RISK AND THE STRATEGY OF FOREIGN LOCATION CHOICE IN REGULATED INDUSTRIES

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We argue that firms in regulated industries react to macroeconomic and policy risks in sharply different ways. While they seek to avoid countries with high levels of macroeconomic uncertainty, we predict that they find it more attractive to expand into countries characterized by governments with discretionary policymaking capacities so as to be able to negotiate favorable conditions of entry. We also argue that firms are heterogeneous in their attitudes toward risk. We predict that firms in which the state holds a partial equity stake exhibit a more tolerant attitude. We also expect that as firms accumulate foreign experience, they develop an aversion toward further foreign entries into politically unstable markets. Support for these predictions is provided by an analysis of the Latin American market entries of all listed Spanish firms in regulated industries between 1987 and 2000. Copyright © 2008 John Wiley & Sons, Ltd.

INTRODUCTION

Firms seek to formulate strategies conducive to superior performance taking into account not only market but also political factors (Baron, 1995; Hillman and Hitt, 1999; Bonardi, Hillman, and Keim, 2005). Government policy is relevant to strategy formulation given its influence on the supply and demand of goods and services, which can be altered by a wide array of regulations including: product standards; production requirements; excise taxes; pricing guidelines; and entry and exit rules, to name but a few. While regulation has come to affect virtually every sector of the economy, the so-called 'regulated' industries (e.g., telecommunications, electricity, water, oil, gas, and banking)

are subject to an unusual degree of intervention and policy risk. In these industries, governments have the ability to dramatically alter the profitability of firms and investment projects (Henisz, 2000; Henisz and Zelner, 2001). Strategy scholars have long recognized that firms in such industries require specific theoretical and empirical analysis (Mahon and Murray, 1981; Reger, Duhaime, and Stimpert, 1992), especially when it comes to studying their patterns of international expansion and their exposure to regulatory risk in different countries (Bonardi, 2004; Delios and Henisz, 2003).

During the last two decades, the predicament of firms in regulated industries has changed substantially. Until the 1980s they enjoyed what can be described as a 'quiet life' (Hicks, 1935: 8) due to their oligopolistic and even monopolistic advantages stemming from regulation and/or technology. Over the last twenty years, however, globalization, deregulation, privatization and technical change have altered their domestic competitive environment in substantial ways. International expansion

has been a frequent response to these challenges, as firms sought to compensate falling margins in their deregulating home market by entering foreign markets where regulations kept margins at higher than competitive levels (Sarkar, Cavusgil, and Aluakh, 1999; Bonardi, 2004).

Firms in regulated industries face a significant strategic dilemma when expanding abroad. On the one hand, established theory and practice recommend following a gradual, staged model of international expansion so as to minimize risks and cope with uncertainty (Johanson and Vahlne, 1977; Chang, 1995; Rivoli and Salorio, 1996; Guillén, 2002; Vermeulen and Barkema, 2002), that is, to overcome the so-called liability of foreignness (Hymer, 1976; Zaheer, 1995). On the other, the regulated nature of these industries tends to require a strong commitment of resources and a fast pace of entry into foreign markets. This is the case for three interrelated reasons. First, these industries tend to be highly concentrated, and they often exhibit certain features of the 'natural monopoly.'[1] Second, entry may be restricted by the government, frequently under a system of licenses. And third, the government may own significant parts of the industry. Under these circumstances, foreign entrants face strong incentives to commit large amounts of resources and to establish operations quickly, whenever and wherever opportunities arise, and frequently via acquisition as opposed to greenfield investment (Sarkar *et al.*, 1999). Thus, the regulated and oligopolistic nature of these industries generates strong first-mover advantages (Doh, 2000; Knickerbocker, 1973).

Recent research in strategy argues that firms in regulated industries follow 'asymmetric strategies' in that they seek to defend their home-country position by preventing rivals from competing on a level playing field while pursuing entry into foreign markets as deregulation occurs. Given that deregulation has taken place at different moments in time and to different degrees from country to country, firms in regulated industries tend to follow a multidomestic strategy of foreign expansion, namely, they pick and choose which markets to enter depending on the specific circumstances

present in each foreign country, arranging their operations with a local rather than a global logic in mind, and engaging in limited cross-border coordination (Bonardi, 2004). Another distinctive feature of regulated industries is the role of the state as a shareholder. Some of the most active firms in regulated industries expanding abroad are former monopolies in which the state has or has had a controlling stake (Doh, Teegen, and Mudambi, 2004).

In the next section we develop a theory of the strategic choices facing companies as they sort out the effects of macroeconomic and policy risks on foreign location choice in the context of regulated industries. We build on Bonardi's (2004) insight that when expanding abroad, firms in regulated industries tend to follow a multidomestic strategy, negotiating separately for each market entry and arranging their operations as compartmentalized national organizations. We also examine the effect of firm heterogeneity in terms of state ownership and previous foreign experience, thus building on Holburn's (2001) argument that firms with strong political skills may prefer to expand into riskier countries in which they can exploit such a distinct capability. Our point of departure is the well-established observation in the strategy literature that firms in regulated (and concentrated) industries invest less in countries characterized by high macroeconomic and political risks (Henisz and Zelner, 2001; Delios and Henisz 2003). We test our predictions with data on the investment decisions of Spanish listed firms in regulated industries between 1987 and 2000.

THEORY AND HYPOTHESES

Established theory posits that the multinational enterprise (MNE) exists as a consequence of failures in the market for firm-specific competencies, whether technological or marketing related (Caves, 1996; Buckley and Casson, 1976; Hennart, 1982; Teece, 1977). A superficial analysis of the evidence would suggest that this theory is not applicable to the phenomenon of MNEs in regulated industries such as utilities or telecommunications due to the facts that they generally lack proprietary technology and that their marketing abilities have not been fully developed because they have enjoyed a position of market power in the home country. However, recent

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[1] A natural monopoly emerges when it is possible to exploit economies of scale over a very large range of output. As a result, the optimally efficient scale of production becomes a very high proportion of the total market demand for the product or service.

research shows that these firms also seek to replicate in foreign countries the same advantages enjoyed in the home country and the experience accumulated at running the business (Sarkar *et al.*, 1999; Guillén, 2005). For instance, they may invest abroad so as to exploit some valuable firm-specific resource like the ability to manage relationships with regulators and customers (Boddewyn and Brewer, 1994; Henisz, 2003; Bonardi, 2004; Henisz and Zelner, 2005), or the ability to execute projects efficiently and in due course (Amsden and Hikino, 1994). Therefore, even firms in regulated industries lacking technology and marketing know-how may expand abroad on the basis of other useful, firm-specific skills. In fact, the United Nations reports that foreign direct investment in regulated services now exceeds investment in primary or manufacturing activities, and that 28 of the world's largest 100 multinational corporations operate in regulated sectors such as telecommunications, electricity, oil, gas, or water (United Nations Conference on Trade and Development 2006: 266, 280–282).

