

Impact of Internationalization on Firm Performance in Emerging Markets with Home Country Uncertainty and Region of Expansion as Moderating Variables 2009-2017

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ABSTRACT

This study determines the influence of internationalization on the performance of firms in Indonesia, Philippines, and Malaysia. This study also determines whether home country uncertainty and region of expansion strengthen relations between internationalization and firm performance. This study uses generalized least square (GLS) unbalanced panel data with annual data for 2009–2017. Results show a positive and significant influence of internationalization on firm performance. Home country uncertainty (political risk and level of corruption) as independent variables positively and significantly affect firm performance. As moderating variables, political risk and level of corruption have different significant influences. Political risk negatively affects firm performance, whereas level of corruption exerts positive effects. As moderating variable, regional expansion exerts significant influence only on level of corruption, whereas non-regional expansion significantly affects on level of corruption and political risk.

Keywords: Internationalization, Firm Performance, Home Country Uncertainty, Region of Expansion

1. INTRODUCTION

Continuous growth of information and technology has caused the world to become more connected and integrated, a phenomenon known as globalization. Globalization is a condition in which geographic, economic, social, political, and institutional boundaries between countries are diminishing. Globalization increases the dependence of the world economy through growing trade in goods and services and capital flows between countries (Shangquan, 2000).

According to Shangquan (2000), economic globalization has positive and negative effects. It can encourage economic growth, which elevates literacy, public welfare, and life expectancy. However, it also has increased inequality worldwide for the past two decades (International Monetary Fund, 2007).

Globalization has increased involvement of companies in international operations (Welch & Luostarinen, 1988). Its main drivers are multinational companies that pursue profit maximization by

organizing production and allocating resources by internationalizing. Companies can internationalize through intermittent exports, exports through independent representatives, building foreign sales subsidiaries, and shifting production overseas (Johanson & Wiedersheim-Paul, 1975). Smith and Omar (2005) find that the central role of multinational companies in globalization is evident through foreign direct investment (FDI) inflows.

The average yearly growth in emerging economies is higher than in developed economies (Sraders, 2018). Emerging market countries display high growth in industrial infrastructure, increased revenues, and rapid economic growth, but they lack FDI experience (Amadeo, 2019). Uncertainty in emerging market countries exceeds that in developed economies. We examine uncertainty as political risk and the level of corruption in firms' home countries.

Among ASEAN emerging market countries, Indonesia, the Philippines, and Malaysia have the best economies as measured in GDP growth in 2017. In addition, 2017 FDI inflows were \$23,063.6 million to

Indonesia, \$10,049.4 million to the Philippines, \$9,447.2 million to Malaysia, and \$9,100.9 million to Thailand (ASEAN Economic Integration Brief No.4, 2018). This research examines Indonesia, the Philippines, and Malaysia. These three countries have the best economic conditions in terms of GDP growth and investment flows seen from FDI inflows.

We investigate whether companies in emerging market countries that internationalize perform better than domestic companies. We ask whether relations between company performance in emerging markets and internationalization are stronger in firms from more uncertain emerging markets. We document whether firms' capabilities to manage uncertainty have more influence on performance when they expand outside its regional area. We limit internationalization to FDI only.

2. THEORETICAL REVIEW

2.1. Internationalization

Calof and Beamish (1995) call internationalization a way companies adapt operations (including resources, structures, and strategies) to the international environment. Penrose (1959) and Prahalad and Hamel (1990) in Wang (2014) identify internationalization as in way firms maximize resources and competencies by seizing opportunities abroad.

Cuervo-Cazurra, Narula, and Un (2015) expose several motives to internationalize: sell more to maximize existing resources and capabilities, to access resources and capabilities of the destination country while avoiding comparative disadvantages in their country, to upgrade generally (e.g., seeking new resources and capabilities that bolster competitiveness), and to escape conditions in their home countries.

According to the Uppsala Model of Internationalization theory, internationalization proceeds in stages from activities with the lowest to the highest level of commitment, and from the closest to the farthest regions (Johanson & Wiedersheim-Paul, 1975). Dunning's eclectic paradigm (the OLI model) explains that companies' desire to internationalize increases when they enjoy advantages of ownership, location, and internationalization. The three-stage model of international expansion refers to a negative slope (obstacles and costs), a positive slope (profits from efficiency), and a negative slope (international exposure exceeding the optimum).

