



Towards a behavioral theory of MNC response to political risk and uncertainty: The role of CEO wealth at risk

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ABSTRACT

Drawing on behavioral agency research, we examine how CEO equity wealth at risk of loss in the form of restricted stock influences the response of multinational corporations (MNCs) to political risk and political uncertainty. In a sample of 14,765 cross-border greenfield investments and full acquisitions announced by U.S. firms from 2004 to 2016, we find that while greater CEO equity wealth at risk of loss in the form of restricted stock strengthens the (positive) relationship between political risk and MNCs' choice of greenfield investments over full acquisition, CEO equity wealth at risk of loss does not influence the relationship between political uncertainty and MNCs' choice of greenfield investments. We contribute to international business theory by introducing a behavioral theory of MNC responses to adverse host country political environments. As such, unlike previous studies that have treated political risk and political uncertainty interchangeably, our study highlights the need to differentiate between political risk and political uncertainty as related yet distinct concepts.

1. Introduction

Brexit, the armed rebellion in Ukraine, and increasing violence in South Sudan are only a few examples of recent geopolitical shocks that contributed to the perception that multinational corporations (MNCs) operate in an increasingly challenging geopolitical environment (Banalieva, Cuervo-Cazurra, & Sarathy, 2018; Zhu & Sardana, 2020). This has resulted in a renewed interest among international business (IB) scholars in how MNCs strategize to manage their exposure to multiple political systems (Banalieva, Cuervo-Cazurra, & Sarathy, 2018; Liou, Brown, & Hasija, 2021). A recent insight that has emerged from this research is that there is a clear difference between political risk and political uncertainty (John & Lawton, 2018; López-Duarte & Vidal-Suárez, 2010). Specifically, from a conceptual standpoint, risk and uncertainty differ in the degree to which the probability distribution of an undesirable event occurring, and its associated consequences are known (Knight, 1921). Risk can thus be defined as “the chance that an undesirable event will occur and the consequences of all its possible outcomes” (Lough, Stone, & Tumer, 2005: 455), while uncertainty arises

from imperfect knowledge and information, which makes the probability of an undesired event occurring and its consequences unknown to decision makers (Knight, 1921). In essence, these definitions reflect the idea that risk is quantifiable, whereas uncertainty is not.

In the context of the political environment, an undesirable event has been primarily conceptualized as an instance of adverse policy change (Fitzpatrick, 1983; Kobrin, 1979). As such, political risk occurs when the probability distribution of an adverse political change occurring and its associated consequences are known to decision makers, and has thus been mainly linked to situations in which “a change in the preferences of any one actor may lead to a change in government policy” (Henisz, 2002: 363). By contrast, political uncertainty occurs when incomplete information impedes decision makers ability of to estimate the probability of adverse policy change materializing and its consequences. Accordingly, political uncertainty occurs in situations in which episodic or rare events, such as political violence (Witte, Burger, Ianchovichina, & Pennings, 2017; Witte, Burger, & Pennings, 2020), result in a threat of adverse policy changes. Hence, while both concepts describe the threat of adverse policy change, there are important differences in the

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underlying sources and mechanisms that lead to such a threat and the ability to objectively estimate the probability that such an event occurs and, if it materializes, its associated consequences.

Surprisingly, although IB scholars have started to acknowledge that political risk and uncertainty are indeed different concepts, a majority of previous research continues to use these terms almost interchangeably (John & Lawton, 2018; López-Duarte & Vidal-Suárez, 2010). Thus, we still lack an understanding of the theoretical and practical implications of these conceptual differences, which is problematic as it remains unclear what exactly is theorized about (Makadok, Burton, & Barney, 2018) and more specifically how political risk and political uncertainty may relate to each other. In particular, while it is broadly accepted that risk and uncertainty are indeed distinct concepts, it remains unclear whether they are independent from each other, co-exist or whether they occur sequentially, with uncertainty (risk) gradually turning into risk (uncertainty). This is an important shortcoming given that the nature of the relationship between risk and uncertainty influences our understanding of how decision makers operate in dynamic environments (Samson, Reneke, & Wiecek, 2009).

One possible reason for this omission is that prior research has paid insufficient attention to individual differences across powerful actors in MNCs such as CEOs and how these differences may be reflected in MNC responses to host country political environments. To date, extant research largely assumes the role of CEOs to be merely instrumental in that their main task is to align the MNC's strategy with the demands of the host country political environment (e.g., Delios & Henisz, 2003; Demirbag, Glaister, & Tatoglu, 2007; Slangen, 2013). While this view is consistent with environmental determinism perspectives that are inherent in most mainstream IB theories (Elia, Møller-Larsen and Piscitello, 2019), it runs counter to a growing stream of research that has advanced a behavioral perspective on MNC strategy. That work has identified the CEO as an important source of heterogeneous responses to environmental stimuli (Benischke, Martin, Gomez-Mejia, & Ljubownikow, 2020; Krause, Filatotchev, & Bruton, 2016). As such, the behavioral perspective is useful as it can inform our understanding of MNCs' heterogeneous responses to political risk and political uncertainty as distinct sources of adverse policy changes.

The objective of this study is thus to introduce a behavioral theory of MNC responses to host country political risk or political uncertainty that focuses on individual differences across CEOs. To do so, we integrate prior research on how MNCs manage host country political environments with the behavioral agency model (BAM; Wiseman & Gomez-Mejia, 1998). Drawing on the insight from prospect theory (Kahneman & Tversky, 1979) that individuals are more sensitive to losses than gains, BAM suggests that strategic choices of self-interested CEOs are at least in part determined by their "perceived threat to agent wealth" (Wiseman & Gomez-Mejia, 1998: 136), defined as equity wealth at risk of loss. Extending these insights to our context, we propose that CEO equity wealth at risk of loss is an important contingency that may explain heterogeneity in MNC responses to political risk and political uncertainty. Specifically, we test the moderating effect of CEO equity wealth at risk of loss – as reflected in the CEO's restricted stock wealth – on MNC responses to host country political risk and political uncertainty in the context of the choice between cross-border greenfield investments and acquisitions. Using a sample of 14,765 cross-border acquisitions and greenfields announced by publicly-listed U.S. companies between 2004 and 2016, we find that companies led by CEOs with higher restricted stock wealth will opt for greenfield establishment modes over acquisitions in the presence of high levels of political risk, but we do not find a moderating effect of CEO restricted stock wealth on the relationship between political uncertainty and the choice of establishment mode.