Similarly, received theory concerning foreign location choice indicates that MNEs pick and choose where and when to exploit their proprietary advantages depending on location-specific opportunities and risks (Dunning, 1988; Rivoli and Salorio, 1996). Holding constant for the opportunities, the received wisdom is that MNEs seek to minimize the risks, entering macroeconomically and politically 'safe' countries and avoiding problematic ones (Henisz and Zelner, 2005; Henisz and Delios, 2001). Although international expansion always entails risks, regulated firms are unusually exposed because of both the large size of their investments and their dependence on the host country government for munificent regulations (Henisz and Zelner, 2001). Below we follow the extant literature in analyzing economic and policy risks separately, but we arrive at different predictions. We also consider the moderating effect of state ownership on the foreign investing firm's response to economic and policy risks in the host country, given the fact that many firms in regulated industries are wholly or partly owned by the state. Finally, we argue that over time firms develop an experiential aversion toward countries characterized by high policy risk, adjusting their subsequent market entry decisions.

Macroeconomic uncertainty and foreign expansion

The literature on foreign expansion decisions highlights that firms prefer to enter markets with low levels of macroeconomic uncertainty, especially those undertaking horizontal, that is, market-seeking, investments (Dunning, 1993). The reason is that if the firm sets up operations in the foreign country in order to service the local market, unexpected variations in gross domestic product (GDP) growth rates and other macroeconomic magnitudes will make it more difficult for the firm to plan and to manage its foreign market entries. Most foreign market entries by firms in regulated industries tend to be horizontal in nature, for they are undertaken as a necessary condition to be able to sell in the local market.

A specialized branch of the literature on international investment decisions known as the hysteresis hypothesis shows that when faced by uncertainty in the economic environment the best strategy is to *wait and see* (Dixit, 1989, 1992). Building on this insight, Rivoli and Salorio (1996) argue that even firms with valuable assets and useful knowledge may postpone investments in countries characterized by economic uncertainty. Having such valuable knowledge, these firms can delay the investment because of the monopoly they have over it. Although not entirely conclusive, there is some empirical evidence showing that firms tend to avoid investing in countries with high economic uncertainty, especially if the size of the investment is large (Campa, 1993). Given that regulated industries usually entail large initial capital outlays (Sarkar *et al.*, 1999), we expect that firms will tend to avoid countries with high macroeconomic uncertainty. Several executives of the Spanish companies included in our sample for analysis are on record arguing that they prefer to avoid countries with macroeconomic uncertainty (Ontiveros, Conthe, and Nogueira, 2004: 19).[2] Thus, we predict that:

Hypothesis 1: Macroeconomic uncertainty in the host country discourages entry by foreign firms.

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[2] See also Manuel Pizarro Moreno, president of the Association of Spanish Savings Banks, *Diario de Sesiones del Senado: Comisión de Asuntos Iberoamericanos* (subsequently, *Diario*) **186**, 17 October 2001, 20.

Policy stability, host government discretion and foreign expansion

Although much of the literature dealing with country risk has traditionally analyzed financial and economic variables, for example, foreign exchange volatility or macroeconomic uncertainty (Click, 2005), during the last decade empirical research has turned to analyzing the impact of host governments on foreign market entry decisions. The concept of 'policy instability' refers to the likelihood that the government might change the rules of the game in a way that adversely affects the interests of the foreign entrant. In general, firms prefer the government to be credibly committed to a set of policies and rules, because that reduces the risk of investing (Murtha and Lenway, 1994; Murtha, 1991; Henisz, 2000; Holburn, 2001; Henisz and Zelner, 2005). The literature also points out that governments are more credible in their commitment when their actions are constrained by institutional checks and balances that make unilateral changes to regulations less likely. The key insight is that when the executive branch of government is not constrained in its decision making by other branches or institutions within the host country (e.g., the legislature or the judiciary) there is a greater possibility of negatively affecting the performance of foreign firms (Knack and Keefer, 1995). The chain of reasoning thus starts with the observation of the fact that governments differ in the extent to which they enjoy discretion in decision making, which in turn reduces the credibility of their commitments and ultimately increases the degree of policy instability affecting foreign firms. Institutionally constrained governments are more credible, thus reducing uncertainty in the eyes of the foreign direct investor (Murtha and Lenway, 1994; Henisz, 2000; Henisz and Williamson, 1999). Previous research using data on manufacturing firms has demonstrated that firms prefer to avoid countries with high levels of policy instability (e.g., Henisz and Delios 2001).

Although policy instability potentially affects firms in any industry, its influence is especially relevant in the case of regulated sectors (Sarkar *et al.*, 1999). Host governments can introduce general policy changes of an economic or fiscal nature. More specifically, governments can affect prices and investment incentives in industries in which they have the authority to regulate such matters, or

can expropriate the assets of firms. For these reasons, firms operating in regulated industries will tend to minimize the risk they are assuming by entering only countries where the stability of policymaking inspires enough confidence in them to commit to an investment.

Several of the top executives of the Spanish firms included in our sample for analysis have over the years emphasized that they prefer to operate in host countries in which the executive branch of government, which regulates their activities, is subject to legislative and judicial controls, that is, where there is, in their own words, 'political stability' (Ontiveros *et al.*, 2004: 4). For instance, in hearings at the Spanish Senate, the president of Endesa, the world's eighth largest electrical utility and a major investor in Latin America, equated 'certainty' with 'the rule of law' and with an 'impeccable institutional functioning.' 'Most of our difficulties in Latin America have had to do with regulatory uncertainty.'[3] Top executives of Gas Natural and electrical utilities Iberdrola and Unión Fenosa clearly indicated in their own writings that their companies prefer low regulatory risk (Brufau Niubó, 2002; Azagra Blázquez, 2002; Prieto Iglesias, 2002). In a prominent example, the Bolivia country manager for Repsol-YPF, the world's ninth largest oil company, explained that government plans to change existing investment rules for companies operating in the country were 'confiscatory' in that firms like his own had entered assuming certain conditions (*International Gas Report*, 24 September 2004). Given foreign direct investors' preference for policy stability, we predict:

> *Hypothesis 2a: Policy instability due to a lack of institutional constraints on the executive branch of government in the host country discourages entry by foreign firms.*

Recent research on the international expansion of firms in regulated industries, however, challenges the notion that countries with high levels of policy instability are unattractive to foreign firms. Companies in regulated industries tend to pursue 'asymmetric' strategies (Bonardi, 2004). On the one hand, they seek to protect their market position in the home market through political influence,

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[3] Rodolfo Martín Villa, president of Endesa, *Diario* **155**, 26 June 2001, 33.

that is, they employ a defensive political strategy. On the other hand, they wish to enter foreign markets, though only if they can obtain special treatment relative to their competitors, that is, they employ an aggressive political strategy of entry into foreign countries. Moreover, governments around the world have allowed foreign entry at different points in time, and often under vastly different operating conditions. Holburn (2001) demonstrated that in the electricity generation industry, firms prefer to enter foreign countries in which the competitive regime—ranging from monopsony to competitive—matches the type of regime in which the company has operation experience.

