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The Value of Internationalization for Emerging Market Firms -- Family versus Non-Family firms

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Abstract

This paper examines how the market responses to emerging market firms' internationalization. Using the sample of 638 Taiwanese multinational firms, the result shows that the firm value decreases with its overseas assets whereas the negative impact is significantly weaker for the family firms than non-family firms. When analysing only family firms further, controlling families with high deviations of cash flow and control righ will be associated with lower value than normal family firms.

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1. Introduction

Foreign direct investment (FDI) in emerging markets grew rapidly during past decade, accounting for 10% of world in 1999 to 19% in 2013 (UNCTAD, 2015). Topics about FDI by emerging market multinational enterprises (EMEs) thus have been emphasized gradually. (Hoskisson, Eden, Lau, and Wright, 2000; Wright, Filatotchev, Hoskisson, and Peng, 2005). In contrast with developed countries were most firms are held by dispersed shareholders, most EMEs are controlled by families. (Claessens, Djankov, and Lang, 2000; Young, Peng, Ahlstrom, Bruton, and Jiang, 2008). Paying effort on the study of family-controlled firms is thus a good start of understanding EMEs' FDI behaviors. A growing body of research pays attention on the likelihood of internationalization for family firms in developed countries (Graves and Thomas, 2008 and Zahra, Neubaum, and Naldi, 2007) and in emerging countries (Liu, Lin, and Cheng, 2011 and Liang, Wang, and Cui, 2014). Issues associated with family-controlled firms' FDI strategies have also been wildely noticed recently, such as family firms' foreign entry decision (Filatotchev, Strange, Piesse, and Lien ,2007; Kuo, Kao, Chang, and Chiu, 2012), location choice (Strange, Filatotchev, Lien, and Piesse, 2009), international diversification (Gomez-Mejia, Makri, and Kintana, 2010) and the timing of internationalization (Ferris, Sen, and Thi Anh Thu, 2010). However, few papers focus on how internationalization affects the values of family-controled firms. Thus, this paper attempts to fill the void.

Dunning's (1988) eclectic paradigm and the internalization theory suggest that internationalization increases the value of a firm through internalizing market for certain of its intangible assets, such as superior production skills, marketing ability, and managerial skills. (Morck and Yeung, 1991; Christophe,1997; Mishra and Gobeli,1998; Marisa,2001; Pantzalis, 2001). However, firms of emerging countries are usually less competitive than those of developed countries. Thus, internalization theory does not well explain the internationalization of the firms in emerging countries. Another theory to discuss the relation between internationalization and firm performance is agency theory. Agency theory predicts that internationalization raises difficulty for investors to monitor the firm, and results in a decrease of firm value. Because the firms of emerging countries commonly have poor governance, the investors' assets can not be monitored well when being moved abroad. Foreign investment thus becomes a tunnel for embezzlement. Therefore, the market will regard agency cost, rather than internalization advantage, as the dominant effect on firm value, indicating that the market will require higher premium and attach lower value for emerging market firms when they decide to go abroad. Besides, when firms are controlled by family, its highly concentrated owenership structure and longer busisness planning mitigate the concern of agency cost (Anderson and Reeb, 2003, Claessens et al., 2000; La Porta, Lopoz-de-Silanes, Shleifer, and Vishny, 1999). The market thus attaches higher value to family firms than non-family firms when firms go abroad.

This study uses a sample of 638 Taiwanese listed firms with foreign investment to test the hypotheses as describing above. The empirical results support our hypotheses that the firms' market values are negatively correlated with the size of their overseas asset, and the negative correlation is weaker for family firms than non-family firms. Moreover, we find that family firms with high deviation of cash flows and control right show lower value than normal family firms do, indicating that the market is concerned about controlling family shareholders' expropriations on minority shareholders when the controlling family has no enough investment as the commitment for good management.

2. Method

2.1 Sample and Data

The study analyzes Taiwanese firms with overseas investments in 2010. Financial data and information are taken from the Taiwan Economic Journal (TEJ) database. TEJ was founded in 1990, and its database contains all overseas investments carried out by publicly listed firms in Taiwan. The regulation of Taiwan requires all publicly listed firms to seek ex ante approval or to carry out ex post filing for all overseas investments, so the data is complete. After eliminating the firms with missing data, the sample contains 638 target firms of which 511 are controlled by families.

