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Ownership structure and internationalization of Indian firms

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ABSTRACT

We examine the longitudinal relationship between ownership structure and firm internationalization, in a sample of Indian firms. Drawing on principal-principal (PP) agency theory and the resource-based-view (RBV) of the firm, we argue that divergent preferences (motivations) of a firm's owners affect the firm's propensity to internationalize, while resource heterogeneity among these owners (owners' capability to access and provide resources) affects the firm's capability to internationalize. We argue that both motivation and capability are required for firms to pursue internationalization and that when either of these is missing in an owner, that owner's shareholding will be negatively associated with internationalization. Additionally, our results uncover an interesting dichotomy. While family owners with lower levels of ownership favor their firms' internationalization, they do not favor it at higher levels of ownership. Our results indicate that foreign owners appeared to adjust their roles to accommodate the preferences of the dominant family owners.

1. Introduction

Emerging economies are increasingly prominent influences in the world economy. There is considerable interest in the activities of emerging market multinationals from these countries (Cuervo-Cazurra, 2012), mainly because of the increase in the outflows of foreign direct investment (FDI) from these emerging economies in recent years. According to data reported by the United Nations Conference on Trade and Development (UNCTAD, 2014),[1] the annual FDI outflows from countries in Asia exceeded US$ 326 billion in 2014, reflecting a rapid rate of increase from US$ 168 billion in 2006 to US$326 billion in 2014. However, outward FDI from India has been lower compared to that from other emerging markets such as China and Russia. Even though India appears in the top 20 list when it comes to FDI inflows, it does not appear in the top 20 rankings when it comes to FDI outflows (UNCTAD, 2014). This indicates that compared to firms from other emerging markets, Indian firms are still at a nascent (initial) stage of internationalization. This anomaly prompted us to examine some of the antecedents of outward FDI (i.e., internationalization) in the context of Indian firms. Specifically, we attempt to study the impact of owner heterogeneity (arising from firm ownership or shareholding differences) on outward FDI (i.e., internationalization) among a sample of Indian firms. Prior studies examined the impact of family owners and foreign corporate owners on the internationalization of Indian firms. We build on these earlier contributions by employing a more holistic framework that captures all the different categories of ownership. In a recent review article on ownership, Boyd and Solarino (2016) suggested that the extant literature primarily examined family and institutional owners. Consequently, these authors called for studies that address multiple owner types (p. 16, Boyd & Solarino, 2016). This paper seeks to bridge this perceived gap by examining the impact of five major ownership categories on internationalization. We also examine the impact of an important owner category, the 'domestic corporate', which has not been previously examined in the ownership-internationalization literature. These owners are important because they tend to represent pyramidal structures and cross-holdings by corporates, all of which together may be controlled by the several categories of owners. They are thus important mechanisms for exercising control in India. Further, both Eisenhardt (1989; p.71) and Boyd and Solarino (2016) advocate the need to integrate multiple theoretical perspectives in order to fully understand the complexities of the ownership-internationalization relationship. This paper seeks to fulfil this theoretical need by integrating the dominant paradigm, i.e., the principal-principal (PP) agency theory, with the resource-based view (RBV). Using these twin lenses, we develop a theoretical framework (2 × 2 matrix) that enables us to understand the ownership-internationalization relationship in a more nuanced manner.

Most of the extant work that examined the ownership-

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[1] http://unctad.org/en/PublicationsLibrary/wir2014_overview_en.pdf (last accessed on June 28, 2015).

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internationalization relationship used developed economy contexts, wherein firms have typically already achieved high levels of internationalization. Among the emerging markets, there has been some work on Chinese firms (Boyd & Solarino, 2016). However, there is very limited work on firms in the Indian context, which is arguably the next biggest emerging market (after China) and one that is becoming increasingly intertwined with the global economy. According to Cuervo-Cazurra (2012), emerging market firms could behave differently from developed market firms during the initial phases of internationalization. Therefore, it is important to examine whether the extant theories that were formulated in the context of developed economies can be consistently applied to emerging economy contexts. Cuervo-Cazurra (2012) specifically called for more research in emerging markets that incorporated owners' attitudes and their impacts on decision making. In this study, we make a significant attempt to address this research gap by linking our arguments to both owners' motivations and their capabilities, each of which has been posited to determine owners' influences.[2]

