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INTERDEPENDENCY BETWEEN INTERNATIONALIZATION AND FIRMS' PERFORMANCE

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ABSTRACT

This research analyzes whether there is an interdependency between internationalization (IS) and firms' performance in manufacturing industry. This study includes 57 companies that are listed in the Indonesian Stock Exchange (IDX) from 2011 to 2015. In order to know which explanatory variables that significantly lead to the Relative Performance based on Historical Target (RPH) and Relative Performance based on Industrial Target (RPI), this research exercises two-stage of least squares regression analysis. The result reveals that IS has a significant positive effect on RPHat0 and RPH itself has a positive effect on IS. It can be said that whenever the number of companies that internationalize themselves increase by a certain degree will have a positive impact on RPH and conversely. Other result shows that IS has significantly negative effect on RPI, however, RPI has an insignificant effect on IS. This means that the more companies internationalize themselves the more negative will be visible on their performance and conversely. Nevertheless, undertaking further research on the same topic with larger sampling population is necessary so that the puzzle whether or not IS and firm's performance involving RPI and RPH remains interconnected can be explained more comprehensively.

Keywords**:** internationalization, firm performance, relative performance, interdependency

1. Introduction

Internationalization (IS) can provide companies with the following benefits, for instance, it can elevate (1) the economies of scale, (2) economies of scope, (3) information and innovation, (4) give access to obtain resources, (5) lower the risks and (6) increase the bargaining power. However, the drawback of IS is that the cost that is due to an uncertainty. IS can also increase the cost of transaction and other cost which occurs when the firms want to obtain information. These costs can lead to deflate the firms' performance.

Based on the respective benefits and costs from the process of IS, it can be said that the process of IS will affect the firms' performance. But, the question is that "Is the internationalization able to improve the firms' performance?". This research topic had previously been studied by researchers to reveal the correlation between IS and the firms' performance. The results of their studies remain contrast from one to another. Some researchers like Rugman (1979), Delios and Beamish (1999), Pangarkar (2008) remarked that the correlations were positive and creating linear patterns. However, some researchers such as Brewer (1981), Collins (1990), Colpan (2008), Qian (1997), Kistruck, Qureshi and Beamish (2013) with the U-shaped model, Hit *et al*., (1997), Driffield, Du and Girma (2008) with the inverted U-shaped model, and Contractor *et al.*, (2003), Lu and Beamish (2004), Sung, Bell and Park (2008), Fisch (2012) with the *S-Shaped* model revealed the negative correlation and linear patterns.

Contractor et al.(2007) studied the correlation between IS and firms' performance in India. They used return on assets (ROA) as a dependent variable. Meanwhile, the IS, age and size exercised as independent variables. The result showed that IS and firms' performance were not correlated and it manifested the U-Shape pattern. Nevertheless, the age has significant correlation with ROA, likewise for the firm's size. Rugman and Oh (2010) conducted their research on the same topic using ROA as a dependent variable, and then IS as independent variable along with the controlled variables such as size, advertising intensity, research and development (R&D). Their empirical studies revealed a positive correlation between IS and firms' performance and it showed an inverted S-Curve pattern. The firm's size has significantly correlated with ROA, meanwhile advertising intensity and R&D intensity were insignificant towards ROA.

Osorio et al. (2016) analyzed whether the size of company affected the correlation between IS and firms' performance. They applied ROA to indicate the firms' performance as a dependent variable and they opted for IS as an independent variable and the controlled variables were comprised of sales growth, age, size, advertising intensity, R&D intensity, productivity, debt and share price. The result showed that negative correlation occurred to large companies followed by the U-Shape pattern to medium size firms, and negative linear happened to small firms. Nonetheless, other controlled variables; sales growth, age, size, advertising intensity, R&D intensity, productivity and share price were significantly correlated to ROA and debt did not correlate with ROA.