The primary contribution of this study is to introduce a behavioral explanation of how CEO self-interest – as reflected in the CEO's level of equity wealth – influences MNCs' strategic choices in the presence of political risk and political uncertainty. We achieve this by shifting the level of the theory from the firm to the CEO. By doing so, we are able to

clarify the relationship between political risk and political uncertainty, showing that they are independent and can co-exist. As such, our study also modifies existing theory which has largely adopted a deterministic perspective, whereby environmental conditions determine MNCs' adaptive responses to host country political environments (Cavusgil et al., 2020). As argued by others (e.g., Herrmann & Datta, 2002, 2006), this view leaves little room for managerial agency. In contrast, our theory explicitly allows for managerial agency, and specifically choices that are explained by behavioral factors and may thus not always be fully predicted by mainstream IB theories. The present study can thus serve as a platform for IB scholars interested in further unpacking how the political influences MNC strategy.

2. Theoretical background: Risk, uncertainty, and behavioral agency in multinational foreign establishment

IB scholars have long recognized that host country political environments can pose a number of challenges for MNCs when expanding or operating abroad (Zhu & Sardana, 2020). While the IB literature initially adopted a normative perspective on the political environment (Hymer, 1976) that focused on the "universality of government interference as a negative factor" (Fitzpatrick, 1983: 249; see also Doh & Ramamurti, 2003), subsequent work has mainly viewed the political environment in terms of the likelihood of political events occurring that may result in unfavorable "regulatory or tax policy shifts or, at the extreme, outright expropriation of private sector assets" (Delios & Henisz, 2000: 307). In this regard, IB scholars have identified two related yet distinct concepts that capture the threat of adverse policy changes; political risk (e.g., Delios & Henisz, 2000; López-Duarte & Vidal-Suárez, 2010) and political uncertainty (e.g., Slangen, 2013; Williams, Lukoianova, & Martinez, 2017). However, most prior studies have used these terms almost interchangeably implying that risk is uncertainty (or vice versa). Yet, there is strong reason to believe that a clear distinction between these two concepts exists, specifically with regards to the sources that underpin and the mechanisms through which the threat of adverse policy change manifests itself (e.g., John & Lawton, 2018; Oh & Oetzel, 2017; Witte, Burger, Ianchovichina, & Pennings, 2017; Witte, Burger, & Pennings, 2020).

2.1. Differentiating between risk and uncertainty

As described by Knight (1921), risk occurs when decision makers can use available information to objectively estimate the probability distribution of an undesirable event materializing and its potential consequences (see also Kaplan & Garrick, 1981). In the context of the political environment, such an undesirable event refers to adverse policy change that has a material effect on the MNC's foreign operations. By contrast, uncertainty involves imperfect knowledge and information. Consequently, decision makers cannot objectively estimate the probability of an undesirable event occurring, and its associated consequences. Hence, decision makers will be unable to objectively estimate how the "future will turn out if we undertake a certain course of action (or inaction)" (Kaplan & Garrick, 1981: 12). Hence, while both concepts relate to the possibility of an undesirable event materializing, there are important differences in decision makers' ability to objectively estimate that probability and, should it materialize, its potential consequences. Such differences exist because the underlying factors that lead to such undesirable events and thus the information available to decision makers can differ (Fitzpatrick, 1983). As such, we argue that it is critical to pay close attention to the underlying sources that can lead to high levels of *political risk* and *political uncertainty*.

The primary source of political risk is the lack of political constraints. Political constraints are determined by the veto rights that independent branches of government possess and the degree to which multiple branches of government are aligned (e.g., the ruling party controls multiple or all branches of government) (Henisz, 2002). To illustrate,

countries characterized by high political risk include China, Cuba, or the Democratic People's Republic of Korea (Henisz, 2017). In these countries, the political system is designed in such a way that independent branches of government have no meaningful veto rights and most, if not all, branches of government are controlled by the same party. In these contexts, political actors face few constraints when seeking to change policy. This, in turn, increases the threat of adverse policy change for foreign MNCs. As such, in the case of political risk, the extent of the threat of adverse policy change is at least to some degree embedded in the political system, meaning that a given level of political risk tends to persist over time. Hence, decision makers have access to a wide range of information from which they can more objectively estimate the probability distribution that adverse policy change materializes. Consistent with the definition of risk, we thus follow Henisz (2002) and conjecture that the underlying source of political risk is the presence of absence of political constraints.

In contrast, *political uncertainty* occurs when decision makers cannot objectively estimate the probability distribution that an undesirable political event – i.e., adverse policy change – materializes and its associated consequences. This is the case in the event of rare and episodic political events such as political violence, whereby insurgents seek to overthrow the government to change existing policy (Witte, Burger, Ianchovichina, & Pennings, 2017; Witte, Burger, & Pennings, 2020). Political violence is a rare or episodic event whereby political actors challenge the government outside the formal branches of government. Given the rare or episodic nature of political violence, there is less reliable information available to decision makers based on which they would be able to objectively estimate the probability that such political violence leads to adverse policy change. Indeed, even in countries that are characterized by more frequent episodes of political violence, the nature of these conflicts often fluctuates significantly over time, which makes it difficult to predict decision outcomes in the presence of these conflicts (John & Lawton, 2018; Oh & Oetzel, 2017). Relatedly, experience with such rare events in one context cannot be applied to others (Oetzel & Oh, 2014). Consistent with the definition of uncertainty, we therefore argue that the threat of adverse policy change due to political uncertainty is high (low) in countries with high (low) political violence.

2.2. Political risk and uncertainty and the choice between greenfield and full acquisition

Prior research linking political risk or political uncertainty to MNC establishment mode strategy is broadly based on the logic that political risk and political uncertainty may hinder MNCs from exploiting their firm-specific advantages when expanding abroad (Witte, Burger, Ianchovichina, & Pennings, 2017; Witte, Burger, & Pennings, 2020). Specifically, although discrimination against MNCs used to be more overt, often taking the form of outright nationalism and expropriation, it has increasingly become more subtle, taking the form of differential regulatory treatment of foreign MNCs or “creeping” expropriation (Doh & Ramamurti, 2003). Particularly problematic for MNCs are adverse policy changes post-market entry (Duanmu, 2014) as these changes pose a direct threat to any location-specific investments that have already been made (De Villa, Rajwani, Lawton and Mellahi, 2019). In this situation, real options theory (Reuer & Leiblein, 2000) suggests that MNCs should select the establishment mode that allows them the most strategic flexibility, while at the same time limiting potential of losses in case MNCs have to quickly exit from the market if adverse policy changes occur (Brouthers, Brouthers, & Werner, 2008; Slangen, 2013).

