The Effects of Corporate Governance on Internationalization in Korean Firms: Focusing on the Moderating Effect of Ownership Concentration*

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This paper examines the effects of corporate governance on internationalization in Korean firms. Using the data from 454 Korean manufacturing firms listed in the Korean Stock Exchange (KSE) from 1999–2006, we analyzed the role of corporate governance on internationalization in Korean firms, including Chaebols (Korean business groups) and family firms. In addition, we investigated the moderating effect of concentration of ownership on internationalization. The results of the analysis showed a positive association between corporate governance in Chaebols and family firms and internationalization. Interestingly, the influence of ownership concentration overpowered the ambivalent behaviors of Chaebols, leading to less internationalization. We conclude that corporate governance in Chaebols and family firms is important to internationalization strategy.

Keywords: Internationalization, Corporate Governance, Chaebol, Family Firm, Ownership Concentration

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기업지배구조가 한국기업들의 국제화수준에 미치는 영향: 소유지분 집중도의 조절효과를 중심으로

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본 연구는 1999년부터 2006년까지 한국 상장기업(제조기업으로 한정) 454개사를 대상으로, 기업지배구조(재벌기업, 가족기업 여부)가 기업의 국제화 수준에 미치는 영향을 소유지분 집중도의 조절효과를 중심으로 분석하고 있다. 실증분석결과 재벌기업과 가족기업의 기업지배구조는 기업의 국제화수준에 유의한 정(+)의 영향을 미치는 것으로 나타났다. 소유지분 집중도의 조절효과를 검증한 결과 소유지분집중도가 높을수록 재벌기업의 지배구조가 국제화 수준에 미치는 정(+)의 영향이 약화된다는 증거가 발견되었다. 하지만 소유지분 집중도가 가족기업의 지배구조와 국제화 간의 관계에는 아무 영향을 미치지 않는 것으로 나타났다. 이러한 분석결과는 재벌기업과 가족기업의 경우 그렇지 않은 기업보다 국제화에 긍정적인 영향을 미칠 수 있지만, 소유지분 집중도가 높은 경우 높은 위험회피 성향으로 인해 재벌기업이 국제화에 미치는 정의 영향이 약화될 수 있다는 것을 시사한다.

핵심용어: 국제화수준, 기업소유구조, 재벌기업, 가족기업, 소유지분집중도
I. Introduction

Many empirical studies have examined internationalization strategy in different countries. However, the impact of corporate governance on internationalization strategy remains unclear (Fernandez and Nieto, 2005; Lu, Xu and Liu, 2009; Filatotchev, Strange, Piesse and Lien, 2007; Peng, Wang and Jiang, 2008; Bhaumik, Driffield and Pal, 2010). The research related to this topic has mainly focused on state (Cui and Jiang, 2012) or family ownership (Fernandez and Nieto, 2006; Filatotchev et al., 2007; Luo, Chung and Sobczak, 2009; Bhaumik, Driffield and Pal, 2010; Banalieva and Eddleston, 2011). The findings of these few notable studies are inconclusive regarding the effects of corporate governance on internationalization (Lu, Xu and Liu, 2009). Therefore, our understanding of corporate governance and its relationship to internationalization is inadequate.

In the present analysis of corporate governance and internationalization, the corporate governance structure of Korean firms is examined. We focus on particular features of Korean business groups, known as Chaebols, such as their interlocking ownership structure and extensive strategies for diversification (Chang, 2003; Chang and Hong, 2000). In this study, family business operation is also examined as a common governance structure of firms in Korea (Kim and Lee, 2007). The effects of these distinctive but very different governance structures of Korean firms on internationalization behavior are investigated. In addition, we examine the interrelationship between corporate governance structure (such as Chaebols and family business operation) and concentration of ownership, and the influence of this interrelationship on internationalization. Empirical testing from this perspective has been neglected in most previous studies, although Bhaumik et al. (2010) and Lu, Xu and Liu (2009) are important exceptions.

