Through Thick and Thin:
Political Risk and the Interdependencies between MNCs and Host Countries

Jennifer L. Blouin
The Wharton School, University of Pennsylvania
blouin@wharton.upenn.edu

Clare Wang
Tippie College of Business, University of Iowa
clare-wang@uiowa.edu

Laura A. Wellman
Smeal College of Business, Penn. State University
law@psu.edu

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Abstract

Using several unique datasets, we predict and find that multinational corporations' (MNCs') performance abroad improves with the depth and strength of their local business relationships, particularly during periods of heightened political risk in the host country. This evidence is consistent with the idea that MNCs rely on local relationships in foreign jurisdictions to help navigate local institutions. While it is likely that MNCs with the resources to invest in managing political risk do so with the expectation of some future economic returns, it is less clear whether the nature of MNC engagement abroad generates positive or negative externalities for the host country. We document that host country political risk is decreasing with the aggregate level of relationships between MNCs and local companies, suggesting a positive externality in the form of lower future political risk. Finally, we shed light on the potential mechanisms for institutional change by identifying additional resources/expertise – beyond MNCs' current economic activities – that MNCs can draw on in their interactions with local government and non-government organizations.

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1. Introduction

Ongoing political violence in Russia, Turkey, and Iraq; expropriation risk in Venezuela; tax uncertainty in India; and debate over policies that threaten the development of intellectual property in countries such as Brazil and China all represent highly unpredictable and nontrivial by-products of internationalization. Understanding the nuances of host country political risk is less straightforward than its economic counterpart, as subtle differences in institutional details are more challenging to quantify than readily observable economic trends. Anecdotal evidence suggests that in response to ongoing uncertainty, and perhaps in an attempt to appear as model citizens, multinational corporations (MNCs) can take steps toward managing host country political risk by establishing strategic partnerships that align and improve business interests and the public good. At least, that is the claim made by some of the largest multinationals on the global policy portions of their websites. However, it is difficult to reconcile these claims with media articles highlighting MNCs' self-serving behavior in foreign markets, which can sometimes jeopardize the social, political, and economic conditions of host countries.[1]

While it is likely that MNCs with the resources to invest in managing geopolitical risk do so with the expectation of some future economic returns, it is less clear whether the nature of MNC engagement abroad generates positive or negative externalities for the host country. Along these lines, we investigate two related research questions. First, at the firm level, we study whether MNCs' performance abroad improves with the number and strength of their local business relationships, particularly during periods of

[1] For example, on the "Public policy and advocacy" page of its corporate website, Nestle (2017) claims to play an "Increasingly active role in society, including in development of laws, rules and policy documents . . . [and] providing expertise to assist in more informed decision making." Contrast these claims with reports that Nestle is "stymieing public health officials seeking soda taxes or legislation aimed at curbing the health of impacts of processed food" in China, South Africa, and Columbia (NYT 2017). In another example, Goldman Sachs claims to provide "research and high-level advisory services to policymakers, regulators and investors around the world" (Goldman Sachs Global Markets Institute 2017). However, many who have scrutinized Goldman's advisory services to policymakers in Greece believe that they may have significantly contributed to Greece's recent financial crisis (NYT 2015).

heightened political risk. Second, at the host country level, we investigate whether future political stability varies with the aggregate level of MNCs' local relationships. We also separately study this association conditional on the nature of MNC engagement with host country government and non-government organizations.

We begin by developing predictions about the association between local relationships and firm performance. In principle, avoiding political hazards provides a strong incentive for MNCs to team up with local organizations (Henisz and Williamson 1999). The ability of governments to modify regulations, tax rates, or other economic policies represents a significant source of uncertainty for firms (Hassett and Metcalf 1999; Pindyck and Solimano 1993; Rodrik 1991; McDonald and Siegel 1986). To the extent that local relationships allow MNCs to navigate this source of uncertainty, we expect MNCs with local ties to have stronger future performance relative to MNCs that do not maintain those relationships. Further, we expect MNCs to favor strategic partnerships over simple contracts in politically risky jurisdictions (Henisz and Williamson 1999). Cultivating partnerships not only aligns the interests of MNCs and local companies, but also provides protection from adverse political action (Delios and Henisz 2003).

Ex ante, however, it is unclear what externalities will extend to the host country from a greater multinational presence. On one hand, to the extent that host country governments consider MNCs' sensitivity to political hazards that threaten the profitability of MNCs' investments (e.g., expropriation risk or intellectual property protection), host country governments have an incentive to stabilize their political environment. Evidence that links political stability to economic growth suggests that all parties have the potential to gain from strengthening local economic and political institutions (e.g., Alesina and Rodrik 1994; Henisz 2000; Acemoglu and Robinson 2013, 2016, 2017). As a result, relationships between MNCs and local firms may be positively associated with future political stability in the host country. On the other hand, MNCs may lobby local governments in countries dominated by corrupt political institutions with the expectation of securing political favors. Indeed, several studies document evidence consistent with collusion between firms and policymakers at the expense of external

stakeholders (e.g., Shleifer and Vishny 1994; Faccio, Masulis, and McConnell 2006; Amore and Bennedsen 2013). As a result, greater MNC presence may actually engender instability. Thus, it is not obvious what association partnerships between MNCs and local firms will have with host country political stability.

To investigate these questions, we rely on a novel dataset constructed by Factset Revere that covers customer contracts and other business relationships between 2003 and 2016. At the firm level, we document the types of economic relationships that MNCs form with local companies through a broad set of external contracts (e.g., supply, distribution, marketing, and manufacturing services) and strategic partnerships (research and technology collaborations, integrated product offerings, and joint ventures). Our sample consists of 4,064 unique firms with 34,055 unique relationships (18,777 external contracts and 15,278 strategic partnerships) located in 75 host countries. To capture time-series variation in political risk, we rely on the International Country Risk Guide (ICRG) political risk index. Consistent with the idea that MNCs rely on host country relationships to navigate local institutions, we document that the likelihood of maintaining local relationships is increasing with the level of political risk in the host country.

We continue our firm-level analysis by investigating variation in MNC performance abroad conditional on the number and type of local relationships that MNCs maintain in the host country. Ideally, we would measure variation in profitability (e.g., return on assets). However, one limitation of the data is that we are unable to observe revenue by jurisdiction. Alternatively we proxy for MNC performance by measuring growth in MNCs' customer base by jurisdiction.

To identify the effect of local relationships on future customer growth, we regress host country customer growth on MNCs' local relationships, controlling for firm and host country characteristics identified in prior literature. It is possible that maintaining local relationships correlates with the importance of the revenue stream coming from customers in the host country. Thus, firms that choose to maintain local relationships may systematically differ from firms that choose not to maintain local relationships, simply because they differ in their economic exposure to that jurisdiction. To address this

concern, we study the association between MNCs' local business relationships and future customer growth among MNCs with existing customer contracts (i.e., existing economic exposure). We include indicator variables for each MNC home country-host country combination. These indicators control for time-invariant characteristics that are also correlated with maintaining cross-border economic ties (e.g., whether the home and host country share a physical border, etc.). To mitigate concerns that time-invariant country and industry characteristics (e.g., country- or industry-level shocks to growth opportunities) affect our inferences, we also include indicator variables for each country-industry combination. Finally, we include year fixed effects to capture the influence of aggregate time-series trends. We document a positive association between MNCs' relationships and future customer growth in the host country, on average. A one standard deviation increase in the number of business relationships results in an increase in customer growth of 3%.

We recognize that the choice to maintain local relationships in the host country is not random and correlates, in part, with unobservable firm characteristics. To address this concern, we perform several additional tests. First, we replace host country-industry indicators with firm indicators to control for time-invariant differences across firms with and without local relationships. We continue to find a positive association between local relationships and future customer growth. Second, if local relationships are important for navigating local political risk, then we predict that the association between local relationships and future customer growth is stronger when ex ante political risk is high. To test this prediction, we separately estimate the interaction between host country relationships and three periods of increasing or high political risk: the level of political risk, changes in political risk, and recurring national elections that represent spikes in political risk. Our results indicate that the benefit of local relationships is most valuable around these periods, consistent with the notion that local relationships are important for navigating local political risk.

After establishing an association between MNCs' host country relationships and future customer growth, we examine whether economic ties between MNCs and local firms generate positive or negative externalities for the host country's political environment. To do this, we aggregate all MNC relationships

with host country firms by host country-year and investigate the association between the total number of MNCs' relationships and future political risk in the country. We find a negative and significant association between the total number of MNCs' relationships and future political risk. This suggests that a greater multinational presence is associated with positive outcomes for the host country in the form of lower future political risk.

One concern is that our proxy for host country political risk correlates with a number of other environmental factors (e.g., general economic risk). To shed light on the potential mechanisms for institutional change, we identify additional resources/expertise – beyond MNCs' current economic activities – that MNCs can draw on in their interactions with local government and non-government organizations. To do this, we augment our primary dataset with two additional datasets that are available only for a subset of firm-year observations.

First, for a sample of U.S. MNCs, we identify whether MNCs maintain a government relations department and expect MNCs that invest in this resource to be in a better position to navigate the local political landscape. Consistent with this prediction, we document that the benefits extending from local relationships for customer growth are concentrated among firms that maintain this resource. Further, we expect that MNCs maintain a government relations department in order to navigate political risk specifically, as opposed to economic risk in general.[2] Consistent with this expectation, we predict and find that the total number of relationships stemming from MNCs with government relations departments is associated with lower future political risk in the host country. In contrast, we do not find that this resource has any direct association with reducing future economic risk in the host country.

Second, we investigate variation in whether firms proactively manage their exposure to social and environmental risks in the host country. Social and environmental risk management strategies that align firms' business interests with the public good can strengthen firms' economic outcomes in the host country (Henisz 2014). In addition, MNCs' risk management strategies may complement (or strengthen)

[2] MNCs can also maintain resources useful in economic risk analysis. For example, Caterpillar, Inc. invests in macroeconomic forecasting, complementing its quarterly earnings announcements with a macroeconomic outlook.

host country policies (e.g., entitlement and environmental protection programs). As a result, we may observe a positive association between host country political stability and relationships between local firms and MNCs with this expertise. To investigate these predictions, we rely on firms' MSCI ESG risk ratings. We find that MNCs' ability to successfully manage social and environmental risks contributes to MNCs' customer growth in the host country. We also find that local relationships extending from MNCs with this resource have a greater impact on host country political stability. Additional analysis reveals that expertise in managing social and environmental factors does not serve to stabilize host country economic risk, which suggests that this MNC resource is correlated with firms' ability to navigate (and influence) host country political risk, specifically.