We thus argue that the potential losses for an MNC in the presence of high levels of political risk and political uncertainty are greater for full acquisitions than greenfield investments and, hence, the MNC is more likely to select the greenfield establishment mode. Specifically, we claim that greenfields will provide MNCs with greater investment flexibility. The reason for this is that MNCs that set up a greenfield investment can relatively easily manage investments in the foreign subsidiary, for

example by successively investing into the equipment and facilities needed (Pacheco-de-Almeida, Henderson, & Cool, 2008), whereas acquisitions normally require the immediate purchase of all existing assets (Brouthers & Dikova, 2010). Similarly, greenfield investments also have the advantage that they can be “built to match the company’s exact production requirements rather than having to accept existing – possibly too large or inefficient – operations in an acquired subsidiary (Harzing, 2002: 213). Overall, these arguments suggest that greenfield investments can “be pursued with substantially lower resource commitment, compared to an acquisition” (Brouthers & Dikova, 2010: 1054) and, as a result, the downside risk is lower for greenfield investments than acquisitions if the threat of adverse policy change materializes. In other words, MNCs initially incur fewer sunk costs when expanding through greenfield investments than acquisitions (Slangen, 2013), meaning that less capital would be lost in the event of failure due to adverse policy changes. It then follows that if withdrawal from the host country becomes necessary due to adverse policy changes, greenfield investments facilitate such an exit at lower sunk costs. We consequently expect that MNCs will prefer greenfield investments to full acquisitions in the presence of high political risk and political uncertainty:

Hypothesis 1. There is a positive relationship between political risk or political uncertainty and the MNC’s preference for greenfield investments versus full acquisitions.

2.3. The behavioral agency model and equity wealth at risk

Our predictions so far have mostly assumed that CEOs will act in the best interests of the firm when considering the optimal establishment mode in foreign market expansion decisions. From this perspective, CEOs would select the establishment mode that safeguards the firm’s owners from potential losses, while at the same time preserving the option to expand operations in the host country if risk or uncertainty resolve favorably in the future. However, as documented in prior behavioral research (e.g., Benischke, Martin, & Glaser, 2019; Martin, Gomez-Mejia, & Wiseman, 2013; Wiseman & Gomez-Mejia, 1998), self-interested CEOs may simultaneously pursue personal goals when making foreign market expansion decisions (e.g., Benischke et al., 2020; Benischke, Martin, Gomez-Mejia, & Ljubownikow, 2020; Giambona, Graham, & Harvey, 2017).

The behavioral agency model (BAM) provides an additional set of insights into the nexus between managerial self-interest and strategic decision making. The BAM draws on the concept of loss aversion, an empirically validated construct derived from prospect theory (Kahneman & Tversky, 1979), to postulate that CEOs’ strategic decision making will be influenced by their “perceived threat to agent wealth” (Wiseman & Gomez-Mejia, 1998: 136). This is because CEO equity wealth correlates with the firm’s underlying share price (Nyberg, Fulmer, Gerhart, & Carpenter, 2010) and as such, the CEO will experience commensurate losses in personal wealth in the event of failure. CEOs with higher levels of equity wealth, such as restricted stock, thus experience a greater threat of personal wealth losses. Hence, these CEOs will be more reluctant to make decisions that would jeopardize their accrued wealth (Benischke, Martin, & Glaser, 2019; Benischke, Martin, Gomez-Mejia, & Ljubownikow, 2020; Devers, McNamara, Wiseman, & Arrfelt, 2008; Martin, Gomez-Mejia, & Wiseman, 2013), meaning that their strategic choices will become increasingly conservative as they accumulate more equity wealth at risk of loss.

In line with prior behavioral research (Lim, 2015; Sanders, 2001), we focus on restricted stock to capture equity wealth. Stock grants can be divided into vested and restricted (unvested) stock. The key difference between these two types of stock is that the CEO cannot take full ownership of restricted stock until a predetermined date in the future. As a result of the 2002 Sarbanes-Oxley Act, which was unfavorable to stock options, the early 2000s witnessed a shift from stock options to restricted stock to align CEO incentives with firm performance (e.g., Jarque &

Price, 2016).¹ From a conceptual standpoint, restricted stock also provides a more direct test of the BAM given that, in contrast to stock options, restricted stock results in a “direct wealth transfer in terms of stock ownership, regardless of stock price” (Victoravich, Buslepp, Xu, & Grove, 2011: 108). That is, while the value of stock options depends on movements in the firm’s underlying share price relative to a predetermined strike price, the value of restricted stock is not contingent on the share price hitting a predetermined strike price. Therefore, managerial agents such as CEOs are assumed to have less incentive to take actions that can drive up the share price when awarded restricted stock relative to stock options (Hall & Murphy, 2002). On the contrary, CEOs will most likely immediately endow the value of their restricted stock into estimates of their current wealth at risk of loss (Devers et al., 2008; Lim, 2015; Sanders, 2001). This is also because, unlike stock options, restricted stock represents an actual ownership stake in the company (Moisan, 2018), meaning that restricted stock is most likely to translate into equity wealth at risk of loss and increases in the CEO’s restricted stock will thus result in more risk aversion (Lim, 2015; Sanders, 2001).

2.4. Political risk versus political uncertainty and equity wealth at risk of loss

In Hypothesis 1, we proposed that under higher levels of host country political risk or political uncertainty, MNCs will be more likely to prefer the greenfield investment establishment than the full acquisition. However, insights from the BAM suggest that CEOs’ behavioral response to political risk or political uncertainty is contingent upon their personal equity wealth at risk of loss. Specifically, we expect that CEOs’ behavioral response to political risk or political uncertainty will be stronger as their restricted stock wealth at risk of loss increases. The reason for this is that the possibility of a worsening political environment post-market entry will pose a greater threat to those CEOs whose personal wealth is tied to firm success. In the context of our study, this suggests that CEOs who hold more restricted stock will have an even stronger preference for greenfield investments over acquisitions as either host-country political risk or host-country political uncertainty increases. We therefore contend that in response to elevated levels of political risk or political uncertainty, CEOs with high levels of equity wealth at risk of loss in the form of restricted stock will react more sensitively to the possibility of adverse policy changes as reflected in an even greater tendency to select the greenfield establishment mode than their counterparts with lower levels of equity wealth at risk of loss.

Hypothesis 2. The positive relationship between political risk or uncertainty and MNC preference for greenfield (versus full acquisition) investments is stronger (more positive) as the level of CEO restricted stock increases.

