

Globalization and International Capital Raisings

A new study explores the characteristics and behavior of firms that raise capital abroad

Financial globalization over the last two decades has revolutionized international and corporate finance and a historically unprecedented magnitude of capital flows today across international borders. The amount raised by firms in foreign markets has grown almost fourfold since 1991, and approached one trillion US dollars in 2005.

In spite of these developments, fundamental questions about the internationalization of capital markets remain unanswered. Why do firms sell stocks and bonds in foreign markets? How do issues of securities in foreign markets affect firm performance? How do firms that raise capital abroad distribute their capital raising activity between domestic and international markets?

Gozzi, Levine and Schmukler explore these questions through an analysis of firm-level data from 116 countries collected during 1991–2005. Unlike most empirical and theoretical work on financial globalization that ignores debt markets, this study looks at both equity and debt issuances in domestic and international capital markets, and offers the following key insights on patterns of international capital raisings:

- *Internationalization is restricted to a small set of firms, and capital raising activity is highly concentrated within a small fraction of such firms.* Only 14.5 percent of the firms issued securities outside their home market during the survey period. The top 10 percent of the firms accounted for 69 percent (54 percent) of the total capital raised abroad by developed (developing) country firms.

- *Debt issues dwarf equity issues as a source of capital for firms.* In addition, bond markets tend to be more internationalized than equity markets. Debt issues in public markets accounted for 80 percent of the total amount raised through security issues during the survey period.

About 35 percent of all capital raised through debt issues was acquired in a foreign market, compared to only 8 percent of all capital raised through equity issues.

- *“Internationalized” firms do expand and invest significantly more after raising debt or equity abroad relative to non-internationalized counterparts, but experience a long-term decrease in growth and profitability.* Thus firms became bigger but not necessarily “better” following internationalization. Moreover, these changes in firm performance are qualitatively similar to changes that followed equity and debt issuance at home, which suggests that issues in international markets are not intrinsically different from issues in the domestic market.

- *Firms not only continue but expand use of domestic debt and equity markets after they raise capital abroad, although they use foreign markets for relatively larger issuances.* A typical firm in the developed (developing) world that raised capital abroad accounted on average for 0.1 percent (0.3 percent) of the total capital raised in its domestic market each year prior to internationalization, and this share subsequently rose to 0.3 percent (0.5 percent). The authors argue that a possible reason why firms prefer to use both domestic and international markets and do not opt out of the former is that the two markets may provide different services: firms will access one or the other depending on their particular financing needs and market conditions.

These findings call into question the explanatory power of existing theories of internationalization and corporate finance. For instance, the argument that capital raisings in international markets are intrinsically different from capital raisings in domestic markets predicts improved firm performance after internationalization, potentially through adoption of better corporate governance systems. The present study finds, however,

that issues in international markets do not appear to lead to performance outcomes that differ significantly from those following issuances at home.

Another view maintains that international markets offer unambiguously better services and/or less expensive capital than local markets. However, this idea is inconsistent with the finding that firms increase participation in domestic capital markets after raising capital abroad, and do not opt out of these markets. Similarly, the argument that price conditions in international securities markets drive a firm’s decision to raise capital abroad does not fully explain why only a small fraction of firms in these data raises capital abroad.

These findings underscore the need for additional research in a number of areas. What factors drive the internationalization of debt markets? How does simultaneous participation in multiple debt and equity markets affect corporate financing choices? What are the implications of the finding that, following internationalization, “internationalized” firms account for a higher percentage of the total capital raised in domestic markets, and how might this affect the ability of smaller firms to obtain financing for growth?

Firms became bigger but not necessarily “better” following internationalization

Juan Carlos Gozzi, Ross Levine and Sérgio Schmukler. Forthcoming. “Patterns of International Capital Raisings.” *Journal of International Economics*.