The economic development of Taiwan lies between developed- and developing- countries. The country has undergone industrialization and experienced rapid economic expansion during the past half century. Studying on Taiwanese firms can be helpful for firms of developed countries to know all kinds of challenges during the industry development in emerging market; meanwhile, Taiwan's successful experience can be a good reference for other emerging countries.

2.2 Measures

Dependent variable. Business value is the dependent Variable in this study. Following Christophe (1997) Mishra and Gobeli (1998) and Morck and Yeung (1991), business value is measured by Tobin q.

Independent variables. In this study, there two independent variables, one is how international the firm is, measured by the variable of *Oversea*; the other is whether the firm is family business or not, measured by a dummy variable of *Family*. We define as follows:

Oversea: According to prior studies, there are varienty ways to measure a firm's level of internatinalization: including the level of internationalization is measured by the ratio of oversea assets to total assets of a firm(Daniels and Bracker, 1989), the number years of worldwide experience (Contractor and Kundu, 1998; Erramilli, 1991;Prasad and Kang, 1996), total number of foreign investment (Delios and Beamish, 1999; Gatignon and Anderson, 1988), the ratio of foreign to total number of investment (Contractor and Kundu, 1998), the ratio of a firm's foreign to total sales (Chang and Rosenzweig, 2001; Yu, 1990). In this study, we use the most common measurement, namely the ratio of oversea assets to total assets of a firm.

Family: To date, no general consensus has emerged concerning the definition of family businesses. The most common way of defining a family business is through a combination of ownership and control rights, in line with Gallo and Sveen (1991), who defined a family business as "a firm where the family owns the majority of stock and exercises full managerial control" (Gallo and Sveen, 1991, p. 182). However, FBs are contingent on the institutional and legal context, which differs from country to country. The share of equity stocks needed for effective control and the rules that dissociate ownership and voting rights also differ from country to country. Hence, a universal definition of FBs may be misleading and inappropriate, because it cannot take into account fundamental differences in various legal and institutional frameworks (Carney, 2005; Dyer Jr, 2006). Yeh, Lee, and Woidtke (2001) have a clear definition about how to define Taiwanese firms as family business, we thus follow their

definition to identify whether the sample Taiwanese firms are family business or not. According to their definition, a family-controlled firm is defined as a firm if the aggregate ownership of the largest family shareholder exceeds the firm's critical control level[1]. The dummy variable *Family* is define by 1 if the aggregate ownership of the largest family shareholder exceeds the firm's critical control level, and by 0 otherwise.The aggregate shareholdings include following three types of direct and indirect ownership: (a) the shares directly owned by all family members (including a person's spouse, parents, children, siblings, mother-in-law, father-in-law, brothers-in-law, sisters-in-law, daughters-in-law and sons-in-law.); (b) the cross-shareholdings of listed companies in the same conglomerate group and the indirect shareholdings through pyramid structures; and (c) the shareholdings of the nominal agents (including investment companies and other legal entities) effectively controlled by the family.

Besides, every family firm has controlling shareholders. This might cause the market to be concerned about the controlling shareholders' expropriation on minor shareholders when internationalizing. To test this conjecture, we further focus only on the sample of family firms and separate those family samples into two groups based on the deviation of controlling shareholders' cash-flow and control right, which is defined by Claessens et al., 2000. High deviation means the controlling shareholder invests too little, which might motive the controlling shareholder to expropriate on minority shareholders. We categorize firms as high deviation firms for those with a deviation level higher than one standard deviation of the sample mean. We use a dummy variable HDF to measure whether the firm is a high deviation firms or not. Firms with high deviations take the value of 1 in the dummy variable *HDF* and the rest of firms take the value of 0 in the dummy variable *HDF*.