We have argued above that in the presence of high levels of political risk and political uncertainty, CEOs with higher levels of restricted stock have an even stronger preference for choosing greenfield investments over full acquisitions. We further postulate that this moderating effect will be stronger for *political risk* relative to *political uncertainty*. If political

risk and political uncertainty are indeed distinct components of a host country’s political environment that may both affect MNC strategies (in our case establishment mode choices), loss-averse CEOs are likely to show a greater behavioral response to the component that is quantifiable, since they can better assess the consequences of that component for their personal wealth. We thus argue that the moderating effect described in Hypothesis 2 will be stronger for *political risk* relative to *political uncertainty*. Formally:

Hypothesis 3. The moderating effect of CEO restricted stock is stronger for political risk than for political uncertainty.

3. Methodology

3.1. Sample

Our sample consists of greenfield investments and full acquisitions announced in the period from 2004 to 2016 by S&P 1500 firms headquartered in the United States. We first identified firms included in the S&P 1500 over the study period and then identified the cross-border acquisitions and greenfield investments that these firms had completed during this time period. These activities took place in 57 unique host countries. We then identified the CEOs that were in office at the time of announcement of the cross-border acquisition or greenfield investment. In terms of data, we collected data on cross-border acquisitions from the SDC Platinum database. Following prior research (e.g., Brouthers & Brouthers, 2000; Chen, 2008; Hennart, 1991), we defined full acquisitions as those transactions in which at least 95 percent of the target firm has been acquired. Data on greenfield investments was obtained from fDi Markets, a database provided by the Financial Times. fDi Markets is the most comprehensive database on greenfield investments and is widely used by government agencies and researchers (e.g., Ang, Benischke, & Hooi, 2018; Castellani & Lavoratori, 2020; Chen, Cui, Li, & Rolfe, 2017; Ketteni & Kottaridi, 2019; Witte, Burger, Ianchovichina, & Pennings, 2017; Witte, Burger, & Pennings, 2020). Although the database was launched in 2003, our sample starts in 2004, since we had to lag some control variables by one year. CEO compensation data was obtained from Execucomp and firm level data was collected from Compustat. After excluding cases with missing data, our final sample consists of 3,601 full acquisitions and 11,164 greenfields. The most frequent host countries were China (1,780 observations), United Kingdom (1,573), India (1,255), and Canada (983).

3.2. Dependent variable

We measured the dependent variable, *establishment mode is greenfield*, as a dummy variable that takes the value of 1 if the MNC invests in a given host country through a greenfield investment and 0 if the MNC invests through a full acquisition.

3.3. Independent variable

Consistent with the definitions of risk and uncertainty, we operationalize *political risk* using the POLCON measure. POLCON captures the “extent to which a change in the preferences of any one actor may lead to a change in government policy” (Henisz, 2002: 363). For example, for countries in which the executive branch of the government can initiate significant policy changes without the approval of the legislative branch, political constraints are relatively lower than in countries in which the legislative branch of government has strong oversight of the executive branch. Thus, the absence of political constraints increases the threat of adverse policy changes (Henisz, 2002). For an in-depth description of the methodology used to calculate this measure, see Henisz (2000). We use the 2017 version of the dataset (Henisz, 2017). The POLCON measure is based on positive political theory and ranges from 0 to 1, whereby 0 (1) denotes that there are no (full)

¹ Following the Sarbanes-Oxley Act, which encouraged the modification to the 2006 FAS 123 of the GAAP code, stock options had to be treated as an expense on the income statement. In the wake of the requirement to expense stock options, firms had to calculate the fair value of an option, which involved the complicated process of determining the volatility and current price of a stock; specific terms of stock options; and its vesting period based on Black-Scholes, binomial, or another valuation model (Berman & Knight, 2009). In addition, if senior executives decided to exercise their stock options, the requirement to expense stock options created a tangible expense on the income statement to their firms and shareholders. As a result, the popularity of CEO stock options has declined, while the prevalence of CEO restricted stock has increased (Bout, Wilby, & Cruz, 2019).

constraints on the branches of government to introduce policy changes. We calculated the variable as 1-POLCON, such that a higher value indicates lower political constraints and, hence higher political risk.

In order to operationalize *political uncertainty*, we follow the lead of recent IB research and focus on political violence (Witte, Burger, Ianchovichina, & Pennings, 2017; Witte, Burger, & Pennings, 2020). Political violence is defined as “a contested incompatibility that concerns government and/or territory where the use of armed force occurs between two parties, of which at least one is the government of a state” (Pettersson & Wallensteen, 2015: 536). Political violence could translate into adverse policy change as government policy may change to either accommodate the demands of those political actors outside the formal branches of government (insurgents), or these insurgents may overturn the government and subsequently change government policy themselves. We follow prior research (Witte, Burger, Ianchovichina, & Pennings, 2017; Witte, Burger, & Pennings, 2020) and measure political uncertainty as the number of battle-related deaths per year per host country. We obtained this data from the UCDP/PRIO Battle Related Death database (UCDP, 2013). The UCDP/PRIO Battle Related Death database covers all battle-related deaths for violent political conflicts. An increasing number of such battle-related deaths creates a situation in which the possibility of adverse policy change becomes more salient for CEOs of MNCs (Li, 2006; Oh & Oetzel, 2017). Yet, given that violent conflicts have both general causes such as weak institutional environment as well as particular causes that are triggered by both context- and conflict-specific events (Oh & Oetzel, 2017), these CEOs will find it difficult to objectively estimate the probability that such an undesirable event – i.e., adverse policy change – indeed materializes.

3.4. Moderating variables

In this study, we focused on one of the most common sources of CEO equity wealth at risk of loss (e.g., Jarque & Price, 2016; Lim, 2015): restricted stock wealth. Following prior research (Devers, McNamara, Wiseman, & Arrfelt, 2008; Lim, 2015; Sanders, 2001), CEO restricted stock wealth was calculated using variables from the Execucomp database. Specifically, restricted stock was measured as the accumulated market value of restricted stock held by the CEO in t-1.

3.5. Control variables

We have included various control variables that have been shown to influence the establishment mode choice in previous studies (Brouthers & Brouthers, 2000; Harzing, 2002; Slangen, 2013). At the individual level, we have controlled for variables including *CEO age* and *CEO tenure* in years. We also controlled for other elements of the CEO's compensation contract such as *CEO cash compensation*, measured as the dollar value of bonus and cash compensation, and *CEO stock options*, measured as the dollar value of the CEO's in-the-money exercisable and unexercisable stock options. To capture CEO power, we control for *CEO ownership*, measured as the percentage of shares owned, and *CEO duality* that takes the value of 1 if the CEO also holds the position as chairman of the board, and 0 otherwise.

