The Mexican Multinational Business Groups, Global Expansion Strategy and Its Impact on Performance

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EXECUTIVE SUMMARY

The purpose of this research is to determine the relationship between ownership structure, the foreign direct investment strategy, and its relationship with the performance of multinational business groups in Mexico using information from EMIS Emerging Markets and the Mexican Stock Exchange in the period from 2012 to 2015. The findings were that higher concentration of ownership will result in a worse performance of the business group and strategies of foreign direct investment and mergers and acquisitions have an ambiguous relationship in terms of performance.

Keywords: Business groups, Ownership concentration, Performance

INTRODUCTION

Business groups in Mexico date from the late nineteenth century, particularly in the city of Monterrey, where at that time there was a wave of industrialization driven by the neoliberal policies of the federal government leading to the creation of the first groups of large manufacturing factories and the banks that financed them. This was due to the need to create capital unions and, in many cases, came about through families and marriages; the investments were made in a diversified form ranging from personal consumption, development of productive consumption goods, mining, passenger and cargo transport, commercial banking, agricultural and complementary services (Cerutti, 1986; Chavarín-Rodriguez, 2011).

At the beginning of the twentieth century, specifically in 1910, the Mexican revolution broke out. A civil war that lasted until 1920. For obvious reasons there are few studies on Mexican enterprise during that time, but already in the 1930s there was an enthusiasm for the creation of a financial system that allowed the creation of banks and financial companies to face the competition of foreign multinational companies. At that time, Mexican business groups were formed of commercial houses, transport companies and financial institutions (Hamilton, 1986). These were created by a group known as Monterrey. These were made up of families such as the Garza-Sada, owners of Cuauhtémoc - Moctezuma, Cydsa, Vidriera Monterrey, Alfa. At the end of the decade, the Garza Sada family kept the Cuauhtémoc Brewery and the Vidriera Monterrey (Cordero & Santín, 1986), which remain in the present era.

In addition, it is known that the formation of business groups was due to the dynamics of concentration of capital that occured in the process of industrialization due to the inefficiency of the market and the scarcity of capital resources (Chavarin, 2011). Similarly, the corporate governance of these groups has been characterized as having a concentrated ownership with few individuals, commonly members of the same family, within a network of businesses based on cross-ownership of shares or exchange of representatives on boards of directors. Therefore, the objective sought in this research is to analyze the impact of corporate governance structures of business groups and internationalization strategies based on FDI in performance, for which we analyze the theories of the agency. This work has the following sections: first, the theoretical framework is analyzed and the studies that have tried to test the relations between the variables are discussed.

THEORETICAL FRAMEWORK

In this section, we begin with the definitions of the terms used in the research, agency theory, as well as a literature review where the empirical evidence of the relationships between FDI, property structure and their effect on the performance of business groups is examined.

Today, business groups have other names, such as *chaebol* in South Korea or *keiretsu* in Japan. These groups are integrated both vertically and horizontally by subsidiaries that form business financial networks, i.e., networks with formal or informal long-term agreements with financial companies that provide financing to other companies through officially regulated mechanisms. These groups have arisen due to market failures, such as lack of financial market development, lack of justice, economic instability, relations between groups and certain economic agents (Fishan, 2001; Khanna 2005; Guriev & Rachinsky, 2005; Deseatnicov & Akiba, 2016). The groups also are formed by sociological and cultural conditions, where individuals seek to create social ties where friendship, the extended family in business networks is implicit (Granovetter 1995; Keister 1998)

Several family business groups have expanded internationally. It was in the 1990s that favorable conditions for such growth arose by consolidating the reforms in trade regulation initiated a decade earlier. This was an historic moment where the groups also started their internationalization strategies; the most common being foreign direct investment (FDI) which made them into multinational companies and caused them to become the dominant force in international trade.

The expansion of business groups has been either through the M & A strategy or Green Field where, according to UNCTAD (2016) studies, in 2015 there was a global FDI of USD 1.76 trillion. This was the highest level since the financial crisis of 2008-2009 when there was an increase in international mergers and acquisitions caused by the reconfiguration of the property structure and legalities, which meant a total of 15% of all flows of FDI at the global level (UNCTAD, 2016).

