Globalization of Capital Markets: Implications for Firm Strategies

Igor Filatotchev, City University London

R. Greg Bell, University of Dallas

Abdul A. Rasheed, University of Texas at Arlington

ABSTRACT

The integration of international capital markets makes it easier for firms to access capital outside of their home countries. To date international business (IB) scholars have developed a rich tradition of research on how globalization of product markets may affect a firm's organizational form and business strategy. Unfortunately, there is a paucity of studies that explore the challenges firms face in capital markets beyond their domestic boundaries, be it equity, debt, or venture capital markets. The objective of this Special Issue is to address these theoretical and empirical gaps in prior IB studies. This paper outlines the main differences between product and capital markets, and explores theoretical and empirical challenges these differences present for international management scholars. We also provide a brief summary of papers in the Special Issue and outline promising avenues for future research.

1. Introduction

The increasing integration of global capital markets now makes it easier for firms to access capital outside of their home countries. Firms access international capital markets through a variety of means such as initial public offerings (IPO), seasoned equity offerings (SEO), cross-listings, depository receipts, special purpose acquisition companies (SPACS), shelf offerings, private equity and other informal equity capital channels. Firms can also access debt resources outside their market through bank loans, and foreign bond issues. For example, foreign firms raise significantly more debt than equity in the U.S. Indeed, the largest component of the international capital market is the bond market (Lau and Yu, 2009). Finally, cross border flows of venture capital (VC) continue to increase rapidly (Tykvová and Schertler, 2014). Venture capital and private equity have truly become global phenomena and take many forms such as cross-border investment, foreign acquisitions, VC firms opening offices overseas, and influencing their portfolio firms to enter and exit international stock exchanges. Further, other global investors such as Sovereign Wealth Funds (SWFs) manage large portfolios that are diversified not only with regard to different asset classes but also across many nations and geographies.

Research on the motivation, the processes, the supporting mechanisms, and the diverse range of outcomes that firms experience as a result of entering international capital markets is extremely limited so far. We believe such research can draw from a variety of theoretical perspectives and research traditions in international business. The choice of whether to access financial resources outside of the firm's home market, how to select the appropriate foreign market, and the manner in which to raise resources, are all relevant questions that parallel prior international business (IB) research on market and entry mode choice (Datta, Hermann and Rasheed, 2002; Kogut and Singh, 1988; Anderson and Gatignon, 1986).

While IB research continues to evaluate the challenges facing firms in foreign product markets, scholars have yet to adequately address the underlying reasons why firms face challenges in foreign equity markets. These include share underpricing, higher underwriting and professional fees, higher listing fees, audit fees (Bronson, Ghosh, and Hogan, 2009), greater risk of lawsuits (Bhattacharya, Galpin, and Haslem, 2007), and home bias on the part of investors (French and Poterba, 1991). Further, research suggests the existence of a "foreign firm discount" relative to host market firms (Frésard and Salva, 2010). IB scholars consider liability of foreignness (LOF) as the "fundamental assumption driving theories of the multinational enterprise" (Zaheer, 1995: 341). Yet, the conceptualization and research on LOF solely based upon product market may be inadequate today given the increasing integration of capital markets (Bell, Filatotchev, and Rasheed, 2012).

Although IB scholars have developed a rich tradition of research on how globalization of product markets may affect a firm's organizational form and business strategy, there is a paucity of studies that explore the challenges firms face in capital markets beyond their domestic boundaries, be it equity, debt, or VC markets. The objective of this Special Issue is to address these theoretical and empirical gaps in prior IB studies. In this Introduction article, we first outline the main differences between product and capital markets, and then explore the theoretical and empirical challenges these differences present for international management scholars. We also provide a brief summary of papers in the Special Issue and discuss promising avenues for future research.

2. Differences between product and capital markets

As Bell et al. (2012) pointed out, factor markets, including capital markets, have distinctively different characteristics compared to product markets, and this may have profound implications in terms of theory building related to the globalization of capital markets. While a full elaboration of these differences is beyond the scope of this paper, the most significant differences are in terms of information production, types of goods traded, the nature of the ongoing linkage between the firm and the buyer, information intensity, information frictions, and sources of arbitrage. Table 1 provides a summary of these differences.

Insert Table 1 about here

First, the information production environments differ between product and capital markets. Capital markets can be largely considered as mediated markets (Pollock, Porac, and Wade, 2004) in the sense that participants rely greatly upon key third parties, such as investment banks, brokers, and investment analysts for information production. Indeed, intermediation is a necessary and inevitable response to costly market imperfections (Campbell and Kracaw, 1980). Second, product markets involve the trading of consumption goods, whereas capital markets engage in the buying and selling of investment and debt products. Over time, most consumption goods typically tend to depreciate in value. In contrast, the expectation for investment products is that they will appreciate in value. While the seller's reputation is important in both product and capital markets, the expectations that reputation produces in the buyers' mind are significantly different. In product markets, buyers associate reputation with the quality and durability of goods. Investors in stocks, bonds and other capital market instruments, however, associate issuers' reputation with expectations about streams of future dividend and interest payments in addition to potential appreciation of the value of their investments over time.

