Corporate multinationalism, organizational learning, and market reaction to international joint ventures: Evidence from Taiwan

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Abstract

This study examines the importance of corporate multinationalism and organizational learning in explaining the wealth effects of international joint ventures announcements in Taiwan. The evidence indicates that firms announcing international joint ventures into countries with no prior operational activity experience significantly favorable market response. In contrast, prior experience in international joint ventures does not explain the cross-sectional difference of announcement period abnormal returns. These findings remain the same even after controlling other explanatory variables. The evidence supports the positive multinational network hypothesis, but is inconsistent with organizational learning hypothesis.

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1. Introduction

Benefits of international corporate expansion have been well documented in the literature. Different from firms operating only in domestic markets, the primary advantage of multinational corporations lies in the flexibility to transfer resources across borders through a globally maximizing multinational network (Kogut, 1983). Through expanding the global network, the multinational corporation processes valuable options that allow them to take

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advantage of market imperfections. Specifically, multinational firms may reduce tax payment through intrafirm financial transaction. They are also provided the option to minimize manufacturing costs by shifting the production plants to countries with low material and labor costs (Chen, Hu, & Shieh, 1991; Doukas & Travlos, 1988). In addition, operating in a global network better protects multinational firms from local economic shocks due to international diversification. Finally, the multinational network extends the possibility to locate suitable partners for strategic alliances (Chung, Koford, & Lee, 1993; Doukas & Travlos, 1988; Gupta & Misra, 2000; Kogut, 1983; Lewis, 1990). Those benefits are not possible for domestic firms. To the extent that values of multinationals cannot be acquired by investors, announcements of international expansion should increase shareholders’ wealth to reflect the incremental value creation by expanding multinational network.

International joint ventures have emerged as one of the most popular means of entering new markets. A typical joint venture involves two or more parent companies that represent partial combination of their resources under the original management. Despite the advantages of expanding multinational network through international joint ventures, previous studies on the wealth effects of international joint ventures have shown inconclusive results. Chen et al. (1991), Chen, Ho, Lee, and Yeo (2000), Crutchley, Guo, and Hansen (1991), and Lummer and McConnell (1990) find significantly positive abnormal returns for firms announcing international joint ventures. These studies also show that factors such as size of investment, free cash flow, and growth opportunity have significant explanatory power. In contrast, Finnerty, Owes, and Rogers (1986) document neutral market response to the announcements of international joint ventures. Chung et al. (1993) and Lee and Wyatt (1990) even report negative valuation effect associated with such announcements. Lee and Wyatt (1990) also find that only those international joint ventures with firms from less developed countries have nonnegative announcement effects, while Chung et al. find that markets tend to respond unfavorably to announcements of international joint ventures regardless of the economic status of the partner’s home country. Previous research, however, mainly investigates the wealth effect of international joint ventures made by parent firms in the US. Little has been done for parent firms in the less developed or developing countries.1

The role of corporate multinationalism in explaining cross-sectional differences in market reactions to announcements of international joint ventures has been relatively less examined in the literature. Most of previous studies focus on the differential wealth effect of expanding into developed versus less developed countries, and find that US multinational firms expanding into developing countries receive significantly positive market reactions (Chen et al., 1991; Chung et al., 1993; Gupta & Misra, 2000; Lee & Wyatt, 1990). Doukas and Travlos (1988) provide an alternative test of corporate multinationalism on firm value. They investigate the wealth effect of international acquisition announcements, and find significant abnormal returns for shareholders of MNC not yet operating in the target firms’ countries. In contrast, international acquisitions that do not expand firms’ multinational network fail to change the market’s perception about acquiring firms’ ability to utilize benefits of multi-

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1 With the exception of the Chen et al. study that investigates Singapore listed firms.
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