# CHAPTER 5:

# CONCLUSION AND RECOMMENDATIONS

## 5.0 Introduction

After presentation of the results of the study, it is imperative to draw a conclusion of the overall research and discuss the implications of the study on internationalization of Malaysian firms by large. This chapter therefore concludes the study of the relationship between internal diversification and firm performance as well as the performance comparison between domestic and international diversified companies. Furthermore, the discussion also covers the limitations of the study and the room of improvement and suggestion for future research purpose

## 5.1 Summary and Conclusion

The result presented in the previous section can be summarized by interpreting the outcomes of both Hypothesis 1 and 2:

### 5.1.1 Relationship between International Diversification and Performance

Hypothesis 1 which, states that for international diversified firms, the firm performance will be influenced by degree of internationalization of the firm according to S-shape, is well supported. This means that the Malaysian firms venturing overseas suffer initially in terms of financial performance, as the firms attempt to overcome the liability of newness in the foreign land, another possibility after inspecting the profiles of the selected international diversified companies, which are mainly from heavy capital subsectors such as banking, plantation, infrastructure and construction. Typically, the foreign venture for these companies will require sizeable capital outlaid in the early stage, hence, the upfront investment may affect the overall performance of the companies. This observation seems to exhibit the same pattern as described by Contractor et al (2004) on the difference between capital intensive sector and knowledge based sector.

The second stage of internationalization among Malaysian listed companies are observed when the firms have their foreign sales percentage reaches the threshold value of 15% -20%, in which, the firms will start to reap the benefits of internationalization by reversing the early trend of deteriorating performance in terms of ROA and ROS, this phenomenon could be explained by resources exploitation theory which suggests the firms at this stage start to experience the benefits of economic of scale and scope, as well as access to lower cost of labor and material. This stage of trend will attract the firms to increase their foreign sales because of the improving firm performance, it is observed that the firms typically continue to increase their foreign sales. From the data, there are only about 30% of the cases in the sample collected that have degree of international diversification (DOI) 15% or less, hence , it can be concluded that Malaysian firms are motivated to increase their foreign sales percentage after crossing their first threshold of 15%. This typify the pattern of mid stage internationalization process.

The mid stage of internationalization process with positive financial performance extend with the increasing of foreign sales ratio till the DOI reaches the second threshold value of around 60%, which statistically the firms shall obtain the highest performance in terms of ROS, beyond this threshold value, the firms performance will start to deteriorate as the firms seems to over stretch their international operation. This phenomenon could be due to the increasing coordinating, monitoring and controlling cost as the firms expose more to foreign activities. Another plausible reason is because of venturing into periphery markets which again lead the firms to experiencing "newness" to the new markets. This cost escalation will affect the firms' overall performance negatively as demonstrated in the result obtained. Why do firm continue to venture beyond the $2^{nd}$ DOI threshold value?

The motivation of the firms to exceed the optimum level of internationalization might be non-monetary and hence, less readily apparent. One of the reasons could be the strategy move to increase the foreign share market as the firms continue to increase their presence in some of the markets that are newly developed such as Middle East, India, China and other South East Asia countries, or their increase in level of activities in overseas despite negative marginal returns because the firms seek to capitalize on intangible benefits, such as technology and proprietary input access, that are essential for the firms to maintain their business network. Another plausible explanation is the firms' negative performance does not immediately materialize as it will typically lag the decision on international diversification a certain period of time, as such the firms may not be able to react to the negative returns immediately by cutting foreign operation. Lastly, the underlining factors that determine the overall cost structure of overseas expansion begin to change over time, that the companies may unintentionally operate beyond the threshold level of overseas expansion.

### 5.1.2 Performance Comparison between Non-international Diversified Firms and International Diversified Firms

Statistical performance comparison finds that non-international diversified companies in fact outperform their more international diversified counterparts among the Malaysian top listed companies. The domestic based companies register 25.8% mean score for ROS versus international diversified companies of around 17.6%, and the difference is statistically significant. This finding is contrary with Hymer’s (1976) theory of FDI, which posits that firms will go overseas only when they can earn returns that are greater than what they can earn at home. Ideally, this statement could be true but the business decision making and market forces are extremely complex that many firms are forced to take premium risk based on their subjective assessment of the risk nature in order to satisfy the stakeholders’ expectation. This decision making of overseas expansion can be viewed in the forms of “pull” and “push” factors. Some companies are “pulled” by the true potential of overseas extended markets to reap better profit for the firms, whereas other companies may be forced to venture overseas market due to over-saturated local demand or due to stiff competition at home market. As such, the motive of overseas expansion may not be entirely based on Hymer' overseas expansion logic.

It is interesting to note that the domestic firms that are among the top 100 listed companies have many of them, enjoy monopoly or near monopoly in their business market in Malaysia, these companies include Tenaga, Petronas Gas, Astro, Berjaya Toto, Plus, Litrack, Digi and etc. This can explain why the domestic-based top 100 listed companies in Bursa Malaysia outperform their counterparts that have more exposure to foreign sales. Further to that, the nature of Malaysia business scenes which for years, being dominated by interplays of various forces such as privatization, political patronage and economic affirmation action (Gomez. ET, 2004), have created favored market conditions for certain politically well-connected companies, whose financial performance are envies of even many overseas multinational companies. Government's heavy participation in economy development such as the establishment of Government Link Companies (GLCs) also plays major parts in ensuring some of these companies reaping excessive returns that are not matched by internationalized firms.

