

Cautious Giants: Firm Size, Political Risk, and Foreign Direct Investment^{*}

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Abstract

The prevailing theories of foreign investment suggest that larger multinationals should be more willing than smaller multinationals to invest in markets with high political risk. To the contrary, I argue that large multinationals are especially unlikely to operate in high-risk markets because they have more resources to evade suboptimal markets and because their size makes them tempting targets for both state and non-state actors in host countries. I test this argument using an original dataset on all public US companies with subsidiaries abroad from 2007-2022. I find that larger firms are significantly more averse to operating in politically risky environments than smaller firms. I further test this core finding examining MNCs' reactions to negative and positive shocks to political risk induced by coups and international agreements. I also present evidence consistent with the mechanisms outlined in the theory. These findings illustrate that firm size is an important factor in shaping multinational firms' choice of FDI location: host countries eager for the dynamic and impactful investments of the largest firms must successfully mitigate investor uncertainty.

Key Words: FDI, Firm Size, Political Risk

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1 Introduction

Multinational corporations (MNCs) are the largest and most profitable firms in their industries and larger firms have more diverse global production networks. If asked which multinational firms are likely to be more tolerant of political risk in foreign host markets, an intuitive answer would be the absolute largest multinationals.¹ This fits conventional arguments about larger firms' greater economic and political resources and their greater ability and willingness to absorb costs, including the costs of political risk. However, surprisingly little research on the connection between firm size and political risk exists. This raises the research question: *does firm size affect MNCs' tolerance for political risk as they locate their subsidiaries abroad?*

In this paper, I develop a theory of how multinational corporations (MNCs) select the locations of their foreign subsidiaries. I argue that international expansion is characterized by substantial uncertainty, occurs within a competitive environment, and unfolds in contexts in which host country state and non-state actors may pursue objectives that diverge from firms' preferences. Accordingly, I stress the strategic and interactive nature of firms' location decision emphasizing two factors: firms' capacity to select among potential markets, which varies according to differences in search capabilities and competitive advantages, and their susceptibility to predatory behavior by host country government and non-government actors. Importantly, I argue that both dimensions are conditioned by firm size—a firm-level characteristic that has received surprisingly limited attention in the foreign direct investment (FDI) literature. This disinterest is puzzling given that firm size is perhaps the single most important predictor of firms' economic behavior² and political

¹Large multinational corporations often feature in prominent newspaper articles for their foreign operations in countries with high political risk. Some example of this are Apple, Google, Tesla and Microsoft's ties to the Democratic Republic of Congo (<https://www.bbc.com/news/world-africa-50812616>), Shell's operations in Nigeria (https://www.theguardian.com/environment/2025/jun/20/nigerian-communities-shell-high-court-oil-pollution?utm_source=chatgpt.com), Mars, Nestle, and Hershey's production links with the Ivory Coast (<https://www.washingtonpost.com/graphics/2019/business/hershey-nestle-mars-chocolate-child-labor-west-africa/>)

²Firm-centered approaches in economics have examined the relationship between firm size and FDI location while largely overlooking the political dimensions of internationalization (Helpman, Melitz and Yeaple, 2004; Yeaple, 2009;

behavior³.

Contrary to arguments emphasizing firms' capacity and willingness to operate in risky environments, my theory posits that large MNCs should be *the least* willing to operate in countries with high levels of political risk. Large MNCs are better able to avoid the riskiest markets because they have greater resources and more time with which to carefully sift through potential markets. They may also benefit from 'first-mover advantage' and select into and assert leadership in safer markets. Large MNCs may also need to avoid politically risky markets because large firms represent ideal targets of predatory behavior by host country government and non-government actors. Attacking the resources of a few large companies rather than many smaller ones will often yield higher returns with lower costs. Reputational concerns and visibility benefits may further incentivize government and non-government actors to target larger MNCs.

To test my theory, I construct an original firm-level dataset of all publicly listed US-owned firms with subsidiaries abroad from 2007 to 2022 from the Orbis Historical Data. Orbis provides information on the operating revenue of the parent company, the location of subsidiaries, and the industry classification (NAICS). These data total over 6.4 million observations at the company-host market-year level. I combine these data with measures of political risk from Credendo, one of Europe's leading credit insurance groups covering trade credit and political risk insurance. Credendo provides up-to-date information regarding expropriation risk, transfer risk, and violence and civil unrest risk for all countries worldwide.

I estimate how firm size moderates the negative effect of political risk on willingness to invest in host markets using a series of linear models with interaction term and three-way fixed effects (industry, year, and host country). The results are consistent with my theory. Going from an average political risk of 1 (the United Kingdom) to a risk of 7 (Afghanistan), the predicted number

Bernard et al., 2012).

³Gulotty (2022); Kim (2017); Osgood (2016); Osgood et al. (2017); Osgood (2021); Plouffe (2017).

of subsidiaries by US parent-firm decreases from 0.4 to 0.25 for larger firms and from 0.37 to 0.27 for medium ones, while for smaller firms we observe no change. These results are substantively meaningful given that US multinationals own on average only 0.2 firms in any host country-year. I further assess the robustness of the findings by employing alternative measures of political risk and firm size. Finally, I examine the proposed mechanisms using data from the Transparency Index (HRV), information on diplomatic posts, and survey data from the World Bank, uncovering suggestive evidence consistent with the theoretical mechanisms.

I further validate my main results using data on coups and international trade agreements, which represent respectively negative and positive quasi-exogeneous shocks to host countries' political risk. In line with my theory, I find that coups decrease larger US firms' presence in a host country experiencing the coup, while they increase smaller firms' operations. Free trade agreements have the opposite impact on FDI: larger US firms increase their operations in host countries following the introduction of a free trade agreement between that country and the United States, while smaller firms decrease their presence.

This paper makes several contributions to the literature on the determinants of FDI location. Previous scholarship tends to focus mostly on host country features;⁴ home country institutions;⁵ the dyadic relationship between home and host country;⁶ and the benefits that foreign firms bring to the host market.⁷ I combine ideas from the literature on host country determinants—and more specifically on political risk—with insights from trade models and the business scholarship. By stressing the strategic nature of firms' decision-making and combining firms' economic and political concerns, I identify firm size as a meaningful driver of MNCs' choice of FDI location. As

⁴Busse and Hefeker (2007); Jensen (2003, 2008*a,b*); Harms and Ursprung (2002); Johns and Wellhausen (2016, 2021); Li and Resnick (2003); Osgood and Simonelli (2020); Staats and Biglaiser (2012); Henisz (2000); Kobrin (1979)

⁵Wellhausen (2014); Beazer and Blake (2018)

⁶Büthe and Milner (2008); Simonelli and Osgood (2024); Neumayer and Spess (2005); Neumayer (2007, 2008); Rosendorff and Shin (2012); Li and Vashchilko (2010); Biglaiser and DeRouen Jr (2007); Bandyopadhyay, Sandler and Younas (2018); Lee (2017)

⁷Chowdhury and Mavrotas (2006); Cipollina et al. (2012); Hansen and Rand (2006); Javorcik (2015); Noorbakhsh, Paloni and Youssef (2001); Lee and Tan (2006); Owen (2019)

such I extend the firm-centered approach⁸ to the study of MNCs navigating political risk in host markets. Finally, while this paper focuses only on political risk, the findings could extend outside that domain. Firm size could also be an important indicator of how firms react (or engage) in corruption in host countries, and how they navigate security risks and the imposition of trade barriers.

Host countries characterized by high levels of political risk may forgo the substantial economic benefits associated with attracting large MNCs. Because larger firms are especially sensitive to predatory behavior and policy uncertainty, politically unstable environments are likely to deter precisely those investors capable of generating the greatest developmental gains. The presence of large MNCs can stimulate economic growth, expand employment opportunities, enhance consumer welfare, and facilitate the transfer of skills, managerial practices, and advanced technologies to domestic firms and workers. Consequently, host countries interested in attracting larger and more dynamic investment may need to carefully develop institutions that increase their credibility and appease foreign investors' fears and concerns over their operations being negatively impacted by political risk. By reducing political risk and strengthening institutional protections, governments may improve their ability to attract large foreign investors and, in turn, capture the broader economic and social benefits that accompany large MNCs' investment.

2 Theory

In this section, I develop a new theoretical framework that integrates economic and political determinants of FDI with a firm-centered perspective emphasizing the role of firm size. I argue that MNCs differ systematically in how they manage uncertainty, competition, and political risk. This in turn affects both their ability to select investment locations and their attractiveness as targets of predatory behavior by host country actors. Crucially, I posit that firm size shapes both

⁸Gulotty (2022); Baccini, Pinto and Weymouth (2017); Kim (2017); Osgood (2021); Osgood et al. (2017); Osgood and Simonelli (2020)

of these dimensions. Contrary to the implications of standard trade and business models and some conventional wisdom, I argue that the largest MNCs are, in fact, less likely to invest in politically risky environments than their smaller counterparts. This counterintuitive prediction emerges from a set of firm-level explanations highlighting the fundamental uncertainty of international expansion, the strategic nature of firms’ interactions with their competitors, and the potential adversarial nature of host country political actors towards foreign investors.

2.1 Host Country’s “Credibility Problem” and Political Risk

Host countries face a credibility problem with foreign investors in light of the temporal asymmetry of capital mobility. While capital is highly mobile prior to investment, it becomes largely immobile once committed to fixed assets such as factories, infrastructure, or extractive facilities. Host countries want to attract foreign investment *ex ante*, however, they struggle to credibly commit to protect the assets of foreign firms *ex post*. Once the investment is “sunk”, MNCs are vulnerable to opportunistic and predatory behavior by host governments (Vernon, 1971). Such behavior is referred to as “political risk”, and encompasses a wide range of actions that governments can take or fail to prevent, that threaten FDI (Jensen, 2008*b*; Henisz, 2000; Kobrin, 1979).

Three types of risk are commonly emphasized in the political risk literature: expropriation risk, transfer and currency inconvertibility risk, and risks connected with violence and civil unrest. Expropriation risk refers to the possibility that host governments may directly seize foreign-owned assets or violate contractual agreements (Jensen, 2008*a*). Although overt “textbook” expropriations have become relatively rare nowadays, governments often engage in more subtle forms of asset appropriation (Graham, Johnston and Kingsley, 2018; Jensen, 2008*a*; Kesternich and Schnitzer, 2010). These practices include a range of policy interventions that gradually erode the profitability of foreign investments. Among these, transfer risk—defined as restrictions on the ability of firms to convert local earnings into hard currency and repatriate profits—has emerged as par-

ticularly salient (Graham, Johnston and Kingsley, 2018, p. 1785). There is also strong evidence that violence and civil unrest significantly deter foreign investment by increasing uncertainty and operational costs (Blanton and Blanton, 2007; Jensen and Young, 2008; Osgood and Simonelli, 2020; Busse and Hefeker, 2007; Barry, 2024). While not perpetrated by the state, political violence represents a failure by the state to uphold its commitment to provide a stable and safe environment for MNCs to operate in.

Previous literature has identified several factors that may increase host countries’ credibility with foreign investors, including host country’s political institutions (Li and Resnick, 2003; Jensen, 2003, 2008*b,a*; Busse and Hefeker, 2007; Henisz, 2000); international commitments, such as free trade agreements, bilateral investment treaties, and taxation treaties (Büthe and Milner, 2008; Neumayer and Spess, 2005; Neumayer, 2007; Rosendorff and Shin, 2012); home market’s features (Wellhausen, 2014; Beazer and Blake, 2018); military alliances (Li and Vashchilko, 2010; Biglaiser and DeRouen Jr, 2007; Simonelli and Osgood, 2024); foreign aid (Bandyopadhyay, Sandler and Younas, 2018; Lee, 2017; Simonelli and Osgood, 2024; Nielsen et al., 2011); and the economic and political benefits that firms bring to the host market (Chowdhury and Mavrotas, 2006; Tsai, 1994; Hansen and Rand, 2006; Javorcik, 2015; Noorbakhsh, Paloni and Youssef, 2001; Lee and Tan, 2006; Owen, 2019).

2.2 MNCs’ Economic and Political Behaviors

The literature on political risk and FDI tends to focus on aggregate inflows of foreign investment, and has so far neglected the dimension of firm size as a potential driver of FDI location. This omission is particularly striking given that firm size constitutes one of the most—if not the most—important determinants of firms’ economic and political behaviors.

A growing literature in international economics and political economy highlights systematic differences between firms that engage in international activities and those that do not. In the

context of horizontal FDI, research consistently shows that only the largest and most productive firms establish and maintain foreign affiliates (Bernard et al., 2012; Helpman, Melitz and Yeaple, 2004; Yeaple, 2009). This pattern reflects the substantial fixed and variable costs associated with operating across borders, including costs related to market entry, regulatory compliance, and organizational complexity. Only firms with sufficiently high productivity levels can absorb these costs and remain competitive by spreading them over larger volumes of output (Osgood, 2021, p. 5).

Another strand of scholarship shifts attention from firms' *capacity* to enter foreign markets to their *willingness* to do so by examining the relationship between firm size and risk propensity. Existing research offers competing expectations. One perspective argues that larger firms are more risk-averse because organizational growth generates bureaucracy and inertia (Cyert and March, 1963), agency problems encourage managers to avoid risky projects (Jensen and Meckling, 1976), and heightened scrutiny from investors, regulators, and creditors increases the costs of failure (Shleifer and Vishny, 1997). An alternative perspective contends that larger firms are more willing to undertake risky activities because their superior resources, organizational slack, and accumulated capabilities enable them to absorb uncertainty and engage in experimentation (Penrose, 1959; Cyert and March, 1963; Greve, 1998). Consistent with this view, larger firms should be more likely to invest in innovation and R&D (Cohen and Klepper, 1996), and evidence from the petroleum and banking sectors suggests a positive relationship between firm size and risk tolerance (Walls and Dyer, 1996; Bhagat, Bolton and Lu, 2015).

Beyond their economic capabilities and risk attitudes, larger firms also exhibit distinct political behaviors. They are more likely to support trade liberalization, engage in lobbying activities, and contribute to political campaigns (Baccini, Pinto and Weymouth, 2017; Osgood et al., 2017; Osgood, 2021; Plouffe, 2017). Moreover, they often coordinate their efforts through industry associations and coalitions, amplifying their influence on public policy (Drope and Hansen, 2006;

Kim, 2017; Weymouth, 2012). These patterns suggest that firm size is not merely an economic attribute, but a key factor shaping firms' strategic interactions with political environments.

Insights from the political risk literature and the canonical trade and business scholarship fail to connect firm size and political risk and therefore overlook the interaction between these two factors in determining locational patterns around FDI siting. A straightforward extension of existing theory would suggest that larger MNCs are more likely to invest in politically risky environments. Because internationalization entails substantial fixed costs (Melitz, 2003), larger firms are better positioned to absorb the additional costs associated with political risk. Their geographically diversified investment portfolios also allow them to spread risk across markets (Yeaple, 2009). It could also be that host governments may be less willing to target large firms, whose visibility, economic importance, and political connections raise the reputational and political costs of predatory actions.

The final prediction of such a model would be that large firms should be more acceptant of risk in host markets and therefore be more present in countries with high risk. In the next section, I explain why I believe that to be wrong, and how uncertainty, inter-firm competition, and host country's political risk interact to explain why the largest MNCs will be less active in high risk markets than relatively smaller multinationals.