Collectively, our findings highlight interdependencies that develop between MNCs and host countries characterized by heightened political risk. Our research makes several contributions. First, we contribute to the literature that links complementarities among firm resources to firm performance (e.g., Milgrom and Roberts 1995; Arora 1996; Aral, Brynjolfsson, and Wu 2012; Grabner and Moers 2013). These studies examine how firm-level resources interact, emphasizing that practices implemented in concert produce disproportionately greater benefits for firms. We build on this theory and evidence by documenting the benefits that accrue to MNCs and host countries as MNCs implement a multi-faceted internationalization strategy. Specifically, MNCs benefit from complementing access to local knowledge through local relationships with maintaining a government relations team and/or expertise in managing environmental and social risks.

Second, we contribute to the literature on corporate political strategies. A growing stream of research studies the informational strategies that firms can implement in order to offset negative exposure to political risks (Wellman 2017; Hendricks et al. 2017; Reza, Ovtchinnikov, and Wu 2016). We identify a specific mechanism for information flow – government relations staff – posited in qualitative research to have a significant impact on firms' ability to react to and influence policy (e.g., Hillman and Hitt 1999). We document that the performance benefits for cross-country relationships are strongest for firms that maintain this resource.

Finally, several studies consider the implications of multinational investment for future economic growth (Bekaert, Harvey, and Lundblad 2001; Bekaert and Harvey 2002, 2003). These studies demonstrate that the timing and mode of entry into a particular market influence future economic growth in that region, as well as the institutional context for economic growth (Henisz 2000). We document the types of relationships (i.e., external contracts and strategic partnerships) and additional MNC resources (i.e., government relationships departments and risk management expertise) that are associated with future political stability in the host country. Whereas prior research has taken a nefarious view of corporate political activity (e.g., Chaney, Faccio, and Parsley 2011; Faccio 2006; Faccio, Masulis, and McConnell 2006), we document welfare gains associated with the aggregate level of relationships that stem from MNCs with government relations staff and/or expertise in managing environmental and social risks. To the extent that firms can benefit from more stable political environments, our findings are relevant to managers who are deciding whether or not to pursue local relationships, as well as determining the nature of their engagement with local firms, government, and nongovernment organizations.

2. Hypothesis development

The extent to which policy makers have the incentive and ability to alter policies in response to economic conditions or the demands of their constituents represents a source of uncertainty for MNCs (Henisz and Williamson 1999). Uncertainty from the public policy environment magnifies difficulties in collecting, interpreting, and organizing the information necessary for successful investment (Wellman 2017). Hence, the demand for local knowledge is a significant determinant of maintaining relationships with local companies when entering foreign jurisdictions (Barkema, Bell, and Pennings 1996; Henisz and Williamson 1999).

Traditional theories of international expansion maintain that MNCs curtail chances of failure through knowledge gained along a chain of increasing commitment, from customer relationships to supplier relationships to strategic alliances (Davidson 1980). Accelerating commitment in this way allows

firms to take advantage of "simple transactions" while building a database of local market knowledge (Henisz and Williamson 1999). However, in less stable countries, strategic partnerships can foster incentive alignment between MNCs and local firms, as well as secure commitment from local partners (Henisz 2014).

Further, in politically unstable countries, MNCs face added hazards relative to host country firms, as policymakers favor domestic companies when considering policy change (Delios and Henisz 2003). Indeed, empirical evidence supports the proposition that local partners are more likely to receive a share of equity ownership when MNCs enter countries characterized by high political risk (Agarwal and Ramaswami 1992; Phillips-Patrick 1991). Together, this theory and evidence suggest that MNCs benefit not only from access to local knowledge through their local relationships, but also from protection against adverse political action when these relationships take the form of partnerships. This theory and evidence lead to the following prediction formally stated in alternative form:

> *Hypothesis 1: Relationships with host country firms are associated with MNCs' future performance in the host country, particularly during periods of heightened political risk.*

To the extent that positive externalities extend from foreign presence, host country governments also face strong incentives to cultivate foreign participation in the local economy. For example, spillovers may take place when local firms improve their efficiency by copying the practices of foreign affiliates. In addition, multinationals often provide technical assistance to their suppliers in order to raise the quality of their products, sometimes requiring their suppliers to satisfy International Standards Organization (ISO) standards. Further, case studies (e.g., Moran 2001) indicate that MNCs help suppliers with management training and organization of the production process, quality control, purchase of raw materials, and even finding additional customers. Finally, local companies may also learn to use existing resources more efficiently due to increased competition stemming from foreign presence in the local economy

(Blomstrom and Ari Kokko 1998). Collectively, this evidence suggests that host country economies stand to gain significantly from foreign participation.

However, government enforcement of laws and regulations that promote economic activity varies extensively across countries (La Porta et al. 1998; La Porta et al. 1999, 2008). Acemoglu and Robinson (2013, 2016, 2017) argue that economic policies are an outcome of political choices that are shaped by the quality of political institutions. Acknowledging the close link between the quality of political and economic institutions, Alesina and Rodrik (1994) and Henisz (2000) document a positive association between political stability and economic growth. Building on this theory and evidence, we argue that in order to foster continued *economic* relationships with multinationals, host countries must critically evaluate the quality of their political environment. Consistent with this, several studies document multinationals' sensitivity to the quality of political institutions that shape economic outcomes in the host country. For example, MNCs have been shown to exhibit sensitivity to the strength of intellectual property rights protection (Javorcik 2004), the threat of expropriation from the state (Opp 2012), and political violence (Hiatt and Sine 2014).

If host country governments have an incentive to redesign policies in order to cultivate continued relationships with multinationals, then we expect externalities to extend from foreign presence in the form of changes in political stability. Finally, we expect externalities that extend from relationships between MNCs and local companies to be stronger when those relationships take the form of strategic partnerships. This is in part due to stronger incentive alignment between multinationals and local companies to improve local institutions and thus economic opportunity for all parties (Henisz 2014). We make the following prediction, formally stated in alternative form:

H2: The total number of MNCs' local relationships is associated with future political risk in the host country.

3. Measures for host country political risk, MNCs' relationships, and MNCs' government relations and quality of risk management

3.1 Host country political risk

To capture time-series variation in political risk, we rely on the International Country Risk Guide (ICRG) political risk index. The ICRG staff collects political information and makes subjective assessments based on available information in a consistent pattern of evaluation. The objective of the political risk index is to measure political stability along 12 components. The minimum number of points that can be assigned to each component is zero, while the maximum number of points depends on the fixed width that component is given in the overall political risk assessments. In every case, the higher (lower) the risk point total, the higher (lower) the risk. After a risk assessment (rating) has been awarded to each of the 12 components, the components are added together to create the index.

Appendix B summarizes the risk components and weights. Government Stability, Socioeconomic Conditions, Investment Profile, Internal Conflict, and External Conflict are the most heavily weighted components of the overall index (i.e., a maximum of 12 points can be assigned to each of these categories). Corruption, Military in Politics, Religious Tensions, Law and Order, Ethnic Tensions, and Democratic Accountability can receive up to a maximum of six points, and Bureaucracy Quality a maximum of four points.

To measure the level of political risk for country *k* in year *t*, we use the summary measure of political risk as provided by ICRG. Specifically, *POLITICAL_RISK* is the index value across all twelve components of political risk for country *k* in year *t*.

In Table 1, we observe variation across countries in the level of *POLITICAL_RISK*. ICRG classifies countries as low risk if *POLITICAL_RISK* falls below 30.00, moderate risk if *POLITICAL_RISK* is between 30.00 and 39.99, and high risk if *POLITICAL_RISK* rises above 39.99. Using each country's average political risk across our sample period, we classify the following countries as moderate risk: Argentina, Bahrain, Brazil, Bulgaria, China, Ghana, Greece, Israel, Jordan, Kazakhstan, Morocco, Peru, Philippines, Romania, Saudi Arabia, South Africa, Tunisia, Vietnam, and Zambia. Using

the same measure, we classify the following countries as high risk: Bangladesh, Bolivia, Colombia, Cote d'Ivoire, Egypt, India, Indonesia, Iran, Kenya, Nigeria, Pakistan, Russia, Thailand, Turkey, Uganda, and Venezuela.

3.2 Customer contracts and host country relationships

To capture firms with economic exposure to fluctuations in geopolitical risk, we identify firms with customer contracts in the host country using a novel dataset constructed by Factset Revere. The same dataset is used to track other business relationships (i.e., external contracts and strategic partnerships). Factset analysts systematically collect companies' relationship information exclusively from primary public sources such as SEC 10-K annual filings, investor presentations, and press releases, and they classify them through normalized relationship types. Data quality is monitored using a combination of system quality control (i.e., an internally developed document reader with customizable searching and translation tools) and human quality control. Company information is fully reviewed annually, and changes based on press releases and corporate actions are monitored daily.

Beyond customer contracts, external contracts include supply, distribution, manufacturing, and marketing contracts. Strategic partnerships include research and technology collaborations, integrated product offerings, equity investments, and joint ventures.[3] Appendix C provides more detail on each category type.

So that we can identify MNCs with economic exposure to a particular jurisdiction, and thus exposure to that country's political risk, our sample of firm-host country-year observations includes only those observations for which firm *i* has at least one customer contract in country *k* during year *t*. Our primary independent variable of interest, *RELATIONSHIPS*, is the total number of relationships across both external contract and strategic partnership categories for firm *i* in host country *k* during year *t*. In our

[3] Factset Revere tracks licensing contracts (i.e., contracts whereby the MNC licenses products, patents, intellectual property or technology). We exclude these contracts from our analyses because they are less likely to be accompanied by a physical presence in the host country.

analyses, we also investigate the implications of external contracts and strategic partnerships separately, with $RELATIONSHIPS^{External\_Contracts}$ and $RELATIONSHIPS^{Strategic\_Partnership}$, respectively.

3.2 Measures for government relations and quality of risk management

We consider two additional activities that MNCs can combine with their local relationships: whether or not MNCs maintain a government relations department, and/or the ability of MNCs to manage social and environmental risks.

While the specific objectives of government relations teams vary across firms in our sample, in general, staff interact with government officials in order to gain and maintain favorable policies from the MNC's perspective. We collect data on whether or not firms in our sample have an internal government relations department. These data are available for MNCs domiciled in the United States and are collected from *Representatives*, a directory published semi-annually by Columbia Books & Information Services throughout our sample period.[4]

To identify whether or not our sample firms have any internal government relations staff, we manually search the directory for each firm-year observation. If a company has any internal employees listed as part of the company's government relations staff, *GOV_RELATIONS* is set equal to one, and zero otherwise. Thus, *GOV_RELATIONS* is measured annually at the firm level.