Product and capital markets also differ in terms of linkages and connections between buyers and sellers. In the case of product markets, although the relationship between a buyer and seller may influence a purchase decision, once the purchase is completed the buyer's focus is mostly on the product itself and the utility one derives from it rather than the producer. In contrast, the connections between the issuers and buyers of capital market securities continue long after the transaction. For example, equities represent residual claim rights that are enforceable as long as the firm exists. Similarly, debt instruments involve scheduled payments of interest and loan principal over a specified period of time. The underlying value of the securities that an investor holds is affected positively or negatively on an ongoing basis by the actions and decisions of the issuer. Yet another difference between product and capital markets is in terms of information intensity. In product markets information collection by the buyer is mostly a one-time effort that occurs prior to the purchase. In comparison, capital markets are far more information intensive. Information collection is an ongoing activity that occurs both before and after the purchase. The prices of capital market instruments constantly change reflecting new information that becomes available. The behavior of the investors in terms of their decision to buy, hold, or sell are affected by the availability of information or lack thereof.

Further, capital markets are characterized by frictions that are diverse and widespread, affecting virtually every transaction in some way, although finance theory traditionally assumes it away. By friction we mean anything that interferes with trade. The major types of frictions include transactions costs, taxes and regulations, asset indivisibility, and agency and information problems (DeGennaro, 2005). Each generates real costs for investors and causes them to deviate from theoretically optimal behavior. Although product markets also have frictions, their sources are very different. For example, costs stemming from transportation and storage are two of the main sources of product market frictions. Finally, trading in product markets essentially involve arbitrage in space, whereas trading in capital markets involves arbitrage in time. This brief account of differences between product and capital markets, although far from being exhaustive, clearly points out that theories and frameworks that IB scholars have developed to study the process of globalization and its consequences for individual firms, cannot be directly applied when one considers internationalization of capital markets.

3. Implications of differences between product and capital markets for key theoretical frameworks

Given the significant differences between product and factor markets, it is not surprising that researchers have different theoretical foci when applying mainstream theories to these two distinctive contexts, such as agency and institutional theories, resource-dependency framework and transaction cost economics (TCE). Table 2 provides a brief summary of these differences.

Insert Table 2 about here

As Buckley and Strange (2011) argue in their review article, internalization theory is a key theoretical framework that underpins many IB studies of internationalization in product markets. Internalization theory is rooted in the work of Coase (1937), who sought to explain the existence of the firm as an institution, and why the firm came to supersede the market. Coase (1937) argued that there were transaction costs in effecting exchanges through the market, and that the firm would emerge if the costs associated with organizing these exchanges within the firm were lower. Such costs included *inter alia* those concerned with defining property rights, and those associated with the formulation, negotiation, monitoring and enforcement of contracts (Buckley and Strange, 2011). Internalization theory (Hymer, 1968; Buckley and Casson, 1976; Rugman, 1981; Tomassen, Benito, and Lunnan, 2012) emphasizes the relative costs and benefits of coordinating related economic activities internally by the management of a firm rather than externally through the market (Buckley and Strange, 2011). A parallel literature has focused on the theory of the domestic firm, and has given rise to the transaction costs economics (TCE) paradigm in which the works of Williamson (1985) and Klein et al (1978) have been particularly influential. Both view the firm, domestic or MNE, as an alternative governance structure to the market. And both focus on crafting governance structures which economize on the *ex post* transaction costs of coordinating the activities of the various parties.

When the TCE framework is applied to capital markets the focus is not on how firms can minimize costs associated with production and distribution on global product markets but rather with how firms can minimize costs related to the acquisition of production factors such as capital, that are available globally. Such issues as selecting foreign stock exchanges for the firm's equity, foreign buyers of the firm's debt, and achieving high level of liquidity of its financial assets overseas have become focal points of TCE-grounded studies of global capital markets.

The two main theoretical approaches to international diversification – resource-dependency theory (RDT) and the resource-based view (RBV) - assume that the most efficient firm strategy will be that which maximizes the rents from the firm-specific assets and thus maximizes the long-run value of the firm (Buckley and Strange, 2011). The role of management in such theories is essentially to identify and implement this efficient strategy. The RDT perspective extends these arguments further and suggests that a successful internationalization strategy should also aim at minimizing the firm's dependency on external transactional parties such as suppliers of key inputs and buyers of the firm's products. The IB research on capital markets adds new dimensions to this analysis by focusing on how firms can take advantage of global capital markets to minimize its dependency on local capital providers.

Agency theory is the field where differences in theoretical approaches to product and capital markets are particularly acute. In the context of corporate governance research, Filatotchev and Wright (2011) indicate that since degree of internationalization of the firm's product markets is an important determinant of the complexity it faces, the firm's strategy will depend on its ability to deal with information asymmetries and the potential agency conflicts associated with overseas ventures. Different risk preferences of managers and shareholders may lead to differences in their strategic objectives, leading to a need for a complex governance contract to align their interests rather than governance structures that solely focus on minimizing the costs of effecting a transaction. In the context of firms tapping international capital markets, however, theoretical emphasis shifts towards information asymmetries between the firm and its overseas investors, and possible agency problems associated with adverse selection in the context of valuations of the firm's assets.