2.2. Firm Performance

Firm performance is a common dependent variable used in management research to measure firms' efficiency and effectiveness (Gregory, Neely, & Platts,

1995). The theory of value maximization holds that firms are established to maximize short-term profit and long-term shareholder value (Friedman, 1970; Jensen, 2001). Its adherents prefer financial ratios as measures of performance. Ross et al. (2010) cite five categories of financial ratios: liquidity, solvency, profitability, market value, and activity ratios.

2.3. Uncertainty and Organizational Learning Theory

Elements that firms cannot control are collectively called uncertainty. Uncertainty is unquantifiable risk, so its emergence is difficult to predict. We address two types of uncertainty: political risk and level of corruption. Political risks are uncertainties in the political environment. The level of corruption qualifies as uncertainty because it can influence which and how rules are interpreted and enforced (Cuervo-Cazurra, 2006; Rose-Ackerman, 1975 in Cuervo-Cazurra et al., 2017). The 2017 Euromoney survey 2017 showed that political risk had increased in 64 countries and corruption in 44 countries over the past few years (Weltman, 2017). Uncertainty is a benefit if firms learn by facing it.

Organizational learning theory states divides knowledge into discrete and contextual (Argote, 1982; Levitt & March, 1988 in Cuervo-Cazurra et al., 2017). Discrete knowledge has properties applicable to specific situations. Contextual knowledge is broader and applicable to general situations that share similarities. Firms form capabilities by processing uncertainty and creating strategic solutions. Firms that can manage uncertainty are display better interaction between themselves and external environments (Cuervo-Cazurra et al., 2017). The ability and knowledge from this experience will be useful in managing global complexity as firms internationalize. Firms' contextual knowledge of uncertainty in their home countries prepares them for sudden changes, especially in countries with low political risks and degrees of corruption.

2.4. Political Risk on Moderating Relationship between internationalization and Firm Performance

Political risk can affect firms adversely. It creates uncertainty in home country operations and limits investment when the fear of nationalization or government seizure is high (Heinsz, 2003). Operating in environments that have high political risk advances firms' organizational knowledge to deal with abrupt political changes (Pearson & Clair, 1998 in Cuervo-Cazurra, et al., 2017). Managers faced with risk and uncertainty can learn useful abilities not only when operating in other countries that also have political risks,

but also in managing risk and uncertainty in the international market (Holburn & Zelner, 2010).

2.5. Level of Corruption on Moderating the Relationship between internationalization and Firm Performance

Corruption is a common occurrence that varies over regions and time in emerging markets. Its existence entails managers paying bribes, spending time and effort interacting with politicians, disguising illegal payments, and taking actions of little operating benefit to satisfy corrupt politicians (Mauro, 1995; Rodriguez et al. 2003; Rodriguez, Uhlenruck, & Eden, 2005; Spencer & Gomez, 2011 in Cuervo-Cazurra, et al., 2017). As with political risk, firms learning from managing corruption, and that knowledge can be useful when they internationalize.

2.6. Region of Expansion, Home Country Uncertainty, and Relation between Internationalization and Firm Performance

The Uppsala Model of Internationalization notes that firms initially internationalize within the region of their home country because intra-regional knowledge transfers more readily (Verbeke & Kano, 2016). Regions also share a history and geography (Verbeke & Kano, 2016). However, those firms face competitors who have similar regional knowledge, potentially reducing the benefits of reduced uncertainty.

2.7. Hypothesis

Based on our theoretical review and previous research, we hypothesize the following:

Hypothesis 1a: Home country political risk has a negative impact on performance of emerging market firms.

Hypothesis 1b: Home country political risk strengthens the positive relation between internationalization and performance of emerging market firms.

Hypothesis 2a: Home country level of corruption has a negative impact on performance of emerging market firms.

Hypothesis 2b: Home country level of corruption strengthens the positive relation between

internationalization and performance of emerging market firms.

Hypothesis 3a: The strengthening impact of home country political risk on the positive relation between internationalization and performance of emerging market firms is stronger when firms expand outside their home regions.

Hypothesis 3b: The strengthening impact of home country level of corruption on the positive relation between internationalization and performance of emerging market firms is stronger when firms expand outside their home regions.