Next, we investigate variation in whether firms proactively manage social and environmental risks in the host country. Social and environmental risk management strategies that align firms' business interests with the public good have the potential to build capital among customers, communities, and governments (Henisz 2014). Thus, we expect that firms that take a more holistic approach to engaging with stakeholders in the host country stand to gain the most. In addition, MNCs' risk management strategies may complement (or strengthen) host country policies. As a result, we may observe a positive

[4] The directory lists internal employees who represent their firm in both domestic and international affairs. A limitation of the data is that we cannot observe time-series variation in government relations resources dedicated to specific host countries. If MNCs maintain this firm-level resource but have not dedicated any resources specifically to the host country, this should bias against our finding any benefits extending to either the MNC or the host country for activity in the host country.

association between host country political stability and relationships between local firms and MNCs with this expertise. To test these predictions, we use the MSCI ESG risk ratings to identify firms that are more (less) effective in managing social and environmental issues. Appendix D outlines the components of the ESG risk rating. Companies are rated on a scale of AAA-CC relative to the standards and performance of their industry peers. We separate firms on the relative strength of their rating. For firms receiving a rating of AAA, AA, or A, *STRONG_ESG* equals one, and zero otherwise.

4. Firm-level analyses

In this section, we investigate whether the level of host country political risk contributes to MNCs' decisions to team up with local companies. We examine this question among firms with existing economic exposure to host country political risk through current customer contracts. We then study whether benefits accrue to MNCs that decide to manage local relationships.

4.1 Sample

Our sample consists of firm-host country-year observations where firm *i* has revenue exposure to country *k* during year *t* through customer contracts for the years 2003 through 2016. Our sample period is constrained to these years because of the data needed to construct measures of the various forms of relationships from Factset Revere, which began coverage in 2003. Data on firm characteristics come from Worldscope, and data on country characteristics come from the World Development Indicator database (World Bank).

In Table 2, we document the distribution of MNCs based on location of MNC headquarters. Not surprisingly, the largest concentration of firms is domiciled in the United States, followed by the United Kingdom, Canada, Germany, and France.

4.2 Managing host country relationships, conditional on host country political risk

In this section, we investigate the determinants of managing host country relationships, conditional on revenue exposure in the host country.[5] Our sample includes firm-host country-year observations with economic exposure to host country political risk through existing customer contracts. We use the following firm-host country-year cross-sectional OLS regression specification:

$$Ln(RELATIONSHIP_{ikt}) = \alpha + \beta_1 POLITICAL\_RISK_{kt} + \sum \gamma FIRM\ CONTROLS_{it} +$$

$$\sum \theta HOST\text{-}COUNTRY\ CONTROLS_{kt} + FE + \varepsilon_{ikt} \qquad (1)$$

where *i*, *k*, and *t* indexes firms, host countries, and years, respectively: $RELATIONSHIPS_{ikt}$ represents the number of relationships firm *i* had in host country *k* in year *t* and captures the extent of firms' involvement in the host country through local relationships.

$POLITICAL\_RISK_{ikt}$ is ICRG's summary index value across all twelve components of political risk for host country *k* in year *t*. The coefficient on $POLITICAL\_RISK_{ikt}$ measures whether the level of host country political risk affects the likelihood that MNCs will maintain relationships with host country firms. To the extent that these MNCs are more likely to have relationships with local firms in place during periods of high political risk, we expect a positive and significant coefficient on $POLITICAL\_RISK_{ikt}$.

We include various firm-level and host country-level variables identified in prior research as determinants of global entry decisions (e.g., Ferreira, Massa, and Matos 2010; Martynova and Renneboog 2008). We include variables that capture firms' resources and growth opportunities: firm size, *SIZE*; cash flow, *CF*; market leverage, *LEV*; market-to-book ratio, *MTB*; research and development, *R&D*; and sales growth, *GROWTH*.

For host country characteristics, we include several country characteristics that capture general macroeconomic conditions. Pastor and Veronesi (2013) document that volatility stemming from policy uncertainty worsens with changes in economic conditions. Barro and Sala-i-Martin (1995) argue that government consumption proxies for political corruption, nonproductive public expenditures, or taxation.

[5] Appendix A provides details on how all of the variables are calculated.

Bekaert and Harvey (1995, 1997, 2000) and Levine and Zervos (1998) employ the size of the trade sector as a measure of openness of the particular economy to trade. Barro (1997) provides evidence suggesting a negative relationship between inflation and economic activity. Drawing from these studies, we include GDP growth, *GDP_GROWTH*; government consumption, *CONSUMPTION*; the size of the trade sector, *TRADE*; and the annual rate of inflation, *INFLATION*.

We also include variables that capture development in the banking sector and financial markets. Following the evidence presented in King and Levine (1993), we include *PRIVATE_CREDIT* to capture the level of credit issued by private banks in the region, in contrast to that issued by a central bank. We include two variables that proxy for general development of the equity market: a measure of equity market size (*MARKET_CAP*) and a measure of market liquidity, equity market turnover (*TURNOVER*). We also include indicator variables for each MNC home country-host country combination. These indicators control for time-invariant characteristics that are also correlated with maintaining cross-border economic ties (e.g., whether the home and host country share a physical border). To mitigate concerns that time-invariant country and industry characteristics (e.g., country- or industry-level shocks to growth opportunities) affect our inferences, we also include indicator variables for each country-industry combination. Finally, we include year fixed effects to capture the influence of aggregate time-series trends.

Table 4 documents the results of estimating equation (1). In column (1), the coefficient on *POLITICAL_RISK* is positive and significant, consistent with a positive relation between the level of host country political risk and MNCs' propensity to maintain relationships with local firms. In columns (2) and (3), we further distinguish between the types of relationships (i.e., external contracts vs. strategic partnerships, respectively) in the dependent variable. The results show that there are few differences in the determinants of maintaining external contracts and strategic partnerships. Specifically, the choice to maintain strategic partnerships is increasing with firms' growth opportunities (*MTB*) and investments in research and development (*R&D*). The likelihood of MNCs maintaining either external contracts or strategic partnerships is increasing with the level of host country political risk.

4.3 Customer growth

We continue our firm-level analysis by investigating variation in MNC performance abroad conditional on the number and nature of local relationships that MNCs maintain in the host country. We predict that firms willing to manage local relationships do so with the expectation of achieving future customer growth in the host country. To test this prediction, we examine the association between MNCs' local relationships and customer growth in the host country from *t* to *t*+3. We estimate the following ordinary least squares (OLS) regression:

$$CUSTOMER\_GROWTH_{ikt,\,t+3} = \alpha + \beta_1 RELATIONSHIP_{ikt} + \sum \gamma FIRM\ CONTROLS_{it}$$

$$+ \sum \theta HOST\text{-}COUNTRY\ CONTROLS_{kt} + FE + \varepsilon_{ikt} \qquad (2)$$

where *i*, *k*, and *t* indexes firms, host countries, and years, respectively: customer growth, *CUSTOMER_GROWTH*, is calculated based on the four-year geometric average of the annual growth rate in the customer base from time *t* to *t*+3 for firm *i* in country *k*. We predict that the estimated coefficient on *RELATIONSHIPS* will be positively associated with *CUSTOMER_GROWTH* (i.e., $\beta_1 > 0$).

We include firm and host country characteristics from equation (1). We also include indicator variables for each MNC home country-host country combination. These indicators control for time-invariant characteristics that are also correlated with maintaining cross-border economic ties (e.g., whether the home and host country share a physical border). To mitigate concerns that time-invariant country and industry characteristics (e.g., country- or industry-level shocks to growth opportunities) affect our inferences, we include indicator variables for each country-industry combination. We also include year fixed effects to capture the influence the aggregate time-series trends. Standard errors are clustered by host country and year to control for residual correlation in the growth of firm *i*'s customer base over time and for residual correlation in the growth of firm *i*'s customer base across countries in year *t* (Petersen 2009).

Table 5 provides tests for the association between MNCs' host country relationships and host country customer growth. Panel A of Table 5 provides the results of estimating equation (2). In column (1), we investigate the association between *RELATIONSHIPS* and *CUSTOMER_GROWTH*, controlling

for firm and host country characteristics, as well as home country-host country, host country-industry, and year fixed effects. We document a statistically positive association between *RELATIONSHIPS* and *CUSTOMER_GROWTH* (coefficient = 0.0140, t = 2.13, two-tailed p = 0.03). A one standard deviation change in *RELATIONSHIPS* represents a 3.2% increase in customer growth over the period *t* to *t*+3.[6] In column (2), we replace host country-industry fixed effects with firm fixed effects to control for time-invariant unobservable firm characteristics. We continue to find a positive and significant coefficient on *RELATIONSHIPS* (coefficient = 0.0449, t = 5.41, two-tailed p < 0.01). In column (3), we replace host country-industry and year fixed effects with host country-industry-year fixed effects. These fixed effects control for all time-varying and time-invariant country and industry characteristics that affect companies' decision to maintain local relationships. We continue to find a positive and significant coefficient on *RELATIONSHIPS* (coefficient = 0.0213, t = 3.34, two-tailed p < 0.01). In columns (4) and (5), we separately examine the association between *RELATIONSHIPS* that come from external contracts and strategic partnerships, respectively. In column (4), we do not find evidence that external contracts explain future customer growth. However, in column (5), we find a statistically positive association between strategic partnerships, as evidenced by the coefficient on *RELATIONSHIPS* and *CUSTOMER_GROWTH* (coefficient = 0.0350, t = 3.19, p < 0.01).

Next, we investigate whether the benefit of local relationships for future customer growth is conditional on the level and changes of ex ante political risk. If local relationships are important for navigating local political risk specifically, then we expect that the association between local relationships and future customer growth will be stronger when ex ante political risk is high and/or when there have been significant increases in political risk. To test this prediction, we perform three sets of analyses. First, we investigate whether the association between *RELATIONSHIPS* and *CUSTOMER_GROWTH* from *t* to *t*+3 is conditional on the level of political risk at *t-1* by augmenting equation (2) with an interaction term

[6] 3.2% is calculated by multiplying the value of the coefficient on non-transformed *RELATIONSHIPS* in column (1) (i.e., 2.07, Table 4, Panel B) by the standard deviation of non-transformed *RELATIONSHIPS* for the customer growth sample (i.e., .0154, untabulated).

between *RELATIONSHIPS* and $POLITICAL\_RISK^{High}$. We expect an incremental benefit from host country relationships for customer growth in the host country when political risk at *t-1* is high. The coefficient on the interaction between *RELATIONSHIPS* and $POLITICAL\_RISK^{High}$ captures the association between *RELATIONSHIPS* and *CUSTOMER_GROWTH* for relationships maintained in high-risk countries. If local relationships in high-risk countries are particularly beneficial, we expect a statistically positive coefficient on the interaction term *RELATIONSHIPS x* $POLITICAL\_RISK^{High}$ (i.e., $\beta_3 > 0$).

