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## **Foreign Direct Investment: International Strategies by Business Groups**

*Inversión extranjera directa: estrategias internacionales de los grupos empresariales*

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### **ABSTRACT**

This research analyses the decision of foreign direct investment (FDI) followed by business groups, identifies two forms: acquisition and minority purchase of foreign company shares. Analyses how it affects the performance of such groups. Also includes the concentration of property since it forms part of corporate governance. In order to achieve this, a data panel analysis with information of 39 business groups and a total of 3,443 subsidiaries and that have also made FDI in a period ranging from 2012 to 2015. The findings were that the minority purchase of shares achieves a positive relationship with performance and clearly shows that the company's concentrated ownership has a negative relation to performance.

Key words: Business group; foreign direct investment; acquisitions; minority purchase of shares.

Jel Code: M1, M2.

### RESUMEN

Esta investigación analiza la decisión por los grupos empresariales sobre la inversión extranjera directa (IED). Se identifican dos formas: adquisición y adquisición minoritaria de acciones de compañías extranjeras. Se analiza cómo estas formas afectan el desempeño de dichos grupos. También incluye la concentración de propiedad ya que forma parte del gobierno corporativo. Para lograr esto, se realizó un análisis de panel de datos con información de 39 grupos empresariales y un total de 3,443 subsidiarias y que también hicieron IED en un período que va de 2012 a 2015. Las conclusiones fueron que la compra minoritaria de acciones logra una relación positiva con rendimiento y muestra claramente que la propiedad concentrada de la empresa tiene una relación negativa con el rendimiento.

Palabras clave: grupos empresariales; IED; Adquisiciones; adquisición minoritaria de acciones.

Código Jel: M1, M2.

## INTRODUCTION

The strategy of Mergers and Acquisitions (M&A) is undoubtedly the most common strategy used by business groups in the world and certainly in Mexico. Since the end of the 19th century in Monterrey, Mexico, institutional changes were developed by applying a neoliberal policy. This policy generated a boost to the industrialization of the country and the creation of the first groups, which were formed by large manufacturing factories and banks that were used to finance their investment projects. At the time that these groups they saw the need to create capital unions, they did it through mergers to the universe with family businesses through marriages. With investments that were diversified, ranging from personal consumption, development of producing consumer goods, mining, passenger and cargo transportation, commercial bank, agricultural and complementary services (Cerutti, 1986, Chavarín-Rodríguez, 2011).

In the first decade of the 20th century, specifically in 1910, the Mexican Revolution broke out, which was a civil war that lasted until the 1920s. At this moment, the economy stopped and there were no records of the behaviour of the Mexican company. Already in the 1930s a frenzy had arisen for the creation of a financial system that would allow the creation of banks and financial companies to face the competition of foreign multinational companies. Since at that time the Mexican business group was formed of commercial houses, transportation companies and financial institutions (Hamilton, 1986). All of them were created by a group of families known as the Monterrey group. Integrated by families such as Garza-Sada, owners of Cuauhtémoc -Moctezuma, Cydsa, Vidriera Monterrey, Alfa. At the beginning of the 1940s the Garza Sada family maintained two large corporations the Cervecería Cuauhtémoc and the Vidriera Monterrey (Cordero & Santín, 1986), which are still valid as groups in the current era.

Likewise, it has been found that the formation of business groups has been generated by the dynamics of ownership concentration within the process of industrialization, the inefficiency of the market and the shortage of capital resources (Chavarin, 2011). Similarly, the corporate governance of these groups has been characterized by having a fairly concentrated property with few individual commonly members of the same family; within a network of businesses based on cross-holdings of shares or exchange of representatives in the boards of directors.

It has been found that the business groups are integrated both vertically and horizontally (Chan & Cho, 2017), made up of subsidiary companies that form a business network, with long-term formal or informal agreements with financial companies that provide financing to other companies through officially regulated mechanisms.

These groups have arisen due to market failures as already mentioned, and this may be caused by the poor development of the financial market, deficiency in the procurement of justice, economic instability, relations between groups and certain economic agents (Fisman, 2001; Khanna, 2005; Guriev & Rachinski 2005). Groups are also formed by sociological and cultural conditions, where individuals seek to create social bonds where friendship is implicit, the extended family of business networks (Granovetter 1995; Keister 1998).

