were perfectly marketed and sold in Europe, simply because they were not familiar with the foreign context and in turn failed to comply with the framework of business diplomacy.

Almost every interviewed leader was acquainted with the term “business diplomacy”, and most of them practised it on a daily basis. But if businesses really want to operate successfully in such environments, the company and all its employees must conduct business diplomacy consciously. That is why all of the interviewees live and breathe diplomacy, and not just during working hours.

**Relevant stakeholders**

Since companies differ in size, business goals and their operative sector, there is no one-size-fits-all group of stakeholders that every company should consider when
launching a new venture in a developing country or conflict-prone region. Nevertheless, sub-question two, “Who are the main stakeholders that successful business diplomats deal with in developing countries and conflict-prone zones?”, can be answered by the following list of the most important stakeholders mentioned during the interviews:

1. state security apparatus,
2. local community,
3. NGOs in the field,
4. local government,
5. foreign local media/international media,
6. clients,
7. employees of the company itself
8. embassies,
9. local authorities (e.g. national and central banks),
10. illegal groups,
11. competitors of the company itself,
12. brokers between the company and the client,
and
13. the United Nations of course.

It is not necessary to stay in contact with all of the above-listed stakeholders. In fact, every company planning to do business in a developing country or conflict-prone zone must figure out during a proper preparation (discussed in the last section in detail) which stakeholders are relevant to make the business a success.

Referring to the theory part, the relationship between MNCs and the local military or the local security service is one of the most important ones. During the interviews, it appeared that the military and local security services can step in and bring stability, especially in developing countries and conflict-prone regions with little control. What this looked like in practice is elaborated in the section dealing with research findings about tools of business diplomacy.

Another stakeholder group element that was stressed in the different interviews was the contact with embassies. Most of the interviewed principled leaders stayed in close contact with them and said that embassies are extremely helpful for them when it comes to making first contact with a foreign country. Embassies possess a great deal of information and an established network of important stakeholders ranging from government officials to society representatives. Interviewees emphasized that embassies were always willing to help business diplomats with an entrepreneurial vision by inviting them to events such as trade fairs, but usually the business diplomats had to approach the embassies first. It was rare for embassies to send out invitations or make contact with employees of MNCs in the first place. One of the interviewees had a business in Honduras, where it was not that easy for him to establish any business relationships since the Dutch government did not have its own embassy there. Luckily, there was one in Costa Rica which could provide information and contacts which led his company to success in Honduras. Another interviewee had had a totally different experience and explained that he did most of the contact with his stakeholders directly, but embassies were one of his focal areas.

Main challenges

Another interesting aspect was figuring out what made it so difficult for MNCs to be successful in a turbulent foreign environment and how successful ones dealt with such situations in the end. The three most important answers to sub-question three “What are the main challenges that successful business diplomats face when launching a new venture or operating in developing countries and conflict-prone zones?” were: (1) culture, (2) being blocked by the government, and (3) illegal groups.

To begin with, most of the interviewees mentioned three sensitive issues that every MNC should avoid: (1) do not discuss politics, (2) do not discuss religion, and (3) do not discuss ethnic issues. Taking Ukraine as an example, one company supplied its clients with machines for destroying money and had to deal with the Central Bank of Azerbaijan and the Central Bank of Armenia, since both of them were the company’s customers. The clients were aware that the company was doing business with the other client, which meant the MNC had to be careful not to share information about each project. If any information of its clients had been leaked, barriers and mistrust could have resulted, leaving the MNC without a business relationship with those clients in the future. That is why business diplomats did not make any of the three sensitive issues part of the business itself.

Culture

For most of the interviewed principled leaders, making contact with local stakeholders and authorities as a foreign company was difficult, because local people were culturally different. It was pointed out that culture consisted of two aspects, with language accounting for 20 percent of the barrier and customs, habits and body language accounting for 80 percent. Language barriers could be taken care of by hiring an interpreter to support the business partners with communication. However, the other 80 percent of the barrier and most of is communication happened through body language when the business partners met. Giving a simple example, one of the western business diplomats once tried to shake hands with a business partner originating from the Middle East, which was normal in western society but not in the Middle East. This example shows clearly how easy it is to ruin a business relationship before it has even started.

These days, most of the MNCs operating in developing
countries or conflict-prone regions have American or European expats in their high-level management positions, which makes the whole approach a bit easier for those principled leaders who need to conduct business in the foreign region. One way to tackle this challenge is to educate the company’s employees with an in-depth culture course. In particular, employees can be taught different perspectives considering the dos and don’ts about foreign habits, language, politics, literature, sports, history and food. Unless the employees of such MNCs absorb such information and work in the cultural reality of the certain country or region, their life will be difficult.

In contrast, one of the principled leaders did not think of culture as a main challenge for a company launching a new venture in a developing country or conflict-prone region. He supported this by stating that his company did business with every country regardless of differences in religion or other cultural aspects. This perspective might be an option with cultures that are not overly sensitive to foreign impressions in the first place.

**Being blocked by government**

Local governments still have a lot of authority in unstable regions, even those with rather lethal and weak governance structures. Dealing with corrupt governments represented one of the three main challenges for a company entering this specific country or region to do business. Governments decide, for example, whether a company can be registered to do business legally in that area or not. Governments also dictate that foreign companies must comply with certain rules, such as having a local office and employing local people. This was indeed something that blocked foreign MNCs from launching new ventures successfully. In the end, every company must be clear about whom it must deal with and whether there are exceptional cases when business diplomats can find ways to work around those blocking rules.

**Illegal groups**

Illegal groups also pose a challenging start for foreign MNCs wishing to expand their business in those areas. Most companies arrive in the developing country or conflict zone with a huge underestimation of the local situation. Business diplomats noted that other MNCs failed to provide enough resources such as qualified people, financial support, skills and materials when encountering illegal groups, because most of the time those illegal groups tried to gain the local community’s trust by turning them against the company’s project. MNCs are advised to prepare their principled leaders with relevant resources to prevent them from walking straight into the trap. If there is no proper preparation and support for business diplomats, the process and the outcome goals are very unlikely to be achieved, which in turn leads to low levels of power and legitimacy and ends with great difficulty in recouping any investment and, apparently, no future perspective.

**Business diplomacy on the organizational level**

Regarding sub-question four, “To what extent are any policies introduced within successful operating companies that address [diplomatic] relations with important stakeholders in developing countries and conflict-prone zones?”, most of the interviewed principled leaders did not provide clear information about how business diplomacy was established in their companies, with written or official documents. This also had to do with the size and vision of the respective company. Most of the principled leaders stated that they and all other employees understood company ethics and followed guidance policy books or project-stakeholder strategies, covering all practices and guiding the way in which they approached and maintained relations with all regulatory stakeholders. Those strategies and guidelines were there to build trust and effective communication, representing two vital parts of business diplomacy. The reverse was also found, when foreign companies got involved in the local authorities’ framework by complying with certain standards to obtain a license to operate.

Some MNCs were bound to external performance standards such as the International Finance Corporation Environmental and Social Performance Standards predefined by the United Nations. In fact, it was not always clear how companies needed to implement them, so it was up to the business diplomats themselves to work out the best way possible. This is also related to one of the challenges mentioned above, namely being blocked by the government. If business diplomats failed to comply with those rules and standards, their license to operate could be revoked or the company could be sanctioned by the government or other higher authorities. Therefore, business diplomats are seriously advised to research applicable regulations and policies that the company may be expected to comply with.

**Tools of business diplomacy**

Regarding the tools of business diplomacy, the following section answers the question of “What tools do successful business diplomats use to seek [diplomatic] relationships with relevant stakeholders in developing countries and conflict-prone zones?”.

From the interviews, it appeared that adopting and using a certain set of tools facilitated building new, positive and long-term relationships with local authorities. This was essential for every company striving to do business in developing countries and conflict-prone regions. A variety of indispensable tools were mentioned by the interviewed leaders.

For example, MNCs mainly had educated, intelligent and open-minded people employed in the vital positions.
They spoke the language of business as well as the local foreign language and were familiar with the local habits. The ultimate goal was to employ principled leaders who understood the foreign context and who could navigate from the communities through the state to the market. This of course demanded in-house training before the business diplomats entered a new and unstable market.

A good reputation was mainly seen as an advantage, since it facilitated access and proved the company’s reliability to clients as well as other stakeholders. The key to a good reputation is the perfect quality of the company’s product or service which had been established successfully in other markets, like their home market.

In contrast, one of the business diplomats reported that a good reputation also had a downside because it preceded his company and him as the one in charge when he entered the developing country or conflict-prone region. To put it differently, companies with a good reputation had to be especially careful when they worked on their network in the destination country, since people who knew the company were already trying to use it to make money themselves. It rather helped to be unknown to the locals so the staff could prove how good the company’s business really was. Thus, the type and goal of each company influenced to what extent their good reputation was helpful in building up a new business in a complex and foreign context. The wish to develop and gain knowledge of the foreign business environment played a crucial role here, too.

Using and dealing with international media were mentioned as another important tool of business diplomacy. To include media channels in the company’s business processes had a positive effect on spreading information about its vision and achievements, for example. What business diplomats always considered with this tool was that media channels are difficult to control and do not always display the real facts. Hence, using public media was an option, but it usually depended on the type of business as well as on the foreign government and its regulations. Some companies even decided to deal with local hosts more personally, and spread news and announcements around themselves instead of using public media channels. In this way, MNCs could share information more effectively in terms of building positive and long-term transparent relationships than public local and international media channels would have done. Eventually, business diplomats became familiar with handling media channels and were supported by an organized team of employees experienced in journalism to deal with those aspects appropriately.

One of the best tools regarding business diplomacy was showing true interest in co-developing the local people’s life while launching a new venture in their specific area. To give an example, the company supplying money-destroying machines told its clients that their country and communities benefited from buying these machines as they also took care of the environment by sticking to their clean banknote policy. In turn, this resulted in having clean banknotes circulating in the host country, which was a good image for the country itself. All interviewees highlighted that their companies went abroad with a long-term goal and therefore ensured that local communities also got a piece of the business pie generated from the resources that belonged to the community. Related to the data from the Edelman Trust Barometer mentioned earlier, an interviewee stated that showing true interest in the people’s and country’s success is the beginning of the success chain as it builds trust, which in turn leads to the communities expecting MNCs to act as surrogate governments when local governments fail. With trust, business diplomats can generate power as well as legitimacy, which in turn helps them to achieve process and outcome goals and finally results in success.

In addition, all principled leaders stayed in close contact with local mediators, helping them to get necessary insights into society’s needs and possibilities, with the side effect of building trust among all project partners. Most principled leaders were flexible and used corporate social responsibility policies to engage and strengthen such relationships. In fact, locals were employed where possible, which in some cases resulted in a tripartite agreement between the company, the state security apparatus, and the local community. Local stakeholders had the company’s business and employees monitored and secured against any other threats such as illegal groups. So, it was a win-win situation for the MNCs and the country and its people.

Finally, every business diplomat established a supportive stakeholder network that every business diplomat must forge to gain a foothold in the foreign country or region. Such a network of important string-pullers helps to gain access to other important stakeholders and granted business diplomats the vital information of knowing who was who, where the debate was going, and whom to contact first to get the business done successfully. Part of that were so-called facilitation centers that smoothed business processes to a great extent. Such centers were vital assets helping business diplomats by informing them about the situation at stake, health issues, applying for the right visa and so forth. Working together with such a facilitation center saves time and money that companies would have invested in figuring out all these aspects.

**Business diplomacy on the employee level**

Business diplomacy on the employee level again depended on the history and size of the respective company and the sector it was working in. Sub-question six, “To what extent are any employees specially assigned to deal with [diplomatic] relationships with important stakeholders when launching a new venture or operating in developing countries and conflict-prone zones?”, was answered with
two main trends that appeared during the interviews:

(1) MNCs employed a moderately large team where tasks were divided by stakeholder groups; and

(2) MNCs employed just one person who was responsible for an entire geographical area including all kinds of stakeholders.

Regarding the first trend, an interviewee explained that by assigning certain people to certain stakeholders, it was easy to maintain good and positive relationships with them. This means one employee was dealing only with NGOs, another was handling public affairs, yet another one was the management issue advisor, and one employee was dedicated to dealing with the press. Altogether, a collaboration within a team like this made every project a joint effort.

In contrast, there were also companies that followed the line of employing one person (called a regional manager, an environmental manager, a business developer) or even the CEO working together with a local liaison officer instead of a whole team. One of the principled leaders stressed that this allowed a better transfer of the company’s aims and objectives for the project to the local community.

Business Diplomacy Framework Matrix

The business diplomacy framework matrix (see Table 5, p. 25) was developed to answer the last sub-question, “What can be learned from the experience of business diplomats who already conduct business diplomacy successfully in developing countries and conflict-prone zones?” In particular, this section reveals advice interviewees gave regarding the topic that was not directly covered by the main interview questions. Each advice is a type of analysis and an associated action.

One of the first things that future business diplomats should do is check the following aspects by conducting two related types of analysis. Business diplomats should perform a environmental scan, to investigate the host country’s politics, economy, society, technology, legal framework and environment. Part of that includes making sure that all employees undergo training about the host country’s language, habits, history, sports, religion, food. Furthermore, and especially related to the environment, business diplomats must ensure that all employees working in the developing country or conflict-prone zone are familiar with the conflict setting. This includes abduction training and diplomatic behavior lessons, for example.

As a next step, it was recommended to conduct a SWOT analysis, to investigate the strengths, weaknesses, opportunities and threats of the developing country or conflict region. The SWOT analysis encompasses an evaluation of the company’s business risk, a list of all relevant stakeholders and how they can contribute to the company’s support network, a definition of the company’s business goal, followed by the positive impacts the company brings with it for the host country and its people. All these steps are essential for a thorough preparation that addresses all possible obstacles regarding the company’s business success.

Business diplomats should also have a good understanding of what is to be expected from the launching of the new venture in the respective foreign setting. This means knowing whom they have to deal with and what the aspects, regulations and standards are that they have to obey, and includes taking care of the legal aspects, visas and health issues for employees. Having established the company’s support network, business diplomats should draw on state-owned or private security services located in the host country or region to guarantee the employees’ safety at all times.

Interviewees recommended applying a value-chain approach, meaning that business diplomats who are in charge of the company’s operation should be aware of who their business partners, suppliers and customers are. This provides transparency to all stakeholders and ensures that the whole process proceeds according to the regulations and complies with the International Anti-Corruption and Anti-Bribery Act. It means business diplomats can do business without the fear of running into any hidden accusations or lawsuits.

In summary, the main research question of “How do principled leaders manage their company’s business successfully by conducting business diplomacy in developing countries and conflict-prone zones?” can be answered by a combining all of the aspects above. In other words, successful principled leaders were prepared and researched the company’s new venture setting to minimize risks and maximize opportunities. The Business Diplomacy Framework Matrix is a first step and at the same time a checklist towards properly launching a new venture in developing countries and conflict-prone regions. In particular, the complexity and the unfamiliarity of the foreign setting make it very important to prepare and learn about all the dos and don’ts to be successful.

