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The Influence of Political Risk on the Internationalization of Chinese Multinational Enterprises

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Abstract. Political risk is not only a threat for MNEs, but also an opportunity. Exposure to political risk, MNEs will use the non-market strategy of political action more widely to influence the policies and regulations of the host government in an attempt to create a favorable institutional environment. In order to specifically verify the influence of political risk on MNEs, this paper selected 89 Chinese MNEs with investment in 135 countries as a sample. Through the negative binomial regression, we can find that the political risk has a positive effect on the internationalization of MNEs. Chinese MNEs should accumulate experience from successful investment in different political environment and take note of the potential opportunities. Managers of MNEs should see more about the potential opportunities of the political risk rather than a threat.

Introduction

On November 3, 2014, as China's first high-speed rail export project, China Railway Construction Corporation and China South Locomotive successfully won the bid for high-speed railway project from Mexico City to Querétaro. However, just three days later, the Ministry of Communications of Mexico unilaterally released the news of canceling the bidding result of the project and decided to restart the bidding process. Coincidentally, on September 8, 2016, the German government approved the acquisition of the German chip company Aixtron by China Hongxin Investment Fund, with a total purchase value of over US$700 million. Later on October 24th, the German government suddenly announced the withdrawal of the acquisition approval and restarted the evaluation process. It was reported that the move by the German government was due to the intervention of the United States.US believed that China may use the technology obtained from Aixtron for military which would endanger the national security of the United States. Although the US has never provided relevant evidence, and Chinese Foreign Ministry had also repeatedly stated that the acquisition is a market behavior, the outcome of the acquisition failure had ultimately failed to change.

As the pace of "Going Global" continues to accelerate, the assets exposed by Chinese companies in overseas political risk will become increasingly large. How does political risk influence Chinese MNEs ? Will these influences be same between different industries? And how should mangers of Chinese MNEs deal with political risk? In these paper, we can find the answers to these problems by studying the investment samples of 89 Chinese MNEs in 135 countries. The remainder of the paper is structured as follows: in Section 2, we review the literature focused on political risk and develop our hypotheses. Section 3 describes the sample, model, dependent, independent and control variables, and the collinearity diagnosis. Section 4 shows the results and the robustness tests. Finally, Section 5 presents the main conclusions and managerial contributions.

Literature Review

Research on political risk first appeared in the late 1950s US. Through the years of research, there have been many discussions on political risk, but there has not been a well-established definition. Kobrin(1978) defines political risk as the risk that a host country's economic policy interventions pose to foreign companies and the risks that host country political events pose to investors [1]. Simon(1982) argues that political risk stems from the negative effects of the actions and policies of host governments or societies on the operations and investments of some or most foreign

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companies[2]. On this basis, some research have expanded the definition of political risk and interpreted it as a kind of monopoly power that the government uses above the law to prevent the possibility of signing existing agreements with multinational companies. The purpose is to influence the redistribution of "rents" between the public and private sectors[3].

Political risk threatens the FDI of MNEs in various forms. This threat stems from the growing possibility of opportunistic behavior in the public sector [4,5,6], usually embodied in war risk and political riot risk, political intervention differential intervention risk, foreign investment policy change and regulatory adjustment risk, terrorism and nationalist risk, capital transfer and property deprivation risk [7].

Political risk has traditionally been understood as a threat to multinational enterprises (MNEs), due to an increased probability of opportunistic behavior by the public sector [4,5,6]. However, some research have suggested that political risk can also have a positive impact on some levels. According to the research on corporate resource capability and non-market strategy, MNEs can enhance their own political capabilities through exchanges with host country authorities, and adopt more appropriate measures to achieve their strategic goals [8,9,10,11]. Alfredo Jiménez(2014) believes that political risk contributed to the internationalization of Spanish MNEs through the research of 164 Spanish MNEs' investment sample [12]. These arguments lead us to formulate the following hypotheses:

Hypothesis 1: The level of political risk in Chinese MNEs' FDI location has a positive influence on its internationalization.

Hypothesis 2: The diversity of political risk in Chinese MNEs' FDI location has a positive influence on its internationalization.

Methods

1. Sample

The sample comes from the "2016 China Top 100 Multinational Enterprises List" issued by the China Enterprise Confederation. Due to data acquisition, the sample finally included 89 Chinese multinational companies investing in 135 countries from 2005 to 2016. The investment data was derived from the China Global Investment Tracker released by the US Heritage Foundation.

Table I. shows descriptive statistics describing the dependent, independent, and control variables of the MNEs included in the sample.