2.3 Uncertainty, Competition, and Host Country's Political Risk: Why Large MNCs Avoid Risky Markets

MNCs select the location of their foreign affiliates through a complex decision-making process where economic considerations play a central role (Schneider and Frey, 1985). Firms frequently enter foreign markets to access new consumers and expand sales opportunities (Dunning, 1988; Markusen, 2002). Consistent with this logic, countries with large market size (GDP and population), high income levels (GDP per capita), and strong growth prospects (GDP per capita

growth) tend to attract greater inflows of FDI (Lipsey, 1999; Tsai, 1994). Firms may also locate their subsidiaries in close proximity to valuable resources, production networks, infrastructure, or in countries where legal and economic institutions, such as lower labor and environmental regulations, enhance efficiency (Jensen, 2003; Mosley and Uno, 2007).

However, firms also evaluate prospective host markets through a much broader strategic calculus that extends beyond these conventional economic determinants. Firms are aware that entering and operating in new markets entails a high degree of *uncertainty* across a range of dimensions (Johanson and Vahlne, 1977). Such uncertainty arises from fluctuations in economic conditions, such as changes in exchange rates (Campa, 1993), infrastructure reliability (Wheeler and Mody, 1992), and local institutions' efficiency (North, 1990; Peng, Wang and Jiang, 2008). It may stem from the inability to predict political, regulatory and climate developments, such as war onset, changes in regulatory standards or natural disasters (Choi, Furceri and Yoon, 2021; Oetzel and Oh, 2014), or to correctly understand host country-specific cultural norms (Kogut and Singh, 1988). Other sources of uncertainty may also include industry-specific concerns, such as availability of products or presence of substitute products, and firm-level issues, such as employees' productivity (Liu et al., 2016; Sniazhko, 2019).

Firms make investment decisions in a *competitive environment* in which the actions of rival firms shape both the costs and benefits of market presence. The existence or anticipated entry of other foreign firms may therefore alter the attractiveness of a given location and steer some firms away from some markets Porter (1980). Moreover, foreign firms compete not only against each other but also against domestic firms, which may have advantages in terms of local knowledge, embeddedness in supplier networks, and access to local politicians and state bureaucracy (Hymer, 1976; Kindleberger, 1969; Zaheer, 1995).

Firms anticipate *the behavior of host-country actors* after entry as their decisions can substantially affect the profitability and security of foreign investment (Jensen, 2008*a,b*; Henisz, 2000).

Because market activity is embedded within political and bureaucratic institutions, firms are constrained by the actions of government officials, regulators, and other domestic stakeholders. To mitigate uncertainty and secure favorable operating conditions, firms often invest in relationships with political, administrative actors, reflecting the value of political connections and institutional access in host economies (Fisman, 2001; Jensen, 2008*b*), and also their home country diplomatic staff operating in the host country (Rose, 2007; Zhang, Jiang and Zhou, 2014). Such efforts reflect an awareness that state and non-state actors pursue interests that may diverge from those of foreign investors, creating the possibility of policy changes, regulatory interventions, or other actions that alter the terms under which firms operate and that may reduce the profitability of firms' investment (Jensen, 2008*b*; Henisz, 2000; Kobrin, 1979) .

I argue that firms differ in their ability to navigate uncertainty, compete effectively in foreign markets, and in their likelihood of experiencing adverse behavior by host country actors. These differences shape how firms assess the risks and opportunities associated with international expansion. Although firms can deploy both market and non-market solutions to mitigate these challenges, a consequential strategy of managing exposure to such risks is through market selection itself, and through limited level of engagement in high risk markets. In other words, MNCs can minimize risk either by avoiding high risk markets, by limiting their FDI portfolio in those markets, or by operating exclusively through arm's length trade in high risk environments. I claim that firm size shapes how firms address uncertainty, competition and host country's political targeting, and I provide distinct theoretical mechanisms explaining why large firms are less likely to enter and more likely to limit their operations in countries with high political risk.

2.3.1 Large Firms' Advantages In Searching And Moving First

When MNCs evaluate prospective host markets, they must make important decision based on a wide range of economic, institutional, and strategic factors. Firms may choose to enter a

foreign market through acquisitions or mergers with domestic firms, by forming joint ventures with local partners, or by establishing wholly owned subsidiaries from the ground up. Each of these entry modes requires extensive knowledge of the host market, including information regarding the availability and suitability of potential domestic partners and acquisition targets (Anderson and Gatignon, 1986). Furthermore, firms recognize the substantial uncertainty associated with international expansion and may seek to mitigate risk through mechanisms such as political risk insurance and other forms of coverage (Jensen, 2008a).

Acquiring such information is costly. Firms must expend financial resources, managerial attention, and time to evaluate prospective host markets and reduce uncertainty (Diamond, 1982; Mortensen and Pissarides, 1994). MNCs may allocate internal personnel to investigate the characteristics of prospective host markets, or they may outsource these activities to specialized actors, including consulting firms, international and local law firms, and insurance providers.

Firm size plays a critical role in shaping a MNC's capacity to allocate resources toward the search and evaluation of new markets. Larger firms possess superior financial and managerial resources, enabling them to conduct more extensive due diligence and acquire more comprehensive information about potential host countries. As a result, they are better positioned to identify and select into markets with lower levels of risk and higher overall quality. Smaller firms, by contrast, face more severe resource constraints that limit the breadth and depth of their search processes. Consequently, they are more likely to enter relatively less favorable or riskier markets due to informational deficiencies and a diminished capacity for evaluation.

Firms also vary in their ability to assert dominance in a new market, based on the timing of entry and the level of competition with other existing firms. First movers into a market enjoy competitive advantages associated with early market entry. This may include "technological leadership" which allows early entrants to use patents to deter later entrants from accessing a market. It may entail preemption of scarce assets as early entrance allows firms access to optimal physical

resources, such as natural resource deposits or better retailing and manufacturing locations, and to mobile assets, such as employees, suppliers, and distributors. Finally, first-movers can gain advantages by creating high switching costs for customers, making it more costly for later entrants to compete, as they are forced to attract customers away from the first-mover firm (Lieberman and Montgomery, 1988, 1990).

Larger firms, which are often both older and more resource-rich, are more likely to exploit these first-mover advantages by entering the most attractive markets early. As markets become saturated, later entrants—often smaller firms—may be forced to expand into less desirable and potentially riskier locations. This dynamic further reinforces the tendency for smaller firms to operate in higher-risk environments.

Taken together, these two mechanisms highlight how firm size shapes the extent to which firms can mitigate informational frictions associated with international expansion, and how firm size gives some firms advantages in asserting dominance in new markets. Variation in information acquisition capabilities and in timing thus generates systematic differences in the types of host country environments into which firms self-select.

2.3.2 Large Firms As Ideal Targets For Host Market’s Predation

Firms may also evaluate the suitability of a host market based on their assessment of the likelihood that state and non-state host market actors will target them after entry. Firms are aware that host country actors have incentives to predate on them. As mentioned above, state actors may expropriate or otherwise decrease the value of their assets through more or less subtle ways of predation, they may restrict capital flows or enact punitive regulations. Non-state actors may as well target their personnel and facilities, and block or slow down their operations (Henisz, 2000; Jensen, 2008*b,a*; Kobrin, 1979).

Firm size may shape the incentives for predatory behavior perpetrated by state and non-state

actors. These actors may view large firms as particularly attractive targets due to the potential for higher returns from expropriation or other forms of rent extraction. The logic is straightforward. If predatory actions involve a cost—such as administrative effort, political capital, or the risk of international backlash—then targeting a smaller number of large firms may be more efficient than targeting many smaller firms. This logic applies both to direct and indirect forms of expropriation, such as regulatory changes that disproportionately affect specific firms. Similarly, transfer restrictions may impose greater absolute costs on larger firms, given their higher volumes of cross-border financial flows.

At the same time, governments must balance these material gains against the reputational costs derived from attacking foreign firms. Excessive predation may deter future investment, as firms share information with one another across their production network (Comini and Zhang, 2026). Moreover, firms have ties to their home countries' institutions generating the potential for backlash from the home country (Wellhausen, 2014; Simonelli and Osgood, 2024). This trade-off may lead governments to selectively target firms when the expected benefits of predation outweigh the potential reputational damage. Assuming that larger firms possess larger assets in a host country, state actors may view larger MNCs as ideal targets, as opposed to medium and small-sized MNCs.

Non-government actors, including insurgent groups and other forms of organized violence, may also disproportionately target large firms. From a material standpoint, attacks on larger firms offer the prospect of greater financial gains. From a strategic perspective, such actions can generate greater visibility and media attention, thereby amplifying the actors' political messages.⁹ Firms with highly visible and immobile assets are particularly attractive targets for groups seeking to signal their capabilities or grievances to domestic and international audiences. The prominence of

⁹Anecdotal evidence shows that large firms are indeed targets of violence - Blanton and Blanton (2007) mention two incidents where Shell and Chevron workers were kidnapped by rebel groups in Nigeria and Sudan.

large multinational firms increases the likelihood that attacks against them will receive widespread coverage, enhancing their value as symbolic targets (Simonelli and Osgood, 2024)

To sum up, the explanations I developed imply that larger firms have both greater capacity to avoid risky environments and stronger incentives to do so. Anticipating the heightened risks associated with political instability and predatory behavior, large MNCs are likely to prioritize entry into safer markets and consolidate their presence in low-risk environments. Smaller firms, constrained by limited resources and fewer strategic options, are more likely to operate in riskier contexts.

Consistent with the political risk literature, I expect political risk to reduce foreign investment. However, my argument suggests that the scale of this effect will depend on firm size. Because larger firms are more capable of selecting into low-risk environments and more sensitive to host country political actors' predation, political risk should have a more pronounced negative impact for large MNCs. By contrast, smaller firms, which are less able to select into and establish leadership in safer markets and are less likely to be targets of host country's predatory actions, should be less responsive to increases of political risk. Accordingly, I advance the following hypothesis:

Hypothesis: The negative effect of political risk on foreign investment by multinational firms is increasing in the size of the firm.

3 Empirical Analysis

3.1 Data

Sample To test the argument that firm size conditions the effect of political risk on FDI, I draw on data on US parent firms' overseas operations.¹⁰ Although several data sources could be used for this purpose, I focus on publicly traded U.S. parent firms with foreign subsidiaries.¹¹ Restricting the

¹⁰Detailed information on the data construction procedure is provided in Appendix Section A.1

¹¹The sample includes only subsidiaries that are at least 50 percent owned by the U.S. parent company.

Arguments relating firm size and political risk	
Main Argument	Larger firms are less willing to operate in risky countries
Business strategies	<i>Search costs</i>: larger firms have larger budgets for searching for host markets so they can pick better ones <i>First-mover advantage</i>: larger firms may have been early foreign investors and have entered the best markets first, excluding smaller firms from entering
Firm-host country interaction	<i>Ideal targets for predation</i>: host country government and non government actors may target larger firms rather than smaller ones in order to maximize their gains from predation - <i>Reputational costs</i>: host country governments may prefer to predate on a small set of larger firms to maintain an overall good reputation with foreign investors - <i>Visibility benefits</i>: host country non government actors may prefer to predate on a small set of larger firms to gain more visibility and better project their grievances

Table 1: **Summary of the theoretical mechanisms linking firm size to political risk.** I present firm-level (search costs, first-mover advantages) and host-country-level (predation incentives, reputational costs, visibility) explanations.

sample to U.S. firms helps hold constant unobservable, country-level factors—such as managerial preferences or institutional environments—that may influence firms’ attitudes toward risk. In addition, the large number of U.S. multinationals ensures substantial variation and a sufficiently large sample for empirical analysis. I further exclude privately held firms, as publicly listed companies tend to provide more reliable and standardized information on key characteristics, such as firm size, employment, and industry classification (Lerner and Osgood, 2023).

Drawing on Orbis Historical Data, I generate a new and comprehensive panel dataset of all US-based multinational corporations with subsidiaries abroad using the HPC cluster of the University of Michigan. The unit of analysis is the parent firm–host country–year. I denote parent firms with a subscript i , host countries with a subscript j , and years with a subscript t . The sample comprises approximately 3,000 parent firms operating across 190 host countries. The temporal coverage spans 2007–2022, reflecting the availability of subsidiary-level data from ORBIS Historical

starting in 2007 and the coverage of key control variables, such as GDP and GDP per capita from the World Development Indicators, which extend through 2022.¹²

Outcome Variable The outcome variable, Subs_{ijt} , captures the substantive presence of US MNCs in host countries worldwide, and is measured as the number of subsidiaries that parent firm i owns in host country j in year t .¹³ Unlike a simple binary indicator of foreign presence, this measure captures nuanced variation in multinational activity.

Explanatory Variables To measure host country’s political risk, I rely on three explanatory variables commonly used in the literature to quantify political risk: expropriation risk ($\text{Expropriation Risk}_{jt}$), transfer risk ($\text{Transfer Risk}_{jt}$), and political violence risk ($\text{Violence Risk}_{jt}$). I draw on data by Credendo, a Belgian Export Credit Agency (formerly known as ONDD). Current data by Credendo covers over 200 countries, is updated regularly and available on the company’s website.¹⁴ I select data from this credit agency for several reasons. It provides data disaggregated according to type of political risk - Expropriation and Government Action Risk, Currency Inconvertibility and Transfer Restriction Risk, and Political Violence Risk. Moreover, their ratings are used by IBM-Plant Location International, one of the most influential multinational investment location consultancies. Finally, Jensen (2008) shows that risk pricing from other political insurance providers closely aligns with Credendo ratings. Each measure of political risk ranges between 1 and 7 and lower numbers signal lower risk. I also generate a new political risk variable, Overall Risk_{jt} , which captures the overall level of political risk by taking the average of the three political risk variables provided by Credendo.¹⁵

The moderating variable is the size of the US parent firm, and is operationalized with the annual operating revenue, $\text{Parent Revenue}_{it}$, of the US parent firm provided by ORBIS Historical

¹²Data collection was completed in 2024.

¹³ORBIS Historical Data includes information on parent firms’ names, operating revenue, number of employees, closing dates, types of financial accounts, the geographical distribution of subsidiaries, and NAICS classifications (4-digit core codes).

¹⁴Data for previous years in the dataset has been kindly shared with me by Nancy De Waele at Credendo

¹⁵<https://credendo.com/en/country-risk>.