On contrary, the more international diversified Malaysian companies have to compete square and fair with their foreign counterparts in the overseas markets. Judging from the Global Competitive Index 2009, published by World Economy Forum, a measure of the competitiveness of a country economy against the rest of the countries in the world, which Malaysia sits on number 21st, it is plausible to explain Malaysian companies may have to compete fiercely with those from other countries in order to secure foreign market shares. The fiercer the competition among the industrial players, the set back in terms of financial performance would be greater. This could be one of the reasons the more international diversified companies are outperformed by their more domestic based counterparts. This result is in conflict with the previous study (Collin. J, 1990) which found no significant difference in performance between domestic US companies and those venturing to developed or developing countries.

## 5.2 Limitations

While this study generally bases on assumptions and theories accepted in larger literature, few key limitations must be acknowledged. First the chosen companies are some of the largest among the Malaysia corporations, thus the findings may not be applicable to smaller Malaysian companies. It will be of benefits to the Malaysian companies as a whole, should the samples selection can be generalize to this group of companies, as in the era of globalization, overseas expansion is no longer just the domain of large companies, but become part and parcel of smaller Malaysian companies as well. While this study has included firm size as the control variable to alleviate the firm size effects, nonetheless, including more smaller companies in the sample will certainly make this study more complete and comprehensive.

The data and information used for this study are mainly from the respective companies' as well as Malaysia Bursa Saham' official published reports for the year 2003 to 2007. These secondary source of data have provided sufficient insights on the operational aspects of the companies, however, the attitudinal type of information on the companies' internationalization are unavailable, as such the measure of degree of international diversification in this study is single dimension construct instead of the multi dimension construct recommended by some in the previous researches. The measurement of DOI and performance indicators selection may only capture some of the important information on these independent and dependent variables, these measurement could be refined further, for examples, DOI is a complex measurement, as such by only considering the ratio of foreign sales to total sales due to constraint in data available, may result in capturing only the portfolio related internationalization information and excluding the operational intent and attitudinal attributes of DOI. Likewise, the performance indicators with ROS and ROA are actually capturing the same aspect of accounting performance information, hence, other performance indicators, like operational and market based performance are not included in this study.

Lastly, this study did not examine the possibility of bi-directional causation (ie..whether good performance causes firms to make further overseas expansion). Even the above listed limitations do not debilitating the explanatory power of this study, it surely will help to strengthen the conclusiveness of the findings should further studies take relevant measures to eliminate these limitations.

### 5.3 Suggestion for Future Studies

A conceptual framework of international diversification impacts on firm performance has been developed and illustrated in the context of Malaysia corporations. It is noticed that similar research is still limited in Malaysia and therefore future researches are very much welcomed. It is further suggested that future research could modify, verify or elaborate the current framework to gauge different interesting findings, for examples, other relevant variables to firm performance directly or indirectly could be analyzed. These potentially relevant variables include product diversity, R&D and advertising intensity and firm related organization structure attributes. In addition, future study could be built on larger sample size to enable higher generalization power of the findings to the rest of the Malaysian companies. Lastly, the measurement limitation for DOI and performance indicators could be further refined to include multi dimensions construct to obtain fuller understanding of internationalization process and relevant information.

## 5.4 Management Implication

This study provides some key insights to managers on international business, especially in the local Malaysia context, it is the first attempt to quantify empirically the relationship between international diversification and firm performance, as well as measuring the statistical performance comparison between firms which are more domestic based and those are more international diversified firms. Managers responsible for international sales could be benefited from this study by recognizing the existence of 2 threshold levels of international diversification which firm performance will make change from the earlier prevailing profitability trend. For instance, if the managers were more explicitly conscious of the temporary negative performance in the early stage of internationalization (stage 1) they could take precautionary steps to lower the cost of the initial international expansion, or recognize the early stage of performance setback with open heart and do not assume increasing foreign sales as guaranteed superior financial performance.

By the same token, for the highly internationalized firms, if the managers are aware of reaching optimum (second threshold) level of performance growth, they may restrain further international expansion, which will have the companies' fortune taking a bad turn. Hence, the next question is, how does the firm know about the threshold levels? One way for the firm is to conduct econometric analysis like this one on a cross-section of firms in their industry sector, to find the nature of performance as regards to the degree of internationalization. If the companies do not have resources to perform the empirical test, the awareness of over-expansion could serve as the reminder for the managers to “watch over” their intensity of international expansion, and be mindful of the potential setback if the companies do reach this level.

**5.5 Summary**

This study explores the impact of international diversification towards the firm performance for the top 100 listed companies in Malaysia. Through the larger literature available in this area, the conceptual framework is developed and tested through empirical analysis. The findings from this study reveal significant impact of international diversification towards the firm performance and the relationship is of S- shape, in which firm encounters negative performance growth in the stage 1 of internationalization, then the firm experience positive performance growth in stage 2 and finally, when the firm enters stage 3 of internationalization, the firm performance take a dip to negative region again due to over-expansion.

Despite theoretical argument, that firms are motivated to expanse overseas only if they can earn more than what they can earn at home, the finding of Hypothesis 2 suggests that firms which operate locally in fact outperform those firms that have significant overseas presence. This result underlines the very fact of the inherent economy activities in Malaysia which still sees many firms enjoying near monopoly business environment in industries which are highly competitive in other countries.

From management's point of view, this study identifies several important considerations for companies venturing abroad seeking better financial performance. There are few limitations in this report and future researches are needed to refine and further testing the robustness and stability of instruments used.