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MNE responses to host country geopolitical conflict

The strategic MNE decisions of adjusting operations in Russia post-Ukraine invasion

International Business

Bachelor's thesis

Author:

Tytti Virta

Supervisor:

D.Sc. Jonathan Van Mumford

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Geopolitical conflicts, such as war, influence the institutional environments in which MNEs operate. MNE responses to such geopolitical changes vary depending on different factors within the company, industry, or home country from not making any change to full-scale divestment. The still ongoing Russia-Ukraine conflict has garnered significant attention from Western countries and had major implications for MNEs operating in Russia. Formal and informal home and host country institutional pressures have forced MNEs to reconsider their strategies and possibly adjust their Russian operations according to those institutional demands. In this thesis, I examined the effect of geopolitical turbulence, war in particular, on the MNE host country's business environment, the drivers influencing MNEs to make changes to their operations and the different MNE responses to these institutional pressures. I attempted to answer these questions on a general level and in the case of the 2022 Russian invasion of Ukraine through the lens of the institutional theory.

I found that the significance of geopolitical events in a host country to an MNE can be major. Host country regulatory changes and uncertainty can cause disruptions to MNE operations. Home governments can for example impose sanctions on the MNE host country greatly impacting business activities to the point where divestment is considered, while host country governments can impose counter-sanctions hindering the possibility to exit. In addition to financial considerations, not complying with sanctions can cause damage to company reputation, forcing MNEs to calculate between operational costs of leaving and the reputational costs of staying. To respond to these varying institutional pressures, MNEs can in general employ 3 different tactics: conformity (complying with home pressures), avoidance (complying with host pressures) or balancing (finding a balance between both), depending on their specific situation and strategic goals. All of these three strategies have been used by Western MNEs in Russia since the 2022 invasion.

Keywords: geopolitics, conflict, war, divestment, Russia-Ukraine conflict, institutional theory

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Geopoliittiset konfliktit, kuten sota, vaikuttavat monikansallisten yritysten toimintaympäristöihin ja niissä vaikuttaviin instituutioihin. Yritysten reaktiot tällaisiin geopoliittisiin muutoksiin vaihtelevat eri tekijöiden mukaan riippuen yrityksestä, toimialasta tai sen kotimaasta. Tilanne ei välttämättä joidenkin yritysten kohdalla vaadi mitään toimia, kun taas toiset päätyvät lopettamaan kaiken toiminnan isäntämaassa. Käynnissä oleva Venäjä-Ukraina-konflikti on herättänyt mittavaa huomiota länsimaissa, mikä on vaikuttanut Venäjällä toimiviin yrityksiin. Koti- ja isäntämaiden muodolliset ja epämuodolliset institutionaaliset paineet ovat pakottaneet yritykset uudelleenarvioimaan strategioitansa ja mahdollisesti sopeuttamaan toimintojansa Venäjällä institutionaalisten vaatimuksien mukaisesti. Tässä tutkielmassa tarkastelin geopoliittisen myllerryksen, erityisesti sodan, vaikutusta yrityksen isäntämaassa vallitsevaan liiketoimintaympäristöön, sekä tekijöitä, jotka ovat saaneet yrityksiä muuttamaan toimintojansa, sekä erilaisia monikansallisten yritysten reaktioita sodasta seuraaviin institutionaalisiin paineisiin. Pyrin vastaamaan näihin kysymyksiin instituutioteorian kautta yleisellä tasolla, sekä lisäksi vuoden 2022 Venäjän hyökkäyksen tapauksessa.

Tutkimani mukaan isäntämaan geopoliittisten tapahtumien merkitys yritykselle voi olla hyvinkin merkittävä. Isäntämaan muutokset laissa ja säädöksissä sekä niiden epävarmuus voivat aiheuttaa häiriöitä liiketoimintaan. Kotimaan viralliset tahot voivat esimerkiksi asettaa taloudellisia sanktioita yrityksen isäntämaalle vaikuttaen liiketoimintaan siten, että markkinoilta vetäytymistä harkitaan. Isäntämaan tahot taas voivat asettaa vastasanktioita vaikeuttaen mahdollisuutta lähteä markkinoilta. Taloudellisen haitan lisäksi sanktioiden noudattamatta jättäminen voi aiheuttaa mainehaittaa, mikä pakottaa yritykset punnitsemaan vetäytymisen kustannuksia markkinoille jäämisen kustannuksia vastaan. Vastatakseen näihin vaihteleviin institutionaalisiin paineisiin yritykset voivat yleisesti ottaen käyttää kolmea eri strategiaa: sopeutuminen (conformity, kotimaan vaatimusten noudattaminen), välttely (avoidance, isäntämaan vaatimusten noudattaminen) tai tasapainottelu (balancing, tasapainon etsiminen monen tahon vaatimusten välillä). Strategian valintaan vaikuttavat yrityskohtainen tilanne sekä tavoitteet. Länsimaalaiset yritykset Venäjällä ovat havaitusti käyttäneet näitä kolmea strategiaa vuoden 2022 Ukraina-hyökkäyksen jälkeen.