Institutional theory has been widely deployed in both product and capital market studies, but here too we find a number of subtle differences in theoretical emphasis and focus. Studies of international product market diversification build on the observation that successful international expansion must be associated with at least some type of non-location bound firm-specific advantages (FSAs). These are FSAs that can be transferred, deployed and exploited across borders. However, this transfer may be materially affected by institutional and cultural differences between the firm's home and host countries. Sociological and institutional perspectives on financial market behavior suggests an alternative theoretical approach to the role of macro-institutions by arguing that capital market reactions to firm-level financing strategies are institutionally embedded (Bell, et al., 2014; Zajac and Westphal, 2004). From this perspective, market perceptions of the firm's actions are an outcome of investors' perceptions of its legitimacy rather than rational, efficiency-centered investor decisions (Filatotchev, Chahine and Bruton, 2016). *Legitimacy* is the "generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate, within some socially constructed system of norms, values, beliefs, and definitions" (Suchman, 1995: 574). Thus, in the setting of uncertainty associated with the process of capital raising, investors tend to focus on institutionalized rules (also called institutional logics) when evaluating the quality of financial products offered by firms (Pollock, Fund, and Baker, 2009). These rules are formed by macro-institutions that frame the process of investor assessment of the firm.

Given imperfect information and limited information processing capacity, IB studies in the product market domain based on the knowledge-based view (KBV) of the firm are focused on the need to deal with problems associated with bounded rationality (or 'scarcity of mind', Verbeke and Asmussen, 2016). For example, lower compounded distance, suggests greater intra-regional similarities. This extends to similiarities among country environments and similiarities among the configurations of firm-level activity sets conducted in the relevant countries. These similiarities function to reduce spatial transaction costs, and foster a home-region strategy approach (Verbeke and Asmussen, 2016). Scholars suggest that these similarities could be in the form of regulatory commonalities at the institutional level, or similar quasi-identical firm level activities (e.g. human resource management practices, customer service activities) (Verbeke and Asmussen, 2016). As a result, bounded reliability (or 'scarcity of making good on open ended promises') challenges inside the home region can also be substantially reduced vis-à-vis outsider regions (Verbeke and Asmussen, 2016). Firms adopting established and widely accepted routines and heuristics when making decisions can also be much more effective than in high compounded-distance environments (Verbeke and Asmussen, 2016).

The fundamental differences between product and capital markets shift focus of KBV towards exploring liability of foreignness in the capital market context, referred to as CMLOF (Bell, Filatotchev and Rasheed, 2012) Increasing evidence suggesting the existence of LOF in capital markets comes from a body of research in finance that demonstrates that investors in both developed and developing markets strongly prefer to invest in domestic firms rather than foreign firms in capital markets (Ke, Ng, and Wang, 2010). This "home bias puzzle", first documented by French and Poterba (1991) and Tesar and Werner (1995) is one of the major research questions in international finance and economics (for a review see Obstfeld and Rogoff, 2000). The existence of home bias in finance markets clearly suggests that foreign firms face disadvantages while trying to access resources in foreign capital markets, compared to local firms. Research in IB has long recognized that firms face liabilities of foreignness when competing abroad (Denk, Kaufmann, and Roesch, 2012; Maruyama and Wu, 2015; Newburry, Gardberg, and Sanchez, 2014). However, IB research has been slow to provide a comprehensive theoretical explanation for the disadvantages that firms face in foreign capital markets, or to offer solutions that firms can use to overcome them.

To summarize, capital and product markets differ significantly in terms of information environment, time structure of transactions, and linkages between buyers and sellers, which suggests that the process of internationalization and its impact on individual firms in the two markets may be different. Further, if there are indeed fundamental differences in the sources of LOF between product and capital markets, then researchers need to re-think possible solutions foreign firms may deploy to minimize these liabilities. To address these theoretical challenges, we also need to re-consider our applications of key research frameworks that have been widely used in IB research, including TCE, RBV/RDT and institutional theory. In the following sections, we outline a few key areas for research that may extend the existing boundaries of studies on globalization and its impact on the firm's strategy.

4. Directions for research on the strategic implications of the globalization of capital markets

The firm-level implications of the globalization of capital markets present IB researchers with a number of avenues for exciting research in the years to come. In this section we identify a select set of research opportunities that seem most promising. We suggest that key research frameworks that have been widely used in IB research, including TCE, RBV, RDT and institutional theory, which we discuss in the prior section, should be considered as potential lenses to evaluate these areas of future research. The topics we have identified are by no means exhaustive. However, we hope it would help develop an understanding of the range and richness of research issues that remain to be explored.

4.1 Interactions between product and capital markets

Research in finance area suggests there are information spillovers from product markets to capital markets. This may have implications for both TCE and RBV theory building. In terms of empirical evidence, Kent and Allen (1994) indicate that high brand recognition serves as a focal point for information about companies. Frieder and Subrahmanyam (2005) found that individual investors prefer to invest in stocks with easily recognized products. Grullon, Kanatas and Weston (2004) found that a firm's advertising expenditures and thus its overall visibility leads to a greater number of both individual and institutional investors as well as better liquidity for their common stock. Chemmanur and Yan (2010) found that a firm going public with a greater extent of advertising in its IPO year is valued higher both in the IPO as well as in the immediate market. Another recent study by Keloharju, Knupfer and Linnainmaa (2012) found that investors are more likely to purchase and less likely to sell shares of companies they frequent as customers. Based on data from brokerage and automotive industries, they report a strong positive relationship between customer relationship, ownership of a company, and size of ownership stake.

