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Capital investment, internationalization, and firm performance: Evidence from Southeast Asian countries

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ABSTRACT

This study asks whether firms that invest more have higher degrees of internationalization and whether firms with higher degrees of internationalization perform better than those with lower degrees of internationalization. Using a large panel sample that consists of non-financial firms in five countries in the Southeast Asia region during the period 1990–2014, I show that capital investment negatively affects the level of internationalization but has a positive effect on foreign sales growth. The negative effect of capital investment on internationalization levels is weaker for firms with higher degrees of internationalization. The level of internationalization is not associated with firm performance, measured as return on assets; however, there is some evidence for the positive relation between the level of internationalization and firm performance, measured as the stock return.

1. Introduction

In this paper, I present new empirical evidence regarding (1) the relationship between capital investment and the degree of internationalization and (2) the relationship between the degree of internationalization and firm performance. I collect data on publicly listed firms in the Southeast Asian region in order to test whether firms with larger capital investment have higher internationalization levels and whether firms with higher internationalization levels have better performance. I observe that firms with foreign sales account for about 58% of my final sample (1,270 firms out of 2,172 firms). I show that firms with larger capital investment tend to have lower degrees of internationalization and that firms with higher degrees of internationalization do not necessarily have better firm performance than those with lower degrees of internationalization.

The originality of this paper arises from the fact that I use a large panel sample of publicly listed non-financial firms in five Southeast Asian countries over the period 1990–2014 to examine the impact of capital investment on internationalization levels and the impact of internationalization levels on firm performance. Essentially, this study is a multi-country study while most of the prior related studies (see e.g., Bae et al., 2008; Hsu et al., 2013; Paul and Gupta, 2014; Ruigrok et al., 2007; Singla and George, 2013) focus on the analysis of the relationship between internationalization and performance of firms in a single country.[1] Focusing on firms in emerging markets countries allows us to better understand how internationalization

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[1] An example of recent studies using a cross-country sample is de Jong and van Houten (2014).

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strategy plays a role in improving firm performance in a period of globalization, especially during the period in which firms from developing countries have expanded their business internationally. The findings complement prior studies that focus on the effect of internationalization on performance of firms in developed countries.

Internationalization is a complex process and has several dimensions, thereby leading to a difficulty of accurately measuring a firm's internationalization level. In this paper, I define the firm's internationalization as the ratio of foreign sales to total sales (FSTS). This measure has been widely used in the literature (see e.g., Bae et al., 2008; Singla and George, 2013). I also test whether the results are robust to using the ratio of foreign assets to total assets (FATA) as an alternative measure of internationalization. Consistent with the literature, I measure firm performance as returns on assets (ROA) and the stock return (RETURN).

I expect capital investment to have a positive effect on internationalization levels due to the economies-of-scale argument. However, I find that capital investment negatively affects the degree of internationalization. This effect is weaker for firms with higher degrees of internationalization. There is also evidence for a non-linear effect of capital investment on the degree of internationalization. My results show that firms tend to have higher degrees of internationalization when a country's currency depreciates against the US dollar. As expected, GDP growth has a positive effect on the firm's internationalization levels. This set of results is consistent with the literature. For example, using data at the aggregate level, some studies such as that of Froot and Stein (1991) and of Méon and Sekkat (2012) show that macroeconomic factors (e.g., GDP growth, exchange rates, openness to trade) play an important role in determining foreign direct investment.

Consistent with the literature (see e.g., Oesterle et al., 2013), the results show that firm size is positively associated with the degree of internationalization. My findings indicate that firms with higher market-to-book (MBV) ratios or higher sales growth rates have lower degrees of internationalization. While profitability (ROA) and gross profit margin (GPM) do not affect the level of internationalization, operating risk (RISK) has a positive effect on the level of internationalization. Prior studies such as Gaur et al. (2014) show that firm size, R&D expenditure, export intensity and export experience affect foreign direct investment.

Does a firm's internationalization improve its performance? This question has been empirically investigated over past decades (see e.g., Bausch and Krist, 2007; de Jong and van Houten, 2014; Hsu and Boggs, 2003; Singla and George, 2013); however, prior empirical studies often show mixed results regarding the relationship between the degree of internationalization and firm performance. While I expect firms with higher degrees of internationalization to have better firm performance, I find that, based on a full sample that includes firm-year observations with and without foreign sales, the degree of internationalization is not associated with firm performance, measured as ROA. However, I find some evidence for the positive effect of internationalization on the stock return (RETURN). Overall, my findings differ from those of prior studies. For instance, Hsu et al. (2013) and de Jong and van Houten (2014) show that the degree of internationalization is positively related to firm performance, while Singla and George (2013) and Xiao et al. (2013) report that the relationship is negative. One plausible explanation for the documented insignificant effect of internationalization on firm performance in this current study is that I include a large set of country-, industry-, and firm-level control variables in my specifications.

I organize the remainder of the article as follows. Section 2 describes and presents data, variables, and methodology. Section 3 analyzes the impact of capital investment on the degree of internationalization. Section 4 presents empirical results of the effect of capital investment on foreign sales growth. Section 5 analyzes the impact of internationalization on firm performance. I conclude the paper in Section 6.

2. Related literature

Following decades of the globalization process, almost all firms operating in an open economy are directly and/or indirectly exposed to the influence of globalization. Given these circumstances, it seems natural to ask whether a firm's internationalization improves its performance. Prior empirical studies regarding the relationship between the degree of internationalization and firm performance (see e.g., Bausch and Krist, 2007; de Jong and van Houten, 2014; Hsu and Boggs, 2003; Ruigrok et al., 2007; Singla and George, 2013) often show mixed results. For example, on the one hand, Hsu et al. (2013) and de Jong and van Houten (2014) indicate that the degree of internationalization, earliness of internationalization, and scope of internationalization have a positive effect on firm performance. On the other hand, Singla and George (2013) and Xiao et al. (2013) show that a firm's internationalization is negatively associated with its performance.

Another related question, which has not often been asked, is whether a firm with larger capital investment has a higher degree of internationalization. Firms with larger capital investment are arguably more inclined to focus on expanding their businesses in international markets. It has been well documented that international markets are important for multinational firms, especially those located in export-oriented countries (see e.g., Chetty and Blankenburg Holm, 2000; Jansson and Sandberg, 2008). Importantly, relative to firms in large advanced countries, those in developing and emerging markets countries (or those in small advanced countries) benefit relatively more from foreign markets due to their relatively small domestic markets. In addition, entering into foreign markets might improve the firm's stock of knowledge and capability that helps subsequently expand its business (Fabling and Sanderson, 2013). When the firm engages in a large investment project, it should attempt to increase its revenue generated from international markets. As a consequence, the impact of capital investment on the degree of internationalization is expected to be positive.

If the short-term effect of investment on performance is negative and substantial, the positive impact of internationalization on performance, if any, might not be observed in the short run. Thus, it is possible that the mixed results reported in