



THE EFFECTS OF GLOBALIZATION ON FIRM PERFORMANCE IN EMERGING MARKETS: EVIDENCE FROM EMERGING-7 COUNTRIES

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ABSTRACT

Although there exists a wide array of literature regarding almost every aspect of globalization at macro level, surprisingly, the micro level of the subject area seems to be a little ignored and consequently, almost nothing is known about the impact of globalization on firm performance/value. In an attempt to contribute to fulfilling this gap, this research focuses on the impact of the overall globalization level of a country and its single dimensions, specifically her economic, her political and her social globalization levels on firm performance which is measured by the stock market index returns for “Emerging-7 (E7)” countries, specifically Brazil, China, India, Indonesia, Mexico, Russia and Turkey, for the period 1998-2009 by using panel data estimation. The findings suggest that the overall level of globalization significantly improves firm performance. Besides, the single dimensions of globalization are also found to have value enhancing effects though the result for economic globalization is insignificant at conventional levels. Additionally, the political globalization seems to be the most promising dimension of globalization with regard to performance enhancing prospects for firms.

Keywords: Globalization, Firm performance, Emerging countries, Panel data

JEL Classification: F6, G3, C33

INTRODUCTION

The massive trade liberalization and financial integration accompanied with growing political, socio-cultural and military interdependence as well as the excessive technological progresses has led the term “globalization” to become one of the hottest topics of our era. Although the term ‘globalization’ is used to refer to a single phenomenon, it is not a single, unified process (Ardıç, 2009), but a catch-all concept to describe a wide range of forces (Archibugi and Iammarino, 2002). This process has effects on the environment, on culture, on political systems, on economic development and prosperity, and on human physical well-being in societies around the World (Kefela, 2011). Consequently, there is no unified definition of globalization as well². In fact, it is

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² Despite the fact that the definition of globalization has been attempted by hundreds of authors and distinguished speakers on the topic, the word continues to mean very different things to different people (Kefela, 2011). According to International Forum on Globalization, it stands for the present worldwide drive toward a globalized economic system dominated by supranational corporate trade and banking institutions that are not accountable to democratic processes or national governments (<http://www.ifg.org/analysis.htm>). World Health Organization underlines two interrelated elements in defining globalization: the opening of borders to increasingly fast flows of goods, services, finance, people and ideas across international borders; and the changes in institutional and policy regimes at the international and national levels that facilitate or promote such flows (<http://www.who.int/trade/glossary/story043/en/index.html>). According to Oxford English Dictionary, globalization is the process by which businesses or other organizations develop international influence or start operating on an international scale (<http://oxforddictionaries.com/definition/english/globalization>). Szeman (2003) defines globalization as the moment of mass migration, multiculturalism, and cosmopolitanism and Giddens (1990) defines

observed that the definition of globalization depends on the aim and the scope of the debate. Accordingly, the effects of globalization have been argued from a wide spectrum as well. Just to mention a few, for example, some authors concentrate on economic factors (such as Dreher, 2006; Jamison, Jamison and Hanushek, 2007; Pehnelt, 2007; Leitao, 2011; Rao, Tamazian and Vadlamannati, 2011; Rao and Vadlamannati 2011), while some others address political issues (such as Bezemer and Jong-A-Pin, 2008; Dreher, Sturm and Ursprung, 2008; Dreher, Sturm and Vreeland, 2009; Bjornskov and Potrafke, 2011; Chang and Berdiev, 2011) or raise social notions (such as Lee and Vivarelli 2006; Dreher and Gaston, 2007). Further, there are still many others who investigate many other various aspects such as human development (for ex., De and Pal, 2011), human welfare (for ex., Tsai, 2007) and life satisfaction (for ex., Bjornskov, Dreher and Fischer, 2008), entrepreneurial activity (for ex., Vinig and Kluijver, 2007), willingness to help immigrants as well as sick and disabled (for ex., Koster, 2007), environmental standards (for ex., Gassebner, Gaston and Lamla, 2008), water pollution (for ex., Lamla, 2009), military interstate disputes (for ex., Choi, 2010), etc. Hence, clearly there exists a wide array of literature regarding almost every aspect of globalization at macro level such as the dimensions of globalization and their impacts on nations including the national economy, politics, social and cultural aspects etc., but, surprisingly, the micro level of the subject area seems to be a little ignored.