The next section provides a conclusion accompanied by recommendations for future research on business diplomacy in the context of developing and conflict-prone regions.

Conclusion and future research

Conclusion

The nine business diplomats, who all worked for MNCs, investigated and practised business diplomacy to different extents. The data from the interviews with business diplomats from different MNCs revealed that
Applying business diplomacy is inevitable these days for MNCs, especially when launching ventures in developing countries or conflict-prone zones. The data helped to answer all sub-questions and the main research question by developing the Business Diplomacy Framework Matrix. In theory, the matrix encompasses all necessary steps that business diplomats must take care of before the actual launch happens. The interviewees’ experiences revealed that principled leaders face certain challenges and manage their company’s and stakeholders’ needs and demands by conducting business diplomacy. Performing business diplomacy and using its tools provided them with soft power and hence with a legitimate license to operate in the respective developing country and conflict-prone region. Gaining soft power and a legitimate license to operate allow smooth realization of the company’s process goals and outcome goals with its stakeholders. This resulted in a successful performance of the MNCs with a minimized business risk and a possibility to establish a positive and long-term relationship in the host country.

In summary, it can be stated that developing countries and conflict-prone regions were and still are promising destinations for MNCs who plan on expanding their business. Such a setting is not comparable to European markets and must not be underestimated.

**Future research**

For the present study, semi-structured telephone interviews were conducted. Using grounded theory made it possible to explore the existing concept of business diplomacy by adding data from business diplomats in a totally unexplored setting, namely developing countries and conflict-prone zones. Data and the permission to disclose information about the MNCs were limited to the extent that no names and no in-depth knowledge of specific cases could be revealed.

Future research should confirm those experiences and the steps outlined in the Business Diplomacy Framework Matrix. This can be done by researching a wider array of MNCs who are active in developing countries and conflict-prone regions. Surveys or interviews with actual stakeholders of MNCs investing abroad offer relevant insights and understanding of what might be expected from them. This might serve as an eye-opener to business diplomats who failed to launch a new venture in such a complex setting.

Apart from that, we recommend building a support network for the researchers of this topic and offer the possibility also to MNCs who are interested in learning about business diplomacy. This can be realized by means of a World café, where MNCs are invited along with government officials, NGO representatives, and other stakeholders.

**References**


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Sidibe & Saner (n.d.). *Business Diplomacy in Emerging markets: Intersection of Roles between States and Multinationals*.


<table>
<thead>
<tr>
<th>Type of analysis</th>
<th>Action</th>
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<tbody>
<tr>
<td>PESTLE analysis → Socio-cultural factors covered → Preparation</td>
<td>✓ Make sure all employees undergo training about the target country/zone (including language, habits, history, sports, religion, food)</td>
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<tr>
<td>PESTLE analysis → Political, Economic, Socio-cultural, Technological, Legal, and Environmental factors covered → Preparation</td>
<td>✓ Make sure all employees are familiar with the conflict setting</td>
</tr>
<tr>
<td>PESTLE analysis → Socio-cultural factors covered → Preparation</td>
<td>✓ Make sure all employees behave in a diplomatic way regarding stakeholders</td>
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<td>SWOT analysis → Threats → Preparation</td>
<td>✓ Make an evaluation of the company’s business risks when launching a new venture in the target country/zone</td>
</tr>
<tr>
<td>SWOT analysis → Opportunities and Threats → Network</td>
<td>✓ Perform a stakeholder analysis</td>
</tr>
<tr>
<td>SWOT analysis → Strengths</td>
<td>✓ Define the company’s goal by launching this new venture (short-term or long-term perspective?)</td>
</tr>
<tr>
<td>SWOT analysis → Opportunities</td>
<td>✓ Define positive impacts the company’s work might have for the target country/zone</td>
</tr>
<tr>
<td>SWOT analysis → Opportunities → Network</td>
<td>✓ Contact the company’s own government/embassies for information and support</td>
</tr>
<tr>
<td>SWOT analysis → Opportunities → Network</td>
<td>✓ Contact people/companies/authorities related to your industry in the target country/zone</td>
</tr>
<tr>
<td>SWOT analysis → Threats → Preparation</td>
<td>✓ Make a list of competitors who are also active in the target country/zone</td>
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<tr>
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<td>✓ Contact people/companies/authorities associated with legal matters in the target country/zone</td>
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<tr>
<td>SWOT analysis → Opportunities → Network</td>
<td>✓ Contact people/companies/authorities regarding immigration in the target country/zone</td>
</tr>
<tr>
<td>PESTLE analysis → Legal factors covered → Preparation</td>
<td>✓ Make sure all employees have the right visa</td>
</tr>
<tr>
<td>PESTLE analysis → Legal factors covered → Preparation</td>
<td>✓ Make sure all employees are provided with the right health matters (e.g. vaccinations)</td>
</tr>
<tr>
<td>SWOT analysis → Opportunities → Network</td>
<td>✓ Contact security services (state-owned or private)</td>
</tr>
<tr>
<td>Business design</td>
<td>✓ Apply a value-chain approach to grant transparency to all stakeholders</td>
</tr>
<tr>
<td>PESTLE analysis → Political and Legal factors covered → Preparation</td>
<td>✓ Comply with the International Anti-Corruption and Anti-Bribery Act</td>
</tr>
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</table>
Appendix

Figure 1: Business vs. Government, percent in trust

![Business vs. Government Chart]

Source: 2016 Edelman Trust Barometer Q1-Q4. Below is a list of institutions. For each one, please indicate how much you trust that institution to do what is right using a five-point scale ranging from 1 (Not at all) to 5 (Great deal). Trust is calculated on a 100-country global scale. Average of all countries.

Figure 2: Business must lead to solve problems

![Business Must Lead to Solve Problems Chart]

Source: 2016 Edelman Trust Barometer Q1-Q4. Please indicate how much you agree or disagree with the following statement: “A company can and should take specific actions that both increase profits and improve the economic and social conditions in the community where it operates.”
Figure 3: Fragile States Index 2015

Table 1: Current Peacekeeping Operations of the United Nations

<table>
<thead>
<tr>
<th>Mission</th>
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<tr>
<td><strong>The Middle East und Maghreb</strong></td>
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<tr>
<td>UN Truce Supervision Organization</td>
<td>May 1948</td>
</tr>
<tr>
<td>UN Interim Force in Lebanon</td>
<td>March 1978</td>
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<tr>
<td>UN Mission for the Referendum in Western Sahara</td>
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<tr>
<td>UN Disengagement Observer Force</td>
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<td><strong>Asia and Oceania</strong></td>
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<td>UN Military Observer Group in India and Pakistan</td>
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<tr>
<td><strong>Europe</strong></td>
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<tr>
<td>UN Peacekeeping Force in Cyprus</td>
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<td>UN Interim Administration Mission in Kosovo</td>
<td>June 1999</td>
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<td><strong>Sub-Saharan Africa</strong></td>
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<td>UN Mission in Liberia</td>
<td>September 2003</td>
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<td>UN Operations in Côte d'Ivoire</td>
<td>April 2004</td>
</tr>
<tr>
<td>African Union-United Nations Hybrid Operation in Darfur</td>
<td>July 2007</td>
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UN Organization Stabilization Mission in the Democratic Republic of the Congo
UN Interim Security Force for Abyei
UN Mission in the Republic of South Sudan
UN Multidimensional Integrated Stabilization Mission in Mali
UN Multidimensional Integrated Stabilization Mission in the Central African Republic

The Americas
UN Stabilization Mission in Haiti

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<th>Critical impact</th>
<th>Significant impact</th>
<th>Limited impact</th>
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<td>Taliban in Afghanistan</td>
<td>Since 1978</td>
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<tr>
<td>Civil War in Syria</td>
<td>Since 2011</td>
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<td>Territorial disputes in the South China Sea</td>
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<td>Tensions in the East China Sea</td>
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<td>North Korea Crisis</td>
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<td>War against IS in Iraq</td>
<td>Since 2003</td>
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<td>Civil War in Libya</td>
<td>Since 2011</td>
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<td>Islamist militancy in Pakistan</td>
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<td>Sectarian conflict in Lebanon</td>
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<td>Islamist militancy in Egypt</td>
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<td>Kurdish – Turkish Conflict</td>
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Violence in the Democratic Republic of Congo Since 1996
Sectarian violence in Myanmar Since 1948
Civil War in South Sudan Since 2013
Islamist Militancy in Russia Since 2009
Al-Shabab in Somalia
Uighur conflict in China
Political crisis in Burundi Since 2015
Balochistan conflict Since 1948 (Pakistan-Iran)
South Thailand insurgency Since 1960
Insurgency in Northeast India Since 1963
Colombian conflict Since 1964
Naxalite-Maoist insurgency (India) Since 1967
CPP-NPA-NDF rebellion (Philippines) Since 1969
Moro conflict (Philippines) Since 1969
Sectarianism in Pakistan Since 1989
Xinjiang conflict (China) Since 1989
Oromo conflict (Ethiopia) Since 1992
Ogaden insurgency (Ethiopia) Since 1995
Communal conflicts in Nigeria Since 1998
Insurgency in the Maghreb (Algeria-Tunisia) Since 2002
War in Darfur (Sudan) Since 2003
Kivu conflict (DRC-Burundi) Since 2004
Sudanese nomadic conflicts (Sudan-South Sudan-Ethiopia) Since 2009
Turkey-ISIL conflict Since 2015
Arab separatism in Khuzestan (Iran) Since 1922
Kurdish separatism in Iran Since 1946
West Papua conflict (Indonesia) Since 1963
Cabinda War (Angola) Since 1975
Internal conflict in Peru Since 1980
LRA insurgency (DRC-CAR-South Sudan) Since 1987
Internal conflict in Bangladesh Since 1989
Second Afar insurgency (Eritrea-Ethiopia) Since 1995
Ituri conflict (DRC) Since 1999
Syrian civil war spillover in Lebanon Since 2011
RENAMO insurgency (Mozambique) Since 2013
ISLI insurgency in Tunisia Since 2015

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Antecedents of Conformity in Multinationality: A Systematic Review of the Literature

Makafui Kwame Kumodzie-Dussey, University of Ca Foscari Venice, Italy

The phenomenon of conformity in multinationality has gained significant attention in the management literature in recent years. It is worthwhile noting that, numerous gaps exist in comprehending firms’ conforming behaviour in multinationality and its consequential performance outcomes. A fragmented array of theoretical perspectives has been adduced by various scholars in their attempt to investigate firms’ engagement in this strategic action particularly in multinationality activities. This paper attempts to consolidate the state of academic research on this phenomenon by reviewing the literature on conformity in multinationality and attempts to offer some framework to comprehend what the theory has said about the antecedents of this strategic behaviour among firms.

Multinationality is a key phenomenon that has attracted quite considerable attention in the international business literature in recent years. It has attracted this attention because it critically interacts with the structure, strategy, functioning, and performance of firms (Kirca, Hult, Deligonul, Perryy, & Cavusgil, 2012). Firms engaging in multinationality, i.e. exploring value adding activities outside their home country can encounter different types of cost when undertaking this endeavour. Examples of sources of such costs are lability of foreignness (Zaheer & Mosakowski, 1997), liability of newness (Lu & Beamish, 2004), coordination and the complexity of managing such multinational enterprises (Kostova & Zaheer, 1999) among others. In order to minimize the cost associated with multinationality the literature suggests that firms conform in multinationality (Giachetti & Spadafora, 2017) to the decisions of industry rivals to reduce the risk and uncertainty associated with this strategic decision (Guillén, 2002; Haveman, 1993; Henisz & Delios, 2001). Our reference to conformity in multinationality is the situation where the multinationality of a focal firm resembles those of other industry rivals (Giachetti & Spadafora, 2017), i.e. when firms deliberately choose to imitate the strategic actions of rivals, specifically, those concerning multinationality decisions. It is worthwhile noting that, this strategic behaviour has gained some attention among International Business scholars, with different studies showing in various ways both theoretically and empirically how firms imitate the multinationality decisions of rivals (Chan, Makino, & Isebe, 2006; Delios, Gaur, & Makino, 2008; Giachetti & Spadafora, 2017; Greve, 1998; Guillén, 2002; Henisz & Delios, 2001; Lu, 2002). This is particularly evident from a preliminary scan of top tier management and business journals which shows a total of 35 studies that have attempted to look at the conforming behaviour of firms when they engage in multinationality. This scan points to the fact that quite a considerable amount of studies examined this phenomenon albeit under various theoretical and empirical considerations, a sine qua non when attempting to undertake a literature review.

A careful view of the theoretical landscape of conformity in multinationality shows that numerous theoretical perspectives which cuts across various disciplines such as economics, organisational ecology, sociology (Lieberman & Asaba, 2006) have been employed in an attempt to comprehend this phenomenon. Some scholars have drawn on institutional theory (e.g., Davis, Desai, & Francis, 2000; Henisz & Delios, 2001), resource based view (e.g., Chang, 1995), learning theory (e.g., Fernhaber & Li, 2010), legitimacy theory, and competitive dynamics (e.g., Gimeno, Hoskisson, Beal, & Wan, 2005) among others to look at the phenomenon. This varying theoretical expositions on firms conforming behaviour in general and its performance implications still remains loosely understood. This substantial gap in our comprehension of what drives firms’ conforming behaviour when engaging in multinationality thus provides the need for a deeper and fine grain analysis of the factors underpinning such decisions. The review therefore seeks to address the question, what are the main drivers of firms’ conforming behaviour in multinationality? To that effect, undertaking this review would afford us the opportunity not to only answer the above question, but to as well direct some attention to this strategic behaviour of firms, since the discussion on firms’ conforming behaviour is largely driven by varying contextual factors, alternate theoretical perspectives and in some cases, inconclusive empirical results.

In the end, this paper contributes in diverse ways to the literature on multinationality and firm imitation. First, we draw on the theoretical pluralism and diverse empirical settings in the extant literature to understand the drivers of firms conforming behaviour in their quest to undertake value adding activities outside their home country. Second, the paper complements previous reviews on imitation (Lieberman & Asaba, 2006; Ordanini, Rubera, &
since it lays specific emphasis on firms’ imitation of multinationality strategies and its performance implication rather than imitation in general as previous reviews have done. Lastly, the paper highlights several avenues to advance the field of study. After setting the tone for this insightful review, the paper is structured as follows. Section One describes the methodological approach i.e. how the journals were selected, the determination of the sample of 35 articles to be included in the review. Next, Section Two presents the general outcome of the review. It illustrates the dominant theories as well the contextual settings used by scholars to explain conformity in multinationality. In our final section, we discuss the implication for theory and provide a research agenda for future studies on conformity in multinationality.