Earlier researches documented that IS can have an effect on the firms' performance and conversely because they were interdependent. Companies with better performance than their rivalries can internationalize their firms more easily. Fiegenbaum et al. (1997), Grant et al. (1988) cited in Jung and Bansal (2009) study where they opined that companies with better performance possess tangible and intangible assets that help actualizing the process of IS alone. Further, they analyzed whether firms' performance has an influence on IS. They comparatively opted for ROA to know whether it attributed to the firms' performance. For instance, ROA at 10% is considered as a failure in the industry A that has an average ROA at 20%, but with ROA at 10% will be regarded as a successful achievement for a particular firm in the industry B that has commonly average ROA at 7%. The same thing can happen to a company that has ROA at 20% in their historical achievement, will affirm that 10% of ROA will be regarded as the least amount of achievement level for the same firm. However, having 10% of ROA is relatively good achievement for a certain firm that has generally a bad bookkeeping in its historical performance. Further, IS as a dependent variable, RPH and RPI as independent variables. The controlled variables consisted of prior multi nationality, absorbed slack, available slack, potential slack, exporting intensity, R&D intensity, group membership. Firm age, firm size, wage change, exchange rate, the number of Japanese subsidiaries worldwide, and industry growth, Jung and Bansal (2009) documented the research findings where the firms' performance positively correlated to IS and an inverted U-Shape was depicted for RPH and a positive linear for RPI. Other result showed that under the variables such as available slack, the number of Japanese subsidiaries worldwide and firm size were strongly correlated with IS, RPH and RPI. Simultaneously, variable such as exporting intensity has negative correlation with IS, RPH and RPI. Likewise, group membership, firm age, and wage change have negative correlations with IS, RPH and RPI. Nevertheless, absorbed slack, potential slack, R&D intensity, exchange rate, and industry growth were positively linked to IS, RPH and RPI.

2. Theoretical Review

In the early research, Osorio et al. (2016) and Contractor et al. (2007) demonstrated that IS has negative influence on firms' performance. This negative affect was triggered by the cost of internationalization process, which was greater than the benefit that the firms should have attained. And the location where the firms were initially operating their businesses were not well-recognized so firms' performance were considerably low. In contrast to Osorio et al, Rugman and Oh (2010) opined that by internationalizing, companies will expand their target market and improve their sales so that the firms have better performance.

Hypothesis 1: Internationalization has an effect on firms' performance

The hypothesis is formulated based upon the previous studies showing that firms' performance has positively correlated with IS (Jung and Bansal, 2009). Opposite to them, Sun and Lee (2013) revealed that firms' performance did not have positive correlation with IS. Further, based on the research findings of Fiegenbaum *et al.* (1997) and Grant et al. (1988) that were cited in Jung and Bangsal (2009) research, they remarked that companies with good performance possess the intangible and tangible resources that can be exercised to actualize the process of their internationalization.

Hypothesis 2: Firms' performance has an effect on Internationalization

Sun and Lee (2013) analyzed the factors that determine the degree of IS for companies in the restaurant industry. Their research exercised the financial performance, level of franchising and type of restaurant as factors that affect the business expansion in international markets. They used IS as a dependent variable, determined the independent variables such as RPH, RPI, tobin's q based on historical target, tobin's q based on industrial target and franchising. Furthermore, the controlled variables used in their study were size, debt, market excess return, industry growth rate, exchange rate and dummy variable for type of restaurants. The result manifested that there was no significant correlation between IS and firms' performance. The performance of individual company was measured by looking at their historical target and industrial target. Debt, market excess return, industry growth rate and exchange rate were not strongly correlated with the IS. Nonetheless, only the firm size that was positively correlated with IS.

3. Research Method

Sample population in this study is comprised of firms in the manufacturing industry and consists of 57 companies which are listed in IDX over the period of 2001- 2015. This study remarks the performance of 57 companies and finds 285 points. The following research variables are chosen and then statistical hypothesis test will be conducted using E-view 8.0.

