Foreign Divestment and the Insolvency Risk: Evidence from Nordic Firms[☆]

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Abstract

This study examines the relationship between the foreign divestment and insolvency risk of parent firms, by using a large sample of Nordic firms over the period from 1992 to 2019. By integrating resource-based view theory (RBV) with foreign divestment literature, we examine how the insolvency risk of parent firms is influenced by the foreign divestment due to the loss of valuable resources. Our study employs both traditional, Merton's distance to default measure, and innovative credit default swap (CDS) spread, to proxy insolvency risk of the parent firms. We document a positive relationship between foreign divestment and insolvency risk of firms. We further argue that the relationship between foreign divestment and insolvency risk is moderated by the level of corporate social responsibility (CSR) activities performed by the parent firms.

JEL classification: G01, G33, G34, M14, M16

Keywords: Foreign divestment, Insolvency risk, RBV, CSR, Firm performance

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1. Introduction

"Even in good times there are bankruptcies, product failures, company restructurings, and the like." (Boddewyn, 1979, p. 21)

Increasing business opportunities motivate organizations to explore the potential of international markets, obtain valuable resources, and reduce the imperfections in their business operations, (Borda, Geleilate, Newburry & Kundu 2017; Contractor 2007; Hitt, Bierman, Uhlenbruck & Shimizu 2006; Gartland & Keane 2007). The internationalization of firms is commonly linked to outcomes that indicate firms' value, Return on Assets, and growth (e.g. Lin, Liu & Cheng 2011; Sapienza et al., 2006; Lu & Beamish 2001). This trend highlights the significance of global expansion for international firms. However, international growth is also associated with parent firms' risk of failure (Likitwongkajon & Vithessonthi 2022; Kim, 2011; Akbar, Akbar, Tang, & Qureshi, 2019). Contrary to this, is foreign divestment related to the parent firm's risk of failure? While the question we ask may appear simple, there is a limited understanding of this question in the existing body of research.

It has been found that even half of the established foreign subsidiaries are divested (Chung, Lee, Beamish, Southam, & Nam, 2013), as the coordination and management of foreign subsidiaries demand a significant number of resources (Bartlett & Ghoshal, 1998; Reuer & Leiblein, 2000; Tong & Reuer, 2007). In the international business (IB) literature, foreign divestments, their strategic motives, and contingencies have attracted very little attention compared to foreign direct investments (e.g. McDermott, 2010; Iurkov & Benito 2018; Tan & Sousa, 2018; Schmid & Morschett 2020).

We define divestment as, "the deliberate and voluntary liquidation or sale of all or a major part of an active operation" (Boddewyn, 1979), either through closure, sell off, split-ups, spin-offs, or equity carve-outs (Mulherin & Boone, 2000). During the internationalization process, many firms experience the divestment of their foreign subsidiaries (Chung, Lee, Beamish, Southam, & Nam, 2013). For instance, increasing international competition and quick business cycles force multinational organizations to regularly adapt their structure and corporate business strategy. This makes divestment an important strategic option for firms (Bowman & Singh, 1993; Harrigan, 1981).

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Researchers have used different terms in the existing literature as synonyms of the term 'divestment,' such as divesture, closure, exit, de-internationalization, dissolution, divestiture, disposition, disengagement, and disposal, among others. However, in this study, we categorize these various terms as divestment. This study specifically considers the impact of foreign divestments on insolvency risk of parent firms since foreign operations are more volatile than domestic ones and, thus, more prone to divestment (Boddewyn, 1979). Therefore, firms tend to divest foreign operations to achieve operational goals (Iurkov & Benito, 2020).

Divestments are often considered an admission of failure, especially when a subsidiary is closed (Benito 1997a, Benito 1997b). Foreign divestment also plays a significant role in relation to a parent firm's survival and insolvency risk, as it has the potential to impact numerous employees, suppliers, and other communities and firm stakeholders. These individuals may perceive the divestment actions as detrimental to their interests, and some may even consider it unethical (Harrison & Wicks, 2021). Insolvency is a state in which a parent firm is not capable of repaying its debts on time (Rashid Shamim 2019). However, finding literature on foreign divestment and its influence on the insolvency risk of a parent firm is challenging. As insolvency risk represents one of the most important concerns for key stakeholders like shareholders, debtholders, and customers (Rego, Billett & Morgan 2009; Campbell, Hilscher & Szilagyi 2008), it is of utmost importance to investigate the relationship between foreign divestment and insolvency risk.

In recent times, there has been widespread recognition of the strategic importance of corporate social responsibility (CSR) as the growth and survival of firms depend upon the ability of their managers to address the interests and demands of stakeholders (Aguilera et al., 2007; Freeman et al., 2007; King, 2008). Moreover, being sunk costs (Habib and Hasan, 2016; Sprinkle and Maines, 2010), CSR activities also play a major role in divestment decisions, as significant sunk cost investments discourage firms from divestment (Belderbos and Zou, 2009; Chen and Wu, 1996; Li, 1995; Mata and Portugal, 2000). CSR activities are also considered costly and resource-consuming (Zeng, 2021), making it difficult for firms to divest foreign operations with higher sunk costs (Bragger et al., 2003; Kumar, 2005; Miller and Folta, 2002). Therefore, it is also valuable to explore the moderating role of CSR activities on the relationship between foreign divestment and insolvency risk.

To better understand how divestments of foreign subsidiaries affect the stability of parent firms, our study analyzes two main aspects. First, we investigate how foreign divestment

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influences the insolvency risk of parent firms (RQ1). Although existing studies emphasize the impact of foreign divestment on parent firm performance (with no consensus), none explore how foreign divestment influences insolvency risk. Some researchers have also emphasized that divesting firms are usually low performers (e.g., Markides & Singh, 1997; Porter, 1987), while others found that even high-performing firms also engage in divestment (e.g., Kaul, 2012; Vidal & Mitchell, 2015). Thus, we believe it is essential and valuable to find out how the insolvency risk of the parent firm is affected by foreign divestments. Second, we investigate the moderating role of CSR activities on this relationship between foreign divestment and insolvency risk (RQ2). Third, in additional analysis, we also explore the role of parent firm size (RQ3) and how it influences the relationship in question. We test this framework on a large sample of firms from the four Nordic countries, including Finland, Sweden, Norway, and Denmark.

