

POLITICAL RISK AND PROFITABILITY: THE CASE OF SPANISH MULTINATIONAL ENTERPRISES

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Abstract: *The present study analyzes the relationship between the political risk assumed by Spanish multinational enterprises in their internationalization strategies and their profitability over a five-year period, from 2000 to 2005. Significant evidence is obtained of a positive and circular relationship between political risk and profitability through the use of simultaneous equations applied to a sample of 164 firms. These results are consistent with the premises of the “Prospect Theory” and with the traditional financial and economic theory grounded in risk aversion. They also explain the proactive use of political risk, to the extent that greater risk results in greater profitability, which in turn contributes the amount of resources that are needed to undertake investments in countries with greater risk.*

Keywords: *Political risk, performance, multinational enterprise, internationalization.*

1. INTRODUCTION

The literature on the relationship between the degree of multinationality and the profitability of firms is relatively abundant (see Verbeke and Brugman, 2009 for a sample of more representative studies over the last 50 years in this field). Various authors have identified a relationship in the form of an inverted S, which implies that firms go through three stages in their internationalization processes. At first, an increase

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in the degree of multinationality impacts negatively on performance, given that the firm faces problems which are, to a great extent, unknown. In the second stage, once the firm has started to acquire the necessary knowledge to manage foreign operations, the increase in the degree of multinationality is accompanied by an increase in performance, until the third stage is finally reached, in which management of the foreign operations is at an excessively complicated level which implies worse performance.

However, more recently this literature has left risk analysis to one side, despite it having been a mainstream component in earlier studies (Verbeke and Brugman, 2009). This lack of analysis might be due to traditional arguments which assumed that internationalization allowed to reduce the firm's exposure to risk through diversification (Hughes and Sweeney, 1975; Agmon and Lessard, 1977; Brewer, 1981, Kim et al. 1993). On the contrary, various authors point out that, in reality, firm risk increases due to fluctuations in exchange rates, agency problems and mainly institutional risks (Siegel et al. 1995; Bartov et al. 1996; Reeb et al. 1998). Moreover, it may be argued that the firm has no need to carry out international operations to gain the advantages that ensue from international diversification, as these may be achieved through contractual arrangements such as licenses or supply contracts, among others (Verbeke and Brugman, 2009).

It is precisely this scant attention that previous research has paid to risk in overseas operations, as well as the relevance of these institutional risks for the management of Spanish Multinational Enterprises (MNEs) that justifies the objective of this present study. Specifically, our paper seeks to fill the gap in the literature on the relation between political risk and firm performance, taking as its sample the case of the Spanish MNEs.

The remainder of the paper is structured in the following way. In the second section, we review prior research on the relation between political risk and the degree of internationalization of the firm. The third section covers the hypothesis relating to the influence of the political risk assumed by Spanish MNEs on their performance, as well as the effect of Spanish MNE performance on the level of political risk. The subject of sections four and five are the sample, variables and the results. The study closes with a presentation of its principal conclusions, limitations and future lines of research.

2. LITERATURE REVIEW

The literature has traditionally interpreted political risk as a threat for MNEs. Thus, most studies establish a negative effect of corruption (Wei, 2000a, 2000b; Habib and Zurawicki, 2001; Lambsdorff, 2003; Cuervo-Cazurra, 2006, 2008), political discretionality (Henisz and Zelner 2001; 2002a and 2002b) and lesser economic freedoms and the protection of property rights (Bengoa and Sánchez-Robles, 2003; Kapuria-Foreman, 2007) on foreign direct investments.

However, these results do not imply generalized behavior by all firms nor for all investor countries. In fact, Spanish MNEs are characterized, on occasions, by their proactive use of political risk in their overseas expansion strategies², which is based on obtaining competitive advantage through negotiating skills (Hillman and Hitt, 1999; Holburn, 2001; McWilliams et al. 2002; Henisz, 2003; Wan, 2005).

Thus, García-Canal and Guillén (2008) find that Spanish MNEs in regulated industries show a bias by countries with low governmental constraints, even in spite of their aversion to macroeconomic uncertainty. This is due to the possibility of their using negotiating skills, originally honed in their home country, to obtain advantageous entry conditions but it can also be due to the avenues they find to exert pressure or even to commit bribery.

Following this line of research, Jiménez et al. (2010) found that greater levels of political constraint positively influence the probability of investments in Europe and North America, in concordance with the results of Galán et al. (2007). The same happens in Asia and Europe when testing lower levels of corruption. However, in the case of Latin America, higher levels of corruption favor Spanish investment. In turn, Jiménez (2010) has recently shown that the greater the political risk, measured by the relative degree of corruption, the greater the scope of internationalization, using a sample of 166 Spanish MNEs with investments in 119 countries. In an earlier paper, in 2009, he demonstrated that in the countries of North Africa and those of Central and

² Evidence for this behavior has also been found among North-American firms in the electricity sector (Holburn, 2001)

Eastern Europe that have recently joined the European Union, greater levels of political risk measured through levels of political discretion, corruption and economic freedoms, attract greater direct investment inflows from Spain, France and Italy.