From the TCE perspective, one possible explanation for these observed interactions between product and capital markets is that individuals use simple rules of thumb when making decisions under uncertainty (Kahneman and Tversky, 1982; Tversky and Kahneman, 1973) and that information about the brand and familiarity with the product are equated as information about the securities. The possibility of interaction between product and capital markets has been demonstrated in the international context as well. A number of studies show that greater trade between two countries results in increased cross-border asset holdings (Heathcote and Perri, 2004; Portes and Rey, 2005; Aviat and Coeurdacier, 2007; and Lane and Milesi-Feretti, 2004). While the above studies demonstrate the spill-over from product markets to capital markets, such spill-over is, by no means, unidirectional. Research by Sarkissian and Schill (2004) shows that firms raise capital in countries where their products are known. They found that "trade has an important effect, in that firms that are relatively more familiar to foreign investors before the listing benefit more by the listing" (p.4). Singh, Faircloth and Nejadmalayeri (2005) found that higher advertising expenditures lead to lower cost of capital and thus higher performance. Peress (2010) suggested that because products trade in imperfect markets and equity shares in perfect markets, firms are able to use their monopoly power to insulate their profits which in turn encourages stock trading and improves allocation of capital.

On the other hand, cross-listing can have multiple benefits, including bolstering the firm's competitive position in its industry, as well as heightening the firm's brand recognition, and reputation with suppliers, employees, and customers (Pagano et al., 2002). This adds new interesting dimensions to the analysis of firm resources and related competitive advantages within the context of RBV. Fanto and Karmel (1997) report that managers of foreign companies cite industry-specific reasons as the main motivations for U.S. listing. That is, firms may decide to raise capital abroad so that their products can become better known in foreign markets. Thus, the choice to list abroad, as Bancel and Mittoo (2001) suggest, maybe an important aspect of the global business strategy of firms.

Although the research on the interactions between product and capital markets is still in its early stages, it provides several important insights. First, it is clear that managers view product and capital markets as linked and they actively try to take advantage of these linkages by reducing information costs of transactions. Second, consumers of products and services are also investors in stocks and therefore this interconnectedness exists in their minds as well providing a new perspective on the context of firm resources. Third, there exists a two-way relationship between firms' product and capital market strategies. Therefore, differences between product and capital markets, as well as their inter-connectedness, provide a foundation for further theory building within the context of TCE and RDT as indicated in Table 2.

Although disciplinary boundaries have separated product and capital market strategies into distinct silos, it is encouraging to see that researchers in marketing and finance are becoming increasingly interested in the multiple ways in which the two markets interact. The increasing integration of global capital and product markets challenges IB researchers to further explore the implications of these interactions.

4.2 Stock exchange competition and listing choice

Leading stock exchanges around the world are engaged in fierce competition to attract more foreign firms to list with them. Such competition has made it easier for firms to make a choice among multiple exchanges. Not only are more and more countries establishing stock exchanges (Weber, Davis and Lounsbury, 2009), they are also trying to attract foreign firms to list with them. Today there are fewer technical barriers to trading in newer exchanges. Also, the securities markets are considerably more liberal. As a result, national stock exchanges do not maintain the monopoly advantages that they have historically enjoyed.

Competition among stock markets may have interesting implications for both stock markets themselves and for firms deciding to list with them. One of the explanations for cross-listing from the TCE perspective (Table 2) has been that it enables firm to overcome market segmentation and tap into trapped pools of liquidity in distant markets (Coffee, 2002). This explanation is no longer considered valid because capital can reach any market in an era of globalization of capital markets. Instead, "bonding" seems to be a superior explanation. That is, firms list in an exchange with higher disclosure standards, better private and public monitoring, and stronger enforcement than their home-country capital markets in order to signal better governance. However, this explanation leaves us with a number of questions. First, if bonding is the main driver of foreign listings, why is it that many countries are establishing alternative exchanges with lower disclosure requirements? Second, if foreign listing through bonding results in higher valuation and lower cost of capital, why is it that only a small percentage of firms actually do so? Coffee (2002) offers an interesting explanation for the second question. He argues that cross-listing firms have higher growth prospects than firms who do not list abroad and are hence seeking more capital even if it comes at the cost of some of the private benefits of control. Thus differences in the need for capital and control may result in the continued existence of specialized markets to accommodate both types of firms. Third, what prevents public companies from seeking exchanges with the lowest disclosure standards and minority shareholder protection? Theoretically at least, it seems possible that while some firms may indeed be engaging in bonding, others may be doing exactly the opposite. Each of these questions requires further investigation which may extend boundaries of TCE-grounded research.

Heightened competition among stock exchanges has elevated decisions about which markets to enter and the choice of entry mode to be one of the most important decisions that managers seeking equity or debt resources can make. Market choice and entry mode choice are just as important in capital markets as they are in product markets. Given the increasing choices a firm has among capital markets around the world and the multiple types of equity and debt instruments that are available to them, managers are faced with complex decision making situations. To argue that firms are merely trying to minimize the cost of capital from the TCE perspective is an oversimplification that provides very little understanding about this important strategic choice. In one of the first studies that examined capital market choice decisions, Pagano, Randl, Roell and Zechner (2001) found that European companies are more likely to cross-list in more liquid and larger markets, and in markets where several companies from their industry are already cross-listed. They are also more likely to cross-list in countries with better investor protection, and more efficient courts and bureaucracy, but not with more stringent accounting standards. Moore, Bell, Filatotchev and Rasheed (2012) advanced a comparative institutional perspective to explain capital market choice by firms making an IPO in a foreign market. By integrating agency framework with institutional theory, they found that internal governance characteristics and external network characteristics are significant predictors of foreign capital market choice by foreign IPO firms. Their results suggest that foreign IPO firms select a host market where the firms' governance characteristics and third party affiliations fit the host market's institutional environment. Gao (2011) found that foreign firms rely less on the U.S. public bond market after the implementation of the Sarbanes-Oxley Act. This suggests that a country's regulatory environment can have a significant impact on market choice by firms.