Table 1. Research Variables

Names of Variables	Formulas
Internationalization (IS)	$\text{Internationalization} = \frac{\text{Foreign Sales}_t}{\text{Total Sales}_t}$
Relative Performance Based on Historical Target (RPH)	$\text{ROA}_t = \frac{\text{Net Income}_t}{\text{Total Asset}_t}$ $\text{TPH}_t = \left(\frac{\text{ROA}_{t-1} + \text{ROA}_{t-2} + \text{ROA}_{t-3}}{3}\right)$ $\text{RPH}_t = \text{ROA}_t - \text{TPH}_t$
Relative Performance Based on Industrial Target (RPI)	$\text{TPI}_t = \left(\frac{\text{IAROA}_{t-1} + \text{IAROA}_{t-2} + \text{IAROA}_{t-3}}{3}\right)$ $\text{RPI}_t = \text{ROA}_t - \text{TPI}_t$
Age of the firm (AGE)	$\text{AGE}_t = \sum \text{Number of years in the business}$
Size of the firm (SIZE)	$\text{SIZE}_t = \ln(\text{Total Sales}_t)$
Absorbed Slack (ABS)	$\text{ARS}_t = \frac{\text{SGA Expenses}_t}{\text{Total Sales}_t}$
Available Slack (AVS)	$\text{AVS}_t = \frac{\text{CA}_t - \text{CL}_t}{\text{Total Sales}_t}$
Potential Slack (PTS)	$\text{PTS}_t = \frac{\text{Total Debt}_t}{\text{Total Equity}_t}$
Exchange Rate (EX_RATE)	$\text{EX\_RATE}_t = \frac{\text{EX\_RATE}_t - \text{EX\_RATE}_{t-1}}{\text{EX\_RATE}_{t-1}}$

Where;
ROA_t = *Return on Asset* of a firm at year t
TPH_t = *Target performance based on firm's historical performance* at year t
RPH_t = *Relative performance based on historical target*at year t
IAROA_t = Average ROA of industry at year t
TPI_t = *Target performance based on industry performance* at year t
RPI_t = *Relative performance based on industrial target*at year t

Furthermore, this research opts for two-stage least squares regression analysis to reveal the influential independent variable towards the dependent variable. The dependent and independent variable are IS, RPH and RPI. The controlled variables are comprised of age of the firm (AGE), size of the firm (SIZE), absorbed slack (ARS), available slack (AVS), potential slack (PTS), and exchange rate (EX_RATE).

This study has two research models, the first research model is to document the simultaneous relationship between IS and firms' performance where performance of the companies is weighted using RPH. And, the second research model is also meant to demonstrate the simultaneous relationship between IS and firms' performance. The performance of companies is weighted by means of using RPI.

Research Model 1 (Internationalization – RPH)

$$RPH_t = \beta_1 + \beta_2\, IS + \beta_3\, AGE + \beta_4\, SIZE + \varepsilon \quad (1)$$

$$IS_t = \beta_5 + \beta_6\, RPH + \beta_7\, AGE + \beta_8\, SIZE + \beta_9\, ARS + \beta_{10} AVS + \beta_{11}\, PTS + \beta_{12}\, EX_{RATE} + \varepsilon \quad (2)$$

Research Model 2 (Internationalization – RPI)

$$RPI_t = \beta_1 + \beta_2\, IS + \beta_3\, AGE + \beta_4\, SIZE + \varepsilon \quad (3)$$

$$IS_t = \beta_5 + \beta_6\, RPI + \beta_7\, AGE + \beta_8\, SIZE + \beta_9\, ARS + \beta_{10} AVS + \beta_{11}\, PTS + \beta_{12}\, EX_{RATE} + \varepsilon \quad (4)$$

3. Analysis

According to table 5.1, it can be said that H1a and H2a are acceptable under the research model 1. This means that dependent variable IS has positive correlation with RPH and on the way around. Having seen this experimental outcome, it becomes clear that the simultaneous relationship between IS and firms' performance in the manufacturing industry that are listed in the IDX for the period of 2011 – 2015 are computable by means of exercising model 1.