These results are consistent with the **Bribe Payers Index 2008**³ prepared by Transparency International, in which both Spain and France, together with the United States, and Singapore, which are found in Cluster 2, have a greater likelihood of resorting to bribery and corruption than the other countries within Europe placed in Cluster 1 (Germany, Belgium, the Netherlands, Switzerland, and the United Kingdom). From among all the European countries under analysis, only Italy, in Cluster 3, and Russia, in Cluster 4 are more likely to bribe than Spain and France.

3. HYPOTHESES

This greater concentration of Spanish MNEs in countries with a high level of risk raises the question of whether the degree to which they are present in those countries is associated with greater profitability. Indeed, if we assume the traditional risk-return arguments of financial and economic theory (e.g., Brealey, Myers and Allen 2005) we might expect a positive correlation between risk and profitability. This argument rests on the traditional reasoning of risk aversion. The owners of a firm would not accept a higher risk in the face of similar returns, or put another way, they would only accept greater levels of risk if they expect to obtain higher returns.

A second argument that is consistent with this positive influence of risk levels on MNE profitability may be taken from the “Prospect Theory” (Kahneman and Tversky, 1979). In accordance with the arguments of the “Prospect Theory”, the better the financial results of the firm, the lower its desire to assume risk in order to increase its expected returns. In particular, a firm with above average results for its industry should be especially risk averse, such that it would only be willing to accept an increased level of risk if the expected return on investment is attractive.

³ Bribe Payers Index 2008 catalogues countries into four clusters according to their bribe levels, including countries with lower bribery levels in cluster 1 and countries with higher levels in cluster 4.

Thus, for firms with above average performance, increased risk levels are associated with an increase in subsequent performance (Miller and Bromiley, 1990). In accordance with the theory of internationalization (Buckley and Casson 1976, Buckley, 1989) and the eclectic paradigm of Dunning (1981; 1988), MNEs gain competitive advantages against purely domestic firms thanks to the internationalization of their activities and the positive externalities associated with them, the outcome of which are above-average returns in their industries. Numerous works have shown empirical evidence of this fact, (Benvignati, 1987; Head and Ries, 2003; Girma et al. 2003; Arnold and Hussinger, 2005; Castellani and Zanfei, 2006). Thus, on the basis of the arguments taken from the “Prospect Theory”, we propose that the investments of Spanish MNEs in countries with high risk levels will positively influence their performance.

H1a. The level of political risk faced by Spanish MNEs in their investment projects in the exterior positively influences their performance.

Nevertheless, the literature has also found evidence of the negative influence of risk in firm performance (Miller and Bromiley, 1990; Bromiley, 1991; Deephouse and Wiseman, 2000; Veliyah and Ferris, 1997). This relation is justified because firms that assume high levels of risk have a greater probability of not satisfying their implicit and explicit commitments towards their stakeholders. In this situation, some stakeholders, such as clients, debtors, suppliers and employees require greater financial incentives to engage in a transaction with these firms (Miller and Bromiley, 1990), which has a negative effect on the profitability of the firm. Following this argument, we hypothesize a negative influence of the average risk level assumed by MNEs on their financial performance.

H1b. The level of political risk faced by Spanish MNEs in their foreign investment projects has a negative influence on their performance.

It should be taken into account that the performance of the Spanish MNEs can also influence the level of risk that they assume. Indeed, it may be argued that, compared to Spanish MNEs with low performance, those Spanish MNEs with higher performance will be more able to make investments in new countries where high levels

of risk may require the commitment of a greater level of resources. Thus, we might expect the performance of Spanish MNEs to have a positive influence on the average risk level of those countries in which the Spanish MNEs have a presence.

H2a. The level of performance of Spanish MNEs has a positive influence on the levels of political risk that they assume in their foreign investment projects.

However, the literature is not unanimous on the positive relation between risk and performance. In fact, the seminal works of Bowman (1980; 1982) have already demonstrated the existence of a paradox in the relationship between risk and performance in the context of strategic management. This paradox is founded on a negative correlation between risk and the performance of a firm. Since the appearance of these seminal works, various studies have sought to support this evidence (e.g. Fiegenbaum and Thomas, 1988; Deephouse and Wiseman, 2000; Palmer and Wiseman, 1999). One of the justifications for this paradox put forward by Bowman (1982) centers on firm attitudes towards risk: in other words, the likelihood of firms with limited profitability to actively seek out and assume risk in the hope of improving their results. Hence, the Spanish MNEs with lower levels of profitability may invest in countries with higher levels of risk:

H2b. The level of performance of Spanish MNEs has a negative influence on the level of political risk that they assume in their foreign investment projects.

4. METHOD AND VARIABLES

4.1 Sample

The sample includes all Spanish MNEs with over 250 employees present on the registers of the Instituto de Comercio Exterior (ICEX), the www.oficinascomerciales.es webpage and other foreign institutions dedicated to direct investment contacted through the ICEX which provided directories of Spanish MNEs with direct investments in their country, removing those with a company matrix that owns at least 50.01% of their share

capital. In total, the sample is composed of 164 Spanish MNEs with investments in 119 countries⁴. Annex 1 provides the list of Spanish MNEs included in this study.

