The Political Driver of Emerging Multinationals: Evidence from Brazil

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Expanded Abstract:
Much of the literature on internationalization does not take into account the role of the home country and the exchange of firms with politicians. Different from the host country perspective, the home country viewpoint attempts to comprehend the relevance of politics in the environment where the firm is originally located. Baysinger (1984) argues that the concern of firms for controlling their political environment mainly relates to their interest in defending their private interests, maintaining an established position or administering the public decisions that could impact the firm. In the home country perspective, research has found both, positive and negative reasons, for companies engaging into internationalization, that derive from the influence of politics. On the negative side, Caves points that items such as high taxes, could influence international investment (Caves, 1996), companies may also engage in business abroad to scape specific local policies (Dunning 1996) or they could be escaping a high level of corruption. On the other end companies may expand because of an existing alignment between a foreign entity and the company's strategy or due to a favorable relationship between home country and host country (Blumepritt, 2003; Johanson, 1977). We argue in this paper that nurturing political connections with the home country government is an important driver of internationalization. We use a sample of Brazilian firms to test our propositions. Brazil is a major player in today's global economy. According to America Economia, four Brazilian firms are among the top 10 Multilatinas. More important, the context of Brazil provides a natural laboratory to isolate the effect of political connections. We measured whether connected firms to an election were more likely to show greater levels of internationalization after the election. We fitted two models to take into account the internationalization decision and the internationalization levels. We also used a series of control variables and robustness checks to account for possible confounding effects. We find strong indications for our propositions that political connection is highly associated to both whether a firm decide to go international and the speed at which this internationalization occurs. Our results shed some light into the extent to which existing theories internationalization explains the phenomenon of emerging multinationals. Market-based theories consider the role of the home country as merely a regulator or a corrupt force that pushes domestic firms abroad. We show that firms act as a political actor to seek home country institutional support to reinforce their international position.

1. Introduction

Much of the literature on internationalization does not take into account the role of the home country and the exchange of firms with politicians. Different from the host country perspective, the home country viewpoint attempts to comprehend the relevance of politics in the environment where the firm is originally located. Baysinger (1984) argues that the concern of firms for controlling their political environment mainly relates to their interest in defending their private interests, maintaining an established position or administering the public decisions that could impact the firm.

In the home country perspective, research has found both, positive and negative reasons, for companies engaging into internationalization, that derive from the influence of politics. On the negative side, Caves points that items such as high taxes, could influence international investment (Caves, 1996), companies may also engage in business abroad to scape specific local policies (Dunning 1996) or they could be escaping a high level of corruption. On the other end companies may expand because of an existing alignment between a foreign entity and the company's strategy or due to a favorable relationship between home country and host country (Blumepritt, 2003; Johanson, 1977).

We argue in this paper that nurturing political connections with the home country government is an important driver of internationalization. We use a sample of Brazilian firms to test our propositions. Brazil is a major player in today's global economy. According to America Economia, four Brazilian firms are among the top 10 Multilatinas. More important, the context of Brazil provides a natural laboratory to isolate the effect of political connections. We measured whether connected firms to an election were more likely to show greater levels of internationalization after the election. We fitted two models to take into account the internationalization decision and the internationalization levels. We also used a series of control variables to account for possible confounding effects. We find strong indications for our propositions that political connection is highly associated to both whether a firm decide to go international and the speed at which this internationalization occurs.

2. Theories of internationalization

The rise of the Dutch East India Company in 1602 marked the establishment of the first modern Multinational Enterprise generating a new wave of interest for scholars studying the factors that lead to the growth expansion of firms. The earliest effort in describing the reasons for internationalization can be found in the work of Adam Smith who focused on describing the reasons that lead countries to engage in the importation and exportation cycles (Morgan & Katsikeas, 1997). Following Adam Smith, David Ricardo developed his theory of comparative cost advantage, explaining the mutually beneficial gains in trade relations, even when only one of the countries involved holds an advantage in the production of the two exchanged products (Ruffin, 2002).