Avainsanat: geopolitiikka, konflikti, sota, divestointi, Venäjä-Ukraina-konflikti, instituutioteoria

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1 Introduction

1.1 Background

On February 24, 2022, Vladimir Putin, the President of Russia, started a large-scale invasion of Ukraine, and this aggression by Russia was met with widespread condemnation across the globe (Owens 2023). The Russia-Ukraine war is regarded by many as one of the most profound geopolitical shocks of this century for multinational enterprises (MNEs) and their stakeholders, with some even referring to it as the most influential event in Europe after World War II (Pereira, Bašić, Bogunovic & Barcelo 2022). It must be noted that war is more than just armed conflict: it also involves economic warfare, often including broader armed conflict dynamics (Centeno & Enriquez 2016).

When confronted with external pressures beyond their control, such as geopolitical turbulence, MNEs may choose to partially or entirely withdraw their operations. The decision to exit allows MNEs to reconsider their portfolios and adjust their strategies to align with the new situations of the market. (Kafouros, Cavusgil, Devinney, Ganotakis & Fainshmidt 2021.) This process is commonly referred to as divestment, which involves reducing the size or scale of a business. During the divestment process, firms may choose to dispose of subsidiaries, units or decrease their equity ownership in certain ventures. (Evenett & Niccolò 2023.)

The globalization of firms to and from emerging markets has highlighted the significance of Institutional Theory within the study of International Business (IB) (Sahin & Mert 2021). Strategic decisions made by MNEs are influenced not only by their internal capabilities and industry dynamics but also by the formal and informal obstacles imposed by their institutional environments (Lee, Peng & Lee 2008). Formal institutions encompass laws and regulations, and informal institutions encompass dominant practices or norms (Owens 2023). Wars bring out significant economic, social, and political turbulence, leading to changes in both the formal and informal institutional landscapes of the home and host markets of MNEs (Witte, Burger & Pennings 2020). Furthermore, MNEs operating in war zones may encounter conflicting new institutional pressures in many jurisdictions (Kostova, Roth & Dacin 2008). This influence is particularly pronounced in emerging markets, where institutional frameworks often differ from those

found in developed markets. Given that Russia is classified as an emerging market (Rebiazina, Sharko & Berezka 2024), adopting an institutional-based perspective offers valuable insights into understanding the institutional environments for MNEs in warring states, such as Russia.

1.2 Aim of the thesis

The aim of this thesis is to examine the effects of geopolitical conflict, war in particular, within host countries on MNEs with a focus on understanding how such conflict shapes MNEs' strategic decision-making to adjust operations accordingly. This topic will be further examined using the 2022 Russia-Ukraine conflict as a case example throughout the thesis. As the conflict is still on-going and one of the most pressing current geopolitical events, its impact on Westerns MNEs in Russia has been and still is significant. The effects on MNEs will be looked at through the lens of the institutional theory. The main research question is: How does geopolitical conflict in a host country influence MNE strategic decisions regarding operational adjustments? To answer the main research question, three subquestions will be discussed:

- How does geopolitical conflict in MNE host country affect the business environment?
- What are different factors influencing MNE responses?
- What have the responses been in the Russia-context?

The subquestions provide a structure for the thesis. In chapter 2, the effects of geopolitical conflict on the business environment of MNEs will be discussed, first on a more general level and then applied to the case of the Russia-Ukraine conflict. The geopolitical factors prompting strategic changes in MNE behaviour are examined both generally, and in the Russia-Ukraine context in chapter 3, along with the analysis of actual MNE responses in Russia.

2 Impact of geopolitical conflict on business environment

2.1 Understanding the geopolitical conflict

The conflict between Ukraine and Russia is one of the most influential global business concerns, extending beyond its political and social dimensions to directly shape business operations worldwide (Ratten 2022). The invasion has triggered significant transformations within Russia's political, economic, and social landscape, influencing governmental policies, international alliances, and public sentiment. Politically, it has fuelled imperial nationalism in Russia, shaping the country's foreign policy decisions and regional alliances (Kuzio 2022). Economically, experts predict a recession surpassing previous crises, accompanied by inflation and increased living costs for households. These implications are further worsened by the withdrawal of services by international financial institutions in protest against the invasion (Nezhyva & Mysiuk 2022, He 2022.) This has been particularly evident in its impact on regional stability and international relations, affecting IB and MNEs operating in Russia (Ahmed, Hasan & Kamal 2022). Inter-state wars pose significant challenges for MNEs, especially when involving significant economic and political powers, as they tend to disrupt the highly interdependent national and multinational economic and political systems (Witte, Burger & Pennings 2020).

To comprehend the impact of war on MNEs, it is essential to examine the relationship between war and MNEs in an institutional context. The institutional environment plays a crucial role in shaping MNE strategy and behaviour (Doh, Lawton & Rajwani 2012). IB scholars have used institutional theory to investigate how MNEs navigate politically unstable environments, particularly in the context of inter-state wars (Witte, Burger & Pennings 2020). As war becomes entrenched within a broader institutional framework, it can disrupt market functioning and institutional dynamics, leading to regulatory changes that affect MNE operations (Thoradeniya, Lee, Tan & Ferreira 2022). Additionally, wars have the potential to change the preferences of MNEs' institutional stakeholders, necessitating organizational responses to maintain legitimacy and competitiveness (O'Reilly & Powell 2015, Peng 2003). Legitimacy is defined 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," and it is a central concern for MNEs. Without legitimacy, MNEs face challenges in sustaining

growth, acquiring resources, and succeeding in their operating environments. (Suchman 1995, 574.)

