TOWARD A LEGITIMACY-BASED VIEW OF POLITICAL RISK: THE CASE OF GOOGLE AND YAHOO IN CHINA

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Traditional political risk theories often focus on a developing host country government’s ability to intervene in the activities of foreign multinationals in the extractive or infrastructure sectors. This results in inadequate understanding of (1) how a government’s motivation to intervene is influenced by the broader societal context, (2) the importance of multinationals’ political risk at home, and (3) the increasing political risk faced by high-tech and service firms. We argue that there is a need to update the bargaining power and political institutions theories and further develop a legitimacy-based view of political risk. Then, we examine the political risk experienced by Google and Yahoo at home and abroad due to their activities in China to illustrate the benefits of a holistic approach to political risk. Copyright © 2015 John Wiley & Sons, Ltd.

INTRODUCTION

Strategic management and international business research regularly examines government actions that have a negative impact on firm performance, a phenomenon known as political risk (Boddewyn, 2005, 2014; Brewer, 1985). Revenues lost due to political risk can run into the billions of dollars for multinational enterprises (MNEs) each year, making it a key area of concern for researchers as well as practitioners. This phenomenon is typically explored using a bargaining power approach (BPA) or a political institutions approach (PIA), which focus, respectively, on (1) the balance of bargaining power between a firm and a government and (2) the degree of checks and balances in a country’s political institutions. The majority of the political risk literature has focused on attributes affecting a government’s ability to intervene in the specific context of conflicts between a developing country host government and foreign MNEs in the extractive or infrastructure sectors. While this line of inquiry has generated considerable insights, we propose that the focus on this particular context has hampered the development of a more holistic and more generalizable approach to understanding political risk faced by firms in a widening range of industries in an increasingly complex and interconnected global economy. In such a world, MNEs may not have to deal with political risk only abroad in host countries, but also at home. What are the contours of such a new approach? What are the new insights from this approach that are above and beyond the insights from BPA and PIA?

The purpose of this article is to take up this challenge and develop such an approach. Specifically, we propose that there are benefits to examining political risk through the lens of three distinct but complementary perspectives. Adding to the traditional BPA and PIA approaches, we suggest that the “missing link” is the nascent legitimacy-based view...
(LBV), which has begun to gain attention in the field of political risk (Henisz and Zelner, 2005; Kostova and Zaheer, 1999; Luo, 2001). Consequently, we (1) develop the LBV, which we believe can help to explain governments’ motivation to intervene, in contrast to the literature’s traditional focus on factors impacting governments’ ability to intervene; (2) consider the ramifications for firms’ actions not only on the political risk they face overseas, but also the risk they face at home; and (3) consider political risk in contexts ranging from firms in fixed-asset intensive industries in developing countries to high-tech service industries in developed countries.

We begin with a brief overview of the BPA and PIA. Then, we introduce a legitimacy-based view of political risk and develop it further. We then turn to a detailed example: the well-publicized case of the interactions of Google and Yahoo with the Chinese government that created political risk both in China and at home. Although the setbacks faced by these firms have gained considerable attention in the press, they have only recently started to receive attention in the academic literature (Brenkert, 2009; Dann and Haddow, 2008; Scherer, Palazzo, and Seidl, 2013). Sizeable aspects of the political risk faced by these firms are consistent with what can be explained by the BPA and PIA. However, a number of relatively unique aspects of their experiences suggest the value in updating these traditional theories and developing alternative perspectives based on legitimacy that may shed new light on political risk.

To be clear, we do not intend to claim that the political risk faced by Google, Yahoo, and fellow tech firms means that the BPA and PIA are now obsolete, and that the LBV is the sole paradigm for political risk. Instead, this article argues that a better understanding of political risk will have significant ramifications for future theory building and empirical efforts in all three theoretical paradigms. In particular, examining these firms’ experiences has considerable implications for several less-understood aspects of political risk: (1) why political risk is increasingly seen as not just a concern for firms in the asset-intensive extractive and infrastructure sectors, but a highly salient issue for high-tech, innovative, and service-oriented firms as well; (2) how actions taken overseas can result in political risk at home; and (3) why powerful firms from a powerful home country (e.g., Google and Yahoo) would experience more political risk than less powerful, and presumably more vulnerable, firms.

TRADITIONAL THEORIES OF POLITICAL RISK

The bargaining power approach (BPA)

Bargaining power derives from “resources controlled by one party and demanded by the other” (Kobrin, 1987: 617) and “the ability to withhold resources that the other party wants” (Eden and Molot, 2002: 365). According to the BPA, an MNE’s bargaining power erodes over time as first the foreign entrant sinks fixed investments in the host country and then its technological or managerial superiority erodes, making it easier for local firms to replace the MNE (Poynter, 1986; Vernon, 1971). As the MNE’s power to stop the government from changing the initial bargain decreases, its political risk increases (Boddewyn, 2005). Highlighting the importance of BPA logic in the political risk field, Grosse (2005: 276) states: “This idea of a company’s deteriorating bargaining power once physical facilities are committed is one of the enduring concepts that remain relevant to analyzing government-business relations.” Developed by Vernon (1971) in the extractive sector, the BPA has been primarily applied to this sector and other industries characterized by large amounts of fixed assets such as infrastructure and heavy manufacturing (Doh and Ramamurti, 2003; Makhija, 1993; Moran, 1974; Wint, 2005).

The political institutions approach (PIA)

In addition to bargaining power, other researchers focus on attributes of a country’s political institutions as a clue to better understand political risk (Henisz, 2000). Specifically, the PIA predicts that because governments face the inherent temptation to alter policies to their advantage (and to the detriment of foreign firms), more political constraints on the government’s ability to change existing policies will be associated with less political risk for firms. A larger amount of political checks and balances is posited to be associated with greater constraints. Similar to the BPA, empirical analyses using the PIA have focused on industries with large amounts of fixed assets, such as the infrastructure sector (Henisz and Zelner, 2001).
Strengths and limitations of traditional theories

Both approaches have generated numerous insights. The BPA has explored factors that allow firms to forestall obsolescence and maintain their bargaining power, such as leveraging greater intangible resources (Gomes-Casseres, 1990; Poynter, 1982; Vachani, 1995) or hailing from a powerful home country (Ramamurti, 2001). The PIA provides a valuable tool for understanding why a certain country may entail more risk than another. It has been empirically associated with FDI location choices (Henisz, 2000, 2002; Henisz and Zelner, 2001), protectionist policies (Henisz and Mansfield, 2006), and infrastructure development (Henisz and Zelner, 2006).