Firm-level controls include *firm size*, measured as total assets, and *prior performance*, measured as return on sales (ROS). We measured these variables at t-1. We further controlled for *prior acquisition experience* and *prior greenfield experience* of the MNC, measured as the total number of full acquisitions or greenfields that have been completed in a one-year period prior to the focal transaction. We also used a three-year moving time window in a robustness check and the results remain similar to those reported in our main analyses. Second, we also control for host country-specific experience. We have measured *prior host country acquisition experience* (*prior host country greenfield experience*) as the total number of full acquisitions (*greenfields*) that have been completed in a one-year period prior to the focal transaction in the same host country. We further control for the *relatedness* of the transaction by

including a dummy variable that takes the value of 1 if the investment takes place in the same two-digit SIC code as the focal firm's primary activities, and 0 otherwise.

At the country level, we have controlled for the cultural distance between the U.S. and the host country, using the index developed by Kogut and Singh (1988) based on (Hofstede, 1980) items. *GDP per capita* is included to control for the economic development of the host country. We also control for *investment restrictions*. While investment restrictions are most likely related to both acquisitions and greenfields, the inclusion is necessary to rule out alternative explanations. To measure investment restrictions, we take the annually reported survey response to the statement “Foreign investors are free to acquire control in domestic companies” from IMD's World Competitiveness Yearbook. We reverse coded this measure so that a higher value indicates higher investment restrictions. We further include *industry* and *year dummy* variables.

4. Results

Table 1 represents the descriptive statistics and correlations among the first-order variables, except the year dummy variables. All correlation coefficients as well as variance inflation factors are below conventional thresholds (Cohen, Cohen, West, & Aiken, 2003).

Since the dependent variable is a binary variable, we use logistic regression for our analysis. Given that our sample includes firms that have announced multiple cross-border greenfields or full acquisitions over the observation period, we need to control for within-firm correlation that may affect our results. To do so, we follow prior research (Muehlfeld, Sahib, & van Witteloostuijn, 2012) and have clustered standard errors at the firm level. The results of the hypotheses testing are presented in Table 2. Model 1 of Table 2 is the baseline model, which includes the control variables. We have introduced our independent variables in Models 2 through 5 and interaction variables in Models 3 through 5.

Hypothesis 1 suggests that both political risk and political uncertainty have a positive impact on the choice of greenfield investment. As can be seen from Table 2, the coefficients of both political risk (Model 2; $\beta = 0.67, p < 0.001, CI [0.305, 1.042]$) and political uncertainty (Model 2; $\beta = 0.05, p < 0.001, CI [0.022, 0.084]$) are positive and significant. Hence, we conclude that Hypothesis 1 is supported.

Hypothesis 2 predicts that CEO restricted stock wealth will strengthen the positive relationship between both political risk as well as political uncertainty and the MNC's preference for greenfield ownership. We find that Hypothesis 2 is partially supported. Specifically, we find that the coefficient of the interaction term “political risk x CEO restricted stock” is positive and significant (Model 3; $\beta = 0.08, p < 0.05, CI [0.008, 0.162]$). By contrast, we find that the coefficient of the interaction term “political uncertainty x CEO restricted stock” (Model 4; $\beta = 0.00, p > 0.10, CI [-0.005, 0.006]$) is statistically insignificant. The results reported in the full model (Model 5) are consistent with these results.

Given the nature of our dependent variable, evaluating the significance levels of the coefficients is not sufficient. We thus followed the procedure suggested by Wiersema and Bowen (2009) to examine how the marginal effects of the independent variables change at the low (one standard deviation below the mean), mean, and high (one standard deviation above the mean) value of CEO restricted stock. We hold all other variables at their means. These results are presented in Table 3 (political risk x CEO restricted stock) and Table 4 (political uncertainty x CEO restricted stock). As can be seen from Table 3, as the level of CEO restricted stock increases from low to mean and then to high, the marginal effect of political risk increases significantly from 0.33 to 0.68 and then to 1.04. By contrast, as can be seen from Table 4, the marginal effect of political uncertainty barely increases (from 0.05 to 0.06). These results confirm our initial findings, revealing that CEO restricted stock only moderates the effect of political risk on the decision to select greenfield investments over full acquisitions. Therefore, we conclude

Table 1
Descriptive Statistics and Correlations

Variable	Mean	S.D.	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	
(1) Ownership strategy is greenfield	0.76	0.43																				
(2) Political risk	0.61	0.20	0.14																			
(3) Political uncertainty	1.65	2.69	0.19	-0.20																		
(4) CEO restricted stock	5.65	4.19	0.00	0.01	0.00																	
(5) CEO age	55.00	6.93	0.02	0.02	-0.00	0.01																
(6) CEO tenure	7.41	7.23	0.01	-0.03	-0.03	-0.19	0.46															
(7) CEO cash compensation	6.94	1.42	0.02	0.05	0.05	0.26	0.15	-0.12														
(8) CEO stock options	7.22	4.03	-0.01	0.01	0.02	0.07	0.11	0.01	0.32													
(9) CEO ownership	1.84	5.36	0.07	-0.03	-0.02	-0.30	0.11	0.53	-0.38	-0.20												
(10) CEO duality	0.57	0.50	0.07	0.02	0.03	-0.01	0.29	0.26	0.13	0.16	0.12											
(11) Firm size (assets)	18.65	2.10	0.26	0.06	0.07	0.17	0.10	-0.08	0.20	0.01	-0.07	0.18										
(12) Prior performance (ROS)	0.08	0.19	0.01	-0.01	-0.03	0.02	0.01	0.02	0.01	0.07	0.01	-0.01	0.13									
(13) Prior acquisition experience	0.37	0.55	-0.09	-0.03	-0.02	0.04	-0.04	-0.06	0.02	-0.04	-0.04	-0.01	0.23	0.12								
(14) Prior greenfield experience	1.27	1.17	0.32	0.05	0.05	0.01	0.03	0.02	0.04	-0.03	0.10	0.11	0.59	0.09	0.30							
(15) Prior host country acquisition experience	0.03	0.16	-0.19	-0.03	-0.05	0.00	0.00	0.01	0.00	-0.00	-0.01	0.00	-0.00	0.03	0.30	-0.01						
(16) Prior host country greenfield experience	0.19	0.46	0.20	0.14	0.07	-0.03	0.01	0.03	0.02	-0.02	0.09	0.05	0.25	0.02	0.10	0.49	-0.03					
(17) Relatedness	0.49	0.50	-0.02	0.02	0.00	-0.03	0.02	-0.02	0.05	0.06	-0.03	-0.03	-0.08	-0.01	-0.10	-0.08	-0.03	-0.02				
(18) Investment restrictions	3.09	1.56	0.28	0.35	0.37	0.01	0.00	-0.07	0.07	0.04	-0.04	0.03	0.10	-0.01	-0.03	0.09	-0.08	0.17	0.03			
(19) Cultural distance	6.54	5.14	0.33	0.46	0.30	0.01	0.01	-0.06	0.06	0.02	-0.05	0.04	0.14	0.01	-0.02	0.11	-0.12	0.08	0.03	0.58		
(20) GDP per capita	28568.36	17204.50	-0.26	-0.13	-0.56	0.01	0.01	0.07	-0.08	-0.06	0.04	-0.05	-0.10	0.03	0.02	-0.10	0.07	-0.16	-0.02	-0.68	-0.44	

Note: N = 14765 observations.

that Hypothesis 2 is partially supported.