Although ‘Globalization’ is a well known and widely used term for a long time and continues to affect businesses in all aspects, there are only a few researches that address the impact of globalization on firm performance. Among these, Acheampong et al. (2000) examined whether increasing globalization equalizes speeds of profitability adjustment of global firms in the beverage and tobacco industry and the food and consumer products industry and their findings report no significant country effect in the beverage and tobacco industry while in the food and consumer products industry, speeds of profitability adjustment was found to vary across countries. In another study, Peltonen et al. (2008) analyzed the impact of import penetration on firm’s profitability in 15 manufacturing industries in 10 euro area countries during 1955-2004 and their results indicate that import competition from emerging market economies has had an overall negative impact on company profitability in the euro area manufacturing sector. However, contrary to the findings of Peltonen et al. (2008), Georgiou (2011) report a positive impact of globalization (as measured by total trade to GDP) on company profitability (as measured by net return on equity) for Europe and the findings of Akinola (2012) suggest that the performance of Nigerian Banks as measured by profit before tax increases with globalization. Nevertheless, it is obvious that there exists a limited body of knowledge about the impact of globalization on the firm performance/value and further research is crucially needed.

This research is hoped to contribute to fulfilling this gap through focusing on the impact of the degree of overall globalization level of a country as well as its single dimensions, specifically the economic, the political and the social dimensions by using KOF Index of Globalization on the firm performance/value as measured by the stock market index returns³. For this purpose, this research concentrates on “Emerging-7 (E7)” countries, referring to a group of seven emerging countries, namely Brazil, China, India, Indonesia, Mexico, Russia and Turkey. E7 countries provide an interesting sample set as they constitute the major emerging economies in the World. These countries have been recorded substantial developments within the last few decades and are predicted to have larger economies than G7 countries, specifically Canada, France, Germany, Italy, Japan, United Kingdom, and United States, within the next couple of decades. According to the

globalization as the intensification of world-wide social relations which link distant localities in such a way that local happenings are shaped by events occurring many miles away and vice versa.

³ The fact that the objective of the firm is to maximize its value to its shareholders where value is represented by the market price of the company’s common stock (Van Horne, 1974) provides an additional incentive to use the stock market index returns as a proxy for firm performance as well.

projections of PricewaterhouseCoopers the E7 emerging economies will be around 50% larger than the G7 economies by 2050 (Hawksworth and Cookson, 2008)⁴.

Although emerging economies are more globalized than others (Naghshpour and Marie, 2008) very little is known about the impact of globalization on firm performance. Besides, the effect of different dimensions of globalization, especially at the micro level, is again somewhat neglected. So, this paper not only addresses a crucial empirical question through focusing on the impact of globalization on firm performance/value but is also hoped to provide insights on the effects of different dimensions of globalization on firm performance/value as well. Within the scope of this study, following De and Pal (2011), globalization can be defined as the process of opening up of economies to the outside world to facilitate trade, reduction in physical and other barriers to increase mobility of goods and factors of production as well as labor force: that is, it is a process of integration of economies through economic, social and political processes.

The research undertaken in this study deviates from the majority of the previous work in some important aspects. First of all, although not at a firm level, it concentrates on the effect of globalization on firm performance by using stock market index returns as a proxy. Considering that the limited previous research mainly employed accounting based performance measures such as gross operating rate, return on equity etc., using a market performance measure also provide an important additional contribution. Besides, it not only examines the impact of a country's overall globalization level on firm performance but also investigates the effects of the economic, the political and the social globalization levels of a country on firm performance. In this respect, it is hoped to provide important additional insights to assess the relative importance of different dimensions of globalization on firm performance/value as well.

DATA AND METHODOLOGY

This study aims to investigate the impact of globalization and its single dimensions on stock market index returns for E7 countries with panel data estimation. The research is undertaken for the period of 1998-2009 by using annual data.