Yet, both approaches face important limitations as well. Given its focus on fixed assets and technology spillovers, the BPA has done well in explaining the political risk faced by firms in industries characterized by higher degrees of fixed assets and more easily-learnable technology, such as mining or oil extraction. However, Kobrin (1987: 636) notes that “in other industries, characterized by changing technologies and the spread of global integration, the bargain will obsolesce slowly, if at all, and the relative power of MNCs may even increase over time.” This suggests that predicting political risk based on an assumption of bargaining power obsolescence may not be appropriate for a wide swath of firms in more globally-integrated and technology-intensive industries (Bremmer, 2010b; Dunning, 1997). As a country-level theory, the PIA seems best suited for explaining cross-country rather than within-country variations. In other words, political institutions may explain why Russia can be a riskier place to invest than Germany, but such macro-level institutions provide little explanation for why a particular industry (or even a specific MNE) would be singled out for intervention within Russia or within Germany.

Importantly, both approaches focus on constraints on a government’s ability to intervene, taking its desire to do so as given. At the time when theory on political risk was first developed, such an assumption likely was valid in many cases. During the first few postwar decades, many governments in developing countries pursued import substitution policies and anti-foreign sentiment was widespread, especially in countries just years removed from colonization by foreign powers (Boddewyn, 2005, 2014). However, the potential use of power does not necessarily translate into its actual use in business-government relations (Dunning, 1997; Kobrin, 1987; Luo, 2001). This has led Henisz and Zelner (2005) to criticize traditional political risk theory as deterministic, and Jones (1995) to call it “undersocialized” for not considering the broader societal influences affecting business-government interactions and the policy-making process. Recognizing that both intervening and not intervening in the activities of firms carries risks, government intervention is no less important—but it is increasingly selective (Bremmer, 2010b; Minor, 1994; Stevens and Cooper, 2010). Moreover, firms are increasingly under scrutiny from home country stakeholders for issues including the natural environment, human rights, national security, and tax inversion (Kostova and Zaheer, 1999; Scherer et al., 2013). These complex issues often involve matters beyond bargaining power and country-level checks and balances (Henisz and Zelner, 2005) and may have political risk ramifications that cross borders.

Some of these limitations can be addressed by continuing to augment the traditional theories, an issue we will return to later in this article. However, we argue that other limitations reflect inherent aspects of these approaches’ underlying assumptions and mechanisms, suggesting the potential value in using an alternate conceptual lens to view political risk. In the next section we provide an overview of such an approach, based on the construct of legitimacy.

**THE EMERGENCE OF A LEGITIMACY-BASED VIEW**

Responding to the changing face of political risk, a newer stream of research suggests that government intervention based on short-term shifts in bargaining power can be short-sighted and indeed counter to the government’s own goals, which often rely on FDI to be attained (Luo, 2001). Instead, the government is increasingly looking at the attributes and activities of the foreign firms in the host country over time and evaluating whether they appear consistent with the government’s long-term economic, political, and social goals (Henisz and Zelner, 2005). When such congruence is perceived to exist, the legitimacy of these firms in the eyes of the government increases (Kostova and Zaheer, 1999; Marquis and Qian, 2014; Suchman, 1995).
Suchman (1995: 574) defines legitimacy as “a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions.” By “generalized,” Suchman (1995: 574) argues that legitimacy represents “an umbrella evaluation that, to some extent, transcends specific adverse acts or occurrences; thus, legitimacy is resilient to particular events, yet it is dependent on a history of events.” Perceptions of legitimacy are socially constructed within “some group of observers” (e.g., a government, organization, interest group, or any other group of individuals), but there need not be unanimity of opinion regarding a firm’s legitimacy either within or across these groups (Suchman, 1995: 574). Indeed, Bucheli and Salvaj (2013) find that tradeoffs can exist—gaining legitimacy from one social group can result in a loss of legitimacy in the eyes of another. Moreover, Bitektine (2011: 157) notes that the benefits of a firm’s actions or existence may be diffuse or concentrated.

Three types of legitimacy—pragmatic, moral, and cognitive—have been identified by Suchman (1995). Pragmatic legitimacy “rests on the self-interested calculations of an organization’s most immediate audiences” (Suchman, 1995: 578). An organization achieves pragmatic legitimacy if its actions are seen as contributing value to a legitimacy-conferring stakeholder, directly or indirectly. Moral legitimacy also involves an evaluative component. However, it rests “not on judgments about whether a given activity benefits the evaluator, but rather on judgments about whether the activity is ‘the right thing to do’” (Suchman, 1995: 579). Stakeholders confer moral legitimacy on an organization if they believe it is contributing to the societal welfare and acting in accordance with norms and values shared by that society (Palazzo and Scherer, 2006). Finally, cognitive legitimacy involves “acceptance of the organization as necessary or inevitable based on some taken-for-granted cultural account” (Suchman, 1995: 582). This type of legitimacy is based not on conscious evaluation of the organization’s merits, but subconscious acceptance of its actions and existence (Jepperson, 1991).

The notion of legitimacy has particular salience for relations between foreign firms and the host government. Bitektine (2011: 156) notes that legitimacy with government regulators is a “commonly studied type of legitimacy,” as these government agents are “carefully attended to in institutional contexts” due to “their influence on performance and the very existence of industries and organizations.” As a result, governments and government actors often assess the legitimacy of these firms (Baum and Oliver, 1991; Deephouse, 1996; Marquis and Qian, 2014; Naughton, 2007; Rao, 2004). Bitektine (2011: 152) argues that the judgments about firms’ legitimacy that are rendered by government actors “can be a matter of life and death for an organization.”

Several works have contributed to the LBV. For instance, Marquis and Qian (2014: 132) focus on the issue of corporate social responsibility in China. They find that “by taking action in accordance with government policies, positions, and regulations … firms and their executives maintain their legitimacy in the eyes of the government.” Kostova and Zaheer (1999: 65–66) explicitly link firms’ legitimacy with the political risk that they face, noting that “the political processes or negotiations between MNEs and host governments … could affect the legitimacy of firms directly—in the regulatory domain—or indirectly—through the social construction engaged in by political interest groups.” Luo (2001) finds evidence that MNEs can build legitimacy in the eyes of their host governments through trustworthy behaviors, social capital, and investments of resources that are valuable and rare in the host economy, thus reducing their political risk. Henisz and Zelner (2005) predict (1) that MNEs’ political risk would decrease over time as these firms’ tenure allows them to build legitimacy and acceptance in the host environment, and (2) that firms that focus predominantly on building power as opposed to building legitimacy do so at their peril. In sum, research linking legitimacy and political risk has begun to emerge. Next, we develop and expand this nascent approach further.

DEVELOPING AND EXPANDING THE LBV

Despite researchers’ progress on the LBV, a detailed conceptual model has not yet been proposed. Doing so would enable us to expand the scope of the theory—specifically, it helps to address three gaps in the emerging LBV: A lack of clarity about (1) the specific mechanisms linking firms’ legitimacy and their political risk, (2) the role of legitimacy-granting actors other than the
government, and (3) the role of legitimacy in the home country. This suggests the need to further develop the LBV to explain and predict firms’ political risk in all manner of industries, both at home and abroad. Figure 1 illustrates a model of how we expect legitimacy to impact political risk, which we discuss below. Table 1 contrasts this logic with the BPA and PIA approaches.