The heightened geopolitical tensions and market volatility have magnified regulatory challenges for MNEs in Russia, negatively affecting various sectors such as energy markets, commodity trade, and financial markets, introducing additional layers of regulatory complexity and uncertainty (Theiri, Nekhili & Sultan 2022). Additionally, the conflict has triggered currency fluctuations impacting the European stock market and potentially affecting the exchange rates of the Russian ruble. These fluctuations pose challenges for MNEs and financial transactions, escalating risks and uncertainties in currency markets (Boungou & Yatié 2022). Such fluctuations can reoccur through the stock returns of multinational companies, influencing their financial performance and competitive position (Sandamini, Jeewanthi & Indrani 2021).

This change in the regulatory environments of MNEs often leads to the introduction of new regulations as a tool of war (Casson & da Silva Lopes 2013). Wars prompt non-governmental actors to impose new expectations on business entities, compelling MNEs to adapt in order to mitigate risks to their legitimacy (Witte, Burger & Pennings 2020). The effects of the Russia-Ukraine conflict on the business environment of MNEs operating in Russia underscore the need for MNEs to adapt to a complex regulatory landscape while managing geopolitical risks and maintaining legitimacy in their operating environments.

2.2 Impact on business environment

During inter-state wars, institutional tensions and conflicts for MNEs are particularly pronounced. MNEs must manage local institutional stakeholders like employees and host governments, and the demands of international stakeholders, including home governments and customers (Getz & Oetzel 2009), as illustrated in Figure 1. These pressures can sometimes conflict with each other, leading MNEs to adopt purposive actions aimed at shaping their institutional environment in response (Owens 2023).

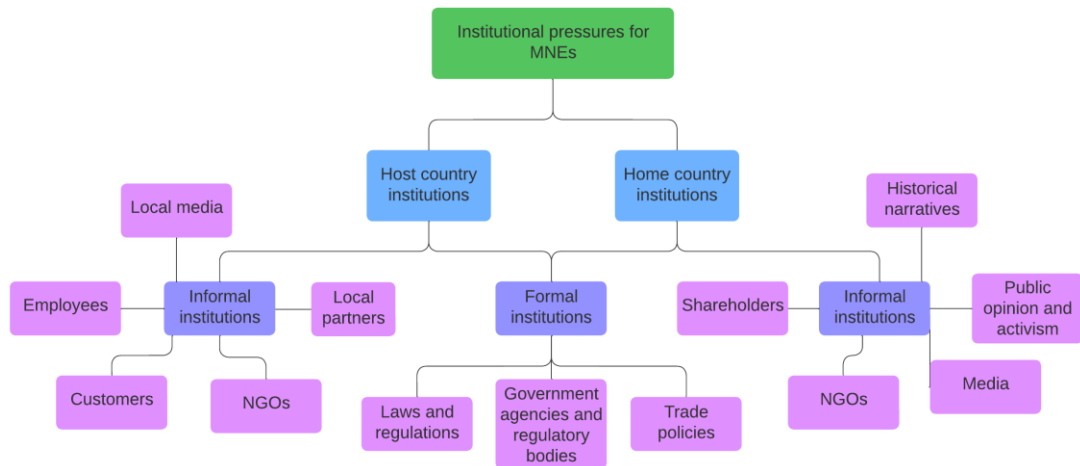


Figure 1 Institutional pressures for MNEs

Host market formal institutions have significant power over MNEs' behaviour in foreign markets, as host governments use regulatory power to control MNE activities (Grewal & Dharwadkar 2002). During political conflicts, such as the Russian-Ukrainian conflict, host governments are more inclined than normal to alter existing regulations or impose new ones (Witte, Burger & Pennings 2020). For instance, host governments may in uncertain conditions impose new regulations legalizing the expropriation of MNE assets (Casson & da Silva Lopes 2013). In 2022, Russia threatened the seizure of assets of MNEs that were planning to cease operations due to the invasion (Financial Times 2022a). Furthermore, there were reports of corporate leaders facing arrest for criticizing the government. Heineken beer disclosed receiving official warnings from Russian authorities, threatening with nationalization if they were to suspend operations of its Russian subsidiary (New York Times 2023).

Home market formal institutional pressures encompass laws, rules, and mechanisms for monitoring and sanctioning, which shape specific types of organizational behaviour while constraining others (Scott 2014). Regulatory factors such as rules on investment, intellectual property protections and requirements of transparency have a direct impact business activities. During inter-state wars, changes in the home regulatory environment for MNEs can occur as states employ economic regulation as a tool of warfare. (Casson & da Silva Lopes 2013.) States and multinational governmental organizations, referred to as the sender, implement economic sanctions in inter-state conflicts to inflict harm on enemies of state, corporations, or individuals, known as the target, to change their behaviour (Felbermayr, Morgan & Syropoulos 2021). As non-military coercive measures,

they hold the capability to swiftly disrupt the international business landscape, often with little warning, and to reshape the current rules and regulations (Meyer, Fang, Panibratov, Peng & Gaur 2023). In recent times, there has been a notable uptick in both the scale and frequency of sanctions being enforced (van Bergeijk 2021). The political goals behind sanctions commonly revolve around penalizing the target country for infractions of international law or widely accepted norms, such as those concerning human rights. Common types of sanctions are for example restrictions or bans on exports and imports, FDI, investments, transactions, technology transfer and travel (Meyer, Fang, Panibratov, Peng & Gaur 2023). The escalating geopolitical tensions indicate a potential for increased government interventions that could further constrain IB activities (Meyer & Li 2022).