To measure insolvency risk, we employ both traditional methods (i.e., distance to default [DD]) and an innovative market-based measure (i.e., credit default swap [CDS] spread). We utilize DD and CDS spread because these measures are bondholder-facing and can also help illustrate how the divestment of foreign subsidiaries is perceived in the credit market. Our study goes beyond earlier research on insolvency risk by linking the divestment of foreign subsidiaries to the credit market reaction. We contribute to this debate by empirically examining whether the divestment of foreign subsidiaries affects the CDS spread for the parent firm. We also argue that a higher level of CSR activities by parent firms moderates the relationship between divestment and insolvency risk. Hilscher and Şişli-Ciamarra (2013) argue that a higher CDS spread may indicate the reallocation of wealth from bondholders to shareholders. Previously, Bolton, Mehran, and Shapiro (2015) used CDS spread to measure insolvency risk and suggested that it is preferable because it also accounts for creditors' risk (Colonnello, 2017; Feldhutter, Hotchkiss, and Karakas, 2016). Despite the considerable body of research that examines the role of CDS spread in understanding corporate finance issues, it is surprising that there exists a scarcity of studies investigating the connection between the divestment of international subsidiaries and CDS spread.

Using an unbalanced panel dataset of 119 Nordic firms spanning the period from 1992 to 2019, we find that foreign divestment in a given year is significantly and positively associated with the insolvency risk of its parent firm in the subsequent year. These findings indicate that foreign divestments contribute to the weakened financial stability of the parent

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firms. These results remain robust when alternative proxies of foreign divestment and insolvency risk are employed, and potential endogeneity bias is addressed through firm fixed effects and lagged independent variables. Additional analysis reveals that parent firms engaging in higher CSR activities and foreign subsidiaries' divestment experience notably increased insolvency risk. These results highlight the potential detrimental role of CSR activities in exacerbating the adverse effects of foreign divestments on a firm's financial well-being.

We make important contributions to the existing literature. First, this paper adds to the body of research on foreign divestment by utilizing the Resource-Based View (RBV) as a theoretical framework to analyze the strategic implications of foreign divestment on the insolvency risk of parent firms. From a resource perspective, firms may lose valuable resources due to foreign divestment, which can be crucial for obtaining sustainable competitive advantage. Since competitive advantage is vital for firm performance and survival, it is important to examine how foreign divestment may influence the insolvency risk of the parent firm. The RBV theory proposes that effective management of a company's resources is a fundamental component in establishing a sustainable competitive edge (Barney, 1991; Wernerfelt, 1984). These resources are considered valuable, scarce, not easily replicable, and non-substitutable, enabling them to generate a competitive advantage and enhance a firm's overall performance (Battisti, Nirino, Leonidou & Thrassou, 2022). On the other hand, it is crucial for a company not just to possess these resources but also to be an organization capable of effectively managing them (Battisti, Nirino, Leonidou & Thrassou, 2022).

Furthermore, while prior studies have predominantly focused on the relationship between foreign divestment and firm performance (e.g., Denning, 1988; Hillier et al., 2009; Brauer & Wiersema, 2012; Teschner & Paul, 2021), our contribution goes beyond by empirically examining the link between foreign divestment and insolvency risk. We also respond to the calls by researchers (e.g. Batsakis et al., 2023; Schmid and Morschett, 2023) by establishing the link between FD and firm performance. Our study stands as one of the pioneering efforts to relate foreign divestment with the potential failure of parent firms. Moreover, we delve into the moderating effect of CSR activities on the relationship between foreign divestment and insolvency risk.

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2. Theoretical Framework

2.1. Resource-based View (RBV)

Researchers have employed various theories to elucidate the motives behind firms' internationalization and their choices to pursue foreign divestment as a strategic option. Some researchers (e.g., Kotabe & Ketkar, 2009; Silva & Moreira, 2019) assert that foreign divestment theories remain relatively underdeveloped, primarily due to the challenges associated with collecting divestment data, whether qualitative or quantitative. We examine the phenomenon of foreign divestment through the lens of international business, using the Resource-Based View (RBV) framework introduced by Wernerfelt (1984).

The Resource-Based View (RBV) postulates that firms gain a competitive edge by effectively controlling and leveraging unique resources (Barney & Hesterly 2006). The origins of the Resource-Based View (RBV) can be traced back to the work of Penrose (1959) and Nelson and Winter (1982), suggesting that enduring qualities, often referred to as the firm's 'winning genes,' are rooted in the development of its most valuable resources and routines. This perspective was further elaborated upon by Barney (1991), explaining how these attributes are utilized to achieve above-normal sustainable performance. These resources are used in a way that leads customers to expect the most valuable products and services. When a firm manages to maintain a competitive advantage and unique conditions over time, it achieves a 'sustainable competitive advantage' with above-average returns (Barney & Hesterly 2006). These resources include a firm's assets, processes, capabilities, attributes, knowledge, information, etc. (Barney 1991). In the extended version of RBV (Mathews 2003), external resources such as law-making entities, customers, suppliers, etc., are also included.

Exporting a portion of a company's sales to international markets is considered a significant measure of competitive success, both on a national and regional scale (O'Farrell et al. 1996). Additionally, the capacity to participate in export activities is considered an essential element for the growth and survival of smaller and newer firms (D'Souza and McDougall 1989). Even though RBV and survival analysis have different emphases, both are rooted in performance, and a connection can be established between these concepts (Li, Shang, and Slaughter 2010). Since the effective utilization and control of unique resources provide a

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competitive edge, we explore how the loss of such resources due to foreign divestments may reduce the competitive advantage and increase the insolvency risk for parent firms.

2.2. FD, Firm Performance, and firm risk

Due to limitations in securing external capital from the financial market, parent firms often obtain funding by divesting their subsidiaries or business units (Kolev, 2016). This defensive strategy not only provides additional cash flow but also enhances the competitiveness of the firms (Kolev, 2016; Konara & Ganotakis, 2020). Researchers have found that divestment positively influences the performance of the parent firm (e.g., John & Ofek, 1995; Hanson & Song, 2003; Quigley and Hambrick, 2012; Brauer et al., 2017; Lee & Roh, 2020). Existing literature also highlights various positive reasons and outcomes of foreign divestment, including proactive restructuring (Hui et al., 2021; Kafouros et al., 2022), streamlining operations (Chakrabarti & Mondal, 2017), focusing on core business and reinvesting (Hui et al., 2021; Weng & Peng, 2018), increasing efficiency, competitiveness, and growth (Kafouros et al., 2022; Sohl & Folta, 2021), and avoiding political and economic instability (Liu et al., 2022).

