INTERNATIONAL FINANCE REVIEW
VOLUME 7

VALUE CREATION IN MULTINATIONAL ENTERPRISE

J. JAY CHOI
REID W. CLICK
Editors

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International Finance Review is an annual book series in the international finance area (IFR, broadly defined). The IFR will publish theoretical, empirical, institutional or policy-oriented articles on multinational business finance and strategies, global capital markets and investments, global risk management, global corporate finance and institutions, currency markets and international financial economics, emerging market finance, or related regional or country-specific issues. In general, each volume will have a particular theme. Those interested in contributing an article or editing a volume should contact the Series Editor, J. Jay Choi at E-mail: jjchoi@temple.edu

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INTRODUCTION TO *VALUE CREATION IN MULTINATIONAL ENTERPRISE*

J. Jay Choi and Reid W. Click

OVERVIEW

In a fundamental sense, creation of value is the purpose of a firm. Values – measured by profits, cash flows, stock prices, or some strategic objectives – are the ultimate reasons why a firm exists. The ongoing and ever-expanding discussion of globalization, whether based on trade flows or financial flows, draws attention to the value of multinational enterprise. Existing empirical work on the impact of multinational firms, however, is inconclusive. Some observers point to the valuation discount with international operations due to the costs of agency and control and the difficulty of coordinating complex organizations and cultures. Others emphasize the value of a multinational network and the operational efficiency of a multinational enterprise (MNE). Thus, issues related to value creation are important and lively areas of business and finance. In fact, value creation is now at the frontier between the functional areas of finance and strategy. In international finance, the topic also interacts with economics in the areas of strategic trade policy and exchange rate behavior, as well as business strategy, as it relates to the management of an MNE. The role of government policy is also part of the debate, because the importance of public policy and the behavior of

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policymakers are elevated when finance and business become international, as evidenced by consistent attention to political risk.

The papers in this volume of *International Finance Review* provide a reflection on the role of international finance – and its relationship to strategy, economics, political science, and public policy – in examining value creation in multinational enterprise. These are 22 original papers, not published elsewhere, submitted specifically for this volume based on its theme. The papers present a breadth of methodologies, including theoretical, empirical, conceptual, and case study approaches. Several papers offer combinations of these different categories. Among the empirical papers, there are many kinds of data sets analyzed, ranging from macroeconomic data to firm-level financial data to survey data. In addition, the data sets are rigorously analyzed in many different ways.

This volume also takes a broad perspective on multinational enterprise, which not only allows discussion of traditional areas in the study of MNEs as corporations but also includes topics related to multinational enterprise as an undertaking and not just as corporation. For example, there is attention to small- and medium-sized companies as well as larger MNEs. There are also papers that consider exporting enterprises and the environment of multinational enterprise. In this spirit, the volume covers multinational enterprise from a variety of perspectives, including views from private corporations and government policymakers, and the authors of the papers include both academics and practitioners. Altogether, the papers offer insights into value creation through a variety of lenses.

One prominent feature of the volume is that the papers collectively cover nearly all areas of the world. As some acknowledgment of its current importance in the world economy, there are four papers on China, ranging from financial studies to industry studies. There are specific country inquiries for Korea, Russia, the U.K., Spain, Turkey, Lithuania and Moldova, and Australia and New Zealand. There are also regional studies of Asia, Latin America, and Central and Eastern Europe. In addition, four papers consider general foreign operations of U.S. enterprises. Another feature of the volume is that many different industries are examined. There are naturally several papers on financial services, but there are also papers on telecommunications firms, the steel industry, and textiles and apparel.

The papers are divided into seven parts, including, as Part I, this overview. Part II begins our examination of value creation in multinational enterprise with broad attention to MNEs and foreign direct investment (FDI). In Part III, there is greater focus on strategies and firm performance. Parts IV–VI offer deeper analysis in three specific, yet prominent, areas of value creation and MNEs: mergers and acquisitions, finance and governance, and the financial services sector. Part VII returns to a broader picture, examining the influence of the state in value creation in multinational enterprise, as a way to wrap up the volume.

MULTINATIONALS AND FOREIGN DIRECT INVESTMENT

Part II examines multinationals and FDI from both empirical and theoretical perspectives.

Jay Choi and Eric Tsai open the discussion with "Strategic and Financial Determinants of Foreign Direct Investments." They point out that conventional theories regard FDIs as strategic moves based on operational or industrial organization considerations. Choi and Tsai, however, demonstrate that financial factors are also important in corporate FDI decisions. The paper offers a comprehensive assessment through an integrated model with both strategic and financial factors, and empirically investigates the factors using firm-level data from the FDIs of U.S. corporations. The financial factors concern internal capital market strength and corporate governance and include exchange rate changes, internal and external financing cost, risk diversification, and agency costs. The results of the study demonstrate that there is variability in the significance of financial variables depending on industries and destinations. The integrated model with both strategic and financial factors is shown to be superior to either component model in explaining FDIs, and financial factors are shown to be no less important in their ability to explain the prevailing FDI phenomena than strategic or operational variables.

Specific attention to international joint ventures is provided in Elmar Lukas's "Modeling the Evolutionary Sequence of International Joint Ventures." The paper is a theoretical contribution to the literature on FDI under uncertainty and underscores the importance of modeling the evolutionary sequence pattern of foreign market entry. The model in the paper helps refine the application of real options in the international joint venture context by providing a closed-form solution in continuous time to value their overall strategic flexibility. Moreover, the analysis provides a novel perspective on existing empirical results and generates a number of new testable predictions.

The final paper in this section is an examination of FDI from a different part of the world. Seong-Bong Lee examines the empirical patterns of

Korean FDI in "New Trends and Performances of Korean Outward FDI after the Financial Crisis" using macroeconomic data and firm-level data aggregated to the macro level. Korean outward FDI increased rapidly during the 1990s, and the Korean *chaebols* were the main players in this increase. However, Lee points out that outward FDI decreased significantly during the three to four years after the financial crisis and then reversed in 2002, increasing once again. Lee documents that a feature of the current rise in outward FDI is that not only are large enterprises engaging in FDI, but small and medium-sized companies are too. Therefore, Korean outward FDI now shows a mixed investment pattern in which two different types of investment coexist: one is performed by big companies to secure large local markets and the other by small- and medium-sized companies attempting to ensure low labor costs. This new pattern reflects structural changes in the Korean economy as well as the growing trend of reciprocal influences. Lee not only analyzes these new outward FDI patterns, but also examines the performance of outward FDI after the financial crisis in Korea. Lee also offers a concluding discussion of the anticipated impact of these changes in outward FDI on the Korean economy.

STRATEGIES AND FIRM PERFORMANCE

With a broad picture generally established, Part III moves on to consider strategies and firm performance. The four papers in this section address the issue of value creation in MNEs through empirical investigations. Two papers utilize data on the foreign operations of U.S. MNEs and the other two utilize data from the Asia/Pacific and Central/Eastern European regions.

A general background to strategy and firm performance is provided in the first paper of this section, "The Value Creation Perspective of International Strategic Management." In this paper, Reid W. Click uses the principle of value creation to analyze the strategic management of MNEs. International strategic management is first defined as the process through which value is created by managers operating across a national border. The domain of international strategic management is thus determined by activities that distinguish international management from domestic management in the process of value creation. Click then uses this perspective on value creation to answer three questions pertaining to international strategic management. First, how important *is* international strategic management? Simple statistics presented in the paper demonstrate that the international component of value creation is important in the U.S. economy. Second, what is the