In the following section, the relevant literature is reviewed and hypotheses are developed. The third section describes data collection, research methodology, and measurement of variables. The fourth section explains the results, and the last section describes the conclusions of this research.
II. Literature Review and Hypotheses

Studies on corporate governance have most often been conducted in developed countries such as the U.S. and U.K. (Peng et al., 2008). In those countries, corporate governance has frequently been characterized as dispersed ownership, in which ownership and control are separated and market-based financing and monitoring are external (Luo, Chung and Sobczak, 2009; Peng, Wang and Jiang, 2008). Recent studies have shown that corporate governance in emerging countries differs significantly from that in developed countries (Peng et al., 2008; Luo, Chung and Sobczak, 2009; Filatotchev et al., 2007; Kang, 2009). Specifically, ownership of firms in emerging economies is more concentrated; companies are often controlled by a family or founding families who make key strategic decisions. Alternatively, a group of family-headed member firms may coordinate efforts within business groups (Filatotchev et al., 2007; Bhaumik, Driffield and Pal, 2010; Banalieva and Eddleston, 2011). These forms of corporate governance are discussed in more detail below.

1. Chaebols and internationalization

Korean business conglomerates, known as Chaebols, are owned and managed by founders and their families (Choi and Patterson, 2007). However, they are distinct from family firms in that Korean Chaebols exercise absolute control over company affairs despite minimal shareholdings (Shin, 2000). This form of ownership is referred to as interlocking ownership (Kim, 2003). In addition, the proportion of professional managers is higher in Chaebols than that in family firms (Lee et al., 1991).

From the resource-based viewpoint, productive resources are abundant in Korean Chaebol firms compared to non-Chaebol firms. Resource-based view suggest that the unique bundle of resources of a focal firm generate sustained competitive advantage (Penrose, 1959; Wernerfelt, 1984; Collis and Montgomery, 1995). Dierickx and Cool (1989) introduced the idea of strategic asset as a stock accumulated over a period of time. The same point of view, Barney (1991) emphasized that a strategic asset which can yield sustainable competitive advantage should be valuable, rare, imperfectly imitateable and nonsubstitutable. Following the perspective of RBV, the resources of Chaebol are history dependent,
causally ambiguous and socially complex (Barney, 1991), these strategic resources can not easily imitate by other firms it can play an important role for performance (Khanna and Rivkin, 2001; Douma, George and Kabir, 2006) and the internationalization of firms (Kumar, Gaur and Pattnaik, 2012; Hwang, 2013). Especially, these strategic resources performed more important role in the process of internationalization, as firms need to overcome the liability of foreignness in the foreign market (Zaheer, 1995; Gaur et al., 2011).

These strategic resources are embedded within the firms that make up the Chaebol (Park, Lee and Hong, 2011). For example, Korean Chaebols are composed of many independent member firms, including financial institutions, all of which may use subsidiary profit to repay their loans (Kim, 2003; Choi and Patterson, 2007), which implies special connections within and among the firms. Chaebols benefit from transacting business internally (Chang and Hong, 2000; Chang, 2003). Hence, Chaebol firms are usually at an advantage when accessing resources compared to non-Chaebol firms.

In contrast, non-Chaebol firms may lack resources to establish operations abroad due to limited technology, marketing knowhow, and prior international experience (Park, Lee and Hong, 2011). Therefore, international expansion differs between Chaebol firms and non-Chaebol firms. Thus, we hypothesize as follows:

**Hypothesis 1:** Korean Chaebol firms will be more internationalized than non-Chaebol firms.

2. Family firms and internationalization

The arguments and results of previous empirical studies showed both negative (Fernandez and Nieto, 2005; Bhaumik et al., 2010; Luo, Chung and Sobczak, 2009) and positive relationships between family operation of firms and internationalization (Sciascia et al., 2012; Eddleston and Kellermanns, 2007; Zahra, 2005) in comparison with non-family firms. The literature on family-run businesses has approached these relationships from two competing perspectives: stewardship theory and the stagnation perspective (Sciascia, Mazzola, Astrachan and Pieper, 2012; Claver, Rienda and Quer, 2009).