In the last 100 years, research has moved beyond the analysis of country trade advantages into unraveling the industry and firm level reasoning behind the internationalization process. One of the pioneers of these efforts was Raymond Vernon, the proponent of the life cycle theory. In his work Vernon aimed at explaining the different maturation stages that a product experiences and how such evolution foretells opportunities for internationalization (Morgan & Katsikeas, 1997). In his framework, Vernon explains the expansion of an MNE predicting that the mastering of the production cycle allows for a product to be manufactured in the country that offers the best cost-advantage (Vernon 1966).

Despite his work being published in 1960, the leading research circle would not treat the ideas of Stephen Hymer until late 1960s (Dunning, 2005). Hymer was the first researcher to question the reasons for MNEs to engage in FDI as opposed to using other indirect methods for engaging in international activities abroad (Pitelis, 2007). According to Hymer, there are specific circumstances that lead to the decision of ownership of a foreign subsidiary including the firm's leading role in a particular activity, the need to eliminate competition and the search for risk diversification (Hymer, 1960). His later work also provided new insights regarding the relationships between MNEs, governments, states and labor, calling into question the loss of sovereignty over the presence of the MNE and the government's role as legitimizer and stabilizer.

In the 1970s a group of Swedish scholars best known as the Uppsala Group, directed the creation of an internationalization research project contemplating Swedish companies. This venture generated a number of new proposals under the internationalization scope as results revealed the degree to which smaller firms, were too, subject to internationalization, the existence of companies that from the beginning had internationalization as a business purpose, the fact that companies develop a learning ability to deal with the complexities of internationalization and the relevance of psychic distance between territories as a determinant to choose where to move first (Johanson, 1977). This psychic distance, one of the key outcomes of the Uppsala school, served understand the reason behind why companies choose to do business in nations that have similar cultures, structures or institutions to those in the home country (Kutschker, 1997).

By 1971 Richard Caves proposed that international expansion follows the same principles as those of national growth. In his view, an MNE could be comparable to a rising multiplant firm, where the ownership of proprietary assets, would lead to developing a competitive advantage worth of expanding into new territories. This concept of proprietary assets referred to a specific kind of resources that are difficult to acquire and represent an added value. On the other hand, Caves considered the upsurge of international vertical integration as an effect of a search for resources, information and production markets.

In this context, Buckley and Casson would move their attention towards the specific firm activities and resources that favored internationalization, coining the concept of internalization (Buckley, 2007). In their view, the inner structures of a firm would be determinant for achieving foreign success with innovation being a key to gaining an internationalization advantage (Henisz, 2003). The authors went beyond the concept of internalization and recognized other actors in the process, including the latent possibility of host government intervention, where they would not go any further into specifying the differences that this implies across different countries (Henisz, 2005).

Dunning would later integrate the concept of internalization as a competitive advantage along with the concepts of ownership and location into a theory known as the eclectic paradigm or Ownership, Location, Internalization (OLI) model. The OLI model served explain, in the context of international production, that neither location, nor exclusive assets help explain the reasons for internationalization, and that only the adequate analysis of each factor would reveal the characteristics involved with foreign investment (Dunning, 2000). For Dunning home and host country institutions have an effect on the firm and issues such as government intervention and policies can generate advantages in the fields of ownership and internalization.

2.1 The role of political factors

The work of Boddewyn (1988; 1994) contemplated the need for including the role of political factors into Dunning's eclectic paradigm (OLI). Boddewyn acknowledged that prior researchers including Dunning were indeed covering politics as a factor, but in general treated the role of the MNE as a reactionary to public decisions as opposed to MNEs being an agent of influence over local or foreign governments (Boddewyn 1988). Boddewyn categorized the term political as the non-market actors including the state and the community (though leaders, organized groups) and listed some of the mechanisms of interaction between firms and the government including lobbying, public relations, alliances, bribery and suing.

