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Export intensity of foreign subsidiaries of multinational enterprises: The role of trade finance availability

Quyen T.K. Nguyen[a,*], Paloma Almodóvar[b]

[a] International Business and Strategy, Henley Business School, University of Reading, Whiteknights Campus, Reading, England RG6 6AH, United Kingdom
[b] Business Organization Department, Complutense University of Madrid, Pabellón de 3°, Despacho 201, CP 28223 Madrid, Spain

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ABSTRACT

We examine the relationship between the role of trade finance availability and the export intensity of foreign subsidiaries of multinational enterprises (MNEs). In developing our hypotheses, we draw upon insights derived from "new" internalisation theory (international business literature) and international trade finance (international economics literature). We empirically test these hypotheses using survey data compiled from subsidiary managers in six ASEAN countries, supplemented with host-country level data. We conceptualise, empirically test, and establish that the subsidiary-level capability in combining and utilising internal and external debts is an important subsidiary-specific advantage to support export intensity. We find that subsidiaries employ intra-firm loans from MNE internal capital markets and, to some extent, bank loans from external financial institutions to boost their export intensity. Subsidiaries may have concerns about foreign exchange risks, but the use of appropriate foreign exchange risk management is positively associated with export intensity. We discuss the implications of our findings for theory and practice.

1. Introduction

Over half of international trade in the world is conducted by the largest multinational enterprises (MNEs) and their foreign subsidiaries (Rugman & Collinson, 2012). Even when exports are not the initial mandate for a subsidiary, many subsidiary managers discover new ways to combine their local knowledge with resources from the parent firm in order to develop new business opportunities outside of a national market (Birkinshaw, 1996). In cases where the parent firm does not establish a foreign subsidiary in each host country, or where the geographic distance from the headquarters (HQs) to export markets is high, it is more viable for the parent firm to bestow a foreign subsidiary which is located near export markets with a mandate to sell products and services internationally. Furthermore, a subsidiary may develop strategic specialised resources and acquire a world product mandate (D'Cruz, 1986; Rugman & Bennett, 1982). A subsidiary's mandate is broadly defined as a business or a part of a business in which the subsidiary is involved and for which it has duties beyond its national market (Birkinshaw, 1996). Indeed, it has been agreed that a subsidiary's mandate may be extended to include exports, because exporting is central to the overall strategy of subsidiaries (Birkinshaw, 1996, 1997; Estrin et al., 2008; Nguyen & Rugman, 2015b; Nguyen, 2014, 2015).

Financing is instrumental in the export success of foreign subsidiaries of MNEs. Exporting involves substantial fixed and variable costs, a longer trading time relative to domestic trade, and increased risks (e.g. exchange rate movements) (Foley & Manova, 2015; Manova, 2013). Subsidiaries may also require more capital to finance equipment for export-oriented production (Manova, 2013) or service provision. Sufficient working capital and liquidity are needed to allow them to offer attractive terms of payment and thus win purchase orders and contracts from foreign customers. They are also needed for the execution of shipments and deliveries (Antràs & Foley, 2015). Most of these large upfront costs cannot be funded through retained earnings and internal cash flows from operating activities (Foley & Manova, 2015; Manova et al., 2015; Manova, 2013). We explain this point in detail in the theoretical development section. This is referred to as (international) trade finance: the financing of international trading activities. Thus, the financing of subsidiary exports requires the availability of internal and external debts (i.e. intra-firm loans, bank loans, and export credit finance).

However, little is known about the financing of exports of MNE

Abbreviations: ASEAN, Association of Southeast Asian Nations; FSA, firm specific advantage; FX, foreign exchange; HQ, headquarter; IB, international business; IE, international economics; LB, location bound; MNE, multinational enterprise; SSA, subsidiary-specific advantage

* Corresponding author.
E-mail addresses: t.k.q.nguyen@henley.ac.uk (Q.T.K. Nguyen), paloma.almodovar@ccee.ucm.es (P. Almodóvar).

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foreign subsidiaries. Many of the previous international business (IB) studies on the subsidiary export mandate in particular (Birkinshaw, 1996), as well as subsidiary management in general, pay little or no attention to finance considerations and the financial management strategies of foreign subsidiaries (Aulakh & Mudambi, 2005; Mudambi, 1999; Nguyen, 2013; Nguyen & Rugman, 2015a). As such, our academic and managerial understanding of this important topic that underlies subsidiary export success is significantly limited.

This study aims to address this limitation and contributes to the literature examining how the exports of foreign subsidiaries are financed. We build upon "new" internalisation theory (Rugman & Verbeke, 1992, 2001, 2003), which is an extension of "classic" internalisation theory (Buckley & Casson, 1976; Hennart, 1982; Rugman, 1981), in the IB literature. "New" internalisation theory postulates that firm-specific advantages (FSAs) can be created by both parent firms and by foreign subsidiaries. These FSAs are strengths and benefits of the firm relative to its rivals, which arise from product and process technology, innovation, R & D, brands, finance resources and access to finance, and management skills. If FSAs are developed at the subsidiary level, they allow national responsiveness in a host-country economy, a type of location-bound (LB) FSAs, and they are known as subsidiary-specific advantages (SSAs). Furthermore, we also draw upon insights from the international economics (IE) literature into international trade finance and multinational activity. It is noted that we focus on factors within the control of subsidiaries and that we aim to address two key research questions:

(i) How do foreign subsidiaries use internal and external debt finance to support export intensity?
(ii) Do subsidiaries' perceived concerns about foreign exchange (FX) risks affect their export intensity? What are the effects of using FX risk management on subsidiary export intensity?