**Method**

A literature review helps map relevant literature to specify a research question with the aim of developing the knowledge base of the field. A systematic literature review deviates from the traditional narrative exposition which often lacks scientific rigor to a more detailed, scientific and transparent assessment of the existing state of studies (Tranfield, Denyer, & Smart, 2003). In addition, it also seeks to avoid biases usually associated with the narrative form of literature review. In order to conduct a successful systematic review, we follow the approach outlined by Tranfield et al. (2003). The authors suggest that once the rationale for the literature review has been adequately satisfied, a three-stage framework can be adopted in undertaking the review. The stages are:

- **Stage 1. Planning the review**
- **Stage 2. Conducting the review**
- **Stage 3. Reporting**

During the planning stage, scoping studies can be done to know the relevance and size of the literature and to set boundary conditions for the subject area and topic. Particularly, the scoping can include an overview of the theoretical, practical and methodological history of the extant literature on the subject matter. Based on these, scoping a review protocol is then designed to set the direction of the study (Tranfield et al., 2003). The second stage entails an unbiased search of the literature for relevant studies based on the protocol designed. The reviewer initially conducts a review of the potential studies in the literature search. Those studies deemed relevant would be retrieved for more detailed evaluation of the text from which more important ones would be selected for the review. The number of studies included and excluded are documented with some justifications provided for the excluded studies (Tranfield et al., 2003). Lastly, the third stage which is the reporting stage synthesises the outcome of the review based on the protocol that was designed at the genesis of the review. A ‘thematic analysis’ of the review should be reported. The review report can focus on the extent to which some consensus is reached across various themes or identify emerging themes in the extant literature (Tranfield et al., 2003). Since this review seeks to reconcile the divergent theoretical views of the main drivers of firms’ conforming behaviour when they engage in multinationality rather than presenting just the findings of empirical studies, the review would carefully assess literature contributions with important theoretical components. To that effect this review would follow the methodological principles outlined by Tranfield et al. (2003).

**Definition of Boundaries and the Inclusion Criteria**

A great deal of the management literature in general has given considerable attention to the concept of imitation though it is conceptualised from different theoretical perspectives. But it is important to point out that only a sizeable number of these literature streams directly deal with imitation with a vast majority indirectly addressing the phenomenon of imitation (Ordanini et al., 2008). In our bid to better position this study and conduct a review that is meaningful we ought to define the conceptual boundaries i.e. the theoretical and empirical frontiers within which this review is conducted, as suggested by Tranfield et al. (2003) as the premier activity to be considered when one decides to undertake a review. With this consideration in mind we would define the conceptual perimeter of our focal concept: *conformity in multinationality*. In this study, we define conformity in multinationality as a firm-level construct where a firm’s multinationality resembles the multinationality posturing of other industry rivals at one point in time (Giachetti & Spadafora, 2017). We take cognisance of the fact that, the phenomenon of conformity in multinationality can be influenced by other variables at the firm level such as the size and age of the organisation, as well as other exogenous environmental factors (Giachetti & Spadafora, 2017). But our focus would be on the set of broad decisions that are deliberate in firms’ conforming multinationality actions which has broad impact at the organisational level (Rivkin, 2000). Thus, our conceptualisation of conformity in multinationality means it is an intended strategic decision, where a firm receives some impetus of multinationality actions from rival firms and then decides to conform to multinationality decisions of these rivals. With this approach, we are able to delineate this strategic behaviour from the more general isomorphic phenomenon which emphasises a similarity in organisational forms due to the emergence of some shock or the convergence to similar behaviour due to some common external source (Lieberman & Asaba, 2006).

Having sufficiently defined the scope within which this review is undertaken, we proceed to establish some guidelines to complete the review protocol of the analysis.
The literature review would attempt to shed some light on what the extant literature says about the drivers of conformity in multinationality i.e. what are the underlying factors enhancing the propensity for firms to conform in multinationality. After providing the scope for the review we advance to the selection criteria that was employed in selecting the papers for the review. To retrieve the papers that formed the nucleus of this review, first, web of science which provides access to comprehensive literature search was used in retrieving articles. The key words imitation and mimicry were used to capture conformity whilst internationalisation, entry mode, FDI, international expansion captured multinationality, given that the concept of multinationality is a multi-dimensional construct. Second, we then retrieved other papers that have been cited as dealing with the same phenomenon to be included in our literature review once it meets the boundary conditions that where stipulated above. Those that did not meet the criteria set up were excluded from the review, in the end a total of 35 articles was settled on.

**Broad Outcomes of The Literature Review**

After carefully going through the selection process to select the relevant papers that would help us attain our objectives, we proceed to present the results of our initial assessment of the various articles for our review analysis. Various contributions made by different scholars on the imitation of multinationality strategies were classified into the dominant theoretical perspectives that were highlighted in these studies, our review showed that more than one theoretical perspective seemed to provide the basis for the conforming behaviour of firms as they engage in multinationality. We would like to point out that these theoretical perspectives were not mutually exclusive in how we categorise them. In such cases where more than one theoretical view was espoused, we decided the classification based on the dominant theoretical approach adopted in providing explanation for this phenomenon. Although we do admit some of the papers do show some significant link between the varying theoretical views used in explaining the phenomenon, we opine that our method of classification affords us the opportunity and possibility to properly categorise the papers. This would significantly aid in our reporting outcome since we can thematically map out the findings of our study and adequately identify areas where further scientific inquiry would be of essence.

**Conformity in Multinationality Main Theoretical Perspectives**

**Neo institutional perspective**

Neo institutional theory (NIT) is a well-established theory which emanated from institutionalism (Szelnick, 1949). Later, Meyer and Rowan (1977) as well as DiMaggio and Powell (1983) provided some very strong theoretical and empirical foundation for this theory. The basic argument of neo institutional theory is that organisational behaviour occurs as a response to some social pressure emanating from the environment created by other organisations (Suddaby, Seidl, & Lê, 2013). The theory thus gained popularity because of its use of social considerations in its attempt to provide some explanation for firm behaviour rather than rational economic justifications (Suddaby et al., 2013). The use of non-economic explanations for firm behaviour which deviates from classic economic theory, but rather the socially constructed beliefs that the organisation may have formed from its environment seems to suggest that organisations might undertake certain practices not for performance implications only but also for legitimacy effect as well. Thus, certain organisational practices may be adopted or diffused through a population regardless of whether it has performance implications or not (Tolbert & Zucker, 1983). DiMaggio and Powell (1983) contributed to the advancement of the NIT theory by introducing the concept of *isomorphism*, through which they argue that organisations converge in structure and process when the organisational fields within which they exist become more structured i.e. institutionalised. They further suggested that, three main institutional forces shape the organisational field which leads to isomorphism. First, the one that emanates from political influences (coercive isomorphism); second, responses to uncertainty (mimetic isomorphism), and lastly the ones associated with professionalization (normative isomorphism). With mimetic isomorphism, uncertainty is the predicator of such isomorphic behaviour. When organisational goals are blurred, leading to some form of symbolic uncertainty, it turns out to be a powerful force for imitation. To that effect, organisations then tend to model themselves onto others (imitate) as a response to this uncertainty (DiMaggio & Powell, 1983). Ordanini et al. (2008), was quick to point out that with mimetic isomorphism it can be argued to be a form of imitation, since there is a deliberate action by organisations to overcome the uncertainty that has riddled the organisation. But same cannot be said for the other forces of isomorphism since firms can behave similarly and look alike or be isomorphic because they belong to the same environment and need to adapt themselves to survive, even without a deliberate action to copy the strategic behaviour of others, as exemplified in the study of Davis et al. (2000).

The general thesis of mimetic isomorphism has been employed by scholars in the international business arena to study firms’ conforming behaviour i.e. the extent to which a firm’s multinationality resembles those of other industry rivals. Lu (2002) in her study of Japanese firms’ entry mode
choices found support for memetic isomorphism by showing that later entrants tend to follow the entry mode choices of earlier entrants, with uncertainty about the market playing a key role in this conforming behaviour. Similarly, Henisz and Delios (2001) also adopted the neo institutional argument to explain FDI decisions and plant locations choices by Japanese firms, and consequently found support for firms’ conforming behaviour, employing the memetic isomorphism framework. Guillén (2003) also found that business group association did play a role to the extent that firms conform to the multinationality posturing of group members. Haunschild and Miner (1997) employed the institutional argument to offer explanation for firm’s imitative action in multinationality. Similarly, the institutional perspective was used to explore the driving force for internationalisation by F. Li and Ding (2013), who also found that mimetic isomorphic pressure plays a role in firms’ internationalisation intensity. In De Beule, Somers, and Zhang (2018) study of Chinese location decision of greenfield investment into Europe, the authors found that Chinese firms follow other Chinese firms in the same sector thereby giving credence to the neo institutional perspective. In all these studies uncertainties about the outcome of such multinationality actions seems to be the motivation for such conforming behaviour in multinationality.

Organisational learning perspective

The organisational learning theory suggests that firms may learn from the experience of others (Levitt and March). This theory has also contributed to studies of inter-organisation imitation by suggesting that firms may be able to leverage on the experience of other organisations to make decisions. Using the key arguments from the organisational learning theory Oehme and Bort (2015) found that firms imitate the internationalisation mode of peers that are located within their network with the propensity to imitate contingent on two main factors, namely, the firm’s past experience and its position in the network it is embedded in, with this imitative action serving as a shortcut to the hitherto known, planned, or experience-driven approach to multinationality. Similarly, J. Li, Qian, and Yao (2015) also used the organisational learning argument to show that, the location decision of experienced firms increases the confidence of other firms to imitate such location decision.

Mixed theoretical perspectives

Some scholars advanced more than one theoretical perspective in trying to understand firms conforming behaviour in multinationality. For example, Henisz and Delios (2001) employed institutional perspective and political institution to understand firms conforming behaviour in multinationality, Yuan and Pangarkar (2010) also examined the phenomenon by leveraging on both institutional and ecology literature to explain Chinese foreign investment location choices and found that behavioural inertia was more influential in understanding firms FDI decisions than behavioural mimicry. Introducing an interesting twist to the discussion on firms conforming behaviour in multinationality, C. Li and Parboteeah (2015) explored how cultural dimensions play a key role in firms’ mimetic tendencies. The results of their study found that individualism-collectivism and power distance significantly affect firms conforming behaviour. Delios et al. (2008) examined firms conforming behaviour by employing both institutional argument and competitive rivalry-based arguments to understand which better explains this phenomenon, and they found that the competitive context in the home country influences the firms’ propensity to conform to the multinational posturing of rivals. And ultimately concluded that both theories are complementary.

Antecedents of Conformity in Multinationality

In examining the antecedents of conformity in multinationality, authors have enumerated various factors at the industry level, the focal firm’s rivals-level and lastly the focal firm-level as the key drivers of imitative actions. At the industry-level, referring to the structural characteristic of the industry, some authors for example found that home country industry concentration influences a firm’s propensity to conform to multinationality decisions of rivals (e.g., Anand & Kogut, 1997; Delios et al., 2008; Flowers, 1976; Gimeno et al., 2005). Whiles at the focal firm’s rivals-level which refers to the strategic actions of rival firms, authors found that the amount of past entries or exist of a foreign market by rival firms influences a focal firm’s propensity to conform to rivals’ multinationality decisions (e.g., Chan et al., 2006; Fernhaber & Li, 2010; J. Li & Yao, 2010). Lastly, some empirical investigations of the focal firm-level antecedent of conformity in multinationality reveals that a firm’s association with business groups, as well as firms’ prior multinationality engagements influences the focal firm’s propensity to conform in multinationality (Chan et al., 2006).

Conclusions: Implications and Indications for Future Research

To conclude the analysis, we would want to discuss the main contribution, implications and indication for future research that can emanate from this review. The review synthesised the main theories used to explain firms conforming behaviour in multinationality. In the end, we sought to show what the theories have said about conforming in multinationality. At the generic level, the literature suggests two main reasons for firms conforming
to the multinationality posturing of others. The reasons are: uncertainty reduction and ways of being effective in their multinationality engagements. In suggesting some avenues for further research, we suggest that new studies be carried out at individual level to understand how firms’ decision to conform to the multinationality posturing of rivals is influenced by individual actors in the firm. More precisely, a cognitive perspective can throw more light on the role played by individual actors in this strategic decision-making process. Secondly, scholars might also be interested in understanding empirically what the outcomes of such conforming behaviour is by employing the concept of mutual forbearance to understand the success outcome of this multinationality actions. Thirdly, the performance implications of such conforming behaviour would be of significant interest as well to scholars in this field. Lastly, since the governance of the firm is very critical in firms’ strategic decision-making process, examining the role of corporate governance in this strategic play may also be insightful to investigate since the governance of the firm plays a key role in firm multinationality as established by the extant literature.

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This paper examines the rise of the digital tax concept as a political risk for MNEs. An historical and chronological approach is used to demonstrate how and when the international tax system was established, and how it provided a relatively stable environment for MNEs to flourish. The ascent of digital economy however, although in the past decade provided unimaginable opportunities to MNEs, now became the source of the destabilization of the existing international tax system. Not only the OECD is considering significant changes in their model tax treaties; but also, European Union is suggesting a digital tax and a new concept of virtual permanent establishment to recapture untaxed profits of MNEs that operate in the digital economy. States have split views and some are considering unilateral actions. This means that there is a significant political risk for MNEs with respect to international taxation on the horizon.

Having some kind of risk is a sine qua non for all types of businesses. When it comes to the risks in international business, several categorizations can be made. For example, according to Miller (1992, pp. 311-331), MNEs are exposed to five types of international risks: natural, legal, societal, political and governmental. Daniell (2000), however, categorizes such risks as financial, cultural, legal and political.

One can define political risk as potential harm (or, sometimes, potential benefit) to a business operation arising from political behavior. When making a policy decision, a government is motivated by both economic and non-economic objectives. The political environment in a state or a region may compel political actors to substantially alter existing policies with respect to economic factors such as taxes, currency valuation, trade tariffs or barriers, investment incentives, wage levels, labor laws, environmental regulations, development priorities etc. Same can be said with respect to non-economic factors as well. For example, political disruptions such as elections, riots, coups, civil or international wars or terrorism may result in a change in the ruling government. Obviously, uncertainty about government actions drastically affect MNEs’ (and all other businesses) investment plans and ability to operate.

In this paper, I aim to point out only one aspect of all political risk categories: governments’ changing position with respect to international taxation, and more specifically, with respect to taxation of the digital economy. Following a chronological path will provide us why international tax policies in general, and the EU’s digital tax proposal in particular might become a major political risk for MNEs that operate in the digital economy.

How Did the Digital Tax Become a Political Risk?