Control variables. The control variables contain firm size (*Size*), firm age (*Age*), operation leverage (*Leverage*), RandD expenditure (*RD*), advertising expediture (*AD*), and the industry which a firm belongs to (*Industry*). *Size* is defined as the natural logarithm of the aggregate asset value of a firm. *Age* is the number of years since a firm founded up to 2010. *Leverage* is defined by the ratio of total debt to equity. *RD* (*AD*) is defined as the ratio of a firm's annual RandD (advertisement) expenditure to annual revenue. We further control the industry.

3. Empirical Results

Table 1 displays the summary statistics and correlations for the main variables. Tobin q is 1.29 averagely. 83% of the target firms are family-controlled firms, and the mean value of the ratio of firms' oversea asset is 40%. Moreover, the correlation coefficients between variables are

[1]The critical control level is computed based on Cubbin and Leech's (1983) formula:

$$P^* = Z_\alpha \sqrt{\frac{\pi H}{1 + {Z_\alpha}^2 \pi}}$$

where $H = \sum_{i=1}^{k} \left(\frac{S_i}{N_i}\right)^2 \times N_i$ and Z_α is the Z-value such that $\text{Prob}(Z \sim N(0,1) < Z_\alpha) = \alpha$. α is the probability of winning the vote at shareholder meeting and is assumed 1; π is the probability that shareholders exercise their vote and assumed 0.999; H is the Herfindahl index used to measure the ownership concentration; N_i is the number of shareholders in the *i*th shareholder bracket while S_i counts their percentage shareholdings; *k* is the number of shareholder brackets.

generally lower than 0.5, ruling out the possibility of collinearity.

Table 2 shows the results of regression. Model 1 examines the relation between the oversea asset and the business value, and Model 2 considers the effect moderated by family which is measured by an interaction term, *Family*×*Oversea*. The F-statistic of model 1 and model 2 are 5.95 (P<0.01) and 5.64 (P<0.01), implying high explanatory power of each model. In Model 1, the coefficient of *Oversea* is significantly negative, implying that investors are pessimistic about the foreign investment of firms and supports the argument that EMEs' foreign investments result in a high agency problem.

In model 2, the coefficient of *Family* × *Oversea* is significantly positive. This means that the negative impact of internalization is weaker for family-controlled firms. The result supports Anderson and Reeb (2003), who suggest that family involvement mitigates agency problem of firms so that family firms perform better than non-family firms. Model 2 extends Anderson and Reeb's (2003) argument and shows consistent results when firms go abroad.

Table 3 shows the impact of the deviation on family firms. In model 3, the coefficient of *Oversea* shows no significant impact on the firm value, meaning that internationalization does not influence how the market values family firms. However, the interaction term of *HDF*×*Oversea* is significantly negative (P=0.06) in model 4, implying that the market attaches lower value to high deviation family firms than normal family firms. In other words, the market is concerned about the expropriation by controlling shareholders when facing family firms.

4. Discussions and Conclusions

This paper examines how investors react to the internationalization in the emerging markets. Using the 638 Taiwanese multinational firms as our sample, the evidence shows that market value of a firm decreases with its overseas assets whereas the negative impact is significantly weaker for the family firms than non-family firms. When analysing only family firms further, the family firms with high deviation level of cash flow and control right will be associated with low value, implying that expropriation on minority shareholder from controlling shareholder is what the market concerns for family firms.

Theoretically, the contribution are mainly in three aspects: Firstly, departing from most prior research which targets the samples of firms from U. S. or other developed countries (Grant,1987;Morck and Yeung,1991;Pantzalis, 2001; Olsen and Elango, 2005). Our study focuses on those from emerging countries. Due to emerging countries' extreme differences in business environments, firm types and cultures comparing to developed countries, it is worth paying more effort to understand EMEs (Hoskisson et al., 2000; Wright et al., 2005). Secondly, the majority of studies on valuing internationalization have focused predominantly on a firm's