Russia's invasion of Ukraine in February 2022 inflicted a strong response from the US and its allies, including economic sanctions against Russia and providing assistance to Ukraine (Ciravegna, Ahlstrom, Michailova, Oh & Gaur 2023). The invasion triggered condemnation from approximately 40 nations, leading to extensive economic, financial, and trade sanctions being implemented. The governments of the Group of Seven (G7) nations, along with the Member States of the European Union (EU), Australia, Iceland, Liechtenstein, New Zealand, Norway, the Republic of Korea, Switzerland, and Taiwan, have imposed sanctions on Russia. (Evenett & Niccolò 2023.) The sanctions are often framed as efforts to hinder Russia's capacity for warfare. Particularly, the EU's sanctions have the aim of weakening Russia's economic foundation and reducing its ability take part in war by restricting access to critical technologies and markets. The EU has implemented a ban on new investments in the Russian energy and mining sectors. On April 6, 2022, President Biden issued Executive Order 14071, which bans new investments in Russia by "US persons, wherever located." (Evenett & Niccolò 2023, 514.)

Targeted sanctions are specific in terms of commercial activity, type of company, good, service, or technology. Since the Western sanctions on Russia include restrictions on imports and exports, complying MNEs in Russia may experience significant difficulties in sourcing goods and services from Western countries and exporting their products there. (Evenett & Niccolò 2023.) Sanctions can pose significant disruptions for firms engaged in technological innovation, particularly those that rely on imported and domestic knowledge. In theory, restrictions on technology transfer could hinder technological advancement in host countries. For instance, research and development subsidiaries that

create innovations typically rely on sharing technology between foreign a subsidiary and headquarters. (Meyer, Fang, Panibratov, Peng & Gaur 2023.)

In addition to the significant challenges created by sanctions imposed by home countries on MNE host countries, counter-sanction measures implemented by host governments further escalate the difficulties of MNEs by introducing stricter regulations and more frequent inspections, thereby hindering international cooperation, while additionally making divestment difficult and an unattractive choice for MNEs. (Hinčica, Řezanková & Worcester 2020). In 2022, in response to the Western sanctions, Russia enacted countersanctions shortly after (Evenett & Niccolò 2023).

3 MNE decision-making in response to geopolitical conflict

3.1 Factors influencing MNE decision-making

In strategic research, the geographical location of a subsidiary within the host country has long been acknowledged as a major factor influencing the level of political hazards it faces operating in a country at war. If a firm remains shielded from direct harm, its vulnerability decreases, thereby reducing the likelihood of exiting. In situations where exposure to war-related risks is minimal, foreign MNEs are expected to experience higher costs by exiting compared to the costs associated with maintaining operations. (Dai, Eden & Beamish 2017.) While the Ukraine-Russia conflict has sparked geopolitical tensions and economic fluctuations, the absence of direct war activities on Russian territory reduces the immediate threats faced by MNEs operating in the region. With low exposure to risks, the pressures of the actual war to exit may be minimal.

Financial factors, particularly unsatisfactory performance, have been identified as the primary determinant influencing a firm's decision to divest (Berry 2010). Research suggests that a decrease in a unit's profitability substantially raises the probability of divestment of that particular unit (Ravenscraft & Scherer 1991). Studies indicate that firms generally avoid divesting profitable units, indicating that such instances are uncommon (Capron, Mitchell, & Swaminathan 2001). However, assuming a straightforward relationship between poor performance and divestment is overly simple without considering potential moderating factors that could influence this relationship (Berry 2013). Besides the common belief that firms leave markets due to falling profits and poor performance, other factors also play a role in their decisions (Tan & Sousa 2018). Prior research has shown that firms leaving a foreign market may be affected by factors such as political risk (Soule, Swaminathan & Thanyi 2014), seeking better opportunities (Berry 2010), risen operational costs and damage to company reputation (Mol, Rabbiosi & Santangelo 2023), the ethical values of top management teams and size of the subsidiary (Song 2015).

The war between Russia and Ukraine shows a clear determinant that fundamentally alters divestment decisions for firms. In this geopolitical context, the war itself acts as the main reason behind MNE divestment, surpassing the usual motivations that traditionally guide similar strategic IB decisions. The complicated nature of the conflict reshapes the risk

landscape for businesses, forcing them to instead of traditional reasons of divestment prioritize the responses to the geopolitical climate. (Sarkodie, Keefe & Boasiako 2023).

3.1.1 Sanctions

After the invasion of Ukraine, Russia was hit with various sanctions imposed by Western countries. These sanctions have the ability to negatively affect Russia's economy and the business of Western MNE's affiliates in Russia. These sanctions include for example trade, investment and financial limitations. However, none of these sanctions by the EU or the US mandate the divestment of Western companies from Russia. (Evenett & Niccolo 2023.) While the consequences of sanctions may compel firms to completely withdraw, more precisely targeted sanctions provide room for a variety of strategic responses. Sanctions affect not just companies within the sanctioned nation, but also their associates and consumers (Meyer, Fang, Panibratov, Peng & Gaur 2023).

