INTERNATIONALIZATION IN TAIWANESE FAMILY FIRMS

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ABSTRACT

This paper studies the corporate internationalization decision of family firms and the effect of family ownership on internationalization. Using a panel data set of manufacturing firms listed on the Taiwan Stock Exchange during 2000–2007, the empirical results indicate that internationalization is positively and significantly related to family firms and family ownership. The findings suggest that, compared with non-family firms, family firms are more likely to internationalize. Additionally, compared with firms with lower family ownership, firms with higher family ownership are more likely to go international. The evidence is consistent with the argument that family firms may confer some unique features, and these features enable them to undertake risky, but profitable, internationalization.

JEL: F23; G32; G34

KEYWORDS: Family firms, family ownership, family board of directors, internationalization.

INTRODUCTION

The decline in barriers to trade and investment and the use of efficient communication technology and transportation have greatly improved opportunities for a company to do business anywhere and with anyone. Although internationalization is associated with a set of benefits, it also comes with many challenges and threats. Therefore, firms frequently face a dilemma regarding whether or not to internationalize. Accordingly, it is worthwhile to identify factors that influence a firm's decision to internationalize.

Family firms have been recognized as an important organizational structure in both developed and developing economies (Chu, 2009). In particular, family influence is substantial in Asian countries. Nevertheless, the corporate internationalization decision of family firms in Asian countries has not been explored in depth. This paper is particularly interested in investigating the internationalization decision of family firms and the effect of family ownership on internationalization in Asian countries.

Among the extant research, some scholars have suggested that family firms possess a set of unique features, including natural alignment of interests between family managers and the firm (Tsai, Hung, Kuo, and Kuo, 2006), intensive communication and enduring information sharing among family members (McCollom, 1988; Zahra, 2003), the capability to respond to rapid changes and challenges in international marketplaces (Fernandez and Nieto, 2006), and the ability to access important resources (Miller and Le Breton-Miller, 2006). These unique features may reduce the probability of failure during the internationalization process. Therefore, the willingness of family members to internationalize may be increased, which may enhance the firm's competitiveness and achieve long-run profitability. On the other hand, some scholars have argued that family firms tend to be risk-averse and have limited resources, and therefore may not attempt to undertake risky and costly internationalization (e.g., Fernandez and Nieto, 2005; Sapienza, Autio, George and Zahra, 2006). As the results of the extant studies are inconclusive, this paper aims to clarify this issue by examining the internationalization decision of family firms and the effect of family ownership on internationalization.

This paper explores the corporate internationalization decision of family firms and the effect of family ownership on internationalization. Conducting a two-way fixed-effects approach to analyze a panel data

set of manufacturing firms listed on the Taiwan Stock Exchange (TSE) during 2000–2007, the empirical results indicate that internationalization is positively and significantly associated with family firms and family ownership. The findings thus suggest that, compared with non-family firms, family firms are more likely to internationalize. Additionally, compared with firms with lower family ownership, firms with higher family ownership are more likely to go international. This phenomenon implies that family firms possess some unique features that favor internationalization and consequently increase the likelihood of success in internationalization, which in turn increase family members' willingness to expand internationally.

The remainder of the paper is organized as follows: the second section discusses the benefits and costs of internationalization and lays out the arguments of the hypotheses; the third section describes the sample, variables and methods; the fourth section reports the empirical results; and the conclusions of this paper are contained in the fifth section.

LITERATURE REVIEW

The Benefits and Costs of Internationalization

Internationalization comes with both benefits and costs. In terms of benefits, internationalization may achieve economies of scale and scope (Lu and Beamish, 2004), make domestic products available in international markets (Cullen and Parboteeah, 2005), reduce revenue fluctuations by spreading investment risks over different countries (Kim, Hwang and Burgers, 1993), and enhance revenues by increasing the market power (Miller, 1992). Accordingly, internationalization may be recognized as a necessary and valuable strategy to increase a firm's competitiveness and enhance long-run profitability (Graves and Thomas, 2008).On the other hand, the costs associated with internationalization come from (1) unfamiliarity with environments and cultural, political and economic differences (Lu and Beamish, 2004); (2) coordination difficulties, incentive misalignment and information asymmetry between headquarters and subsidiaries (Zaheer, 1995); and (3) substantial investments such as facilities procurement and installation, and recruitment and training of qualified staff (Lu and Beamish, 2004). Accordingly, internationalization is considerably risky and costly because it involves various challenges, threats and investments during the process.

The coexistence of benefits and costs means that firms frequently face a dilemma regarding whether or not to go international. As family firms have been recognized as an important organizational structure and have a substantial influence on the development of national economies (Chu, 2009), this paper is particularly interested in investigating the internationalization decision of family firms and the effect of family ownership on internationalization.