On the contrary, divestment is also associated with failure (Berry, 2013; Crick, 2004), as it is linked with poor performance (Park & Russo, 1996). Foreign divestment creates negative stock returns as it reduces geographic scope, operational flexibility, and increases the market failure risk (Veld & Veld-Merkoulova, 2004). Brahmana et al. (2021) conducted a study in Malaysia on a sample of 319 non-financial publicly listed companies during 2012–2016 and found that the divestiture strategy decreased firm performance. Moreover, divestments carried out to address firm-level issues typically result in negative reactions in the stock market (Tsetsekos & Gombola, 1992). Similarly, when firms divest to alleviate bankruptcy issues, it does not benefit the firms (Francoeur & Niyubahwe, 2009). Thus, we believe it is extremely interesting to find out how the insolvency risk of parent firms is influenced due to foreign divestments. Unexpectedly, some scholars have also found an inconclusive relationship between divestment and parent firm performance and firm value (e.g., Duhaime and Baird 1987; Hoskisson et al. 1994; Shimizu & Hitt, 2005; Colak, 2010; Sharma & Ho, 2002). All in all, extant literature offers inconclusive results about the impact of divestment on parent firm performance.

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Based on the discussion, we conclude that foreign divestment causes performance volatility, which is widely acknowledged as a measure of risk (Woo, 1987; Miller & Bromiley, 1990; Bloom & Milkovich, 1998). Increased stock performance volatility is also associated with higher risk and negative outcomes (Low, 2009; Ang & Liu, 2007). Researchers have also found that higher performance volatility is linked with a higher risk of firm bankruptcy or credit issues (e.g., Merton, 1974; Kim, Kim & Pantzalis, 2001; Correia et al., 2018). Surprisingly, compared to divestment antecedents, existing literature has not given much attention to divestment outcomes (Mohr et al., 2020).

In the context of the resource-based view (RBV), scholars posit that the reduction of foreign operations may lead to a decrease in the financial resources of parent firms (Marshall et al., 2021; Luo et al., 2022). Moreover, foreign divestment (FD) can result in various challenges, including decreased cash flow, lower profitability, and an overall weak financial position of the firm. Other challenges can include costs and expenses (Mohr et al., 2020), a reduction in revenue and market share (Chen & Jorgensen, 2018), goodwill and intangible asset reduction (Chakrabarti & Mondal, 2017), and a loss in firm value (Marshall et al., 2021). Overall, these negative consequences of foreign divestments can significantly influence the insolvency risk of parent firms. However, the literature has overlooked investigating this relationship. Therefore, we find it very valuable to examine the relationship between foreign divestment and parent firm insolvency risk.

2.3. Role of CSR

Since 2010, after the issuance of ISO 26000 on CSR, most large organizations have been disclosing information about their CSR activities in their annual reports. Corporate social responsibility (CSR) is 'a concept whereby companies integrate social and environmental concerns into their business operations and their interaction with their stakeholders' (Commission of the European Communities 2001: 6). In the academic and business world, this definition is widely accepted (Park, Song & Lee, 2017).

Even though CSR and its influence on organizational performance have received scholars' attention (e.g., López-Arceiz, Bellostas-Pérezgrueso, Moneva-Abadía, & Rivera-Torres 2018; Miras Rodriguez, Carrasco Gallego, & Escobar Perez, 2014; Petrenko, Aime, Ridge & Hill 2016; Stanwick & Stanwick 1998), the results of these studies are inconclusive and ambiguous (Margolis & Walsh 2003; Mishra & Suar 2010; Oeyono, Samy, & Bampton

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2011). While some studies indicate a positive relationship between the two factors (e.g., Abu Bakar & Ameer 2011; Orlitzky, Schmidt, & Rynes 2003; Van Beurden & Gössling 2008), others reveal a negative relationship (Crisóstomo, Freire, & Vasconcellos 2011; Malcolm, Khadijah, & Ahmad Marzuki 2007). Aupperle, Carroll, and Hatfield (1985) are among those who have found no relationship.

The existing body of literature has widely recognized the challenges associated with the CSR of international firms (Husted & Allen, 2006; Arnold & Valentin, 2013). Firms realize that their success and even survival (occasionally) depend on the natural and social environment of their business market. Therefore, most international firms have a strategic approach to CSR activities and deploy resources to maximize 'shared value' (Bhattacharya et al., 2011; Porter & Kramer, 2006). Increased CSR activities result in increased financial performance and lower risk for parent firms (e.g., Pava & Krausz, 1996; Albuquerque et al., 2019; Cho et al., 2013; Harjoto & Laksmana, 2018) and bring positive reputation (Fombrun, Gardberg, & Barnett 2000). Conversely, firms with lower levels of CSR are more exposed to risk than firms with high CSR (Goss & Roberts, 2011; Minor & Morgan, 2011). Because CSR activities can yield goodwill and moral capital for stakeholders, leading to protection like an insurance to limit firms' risk exposures (Godfrey et al., 2009, Luo and Bhattacharya, 2006).

However, this may differ in crisis situations and unlikely events like foreign divestment, as firms do well when they do good (Lys et al., 2015). Managers can also overinvest in CSR activities for their personal interests (Kruger, 2015; Benabou & Tirole, 2010), which becomes particularly expensive during periods of crisis and has a damaging effect on the overall value of parent firms (Buchanan et al., 2018). They further found that American firms with high CSR exhibit increased firm values before financial crisis yet undergo more significant losses in firm value during the crisis. Noulas and Genimakis (2014) state that avoiding insolvency or bankruptcy, therefore, stands as the main goal of CFOs as they make capital structure decisions. Existing literature mainly focuses on how CSR affects firm performance and other financial outcomes (e.g., Gregory et al., 2014, Jo and Harjoto, 2012, Servaes and Tamayo, 2013). Yet, none of these studies investigate particularly how CSR activities might mitigate an unlikely scenario of insolvency risk resulting from international divestments. We propose that parent firms' foreign divestment and insolvency risk can provide an ideal context to explore the actual impact of CSR activities, as the role of CSR in firm risk is largely unexplored (Nguyen & Nguyen 2015).