It has also been found that in the 1990s, several business groups in Latin America began their expansion internationally. It was a moment where favourable conditions were given for such growth, consolidating the reforms in trade regulation begun a decade earlier, a historic moment in which the groups. They also started their internationalization strategies, the most common of which is foreign direct investment (FDI), which turns them into multinational companies, which caused them to become the dominant force in international trade.

The FDI exists when a company uses the strategy of M&A or Green Field. According to studies by UNCTAD (2016), in 2015 there was an FDI of 1.76 trillion US dollars. It means the highest level since the financial crisis of 2008-2009 was unleashed. There has been an increase in international M&A by the reconfiguration of the legal ownership structure which meant a total of 15% of all FDI flows worldwide (UNCTAD, 2016). These multinational companies decide to use FDI in certain countries that have certain macroeconomic variables such as: low interest rates, GDP growth. As well as variables of the business environment as a system of free market and fiscal freedom (Cortes, Agudelo & Mongrut, 2017).

In turn, China has become the third country that has made more investments in 2015, only after the United States and Japan with a total of 128 billion dollars, especially through its M&A. In the Latin American region has seen that their companies have invested 5% more in 2015 than in 2014. Mexico, Brazil, Chile, Colombia and Peru were the countries that have made the most FDI between 2007 and 2014, following

the strategy of M&A. In 2015, these multinational companies invested 8,072 (Mexico); 3.072 (Brazil); 15.513 (Chile); 4,218 (Colombia) and 127 (Peru) million dollars respectively. It should be noted that the trend in this rule has been negative in recent years, for example; Mexican multinationals in 2010 had an FDI of 15,050; the Brazilian ones of 22,060; the Chilean ones of 10,534; the Colombian ones of 5,483; and the Peruvians, 266 million dollars. Likewise, the economic sector that has received most FDI worldwide is a business services with 64%, followed by manufacturing with 27% (UNCTAD, 2016). This has generated benefits for local markets, but has also affected the supply chain of the FDI recipient country since, in a large number of cases, the multinational business groups are articulated in international value chains.

Therefore, the objective of this research is to analyse the relationship of the corporate governance structure of business groups and the internationalization strategy based on FDI in performance, for which the theories of the agency are analysed. and the institutional one. For this, this work has the following sections: first, the theoretical framework is analysed, where the studies that try to prove the relationships between the variables are discussed, to then propose the most appropriate method to test the hypotheses, moving on to the analysis of the data and ending with the conclusions.

## **THEORETICAL FRAMEWORK**

In this section, the Agency theory and the resources and capabilities theory are discussed. As well as the concepts, such as a business group, corporate governance, the concentration of property, which support the hypothesis of the present investigation.

A business group is a legal entity that includes parent companies and their subsidiaries. Gaur (2010) maintains both formal and informal relations. The author defines a business group as legally constituted companies with a management relationship. The business groups are usually initiated by bonds of trust or family and they are united by common council members and cross-ownership (Chang, Choi & Encarntion, 1989).

Through the interrelationships, they can allow their affiliates to use their technology, market opportunities and strategies (Keister, 1998), in turn depend on each other for

financing and brand value jointly (Dutta, 1997). Likewise, corporate governance can be defined by the relationships existing in the different agents that determine the direction and performance of the firm (Eiteman, Stonehill & Moffet, 2007). It is why studying the structure of corporate governance, which is related in a direct to the organizational goals in the generation of return on investment, in such a way that by developing an adequate corporate governance structure, strategies can be established that are more appropriate to improve the financial performance of the organization (Aaker, 1996).

At the same time, there is the Agency Theory. This theory maintains that ownership in large companies is diversified into multiple shareholders. Shareholders transfer decision making to CEOs, with the objective of obtaining efficient performance. The fact that the shareholders have a small ownership originates a problem to obtain information about the acts carried out by their CEOs (Jensen & Meckling, 1976). The control is expensive and the information is expensive to obtain, especially for a person, but in emerging markets, there are market failures that are solved with the concentration of ownership and control through controlling families (Khanna and Palepu, 1999).

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In this concentration of ownership, it has been found that in countries such as Mexico and Colombia it has a positive effect on the financial performance of business groups (Pelayo & Camarena, 2013). These results can be caused by the formal or informal relationships or links are created towards the interior and between companies, developing a personalized trust that allows reducing opportunistic behaviours (Lansberg & Gersick, 2006). As part of the objective sought in this document is to analyse the multinational business groups, then analyse research that has identified relationships between FDI and ownership structure with the performance of the business group.