China was the third country with the most investments in FDI in 2015, just after the United States and Japan, with a total of 128 billion dollars occurring mainly through its mergers and acquisitions. In the Latin American region, companies invested 5% more in 2015 than in 2014. In this context, Mexico, as well as Brazil, Chile, Colombia and Peru, had the most foreign direct investments between 2007 and 2014. This was due to a strategy of mergers and acquisitions and the investment of multinational companies in 2015 of $8,072, $3.072, $15,513, $ 4,218 and $ 127 million, respectively. It should be noted that this trend has been negative in recent years. For example, Mexican multinationals in 2010 had a FDI of 15.05 billion dollars; Brazil had 22.06 billion dollars; Chili had 10.534 billion dollars; Columbia had 5.483 billion dollars; and Peru had 266 million dollars. Also, the industries that received the most FDI globally were service industries with 64%, followed by manufacturing with 27% (UNCTAD, 2016).

A business group is a legal entity that includes a headquarter company and its subsidiaries. These companies establish formal relations and can also be defined as a group of legally constituted companies with a management relationship (Gaur, 2010). It is known that business groups are usually initiated by bonds of trust or family and united by cross-ownership and members of the common board (Chang & Rhee, 2011).

Through the interrelationships, they can allow their subsidiaries to use their technology, market opportunities and innovative strategies (Keister, 1998) and in turn rely on each other for financing and brand value (Dutta, 1997). Corporate governance can be defined as the existing relationships in the different agents that determine the direction and the performance of the firm (Eiteman, Stonehill, & Moffet, 2007). The above is related directly to the organizational goals of the generation that developed an adequate corporate governance structure. As such, it is possible to establish more adequate strategies to improve the financial performance of an organization (Aaker, 1995).

To explain the relations of the variables, agency theory in this paper was implemented. Agency theory says that ownership in large companies is diversified through multiple shareholders who transfer authority for decision making to managers in order to obtain optimum performance. The fact that the shareholders have a small shareholding gives rise to the difficulty of accessibility to information about the actions performed by their managers (Jensen & Meckling, 1976). Control and information are expensive to obtain, especially for an individual; this is known as the agency problem. In the case of business groups, ownership concentration arises from the a need to mitigate agency problems. However, as has been mentioned previously in emerging markets, there are market failures that are solved by the concentration of ownership and control through controlling families (Khanna & Palepu, 1999; Mork & Yeung, 2003) where formal relationships or bonds are created inwardly and between companies, developing a personalized trust that reduces opportunistic behaviors (Lansberg & Gersick, 2006). Part of the objective in this paper is to analyze the multinational business groups below that have identified relationships between FDI and ownership structure with the performance of the business group.

Foreign Direct investment of the Business Group

There are several studies that analyze the international expansion of multinational business groups. For instance, Gaur and Kumar (2009), using multiple linear regression, found that the international diversification variable measured by FDI has a positive and significant relation with performance and that the capital structure has a negative effect (Gaur, 2010).

In turn, studies have also been developed where the level of internationalization was studied, using the theory of resources and capabilities. The variables that affect the internationalization of business groups are resources of experience and diversification (Kumar, Gaur, & Pattnaik, 2012). At the same time, it has been found that international diversification is an important factor influencing performance. A comparative study analyzed autonomous companies as subsidiaries of business groups and concluded that there are no differences in performance in global expansion between these two types of companies, contradicting what some authors have mentioned, i.e., that business groups have advantages in their resources and capacities that achieve development (Ganguli, 2007). Foreign direct investment, which is an indicator of organizational learning and international expansion, has also been analyzed (Peng, Yang & Liang, 2011). Therefore, the following hypothesis is proposed:

H_1: FDI and international experience positively affect the performance of the company.

Ownership Structure

In previous studies, we have seen the implications of the ownership structure of business groups with their subsidiaries, however, the differences between different ownership structures and the performance of their subsidiary companies have not been sufficiently analyzed (Chung, Chang, 2012; Carney, Gedajlovic, Heugens, Van Essen, & Van Oosterhout, 2011).

When analyzing business groups in the emerging economies, the family establishes a pyramidal property structure to control its multiple affiliated companies (Almeida & Wolfenzon, 2006; Claessens et al., 2000; La Porta et al., 1999, 2002; Morck, Percy, Tian & Yeung, 2005). In other words, they have a certain percentage of ownership sufficient to exert control. In addition to the business groups is the structure that prevails at an international level (Masulis, Pham & Zein, 2011). Research based on information from the Taiwan Stock Exchange (Chung & Luo, 2008) found that business groups with pyramid structures are created to reduce agency costs and that these are also given some institutional context. However, for Attig, Fischer and Gadhoum (2002), based on a study done in Canada, found that when generating these types of structures there are agency costs for small shareholders and benefits exist for the controlling family, as well as having lower financial performance than companies that are totally independent.