In the context of RBV, the array of choices that a firm has with respect to a "mode of entry" is significantly greater in capital markets compared to product markets. The primary choice is, of course, between debt and equity. However, within each of these categories, there are a multiplicity of alternatives. Within equity, important alternatives include foreign IPO, cross-listings, and depository receipts. In the debt market, choices include foreign bonds, Eurobonds, bank credit, and convertible bonds. Private capital of various kinds is also becoming increasingly important. The wide variety of alternative modes of entry underscores the need for capital market researchers to embark on a research trajectory that parallels the efforts made by product market researchers in the last thirty years.

There are a number of important research questions that require examination regarding the choice of mode of entry into a capital market. First, does the choice of market to enter determine mode of entry or does the causality work in the opposite direction? It is entirely possible that these decisions are neither independent nor sequential. It is equally likely that they evolve jointly. Second, decisions by individual firms may not be independent of decisions made by other firms. There may indeed be considerable isomorphism in the behavior of firms and later entrants are likely to follow what earlier entrants did. Third, one type of entry does not preclude other modes of entering the market subsequently. For example, Ball, Hall, and Vasvari

(2010) found that firms raise debt capital more frequently and issue fewer syndicated loans following an equity cross-listing. The internationalization theory originally advanced by the Uppsala school (Johanson and Vahlne, 1977) suggests that firms follow a stage model as they learn from low commitment entries and use this knowledge to increase their commitment at the subsequent stages. That is, the KBV perspective suggests that they start with low-involvement modes and incrementally move to higher involvement modes. A reasonable, KBV-grounded argument is possible that such behavior is likely in the capital markets as well, especially in the context of LOF in capital markets (Table 2). An initial equity listing, for example, may be a prelude to subsequent seasoned equity offerings, as the firm's LOF gradually declines. A longitudinal examination of the sequence in which a firm makes multiple attempts to tap into a foreign capital market and the determinants of this sequence represent an avenue for further research.

4.3 Corporate governance and capital market integration

The increasing integration of capital markets has profound implications for corporate governance research in general, and agency perspective outlined in Table 2 in particular. One argument is that the huge flows of capital, both debt and equity, across borders can bring about convergence in governance practices through the fundamental transformation in the ownership structure of corporations that result from such flows. The convergence thesis was originally presented by Hansmann and Kraakman (2001) who argued that convergence of governance practices of public corporations around the world is inevitable and that they will converge towards the Anglo-American model of shareholder value maximization. Some authors go so far as to suggest that the integration of financial markets is the primary driver of convergence of governance practices (Khanna and Palepu, 2004; Nestor and Thompson, 2000).

There are multiple mechanisms through which integration of capital markets can result in governance convergence (Yoshikawa and Rasheed, 2009). First, foreign listing may be a means by which firms from countries with lower disclosure standards and minority shareholder protection are bonding to the higher standards expected in foreign stock exchanges. There is no evidence that the presence of significant regulatory and compliance costs associated with cross-listing have discouraged the flow of foreign equity listings (Saudagaran and Biddle, 1995). Instead, there has been a significant increase in the number of firms that altogether forego their domestic equity markets and make their first issue of equity in New York or London (Chemmanur and Fulghieri, 2006). Although, on the surface, it would seem that firms would be motivated to list in countries with the least demanding regulatory requirements resulting in a 'race to the bottom', the observed pattern, however, is exactly the opposite (Coffee, 2002). Thus, entry into foreign capital markets, either through cross-listing or IPOs, can potentially result in convergence as a byproduct. Second, the fear that flight of domestic firms into foreign exchanges may drain their exchanges of liquidity can cause national exchanges to create higher disclosure standards.

National governments may also try to pass legislation requiring higher levels of minority protection in order to stem migration of local firms to foreign exchanges. These steps can also lead to greater convergence in governance practices. Third, there has been a substantial increase in foreign portfolio investment in most regions of the world (Useem, 1998). Foreign investors typically own relatively small stakes and trade their shares frequently (Davis and Steil, 2001). Most firms find it desirable to attract foreign institutional investors because the resulting demand for the stock can drive up stock prices and increase firm valuation. However, it is not possible to attract foreign investors without complying with their expectations of good governance in matters such as disclosure and respect for the rights of minority shareholders. The only way to attract and retain foreign investors is to live up to their expectations of good governance (David, Yoshikawa, Chari, and Rasheed, 2006). Finally, cross-border mergers and acquisitions (Yildiz, 2014. Yang and Hyland, 2012) are yet another mechanism that can potentially lead to convergence. Listing in a foreign exchange may often be the prelude to acquiring firms in that country through stock swaps. When a firm from one country is acquiring a firm from another country, it is inevitable that the new entity will exhibit at least some of the governance characteristics of its country of origin. This, in turn, leads to increasing convergence in governance practices.