The impact of firm actions and attributes on legitimacy as perceived by governments

Although “the government” is often treated as a single actor, the political science literature has long acknowledged that the government is itself a social group made up of many individuals and subunits (Lieberthal, 1995; Miller, 1974). Thus, the higher the degree to which governmental actors perceive a firm’s actions to be “desirable, proper, or appropriate” (Suchman, 1995: 574), the higher the firm’s legitimacy in the eyes of the government as a whole (Marquis and Qian, 2014). Because the political risk literature pays particular attention to the impact of government actions that affect firms, we start our conceptual development by first considering firm legitimacy from the perspective of the government.

Gaining legitimacy in the eyes of the government may be accomplished through pragmatic legitimacy: the degree to which a firm’s attributes and actions provide tangible benefits to an immediate audience—in this case individuals within the government (Makhija, 1993; Suchman, 1995). Alternatively, acceptance may be achieved through moral legitimacy, if the firm is seen as acting appropriately and in good faith with respect to promoting societal welfare, regardless of the direct benefits to the government (Aldrich and Fiol, 1994; Suchman, 1995). A firm can also achieve cognitive legitimacy if its presence is seen as necessary or inevitable by government officials or bureaucrats.

Given that the political, economic, and social impacts of a firm’s actions are tightly intertwined (Bergsten, Keohane, and Nye, 1975), from the government’s perspective the three types of legitimacy may intertwine as well. For instance, a firm’s action to hire a large number of local workers can reduce unemployment, which helps keep the government in power (raising the firm’s pragmatic legitimacy). This may be viewed as a pro-social behavior (increasing moral legitimacy), and may result in its presence being seen as necessary and taken for granted by the government (resulting in cognitive legitimacy). It is for this reason that governments pay close attention to firms within their borders to determine the degree to which their

Figure 1. Legitimacy-based view of political risk

Table 1. Contrasting the three theories

<table>
<thead>
<tr>
<th></th>
<th>Bargaining power approach (BPA)</th>
<th>Political institutions approach (PIA)</th>
<th>Legitimacy-based view (LBV)</th>
</tr>
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<tbody>
<tr>
<td>What it explains</td>
<td>A government’s ability to intervene due to shifts in bargaining power.</td>
<td>A government’s ability to intervene based on the checks and balances in a country’s political institutions.</td>
<td>A government’s motivation to intervene based on a firm’s pragmatic, moral, and cognitive legitimacy.</td>
</tr>
<tr>
<td>What it is less suited to explain</td>
<td>When a government will choose to not exercise its power in a way that is detrimental to firms, even when it has the power to do so.</td>
<td>Country-level focus results in difficulties in explaining within-country differences in political risk at the industry or firm level.</td>
<td>Less suited than BPA or PIA for explaining a government’s ability to intervene in firms’ activities.</td>
</tr>
<tr>
<td>Primary country context</td>
<td>Host country.</td>
<td>Host country.</td>
<td>Both home and host countries.</td>
</tr>
<tr>
<td>Primary industry context</td>
<td>Extractive and infrastructure industries.</td>
<td>Extractive and infrastructure industries.</td>
<td>Both developing and developed countries.</td>
</tr>
<tr>
<td>Role of power</td>
<td>Unclear distinction between a government’s potential use of power and its actual use of power.</td>
<td>Governments assumed to be inclined to exercise their power, unless political constraints exist.</td>
<td>A government’s amount of power not necessarily directly related to the likelihood it will use its power; there needs to be a clear motivation to intervene.</td>
</tr>
<tr>
<td>Role of institutions</td>
<td><strong>Multilateral institutions</strong> <em>(international organizations such as the WTO or World Bank)</em> may influence power relations between a firm and a government.</td>
<td>Focus on the structure of a country’s political institutions.</td>
<td>Regulatory, normative, and cognitive institutions influence the relations between firms and governments.</td>
</tr>
<tr>
<td>Inclusion of civil society actors</td>
<td>Considers the bargaining power of other actors (e.g., NGOs) to influence the bargain struck between a firm and a government.</td>
<td>Interest groups are better able to influence policy when policy change is made easier by a lack of political constraints.</td>
<td>Societal actors (customers, competitors, the media, NGOs, etc.) evaluate the legitimacy of firms and governments, influencing government intervention.</td>
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The political risk literature has largely focused on a firm’s host country environment. However, the literature on legitimacy argues that it is imperative to acknowledge that MNEs face a large degree of conflicting demands from key stakeholders both at home and abroad (Greenwood et al., 2011; Kostova and Zaheer, 1999). Globalization has only increased the complications a firm faces, as its actions abroad can have a direct impact on its legitimacy at home—either positive or negative (Pache and Santos, 2010; Scherer et al., 2013). Thus, we expect a firm’s actions and attributes to impact directly the legitimacy it gains in the eyes of the governments it interacts with—both at home and abroad (see Figure 1).

**The impact of firm actions and attributes on legitimacy as perceived by society**

A firm’s legitimacy is evaluated by a broad set of social groups and stakeholders in addition to the government, including interest groups, competitors, the media, NGOs, financial institutions, employees, customers, “elite” members of society, and other members of civil society (Bucheli and Salvaj, 2013; Suchman, 1995). These actors can also provide or withhold their “social license to operate” from an organization, depending on the degree to which
they perceive it as a legitimate and accepted part of the community (Thomson and Boutilier, 2011b; Henisz, Dorobantu, and Nartey, 2014; Prno and Slocombe, 2012; Thomson and Boutilier, 2011a).

Unlike the government—which has a “monopoly of legitimate coercive power” (Stoker, 1998: 1), with the ability to provide directly or revoke a formal, legal license for a firm to operate—the “social license” granted by actors in civil society is a social contract, rather than a legal one (Boutilier, 2009; Thomson and Boutilier, 2011b; Prno and Slocombe, 2012). Nevertheless, this social license has important consequences for firm performance and survival, both directly and through its impact on policy. Thus, it is important for firms to manage relations with such stakeholders (Henisz et al., 2014). However, the political risk literature has not traditionally given adequate attention to these issues, leading to Jones’s (1995) criticism that political risk research is undersocialized. Thus, while the government necessarily plays a large role in a legitimacy-based approach to political risk, just focusing on the government is not sufficient. As we indicate in Figure 1, we expect that the more the public perceives a firm’s attributes and actions to be desirable, the higher its legitimacy in the eyes of that society.