Figures 1 and 2 display the moderating role of restricted stock on the main effect between political risk and political uncertainty on the decision to select greenfield investments, respectively.

Hypothesis 3 predicts that the moderation effect of CEO restricted stock wealth is stronger for political risk than for political uncertainty. To test this hypothesis, we followed McDonnell and Cobb (2020) and performed a post-analysis Wald Chi-square test comparing the coefficients of the interactions of ‘political risk x CEO restricted stock’ and ‘political uncertainty x CEO restricted stock’. Based on Model 5 (Table 2), the post-analysis Wald Chi-square test shows that the coefficient for ‘political risk x CEO restricted stock’ is significantly larger (p<0.05). Thus, we conclude that Hypothesis 3 is supported in our data.

5. Discussion, implications, and conclusion

The primary objective of our study was to advance the literature on the MNC responses to host country political environments by introducing a behavioral perspective that has allowed us to uncover heterogeneous responses to political risk and political uncertainty. Beyond documenting that political risk and political uncertainty have independent main effects on MNC strategy with respect to cross-border establishment modes, our study suggests that CEO equity wealth at risk of loss is an important contingency that explains how political risk and political uncertainty affect MNCs’ choice between greenfield investments and acquisitions. These findings have important theoretical and practical implications.

5.1. Contributions and implications

Most importantly, our study departs from prior research by shifting the level of theory from the firm to the CEO. To that end, we introduce a behavioral theory that allows us to consider more explicitly how behavioral factors may explain heterogeneous responses to different dimensions of the host country political environment. Importantly, the finding that CEO equity wealth at risk of loss only moderates the positive relationship between political risk and the choice of establishment mode suggests that the effect that the two sources of potentially adverse policy change – political risk and political uncertainty – have on MNC strategy differs from a behavioral perspective. Specifically, while both political risk and political uncertainty independently influence MNC establishment mode strategies, CEOs with high levels of equity wealth at risk of loss show a greater behavioral response to political risk than political uncertainty. One explanation for this finding could be that the downside risk becomes more salient when political risk is high, given that the threat to the CEO’s equity wealth at risk can be objectified or quantified. As noted above, this is not the case in situations in which the threat of adverse policy change is derived from political uncertainty. This suggests that traditional IB theories may still be adequate when explaining MNC responses to the threat of adverse policy change due to political uncertainty.

However, there is significant heterogeneity in how CEOs respond to the threat of policy change associated with political risk depending on their level of equity wealth at risk of loss. While behavioral approaches may generally be useful when seeking to explain why decision makers select establishment modes that are not predicted by mainstream IB theory (Elia, Møller-Larsen and Piscitello, 2019), it appears that this mostly applies to decision making under risk (versus uncertainty). It is important to note, however, that this finding clearly points towards the need for more research. For example, we believe that this finding as well as our distinction between political risk (associated with the formal branches of government itself) and political uncertainty (associated with political actors that operate outside the formal branches of government) has particularly strong implications for non-market scholars. Much of this work has focused on MNCs’ efforts to buffer against political risk by accumulating political capital (Doh, Lawton, & Rajwani, 2012; Rajwani

Table 2
Logistic Regression of Political Risk and Uncertainty on Choice between Greenfields and Acquisitions

	Model 1		Model 2		Model 3		Model 4		Model 5	
	b (se)	P-value	b (se)	P-value	b (se)	P-value	b (se)	P-value	b (se)	P-value
CEO age	-0.01 (0.01)	0.231	-0.01 (0.01)	0.221	-0.01 (0.01)	0.226	-0.01 (0.01)	0.222	-0.01 (0.01)	0.227
CEO tenure	0.00 (0.01)	0.440	0.01 (0.01)	0.410	0.00 (0.01)	0.437	0.01 (0.01)	0.410	0.00 (0.01)	0.438
CEO cash compensation	-0.04 (0.03)	0.231	-0.04 (0.03)	0.231	-0.03 (0.03)	0.237	-0.04 (0.03)	0.232	-0.03 (0.03)	0.239
CEO stock options	-0.01 (0.01)	0.209	-0.01 (0.01)	0.202	-0.01 (0.01)	0.228	-0.01 (0.01)	0.202	-0.01 (0.01)	0.229
CEO restricted stock	0.00 (0.01)	0.664	0.00 (0.01)	0.668	-0.04 (0.02)	0.063	0.00 (0.01)	0.733	-0.05 (0.03)	0.060
CEO ownership	0.02 (0.01)	0.008	0.02 (0.01)	0.008	0.02 (0.01)	0.008	0.02 (0.01)	0.008	0.02 (0.01)	0.008
CEO duality	0.00 (0.07)	0.973	-0.00 (0.07)	0.981	-0.00 (0.07)	0.981	-0.00 (0.07)	0.981	-0.00 (0.07)	0.981
Firm size (assets)	0.19 (0.03)	0.000	0.20 (0.03)	0.000	0.20 (0.03)	0.000	0.20 (0.03)	0.000	0.20 (0.03)	0.000
Prior performance (ROS)	-0.20 (0.21)	0.334	-0.19 (0.21)	0.388	-0.19 (0.21)	0.380	-0.19 (0.21)	0.387	-0.19 (0.21)	0.375
Prior acquisition experience	-0.71 (0.07)	0.000	-0.70 (0.07)	0.000	-0.70 (0.07)	0.000	-0.70 (0.07)	0.000	-0.71 (0.07)	0.000
Prior greenfield experience	0.49 (0.05)	0.000	0.49 (0.05)	0.000	0.49 (0.05)	0.000	0.49 (0.05)	0.000	0.49 (0.05)	0.000
Prior host country acquisition experience	-1.48 (0.16)	0.000	-1.51 (0.16)	0.000	-1.51 (0.16)	0.000	-1.51 (0.16)	0.000	-1.51 (0.16)	0.000
Prior host country greenfield experience	0.79 (0.16)	0.000	0.77 (0.16)	0.000	0.76 (0.16)	0.000	0.77 (0.16)	0.000	0.77 (0.16)	0.000
Relatedness	-0.27 (0.11)	0.018	-0.26 (0.11)	0.023	-0.26 (0.11)	0.022	-0.26 (0.11)	0.023	-0.26 (0.11)	0.021
Investment restrictions	0.15 (0.03)	0.000	0.14 (0.03)	0.000	0.14 (0.03)	0.000	0.14 (0.03)	0.000	0.14 (0.03)	0.000
Cultural distance	0.13 (0.01)	0.000	0.11 (0.01)	0.000	0.11 (0.01)	0.000	0.11 (0.01)	0.000	0.11 (0.01)	0.000
GDP per capita	-0.00 (0.00)	0.000	-0.00 (0.00)	0.000	-0.00 (0.00)	0.000	-0.00 (0.00)	0.000	-0.00 (0.00)	0.000
Political risk			0.67 (0.19)	0.000	0.20 (0.29)	0.482	0.67 (0.19)	0.000	0.19 (0.29)	0.523
Political uncertainty			0.05 (0.02)	0.001	0.05 (0.02)	0.001	0.05 (0.02)	0.026	0.04 (0.02)	0.053
Political risk * CEO restricted stock					0.08 (0.04)	0.030			0.09 (0.04)	0.028
Political uncertainty * CEO restricted stock							0.00 (0.00)	0.865	0.00 (0.00)	0.600
N	14,765		14,765		14,765		14,765		14,765	
Pseudo R ²	0.30		0.30		0.30		0.30		0.30	