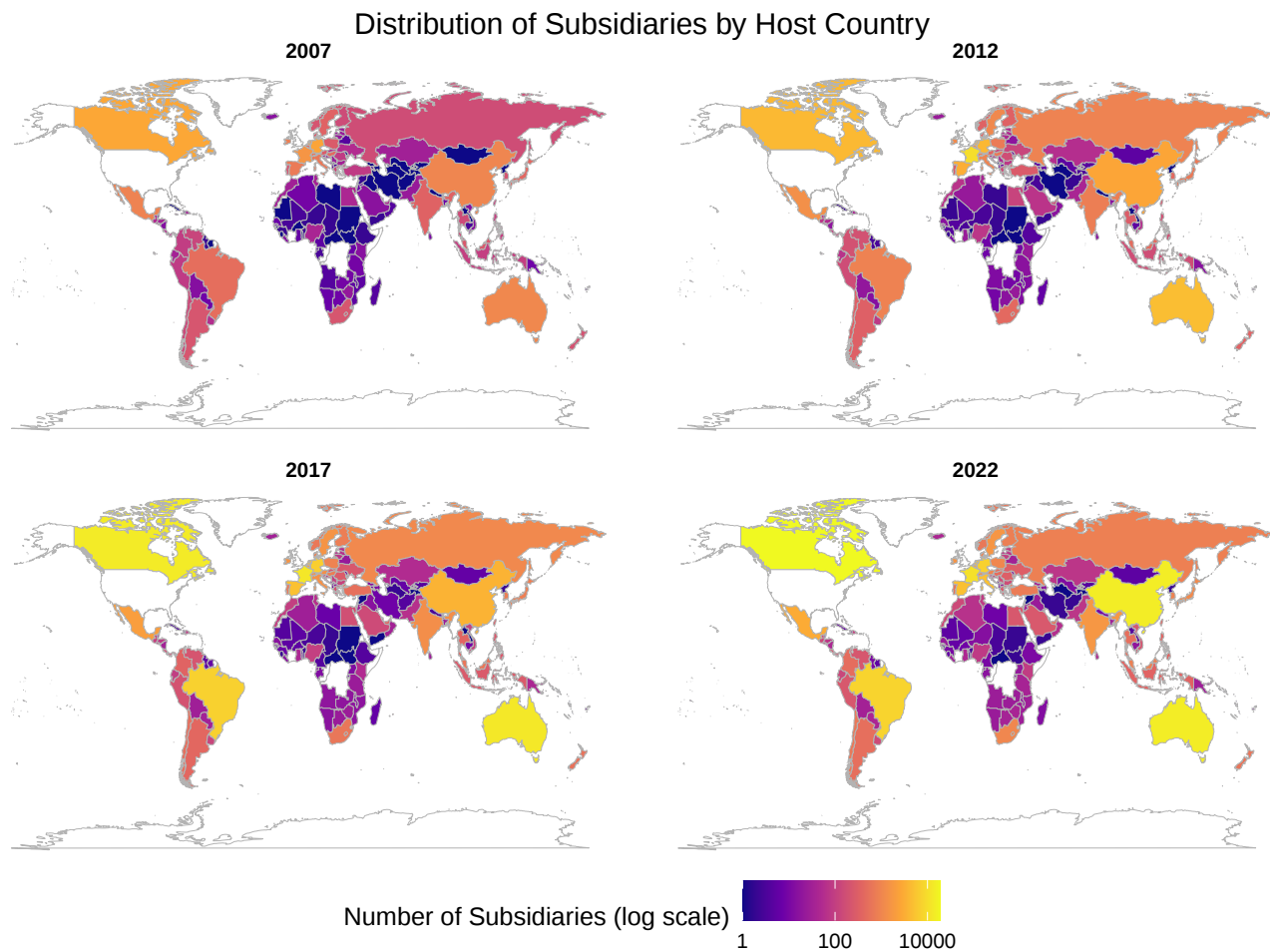


Figure 1: **Global distribution of subsidiaries by host country over time.** Each panel represents a different year, with countries colored by the number of subsidiaries they host. Lighter colors indicate higher numbers of subsidiaries, while darker colors indicate lower numbers. A logarithmic color scale is used to account for the highly skewed distribution of subsidiary counts, enhancing the visibility of variation across countries.

Data.¹⁶ This measure is right-skewed and contains both zeros and negative numbers. Given the small number of firms for which operating revenue is negative, I drop those firms from the dataset.¹⁷ The new measure ranges between 0 and USD 600 billion with a mean of USD 5.8 billion. Similarly to the outcome variable, I normalize it by adding 1 and taking the natural log.

Controls In all models, I include a range of firm- and host country-level control variables to account for alternative explanations of foreign direct investment (FDI) decisions. These controls capture factors that influence the scale of firms' international operations, the attractiveness of host countries, and the institutional environment in which investment takes place.

At the firm level, I control for the total number of subsidiaries each parent firm operates outside the focal host country. This variable serves as a proxy for the firm's overall international scale and experience and is log-transformed, as described previously. Larger multinational firms typically possess greater financial and organizational resources, making them more capable of establishing subsidiaries abroad regardless of the level of political risk in the host country. Controlling for a firm's existing international presence therefore helps isolate the relationship between political risk and subsidiary location decisions.

At the host country level, I control for several economic characteristics that are known to influence FDI. GDP is included as a measure of market size, reflecting the attractiveness of a host country for market-seeking (horizontal) investment. GDP per capita captures the level of economic development, while GDP per capita growth measures the pace of economic expansion and the potential for future market growth. Data on these variables are obtained from the World Bank's World Development Indicators. Because political institutions are correlated with both

¹⁶U.S. firms determine the start and end dates of their fiscal years, with certain industries exhibiting common preferences; for example, retailers such as Walmart often close their financial year at the end of January. Details regarding the procedure used to align operating revenue with the calendar year are provided in the Appendix Section A.1.

¹⁷The operating revenue variable contains 1970 negative numbers over more than 6 million observations. I also estimate the results without dropping the negative numbers and instead of using a log-transformation, I apply the inverse hyperbolic sine transformation - the results are provided in the Appendix Section C.

investment risk and economic development, I also include the Democracy Index from the Varieties of Democracy (V-Dem) project (v2x_polyarchy).¹⁸ Including democracy as a control helps distinguish the effect of political risk from broader institutional characteristics that may independently influence firms' investment decisions.

Consistent with standard practice in the FDI literature, I further control for the existence of a bilateral investment treaty (BIT) between the United States and each host country in a given year using data from the U.S. Department of State.¹⁹ BITs provide legal protections for foreign investors and reduce uncertainty by guaranteeing investment protections and access to international arbitration. As a result, they may encourage FDI independently of political risk and are therefore included as an additional control.

All models also include industry, host-country, and year fixed effects. Industry fixed effects, based on four-digit NAICS codes from ORBIS, account for persistent differences across industries in their propensity to invest abroad, such as differences in capital intensity, production technologies, and the importance of intangible assets. Host-country fixed effects absorb time-invariant characteristics of destination countries that could otherwise confound the estimated relationship between political risk and FDI, including geographic distance from the United States, common language, colonial ties, legal origins, and other persistent cultural or institutional features. Year fixed effects control for global shocks that affect all firms simultaneously, such as worldwide economic conditions, changes in international financial markets, or major geopolitical events. Together, these fixed effects reduce bias arising from unobserved factors that are constant across industries or host countries, or common to all observations within a given year.

¹⁸Accessed through the V-Dem official website.

¹⁹Accessed through the USTR official website.

3.2 Research Design

The theory predicts that the relationship between political risk and firms' multinational presence in a host country depends on the size of the parent firm, which requires the use of interaction models. Accordingly, I estimate a series of linear regression models with interaction term between firm size and political risk and three sets of fixed effects: industry, host country, and year. Although the dependent variable represents a count variable, it is treated as continuous to facilitate the inclusion of the three-way fixed effects. Given the high correlation among the four political risk measures, each is introduced in separate models to mitigate multicollinearity concerns.²⁰

$$\begin{aligned}
\log(\text{Subs}_{ijt}) = & \beta_0 + \beta_1 \cdot \log(\text{Parent Revenue}_{it}) + \beta_2 \cdot \text{Political Risk}_{jt} \\
& + \beta_3 \cdot \log(\text{Revenue}_{it}) \cdot \text{Political Risk}_{jt} + \beta_4 \cdot \log(\text{GDP}_{jt}) \\
& + \beta_5 \cdot \log(\text{GDP pc}_{jt}) + \beta_6 \cdot \text{GDP pc Growth}_{jt} + \beta_7 \cdot \log(\text{Foreign Subs}_{jt}) \\
& + \beta_8 \cdot \text{Democracy Index}_{jt} + \beta_9 \cdot \text{BIT}_t + \mu_{\text{industry}} + \mu_j + \mu_t + \varepsilon_{ijt}
\end{aligned} \tag{1}$$

where $\log(\text{Subs}_{ijt})$ denotes the log of the number of subsidiaries parent firm i owns in host country j in year t and $\log(\text{Parent Revenue}_{it})$ represents the log-transformed annual operating revenue of the parent firm. $\text{Political Risk}_{jt}$ captures one of the four political risk indicators for host country j in year t , and the interaction term $\log(\text{Parent Revenue}_{it}) \cdot \text{Political Risk}_{jt}$ tests whether the effect of political risk is conditional on firm size. I control for the log of GDP, GDP per capita, GDP per capita growth, and host country institutional quality ($\text{Democracy Index}_{jt}$), and firm-level variables— $\log(\text{Foreign Subs}_{ijt})$ and the presence of a bilateral investment treaty (BIT_{jt}). Industry (μ_{industry}), host-country (μ_j), and year (μ_t) fixed effects are included to account for unobserved, time-invariant heterogeneity at multiple levels. Standard errors are clustered to address potential autocorrelation in the error term within parent firms over time.

²⁰See Appendix Section A.2 for the correlation matrix.

3.3 Empirical Results

I present the results of the model in Table 2.²¹ Because coefficients from multiplicative models are not directly informative about substantive effects, I plot predicted values across levels of political risk and firm size. Figure 1 displays the results for the four measures of political risk: Overall Risk, Expropriation Risk, Transfer Risk, and Political Violence Risk. Overall Risk is measured as the average of Expropriation Risk, Transfer Risk, and Political Violence Risk. Firm size is set at the 20th (“Small”), 50th (“Medium”), and 80th (“Large”) percentiles of parent revenue, $\log(\text{Parent Revenue}_{it})$. All covariates are held at their medians, except BIT, which is set to 0 (mode).

The results indicate that higher levels of political risk are associated with lower multinational activity among large firms. Specifically, as Overall Risk increases from 1—characteristic of a country such as the United Kingdom—to 7 (e.g., Afghanistan), the predicted number of subsidiaries per firm–host country–year declines from approximately 0.4 to 0.25. A similar but attenuated pattern is observed for medium-sized firms, for which predicted values decrease from around 0.37 to approximately 0.28. In contrast, for firms at the 20th percentile of revenue, the relationship is neutral: moving from a risk level of 1 to 7 is not associated with a decrease in the predicted number of subsidiaries.

Changing the political risk measure to Expropriation Risk yields a similar pattern. For firms at the 80th percentile of revenue, higher levels of expropriation risk are associated with a substantial decline in the predicted number of subsidiaries per firm–host country–year, from approximately 0.4 to 0.28 as risk increases from 1 to 7. For medium-sized firms (50th percentile), the relationship remains negative but smaller in magnitude, with predicted values decreasing from about 0.37 to 0.3 over the same range. In contrast, for firms at the 20th percentile of revenue, the relationship is

²¹See Appendix Section B for regression tables including all control variables.

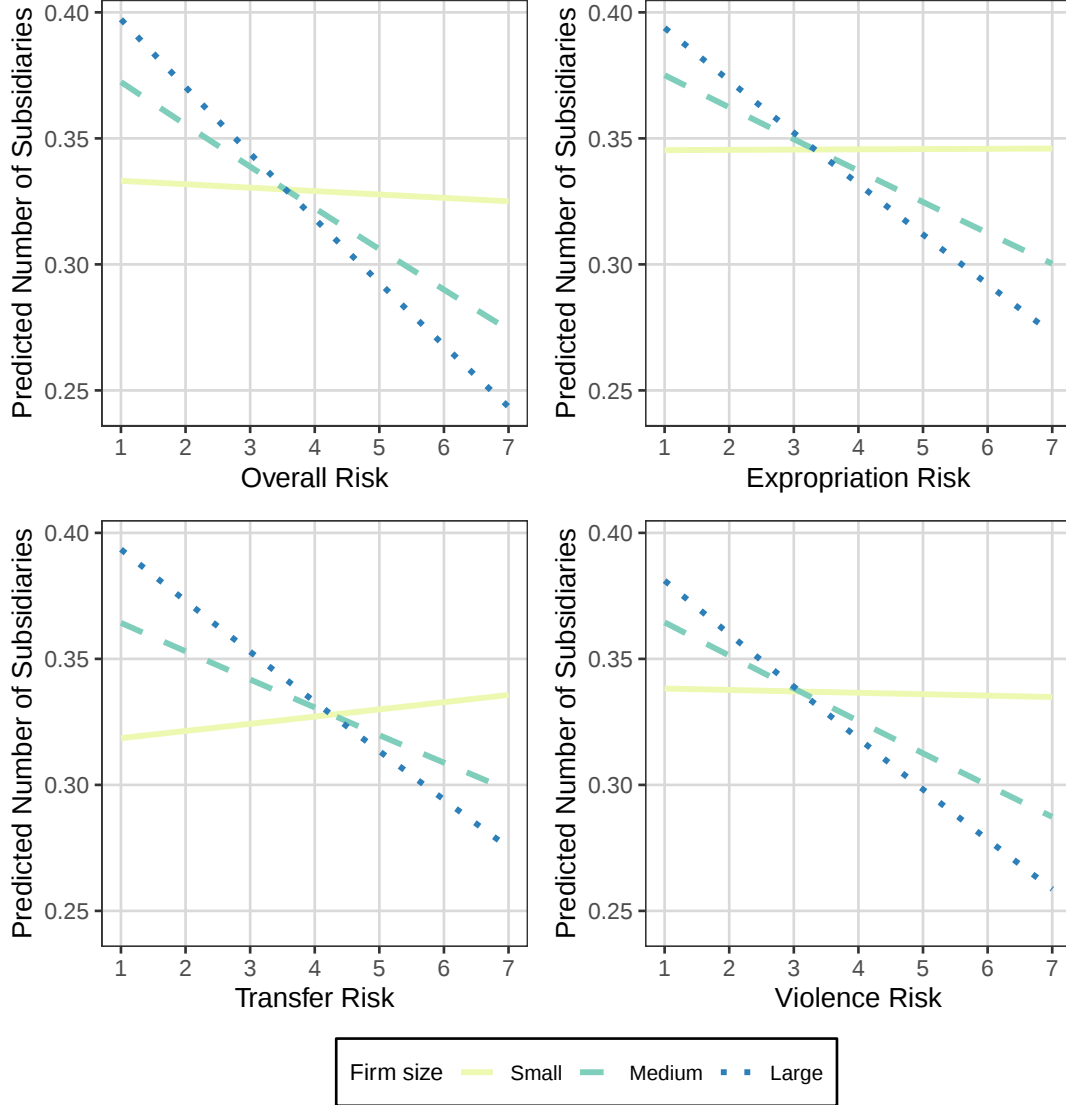


Figure 2: **Predicted number of subsidiaries by parent firm-host country-year as a function of political risk and firm size (annual parent firm revenue logged).** This figure shows the conditional effect of different dimensions of political risk (Overall, Expropriation, Transfer, and Violence Risk) on the predicted number of subsidiaries by parent firm-host country-year for three levels of annual revenue (Firm Size). The moderating variable (Firm Size) is set at the 20th percentile for “Small”, the 50th percentile for “Medium”, and the 80th percentile for “Large”.

Table 2: The effect of political risk on the number of foreign subsidiaries at different levels of firm size measured as the annual parent firm revenue (logged).

