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The influence of ownership structure on internationalization

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ABSTRACT

Common reasons mentioned for a firm's internationalization are related to advantages for the firm. However, if firms are conceptualized as political coalitions, this view does not seem to be sufficient to explain why and to what extent firms internationalize. A principal-agent theoretical approach focusing the ownership-stake-related motivations and bargaining power of owners plus the range of actions managers can employ in different ownership situations offers an alternative explanation. We consequently studied the influences of ownership structure – defined as the concentration of ownership – on a firm's degree of internationalization and the main regions of international diversification. Overall, we conclude that the relationship is non-linear. To test our hypotheses, we utilize panel data for the 102 largest German manufacturing firms from 1990 to 2006. The analysis confirms our assumptions.

1. Introduction

When discussing reasons for a firm's internationalization, researchers in international business usually think in terms of advantages for the firm – and, according to official statements, practitioners do so, too (e.g. Rocco, 1996). Those advantages are usually viewed and analyzed as elements of an assumed rational decision process. Especially Dunning's (1973, 1977, 1988) OLI-Paradigm provides well-accepted rational explanations for the choice of market entry and market development forms. Despite the fact that there are also some critical considerations such as those by Buckley, Devinney, and Louviere (2007) which question the rational decision process, the very common theoretical arguments for a firm's internationalization are the utilization of monopolistic advantages (Hymer, 1976; Kindleberger, 1969), the diversification of investment portfolios (Rugman, 1976, 1979), or the internalization of imperfect markets (Buckley & Casson, 1976). However, although we do not assume that a firm's internationalization is a completely irrational phenomenon, we argue that if firms are conceptualized as political coalitions in which their goals are bargained between their participants (March, 1962), the mere rational view seems to be insufficient to explain why and to what extent firms internationalize. A principal-agent theoretical approach focusing the ownership-stake-related motivations and bargaining power of owners plus the range of actions managers can employ in different ownership situations offers an alternative explanation. The conflicts between these two groups have been extensively reviewed within the research on the separation of ownership and control (Berle & Means, 1932; Dodd, 1932; Jensen & Meckling, 1976; Steinitzer, 1908). Their bargaining power within the firm as a political coalition

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and as a result of this, their ability to enforce actions in favor of their own interests depends largely on the structure of ownership. In contrast to a broad view that also takes the owner's identity into account, we define ownership structure only as the distribution of ownership stakes with regard to capital and the associated votes. Managers are supposed to have more degrees of freedom in firms with dispersed ownership compared to firms with a higher degree of ownership concentration (Eisenhardt, 1989; Jensen & Meckling, 1976; Shleifer & Vishny, 1997). The interests of managers are mainly the safeguarding and maximization of their current and future income (Amihud & Lev, 1981; Fama, 1980) as well as their current and future non-monetary rewards and prestige (Aggarwal & Samwick, 2003; Denis, Denis, & Yost, 2002; Harris & Raviv, 1991; Jensen, 1986; Morck & Yeung, 1991). Those interests can be realized inter alia by growth (Baumol, 1959; Mandelker, 1974; Marris, 1963; Mueller, 1969; Penrose, 1959) or more precisely by industry diversification (Amihud & Lev, 1981) or geographical diversification, i.e. internationalization enabling growth (Aggarwal & Samwick, 2003; Chandler, 1962; Denis et al., 2002; Jensen, 1986; Morck & Yeung, 1991). It is therefore assumed that managers favor high degrees of diversification. This is exclusively about their preference for a relatively high degree of internationalization, while the question of target markets and market entry forms may still be solved by means of analysis according to Dunning's (1973, 1977, 1988) OLI-Paradigm. In contrast, owners are usually supposed to favor lower levels of diversification since they can use the (perfect) capital market to diversify their portfolio more efficiently. Consequently, diversification serves as a prominent example for the agency relationship between the managers and the owners (Aggarwal & Samwick, 2003). Nevertheless, compared to management research in general, studies in international management still lag behind when looking for the effects of different ownership structure situations on a firm's geographical diversification.

This research gap is especially surprising as there is a strong agency theoretical link between ownership structure and diversification in general (Aggarwal & Samwick, 2003; Denis et al., 2002; Goranova, Alessandri, Brandes, & Dharwadkar, 2007; Thomsen & Pedersen, 2000) as well as a vast amount of research work studying the relationship between ownership structure and industrial diversification (e.g. Amihud & Lev, 1981; Bergh, 1995; Bethel & Liebeskind, 1993; Denis, Denis, & Sarin, 1997; Hill & Snell, 1988, 1989; Lloyd, Modani, & Hand, 1987). In spite of this, there seem to be only very few contributions such as the one by Bhaumik, Driffield, and Pal (2010) investigating the relationship between ownership structure and international diversification directly. However, while Bhaumik et al. (2010) focus firms from emerging markets and utilize a fairly simple linear approach that is based on institutional arguments, but almost no comprehensive theory-building to model the influence of ownership concentration on a firm's internationalization, they also state: "there is virtually no coherent literature covering the impact of ownership concentration on firm strategies, and certainly not in the context of outward FDI" (Bhaumik et al., 2010, p. 440). There is therefore still no analysis if the agency theory's assumptions are valid for international diversification as well. Instead, most researchers who are interested in the relationship between ownership structure and international diversification refer to the well-accepted arguments that ownership structure has an impact on international diversification and this again influences performance measured by accounting-based or capital-market-based indicators. Derived from those arguments they conclude that it is sufficient to consider only the relationship between international diversification and performance in their analyses (e.g. Denis et al., 2002; Kim & Mathur, 2008). Given the contradictory findings of research on the relationship between industry diversification and performance (e.g. Denis et al., 1997; Gedajlovic & Shapiro, 1998; Markides & Williamson, 1994; Palich, Cardinal, & Miller, 2000) as well as international diversification and performance (e.g. Glaum & Oesterle, 2007; Verbeke, Li, & Goerzen, 2009), it is, however, not sufficient to transfer the results on a link between diversification and performance to the relationship between ownership structure and international diversification. It may even be possible that ownership structure is an antecedent factor to international diversification and therefore influences a firm's profitability via its internationalization. Against this background, the aim of our paper is to apply the principal-agent theoretical reasoning to the relationship between ownership structure and a firm's internationalization and in this manner to propose an alternative or at least an additional explanation for a firm's internationalization. Although this is beyond the scope of our paper, we think that understanding the link between ownership structure and international diversification may contribute to a deeper knowledge about the nature of the internationalization–performance relationship, too.

The remainder of this paper is organized as follows: The foundations are outlined in Section two, which provides first a discussion of internationalization from a – common – firm's point of view and then discusses separately the manager's perspective on international diversification and the respective owner's point of view. Finally, we collate these two lines of reasoning, analyze the effect of different ownership situations on a firm's degree of internationalization, and derive corresponding hypotheses. In Section three, we test our hypotheses empirically and discuss our findings. In Section four, we present our conclusions.

2. Internationalization as a business strategy

2.1. Internationalization and firm-specific logics

Roughly described, a firm's internationalization – or rather its international diversification – is the extension of its business across borders. The amount of a firm's business across borders is expressed by its degree of internationalization (DOI). The common reasons mentioned to justify a firm's internationalization are the utilization of monopolistic advantages (Hymer, 1976; Kindleberger, 1969), the internalization of imperfect markets (Buckley & Casson, 1976), market seeking motives (Luostarinen, 1979), leveraging industrial economical effects (Kogut, 1983; Krugman, 1983), the gain in operational