Drawing on the twin planks of the PP agency theory and the RBV, we hypothesize that both foreign corporate ownership and foreign institutional ownership are positively related to internationalization. In contrast, family and domestic corporates and institutional ownerships are hypothesized to negatively impact a firm's internationalization. Further, we hypothesize that foreign ownership positively moderates the relationship between family ownership and internationalization as well as that between domestic corporates and internationalization. Our empirical results provide broad support for these hypotheses, and the findings from the cumulative model where all the owner types are present in the regression specification and from the models with interaction effects are particularly noteworthy. They bring out two particularly important observations. Firstly, these models flesh out the relative power positions of these owners with respect to their individual impact on internationalization. Our findings indicate that the positive influence of foreign investors is contingent on the extent of family holding. While prior work from advanced economies showed the positive impact of institutional investors on FDI (e.g., Tihanyi, Johnson, Hoskisson, & Hitt, 2003), our findings confirm the assertions made by Cuervo-Cazurra (2012) that emerging market firms behave differently when compared to advanced market firms. Our tentative conclusion that owners' motivation (and hence the firm's motivation) is more important than their capabilities in their effects on internationalization decisions requires further research. Secondly, the interactions of foreign owners (institutions and corporates) with family owners at high and low thresholds of family owners appears to be indicative of collusion and monitoring tendencies among these foreign owners. This finding appears to illustrate the dominance of family owners and the changing role of foreign owners from being conscientious monitors of the family's choices to potential colluders (Attig, Guedhami, & Mishra, 2008; Maury & Pajuste, 2005). While this finding is admittedly very tentative, it holds substantive promise for further investigation into this phenomenon. This study is a pioneering work that teases out the nuances associated with the ownership-internationalization relationship by examining the roles played by both firm owners' motivations as well as their capabilities to access resources. In the next section where we develop the theoretical framework, we discuss the PP agency theory and RBV in greater detail.

2. Theoretical background

The principal-principal (PP) agency problem (La Porta, Lopez-De-Silanes, Shleifer, & Vishny, 2000; Ward & Filatotchev, 2010) focuses on conflicts between principals (i.e., majority owners and minority owners), as compared to the traditional agency theory that addresses principal-agent (PA) related conflicts. The PP agency theory argues that owner concentration combined with identity differences among owners such as family, foreign, domestic, institutional, and corporate owner categories (Douma, George, & Kabir, 2006; Villalonga & Amit, 2006) could lead to different risk preferences, time horizons, and goals,[3] spurring the inclinations among dominant owners to appropriate the private benefits of control. These inclinations create differences in owners' motivations (and hence the firm's motivations) to pursue different strategic decisions such as internationalization (Thomsen & Pedersen, 2000; Tihanyi et al., 2003). Since concentration of ownership is the norm in most emerging market settings, PP conflicts abound in those contexts (Su, Xu, & Phan, 2008; Young, Peng, Ahlstrom, Bruton, & Jiang, 2008).

Therefore, extant research argued that the ownership structure of emerging market firms determines their strategic orientations and influences their attitudes toward growth (Peng, Tan, & Tong, 2004; Cui, Meyer, & Hu, 2014). Since the risk-tolerances, goals, and motivations of owners can differ, different types of (minority) owners have to *monitor* the preferences of other (majority) owners and encourage them to support value-maximizing decisions such as internationalization. If all owners are risk-averse or risk-neutral, their motivations are already synchronized; however, this is most likely not the case. Therefore, if one owner group is risk-neutral and the other (especially the dominant) owner group is risk-averse, then the owners' motivations and goals do not match, which has consequences for the firm's strategic actions. According to the PP agency theory, some of the dominant owners may not encourage the firm to pursue value-maximizing strategies such as internationalization because it jeopardizes their investments in the firm. In such instances, the minority owners can impact the firm's decisions by actively monitoring and questioning the dominant owners' preferences, and by persuading them to support value-maximizing strategies for the firm. Thus, owner types and their interactions can materially impact the firm's motivation to pursue internationalization.

However, motivations alone are not enough to pursue any strategic decisions (Cui et al., 2014). Firms and their managers also need to have the capabilities to pursue and accomplish strategic decisions. Therefore, we employ the resource-based view (RBV) to understand the implications that resource heterogeneity stemming from ownership structure differences has on the competitive advantages of firms (Douma et al., 2006). While emerging market firms have resource endowments, these endowments are typically not as large as those of their counterparts in developed countries because of the lack of institutional development in emerging economies and the relatively younger ages of these firms (Hitt, Dacin, Livitas, Arregle, & Borza, 2000). These firms need additional resources such as financial capital, technical capabilities, managerial capabilities, and reputation to become competitive in international markets (Peng, 2012). Consequently, emerging market firms use alliances to tap into these resources and capabilities (Cuervo-Cazurra, 2012; Hitt et al., 2000). These alliances could be in the form of shareholdings invited from the different owner types such as domestic and foreign corporates, domestic and foreign institutional investors, or family ownership. We postulate that emerging market firms that are dependent on these owners to gain access to certain resources and capabilities are more susceptible to having their strategic decisions influenced by the preferences of these influential owners.

Since different owner types possess and/or have access to different types of resources, access to these resources enables firms to pursue

[2] We use the terms 'owners' motivation' and 'firm's motivation' interchangeably. A firm's motivation is a composite of the various owners' motivations. Similarly, the owners' capability to access and provide resources and the firm's capability have been used interchangeably.

[3] Costs are associated with bearing risks, monitoring (Jensen & Meckling, 1976), decision making, and market contracting, which include the conventional losses attributed to market power distortions (Thomsen & Pedersen, 2000), while the benefits include dividends and the private benefits of control.