According to the stagnation perspective, family firms may have growth difficulties and struggle for survival due to resource restrictions, conservative strategies chosen for stability, and family conflicts (Sciascia et al., 2012). Results of previous studies indicated that family firms often do not choose to
internationalize their operations due to lack of resources and the capabilities essential to build competitive advantage in international markets (Fernandez and Nieto, 2005; Fernandez and Nieto, 2006). In fact, most empirical studies found a negative relationship between family operation of firms and internationalization (Fernandez and Nieto, 2005; Bhaumik et al., 2010; Gomez-Mejia, Makri and Larraza-Kintana, 2010; Luo, Chung and Sobczak, 2009). Therefore, based on the stagnation perspective, the following hypothesis was developed.

Hypothesis 2a: Korean family-run firms will be less internationalized than non-family firms.

However, according to the stewardship perspective, the impact of family involvement in corporate operations on internationalization is positive. In family firms, long-term survival of the firm is a priority; therefore, investment decisions are made for the benefit of all family members and firm longevity. This is called stewardship over continuity (Sciascia, Mazzola, Astrachan and Pieper, 2012). Family firms seek to grow for future generations (Banalieva and Eddleson, 2011). Therefore, if the owner views internationalization as relevant to the firm’s long-term survival, the firm may go abroad, even if the immediate benefits of internationalization are minimal and perceived risks are relatively high (Sciascia, Mazzola, Astrachan and Pieper, 2012). In fact, internationalization is valuable for the long-term growth of firms (Lu, Xu and Liu, 2009). In order to survive, firms must adopt new strategies in each generation; internationalization may be such a strategy (Claver, Rienda and Quer, 2009). Therefore, in line with the stewardship perspective, family firms may be expected to engage in internationalization as a reasonable strategy despite the risk. So far, based on the stewardship perspective, the following alternative hypothesis was developed.

Hypothesis 2b: Korean family-run firms will be more internationalized than non-family firms.

3. The moderating role of ownership concentration

Previous research suggested an association between ownership concentration within a firm and its degree of risk aversion (Bhaumik et al., 2010). Firms with higher levels of ownership concentration tend to be more risk-averse (Lu et al., 2009). Bhaumik et al. (2010) provided evidence of a negative impact of ownership concentration on firms’ strategic behavior, including overseas investment.
Ownership concentration affects the wealth of large shareholders who are involved in decision-making (Bhaumik, 2010; Lu et al., 2009). If the ownership concentration is high, the owners tend to choose low risk strategy (Liu, Li and Xue., 2011). Since internationalization is related to risk due to a great uncertainty stemmed from differences in operational environments (Luo and Shenkar, 2011), ownership concentration would have impact on the relationship between corporate governance and internationalization. In case of owners of family firms typically have more of their wealth tied up in the operations of the business. Hence, they are more risk-averse than owners of non-family firms (Fernandez and Nieto, 2006).

In this study, most Korean listed firms were family-controlled firms, including those with Chaebol membership. In these firms, families and their affiliates own a large proportion of shares and have significant influence over management decision-making. We hypothesize interrelationships between corporate governance and ownership concentration in Chaebols and family firms. We argue that ownership concentration offsets the positive relationship between Chaebol membership and international expansion.

**Hypothesis 3a:** The level of ownership concentration negatively moderates the impact of Chaebol membership on internationalization.

**Hypothesis 3b:** The level of ownership concentration negatively moderates the impact of family firm ownership on internationalization.

### III. Methodology

#### 1. Sample

The sample in this study included Korean manufacturing firms listed on the Korean Stock Exchange (KSE) from 1999 - 2006. The panel dataset consisted of time-series observations of 454 cross-sectional units including 3632 firm-year observations. The sample included firms from 23 manufacturing industries based on the Korean Standard Industry Classification (KSIC). We constructed the

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1) Concentrated ownership is common among family firms. However, these two concepts should not be treated as synonymous, since ownership concentration is founded in other forms of organizations (Bhaumik, et al., 2010).
dataset from several sources. Data on corporate governance and financial performance of Korean listed firms were drawn from the Korean Information Service, the Korean Listed Companies Association (KLCA), and the TS2000 database, which was compiled by the KLCA.