In column (1) of Table 5, Panel B, we find that the coefficient on the interaction term *RELATIONSHIPS x* $POLITICAL\_RISK^{High}$ is positive and significant. This is consistent with the notion that MNCs experience a more substantial benefit from maintaining relationships in high-risk countries.

Second, we investigate whether the association between *RELATIONSHIPS* and *CUSTOMER_GROWTH* from *t* to *t*+3 is conditional on significant increases in the level of political risk from *t*-1 to *t* by augmenting equation (2) with an interaction term between *RELATIONSHIPS* and $POLITICAL\_RISK^{Increase}$. To do this, we identify host country-years that experience a significant increase in political risk (i.e., move from low to moderate risk or from moderate to high risk) as defined in the International Country Risk Guide. If relationships in place around periods of increasing political risk are particularly beneficial, we expect a statistically positive coefficient on the interaction term *RELATIONSHIPS x* $POLITICAL\_RISK^{Increase}$ (i.e., $\beta_3 > 0$).

In column (2) of Table 5, Panel B, we present the results of this analysis. We document a positive and significant coefficient on the interaction term *RELATIONSHIPS x* $POLITICAL\_RISK^{Increase}$. This finding is consistent with MNCs benefiting from relationships, particularly around periods of increasing political risk.

One remaining concern is that trends in political risk correlate with trends in general economic conditions. To address this concern, we build on the findings of Julio and Yook (2012) and study shocks to political risk relying on elections in which the national leader is determined. As the authors point out, term limits imposed by recurring elections introduce the possibility that new leaders with different policy

preferences may replace current leaders. As a result, firms face uncertainty over how election outcomes will alter policies that affect profitability. In our setting, election-induced political risk is only one component of overall political risk. That is, predicting (or observing) the outcome of the election is only one piece of the puzzle. Uncertainty about how newly elected officials pursue their agendas alongside other elected and/or appointed government officials suggests that firms continue to face political risk even after election outcomes are known (e.g., Fowler 2006, Goodell and Vähämaa 2013, Füss and Bechtel 2008). Nevertheless, relying on national elections as shocks to political risk is a useful empirical tool for separating political risk from general economic risk, as timed elections represent recurring, temporary spikes in political risk that are exogenous to economic conditions.

To investigate whether local relationships are useful for navigating election-induced political risk, we collect data on the timing of national elections relying on the methodology of Julio and Yook (2012). Specifically, Julio and Yook (2012) collect detailed election information from a variety of sources, beginning with identifying the chief executive of each country and the national elections associated with the selection of the chief executive.[7] Next, the authors classify countries as having either exogenous timing or endogenous timing. In our setting, we are only interested in those national elections where the timing of the election is exogenously specified by electoral law, as these elections are less likely to correlate with variation in other country-level characteristics (e.g., general economic trends). In Table 1 of Julio and Yook (2012), the authors report 20 countries having exogenous (i.e., fixed) timing (pg. 53). Of these 20 countries, 18 are included in our sample: Argentina, Brazil, Chile, Colombia, France, Hungary, Indonesia, Luxembourg, Mexico, Norway, Peru, Philippines, Russia, South Korea, Sweden, Switzerland, United States, and Venezuela. For these 18 countries, we collect data on the timing of the elections relying on the World Bank Database of Political Institutions and various internet sources for cases in which election information is missing.

[7] See Section II (pg. 51) of Julio and Yook (2012) for more detail on data collection and validation.

We investigate whether the association between *RELATIONSHIPS* and *CUSTOMER_GROWTH* from *t* to *t*+3 varies between election and non-election years by augmenting equation (2) with an interaction term between *RELATIONSHIPS* and $POLITICAL\_RISK^{Election\_YR}$. We isolate host countries that that have at least one national election during our sample period, reducing our sample to 12,499 firm-host country-year observations. $POLITICAL\_RISK^{Election\_YR}$ is set equal to one if country *k* experiences a national election in year *t*, and zero otherwise. The coefficient on the interaction between *RELATIONSHIPS* and $POLITICAL\_RISK^{Election\_YR}$ captures the incremental effect between *RELATIONSHIPS* and *CUSTOMER_GROWTH* for relationships in place during election years compared to non-election years. If relationships in place during election years are particularly beneficial, we expect a statistically positive coefficient on the interaction term *RELATIONSHIPS x* $POLITICAL\_RISK^{Election\_YR}$ (i.e., $\beta_3 > 0$).

In column (3) of Table 5, Panel B, we present the results of this analysis. The coefficient on the interaction term *RELATIONSHIPS x* $POLITICAL\_RISK^{Election\_YR}$ is positive and significant, consistent with a stronger benefit in election years relative to non-election years. However, we note that the overall effect is moderate in this subsample of countries.

Finally, we perform a falsification test to identify whether host country relationships specifically, rather than MNCs' business relationships in general, contribute to host country customer growth. To the extent that maintaining host country relationships captures unobservable firm resources that allow MNCs to navigate uncertainty in general, we expect all MNC relationships (regardless of where those relationships are maintained) to have a positive association with future customer growth in the host country. In contrast, if firms maintain local relationships to navigate local institutions specifically, then we expect no association between relationships maintained in other foreign jurisdictions and host country customer growth. To test this prediction, we separately count relationships that MNCs have with local companies in all *other* foreign jurisdictions (i.e., firm *i*'s total foreign relationships, less relationships in the focal host country) by firm-year and regress host country customer growth on MNCs' residual foreign relationships. To illustrate, firm *i* has nine foreign relationships across all jurisdictions where firm *i* has

existing customer contracts, one of which is Mexico, where firm *i* maintains two local relationships. Our measure of other foreign relationships, $RELATIONSHIPS^{Other\_Foreign}$, equals seven (i.e., nine total relationships, less two relationships in Mexico) for firm i's Mexico observation in year *t*.

Table 6 reports the results of re-estimating equation (2) including $RELATIONSHIPS^{Other\_Foreign}$. In column (1), we replace *RELATIONSHIPS* with $RELATIONSHIPS^{Other\_Foreign}$ and find no significant association between $RELATIONSHIPS^{Other\_Foreign}$ and *CUSTOMER_GROWTH*. In column (2), we re-estimate equation (2) including both $RELATIONSHIPS^{Other\_Foreign}$ and *RELATIONSHIPS* and continue to find no significant association between $RELATIONSHIPS^{Other\_Foreign}$ and *CUSTOMER_GROWTH*. Taken together, the evidence in Table 6 is consistent with our prediction that host country customer growth does not vary with MNCs' foreign relationships maintained outside of the host country.

Collectively, the results of our firm-level analysis show that MNCs' relationships are beneficial to their host country customer base. We find a positive association between MNCs' relationships and future customer growth, and the association appears to be driven by strategic partnerships, rather than external contracts. Further, our evidence is consistent with firms maintaining relationships with local companies in the host country in order to navigate host country political risk. As a result, firms that maintain relationships enjoy greater future customer growth in the host country.

5. Host country analysis

Next, we examine whether economic relationships between MNCs and local firms generate positive or negative externalities for the host country's political environment. On one hand, to the extent that host country governments consider MNCs' sensitivity to political hazards that threaten the profitability of MNCs' investments (e.g., expropriation risk or intellectual property protection), host country governments have an incentive to stabilize their political environment. As a result, relationships between MNCs and local firms may be positively associated with future political stability in the host country. On the other hand, MNCs may lobby local governments in countries dominated by corrupt political institutions with the expectation of securing political favors. As a result, greater MNC presence

may actually engender instability. To test the association between the total number of MNCs relationships with local firms and future political stability in the host country, we estimate the following ordinary least squares (OLS) regression:

$$POLITICAL\_RISK_{k,t+1} = \alpha + \beta_1 RELATIONSHIPS^{Aggregate}_{kt} + \sum \theta HOST\text{-}COUNTRY\ CONTROLS_{kt} + FE + \varepsilon_{kt} \quad (3)$$

where *k* and *t* indexes host countries and years, respectively: political risk, *POLITICAL_RISK*, is calculated based on the level of political risk in *t*+1 for country *k*. We predict that the estimated coefficient on $RELATIONSHIPS^{Aggregate}$ will be negatively associated with *POLITICAL_RISK* (i.e., $\beta_1 < 0$). Because policymakers' actions are sensitive to changes in macroeconomic conditions (Pastor and Veronesi 2013), there is a natural link between fluctuations in the macro economy and political stability. Thus, in studying the relation between aggregate relationships formed between MNCs and local firms, we control for factors that describe macroeconomic and market conditions: *GDP_GROWTH*, *CONSUMPTION*, *TRADE*, *INFLATION*, *PRIVATE_CREDIT*, *MARKET_CAP*, *NUMBER_COMPANIES*, and *TURNOVER*. We also include an additional control for ex ante political risk for country *k* at *t*-1. We cluster standard errors by host country and year to control for residual correlation in political risk for country *k* over time and residual correlation in political risk across countries in year *t* (Petersen 2009).

Table 7 presents the results of estimating equation (3). In column (1) of Panel A, we document a negative and significant association between $RELATIONSHIPS^{Aggregate}$ and $POLITICAL\_RISK_{t+1}$ after including country characteristics, as well as host country and year fixed effects (coefficient = -0.0014, t = -2.39, p = 0.02). A one standard deviation change in $RELATIONSHIPS^{Aggregate}$ (186.15, untabulated) results in a 0.26 change in the political risk score. Relative to the sample mean of 20.40 (Table 3, Panel B), this represents a change of about 1.2%. In column (2), we continue to find a negative association between $RELATIONSHIPS^{Aggregate}$ and $POLTICAL\_RISK_{t+1}$ when we estimate equation (3) focusing exclusively on external contracts as our dependent variable (coefficient = -.0016, t = -2.33, p = 0.02). Interestingly, we document an insignificant coefficient on $RELATIONSHIPS^{Aggregate}$ when we focus on

strategic partnerships alone. This suggest that externalities extending from strategic partnerships do not manifest within a one-year horizon. Thus, we extend our analysis to include two- and three-year horizons.

In Table 7, Panels B and C, we document the results of estimating equation (3) using longer horizons of future political risk. In Table 7, Panel B, we extend the horizon of political risk to represent the average level of future political risk for host country *k* over the periods *t*+1 and *t*+2. Requiring an additional year reduces the sample from 651 host country-year observations to 516 host country-year observations. In columns (1) and (2) of Panel B, we continue to find that the aggregate number of MNC relationships in host country *k* during year *t* is negatively associated with the level of future political risk for country *k*, regardless of whether we estimate equation (3) relying on all MNC relationships (column (1)) or just external contacts (column (2)). However, unlike the results in Panel A, the results in column (3) of Panel B show a negative and significant association between strategic partnerships and future political risk (coefficient = -0.0029, t = -2.03, p = 0.04). This suggests that externalities extending from MNCs' strategic partnerships with local firms come with some delay, relative to external contracts.