3. RESEARCH DESIGN

3.1. Sample and Data

This study uses panel data from public firms in Indonesia, the Philippines, and Malaysia spanning 2009–2017. The sample includes only non-financial firms with complete data. Of the initial 1,306 firms, 1,046 met all criteria and provided 8,829 observations. Of the final sample 259 firms are Indonesian, 146 Philippine, and 641 Malaysian. Data are from firms’ financial statements and websites and Thomson Reuters.

3.2. Research Framework and Model

We modeled our research framework on Cuervo-Cazurra (2017).

Model 1

$$ROA_{i,t} = \alpha_0 + \alpha_1 INTER_{i,t-1} + \alpha_2 POLRISK_{i,t-1} + \alpha_3 INTER_{i,t-1} * POL_{i,t-1} + \alpha_4 CORRUPT_{i,t-1} + \alpha_5 INTER_{i,t-1} * CORRUPT_{i,t-1} + \alpha_6 CAGE_{i,t} + \alpha_7 CSIZE_{i,t} + \alpha_8 DNRB_{i,t} + \alpha_9 DMANUF_{i,t} + \alpha_{10} DSERV_{i,t} + \alpha_{11} DPOL_{i,t} + \alpha_{12} INTEREXP_{i,t} + \alpha_{13} CBUSCYCLE_{i,t-1} + \alpha_{14} COPENNESS_{i,t-1} + \epsilon_{i,t}$$

(1)

Model 2

$$ROA_{i,t} = \alpha_0 + \alpha_1 REGINTER_{i,t-1} + \alpha_2 NREGINTER_{i,t-1} + \alpha_3 POL_{i,t-1} + \alpha_4 REGINTER_{i,t-1} * POL_{i,t-1} + \alpha_5 NREGINTER_{i,t-1} * POL_{i,t-1} + \alpha_6 CORRUPT_{i,t-1} + \alpha_7 REGINTER_{i,t-1} * CORRUPT_{i,t-1} + \alpha_8 NREGINTER_{i,t-1} * CORRUPT_{i,t-1} + \alpha_9 CAGE_{i,t} + \alpha_{10} CSIZE_{i,t} + \alpha_{11} DNRB_{i,t} + \alpha_{12} DMANUF_{i,t} + \alpha_{13} DSERV_{i,t} + \alpha_{14} DPOL_{i,t} + \alpha_{15} INTEREXP_{i,t} + \alpha_{16} CBUSCYCLE_{i,t-1} + \alpha_{17} COPENNESS_{i,t-1} + \epsilon_{i,t}$$

(2)

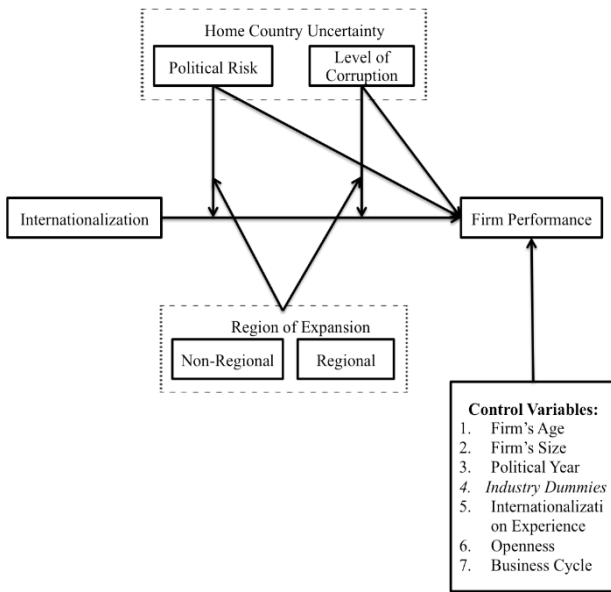


Figure I. Research Framework

3.3. Variables and Measures

The 22 variables used refer to research conduct by Cuervo-Cazurra et al. (2017) and additional sources. Several are lagged one year to avoid influencing the independent variable the following year. The dependent variable is firm performance measured as return on assets (ROA). Independent variables are internationalization, home country political risk, home country corruption, internationalization experience, company age, company size, business cycle, openness, an industrial dummy (natural resource base, manufacturing, service) and year of election. We employed as moderating variables home country uncertainty and region of expansion to capture whether they strengthen or weaken relations among the independent variable internationalization and the dependent variable firm performance. We summarize research variables on table below, the indicators refer to Cuervo-Cazurra et al. (2017)