We chose Korea as the research setting for several reasons. First, Korea’s economy is classified as an emerging economy that has successfully progressed to an advanced emerging economy (Kim, Kim and Hoskisson, 2010; Park and Yang, 2011). Although Korea is still evolving on the path toward development, its economy has become a role model for many other emerging economies. Accordingly, our understanding of international expansion by Korean firms may have important implications for firms from other countries with emerging economies such as Brazil, Russia, India, China, and South Africa (the BRICs nations). Second, after the Asian financial crisis in late 1997, several market-oriented institutional changes have occurred involving market liberalization and corporate governance reforms in Korea. In particular, the Korean government, led by Kim Dae Jung, initiated a set of structural reforms that induced firms to adopt global standards in corporate governance and structure (Kim, Kim and Hoskisson, 2010; Chizema and Kim, 2010). In adopting corporate governance models originally utilized by firms from developed countries, Korean firms have made substantial changes from past methods of corporate governance. Also, the global financial crisis in 2008 that began in the U.S. has had great influence on the Korean economy. Because of the recession that had begun in 2007, the Korean economy slowed down prior to 2008. Therefore, taking the starting sample period from 1999 to 2006 is an appropriate time to investigate the effects of ownership structure on internationalization of Korean firm, since the turbulent financial crisis effects on Korean firms can be avoided.

2. Dependent variables

1) Internationalization

Following the methods used in previous research, the degree of internationalization was measured as the ratio of foreign sales to total sales (Yoon and Rhee, 2007; Sullivan, 1994; Kim, Kim and Hoskisson, 2010). This ratio is a well-established measure of internationalization (Fernandez and Nieto, 2005; Carpenter, Pollack and Leary, 2003).
3. Independent variables

1) Chaebols

Chaebols were identified as the largest Korean business group affiliates which are listed by the Korea Fair Trade Commission. All other firms were classified as non-Chaebols (Chang, 2003; Lee, Beamish, Lee and Park, 2009). The Korean listed firms that were members of those Korean business group affiliates were then identified (Kim, 2011). A dummy variable was used to identify firms as belonging to Chaebols (1 = Chaebol and 0 = other firms).

2) Family firms

Following the standard criteria used in the literature on family businesses, firms were considered family firms if the following two conditions were met: if a family was the largest shareholder in a firm, and if a family member was CEO or President (Fernandez and Nieto, 2005; Jones, Makri and Gomz-Mejia, 2008; Luo et al., 2009; Bhaumik, Driffield and Pal, 2010; Peng, Wang and Jiang, 2008; Banalieva and Eddleston, 2011). We constructed a dummy variable that takes the value of 1 if both of conditions were met. Those firms that did not meet both criteria were considered non-family and coded as 0.

3) Ownership concentration

Ownership concentration was measured by the percentage of stocks owned by the largest shareholder, including stocks owned by family members (Kim, 2007).

4. Control variables

To control for other exogenous effects on internationalization, we included firm age, sales, marketing capability, R&D capability, board size, outside director (OD) ratio, foreign investment, industry competition, and industry dummy variables.

Firm age was measured by the number of years since the establishment of the firm (Bhaumik et al., 2010). R&D capability was measured as expenditures related to research and development divided by total sales (Sanders and Carpenter, 1998;
Marketing capability was measured as annual expenditure on advertising divided by total sales (Delios and Beamish, 1999; Park and Hennart, 2004). Total sales were included as a control for firm size (Chang, 2003) and is measured by the amounts of sales revenue per each firm (Lee and Rugman, 2012).

Board size was calculated by the number of people on the board of directors (Kim, 2007). The OD ratio was measured as the number of directors from outside the firm divided by the total number of directors on the board (Lu, Xu and Liu, 2009). Foreign investment was measured as the percentage of shares owned by foreign investors (Lu, Xu and Liu, 2009). Debt ratio was measured as a firm’s debt-to-equity ratio (Chang, 2003; Kim, 2007).

Industry competition was measured by the number of competitors compared to the overall number of firms in each industry (Park, 2007; Lee, Beamish, Lee and Park, 2009). Potential industry effects on firm internationalization were controlled (Lee, Beamish, Lee and Park, 2009). This study includes top two industry dummies (chemistry, metal) by using four-digit Korean Standard Industrial Classification codes (Choi, Lee and Park, 2009), to control for unobserved influences on firms’ internationalization.