Data were taken principally from the SABI (*Sistema de Análisis de Balances Ibéricos*) database. This database provides financial company information and business intelligence for companies in Spain and Portugal. Data was complemented with information taken from AEB (Asociación Española de Banca] and CECA (Confederación Española de Cajas de Ahorro) for the financial entities, as well as the annual accounts from the firms themselves.

The arithmetic mean of the data corresponding to 2000-2005 (inclusive) was calculated for all variables. In this way, more satisfactory and stable estimates are obtained than from a set of data referring to only one year (Wiggings and Ruefli, 2005, Brouthers et al. 2008). In those cases in which available information is not found from some year, we decided to take as a reference the value of the variable in the following or the preceding year, or the arithmetic mean of both if possible. Annex 2 shows the descriptive statistics of all the variables that were used in the equations.

4.2 Performance equation

The performance of firms was measured, as usual in the literature, through the Return on Equity (ROE) ratio of the MNE for the period of study to which this work refers. According to Bowman (1980), it is the most widely used measure by researchers and is even the measure for profits that is of greatest interest for executives .

The age of the firm, total assets (both submitted to a logarithmic transformation), whether the firm is listed on any stock exchange and the sector to which the Spanish MNE belongs make up the predetermined variables that, together with the variable for political risk, constitute the remainder of the equation. In particular, we identified six different sectors in the sample: manufacturers, food production, construction, regulated sectors -those firms traditionally subjected to regulation by the government, although

⁴ Direct investments in Afghanistan, Andorra, Puerto Rico and San Tome are not included due to an absence of data. In addition, investments in Serbia, Montenegro and Kosovo are accounted for as one country as they all formed one country in 2005.

more recently, increasingly subjected to deregulation, such as air traffic controllers, telecommunications, energy and water (OECD, 1993)-, financial and other sectors that are maintained as a reference group to avoid problems of multicollinearity.

The results using other variables related with the size of the firm, such as the number of employees or even, as in the political risk equation, sales income, offer very similar results to those shown in section 4, with any significant difference.

$$ROE = \gamma_0 + \gamma_1 AGE + \gamma_2 LISTED\ PRICE + \gamma_3 ASSETS + \gamma_4 MANUFACTURERS + \gamma_5 CONSTRUCTION + \gamma_6 FOOD + \gamma_7 REGULATED + \gamma_8 FINANCIAL + \gamma_9 POLITICAL RISK + \varepsilon_{ij}$$

4.3 Political risk equation

Given the complexity of the phenomenon, different variables have been used to measure the political risk faced by Spanish MNEs in their foreign investment projects. Thus, this work will use three frequently used indices in research in this field as variables of political risk, with the aim of including all aspects comprised within this concept.

The first of the variables that we used is the **Corruptions Perception Index (CPI)** prepared by Transparency International (www.transparency.org)⁵ The second variable to take into consideration is the **Political Constraint Index (POLCON)** proposed by V. Henisz (1998)⁶. Finally, we also included the **Index of Economic Freedom** prepared by the Heritage Foundation (www.heritage.org)⁴.

⁵ Transparency International's Corruption Perception Index constitutes a measure of perceived corruption based on surveys of businesses and experts from each country. This index ranges from 0 that represents a completely corrupt state to 10 for an entirely corruption-free state (Pournarakis and Varsakelis, 2004; DiRienzo et al. 2007).

⁶ This index takes account of the number of independent powers that can exercise a veto in each country. It modifies the score obtained according to the possible alignments between powers, in such a way that it affects the actual constraints to which the government is subjected. Additional modifications are made when some political powers are neither totally aligned nor totally opposed to each other, in such a way that their composition is a relevant factor when determining the extent of the political constraints.

We used a fourth dependent variable that is calculated as the average score of the different locations in which each MNE is present, for each of the indices of political risk. Together with these three resulting variables, which are individually tested, a fourth one was also used that was made up of the arithmetic mean of the scores received by the MNE on all three aforementioned indices.

In the case of there being no available information for any of the indices on any one particular country location in which a Spanish MNE is present (as happens, for example, in the cases of Cabo Verde, Mauritania and Guinea Bissau), we decided to calculate the average omitting the country in question.