DV: ln(Number of subsidiaries)	Type of political risk			
	Overall	Exprop.	Transfer	Violence
ln Parent Revenue	0.013*** (0.003)	0.010*** (0.002)	0.015*** (0.003)	0.009*** (0.002)
Political Risk	0.063*** (0.013)	0.053*** (0.012)	0.061*** (0.011)	0.052*** (0.0006)
Political Risk · ln Parent Revenue	-0.004*** (0.0007)	-0.003*** (0.0006)	-0.003*** (0.0006)	-0.003*** (0.0006)
Observations	5,349,076	5,349,076	5,568,274	5,568,274
Firm characteristics	✓	✓	✓	✓
Host market characteristics	✓	✓	✓	✓
Industry fixed effects	✓	✓	✓	✓
Host country fixed effects	✓	✓	✓	✓
Year fixed effects	✓	✓	✓	✓

Notes: All models are linear probability models with interaction term with industry, country and year fixed effects and clustered standard errors. Industry, year and country fixed effects partial out unchanging industry, year and country factors. + * p < 0.1; ** p < 0.05; *** p < 0.01.

neutral: the predicted number of subsidiaries does not vary as expropriation risk rises. The same pattern is observed when plotting the expected outcomes for Transfer Risk and Violence Risk.

Overall, the results are consistent with the theoretical expectations. Larger firms appear more likely to avoid politically risky markets than smaller firms, as indicated by the more pronounced negative change in the predicted number of foreign subsidiaries per firm–host country–year as political risk increases. Although the estimated changes are modest in magnitude, they are substantively meaningful given the distribution of the dependent variable. The outcome variable is highly right-skewed: 96% of observations are zeros and only 2% are ones. In this context, relatively small differences in predicted values correspond to meaningful differences in underlying firm behavior.

The results also speak to the composition of firms operating in politically risky environments. At high levels of political risk (values of 6 and 7), large firms are nearly absent, while medium- and small-sized firms remain active. Notably, in these settings, small firms on average own more subsidiaries per firm–host country–year than medium-sized firms. This pattern is consistent with the argument that smaller firms are comparatively less deterred by political risk.

3.4 Alternative measures of political risk and firm size

To assess the robustness of the results to alternative measurement choices, I re-estimate the models using two commonly employed variables: the PRS political risk index and parent firm employment as a proxy for firm size. These alternative specifications allow me to examine whether the main findings are sensitive to different operationalizations of political risk and firm size. Consistent results across these robustness checks would strengthen confidence that the reported relationships are not driven by the specific measures used in the baseline analysis.

The PRS index, produced by the PRS Group, is widely used in the literature on multinational firms and political risk (Kesternich and Schnitzer, 2010; King, Loncan and Khan, 2021; Zhu, Jia and Wu, 2019; Busse and Hefeker, 2007), and is “the only political risk data accepted by the courts in commercial disputes and is often used by MNCs when making entry or exit decisions” (Gonchar and Greve, 2022, p. 5). It aggregates twelve components—including government stability, investment profile, internal and external conflict, corruption, and bureaucratic quality—into a composite measure of country risk. Compared to the Credendo indicators used in the main analysis, PRS captures a broader set of political risk dimensions but covers a smaller set of countries (approximately 140). Because the PRS scale ranges from 0 to 100, with lower values indicating higher risk, I recode the index so that higher values correspond to higher risk to facilitate comparison (Egan, 2012).

I also replace parent firm revenue with the annual number of employees, drawn from Orbis

Historical Data, as an alternative measure of firm size. This variable is widely used in prior research (Becker-Blease et al., 2010; Gallegati and Palestini, 2010), is highly skewed, and ranges from 1 to 2.1 million. I transform it by taking the natural logarithm of employment plus one. Coverage for this measure is more limited than for parent firm’s revenue, which further reduces the sample size in these specifications.

The results are broadly consistent with the main findings.²² Using the PRS-based measure of political risk, increases in risk are associated with a sharp decline in the predicted number of subsidiaries per firm–host country–year for large firms, a more moderate decline for medium-sized firms, and an increase for small firms. These patterns are robust to substituting employment for revenue as the measure of firm size. Across specifications using both PRS and the Credendo indicators, the interaction between political risk and firm size remains consistent: higher levels of political risk are associated with reduced multinational activity among large firms, weaker effects for medium-sized firms, and, in some cases, increased activity among small firms.²³

3.5 Shocks to political risk

In addition to the expert-based measures used in the main analysis, I conduct two supplementary tests using data on coups d’état and free trade agreements (FTAs).²⁴ These events provide alternative, event-based measures of changes in the political risk environment facing multinational firms. Coups d’état constitute plausibly exogenous shocks that abruptly increase political uncertainty by disrupting existing political institutions, raising concerns about policy instability, and heightening the risk of violence or expropriation. In contrast, FTAs represent institutional arrangements that reduce uncertainty by strengthening commitments to trade and investment, improving market access, and increasing the credibility and predictability of government policies.

²²Full regression results and plots are reported in the Appendix E.

²³Full regression results and plots are reported in the Appendix E.

²⁴I also examine rebellions; the results are consistent with the main findings and are reported in the Appendix.

These tests provide a useful complement to the main analysis and offer an additional evidence of whether changes in the political environment shape firms' international investment decisions in the expected direction.

3.5.1 Coup d'état

Coups d'état are abrupt attempts by the military or other political elites to remove an incumbent leader from power, often resulting in substantial disruptions to the political and institutional environment. Such events can generate uncertainty over the continuity of government policies, the enforcement of contracts, the protection of property rights, and the broader regulatory framework governing foreign investment. A large body of research finds that political instability—including coups, riots, strikes, and other forms of political violence—discourages foreign direct investment (FDI) by increasing the expected costs and risks of operating abroad (Feng, 2001; Schneider and Frey, 1985). Because coups typically occur with little warning and are difficult for firms to anticipate, they can be treated as plausibly exogenous shocks to the host country's political environment. As a result, they provide a useful setting for examining how sudden increases in political uncertainty affect the behavior of multinational corporations, including their investment decisions and exposure to political risk.

I draw on the dataset compiled by Powell and Thyne (2011)²⁵ and restrict the analysis to countries in Sub-Saharan Africa.²⁶ This regional focus is motivated by both empirical and methodological considerations. First, Sub-Saharan Africa experienced a relatively large number of coup attempts during the period covered by the firm-level data (2007–2022), providing sufficient variation to identify the effects of sudden increases in political uncertainty. Second, limiting the sample to a single region helps reduce concerns that cross-regional differences in institutions, economic development, or geopolitical conditions drive the results. It also allows the empirical specifica-

²⁵I access it through <https://militarycoups.org/cam>

²⁶See the Appendix for the full list of countries included in the sample.

Table 3: The effect of a coup on the number of foreign subsidiaries at different levels of firm size measured as the annual parent firm revenue (logged) in Sub-Saharan countries.

DV: ln(Number of subsidiaries)	
Coup (Binary)	0.011* (0.005)
Coup (Binary) · ln Parent Revenue	-0.0006* (0.0003)
Observations	1,494,338
Firm characteristics	✓
Host market characteristics	✓
Industry fixed effects	✓
Host country fixed effects	✓
Year fixed effects	✓

Notes: All models are linear probability models with interaction term with industry, country and year fixed effects and clustered standard errors. Industry, year and country fixed effects partial out unchanging industry, year and country factors. + . $p < 0.1$; * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$.

tion to more effectively account for unobserved regional trends that might otherwise confound the estimated relationship between coups and firm behavior.

To operationalize coups, I construct a binary indicator that equals 1 if one or more coup attempts—successful or unsuccessful—occur in a given country-year, and 0 otherwise.²⁷ I do not distinguish between successful and failed coups because both types of events generate substantial uncertainty for firms. Even unsuccessful coup attempts can disrupt government operations, raise doubts about political stability, increase security risks, and create uncertainty regarding future policy and regulatory decisions. From the perspective of multinational corporations, the immediate uncertainty surrounding a coup attempt is likely to be more consequential than its eventual outcome. While the success or failure of a coup may ultimately shape firms’ longer-term assessments of the costs and benefits of operating in the host country, I treat this distinction as a secondary consideration and focus instead on the occurrence of the shock itself.

²⁷Multiple coups occur in some country-years (e.g., Mali in 2012, Burkina Faso in 2022, and Sudan in 2021).

To assess whether firms of different sizes respond differently to coups, I interact the coup indicator with firm size revenue. This specification allows the effect of coups to vary continuously across firms according to their size. I include the same set of control variables,²⁸ and industry, year, and host-country fixed effects to account for unobserved heterogeneity. Standard errors are clustered by industry, year, and host country. This estimation strategy isolates the relationship between coups and foreign subsidiary activity while allowing the effect of coups to differ systematically across firms with different sizes. Figure 2 shows the results of the model. For firms in Sub-Saharan Africa, coups have a negative impact on the number of subsidiaries owned by foreign firms among medium-sized and large firms, supporting the argument that larger firms are less likely to operate in environments characterized by high political risk. The effect is most pronounced for the largest firms, suggesting that they are the most responsive to increases in political instability. This pattern is consistent with the view that larger firms are especially cautious about maintaining or expanding their presence in countries with high political risk.

3.5.2 Free Trade Agreements (FTAs)

Free trade agreements (FTAs) are treaties through which countries commit to reducing or eliminating barriers to cross-border trade, including tariffs, quotas, and other restrictions on trade and investment. Beyond lowering the direct costs of international exchange, FTAs often establish formal rules governing investment, dispute settlement, intellectual property protection, and regulatory cooperation. By embedding these commitments in an international legal framework, FTAs can increase the credibility of host governments' policies and reduce concerns about arbitrary policy reversals or discriminatory treatment of foreign firms. As a result, they may lower the political and institutional uncertainty associated with operating in foreign markets, making investment decisions more predictable for multinational corporations.

A substantial literature argues that international agreements serve as commitment devices that

²⁸Full regression results and alternative plots are included in Appendix.

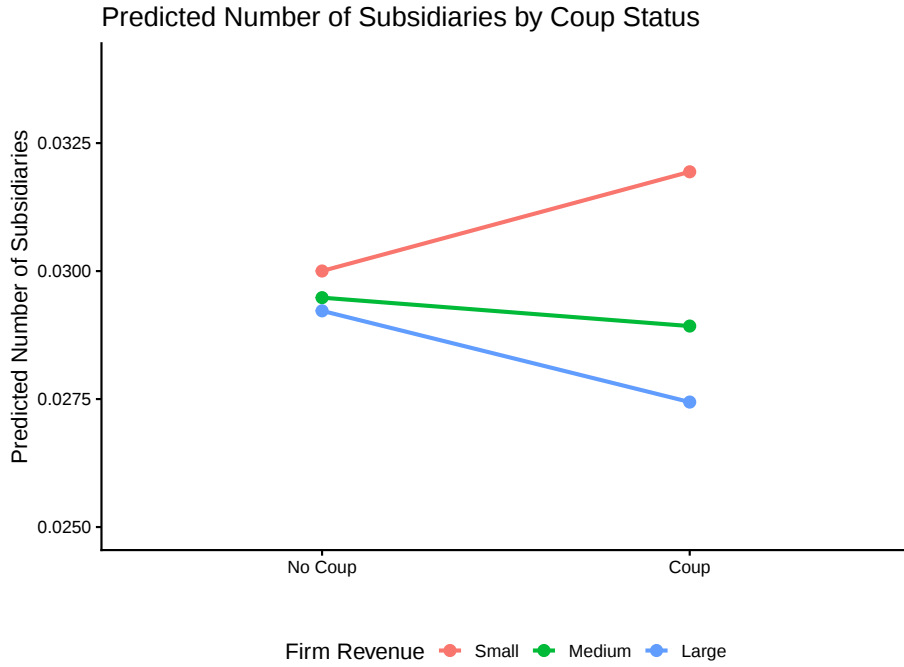


Figure 3: **Change in the predicted number of subsidiaries under coup and non-coup conditions for firms at different levels of operating revenue.** The horizontal axis distinguishes between observations without a coup and those experiencing a coup, while the vertical axis reports the predicted number of subsidiaries. The separate lines correspond to firms at the 20th, 50th, and 80th percentiles of the operating revenue distribution. Predicted values are derived from a fixed-effects regression model that includes an interaction between coup incidence and firm revenue.

reassure foreign investors by constraining governments' ability to renege on policy commitments. Consistent with this argument, Bütte and Milner (2008) show that developing countries participating in a larger number of FTAs attract significantly higher levels of FDI. If multinational firms adjust their international operations in response to changes in political risk, then FTAs should generate effects that mirror those of destabilizing political events. Whereas coups and rebellions increase uncertainty by undermining confidence in the stability of the political and regulatory environment, FTAs should reduce uncertainty by strengthening expectations of policy continuity and institutional reliability. Accordingly, I expect FTAs to affect multinational activity in the opposite direction of coups and rebellions. Although FTAs are not plausibly exogenous, as the decision to negotiate and implement an agreement is itself shaped by economic and political factors, they nevertheless provide a useful benchmark for examining whether institutional arrangements

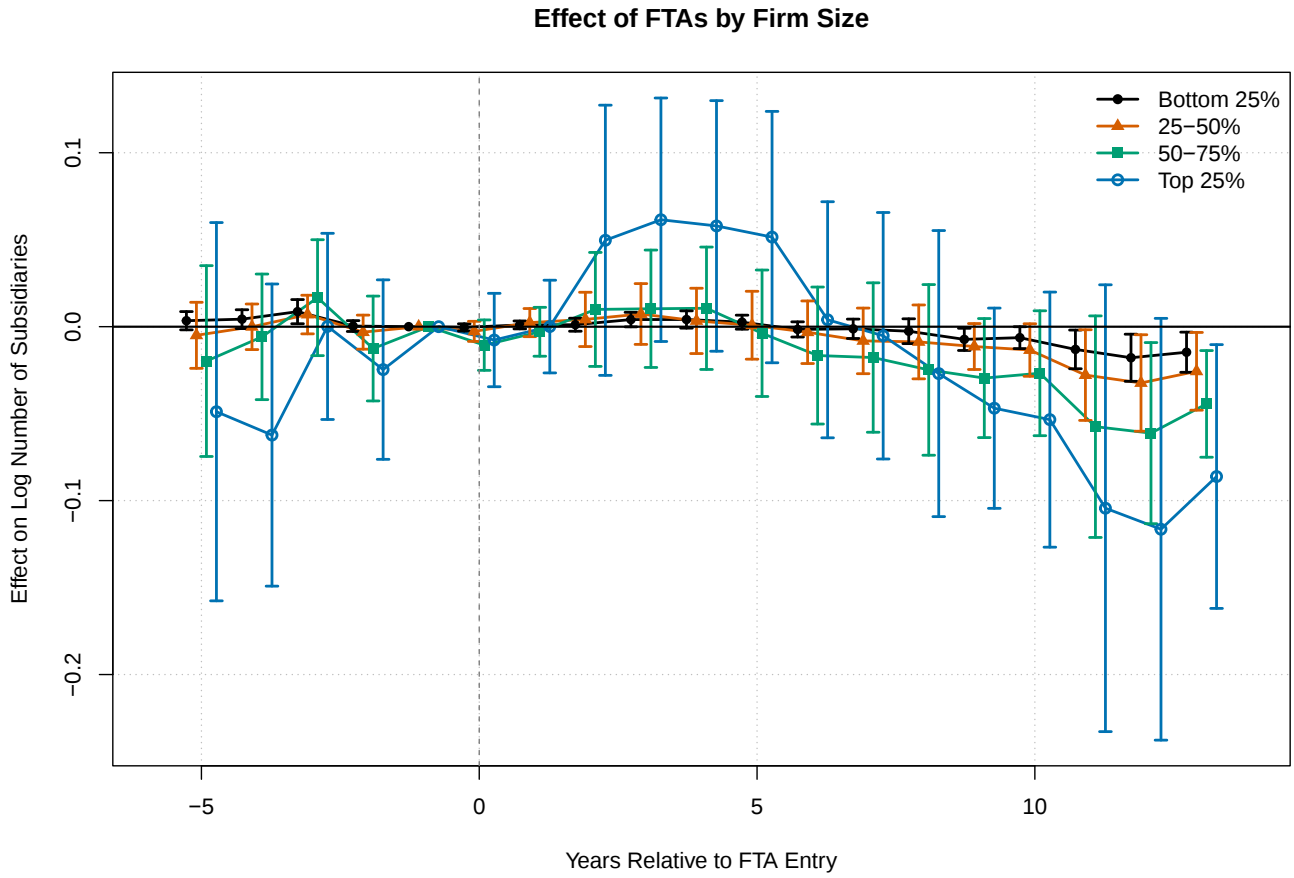


Figure 4: **Dynamic effects of free trade agreements by firm size.** The figure plots Sun and Abraham (2021) event-study estimates of the effect of free trade agreement (FTA) implementation on the log number of foreign subsidiaries. Separate lines correspond to firms in the bottom 25 percent, 25-50 percent, 50-75 percent, and top 25 percent of the parent operating revenue distribution. The horizontal axis measures years relative to FTA entry into force, with year 0 indicating the implementation year and year -1 serving as the omitted reference period. The vertical axis reports estimated effects on the log number of subsidiaries relative to the pre-treatment period. The horizontal reference line indicates zero effect, while the vertical dashed line marks FTA implementation.

that improve the investment climate produce behavioral responses consistent with the broader theoretical argument.