4.4 Sovereign wealth funds

The growing importance of new types of investors, including sovereign wealth funds (SWFs), adds new dimensions to research on the governance roles of global investors in general, and agency research in particular, as we indicated in Table 2. Although SWFs have been around for a long time, in recent years we have seen an unprecedented growth both in terms of their scale and scope. SWFs differ from traditional investment funds in a number of ways including their ownership, strategic objectives, time horizon, capacity to bear risk, and transparency. There is, however, very little research on SWFs (Butt, Shivdasani and Wyman, 2008; Knill, Lee and Mauck, 2012) and even less on their effects at the firm level. The very fact that these funds are owned by governments introduces a political dimension to investment decisions unlike in the case of traditional investment funds. Given that a substantial amount of the investment of SWFs take place outside the home country, international relations also play a part in investment decisions. Because governments are not under pressure to show short term returns, these funds can have very long time horizons. Many of the investments may have strategic objectives which are far more important for the government than immediate financial returns such as control over scarce raw materials, access to emerging technologies, or desire to change the structure of an industry. There are also security and strategic implications that stem from foreign government control of important sectors of a country's economy. Traditionally, researchers have viewed governments and markets as distinct entities but when governments begin to play such an important role in the market as a critical resource provider, it has significant implications for firm strategies and outcomes. The activities of SWFs are also less subject to public scrutiny because of limited disclosure requirements and because of their ability to channel their investments through intermediate investment vehicles. The investment choices of SWFs, strategies followed by firms to either attract or deter investment by SWFs, and the longer term strategic, financial, and governance consequences at the firm level resulting from this new type of capital presents a fertile area for future research.

4.5 Culture and capital markets

There has been increasing recognition in recent years, in particular within the context of neo-institutional research, that culture affects both economic exchange and outcomes by affecting expectations and preferences. A new stream of literature in economics, for example, has been examining the effect of culture on economic and political outcomes (Alesina, and Giuliano, 2013; Guiso, Sapienza, and Zingales, 2009; Tabellini, 2010; Ahern, Daminelli, and Fracassi, 2015). Culture can affect economic behavior through mechanisms such as trust or by being part of the overall concept of distance. Because culture plays an important role in economic exchange, it is only natural that cultural differences between countries will have a significant impact on a wide variety of cross-border economic transactions.

Few concepts in international business have attracted as much application in diverse areas of research as cultural distance (Hofstede; 1980; Kogut and Singh, 1988; Sousa and Bradley, 2006). While the impact of cultural difference on the activities of individuals and firms has received considerable research attention, the role of culture is increasingly being recognized for its influence on investor behavior. Research evidence also suggests that culture affects capital market decisions by firms in equity and debt markets as well as in informal capital markets. These arguments provide novel dimensions to the institutional perspective in IB research by suggesting that capital market strategies may be framed not only by underlying efficiency models but also by differences in cultural, macro-institutional factors that underpin institutional logics in different capital markets (Filatotchev et al., 2016) as indicated in Table 2.

Grinblatt and Keloharju (2000) found that investors are more likely to hold, buy, and sell the stocks of firms that are located close to the investor, that communicate in the investor's native tongue, and have chief executives of the same cultural background. Similar results have been reported in a number of subsequent studies. Morse and Shive (2007), for example, found that cultures with high levels of patriotism have larger proportion of their investments allocated at home. Anderson et al. (2011: 930) found that "culture impacts investor behavior directly" even after controlling for geographical distance and regulatory differences. Chui, Titman, and Wei (2010) found that cross-cultural differences in terms of individualism versus collectivism are related to trading activity levels and security pricing across countries. Further evidence of culture's impact on investor behavior is provided by Beugelsdijk and Frijns (2010) who find that societies with higher levels of individualism invest more in foreign equities and that more uncertainty avoiding societies are associated with lower levels of foreign equity investment. Chan, Covrig and Ng (2005) find that when a country is more remote from the rest of the world and has a different language, foreign investors are reluctant to invest in that country. On the other hand, when a country is more developed, larger in market capitalization, and has lower transaction costs, foreign investors are more likely to invest there. Thus, the weight of cumulative research evidence suggests that contrary to economic theory, investor behavior is not entirely rational and that cultural factors affect investor rationality.

Cultural factors play a role not only in the behavior of investors but also in the decisions of firms in terms of their activities in capital markets. Dodd, Frijns and Gilbert (2013) found that firms cross-list in markets with greater cultural similarities, because investors are more willing to invest in culturally familiar firms and also because managers seek to avoid potential conflicts with culturally disparate investors and managers. This is in line with an earlier finding by Sarkissian and Schill (2004) who also found that cultural proximity plays an important role in the choice of a firm's overseas listing venue. In a study of international bond markets, it was found that greater cultural difference between U.S. investors and foreign issuers increases the cost of debt (Zhu and Cai, 2014). Even a firm's preference for short-term versus long-term debt has been empirically found to be related to cultural factors (Zheng, El Ghoul, Guedhami, and Kwok, 2012). Culture plays a role in the venture capital markets as well. Nahata, Hazarika and Tandon (2014), for example, found that cultural distance between countries of the portfolio company and its lead investor positively affects VC success because cultural differences create incentives for rigorous ex ante screening, improving VC performance. Even in informal capital markets culture is a significant factor. A recent study by Burtch, Ghose, and Wattal (2014) found that online crowdfunding lenders prefer culturally similar and geographically proximate borrowers.