In these analyses, the predetermined variables are composed of the number of countries in which the firm is present, as a measurement of international diversification (Caves and Mehra, 1986; Kogut and Singh, 1988; Barkema and Vermeulen, 1998; Tallman and Li, 1996; and Brock and Yaffe, 2008). This allows taking into consideration the lower levels of inconvenience that political risk entails for those MNEs that are present in various countries, given their wider international experience and the reduced number of problems they would face if they had to abandon an unsuccessful project (Fagre and Wells, 1982; Delios and Henisz 2003). Further factors are the log of income and the diversification of the MNE, in order to capture the greater ease with which MNEs can confront greater levels of political risk when they possess greater resource levels. This also takes account of the fact that related diversification is positively associated with international diversification, because it allows greater exploitation of the interdependencies in each business unit, and the same also happens with non-related diversification because it leads to economies of scale and scope (Hitt et al., 1994). In this study, we included three dichotomous variables to differentiate the diversification strategies: non-diversified firms when the MNE has a single product, related diversification when it has various products but all of them can be included within the same sector and finally non-related diversification when at least one of the products belongs to a different sector from the rest. These two last variables are included in the regressions, whereas the group of non-diversified firms is maintained as a reference group.

$$POLITICAL\ RISK = \beta_0 + \beta_1\ RELATED\ DIVERSIFICATION + \beta_2\ NON-RELATED\ DIVERSIFICATION + \beta_3\ NUMBER\ OF\ COUNTRIES + \beta_4\ INCOME + \beta_5\ ROE + \varepsilon_{ij}$$

4.4 Model

The simultaneous equation technique known as the complete information method or “3-stage least squares” was used to analyze the possible circular relation between assumed risk and profitability obtained by the Spanish MNEs. Although this technique is more sensitive to errors in the data or in the specification of the equations, it performs the estimation jointly for all of the model’s parameters, instead of doing so equation by equation, which preserves the objective pursued with simultaneous equations more effectively than the simple isolated estimate of each equation (De Quevedo and De la Fuente, 2003). Moreover, it is a better alternative than others such as the limited information models [for example the “2-stage least squares” (2SLS)] as it does not lose efficiency when correlation exists between the errors of the different equations in the model (Cho, 1998; Kim, 2007).

It should be pointed out that if there were no simultaneity, an ordinary least squares estimation would obtain consistent and efficient estimators, whereas they are not even consistent in the presence of simultaneity, it being necessary to resort to methods that can identify endogeneity. However, if they were applied in the absence of endogeneity, the estimators obtained in this way would be consistent but not efficient, for which reason the least squares method would be preferable (Gujarati, 1997).

Thus, it is necessary to apply the Hausman specification test, in order to verify endogeneity and by doing so, to justify the use of simultaneous equations. This test consists of two steps (Maddala, 1996; Gujarati, 1997). In the first one, the reduced form of the equations are obtained to verify the endogeneity of the regressors; in other words, by obtaining these variables solely in terms of the predetermined variables and the stochastic perturbations, with the aim of predicting their foreseen values. In the second step, a second equation is estimated that corresponds to the original equation in the model, but to which the predicted values taken from step one of the variables with questionable endogeneity are added. It may be verified, through the significativity of the

F test, offered together with the results of the models in Annex 4, that the regressors do in effect present endogeneity rather than exogeneity, for which the use of simultaneous equation techniques is preferable, rather than the use of estimators calculated by ordinary least squares.

It is also necessary to verify that the parameters of the model may be estimated, for which purpose they should comply with the order and rank conditions. With respect to the first one, the number of predetermined variables that are excluded in a certain equation should at least be as high as the number of endogenous variables included in the same equation minus one (Gujarati, 1997). This condition is met in the model as there are only two endogenous variables (profitability and risk) and many other predetermined ones in each equation, on which basis it may be said that the model is over-identified.

With regard to the second one, it should be possible to construct a determinant other than zero, of an order $(M-1) \times (M-1)$, in which M is the number of equations and endogenous variables, on the basis of the coefficients of the variables (endogenous and predetermined) excluded from that particular equation, but included in the other equations of the model (Gujarati, 1997). As only two equations and two endogenous variables are in the model, this condition is also met, as the determinant obtained with the variable coefficients should be solely of the order 1.

4.5. Diagnosis of multicollinearity

The matrix of correlations of the Variance Inflation Factors (VIFs) is shown in Annex 3. Given that all the values are found below the limit of 10 recommended by Neter et al. (1985), Kennedy (1992) and Studenmund (1992) and the strictest limit of 5.3 proposed by Hair et al. (1999), and taking account of the low correlations, it may be affirmed that no serious problems of multicollinearity exist.

5. RESULTS AND DISCUSSION

The results of the various models are presented in Annex 4. The results of model 1, in which the Corruption Perceptions Index is used as a variable of political risk, show

a negative and significant sign in Equation 1 of the variable of political risk. Given that lower values of this index signal higher values of political risk, the hypothesis H1a is supported, as a positive and significant relation exists between the level of political risk assumed and the profitability of MNE. These results are consistent with the financial and economic theory grounded in risk aversion and with the premises of the “Prospect Theory” which state that increases in the level of risk are associated with an increase in subsequent performance for firms with above-average performance. (Miller and Bromiley, 1990).

Furthermore, a negative and significant coefficient for the firm profitability variable was observed in Equation 2. It implies that higher levels of profitability are associated with lower scores on the Corruption Perceptions Index and, as a result, higher levels of political risk. This supports hypothesis H2a which stated that higher levels of profitability provide MNEs with the necessary resources to undertake investments in more compromised locations, and it rejects the possibility of our results upholding the Bowman paradox of a negative correlation between risk and the results of a firm.