The reciprocal nature of a firm’s legitimacy in the eyes of government and society

We also expect the degree to which a firm gains or loses legitimacy from societal actors to impact the legitimacy it has in the eyes of a government. As mentioned above, governments are not unitary actors, nor do they make policy decisions in a vacuum (Putnam, 1988; Zelner, Henisz, and Holburn, 2009). Instead, they consist of individual policy makers, each with their own objectives and priorities (Kistruck et al., 2015; Putnam, 1988). These policy makers frequently receive information from constituents and interest groups that impacts how they make policy decisions (Henisz and Mansfield, 2006; Henisz and Zelner, 2006). Thus, we expect whether these societal actors perceive a firm as beneficial will in turn affect how individual policy makers, dominant coalitions, and the government as a whole perceive the benefit provided by the firm.

Proposition 1: The more the public perceives a firm’s attributes and actions to be desirable, proper, or appropriate, the higher the firm’s legitimacy in the eyes of that society’s government.

We expect that this relationship can work in the reverse direction as well. If a government views a firm as legitimate, it signals its support by providing resources and favorable policies (Oliver and Holzinger, 2008; Pfeffer and Salancik, 1978). Marquis and Qian (2014: 130) note that “responding to government signals and building legitimacy with governmental actors is critical” for firms, as “government action … is as powerful in signaling norms and standards of legitimacy as it is in formally coercing compliance.” This aligns with Boddy and Brewer’s (1994: 135) notion that “partnership with governments is more likely to generate legitimacy … because partnering conveys a derivative ‘seal of approval’ of what international firms are doing.” Thus, governments and individual politicians can and often do signal to the public that a firm’s activities are likely to be beneficial and in line with societal norms and values.

Proposition 2: The more a government perceives a firm’s attributes and actions to be desirable, proper, or appropriate, the higher the firm’s legitimacy in the eyes of the public.

In sum, our first two propositions imply a reciprocal relationship between firm legitimacy as perceived by a government and firm legitimacy as perceived by society. However, governments themselves vary in their legitimacy as viewed by their own people, other countries’ governments and people, and international organizations (Bohman and Rehg, 1997; Bonardi, Holburn, and Vanden Bergh, 2006). Thus, we expect that how society views a firm that has gained the stamp of government approval will depend on how that society views the legitimacy of the government in question.

We expect that a positive endorsement from a government may be seen as desirable when that government is perceived as legitimate, increasing the firm’s legitimacy in the eyes of society in a manner consistent with Proposition 2. However, if the government itself is perceived as illegitimate, the benefit a firm derives from gaining the government’s seal of approval may be reduced (Bucheli and Salvaj, 2013; Kobrin, 2005). This suggests that the positive relationship between a firm’s legitimacy in the eyes of a government and its legitimacy in
the eyes of society proposed in Proposition 2 could weaken when society perceives that government’s legitimacy to be low.

**Proposition 3:** The positive relationship between a firm’s legitimacy in the eyes of the government and its legitimacy in the eyes of the public weakens when the government’s legitimacy is low.

**Firm legitimacy and government motivation to intervene**

Like other types of organizations, governments have goals and objectives and gather information to gauge whether they are on track to achieving such goals (Cyert and March, 1963; Eisenhardt and Zbaracki, 1992; Makhija, 1993). If firms’ actions or presence in the local economy are seen as legitimate and beneficial, we expect the government will be considerably less motivated to interfere. Conversely, we expect that a government would feel the greatest desire to intervene in the operations of firms it deems less legitimate. This is because a government, like other organizations, tends to engage in “problemistic search”—when a goal is not being met or a problem is encountered, it will be much more motivated to make changes and search for solutions (Cyert and March, 1963; Kelman, 2006; Shrivastava and Grant, 1985). Thus, a firm deemed illegitimate by the government may experience increased scrutiny and intervention.

**Proposition 4:** The lower a firm’s legitimacy in the eyes of a government, the higher that government’s motivation to intervene in the firm’s operations.

As mentioned above, governments require legitimacy for themselves and their policies—they cannot act without expecting consequences (positive or negative) from their own constituents and stakeholders both at home and abroad (Henisz, Zelner, and Guillen, 2005; Palazzo and Scherer, 2006; Putnam, 1988; Zelner et al., 2009). How society would react to a policy targeted at changing a firm’s behavior or presence is likely to affect whether a government would try to craft such a policy in the first place (Prino and Slocombe, 2012). Which members of society are most influential may depend on the nature of the political system in question. More authoritarian governments tend to be responsive to a smaller circle of politically connected elites (Bucheli and Salvaj, 2013; Langevoort, 2004). More democratic governments may be responsive to a larger set of interest groups, ranging from the media, to industry lobbyists, to the broader civil society (Brewer, 1992; Putnam, 1988). Thus, we expect that society’s evaluation of a firm’s legitimacy to moderate the relationship between the government’s own assessment of a firm’s legitimacy and its motivation to intervene in its operations.

Specifically, when societal actors view a firm as less legitimate, we expect a government to be more likely to intervene, consistent with the logic of Proposition 4 above. A failure to act may anger key interest groups and constituents. This may result in damage to the government’s own legitimacy in the eyes of these stakeholders. On the other hand, when society views a firm as more legitimate, we expect a government to be less motivated to intervene. In this case, acting to harm a firm seen as providing societal benefits may cause key stakeholders to withhold their support for the government or to criticize actively or protest against it. Even if a government sees the firm’s presence as providing little benefit to the pursuit of its own goals, societal support for the firm will likely create rifts between or within the dominant coalitions in the government, resulting in a bias toward the status quo (Lieberthal, 1995). This suggests that the relationship proposed in Proposition 4 will become weaker the more legitimacy a firm has in the eyes of society.

**Proposition 5:** The positive relationship between a firm’s illegitimacy in the eyes of the government and that government’s motivation to intervene in its operations weakens when society’s perception of the firm’s legitimacy is high.

**Government motivation to intervene and political risk**

If a firm lacks legitimacy, a government motivated to interfere in its operations will then choose a method of intervention. Firms often do not know the basis or timing of these decisions, meaning that firms typically do not anticipate such policy changes (Makhija, 1993). Moreover, firms might not be aware of how their legitimacy is perceived by governments or society, which could lead firms to miscalculate how likely it is that new policies might
be created or existing policies might be changed. Because intervention changes the “rules of the game” for firms, it creates an unanticipated shock to their operations and performance (Kobrin, 1979). Consequently, the more motivated a government is to intervene, the greater the likelihood it will take actions that have an unexpected, negative impact on firm performance.

Proposition 6: The greater a government’s motivation to intervene in a firm’s operations, the greater the likelihood that it will engage in actions that heighten political risk for that firm.