The functioning of capital markets is far more dependent on trust than product markets, making institutional perspective a particular powerful heuristic lens for theory building. Because quality of products can be verified reasonably accurately prior to purchase in the case of physical products, customers feel less need for trust. In the absence of such easy verifiability, capital markets typically resort to a variety of mechanisms to make markets function. One such mechanism is the creation of formal institutions that substitute for trust (Pevzner, Xie, and Xin, 2015). Another approach is for firms to engage in actions that signal trustworthiness. But these approaches work only up to a point because the level of trust in society is to a great extent a cultural characteristic. Guiso, Sapienza and Zingales (2008) found that level of trust is related to amount of trade, portfolio investment, and direct investment. Lack of trust inevitably leads to an increase in transaction costs.

Given the increasing recognition of the role of culture in determining the behavior of participants of capital markets, IB researchers need to pay greater attention to its implications for firm's financing decisions in global capital markets. Country specific factors could also play a key role in determining the capital structure of firms. Indeed, the globalization of capital markets makes capital market choice and the choice of an appropriate capital structure even more complex because firms now seek capital from multiple capital markets with differing norms and regulations.

4.6 Institutional distance, the role of technology, and regulatory arbitrage

Despite the fact that technology has liberated modern finance from geography, geography still matters in a number of ways. Modern financial markets cluster in a relatively small number of concentrated communities which in turn leads to a high level of social connectivity (Carruthers and Kim, 2011). Together, geographic proximity and social connection result in herding and bandwagon behaviors as well as rapid diffusion of innovations and practices. Social connectivity also plays a central role in the venture capital arena where much of the information transfer takes place through informal channels facilitated by social connections. It can be argued that integration of capital markets and the introduction of technology can potentially reduce the social texture of financial markets. On the other hand, it is also possible that technology enables relationships to develop more easily across vast distances and that social connectivity can exist despite spatial separation.

The high spatial concentration of financial markets seems to have some implications for availability of capital to firms in the peripheries. Klagge and Martin (2005) found that capital markets do not function in a space-neutral way and that dispersed markets such as in Germany are far more likely to fund small and medium enterprises than geographically concentrated markets such as UK. If we generalize these results to global capital markets, it raises the possibility that firms coming from countries that are far removed from major financial centers may have less access to global markets even in an era of integrated capital markets.

Ghemawat (2001) has made a strong argument that distance still matters. He has also argued that distance needs to be conceptualized as multi-dimensional and not just as geographic distance. Additional dimensions of distance may include cultural, economic, and administrative distance. If pronouncements about the death of distance are indeed premature, it can be argued that potential for arbitrage still exists. What integration of product markets did in the last few decades was to create greater possibilities for arbitrage because in the final analysis, all international trade is arbitrage across space. According to this logic, integration of capital markets should also lead to similar additional possibilities for arbitrage. That is, market integration does neither make distance irrelevant nor diminish possibilities for arbitrage. Ghemawat (2007) points out that contrary to public perception, even in our globalized economy, arbitrage is a source of both competitive advantage and above normal profits because both labor and capital markets are specialized at the level of location. Global capital markets indeed show a very high level of specialization. US capital markets, both venture capital and equity markets draw Israeli biotechnology companies because of their specialization in biotechnology. Similarly, London has a strong history of mining company listings. Taiwan's higher trading volume, liquidity and P/E ratios have led many overseas firms to list in that market. However, another important consideration has been Taiwan's expertise in supply chains and R&D capabilities (Bell and Rasheed, 2016). Specialization of capital markets, in turn, implies that firms have to make conscious choices about which markets to go to for raising equity and debt capital (Moore, Bell, Filatotchev and Rasheed, 2012).

From TCE perspective in Table 2, although arbitrage is mostly understood in terms of cost differences across spatial and temporal distances, the integration of capital markets also raises the possibility of 'regulatory arbitrage'. For example, capital markets around the world are subject to varying degrees of legal requirements relating to disclosure, shareholder protection and compliance. Integration of capital markets are not accompanied by standardization of regulatory requirements across countries and this offers firms with an opportunity for regulatory arbitrage. Firm responses to arbitrage opportunity can potentially go in two diametrically opposite directions. First, there can be a "race to the bottom" whereby firms gravitate towards capital markets with minimal regulation and enforcements. Second, firms can engage in "bonding" (Coffee, 1999). That is, they can choose to list their stocks in foreign exchanges with higher standards of investor protection and monitoring than their home markets (Bell, Filatotchev and Rasheed, 2012). Such listing can serve as a credible signal of better governance to investors and result in higher valuation. Examination of the managerial choice process between bonding and racing to the bottom and its implications for various stakeholder groups presents opportunities for additional research.

5. Research on the implications of capital market integration for firm strategies

The purpose of this Special Issue is to bring together the growing community of scholars in international business who are beginning to address the implications of capital market integration for firm strategies. As large pools of capital are chasing investment opportunities around the world, managers have been able to greatly expand the options they have for sourcing capital. The integration of product markets gave companies the options to expand their sales around the world in search of new markets in an earlier era. Starting the 1980s, the global dispersion of the value chains of multinational firms in search of lower costs led to the globalization of production operations (Denk, Kaufmann, and Roesch, 2012). The globalization of capital markets presents a new set of opportunities and challenges for managers of both multinational and domestic firms. The contributions of researchers in this special issue clearly suggest that a growing number of IB researchers are beginning to explore the many research questions presented by the globalization of capital markets. The articles in this issue explore issues relating to cost of capital, interrelationships among operational and financial strategies, international investments by SWFs, cross-listing of equity shares, and international venture capital.