Table I. Summaries of Research Variables

Variables	Symbols	Indicators
Firm Performance	ROA	$ROA_{i,t} = \frac{EBITDA_{i,t}}{Total\ Aset_{i,t}}$
Internationalization	INTER	Dummy variable
Regional Internationalization	REG	Dummy variable
Non-Regional internationalization	NREG	Dummy variable
Home Country Political Risk	POLRISK	Political risk index from PRS
Home Country Corruption	CORRUPT	Political risk index from CPI
Firm Age	CAGE	Firm Age = Year of analysis – Year when the company first established
Firm Size	CSIZE	Firm size = Ln(Total Asset)
Natural Resource Base	DNRB	Dummy variable
Manufacturing	DMANUF	Dummy variable
Service	DSERV	Dummy variable
Election Year	DPOL	Dummy variable
Internationalization Experience	CINTEXP	Internationalization Experience = Year since the firm was first internationalized
Business Cycle	CBUSCYCLE	$Business\ Cycle = \frac{GDP_t - GDP_{t-1}}{GDP_{t-1}}$
Openness	COPENNESS	$Openness = \frac{Export + Import}{GDP}$

4. RESULT AND DISCUSSION

4.1. Analysis of Statistics Descriptive

Overall, this study has 8,829 number of observations in the form of panel data, which consists of 1,046 cross-section data of public firms registered in Indonesia, Philippines, and Malaysia stock exchanges and 9-year time series data from 2009 to 2017. Descriptive statistics data for all samples are presented in table 2.

Table II. Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max
ROA	0.0673	0.0728	-0.247	0.250
INTER	0.4003	0.4900	0	1
REG	0.1229	0.3283	0	1
NREG	0.2745	0.4463	0	1
POL	0.3689	0.0535	0.32	0.5
CORRUPT	57.9001	8.8380	48	77
INTERXPOL	0.1458	0.1814	0	0.5
INTERXCORRUPT	17.1577	26.1520	0	77
POLXREG	0.0436	0.1177	0	0.5
POLXNREG	0.1009	0.1663	0	0.5
CORRUPTXREG	6.7490	18.2053	0	77
CORRUPTXNREG	15.8449	26.1657	0	77
CAGE	33.5986	20.7550	2	189
CSIZE	18.7482	1.7367	12.9	24.7
DNRB	0.1948	0.3961	0	1
DMANUF	0.2377	0.4257	0	1
DSERV	0.2375	0.4256	0	1
DPOL	0.1634	0.3698	0	1
CINTEXP	5.5097	9.8444	0	84
CBUSCYCLE	4.9281	2.0421	-1.51	7.63
COPENNESS	112.4163	50.8801	37.44	176.67

The best-performing firm (i.e., the highest ROA (0.250) is Malaysia's Ecobulit Holdings Berhad in 2014. Another Malaysian firm—Focus Dynamics Group Berhad—displays the lowest ROA (-0.247) in 2014, when it lost \$2,554,377 in EBITDA. The average number of firms that internationalized during the period (INTER) is 0.4003, around 40% of firms in the three countries.

We divided the territory of expansion as regional (REG) and non-regional (NREG). As many as 99 companies expanded within ASEAN regions in 2009. The number rose yearly to 139 at yearend 2017. In 2009, 243 firms expanded outside the ASEAN. By yearend 2017 the number was 292.

Data for country political risk (POL) are from the Political Risk Services International Country Risk Guide (PRS), which rates the degree of political risk 0 (increasingly high) to 1 (increasingly lower). We scaled the figure so that higher numbers indicate greater political risk. Indonesia in 2015 shows highest political risk (0.50) and Malaysia in 2009, 2010, 2013, and 2014 the lowest (0.32).

The Corruption Perception Index (CPI) scales the level of corruption from 0 (increasing) to 100 (declining). It is lagged one year. Again, we scaled the figure so that higher numbers indicate greater political risk. The highest level of corruption (76) appears in the Philippines in 2009 and 2010 and the lowest (48) in Malaysia in 2014.