Table 2. Regression Results - Model 1

Variable	Model 1		Hypothesis
	RPH	IS	
IS	0.0393***		Positive
RPH		0.6486***	Positive
AGE	0.0008	-0.0040*	
SIZE	-0.0049*	-0.0249**	
ARS		-0.6874***	
AVS		-0.0531	
PTS		0.0009	
EX_RATE		0.0189	
Adj. R-Squared	0.0298	0.1133	

(*** significant level 1%, ** significant level 5%, * significant level 10%)

As it is depicted in model 1 (table 2), dependent variable IS has coefficient correlation 0.039372 with the level of significant below 1% or 0.0078. This means that variable IS has an effect on firms' performance so that it will reveal a positive linear pattern. The result of this research is in line with the previous studies conducted by Rugman and Oh (2010) and supported by Rugman (1979), Errunza and Senbet (1981), Grant (1987), Kim and Lyn (1986), Delios and Beamish (1999), and Pangarkar (2008) that IS has positive correlation with firms' performance which eventually leads to possess positive linear pattern.

The positive correlation happens for reason which is the benefit that companies have gained from internationalization is greater than the cost that they paid out to improve the firms' performance. The benefits that they have obtained from the positive correlation are associated to greater market access, where companies will generate inputs (e.g. capital or human capital) that are less expensive (Contractor, 2007; Hennart, 1982; Lu and Beamish, 2004; Vernon, 1966). Companies can strengthen their market towards suppliers, distributors and consumers (Hymer, 1976), opportunity to obtain the knowledge and innovation through learning and development (Contractor et al., 2003; Ghoshal & Bartlett, 1990; Kogut & Zander, 1993; Zahra, Ireland, & Hitt, 2000), economies of scale and scope(Caves, 1996; Porter, 1986), and risks diversification in the case of unstable politics or fluctuation of exchange rates (Contractor, Kumar, & Kundu, 2007; Kim, Hwang, & Burgers, 1993). More importantly, this positive correlation shows the growth of internationalization has an impact on the RPH.

The variable RPH has coefficient correlation at 0.648610 with the level of significant below 1% or 0.0040. This means that variable RPH is significantly influential on the IS. The study documents identical result when Jung and Bansal (2009) analyzed the correlation between the firms' performance and IS. Based on Fiegenbaum et al. (1997) and Grant et al. (1988) findings used in Jung and Bangsal (2009) research, where they opined that companies with good performance possess the intangible and tangible resources that can be exercised to actualize the process of their internationalization. Furthermore, it can be said that every time RPH increases at certain point will have positive impact on the incremental of IS.

Table 3. Regression Results - Model 2

Variable	Model 2		Hypothesis
	RPI	IS	
IS	-0.0424*		Positive
RPI		-0.1924	Positive
AGE	0.0046***	-0.0026	
SIZE	-0.0012	-0.0276**	
ARS		-0.6800***	
AVS		-0.0243	
PTS		0.0031	
EX_RATE		-0.0283	
Adj. R-Squared	0.0879	0.0919	

(*** significant level 1%, ** significant level 5%, * significant level 10%)

Based on the result depicted in the table 3 where it can be said that hypothesis (H1b) and (H2b) are rejected by model 2, which means that variable IS does not have significantly positive correlation with RPI and RPI does not have an effect on IS. Having seen this experimental outcome, it becomes clear that the simultaneous relationship between IS and firms' performance in the manufacturing industry that are listed in the IDX for the period of 2011 – 2015 cannot be computed through using model 2.

In model 2 (table 5), variable IS has coefficient towards RPI -0.042460 with the level of significant below 10% or 0.0502. This means that variable IS has negative correlation with firms' performance and it leads to show negative linear pattern. H1b is rejected because it does not fit the initial hypothesis where it was believed that IS would have a positive effect on RPI. Nevertheless, this study discovers an error, where the error happens when the experimental result stated $H_0$was to be rejected but apparently H_0 was correct.

The result of this study is in line with the former research, Osorio et al. (2016) and Contractor et al.(2007) which then underpinned by Brewer (1981), Collins (1990), and Colpan (2008) where the result manifested that IS was negatively correlated with firms' performance and leading to a negative linear pattern. This insignificant correlation happened for some reasons such as cost of internationalization is greater than benefits that the companies should have gained. The costs of IS that companies paid out like cultural adaptation and institutional norms costs. These factors therefore weakened the firms' performance (Ghoshal & Bartlett, 1990). Other costs are like coordination and management costs that appeared due to the differential environments, high transactional and transportation costs (Contractor et al., 2007). Apart from that, cost of capital investment for acquiring or leasing the premises, where the firm will commence its operations, machineries and other necessary assets. These tangible assets inflate the amount of companies' fixed assets. The higher value of tangible assets the firms have there will be more depreciation and amortization costs. As a result, the costs reduce the revenues or firms' performance. Warsono (2003) findings were cited by Hermawan (2016) where he viewed that companies with more fixed assets will have more depreciation and amortization costs to bear. Consequently, the revenues of the companies will decrease.