Table1 Descriptive Statistics

Variables	N.	Min.	Max.	Average	Standard Deviation
Numbers of countries	89	1	62	7.24	11.46
Overseas assets	89	279042	88371552	7422713.31	13459759.73
Overseas incomes	89	12919	81387296	4900401.22	11126091.93
Overseas employees	89	246	120729	10969.84	19710.66
Age	89	1919	2016	1988.78	18.87
Corruption average	89	19.92	86.50	56.42	19.30
Corruption variance	89	0.00	41.60	14.91	12.30
Polconv average	89	0.00	85.87	50.19	24.50
Polconv variance	89	0.00	60.72	17.08	15.84
Stock market	46	51.70%			

2. Dependent Variables and Model

In the same way as Alfredo Jiménez(2014) [12], this paper uses the number of countries in which Chinese MNE has subsidiaries as a dependent variable that measures its level of internationalization. The dependent variable is a non-negative integer, and the goodness of fit test indicates that the sample is subject to an over-dispersion. Li(2016) believes that when the sample obeys an excessively discrete distribution, the Poisson model will underestimate the standard error of the parameter and increase the significant level of the parameter, and a higher deviation will occur [13]. The negative binomial regression model should be used, which is better than the Poisson model and the generalized Poisson model (GP). Therefore, this paper uses the negative binomial regression model to analyze the data.

3. Independent Variables

This paper uses two indicators to measure political risk: the Corruption Perceptions Index by Transparency International and the Political Constraints Index.

The Corruption Perceptions Index reflects the corruption of countries and regions in the world in the form of rankings and ratings. From 1995 to 2011, the Corruption Perceptions Index adopted a very systematic system. Since 2012, the percentage system has been adopted. The higher the scores of the two scoring methods, the lower the degree of corruption in a country or region. Generally speaking, according to the level of the score, the degree of corruption in the countries or regions under evaluation can be divided into four types: relatively clean, slightly corrupt, relatively corrupt, very corrupt.

The Political Constraint Index used in this paper comes from POLCON database. The Political Constraint Index has a numerical range from 0 to 1, the higher the value, the lower the political risk level of a country. This paper adopts two indicators: the Corruption Perception Index and the Political Constraint Index. On the one hand, these two indicators can objectively measure the political risk faced by multinational corporations in investing in one country, and on the other hand avoid the errors caused by the use of a single variable.

We calculate the mean and standard deviation of the investment portfolios of 89 Chinese MNEs selected from 2005 to 2016 under the two indicators. The estimate obtained by this method is more stable and sufficient than the data for selecting a single year. It is also important to note that the higher the value of the political risk and political constraint index, the lower the level of political risk in a country. Therefore, if the average value of the above-mentioned investment location combination calculation results is larger, it indicates that the lower the level of political risk faced by multinational companies in their internationalization strategy process; if the standard deviation of the investment location combination calculation results is larger, indicating the political risk diversity are stronger and the environment of MNEs' FDI is more complicated.

4. Control Variables

This paper also selects some of the control variables, such as the overseas assets, overseas income, the number of overseas employees, the time of establishment of MNEs, and a dichotomous variable to measure whether a multinational company is listed. The selection of these indicators as a control variable is because these indicators affect the ability and attitude of multinational companies to deal with political risk to a certain extent.

5. Collinear Diagnosis

Table II. is the correlation matrix and the variance expansion factors (VIFs). From the results, all values are below the recommended limit of 10 and below the most stringent limit of 5.3 [15], so this model can be considered no serious collinearity problems.

Table2 Correlation Matrices And Variance Inflation Factors (VIFs)

	1	**2**	**3**	**4**	**5**	**6**	**7**	**VIFs**
Overseas assets	1							4.007
Overseas incomes	0.855	1						4.742
Overseas employees	0.619	0.705	1					2.091
Age	0.040	-0.018	0.123	1				1.062
Corruption average	-0.237	-0.160	-0.136	-0.040	1			1.070
Corruption variance	-0.138	-0.120	-0.032	-0.059	0.012	1		1.070
Stock market	0.223	0.164	0.072	0.091	-0.029	0.024	1	1.118
	1	**2**	**3**	**4**	**5**	**6**	**7**	**VIFs**
Overseas assets	1							3.992
Overseas incomes	0.855	1						4.733
Overseas employees	0.619	0.705	1					2.137
Age	0.040	-0.018	0.123	1				1.056
Polconv average	-0.237	-0.160	-0.136	-0.040	1			1.178
Polconv variance	-0.019	0.014	0.127	-0.044	-0.166	1		1.105
Stock market	0.219	0.152	0.068	0.035	-0.263	-0.163	1	1.147

IV. RESULTS AND DISCUSSION

Table III. aims to analyze the results of negative binomial regression analysis of the Influence of political risk on the internationalization of MNEs. In this table, model 1 only includes the control variables. model 2 and model 3 respectively include the mean and standard deviation of the

Corruption Perception Index and the Political Constraint Index to verify hypothesis 1 and hypothesis 2.