The results for model 2, in which the dependent variable of Equation 1 becomes the Index of Political Constraint POLCONV, once again support hypotheses H1a and H2a, as the coefficients for political risk and for profitability variables are significant and negative in their respective equations.

However, we can only validate hypothesis H1a in model 3, which uses the Index of Economic Freedoms, because although the coefficient for the variable of political risk is significant and negative in Equation 1, the profitability variable is not significant (although it maintains its negative sign) in Equation 2.

Finally, as additional evidence of robustness, the average of the 3 indices referred to earlier is used in model 4. The results obtained support hypotheses H1a and H2a, as the coefficient for political risk and profitability that act as explanatory variables once again become negative and significant.

The results are coherent with the financial and economic theory (e.g. Brealey, Myers and Allen 2005), which points out that the owners of a firm only accept greater levels of risk if they can expect greater profitability, as well as with arguments taken from the “Prospect Theory” (Kahneman and Tversky, 1979), which suggest that in firms with above-average profitability for the sector, which is the case of MNEs in general, risk aversion is greater, such that the larger the performance of the firm, the less its desire to assume risks to increase its expected performance, something that it will only do in the case of high expected returns.

Likewise, we have obtained evidence that the results of the Spanish MNEs can also influence the levels of risk that they assume. The greater level of resources that are available to the MNEs with high profitability allows them to make investments in new countries where high risk levels require the commitment of a greater level of resources. These resources may be used to get an accurate assessment of the risk, during the negotiation with the local government, which is especially costly whenever government discretionality is higher and they are more open to corruption, or to get protection, for example, through greater expenditure on publicity to strengthen their corporate image or the purchase of insurance against possible expropriation or renegotiation of contracts.

These results show evidence that the proactive employment of political risk on the part of Spanish MNEs, described by García-Canal and Guillén (2008), Jiménez (2010) and Jiménez et al. (2010), based on the use of negotiating skills to obtain competitive advantages in markets characterized by relatively high risk levels (Hillman and Hitt, 1999; Holburn, 2001; McWilliams et al. 2002; Henisz, 2003; Wan, 2005), will be compensated for in the form of higher rates of profitability, at least in the short and medium term, which in turn will provide a greater amount of resources to MNEs with which to continue this type of internationalization strategy.

The result of the R^2 coefficient, the sign of which is negative, might appear controversial; although it should be pointed out that it can occur in simultaneous equations. This is because some of regressors enter the model as instruments when the parameters are estimated, such that it is feasible for the total sum of the squares of the deviations to be lower than the sum of the squares of the remainders, yielding a negative

R^2 (Hilliard and Lloyd, 1980; Statacorp, 2001)⁷. This implies that the models may not be used for predictive purposes, but are valid for the explanation of significance and the sign of the independent variables.

6. CONCLUSIONS

In this study, we have analyzed the relation between the profitability of MNEs and the level of political risk that they assume, with a view to filling in the gap that exists in the literature in this field. To do so, we employed a sample of 164 large Spanish MNEs with direct foreign investments across the world. As well as confirming the need to take account of the circular nature of this relationship, which entails the use of simultaneous equations as a statistical technique instead of a least squares regression, the results show that the level of political risk assumed by the MNEs has a positive influence on their profitability and vice versa.

This implies that the Spanish MNEs behave in accordance with the expectations of the financial and economic theory (e.g. Brealey, Myers and Allen 2005) and the “Prospect Theory” (Kahneman and Tversky, 1979), as they only assume greater risk levels when the expected profitability of the investments is sufficiently high. Moreover, the additional flow of resources, arising from greater profitability, means that they can set up in places where the level of political risk is that much greater.

It all shows evidence that the internationalization strategy of Spanish MNEs, characterized in part by a proactive approach to the use of political risk, which unlike

⁷ In the majority of estimators, apart from the ordinary least squares, R^2 is no more than a summary measure of the predictive power of the estimator within the sample. The computational formula to calculate R^2 is $1 - \text{RSS}/\text{TSS}$, where RSS is the sum of the square of the residuals, whereas TSS is the sum of the square of the deviations from the average of the dependent variable. In a linear model with a constant, the model from which the TSS is calculated is nested within the complete model in which the RSS is computed- both have a constant term in relation to the same data. It should therefore be the case that the TSS is less than or equal to the RSS and R^2 will therefore be restricted to values of between 0 and 1.

In the 3SLS model, some of the regressors are used in the model as instruments when the parameters are estimated. However, given that the objective is to estimate the structural model, the actual values, and not the instruments for the predictive endogenous variables, are employed to calculate R^2 . The remainders of the models are computed over a different set of regressors than those used to estimate the model. In fact, in this statistical technique, the estimates are not nested in a model on the dependent variable with only the constant and the sum of the squares of the residuals no longer have to be less than the total sum of the squares of the deviations.

the conventional view considers it as an opportunity, is seen to be fed by the higher levels of profitability that it provides in the short to medium term. This is done in two ways: on the one hand, the higher rates of expected profitability are an expected incentive for the firm to assume higher levels of political risk; on the other hand, they provide the necessary resources to undertake such investments and to minimize their negative impact.