capability, such as size, RandD intensity, consumer goodwill, cost structure, or management skill (Morck and Yeung,1991, Bodnar, Tang, and Weintrop,2003, Mishra and Gobeli,1998). However, we argue that the firm's ownership structure should also have an impact on its valuation when internationalizing, since the level of agency cost varies with the type of firm when going abroad. Thirdly, the internalization theory suggests that internationalization increases the value of a firm through internalizing market for certain of its intangible assets, such as superior production skills, marketing ability, and managerial skills. （Morck and Yeung,1991; Christophe,1997; Mishra and Gobeli,1998; Marisa,2001; Pantzalis, 2001）. However, firms of emerging countries are usually less competitive than those of developed countries. Hence, we expect that agency cost, rather than internalization advantage, dominant the effect of internationalization on firm value. This paper provides empirical evidence to confirm our conjectures. Our result is consistent with Anderson and Reeb's (2003) suggestion that family involvement mitigates agency problem and improve business performance. Nevertheless, the market will attach lower value to family firms with high deviation because of the concern on the expropriation by controlling shareholders.

Practically, this paper suggests that EMEs should mitigate information asymmetry when they go abroad. Making the information more transparent especially about the operations of foreign subsidiaries, or inducing a third party (e.g. independent director) to enhance monitoring or be as a certification may be good ways. So, well-performed multinational firms can be separated from poor-performed firms and thus get a fair valuation from the market.

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Table 1 Means, standard deviations, correlations of variables

	Mean	S.D.	1	2	3	4	5	6	7	8
1.Tobin q	1.29	0.80	1.00	-0.17***	-0.08**	-0.13***	-0.18***	-0.09**	0.27***	0.09 **
2.Oversea	0.40	0.26	-0.17***	1.00	0.11***	0.17***	0.12***	0.03	-0.25***	-0.08 **
3.Family	0.83	0.37	-0.08**	0.11***	1.00	0.07*	0.22***	0.03	-0.20***	0.05
4.Size	15.51	1.43	-0.13***	0.17***	0.07*	1.00	0.25***	0.13***	-0.21***	-0.20 ***
5.Age	25.53	11.60	-0.18***	0.12***	0.22***	0.25***	1.00	0.05	-0.29***	0.08 **
6.Leverage	0.84	1.60	-0.09**	0.03	0.03	0.13***	0.05	1.00	-0.13***	-0.07
7.RD	3.51	5.10	0.27***	-0.25***	-0.20***	-0.21***	-0.29***	-0.13**	1.00	0.19 ***
8.AD	0.06	0.06	0.09**	-0.08**	0.05	-0.20***	0.08**	-0.07	0.19***	1.00

Note: *, **, *** indicate statistical significance at the 0.1, 0.05 and 0.01 levels, respectively.

Table 2 Regression Analysis

	Dependent variable = Tobin q					
	Model 1			Model 2		
	β		Std	β		Std
constanst	1.62	***	0.34	1.5	***	0.35
Oversea (%)	-0.25	**	0.12	-0.79	***	0.30
Family				-0.01		0.13
Family×Oversea				0.62	**	0.32
Size	-0.01		0.02	-0.004		0.02
Age	-0.01	***	0.003	-0.01	***	0.003
Leverage	-0.02		0.02	-0.02		0.02
RD (%)	0.03	***	0.01	0.03	***	0.01
AD (%)	-0.18		0.53	-0.11		0.53
Industry dummies have been included						
Sample size	638			638		
Adjusted R^2	0.151			0.154		
F-statistic	5.95***			5.64***		

Note: *, **, *** indicate statistical significance at the 0.1, 0.05 and 0.01 levels, respectively.

Table 3 Regression Analysis on Family Firms

	Dependent variable = Tobin q					
	Model 3			Model 4		
	β		Std	β		Std
constanst	1.74	***	0.36	1.70	***	0.36
Oversea (%)	-0.16		0.12	-0.02		0.03
HDF				0.00		0.09
HDF×Oversea				-0.19	*	0.10
Size	-0.03		0.02	-0.03		0.02
Age	-0.01	**	0.00	-0.01	***	0.00
Leverage	-0.01		0.02	-0.01		0.02
RD (%)	0.05	***	0.01	0.05	***	0.01
AD (%)	0.14		0.51	0.16		0.51
Industry dummies have been included						
Sample size	511			511		
Adjusted R^2	0.120			0.123		
F-statistic	8.78^{***}			7.52^{***}		

Note: *, **, *** indicate statistical significance at the 0.1, 0.05 and 0.01 levels, respectively.