Existing international tax system

Tax laws change, and they change a lot. Usually minor, but sometimes major changes often occur in tax laws of almost all states. Enterprises, local or not, are used to this fact. The international system of taxation, however, still reflects the principles that were developed in the early 1920s. So, basically, there is nothing new for MNEs with respect to international tax policies of governments. Or, is there?

International juridical double taxation is defined as imposition of compatible taxes in two or more states on the same taxpayer in respect of the same subject matter and for identical periods (OECD, 2017, p. 9). It is a known fact that industrialization and increasing international trade in the late 19th century and early 20th century resulted in double taxation (Kobetsky, 2011, p. 110). It was the International Chamber of Commerce (ICC), which was founded in 1919 at the end of the World War I, that first called for a solution to the double taxation problem, which is considered as the main obstacle to the financial reconstruction and international trade. In 1920, at its Brussels Conference, the ICC requested the League of Nations, the political forum of the period to settle disputes among states, to take measures to prevent double taxation (the Technical Experts, 1925, pp.7-8). As a response, in 1921, the League of Nations appointed a committee of four economists (Professor Bruins, Commercial University, Rotterdam; Professor Senator Einaudi, Turin University; Professor Seligman, Columbia University, New York; Sir Josiah Stamp, KBE, London University) to study double taxation. In its report, which was submitted in 1923 (Economic and Financial Commission, 1923), the committee stated that individuals...
should be taxed on their cross-border income in the state to which they have economic allegiance (Vogel, 1998), and according to the committee, economic allegiance had four bases: the place of production of wealth (origin or source), the place possession (location) of wealth, the place of enforcement of rights to wealth, and the place of consumption (residence or domicile) (Economic and Financial Commission, 1923, pp. 22-23). The report concluded that the places of origin (source) of wealth and the places of consumption of wealth (residence) are the main bases of economic allegiance, and in case of double taxation of cross-border income, residence jurisdiction should be the preferred method, source jurisdiction should provide exemptions or tax credits for income derived by non-resident taxpayers (Economic and Financial Commission, 1923, p. 25).

Many consider the 1923 report of the four economists as the basis for the current tax treaties (Kobetsky, 2011, p. 115). Other committees of the League of Nations, further developed the work on double taxation by following their work. However, I should note that the ICC, in close contact with the League of Nations, continued on its study of double taxation. For example, in 1923, at the London Conference the ICC adopted a resolution that the best method to avoid double taxation was to accept residence jurisdiction as the basis of tax on income; source taxation should be restricted to taxing only income that was derived within its territory, and residence state should provide relief for source state taxation (the Technical Experts, 1925, p. 8). Until the end of the World War II, League of Nations further developed its work. In 1928 it released its first draft model tax treaty, which was followed by Mexico (1943) and London (1946) models.

The World War II, of course, was the greatest risk of all for MNEs in all senses, and also was the end of the League of Nations. After the war, the increasing interdependence between Western states clearly showed that a harmonized set of measures to resolve international double taxation was necessary. This time it was the OECD, which was first was established as the OEEC in 1948 to run the US-financed Marshall Plan for reconstruction of a continent ravaged by war and then later transformed into the OECD in 1961, that undertook the work left by the League of Nations. In 1963 the OECD released its first Draft Convention concerning the avoidance of double taxation, which was later named as Model Tax Convention on Income and on Capital. Since then many changes have been made on the Model Convention and on its Commentary (OECD, 2017, pp. 10-11); yet, the basic principles stay the same when it comes to taxation of cross-border income:

There are two significant articles of the Model with respect to taxation of business income; Article 7 titled “business profits” and article 5 titled “permanent establishment”. (I should also note Article 9 titled “associated enterprises” as well.) Article 7 sets a simple rule: only residence state may impose a tax on business profits of an enterprise. Source state, however, may also impose a tax, only if, the enterprise carries on business in that state through a permanent establishment. In that case, the source state’s authority to impose a tax on business profits is limited to the profits that are attributable to the permanent establishment. The permanent establishment itself is defined in Article 5, which is, basically, a fixed place of business or a dependent agent within the source state.

The solution of the OECD, which is adopted by most states with respect to taxation of international business income, in essence, was devised by the four economists, the ICC, and the technical experts of the League of Nations in the early 1920s. The existing network of international tax treaties, approximately 3000 bilateral tax treaties, one way or another, is based on the OECD Model Tax Treaty. States either follow it as a basic document of reference in treaty negotiations or develop their own models (such as the US Model Tax Treaty) as a derivative of the OECD Model. Even the United Nations Model Tax Convention between Developed and Developing Countries reproduces a significant of the OECD’s Model Tax Convention and its Commentaries. In short, the existing system of international business taxation is almost one hundred years old and relatively stable.

**The Ascent of the Digital Economy**

Existing international tax system was designed for brick-and-mortar businesses, and for a considerably long period of time, it worked reasonably well. However, with the growth of the Internet in the late twentieth century, the methods of doing business have started to change. The Internet seems not only to make the traditional economy function more efficiently, but also to offer an even more perfect form of free-market exchange (Zekos, 2003, p. 164). Since the mid-90s there has been a significant increase in e-commerce. Retail e-commerce, for example, is expected to reach $4.479 trillion in 2021 according to a research company, eMarketer (eMarketer, n.d.) Online sales have opened up an opportunity for all types of companies; not only the for ones that sell tangible goods but also for companies that provide intangible goods and services, to reach a worldwide market. Revolution of technology has triggered changes in business organizations, and companies of the digital economy, such as Apple, Amazon, Alphabet (Google) or Facebook are formed. “The new/digital economy is defined as one based on knowledge and information, relying on sub-sectors such as entirely digital goods and services and mixed goods that is, physical goods that are sold through the Internet” (Zekos, 2003, p.197).
The existing system of international taxation is not capable of resolving issues regarding business profits derived from the sale of digital and mixed goods and services. I should note that it took a considerable amount of time for states and international organizations to really comprehend the digital economy and to respond accordingly. For example, in 1996 the US Treasury acknowledged that some of the issues posed by the communications revolution were so complex that they could not be dealt with by existing principles; and therefore, international cooperation was likely to be necessary (US Treasury, 1996). In 1997, the White House issued a framework for global electronic commerce, and with respect to taxation stated that “No new taxes should be imposed on Internet commerce… Governments should cooperate to develop a uniform, simple approach to the taxation of electronic commerce, based on existing principles of taxation.” (White House, 1997) In the following years, many states such as Canada (Canadian National Revenue Ministry, 1998a, 1998b), France (Reinhold, 2004, p. 703), Australia (Australian Taxation Office, 1997, 1999), Netherlands (Netherlands' Ministry of Finance, 1998), Japan (Ministry of International Trade and Industry of Japan, 1997), the United Kingdom (Inland Revenue and HM Customs and Excise, 1999) released similar reports pointing out issues and calling for international cooperation. The EU’s position was similar (European Commission, 1997a, 1997b). In the end, all states and the EU were looking forward to the OECD’s policy decisions on this matter. The “Electronic Commerce: Taxation Framework Conditions” issued by the OECD at the Ottawa Conference in 1998 conveyed the belief of the Committee on Fiscal Affairs of the OECD that “the principles which underline the OECD Model Tax Convention are capable of being applied to electronic commerce” (OECD, 1998). Starting from 1998 to (approximately) until 2005 the OECD worked hard to prove that existing principles, definitions and provisions of international tax treaties (the Model Convention to be honest) could be applicable with respect to e-commerce operations as well (OECD, n.d.). Consequently, the OECD came up with recommendations on the challenges e-commerce poses to the PE concept, which are now set out in paragraph 42 of the Commentary on article 5 of the OECD Model Tax Convention.

There was one state, however, although for a very brief period of time only, that had a different policy approach, or should we say, an attempt to change its international tax policy with respect to taxation of the digital economy. That state was India. In 1999 India established the High-Powered Committee on Electronic Commerce and Taxation. In 2001 the Committee released its first report in which it heavily criticized the existing international tax regime with respect to electronic commerce. The Committee’s view was that “applying the existing principles and rules to e-commerce situation does not ensure certainty and reasonable allocation of revenues between residence and source countries.” The Committee, therefore, supported the view that “the concept of PE should be abandoned and a serious attempt needs to be made within the OECD or the United Nations to find an alternative to the concept of PE” (Ministry of Finance of India, 2001, pp. 71-72) The Committee suggested to adopt a slightly modified version of Professor Richard L. Doernberg’s “base erosion approach”, and therefore, a low rate withholding tax on all (not only on electronic commerce) gross profits of MNEs in the source state as an alternative to the permanent establishment threshold of the tax treaties (Ministry of Finance of India, 2001, pp. 77-78).

As a response to the High-Powered Committee’s report the eComTaxpert Group, basically, a group of experts, most of which are from developed states, and also from MNEs such as IBM, GE and Microsoft, released its report titled “Taxation of Electronic Commerce in India” in 2002 (The eComTaxpert Group, 2002). This report criticized Professor Doernberg’s base erosion approach as a radical departure from the international consensus and argued that it was in conflict with the internationally accepted standards on when a jurisdiction has the right to impose an income tax on a non-resident enterprise. The report cautioned that any unilateral move on India's part to adopt such an approach might lead to disputes between India and its various treaty partners, and also might expose India to intricate issues in relation to the WTO (The eComTaxpert Group, 2002, pp. iv-v).

The government of India announced in 2001 that it was not going to adopt the suggested policy changes by the High-Powered Committee; instead, it was going to wait for the developments in the international community. Therefore, for MNEs it was the business as usual; there was no new political risk with respect to international taxation neither in India nor in any other state to the newly rising digital economy during most of the 2000s. Ever expanding globalization and the digital economy, merged with the aging international tax system have created the perfect environment for MNEs to maximize their inherent advantages in tax planning, and the MNEs have taken full advantage of those conditions (Brauner, 2014, p. 57).

The BEPS

Years ago, many authors, mostly from developing states pointed out the fact that the existing international tax rules were not designed for the new digital economy. As Chang Hee Lee, stated in 2004, “(D)igital technology completely destroys the economic and legal basis for the existing rules of international taxation, implying the necessity of a complete overhaul…” (Lee, 2004, p. 21). However, during the 2000s most states (perhaps all states) preferred to wait and see the developments in the emerging digital economy.
No new policies were adopted with respect to taxation of cross-border income of MNEs derived from electronic commerce or other forms of the digital economy. The tax competition between states further lowered the political risk of taxation for MNEs. Then, with the financial crisis of 2008 and its aftereffects on the global economy, governments that seek new or renewed sources of revenue realized (or acknowledged) that MNEs have been using corporate tax planning strategies that artificially “shift” profits from higher-tax locations to lower-tax locations, thus “eroding” the tax-base of the higher-tax locations. For example, in 2013, Facebook who host 1.9 billion, or 83%, of their 2.3 billion global accounts in Ireland, only paid an Irish effective tax rate of <1%, using a double Irish scheme (Financial Times, 2013).

At the same period, major news on illicit tax schemes like Offshore Leaks (ICIJ, 2013), Luxembourg Leaks (ICIJ, 2014), Swiss Leaks (ICIJ, 2015), Panama Papers (ICIJ, 2016) and Paradise Papers (ICIJ, 2017) started to hit front pages of news outlets on a yearly basis.

All of these developments were actually hinting us about governments’ changing position with respect to international taxation. It took almost a decade for the OECD to accept the reality and to take action. The OECD initiated the Base Erosion and Profit Shifting (BEPS) project following the 2012 G20 Summit and at 2015 G20 Antalya summit in Turkey, the G20 heads of states endorsed a package fifteen actions designed by the OECD to be implemented domestically and through tax treaty provisions. (OECD, n.d.) Although all actions are significant for MNEs, I should note that Action 1, “Addressing the Tax Challenges of the Digital Economy” and Action 7, “Preventing the Artificial Avoidance of Permanent Establishment Status” are directly relevant.

The BEPS is about globalization and MNEs, and it is natural that it focuses on the advantages that the digital economy provides to MNEs, which on the other hand are major challenges for the tax authorities of states. Until BEPS states competed between themselves and MNEs benefitted from the tax competition. The BEPS is the starting point for tax coordination between states against MNEs. Obviously, there is more to come.

The success of the BEPS project is questionable. The US and the EU Commission, for example, have been advancing their own anti-BEPS legislation and tax regimes recently.

**Digital Services Tax, the Final Attempt from the European Union**

Finally, and briefly, I should point out the EU’s attempt to tackle tax issues caused by MNEs. First, in January 2016 the European Commission released an Anti-Tax Avoidance Package as a European response to the finalization of the BEPS project (European Commission, 2016). Later, however, against the suggestions in BEPS Action Plan 1, in March 2018, the EU Commission presented a series of measures aimed at ensuring a fair and effective taxation of digital businesses operating within the EU (European Commission, 2018). The package includes an interim tax, which is a 3% Digital Services Tax on advertising revenues of large internet companies, such as Facebook and Google, and on revenues from digital intermediary activities of online platforms such as Amazon.com Inc., Ebay Inc., and Airbnb Inc. etc. The package also includes a long-term solution based on the new concept of a digital or virtual permanent establishment (“significant digital presence”). However, on April 28, 2018, at the Informal Economy and Finance (Ecofin) Ministers meeting, held in Sofia, Bulgaria, Malta and Luxembourg and some other states of the EU criticized these plans. The finance minister of Malta, Edward Scicluna said that “Malta is in favor of long-term permanent solutions which are agreed to by international consensus under the aegis of the OECD.” In response, ministers of Spain, Italy and France took the position that they would introduce their own levy on digital companies (Malta Today, n.d.; Politico, n.d.).

**Discussion and Conclusion**

The digital economy is the result of a transformative process brought by information and communication technologies. It is increasingly becoming the economy itself, and it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes. Political leaders, media outlets, and civil society around the world have expressed growing concern about tax planning by MNEs. For MNEs, this might not be anything new. However, there is a growing trend at political heights to review, revise or in some cases to repeal the rules of existing international tax system. The existing system, which was established almost a century ago managed to survive until the 2000s. The OECD was (and to some extent still is) reluctant to react to the developments in information and communication technologies and their exploitation by the MNEs. Yet, in the last 5-6 years, things started to change. Both the OECD and the EU have initiatives to tackle tax planning schemes of the MNEs; several states of the EU proposing a special tax for the digital economy. This means a rejuvenated political risk that did not exist for MNEs during the past 50 years. When considered together with the trade wars on the horizon, one may claim that the next ten years might be considerably riskier for MNEs.
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Political Risk Influence on Multinational Corporations Operating in African Markets: Perspectives from Nigeria

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This paper critically examines political risk influence on MNCs in African markets. It uses a sequential mixed method strategy to analyse statistically and thematically data collected from MNCs, including a political risk rating dataset for Nigeria 2011-2016, using a multi-method approach. The findings reveal that political risk impact on MNCs is influenced significantly by factors such as degree of internationalisation, perception of political risk, assessment outcome, leverage, low financial risk, perceived rewards of FDI and a country’s political risk regional variation. These findings provide insights into why some MNCs invest in markets which are associated with high levels of political risk.