In Table III. we can find that the correlation coefficients of the mean of the Corruption Perception Index and the Political Constraint Index in model 2 and model 3 are both negative and significant. This result shows that the scope of internationalization of MNE is related to the level of political risk. That is, the higher the level of political risk, the more obvious the promotion of the internationalization of MNEs, thus confirming the hypothesis 1. Similarly, we can see that the correlation coefficient between the standard deviation of the Corruption Perception Index and the standard deviation of the politically constrained index is positive and significant. This result confirms the hypothesis 2, that is, the diversity of the political environment has a positive impact on the internationalization of MNEs. We can infer that political risk has a positive impact on the internationalization of MNEs. At the same time, the conclusion can also suggest that MNEs can accumulate experience in different political environments, and enhance their political capabilities to achieve their strategic goals.

Table3 Negative Binomial Regression Results

Variables	1	2	3
Overseas assets	1.07e-08	1.05e-08	3.36e-09
	(1.51e-08)	(1.31e-08)	(1.41e-08)
Overseas Incomes	2.14e-08	4.28e-09	1.37e-08
	(2.06e-08)	(1.65e-08)	(1.85e-08)
Overseas employees	9.95e-06	1.23e-05**	1.11e-05*
	(6.47e-06)	(5.85e-06)	(6.52e-06)
Age	9.29e-3	3.99e-03	7.74e-03
	(5.91e-3)	(0.005)	(0.006)
Stock market	-0.313	-0.219	-0.177
	(0.235)	(0.197)	(0.219)
Corruption average		-0.035***	
		(0.005)	
Corruption variance		0.017*	
		(0.010)	
Polconv average			-0.010**
			(0.005)
Polconv variance			0.036***
			(0.010)
Constant	-16.759	-4.740	-13.923
	（11.744）	(10.403)	(11.288)
Num.observations	89	89	89
Log likelihood	-258.707	-253.823	-247.824
Prob≥chibar2	0.0040	0.000	0.000

Standard errors in brackets.

* $p<0.10$ **$p<0.05$ ***$p<0.01$

In order to verify the robustness of the results, this paper has done some other tests. For example, in the control variable, we replaced the MNE's overseas assets with the total assets, and the MNE's total income replaces the overseas income; in the independent variable, the author uses the variance of the political risk index instead of the standard deviation. The results obtained by changing these data are not significantly different from the original results.

Conclusion

Through negative binomial regression, we get the following conclusion: political risk has a positive influence on the internationalization of MNEs. It is reflected in that if the political risk level of the multinational corporation investment location combination is higher, and the diversity of political environment is stronger, the promotion of the internationalization of MNEs will be more obvious. Although in the traditional sense, political risk is a threat to MNEs, exposure to political risk has prompted MNEs to engage with host governments. MNEs use political activities such as negotiation, lobbying, litigation, campaign donations, alliances, and even bribery and buy-outs to enable corporations to obtain preferential investment conditions. Also, it can reduce environmental uncertainty, reduce transaction costs, and promote long-term sustainable development of the corporations. At the same time, the successful investment experience of MNEs in different political environments is also a precious resource, which can help them adapt to a new market environment more quickly and deal with political risk reasonably.

Relevance of Management

The conclusion of this paper has some contribution to the managers of MNEs in how to deal with the political risk in foreign investment and the formulation of enterprise internationalization strategy. Managers of MNEs should regard political risk as an opportunity rather than a threat. MNEs should have more contact with host governments to seek value or protection when investing abroad. Chinese MNEs should accumulate experience of successful investment in different political environments and also pay attention to the potential opportunities brought by the political environment.

Finally, it should be noted that political risk plays an important role in promoting the internationalization of Chinese MNEs. However, managers of Chinese MNEs should still not ignore the potential negative effects of political risk. Failed investment cases（for example, the Myanmar Myitsone hydropower station project and the Mexican high-speed rail project）also alert us that due to the domestic political instability, frequent changes of governments, poor continuity of policies and even Chinese exclusion in the host country, political risk will still cause losses to the foreign investment and transnational operation of Chinese MNEs.

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