In Table 7, Panel C, we extend the horizon of political risk to represent the average level of future political risk for host country *k* over the periods *t*+1 and *t*+3. Requiring an additional year further reduces the sample from 516 host country-year observations to 458 host country-year observations. In columns (1) - (3) of Panel C, we continue to find that the aggregate number of MNC relationships in host country *k* during year *t* is negatively associated with the level of future political risk for country *k*, regardless of whether we estimate equation (3) relying on all MNC relationships, external contacts, or strategic partnerships, respectively. Collectively, these results suggest that relationships between MNCs and local companies are positively associated with future political stability, and this association persists for several years. In the next section, we investigate potential mechanisms for this association.

6. Supplemental analysis: Channels for predicting and influencing political stability

One concern is that our proxy for host country political risk correlates with a number of other environmental factors (e.g., general economic risk). To shed light on the potential mechanisms for

institutional change, we identify additional resources/expertise – beyond MNCs' current economic activities – that MNCs can draw on in their interactions with local government and non-government organizations. Specifically, we identify whether the MNC has a government relations department and/or whether the MNC has expertise in managing environmental and social factors. We expect MNCs that have developed these unique resources and/or expertise to be in a better position to navigate host country political risk. We discuss each of these analyses separately below, as each variable further restricts our sample due to available data on these additional MNC characteristics.

6.1 MNCs' government relations staff

Alongside strategic partners, MNCs can engage in discussions over environmental or labor laws, international trade barriers, or tax concessions for particular investments (Henisz and Williamson 1999; Delois and Henisz 2003). Throughout these interactions, MNCs have the opportunity to inject members of their own government relations department in an effort to influence policy outcomes. In addition to providing opportunities for influence, participating in policy discussions reduces information asymmetry over political outcomes, regardless of whether outcomes are ultimately favorable from the firm's perspective (Henisz and Zelner 2004). To investigate whether maintaining government relations staff improves the overall success of the MNC in the host country, we collect data on whether or not MNCs have internal government relations staff.[8] If a company has any internal employees listed as part of the company's government relations staff, *GOV_RELATIONS* is set equal to one, and zero otherwise. We are able to collect this data only for U.S.-domiciled MNCs. Because our access to data on government relations staff are only available through 2014, we restrict our sample period to 2003 through 2014 for this test. This reduces our firm-host country-year observations from to 11,274. We find that only 843 firm-host country-year observations stem from MNCs that have government relations staff, which represents 100 unique firms. This is not surprising given the cost associated with maintaining this unique

[8] See Section 3 for additional details on the construction of this variable.

resource (Bremmer 2005). We expect to find that the benefits of host country relationships are greatest when firms maintain this resource.

Table 8 reports the results of our analyses related to government relations divisions. In Panel A, column (1), we first replicate the findings of Table 5 for our sub-sample of U.S. MNCs. We continue to find a positive and significant association between *RELATIONSHIPS* and future customer growth (coefficient = 0.0106, t = 2.48, p = 0.01). In columns (2) and (3), we partition our sample on whether or not U.S. MNCs have at least one government relations staff member, and we simultaneously estimate equation (2) across these two subsamples. In column (2), the coefficient on *RELATIONSHIPS* is positive and significant (coefficient = 0.0941, t = 2.37, p = 0.02). In contrast, when we re-estimate equation (2) on the sample of firms without government relations staff, we no longer find a positive association between *RELATIONSHIPS* and *CUSTOMER_GROWTH*. However, the coefficient on *RELATIONSHIPS* is not statistically different across the two columns (F = 2.24, p = 0.1342).

Next, we investigate whether the association between the total number of MNC relationships and future stability in the host country varies between MNCs that do (do not) maintain government relations departments. Through ongoing communication with local policymakers, MNCs can either act in their own self-interest by pursuing policies that provide benefits to their organization at the expense of other stakeholders, or pursue policies that extend benefits to the broader constituency. Securing specific policies can front-load the economic benefits enjoyed by MNCs (Boddewyn and Brewer 1994). However, as policymakers are replaced by newly elected/appointed officials, broader policies are more likely to survive shifts in the preferences of any particular policymaker (Henisz and Zelner 2004). Thus, if MNCs' interactions with local governments result in highly specialized policies, we would not expect their presence in the host country to engender future political stability, on average. Thus, it is an empirical question whether and how MNCs' government relations staff will have any influence over host country political stability.

As in the customer growth analysis, in Panel B, column (1), we first replicate the findings of Table 7 for our sub-sample of U.S. MNCs. We continue to find that the total number of MNC

relationships is negatively associated with future political risk, on average. We then separately aggregate cross-country relationships between MNCs with government relations staff (i.e., $RELATIONSHIPS^{Gov\_Relations\_Firms}$) and those without (i.e., $RELATONSHIPS^{Non\_Gov\_Relations\_Firms}$). In column (2), we find that the coefficient on $RELATIONSHIPS^{Gov\_Relations\_Firms}$ is negative and significant (coefficient = -0.0473, t = -3.12, $p < 0.01$). In contrast, the coefficient on $RELATIONSHIPS^{Non\_Gov\_Relations\_Firms}$ is positive and marginally significant. This evidence is consistent with at least two explanations. First, MNCs with government relations staff are in a better position to predict changes in future political risk. Second, aggregate activity stemming from MNCs with government relations (i.e., influence over policy outcomes) has a positive impact on future political stability in the host country.

Finally, in Table 8, Panel C, we investigate whether activity stemming from MNCs with government relations staff has any association with future economic risk. We expect that MNCs that invest in this resource do so in order to better predict and/or influence specific political outcomes, as opposed to general economic risk. While we observe a negative association between the total number of MNC relationships and future economic risk, this association does not vary with whether activity stems from MNCs that maintain a government relations department. The results of this analysis suggest that government relations staff are a channel through which MNCs can either better predict or alter future political stability in foreign jurisdictions.

6.2 MNCs' expertise in managing environmental and social risks

Multinationals can also make investments in positive change through community engagement related to social and environmental factors, enhancing their social license to operate and ultimately increasing opportunity for growth in the host country (Henisz 2014). To investigate whether expertise in managing environmental and social risks improves the overall success of the MNC in the host country, we collect data on MNCs' ESG risk rating.[9] We are able to collect this data only for a sub-sample of firms covered by RiskMetrics. Also, our access to data on risk ratings are only available through 2014. Thus,

[9] See Section 3 for additional details on the construction of this variable.

we restrict our sample period to 2003 through 2014 for this test. This reduces our firm-host country-year observations to 5,666. We identify whether firms have strengths or weaknesses in managing environmental and social risks. Firms are classified as strong if they have an AAA, AA, or A rating, and weak if they have a BBB, BB, B, or CCC rating. We expect to find that the benefits of cross-country relationships are greatest for strong firms.

In Table 9, column (1), we first replicate the findings of Table 5 and document a positive association between *RELATIONSHIPS* and *CUSTOMER_GROWTH* among a sample of firm-host country-year observations with available ESG data. To test whether MNCs benefit from their relationships when complementing these activities with environmental and social risk management strategies, we partition our sample on strong vs. weak ESG ratings and simultaneously estimate equation (2) across these two subsamples. In Table 9, column (2), the coefficient on *RELATIONSHIPS* is positive and significant (coefficient = 0.0479, $t = 3.64$ $p < 0.01$). In column (3), we re-estimate equation (2) on the sample of firms with weak expertise in managing environmental and social risks. We do not find that the coefficient on *RELATIONSHIPS* is significant. Further, we find that the coefficient on *RELATIONSHIPS* is significantly different across the two sub-samples ($F = 3.36$, $p = 0.07$).

Next, we investigate whether MNCs' ability to successfully manage environmental and social risks serves to stabilize the host country environment. On one hand, positive interactions with local businesses, government, and non-government organizations can front-load gains from internationalization enjoyed by the host country by directly contributing to the quality of host country institutions (Henisz 2014). In contrast, if internationalization activities stem from MNCs that are rated negatively in their environmental and social advocacy efforts, it is unlikely that their internationalization activities will result in welfare gains to the host country.

If MNCs can contribute to host country political stability through superior expertise in managing environmental and social risks, we expect political stability in the host country to improve as the aggregate activity from MNCs with strong ESG ratings increases. Before splitting relationships between firms with strong vs. weak ESG ratings, in Panel B, column (1), we first document that the total number

of MNC relationships continues to have a negative association with future political risk among the subsample of observations with available ESG data. In Panel B, columns (2), we then separately aggregate the total number of local relationships for MNCs with strong ESG ratings (i.e., $RELATIONSHIPS^{STRONG\_ESG}$) and those with weak ESG ratings (i.e., $RELATONSHIPS^{Weak\_ESG}$). In column (2), we find that the coefficient on $RELATIONSHIPS^{STRONG\_ESG}$ is negative and significant (coefficient = -0.0252, p =0.02). In contrast, we find no significant association between $RELATIONSHIPS^{Weak\_ESG}$ and future political risk. This evidence is consistent with the notion that aggregate activity stemming from MNCs with expertise in managing environmental and social risks is positively associated with future political stability in the host country.

Finally, in Table 9, Panel C, we investigate whether activity stemming from MNCs with strengths in managing environmental and social risks serves to stabilize future economic risk in the host country. While MNCs that develop this expertise can positively influence environmental and social policies (relevant parameters for host country governments), it is unclear whether this resource should have any direction association with general economic risk. While we observe a negative association between the total number of MNC relationships and future economic risk in Table 9, Panel C, this association does not vary with whether the activity stems from MNCs with strong vs. weak ESG ratings. Thus, while MNC presence can improve general economic conditions in the host country, investments in environmental and social risk management are relevant for managing and/or influencing facets of political stability, specifically. Collectively, our evidence suggests that positive externalities stem from the nature of MNC engagement with local firms, government, and community organizations.

7. Conclusion

In this paper, we investigate whether there is an effectively symbiotic relationship between MNCs and host country firms that helps mitigate economic loss, particularly in politically unstable jurisdictions. While it is well known that MNCs often partner with local firms to get a toe-hold in particular countries and assistance in navigating the local institutions, it is less well known what externalities these

relationships generate. We suggest that in addition to providing more stable customer growth, MNCs' relationships with both their local customers/partners and the local government can actually serve to dampen the rise of political instability. While many conjecture that MNCs attempt to influence policy in an exclusively self-serving manner, our work suggests that MNCs appear to influence policy in an altruistic manner that has positive implications for the local landscape.