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Hence, it is of utmost importance to establish the relationship between CSR and the insolvency risk of parent firms in the event of foreign divestments. Therefore, this paper contributes to the existing CSR literature by focusing on the insolvency risk phenomenon, whereas previous studies (e.g., Khan et al., 2016; Freeman et al., 2004; Bardos et al., 2020; Chen et al., 2018) have mainly focused on financial success, stock returns, or profitability. Following previous literature, we use environmental, social, and governance (ESG) scores from Thomson Reuters Eikon (now called Refinitiv Eikon) as a proxy to measure CSR (Gillan, Koch, & Starks, 2021; Shahbaz et al., 2020; Uyar, Abdelqader, & Kuzey, 2023).

3. Data and Variables

3.1. Sample and data sources.

Our main sample consists of publicly listed Nordic firms from 1992 to 2019. We chose 1992 as the starting point for our sample period because insolvency risk data from the National University of Singapore (NUS) is only available from that year onwards. We concluded the sample period in 2019 as our study does not consider the impact of the Covid-19 pandemic. Additionally, we included only those firms that underwent at least one foreign divestment in a given year. For the divestment data, following previous studies (e.g., Wang & Larimo, 2020), we began by manually collecting information on Nordic firms from the Thomson Reuters Eikon (now called Refinitiv) and Bureau van Dijk Orbis databases. Then, we performed a systematic analysis of the investing firms' annual reports, press releases, and data gathered via company surveys to collect information regarding the divestment activities. The divestment data is collected with the help of the University of Vaasa's Marketing and Communication Department. The data is also stored in the internal databank of the University of Vaasa which is extremely reliable and trustworthy databank. Lastly, firms were directly contacted as well to collect the divestment data.

We initially identified 153 publicly listed firms. We then merged this foreign divestment data with insolvency risk data collected from the Credit Research Initiative (CRI) database at NUS. This data was merged with the control variables data collected from the Orbis database by Bureau van Dijk. Finally, we eliminated the missing firm-year observations across all the variables and arrived at 967 firm-year observations for our final sample of 119 firms.

Furthermore, we collected environmental, social, and governance (ESG) data from the Thomson Reuters Eikon database to analyze the moderating role of CSR in the relationship

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between foreign divestment and insolvency risk. However, the CSR data is available from 2003 onwards. Therefore, the number of firm-year observations was reduced to 667. Appendix 1 provides detailed information on variables and data sources. The panel data were limited to investments made between 1990 and 2017 and foreign divestments that took place between 1992 and 2019. This ensures that all investments included in the sample survived for a minimum of two years, mitigating the sample bias arising from the honeymoon effect (Gaur and Lu, 2007; Wang and Larimo, 2020).

3.2. Measures of foreign divestment

Following previous studies (e.g., Pattnaik & Lee, 2014; Kang et al., 2017; Wang & Larimo, 2020), we employ the number of foreign divestments (No. of div) by a certain firm in a specific year as the metric for foreign divestment. In our additional analyses, we also utilize a dummy foreign divestment variable, which equals 0 if firms experience no divestment during a particular year and 1 otherwise.

3.3. Measures of insolvency risk

In this study, we employ market-based insolvency risk measures because they overcome the criticism of accounting-based models through the forward-looking nature of market data. These measures reflect expectations of a firm's future cash flows, making them more appropriate for prediction purposes (Beaver, McNichols, & Rhie, 2005). Consistent with prior studies (Ali et al., 2018; Kabir et al., 2020), we employ two proxies for insolvency risk. The main proxy for insolvency risk is the Credit Default Swap (CDS) spread. CDS are credit derivatives that allow the transfer of the firm's default risk between two agents for a predetermined time-period. In a typical CDS contract, the protection seller provides the protection buyer with insurance against the default of an underlying bond issued by a certain firm (the reference entity). If the reference entity defaults, the seller commits to purchasing the bond from the protection buyer for a price equal to its face value. In exchange for this insurance, the buyer pays a quarterly premium, known as the CDS spread, quoted as an annualized percentage of the insured notional value. A higher CDS spread indicates a greater insolvency risk.[1]

[1] CRI refers to the CDS spread as the "Actuarial Spread". The Actuarial spread is built using the traditional CDS design but without an upfront fee under the assumption that market participants are risk-neutral. Thus, actuarial

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The alternative proxy for insolvency risk is Distance-to-Default (DD), a concept originating from the structural credit risk model of Merton (1974). DD is a widely used measure for assessing the proximity of a limited-liability firm to insolvency (e.g., Duan, Sun, & Wang, 2012; Duan & Wang, 2012). It remains a widely employed market-based measure for insolvency risk and outperforms many accounting-based measures in estimating insolvency risk (Bharath & Shumway, 2008; Das et al., 2009; Duan et al., 2012; Duan et al., 2018; Miao et al., 2018). A higher DD indicates lower insolvency risk (i.e., greater firm stability). For methodological details on estimating DD, see the work by Duan et al. (2012).

3.4. Measuring control variables

Building on previous studies (e.g., Ali et al., 2018; Chiang et al., 2015; Schultz et al., 2017), we control certain variables that have the potential to influence insolvency risk. Specifically, we consider variables that could impact insolvency risk. First, we control firm size (SIZE), measured as the natural logarithm of total assets in millions of US dollars. Generally, larger firms are more stable and have a lower default risk. Thus, we anticipate a negative relationship between firm size and default risk. Second, we control leverage, defined as the ratio of total debt to total assets (TLTA). Leverage reflects the capital structure of the firm, indicating how a firm finances its assets and its ability to meet financial obligations. As leverage increases, the financial risk of firms rises, and we expect a positive relationship between leverage and default risk (Chiang et al., 2015; Schultz et al., 2017).

Third, we account for firm profitability using the return on assets (ROA), the ratio of net income to total assets. ROA, based on accounting information, indicates the firm's ability to generate sufficient returns for smooth functioning. Higher ROAs suggest lower default risk. Fourth, we control liquidity (LIQ), indicating the firm's capability to pay short-term obligations. Default risk should be lower in firms with a higher liquidity ratio compared to those with a lower ratio. We capture liquidity through the current ratio (current assets divided by current liabilities).