From the viewpoint of MNEs, sanctions suggest institutional shifts in both their host and home markets, impacting various areas of their operations (Cuervo-Cazurra, Gaur & Singh 2019). International sanctions frequently slow down the advancement of market-supporting institutions and create obstacles to IB activities. For MNEs, the negative consequences of sanctions on profits include for example disruptions in supply chains and heightened operational uncertainty. (Panibratov & Gaur 2022.) For MNEs heavily involved in a sanctioned country, sanctions raise important legal and ethical questions. Meyer and Thein (2014) found that the MNE responses depend on various determinants, including those of the firm itself, its industry, and its country of origin. In response to sanctions, MNEs must make critical strategic choices regarding their operations: do they withdraw entirely or partially, try to find ways to avoid the sanctioned operations and/or transfer operations and resources to other countries? (Meyer, Fang, Panibratov, Peng & Gaur 2023.)

In 2022, the Russian government issued regulations and restrictions on companies headquartered in "unfriendly nations," hindering their ability to distribute dividends and sell assets. For companies seeking to sell shares or assets, permission from a government agency is required. This approval process involves getting permission from the Russian government, and the price of sale has to include a minimum discount of 50%. Additionally, the appropriate Russian agency has the authority to implement an

unfavourable payment schedule for the MNE unless the company voluntarily donates up to 10% of profits to the Russian state. (Evenett & Niccolò 2023.)

These measures increase regulatory hurdles for companies from "unfriendly nations" looking to distribute dividends or sell assets in Russia. Additionally, a rule issued by Russia in August 2022 introduced a new requirement for certain Western financial and energy companies to apply for permission from the Russian president before selling off their shares. These specified companies include major American, European, and Japanese manufacturing and financial firms. These measures collectively serve to discourage divestment MNEs from countries that have imposed sanctions on Russia. Additionally, firms considering exit are advised to assess whether their withdrawal could escalate tensions and whether the potential harm to people outweighs any benefits. This guidance implies that firms involved in the production of critical and essential products and services should refrain from exiting conflict zones. (Evenett & Niccolò 2023.)

An MNE not targeted by sanctions may still feel it is unjust to abandon its local customers, who may have had no involvement in the conflict. Firms may also hesitate to sever long-standing relationships with employees or suppliers or to halt operations if their products and services are deemed socially essential, such as the provision of life-saving medicine. There are also exceptions to the sanctions. For instance, some of the EU's sanctions include exceptions for road freight operators involved in the transportation of "pharmaceutical, medical, agricultural, and food products, including wheat and fertilizers," provided they comply with the regulations. (Evenett & Niccolò 2023, 514.)

Sanctions imposed on Russia by various nations have disrupted the operations of MNEs' affiliates in the country, leading to increased operational uncertainty, disrupted supply chains, and raised transaction costs. While sanctions do not explicitly mandate divestment, they discourage withdrawal due to regulatory hurdles and ethical considerations. MNEs are faced with complex legal and ethical questions, balancing the potential harm to people with the benefits of divestment. Despite these challenges, decisions to exit are influenced by factors such as maintaining relationships with local stakeholders and providing essential goods and services. Overall, sanctions introduce significant hurdles for MNEs operating in Russia, complicating strategic decisions regarding their presence in the country.

3.1.2 Reputational damage

Governmental actions, such as sanctions, have been supported by civil society initiatives, which have demanded MNEs to completely cut off their connections with Russia. Informal institutional influences from the home market typically stem from prominent social actors who mandate appropriate organizational behaviour (Scott 2014). Moral legitimacy involves a favourable normative assessment of the MNE and its operations among stakeholders, based on judgments about whether actions, such as withdrawing from Russia, align with their ethical standards (Suchman 1995). Continuing operations in Russia risks involvement in financing the war for example through taxes (Hotho & Girschik 2019), possibly leading to moral illegitimacy for MNEs. During wartime, moral legitimacy pressures may stem from government directives, customer expectations, and collective social movements protesting against the war (Owens 2023). Social actors in the MNEs' home institutional environments including the society, customers, and employees voice demands on the conflict through social media, public protests, and potential boycotts (Smith 2016).

The goals and obligations of businesses towards society have sparked a dynamic and ever-evolving dialogue, particularly in the past decade with the introduction of the 17 Sustainable Development Goals (SDGs). There is a growing number of stakeholders who anticipate MNEs to conduct sustainable and ethical operations and supply chains internationally (Wettstein, Giuliani, Santangelo & Stahl 2019). If MNEs fail to meet these expectations, they face the risk of facing campaigns from Non-Governmental Organizations (NGOs) and activists, leading to negative effects on their corporate reputation (Maggioni, Santangelo & Koymen-Ozer 2019). The costs associated with reputational damage can be significant, as rebuilding a tarnished reputation is a challenging task (Harvey 2021). Consequently, the risk of reputational damage and the resulting legitimacy deficit are becoming significant drivers for MNEs to engage as responsible corporate citizens and elevate standards locally in the regions where they have a direct presence or through collaborative partnerships (Scherer & Palazzo 2011).

