J. of Multi. Fin. Manag. 21 (2011) 55–67

Contents lists available at ScienceDirect

Journal of Multinational Financial Management

journal homepage: www.elsevier.com/locate/econbase

Factors in multinational valuations: Transparency, political risk and diversification

NyoNyo A. Kyaw*, John Manley, Anand Shetty

Department of Finance, Business Economics and Legal Studies, Hagan School of Business, Iona College, New Rochelle, NY 10801, United States

ARTICLE INFO

Article history:
Received 5 August 2010
Accepted 14 December 2010
Available online 21 December 2010

JEL classification:
F37, G30

Keywords:
Multinationals
Valuation
Transparency
Geographic diversification
Political risk

ABSTRACT

This paper examines the role of geographic diversification, transparency, and political risk, in the determination of the value of multinational corporations (MNCs). Using alternative measures for geographic diversification, this paper finds the evidence supporting the positive effect of the degree of multinationality on the firm value. The evidence also provides support for the theories that argue that political risk and transparency have negative impact on the MNC value.

Published by Elsevier B.V.

1. Introduction

The factors impacting the performance of multinational firms remain of much interest to managers, investors and researchers. A number of theories have been put forth and tested empirically to link the international expansion with the firm value. The internalization theory (INT) posits the idea that multinational firms can create value by internalizing the markets for key intangible assets of the firm such as marketing, managerial and production skills, patents and goodwill. For example, Malone and Rose (2006) argue that a firm's unique intangible assets provide a competitive advantage that may be best claimed through geographic expansion. Using transaction cost theory, they argue that man-

* Corresponding author at: Department of Finance, Business Economics and Legal Studies, Hagan School of Business, Iona College, 715 North Avenue, New Rochelle, NY 10801, United States. Tel.: +1 914 633 2269; fax: +1 914 633 2012.

E-mail addresses: nkyaw@iona.edu (N.A. Kyaw), jmanley@iona.edu (J. Manley), ashetty@iona.edu (A. Shetty).

1042-444X/$ – see front matter. Published by Elsevier B.V.
doi:10.1016/j.mulfin.2010.12.007

agement skills provide low transaction costs which motivate foreign expansion in search of growth opportunities. Pak and Park (2004) argue that benefits associated with internalization are derived from knowledge, and the value of this knowledge benefit is maximized with international expansion and enhanced with an increasing degree of R&D intensity, international experience, cultural diversity, and political risk.

The multinational network hypothesis (MNH) argues that multinational firms can take advantage of a set of real options on contingent outcomes that cannot be otherwise acquired by investors directly. As such, multinational enterprises are in a position to capitalize on the imperfection in world capital markets, with the possibility of optimizing global tax liabilities and available low-cost inputs, especially in less developed countries (Morck and Yeung, 1991). The higher the level of multinationality, the stronger is their position to capitalize, and the higher the MNC's level of performance.

The MNH also argues that the prime benefits from internationalizing operations are derived from the choices that will be open to the MNC from the expansion. The international scope of the firm's operations provides options for actions unique to its own characteristics and situation, but otherwise previously not available. For example, opportunities to arbitrage factors of production across borders are a unique and valued option, such as cheaper (as well as easier, more convenient, more accessible) internal financing opportunities for foreign divisions than external markets offer, and/or availability of cross-border transfers of various assets, including sales (profit) declarations[1] (Doukas et al., 1999). The MNH emphasizes the advantage the firms have in terms of operational flexibility that the international network of operations offers.

In the merger and acquisition literature, many argue that the key benefits to merger only exist if the combination of firms is due to or provides unique characteristics that cannot be duplicated by other acquirer-target combinations or by investors independently. This concept can equally apply when firms expand abroad through acquisitions or Greenfield investment.[2] As multinationals enter into foreign markets, the various aspects and characteristics of operations within those markets may well differ from the descriptors of the home markets of the multinationals. The expansion would, however, provide for such benefits as access to internal, but unique, value-laden intangible assets, such as advantages associated with technology, knowledge bases, or management skill. In addition, it may provide methods for by-passing capital repatriation rules and/or lowering tax liabilities. (Morck and Yeung, 1992; Dunning, 1998).

This study extends the research on the valuation of multinational corporations to investigate the importance of transparency (firm's willingness to disclose), political risk (country specific risk faced by the firm) and the extent of the MNC's operations (geographic diversification by MNCs). While the extent of multinational diversification has received a lot of attention in earlier studies, the transparency and the political risk aspects of MNC operations have not received much attention at all.

In this study, we find that **Transparency** and **Political Risk** have a negative effect on the performance of the MNC. In addition, unlike Freund et al. (2007) who find returns and performance are lower with geographic diversification, we find a positive relationship between the level of MNC **Diversification** and the firm's performance.

The remainder of the paper is organized as follows. The next section reviews the prior literature and develops testable hypotheses. Section 3 describes the sample and the methodology used in this study. Section 4 reports empirical findings and a brief conclusion is drawn in Section 5.

2. Literature review and hypothesis development

2.1. Geographic diversification

The idea of value creation through the internalization of the markets for key intangibles was initially studied by Coase (1937), developed by Buckley and Casson (1998), Wolf (1977), Dunning (1980),

[1] See also: Rugman (1981) and Buckley and Casson (1998).

[2] A Greenfield investment is a foreign direct investment by a parent company in new operating facilities built in a foreign nation, often with encouragements such as tax breaks, subsidies or other incentives.