

## **Correlation aversion in Multinationals: Evidence from Japanese MNEs**

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### **Abstract**

Decisions under risk are often *multidimensional*, where the preferences of the investor depend on several factors. The existing literature in international economics and uncertainty has considered the case of a single shock when analyzing the decision-making of multinational enterprises (MNEs) on foreign direct investment (FDI). This paper aims to fill this gap and analyze the decision of multinationals on where to invest in the presence of two distinct sources of risk. The sources of risk, in this paper, are related to demand in the FDI host country, and the host country's exchange rate. When there are multiple sources of risk, the correlation of these risks matters to the investors. Constructing new large panel data on industry-level FDI, and using firm-level data on Japanese Multinationals, this paper shows that in the presence of two shocks, MNEs exhibit *correlation aversion* and that the correlation of two distinct shocks explains the variation in geographic allocation of FDI both at the industry-level and on the firm-level.

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