Using several unique datasets, we find a positive association between the likelihood of maintaining a cross-country relationship and the level of host country political risk. This finding is consistent with MNCs teaming up with local organizations in order to navigate host country political risk. We predict and find that MNCs that maintain cross-country relationships enjoy greater future customer growth, particularly during periods of high political risk. However, we also find that the aggregate level of MNC local-country relationships is associated with lower levels of future political risk. This finding suggests that these local partnerships help align the MNCs' interests with those of local businesses and lead to the adoption of policies/regulations that benefit all economic activity, not just the MNCs'.

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Appendix A

Variable Definitions

Variable Name	Variable Description
Variables of Interest	
CUSTOMER_GROWTH	Customer growth is calculated based on the four-year geometric average of annual growth rate in customer base from time *t* to *t*+3 for firm *i* in country *k*. Customers are entities to which the source company sells products/services. Available from Factset.
$RELATIONSHIP^{External\_Contract}$	The total number of manufacturing, marketing, distribution, and supplier relationships between the source company domiciled outside of the host country and firms domiciled within the host country, measured at the end of year *t*. Available from Factset.
$RELATIONSHIP^{Strategic\_Partnership}$	The total number of relationships between the source company domiciled outside of the host country and firms domiciled within the host country that are represented by equity investments, integrated product offerings, joint ventures, research collaborations, and technological collaborations, measured at the end of year *t*. Available from Factset.
GOV_RELATIONS	*GOV_RELATIONS* is an indicator variable equal to 1 if firm *i* has any government relations staff in year *t*; 0 otherwise. Collected from an annual publication of *Representatives* by Columbia Books & Information Services.
STRONG_ESG	STRONG_ESG is an indicator variable equal to 1 if firm *i* receives an ESG rating of "AAA", "AA", or "A"; 0 otherwise. Ratings are are available through MSCI ESG risk ratings.
POLITICAL_RISK	An annual index accounting for government stability, socioeconomic conditions, investment risk, risk of internal conflict, risk of external conflict, corruption, the presence of the military in politics, religious tensions, ethnic tensions, democratic accountability and bureaucracy quality. The original index ranges from 0-100. We subtract the original index from 100 so larger values correspond to higher political stability. Available from the International Country Risk Guide.

POLITICAL_RISK^{High}	The International Country Risk Guide classifies country-level risk as "low", "moderate", or "high" based on the level of the annual political risk index. A country is classified as "high" if the annual index is above 39.99. We use this classification and set POLITICAL_RISK^{High} equal to one if the index is above 39.99; zero otherwise.
POLITICAL_RISK^{Increase}	The International Country Risk Guide classifies country-level risk as "low", "moderate", or "high" based on the level of the annual political risk index. POLITICAL_RISK^{Increase} is set equal to one if the index moves from a "low" to "moderate" classification or "moderate" to "high" classification from *t-1* to *t*; zero otherwise. There are no countries in our sample that experience an increase in the risk score from "low" to "high" from *t* to *t*+1.
POLITICAL_RISK^{ElectoinYr}	Data on elections come from the World Bank's Database of Political Institutions (DPI). POLITICAL_RISK^{Election_YR} is set equal to one if there is a national election in country *k* in year *t*; zero otherwise.

Control Variables

Firm Characteristics

SIZE	Size is the logarithm of the firms' total assets. Available from Worldscope.
CF	Cash Flow is the ratio of total cash flow to total assets constructed as ((Net cash flow from operating activities + Net cash flow from investing activities + net cash flow from financing activities)/total assets) at the end of quarter *t*. Available from Worldscope.
LEV	Leverage is the ratio of total debt to total market value of assets constructed as (Total debt/Market capitalization). Available from Worldscope.
MTB	Market-to-book is the ratio of market equity and book equity constructed as (Market capitalization/Book value of equity). Available from Worldscope.

R&D	Research and development (R&D) expense is the ratio of total R&D expenses and total sales constructed as (R&D Expense/Total sales). Available from Worldscope. R&D is set equal to zero where missing. Available from Worldscope.
GROWTH	Two-year geometric average of annual growth rate in net sales. Available from Worldscope.
<u>Country-level economic indicators</u>	
GDP_GROWTH	Growth of real per capita gross domestic product constructed as (GDP per capita growth (annual%)). Available from the World Bank Development Indicators.
TRADE	Trade is the sum of exports and imports of goods and services measured as a share of gross domestic product constructed from (Trade (%of GDP)). Available from the World Bank Development Indicators.
GOV_CONSUMPTION	Government consumption divided by gross domestic product constructed from (General government final consumption expenditure (% of GDP)). General government consumption includes all current expenditures for purchases of goods and services by all levels of government, excluding most government enterprises. It also includes capital expenditure on national defense and security. Available from the World Bank Development Indicators.
INFLATION	Inflation as measured by the annual growth rate of the gross domestic product implicit deflator constructed from (Inflation, GDP deflator (annual %)). Available from the World Bank Development Indicators.
PRIVATE_CREDIT	Private credit divided by gross domestic product (constructed from Domestic credit to private sector (% of GDP)). Credit to private sector refers to financial resources provided to the private sector, such as through loans, purchases of non-equity securities, and trade credits and other accounts receivable that establish a claim for repayment. Available from the World Bank Development Indicators.

MARKET_CAP	Equity market capitalization divided by gross domestic product constructed from (Market capitalization of listed domestic companies (% of GDP)). Available from the World Bank Development Indicators.
NUM_COMPANIES	The log of the number of domestic companies covered constructed from (Listed domestic companies, total). Available from the World Bank Development Indicators.
TURNOVER	The ratio of equity market value traded to the market capitalization constructed from (Stocks traded, turnover ratio of domestic shares). Available from the World Bank Development Indicators.

Appendix B
***POLITICAL_RISK* Components**

Component	Subcomponents	Points (max.)
Government Stability	The ability of the government to carry out its declared program(s), and its ability to stay in office. Subcomponents: Government Unity, Legislative Strength, Popular Support	12
Socioeconomic Conditions	Socioeconomic pressures at work in society that could constrain government action or fuel social dissatisfaction. Subcomponents: Unemployment, Consumer Confidence, Poverty	12
Investment Profile	Risks to investment related to subcomponents: Contract Viability/Expropriation, Profits Repatriation, Payment Delays	12
Internal Conflict	Political violence in the country and its actual or potential impact on governance. Subcomponents: Civil War/Coup Threat, Terrorism/Political Violence, Civil Disorder	12
External Conflict	The risk to the incumbent government from foreign action. Subcomponents: War, Cross-Border Conflict, Foreign Pressures	12
Corruption	Corruption within the political system, such as demands for special payments and bribes connected with import and export licenses, exchange controls, tax assessments, police protection, or loans.	6
Military in Politics	General involvement in politics because of an actual or created internal or external threat, which can imply the distortion of government policy in order to meet the threat, for example by increasing the budget at the expense of other budget allocations. The threat of military takeover, or whether or not the country operates under a full-scale military regime.	6
Religious Tensions	Religious tensions may stem from the domination of society and/or governance by a single religious group that seeks to replace civil law by religious law and to exclude other religions from the political and/or social process; the desire of a single religious group to dominate governance; the suppression of religious freedom; the desire of a religious group to express its own identity, separate from the country as a whole.	6
Law and Order	The strength and impartiality of the legal system and popular observance of the law.	6
Ethnic Tensions	The degree of tension within a country attributable to racial, nationality, or language divisions.	6
Democratic Accountability	How responsive government is to people, on the basis that the less responsive it is, the more likely it is that the government will fall, peacefully in a democratic society, but possibly violently in a non-democratic one.	6
Bureaucracy Quality	The institutional strength and quality of the bureaucracy is another shock absorber that tends to minimize revisions of policy when governments change.	4

Appendix C
Relationships

Relationship Category	Relationship Type	Definition
External Contract	Supplier	Supplier relationships occur when the source company purchases goods or services from other entities.
	Manufacturing	Manufacturing relationships occur when other entities provide paid manufacturing services to the source company.
	Marketing	Marketing relationships occur when other entities provide paid marketing and/or branding/advertising services to the source company.
	Distribution	Distribution relationships occur when the source company pays other entities to distribute the source company's product/services.
Strategic Partnership	Integrated Product Offering	Integrated product offerings occur when the source company and another entity agree to bundle their standalone products/services, which are marketed together as one offering. No money is exchanged up front, and costs, risks, and profits are shared.
	Research Collaboration	Research collaborations occur when entities in the host country collaborate with the source company for research and development, generally for new product development. Research collaboration is common for products in development, not products already marketed.
	Technology Collaboration	Technology collaborations occur when entities in the host country collaborate with the source company for technology development, generally for new product development. Technology collaboration is common for products in development, not products already marketed.
	Equity Interest	Equity investments occur when the source company owns an equity stake in another entity. This designation applies only when the source company owns a share equity stake in another company. Working interests, royalties, property, or well claims do not qualify for the equity investment designation.
	Joint Ventures	Joint ventures occur when the source company jointly owns a separate company with one or more companies.

Appendix D
Environmental, Social, and Governance Ratings

Category	Subcategory	Definition
Environment	Climate Change	Carbon Emissions, Energy Efficiency Product, Carbon Footprint, Financing Environmental Impact, Climate Change Vulnerability
	Natural Resources	Water Stress, Biodiversity & Land Use, Raw Material Sourcing
	Pollution & Waste	Toxic Emissions, Packaging Material, and Electronic Waste
	Environmental Opportunities	Opportunities in Clean Tech, Green Building, and Renewable Energy
Social	Human Capital	Labor Management, Health & Safety, Human Capital Development, Supply Chain Labor Standards
	Product Liability	Product, Chemical, and Financial Product Safety; Privacy & Data Security; Responsible Investment; Health & Demographic Risk
	Stakeholder Opposition	Controversial Sourcing
	Social Opportunities	Access to Communications, Finance, Health Care, Opportunities in Nutrition & Health
Governance	Corporate Governance	Board, Pay, Ownership, Accounting
	Corporate Behavior	Business Ethics, Anti-Competitive Practices, Corruption & Instability, Financial System Instability

Table 1

***POLITICAL_RISK* by host country**

Low	*POLITICAL_RISK*[a] <= to 30.00
Moderate	30.00 < *POLITICAL_RISK* <= 39.99
High	39.99 < *POLITICAL_RISK*

Host Country	Mean	Host Country	Mean	Host Country	Mean
Argentina	34.55	Hungary	25.97	Philippines	38.05
Australia	15.07	India	40.72	Poland	23.04
Austria	15.17	Indonesia	42.76	Portugal	22.54
Bahrain	30.05	Italy	24.92	Qatar	27.39
Bangladesh	49.92	Iran	50.29	Romania	31.54
Belgium	18.37	Ireland	18.39	Russia	40.12
Bolivia	43.46	Israel	35.25	Saudi Arabia	31.98
Brazil	32.60	Japan	18.66	Singapore	16.02
Bulgaria	34.00	Jordan	37.35	Slovakia	25.69
Canada	13.50	Kazakhstan	32.15	Slovenia	28.23
Chile	23.47	Kenya	44.14	South Africa	32.77
China	35.77	Kuwait	22.99	South Korea	23.21
Colombia	40.26	Luxembourg	9.51	Spain	28.33
Cote d'Ivoire	55.12	Malaysia	27.57	Sweden	11.12
Croatia	25.62	Malta	19.23	Switzerland	11.70
Cyprus	27.42	Mexico	29.40	Thailand	41.86
Czech Republic	20.95	Morocco	34.11	Tunisia	34.30
Denmark	13.48	Namibia	22.75	Turkey	41.30
Egypt	47.25	Netherlands	14.74	United Arab Emirates	21.96
Finland	6.52	New Zealand	11.85	Uganda	50.07
France	24.76	Nigeria	54.18	United Kingdom	16.65
Germany	16.41	Norway	11.81	United States	18.22
Ghana	33.12	Oman	27.13	Venezuela	48.54
Greece	31.25	Pakistan	54.33	Vietnam	37.43
Hong Kong	20.47	Peru	36.78	Zambia	37.33

[a] All variables are defined in Appendix A.