IV. Statistical Analyses and Test Results

The panel data used in this study spans 8 years, thereby increasing the chances of heteroskedasticity and autocorrelation. The regression model was estimated using the generalized least squares (GLS) procedure (Finkelstein and Hambrick, 1990), instead of pooled ordinary least squares (OLS). GLS can overcome the problems of heteroskedasticity and serial correlation and has been suggested as the most appropriate method by which to test panel data (Dielman, 1980). Independent and control variables were observed in year $t$ and internationalization was observed in year $t+1$.

<Table 1> presents the descriptive statistics and correlations for all variables. Variation inflation factors were computed to check for multicollinearity, and were found to be within acceptable range. Values for all variables were much lower than the recommended cutoff of 10 (Chatterjee et al., 2000; Kim, Kim, & Hoskisson, 2010).

<Table 2> presents the results of the GLS regression analysis. Model 1
included all control variables. Among these, the estimated effect of firm size, foreign investment, OD ratio, industry competition were positive and significant and found to be positively related to internationalization. These results are consistent with those of previous studies (Elango and Pattnaik, 2007; Lu, Xu and Liu, 2009; Chizema and Kim, 2010). Marketing capability was negatively associated with internationalization, possibly due to its location-bound nature (Lee, Beamish and Lee, 2009).

Model 2 tested the main effect of the key independent variables (Chaebols and family firms). The coefficients of these variables were positive and significant (p < 0.001, p < 0.01, respectively). These findings support Hypotheses 1 and 2b, which suggested that Chaebol membership and family operation of firms would be positively associated with internationalization.

Model 3 shows that the interaction between Chaebol membership and internationalization was negative and statistically significant (p < 0.1). Hence, Hypothesis 3a was supported. However, the interaction between family operation of firms and internationalization was insignificant. Thus, Hypothesis 3b was not supported.
<Table 1> Descriptive Statistics and Correlations

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<td>1. FSTTS</td>
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<td>2. Firm age</td>
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<td>-0.071**</td>
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<td>3. R&amp;D capability</td>
<td>0.01</td>
<td>-0.039</td>
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<td>4. Marketing capability</td>
<td>-0.333**</td>
<td>0.176**</td>
<td>1.427**</td>
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<td>5. Firm size</td>
<td>0.95**</td>
<td>0.011</td>
<td>0.057**</td>
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<td>6. Debt ratio</td>
<td>-0.018</td>
<td>-0.068**</td>
<td>-0.435</td>
<td>-0.036**</td>
<td>-0.015</td>
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<td>7. Foreign investor</td>
<td>0.098**</td>
<td>-0.009</td>
<td>0.025</td>
<td>0.100**</td>
<td>0.389**</td>
<td>-0.133**</td>
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<td>8. Board size</td>
<td>0.103**</td>
<td>0.133**</td>
<td>0.036</td>
<td>0.032</td>
<td>0.306**</td>
<td>-0.032**</td>
<td>0.200**</td>
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<td>9. OD ratio</td>
<td>0.184**</td>
<td>-0.036</td>
<td>0.021</td>
<td>0.050**</td>
<td>0.351**</td>
<td>0.096**</td>
<td>0.222**</td>
<td>0.063**</td>
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<td>10. Industry competition</td>
<td>0.041</td>
<td>-0.019</td>
<td>0.035</td>
<td>0.030</td>
<td>0.037**</td>
<td>-0.040**</td>
<td>0.013</td>
<td>-0.005</td>
<td>0.029</td>
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<td>11. Chaebol</td>
<td>0.209**</td>
<td>-0.094**</td>
<td>0.074**</td>
<td>-0.040**</td>
<td>0.357**</td>
<td>0.071**</td>
<td>0.300**</td>
<td>0.120**</td>
<td>0.306**</td>
<td>0.16**</td>
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<td>12. Family firm</td>
<td>0.087**</td>
<td>0.012</td>
<td>0.049</td>
<td>0.086**</td>
<td>0.090**</td>
<td>-0.096**</td>
<td>-0.033</td>
<td>0.061**</td>
<td>-0.011**</td>
<td>0.057**</td>
<td>0.176**</td>
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<td>Ownership concentration</td>
<td>-0.031**</td>
<td>-0.022</td>
<td>-0.055**</td>
<td>-0.058**</td>
<td>-0.105**</td>
<td>-0.206**</td>
<td>-0.012</td>
<td>-0.055**</td>
<td>-0.053**</td>
<td>-0.046**</td>
<td>-0.018</td>
<td>0.038**</td>
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Mean: 29.3055 31.84 0.00263 0.00945 62.05066 0.06075 0.5307 10.3738 6.13 0.10 35.16 0.78 33.0398
S.D.: 29.912 14.187 0.00938 0.02050 57.92643 0.18185 0.2926 15.3341 5.686 0.25 18.307 0.370 17.8304
min: 0.0005 1 0.0000 0.0000 31.00000 0.00028 0.01 0.0115 0.01 0.0 0 0.01
max: 99.9 1.08 211.200 1484 578.32359000 0.0 27.4788 92.97 132 0.333 67 1 1 95.68