As a result of these circumstances, foreign firms in regulated industries tend to adopt a multidomestic, one-country-at-a-time approach to foreign expansion (Bonardi, 2004). As the top executive of Telefónica, one of the world's top four telecommunications firms once put it, 'in this company we always say that we are not a multinational firm, but rather a multidomestic company, and the message conveyed to each executive is precisely this one: we are a company deeply rooted in each of the countries in which we operate.'[4] An asymmetric strategy works best if the foreign entrant negotiates directly with the host country government and obtains preferential treatment, something that can be more easily accomplished if the executive branch is not constrained by the veto power of the other branches, that is, when policy discretion is high. Research has documented that technological or marketing skills are not as important in regulated industries as the ability to deal with governments and regulators (Henisz, 2003; Henisz and Zelner, 2005; Lyles and Steensma, 1996).

The paradox of these asymmetric strategies is that while the foreign firm would prefer a constrained executive branch during the operational phase of the investment, that is, a government or regulator that cannot easily change the rules of the game (as reflected in the above statements by the company executives), at the time of entry the foreign firm prefers to deal with a politically unconstrained executive branch in the host country so as to obtain preferential treatment.

Not surprisingly, Spanish MNEs in regulated industries seem to value direct access to host governments, especially institutionally unconstrained

ones. For instance, the president of Agbar—one of the world's largest multinational water utilities—candidly shared with senators during a hearing that 'another surprise we came across in South America was that authorities are much more approachable than in Spain or Europe. I can tell you that in [Latin American] countries similar to Spain in terms of population, one finds it easier to meet with a cabinet minister; it is even easier to change the appointment time. This is not as easy in Spain, and it is likely not easy either in France or Germany.'[5]

In addition to the advantages of negotiating special treatment with an institutionally unconstrained government, managers of regulated firms also point out that privatization processes—which offer opportunities for foreigners to enter foreign markets—are less likely to occur when the executive branch is subject to the checks and balances of the other branches. For instance, the president of electrical utility Endesa suggested that, although during the operative phase of its foreign investments his company preferred governments with little discretion (as predicted by Hypothesis 2a above), the reverse was true during the time leading up to initial entry: 'The other big opportunity [besides Brazil] lies in Mexico, but [. . .] the privatization of Mexican firms requires a constitutional amendment [. . .] We shall see whether during the upcoming official visit of the [Spanish] Head of Government to Mexico we receive some signals regarding this issue, although I do not think it will happen immediately.'[6] Executives at Repsol-YPF made the same point concerning the possibility of privatizations in the oil industry (*Corporate Mexico*, 22 October 2004). In the case of Mexico, the need for a constitutional amendment if any privatization in the electricity or oil industry is to be undertaken places a key check and balance on the decision-making discretion of the executive branch of government, thus reducing the chances that a foreign firm might be able to enter the country or to obtain preferential treatment.

The corollary to the preceding arguments is that firms in regulated industries would prefer to expand throughout the world with a global strategy in mind, but the different moments and ways

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[4] César Alierta, president, Telefónica, *Diario* **155**, 26 June 2001, 21.

[5] Ricardo Fornesa Ribó, president and CEO of Aguas de Barcelona, *Diario* **148**, 12 June 2001, 3.
[6] Rodolfo Martín Villa, president of Endesa, *Diario* **155,** 26 June 2001, 32. At the time of writing, Mexico had not yet privatized electricity.

in which governments make it possible for them to enter and to operate require a country-by-country negotiation and strategy. As a result, the managers of firms in regulated industries have a preference for striking deals that offer them a political advantage, both in terms of gaining entry into the country and in terms of operating conditions. They see the advantages of dealing with an institutionally unconstrained executive who can help them gain entry under favorable conditions, notwithstanding the possibility that the rules of the game might change precisely because the executive is not subject to checks and balances. In their calculation, the benefits of preferential entry under munificent conditions exceed the potential costs or damages that might occur if the executive unilaterally changes operating conditions such as prices, regulations concerning new entrants, investment requirements, and so on, after the firm has entered. Hence, we argue that in regulated industries, institutionally constrained executive governments are not in the best interest of firms at the time of negotiating entry. Rather, when it comes to making the strategic choice of which foreign market to enter, a firm in a regulated industry will prefer countries in which the government is free from institutional constraints and enjoys policymaking discretion so that it can obtain favorable regulatory treatment:

Hypothesis 2b: In regulated industries, policy-making discretion due to a lack of institutional constraints on the executive branch of government in the host country encourages entry by foreign firms.

State ownership and policy risk

Although macroeconomic uncertainty and policy instability affect all potential entrants, firms are heterogeneous in their attitudes toward risk, that is, they exhibit different levels of tolerance. Social influences and organizational control systems condition the way in which decision makers perceive and take risks (Sitkin and Pablo, 1992). A key characteristic of firms in regulated industries is whether they are state owned or not. A large body of literature indicates that state-owned enterprises (SOEs) exhibit a different propensity to take risks. Compared to publicly listed firms, SOEs are not subject to the discipline of the stock market. Moreover, they can borrow money on better terms because the state is ultimately responsible for their

finances. Many countries around the world historically adopted the practice of using the state's budget to fund the investments of SOEs and to cover their (frequent) losses. As a result of their lack of accountability and the backing of the state, SOEs have traditionally tended to be less efficient than publicly listed companies and more willing to take risks (see Meggison and Netter, 2001, for a review of the empirical literature).

State ownership is also associated with inferior operating and financial performance because managers must pursue not only purely economic goals but also political ones, and there is no specific principal or owner in charge of monitoring (Sheshinski and López-Calva, 2003). Managers of wholly state-owned firms can rest assured that their financial underperformance relative to other comparable firms will not endanger their tenure as long as they successfully pursue the other goals imposed on them by the state.