As reviewed before the role of politics as a non-market factor for the firm is in the process of consolidating as a key component of the internationalization process. In its initial appearences in the academic environment, politics has been analyzed in terms of its role for organizations' decisions, international development and likelihood for success. As proposed by Boddewy there is evidence that politics can also be reviewed as a maneagable and changeable force.

In this context, several authors have focused on differentiating the influence of host vs. home country governments. In general, more focus has been given to understanding host country negotiations, a situation potentially resulting from the natural move of internationalization from developed into emerging economies. In the host country perspective, authors have explored several issues including the carachteristics of a host country that may lead to better subsidiary integration of political activities (Blumetritt, 2003), discrimination from host country governments (Cuervo-Cazurra, 2007), the power of government in negotiations (Blumentrit 2003), the interest of governments in attracting specific industries (Henisz 2005) and the ability of firms to influence host country political decisions (Hillman 2005).

In a cross-country study Wan and Hoskisson explored the relevance of home country environment and institutions as drivers of internationalization finding that powerful and diversified firms are more likely to take advantage of generous environments (Wan & Hoskisson, 2003). Other studies are focusing on understanding the linkages between government relations and competitive advantage (Hillman, 1998) and establishing the types of exchanges that may exist between companies and governments for which Hillman and Hitt mention three elements; information, money & votes (Hillman & Hitt, 1999).

The use of political strategies by MNEs has been gaining interest in the case of emerging economies, as government institutions tend to have less stable mechanisms and be more corrupt, according to Transparency International. The work of Holburn and Zelner (2008) suggests that companies in less organized environments can develop capabilities and experiences that serve and facilitate their international expansion.

Under this scope, we will try to understand the relevance of using some of the different structures of government exchanges (Hillman, 2005) namely the financial support that firms provide during a presidential campaign and the influence of integrating government officials as members of the board, in the internationalization process. This research will attempt to demonstrate the effects of companies using their political connections, as a non-market strategy for consolidating or accelerating their foreign position. In these terms, this study proposes the following hypotheses:

Hypothesis 1: Internationalized firms are more likely to show political connections

Hypothesis 2: The political connection drives the speed at which firms internationalize

3. Empirical investigation

3.1 Sample

We relied on the initial sample of listed firms with Brazilian control for the year of 2006. Listed firms are preferable because they mitigate the problem of dealing with unreliable data, which is a relevant problem in researching emerging economies (Hoskisson et al., 2000). We collected firm financial data using Economatica to assemble a data set of 4 years, from 2007 to 2010. This period refers to the last term of President Lula in office, as well as the term for senators, governors, and deputies. This design allowed us to test whether firm political connections in the 2006 election affected their internationalization patters during the term recipient candidates were in office. Since data on Brazil matches firms to politician, we could also run robustness checks considering the effects of the electoral results of each politician on the internationalization pattern of the supporting firm. Hence, the analysis post-electoral period provides a natural experiment through which we can test our hypotheses.

Our initial sample consisted of 184 multinational and local firms. Missing data did not seem to be problem, but some firms were not included because they did not show complete information or they showed figures that were not compatible with a valid measure. This happened because firms had near zero equity or negative or went some financial restructuration that made financial indicators mathematical artifacts.

3.2 Methods

Our objective was to test whether firm political connections are a driver for the internationalization of emerging multinational firms. The first hypothesis predicts the decision to internationalize. The second predicts the extent to which the firm goes international. Thus we had to model two dependent processes. The decision to internationalize and, once this decision was made, the extent to which the firm implements internationalization. We chose a probit regression with cluster robust standard errors at the industry level to model the first process. From this regression, we calculate the selection hazard (Mills ratio) to introduce it in the next process model.