Table 2
Distribution of MNCs based on location of MNC headquarters

Country	% of Sample	Country	% of Sample
Argentina	0.04	Kuwait	0.11
Australia	0.13	Lithuania	0.01
Austria	0.08	Luxembourg	0.13
Bahamas	0.20	Macau	0.01
Bahrain	0.02	Malaysia	0.05
Belgium	0.20	Marshall Islands	0.03
Bermuda	1.13	Mexico	0.32
Brazil	1.07	Morocco	0.01
British Virgin Islands	0.02	Netherlands Antilles	0.01
Bulgaria	0.02	Netherlands Antilles	0.77
Canada	4.17	New Zealand	0.01
Cayman Islands	0.13	Norway	0.17
Chile	0.82	Oman	0.14
China	0.92	Peru	0.27
Colombia	0.01	Poland	0.18
Croatia	0.04	Qatar	0.02
Curacao	0.01	Russia	0.16
Czech Republic	0.02	Saudi Arabia	0.09
Denmark	0.04	Serbia	0.04
Finland	0.12	Singapore	0.38
France	1.89	Slovenia	0.02
Germany	2.10	South Africa	0.06
Gibraltar	0.01	South Korea	0.31
Greece	0.75	Spain	0.46
Guernsey	0.03	Sweden	1.17
Hong Kong	0.42	Switzerland	1.53
Iceland	0.03	Taiwan	0.24
India	0.09	Turkey	0.75
Indonesia	0.52	United Arab Emirates	0.06
Ireland	0.16	United Kingdom	3.76
Israel	4.16	United States	68.12
Italy	0.85	Uruguay	0.02
Japan	0.23	Venezuela	0.05
Jersey	0.10	Other	0.03

Table 3
Descriptive Statistics for Firm-level Analysis

Panel A: Sample Composition

Unique MNCs	4,064
Unique host-countries where relationships are formed	75
Unique business relationships	
External Contracts	18,777
Strategic Partnerhsips	15,278

Panel A: Distribution of Model Variables, 2003 - 2016 (n = 41,977)

Variable[a]	Mean	Std Dev	p25	Median	p75	p99
RELATIONSHIPS	0.62	2.07	0.00	0.00	0.00	10.00
RELATIONSHIPS $^{External\_Contract}$	0.34	1.29	0.00	0.00	0.00	5.00
RELATIONSHIPS $^{Strategic\_Partnership}$	0.28	1.14	0.00	0.00	0.00	5.00
SIZE	20.19	1.98	18.81	20.17	21.62	24.31
LEV	37.99	625.47	0.00	0.12	0.46	252.92
MTB	2.64	3.31	1.06	1.98	3.42	16.78
R&D	0.12	0.27	0.00	0.04	0.16	1.53
CF	0.25	0.22	0.07	0.19	0.39	0.87
GROWTH	0.14	0.57	-0.03	0.07	0.20	1.64
POLITICAL_RISK	20.40	7.73	14.96	18.33	22.96	42.37
GDP_GROWTH	1.49	2.71	0.10	1.45	2.42	9.95
TRADE	81.52	75.38	41.24	59.10	89.76	447.06
GOV_CONSUMPTION	18.11	4.26	15.17	18.71	20.25	26.45
INFLATION	1.94	3.16	0.40	1.54	2.48	15.58
PRIVATE_CREDIT	124.78	45.63	94.71	118.62	169.19	221.29
MARKET_CAP	104.36	130.69	51.59	78.51	115.56	1076.94
NUMBER_COMPANIES	1531.13	1431.05	285.00	742.00	2323.00	5294.00
TURNOVER	96.66	62.30	56.57	84.10	125.11	377.25

Table 4
Determinants of maintaining local relationships

	Dep. Var. = *Ln* (*RELATIONSHIPS)*		
	All Relationships	External Contracts	Strategic Partnerships
Variable [a,b]	(1)	(2)	(3)
Firm-level Characteristics			
SIZE	0.0335***	0.0123***	0.0272***
	(13.26)	(7.63)	(14.20)
LEV	-0.0000	-0.0000	-0.0000
	(-1.46)	(-1.38)	(-0.05)
MTB	0.0007	-0.0005	0.0014**
	(0.84)	(-0.62)	(2.40)
R&D	0.1103***	0.0008	0.1160***
	(9.38)	(0.08)	(10.43)
CF	0.1217***	0.0591***	0.0794***
	(7.86)	(4.47)	(6.26)
GROWTH	0.0035	0.0040	-0.0011
	(0.75)	(0.91)	(-0.36)
Host-Country Characteristics			
POLITICAL_RISK	0.0051**	0.0035**	0.0036***
	(2.55)	(2.34)	(2.65)
GDP_GROWTH	-0.0010	0.0005	-0.0016
	(-0.50)	(0.29)	(-1.06)
TRADE	0.0005	0.0003	0.0003
	(1.35)	(1.01)	(1.20)
GOV_CONSUMPTION	-0.0001	0.0013	0.0008
	(-0.01)	(0.29)	(0.16)
INFLATION	-0.0030***	-0.0014*	-0.0022***
	(-2.76)	(-1.87)	(-3.00)
PRIVATE_CREDIT	-0.0001	-0.0000	-0.0003
	(-0.54)	(-0.06)	(-1.46)
MARKET_CAP	0.0000	0.0000	0.0000
	(0.15)	(0.35)	(0.55)
NUMBER_COMPANIES	0.0001*	0.0000	0.0001*
	(1.65)	(1.15)	(1.93)
TURNOVER	-0.0000	-0.0001	0.0001
	(-0.01)	(-1.19)	(0.67)
Intercept	-	-	-
Home Country x Host Country Indicator	Y	Y	Y
Host Country x Industry Indicator	Y	Y	Y
Year Indicator	Y	Y	Y
Cluster by Host Country and Year	Y	Y	Y
Adjusted R2	40.74%	33.81%	34.21%
N	41,977	41,977	41,977

Table 5
Local relationships and growth in host country customer base

Panel A: Cross-country relationships and future customer growth

	Dep. Var = CUSTOMER_GROWTHt,t+3				
	All Relationships			External Contracts	Strategic Partnership
Variable [a,b]	(1)	(2)	(3)	(4)	(5)
Ln(RELATIONSHIPS)	0.0140**	0.0449***	0.0213***	-0.0038	0.0350***
	(2.13)	(5.41)	(3.34)	(-0.51)	(3.19)
SIZE	0.0108***	0.0253***	0.0111***	0.0113***	0.0103***
	(5.42)	(2.75)	(5.21)	(5.69)	(5.17)
LEV	0.0000	0.0001***	0.0000	0.0000	0.0000
	(1.20)	(2.70)	(1.05)	(1.18)	(1.17)
MTB	0.0028***	0.0006	0.0024***	0.0028***	0.0027***
	(3.42)	(0.60)	(2.59)	(3.43)	(3.37)
R&D	-0.0246*	-0.0320	-0.0240	-0.0230*	-0.0271**
	(-1.85)	(-1.61)	(-1.54)	(-1.73)	(-2.06)
CF	0.0459***	0.0644**	0.0394**	0.0478***	0.0448***
	(2.99)	(2.57)	(2.41)	(3.09)	(2.94)
GROWTH	0.0211***	0.0139***	0.0210***	0.0212***	0.0212***
	(4.60)	(2.76)	(4.10)	(4.60)	(4.63)
POLITICAL_RISK	-0.0043*	-0.0041*		-0.0042*	-0.0043*
	(-1.86)	(-1.96)		(-1.82)	(-1.87)
GDP_GROWTH	0.0030	0.0019		0.0030	0.0031
	(1.21)	(0.87)		(1.21)	(1.23)
TRADE	-0.0006	-0.0004		-0.0005	-0.0006
	(-1.42)	(-1.25)		(-1.41)	(-1.43)
GOV_CONSUMPTION	0.0042	0.0052		0.0041	0.0041
	(0.78)	(1.00)		(0.78)	(0.77)
INFLATION	0.0008	-0.0004		0.0007	0.0008
	(0.55)	(-0.32)		(0.52)	(0.58)
PRIVATE_CREDIT	0.0001	0.0003		0.0001	0.0001
	(0.46)	(0.85)		(0.47)	(0.48)
MARKET_CAP	-0.0001	-0.0001		-0.0001	-0.0002
	(-1.51)	(-1.47)		(-1.51)	(-1.52)
NUMBER_COMPANIES	0.0000	0.0000		0.0000	0.000
	(0.37)	(1.05)		(0.41)	(0.34)
TURNOVER	-0.0002	-0.0001		-0.0002	-0.0002
	(-1.51)	(-0.61)		(-1.52)	(-1.52)
Intercept	-	-	-	-	-
Home Country x Host Country Indicator	Y	Y	Y	Y	Y
Host Country x Industry Indicator	Y	N	N	Y	Y
Firm Indicator	N	Y	N	N	N
Year Indicator	Y	Y	N	Y	Y
Host Country x Industry x Year Indicator	N	N	Y	N	N
Cluster by Country and Year	Y	Y	Y	Y	Y
Adj. R-squared	19.18%	39.78%	34.34%	19.16%	19.20%
N	41,977	41,977	52,225	41,977	41,977

Table 5, *continued*

Local relationships and growth in host country customer base

Panel B: Conditional on ex-ante political risk

	Dep. Var. = $CUSTOMER\_GROWTH_{t,t+3}$		
	All Relationships		
Variable [a,b]	(1)	(2)	(3)
Ln(RELATIONSHIPS)	0.0123*	-0.0490	0.0004
	(1.85)	(-1.14)	(0.04)
$POLITICAL\_RISK^{High}$	-0.101***		
	(-2.98)		
$Ln(RELATIONSHIPS) \times POLITICAL\_RISK^{High}$	0.227***		
	(5.99)		
$POLITICAL\_RISK^{Increase}$		-0.0497	
		(-0.70)	
$Ln(RELATIONSHIPS) \times POLITICAL\_RISK^{Increase}$		0.1526**	
		(2.69)	
$POLITICAL\_RISK^{Election\_YR}$			-0.0058
			(-0.34)
$Ln(RELATIONSHIPS) \times POLITICAL\_RISK^{Election\_YR}$			0.0307**
			(2.27)
Firm Characteristics (Table 4, column 1)	Y	Y	Y
Host Country Characteristics (Table 4, column 1)	Y	Y	Y
Home Country x Host Country	Y	N	Y
Host Country x Industry Indicator	Y	Y	Y
Year Indicator	Y	Y	Y
Cluster by Country and Year	Y	Y	Y
Adj. R-squared	19.19%	44.39%	23.91%
N	41,977	1,406	12,499
F-test $\beta_1 + \beta_3$			
F-statistic	29.33	5.75	2.29
p-value	0.0000	0.0218	0.1320

*, **, *** indicate statistical significance at the 0.10, 0.05, and 0.01 levels, respectively.