Why would some Multinational Corporations (MNCs) invest in African markets despite the presence of high political risk? Political risk has been identified as one of the key determinants of FDI for MNCs (World Bank, 2014; Stevens & Newenham-Kahindi, 2017). Political risk is constantly evolving, with different consequences for MNCs (Darendeli & Hill, 2015; Huang et al., 2015). This has included, for instance, from nationalisation to expropriation, and after that to others issues such as license cancellation, tax restrictions, investment agreement changes, terrorism and protectionism amongst others (Bakaert et al., 2014; Sottilotta, 2015; World Bank 2014). These different manifestations of political risk have influenced the type of strategies MNCs adopt for different markets depending on their type of international business activities (Ferrari & Rolfini, 2008; Kerner & Lawrence, 2014; Kesternich & Schnitzer, 2010).

Increasing FDI inflow into African markets by MNCs from developing economies has brought more concerns about political risk in the continent (World Bank, 2014). This increase in FDI inflow has led to an increase in studies of political risk in African markets compared to other developed economies (Mshelia & Anchor, 2018; Osabutey & Okoro, 2015; Han et al., 2018; Stevens & Newenham-Kahindi, 2017). Recent studies have reported that almost all forms of FDI are more susceptible to political risk consequences than other market entry modes (Bekaert et al., 2014; Kerner & Lawrence, 2014; Sottilotta, 2015; World Bank, 2014).

According to United Nations Conference on Trade and Development (UNCTAD)’s World Investment Report 2017, the continent has maintained a robust FDI stock even though a decline of about 3.5% to $59 billion was witnessed in 2016 (UNCTAD, 2017). A number of increases and decreases in FDI have been reported for the continent for the past 7 years. This flux in FDI could be attributed to fluctuating political, social, economic and cultural challenges within many countries on the continent (Baek & Qian, 2011; Jensen, 2008). For this reason, political risk could be viewed to manifest itself differently in African markets compared to others. Therefore, there is a need to understand variations in countries’ specific political risk factors and why MNCs invest in some African countries (Baldacci, Gupta, & Mati, 2011; Bekaert et al., 2014; Quer et al., 2012).

Most African countries have specific political risk factors that differentiate one from another, based on inherent factors in their political environments. Some of these inherent factors are related to religious, ethnic and cultural cleavages (Asiedu, 2006; Baek & Qian, 2011; Jensen, 2008). These cleavages may also lead to regional variations in political risk within a country. Therefore, it is possible for there to be low political risk regions in high political risk countries. This article investigates country-specific political risk factors to determine the extent how they influence FDI by MNCs into an African market.

However, MNCs have attributes that differentiate one firm from another that could significantly influence the rate of FDI into markets. Likewise, these attributes of MNCs make them perceive political risk differently (Al Khattab et al., 2011; Jiménez, Luis-Rico & Benito-Osorio, 2014). There are different dimensions to political risk perceptions. For example, there are differences in perceived risk and actual risk between new entrants and the accrued operating experience of incumbents. Similarly, differences in firm behaviour could arise from dissimilar attitudes to risk (risk takers versus risk-averse), which may also vary by sector, home country and age (Al Khattab et al., 2011; Jiménez et al., 2014).

UNCTAD (2017) reported that Nigeria is among the top 5 FDI inflow host economies in 2016. The country is a major supplier of oil and gas to the global market which,
coupled with its large market size, has made it an attractive destination for FDI (NBS, 2014). Despite the flux in her political situation due to the multi-ethnic, multi-cultural and multi-religious nature of the country, it has one of the significant stocks of FDI on the continent (Ikeze et al., 2004; NBS, 2012; UNCTAD, 2016).

This article aims to examine political risk influence on MNCs in African markets in order to determine why some invest in the market despite the presence of high political risk. We use a sequential mixed method strategy to analyse statistically and thematically data collected from MNCs in Nigeria, using a multi-method approach. We also analyse the dataset of the International Country Risk Guide (ICRG) Political Risk Assessment (PRA) annual rating by the Political Risk Service Group in the US for Nigeria during the period 2011 to 2016. We investigate country-specific political risk factors and MNC specific attributes for determinant that influences their FDI decision in Nigeria. The study offers valuable insights into why some MNCs invest in markets which are associated with high levels of political risk within the Nigerian context. The article contributes to the literature of political risk concerning the factors that influence MNCs’ FDI in high political risk markets.

The remaining parts of this article are organised into five sections. The first section presents a literature review of political risk theory, the Nigerian context to MNCs’ FDI decisions. The second section describes the methodology, including the data collection and the data analysis. The third section discusses the study’s findings. The fourth section presents the research contributions, and the final section is a conclusion.

**Literature Review**

**Political Risk and Firms’ Internationalisation**

Political risk appeared as a discrete field of study in international business devoid of an accepted theory that summarises the fundamental principles clarifying how responses of MNCs towards host nations’ policies regulating them within markets (Robock, 1971; Grosse & Behrmann, 1992). Even though some theories have been ascribed to international business none has focused on how political risks, due to government policies showing cross-national business behaviour, affect MNCs.

The causes of political risk are political, and through the interplay of actors with different interest, power and constraints in a given environment refer to like politics, institutions are created. Therefore, institutions become the rules of the game regulating how MNCs operate in an environment in this context. It is in the same context that previous studies about political risk have attempted to interrelate it with institutional theory in explicating what influences a company’s decision to invest in a location (Mshelia & Anchor, 2018; Jiménez et al. 2011, 2014; Quer et al., 2012).

Neo-institutional theory has an inclusive theoretical concept with an emphasis on isomorphism, rational myths and legitimacy that focus on resilient facets of social structure. The legitimacy facet of neo-institutional theory could be considered relevant in this context since MNCs always try to attain relative legitimacy as they react to different institutional regulations in a host country (Darendeli & Hill, 2015; Meyer, 2008; Quer et al., 2012). Consequently, this implies that some changes in regulations made by institutions could lead to the emergence of political risk in a host country, especially if a political environment is unstable or if its institutions are weak. Both informal and formal regulations could determine if an MNC could operate in a proposed market (Quer et al., 2012). Consequently, the rules set by institutions are factors that could distinguish profitable from a non-profitable investment. There follows a literature review about political risk and the internationalisation of MNCs in Nigeria. This provides some insights into the country’s specific political risk factors and the characteristics of MNCs which cause them to perceive political risk differently.

**Political Risk**

Producing a consensus definition of ‘political risk’ has been challenging in the past few decades. Political risk has been linked with concepts such as ‘political instability’, ‘political uncertainty’ and ‘country risk’, which raises further complexity regarding its conceptualisation (Brink, 2004; Fitzpatrick, 1983; Howell, 2002a; Overholt, 1982; Sottolitta, 2013). However, a number of authors have attempted to conceptualise and define political risk with diversity which encompasses political events and government interventions. According to Kobrin (1979), the consequences of an event depends on the circumstances under which it occurs and the type of the investment, as well as the environment. It is for these reasons that Fitzpatrick (1983) proposed that if political risk is viewed as a process variable instead of an event variable. This suggests that the level of political risk can change over time.

However, this study considers other factors, both in the process and event variables, in defining political risk. Therefore, political risk could be defined as any unpleasant possibilities in the political environment as a result of government actions or any condition/event that affects an investor achieving its business objectives in a host country. This definition implies that political risk does not always emanate from government political decisions because some variables or factors that cause political risk are not associated with political events or government decisions, and instead are inherent in the political environment.
Political risk is different from political uncertainty and political instability. Political instability refers to unexpected changes in the political environment while political uncertainty refers to doubt regarding the likelihood of government changes in a political environment. Both are used interchangeably in place of political risk. However, political risk refers to unpleasant possibilities in the political environment as a result of government actions or any condition/event. It is a more objective way of measuring the amount of doubt from political instability and political uncertainty, rather than the former, which captures the subjective nature of instability and uncertainty (Brink, 2004).

**Classification of Political Risk**

Political risk can be classified according to its source since not all risks are as a result of changes arising from host government decisions. Political risk can be categorised into four sources; namely host-government, host-society, neighbouring countries and non-neighbouring countries (Al Khattab et al., 2011). This article includes non-neighbouring countries as a source considering the effect of the ‘Arab Spring’ that brought a new example to how political risk could emerge. Table 1 provides a summary of political risks and their origins.

<table>
<thead>
<tr>
<th>Serial</th>
<th>Host government</th>
<th>Host society</th>
<th>Neighbouring countries</th>
<th>Non-neighbouring countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Taxation restrictions</td>
<td>Demonstrations/riots/strikes</td>
<td>Wars</td>
<td>Revolutions</td>
</tr>
<tr>
<td>2</td>
<td>Currency inconvertibility/devaluation</td>
<td>Revolutions,</td>
<td>Sanction</td>
<td>Regional blocs</td>
</tr>
<tr>
<td>3</td>
<td>Contract repudiation</td>
<td>Terrorism</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Import or export restrictions</td>
<td>Coups d’état</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Ownership/personnel restrictions</td>
<td>Civil wars</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Delayed profit repatriation</td>
<td>Hijacking</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>License cancellation</td>
<td>Piracy</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Price control</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Expropriation/nationalisation</td>
<td></td>
<td></td>
<td>Political instability</td>
</tr>
<tr>
<td>10</td>
<td>Investment agreements changes</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Changes in rules and regulations</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Developed from Al Khattab et al. (2011)

According to Brink (2004: 21) ‘political risk is a concern in an investment scenario, which should include current information covering areas such as history, politics, culture, religion, economics and international relations, as well as knowledge of the firm’s likely role in the host country’. He further states that the ‘presence of political risk in a host country does not always have to result in a negative impact. There are possibilities of changing it into an advantage as long as an investor is aware of it’ (Brink, 2004, p. 21). The generative agents of political risk are divergent and vary among countries, and likewise their effects on MNCs (Burmester, 2000; Kobrin, 1982).

Even in the same country, political risk types, costs, probability and the degree of its intensity can vary from one part of the country to another; likewise, their consequences vary in their impact. Political risk can be attributed to differences in political environments, especially in developing countries with weak regulation institutions, and where ideological, ethnic and religious cleavages are inherent in their environment (Fitzpatrick, 1983). PRS Group (2015) argues that it is possible for poor political risk in a country to be compensated for a good financial and economic risk. The resultant inability of some MNCs to fully understand diverse political environments has resulted in across-the-board policies, dichotomising some developing countries as either safe or unsafe (Fitzpatrick 1983, 251). Hence, there is a need for firms to understand the different political environments in their processes of internationalisation into developing countries.

**Firms’ Internationalisation**

Internationalisation is defined as “the process by which a firm enters a foreign market” (Rugman & Collinson 2012) through different modes of entry. A number of factors influence firms’ internationalisation process to new foreign markets, apart from firms’ market-specific knowledge as well as their generalised knowledge of operating internationally (Johanson & Vahlne, 1990; Clark, Pugh et al., 1997). The Uppsala Model suggests that the process of internationalisation is consequent upon firms’ experiential knowledge of a particular market (Clark, Pugh et al., 1997). However, Millington & Bayliss (1990) argued that the
market-specific knowledge available to firms is not just the source of information for internationalisation. This is because firms could develop extra networks of institutional arrangements as they keep operating in foreign markets, which could give some leverage as they internationalised.

There are different types of international investment that MNCs use for internationalising into different markets. They could choose among the different entry modes into foreign markets such as by owning subsidiary, joint venture or merger and acquisition, based on their institutional arrangement and resources available for competitive advantage (Andersen, 1993; Andersen, 1997). Firms’ decisions on the best entry mode strategy depend on a wide range of factors, considering the costs and benefits of each mode of entry, and most importantly their perceptions of risk and how it could be mitigated (Tayeb, 2000; Hill and Jain, 2013). In the context of political risk, Dunning (1998) suggested that the choice between FDI and exporting will depend on factors such as internationalisation advantage, location advantage and ownership advantage (Agarwal & Feils 2007). In his eclectic theory, he stated that a firm should have all these advantages in order to be successful in FDI. However, for strategic reasons, firms with increasing resource-based advantages could move into certain markets due to their strategies, structures and control mechanisms thereby increasing their market knowledge as well as commitment (Agarwal & Feils 2007). Therefore, a firm enter different foreign markets, its international business activities increases, thereby increasing the degree of internationalisation.

A number of variables are used as criteria to measure a firm’s degree of internationalisation, such as number of years, revenue generated and coverage in international business (Rice & Mahmoud 1990; Pahud de Mortanges & Allers 1996; Al-Khattab et al., 2011). It is assumed and expected that as these determinants of internationalisation increase, the degree of internationalisation will also increase. It is applicable for firms whose type of international business activities are either by FDI or exporting. Consequently, this implies a positive relationship between the determinants of the degree of internationalisation. However, due to differences in their nature of international business that MNCs are engaged in, it will be problematic to determine the degree of internationalisation of some firms based on their characteristics.

It is most likely to have firms with a high level of internationalisation operating in riskier markets based on their knowledge of these markets to be able to manage political risk (Pahud de Mortanges & Allers, 1996; Iankova & Katz, 2003; Al-Khattab et al., 2008). However, firms have various institutional arrangements with different leverage that enables them to operate even in the presence of some types of political risk and weighing up that the consequences will have less impact. Their perceptions of political risk vary and could be viewed from different dimensions apart their perceived reward of investment in relation to the cost of political risk in a country.

There are different dimensions about risk perceptions, for example; there are differences in risk perception and actual risk between new entrants and the accrued operating experience of incumbents. Likewise, differences in firm behaviour arise from different attitudes to risk (risk takers versus risk-averse), which may also vary by sector, home country and age amongst others (Liesch et al., 2011; Kraus et al., 2015). It is possible to have an endogeneity between firm entry and perceptions of risk. The greater the profitability of incumbents, the more likely it is that new firms will enter (hence greater FDI inflows), the lower the perception of risk but likely returns can be expected to fall owing to increasing competitive intensity.

**Political Risk and MNCs in Nigeria**

The literature on political risk in Nigeria has been growing due to the country’s position as one of the five largest African FDI inflow destination. The country has experienced series of transformations that have formed and reformed its political landscape since it was created in 1914. After independence in 1960, the country has undergone several economic and political reforms by both the democratic and military governments that have had consequences on for MNCs (John, 1997; Umoren, 2001). The staging of a military coup and a civil war that happened from 1967 to 1970 set the stage for the emergence of political risk in the country after 1966. After, that the government introduced a succession of policies that led to the nationalisation of a number of MNCs in 1972 that lasted for about 10 years. Subsequently, a number of military interventions in the government, as well as different political and religious crises were witnessed (Babawale, 2001; Bienen, 2003; Onapajo, 2012; Orugbani, 2005). Presently, the increasing wave of terrorism, high level of corruption, high rate of unemployment, inadequate infrastructure, poor legal system and the unstable situation in the oil-rich Niger Delta region have been reported in the country (Aon, 2014; Wafure & Nurudeen, 2010). The country’s economy is also growing with an increasing inflow of FDI (UNCTAD, 2016). However, the dataset by ICRG PRA annual rating conducted for Nigeria within the period from 2011 to 2015 reported a very high political risk score.