We also had to take into account the endogeneity problem in the second process. Not all firms decide to nurture political connections. This is a managerial decision that considers firms capabilities and other variables to sustain this political strategy. Therefore, we cannot assume that an unconnected firm, whose managers decided to so, if it were connected, it would show the same effect of an observed connected firm. This problem of endogeneity was controlled using instrumented regressions. We considered that only firms that actually needed to be connected in order to go abroad should decide to nurture political connections. These firms are often firms that show vulnerable leveraged positions and hence they seek protection from the government in order to mitigate this risk and implement their strategies. Debt to assets ratio was used as an instrument to the decision to donate. Therefore, the final process was modeled by an instrumented regression with cluster robust standard errors at the industry level.

3.3 Variables

The dependent variables are related to internationalization. We used the decision to internationalize as a dummy variable (“1” for firms that are internationalized, “0” otherwise). Whether the firm is multinational or not and the extent to which internationalization is brought about were measured by the global internationalization index produced by “Jornal Valor/SOBEET”. We calculated the average index for each firm considering the time span of 4 years (2006-2009). We used the log value of this average in our models.

The variable of interest, political connections, was measured by the firm financial contributions to the 2006 campaign. Since official data do not reflect reality due the practice of “under the table” contributions, we used a binary measure (“1” for firms that donated, “0” otherwise). We also controlled for other possible connections. The first is whether the firm had a former politician in the board (“1” for firms with connected board, “0” otherwise). The others are government ownership (“1” for firms with direct or indirect government ownership, “0” otherwise), and state control (“1” for state-owned firms, “0” otherwise).

Other control variables that affect the internationalization patterns were added. Group affiliation (“1” for firms affiliated to a business group, “0” otherwise) and foreign capital (“1” for firms with foreign investors as minority shareholders, “0” otherwise). Since age matters in developing capabilities that may be drivers of internationalization, we added the year of founding of the firm. We also included the operational profit (the ratio of the earnings before interest and taxes to total assets), size (the log of the total assets), and the capability to invest (the ratio of capital expenditure to total assets). These three last variables were year averages of the four-year period after the election. We also used their lagged values (the previous four-year period) in order to capture their effects on the decision to internationalize. Finally, we controlled for industry effects.

4. Results

Table 1 shows the descriptive statistics and the correlation matrix for the full sample. All variables present the expected sign and correlations with the decision to internationalize, but state control. Only group affiliation and size show significant correlations with other predictors what may generate collinearity problems. However, when we exclude them from the models, the main results do no change.

Around 20% of the firms are multinationals, and 38% decided to donate in the 2006 elections. The average founding year is 1954, the average size is 3bi US$, and the average operational profit is 14%.

Table 1: Descriptive Statistics and the Correlation Matrices[a]

Variable	Mean	s.d.	1	2	3	4	5	6	7	8	9	10	11
1. Internationalized	.21	.40											
2. Political contributions	.38	.49	*.32*										
3. Board participation	.61	.49	*.30*	.09									
4. Government Ownership	.37	.48	*.33*	-.02	*.32*								
5. Founding year	1954	30.3	*.12*	-.06	.05	.08							
6. State Control	.94	.23	.07	*.19*	*-.15*	*-.28*	-.11						
7. Foreign Capital	.32	.47	*.22*	.06	*.14*	*.31*	.07	-.07					
8. Group Affiliation	.42	.50	*.44*	.06	*.40*	*.38*	.11	-.06	*.22*				
9. Operational profit	.14	.06	*.30*	*.15*	*.15*	.10	.01	.06	.08	*.33*			
10. Firm size	3,760	14.0	*.30*	.04	*.41*	*.41*	*.18*	*-.25*	*.22*	*.65*	*.42*		
11. Tobin's Q	1.60	.89	*.15*	-.07	-.04	-.09	.09	.12	-.02	.05	.16	-.14	
12. Debt to assets	.44	.52	*-.03*	-.08	-.13	-.06	-.06	.04	-.07	-.09	*-.25*	*-.19*	*.62*

[a] Firm size is in Millions of Dollars. Significant correlations are in italics.