To estimate the effect of FTAs on firms' foreign subsidiary, I employ the Sun and Abraham (2021) event-study estimator. This approach is well suited to the empirical setting because FTA adoption is staggered across countries and years, with host economies entering into agreements at different points in time. In such settings, event-study designs can be distorted when treatment effects are heterogeneous across cohorts or evolve over time, since comparisons may inadvertently

mix treated observations from different adoption cohorts. The Sun and Abraham estimator addresses this concern by constructing cohort-specific event-time effects relative to a valid control group of not-yet-treated units and then aggregating these effects across cohorts using a weighting scheme that preserves the correct interpretation of dynamic treatment effects. In combination with three-way fixed effects, which absorb unobserved heterogeneity across firms, countries, and time, this approach delivers more credible estimates of the dynamic impact of FTA implementation before and after treatment. While the Sun and Abraham (2021) estimator accounts for staggered adoption and heterogeneous treatment effects, the presence of anticipatory behavior, likely in the case of FTAs, violates one of the assumption of the model. In this case, estimated effects should be interpreted relative to a potentially anticipatory pre-trend rather than a fully untreated baseline.

The empirical models include industry, year, and host-country fixed effects to account for time-invariant differences across countries and industries, as well as common shocks affecting all firms in a given year. Standard errors are clustered by industry, year, and host country to account for correlated error structures along each of these dimensions. Finally, the models are estimated separately for firms in different operating revenue quartiles, allowing the dynamic effects of FTAs to vary systematically across firms of different sizes. Estimating separate event studies by firm size makes it possible to assess whether reductions in political and institutional uncertainty disproportionately benefits larger firms in line with my theoretical expectations.

Figure 3 illustrates the effect of FTA introduction on the predicted (log) number of subsidiaries over a period of time spanning five years before implementation and up to fifteen years after, separately for four groups of firms based on their size. The results show that firms in the top 25th percentile of Parent Revenue experience a stronger increase in number of foreign subsidiary following FTA implementation, whereas the effects for all other firm groups are comparatively small and much more muted. Overall, these results provide additional evidence that larger firms

are more susceptible to changes in political risk than smaller firms in the way predicted by my theory.

4 Testing the mechanisms

Having established that the empirical evidence supports my argument that larger firms are less likely to operate in politically risky markets, I next conduct a series of additional tests to examine the mechanisms proposed in the theory section. My theoretical argument emphasizes that firm size systematically shapes how multinational corporations manage uncertainty, competition, and political risk, affecting both their ability to select investment locations and their attractiveness as targets of predatory behavior by host-country actors. Specifically, I assess whether the observed patterns are consistent with the theoretical expectations that larger firms possess stronger capabilities for selecting investment locations under uncertainty and are better able to assert leadership in a context characterized by high inter-firm competition, while simultaneously facing greater exposure to strategic or predatory actions by host-country political actors. I find little evidence for the “search costs” mechanism, whereas the evidence is broadly consistent with the “first-mover advantage” and “ideal target” mechanisms influencing multinational firms’ investment location decisions.

4.1 “Search costs” mechanism

Acquiring or merging with a foreign company or setting up a new venture in a foreign country generate costs connected to searching for possible partner firms or researching host countries’ conditions. All these costs, so-called “search costs”, accrue long before any profits are made. Quantifying search costs is hard because these costs encompass different dimensions of firm internationalization, such as marketing costs, research on host market laws and regulations—e.g. labor or trademark protection—and domestic firms’ competition, which are neither observable nor

openly disclosed by MNCs themselves.

One indirect way to quantify search costs is to measure how easy it is to acquire information based on the availability of data. When data is readily available, we can assume that search costs will be low. Similarly, when data is hard to acquire, the opposite should be true. The HRV index by Hollyer, Rosendorff and Vreeland (2017) provides an helpful tool to test this mechanism. The HRV index measures the availability of reliable economic data and is generated using an item response model where transparency is treated as a latent predictor of the reporting of data to the World Bank’s World Development Indicators. Simply put, countries will be scored as more transparent if the level of ‘missingness’ in the WDI data is lower and vice versa.

The second version of the data (HRV2) covers the time period between 1980 and 2015. This is because reporting delays to the World Bank from the side of countries influence the index for several years which prompted the authors to drop the last 6 years of available data (Hollyer et al., 2024). Given that transparency on average tends to change slowly, I generate the missing years in my time-series cross-sectional data (2016-2022) by regressing the index on the years (2007-2015) and predicting the index values for the subsequent years.²⁹

If the search costs mechanism is responsible for the evidence that larger firms are less likely to operate in politically riskier markets, we should find that larger firms are not impacted by different levels of transparency while firms of medium and small size do. The rationale behind this is that even when transparency is low and therefore the cost of acquiring information is high, larger firms are able to shoulder those costs and avoid political risk. On the contrary, smaller companies should struggle to discern between non-risky and risky markets when transparency is low.

To test this mechanism, I estimate a linear regression model that includes a triple interaction term, industry, host-country, and year fixed effects, and three-way clustered standard errors (by

²⁹Results generated predicting the missing years should be interpreted with caution.

Table 4: The Moderating Role of Transparency in the Relationship Between Firm Size, Political Risk, and Foreign Subsidiary Expansion.

DV: ln(Number of subsidiaries)	
ln Parent Revenue	0.015*** (0.004)
Overall Risk	0.062*** (0.016)
Transparency Index	-0.012 (0.013)
Transparency · ln Parent Revenue	0.0003 (0.0006)
Overall Risk · Transparency	0.004 (0.003)
Overall Risk · ln Parent Revenue · Transparency	-0.0002 (0.0001)
Observations	4,121,051
Firm characteristics	✓
Host market characteristics	✓
Industry fixed effects	✓
Host country fixed effects	✓
Year fixed effects	✓

Notes: All models are linear probability models with interaction term with industry, country and year fixed effects and clustered standard errors. Industry, year and country fixed effects partial out unchanging industry, year and country factors. + . p <0.1; * p <0.1; ** p <0.05; *** p <0.01.

industry, host country, and year). The triple interaction between political risk, firm size, and transparency tests whether the relationship between firm size and political risk differs systematically across host countries with varying levels of transparency. Table 4 reports the results. The interaction between firm size and transparency is small and statistically insignificant, suggesting that transparency does not systematically alter the relationship between firm size and foreign subsidiary expansion. Likewise, the interaction between political risk and transparency is also statistically insignificant, indicating that transparency does not meaningfully moderate the direct effect of political risk on firms' foreign operations.

Most importantly, the triple interaction between firm size, political risk, and transparency is

negative but statistically insignificant. This finding indicates that there is no robust evidence that host-country transparency conditions how firm size and political risk jointly shape multinational firms' foreign subsidiary networks. Overall, the results provide little support for the hypothesis that search costs, proxied by firms' ability to access information about host markets, explain heterogeneity in firms' responses to political risk. Put differently, the evidence suggests that differences in firms' information acquisition are unlikely to account for why larger multinational corporations are less likely to operate in politically risky environments.

4.2 “First-mover advantage” mechanism

Firms that enter foreign markets early enjoy several important advantages. They can establish product leadership, secure scarce resources, and build relationships with key stakeholders before competitors arrive. Even when early entrants cannot completely deter subsequent entry, foreign markets have limited capacity before becoming saturated. Consequently, firms have incentives to enter the most attractive markets early. Over time, however, these markets become increasingly occupied by incumbent firms that have already established strong positions. Later entrants therefore face a progressively smaller set of available opportunities and may be forced to expand into less attractive and more politically risky—host-country environments.

I evaluate this mechanism using a combination of descriptive and regression-based analyses. If first-mover advantages help explain why larger firms are less likely to operate in politically risky countries, two observable implications should follow. First, as safer markets become progressively occupied, newly established foreign subsidiaries should, on average, be located in increasingly politically risky host countries over time, raising the overall average of subsidiary location's political risk in the sample. Second, because larger firms possess greater resources and internationalize earlier, they should account for a disproportionate share of foreign subsidiary incorporations in the earlier years of the sample period.

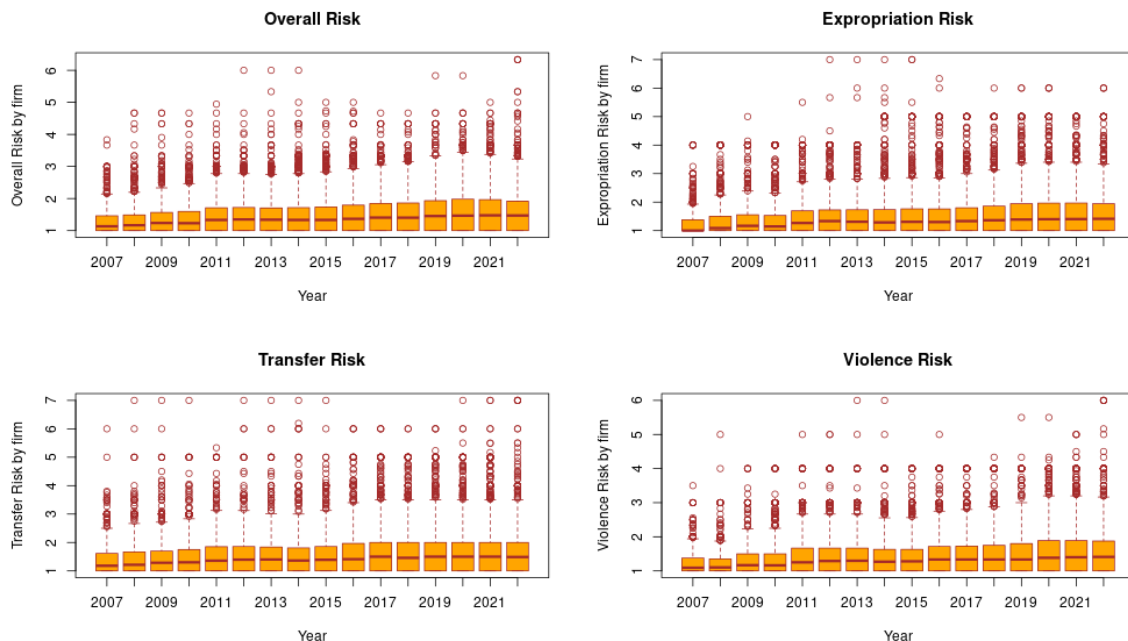


Figure 5: **Change in the average political risk of the foreign locations of US MNCs' subsidiaries for 2007-2022.** This figure shows an increase in the average level of political risk—measured using the 4 measures of political risk (Overall Risk, Expropriation Risk, Transfer Risk, Violence Risk).

4.2.1 Foreign subsidiaries become increasingly exposed to political risk over time

The first implication can be examined by tracing the average political risk of the host countries in which U.S. multinational corporations establish foreign subsidiaries between 2007 and 2022. If firms entering foreign markets later face fewer opportunities to invest in relatively safe countries, the level of political risk associated with new foreign subsidiaries should increase over time increasing the average level of political risk in the entire sample.

Figure 5 plots the average political risk of the host countries in which subsidiaries of publicly traded U.S. multinational corporations are located during the 2007–2022 period. Consistent with the first-mover advantage mechanism, the average level of political risk exhibits a gradual upward trend over time. Although the magnitude of the increase is modest, it is nonetheless meaningful because for the majority of parent firm-host country-year observations the outcome variable is either 0 or 1.

Table 5: Regression-based test of overall risk on year of subsidiary incorporation

DV: Overall Risk	
Year of Incorporation	0.032*** (0.0003)
Constant	-63.707*** (0.600)
Observations	966,088

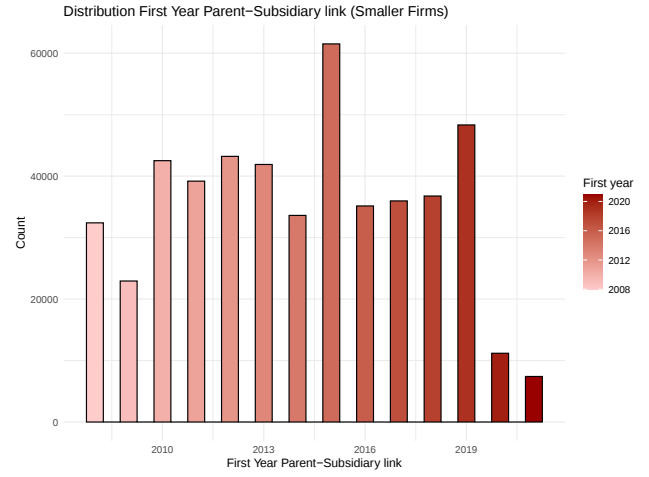
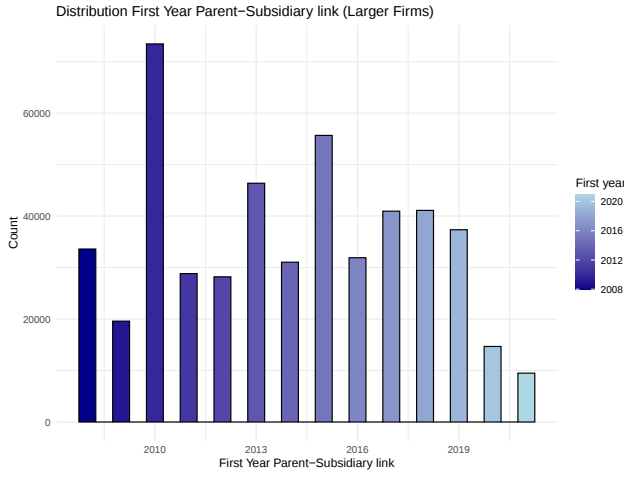
Notes: + . $p < 0.1$; * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$.