Notes: Standard errors clustered at the firm-level are reported in brackets. Industry and year dummy variables included but not reported in the Table.

& Liedong, 2015); yet, it remains unclear how such political capital will influence MNC strategy in the presence of both political risk as well as political uncertainty.

The findings reported in this study also advance a recent discourse in the IB literature on behavioral explanation of MNC strategies that are not readily predicted by mainstream IB theory (Clarke & Liesch, 2017; Elia, Møller-Larsen, & Piscitello, 2019). This research has started to acknowledge the role of individual differences in explaining strategic choices that are inconsistent with boundedly rational choice models. Yet, these studies remain somewhat silent on relevant sources of such

Table 3
The Effect of CEO Restricted Stock on the Marginal Effect of Political Risk on the Probability of Greenfield

Value of moderator CEO restricted stock	Marginal effect of political risk	z-statistic
Low	0.33	1.32
Mean	0.68	3.64
High	1.04	4.16

Note: The low value of CEO restricted stock is one standard deviation below the mean and the high value of CEO restricted stock is one standard deviation above the mean.

individual differences, specifically when it comes to decision making under risk or uncertainty. Our findings advance that line of inquiry by drawing attention to the CEO's equity wealth at risk of loss as a driver of decision makers' strategic choices. Indeed, our finding that CEO's equity wealth at risk of loss will result in more conservative decision making contrasts some earlier work in the IB literature that has suggested that CEOs will attempt to maximize their equity wealth and thus pursue strategies with higher upside, but also more downside potential (Mus-teen, Datta, & Herrmann, 2009). As such, scholars interested in the effect of CEO equity wealth on MNC strategy should carefully consider the

Table 4
The Effect of CEO Restricted Stock on the Marginal Effect of Political Uncertainty on the Probability of Greenfield

Value of moderator CEO restricted stock	Marginal effect of political uncertainty	z-statistic
Low	0.05	2.56
Mean	0.05	3.39
High	0.06	2.95

Note: The low value of CEO restricted stock is one standard deviation below the mean and the high value of CEO restricted stock is one standard deviation above the mean.

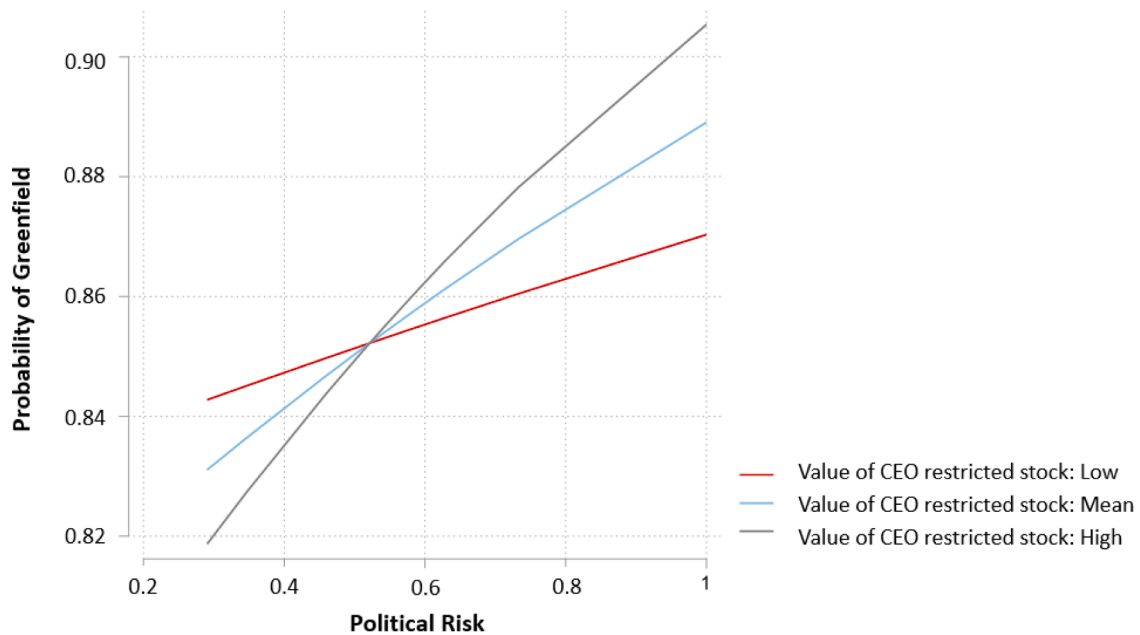


Figure 1. The Effect of CEO Restricted Stock on the Marginal Effect of Political Risk on the Probability of Greenfield
 Note: The low value of CEO restricted stock is one standard deviation below the mean and the high value of CEO restricted stock is one standard deviation above the mean.