The response of foreign firms conducting business in Russia after the invasion of Ukraine has garnered considerable attention from the media (Evenett & Niccolò 2023). Western MNEs encountered a significant dilemma after the invasion: even in cases where sanctions didn't directly apply, these companies risked facing widespread criticism from

both investors and consumers if they chose to remain engaged in business activities in Russia. (Ciravegna, Ahlstrom, Michailova, Oh & Gaur 2023.) For companies based in Western democracies with operations or suppliers in Russia, responding to the demands from civil society to reassess their presence in the country requires a delicate balance between social responsibility and economic viability. The evolving geopolitical landscape raises critical questions about whether business objectives can take a backseat to societal concerns and prompts MNEs to rethink their strategies in response to these shifting global dynamics (Mol, Rabbiosi & Santangelo 2023).

Finding the right balance between the reputational risks associated with staying in a market and the operational challenge of leaving is a critical consideration for MNEs. In many cases, MNEs discover that one type of cost outweighs the other, leading them to prioritize their strategic decisions accordingly. There are instances where both reputational and operational costs are minimal, simplifying the decision-making process. However, MNEs may also encounter situations where both types of costs are high, presenting a more complex scenario. (Mol, Rabbiosi & Santangelo 2023.) In this context, the balance between operational and reputational factors that MNEs must navigate is crucial, and the strategy they ultimately choose will depend on particular circumstances and variables (Maggioni, Santangelo & Koymen-Ozer 2019).

Mol, Rabbiosi & Santangelo (2023) found that many Danish companies expressed their worry for their local employees as a rationale for remaining in Russia. Using this justification may have severe negative effects if it contradicts stakeholders' condemnation of the country's actions. Some companies are accused of using the expressed worry for local employees as an excuse to continue operations, especially after McDonald's continued to pay salaries for an extra six months after withdrawing. (Financial Times 2022b).

Additionally, the actions of other firms can indirectly result in reputational costs. As more companies opt to withdraw from Russia, it sets an example throughout the industry. The departure of MNEs sends a clear message to the public that exiting is a viable choice, further reinforcing stakeholder expectations for social responsibility. This escalates the reputational burden, especially when competitors decide to exit. (Mol, Rabbiosi & Santangelo 2023.)

In addition to financial and social considerations, moral legitimacy considerations, including ethical standards and societal expectations, influence MNEs' decision-making during geopolitical conflicts. Reputational damage from perceived part-taking in the funding of war efforts or human rights violations pose significant risks, driving MNEs to act as responsible corporate citizens. However, balancing reputational risks with operational challenges and having to choose the appropriate strategy accordingly is a dilemma for MNEs. Stakeholder perceptions and public opinion have significant influence, as evidenced by the reputational costs associated with both staying and exiting the Russian market. Ultimately, MNEs must balance these varied pressures to align their strategic decisions with broader societal expectations while preserving their corporate reputation and legitimacy.

3.2 MNE responses

In the case of heavy institutional pressures stemming from various sources during geopolitical conflict, MNEs may be compelled to take action to manage the changes in stakeholder demands and business environment. For examining MNEs' reactions when faced with institutional pressures to exit, Oliver's (1991) institutional response framework outlines three key strategies: conformity, avoidance, and balancing.

Some MNEs decide to conform to formal institutional pressures in their home markets during a time of conflict. By adhering to home government laws, regulations, and directives, MNEs aim to enhance their resilience and expansion prospects. In the context of war, MNEs are likely to comply with formal economic sanctions imposed by their home markets, as failure to do so can result in negative repercussions. (Meyer, Fang, Panibratov, Peng & Gaur 2023.) In 2021 prior to the invasion, Carlsberg, a Danish brewery, held a market share of approximately 27% in Russia. Immediately after the attack on Ukraine, Carlsberg halted new investments and exports. By the end of March 2022, Carlsberg declared its intention to divest fully from its Russian operations and exit the market. (Mol, Rabbiosi & Santangelo 2023.) This decision demonstrates conformity to home country institutional pressures and reputational concerns over operational considerations.

MNEs aiming to conform to changes in their home market institutions may opt to avoid complying with host market institutional demands. The degree of MNE conformity to informal market institutions in the home market is likely to be affected by the scale of the

MNE's subsidiary in the host market. (Owens 2023.) MNEs with sizable subsidiaries in Russia that are deeply rooted in the Russian institutional landscape may argue that maintaining operations in the country is morally justifiable (Oliver 1991). A chief operating officer of Koch Industries used their responsibility towards their employees to defend the decision to continue operations in Russia. Similarly, the French MNE, Danone, rationalized its choice to remain active in Russia by emphasizing its duty to Russian consumers and local supply chains (Financial Times 2022c).

One motivation for compromising with institutional pressures during wartime can be organizational experience that has developed the MNEs' capabilities in managing political risk (Oh & Oetzel 2017). MNEs lacking experience in conflict countries are typically less resilient, as tolerance for political instability is developed over time. Similarly, experienced and resilient MNEs may exhibit a higher capability of enduring the costs associated with operating in such environments and may refrain from abandoning their operations early on. (Dai, Eden & Beamish 2017.)