In any case, and taking into account the increasing importance of corporate social responsibility, those MNEs that actively employ corruption to obtain advantageous competitive positions, should not forget that they sacrifice their social standing and run the risk of losing influence and effectiveness due to the negative impact on their status in the international community (Ghosal and Moran 2005), which can prejudice profitability in the long term.

As limitations, it should be mentioned the impossibility of including the influence of the internationalization process followed by the MNE (Welch and Luostarinen, 1988), due to the lack of reliable data. This is because, despite the fact that the inclusion of the variable that measures the number of countries in which each MNE is present partially alleviates this problem, it is not possible to make a distinction between whether such growth is organic or inorganic through acquisitions (De Beule and Van den Bulcke, 2009). In the same way, it is not possible to distinguish between the different motivations for foreign investment: resource or efficiency seeking foreign direct investment.

Finally, in addition to the circular relation between profitability and political risk in Spanish MNEs, it would be interesting to widen the study to include small and medium enterprises and MNEs from other countries also characterized by their proactive use of political risk, as well as in relation to their perspectives over time, including a larger number of years over which reliable information is available.

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ANNEX 1 SPANISH MNEs INCLUDED IN THE SAMPLE

1. ABERTIS INFRAESTRUCTURAS SA	2. AC HOTELES SA
3. ACERINOX SA	4. ACS ACTIVIDADES DE CONSTRUCCION Y SERVICIOS SA
5. ADOLFO DOMINGUEZ SA	6. AGENCIA EFE SA
7. ALTADIS SA	8. ANGEL IGLESIAS SA
9. ARTECHE LANTEGI ELKARTEA SOCIEDAD ANONIMA	10. ASPRO OCIO SA
11. AVANZA AGRUPACION PARA EL TRANSPORTE SA	12. AVANZIT SA
13. AZKOYEN SA	14. AZUCARERAS REUNIDAS DE JAEN SA
15. BAMESA ACEROS SL	16. BANCO BILBAO VIZCAYA ARGENTARIA
17. BANCO DE SABADELL	18. BANCO PASTOR
19. BANCO POPULAR	20. BANCO SANTANDER CENTRAL HISPANO
21. BARCELO CORPORACION EMPRESARIAL SA	22. BIMBO SA
23. BORGES HOLDING S.L	24. CAIXA D'ESTALVIS I PENSIONS DE BARCELONA
25. CAIXAGALICIA	26. CAIXANOVA
27. CAJA BADAJOZ	28. CAJA DE AHORROS DE ASTURIAS
29. CAJA DE AHORROS DE SALAMANCA Y SORIA	30. CAJA DE AHORROS DEL MEDITERRANEO
31. CAJAMADRID	32. CAMPER SL
33. CAMPOFRIO ALIMENTACION SA	34. CAMELO GESTION SL.
35. CATA CORPORACIÓN	36. CEMENTOS MOLINS SA
37. CEMENTOS PORTLAND VALDERRIVAS SA	38. CHUPA CHUPS SA
39. CINTRA CONCESIONES DE INFRAESTRUCTURAS DE TRANSPORTE SA	40. CODERE SA
41. COLOMER Y MUNMANY SA	42. COMPANIA ESPAÑOLA DE PETROLEOS SA
43. CONSERVAS GARAVILLA SA	44. CONSTRUCTORA HISPANICA SA
45. COPERFIL GROUP SA	46. CORPORACION DERMOESTETICA SA
47. CORPORACION GESTAMP SL	48. CORPORACION MEDICHEM SL
49. CORTIZO CARTERA SL	50. CURTIDOS CODINA SA
51. DENION CONTROL Y SISTEMAS SA	52. DOGI INTERNATIONAL FABRICS SA
53. DOMINGO ALONSO SA	54. DURO FELGUERA SA
55. EBRO PULEVA SA	56. EL CORTE INGLES SA
57. EMPRESA DE TRANSFORMACION AGRARIA SA	58. ENDESA SA
59. ERCROS SA	60. ESPANOLA DE MONTAJES METALICOS SA
61. ESTEBAN ESPUNA S A	62. EULEN SA
63. EUROPA PRESS GRUPO SA	64. FADESA INMOBILIARIA SA
65. FAES FARMA SA	66. FAGOR ELECTRODOMESTICOS SCL
67. FELIX SOLIS SA	68. FERMAX ELECTRONICA SA
69. FICOSA INTERNATIONAL SA	70. FINANCIERA MADERERA SA
71. FLAMAGAS SA	72. FOMENTO DE CONSTRUCCIONES Y CONTRATAS SA
73. FREIREMAR SA	74. FREIXENET SA
75. FRITTA SL	76. FUNESPANA SA
77. GAMESA CORPORACION TECNOLOGICA SA	78. GAS NATURAL SDG SA