Variable RPI has a coefficient correlation with RPI -0.192478 with level of significant above 10% or 0.2290. This means that RPI has negative influence on the IS. The result of this study is in accordance with previous findings documented by Lee and Sun (2013) where they opined that RPI has an insignificant effect on IS. The negative correlation indicates that companies with good performance has low intention to proceed its internationalization. This occurs because the companies are sufficiently sustainable in their domestic markets. Hence, they are neither interested in entering international markets nor proceeding their internationalization. The internationalization will increase their costs, will make the firms face the risks that somewhat can reduce their firms' performance.

One of the critical reasons for documenting the insignificant correlation occurred in this research is that the numbers of population sampling are probably insufficient, either way it requires more research variables. Variable RPI is weighted by looking at the targeted industry meanwhile the sampling population that is exercised in this study consists of 57 listed companies in IDX for a particular manufacturing industry. Therefore, RPI is not sufficiently attractive to be used as a determinant factor to gauge the firms' performance. This means that the utilization of variable RPI cannot be claimed as a successful variable to demonstrate the correlation between IS and firms' performance or else the RPI is incapable of providing a considerable influence on the augmentation and decrement of internationalizing companies.

4. Conclusion

The objective of this research is to study whether or not the interdependency between IS and firms' performance is in existence. Under the t-test, the result of model 1 shows that variables in the IS are significantly correlated with the firms' performance, and therefore it creates positive linear. Likewise, variable RPH demonstrates its positive correlation with IS and it creates positive linear pattern. The result shown in the model 1 can be then concluded that the existence of interdependency between IS and firms' performance in the manufacturing industry is verifiable. Under the same t-test, the result of model 2 manifests that variables in the IS are insignificantly correlated with firms' performance and therefore it creates negative linear pattern. In addition, variable RPI has a negative influence on IS. Hence, it is possible to clinch the model 2 that there is no empirical evidence that documents the IS and firms' performance is interdependent.

One of the critical reasons for documenting the insignificant correlation occurred in this research is that the numbers of population sampling are probably insufficient, either way it requires more research variables. Nevertheless, undertaking further research on the same topic with larger sampling population is necessary so that the puzzle whether or not IS and firm's performance involving RPI and RPH remains interconnected can be explained more comprehensively.

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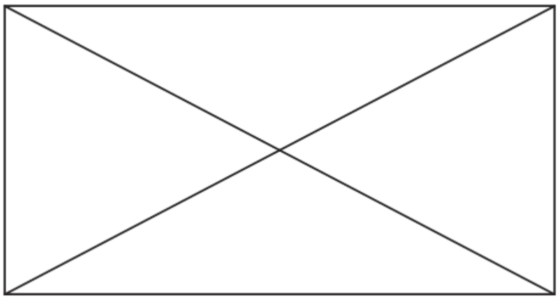

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In this case, the governing system of equations can be written as follows:

$$\frac{\partial \rho}{\partial t} = -\nabla \cdot (\rho\, \mathbf{u}) \tag{1}$$

$$\rho \left(\frac{\partial}{\partial t} + \mathbf{u} \cdot \nabla \right) \mathbf{u} = -\nabla P + \rho \mathbf{g} + \frac{1}{\boldsymbol{c}} \mathbf{J} \times \mathbf{B} \tag{2}$$

$$\rho \left(\frac{\partial}{\partial t} + \mathbf{u} \cdot \nabla \right) e = -P \nabla \cdot \mathbf{u} + \rho \mathbf{u} \cdot \mathbf{g} + \frac{1}{\sigma} \mathbf{J}^2 \tag{3}$$

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