CHAPTER 1:

INTRODUCTION

1.0 Introduction

Globalization has changed the course of doing business in the corporate world for both developed and developing countries. It causes increasing economic, financial, social, cultural, political, market and environmental interdependence among nations. Many companies, especially in the developing nations are facing with the dilemma of both opportunities and threats created by increasing globalized market place (Hitt, Keats, & DeMarie; 1998; Molle, 2002; Sanchez, 1997), "Going global or remain local?" has become a frequent question in the board discussion among the corporate executive in the race for satisfying the stock market expectation for better financial performance each year. Globalization is found to improve the performance of US enterprises (Oxley & Schnietz, 2001). International Diversification is one of the strategies adopted by many companies in the age of globalization, which helps firms operating in multiple nations to outperform their domestic counterparts due to exploitation of economies of scope, economies of scale and economies of location across the boarders that their competitors cannot capitalize (Tallman & Li, 1996).

While many theories and empirical findings suggested international diversification improves firms' financial performance, there is only one similar research conducted the study among some Malaysian companies, however neither its scope of research nor the result has been described in detail (Sally Sledge, 2007). However, there were few articles published on the internationalization strategy, process and characteristics of Malaysia companies (Sim and Pandian, 2007; Ahmad and Kitchen, 2007; Ahmad, 2008). As such, the focus of this study is to, for the first time, establish the relationship between international diversification and firms' financial performance among the top 100 Malaysian listed companies by market capitalization value during the period of 2003-2007.

1.1 Background

The term International Diversification is found to be interchangeable with Multinationality or International Diversity in the context of international business study. This study will use the term International Diversification for the sake of consistency throughout the report. International Diversification can be defined as a firm's expansion geographically beyond the borders of its original home countries. It also refers to the extent of which firms operate internationally by investing in assets and / or controlling activities outside their home country (Cantwell and Sanna-Randaccio, 1992; Teece, 1981). The extent of international diversification can be broadly categorized by observing the operation, ownership and orientation of the firms (Annavarjula and Beldona, 2000), which the later chapter uses to establish the measure of this phenomenon.

On operation, a firm can be classified as international base on its "value creation activities" which spread across various country boarders (Porter, 1985; Maisonrouge, 1974; Dunning, 1971; Rolfe, 1970). Whereas, ownership refer to the extent to which a firm own value-generating assets abroad, as well as the extent to which it is owned by individuals and institutions abroad. Lastly, Orientation indicates the attitudinal posturing or “intent” of the international firm and its management in terms of its vision, strategy and structure.

The above definition and studies were mainly from economistic and western-centric theories developed predominantly in industrial and institutional economics (Buckley and Casson, 1985; Dunning, 1988, 1993). It is understandable as the trend of outward investments from developing countries only began to accelerate in the 1990s (United Nation, 1988, 1993). However, there are several scholars who tracked the flow of foreign direct investment from developing countries much earlier, and concluded the trend started during 1970s to 1980s (Lecraw, 1981, 1993; Wells, 1977, 1981; Lall 1983a, 1983b; Kumar and Lim, 1984; Ulgado et at, 1994). Later on, some scholars characterized during the first wave of FDI outflow, developing country MNCs in the 1980s as those more concerned with cost competitiveness vis -à-vis their competitors (van Hoesel, 1999), whereas the second wave during the 1990s, developing countries MNCs placed greater emphasis on the development and/or redirection of business strategies in response to the changing patterns of world business structure brought about by trade liberalization and economic globalization (Dunning et al., 1997)

The above mentioned economic growth of East Asia in the late 1980s (World Bank, 1993) and early 1990s resulted in increased intra-regional direct investments (Dobson and Chia, 1997). This economic growth is characterized with direct investment processes and activities transferring from one level of economies to another, starting from Japan, followed by the NICs (Korea, Taiwan, Hong Kong and Singapore). This pattern carried through to the rapidly growing economies such as Indonesia, Malaysia and Thailand (Toh and Low, 1994; Guisinger, 1991). Firms from these Asian capital exporting countries were internationalizing their business activities and had emerged or were emerging as Asian MNEs.