Our fifth variable, Tobin's Q (TOBINQ), considers market information and is arguably a better measurement of both performance and growth opportunities. Tobin's Q, measured by summing the fair market value and total liabilities divided by total assets, is expected to have

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spread has the same features as the standard CDS spread. This adjustment allows calculation of the CDS spread for a large number of firms.

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a negative impact on default risk since better performance leads to higher stability (Chiang et al., 2015). The sixth control variable, the sales-to-asset ratio (SALES), is measured as the ratio of sales to total assets. SALES represents management efficiency and is expected to have a negative influence on default risk (Miglani et al., 2015). Seventh, we control tangibility (TANG), measured as the ratio of net property, plant, and equipment divided by total assets. Tangibility is found to be negatively related to firm value (Fukui & Ushijima, 2007; Nakano & Nguyen, 2013). Hence, we expect tangibility variables to be positively related to default risk (Chiang et al., 2015).

To reduce the influence of outliers in our estimates, we have winsorized all other control variables at 1%. We keep the key independent variables, foreign divestment, at their original values because we observed no issues regarding outliers in the descriptive statistics. Similarly, we retain the dependent variables (DD and CDS) at their original values, as extreme values in DD and CDS indicate poor performance (insolvency).

4. Empirical analysis

4.1. Descriptive statistics and correlation

Table 1 reports the descriptive statistics of the dependent and independent variables used in the empirical analysis. The descriptive statistics show a notable heterogeneity in our sample firms in relation to the divestment of foreign subsidiaries. Specifically, the variable *FD* exhibits a range from 1 (minimum) to 226 (maximum), with an average of 3.36. In terms of number of divestments, the mean of 3.36 indicates that, on average, there were no more than 3 divestments per year in our sample. In addition, our sample displays significant heterogeneous in terms of insolvency risk. The variable *DD* has a minimum value of -2.62 and a maximum value of 54.11. Moreover, *CDS* range from -7.36 to 5.98, with a mean value of 2.71. Lastly, Table 2 indicates that our sample exhibits considerable heterogeneity related to the control variables. For instance, there is substantial variation in size, ranging from 4.63 million to 2.26 trillion USD.

(Insert Table 1 about here)

Table 2 shows the pairwise correlations among the variables used in the analysis. It is evident from the table that the number of foreign divestments (*FD*) has a negative correlation with *DD* and a positive correlation with *CDS*, implying that a higher frequency of divestments

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of foreign subsidiaries corresponds to an increased level of insolvency risk. Moreover, as expected, the two insolvency risk variables, *DD* and *CDS*, are negatively correlated by construction (r=0.93). As the correlation results are not controlled by other factors that may affect the insolvency risk, they should be interpreted with prudence.

(Insert Table 2 about here)

4.2. Baseline regression results

We employ panel data where insolvency risk serves as the dependent variable for estimating our model. Our baseline model to examine the association between divestment and insolvency risk follows several alternative panel regressions of the equation (1) below:

$$Insolvency\ Risk_{i,t} = \alpha + \beta_1 FD_{i,t} + \beta_2 Size_{i,t} + \beta_3 Return\ on\ assets_{i,t} + \beta_4 Leverag + \beta_5 Liquidity_{i,t} + \beta_6 Tangibility_{i,t} + \beta_7 Int.Experience_{i,t} + \sum_{k=1}^{n-1} \alpha_k Fir + \sum_{y=1992}^{2019} \omega_y Period_i^y + \varepsilon_{i,t} \quad (1)$$

where the dependent variable, *Insolvency Risk*$_{i,t}$ encompasses one of two alternative measures of insolvency risk: the distance to default or the CDS spread for a firm *i* at time *t*. *FD* represents the number of divestments carried out by firm *t* during a particular year *i*. As discussed above, several firm-level control variables that could affect divestment and insolvency risk are included. The definition of each variable is given in Appendix 1. The regressions also include firm and year fixed effects, with errors clustered at the firm level. Finally, we also control for country-fixed effects. Country dummies are based on the first two letters of a firm's ISIN code. To address potential outlier effects, all independent variables are winsorized at the 1st and 99th percentiles.[2]

Table 3 reports the results for six alternative versions of Equation (1). Models 1 to 3 employ the distance to default (*DD*) as the dependent variable, while Models 4 to 6 employ the credit default swap spread (CDS) as the dependent variable. Models 1 and 4 adopt a more parsimonious approach, including only *Size*, *Return on assets, and Leverage* as the control

[2] We adopt the approach of Ellul and Yerramilli (2013) and apply winsorization to the independent variables. It is worth noting that the results remain robust even when not applying winsorization.

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variables. Models 2 and 5 include the complete set of control variables and year fixed-effects, while Models 3 and 6 include both year and firm fixed-effects along with the full set of control variables. All the models include country-fixed effects.

(Insert Table 3 about here)

Table 3 shows that the number of divestments (*FD*) has a statistically significant and negative coefficient in Models 1, 2, and 3 when *DD* is the dependent variable. These results indicate that an increased divestment of foreign subsidiaries amplifies the insolvency risk of parent firms. Additionally, Table 3 shows coefficient estimates for the number of *FD* that are positively associated with the CDS spread (in Models 4, 5, and 6). This indicates that a greater frequence of divestment of foreign subsidiaries correspond to an elevated level of insolvency risk. The coefficients related to firm-specific variables also provide important insights. For instance, firm *Size* is positively connected to the CDS spread (in Model 6) and negatively linked to DD (in Model 3), suggesting that larger firms carry higher insolvency risk. This finding is consistent with the view that larger firms tend to take more risks. As expected, the return on assets has a negative relationship with the *CDS* spread and a positive relationship with *DD*, suggesting that firm stability increases with greater profitability. Finally, our findings indicate that firms with higher leverage are exposed to increased insolvency risk.

In summary, Table 3 indicates that firms engaging in a higher frequency of divestment activities are associated with heightened insolvency risk. These findings support our main hypothesis that firms divesting their foreign subsidiaries are prone to greater insolvency risk. Overall, the findings reported in Table 3 broadly align with the existing literature on firm risk (see for e.g., Mohr, Konara, Ganotakis, 2020).