79. GBI SERVEIS SA	80. GIRBAU SA
81. GLOBALIA SA	82. GONZALEZ BYASS SA
83. GRANINTER SA	84. GRIFOLS SA
85. GRUPO AC MARCA SL	86. GRUPO ANTOLIN IRAUSA SA
87. GRUPO EMPRESARIAL ENCE SA	88. GRUPO EMPRESARIAL SANDO SL
89. GRUPO ENTRECANALES SA	90. GRUPO ESTAMPACIONES SABADELL SL
91. GRUPO FERROVIAL SA	92. GRUPO INDUKERN SL
93. GRUPO INVERSOR HESPERIA SA	94. GRUPO LECHE PASCUAL SA
95. GRUPO PRA SA	96. GRUPO VILLAR MIR SL
97. GRUPO ZETA SA	98. IBERDROLA SA
99. IBERIA LINEAS AEREAS DE ESPAÑA SA	100. IDOM SA
101. INDAL CORPORACION DE NEGOCIOS SL	102. INDO INTERNACIONAL SA
103. INDRA SISTEMAS SA	104. INDUSTRIA DE DISEÑO TEXTIL SA
105. INDUSTRIAS LACTEAS ASTURIANAS SA	106. INFORMA D&B SA
107. INFORMATICA GESFOR SA	108. INGELECTRIC TEAM SA
109. INSTITUTO DE EMPRESA SL	110. J & A GARRIGUES SL
111. LUCTA SA	112. MAC PUAR CORPORACION SL
113. MANGO MNG HOLDING SL	114. MAPFRE QUAVITAE SA
115. MARINA D'OR-LOGER SA	116. MAXAM EUROPE SA
117. MECALUX SA	118. METROVACESA SA
119. MIQUEL Y COSTAS & MIQUEL SA	120. MULTIOPTICAS INTERNACIONAL SA
121. NATRA SA	122. NH HOTELES SA
123. NICOLAS CORREA SA	124. PARQUES REUNIDOS SA
125. PESCANOVA SA	126. PEYBER HISPANIA EMPRESA CONSTRUCTORA SL
127. PLANETA CORPORACION SL	128. PLANTAS DE NAVARRA SA
129. PROSEGUR COMPAÑIA DE SEGURIDAD SA	130. PUIG BEAUTY & FASHION GROUP SL
131. REALIA BUSINESS SA	132. RED ELECTRICA DE ESPAÑA SA
133. REPSOL YPF SA	134. ROCA CORPORACION EMPRESARIAL SA
135. S TOUS SL	136. SACYR VALLEHERMOSO SA
137. SENER GRUPO DE INGENIERIA SOCIEDAD ANONIMA.	138. SIMON HOLDING SL
139. SISTEMAS AVANZADOS DE TECNOLOGIA SA	140. SOCIEDAD GENERAL DE AGUAS DE BARCELONA SA
141. SOL MELIA SA	142. SOS CUETARA SOCIEDAD ANONIMA.
143. TAMISA SL	144. TAVEX ALGODONERA SA
145. TECNICA Y PROYECTOS SA	146. TEKA INDUSTRIAL SA
147. TELEFONICA SA	148. TELEPIZZA SA
149. Tinsa TASACIONES INMOBILIARIAS SA	150. TOLSA SA
151. TORRASPAPEL HOLDING SA	152. TORRECID SA
153. TRANSPORTES CARRERAS SA	154. TRANSPORTES FERROVIARIOS ESPECIALES SA
155. TUBACEX SA	156. TUBOS REUNIDOS SA
157. UDRA SA	158. UNION FENOSA SA
159. URALITA SA	160. VALDEPESA TEXTIL SL
161. VISCOFAN S A	162. VIZA G.E.C.A. SL.
163. WERFEN LIFE GROUP SA	164. ZED WORLDWIDE SA

ANNEX 2 DESCRIPTIVE STATISTICS

Variables	N.	Min.	Max.	Average	Standard Deviation
INCOME(LOG)	164	4.29	7.61	5.55	.702
ASSETS(LOG)	164	4.06	8.68	5.72	.93
ROE	164	-104.45	77.5	15.1	17.2
AGE (LOG)	164	.78	2.37	1.66	.32
NUM. COUNTRIES IN WHICH IT OPERATES	164	1	89	11.20	12.917
INDEX OF ECONOMIC FREEDOMS	164	5.1	7.92	6.43	.43
CORRUPTION INDEX	164	2.52	8.2	5.29	1.25
POLITICAL CONSTRAINTS	164	0	8.93	6.33	1.16
INDEX AVERAGE ALL 3 INDICES	164	4.43	8.00	6.02	.80389
NON-DIVERSIFIED	164		32.3%		
RELATED	164		53%		
DIVERSIFICATION					
NON-RELATED	164		14.6%		
DIVERSIFICATION					
MANUFACTURERS	164		37.2%		
FOOD	164		11.6%		
CONSTRUCTION	164		11.6%		
REGULATED	164		7.9%		
SECTORS					
FINANCIAL	164		8.5%		
OTHER SECTORS	164		23.2%		
LISTED VALUE	164		36.6%		