The development of cross boarders economic integration within the East Asia region has hastened the growth of international diversification among the local MNCs, for example ASEAN members will commence full fledge AFTA policy in year 2010 which there will be tax free for cross borders economic activities among the members. Further to that, ASEAN also separately working with other economic powers such as Japan, China and India for free trade agreement. In Malaysia, the government often plays a direct and active role in the internationalization of its multinationals (Ahmad, 2008). The Ministry of International Trade and Industry (MITI) and its related agencies, such as the Malaysia External Trade Development Corporation (MATRADE)), and the Malaysian Industrial Development Authority (MIDA), have been given the responsibility for the task of promoting and facilitating Malaysia's foreign investments. The government of Malaysia also formulated the investment incentives policies for local enterprises, which can be divided into four categories: fiscal incentives, tariff-related incentives, financial incentives, and finally non-financial incentives (Mehmet, 1990). Another effort to encourage domestic entrepreneurs to engage in international business, the Export-Import Bank of Malaysia (Exim Bank) was established in August 1995. The main objective was and is to provide financial support to Malaysian exporters in enhancing their role in international business, especially to non-traditional markets (Exim Bank Annual Report, 2006)

This trend of globalization, economic integration among regions and government incentive will continue to create both opportunities and risks for the Malaysian local enterprises. From “push” and “pull” point of view, the natural reaction from the enterprises will be considering international diversification, in order to survive in this more globalized competition. With that in mind, it is logical to predict that there will be more Malaysian firms increasing their foreign operation, as such become more internationalized in nature.

1.2 Research Questions

The following research questions attract the interest of this study:

1) Is there any direct link between degree of international diversification (DOI) and firm performance among the Malaysian companies going abroad
2) If indeed there is relationship between the DOI and firm performance, what kind of relationship will that be: linear, quadratic or cubic in form?
3) Is the performance of fully domestic based companies and internationalized companies different statistically?

1.3 Objective of The Study

This study examines the relationship of the extent of firms' international diversification and their financial performance among the listed Malaysian companies. The objectives of the paper are therefore to explore the following:

- Among the top 100 listed companies in Malaysia (Appendix 1.1) by market capitalization with more than 10% of international diversification, what is the relation between the degree of international diversification and firms' performance
- The existence of optimum degree of international diversification strategy for maximum firms performance among the Malaysian listed companies

- The comparative study of firms performance among the listed companies with abroad operation and full fledge domestic based companies

The scope of this study covers the top 100 listed companies in Malaysia Bursa Saham, categorized by the market capitalization. These companies are also among the largest companies in Malaysia by assets and comprise of various sectors such as retail, manufacturing, banking and finance, construction and property, as such there are good representation of Malaysian companies in general.

1.4 Significance of The Study

This study will expand our understanding on the financial effects of international diversification on Malaysian companies. The finding will provide a valuable perspective for companies to formulate their internationalization strategy during different phases of overseas business expansion. The existence of performance pattern with regards to the degree of international diversification will certainly provide an insight for managers of international business to assess the risk and return in statistical and empirical approach. While the actual return and risk of international diversification depend on many factors such as organization structure, competitive advantages, corporate leadership quality and etc, the examination on the effects of degree of international diversification could be used to monitor the overseas expansion, and trigger necessary remedied actions early when the signs of negative performance are observed.

The empirical comparison of financial performance between domestic companies and their more internationalized counterparts also shed lights onto the validity of general presumption that, internationalized companies are normally achieving superior financial performance compared to domestic operated companies.

1.5 Summary

In summary, this empirical study is through quantitative method and its rational of research framework adopts the methodology of work done by Contractor, Kundu and

Hsu (2003). It examines the relationship between firms' international diversification and financial performance. The independent variable is the degree of international diversification, dependent variable being firms' performance which could be measured in Returns on Assets (ROA) and Returns on Sales (ROS). This study treats firms' size and industry sector of the firms as the control variables to ensure firms' performance is accounted as much as possible by the independent variable selected.