The data on both the level of overall globalization and on its single dimensions, specifically the levels of economic, political and social globalization, for the sample countries are obtained from KOF Index of Globalization 2012 which is developed by Dreher (2006), updated by Dreher, Gaston and Martens (2008) and provided by Swiss Federal Institute of Technology, Zurich. KOF Index of economic globalization is characterized as long distance flows of goods, capital and services as well as information and perceptions that accompany market exchanges. It consists of both the actual flows and the restrictions. Actual flows cover the variables trade, foreign direct investment, portfolio investment and income payments to foreign nationals where all the variables are expressed as a percentage of GDP and restrictions cover hidden import barriers, mean tariff rate, taxes on international trade as a percentage of current revenue and capital account restrictions. The political globalization is characterized by a diffusion of government policies and the sub-index covers the variables: the number of embassies in a country, the number of memberships in international organizations, the number of UN peace missions she participated in and the number of treaties she signed with other nations. The social globalization through combining the data on personal contacts, on information flows and on cultural proximity, is expressed as the spread of ideas, information, images and people. Personal contacts data include the international telecom traffic measured in minutes per person, the degree of international tourism both incoming and outgoing, the percentage of foreign population as a percent of total population, the number of

⁴ http://www.pwc.com/en_GX/gx/world-2050/pdf/world_2050_brics.pdf
<http://www.pwc.com/gx/en/world-2050/beyond-the-brics.jhtml>

international letters sent and received as well as government and workers' transfers received and paid as a percentage of GDP. The data on information flows consist of the share of internet users, the fraction of households who have a television and the international newspapers traded which is measured as a percentage of GDP. Finally, Cultural Proximity represents the number of McDonald's restaurants per capita, the number of IKEA in a country per capita and the value of imported and exported books as a percentage of GDP. Then, these three sub-indices, specifically the economic, the social and the political globalization indices are combined into a single overall globalization index⁵.

The stock market indices of the countries, which are obtained from Bloomberg, are used as a proxy for firm performance and the GDP growth rate which is sourced from IMF database⁶, is used as a control variable in the model. To test the impact of the overall globalization level of a country and the effects of her economic, her political and her social globalization levels on firm performance, two separate models are used:

Model 1:

$$Rm_{i,t} = \beta_0 + \beta_1 GlobalizationLevel_{i,t} + \beta_2 GDPGrowthRate_{i,t} + \varepsilon$$

Model 2:

$$Rm_{i,t} = \beta_0 + \beta_1 EconomicGlobLev_{i,t} + \beta_2 PoliticalGlobLev_{i,t} + \beta_3 SocialGlobLev_{i,t} + \beta_4 GDPGrRate_{i,t} + \varepsilon$$

In conducting the panel data estimation of the above models, first Hausman Test is applied to determine whether fixed or random effect would be appropriate which suggest that random effects specifications are more suited. Then, time and cross section dummies are used to check for time and individual level heterogeneity.

RESEARCH RESULTS

The results of the random effect panel data estimation results for both models are provided in Table 1.

Table 1. The Random Effect Panel Data Estimation Results

Variable	Coefficients	
	Model 1	Model 2
Constant	-0.173 (-0.731)	-1.326 (-2.578)
Globalization Level	0.010*** (4.109)	
GDP Growth Rate	-0.021 (-0.978)	-0.021 (-1.206)
Economic Globalization Level		0.006 (1.514)
Political Globalization Level		0.015*** (2.694)
Social Globalization Level		0.003** (2.160)

t-statistics are presented in parentheses.

***, **, * denote statistical significance at 1%, 5% and 10% levels, respectively.

⁵ For detailed information on the KOF Globalization Indices please visit: <http://globalization.kof.ethz.ch/>

⁶ World Economic Outlook Database, April 2012 Edition.