Our analysis of the attitudes toward risk of the managers of SOEs focuses on the framing of the foreign market entry decision. We borrow from prospect theory (Kahneman and Tversky, 1979; Wiseman and Gomez-Mejia, 1998), which posits that behavior toward risk changes with the framing of the situation. When it comes to international expansion, we argue that firms *partially* owned by the state have a different attitude toward risk than firms wholly owned by the state or than fully privatized firms. The managers of firms wholly owned by the state and not undergoing a privatization process tend to have little interest in restructuring, investing abroad, or introducing radical strategic changes (Cuervo and Villalonga, 2000; Zhara *et al.*, 2000). They have little to gain from such actions and much to lose: their position in the domestic market seems assured, and they must pursue political in addition to financial goals.

As a firm owned by the state undergoes partial privatization, its incumbent managers are confronted with a different type of situation. The literature documents that the new shareholders tend to push SOE managers to adopt more aggressive strategies in order to improve financial performance, especially if some of the equity becomes publicly listed (Zhara *et al.*, 2000; Gupta, 2005; Roland and Sekkat, 2000). As a result, the incumbent management team members may fear losing their jobs if they do not deliver better results. In

fact, privatization processes, even partial ones, frequently bring about the replacement of incumbent managers (Cuervo and Villalonga, 2000), and in some countries as many as half of former SOE managers fail to get a job in the private sector subsequent to their dismissal (Gupta, 2005). This situation ends once the firm becomes fully privatized as the incentives managers face are the same as for publicly listed companies (Cuervo and Villalonga, 2000).

Our argument is that the incumbent managers of a partially privatized SOE tend to frame the situation confronting them in a different way than the managers of firms fully owned by the state or than those of fully privatized firms. They face the possibility of an important loss—being fired by the incoming shareholders. According to prospect theory, people are much less risk averse when it comes to minimizing or avoiding losses than when they seek to lock in gains (Kahneman and Tversky, 1979). In a situation of partial privatization, incumbent managers will downplay the risks of major strategic changes (including foreign expansion) in order to play to the interests of new shareholders and thus minimize the probability of losing their jobs. Recent theoretical and empirical research on privatization shows that managers prepare themselves for privatization by restructuring their companies, and that partially privatized firms invest more in fixed assets (Roland and Sekkat, 2000). Our prediction is that the managers of partially privatized SOEs will perceive the risks associated with macroeconomic uncertainty and policy instability in the foreign countries that they might potentially enter as being lower or more easily tractable than the managers of either firms fully owned by the state or firms in which the state holds no equity. Therefore, we formulate:

Hypothesis 3: Compared to other types of firms, companies partially owned by the state are willing to expose themselves to greater macroeconomic uncertainty and policy instability in foreign countries.

Experiential learning and policy risk

Firms are also heterogeneous in their strategic approach to foreign market entry because of their different previous experiences of expansion. Experiential learning leads firms to adjust their strategies as they accumulate new facts and perspectives. Companies acquire knowledge from experience, record it in their memories, and change their strategies based on the new knowledge, especially if performance falls short of expectations or they encounter unanticipated problems (Cyert and March 1963; Levitt and March 1988; March and Olsen 1976). Such processes of organizational learning have been documented in the case of strategic decision making concerning foreign market entry (e.g., Barkema, Bell, and Pennings, 1996; Chang 1995; Holburn, 2001 Delios and Henisz 2003). Thus, past experience in the form of the outcomes of previous decisions can change the firm's subsequent strategy (March, 1988) as well as its attitudes toward risk taking, as predicted by prospect theory (Sitkin and Pablo, 1992). Specifically, the negative feedback from past risky decisions reduces the propensity to take new risks, as the empirical work of Sitkin and Weingart (1995) has demonstrated. In the electricity industry, Holburn (2001) found evidence of experiential learning.

As noted above, firms in regulated industries may prefer to negotiate terms of entry with a government that possesses unconstrained, discretionary decision-making abilities. However, after entering the market, the firm would prefer the government to be institutionally constrained so that it cannot unilaterally change or seek to renegotiate the terms of the investment. If the firm has entered a country lacking institutional constraints on discretionary policymaking, it will experience policy changes or reversals adverse to its interests more frequently or with greater likelihood than in the case where the constraints are present.

Adverse policy changes or reversals frequently take place in the wake of some economic or political crisis. In Argentina, for example, Spanish, French, and Italian companies in regulated industries saw their rates cut and the value of their investments sink as the government sought to cope with the effects of the sovereign default and currency devaluation of early 2002. The companies had signed contracts with a previous president during the early and mid-1990s, which were simply brushed aside by the executive in the wake of the crisis. Similarly, Brazilian and Spanish companies operating in the Bolivian gas and banking sectors had entered the country during the 1990s under a given set of assumptions that subsequent presidents sought to renegotiate or unilaterally change.

Spanish firms in electricity and telecommunications suffered from changing regulations and tax provisions imposed by the new Peruvian president elected in 2001, years after they had first entered the country. For instance, in the wake of the Peruvian government's unilateral decision to slash rates by 10 percent in 2004, the head of Telefónica's local subsidiary noted that 'we trust the regulator will reconsider its decision so that we can continue with our planned investments and persuade our shareholders that investing in Latin America is worthwhile' (*Expansión*, 12 August 2004). As a result of these incidents, the companies affected fought for their contractual rights, first in courts of arbitration and, later, of law. While the events unfolded, they put investments on hold not only in the country in which they were threatened but also in others, especially risky ones. In fact, a recent survey conducted on a sample of managers of Spanish regulated firms with extensive experience in Latin America reflected the widely shared view that policy instability was an important obstacle to their operations (Ontiveros *et al.*, 2004: 4).

We argue that, as firms gain international experience and compare the post-entry performance of investments in countries with different levels of policy instability, they become more reluctant to enter countries that are politically unstable. To the extent that experiential learning takes place, firms will update their decision-making criteria for foreign market entry, lowering their tolerance of policy risk. As time passes, experiential learning based on the less-than-expected performance of operations in risky environments—as compared to policy-stable countries—is likely to lead to changes in risk attitudes and, as a consequence, in foreign market entry strategy. Thus, companies update their foreign market entry strategies and, specifically, their propensity to enter policy unstable countries in response to the problems that tend to emerge from operating there. Given that firms are heterogeneous in terms of their previous experience with foreign entry, we predict that:

> *Hypothesis 4: As firms accumulate experience in foreign countries, they develop an aversion toward further foreign entries into policy unstable countries.*

EMPIRICAL SETTING, DATA, AND METHOD

Empirical setting

We focus our analysis on the Latin American market entries by Spanish listed companies in banking, electricity, water, oil and gas, and telecommunications. Most of these firms are among the biggest in the world in their respective industries. For instance, the largest Spanish telecommunications (Telefónica), electricity (Endesa, Iberdrola) and oil (Repsol) companies are among the top 12 within their respective industries as ranked in the Fortune Global 500 list, and the biggest Spanish banks (BBVA, Santander) among the top 25. Most of the foreign market entries of these companies have taken place in Latin America, due to a variety of cultural, economic, and timing factors (Guillén, 2005). This empirical setting provides an excellent opportunity for studying the impact of risk aversion in regulated industries, for the following reasons. First, Spanish firms in regulated industries have been among the largest foreign direct investors in the world. Overall, Spain ranks as the tenth largest foreign direct investor (United Nations Conference on Trade and Development, 2006: 303). Second, prior to the late 1980s, foreign direct investments made by these firms were negligible due to the inward-looking character of the Spanish economy, making it possible to avoid left-censoring problems altogether. Third, these industries have undergone a rapid process of deregulation starting in the late 1980s. Firms reacted to this change by pursuing foreign opportunities, especially in Latin America. Thus, Spanish firms in these industries tried to replicate in Latin America the same advantages that they had once enjoyed in the home country (Guillén, 2005). Finally, Latin American countries differ substantially in terms of the economic and political risks that they pose to foreign firms.