Source: ** p < 0.01, * p < 0.05 (2-tailed). FSTTS: the ratio of foreign sales to total sales; R&D: research and development; OD: outside director.
The first hypothesis posited that firms belonging to Chaebols would be more internationalized than non-Chaebol firms. This hypothesis was supported by the results of this study. The second hypothesis expected that Korean family firms would
be more internationalized than non-family firms. Although the results supported these hypotheses, these findings were opposite to those in most studies on family businesses. Therefore, further examination and theoretical explanation should be investigated. The third hypothesis postulated a moderating role of ownership concentration on internationalization of firms belonging to Chaebols and family-operated firms. The results showed a negative moderating effect of ownership concentration on the relationship between corporate governance and internationalization in Korean firms.

V. Conclusion

In this paper, the internationalization behavior of Korean firms was examined with a particular focus on the connection between corporate governance and internationalization. We analyzed the role of corporate governance in Chaebols and family firms on internationalization of Korean firms. Also, we investigated the moderating effect of ownership concentration on internationalization. The key variables expected to impact internationalization of Korean firms were investigated using data from 454 Korean manufacturing firms listed on the KSE from 1999 - 2006.

The results showed positive associations of membership in Chaebols and business operation by families with internationalization. Interestingly, the influence of ownership concentration overpowered the ambivalent behaviors of Chaebols, leading to less internationalization. More specifically, we have found out evidence that corporate governance which includes Chaebols and family firms gives the positive effect on Korean firm’s internationalization. Furthermore, we considered a moderating effect of ownership concentration on the relationship between corporate governance and internationalization. As a result, the positive relationship between Chabols as a corporate governance and internationalization was significantly declined when the ownership concentration is high. As previous studies have indicated that a firm with high level of ownership concentration has a strong tendency to avoid risk. However ownership concentration dose not have any influence over the relationship between family firm as a corporate governance and internationalization. We conclude that corporate governance structure must be considered an important factor affecting internationalization
strategy, as evidenced by its influence on internationalization in the Chaebols and family firms included in this study.

This paper makes a number of contributions to the literature. First, corporate governance was confirmed as an important factor affecting internationalization strategy. Second, the interrelationship between corporate governance structure (such as that in firms belonging to Chaebols and family firms) and ownership concentration and its influence on firms’ internationalization has been neglected in previous studies. The findings of the current study may therefore provide useful insights into the interaction of corporate governance and ownership concentration and their joint effect on internationalization behavior of firms.

Despite its contributions, this study also has a number of limitations and suggests directions for future research. First, the research context limits the findings. Conducting research in only one country may limit the generalizability of its findings to some degree. Second, some theoretically important variables may have been omitted from the analysis. Thus, future research should include additional variables to explain the relationship between corporate governance and firms’ internationalization behavior and strategies. Third, Chaebols have a characteristic that group affiliates hold cross and complicated share each other. However, this study does not reflect this characteristics of Chaebols. Therefore, future research need to be considered the characteristics of cross and complicated share holding between Chaebols’ affiliates. Fourth, even though the ratio of foreign sales to total sales is a well-established measurement of the degree of internationalization, the future research should consider other comprehensive measure of internationalization.
References


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