Another study by Kuhnen (2009) mentions that business groups can mitigate agency conflicts by facilitating the transfer of information efficiently, suggesting that the effects of a pyramid structure give better oversight of the board of directors and increase the possibility of collusion, but does not improve the results for shareholders. Therefore, the following hypothesis is proposed:

H_2. The concentrated ownership structure impacts the performance of the business group.

METHODOLOGY

To verify the hypothesis of the present investigation, a longitudinal analysis of panel data was developed,[1] which is longitudinal with the objective of being descriptive and explanatory. Thirty-nine business groups with a total of 3443 subsidiaries were analyzed in a period from the year 2012 to 2015. The business groups were chosen for having made some foreign investment

[1] Statistical tool where a set of observations are analyzed within a certain period; said set includes both transverse and longitudinal observations.

during that period. The information was obtained from EMIS Emerging Market and the reports published on the Mexican Stock Exchange.

Measurement of Variables

Dependent variables: to measure the performance of the business groups, financial indicators were used with a lag period ROA, ROE, ROS. To avoid yearly fluctuations we used one-year delay of Return on Assets (ROA), Return on Equity (ROE) and Return on Sales (ROS) at time t – 1 (Gaur & Kumar, 2009; Kuhnen, Peng, Yang & Liang, 2011; Masulis, Pham & Zein, 2011; Chang & Rhee, 2011).

Independent variables: the natural logarithm of FDI measured in millions of dollars and concentration of ownership measured in percentage of ownership (Chung & Chan, 2012; Khanna & Palepu, 2000). In addition, the variables, size of the company (revenue); age (years of company life); and the use of the acquisition and merger strategy (number of foreign subsidiaries), were taken into account (Kumar, Gaur & Pattnaik, 2012).

RESULTS

To develop the panel analysis, it is necessary first to analyze the inflation factor of the variance which is necessary to prove that there is a low collinearity (Gaytan-Cortes, 2016). This must be between 1 and 10 to accept this criterion, as shown in Table 1.

TABLE 1: VIF FOR EVERY MODEL

Variables	ROA		ROE		ROS	
	VIF	1/VIF	VIF	1/VIF	VIF	1/VIF
LNFDI	1.30	0.767237	1.70	0.586880	1.70	0.586880
Concentrated ownership	1.17	0.857448	1.10	0.908964	1.10	0.908964
Company size	1.28	0.779355	1.67	0.597565	1.67	0.597565
Age	1.22	0.818887	1.16	0.864328	1.16	0.864328
M&A	1.19	0.837208	1.19	0.840039	1.19	0.840039
Mean VIF	1.27		1.30		1.30	

Source: Authors' elaboration with EMIS Emerging Market data and the Mexican Stock Exchange.

After testing the use of collinearity, we went on to analyze each of the models to test our hypotheses. We used the regression model with the panel data analysis in each of the models and found that concentrated ownership has a negative value, with a significance level of 0.10. With respect to the variable ROA and ROE, we observed that the foreign direct investment strategy has a negative relation with ROS with a level of significance of 0.01. The merger and acquisition strategy has a negative relationship, but with only a significance level of 0.10, while the size of the company has a positive and significant relationship to 0.01 with ROS (Table 2).

TABLE 2: REGRESSION MODELS WITH PANEL DATA

Variables	ROA	ROE	ROS
Constant	-4.137159**	-3.434681***	0.1677565*
LNFDI	0.000037	0.0002335	-0.0002967 ***
Concentrated ownership	-0.8251186*	-2.207283*	-0.1169114
Company size	0.0569991	-0.000000000495	0.0000000023***
Age	0.009668	0.0058554	-0.0015423
M&A	-0.1690103	0.4849286*	-0.1978045*
Number of observations	156	156	156
Number of groups	39	39	39
Chi square	7.77*	8.56 *	21.94 ***
R^2	0.14	0.22	0.15

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

CONCLUSIONS

The findings of this research draw conclusions similar to Attig et al. (2002) who state that concentrated ownership has negative effects on performance since it causes agency costs. This contradicts other authors who have found the opposite to be true (Masulis et al., 2011; Chung & Luo, 2008). It is well known that the M & A strategy is most commonly used by multinational companies in emerging countries. This cannot be said to affect performance of a company since it does not have seem to have a very significant effect, as found in previous studies (Gaur & Kumar, 2009; Gaur, 2010; Kumar et al., 2012; Ganguli, 2007; Peng, Yang & Liang, 2011).

The above reflects the need to continue with this line of research. This can be done by extending the period analyzed. There may also be some limitations, as it cannot be verified that there is a significant high relation with foreign direct investment. Therefore, other types of statistical analysis and qualitative analysis are necessary.

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