Data

Given that we seek to predict the occurrence of firm entries into specific foreign countries, the unit of observation is the firm-country-year. We took into consideration the foreign entries into a Latin American country undertaken by the 25 Spanish publicly listed firms in banking, electricity, water, oil and gas, and telecommunications that were

included in the Madrid Stock Exchange's General Index during the second half of the eighties. First, we followed the U.S. Bureau of Economic Analysis (2004) in considering a foreign direct investment as any acquisition of 10 percent or more of a foreign business enterprise. In addition, in our sample we only considered entries that entailed the effective involvement of the firm in the management of a regulated service in a Latin American country. As a consequence, marketing agreements, unsuccessful bidding attempts, financial investments without any involvement in the management of a local firm and, in the specific case of banks, the opening of investment banking branches or representative offices were not considered. Some of the entering firms in our sample were formerly wholly owned by the state, although by 1990 all of them where privatized, at least in part, and listed on the Madrid Stock Market (Vergés, 1999). Most of the foreign market entries conducted by the firms in our sample were acquisitions of controlling stakes in existing companies, frequently as the result of privatization. We compiled information on each entry that occurred between the beginning of 1987 and the end of 2000. If in a given firm-country-year combination no entry occurred, our dependent variable was coded as 0. Otherwise, it was coded as a nonnegative integer, depending on the number of investments that took place, given that firms often made several acquisitions and/or established several companies in the same country, sometimes within the same year.

Our main source of information was the Prensa Baratz and MyNews press databases. These databases include all of the news published in all Spanish newspapers. Specifically, we introduced iteratively the name of each Latin American country, the name of each company, and the terms 'investment,' 'subsidiary,' 'joint venture,' or 'acquisition.' We also searched each company's annual reports and Web pages. We identified 247 entries into Latin American countries during the period under consideration, whose distribution by company is shown in Table 1 and by country in the Appendix.

Our independent variables were constructed as follows. First, we calculated macroeconomic uncertainty following Servén's (1998) methodology for measuring unexpected changes in the rate of growth of the economy, calculated as the natural logarithm of the conditional variance of nominal GDP growth in a given year fitted by using the

Table 1. Entries by Spanish firms in Latin America, 1987–2000

Industry/firm	Number of entries
Banking	**101**
Argentaria (formerly Banco Exterior de España, BEX)	6
Banesto	4
BBVA (formerly Banco de Bilbao)	36
Banco Central Hispanoamericano (formerly Banco Central)	13
Banco de Fomento	0
Banco Hispano Americano	0
Bankinter	0
Banco Pastor	0
Banco Popular Español	0
BSCH (formerly Banco Santander)	42
Banco de Vizcaya	0
Banco Herrero	0
Banco Zaragozano.	0
Water	**13**
Aguas de Barcelona (Agbar)	13
Electricity	**59**
Hidrocantábrico	2
Endesa	17
Fuerzas Eléctricas de Cataluña (Fecsa)	0
Hidroeléctrica Española (Hidrola)	0
Iberdrola (formerly Iberduero)	17
Compañía Sevillana de Electricidad	0
Unión Fenosa	23
Petroleum and gas	**40**
CEPSA	2
Gas Natural	7
Repsol	31
Telecommunications	**34**
Telefónica	34
Total number of entries	**247**

information on GDP growth until that year, which is known to executives at companies.[7] According to this measure, Nicaragua had the highest level of macroeconomic uncertainty, 3.57 in 1990, compared to −0.28 for Chile in the same year (the sample mean is 0.06 and the standard deviation 0.87). Second, we measured policy instability

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[7] Specifically, we used Servén's (1998) GARCH(1,1) model, originally suggested by Bollerslev (1986):

$$y_{it} = \alpha_1 t + \beta_1 y_{i,t-1} + \varepsilon_t; t = 1, \ldots, T;$$
$$\sigma_t^2 = \gamma_{i,0} + \gamma_{i,1} \varepsilon_{i,t-1}^2 + \delta_i \sigma_{i,t-1}^2$$

with y_{it} being GDP of country i during year t, σ_t^2 denoting the variance of ε_t conditional on the information up to year t, which is estimated separately for each country.

using Henisz's (2000) POLCON V index of political constraints, which ranges between 0 (no constraints on the executive branch's power to introduce policy changes) and 1 (full constraints). We subtracted the constraints index from unity in order to use it as a measure of policy instability or governmental policymaking discretion free from institutional constraints. Both macroeconomic uncertainty and policy instability were lagged one year in all analyses.

Third, we measured partial state ownership as a dummy variable taking a value of 1 if the state held a stake in the equity of the company as of the end of the previous year, and 0 otherwise. The information to build this variable was obtained from Vergés (1999). Finally, we measured each firm's experience in Latin America through a counter for the number of previous entries into Latin American countries made by the company as of the end of the previous year.

In addition to firm, host-country, industry and year fixed effects, we also used a series of time-varying control variables. At the firm level, we controlled for the entering firm's Tobin's q ratio[8] and for inflation-adjusted total sales. At the country level, all regressions include: GDP in constant 1995 dollars to account for the size of the host country's economy; the GDP growth rate to control for the business cycle; total inward foreign direct investment flows as a percentage of GDP to control for the overall attractiveness of the country to foreign firms; and imports plus exports as a percentage of GDP to account for openness to trade. These variables were obtained from the World Bank. We also included a time-varying dummy to indicate whether the country had initiated the process of implementing market-oriented reforms, including privatization and deregulation. The information to build this variable was obtained from Lora (2000) and from various press reports. All of these control variables were lagged one year.