I also estimate a regression model in which Overall Risk is regressed on the year in which each foreign subsidiary was incorporated within the parent firm’s affiliate network (Table 5). The estimates indicate that subsidiaries incorporated in later years are systematically located in countries with higher levels of political risk. This finding is consistent with the expectation that firms entering foreign markets later increasingly expand into riskier host-country environments.

4.2.2 Larger firms internationalize earlier

A second implication of the first-mover mechanism is that larger firms should have established a greater share of their foreign subsidiaries earlier in the sample period than smaller firms. To evaluate this prediction, Figure 6 plots the distribution of subsidiary incorporation years separately for firms above and below the median firm size. As expected, the distribution for larger firms is concentrated in the earlier years of the sample, whereas the distribution for smaller firms is concentrated in later years. This pattern is consistent with the argument that larger firms entered foreign markets earlier and were therefore better positioned to secure attractive investment opportunities before markets became increasingly saturated.

Taken together, these findings are consistent with the “first-mover advantage” mechanism shaping multinational firms’ international expansion. The upward trend in the political risk of newly established foreign subsidiaries, together with the positive association between subsidiary incor-



(a) **Large MNCs.** Distribution of first year of incorporation for firms with annual revenue above the median.

(b) **Smaller MNCs.** Distribution of first year of incorporation for firms with annual revenue below the median.

Figure 6: **Distribution of first year of incorporation for multinational firms.** Larger MNCs tend to have incorporated earlier in the period 2007–2022, while smaller MNCs tend to have incorporated later.

poration year and host-country political risk, suggests that firms entering foreign markets later increasingly operate in less favorable environments. Moreover, the earlier international expansion of larger firms is consistent with the view that they were better positioned to secure access to safer and more attractive markets before those opportunities became increasingly limited. While these results do not constitute definitive evidence on their own, they provide meaningful support for the argument that sequential market entry and market saturation contribute to the relationship between firm size and political risk documented in the previous results.

4.3 “Ideal target” mechanism

Host-country governments and non-state actors may strategically target larger firms in order to seize valuable assets, restrict capital repatriation, or inflict damage on property and personnel. As noted above, governments that seek to attract foreign investment face an inherent trade-off: predatory actions such as expropriation, restrictions on capital flows, or contract violations can generate short-term gains, but they risk damaging the country’s reputation and deterring future investment. This logic implies that such behavior is more likely to occur when potential returns

are sufficiently high. If larger firms tend to undertake larger-scale investments, then they may be disproportionately attractive targets, making it strategically optimal for governments to focus predation on a smaller number of large firms rather than many smaller ones.

Empirically testing this mechanism is challenging. There is no comprehensive measure that captures the full spectrum of government predatory behavior. While outright expropriations are rare, more subtle forms of coercion and contract violations are difficult to observe systematically. Moreover, the absence of observed violations is inherently ambiguous: it may reflect a genuine absence of predatory intent, successful private bargaining between firms and governments, or firms' decisions not to challenge adverse actions (Johns and Wellhausen, 2016).

To provide suggestive evidence consistent with this mechanism, I draw on data from the World Bank Enterprise Surveys. The surveys ask respondents: "To what degree is political instability an obstacle to the current operations of this establishment?" Firms can choose among five responses ranging from "No obstacle" to "Very severe obstacle." The results are then aggregated into two categories: 0 for "Moderate Obstacle", "Minor Obstacle", "No Obstacle", and 100 for "Very Severe Obstacle" and "Major Obstacle". I then calculate the proportion of firms claiming that political instability is a very severe or a major obstacle to making business, and disaggregate the results by firm size.

Figure 7 presents the results. Across the three panels, which correspond to different dimensions of political risk (Expropriation, Transfer, and Political Violence), a consistent pattern emerges: in more politically risky environments, larger firms are more likely than smaller firms to report political instability as a major obstacle to doing business. This pattern is suggestive of greater sensitivity among larger firms to adverse political conditions. However, the Enterprise Surveys include firms with at least 10 percent foreign ownership, whereas this paper defines foreign subsidiaries as those with majority (greater than 50 percent) foreign ownership. As a result, the survey evidence cannot be directly mapped onto the main sample. It should therefore be interpreted as providing

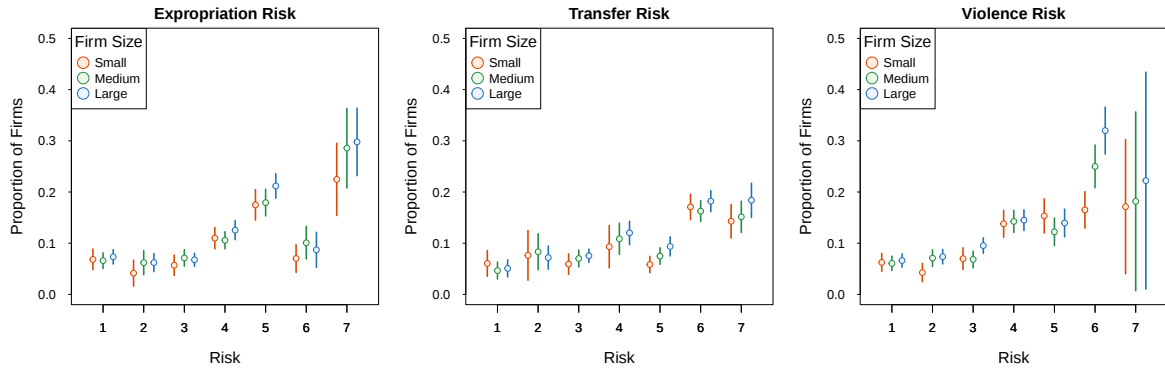


Figure 7: **Proportion of firms claiming that political instability is a very severe or major obstacle of doing business at different levels of firm size (small, medium, large).** These figures show that, as the political risk of the host country increases, larger firms are more likely to identify political instability as the main obstacle of making business.

only indirect and conservative evidence of the underlying mechanism.

Non-state actors may also engage in targeted attacks against corporate assets, and such actions may disproportionately affect larger firms. This may be because larger firms possess more valuable and visible assets, making them more attractive targets, or because attacks on prominent firms are more likely to generate media attention and thus maximize political visibility. In this sense, targeting large multinational corporations can serve as a mechanism for signaling grievances to domestic and international audiences (Simonelli and Osgood, 2024).

The Global Terrorism Database provides systematic data on terrorist attacks worldwide through 2020, including incidents targeting firms.³⁰ However, direct attacks on firms remain relatively rare in the data, limiting the ability to conduct systematic statistical analysis. As a result, this mechanism is best understood as suggestive and remains an important avenue for future research.

5 Conclusion

This paper develops a new theory explaining how multinational corporations (MNCs) choose the locations of their foreign subsidiaries, emphasizing how uncertainty, competition and endogenous targeting of firms by host country state and non-state actors shape firms' internationalization

³⁰<https://www.start.umd.edu/>

decisions. Crucially, I show how firm size plays a central role in moderating these dimensions. While prior research in economics and political science has separately highlighted the roles of host-country political risk and firm size in shaping FDI, it has largely overlooked how these two dimensions jointly structure which firms operate in politically risky environments. By focusing on their interaction, this study brings these scholarships into closer dialogue.

Contrary to conventional wisdom, I argue that larger firms may be less willing to operate in politically risky environments. Using an original large-scale dataset covering all U.S.-owned foreign subsidiaries from 2007–2022, combined with data on coups and free trade agreements, I present empirical evidence consistent with this claim and develop three distinct mechanisms. Larger firms may possess greater resources to search for and select more attractive investment locations, reducing the need to enter riskier markets. They may also benefit from first-mover advantages that allow them to secure leadership positions in desirable markets early on. Alternatively, their larger asset bases may make them more attractive targets for predatory behavior by host-country governments and non-state actors, thereby incentivizing avoidance of the riskiest environments. I provide empirical tests and descriptive evidence for these mechanisms, showing that the “search-cost” mechanism is not supported by the data, while the evidence is more consistent with the “first-mover advantage” and “ideal target” mechanisms.

This paper makes several contributions. First, it highlights the importance of firm-centered approaches for understanding MNC behavior. Second, it underscores uncertainty, competition, and strategic predation by host-country actors as key drivers of firms’ decisions regarding subsidiary expansion. Finally, it places firm size—an often underappreciated dimension—at the center of the theoretical framework, thereby bridging economic and political explanations of FDI location decisions.

The evidence provided in this paper suggests that future research should pay closer attention to the interaction between firm size and other sources of host-country political risk, such as corruption

or security concerns. In particular, understanding whether and how firm size conditions firms' exposure to different dimensions of political risk may help refine existing theories of multinational firm behavior and foreign direct investment.

Moreover, the theoretical framework developed here can be extended beyond traditional conceptions of political risk to incorporate other domains of uncertainty that shape firm behavior. In particular, environmental and climate change-related risks may generate similar strategic incentives for both firms and host-country actors, potentially reproducing patterns of uncertainty, inter-firm competition and selective targeting leading to heterogeneous firm responses. Exploring these extensions would help understand with even more nuance the complex interaction of firms and political actors, and further integrate economic, political, and environmental dimensions of international investment decisions.

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Supplementary Appendix

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A Panel Data description

A.1 Firm-level data from ORBIS Historical Data

I generated the panel dataset using Great Lakes, the University of Michigan HPC cluster. I accessed ORBIS Historical Data through the Kresge Library of the University of Michigan using the cluster. ORBIS Historical Data files are released twice a year (in June and December) and each release contains a snapshot of the entire ORBIS database. Financial information (such as operating revenue, number of employees etc) are available from 1995 to June 2023, ownership data is available from 2007 to June 2023. Data is released in structured sets of compressed tab-delimited TXT files.³¹ The version I used in this paper was the most recent version stored on the cluster at the time I accessed it (May-June 2024) and is the one released in June 2023.

Given the extremely large size of the files included in the snapshot, I selected only those tab-delimited TXT files containing the variables used in my regressions and subsetting them to include only the minimum amount of data necessary to generate the final dataset. The snapshot contains 3 folders: descriptive, financials and ownership. From the descriptive folder, I unzipped the files "BvD ID and Name", "Industry classifications" and "Legal info". The file "BvD ID and Name" connects the Bureau van Dijk (the company that owned Orbis prior to Moody's) id code with the names of the companies - the BvD ID code is the essential identifier to perform the many merges necessary to achieve the final dataset. The file "Industry classifications" provides the NAICS core code (4 digits) I used to apply industry fixed effects. The file "Legal info" allowed me to subset only publicly listed companies. From the financials folder, I unzipped only "Key financials USD". This file provides the following variables measured in USD: Closing date, Consolidation code, Filing type, Number of months, Source for publicly quoted companies, Operating revenue Turnover, Number of employees and year. From the ownership folder I unzipped each "links" file for each year starting from 2007 until 2023. The links files record the ownership structure of each subsidiary relative to its shareholders in each year. For each year, I created a list of all the companies defined as "GUO50", Global Ultimate Owner with ownership share of 50 percent or more, incorporated in the United States (their BvD ID starts with US) with subsidiaries located outside the United States.

I then merged each of the subsetting "links" files with the "legal" file to extract only publicly listed companies. I transformed the dataset so that it would record the number of subsidiaries each company owns in each country and I balanced the dataset with 0s for the countries where a company does not own any subsidiary. I repeat this procedure for each year using R with the exception of 2023 where R was not able to handle the extreme size of the dataset - in that case I used SQL. I then merged all years together to create the skeleton of the dataset. To this basic dataset, I joined the subsetting version of the previous files to include the NAICS code and all the financial variables needed to identify the size of the parent firm measured as operating revenue turnover. In order to have a unique value for each year, I set the following variables to the following values: "C1" for Consolidation code (C1 refers to the case where firms own at least 50 percent of a subsidiary and therefore choose to consolidate the financial statements), "Annual Report" for Filing type, "12" to Number of months, "10-k" for Source for publicly quoted companies. The US Securities and Exchange commission requires that each publicly traded company submits a 10-k form annually. However, companies can set their own financial year and the operating revenue reported in the 10-k form reflects the revenue at the closing date of their chosen financial year. For example, retailers such as Walmart tend to have a closing date of January 31 in order to take advantage of the holiday season. However, the vast majority of firms tend to have a closing date

³¹<https://kresgeguides.bus.umich.edu/az.php?q=Orbis>

at the end of December. In order to correctly assign operating revenue to a year when the closing date does not match the end of the calendar year, I recoded the year as follows: for closing dates before or on June 30, I assign the operating revenue to the year prior to the one in the closing date; for operating revenues with closing dates after June 30, I assign the operating revenue to the year of the closing date. In an handful of cases, this procedure creates errors if a company has a closing date that changes year by year around June 30. For cases, where this was clearly a coding issue, I recoded the year variable manually. For cases, where I could not understand the reasoning for the error, I dropped the firm - this was the case only for 5 companies.

Finally, I merged in the political risk variables by Credendo and the GDP and GDPpc (in current US dollars) data from the World Development Index. The final panel dataset has 10,364,480 rows. However, a third of the observations are lost, due to NAs in the firm-specific variables (closing date, consolidation code, filing type, Number of months, source for publicly quoted companies, original units, operating revenue turnover, number of employees).

A.2 Host country's political risk data from Credendo

In the context of foreign direct investment, Credendo provides ratings based on a qualitative and quantitative assessment for three types of risk: Expropriation Risk, Political Violence Risk and Currency Inconvertibility and Transfer Restriction Risk. According to the Credendo website³², the three variables are rated using the following criteria:

- "In order to assess the political violence risk, Credendo looks at the actual levels of internal violence in and external conflict with a country, but also at the conflict potential that arises from (lingering) internal and external tensions, frustration and dissatisfaction."
- "In order to assess the expropriation risk Credendo not only assesses the risk attached to expropriation as such, but also the functioning of legal institutions in the host country and the probability of a negative change in attitude towards foreign investments."
- "The assessment of the currency inconvertibility and transfer restriction risk is based on the same risk drivers as the assessment of political and assimilated risks related to medium-/long-term trade transactions."

In order to check whether all Political Risk variables could be included in the same regression, I generated the correlation matrix between each political risk variables plus the average (Overall Risk). As shown by this table, there is a high level of collinearity especially between Expropriation Risk and Transfer Risk, and between Expropriation Risk and Violence Risk. Therefore, it is not advisable to perform the regression including all three variables on the right hand side.

A.3 Controls

Data on GDP (current USD), GDP per capita (current USD), GDP per capita growth (annual percentage) come from the World Development Index.³³ The data on BITs comes from the US Department of State website and is identical to the data found on UNCTAD.³⁴ The polyarchy measure comes from V-Dem (v2x_polyarchy).