Lindorfer and d'Arcy (2016)'s study of foreign listing by European firms is an interesting addition to the literature on the interaction between product and capital markets. Their results suggest that managers do not make capital sourcing decisions solely based on cost of capital considerations. Instead, choices about capital and product markets potentially influence each other and evolve jointly. Their finding that ex ante host-market operational activity influences the foreign-listing decision but that a foreign listing does not necessarily lead to higher ex-post host-market operational activity suggests that there is greater likelihood of financial spillover than operational spillover. This asymmetry between financial and operational spillovers is intriguing, but not entirely surprising. It suggests the possibility that liabilities of foreignness in capital markets are higher than in product markets and prior operational presence can reduce some of the problems related to unfamiliarity.

The paper by Lindner, Müllner and Puck (2016) investigates the role of institutional quality, institutional distance, and institutional dynamics in capital markets. Their specific focus is on cost of debt, specifically the impact of FDI on a firm's cost of debt. By developing a framework of institutional influences and their interdependencies on the cost of debt, they demonstrate the relevance of the institutional perspective in financial markets. Their results also suggest that in evaluating the costs and benefits of investment into a country, MNC managers need to take into consideration the impact it may have on the overall cost of the firm's debt.

SWFs are ushering in a new era of state capitalism, blurring the boundaries between finance and politics (Aguilera, Capapé, and Santiso, 2016). Murtinu and Scalera's (2016) paper sheds light on the somewhat opaque world of sovereign wealth funds and their investment strategies and is indicative of the growing research interest on the strategies followed by SWFs. Their analysis of SWFs is more fine-grained than prior studies because they distinguish between different types of investment vehicles and attempt to predict a firm's choice among them by examining deal specific, SWF-specific and country-specific antecedents.

Temouri, Driffield, and Bhaumik (2016) examine cross-listing by emerging market firms. Based on a sample drawn from Indonesia, Mexico, Poland, and South Africa, they try to identify the characteristics of firms that cross-list and evaluate the benefits they derive from cross-listing. Cross-listing is both a signaling and a bonding mechanism. It signals that a firm is well governed and that it is willing to bond to the demands of a more developed market. The study finds that the benefits of cross-listing are greater for informationally opaque firms and those that have incumbent foreign shareholders. Interestingly, it was found that the benefits from bonding decline with improvement in the quality of home institutions of the firms.

The focus of Khavul and Deeds (2016) is on explaining how networks of actors develop in an emerging VC market, one in which both domestic and foreign VCs are active. They explore how domestic and foreign VC syndicate partners select each other for their *initial co-investment* by examining observable economic and social signals, captured as investor experience and conferred status. They find that in the absence of dense local networks, existing industry focused networks and overlapping knowledge bases become important in the decision of with whom a VC is going to co-invest. They also find evidence for path dependence in VC entry into an emerging VC market.

CONCLUSIONS

In this article, we have summarized the findings of the papers presented in this special issue and outlined an agenda for further research on the globalization of capital markets and its implications for theory building and empirical research in a number of areas of IB research. The articles contained in this special issue contribute to addressing some of these challenges but many other challenges remain. The analysis in this paper has identified a number of research questions and issues we believe are important because currently we do not have theoretically and empirically adequate answers to address them. While there have been important global developments in capital markets and finance, systematic research on the strategy and governance aspects of the international dimensions of factor markets remains under-developed. We have identified a number of important themes that will both help our understanding and also provide an evidence base for policy-makers and regulators at both national and international levels. In conclusion, for the same reason that internationalization strategy practice pushes the frontier in strategic thinking, an integration between finance and IB research, both as an opportunity and as a necessity, is challenging conventional wisdom in academic thinking and theories. We are confident that a new generation of scholarship pursuing some of the future research questions outlined in this Special Issue will widen the trail blazed by the papers included here.

Table 1 Distinctive Characteristics of Product Market and Capital Markets

	Distinctive Characteristics of Product Market and Capital Markets	
	Product	**Capital**
Informational Production Environments	Dispersed	Concentrated
Types of Goods Traded	Consumption goods	Investment goods
Buyers and seller linkages	Linkages until the point of sale	Linkages beyond the point of sale
Information Collection Intensity	Collection at a single point in time	Collection and dissemination is continual
Information Frictions	Similar to Capital market PLUS transportation and storage	Transactions costs, taxes and regulations, asset indivisibility, and agency and information
Source of Arbitrage	Arbitrage in space	Arbitrage in time

Table 2 Product Market and Capital Markets: Key Theory Frameworks

	Globalization of markets and theory focus	
	Product markets	**Capital markets**
Transaction Cost (TCE)	Minimization of transaction costs; Internalization vs externalization	Liquidity of the firm's financial assets; Costs of capital
Resource dependency theory (RDT)	Resource orchestration and configuration; bargaining power of buyers and suppliers	Choice of capital markets; Investors' "home bias"
Agency theory	Headquarters/subsidiary relations; Agency problems of multi-point competition	Adverse selection; Misappropriation of capital
Institutional theory	Effects of economic, cultural and institutional distances	Differences in institutional logics of capital markets
Knowledge based view	Bounded rationality and bounded reliability	Liability of foreignness in capital markets (CMLOF)

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