Method

The dependent variable is the count of entries in each unique firm-country-year combination, which is nonnegative, integer-valued, overdispersed, and longitudinal. When the outcome variable is nonnegative and integer-valued, Poisson regression is more appropriate than ordinary least squares. To adjust for overdispersion, we used the negative binomial model, a generalization of the Poisson model in which the assumption of equal mean and variance is relaxed (Hausman *et al.*, 1984; Cameron and Trivedi, 1998). Finally, we dealt with the longitudinal character of the data with firm fixed effects. Missing data on one or more of the independent variables reduced the effective sample for analysis to 3,780 firm-country-year observations. The fixed-effects sample includes 22 potential host countries in which the firm could potentially enter and spans 14 years. We use the fixed-effects specification of Hausman, Hall, and Griliches (1984), which includes a time-invariant variance-to-mean ratio for each firm (Allison and Waterman, 2002). We entered industry and year dummies as separate regressors. Due to the fixed-effects specification of our models, the number of firms in our sample fell from 25 to 14, those that entered at least one country in Latin America during the period of study. Results without the fixed effects exhibited patterns of significance similar to those reported below.

Table 2 presents the descriptive statistics and the correlation matrix. Given the high correlation between the interaction terms calculated to test the last hypothesis and the main effects, we mean-centered the relevant continuous variables (policy instability and macroeconomic uncertainty) before calculating the interactions. Following established practice, the dichotomous main effects (partial state ownership) and the counter of previous entries were not centered (Jaccard and Turrisi, 2003).

RESULTS

Table 3 reports the results from negative binomial regressions using four different specifications: control variables only, main effects added (Hypotheses 1 and 2), hypothesized interaction effects for partial public ownership added (Hypothesis 3), and hypothesized interaction effects for experience in foreign countries added (Hypothesis 4). The results are consistent across specifications.

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[8] We include Tobin's q as an additional control for firm heterogeneity. Tobin's q proxies the firm's intangible assets (e.g., Berry 2006) and investment opportunities (e.g., Carow, Heron, and Saxton, 2004). Tobin's q ratio was calculated as of the 31st of December of each year, and entered in the regression with a one-year lag. We followed Chung and Pruitt's (1994) procedure.

Table 2. Sample descriptive statistics and correlations (N = 4,198 firm-country-years, 14 firms, 22 countries, 1987–2000)

Variable	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1 Number of entries in firm-country-year	0.06	0.30	1														
2 Macroeconomic uncertainty	0.06	0.87	0.03†	1													
3 Policy instability	−0.04	0.24	−0.06***	−0.08***	1												
4 Partial state ownership	0.23	0.42	0.01	0.01	0.02	1											
5 Macroeconomic uncertainty × Partial state ownership	0.02	0.43	0.04*	0.49***	−0.03†	0.08***	1										
6 Policy instability × Partial state ownership	−0.01	0.12	−0.03*	−0.03†	0.49***	−0.09***	−0.07***	1									
7 Previous firm entries in Latin America	4.61	7.34	0.19***	−0.07***	−0.17***	−0.08***	−0.02	−0.04**	1								
8 Policy instability × Previous firm entries in Latin America	−0.47	1.84	−0.12***	−0.09***	0.48***	0.05*	−0.03	0.19***	−0.46***	1							
9 Firm Tobin's q	3.19	10.14	−0.04*	0.03†	0.05*	0.32***	0.06***	0.05**	−0.12***	0.05**	1						
10 Firm sales	44 056.94	41 920.10	0.15***	−0.05***	−0.09***	0.18***	−0.01	−0.05*	0.64***	−0.27***	−0.11***	1					
11 Market reforms initiated	0.83	0.37	0.09***	−0.01	−0.32***	−0.01	0.00	−0.15***	0.23***	−0.16***	−0.08***	0.16***	1				
12 Host country's GDP[a]	0.72	1.52	0.17***	0.09***	−0.22***	−0.01	0.04*	−0.11***	0.04*	−0.09***	−0.01	0.02	0.15***	1			
13 Host country's GDP growth	3.03	4.11	0.08***	−0.05*	−0.14***	0.02	−0.03†	−0.08***	0.02	−0.08***	−0.03†	0.02	0.22***	−0.03	1		
14 Host country's inward FDI	2.72	3.99	0.05**	−0.03†	−0.21***	−0.06***	0.00	−0.06***	0.25***	−0.24***	−0.06***	0.14***	0.23***	−0.09***	0.24***	1	
15 Host country's trade openness	62.77	40.15	−0.11***	0.04*	0.02	−0.01	0.02	0.03	0.06**	−0.07***	−0.02	0.03*	0.10***	−0.38***	0.10***	0.54***	1

*** p < 0.001 ** p < 0.01
* p < 0.05 † p < 0.10
[a] Mean and std. dev. divided by 100,000,000,000.

Table 3.   Firm fixed-effects negative binomial regressions predicting foreign market entries

Hypothesis		Model 1	Model 2	Model 3	Model 4
Macroeconomic uncertainty	H1 (−)		−1.099	−1.307	−1.392
			(3.74)***	(4.10)***	(4.44)***
Policy instability	H2a (−)		2.060	1.624	2.451
	H2b (+)		(2.41)*	(1.74)†	(2.42)*
Partial State ownership		0.922	0.965	0.902	0.831
		(2.71)**	(2.92)**	(2.65)**	(2.40)*
Macroeconomic uncertainty × Partial State ownership	H3 (+)			0.452	0.561
				(1.89)†	(2.19)*
Policy instability × Partial State Ownership	H3 (+)			1.834	1.252
				(2.23)*	(1.59)
Previous firm entries in Latin America		−0.051	−0.052	−0.052	−0.091
		(2.44)*	(2.40)*	(2.40)*	(3.53)***
Policy instability × Previous firm entries in Latin America	H4 (−)				−0.206
					(3.49)***
Firm Tobin's q		−0.079	−0.079	−0.080	−0.076
		(1.00)	(0.79)	(0.83)	(0.82)
Firm sales[a]		11.6	12.4	12.3	11.9
		(3.30)**	(3.39)**	(3.16)**	(3.26)**
Market reforms initiated		0.771	−0.056	0.008	0.072
		(0.78)	(0.05)	(0.01)	(0.06)
Host country's GDP[b]		−0.260	−0.151	−0.150	−0.208
		(5.46)***	(3.58)***	(3.55)***	(4.67)***
Host country's GDP growth		0.057	0.010	0.012	0.026
		(2.70)**	(0.44)	(0.49)	(1.11)
Host country's inward FDI		0.035	0.019	0.008	−0.049
		(0.80)	(0.40)	(0.17)	(0.92)
Host country's trade openness		0.026	0.020	0.021	0.050
		(1.76)†	(1.33)	(1.30)	(3.28)**
Constant		13.162	13.211	12.812	15.199
		(3.58)**	(3.76)**	(3.27)**	(4.27)**
Number of observations		3780	3780	3780	3780
Log likelihood		−615.28	−584.15	−581.29	−585.14

Notes: z-scores shown in parentheses beneath regression coefficients.
*** $p < 0.001$ ** $p < 0.01$ * $p < 0.05$ † $p < 0.10$
[a] Coefficient multiplied by 1,000,000.
[b] Coefficient multiplied by 1,000,000,000,000.
All regressions include firm in addition to industry, host-country and year fixed effects.