The role of a firm’s country of origin

We argue that the degree to which a government’s motivation to intervene in the operations of a firm translates into actual action will be affected by that firm’s country of origin—more specifically, by the legitimacy of the firm’s home country government. Although much of the traditional political risk literature has focused on host country factors (i.e., bargaining power, political institutions), the literature on legitimacy would also expect the country from which a firm originates to strengthen (or weaken) a government’s motivation to intervene. Kostova and Zaheer (1999: 74) note that the stereotypes and heuristics used to judge MNEs “may arise from long-established, taken-for-granted assumptions” about an MNE’s home country in general, or that country’s government more specifically. They raise the case of Cargill in India, whose “arrival in India was equated with the arrival of the British colonialists,” leading to social and political friction that eventually led to its withdrawal from India.

Conversely, when a firm’s home country government is perceived as more legitimate, we expect this to weaken the likelihood that a host government’s motivation to intervene would actually translate into action. For example, although seaport management in the United States is politically sensitive, the U.S. government refrained from intervening in the operations of P&O, a British firm managing U.S. seaports. However, as soon as a firm from the United Arab Emirates, Dubai Ports World, attempted to take over the management of these seaports from P&O, the U.S. government intervened to block the deal. Both firms had good reputations themselves; the only key difference was their country of origin (Gopinath, 2011). Thus, we expect the relationship proposed in Proposition 6 to weaken when the legitimacy of a firm’s home country government is high.

Proposition 7: The positive relationship between a host country government’s motivation to intervene in a firm’s operations and the political risk faced by a firm weakens when the legitimacy of the firm’s home country government is high.

GOOGLE, YAHOO, AND A HOLISTIC APPROACH TO POLITICAL RISK

Having further developed the LBV, we want to reiterate our belief that it complements rather than substitutes for the traditional BPA and the PIA. As Gioia and Pitre (1990: 584) note, “the use of any single research paradigm produces too narrow a view to reflect the multifaceted nature of organizational reality.” For a phenomenon as complex as political risk, we would expect such a multifaceted approach to be particularly valuable. To illustrate this, we turn the spotlight on a timely and important recent example of political risk: the effects felt by Google and Yahoo both abroad and at home as a result of their activities in China.

Background

After a long period of planning and negotiating with the Chinese government, Google created its Chinese domain Google.cn in January 2006. At first, Google was quite successful, quickly grabbing about one-third of the Chinese search engine market (Baker, 2006). However, just a few years after Google’s entry, Google became unhappy with the Chinese government’s censorship demands and suspected that the government might be behind hacker attacks on Google originating from China (Bremmer, 2010a). As the conflict escalated, Google took steps in 2010 to reduce its presence in China after threatening to pull out entirely. As a result, Google has seen its market share in China plummet. After capturing approximately 35 percent of the market by the fourth quarter of 2009, Google dropped to under two percent of search engine volume in China by the start of 2014, falling into fourth place behind Chinese competitors Baidu, Qihoo 360, and Sogou (Investor’s Business Daily, 2014; MarketWatch, 2012).
Google and the Chinese government were on poor terms almost from the start. Shortly after the initial bargain was struck, Google indicated that it viewed these terms of entry (particularly those relating to censorship) not as a long-term, contractual agreement but rather as temporary terms that could and would be revisited, perhaps with “guidance” from the Chinese government (Grogan and Brett, 2006). This was likely not received favorably by the Chinese government, which views censorship as nonnegotiable. Google further angered the Chinese government by explicitly alerting users that their search results were being censored in accordance with Chinese law. An editorial in the China Business Times rhetorically questioned, “Is it necessary for an enterprise that is operating within the borders of China to constantly tell your customers you are following domestic law?” (Pan, 2006). Furthermore, Google aired its disputes with the government publicly, blaming the government for alleged hacker attacks on the company and disruptions to its operations in China and threatening to leave the country in a widely read memo (Quelch and Jocz, 2010). Indeed, starting in January 2010 the company announced it would no longer censor search results on its Chinese search engine.

Yahoo first entered China in 1999. It took a more conciliatory approach toward the Chinese government. Yahoo signed a pledge to self-censor its services in China (Dann and Haddow, 2008) and allegedly provided sensitive information to the Chinese government (Scherer et al., 2013). Dann and Haddow (2008: 229) assert that the arrest and imprisonment of two Chinese individuals “was only possible because Yahoo chose to give information about the identity of its users to the Chinese government.”

At the same time, both firms faced considerable scrutiny at home—including calls for boycotts and twice being called before a Congressional Committee hearing—as a result of their actions in China and their interactions with the Chinese government (Dann and Haddow, 2008). Even though Google was praised in some corners for publically confronting the Chinese government, others criticized it for going too far in its complicity with the Chinese government (Dann and Haddow, 2008). For example, Amnesty International, Reporters without Borders, Human Rights Watch, and others accused Google of violating Chinese citizens’ human rights through their censorship program (Brenkert, 2009). In other words, although Google suffered from low legitimacy in the eyes of the Chinese government, it also suffered from low legitimacy in the eyes of home country stakeholders.

Although Yahoo’s legitimacy in China remained relatively high when compared with Google, Yahoo’s legitimacy lowered back home as a result of its activities in China. Despite—or perhaps because of—smoother relations with the Chinese government than Google, Yahoo faced intense criticism at home. As an example, the chairman of the U.S. House Foreign Affairs Committee said of Yahoo, “While technologically and financially you are giants, morally you are pygmies” (New York Times, 2007). Due in part to these increasing conflicts with home country stakeholders and pressures from shareholders, Yahoo exited China in late 2013.

Actions by home and host country governments resulted in negative performance outcomes for these firms, representing a clear case of political risk. Moreover, several interesting and relatively unique aspects of these firms’ experiences are of note. First, the cross-border nature of these firms’ political risk stands in contrast to the traditional focus in the literature on the risk faced by firms in a single host country. Second, where the literature has generally considered the home country government’s role as supportive (Ramamurti, 2001), in this case the home government actually represents a source of political risk for both firms. Third, the high-tech industry context stands in contrast to the traditional focus on extractive or infrastructure firms. Precisely due to the nuanced and complex nature of these firms’ experiences, we argue that each of the three approaches to political risk can provide valuable insights. Moreover, we argue that the experiences of Google and Yahoo suggest avenues for conceptual development in each area.

**Extending the political institutions approach**

The PIA is particularly strong at identifying why China would be an inherently risky place to do business (Henisz, 2000). With its single party system and lack of checks and balances, there is little to stop the government from changing policies. Thus, the PIA can explain why the political institutions of China would allow its government to impose its wishes on firms. Note, however, that the PIA alone is not adequate to explain why even within the same country and industry, two firms in similar circumstances would face considerably different levels of
risk: Yahoo faced noticeably less hostile relations with the Chinese government than Google did.

