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Multinational firms and cash holdings: Evidence from China[☆]

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ABSTRACT

To adapt to globalization, Chinese multinational firms have more exploitation of cash. This paper shows that Chinese multinational corporations (MNCs) do not hold significantly more cash relative to domestic firms unless these multinationals heavily relay on the foreign sales. In addition, the multinationals of non-State-Owned Enterprises (Non-SOEs) exhibit the insignificant difference in cash holdings for non-multinationals. We also find that Chinese MNCs invest more but are less profitable, especially in non-SOE subsample. Overall, we conclude that the need of cash liquidity of multinational corporations in China is different from those in U.S.

1. Introduction

Cash holding of multinational corporations (MNCs hereafter) is an essential issue in the literature of corporate capital structure and corporate cash holding. Considerable media attention has been devoted to the increase in cash holdings of U.S. multinationals, such as Apple which holds trillion dollars of cash overseas but borrows money in the domestic market.[1]

The explanations offered by academic research are based on trade-offs motivated by repatriation tax. Foley et al. (2007) show that the reason for cash buildup is that U.S. firms had foreign profits that would have been taxed had they been repatriated. However, Pinkowitz et al (2016) document that in the U.S. domestic firms and multinationals (MNCs) are no different at the median, but the right tail of MNCs pushes up the average cash holding. In the most recent work by Fernandes and Gonenc (2014), the authors compare the determinants of cash holdings across developed and emerging market using international data, and do not find MNCs holding more cash.

Compared with fruitful studies on MNCs in the developed markets, little attention has been paid on companies' cash holding in the emerging markets. This paper shed new light on the determinants of cash holdings for multinationals in emerging markets, China.

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[1] Peter Lattman and Peter Eavis, "To Satisfy Its Investors, Cash-Rich Apple Borrows Money", the New York Times (April 30, 2013).

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From existing literatures, we find Chinese firms to become multinationals for many reasons. First, firms want to have access on the foreign capital market (Deng, 2007; Ding et al., 2009). Unlike MNCs from other emerging markets, Chinese MNCs tend to invest and operate their business in the most industrialized countries, like U.S. or Japan. Wang (2002) notes that more than 70% Chinese foreign branches are operating in developed regions excluding Hong Kong and Macau. Another reason might be to seek for natural resources (Lee, 1996). Most of the big State-Owned MNCs, like Sinopec and PetroChina, run branches in some developing but rich-resource countries, like Sudan, Indonesia etc. Besides, the fiercely competing domestic market forces many Chinese firms to globally enlarge market share. Finally, another plausible explanation for global extension is to seek for segment diversification. Generally, in the early stage of global expansion, Chinese multinationals would invest plenty of cash to support their international operations and try to diversify their risks in other developed countries so that holding of cash is reduced for taking various investment opportunities.

In this study, we use different proportions of foreign sales ratio as proxies for multinationals and focus on explaining the difference in cash holdings of MNCs relative to non-MNCs. Contrary to the hypothesis that MNCs hold more cash, we do not find significantly positive result for MNC dummies unless we use foreign sales ratio of 50% cutoff (MNC50) in full sample.

Also, government in China has a significant influence in firm's ownership structure and outward investment decision. So, we divide the sample into two types, state-owned enterprises (SOEs) and non-SOEs. We find that SOEs in average hold 3% less cash than non-SOEs. In addition, the positive coefficient for MNCs with 50% foreign sales ratio is only significant for SOE subsample. Thus, we conclude that the insignificance in full sample is mainly caused by non-SOEs.

To further explore why Chinese MNCs do not hold more cash, we study the investment behaviors of our sample firms. We find that MNCs with more than 50% foreign sales ratio invest more than other non-MNC firms and this effect is accentuated in non-SOE subsample. Different from non-SOEs, MNC50s in SOE subsample actually invest less compared to non-MNCs. When examining the difference of future profitability, we see that MNC dummies are negatively related to profitability. The results also show that this difference is accentuated in non-SOEs regardless of the cutoff of MNC dummies, while a significantly negative result for SOEs is not found. Our findings suggest that Chinese MNCs do not hold significantly more cash than the domestic ones because they tend to spend the cash flows and are less profitable, and those two effects together might prevent the accumulation of firm's excess cash.

Our paper contributes to the literature of cash management by multinational firms. Opler et al. (1999) suggests a tradeoff theory of cash holdings in firms. Bates et al. (2009) find that U.S firms hold more cash for precautionary motives rather than agency problem. And shareholders discount companies' foreign cash holdings as Harford et al (2014) mentioned. Cai and Warnock (2012) show that US domestic multinationals hold significant foreign exposure by holding domestic equities. Recent literature has studied the benefits and costs of cash with firm's investment decision (Almeida et al., 2004; Acharya et al., 2007; Bates et al., 2009; Duchin et al., 2010) as well as agency problem (Pinkowitz et al., 2006; Dittmar and Mahrt-Smith, 2007; Kalcheva and Lins, 2007; Harford et al., 2008). Our results show that, contrary to the case in developed country like U.S., multinational corporations in China do not hold significantly more cash than the domestic firms since they tend to invest more and are less profitable.

The rest of paper is organized as follows. Section 2 presents the data and sample used in this paper. Section 3 studies the determinants of cash for MNCs in China. Section 4 explores MNCs' cash holdings from the investment and profitability angles. Section 5 summarizes the paper.

2. Data description and summary statistics

Our baseline sample covers China-incorporated firms that are listed on the Shanghai Stock Exchange (SSE) and the Shenzhen Stock Exchange (SZSE). We only consider the main board market because the Growing Enterprise Market (GEM) in SZSE starts from 2009. Those financial and utility firms are also excluded since they have different disclosure regulations and their liquidity positions are different from other firms. Our main variables are obtained from the Chinese Stock Market Accounting Research (CSMAR) for the period from 2000 to 2013. The sample period is chosen to match the availability of foreign sales in WIND database as WIND starts to collecting foreign sales from 2000. Besides, the year 2000 is the first year that firms are required to adopt a unified set of accounting standards and principles (Chen et al., 2012). We drop off delisted firms, such as ST or S∗T because they have more strict regulation requirement. Considering the impact of extreme values and outliers, we winsorize all firm characteristics at the 1st and 99th percentiles. As a result, the whole sample consists of 18,135 firm-year observations with 1873 firms from 2000 to 2013.

Based on the current political and economic systems, Chinese government plays a crucial role in firm's outward investment and business activities. We group Chinese companies into two types, state-owned enterprises (SOEs) which are owned directly by the central or provincial or municipal governments and non-SOEs. Meggion et al. (2014) indicates that SOEs hold less cash because of soft budget constraint (SBC) effect. So in this paper, we add a SOE dummy to control for different cash level and further separate it into two subsamples.

Our main measure of foreign sales ratio is the proportion of a firm's total foreign sales divided by the total revenue. This variable is used as a proxy for how much cash firms are held abroad. All missing foreign sales ratio are replaced with zero value. In China, firms are recommended to disclose their foreign sales ratio starting from year 2000 and required to disclose