Despite facing normative pressures from their home markets to exit states at war, certain MNEs may go for an avoiding response, choosing to maintain their presence in the conflict-affected region. For these MNEs, staying in the warring state may serve as a strategy to evade potential retaliation from the host government in response to divestment actions, while also attempting to ensure the continuity of their operations within the host market (Alaydi, Buck & Tang 2021). The perceived high costs associated with divestment are likely to discourage MNEs from complying with institutional pressures from their home markets, leading them to prioritize compliance to institutional pressures from the host market during times of war (Owens 2023).

In the warring state, such as Russia, foreign firms face significant obstacles to divestment due to market barriers made worse by economic sanctions and heightened uncertainty. With Russia subjected to a variety of economic sanctions and cut off from the global financial system, divesting assets has become particularly difficult for certain MNEs operating in the region. These conditions can severely reduce buyer confidence in the corporate asset market, making divestment difficult for many MNEs. (Owens 2023.) MNEs may perceive that complying with home market institutional pressures to exit a warring state does not outweigh the considerable costs associated with such an exit (Boddeyn & Brewer 1994). This sentiment is especially prevalent among MNEs

operating in capital-intensive industries, such as the energy sector, where the costs of exiting the market are particularly high (Getz & Oetzel 2009).

It's evident that firms from countries designated as 'friendly' by Russia are maintaining operations more than others. These countries include both allies of Russia and neutral countries striving to adopt a diplomatic stance in the conflict. In contrast, most Western countries find themselves categorized as 'unfriendly' by Russia. While airlines like Lufthansa, Austrian Airlines, and KLM-Air France quickly decided to suspend all flights to and from Russia, Turkish Airlines continued its operations serving destinations within Russia. (DeBerge 2023.) These 'unfriendly' nations use varying degrees of confrontational approaches in their relations with Russia, particularly among those nations heavily reliant on Russian fossil fuels. MNEs from countries with a heavy dependency on Russian oil and natural gas tend to demonstrate a slightly higher tendency to remain in the Russian market. For example, despite notable divestments by industry giants like BP and Shell from their partnerships with Russian entities, the French oil company Total Energies has shown resistance to significant divestment actions, owing to its extensive investments in Russia dating back to 1991 (Wall Street Journal 2022).

MNEs may also employ the third strategy recognized by Oliver (1991), balancing. Balancing with institutional demands involves partially complying with pressures from both home and host markets during times of war. This approach allows MNEs to navigate conflicting demands and maintain legitimacy by accommodating various stakeholders. During the Russia-Ukraine war, some MNEs have utilized this strategy, maintaining their presence in the market while scaling back operations, postponing new investments, and suspending certain activities. Additionally, these MNEs have continued to support their local staff by ensuring regular salary payments. For instance, the global snacks giant, Mondelez International, chose a compromising strategy by partially contracting its business in Russia while providing assurances of support to its local colleagues. (Owens 2023.)

The potential for reverting a strategic response is a crucial factor affecting operational costs. If a firm can readily re-enter a market, it helps mitigate concerns about operational expenses. Consequently, divesting a business that is deeply entrenched in the local market and holds valuable intellectual property rights and expertise can result in lasting repercussions, such as technology loss and the emergence of considerable global

competitors. The divestment of a Western MNE with distinctive technology from Russia could boost the technological capabilities and international presence of local competitors, posing further challenges for the MNE's re-entry into the market. (Mol, Rabbiosi & Santangelo 2023.) During the divestment process, certain Western firms have included "buy-back" clauses in sales contracts for their subsidiaries in Russia. For instance, Nissan reportedly sold its Russian subsidiary with a buyback provision lasting 6 years. Similarly, reports suggest that McDonald's may have the option to repurchase its Russian operations within 15 years. This implies that even after completing a divestment, firms may retain the possibility of re-entering the Russian market in the future. (Evenett & Niccolò 2023.)

Table 1 Oliver's (1991) MNE response strategies in the Russian context

Strategy	Case	Justification	Outcome
Conformity	Carlsberg	Prioritization of home country institutional pressures and reputational concerns over operational considerations	Complete divestment from Russian operations, aligning with home market expectations
Avoidance	Koch Industries and Danone	Emphasis on responsibility towards employees, consumers, and local supply chains	Continued operations in Russia despite normative pressures to exit, citing moral justifications
Balancing	Mondelez International	Partial contraction of business operations in Russia, while ensuring support for local colleagues	Maintained presence in the market, scaled back operations and supported local staff, accommodating various stakeholders during the conflict
Balancing (buy-back clauses)	McDonald's and Nissan	Potential for re-entry into the market, mitigating concerns about operational expenses	Buyback clauses in divestment contracts provide flexibility for potential re-entry into the Russian market in the future

As illustrated in Table 1, MNEs demonstrate various strategies while facing institutional pressures due to operating in a warring state condemned by others. The inclusion of buyback clauses in a divestment contract can be seen as a strategic move to provide flexibility and potential to re-enter the market in the future. This aligns closely with the balancing strategy, as it allows MNEs to navigate conflicting pressures from both home and host markets by maintaining some level of presence in the host market while also

preparing for potential future changes in the institutional landscape. Therefore, it is reasonable to include buyback clauses under the balancing strategy in this context, as it reflects a strategic response aimed at managing conflicting institutional pressures and maintaining options for future action.