The Positive Effect of Family Firms on Internationalization

Some scholars have suggested that family firms possess a set of unique features including natural alignment of interests (Tsai, Hung, Kuo, and Kuo, 2006), information sharing among family members (McCollom, 1988; Zahra, 2003), flexibility and speedy decision-making (Fernandez and Nieto, 2006), and access to resources (Miller and Le Breton-Miller, 2006). These features may affect internationalization positively. First, family members generally serve as CEOs and/or other top managers in family firms and as such may create a natural alignment of interests between family managers and the firm (Lansberg, 1999). Family managers tend to be profit-oriented and undertake profitable investments. Internationalization may achieve a firm's competitiveness and enhance long-run profitability (Graves and Thomas, 2008); therefore, family managers may opt for internationalization despite its associated risks and costs.

Second, intensive communication and enduring experiences and knowledge-sharing among family members pervade family firms (McCollom, 1988). Family members therefore have a better understanding of organizational objectives and consequently promote a willingness to support risky investment activities. With family support, family managers are more likely to pursue risky, but profitable, international expansion (Zahra, 2003).

Third, decision-making in family firms is centralized, suggesting flexible and speedy decision-making. Internationalization requires today's companies to respond to markets at an increasingly faster pace (Ruzzier, Hisrich, and Antoncic, 2006). The characteristics of flexibility and speedy decision-making of family firms enable them to respond to many rapid changes and challenges in international marketplaces (Fernandez and Nieto, 2006) and consequently reduce the risks associated with internationalization, which in turn increase the willingness of family members to internationalize.

Finally, family members may actively develop and sustain long-term relationships with outside connections, such as buyers, suppliers and capital providers, which provide access to resources. For instance, family firms generally build a close relationship with banks and as such may facilitate access to bank capital (Miller and Le Breton-Miller, 2006). As internationalization involves substantial investment in procuring and installing facilities and recruiting and training qualified staff (Lu and Beamish, 2004), access to bank capital may enable family firms to accumulate the financial capital needed for internationalization.In summary, with profit orientation, information sharing among family members, flexibility and speedy decision-making and the ability to access resources, family firms are more likely to internationalize. Therefore:

H1a: Compared with non-family firms, family firms are more likely to go internationally.
H2a: Family ownership has a positive influence on the corporate decision to internationalize.

<u>The Negative Effect of Family Firms on Internationalization</u>

On the other hand, some scholars have argued that family firms confer some disadvantages, such as a risk-averse propensity and an unstructured nature, which may affect internationalization negatively (e.g., Fernandez and Nieto, 2005; Graves and Thomas, 2006). With undiversified investments and a desire to pass the business on to their offspring, family members are considered risk-averse (Graves and Thomas, 2006) and may mainly focus on firm stability and survival (Lee, 2006). From this viewpoint, Chen and Hsu (2009) argue that family members have a conservative attitude towards risky investments and find a negative relationship between family ownership and risky investment in R&D. Internationalization exposes firms to environmental and organizational uncertainties and thus is associated with variable outcomes. To protect their family's wealth, as well as to build an enduring legacy for succeeding generations, family members may opt not to invest in risky international expansion that may jeopardize firm viability.

The conservative and unstructured nature of family firms may impede them in amassing the capabilities and resources necessary for internationalization (Davis, 1983; Ward, 1988). Decision-making in family firms is centralized with little horizontal differentiation and formalization, unclear lines of authority, informal control and poorly-developed information systems (Fernandez and Nieto, 2006). Entering the international marketplace, which consists of different cultural, economic and political systems, is definitely more complicated and demanding (Gomez-Mejia, 1988), and thus requires more complex structures, formal control and decentralization (Fernandez and Neito, 2006). However, the above requirements such as decentralization are considered by family members as a loss of control (Ward, 1988). With a centralized organizational structure, family firms may not be able to respond to the challenges and threats in international marketplaces quickly, and that consequently increases the risks associated with internationalization. As a result, family members are less likely to internationalize.

Family members have the desire to maintain the family's independence and control, and therefore may tend to rely on firm-generated family resources or funds financed from institutions (Chen and Hsu, 2009). With limited access to financial resources, family members are less likely to commit money to international expansion, which requires significant financial availability (Cullen and Parboteeah, 2005) to support facility procurement and installation and the recruitment and training of qualified staff (Lu and Beamish, 2004).

Additionally, family firms generally prefer to appoint family members to managerial positions instead of hiring more qualified outsiders (Weidenbaum, 1996), which in turn may lead to a low level of qualified professional managers who can handle the complexities brought about by international expansion (Dyer, 1989). Graves and Thomas (2006) indicate that, compared with non-family firms, family firms have fewer professional managers as they expand internationally. In summary, with a conservative attitude towards risky investments and limited access to financial and human resources, family firms are less likely to internationalize. Therefore:

H1b: Compared with non-family firms, family firms are less likely to go international.
H2b: Family ownership has a negative influence on the corporate decision to internationalize.