4.3. Lagged variables.

Regressions based on contemporaneous variables are susceptible to endogeneity bias due to reverse causality. In contrast, a regression based on lagged values of independent variables helps control for reverse causality, and thus tends to be less vulnerable to endogeneity effects. To overcome this concern, we follow Huang et al. (2019) and re-estimate equation (1) by utilizing the number of FD by firms and control variables in the prior period (t-1) along with the *CDS* (*DD*) from the current period (t). The results reported in Table 4 are similar to those presented in Table 3. The relation between divestment and insolvency risk remains significantly negative with *DD* and positive with *CDS* in the one period lag specification. These

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results support the interpretation that firms' divestment actions influence the current insolvency risk, rather than the alternate interpretation of past insolvency risk influencing the current divestment activity. These findings provide additional support to the baseline results and suggest that the foreign divestment of subsidiaries can predict insolvency risk. That is, a high level of divestment activity in the current period prompts a higher level of insolvency risk in the subsequent period.

(Insert Table 4 about here)

4.4. Moderating Role of CSR

To examine the moderating role of CSR on the divestment-insolvency relationship, we re-estimate equation one by including an interaction variable Foreign *Divestment* × *high CSR*. In this context, *high CSR* denotes firms that fall in the top quartile based on their CSR activities. The results, as reported in Table 5, feature *DD* as the dependent variable in Models 1 to 3, and *CDS* as the dependent variable in Models 4 to 6. Consistent with our hypothesis, we observed that the interaction terms exhibit negative and statistically significant coefficients with *DD* (in Models 1 to 3). This suggest that parent firms with a higher level of CSR activities encounter increased insolvency risk when involved in foreign divestments as the distance to default reduces. Similarly, the interactions terms demonstrate positive and statistically significant coefficient with *CDS* (in Models 4 to 6), reinforcing the notion that parent firms with higher CSR activities face increased insolvency risk in the case of foreign divestments as the CDS increases. An alternative explanation of these findings suggests that the higher level of CSR activities are considered as sunk costs and also a waste of time, trust, and resources in the event of divestment to reduce the financial stability of the parent firms. Our findings indicate that parent firms intending to divest foreign subsidiaries should avoid spending too much time and resources on CSR activities to create goodwill or for survival.

(Insert Table 5 about here)

4.5. Additional analysis

In order to check the robustness of our empirical findings, we perform several additional tests. First, we examine the relationship between foreign divestment and insolvency risk using alternative proxy for insolvency risk: the probability of default. We use one month, three months, six months, one year, two years, three years, and five years probability of default

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in our analyses. The results (un-tabulated) show that higher divestment of foreign subsidiaries is positively associated with the probability of default. These results suggest that higher divestment activity by parent firms lead to greater insolvency risk. Second, we check the robustness of our results using an alternative sample specification by excluding observations from the years 2007, 2008, and 2009 to avoid the Global Financial Crisis (GFC) effect. Since GFC may have contributed to the temporary increase in foreign divestments, which can also affect the findings of this study. The (un-tabulated) results show that our study findings are not changed due to abnormal observations of GFC.

Third, we examine the role of firm size in the context of foreign divestment and insolvency risk relationship. The (un-tabulated) results show that as the size of parent firms increases their insolvency risk decreases in the event of foreign divestment and vice versa. These results are in line with earlier studies (e.g. Daley et al., 1997; Schlingemann et.al., 2002; Berry, 2013) which state that larger firms try to divest un-related and poorly performing subsidiaries in order to focus on the core business. Lastly, we found out that international experience shows no impact on the relationship between foreign divestment and insolvency risk of parent firms. The un-tabulated results show that foreign divestment have the same impact on insolvency risk for firms with higher or lower international experience.

5. Conclusion

This study explores the correlation between the divestment of foreign subsidiaries and the insolvency risk of parent firms among Nordic companies. We employ both traditional (Merton's distance to default) and innovative (credit default swap spread) market-based measures to proxy the insolvency risk of the parent firm. Our contribution to the existing international business and firm risk literature is evident in revealing a positive association between the number of foreign divestments and the insolvency risk of the parent firm. In simpler terms, a higher divestment of foreign subsidiaries is connected to a greater level of insolvency risk.

Moreover, this research delves into the moderating role of corporate social responsibility (CSR) activities by the parent firm in the relationship between divestment and insolvency risk. Our findings suggest that higher levels of CSR activities by parent firms are associated with increased insolvency risk in the context of foreign divestments. This implies that firms with increased CSR activities expend precious resources and incur sunk costs, which

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can be detrimental to parent firms in the unlikely event of foreign divestment. Our study contributes to the existing CSR literature by addressing the financial failure aspect, which diverges from previous studies that primarily focus on financial success indicators such as stock returns or profitability.

Furthermore, our study adds to the international business literature by offering insights into the less-explored area of foreign divestments and their impact on insolvency risk, with a focus on market-based measures. Additionally, we explore the potential role of CSR activities in crisis situations like divestment on parent firms' financial health. Our study surpasses earlier research in international business literature by linking the divestment of foreign subsidiaries to credit market reactions. This provides crucial insights into the perception of bondholders and the risk faced by the parent firm in the bond market due to divestment decisions.

Overall, findings of this research shed light on the significance of considering the relationship between foreign divestment and insolvency risk, as well as the moderating role of CSR activities. Understanding these dynamics can aid firms in making more informed strategic decisions and managing potential risks associated with international divestments. It is important to note that our study has its limitations, such as the restricted sample and the data sources used, thus providing opportunities for future studies to build upon our findings and delve deeper into the complex dynamics between foreign divestments, CSR, and firm survival.

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Declaration of generative AI and AI-assisted technologies in the writing process

During the preparation of this work the authors used ChatGpt 3.5 by OpenAI in order to improve language and readability. After using this tool/service, the authors reviewed and edited the content as needed and take full responsibility for the content of the publication.

