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Corporate Financial Strategies for Global Competitiveness

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This paper focuses on the role of corporate financial strategies to improve their market valuations and lower their cost of capital. The identification of successful strategies is accomplished within an overall strategic framework. The paper is built on 12 longitudinal case studies from the Nordic countries to illustrate the linkages between business strategy, firm motivation, and various financial strategies.

Keywords: Financial strategy, Corporate strategy, Global competitiveness, Cost of capital

Introduction

During the last two decades the small Nordic economies have been able to foster a remarkable number of high-growth capital intensive companies, such as Nokia from Finland, Ericsson from Sweden, Novo-Nordisk from Denmark, and Nycomed from Norway. We argue that without the skilful global financial strategies that enabled these companies to access global savings, the limited domestic availability and high cost of capital would have hampered their growth. We suggest that these company stories provide valuable insight for scholars as well as for European executives, in particular those of smaller and medium-sized growth-oriented firms.

In order to succeed in a global financial market, firms' 'executives must be capable of delivering the strategy story to the stock analysts and, ultimately, share value to the money managers', Useem (1998, p. 43). The on-going globalization of equity markets provides the firm with the opportunity to actively reduce information and agency costs, and hence to contribute to higher firm values and lower cost of capital (Bekaert and Harvey, 2000; Stulz 1999, 1996). The rise of global portfolio investment has laid the ground for more emphasis on shareholder relations. The international portfolio managers judge the potential company to invest in against the best-performing firms in each industry and no longer against its domestic peers only. For small- and medium-sized companies in particular, but also for large companies outside the Anglo-American world, and major countries like Japan and Germany, the gain of access to highly liquid capital markets can effectively boost growth. In the rest of this paper we will emphasize successful financial strategies for large companies from small and/or emerging economies for gaining global investor recognition. The brief story of Hafslund Nycomed and Nokia may serve as appetizers.

In 1992, Hafslund Nycomed (now Nycomed Amersham), a Norwegian pharmaceutical company, simultaneously listed on the New York Stock Exchange (NYSE) and made a US$ 74.7 million US equity issue. At the time of the issue the company represented as much as 11 per cent of the value of all shares on the Oslo Stock Exchange. The NYSE listing provided Hafslund Nycomed with enhanced visibility within the pharmaceutical industry and cultivated a reputation with US institutional investors. Also in 1992, the financial strategy of Hafslund Nycomed paved the way for a US$ 400 million acquisition of its major US rival Sterling Winthrops. The interplay between the corporate strategy and the financial strategy was paramount to the firm's global success.

When the fast growing telecommunication company Nokia of Finland needed US$ 485 million in 1994, access to competitively priced funds was necessary in order to keep pace with competitors. In early 1994 the common stocks of Nokia's major competitors were priced at 22 (Motorola) and 25 (Ericsson) times earnings, however, Nokia was down at only 14 times earnings. To become more attractive to global investors, the firm listed on the NYSE (New York Stock Exchange) and made a Euro-equity offering. Within three months of NYSE trading Nokia's stock had gained 45 per cent versus a 2 per cent gain for the NYSE composite index. Nokia had achieved global recognition among investors, and was now classified and priced as one of the peers in the telecommunication industry.

Historically there has been considerable theoretical and empirical research on the segmentation of international capital markets, as well as recent studies such as those done by Karolyi (1998), Modén and Oxelheim (1997) and Sundaram and Logue (1996). However, few studies have addressed the specific *managerial* challenges that internationalization of capital implies. The research issue of this paper is to focus on the way individual companies can undertake actions to improve their market valuations, and thus their cost of capital. The key ingredients are the linkages between business strategy, firm motivation, and various financial strategies to reduce the corporate cost of capital.

Why Financial Strategy Matters

There is a widespread misconception that financial strategy does not add value to the firm. This line of reasoning goes back to the research of two Nobel prize economists, Modigliani and Miller. In the best-selling book *The Business of Economics* (1997), a UK professor John Kay argues that finance is basically irrelevant to corporate success. However, this argument ignores the facts that all capital markets are not alike and information is not evenly distributed across nations. Even for highly liquid and well functioning capital markets, such as the one in the United States, a study of 750 companies reveals that better disclosure boosts stock price (Lang and Lundholm, 1996). If there is no value creation in pursuing specific financial strategies, then companies ought to lay off their highly paid investor relations executives to enhance their stock price. On the contrary, we suggest that companies from small and/or highly regulated capital markets are more dependent on investor relations than their peers in other markets in order to escape a mispriced and/or illiquid domestic stock market. The need for an active investor relations function is also shown by the fact that global investors strongly favor more visible (and larger) firms when investing in small equity markets (Dahlquist and Robertsson, 2001).

Barriers to an International Cost of Capital

We argue that corporate competitiveness is enhanced when a firm's dependence on an illiquid or partially segmented capital market is reduced. Financial market segmentation implies that a firm from one country faces higher financial costs than an exact similar company from another country. The main ingredient to internationalize the cost of capital is to list a company's shares on one or more foreign stock exchanges and/or float equity issues to investors in one or more foreign countries. The listing enhances liquidity of shares, and an issue is necessary to provide the availability of capital. A third approach to internationalizing the cost of capital can be made by strategic alliance. Foreign industrial investors can overcome a segmented capital market by infusing equity into a target partner.

In the 1980s and the beginning of the 1990s one major venue for companies to escape a 'thin', inefficient and heavily regulated domestic market was to place an equity issue on a foreign 'prestigious' capital market. Oxelheim (1996) argues that the internationalization of the cost of capital should be seen as a process with three stakeholders: investors, regulators, and managers. Investors are characterized by an endless search for new profit opportunities and portfolio risk reduction. On the other hand regulators pursue policies that are aimed at insulating the domestic market from the global one, and managers strive to eliminate disadvantages by trying to circumvent barriers and restrictions imposed by regulators. A successful stock issue should render the company benefits from a higher price/earnings ratio (P/E), or price to book ratio, abroad as compared to the one at home. This paper looks at the strategies that individual companies pursue in order to reduce their cost of capital.

Corporate managers of firms resident in segmented equity markets have had to devise strategies to overcome the root causes of capital market segmentation. These causes are as follows:

- ❖ Asymmetric information available to investors resident in different countries. This includes not only financial data on corporations but also the analytic methods used to evaluate the validity of a security's price.
- ❖ Different tax regulations, especially with regard to the treatment of capital gains and the double taxation of dividends.
- ❖ Regulation of securities markets.
- ❖ Alternative sets of optimal portfolios from the perspective of investors resident in one equity market compared to investors resident in other equity markets.
- ❖ Different agency costs for firms located in bank-dominated markets compared to firms located in the Anglo-American markets.