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Foreign equity configurations in an emerging country: Implications for performance

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Summary The aim of this study is to compare and contrast the control characteristics and performance implications of different levels of foreign equity involvement in an emerging country. It is proposed that foreign investors' assessment of behavioral and contextual uncertainties in the host environment shape these configurations. Different levels of foreign involvement are represented in three foreign ownership configurations, namely foreign majority, shared equity, and foreign minority. Data consists of 164 firm-year observations for the period 1999–2002 at the Istanbul Stock Exchange. We provide evidence on the presence of distinct configurations which vary in their ability to meet the requirements of the institutional context. Among these, the shared equity configuration is found to display superior performance, by virtue of responding both to the efficiency concerns of transaction cost theory and the legitimacy focus of institutional theory.
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Introduction

Globalization of business activity makes and keeps the issue of foreign ownership one of the most important topics in the research agenda. Most studies treat foreign ownership as a homogenous category, rarely taking into account the impact of various levels of foreign equity ownership (Mani, Antia, & Rindfleisch, 2007). In this paper, we alternatively focus on different foreign ownership configurations and their implications. We aim to complement the findings of prior studies which treat foreign equity firms as a single homogenous entity, but intend to discover whether different levels of foreign involvement may exhibit different ownership structures, board characteristics, organizational attributes and performance implications. Levels of foreign involvement are assessed in terms of three foreign ownership configurations, namely foreign majority, shared equity and foreign minority.

There is relatively limited research on foreign equity configurations in emerging markets (Hitt, Dacin, Levitas, Arregle, & Borza, 2000). As globalization accelerates, there is an increased need for more research on these markets (Demir & Söderman, 2007). Aggarwal, Klapper, and Wysocki (2005) claim that providing evidence from emerging markets is likely to contribute to the literature on foreign ownership

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structure. In fact, this study aims to compare and contrast control characteristics, firm attributes and performance implications of different foreign equity configurations in an emerging country context. Lee, Chen, and Kao (2003) name three types of ownership structures in relation to the equity stake of the foreign investor, specifically foreign majority, equal stake and local majority. We investigated foreign ownership configurations and performances of companies listed in the Istanbul Stock Exchange (ISE), and suggest how these configurations are shaped by foreign investors' assessment of behavioral and contextual uncertainties in the host environment. The findings provide evidence on the presence of distinct configurations of foreign equity. Different configurations vary in their ability to meet the requirements of the institutional context. We propose this ability may in turn influence the relation between foreign ownership and firm performance. We find that shared equity configuration, by responding both to the efficiency concerns of transaction cost theory and the legitimacy focus of institutional theory, performs better than the other two configurations.

The study reported in the rest of this paper will proceed as follows: The first section describes the basic characteristics of the context, and the next section presents the theoretical background and hypotheses. This background allows us then to describe the data and methodology of the study, and argue there are certain clear empirical patterns subject to discussion. In the concluding remarks the implications and limitations of the study are addressed.

Context of the study

One of the basic assumptions of this study is that context is influential for both the control characteristics and performance of the firms. The specific set of institutions and organizations that exist within each country are expected to influence the ownership structure of the firms in that specific context (Aggarwal et al., 2005; Mayer & Whittington, 1999). Especially in emerging markets, institutional context appears to be as important as industry- and firm-level factors are in influencing foreign equity choices (Demirbağ, Tatoğlu, & Glaister, 2009).

In general, emerging markets are characterized by weaker regulatory environments, lower property rights protection, ineffective enforcement of regulations and lower levels of political and economic stability (Makino, Beamish, & Zhao, 2004), often resulting in concentrated ownership structures dominated by family business groups (Khanna & Palepu, 2000; La Porta, Lopez-de-Silanez, & Shleifer, 1999). Additionally, weaker external mechanisms of control further enhance dependence on internal mechanisms and family dominance (Douma, George, & Kabir, 2006). Emerging markets are also characterized by a lack of experienced domestic investors, limited capital base, the high cost of capital and weak financial infrastructure (Hitt et al., 2000), all factors contributing to the perceived importance of foreign equity for these markets. Thus, country specific conditions influence both the determinants and outcomes of foreign investments, increasing the value of studies originating from multiple varied settings.

Turkey has long been identified by various sources as a large emerging market, having a state dependent business system according to Whitley's (1994) typology. Through its ability to allocate capital and other resources, the Turkish state has encouraged the development of family business groups. The state formed partnerships with such businesses, providing credits from state banks and low cost inputs, and protected them from foreign competition (Buğra, 1994). Simultaneously, political connections and maintaining close relationships with politicians and bureaucrats became and remained important, routinely pointing out economic opportunities (Colpan, Hikino, & Tan, 2007). The intricate nature of these relations necessitated involvement of family members in management (Buğra, 1994). State dependent business systems are characterized by family dominance at the managerial level. In fact, Turkish business context is typically characterized by family business groups (Guillén, 2000). The family holding firms also constitute the majority of companies in the Istanbul Stock Exchange (Demirağ & Serter, 2003).

Investigating a range of different foreign equity configurations in a context characterized by family business groups may contribute to the literature on foreign investment in emerging markets. Khanna and Palepu (2000) claim that foreign investors avoid partnership with family business groups. However, Selekler-Göksen and Uysal-Tezölmez (2007) point to the fact that Turkish family business groups are among the pioneers in establishing relations with multinational companies, first as their licensees and then as JV partners. These conflicting views clarify the need for further empirical investigation regarding the behavior of different foreign configurations towards alliances with local families. Such a focus may enhance our understanding of how foreign equity deals with the *specific* contingencies of the institutional context.

Additionally, emerging markets have a significant and increasing share in global trade, providing an ever more attractive opportunity for foreign investors. On the other hand, the clear differences between their home business systems and the host systems present a considerable amount of risk for these investors. Turkey as one of the fastest growing emerging countries is a valuable setting to investigate international business and these contextual relationships. It is particularly important for a European audience since its major trade partners originate mainly from developed countries, especially from within Europe.

Theoretical background and hypotheses

Early studies adopt a transaction cost perspective in explaining foreign ownership structure (Guillén, 2002). Emphasizing efficiency, the transaction cost perspective of Williamson (1985) suggests that companies decide on an ownership structure if the benefits are higher than the related costs. The factors influencing a multinational parent's preference for full or shared ownership of affiliates are often investigated using transaction cost perspective (Desai, Foley, & Hines, 2004).

Transaction costs mainly result from investment barriers and information asymmetries (Kang & Stulz, 1997; Dahlquist & Robertson, 2001). To deal with this information

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