4.2. Regression Results

Classical test results indicate violations of multicollinearity, heteroscedasticity, and autocorrelation. To address multicollinearity, we standardized all continuous independent variables per Cuervo-Cazzura et al. (2017). We adopted generalized least squares (GLS) to address heteroscedasticity and autocorrelation per Gujarati & Porter (2009). Regression results for Models 1 and 2 are in Table 3.

Table III. GLS Regression Result of Model 1 & 2

Dependent Variable	Return on Asset			
Independent Variable	Model 1		Model 2	
	Coefficient	Probability	Coefficient	Probability
Constanta	-0.1390	0.000***	-0.1447873	0.000***
INTER	0.0049623	0.018**		
REG			0.0140554	0.000***
NREG			0.0001251	0.957
sPOL	0.0224878	0.000***	0.0221988	0.000***
sCORRUPT	0.0092066	0.000***	0.0091282	0.000***
INTERXsPOL	-0.0090794	0.000***		
INTERXsCORRUP T	0.0053232	0.038**		
sPOLXREG			-0.0077602	0.059
sCORRUPTXREG			0.0111967	0.014**
sPOLXNREG			-0.0102678	0.000***
sCORRUPTXNREG			0.0048947	0.083*
CAGE	-0.0000428	0.268	-0.0000444	0.251
CSIZE	0.0071321	0.000***	0.0074924	0.000***
DNRB	0.0018895	0.381	0.0017589	0.415
DMANUF	0.0195125	0.000***	0.0192695	0.000***
DSERV	0.0066172	0.001***	0.0066091	0.001***
DPOL	0.0007057	0.734	0.0006974	0.737
CINTEXP	0.0002176	0.036**	0.0002732	0.009***
CBUSCYCLE	-0.0000293	0.939	-0.0000154	0.968
COPENESS	0.0005718	0.000***	0.0005649	0.000***
Obs.	8,829			
Prob>chi²	0.000			

*Significant at 10%, **Significant at 5%, ***Significant at 1%

Results for Model 1 show the positive influence of internationalization (coefficient = 0.00496) during the previous year on performance of firms in emerging markets the next year (Table 3). The t-statistic (0.018) indicates that internationalization the previous year influenced next year's performance at 1% significance. The coefficient for political risk (0.02249) is significant at 1%. The coefficient for degree corruption (0.00921) is significant at 1%.

Political risk strengthens the influence of internationalization on performance in emerging market countries. However, the relationship turns negative with a coefficient of -0.00908 significant at 1%. The level of corruption does not strengthen the relation between internationalization and performance in emerging market countries. That relation remains positive with a coefficient of 0.00532 at 5% significance.

Model 2 examines how regional and non-regional internationalization affected performance. Results for Model 2 (Table 3) shows that the positive influence of internationalization strengthens at 1% significance. The coefficient is 0.01406 for companies that expanded intra-regionally. The coefficient for interaction between political risk and non-regional expansion (-0.00776) is not significant. The coefficient for interaction between political risk and non-regional expansion (-0.01027) is significant at 1%.

Results indicate a positive relation between corruption and intra- and extra-regional internationalization. The coefficient for interaction between level of corruption and regional expansion (-0.00776) is significant at 5%. The coefficient for interaction between level of corruption and non-regional expansion (-0.01027) is significant at 10%.

Control variables in Models 1 and 2 show consistent results. Firm age has a negative but statistically insignificant relation with performance (coefficient = -0.00004) in both models. Firm size relates positively to performance (coefficient = 0.00713 in Model 1 and 0.00749 in Model 2) at 1% significance. These results accord with Cuervo-Cazurra et al. (2017). Majumdar (1997), who sampled 1,020 Indian companies, also shows a positive relation between size and performance. Election year has a positive but statistically insignificant relation to performance (coefficient = 0.00071 in Model 1 and 0.00070 in Model 2).

International experience shows a positive relation to firm performance (coefficient = 0.00022 in Model 1 and 0.00027 in Model 2), both at 5% significance. This finding accords with organizational learning theory that firm knowledge is accumulative. The business cycle shows a negative and statistically insignificant relation to firm performance (coefficient = -0.00003 in Model 1 and -0.00002 in Model 2).