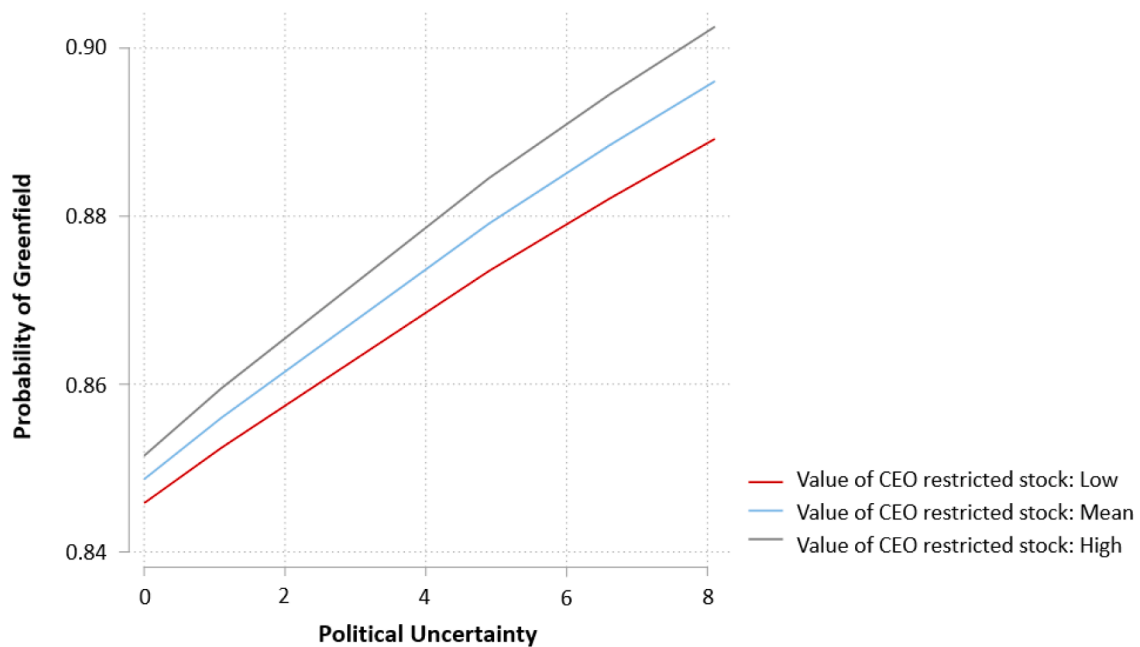


Figure 2. The Effect of CEO Restricted Stock on the Marginal Effect of Political Uncertainty on the Probability of Greenfield
 Note: The low value of CEO restricted stock is one standard deviation below the mean and the high value of CEO restricted stock is one standard deviation above the mean.

context (risk or uncertainty) in which such decisions are made. Moreover, our contingency approach also complements prior IB research that has already drawn attention to the important role of CEO characteristics in explaining MNC strategy (e.g., Herrmann & Datta, 2002, 2006; Musteen, Datta, & Herrmann, 2009). To date, this literature tends to assume that the threat to the CEO’s equity wealth (or other forms of firm-specific CEO wealth such as human or social capital) is given by the choice of entry mode choice itself. For example, high

control entry modes have generally been considered to pose a greater threat to the CEO’s wealth. By contrast, we emphasize that the threat an establishment mode poses to the CEO’s wealth is contextual. Specifically, our findings suggest that CEOs perceive full acquisitions to pose a greater threat to their equity wealth in host countries in which political risk is high. In contrast, in host countries in which political risk is low, CEOs may perceive the same establishment mode – full acquisitions – to pose a relatively lower threat to their equity wealth. Our study therefore

adds further nuance to this stream of work.

The overall pattern of our results also suggests that IB scholars need to consider the multifaceted nature of a host country political environment more carefully. While Fitzpatrick (1983) has already made a case for more explicitly considering the multiplicity of the political environment, IB scholars have not only tended to focus on one particular dimension in isolation but often also imprecisely used the terminology that describes those different dimensions. Our findings suggest that a more integrated approach is needed to capture not only the threat of adverse policy change, but also the different underlying sources that can lead to that threat. In other words, our study suggests that it is the underlying sources – political constraints and violence – that should inform theorizing about the effect of the political environment on MNC strategy, instead of the threat of adverse policy change itself.

Our findings also suggest that IB scholars need to pay closer attention to internal validity when examining the effect of the host country political environment on MNC strategy. While both the POLCON and political violence measure capture the threat of adverse policy change, the mechanisms through which they influence MNC strategy may differ. At the very minimum, our study therefore suggests that there is a need to clearly distinguish between political uncertainty and political risk.

From a practitioner and policy perspective, our findings suggest that shareholders and boards of directors should be aware that CEOs of MNCs may not always act in the best interests of the firm. While this reality is widely recognized in other disciplines such as strategic management and finance, this insight should also be extended to IB decision making where CEOs may influence firms to take less ambitious approaches to establishment mode decisions than would otherwise be expected or desired. Relatedly, boards of directors may wish to establish additional checks on the tendency of CEOs to engage in self-serving behaviors through board committees or other means, as they do in other areas such as compensation. From policy makers' perspective, governments are already aware that risk and uncertainty deter attractiveness to foreign investors generally; however, our research adds additional nuances to the differential ways that risk versus uncertainty may influence MNC establishment mode choices.

5.2. Limitations and future research

The result of this study should be interpreted in light of a number of limitations. First, we focused on a single home country (U.S.) to ensure consistency in measuring our restricted stock wealth variable. Even though the U.S. remains a leading source of FDI, we acknowledge that CEOs of MNCs headquartered in other countries may respond differently to restricted stock equity wealth at risk of loss. Second, following the lead of previous studies (Brouthers & Brouthers, 2000; Chen et al., 2017; Harzing, 2002; Slangen, 2013), we examined our framework in the context of the typical choice between greenfields and full acquisitions, given the crucial role of these establishment mode strategies for the global economy (Report, 2013) and the fact that the study of cross-border acquisition strategies is not unprecedented in the literature. However, future researchers should validate our findings in the context of a wider range of non-FDI ownership strategies. Third, we have focused on the BAM to introduce a behavioral theory of MNCs' responses to political risk and political uncertainty. Prior research on CEOs shows that demographic variables also influence CEOs' strategic decision making (Herrmann & Datta, 2002, 2006). While it was out of scope for the present study to examine such effects, future research is encouraged to explore this promising avenue.

5.3. Conclusion

We contend that behavioral perspectives are underrepresented in IB scholarship and, relatedly, that many IB theories and approaches do not sufficiently differentiate between types of ambiguity in host countries, namely risk versus uncertainty. We have sought to address these two

shortcomings by demonstrating that the financial exposure of CEOs can have material impacts on MNC establishment mode decisions in the face of political risk and uncertainty. We hope that our research stimulates further investigation of behavioral approaches to IB phenomenon.

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