EMPIRICAL SETTING

Sample

A panel data set of TSE-listed firms during the period 2000–2007 is used to examine the internationalization decision of family firms and the effect of family ownership on internationalization. To be included in the study sample, an observation must satisfy all the following requirements: (1) the firm was continuously listed on the TSE during 2000–2007; (2) fiscal year-end is on December 31; and (3) all the required accounting data are available. The dependent variables (from 2001-2007) are regressed against the independent and control variables (from 2000-2006), which ensures that the direction of causality is from family ownership to internationalization and not the reverse (Lee and Park, 2008), and allows ownership and governance features time to reveal their impacts on strategic choices (Chen and Hsu, 2009). Therefore, the final sample consists of 1,512 usable observations (216 firms x 7 years). The study data are gathered from Taiwan Economic Journal (TEJ) Data Bank, and include family ownership, family board of directors, established date, the number of foreign subsidiaries, the total number of subsidiaries and financial status.

Variables

This study employs one widely-used measure of internationalization: the number of foreign subsidiaries divided by the total number of subsidiaries as the dependent variable (Sullivan, 1994; Tallman and Li, 1996; Sanders and Carpenter, 1998; Tihanyi, Johnson, Hoskisson and Hitt, 2003).

The independent variable of this study is measured by two methods. First, a dummy variable, FB, is classified as a family firm (=1) if a firm has more than 5% family shareholdings and has at least one family member on the board of directors; otherwise, it is classified as a non-family firm (=0) (Chu, 2009). Second, a numerical measure of family ownership is calculated as the number of shares of all classes held by the family divided by the total shares outstanding (Litz, 1995; Zahra, 2003). The numerator is the sum of family personal shareholding, family unlisted company shareholding, family foundation shareholding, and family listed company shareholding.

Four firm-level control variables are used in the analyses to account for alternative determinants of

internationalization. Total assets, logged to correct for skewness, are included as a measure of firm size (Lee and O'Neill, 2003). Firm age is measured as the natural log of the number of years a firm has been in existence (Chen and Martin, 2001). Past performance is calculated as the ratio of net income to total equity (Zahra, 2003). Leverage is the ratio of total debt to total assets (Chen and Huang, 2006).

ANALYSIS

Two-way fixed-effects regression analysis is used to test the hypotheses. A two-way fixed-effects approach is preferred because it controls for unobservable firm characteristics (Frye, 2004; Kor, 2006) and time effects (Chen and Hsu, 2009). The regression equations below are used to test the internationalization decision of family firms and the effect of family ownership on internationalization:

$$\text{Internationalization}_{it} = \beta_0+\beta_1 (\text{FB})_{it-1}+\beta_2(\text{ControlVariables})_{it-1}+\varepsilon \quad (1)$$

$$\text{Internationalization}_{it} = \beta_0+\beta_1 (\text{FamilyOwnership})_{it-1}+\beta_2(\text{ControlVariables})_{it-1}+\varepsilon \quad (2)$$

where Internationalization is the number of foreign subsidiaries divided by total number of subsidiaries; FB is a dummy variable (family firm = 1, non-family firm = 0); family ownership is the number of shares of all classes held by the family divided by the total shares outstanding; and Control Variables include firm size, firm age, past performance and leverage.

EMPIRICAL RESULTS

Table 1 provides a summary of industry representation by the sample firms. As shown in the table, the final sample of 216 firms spans 18 different industries, among which, there is a certain profusion of electronics firms. Additionally, the rubber industry achieves the highest internationalization level of 88.87%, while the oil, gas and electricity industry has no foreign subsidiaries.

Table 1: Number and Proportion of Firm and Internationalization Level by Industry Classification

Industry	Number of Firms	Percentage of Firms (%)	Internationalization (Number of Foreign Subsidiaries/Total Number of Subsidiaries, %)
Cement	5	2.31	19.01
Foods	8	3.70	37.09
Plastic	6	2.78	37.63
Textile	18	8.33	29.33
Electric Machinery	16	7.41	46.47
Electrical and Cable	8	3.70	34.87
Chemical and Biotech	9	4.17	44.60
Glass and Ceramics	2	0.93	41.41
Paper and Pulp	3	1.39	24.79
Iron and Steel	9	4.17	22.05
Rubber	3	1.39	88.87
Automobile	3	1.39	19.80
Electronics	84	38.89	57.25
Building and Construction	9	4.17	5.63
Ship and Transportation	8	3.70	30.14
Trading and Consumer	5	2.31	27.92
Oil, Gas and Electricity	2	0.93	0.00
Others	18	8.33	33.80

Number of Firms=216.