³²<https://credendo.com/en/credendos-country-risk-assessment>

³³<https://databank.worldbank.org/>

³⁴<https://www.state.gov/investment-affairs/bilateral-investment-treaties-and-related-agreements/united-states-bilateral-investment-treaties/>

Table A1: Correlation Matrix

	Overall Risk	Expropriation Risk	Transfer Risk
Overall Risk			
Expropriation Risk	0.95***		
Transfer Risk	0.93***	0.82***	
Violence Risk	0.92***	0.84***	0.70***

A.4 Descriptive statistics

Table A2: Descriptive statistics

Statistic	N	Mean	St. Dev.	Min	Max	NAs
Nr of subs	6,669,292	0.2	7.9	0	6,168	0
Parent revenue (bil)	6,669,292	4.8	20.9	0	611.3	0
Political Risk (avg.)	5,571,741	3.6	1.8	1.0	7	1,097,551
Expropriation Risk	5,571,741	3.4	1.9	1	7	1,097,551
Transfer Risk	6,508,374	4.3	2.1	1	7	160,918
Violence Risk	6,357,250	3.0	1.8	1	7	312,042
Nr of non-host	6,669,292	45.7	183.5	0	6,194	0
GDP (bil)	6,443,220	315.4	1,058.7	0.03	17,881.8	226,072
GDP per cap.	6,452,776	17,269.3	27,074.7	237.1	226,052	216,516
GDP per cap growth	6,400,438	1.6	5.8	-55.2	91.8	268,854
BIT	6,601,238	0.2	0.4	0	1	68,054
Polyarchy	5,403,091	0.5	0.3	0.01	0.9	925,931

A.5 Data for the Supplementary Analysis

The data on coups in Sub-Saharan Africa comes from Powell and Thyne (2011). I include all countries located south of the Sahara: Angola, Benin, Botswana, Burkina Faso, Burundi, Cabo Verde, Cameroon, Central Africa Republic, Chad, Comoros, Dem. Rep of Congo, Republic of

Congo, Cote d'Ivoire, Djibouti, Equatorial Guinea, Eritrea, Eswatini, Ethiopia, Gabon, Gambia, Ghana, Guinea, Kenya, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mauritius, Mozambique, Namibia, Niger, Rwanda, Sao Tome and Principe, Senegal, Seychelles, Sierra Leone, Somalia, South Africa, South Sudan, Sudan, Tanzania, Togo, Uganda, Zambia, Zimbabwe.

Data on FTAs comes from US Customs and Border Protection.³⁵

A.6 Data for the Mechanisms Testing

A.6.1 “Search costs” mechanism

Data on HRV Index The Hollyer, Rosendorff, and Vreeland (HRV) Transparency Index is a country-level measure of government transparency. It captures the extent to which governments publicly disseminate economic and social information.

The index is based on the number of key indicators that a country reports to international organizations, primarily the World Bank’s World Development Indicators database. The underlying idea is that governments that regularly publish a broader range of reliable statistics are more transparent because they make information about their economy and society more accessible to citizens, investors, and foreign firms.

The HRV index is constructed using an item response theory (IRT) model that aggregates information on whether countries report dozens of economic and social indicators. Higher values indicate greater transparency, reflecting more comprehensive and consistent statistical reporting, while lower values indicate more limited public disclosure.

In studies of international business, the HRV Transparency Index is commonly used as a proxy for a country’s information environment. Greater transparency reduces information asymmetries and search costs by making it easier for firms to obtain reliable information about market conditions, institutions, and economic performance. Consequently, foreign investors face less uncertainty when evaluating investment opportunities, and firms can make more informed location and expansion decisions.

A.6.2 “Ideal Target” mechanism

Data on Enterprise Surveys The World Bank Enterprise Surveys provide standardized firm-level data on the business environment across developing and emerging economies. The surveys collect information through face-to-face interviews with senior managers and business owners, using a harmonized questionnaire that facilitates cross-country comparisons. They gather detailed information on firm characteristics, including size, age, ownership structure, industry, and export orientation, as well as firm performance, such as employment, sales, and productivity. In addition, the surveys capture firms’ experiences with access to finance, infrastructure, regulatory compliance, corruption, crime, innovation, labor markets, and other aspects of the operating environment.

The Enterprise Surveys employ a stratified random sampling design to ensure that the sample is representative of the formal private sector within each country. Firms are typically stratified by industry, firm size, and geographic region, and the surveys generally cover manufacturing and service establishments with five or more employees. Because the questionnaires and sampling methodology are standardized across countries and survey rounds, the data are well suited for comparative analyses of how institutional and business environments influence firm behavior, investment decisions, productivity, and internationalization.

³⁵<https://www.cbp.gov/trade/trade-community/outreach-programs/trade-agreements/fta-ptl>

B Complete Regression Tables - Main Results

Table A3: The effect of political risk on the number of foreign subsidiaries at different levels of firm size measured as the annual parent firm revenue (logged).

DV: ln(Number of subsidiaries)	Type of political risk			
	Overall	Exprop.	Transfer	Violence
Political Risk	0.063*** (0.013)	0.053*** (0.012)	0.061*** (0.011)	0.052*** (0.0006)
ln Parent Revenue	0.013*** (0.003)	0.010*** (0.002)	0.015*** (0.003)	0.009*** (0.002)
Political Risk · ln Parent Revenue	-0.004*** (0.0007)	-0.003*** (0.0006)	-0.003*** (0.0006)	-0.003*** (0.0006)
ln Non-host Subsidiaries	0.053*** (0.007)	0.053*** (0.007)	0.051*** (0.007)	0.051*** (0.007)
ln GDP	-0.080*** (0.022)	-0.085*** (0.022)	-0.080*** (0.022)	-0.083*** (0.021)
ln GDP per capita	0.064** (0.022)	0.069*** (0.022)	0.066*** (0.021)	0.067*** (0.021)
GDP per capita growth	0.0002 (0.0001)	0.0002 (0.0001)	0.0002 (0.0001)	0.0002 (0.0001)
Democracy index	-0.037 (0.023)	-0.039 (0.024)	-0.039 (0.023)	-0.043* (0.023)
BIT	-0.015*** (0.004)	-0.017*** (0.003)	-0.012*** (0.003)	-0.013*** (0.003)
Observations	5,349,076	5,349,076	5,568,274	5,568,274
Firm characteristics	✓	✓	✓	✓
Host market characteristics	✓	✓	✓	✓
Industry fixed effects	✓	✓	✓	✓
Host country fixed effects	✓	✓	✓	✓
Year fixed effects	✓	✓	✓	✓

Notes: All models are linear probability models with interaction term with industry, country and year fixed effects and clustered standard errors. Industry, year and country fixed effects partial out unchanging industry, year and country factors. + * p < 0.1; ** p < 0.05; *** p < 0.01.

C Complete Regression Tables - inverse hyperbolic sine transformation

Table A4: The effect of political risk on the number of foreign subsidiaries at different levels of firm size measured as the annual parent firm revenue (inverse hyperbolic sine transformation).

DV: (Number of subsidiaries)	Type of political risk			
	Overall	Exprop.	Transfer	Violence
lhs Parent Revenue	0.016*** (0.003)	0.013*** (0.003)	0.018*** (0.003)	0.011*** (0.002)
Political Risk	0.079*** (0.016)	0.066*** (0.014)	0.076*** (0.015)	0.065*** (0.014)
Political Risk·lhs Parent Revenue	-0.004*** (0.0008)	-0.004*** (0.0007)	-0.004*** (0.0007)	-0.004*** (0.0007)
lhs Non-host Subsidiaries	0.057*** (0.008)	0.057*** (0.008)	0.054*** (0.008)	0.054*** (0.008)
lhs GDP	-0.101*** (0.027)	-0.106*** (0.027)	-0.100*** (0.027)	-0.103*** (0.026)
lhs GDP per capita	0.081** (0.028)	0.087*** (0.027)	0.083*** (0.026)	0.085*** (0.026)
GDP per capita growth	0.0002 (0.0002)	0.0002 (0.0002)	0.0002 (0.0002)	0.0002 (0.0002)
Democracy index	-0.048 (0.029)	-0.050 (0.029)	-0.050 (0.028)	-0.055* (0.029)
BIT	-0.019*** (0.005)	-0.022*** (0.004)	-0.015*** (0.003)	-0.016*** (0.004)
Observations	5,350,489	5,350,489	5,569,745	5,569,745
Firm characteristics	✓	✓	✓	✓
Host market characteristics	✓	✓	✓	✓
Industry fixed effects	✓	✓	✓	✓
Host Country fixed effects	✓	✓	✓	✓
Year fixed effects	✓	✓	✓	✓

Notes: All models are linear probability models with interaction term with industry, country and year fixed effects and clustered standard errors. Industry, year and country fixed effects partial out unchanging industry, year and country factors. + * p < 0.1; ** p < 0.05; *** p < 0.01.

D Supplementary results

D.1 List of Sub-Saharan countries

I include all countries located south of the Sahara: Angola, Benin, Botswana, Burkina Faso, Burundi, Cabo Verde, Cameroon, Central Africa Republic, Chad, Comoros, Dem. Rep of Congo, Republic of Congo, Cote d'Ivoire, Djibouti, Equatorial Guinea, Eritrea, Eswatini, Ethiopia, Gabon, Gambia, Ghana, Guinea, Kenya, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mauritius, Mozambique, Namibia, Niger, Rwanda, Sao Tome and Principe, Senegal, Seychelles, Sierra Leone, Somalia, South Africa, South Sudan, Sudan, Tanzania, Togo, Uganda, Zambia, Zimbabwe.

D.2 Coups

Table A5: The effect of a coup on the number of foreign subsidiaries at different levels of firm size measured as the annual parent firm revenue (logged) in Sub-Saharan countries.

	DV: ln(Number of subsidiaries)
ln Parent Revenue	-0.0001** (0.000)
Coup (Binary)	0.011* (0.005)
Coup (Binary) · ln Parent Revenue	-0.0006* (0.0003)
ln Non-host Subsidiaries	0.007** (0.003)
ln GDP	-0.018 (0.015)
ln GDP per capita	0.018 (0.013)
GDP per capita growth	0.000 (0.000)
Democracy index	-0.002 (0.004)
BIT	-0.002** (0.0007)
Observations	1,494,338
Firm characteristics	✓
Host market characteristics	✓
Industry fixed effects	✓
Host country fixed effects	✓
Year fixed effects	✓

Notes: All models are linear probability models with interaction term with industry, country and year fixed effects and clustered standard errors. Industry, year and country fixed effects partial out unchanging industry, year and country factors. + * p < 0.1; ** p < 0.05; *** p < 0.01.

E Robustness Checks

E.1 Number of employees

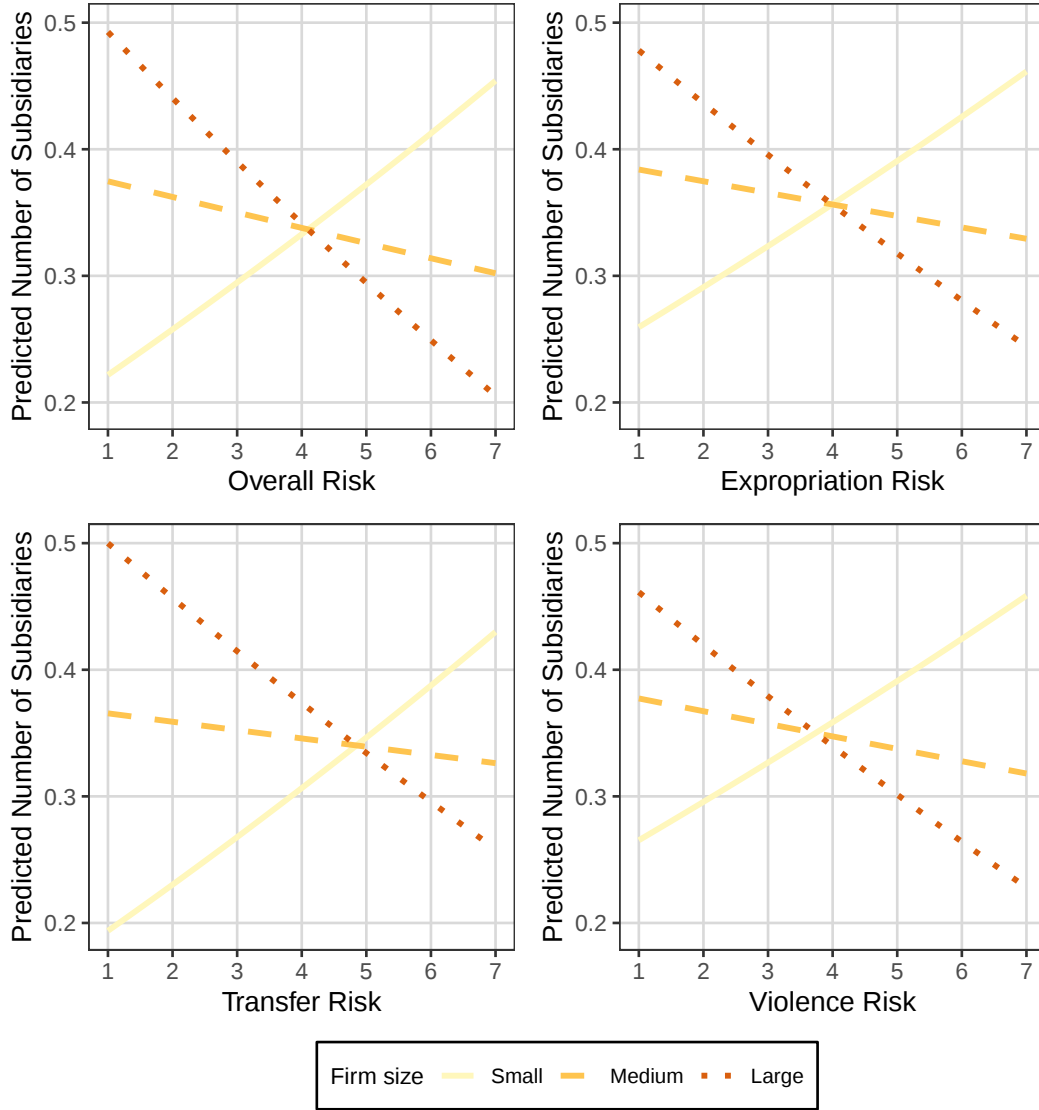


Figure A1: **Predicted number of subsidiaries by parent firm-host country-year as a function of political risk and firm size (annual number of employees logged).** This figure shows the conditional effect of different dimensions of political risk (Overall, Expropriation, Transfer, and Violence Risk) on the predicted number of subsidiaries by parent firm-host country-year for three levels of number of employees (Firm Size). The moderating variable (Firm Size) is set at the 20th percentile for “Small”, the 50th percentile for “Medium”, and the 80th percentile for “Large”.

Table A6: The effect of political risk on the number of foreign subsidiaries at different levels of firm size measured as the annual number of employees (logged).

DV: ln(Number of subsidiaries)	Type of political risk			
	Overall	Exprop.	Transfer	Violence
ln Nr Employees	0.058*** (0.010)	0.046*** (0.008)	0.062*** (0.010)	0.043*** (0.008)
Political Risk	0.097*** (0.017)	0.081*** (0.015)	0.092*** (0.015)	0.079*** (0.015)
Political Risk·ln Nr Employees	-0.014*** (0.002)	-0.012*** (0.002)	-0.013*** (0.002)	-0.011*** (0.002)
ln Non-host Subsidiaries	0.050*** (0.007)	0.050*** (0.007)	0.048*** (0.007)	0.048*** (0.007)
ln GDP	-0.081*** (0.023)	-0.086*** (0.024)	-0.082*** (0.023)	-0.084*** (0.022)
ln GDP per capita	0.063** (0.024)	0.069** (0.024)	0.066** (0.023)	0.066*** (0.022)
GDP per capita growth	0.0001 (0.0001)	0.0002 (0.0002)	0.0002 (0.0001)	0.0002 (0.0002)
Democracy index	-0.039 (0.025)	-0.043 (0.026)	-0.041 (0.025)	-0.047* (0.026)
BIT	-0.014*** (0.003)	-0.019*** (0.003)	-0.010*** (0.003)	-0.011*** (0.003)
Observations	4,642,229	4,642,229	4,833,535	4,833,535
Firm characteristics	✓	✓	✓	✓
Host market characteristics	✓	✓	✓	✓
Industry fixed effects	✓	✓	✓	✓
Host Country fixed effects	✓	✓	✓	✓
Year fixed effects	✓	✓	✓	✓

Notes: All models are linear probability models with interaction term with industry, country and year fixed effects and clustered standard errors. Industry, year and country fixed effects partial out unchanging industry, year and country factors. + * p < 0.1; ** p < 0.05; *** p < 0.01.

