Capital investment and internationalization

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ABSTRACT

Degrees of firm internationalization vary across industries and over time, depending on a number of factors. In this paper, I hypothesize that firms mitigate the investment risk resulting from having large amounts of capital investment by expanding their business internationally. Using a large panel sample that covers non-financial firms listed in the US during the period 1990–2013, I find that capital investment negatively affects the internationalization level. The negative effect of capital investment on internationalization levels is evident for (1) large firms, (2) firms with large fixed assets, (3) firms with small and large capital investment, and (4) firms with non-positive sales growth rates. In addition, the relation between capital investment and the degree of internationalization is non-linear and varies over time. I also find that the effect is negative prior to the burst of the IT bubble in 2001, neutral during the burst of the IT bubble and the non-crisis period, and positive during and after the 2007 global financial crisis.

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1. Introduction

Is capital investment a key factor underlying the level of internationalization? While the literature on internationalization has been substantially expanding in recent years, little is known about whether the degree of corporate internationalization is affected by capital investment. To my knowledge, there has been no empirical study on the impact of corporate investment on corporate internationalization in the US. This paper has two primary objectives. First, I seek to ask whether firms’ capital investment affects their internationalization levels. Second, I ask under what conditions the differential impact of capital investment on internationalization levels exists.

To illustrate the potential importance of this issue, I graphically plot a time-series pattern of capital investment (CAPEXTA), measured as the ratio of capital expenditure to one-period lagged total assets, and of internationalization (FSTS), measured as the share of foreign sales to total sales, for a sample of non-financial firms in the US over the period 1990–2013 in Fig. 1. As a simple matter of interpretation, Fig. 1 suggests that the average firm in the U.S. has higher internationalization levels and lower capital investment in recent years.

1 I will discuss this phenomenon more fully in Section 3.
2 However, there is considerable variation in capital investment and internationalization levels across industries and over time. When I plot the industry-level average value of FSTS and CAPEXTA in 1990 and 2013 (this figure is available upon request), I find that firms in some industries substantially increase their capital investment from 1990 to 2013, while firms in some industries significantly cut back on their capital investment over the same period.

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0148-6195/© 2016 Elsevier Inc. All rights reserved.
Building on prior studies (e.g., Buch, Koch, & Koetter, 2014; Cavusgil & Knight, 2015; Chang & Rhee, 2011; Lu & Beamish, 2004; Tuppura, Saarenketo, Puimalainen, Jantunen, & Kyläheiko, 2008), I hypothesize that firms expand their business internationally to mitigate the investment risk resulting from having large amounts of capital investment. In the short-run, firms with large capital investment that would incur large fixed costs have incentives to better utilize their assets by entering foreign markets. If firms with large capital investment that can be considered sunk and/or overhead costs are to capitalize on their resources and capabilities better than their competitors, then they should expand their business in foreign markets and, consequently, have higher degrees of internationalization, all else being equal. That is, the level of internationalization depends on a firm’s assets-in-place (i.e. existing long-term assets) and new capital investment.

Entering foreign markets can be seen as a growth strategy (Capar & Kotabe, 2003; Kyläheiko, Jantunen, Puimalainen, Saarenketo, & Tuppura, 2011) as well as a diversification strategy (Gulamhussen, Pinheiro, & Pozzolo, 2014). In this respect, I assume that internationalization activities are strategic in nature. If firms manage to overcome a liability of foreignness, they would be able to compete effectively against domestic as well as foreign competitors in the host markets and as such would be less likely to exit the markets. On the other hand, if firms are risk-averse with respect to the internationalization process (e.g., due to expected costs and risk of doing business in foreign markets) and thus do not expand their business into international markets, the relationship between capital investment and internationalization might be negative or non-existent.

I use a panel data set of non-financial firms in the US to empirically test (1) the extent to which capital investment affects internationalization levels and (2) whether firm characteristics affect the relation between capital investment and internationalization levels. Overall, this paper contributes to the literature on internationalization of firms (see e.g., De Haas & Van Horen, 2013; Fung, Bain, Onto, & Harper, 2002; Moshirian, 2001; Siegel, Licht, & Schwartz, 2011) by examining conditions under which capital investment affects the degree of internationalization from a large panel that covers all publicly listed non-financial firms in the US during the period 1990–2013. With this data set, I apply several estimation techniques (i.e., OLS regressions, IV-2SLS regressions, and GMM regressions) and use alternative measures of capital expenditure and of internationalization levels to assess the robustness of the results.

Several key findings in this paper can be briefly summarized as follows. First, a central finding is that capital investment negatively affects internationalization levels after controlling for a large set of firm-specific characteristics. Firms with larger capital investment on average have lower degrees of internationalization. Second, consistent with the prediction, the effect of capital investment on internationalization levels is non-linear and, in particular, U-shaped. That is, the magnitude of the negative effect decreases as capital investment increases, implying that the impact of capital investment on the degree of internationalization is conditional on the relative size of capital investment. Third, the negative association between capital investment and internationalization levels is more pronounced for larger firms than for smaller firms. More specifically, the negative impact of capital investment on internationalization levels is evident in the large firm sample but is not evident in the small firm sample. Fourth, the negative effect of capital investment on internationalization levels is evident only for firms with non-positive sales growth rates. That is, conditional on having a zero or negative sales growth rate, firms with larger capital investments have lower internationalization levels. Furthermore, the negative relationship between capital investment and the degree of internationalization is not present for firms with positive sales growth rates. Last but not least, I test whether the impact of capital investment on internationalization levels varies over time and find evidence

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3 See, e.g., Mata and Freitas (2012) for empirical studies on exits of foreign firms and Denk, Kaufmann, and Roesch (2012) for a review of studies on liabilities of foreignness.
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