We empirically test our hypotheses using survey data from the subsidiary managers of British MNEs in six countries (Malaysia, Indonesia, the Philippines, Singapore, Thailand, and Vietnam) of the Association of Southeast Asian Nations (ASEAN) and control for a wide range of alternative explanations. The ASEAN bloc is an interesting context for our research. It is one of the most open economic regions in the world, with total merchandise exports of over $1.2 trillion – nearly 54% of total ASEAN GDP and 7% of global exports (Asian_Development_Bank, 2015). Member countries are characterised by rapid economic growth and their active involvement in the world economy. They are growing markets that provide business opportunities, as well as being important sources of inputs for MNEs such as products, technology, value-adding capabilities, commodities, and labour (Nguyen, 2014; Rugman & Collinson, 2012). As a group, the ASEAN bloc has free-trade agreements with Japan, Korea, China, India, Australia, and New Zealand (ASEAN + 6). Moreover, ASEAN member-country governments support the export initiatives of multinational subsidiaries, which help to promote national competitiveness and improve balances of payments.

British MNEs are among the largest and the most active investors in the ASEAN bloc, and they have achieved significant international success (Yip, Rugman, & Kudina, 2006). Our survey results show that manufacturing and service ASEAN subsidiaries of British MNEs are predominantly driven by market-seeking motives, in which exports contribute to profitable growth.

Our study makes three new contributions to the IB literature. Firstly, our core theoretical contribution is to conceptualise, empirically test, and establish that the financing of exports by MNE foreign subsidiaries is an important SSA. Specifically, we highlight that, relative to the HQs, foreign subsidiaries have in-depth knowledge and understanding of the underdeveloped financial markets in the host countries in the context of emerging economies. Furthermore, these subsidiaries develop sustainable export financing strategies to overcome these challenges. Foreign subsidiaries are often well positioned to tap into MNE internal capital markets (Aulakh & Mudambi, 2005; Foley & Manova, 2015; Mudambi, 1999; Nguyen & Rugman, 2015a; Rugman, 1980). Furthermore, we show that foreign subsidiaries can access external debt finance not only from local banks within the host countries but also from international banks outside of them, which arise from the benefits of multinationality and the international nature of the MNE (Doukas & Pantzalis, 2003; Eiteman et al., 2012; Nguyen & Rugman, 2015a; Rugman & Collinson, 2012). These multiple funding sources help these subsidiaries to overcome the credit constraints of external capital markets in the host countries and take advantage of differences in the cost of financing across countries. Thus, the subsidiary-level capability in recombining and utilising internal and external debts as trade finance sources is conceptually an important SSA (a type of LB FSA). As such, we extend "new" internalisation theory with a specific focus on financing subsidiary export intensity. This is an interesting and new theoretical contribution, given that the extant IB literature that focuses on subsidiary export mandates (Birkinshaw, 1996) but pays no attention to the important role of trade finance availability and the development of subsidiary-level sustainable export financing strategies.

Secondly, we develop a parsimonious model to examine how the financing of exports and the use of FX risk management affects subsidiary export intensity. Our distinct and innovative approach, which clearly demarcates the differences between intra-firm loans and bank loans, is an innovation in this field. Previous studies of international trade and multinational activity in the IE literature, which introduces corporate finance as a consideration, have not distinguished between sources of finance, although it is identified as a particularly important matter (Foley & Manova, 2015). Furthermore, the role of intra-firm trade finance is under-researched empirically, meaning that it is critical to tackle this relevant issue. Our empirical evidence illustrates the important role of internal debt in supporting subsidiary export intensity, which is consistent in all statistical models. To a certain extent, subsidiaries might combine intra-firm loans with external debt if it is accessible and available. We also find that subsidiaries may have concerns about FX risks but that the use of appropriate FX risk management is positively associated with export intensity.

Thirdly, our innovative research approach of integrating the perspectives of "new" internalisation theory and international trade finance is original. The results provide useful new insights into the relationship between trade finance availability and export intensity at the subsidiary level, which has been largely under-researched in the IB literature. Our findings offer important strategic implications for subsidiary managers and policymakers regarding the contributions of MNE foreign subsidiaries in promoting the exports, finance, and ultimately economic growth of the host countries.

The remainder of the paper is organised as follows. The next section provides a theoretical synthesis and discusses how trade finance availability enhances the export intensity of the subsidiary. The third section is dedicated to theory development and the generation of hypotheses, while the fourth section describes the data and the methods employed to test these hypotheses. The subsequent sections present the results of the analyses and discuss the findings. The final section is the conclusion, including a discussion of the limitations of this research and suggestions for the direction of future research.

2. Literature synthesis and theory development

2.1. "New" internalisation theory

"Classic" internalisation theory (Buckley & Casson, 1976; Hennart, 1982; Rugman, 1981) is a firm-level theory that explains the existence, the function, and the reasons why the MNE exerts proprietary control over knowledge-based FSAs by creating a network of foreign subsidiaries instead of exporting or licensing. Internalisation theory recognises imperfections in goods and factor markets, information