The prediction that firms undertake fewer entries as macroeconomic uncertainty increases (Hypothesis 1) receives support. Firms pursue more entries, not less, as political checks and balances decrease (in support of Hypothesis 2b and in contradiction of 2a), indicating that firms see their chances and conditions of entry improve as a result of the presence of an institutionally unconstrained executive branch enjoying policymaking discretion.

We find some support for Hypothesis 3 in that firms partially owned by the state pursue more entries as macroeconomic uncertainty and policy instability increase, although the significance of the latter interaction effect in the fourth model

falls below the 0.1 level (p = 0.112).[9] However, as compared to other firms, companies partly owned by the state have a higher propensity to enter

[9] Given that Tobin's q cannot be calculated for SOEs in those years in which they were fully owned by the state and hence not publicly listed, we also estimated Model 4 excluding Tobin's q and including a dummy variable valued 1 if the state owned 100 percent of the equity of the company the year prior to the investment. We also added interaction terms between this variable and our measures of policy and macroeconomic instability. Neither of these variables was significant while the results regarding the other independent variables did not change. Thus, according to our hypothesis, firms undergoing a privatization process have an attitude toward risk that is different from that of firms wholly owned by the state and of publicly listed companies.

into Latin American countries, given that the main effect of partial state ownership is a significant predictor.[10] We also find support for Hypothesis 4, as our results show that each new foreign market entry accumulated in Latin America reduces the initial positive attitude toward entering policy unstable countries. In fact, after firms that are not partially owned by the state accumulate 12 entries (11.9 based on the estimates from Model 4), increases in policy instability discourage entry by foreign firms because the net effect of policy instability becomes negative. Given that the main effect of the counter for the number of previous entries in Latin America is negative and significant, each new entry reduces the occurrence of subsequent entries. Concerning control variables, only firm size[11] and GDP are significant in all regressions.

The effects are not only statistically significant and robust to changing specifications but also large in magnitude. Using the fixed-effects coefficient estimates from the fully specified model in Table 3 (Model 4), a one-half standard deviation increase in macroeconomic uncertainty would lead to a 45.4 percent *decrease* in the number of foreign entries by a firm that is not partially owned by the state ($\{\exp[-1.392 \times 0.87 \times 0.5]-1\} \times 100$). The effect of policy instability (or policymaking discretion) needs to be calculated at different levels of the number of previous entries, given that the interaction term is included in Model 4. After one entry, firms that are not partially owned by the state invest 30.9 percent more in response to a one-half standard deviation increase in policy instability. As mentioned above, the magnitude of this effect falls as the number of previous entries increases, and it becomes negative after the eleventh entry. In the case of a firm with 15 previous entries, for instance, a one-half standard deviation increase in policy instability leads to a 7.4 percent *reduction* in the number of subsequent entries. Finally, firms partially owned by the state undertake 30.3 percent fewer entries as a result of a one-half standard

deviation increase in macroeconomic uncertainty, compared to a decrease of 45.4 for other types of firms, as noted above.

DISCUSSION AND CONCLUSION

Our empirical results indicate that firms operating in regulated industries respond to the presence of risks in foreign locations in different ways depending on the nature of the risk and their own characteristics. Specifically, the firms in our sample exhibited different attitudes toward different types of risk. They were definitely averse to macroeconomic uncertainty, like firms from other industries. However, they displayed a preference to enter countries with discretionary governments, most likely because they place more value on the advantages that can be obtained at entry than on the possibility that the government changes the rules of the game subsequent to committing the investment. Our results show that this preference is higher during the first stages of their internationalization process, becoming increasingly lower as firms gain experience in foreign countries. Moreover, firms partially owned by the state behaved in a less risk-averse way than other types of firms in that they entered foreign markets more frequently as macroeconomic uncertainty or policy instability increased.

This empirical evidence is fully consistent with a view of firms in regulated industries emphasizing their need to deal effectively with the local government (Lyles and Steensma, 1996) and to pursue asymmetric strategies (Bonardi, 2004). Our results are also consistent with Holburn's (2001) evidence on the electricity generating industry in that firms with strong political capabilities exhibit a preference for political risk. Moreover, our results parallel Holburn's in that firms adjust their preference as they accumulate investment experience of their own. We found experience to reduce the preference for risk, while Holburn (2001) found this effect only when the experience was in competitive markets, finding a positive effect for experience in monopsony markets.

What is also remarkable about our empirical findings is the fact that our results regarding the preference for countries with discretionary governments are not sensitive to the various industries included. We ran all regressions after excluding

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[10] We also estimated each model in Table 3 with a continuous measure for state ownership instead of the dummy variable partial state ownership. The same hypotheses received support. We prefer to report results with the dummy variable because conceptually it is important to compare different types of firms as defined by discreet categories, and empirically it facilitates the interpretation of the interaction terms.

[11] We also ran models using the number of employees as an alternative measure of firm size. Although the number of employees did not reach significance, the same hypotheses were supported.

from the sample one industry at a time (e.g., banking, water, oil, telecommunications, etc.). The pattern of results reported above did not change.

A cynical reading of our empirical results would be that firms in regulated industries prefer governments with discretionary power because it is easier to lobby or to bribe them. Recent research indicates that there is some evidence for this effect (e.g., Banerjee, Oetzel, and Ranganathan, 2006). Firms in any industry, and especially in regulated ones, value having direct access to government officials and being able to come to agreements with them without the interference of other political players such as the legislature or the judiciary, which might veto the government's decisions. Our results cannot rule out this alternative explanation. Managers of partially privatized firms could well be more willing to engage in backstage deals in order to obtain better financial returns even in situations in which they expose themselves and their companies to a higher risk of subsequent policy reversal. One possible way of reconciling this possibility with our theoretical framework is to argue that managers factor into their decisions the benefits and the costs of dealing with institutionally unconstrained executive branches of government, including the advantages of privileged entry conditions and the associated higher probability of future policy reversals. Whatever the case may be, our results confirm the argument that, when expanding abroad, firms operating in regulated industries exploit their knowledge and skills in dealing with governments and regulators. Although these firms usually lack technological or marketing capabilities, they know how to deal with governments and how to operate in a regulated context (Henisz, 2003). For this reason, policy instability is not a barrier impossible to overcome for these firms. An illustration of this argument comes from Telefónica's negotiations with the Argentine government during 2005, which the company pursued aggressively in order to ensure that regulatory conditions would not adversely change its interests as a new Law of Public Utilities and a revised Law of Telecommunications were being drafted (*Expansión*, 27 August 2005). Policy instability, thus, cannot be considered as being totally exogenous. In fact, policy instability can be an advantage in some situations, as the case of Digicel in Haiti shows. Haiti's regulator, Conatel, found Digicel—an Irish mobile operator—to be in violation of international standards, but was overruled by the government, who argued that Digicel was making the market more affordable for Haiti's poor majority (*Economist*, 2007).

