

## Introduction

MNCs operate in complex environments, balancing global integration and local adaptation, but in times of crisis, such as war, this balance becomes much more difficult (Bartlett et al., 2024). Geopolitical instability has become a major concern for corporate executives around the world, radically changing the strategic priorities and operational frameworks of MNCs. According to comprehensive industry surveys, corporate executives now consider geopolitical tensions and political uncertainty to be the main risks to organisational growth, overtaking traditional concerns related to technological shifts and market volatility (Caldara & Iacoviello, 2022; KPMG, 2023).

Global business faces unprecedented volatility, armed conflicts are spreading geographically across regions, while political disputes intensify between major economic powers. Recent empirical data show that more than 70% of MNCs surveyed have suffered losses related to political risks, and 96% have implemented enhanced political risk management measures in response to the deteriorating geopolitical situation (Willis Towers Watson, 2024). This underscores the need for theoretical models that adequately conceptualize organisational response to extreme political risk scenarios and armed conflict. The conflict between Russia and Ukraine, which escalated into full-scale war in February 2022, is an example of the profound challenges faced by MNCs operating in environments characterized by extreme political risk and institutional collapse.

Political risk exists when unpredictable changes occur in the business environment as a result of political changes and significantly affect a company's profits or other objectives (Robock, 1971). These changes can be caused by political decisions, events or conditions caused by war, terrorism, changes in policy and legislation, or a combination thereof (Liu et al., 2024). Armed conflict and war are the most extreme and sudden form of political risk. It qualitatively, fundamentally and categorically differs from traditional manifestations such as regulatory uncertainty, political instability, or government transformation. Traditional risk management mechanisms adapt to gradual change over time but prove ineffective during extreme events where institutional frameworks deteriorate rapidly or collapse completely during war, rendering risk assessment methods and minimization strategies redundant.

Academic research demonstrates that political risk affects MNCs differently depending on their exposure to macro risks (regional or country risks) and micro risks (type of organisation and industry exposure) (Kobrin, 1979; Robock, 1971). Traditional political risk management models assume a stable institutional environment and predictable political changes, addressing macro-and-micro-instability issues through mechanisms such as government change, new policies, lawlessness, expropriation, nationalization, and treaty violations (Moran, 2004). Studies consider several key aspects of political risk management in crisis regions: institutional fit between parent company requirements and adaptation to the local context (Schnyder & Sallai, 2020), the role of non-market stakeholders in risk mitigation (Oetzel & Miklian, 2017) and exit strategies for markets with security threats (Dai et al., 2013; Vortherms & Zhang, 2024).

Armed conflict fundamentally changes political risk through five key mechanisms which existing institutional frameworks cannot adequately explain. First, war creates systemic disruptions to the institutional environment and new challenges to legitimacy through deliberate violence by state and non-state actors (Liu et al., 2024). Second, conflicts generate significant institutional dynamics (power struggles, instability, and unconscious factors), forcing MNCs to choose between protecting legitimacy (law enforcement, accountability, guarantees) and maximizing economic goals (Liu et al., 2024). Third, war creates qualitatively new types of risks, including disruptions in the labour market due to conscription and population displacement, expropriation of assets for war needs, pressure to reorient production to military needs, destruction of physical infrastructure, and direct threats to personnel, which go beyond traditional categories and create 'deep uncertainty' where conventional risk management tools prove insufficient (Teece, Peteraf & Leih, 2016). Fourth, the

pace of change in wartime creates extraordinary uncertainty that exceeds existing dynamic capabilities (the ability to sense opportunities, reallocate resources, and exploit competitive advantages) of MNCs. The ability to adapt to these unprecedented conditions is an extraordinary test of a companies' dynamic capabilities; those who cannot change fail. Fifth, armed conflict disrupts legal protection mechanisms and creates institutional imbalances in the distribution of power, resources and influence, rendering traditional models ineffective in a state of war (Liu et al., 2024).

Research on companies operating during wartime environments reveals aspects of political risk that are obscure or invisible in peace. More critically, we lack a theoretical understanding of why some MNCs successfully adapt to these extreme conditions while others fail. The comparison between home and host MNCs is theoretically important: institutional theory suggests organisational capabilities are shaped by institutional origins and societal exposure of companies (Simon, 1984, Dunning & Lundan, 2010), while research on dynamic capabilities shows experience influences adaptation (Oh & Oetzel, 2017). Neither concept explain why institutional fit in relation to domicile effects extreme uncertainty caused by war. Military conditions reveal a qualitatively different dynamic, assets become liabilities, neutrality becomes impossible, stakeholder pressure prevails over economic gain, and standard risk management approaches prove insufficient or counterproductive. There is a significant research gap in operational resilience strategies in areas of military conflict (MIGA, 2024).