E.2 PRS Political Risk measure

A note of caution is warranted when comparing results based on PRS with those reported in the main analysis. PRS captures a broader range of political risk types and is therefore a more dispersed measure of political risk than the Credendo indicators, which focus on three specific dimensions of political risk. Consequently, differences in results may reflect differences in construction and conceptual focus rather than substantive contradictions. Furthermore, PRS data are available only from 2007 to 2015,³⁶ so regressions using PRS rely on roughly 1.9 to 2.2 million observations, compared to 5.4 to 6.2 million in the main analysis.

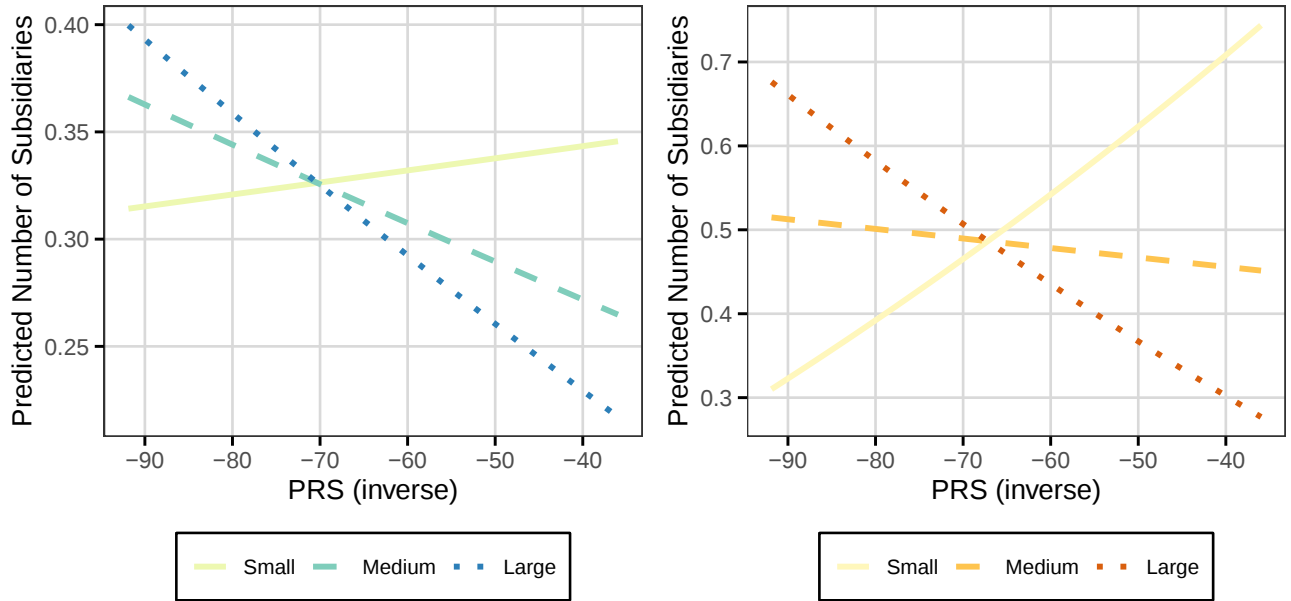


Figure A2: **Predicted number of subsidiaries by parent firm-host country-year as a function of political risk (PRS inverse) and two measures of firm size (annual Parent Revenue logged and annual Number of employees logged).** This figure shows the conditional effect of political risk (PRS inverse) on the predicted number of subsidiaries by parent firm-host country-year for three levels of annual parent revenue and annual number of employees (Firm Size). The moderating variable (Firm Size) is set at the 20th percentile for “Small”, the 50th percentile for “Medium”, and the 80th percentile for “Large”.

³⁶The University of Michigan library provides data through 2015; coverage up to 2023 is available for purchase.

Table A7: The effect of political risk on the number of foreign subsidiaries at different levels of firm size measured as the annual number of employees (logged).

DV: ln(Number of subsidiaries)	Type of firm size	
	ln Parent Revenue	ln Nr Employees
PRS (inverse)	0.011*** (0.002)	0.016*** (0.003)
Firm Size	-0.042*** (0.008)	-0.146*** (0.028)
PRS (inverse) · Firm Size	-0.0006*** (0.0001)	-0.002*** (0.0004)
ln GDP	-0.075*** (0.018)	-0.118*** (0.028)
ln GDP per capita	0.072** (0.024)	0.112*** (0.033)
ln Non-host Subsidiaries	0.060*** (0.009)	0.057*** (0.008)
GDP per capita growth	0.000 (0.0001)	0.0001 (0.0001)
Democracy index	-0.032**	-0.042**
Observations	2,181,196	1,895,747
Firm characteristics	✓	✓
Host market characteristics	✓	✓
Industry fixed effects	✓	✓
Host Country fixed effects	✓	✓
Year fixed effects	✓	✓

Notes: All models are linear probability models with interaction term with industry, country and year fixed effects and clustered standard errors. Industry, year and country fixed effects partial out unchanging industry, year and country factors. + * p < 0.1; ** p < 0.05; *** p < 0.01.

F Testing the mechanisms

F.1 Search costs

F.1.1 Transparency Index (HRV)

Table A8: The Moderating Role of Transparency in the Relationship Between Firm Size, Political Risk, and Foreign Subsidiary Expansion.

	DV: ln(Number of subsidiaries)
ln Parent Revenue	0.015*** (0.004)
Overall Risk	0.062*** (0.016)
Transparency Index	-0.012 (0.013)
Overall Risk · ln Parent Revenue	-0.004*** (0.0009)
Transparency · ln Parent Revenue	0.0003 (0.0006)
Overall Risk · Transparency	0.004 (0.003)
Overall Risk · ln Parent Revenue · Transparency	-0.0002 (0.0001)
ln GDP	-0.074* (0.036)
ln GDP per capita	0.059 (0.040)
ln Non-host Subsidiaries	0.060*** (0.009)
GDP per capita growth	8.61×10^{-5} (0.0001)
Democracy index	-0.019 (0.031)
BIT	-0.010** (0.004)
Observations	4,121,051
Firm characteristics	✓
Host market characteristics	✓
Industry fixed effects	✓
Host country fixed effects	✓
Year fixed effects	✓

Notes: All models are linear probability models with interaction term with industry, country and year fixed effects and clustered standard errors. Industry, year and country fixed effects partial out unchanging industry, year and country factors. + . p <0.1; * p <0.1; ** p <0.05; *** p <0.01.

G Sectoral-specific results: financial and non-financial firms; extractive and non extractive

The 25 US parent firms which own the highest number of foreign firms are predominantly financial institutions. I re-estimate the results subsetting the data into financial and non-financial firms. The trends are largely in line with those in the main regression table. We see that overall the drop in average number of subsidiaries per country is the strongest for the largest firms (95th percentile of firm size). However, in the case of financial firms the drop is more pronounced as their average number of subsidiaries by country in low-politically risky environments - overall risk of 1 - is higher and they are still present in the riskiest environments - overall risk of 7. Therefore, going from a political risk of 1 to 7, the drop for the largest firms in the financial sector is 3 subsidiaries while for non-financial firms the drop is only 1 as they go from owning 1 subsidiary on average per country to owning none. For medium firms the trend is similar but less pronounced, while for smaller firm there is no substantial change regardless as to whether they are financial firms or not. I also subset firms into extractive and non-extractive firms. The regression tables are presented in the Appendix. Again, we see that the drop in average number of subsidiaries per country is the most pronounced for the largest firms. However, for extractive firms, the drop is negligible in substantive terms, as they own on average close to 0 subs per country and an increase in political risk is associated with only a minimal change. This might be due to the fact that the choice of location of subsidiaries in extractive firms is limited due to geography and that firms who operate in this sector are forced to accept political risk in order to access those resources and therefore less reactive to political risk. For non-extractive firms we observe a similar trend as for non-financial firms.

Table A9: Financial firms. The effect of political risk on the number of foreign subsidiaries at different levels of firm size measured as the annual parent firm revenue (logged).

DV: log(Number of subsidiaries)	Type of political risk			
	Overall	Exprop.	Transfer	Violence
Political Risk	0.276*** (0.048)	0.237*** (0.043)	0.231*** (0.039)	0.196*** (0.037)
ln Parent Revenue	0.049*** (0.009)	0.038*** (0.008)	0.049*** (0.009)	0.028*** (0.006)
ln Parent Revenue · Political Risk	-0.014*** (0.002)	-0.012*** (0.002)	-0.011*** (0.002)	-0.010*** (0.002)
ln GDP	0.026 (0.028)	0.012 (0.027)	0.033 (0.026)	0.027 (0.026)
ln GDP per capita	-0.044 (0.030)	-0.027 (0.028)	-0.043 (0.027)	-0.038 (0.027)
ln Non-host Subsidiaries	0.064*** (0.008)	0.064*** (0.008)	0.058*** (0.007)	0.059*** (0.007)
BIT	-0.017*** (0.004)	-0.022*** (0.006)	-0.011*** (0.003)	-0.014*** (0.004)
Observations	128,563	128,563	148,276	146,060
Firm characteristics	✓	✓	✓	✓
Host market characteristics	✓	✓	✓	✓
Industry fixed effects	✓	✓	✓	✓
Host Country fixed effects	✓	✓	✓	✓
Year fixed effects	✓	✓	✓	✓

Notes: All models are linear probability models with interaction term with industry, country and year fixed effects and clustered standard errors. Industry, year and country fixed effects partial out unchanging industry, year and country factors. + * p < 0.1; ** p < 0.05; *** p < 0.01.

Table A10: Non-Financial firms. The effect of political risk on the number of foreign subsidiaries at different levels of firm size measured as the annual parent firm revenue (logged).

DV: log(Number of subsidiaries)	Type of political risk			
	Overall	Exprop.	Transfer	Violence
Political Risk	0.279*** (0.039)	0.230*** (0.036)	0.235*** (0.033)	0.189*** (0.032)
ln Parent Revenue	0.049*** (0.007)	0.038*** (0.006)	0.049*** (0.007)	0.028*** (0.005)
ln Parent Revenue · Political Risk	-0.013*** (0.002)	-0.011*** (0.002)	-0.011*** (0.002)	-0.009*** (0.002)
ln GDP	-0.073*** (0.023)	-0.075*** (0.022)	-0.051** (0.020)	-0.056*** (0.018)
ln GDP per capita	0.058** (0.023)	0.060** (0.021)	0.039* (0.019)	0.044** (0.018)
ln Non-host Subsidiaries	0.057*** (0.007)	0.057*** (0.007)	0.050*** (0.007)	0.051*** (0.007)
BIT	-0.019*** (0.004)	-0.021*** (0.005)	-0.015*** (0.003)	-0.016*** (0.003)
Observations	3,566,522	3,566,522	4,126,000	4,059,507
Firm characteristics	✓	✓	✓	✓
Host market characteristics	✓	✓	✓	✓
Industry fixed effects	✓	✓	✓	✓
Host Country fixed effects	✓	✓	✓	✓
Year fixed effects	✓	✓	✓	✓

Notes: All models are linear probability models with interaction term with industry, country and year fixed effects and clustered standard errors. Industry, year and country fixed effects partial out unchanging industry, year and country factors. + * p < 0.1; ** p < 0.05; *** p < 0.01.

Table A11: Extractive firms. The effect of political risk on the number of foreign subsidiaries at different levels of firm size measured as the annual parent firm revenue (logged).

DV: log(Number of subsidiaries)	Type of political risk			
	Overall	Exprop.	Transfer	Violence
Political Risk	0.089*** (0.024)	0.073*** (0.021)	0.075*** (0.020)	0.074*** (0.019)
ln Parent Revenue	0.016*** (0.005)	0.013*** (0.004)	0.017*** (0.005)	0.012*** (0.003)
ln Parent Revenue · Political Risk	-0.004*** (0.001)	-0.003*** (0.001)	-0.004*** (0.0009)	-0.004*** (0.0009)
ln GDP	0.014 (0.014)	0.014 (0.013)	0.020 (0.013)	0.022* (0.012)
ln GDP per capita	-0.025* (0.014)	-0.025* (0.013)	-0.029** (0.012)	-0.033** (0.012)
ln Non-host Subsidiaries	0.025*** (0.004)	0.025*** (0.004)	0.024*** (0.004)	0.025*** (0.004)
BIT	-0.008*** (0.002)	-0.006 (0.003)	-0.009*** (0.002)	-0.010*** (0.002)
Observations	128,833	128,833	149,253	146,715
Firm characteristics	✓	✓	✓	✓
Host market characteristics	✓	✓	✓	✓
Industry fixed effects	✓	✓	✓	✓
Host Country fixed effects	✓	✓	✓	✓
Year fixed effects	✓	✓	✓	✓

Notes: All models are linear probability models with interaction term with industry, country and year fixed effects and clustered standard errors. Industry, year and country fixed effects partial out unchanging industry, year and country factors. + * p < 0.1; ** p < 0.05; *** p < 0.01.

Table A12: Non-extractive firms. The effect of political risk on the number of foreign subsidiaries at different levels of firm size measured as the annual parent firm revenue (logged).

DV: log(Number of subsidiaries)	Type of political risk			
	Overall	Exprop.	Transfer	Violence
Political Risk	0.289*** (0.040)	0.238*** (0.037)	0.243*** (0.033)	0.196*** (0.033)
ln Parent Revenue	0.051*** (0.007)	0.040*** (0.006)	0.051*** (0.007)	0.029*** (0.005)
ln Parent Revenue · Political Risk	-0.014*** (0.002)	-0.011*** (0.002)	-0.011*** (0.002)	-0.009*** (0.002)
ln GDP	-0.071*** (0.023)	-0.073*** (0.022)	-0.050** (0.020)	-0.054*** (0.018)
ln GDP per capita	0.056** (0.022)	0.059** (0.021)	0.038* (0.019)	0.042** (0.018)
ln Non-host Subsidiaries	0.058*** (0.008)	0.058*** (0.008)	0.051*** (0.007)	0.052*** (0.007)
BIT	-0.020*** (0.004)	-0.021*** (0.005)	-0.015*** (0.003)	-0.016*** (0.003)
Observations	3,566,252	3,566,252	4,125,023	4,058,852
Firm characteristics	✓	✓	✓	✓
Host market characteristics	✓	✓	✓	✓
Industry fixed effects	✓	✓	✓	✓
Host Country fixed effects	✓	✓	✓	✓
Year fixed effects	✓	✓	✓	✓

Notes: All models are linear probability models with interaction term with industry, country and year fixed effects and clustered standard errors. Industry, year and country fixed effects partial out unchanging industry, year and country factors. + * p < 0.1; ** p < 0.05; *** p < 0.01.