With respect to these firms’ home country risk, the PIA is less able to explain why the United States (which is characterized by a large degree of political constraint) would represent a significant source of political risk for these firms as well. In fact, in the case of Yahoo’s decision to take a more conciliatory approach toward the Chinese government, it appears that its home country was as great—if not a greater—a source of political risk as its host country. Yahoo is not unique in this regard. Similar issues arose for Talisman, a Canadian oil company accused of complicity in human rights violations in Sudan and sued in U.S. courts under the Alien Tort Claims Act (Kobrin, 2005). Specifically, Talisman was accused of allowing the Sudanese government to use its airstrip to “stage military action against both rebel and civilian targets” (Kobrin, 2005: 207). Talisman’s close relationship with its host government resulted in smooth operations abroad in Sudan, but “considerable opposition from both the United States and Canadian governments” as well as “a coalition of advocacy groups and NGOs,” resulting in a major financial loss (Kobrin, 2005: 204). These examples suggest that closer ties to a more authoritarian government may result in greater risk not only in that country (as the PIA would traditionally expect), but also at home or in other countries if the “taint” of that government is perceived to rub off onto a firm.

Extending the bargaining power approach

The BPA can shed light onto several key facets of the experiences of Google and Yahoo as well. In particular, a powerful host country would be in a better bargaining position to gain what it desires. Moreover, the presence of capable, local players in this industry (e.g., Baidu, Qihoo 360) certainly gave the Chinese government leverage. However, the BPA seems less well-suited to explain other elements of Google and Yahoo’s experiences. This is certainly the case for the political risk faced by these firms at home, but is also true with respect to their political risk abroad in China. Google and Yahoo did not have large fixed investments “held hostage” by the Chinese government and did not experience technological obsolescence either—the two key BPA mechanisms triggering political risk. On the contrary, Google’s bargaining power might have increased once it entered China, as it provided a valuable and popular source of innovation and technology with a large and growing market share, and exiting might have resulted in an embarrassment to the government (Chao and Back, 2010). Also, despite the traditional expectation that more powerful firms from more powerful countries would experience less risk (Ramamurti, 2001; Vachani, 1995), this was not the case for Google.

Just as the experiences of Google and Yahoo shed some light on the strengths and weaknesses of the BPA, they also have implications for its future development. The BPA has traditionally assumed that firms with large amounts of fixed assets (such as those in extractive and infrastructure industries) are most vulnerable to expropriation. However, the case of Google and Yahoo suggests that the ability to withhold information about and access to a market can be a powerful asset for governments to leverage. In particular, this would be a valuable source of bargaining power vis-à-vis information-hungry service firms. Also, the traditional BPA assumes that knowledge spillovers are the primary mechanism for local firms to catch up to foreign adversaries (Poynter, 1986; Vernon, 1971). However, the rise of Baidu and other firms suggests that the ability of local firms to innovate on their own cannot be overlooked. This suggests that, in contrast to traditional thinking, knowledge spillovers may be a sufficient but not a necessary condition for firm’s bargaining power to obsolesce.

Extending the legitimacy-based view

We argue that the LBV can also provide unique insights into the political risk faced by Google and Yahoo above and beyond those provided by the BPA and the PIA. Actions and attributes of these firms affected their legitimacy as perceived by key stakeholders both at home and abroad. Through its conflicts with the Chinese government over censorship, Google was likely lowering its pragmatic legitimacy in the eyes of its host government. Interestingly, all of these actions—credibly threatening to withhold resources, attempting to set public opinion against the Chinese government, and moving key operations to Hong Kong—would traditionally be seen as increasing Google’s bargaining power. However, these were all moves that directly caused Google to lose legitimacy (Grogan and Brett, 2006). In short, these actions increased Google’s political risk. This supports Henisz and Zelner’s (2005:
argument that “investors [should] exercise caution in exploiting their initial bargaining power” and focus not only on bargaining power but also on legitimacy. Google’s actions might have reduced its pragmatic legitimacy with the general public in China as well, if using Google became more technically difficult—thanks to the government’s heightened blockage of Google sites. This could have shifted the cost-benefit analysis of using Google for the average citizen, further hastening the company’s drop in market share in mainland China.

With respect to moral legitimacy, the idea that the degree to which a firm is seen as pursing “socially acceptable goals in a socially acceptable manner” (Ashforth and Gibbs, 1990: 177) is important fits with the criticisms faced by companies such as Google and Yahoo. Unlike Google, Yahoo was considerably more cooperative with the Chinese government; for example, it continued to participate in the self-censorship program mandated by the government and allegedly turned over information about Chinese users to the government (Dann and Haddow, 2008). While these actions likely gained Yahoo greater pragmatic legitimacy in the eyes of the Chinese government, these same actions likely decreased its moral legitimacy at home—resulting in concerns raised by NGOs, the media, and the general public in the United States (Brenkert, 2009; Dann and Haddow, 2008). Notably, these stakeholders were not directly impacted by these companies’ actions overseas. Instead, it was the perception that these companies’ activities in China were not in accordance with American norms and values that earned them censure from these home country stakeholders (Brenkert, 2009).

It is more difficult to gauge Google and Yahoo’s moral legitimacy in China, due to the lack of trustworthy research and opinion polls. On one hand, some individuals in the host country may have appreciated the attempt of Yahoo and Google to provide additional information, albeit censored. On the other hand, others in China may have had reactions similar to these companies’ home country stakeholders, who criticized their complicity with the Chinese government. Moreover, Google’s public protestations possibly hurt its cause as well. For example, an editorial in the China Business Times compares Google to “an uninvited guest telling a dinner host the dishes don’t suit his taste, but he’s willing to eat them as a show of respect to the host.” If a foreign company like Google is viewed as violating the socially constructed norms and expectations regarding how a guest should behave toward its host, this would likely diminish its moral legitimacy in the host country.

Regarding cognitive legitimacy, even though Google rapidly gained market share in China from 2006 until 2010, its relatively short-lived tenure as well as the presence of domestic competitors likely prevented it from gaining the “taken-for-granted” status that it has achieved in other countries where its dominance has resulted in “Google” representing not only a noun, but also a verb (such as “Google it”). The quick rise and quick fall of Google in China indicates a lack of cognitive legitimacy from the perspective of the general public in China. For instance, a critical opinion piece in the People’s Daily argued that Google “is not just a search engine tool—it is a tool to extend American hegemony” and compared Google to another instrument of economic colonialism by calling it “America’s British East India Company” (Zheng, 2011). While it is likely that not all Chinese citizens agreed, many with a more nationalist bent likely sided with their own government against Google. This would make it very difficult, if not impossible, for firms like Google and Yahoo to be viewed as “necessary” or “inevitable”—crucial ingredients underpinning cognitive legitimacy (Liu et al., 2014).