## PROPERTY CONCENTRATION AND FDI BY BUSINESS GROUP

In previous studies, the different implications of the ownership structure of the business groups with their subsidiaries have been analysed, but nevertheless, when looking for the different ownership structures and the performance of the affiliated companies. It has been seen that they have not been sufficiently analysed (Chung & Chang, 2012) and some studies have found that affiliates in emerging economies generate a better performance than the headquarters located in developed countries (Carney, *et al.* 2011); therefore, the following studies that have addressed this topic are analysed.

When analysing business groups in emerging economies, it has traditionally been seen that the family establishes a structure of pyramidal property to control its multiple affiliated companies (La Porta, Lopez-de-Silanes, Shleifer & Vishny, 1999), but in developed countries it has seen an evolution of the economic groups to have also pyramidal structures yet (Morck, Percy, Tian & Yeung 2005).

In other words, they have a certain percentage of ownership enough to exercise control over these, in addition to the business groups is the structure that prevails at the level world (Masulis, Pham, Zein, 2011). Likewise, it has been seen that the strategy followed by business groups with a high concentration of ownership is that of M&A (Chu, Teng & Lee, 2016).

Based on the above, a research about the Taiwan Stock Exchange (Chung & Luo, 2008) finds that business groups with a pyramidal structure are created to reduce agency costs and that these also occur in a certain institutional context. However, Attig, Fischer and Gadhoom (2002) mention that this type of structure generates agency costs for the small shareholders and the benefits exist just for the controlling family, in addition to having lower financial performance than companies that are totally independent. The researchers based their conclusions on a study done in Canada.

In another study by Kuhnen (2009), mentions that business groups can mitigate agency conflicts, since this structure can facilitate the efficient transfer of information, suggesting that the effects of a pyramid structure provide better oversight of the board of directors and increase the possibility of collusion, but does not find it relevant that

this could improve the results for shareholders. In turn, the decision to develop an M&A strategy can generate high risks for shareholders, but over time this risk decreases and therefore the strategy can be classified as moderate risk (Chang & Cho, 2017). In addition, the risk is relative, since there are studies that show that a developed country will have greater tolerance than a developing one, even though there are similar macroeconomic variables in both countries (Deseatnicov & Akiva, 2016).

In addition to the above, has been found that there are several studies that analyse the internationalization of multinational business groups where FDI is analysed and where a study by Gaur and Kumar (2009), used a multiple linear regression, finding that the variable international diversification measured by FDI has a positive and significant relationship with the performance of the group, and it has also been found that a certain capital structure generates a negative effect (Gaur, 2010).

Elia and Kafouros (2014) analyse the FDI strategy of multinationals from emerging countries such as Brazil, Russia, India and China; using the resource-based vision and the panel data technique. The authors find that investing in developed countries can develop a better international experience that has an impact on financial performance.

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Chang and Rhee (2011) analyse the reasons for using the FDI strategy and find that it improves the performance of companies, especially in industries that have strong global pressures such as electronics and information and communication technologies, and also helps them develop superior resources and capabilities.

It has also developed studies where the internationalization level was studied, using the resources and capabilities theory. The variables that affect the business groups internationalization, which are resources of experience and diversification (Kumar, Gaur & Pattnaik, 2012; Li & Ramaswamy, 2006).

Bolar (2009) finds that international investment is an important factor that influences performance, in his comparative study analysed autonomous companies as subsidiaries of business groups. In addition, this study concludes that there are no differences in the performance in the global expansion between these two types of companies, with which they contradict what some authors have mentioned in terms of the fact that in developing a business group, it has advantages in its resources and capacities that achieve development (Ganguli, 2007). It can be said that foreign direct



investment has also been analysed, which is an indicator of organizational learning and international expansion (Peng, Yang & Liang, 2011). Therefore, the following hypothesis is proposed:

*H1: Decisions of foreign direct investment in the form of mergers and acquisitions positively affect the performance of the company.*

*H2: The decision of foreign direct investment in the form of minority participation positively affects the performance of the company.*

*H3: The concentrated property of the business group positively affects the performance of the company.*