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Table 1. Descriptive statistics

Variables	Mean	Median	SD	Min	Max	P25	P75	Observations
Foreign Divestment								
FD	3.36	3.36	8.88	1.00	226.00	1.00	3.00	967.00
Divestment Dummy	0.19	0.19	0.39	0.00	1.00	0.00	0.00	5,049.00
Insolvency Risk								
CDS	20.85	20.85	21.51	0.00	393.69	9.75	25.51	2,844.00
DD	4.81	4.81	3.11	-2.62	54.11	2.85	6.21	2,738.00
Control Variables								
ROA	5.69	5.69	11.21	-202.81	157.38	3.00	9.35	3,291.00
Int. experience	66.94	66.94	30.28	0.00	673.15	48.26	91.86	2,846.00
Log DD	1.39	1.39	0.69	-3.48	3.99	1.06	1.83	2,702.00
Log CDS	2.71	2.71	0.87	-7.36	5.98	2.28	3.24	2,844.00
Size (Log of Assets)	13.41	13.41	1.81	8.44	18.81	12.03	14.77	3,386.00
Leverage	0.57	0.57	0.19	0.01	3.63	0.47	0.67	3,386.00
Liquidity	0.49	0.49	0.18	0.03	1.00	0.36	0.62	3,307.00
Tangibility	0.28	0.28	0.18	0.00	0.83	0.14	0.41	3,377.00
Sales to assets	1.07	1.07	0.48	-0.10	3.83	0.78	1.33	3,378.00
Tobin Q	0.56	0.56	0.17	0.01	3.36	0.47	0.66	3,068.00
Total Assets (millions)	2,830.17	2,830.17	6,168.51	4.63	147,512.00	167.41	2,602.90	3,386.00
FD winsorized	3.07	3.07	4.65	1.00	32.00	1.00	3.00	967.00
CSR	53.22		20.31	3.2	93.29	39.15	68.83	1042.00

This table reports the descriptive statistics for the variables used in this study. The definition of each variable is given in Appendix 1.

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Table 2. Correlations

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
(1) CDS	1										
(2) DD	-0.584***	1									
(3) FD	0.0662	-0.0796*	1								
(4) size	-0.0388	-0.0132	0.102*	1							
(5) ROA	-0.369***	0.299***	0.0611	0.0227	1						
(6) Leverage	0.299***	-0.447***	-0.0389	0.0421	-0.291***	1					
(7) Liquidity	-0.0683	0.0556	0.00163	-0.228***	0.196***	0.0138	1				
(8) Tangibility	0.0775	-0.122**	0.0992*	0.123**	-0.100*	-0.0492	-0.478***	1			
(9) Sales to assets	-0.0370	-0.0350	0.0268	-0.451***	0.0743	0.00326	0.470***	-0.0830*	1		
(10) Tobin Q	0.298***	-0.444***	-0.0393	0.0419	-0.289***	1.000***	0.0161	-0.0514	0.00425	1	
(11) Int. experience	-0.0209	0.0788	0.0508	0.277***	-0.0734	-0.0148	0.0516	-0.151***	-0.142***	-0.0145	1

The table reports pairwise correlations for the variables used in the empirical analysis. The definition of each variable is given in Appendix 1.

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Table 3. Foreign divestment and insolvency risk

	Distance to default			Credit default swap spread		
	DD	DD	DD	CDS	CDS	CDS
VARIABLES	model (1)	model (2)	model (3)	model (4)	model (5)	model (6)
FD	-0.044**	-0.049**	-0.043*	0.016***	0.017***	0.017***
	(-2.148)	(-2.174)	(-1.863)	(2.757)	(2.772)	(2.844)
Size	0.054	0.011	-0.385*	0.025	0.028	0.131*
	(1.184)	(0.213)	(-1.736)	(1.619)	(1.609)	(1.761)
ROA	0.069***	0.062***	0.028*	-0.025***	-0.023***	-0.011*
	(4.161)	(3.747)	(1.854)	(-4.017)	(-3.668)	(-1.754)
Leverage	-6.153***	-6.825***	-4.594***	1.821***	1.904***	1.036***
	(-8.012)	(-8.802)	(-5.523)	(8.234)	(7.924)	(3.301)
Liquidity		0.142	0.804		0.168	-0.455
		(0.237)	(0.631)		(0.973)	(-1.121)
Tangibility		-0.760	0.006		0.361*	0.330
		(-1.164)	(0.005)		(1.806)	(0.748)
Int. experience		0.006*	0.003		-0.001	0.000
		(1.877)	(0.705)		(-1.264)	(0.156)
Constant	4.060***	5.036***	6.293*	2.238***	2.023***	1.027
	(4.947)	(5.309)	(1.875)	(8.265)	(6.732)	(0.962)
Observations	656	625	625	667	635	635
R-squared	0.508	0.522	0.704	0.387	0.394	0.601
Compno	119	108	108	123	111	111
Year FE	YES	YES	YES	YES	YES	YES
Firm FE	NO	NO	YES	NO	NO	YES
Country FE	YES	YES	YES	YES	YES	YES

The table reports the estimates of six alternative versions of the following panel regression specification:

$$Insolvency\ Risk_{i,t} = \alpha + \beta_1 FD_{i,t} + \beta_2 Size_{i,t} + \beta_3 Return\ on\ assets_{i,t} + \beta_4 Leverage_{i,t} + \beta_5 Liquidity_{i,t} + \beta_6 Tangibility_{i,t} + \beta_7 Int.Experience_{i,t} + \sum_{k=1}^{n-1} \alpha_k Firm_i^k + \sum_{y=1992}^{2019} \omega_y Period_i^y + \varepsilon_{i,t}$$

where the dependent variable, *Insolvency Risk*$_{i,t}$ encompasses one of two alternative measures of insolvency risk: the distance to default or the CDS spread for a firm *i* at time *t*. *FD* represents the number of divestments carried out by firm *t* during a particular year *i*. As discussed above, several firm-level control variables that could affect divestment and insolvency risk are included. The definition of each variable is given in Appendix 1.

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Table 4. Foreign divestment and insolvency risk.