The estimation results of the decision to internationalize are shown in Table 2. Model 1 contains only main effects. The signs of some of the significant coefficients are as expected. Firm size and operational profit are more associated with internationalization. On the other hand, younger firms are more prone to go abroad. As for the political variables, firms with connected boards seem to be more inclined to decide for internationalization. In this model, the coefficient for financial contributions is positive but non-significant. However, we should look to models 2 and 3 with the interaction terms. These interactions are important to isolate possible confounding effects. In Model 2 the basic results for the control variables do not change, but now the coefficient for financial contribution is highly significant and positive. This is so because these two types of political connections seem to be substitutes for one another. Firms with connected boards do not seem to need to give money to politicians. This is an interesting result that merits further exploration. The Model 3 is more complete as we add the interaction of financial contributions and board participation with the firm age. This model shows that for an average aged firm, with no board participation, making contributions to the last election has a strong effect on the decision to internationalize. Further, younger firms seem to profit more from this effect than older firms. This is akin to the idea of national champions, according to which, the government give incentives to some firms to grow fast, concentrate in their domestic markets, in order to be competitive abroad. This is the case for JBS, Coteminas, Ambev, Marfrig, and Marcopolo, for instance.

Model 4 is a robustness check with variations in the intensity of the connections. If firms donate with the purpose of internationalizing, then we would expect that strong connected firms will show greater effects than weak connected firms. We used the interaction term that captures whether the firm supporting a winning candidate who belongs to the federal government coalition is more prone to internationalize. The results indicate that firms supporting winning candidates that are part of the federal coalition are more prone to go abroad than are firms supporting winning that are not part of the coalition. Indeed, for the latter the effect on internationalization is highly negative. Taken together, these results provide strong support for Hypothesis 1.

Table 1: Probit Regression Results for Internationalized[a]

Variables	(1)	(2)	(3)	(4)
Political contributions	.87	4.23**	3.93**	
Board participation	1.64**	4.89**	4.85***	2.65**
Founding year (centered)	.01+	.11+	-.04*	.01
Government ownership	1.11	1.08	1.28+	2.16*
State Control	-.22	-.24	-.26	.48
Group affiliation	.44	.47	.75	.26
Foreign capital	-.21	-.19	-.35	-1.08+
Operational profit (lag)	6.59*	6.54*	6.10*	10.70***
Firm size (lag)	.56+	.55+	.55	.68
Capital expenditure	5.08	5.17	5.4	7.57
Political contributions*Board participation		-3.38**	-3.00*	
Political contributions*Founding year			.04*	
Board participation* Founding year			.02	
Winning recipient candidate				2.06
Coalition recipient candidate				-4.07***
Non-coalition recipient candidate				16.46***
Winning*Coalition recipient candidate				3.53*
Winning*Non-coalition recipient candidate				-17.01***
N	126	126	126	126
R-squared	0.64	0.64	.66	.71
log-likelihood	-25.58	-25.52	-23.86	-20.48

[a] The coefficients for the constant and industry effects are included in all models, but omitted in the table. The dependent variable is whether the firm is internationalized (success) or not (failure).

+ $p < .10$
* $p < .05$
** $p < .01$
*** $p < .001$

While our results suggest that political connections are a driver of internationalization, one might argue that some firms may have already been multinationals before and the causality is reversed: they donate because they are multinational. In fact, we have so far a strong indication of association, but we cannot affirm causality. However, we may affirm that multinationals and financial contributions are highly associated. Table 3 presents the estimation results for the sample of internationalized firms. We seek to test whether political connections affect the degree of internationalization. If this is so, then we have more support to say that political connections drive internationalization.