Openness shows a positive relation to firm performance (coefficient = 0.00057 in Model 1 and 0.00056 in Model 2, both significant at 1%.) Barro and Sala-i-Martin (1997) and Rivera-Batiz and Romer (1991) in Keho (2017) argue that in the long run the openness of the state increases efficiency of resource allocation and productivity via diffusion of technology and knowledge. Industry dummies denoting natural resources firms, manufacturers, and service firms show a positive relation to company performance in Models 1

and 2. Results are statistically significant for manufacturers and service firms but not for natural resource firms.

4.3. Analysis of Regression Results

Political risk has a positive and significant relation to performance in Models 1 and 2 based on our regression results. These differ from the cited literature journals and do not support our first hypothesis. Nevertheless, Desbordes (2010) and Girard and Sinha (2008) in Kriel (2011) associate high risk with high expected returns because uncertainty of future returns increases. Kriel (2011) shows that countries with high political risks can attract direct investment and foreign economic growth. That happens because firms can take transfer ability to manage uncertainty in their own countries to destination countries.

Political risk can strengthen the relation between internationalization and firm performance, but our regression shows a negative coefficient that differs from the referenced study. That is because political risk elevates costs to firms and managers must address political instability in their countries that can affect internationalization. Heinsz (2003) states that home country political risks cause operational uncertainty and limit investment, especially where fears of seizure are elevated.

The level of corruption has a significant positive relation to firm performance in both models. This result does not accord with our initial hypothesis but does mirror results in the referenced literature. Some firms in corrupt environs can enjoy better conditions than competitors by influencing government contracts, regulations, or how law is enforced (Cuervo-Cazurra, 2016; Chen, Ding, & Kim, 2010 in Cuervo-Cazurra, 2017). Corruption may reduce the effects of convoluted bureaucracies and flawed institutions (Wei, 1998).

Results support our hypothesis that level of corruption influences the effect of internationalization on performance. Managers are accustomed to dealing with uncertainty in the application of regulations and the workings of governments in their home countries and apply that knowledge when internationalizing, as organizational learning theory expects.

Regression results in Model 2 answer Hypotheses 3a and 3b. Political risk shows a statistically insignificant and negative relation to intra-regional internationalization and a significant and negative relation to extra-regional internationalization. These results also accord with the referenced literature. The level of corruption shows a significant and positive relation to both modes of internationalization. These results indicate that operating outside of its region area markedly influences performance. Overall, the two

results accord with arguments by Verbeke and Kano (2016) that differences between countries outside firms' home regions are greater than intra-regional differences. Operating in the former requires more extensive adjustments. Operating outside of its region area can reduce a regional domino effect and teach firms how to address uncertainty at home (Cuervo-Cazurra, et al., 2017). In addition, firms bound to one region tend to have similar problems. Their managers have similar learning processes, and that reduces the affirmative effects on internationalization of ability to manage uncertainty.

5. CONCLUSION AND SUGGESTIONS

5.1. Conclusions

Our analysis reveals that firms that internationalize in emerging markets perform better than strictly domestic firms because internationalization heightens performance. The relation between internationalization and performance is higher among firms in emerging markets that exhibit greater uncertainty. The relation between home country uncertainties is strengthened among firms that internationalize outside of its region area, but that finding does not indicate superior ability to manage uncertainty.

5.2. Limitations

This study samples only three emerging market countries in the ASEAN, and the sample has an unbalanced number of firms in each country. We sampled only nine years (2009–2017), so results are constrained to that period. There were difficulties in finding firm micro data for several variables such as firm age and internationalization experience. Also, we use only one measure for each variable.

5.3. Suggestions

Based on the conclusions and limitations of the research, suggestions for related parties are as follows:

1) *For academics:* This research is a reference to for further studies of internationalization and firm performance. Those studies could extend our geographical concentration and research period.

2) *For firms:* It is necessary to evaluate the performance of firms that have internationalized through FDI after internationalization. Firms that have not internationalized can consider doing so because our results confirm its positive impact on performance in emerging market countries. However, for emerging market countries that bear high political risks,

intra-regional internationalizing will be more profitable than internationalized outside its regional area.

3) *For regulators:* Our results show that political risk diminishes performance of firms that internationalize, especially outside of its region area. Therefore, this research can motivate regulators to create the stable political conditions that elevate performance of firms that internationalize.

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