Frequencies

ANNEX 3 MATRIX OF CORRELATIONS AND VARIANCE INFLATION FACTORS (VIFs)

	1	2	3	4	5	6	7	8	9	10	11	12	VIFs
1. AGE	1												2.53
2. LISTED VALUE	0.277	1											2.35
3. ASSETS	0.431	0.436	1										1.70
4. MANUFACTURER	-0.026	-0.035	-0.277	1									1.67
5. FOODSTUFFS	0.0044	0.002	-0.111	-0.279	1								1.51
6. CONSTRUCTION	-0.114	0.002	0.155	-0.279	-0.131	1							1.49
7. REGULATED	0.072	0.339	0.338	-0.226	-0.106	-0.106	1						1.46
8. FINANCIAL	0.425	-0.006	0.523	-0.235	-0.110	-0.110	0.090	1					1.38
9. CORRUPTION INDEX	0.019	0.110	0.083	-0.017	0.059	-0.059	-0.026	0.140	1				1.05
10. POLCON INDEX	0.063	0.005	0.132	-0.035	0.009	0.023	-0.020	0.184	-	1			1.04
11. EC. FREEDOMS INDEX	0.021	0.192	0.080	-0.032	0.008	-0.063	0.032	0.126	-	-	1		1.08
12. AVERAGE 3 INDICES	0.044	0.094	0.121	-0.031	0.037	-0.031	-0.017	0.184	-	-	-	1	1.05

	1	2	3	4	5	VIFs
1. RELATED DIVERSIFICATION	1					1.34
2. NON-RELATED DIVERSIFICATION	-0.440	1				1.31
3. NUMER OF COUNTRIES	-0.068	0.077	1			1.21
4. INCOME	0.162	0.109	0.286	1		1.12
5. ROE	0.088	0.100	-0.053	0.190	1	1.07

ANNEX 4 RESULTS TABLE

	(1)	(2)	(3)	(4)
EQUATION 1				
AGE	-2.819959 (4.485477)	-.9403817 (4.257896)	-4.226865 (5.207341)	-2.037504 (4.177788)
LISTED VALUE	2.447637 (2.998096)	.5670513 (2.65292)	6.04431 (5.407882)	1.744205 (2.642056)
ASSETS	3.022398 (2.278064)	3.371198 (2.267972)	2.209873 (2.646407)	3.329914 (2.200119)
MANUFACTURERS	.5667416 (2.050545)	-.1045648 (3.039252)	-.1361451 (1.947625)	.5206433 (2.299138)
FOOD	.6503961 (2.976626)	-1.659937 (4.099381)	-1.023714 (3.288441)	.1825539 (3.21952)
CONSTRUCTION	1.00139 (3.534916)	4.795599 (4.638097)	1.130225 (3.929245)	2.060074 (3.832855)
REGULATED	-1.905717 (3.930007)	-1.112821 (5.074168)	-1.274554 (3.713692)	-1.247616 (4.045033)
FINANCIAL	.743927 (5.811129)	-2.132395 (7.472342)	3.561043 (7.275207)	.5467713 (6.354443)
CORRUPTION INDEX	-18.92723*** (5.041094)			
POLCON INDEX		-12.76346** (6.034472)		
EC. FREEDOMS INDEX			-76.02204*** (19.43741)	
AVERAGE 3 INDICES				-25.88994*** (7.098212)
CONSTANT	101.472** (31.03415)	77.84274** (37.44349)	495.8883*** (131.8884)	154.1511** (44.69221)
N.	164	164	164	164
R ²	-1.9967	-0.7443	-3.6953	-1.5406
Hausman Test	3.325***	2.100*	3.233***	3.724***
EQUATION 2				
RELATED	.0098262	.0305372	-.0012504	.0169888
DIVERSIFICATION	(.1340348)	(.1822109)	(.0377411)	(.0990731)
NON-RELATED	-.0230212	.0795897	-.0089896	.0075371
DIVERSIFICATION	(.1955467)	(.2629165)	(.0524063)	(.143598)
NUMBER OF	.0015632	-.0059916	.0005678	-.0000602
COUNTRIES	(.0073598)	(.0080529)	(.0018998)	(.0051466)
INCOME	.1883064 (.2155826)	.2357815 (.1833735)	.0481774 (.0708703)	.1525964 (.1379018)
ROE	-.0542098** (.0260492)	-.0480042** (.0217053)	-.0124122 (.0087448)	-.038239** (.0164101)
CONSTANT	5.047346*** (.9858312)	5.780557*** (.8336139)	6.345145*** (.3265738)	5.736989*** (.6289265)
N.	164	164	164	164
R ²	-0.6401	-0.5313	-0.3064	-0.7607
Hausman Test	13.070***	3.808***	23.998***	9.335***

Standard deviation between parentheses
 * p < 0.10 ; ** p < 0.05; *** p < 0.01