The country is divided along cultural, ethnic, language and religious lines within different geographical regions (Bienen, 2013; Onapajo, 2012). There are regional ethnic militia groups that exist across the country. In the south, there is the Movement for the Emancipation of the Niger Delta (MEND), in the East, the Movement for the Actualisation of the Sovereign State of Biafra (MASSOB).
While in the West, Odua People’s Congress (OPC) and the north, ‘Boko Haram’ (Babuwale, 2001). ‘Boko Haram’ is a terrorist group, whose actions have led to the deaths of many, and has resulted in the declaration of a state of emergency in three northern states (Bienen, 2013; Danjibo, 2009). According to Nigerian National Bureau of Statistic (2012b, p. 11), ‘despite the growth of the Nigerian economy, ironically, the percentage of Nigerians living in poverty is on the increase’. The report demonstrated that the percentage of the poverty rate of the population increased considerably during the period 1980 to 2010, with the northern part having the highest percentage. In research conducted by the World Bank on the Investment Climate Assessment Report 2012, it was reported that in 26 states, investors in Nigeria lost 10 percent of their revenue due to poor infrastructure, crime, corruption and insecurity (Iarossi & Clarke, 2011). It also reported that 80 percent of firms offer bribes to government officials for one reason or another. Therefore, it is in this setting that the determinants of political risk will be interrelated to identify their impact on MNCs.

**MNCs in Nigeria**

Although there is a dearth of literature on MNCs in Nigeria, MNCs have been investing in Nigeria even before the country gained independence in 1960. The Nigerian investment climate was under foreign control because foreign investors dominated the ownership and management of firms in the country. A number of MNCs such as Shell, John Holt, Patterson Zocohonis (PZ) and the Swiss Union Trading Company (UTC), Societe Commercial de l’Quest African (CFAO) and Barcelys Bank have invested in Nigeria. However, in the past, it was only the government who was involved in the internationalisation of business in Nigeria. The government conducted international trade by exporting crude oil and agricultural products such as groundnuts, cocoa, and cotton to other countries (Ake, 1985a, 1985b).

It was not until 1972 that this trend changed when the Nigerian government promulgated an enterprise promotion act with two schedules. This act was called the Indigenisation Policy Act and was aimed at promoting local participation in the economy (Ake, 1985b; John, 1997). The promulgation of the act led to the nationalisation of some foreign firms in the banking and oil sectors, with the Federal Government acquiring 40 to 60 percent shares. Subsequently, the Act was reviewed to improve its implementation strategy due to low investor knowledge, fragmented share liquidity structure and politicisation. The government further amended the act in 1989 in order to encourage more foreign capital inflow into the country but exempted the banking, insurance, petroleum and mining sectors. Other businesses not contained in the list of scheduled business were now open for 100% of Nigerian or foreign participation (Ake, 1985b; John, 1997; Olaloku, 1979). This nationalisation policy affected the ownership and control of MNCs in various ways; however, some oil firms with political influence were favoured partially by the government (Frynas & Mellahi, 2003). Hence, it resulted in a drop in the number of foreign investors coming into the country.

Subsequently, this led to the introduction of a privatisation policy, with the establishment of the Bureau for Public Enterprise (BPE) in 1994 by the federal government. It was done to relinquish and limit the government and its agencies’ involvement in the management of the enterprises (whether wholly or partly owned) by deregulation through the CAP 369, Laws of the Federal Republic of Nigeria (Ake, 1985a, 1985b). It was to create a self-sustaining culture with goods and services which reflected real values, as well as to encourage more foreign investors into the country. It led to the promulgation of the Companies and Allied Matters Act in 1990 by the Federal government. Later, the Corporate Affairs Commission was established to be in-charge with registering, regulating and supervising the formation and incorporation or the winding-up of companies doing any form of business in Nigeria (Ake, 1985b; John, 1997). However, despite these policy interruptions, the number of MNCs coming into the country has increased because the Nigerian government has been reforming its policies to offer incentives to encourage more foreign investors into the country.

**Methodology and Data Analysis**

A list of 247 companies obtained from the Nigerian Stock Exchange in Lagos and the Corporate Affairs Commission in Abuja databases were used to identify MNCs operating in the country. A verification on a firm-by-firm basis during a pilot study helped to identify 150 MNCs which 59 of these firms were later found to have suffered nationalisation by previous governments in the 1970s. The balance of 74 firms completed the online survey with 81.3% participation rate. This study uses a sequential mixed method strategy to collect from data these MNCs through an online survey, followed by a stratified sampling semi-structured interview technique from 12 MNCs which were analysed statistically and thematically respectively. It also analysed the dataset of the International Country Risk Guide (ICRG) Political Risk Assessment (PRA) annual rating by a Political Risk Service Group in the US for Nigeria within the period 2011 to 2015. The participant sample size coupled with the results that emerged from the quantitative data collected and for data triangulation informed this approach (Bryman & Bell, 2015; Davies & Hughes, 2014). Statistical analysis was used to delineate the characteristics and to compare the scores of the underlying variables for use to predict their outcomes (Field, 2013).
Validity and Reliability Test

The scales used in the questionnaire were checked for internal consistency using Cronbach’s alpha coefficient statistically to ensure that the research instrument provided an adequate and accurate measurement for the study.

Table 2. Reliability Statistics

<table>
<thead>
<tr>
<th>Cronbach's Alpha</th>
<th>Cronbach's Alpha Based on Standardised Items</th>
<th>Number of Items</th>
<th>Number of cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.86</td>
<td>0.953</td>
<td>117</td>
<td>74</td>
</tr>
</tbody>
</table>

According to the reliability test conducted, Table 2 displays the Cronbach’s alpha coefficient value of 0.86. According to Pallant (2010) “values above 0.7 are considered acceptable. However, values above 0.8 are preferable”. It suggests the value obtained; there is very good internal consistency reliability for the scales used in the questionnaire.

For the interviews, the credibility, transferability, dependability and conformability were used as reasonable criteria for determining the qualitative data collected (Creswell, 2013; Golafshani, 2003). Each one of the criteria was used at each stage to ensure that accepted procedures were followed and detailed records were maintained for each of the firms interviewed to ensure the credibility of the data collected. In order to ensure transferability of the results obtained to another setting, adequate details of the interview procedures used were provided for each specific case. For dependability to be ensured, an assumption in qualitative research was considered that if there is a change in context, it is expected that the data would also change (Golafshani, 2003). In the context of this study, the sampling techniques used can provide the required specific exploratory data to complement the quantitative data collected. The data analysis used was to ensure the robustness and dependability of this study’s finding. To ensure conformability, proper documentation and rechecking of the data collected was ensured (Creswell, 2013).

The questions asked during the semi-structured interviews were based on the questions that needed to be probed from the results of the quantitative data and the criteria used to select each sample. A total of twelve firms from six industries were interviewed. The interview went in the order of the questions; however, the researcher used the opportunity to explore other leading questions that arise. All the interviews were held at the participant firms’ headquarters offices in Lagos, Nigeria. Each interview lasted about 45 minutes on average. The details of the firms that participated in the interview are shown in Table 3.

Table 3. Details of the Firms Interviewed

<table>
<thead>
<tr>
<th>Label</th>
<th>Type of industry</th>
<th>Interviewees</th>
<th>Job Responsibility</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>A1</td>
<td>Banking</td>
<td>A Director</td>
<td>Head of the Risk Management team</td>
<td>01</td>
</tr>
<tr>
<td>A2</td>
<td></td>
<td>Risk Manager</td>
<td>Responsible for developing risk policy</td>
<td>02</td>
</tr>
<tr>
<td>B1</td>
<td>Manufacturing</td>
<td>Senior Manager</td>
<td>Heading the Risk Management team</td>
<td>01</td>
</tr>
<tr>
<td>B2</td>
<td></td>
<td>Financial Manager</td>
<td>In-charge of financial dealing</td>
<td>02</td>
</tr>
<tr>
<td>C1</td>
<td>Communication</td>
<td>Operation manager</td>
<td>CEO, oversees all departments</td>
<td>01</td>
</tr>
<tr>
<td>C2</td>
<td></td>
<td>Sales manager</td>
<td>In-charge of marketing</td>
<td>02</td>
</tr>
<tr>
<td>D1</td>
<td>Insurance</td>
<td>CEO</td>
<td>Head of the Risk Management team</td>
<td>01</td>
</tr>
<tr>
<td>D2</td>
<td></td>
<td>Financial Manager</td>
<td>In-charge of financial dealing</td>
<td>02</td>
</tr>
<tr>
<td>E1</td>
<td>Petroleum &amp;</td>
<td>General Manager</td>
<td>Oversees all departments</td>
<td>01</td>
</tr>
</tbody>
</table>
**Data Presentation and Analysis of Results**

**Characteristics of Nigerian MNCs**

Table 4 shows the six category classifications used for the participants to characterised Nigerian MNCs. In allocating the participants according to their type of industry, Table 4 discloses that manufacturing represented 36.5% of them and petroleum & gas 32.4 % of them. In categorising the participants according to size, based on a firm’s assets (1 Billion Naira equivalent of $ 136 million), Table 4 reveals that 58.1 % were large -size firms. In assigning the participants according to number of employees, Table 4 shows that 71.6 % were large -size firms with more than 300 employees. In assigning the participant firms by type of multinational business, Table 4 reveals that FDI internationalised 64.9 % of the firms. In allocating the participant firms according to entry mode of internationalisation, 56.8% of the firms’ did so by owning subsidiary.

Table 4. Description of Characteristics of Nigerian MNCs

<table>
<thead>
<tr>
<th>Characteristics of Nigerian MNCs</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type of Industry</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td>27</td>
<td>36.5</td>
</tr>
<tr>
<td>Petroleum &amp; Gas</td>
<td>24</td>
<td>32.4</td>
</tr>
<tr>
<td>Banking</td>
<td>12</td>
<td>16.2</td>
</tr>
<tr>
<td>Insurance</td>
<td>5</td>
<td>6.8</td>
</tr>
<tr>
<td>Construction</td>
<td>3</td>
<td>4.1</td>
</tr>
<tr>
<td>Communication</td>
<td>3</td>
<td>4.1</td>
</tr>
<tr>
<td><strong>Type of Business</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FDI</td>
<td>48</td>
<td>64.9</td>
</tr>
<tr>
<td>Export/Import</td>
<td>24</td>
<td>32.4</td>
</tr>
<tr>
<td>FPI</td>
<td>1</td>
<td>1.4</td>
</tr>
<tr>
<td>Others</td>
<td>1</td>
<td>1.4</td>
</tr>
<tr>
<td><strong>Entry Mode</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Owning Subsidiary</td>
<td>42</td>
<td>56.8</td>
</tr>
<tr>
<td>Branch/Office</td>
<td>12</td>
<td>16.2</td>
</tr>
<tr>
<td>Franchise/Licensing</td>
<td>5</td>
<td>6.8</td>
</tr>
<tr>
<td>Joint Venture</td>
<td>5</td>
<td>6.8</td>
</tr>
<tr>
<td>Manufacturing Contract</td>
<td>3</td>
<td>4.1</td>
</tr>
<tr>
<td>Strategic Alliance</td>
<td>3</td>
<td>4.1</td>
</tr>
<tr>
<td>Other</td>
<td>4</td>
<td>5.4</td>
</tr>
<tr>
<td><strong>Asset</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Below N1 billion</td>
<td>3</td>
<td>4.1</td>
</tr>
<tr>
<td>N1 billion -- N10 billion</td>
<td>14</td>
<td>18.9</td>
</tr>
<tr>
<td>N10 billion -- N20 billion</td>
<td>14</td>
<td>18.9</td>
</tr>
<tr>
<td>Above N20 billion</td>
<td>43</td>
<td>58.1</td>
</tr>
<tr>
<td><strong>Number of Employees</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Below 50</td>
<td>4</td>
<td>5.4</td>
</tr>
<tr>
<td>50 - 150</td>
<td>7</td>
<td>9.5</td>
</tr>
<tr>
<td>150 - 300</td>
<td>10</td>
<td>13.5</td>
</tr>
<tr>
<td>Above 300</td>
<td>53</td>
<td>71.6</td>
</tr>
</tbody>
</table>

Source: Author

**The Determinants of Internationalisation**

In the descriptive statistical analysis of the determinants of internationalisation, the variables used as criteria to determine firms’ degree of internationalisation into high-internationalised, medium-internationalised and low- internationalised are the number of Years; Revenue
generated; the number of Countries coverage area. In categorising the participants according to firms’ number of years in international business to determine their degree of internationalisation, Table 5 indicates that 51.4% were low-internationalised firms. 52.7% of the firms were more medium-internationalised firms according to revenue generated from international business activities. 45.0% of the firms were low-internationalised firms according to the number of operating country participants in the survey.

Table 5. Determinants of Internationalisation

<table>
<thead>
<tr>
<th>The Determinants of Internationalisation</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Years</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 – 9</td>
<td>38</td>
<td>51.4</td>
</tr>
<tr>
<td>10-29</td>
<td>12</td>
<td>16.7</td>
</tr>
<tr>
<td>30-90</td>
<td>24</td>
<td>32.9</td>
</tr>
<tr>
<td>Revenue Generated</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Below N160 Million</td>
<td>8</td>
<td>10.8</td>
</tr>
<tr>
<td>N160Million – N320Million</td>
<td>27</td>
<td>36.5</td>
</tr>
<tr>
<td>N320Million -- N2billion</td>
<td>16</td>
<td>21.6</td>
</tr>
<tr>
<td>Above N2 billion</td>
<td>23</td>
<td>31.1</td>
</tr>
<tr>
<td>Number of Operating Countries</td>
<td></td>
<td></td>
</tr>
<tr>
<td>High</td>
<td>25</td>
<td>33.7</td>
</tr>
<tr>
<td>Medium</td>
<td>16</td>
<td>21.3</td>
</tr>
<tr>
<td>Low</td>
<td>33</td>
<td>45.0</td>
</tr>
</tbody>
</table>

Source: own calculations

**Political Risk and the Degree of Internationalisation**

A descriptive statistical analysis was conducted to compare the scores of the variables to determine the relative concern of participants for each type of risk in international business. The participant firms were presented with three types of risks, and 14 types of political risk in international business derived from the literature reviewed. A five-point Likert scale was used to investigate their concerns, where 1 stood for ‘Not concerned’ 2 ‘Slightly’ 3 ‘Moderately’ 4 ‘Very’ and 5 ‘Extremely concerned’. After that, a linear regression analysis was performed with political risk as the independent variable and revenue generated as the dependent variable, to test the hypothesis that an increase in political risk will result in a negative impact on firms’ revenue.