These shifts in legitimacy help explain not only the motivation, but also the timing of government intervention faced by these firms both at home and abroad. Interestingly, while the political risk faced by Google and Yahoo in China has garnered considerable attention (especially in the period during Google’s publicized conflicts with the Chinese government), these firms had been experiencing political risk at home years earlier as a result of their actions in China. Moreover, being a legitimate presence in one market seemed to backfire in the other on more than one occasion: Yahoo’s attempts at conciliation with the Chinese government earned it censure at home, while Google’s prominent status at home raised suspicions about its appropriateness overseas. In the end, the presence and activities of firms such as Google and Yahoo in China seem to have resulted in diminished legitimacy both at home and abroad, contributing to a loss of market share, wealth, and goodwill due to political risk.
DISCUSSION

Heightening political risk, government intervention is driven by a complex web of economic, social, and political concerns. We have argued that the BPA, PIA, and LBV each provide key insights on these factors. Individually, however, each has limitations. The BPA struggles to explain why governments are selective in their intervention, even when they have the power to do so (Henisz and Zelner, 2005). The PIA can be criticized along similar lines, as the lack of structural constraints in a country’s political institutions does not lead inevitably to political risk. The LBV helps to address the concern that the BPA and PIA are undersocialized and can help account for why a government may or may not desire to intervene. Yet, the LBV also has limitations: alone, it cannot account for whether a government has the power or ability to intervene. Individually, each theory is necessary but not sufficient to explain or predict political risk. Instead, we argue that a multiparadigmatic approach that incorporates multiple conceptual perspectives and considers both home and host country factors will result in better explanatory and predictive power for the political risk faced by firms in a broad array of industries in the developing and developed world alike.

While Google and Yahoo represent relatively unique cases, they are far from alone. We argue that a more holistic approach provided by using multiple theoretical lenses can help to explain better and predict many different firms’ political risk experiences. Table 2 indicates ways that the three approaches together can contribute to a holistic, integrative understanding of the political risk phenomenon.

Contributions

At least three contributions emerge from this article. First, both the government’s ability (the strengths of the PIA and BPA) as well as its motivation to intervene (the strengths of the LBV) are now better accounted for. For intervention to occur, both forces must be present. A government with motivation but not ability will be thwarted in its desire to change the status quo. Conversely, a government with the ability but not the motivation to intervene will not feel compelled to do so. Thus, these three conceptual lenses can paint a more nuanced and accurate picture of a government that intervenes selectively rather than indiscriminately—more in line with how governments actually act in a globalized environment. We see this play out in the case of Google and Yahoo, where the PIA and BPA do a good job of explaining why the Chinese government would have the ability to intervene in either firm’s operations, but the LBV is needed to explain why the government was more motivated to interfere with Google than Yahoo. Likewise, at home, the U.S. government had both the leverage and the motivation to call both companies to task for their activities overseas.

Second, by considering issues of power, institutions, and legitimacy concurrently, a more holistic approach allows for greater generalizability across industries and countries (Peng, Wang, and Jiang, 2008). This is a key development for the political risk field, given the increase in FDI across all sectors of the global economy—extractive, manufacturing, and services alike—as well as the increasingly complex patterns of FDI around the world (Boddewyn, 2014; Young et al., 2014). As the case of Google and Yahoo suggests, the assumption that service industries are largely immune from political risk (Jones, 1995) no longer holds. This is a critical issue, as service firms now undertake more than 60 percent of all FDI worldwide (Kolstad and Villanger, 2008; The Economist, 2013).

Google’s industry was particularly sensitive in China because search engine firms and other information technology firms generate and control large sources of information by their very nature. However, China is not alone in this regard. Governments in developing and developed countries alike are sensitive about what information is available to what parties. This is reflected in laws regarding censorship and limiting foreign operations in many information-related service sectors around the globe. Events such as the Wikileaks and the Snowden revelations of the U.S. National Security Agency’s surveillance have only served to fan the flames of such concerns. In addition to China, in Europe, Brazil, and elsewhere, citizens and governments are now protesting the surveillance activities and involvement of U.S. firms, creating additional scrutiny—and political risk. Thus, as firms in industries such as search engines, telecoms, and financial services continue to expand globally, the nature of their business is likely to result in increased tensions with governments around the world (The Economist, 2013).

Finally, a holistic approach allows us to consider how a firm’s home and host country contexts affect...
Table 2. A comprehensive framework for a holistic understanding of political risk

<table>
<thead>
<tr>
<th></th>
<th>Bargaining power approach (BPA)</th>
<th>Political institutions approach (PIA)</th>
<th>Legitimacy-based view (LBV)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary focus</td>
<td>The influence of fixed assets and knowledge spillovers on the balance of power between governments and firms.</td>
<td>The structural attributes of a country’s political institutions that may constrain a government’s ability to change policies easily.</td>
<td>How the legitimacy of a firm may influence a government’s motivation to intervene in its activities.</td>
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<tr>
<td>What this approach can contribute to a holistic understanding of political risk</td>
<td>Helps to understand the power dynamics between actors with imperfectly overlapping wants and needs, such as governments and firms, and how these dynamics can change over time.</td>
<td>Recognizes that “the government” is not a unitary actor, but one comprised of different branches and different actors who wield the power to act as well as the power to veto action desired by others.</td>
<td>Helps to unpack the “black box” of what influences governments to desire to intervene in the operations of some firms but not others.</td>
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<tr>
<td>Future research opportunities that are implied by a holistic approach to understanding political risk</td>
<td>Understand when/how the exercise of bargaining power may weaken legitimacy.</td>
<td>See how the preferences of actors at key “veto points” may change depending on the firm, industry, or issue area in question, due to legitimacy issues.</td>
<td>Seek to understand strategies organizations may follow to gain, maintain, and repair legitimacy in the eyes of the government and societal actors.</td>
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<td></td>
<td>Explore how firms may increase their bargaining power over time, such as through increased legitimacy.</td>
<td>Explore whether changes in a country’s political constraints impact firms’ bargaining power or legitimacy.</td>
<td>See how firms manage different evaluations of their legitimacy by different actors both within and across countries.</td>
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<td></td>
<td>Examine how the sources of a firm’s bargaining power vis-à-vis a home country government may differ from those traditionally considered vis-à-vis a host country government.</td>
<td>Examine how attempts by firms to change political institutions may affect their legitimacy.</td>
<td>Examine how legitimacy may be used as a source of power for firms in their relations with governments.</td>
</tr>
</tbody>
</table>

its political risk. The case of U.S. search engine firms such as Google and Yahoo is particularly instructive: due to their actions in China, they faced political risk both abroad and at home. Overall, moving past the traditional focus on the host country to also incorporate the home country will enhance the predictive and explanatory power of political risk research. The complex interactions between home and host country factors, as well as the potentially different evaluations of legitimacy by actors in these two environments, may indicate how difficult high legitimacy at home and abroad may be for firms to attain. As legitimacy is an important informal institutional driver (Suchman, 1995), the LBV helps to extend the institution-based view (Meyer and Peng, 2005; Peng et al., 2008) and thus our understanding of how informal and formal institutions both at home and abroad affect firms’ political risk (Peng, Sun, and Blevins, 2011).