This study seeks to develop an integrated approach based on dynamic capabilities theory and institutional fit, two complementary theoretical perspectives that together may provide a more comprehensive understanding of how MNCs adapt during armed conflicts. Recent studies examine how MNCs have reacted to the Russian-Ukrainian war, but have major limitations. Owens (2023) explicitly examines formal and informal legitimacy of MNCs in response to western institutional pressure against Russia, combining institutional fit and institutional response framework. Similarly, Marcinkowska (2022) documents eight corporate strategies using stakeholder analysis, finding moral legitimacy and ethical obligations 'take precedence over economic factors' (Marcinkowska, 2022, p. 22).

Both studies focus exclusively on Western MNC participation in Russia, rather than on activities and market microstructure effects in the conflict zone of Ukraine, adopting static frameworks (institutional and stakeholder theories) without analyzing the dynamic reconfiguration of opportunities, while providing conceptual suggestions with no empirical confirmation of how organisations actually adapt in conditions of extreme uncertainty. Owens explicitly acknowledges that 'Ukrainian MNCs, for example, have so far demonstrated considerable resilience and adaptation to the war,' but this remains unexplored (Owens, 2023), and Marcinkowska notes that her analysis is 'based solely on publicly available information' and does not include research on the mechanisms of operational adaptation (Marcinkowska, 2022, p. 20). Neither of the studies integrate dynamic capability theory to explain how MNCs develop capabilities for sensing, exploiting, and transforming, nor do they compare the adaptation of foreign and domestic MNCs in the same conflict.

The theory of dynamic capabilities, pioneered by Teece, Pisano and Schuen (1997), conceptualizes organisational capabilities as the ability to purposefully create, expand and modify resource bases in response to changes in the environment. The theory identifies three main categories of capabilities: sensing opportunities and threats through environmental scanning, exploiting identified opportunities through resource mobilization and decision-making, and transforming organisational assets to maintain evolutionary fitness (Teece, 2007). Although dynamic capability theory emphasizes the adaptability of organisations, it has been studied primarily in the context of technological change or market evolution, rather than institutional collapse (Teece et al., 2016). The

mechanisms by which organisations sense, exploit and transform capabilities when environmental signals become unreliable and institutional structures disintegrate remain insufficiently theorized.

Institutional fit theory, based on organisational institutionalism, emphasizes how MNCs must align structures, strategies and practices with the institutional environment to achieve legitimacy and operational efficiency (DiMaggio & Powell, 1983; Kostova & Zaheer, 1999). This perspective highlights the importance of conforming to the regulatory requirements, normative expectations, and cognitive frameworks that prevail in host environments. Institutional conformity becomes particularly important for MNCs operating in different institutional contexts, where non-conformity can lead to legitimacy deficits, operational constraints, and reduced effectiveness. However, institutional conformity theory presupposes the existence of functioning institutions to which organisations can conform, which makes it conceptually problematic when institutions themselves are destroyed during war (Dieleman et al., 2022).

Companies do not exist in isolation, but in an institutional environment, a system of formal and informal rules, cultural norms, regulations, and societal expectations, which neither theory alone can adequately address. To survive institutional disintegration, MNCs must simultaneously (1) reconfigure their capabilities to identify threats in unreliable environments, exploit opportunities in resource-constrained conditions, and transform operations under existential pressure (dynamic capabilities dimension) and (2) navigate legitimacy when institutional references-regulatory frameworks, property rights systems, contract enforcement mechanisms - have deteriorated or been destroyed (the institutional compliance dimension). Neither theory addresses this. Traditional studies of dynamic capabilities examine adaptation of capabilities in stable institutional contexts, while institutional theory assumes that organisations can identify existing institutional structures and adapt to them. Armed conflict violates both assumptions.

The Russia-Ukraine invasion provides an important empirical context for exploring these theoretical contradictions. MNCs operating in Ukraine have faced complex simultaneous challenges requiring dynamic capability reconfiguration to overcome institutional gaps created by the war. Western MNCs faced unprecedented pressure to withdraw from Russia after the invasion, while addressing business continuity in Ukraine. Meanwhile, domestic Ukrainian corporations faced existential threats and market microstructure restrictions requiring fundamental strategic reorientation. These events allow for a systematic investigation of how organisationally distinct MNCs respond to extreme political risks. Comparisons between Ukrainian / foreign MNCs provide analytical advantage: host corporations have greater access to resources and geographical diversification but face increased pressure from domestic markets regarding legitimacy; home corporations have deep local roots and institutional knowledge, but face greater challenges to survive extreme direct conflict in domestic markets.

This study aims to fill these gaps by developing a new political risk management model that integrates dynamic capabilities with institutional fit theory to examine how MNCs function in extreme conditions of armed conflict and institutional collapse. Focusing on Ukraine, it will determine how home and host MNCs adapt to extreme conditions of organisation, societal, and market microstructure exposure to implement capability reconfiguration and institutional navigation strategies, resolving interrelationships, boundary, and mutual influence conditions where traditional political risk management mechanisms fail (Globsec, 2023; MIGA, 2024). By studying how organisations survive war, overcoming the highest political risk, we gain insight into the fundamental management of political risk in corporations, which remains hidden in less demanding conditions, viewing political risk as dynamic, company-specific multidimensional vectors.