Another important finding is that as firms gain foreign experience, their tolerance for policy risk decreases, as shown by the results on the interaction between experience and policy instability. While firms prefer policy unstable countries at the beginning of their international expansion process, they become more conservative as they accumulate experience. Although we formulate our hypothesis in terms of the impact of previous experience on the propensity to take risks (Sitkin and Weingart, 1995), an alternative explanation for this result could be that profitable investments in policy unstable countries are limited in number. In other words, not all of the countries with discretionary governments are equally attractive to foreign firms because they cannot manage the relationship with the same ease and skill. Thus, although some firms may have what can be called 'political capabilities' (Holburn, 2001; Henisz, 2003), these skills may be country-specific or, even worse, government-specific, so they can only be exploited in specific countries and during specific periods of time. In fact, when reestimating Model 4 in Table 3 counting previous entries in countries with policy instability levels higher than the average (instead of the counter for total previous entries), we found once again that both this counter and the interaction effect between it and policy instability were negative, a result that is fully consistent with this explanation. From this perspective, firms would first enter these countries with approachable, yet risky, governments, and subsequently realize that it is actually better to operate in more stable countries. Experiential learning thus reduces the initial attractiveness of countries with discretionary governments.

A question that may arise is to what extent the result of the interaction between policy instability and previous firm entries in Latin America could be confounded with a time factor, that is, a period effect. After some Spanish firms had painful experiences in some Latin American countries during the second half of the 1990s (see Ontiveros *et al.*, 2004), other firms may have changed their attitude toward countries with approachable but unconstrained governments. To sort out this issue we ran several additional models including an interaction term between policy instability and a dummy

variable indicating the time period after the mid-1990s. We used four different cutoff years, namely, 1994, 1995, 1996, and 1997. This additional interaction term failed to reach significance when added to Model 4, while the interaction between policy instability and firm experience remained negative and significant. Thus, no time factor seems to be confounding the experience effect.

Our study is limited in several respects. We analyzed a specific context: foreign market entries undertaken by Spanish regulated firms in Latin America. Although we have a detailed dataset including all of the foreign entries of these firms, our results may not be entirely generalizable to regulated firms from other home countries investing in other host regions. In addition, this article has not taken into account information regarding entry mode, that is, whether the entering firm was the only investor or not. Delios and Henisz (2000) show how firms adapt the percent equity ownership of their foreign operations to deal with policy risks. Finally, we have analyzed the decision to enter a foreign market without studying subsequent performance and its effects on further entries. The rapid expansion of Spanish firms in Latin America during the last decade has allowed us to obtain very rich data to analyze the relationships among risk, imitation, and the location of investment. However, this rapid international growth may have had negative consequences for some of these firms, as time compression diseconomies may emerge when the firm has a fast foreign expansion pace (Vermeulen and Barkema, 2002). It seems, therefore, that further research using data from other industries and countries, and taking into account entry mode and performance, could shed more light into these controversial issues.

Despite these limitations, our theoretical and empirical analysis advances the existing literature in two key ways. First, we propose a novel theoretical approach that distinguishes between the mechanisms prompting companies in regulated industries to avoid macroeconomic uncertainty and those inviting them to tolerate policy instability as long as they can negotiate entry on privileged terms with governments that enjoy discretionary decision-making power. Thus, this article contributes an important qualification to existing theories of the impact of risk on foreign market entry decisions, showing that policy risk is not exogenous to the firm's international strategy, but rather a factor that can be somewhat managed by the firm.

This first contribution also highlights the importance for firms to develop a political strategy in addition to a market one, at least in the case of firms operating in regulated industries.

The article's second contribution is the prediction and finding that firms are heterogeneous in their attitudes toward risks in foreign countries. Our empirical evidence lends some support to the idea that partial state ownership moderates perceptions of risk, increasing tolerance for governmental discretion and macroeconomic uncertainty in the host country. In addition, firms reduce their preference for entering countries ruled by governments with discretionary decision-making power as they accumulate experience, suggesting that a learning process takes place. These findings offer a more nuanced explanation of the effects of economic uncertainty and policy instability on the foreign entry decisions of firms in regulated industries, going beyond the conventional argument that less risk is always preferable.

Behind this heterogeneity lies the fact that firms can develop political capabilities (Holburn, 2001; Henisz, 2003), that is, skills that enable some companies to obtain better conditions from host governments and regulators. These capabilities might well help bridge the existing gap between the fields of political strategy and international business strategy. Exactly how such political capabilities can be developed and exploited over time is a research question that falls beyond the scope of this article, but one that surely invites further research. Our study also suggests that the value of these capabilities seems to decay over time and/or that they are country specific. In sum, our research implies that companies in regulated industries can create and sustain a competitive advantage by developing political capabilities that are neither country nor government specific.

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APPENDIX: ENTRIES BY SPANISH FIRMS IN LATIN AMERICA, BY COUNTRY, 1987–2000

	Argentaria	Banesto	BBVA	BCH	BSCH	Agbar	HC	Endesa	Iberdrola	Unión Fenosa	CEPSA	Gas Natural	Repsol	Telefónica	TOTAL
Argentina	1	1	5	2	6	5		4	2	2		2	11	13	54
Bolivia	3		1	1					2	1					8
Brazil			3		5	3		1	6		1	1	2	4	20
Chile		2	4	3	8	1		4	3				1	6	33
Colombia					4	1		2	2	2		2	3	1	21
Costa Rica										1					2
Cuba	1					2									3
Dominican Republic				1				1		3					5
Ecuador													3		3
Guatemala									1	2				1	4
Mexico		1	10	4	6		2		1	5		2	2	4	37
Nicaragua										2					2
Panama			1							4	1				6
Peru			4	1	5			4					5	1	20
Puerto Rico			4		4									2	10
El Salvador			1											1	2
Trinidad and Tobago													2		2
Uruguay	1			1	2	1				1			1		7
Venezuela			3		2			1					1	1	8
TOTAL	6	4	36	13	42	13	2	17	17	23	2	7	31	34	247