Table 3: Selection-Corrected Regression Results for Internationalization Levels[a]

Variables	Internationalization Index Average (log)	Internationalization Index Growth
Political contributions	1.77***	1.75*
Board participation	-1.60**	-2.10+
Founding year (centered)	-.00	.01
Government ownership	-1.27***	-1.16+
State Control	-.62	.40
Group affiliation	-.23	1.54***
Foreign capital	1.52***	2.67*
Operational profit (lag)	-12.02*	4.51
Firm size (lag)	.71**	.32
Capital expenditure	4.48	16.14*
N	32	32
R-squared	.68	.62
Wald-Chi2	3009.3***	1198.28***

[a] The coefficients for the constant, industry effects and Mills ratio are included in all models, but omitted in the table. Debt to asset ratio is used as an instrument to the decision to make political contributions.
+ $p < .10$
* $p < .05$
** $p < .01$
*** $p < .001$

Model 1 in Table 3 shows that connected firms through financial contributions shows greater internationalization levels that do non-connected firms. However, firms with board participation show lower levels of internationalization. Again, this incompatibility of types of political connection may serve as new research venues. As expected, firm size and foreign capital show greater effect in this index. But, operational profit has a negative sign. This may indicate that firms are not capable of sustain greater levels of internationalization without sacrificing operational profitability. In Model 2 we introduce the interaction effects and the results for the main effects are sustained, even though the interaction term could not be estimated.

Model 3 gives the final support for the idea that political connections are a driver of internationalization. The dependent variable in this model is the growth in the internationalization index of the firm after the 2006 election. The presence of foreign capital and group membership influence the growth of the internationalization index, while government ownership and board participation decreases internationalization after the election. The main result is for our variable of interest. Financial contributions for the 2006 elections affect the growth of the internationalization index. Connected firms experience greater international growth than do unconnected firms. This is an indication that once connected, the firm is more confident, or more protected, to implement the internationalization expansion. Hypothesis 2 is accepted.

5. Discussion and conclusions

In this paper we show that political connections act as a driver of the internationalization of emerging multinationals. We used a sample of listed firms in Brazil with local control to assess whether these firms established political connections through political contributions to campaign financing in the 2006 elections. We investigated the association between political connection and internationalization, the effect of political connection on the speed at which internationalization occurs. We used a time frame of a four-year term after the election to better capture the effect of such connections. We found strong support for our hypotheses. Connected firms are more likely to be internationalized. And firms with connections in the election showed greater levels of internationalization growth after the election.

The implications of this paper are twofold. First, we contribute to the theory on internationalization by providing empirical evidence of the political power of emerging multinationals (Boddewyn, 1988; 1994). Connected firms are able to exchange financial support for institutional protection and subsidies in order to reinforce their international position. These firms are not only products of policy distortions but they influence the institutional environment in their favor. In the environment of Brazil, this exchange is clear: the politician gets the money and the firm gets the favor. Our result that younger firms are better off at using their connections to internationalize suggests that technical capabilities developed over time are not so important compared to the political capabilities of the connected firms.

The second implication is for the literature about the role of the home country in driving internationalization (Hillman, 1995; Baysinger, 1984; Caves, 1986). Different from the market-based literature, it is the institutional environment that is driving internationalization. Firms seek political support to internationalize. The limited stock and flow of capabilities of younger firms do not impede them to go abroad, if they have institutional support from the government. In Brazil, the huge amount of credit from the National Development Bank (BNDES) available to finance international activities indicates not only the role of the host country, but the active role of the government in picking winners.

The major limitation of this paper is that we did not have data for the period before the election. One might argue that these connected firms were already following a trend of growth before the election. While it is might be true, if more data, we could see if the connection was an inflexion point in this trend. However, our findings provide good indication since connection intensity affects the probability of being international. For instance, firms that were highly leveraged before the election are more likely to make political contributions and to show greater levels of internationalization. If political connection would not be a driver of initiating internationalization, it is clearly a driver to sustain it.

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