Conforming to home market institutional pressures suggests the prioritization of expectations of the home country, as demonstrated by Carlsberg's decision to divest fully from its Russian operations amid conflict tensions. Drivers for the conforming strategy could include the MNE's sensitivity to its domestic environment and seeking to maintain a favourable reputation and legitimacy among domestic stakeholders to take part in ethical conduct and social responsibility to enhance its position and long-term viability in its home market. Avoiding divestment to maintain operations in the host country can be the result of a variety of considerations, such as a desire to preserve market presence and competitiveness, safeguard relationships with local stakeholders including employees and suppliers, maintain access to critical resources or markets, or strategically position the company for future opportunities once the conflict or institutional pressures subside. There can also be significant costs associated with divestments, including potential financial losses from asset depreciation, contractual penalties, or regulatory hurdles. By weighing these costs against the benefits of remaining in the market, the MNE may choose to maintain its presence despite institutional pressures to exit, as demonstrated by Koch Industries and Danone in Russia.

Balancing between conflicting demands serves as a strategy for an MNE to try to comply with institutional pressures from both home and host market. MNEs operating in conflict-affected regions may face pressures from their home countries to withdraw due to ethical concerns or reputational risks, while simultaneously experiencing pressures from the host country to maintain operations for economic stability or employment retention. MNEs operating in industries crucial to the host country's economy, such as energy or infrastructure, may need to balance altering demands from home and host markets. In such cases, MNEs may choose to scale back operations or adjust activities to minimize risks and maintain legitimacy in both markets. Additionally, the potential for reverting a strategic response and organizational experience in conflict environments influence MNEs' decisions to stay or exit, with experienced firms demonstrating higher resilience and capabilities to manage institutional resistance and operational disruptions.

4 Conclusions

The Russia-Ukraine conflict has been one of the most influential events regarding IB through its capability of altering business operations, governmental policies, international relations and public opinion. The invasion changed Russia's political, economic and social landscape, making business more difficult for MNEs in Russia. By examining the institutional view of war-MNE relationships it can be possible to understand the effects of war on MNEs. MNEs are forced to deal with formal and informal pressures from both home and host countries, which are vulnerable to the geopolitical climate. Western MNEs in Russia have made strategic decisions about their responses to these these varying institutional pressures, depending on various factors examines in this thesis.

By using regulatory power to control and guide MNE activities, host market formal institutions have major influence over MNEs. During geopolitical conflict, regulations may be altered or implemented by host governments, making the business environment more uncertain and possibly leading to harmful consequences for MNEs, such as expropriation. Home market formal institutions also hold great power over MNE activities through for example implementing investment rules, intellectual property protections and transparency requirements. The MNE home country using economic sanctions as a tool of warfare will also make operations harder for MNEs by disrupting the IB landscape. Sanctions, such as export/import bans and restrictions on investment and technology aimed to harm the host country will also negatively affect MNEs operating there.

From the viewpoint of MNEs operating in Russia, sanctions imposed by Western countries have lead to increased operational uncertainty and challenges, disruptions in supplychains and the flow of goods and services accross country borders and risen transaction costs. The most common reason for divestment is poor financial performance, however in an unusual situation like the Russia-Ukraine conflict, other factors must be considered as well. Sanctions can raise uncertainty and legal considerations for MNEs and may require specific strategic responses. Sanctions additionally ethical concerns for MNEs, particularly regarding their involvement in potentially funding the host country's warring activities and compliance to international norms and standards. MNEs are therefore forced to balance economic interests with broader ethical expectations.

The response to institutional pressures holds reputational risks for MNEs, as whatever the response is, it will most likely be scrutinized by various stakeholders. The threat of reputational damage drives MNEs to reassess their strategic priorities and potentially alter operations to minimize the risk of reputational damage. Corporate reputation is a valuable asset for MNEs that affects brand loyalty, consumer trust and investor confidence. While making a strategic decision regarding divestment, the reputational costs of staying have to be weighed with the operational challenges and financial cost of leaving.

MNEs faced with strong institutional pressures stemming from their home countries, such as sanctions, often conform to those demands. To for example safeguard their reputation, MNEs may prioritize home market expectations with the emphasis on pleasing stakeholders at home to maintain a good reputation and legitimacy. Some MNEs choose to avoid complying with home market institutional pressures to hold onto operations. Factors such as preserving competitiveness, relationships with local stakeholders and high financial costs of divestment drive to use this strategy. Balancing between home and host country pressures serves as finding some sort compromise in the middle of conflicting expectations. Balancing could mean scaling back operations, adjusting activities accordingly, or maintaining a partial presence to please both home and host markets. The inclusion of buyback clauses in contracts works as a strategic move to maintain flexibility and options for future re-entry.

These three strategies, conformity, avoidance and balancing among others are employed by MNEs to manage institutional pressures during a time of geopolitical conflict. The choice of strategy is influenced by factors such as organizational experience, market competitiveness, reputational risk and the potential costs of divestment. MNEs must examine the trade-offs and consequences of their decisions to make sure they are in line with strategic objectives of the company and stakeholder expectations during geopolitical conflict, such as war, in the host country.

The implications for future research are investigating the long-term strategies of and the consequences of different strategies on MNEs, and the later recovery of operations and the possible re-entry into the Russian market once the conflict is over.

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Appendix

Artificial Intelligence (ChatGPT) was used in this thesis as a tool to generate ideas, help create the structure and rephrase sentences.