## METHODOLOGY

In order to test the hypotheses, a panel data analysis and using the random effects technique was developed. This consisted of a transverse and longitudinal study from 2012 to 2015 and 39 economic groups were selected, of which 3443 were subsidiaries. In order to choose the business groups of interest for this research, we searched for those that during the period analysed had made any direct investment abroad, the information was obtained from the Emerging Markets EMIS, in addition to the reports of the Mexican Stock Exchange. Where you try to validate that the following equation exist.

$$\text{LnDesp} = b_0 + b_1\text{ADQ} + b_2\text{PM} + \text{PRO} + e \quad (1)$$

Where:

*Desp*: it is the performance of the business group measured by the lag of a period of the indicators of return on assets (ROA, for its acronym in English) and the return on capital invested by shareholders (ROE, for its acronym in English), which in turn was applied a natural logarithm to be able to smooth the data:

*ADQ*: is the decision to acquire a company abroad as a dichotomous variable where 1 was the decision to acquire a company abroad and 0 in other cases;

*PM*: is the decision of a minority purchase of shares of a company abroad measured as a dichotomous variable where 1 is the decision of the purchase and 0 in other cases;

*PRO*: it is the property of the company measured by the percentage of ownership that is in the hands of the control group; and

*e*: they are the possible errors in any statistical analysis.

## RESULTS

In this section, the research findings are presented, where the panel study is developed and for this we had to create two models, one to measure the ROA and the other of the ROE, for the above it was necessary to first analyse the inflation factor of the variance, which is necessary to provide if there is a low collinearity (Gaytan-Cortes, 2016), which must be between 1 and 10 to accept this criterion, as shown in table 1.

**Table 1**  
**Variance inflation factor of the models**

Variables	ROA		ROE	
	VIF	1/VIF	VIF	1/VIF
<b>ADQ</b>	1.10	0.934713	1.06	0.942913
<b>PM</b>	1.18	0.857448	1.21	0.826448
<b>PRO</b>	1.12	0.896020	1.08	0.826448
<b>Mean VIF</b>	1.13		1.30	

Source: own elaboration.

After each model is analysed to test the hypotheses of the present investigation for which the analysis of panel data was used with the method of minimum generalized tables. The results show that the concentration of property has a negative relationship with the performance of the company. It means that within the corporate governance structure of the business group there is a high concentration of property in a few people. There is a negative financial performance with a significance level of 0.10, which means that it is a little low and therefore, the results should be taken with caution.

On the other hand, the decision variable of a minority purchase of shares of a foreign company has a partial relationship with the dependent performance variable since it only reaches a significant level of 0.10 and in turn has a positive value with the return on investment of the shareholders, but not with the return of the assets. It could be mentioned that if the business group decides to make only a minority purchase of shares of a foreign company with the objective of making business partners it has a

positive impact on shareholder earnings. It seems that if the business group decides to make a large investment abroad when acquiring a company, it is not possible to prove that there is a significance in its relationship with performance, so it cannot be said that the acquisition of a foreign company affects the performance of business group.

**Table 2**  
**Regression models with panel data**

Variables	ROA	ROE
<b>Constant</b>	-3.233391***	-4.214009***
<b>ADQ</b>	-0.1125379	0.42976
<b>PM</b>	-0.2052912	1.761793*
<b>PRO</b>	-0.8346245*	-1.694398*
<b>Observations</b>	156	156
<b>Groups</b>	39	39
<b>Chi square</b>	7.77*	9.27 *

Source: own elaboration with data from EMIS Emerging Market and the Mexican Stock Exchange. \*\*\*p<0.01; \*\*p<0.05; \*p<0.10.

## CONCLUSIONS

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The conclusions are similar to those obtained by Attin and others (2002). The concentration of property causes negative effects on the performance of a company, this given the agency costs. In turn contradicts authors who have found the opposite. Therefore, the hypothesis three is rejected. The foreign direct investment is the most common strategy that has been found by business groups at the time of their global expansion. The best decision to develop such strategy is to first make a purchase minority, which implies few risks. It is possible to check hypothesis two after the acquisition, but not hypothesis one, achieving results similar to Kumar, Gaur, Pattnaik (2012), and Bolar (2009).

Regarding the limitations found in the present research work, it could be a few years to see the real effects of the decisions made by this type of companies, so it is suggested that for future investigations, extend the period to see if they change the results and also add more variables, which can be of control such as size, age, among others.

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