<http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/weoselco.aspx?g=2200&sg=All+countries+%2f+Emerging+and+developing+economies>

The results obtained from Model 1 suggest that the globalization level of a country positively affects firm performance at 1% significance level ($p=0.0001$). This result indicates that the overall globalization level of a country improves firm performance and provides value enhancing effects for the businesses operating under this environment. Hence, an increase in the overall globalization level of a country may also be argued to provide improved prospects for emerging countries to catch up with industrialized countries. However, an investigation of its single dimensions suggests that this performance/value enhancing prospects mainly comes from the political and the social globalization levels of a country.

As the results of Model 2 reveal, although all the three dimensions of globalization is found to effect firm performance/value positively, the observed positive effect of the economic globalization level of a country on firm performance/value is found to be insignificant ($p=0.1348$) at conventional levels. This may reflect the possibility that although globalization forms a worldwide market for companies, it comes with the expense of a booming competition which in turn brings limits to the profitability gains of companies and may pinpoint that the competitiveness of emerging market firms still lack behind their counterparts operating in more developed countries. This result may also be interpreted as a support to Kaplinsky (2004) who argued that despite the wide diffusion of productive capabilities to developing countries during the last several decades, the growing importance of global buyers has squeezed both profit margins and incomes for developing country producers.

On the other hand, the political and the social globalization levels of a country are found to have a performance/value enhancing effect at 1% ($p=0.0089$) and 5% ($p=0.0343$) significance levels, respectively. These results probably stem from the fact that merging politics enabled more beneficial decisions to be taken for people all over the World especially for developing nations and reflect the effect of the increased diffusion of ideas, norms, values, preferences, and even the consumption patterns through the increased personal contacts and information flows, the increased awareness of different cultural preferences and adaptation as well as the increased openness and tolerance socially.

Besides, an examination of the estimated coefficients suggests that the most promising dimension of globalization is the political globalization. This strong impact of the political globalization level of a country on firm performance underlines once again the importance of inter-political relations between governments, the political power and the political risk of a country on the performance of firms.

CONCLUSION

This paper examines the impact of the overall globalization level of a country as well as its single dimensions, specifically the levels of her economic, her political and her social globalization on firm performance/value in emerging markets. Although, as argued by Naghshpour and Marie (2008), emerging markets are more globalized than others, very little is known about the impact of globalization on firm performance. Hence, in an attempt to contribute in fulfilling this gap, this research focuses on E7 countries who are argued to constitute the major emerging countries in the World.

The major contribution of this research rests in its focus. Though previous research mainly address the topic subject at national level, this paper concentrates on the effects of globalization and its single dimensions on the performance of firms operating under this business environment. Besides, considering that the effects of the different dimensions of globalization, especially at the micro level, are highly under-questioned empirically, this research also contributes the previous literature

by concentrating on the economic, the political and the social dimensions of the globalization separately as well.

The findings indicate that both the overall level of globalization and its single dimensions improve firm performance and value though the result for economic globalization is insignificant at conventional levels. These findings imply that the overall globalization level of a country not only provide performance/value enhancing effects for the businesses operating under this environment, but also offers improved prospects for emerging countries to catch up with industrialized countries. However, a deeper evaluation of the research findings suggests that this performance/value enhancing prospects mainly comes from the political and the social globalization levels of a country. Actually, contrary to what might be expected, the economic globalization seems to fail in providing statistically significant performance enhancing prospects for firms. The findings also reveal that the most promising dimension of globalization seems to be the political globalization and the social globalization seems to provide another important source of improved firm performance.

Overall, these findings indicate that if emerging market policy makers wish to empower the performance of their home country companies, they can take measures to increase the globalization level of their countries, especially with regard to the political and the social globalization dimensions, while taking precautions to enhance the competitiveness of home country firms seems promising.

As a final remark, although this paper contributes to the existing literature in terms of the impacts of the overall globalization level of a country as well as her economic, her political and her social globalization levels on firm performance in emerging market settings through providing evidence from E7 countries, the findings obtained provide a combined overview for the sampled countries. However, as also argued by De and Pal (2011), the impacts of globalization across different countries also depend on their existing productive capacity and quality. So, in an attempt to fill the big picture, more country specific future research is crucially needed.

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