Table 6: Types of Risk in International Business

<table>
<thead>
<tr>
<th>Types of Risk</th>
<th>Mean</th>
<th>Std. Error of Mean</th>
<th>Median</th>
<th>Mode</th>
<th>Std. Dev</th>
<th>Variance</th>
<th>Min</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political risk</td>
<td>4.00</td>
<td>.092</td>
<td>4.00</td>
<td>4</td>
<td>.794</td>
<td>.630</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Financial risk</td>
<td>4.04</td>
<td>.091</td>
<td>4.00</td>
<td>4</td>
<td>.748</td>
<td>.615</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Cultural risk</td>
<td>2.84</td>
<td>.109</td>
<td>3.00</td>
<td>3</td>
<td>.937</td>
<td>.877</td>
<td>1</td>
<td>5</td>
</tr>
</tbody>
</table>

Table 6 shows the results of the mean, mode, SD scores (4 ‘Very concerned’). Most of the participants indicated that they are very concerned with political and financial types of risk in international business with mean scores of 4.00 respectively, while cultural risk had a mean score of 2.80. It indicates that most of the participants are very concerned about political risk.

**The Consequences of Political Risk**

In investigating the consequences associated with political risk, a descriptive statistical analysis was conducted to compare the scores. The participants were presented with 14 types of political risk to indicate the level of the consequences associated with each type of political risk in Nigeria. A five-point Likert scale was used to indicate the level of consequences associated with each type of political risk, where 1 stood for ‘No consequence’, 2 ‘Low’, 3 ‘Moderate’, 4 ‘High’ and 5 ‘Severe’.

Table 7 displays the descriptive statistics of the relative consequences of political risk in Nigeria. Mean scores range from 2.58 to 1.38, mode scores of mostly 1 and SD scores ranging from 1.20 to 0.88. The mean, mode and SD scores (1 ‘No consequence’) indicate that most of the participants believe that there are no consequences of political risk in Nigeria. It submits that most of the types of political risk have few consequences for participant firms doing business in Nigeria.
Table 8 shows FDI inflows to Africa regions, a decline of about 3.5% to $59 billion of FDI was observed in 2016, but the continent still maintains a robust FDI stock. It reveals that there has been a rise and decline in FDI inflow to the continent for the past six years. Nigeria has witnessed a variable inflow of FDI with an increase observed from $3bn in 2015 to $4.4bn in 2016.

Table 8: FDI inflows to Africa Regions, 2011−2016 (Millions of dollars)

<table>
<thead>
<tr>
<th>Region/Year</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nigeria</td>
<td>8 915</td>
<td>7 127</td>
<td>5 608</td>
<td>4 694</td>
<td>3 064</td>
<td>4 449</td>
</tr>
<tr>
<td>Africa</td>
<td>66 018</td>
<td>77 501</td>
<td>74 551</td>
<td>71 254</td>
<td>61 495</td>
<td>59 373</td>
</tr>
<tr>
<td>West Africa</td>
<td>18 926</td>
<td>16 822</td>
<td>14 479</td>
<td>12 176</td>
<td>10 189</td>
<td>11 433</td>
</tr>
<tr>
<td>Southern Africa</td>
<td>26 283</td>
<td>29 376</td>
<td>33 118</td>
<td>30 983</td>
<td>26 039</td>
<td>21 248</td>
</tr>
<tr>
<td>East Africa</td>
<td>5 894</td>
<td>6 596</td>
<td>7 268</td>
<td>6 894</td>
<td>6 284</td>
<td>7 102</td>
</tr>
<tr>
<td>Central Africa</td>
<td>7 367</td>
<td>8 949</td>
<td>7 733</td>
<td>9 112</td>
<td>6 003</td>
<td>5 119</td>
</tr>
<tr>
<td>North Africa</td>
<td>7 548</td>
<td>15 759</td>
<td>11 952</td>
<td>12 086</td>
<td>12 981</td>
<td>14 472</td>
</tr>
<tr>
<td>Other Africa</td>
<td>54 470</td>
<td>61 742</td>
<td>62 599</td>
<td>59 165</td>
<td>48 514</td>
<td>44 901</td>
</tr>
</tbody>
</table>

Source: UNCTAD (2017)

ICRG - Political Risk Assessment Dataset for Nigeria (2011-2016)

Table 9 shows a dataset by ICRG PRA annual rating report conducted for Nigeria within the period from 2011 to 2016 which ranged from 42.5% to 46.0%. This risk rating indicates that a very high political risk ranking was reported by the ICRG for Nigeria within the period (PRS Group, 2015). The highest annual percentage change of political risk (5.9%) for Nigeria was recorded from 2014 to 2015. The net percentage change over this period is -0.9%, implying by this margin no significant reduction was experienced in the level of political risk within the period by ICRG. The total point percentage is used to indicate the level of risk: very high (49.9% - 0.0%), high (59.9% - 50%), moderate (69.9% - 60%), low (79.9% - 70%) or very low (100% - 80%) (PRS Group, 2016).
### Table 9: ICRG - Political Risk Assessment Dataset for Nigeria (2011-2016)

<table>
<thead>
<tr>
<th>Serial</th>
<th>Political Variables</th>
<th>Risk Index Weight</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>Net Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Government Stability</td>
<td>-12</td>
<td>8.0</td>
<td>7.5</td>
<td>8.0</td>
<td>6.0</td>
<td>7.5</td>
<td>6.0</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Socioeconomic Conditions</td>
<td>-12</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Investment Profile</td>
<td>-12</td>
<td>6.5</td>
<td>6.5</td>
<td>6.5</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Internal Conflict</td>
<td>-12</td>
<td>6.6</td>
<td>6.6</td>
<td>6.5</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>External Conflict</td>
<td>-12</td>
<td>9.5</td>
<td>9.5</td>
<td>9.5</td>
<td>9.0</td>
<td>9.0</td>
<td>9.0</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Corruption</td>
<td>-6</td>
<td>1.5</td>
<td>1.7</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Military in Politics</td>
<td>-6</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Religions in Politics</td>
<td>-6</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Law and Order</td>
<td>-6</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Ethnic Tensions</td>
<td>-6</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Democratic Accountability</td>
<td>-6</td>
<td>3.5</td>
<td>3.5</td>
<td>3.5</td>
<td>4.5</td>
<td>4.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Bureaucracy Quality</td>
<td>-4</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total points</td>
<td>-100</td>
<td>45.6%</td>
<td>45.0%</td>
<td>46.0%</td>
<td>42.5%</td>
<td>45.0%</td>
<td>44.0%</td>
<td></td>
</tr>
</tbody>
</table>

**Annual percentage change**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0.0%</td>
<td>-1.3%</td>
<td>2.2%</td>
<td>-7.6%</td>
<td>5.9%</td>
<td>-1.0%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: PRS Group (2016)

### Interview Findings

A thematic method of analysis was used for analysing the interview data collected. Details of the link between the qualitative data collected that informed the interview questions and the interview quotes are shown in Table 10.

### Table 10: Link between Quantitative Data and Interview Questions/Interview Quotes

<table>
<thead>
<tr>
<th>Industry</th>
<th>Quantitative Data</th>
<th>Interview Questions</th>
<th>Interview Quotes</th>
</tr>
</thead>
<tbody>
<tr>
<td>A1- Banking</td>
<td>Weak correlation between types of political risk and firms’ assets</td>
<td>1-What are your firm’s concerns about political risk issues in Nigeria?</td>
<td>concern about political risk, the issue of corruption, problem of terrorism, the offering of bribes, the problem of religious intolerance,</td>
</tr>
<tr>
<td>A2- Banking</td>
<td></td>
<td>2-What are the types of political risk issues mostly concerning their firms in the country?</td>
<td>a type of political risk can exist in one part of a country and not in another, political risk issues as changing over time, located in the Western part of the country</td>
</tr>
<tr>
<td>B1-Manufacturing</td>
<td></td>
<td>3-Are the consequences of political risk significant for your firms?</td>
<td>insignificant for their firms depend on the type of political risk, vary from one part of the country to another</td>
</tr>
<tr>
<td>B2-Manufacturing</td>
<td>No consequences of political risk on firms’ assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>C1- Communication</td>
<td>From the value of R². Types of political risk cannot explain 52% variations only</td>
<td></td>
<td></td>
</tr>
<tr>
<td>C2- Communication</td>
<td></td>
<td>4-What factors influence the impact of political risk on your firm?</td>
<td>engaging in CSR, years of experience operating internationally, understanding of the Nigerian market,</td>
</tr>
<tr>
<td>D1-Insurance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>D2-Insurance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>E1- Petroleum &amp; Gas</td>
<td>The Sig value risk indicates that none</td>
<td></td>
<td></td>
</tr>
<tr>
<td>E2- Petroleum &amp; Gas</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The characteristics of MNCs participants displayed a high percentage of FDI via owning subsidiary. The presence of more firms with investments of over two billion dollars and more than 300 employees confirms that most of them are large-sized MNCs. The results of the determinant of internationalisation by number of years showed a greater number of low-internationalised firms, implying an inflow of more FDI firms in recent times. These findings are consistent with the UNCTAD (2016) report that FDI inflows into Africa have increased significantly. The disparity in each determinant of internationalisation confirms that firms’ degree of internationalisation varies in terms of years, coverage and revenue generated.

This study finds that though MNCs are very concerned about political risk which confirms the World Bank (2014) report that it is has been a major concern for MNCs operating in developing countries. It also supports the views of Baek & Qian (2011) and Baldaaci et al. (2011) that political risk is one of the key determinants of firms’ investment in developing countries. Kerner & Lawrence (2014) and Kesternich & Schniterzer (2010) also mentioned that political risk has resulted in a range of consequences that have influenced the type of strategies which they adopt: changing their ownership structure, entry mode and international investment. Political risk and financial risk can also be considered to offer enhanced opportunities as well as unexpected potential consequences (Knight, 2012; Sadgrove, 2015). Therefore, it implies that how firms will view political risk depends on their perception of the type of political risk.

The interviewees saw political risk issues as changing over time since the socio-economic and political situation keeps altering with changes in federal and state governments in Nigeria. It was also mentioned during the interviews that political risk issues are one of the reasons why most of the MNCs operations are in the Western part of the country. This Nigerian case study has shown that political risk does not always emanate from governmental and political decisions alone. Political risk could originate due to other factors such as ideological, religious, and ethnic cleavages inherent in a political environment (Bienen, 2013; Onapajo, 2012). It is for this reason that most of the factors causing political risk in Nigeria are associated with the evolution of the country as well as with political events and government decisions. However, the general nature of political risk are mostly determined due to institutional specific factors. Therefore, this finding indicates that this is a major concern of political risk.

The findings on the consequences of political risk (mean ranging from 2.6 to 1.4) indicate that there are moderate and low consequences for MNCs in Nigeria. However, the dataset by ICRG PRA annual rating conducted for Nigeria within the period from 2011 to 2016 reported a very high political risk score. This disparity can be explained from the point of view that some MNCs can still operate in a country despite the presence of political risk if its consequences are insignificant on their return on investments. The finding of interviews indicated that there are little consequences of political risk. It also mentioned that the consequences depend on the type of political risk, which means it varies from one type to another. This means that the consequences of political risk vary from one part of the country to another, and likewise so do the impacts. A type of political risk can exist in one part of a country and not in another; therefore, it will have an impact on MNCs operating in that part of the country. This finding can be discussed considering the location of these MNCs in Nigeria. The list of the identified MNCs shows that 75% of these firms are in the western part of Nigeria.

The emergence these findings that each type of political risk has different consequences, even in the same political environment, and the consequences vary from one part of the country to the other. Jiménez et al. (2014) and Kesternich & Schniterzer (2010) pointed out that an MNC’s degree of internationalisation can influence consequences of political risk on a firm. This means the consequences of political risk will have less of an impact on an MNC with a higher degree of internationalisation due to its lower perception of political risk. Likewise, the perceived reward of FDI could also influence the consequences of political risk if it caters for the cost of political risk. A firm’s leverage of operating in a particular political environment can influence the consequences of political risk. This means that the differences in these factors influence the consequences of political risk for MNCs in Nigeria. Thus, some of the reasons why there are small consequences as a result of political risk and why some MNCs have been able
MNCs would locate their investments. The perception of political risk, why they mitigate political risk, & are the reason why some MNCs have been able to manage & mitigate political risk.

In the interviews, some participants mentioned the different factors that influenced the impact of the consequences of political risk in Nigeria. Some mentioned factors such as years of operating intentionally, understanding of the political environment, leverage, a good relationship with government institutions and ability to take advantage of the imperfect market of the country. Others said that their perceived reward of investing influences their perception of the consequences of political risk. Cui & Jiang (2010) & Fang et al. (2013) argue that, for strategic reasons, firms with increasing resource-based advantages move in the direction of a market, based strategies, structures and control mechanisms thereby increasing their market knowledge as well as commitment. They also claim that firms’ market knowledge & commitment continue to increase their ability to manage & mitigate the consequences of political risk.

Some of the issues emerging from these findings suggest that not all the consequences of political risk have the same impact across a country, & further increase the probability of political risk, thereby increasing the cost of doing business. The evidence from this study suggests that differences in firms’ degree of internationalisation could be influenced by the consequences of political risk in diverse ways. The consequences of political risk have different impacts, depending on a firm’s degree of internationalisation (Jiménez et al., 2014). It means the consequences of political risk will have less of an impact on a firm with a higher degree of internationalisation than a firm with a lower degree of internationalisation.

MNCs move to African markets for different reasons, such as resource-based advantages, organisational structure, market knowledge & commitment (Cui & Jiang, 2010; Fang et al., 2013). These factors increase their ability to manage & mitigate the consequences of political risk. The evidence from this study has shown that a firm operating in a particular political environment over time influences the consequences of political risk as it begins to have some leverage & a good relationship with government institutions. Equally, its perceived reward of investing and the imperfect nature of a market can be an advantage, as in the case of Nigeria. It means that the differences in these factors influence the consequences of political risk for MNCs in Nigeria. Thus, this identifies some of the reasons why the consequences of political risk differ between firms & are the reason why some MNCs have been able to manage & mitigate political risk.

The dataset of the ICRG PRA annual rating conducted for Nigeria within the period 2011 to 2016 was analysed. The results of the ranking ranged from 42.5% to 46.0% & revealed that a very high political risk ranking was reported by the ICRG for Nigeria within the period. This also provides one of the factors why some firms invest in African markets like Nigeria, despite the presence of political risk. Since MNCs degree of internationalisation differs; this suggests that their perception of political risk will also vary on their perceived reward for internationalisation in a market.