The means, standard deviations and Pearson product-moment correlations of the variables are presented in Table 2. The average internationalization, FB and family ownership are 42.18%, 0.96 and 27.90%, respectively. Additionally, the matrix shows that there is one significant correlation between past performance and leverage (0.41), suggesting that a degree of multicollinearity may exist between these two variables. Therefore, the variance inflation factors (VIF) of independent and control variables are calculated to test for the effects of multicollinearity. The highest VIF is 1.26, thus suggesting that

multicollinearity is not a problem in the analyses.

Table 2: Means, Standard Deviations and Correlations

Variables	Mean	S.D.	1	2	3	4	5	6	7
1. Internationalization (in %)	42.18	29.67	--						
2. FB (in dummy)	0.96	0.21	0.02	--					
3. Family Ownership (in %)	27.90	15.91	-0.03	0.32***	--				
4. Firm Size (in log)	6.95	0.53	-0.14***	-0.10***	-0.16***	--			
5. Firm Age (in log)	1.42	0.19	-0.25***	0.14***	0.19***	0.15***	--		
6. Past Performance (in %)	5.32	17.70	0.14***	0.00	0.06*	0.09***	-0.08***		
7. Leverage (in %)	40.04	15.11	-0.13***	0.08**	0.05	0.10***	0.15***	-0.41***	--

*Number of Firms=216. ***, ** and * indicate significance at the 1, 5 and 10 percent levels respectively.*

Presenting the regression result of Model 1, Table 3 indicates that internationalization is significantly and positively associated with FB (t-statistic = 3.44). This finding lends support to hypothesis 1a and suggests that, compared with non-family firms, family firms are more likely to internationalize. The regression result of Model 2 presented in Table 3 indicates that internationalization is significantly and positively associated with family ownership (t-statistic = 3.09), a finding that lends support to hypothesis 2a and suggests that compared with firms with lower family ownership, firms with higher family ownership are more likely to undertake risky internationalization. The evidence is consistent with the argument that family firms may possess some unique features that enable them to expand internationally (Zahra, 2003).

Table 3: Results of Regression Analysis

Variables	Internationalization	
	Model 1	Model 2
Constant	184.35*** (7.06)	170.70*** (6.37)
Independent Variables		
FB (in dummy)	7.11** (3.44)	
Family ownership (in %)		0.14** (3.09)
Control Variables		
Firm Size (in log)	-16.93*** (-5.75)	-15.06*** (-5.05)
Firm Age (in log)	-24.37 (-1.62)	-21.79 (-1.44)
Past Performance (in %)	0.05 (1.91)	0.04 (1.72)
Leverage (in %)	0.07 (1.78)	0.07 (1.65)
Adjusted R^2 (in %)	88.31	88.29
F value	51.50***	51.39***

*Two-tailed coefficient tests. Number of Firms = 216. Standardized coefficients are presented with standard errors in parentheses. ***, ** and * indicate significance at the 1, 5 and 10 percent levels respectively.*

The sensitivity of the control variables is tested for different measurement results. Firm size is measured as the log of the number of employees (Fernandez and Nieto, 2006). Past performance is the return on

assets (Chu, 2009). Leverage is measured as log[Leverage/(1-Leverage)], where leverage is the ratio of the book value of total debt to the market value of the equity and book value of debt (Balakrishnan and Fox, 1993). This unreported analysis also yields results similar to those presented in Table 3.

CONCLUSION

This paper examines the internationalization decision of family firms and the effect of family ownership on internationalization by conducting a two-way fixed-effects analysis of a panel data set of TSE-listed manufacturing firms during 2000–2007. The empirical results indicate that internationalization is positively and significantly related to family firms and family ownership. The findings suggest that, compared with non-family firms, family firms are more likely to internationalize. Additionally, compared with firms with lower family ownership, firms with higher family ownership are more likely to go international. The evidence is thus consistent with the argument that family firms may confer a set of unique features that enable them to undertake risky, but profitable, investments such as internationalization.

This paper has some limitations and thereby provides opportunities for further research. One avenue of research would be to investigate the corporate governance of other ownership structures, such as small and medium enterprises. Furthermore, the findings are based on the unique context of firms in Taiwan – other useful studies could be undertaken in Asian countries to compare the results with those reported here. Moreover, further research could use different measures of international expansion such as entry modes (e.g., wholly-owned subsidiaries and joint ventures), if such data are available. Finally, the findings of this study may hold in some industries better than others. Future studies can be enriched by examining this issue by industry if researchers were able to employ alternative research designs and data-collection methods to obtain more observations for each different industry.

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