**Practical implications**

Along the three dimensions of legitimacy—pragmatic, moral, and cognitive—at least three practical implications emerge. In terms of pragmatic legitimacy, foreign investors and managers need to demonstrate and disseminate the benefits they bring to the host country (e.g., jobs, taxes, and technology) through tactics such as lobbying, advertisements, and direct communication. To
show direct, pragmatic benefits, firms may also take actions consistent with government preferences (Marquis and Qian, 2014). For example, in China, when the government calls for firms to “go west,” most multinationals hesitate. However, Texas Instruments (TI) has positively responded to such a call by establishing a major semiconductor plant in Chengdu. TI has not only acquired significant first mover advantages in Western China, but has also earned a great many kudos throughout China (China Daily, 2013). Such an action thus enhances TI’s legitimacy in the eyes of the government and the public, ultimately reducing its political risk.

To gain moral legitimacy, firms may participate in high-profile disaster relief efforts (as firms have recently done after hurricanes, droughts, tsunamis, and other humanitarian crises around the world, ranging from developed countries such as the United States and Japan to developing regions such as Africa and Southeast Asia) (Baker, 2009; Baker and Hill, 2013). Of course, managers need to make sure that their firms are perceived as doing “the right things for the right reasons,” rather than as a symbolic gesture or a means to increasing profitability (Suchman, 1995). Firms that are seen to be engaged authentically with the communities they support are less likely to be perceived as purely profit-motivated in their response to disasters. For example, Proctor and Gamble’s “Tide Loads of Hope” program is likely to be perceived as authentic and supportive when it supports impacted communities, but it is unlikely to be effective—and may trigger a backlash—when it is seen as a ploy to sell more laundry soap (Baker et al., 2014).

Enhancing cognitive legitimacy is inherently challenging, especially for foreign firms, which must overcome liabilities due to their foreignness or their country of origin (Jimenez, Luis-Rico, and Benito-Osoria, 2014; Kostova and Zaheer, 1999; Stevens and Shenkar, 2012). It will be a long-term endeavor leveraging MNEs’ long tenure of operating in a host country environment (Henisz and Zelner, 2005). For example, Austrian energy drinks maker Red Bull not only sponsors sports teams and car and motor cycle race teams around the world, but it also sponsors a prime time program on the dedicated military channel of China Central Television (CCTV). “Red Bull salutes the Chinese military,” exclaims the Red Bull commercial every weekday evening on CCTV. Because typically only Chinese firms would air commercials to sponsor CCTV’s military channel, a lot of well-educated Chinese college students whom we interviewed have (mistakenly) taken for granted that Red Bull is a Chinese firm. While this may be an extreme case, the necessity to build cognitive legitimacy by demonstrating loyalty to a country’s most popular (or most sacred) institutions such as sports teams and the military is clearly shown.

**Future research directions**

At least four promising avenues for future research emerge. First, continued conceptual development within each of the three conceptual approaches is needed. For instance, opportunities exist for further conceptual development in the BPA, perhaps starting with the need to revisit several common assumptions of the theory. For example, the BPA traditionally assumes that, over time, a host government’s bargaining power will increase and that it will then unilaterally change the terms of a deal with a foreign firm. In the case of Google, it is the foreign firm that threatens not to abide by the initial bargain as a result of increased bargaining power after entry—an inversion of this classic BPA assumption. There is also a need for a better understanding of the antecedents of MNEs’ bargaining power at home, as these are likely to differ in some cases from those overseas. Moreover, although knowledge spillovers play a key role in traditional BPA theory, the examples of Google and Yahoo suggest that the role of these spillovers and their relationship with bargaining power obsolescence may need to be reconsidered in a globally competitive environment.

Second, we believe that a multiparadigmatic approach creates opportunities to understand better how these conceptual approaches complement each other. While the three approaches may not always carry equal weight in all situations, they are all needed to have a complete picture of firms’ political risk. For example, the BPA emphasizes that firms should maximize and act on their bargaining power. Yet the LBV suggests that leveraging bargaining power vis-à-vis a government may result in short-term gains but long-term damage to a firm’s legitimacy in that country (Henisz and Zelner, 2005). Likewise, attempts to change or influence the political institutions of a country may not only increase a firm’s ability to prevent political changes in the short run, but may also increase the likelihood of future conflicts if its actions are seen as unwelcome meddling in domestic politics (Bucheli and Salvaj, 2013). Also,
although the PIA has acknowledged that differences in preferences held at key veto points can constrain a government’s ability to intervene (Henisz and Zelner, 2006), such political constraints are usually treated as a country-level attribute that is constant across issue areas. Yet, the political science literature argues that political dynamics within a country differ greatly across issue areas (Brewer, 1992). A holistic approach may shed light on how preferences of different governmental actors can align or clash with respect to how given firms or industries are perceived, resulting in within-country variation in political constraints (Lieberthal, 1995).

Third, political risk theory continues to evolve from a narrow focus on a dyad between a foreign firm and a host government in the early days of the BPA to a broader, multilevel, and multiactor conceptualization that is beginning to consider the impact of society on business—and business on society (Boddewyn, 2014). By widening the focus of political risk studies beyond that of a single host country, the LBV has the opportunity to inform the complex, nuanced, and global interplay of a firm’s political risk. The BPA has traditionally looked at economic resources as a source of firm bargaining power (Makhija, 1993; Vachani, 1995). Yet, leveraging the ability to provide a social benefit as a bargaining chip in negotiations with a government is not inconsistent with the BPA focus on resources and capabilities one party can provide that the other desires.

Finally, the holistic approach taken here has implications for the specific mechanisms driving governmental action as well as the issue of pluralism in political risk research. The BPA traditionally focused on “the government” as a single actor. However, the development of the PIA and more recently the LBV suggests the importance of recognizing that, like any organization, the government is both a collective actor as well as comprised of individuals and coalitions of individuals with different preferences and priorities (Cyert and March, 1963). In this article, we note that governments and society are made up of many actors and have suggested a number of ways that governmental and societal actors may act that influence a government’s motivation to intervene in firms’ activities.

CONCLUSION

In the twenty-first century, political risk has changed in its nature but not its importance. We have argued that political risk does not simply “happen” to firms as a deterministic result of their initial bargaining position or country-level attributes, but rather that firms’ actions can greatly influence their bargaining power, legitimacy, and the political institutions with which they interact. To a large extent, firms can create—or mitigate—their own political risk. In conclusion, scholars interested in political risk may yield larger dividends if they can leverage a more holistic approach with a new focus on the intriguing but underexplored aspects of legitimacy-building—both at home and abroad.

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