Firms can internationalise to African markets despite the presence of political risk looking at the differences in risk perception and actual risk between new entrants and the accrued operating experience of incumbents. Also, differences in firm behaviour arise from different attitudes to risk (risk takers versus risk-averse), which may also vary by sector, home country and age amongst others (Liesch et al., 2011; Kraus et al., 2015). The greater the profitability of incumbents, the more likely it is that new firms will enter (hence greater FDI inflows), the lower the perception of risk but likely returns can be expected to fall owing to increasing competitive intensity. Therefore, there is endogeneity between firm entry and perceptions of risk.

Nigeria has witnessed a variable inflow of FDI over the years which makes analysing the FDI inflow trend & the changes of political risk in the country challenging. From the FDI inflow trend, it will be problematic to determine if there is a significant correlation with political risk. To what extent would very political risk & over what sort of period would it significantly impact to make any changes in FDI inflows to Nigerian PRA. Consequently, it could be concluded that there are other determinants of FDI for MNCs in African markets.

Contributions

Al Khattab et al. (2011) & Jiménez et al. (2014) suggest that degree of internationalisation influences firms’ perception of political risk. This article has contributed theoretically that the impact of political risk on MNCs are significantly influenced by factors such as degree of internationalisation, assessment outcome, leverage, perceived rewards of FDI, low financial risk & a country’s political risk regional variation. It identifies reasons why firms MNCs invest directly in some markets despite the presence of high political risk, why they mitigate political risk in some markets and why some internationalise into specific markets.

This study has shown that the consequences of political risk vary from one part of a country to another, as do the consequences of their impacts. It has additionally suggested the reasons why the clusters of MNCs would be located in some parts of a country, & how the consequences of political risk would differ between firms, depending on their location in a country. Most MNCs, for one reason or another, will avoid parts of the country that have high political risks. It means the consequences of political risk vary from one part of a country to another. This could be attributed to regional variations in political risk within a country. Therefore, MNCs would locate their investments
in a region with the lowest political risk even when a high political risk exists in a country. Although this finding is contextual, it would influence the decision making by MNCs with regards to where they could locate their firms during internationalisation, especially in African markets.

Firms could internationalise to certain markets despite the presence of political risk due to the differences in risk perception and actual risk between new entrants and the accrued operating experience of incumbents. Equally, differences in firms’ behaviour arise from different attitudes to risk (risk takers versus risk-averse), which may also vary by sector, home country and age amongst others (Liesch et al., 2011; Kraus et al., 2015). The greater the profitability of incumbents, the more likely it is that new firms will enter (hence greater FDI inflows), the lower the perception of risk but likely returns can be expected to fall owing to increasing competitive intensity. Therefore, there is endogeneity between firm entry and perceptions of risk.

The presence of high political risk does not deter firms if the financial & economic risks are low (PRS Group, 2015). It implies that there are other factors which could influence firms to internationalise into a particular market apart from political risk. It has suggested why some firms invest in particular African markets, despite the presence of high political risk. Therefore, MNCs would need to consider other forms of risk apart from political risk when making their decision during market entry.

Conclusion

This study has provided reasons why would some Multinational Corporations (MNCs) invest in African markets despite the presence of high political risk. Political risk has been identified as one of the key determinants of FDI, and its different manifestations have influenced the type of strategies MNCs adopts for different markets. It has been viewed to manifest itself differently in African markets compared to others thereby it has created the need to understand variations in countries’ specific political risk factors and why MNCs invest in some African countries. Most African countries have specific political risk factors that differentiate one from another, based on inherent factors in their political environments. Some of these inherent factors are related to religious, ethnic and cultural cleavages. These cleavages may also lead to regional variations in political risk within a country. However, MNCs have attributes that have differentiated one firm from another and have informed to have significantly influenced their rate of FDI into various markets. These attributes have also made them to perceived political risk differently.

This paper critically examines political risk influence on MNCs in African markets. It uses a sequential mixed method strategy to analyse statistically and thematically data collected from MNCs, including a political risk rating dataset for Nigeria 2011-2016, using a multi-method approach. It has been reported that Nigeria is among the top 5 FDI inflow host economies in 2016. The country is a major supplier of oil and gas to the global market which, coupled with its large market size, has made it an attractive destination for FDI. Despite the flux in her political situation due to the multi-ethnic, multi-cultural and multi-religious nature of the country, it has one of the significant stocks of FDI on the continent.

This study has shown that the consequences of political risk vary from one part of a country to another, as do the consequences of their impacts. It has additionally suggested the reasons why the clusters of MNCs would be located in some parts of a country, & how the consequences of political risk would differ between firms, depending on their location in a country. Most MNCs, for one reason or another, will avoid parts of the country that have high political risks. It means the consequences of political risk vary from one part of a country to another. This could be attributed to regional variations in political risk within a country. Therefore, MNCs would locate their investments in a region with the lowest political risk even when a high political risk existing in a country. Although this finding is contextual, it would influence the decision making by MNCs with regards to where they could locate their firms during internationalisation, especially in African markets.

Firms could internationalise to certain markets despite the presence of political risk due to the differences in risk perception and actual risk between new entrants and the accrued operating experience of incumbents. Equally, differences in firms’ behaviour arise from different attitudes to risk (risk takers versus risk-averse), which may also vary by sector, home country and age amongst others. The greater the profitability of incumbents, the more likely it is that new firms will enter (hence greater FDI inflows), the lower the perception of risk but likely returns can be expected to fall owing to increasing competitive intensity. Therefore, there is endogeneity between firm entry and perceptions of risk.

The presence of high political risk does not deter firms if the financial & economic risks are low (PRS Group, 2015). It implies that there are other factors which could influence firms to internationalise into a particular market apart from political risk. It has suggested why some firms invest in particular African markets, despite the presence of high political risk. Therefore, MNCs would need to consider other forms of risk apart from political risk when making their decision during market entry.

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When the Family Becomes the Biggest Obstacle for a Family Business: ‘Who is the Best Fit for the Position’

Nesrin Ada, Ege University, Turkey
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Small and medium sized firms (SMEs) are the major building blocks in all countries’ economies. Particularly for employment generation they have a vital role. Many SMEs are also family firms. Therefore, they are established, owned and operated by families. In this line, their performance is also strongly related to the performance of family members as business people, managers or workers. In many cases, after the first generation’s involvement in such a business is ended, the viability of the company may face critical difficulties if the following generation does not have managerial qualities as well as their predecessors. Then ‘a family business becomes the biggest obstacle for a family business’.

Family businesses are businesses that are founded and operated by people who come from the same family and relatives for the sake of the economic interests of that particular family. Normally founder is an entrepreneur who is capable of successfully starting and then running the business. In this process, s/he may also get the help of other family members under her/his leadership. Hence, roles of the other family members are normally determined by the leading entrepreneur. However, this approach may sometimes lead to misuse of the organizational functions as the managerial performance could be secondary for appointment in comparison with the strength of the family tie between the founder and the person or people involved. During the founder’s actual managerial period, such problems may be overcome due to her/his interventions. However, after the founder’s leave, such managerial inefficiencies can absolutely be fatal for the sustainability of the firm. Furthermore, sometimes such a case can be worsened if there are succession problems after founder among the family members. These types of disagreements can easily take the company ship directly to the rocks.

With this regard, in this paper, we first focus on basic organizational functions of any business. Here, organizational functions are explained by referring to the characteristics.

Family business and its characteristics

Family businesses first came to the scene with the emergence of private property. There are two basic characteristics of a family business in terms of historical and modern perspective (Boungou Bazika, 2004):

Traditionally, family businesses can be indicated as the roots of the modern society. In fact, the company form itself is a family-oriented organization. The first family organizations have evolved into the modern day businesses throughout the history. Therefore, this is even reflected in the existence of modern large scale multinational corporations. These companies even now preserve some of significant family character traits as we can easily see with Peugeot, Toyota, or Phillips.

On the other hand, from a modern point of view, family businesses are just pure economic organizations. However, they have a different mechanism to manage certain organizational risks. These are related to trust-based relationships. In a family environment, as we may normally expect higher levels of trust such risks can be managed in an easier way.

Let us attempt now to define a family business by referring to all these issues. A family business is a company whose objectives are formed and controlled by the founding family. Family companies – at least in Turkey – have a number of features which make them different from other types of companies (Ada, Şengül and Çapraz, 2004):

- The company’s founder is generally the father of the family (the first generation); Management boards also made up of other family members.
- The company looks after the family’s interests.
- Many management decisions must be approved by the father.
- Task responsibilities and authority limits are not determined with clarity.
- Company positions are distributed among family members or relatives in accordance with relational proximity.
- Getting a job at the company depends on kinship.
- Lack of professional thinking and tendency to act emotionally.
- Distrust for managers who are not members of the founding family, or their relatives.
- Strong resistance to authority transfer.
- Lack of training among family members.
In spite of growth of the company and changes in the business environment, the founding management is generally maintained without the required changes or adaptations.

Accusing the personnel composed of non-family people for business failures and bad decisions.

Reluctance to use professional help while business problems are faced.

Confusing the family financial accounts and personal accounts, and acting to exploit the company’s financial capabilities in an unprofessional way.

Though the already mentioned aspects are all negative, there are some positive aspects of such family-owned companies such as the followings:

The managers can normally easily communicate, and hence escape from the inefficiencies of the use of bureaucratic communication.

They are flexibility and quick in decision making.

They have faster business processes and hence progress.

They have the ability to intervene quickly in case of a crisis.

Management and Organization

Management is defined as achieving the objectives of the firm through an effective and productive way by planning, organizing, supervising, conducting and controlling the resources available with the help of people (Mirze, 2010). In other words, management is the process of doing things with people who work for the firm in an efficient and productive way. In this respect, the concept of management is ‘to work through others’ by ‘aiming the efficient use of production factors’ (Yuksel, 2003). The management functions are defined by Fayol (1916) a century ago as planning, organizing, directing, coordinating and controlling. Over time, these functions have undergone changes and improvements in line with business needs. In the business administration literature, orientation and coordination functions seem to be combined. Planning involves preparing sub-plans to identifying goals, setting up strategies, and coordinating activities. Organizing involves identifying what, how, and by whom it will be done, how the tasks will be grouped, who will report to whom, and who will take the decisions. Orientation is part of the manager's job of directing and coordinating people's activities. The supervisory function is monitoring, comparing and correcting performance.

In addition to these functions that constitute the basis of the management theory as Fayol has set, Drucker pointed out the importance of business goals, organization, motivation, communication and human resources development. Drucker also emphasizes that management functions must be used in line with the expectations of business and common objectives, as well as the importance of creating business values as an organizational culture. In family businesses, organizational culture and goals are determined by the family members. As a result, the problems of the organizing function may be an important obstacle in family businesses (Misetić, 2001).

Organizational problems in family businesses

When we look at role distribution in a family business, the family ownership dimension has an important role. And this may create significant problems over the organization with regard to specialization, command-control, power-responsibility, supervision, and formalization issues.

Organizing problems stem from the fact that the organizing function has not been designed well. As a result, the misrepresentation of organizational structure causes confusion and complexity within the organization (Koç, Topaloğlu, 2010). This complexity leads to various problems and these are reflected negatively in the business management.

There could be a number of organizational problems in a family business that are rooted in occupational and organizational structure. The conflicts and effects that exist between family members constitute the main theme in some them. These could be as follows:

- Conflict → sibling conflict → conflicts between the founder and/or siblings or between the second and third generations.
- The power ambition of the family members.
- Leadership problems such as multiple leadership or expectancies for multiple leadership
- The influence of the personality problems of the family members or the founder and also negative aspects of the family culture on organizational function.
- Confusion of authority among family members.
- Overlaps regarding the responsibility and authority areas of the management.
- The disadvantages of having multiple roles and duties for the family member and task complexity.
- The decisions taken by the top management may not be fully implemented in the units in which are run by other the family members due to power balances among them.
- Responsibility and authority areas may be outside of the family-member managers’ professional specializations.
- Lack of institutional capacity
- Focusing on family values instead of strategic requirements

Another organizational problem area that can be widely seen in family businesses is related to the personal
relationships between the family members and professional employees. Some of such problems can be as follows:

- Problems regarding the command-line relationships of professional managers due to their close proximity to the family members.
- Insecurity feeling of the professional managers before the family members.
- Sometimes supervisory areas of the professional managers are overlapped.
- Distrust among the employees created by the wage injustice between the family members and the professionals.
- Lack of organizational commitment in occupations, resulting in high labor turnover.
- High labor turnover leading to organizational commitment by professional managers.
- The existence of organizational silence.
- Resistance to institutionalization processes,
- Adaptation problems to the organization-family culture.
- Some senior professionals privileged position leading to informal communication with the second or third generation family members, and hence corporate communication and efficiency problems.

Another organizational problem area in family businesses is directly related organizational structure / framework / schema. The organizational structure is a mechanism by which all employees work together to achieve common business processes in a structured social system for the purposes (Mirze, 2016). Within this mechanism, it is expected to act towards organizational policies and business purposes. However, deficiencies and disruptions in organizational structure are reflected negatively in organizational function. As Erdoğan and Develioglu (2008) pointed out, organizational problems related to organizational structure are:

- The lack of appropriate organizational structure for the purposes of family management.
- Lack of organizational function and complexity, failure to determine basic organizational policies at a good level, lack of understanding of organizational planning.
- Lack of strategic perspective, turning the organic structure into a solid mechanical closed organization system.
- Sometimes the distribution of authority and responsibilities according to the various departments in the family business is not balanced and clearly defined.
- The organization and the command channels are not clearly defined and mixed in the structure of the organization.
- Formal and unformal structures are intertwined and complex (Erdoğan and Develioglu 2008).

In addition to the following problems are also common:
- Problems related to improvements of the organizational structure suitable for the family-organization culture.
- Formalization incompleteness (such as non-implementation of board decisions).
- Hierarchy ambiguity and hidden hierarchy presence (hidden decision maker).
- Problems such as trying to move to the growth phase of the operation with the simple organization structure that the founder has formed during the period of entrepreneurship.

Conclusion

Family business is distinguished from other types of business by its unique characteristics (Collins et al., 2012). Lumpkin et al. (2008) found that these characteristics specific to family operations are related to ‘tradition’ (roles are obvious → common past), ‘stability’ (rules are predictable → behavior), ‘loyalty’ (duty and responsibility, sense of indebtedness, sense of belonging ), ‘trust’ (protection, security, safety, reciprocity, honesty, trustworthiness) and ‘loyalty’ (emotional ties → family members support each other) (Lumpkin et al., 2008).

The father’ desire to provide employment to the family members is very important in the process of organizing a family business. All these are good and understandable. But when such family members who are not really fit for the position that the job requires, significant inefficiencies can arise. In addition the decision quality in the business making process may have serious obstacles. Therefore, if not organized as the competitive conditions impose, a family itself could be biggest obstacle for the family business.

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