[a] All variables are defined in Appendix A.

[b] All p-values are based on two-tailed tests (in parentheses).

Table 6

Falsification test: MNCs' other foreign relationshiops and host country customer growth

	Dep. Var. = $CUSTOMER\_GROWTH_{t,t+3}$	
Variable [a,b]	(1)	(2)
$Ln(RELATIONSHIPS^{Other\_Foreign})$	-0.0009	-0.0029
	(-0.23)	(-0.72)
Ln(RELATIONSHIPS)		0.0151**
		(2.13)
Firm Characteristics (Table 4, column 1)	Y	Y
Host Country Characteristics (Table 4, column 1)	Y	Y
Home Country x Host Country Indicator	Y	Y
Host Country x Industry Indicator	Y	Y
Year Indicator	Y	Y
Cluster by Country and Year	Y	Y
Adj. R-squared	19.16%	19.18%
N	41,977	41,977

*, **, *** indicate statistical significance at the 0.10, 0.05, and 0.01 levels, respectively.

[a] All variables are defined in Appendix A.

[b] All p-values are based on two-tailed tests (in parentheses).

Table 7
Host country political risk

Panel A: Local relationships and future political risk at $t+1$

	Dep. Var. = $POLITICAL\_RISK_{t+1}$		
	All Relationships	External Contracts	Strategic Partnership
Variable [a,b]	(1)	(2)	(3)
RELATIONSHIPS ^{Aggregate}	-0.0014**	-0.0016**	-0.0047
	(-2.39)	(-2.33)	(-1.62)
POLITICAL_RISK	0.3751***	0.3754***	0.3783***
	(9.87)	(9.88)	(9.97)
GDP_GROWTH	-0.1908***	-0.1905***	-0.1907***
	(-5.55)	(-5.54)	(-5.52)
TRADE	0.0023	0.0025	0.0020
	(0.45)	(0.49)	(0.39)
GOV_CONSUMPTION	0.0246	0.0247	0.0350
	(0.34)	(0.34)	(0.48)
INFLATION	-0.0125	-0.0126	-0.0127
	(-1.27)	(-1.28)	(-1.27)
PRIVATE_CREDIT	0.0308***	0.0309***	0.0305***
	(4.29)	(4.29)	(4.22)
MARKET_CAP	-0.0025	-0.0025	-0.0025
	(-1.26)	(-1.27)	(-1.26)
NUMBER_COMPANIES	0.0000	-0.0000	0.0001
	(0.02)	(-0.00)	(0.24)
TURNOVER	0.0015	0.0013	0.0023
	(0.41)	(0.35)	(0.63)
Intercept	-	-	-
Host Country Indicator	Y	Y	Y
Year Indicator	Y	Y	Y
Cluster by Country and Year	Y	Y	Y
Adj. R-squared	97.13%	97.13%	97.12%
N	651	651	651

Table 7, *continued*

Host country political risk

Panel B: Local relationships and average level of future political risk over $t+1,t+2$			
	Dep. Var. = $POLITICAL\_RISK_{t+1,t+2}$		
	All Relationships	External Contracts	Strategic Partnership
Variable [a,b]	(1)	(2)	(3)
RELATIONSHIPS ^{Aggregate}	-0.0008**	-0.0009**	-0.0029**
	(-2.55)	(-2.38)	(-2.03)
Host Country Characteristics (Table 4, column 1)	Y	Y	Y
Host Country Indicator	Y	Y	Y
Year Indicator	Y	Y	Y
Cluster by Country and Year	Y	Y	Y
Adj. R-squared	99.29%	99.29%	99.28%
N	516	516	516
Panel C: Local relationships and average level of future political risk over $t+1,t+3$			
	Dep. Var. = $POLITICAL\_RISK_{t+1,t+3}$		
	All Relationships	External Contracts	Strategic Partnership
Variable [a,b]	(1)	(2)	(3)
RELATIONSHIPS ^{Aggregate}	-0.0008**	-0.0008*	-0.0034**
	(-2.05)	(-1.66)	(-2.51)
Host Country Characteristics (Table 4, column 1)			
Host Country Indicator	Y	Y	Y
Year Indicator	Y	Y	Y
Cluster by Country and Year	Y	Y	Y
Adj. R-squared	99.56%	99.56%	99.56%
N	458	458	458

*, **, *** indicate statistical significance at the 0.10, 0.05, and 0.01 levels, respectively.

[a] All variables are defined in Appendix A.

[b] All p-values are based on two-tailed tests (in parentheses).

Table 8
Government Relations

Panel A: Government relations and growth in host country customer base			
	Dep. Var. = $CUSTOMER\_GROWTH_{t,t+3}$		
	Full Sample	Gov Relations	No Gov Relations
Variable[a,b]	(1)	(2)	(3)
$Ln(RELATIONSHIPS^{All})$	0.0106**	0.0941**	0.0140
	(2.48)	(2.37)	(1.19)
Firm Characteristics (Table 5, column 1)	Included	Included	Included
Host Country Characteristics (Table 5, column 1)	Included	Included	Included
Industry and Year Fixed Effects	Included	Included	Included
Host Country Fixed Effects	Included	Included	Included
Adj. R-squared	6.84%	20.88%	5.61%
N	11,274	796	10,478
		F-statistic	2.24
		p-value	0.1342

Panel B: Government relations and future political risk		
	Dep. Var. = $POLITICAL\_RISK_{t+1}$	
	(1)	(2)
$Ln(RELATIONSHIPS^{All})$	-0.1820*	
	(-1.90)	
$Ln(RELATIONSHIPS^{All})_{Gov\_Relations\_Firms}$		-0.0473***
		(-3.12)
$Ln(RELATIONSHIPS^{All})_{Non\_Gov\_Relations\_Firms}$		0.0096*
		(1.66)
Host Country Characteristics (Table 5, column 1)	Included	Included
Year Fixed Effects	Included	Included
Adj. R-squared	94.40%	97.20%
N	418	418

Panel C: Government relations and future economic risk		
	Dep. Var. = $ECONOMIC\_RISK_{t+1}$	
	(1)	(2)
$Ln(RELATIONSHIPS^{All})$	-0.2430***	
	(-3.16)	
$Ln(RELATIONSHIPS^{All})_{Gov\_Relations\_Firms}$		0.0072
		(0.70)
$Ln(RELATIONSHIPS^{All})_{Non\_Gov\_Relations\_Firms}$		-0.0013
		(-0.34)
Host Country Characteristics (Table 5, column 1)	Included	Included
Year Fixed Effects	Included	Included
Adj. R-squared	80.54%	91.50%
N	418	418

*, **, *** indicate statistical significance at the 0.10, 0.05, and 0.01 levels, respectively.

[a] All variables are defined in Appendix A.

[b] All p-values are based on two-tailed tests (in parentheses).

Table 9
Environmental and Social Risk Management

Panel A: Environmental and social risk management and growth in host country customer base

	Dep. Var. = $CUSTOMER\_GROWTH_{t,t+3}$		
	Full Sample	Strong ESG Rating	Weak ESG Rating
Variable[a,b]	(1)	(2)	(3)
$Ln(RELATIONSHIPS^{All})$	0.0297***	0.0479***	0.0144
	(2.64)	(3.64)	(1.12)
Firm Characteristics (Table 5, column 1)	Included	Included	Included
Host Country Characteristics (Table 5, column 1)	Included	Included	Included
Industry and Year Fixed Effects	Included	Included	Included
MNC and Host Country Fixed Effects	Included	Included	Included
Adj. R-squared	50.80%	45.74%	57.50%
N	5,666	3,627	2,039
		F-statistic	3.36
		p-value	0.0668

Panel B: Environmental and social risk management and future political risk

	Dep. Var. = $POLITICAL\_RISK_{t+1}$	
	(1)	(2)
$Ln(RELATIONSHIPS^{All})$	-0.0059***	
	(-2.92)	
$Ln(RELATIONSHIPS^{All})_{Strong\_ESG\_Firms}$		-0.0252**
		(-2.32)
$Ln(RELATIONSHIPS^{All})_{Weak\_ESG\_Firms}$		0.0091
		(1.13)
Host Country Characteristics (Table 5, column 1)	Included	Included
Year Fixed Effects	Included	Included
Adj. R-squared	97.57%	97.60%
N	228	228

Panel C: Environmental and social risk management and future economic risk

	Dep. Var. = $ECONOMIC\_RISK_{t+1}$	
	(1)	(2)
$Ln(RELATIONSHIPS^{All})$	-0.3890***	
	(-2.89)	
$Ln(RELATIONSHIPS^{All})_{Strong\_ESG\_Firms}$		0.0055
		(0.76)
$Ln(RELATIONSHIPS^{All})_{Weak\_ESG\_Firms}$		-0.0087
		(-1.63)
Host Country Characteristics (Table 5, column 1)	Included	Included
Year Fixed Effects	Included	Included
Adj. R-squared	76.52%	75.98%
N	228	228

*, **, *** indicate statistical significance at the 0.10, 0.05, and 0.01 levels, respectively.

[a] All variables are defined in Appendix A.

[b] All p-values are based on two-tailed tests (in parentheses).