	Distance to default			Credit default swap spread		
	DD	DD	DD	CDS	CDS	CDS
VARIABLES	model (1)	model (2)	model (3)	model (4)	model (5)	model (6)
FD	-0.053***	-0.056***	-0.040**	0.019***	0.020***	0.016**
	(-3.273)	(-3.434)	(-2.485)	(2.975)	(3.131)	(2.151)
Size	0.063	0.015	-0.445*	0.022	0.030*	0.174**
	(1.292)	(0.278)	(-1.890)	(1.362)	(1.747)	(2.198)
ROA	0.048***	0.046***	0.014	-0.013**	-0.013**	-0.001
	(2.661)	(2.594)	(1.064)	(-2.501)	(-2.438)	(-0.191)
Leverage	-6.335***	-6.958***	-4.317***	1.893***	2.068***	1.123***
	(-7.554)	(-8.413)	(-5.044)	(6.952)	(8.013)	(3.563)
Liquidity		-1.809**	-1.926		0.745***	0.408
		(-2.466)	(-1.419)		(3.398)	(0.956)
Tangibility		-2.295***	-2.182*		0.782***	0.822*
		(-3.418)	(-1.674)		(3.906)	(1.697)
Int. experience		0.004	0.003		-0.001	-0.001
		(1.228)	(0.860)		(-0.733)	(-0.446)
Constant	4.276***	6.570***	7.755**	2.075***	1.349***	-0.722
	(4.259)	(5.926)	(2.249)	(6.560)	(3.992)	(-0.647)
Observations	656	625	625	666	634	634
R-squared	0.468	0.501	0.730	0.313	0.353	0.608
Compno	114	103	103	118	106	106
Year FE	YES	YES	YES	YES	YES	YES
Firm FE	NO	NO	YES	NO	NO	YES
Country FE	YES	YES	YES	YES	YES	YES

The table reports the estimates of six alternative versions of the following panel regression specification:

$$Insolvency\ Risk_{i,t} = \alpha + \beta_1 FD_{i,t-1} + \beta_2 Size_{i,t-1} + \beta_3 Return\ on\ assets_{i,t-1} + \beta_4 Leverage_{i,t-1} + \beta_5 Liquidity_{i,t-1} + \beta_6 Tangibility_{i,t-1} + \beta_7 Int.\ Experience_{i,t-1} + \sum_{k=1}^{n-1} \alpha_k Firm_i^k + \sum_{y=1992}^{2019} \omega_y Period_i^y + \varepsilon_{i,t}$$

where the dependent variable, *Insolvency Risk*$_{i,t}$ encompasses one of two alternative measures of insolvency risk: the distance to default or the CDS spread for a firm *i* at time *t*. *FD* represents the number of divestments carried out by firm *t-1* during a particular year *i*. As discussed above, several firm-level control variables that could affect divestment and insolvency risk are included. All the control variables are also lagged one period (*t-1*) The definition of each variable is given in Appendix 1.

Table 5. Moderating Role of CSR.

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	Distance to default			Credit default swap spread		
	DD	DD	DD	CDS	CDS	CDS
VARIABLES	model (1)	model (2)	model (3)	model (4)	model (5)	model (6)
Foreign Divestment	0.021	0.025	0.042	-0.004	-0.003	-0.005
	(0.843)	(0.953)	(1.522)	(-0.534)	(-0.413)	(-0.511)
Foreign Divestment × high CSR	-0.107**	-0.121**	-0.146***	0.033**	0.034**	0.037***
	(-2.284)	(-2.320)	(-3.339)	(2.347)	(2.167)	(2.643)
High CSR	0.451**	0.535***	0.528**	-0.133**	-0.140**	-0.099
	(2.248)	(2.593)	(2.480)	(-2.129)	(-2.207)	(-1.298)
Size	0.064	0.022	-0.458**	0.022	0.025	0.153**
	(1.470)	(0.445)	(-2.022)	(1.494)	(1.487)	(2.033)
ROA	0.071***	0.064***	0.030**	-0.025***	-0.024***	-0.011*
	(4.227)	(3.811)	(1.983)	(-4.092)	(-3.735)	(-1.841)
Leverage	-6.191***	-6.852***	-4.785***	1.833***	1.913***	1.071***
	(-8.096)	(-8.951)	(-5.820)	(8.317)	(8.039)	(3.408)
Liquidity		0.238	0.793		0.142	-0.455
		(0.393)	(0.616)		(0.824)	(-1.113)
Tangibility		-0.824	-0.024		0.375*	0.310
		(-1.264)	(-0.020)		(1.883)	(0.691)
Int. Experience		0.006*	0.003		-0.001	0.000
		(1.936)	(0.780)		(-1.331)	(0.100)
Constant	3.588***	4.426***	7.233**	2.373***	2.178***	0.809
	(4.511)	(4.820)	(2.119)	(8.852)	(7.415)	(0.763)
Observations	656	625	625	667	635	635
R-squared	0.515	0.530	0.713	0.394	0.402	0.608
Compno	119	108	108	123	111	111
Year FE	YES	YES	YES	YES	YES	YES
Firm FE	NO	NO	YES	NO	NO	YES
Country FE	YES	YES	YES	YES	YES	YES

The table reports the estimates of six alternative versions equation 1 by including an interaction variable *Foreign Divestment × high CSR*. In this context, *high CSR* denotes firms that fall in the top quartile based on their CSR activities. The definition of each variable is given in Appendix 1.

Appendix 1. Variables

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Variable Name	Notation	Definition	Source
Foreign Divestment			
Foreign Divestment (Sell-off and closure)	FD	Any voluntary or forced actions that reduce a company's engagement in or exposure to current cross-border activities (Benito and Welch 1997).	Primary Data
Insolvency Risk			
Credit Default Swap Spread	CDS	Credit derivatives that allow the transfer of the firm's default risk between two agents for a predetermined time period.	CRI-NUS
Distance to default	DD	Annual average of distance to default based on stock price variability.	CRI-NUS
CSR Activities			
CSR score	CSR score	Level of corporate social responsibility activity performed by the firm and represented by a score of minimum 0 and maximum 100.	Thomson Reuters
Controls			
Firm size	Size	Natural logarithm of total assets of a firm.	Thomson Reuters
Leverage	Leverage	It is the ratio of total debt to total assets (TLTA). Leverage reflects the capital structure of the firm	Thomson Reuters
Liquidity	Liquidity	Ability of the firm to pay its short-term obligations	Thomson Reuters
Performance/Profitability	ROA	Net income divided by total assets.	Thomson Reuters
Tobin's Q	Tobin Q	The market value of a company divided by its assets' replacement cost.	Thomson Reuters
SALES	Sales	Ratio of sales to total assets	Thomson Reuters
Tangibility	Tangibility	Ratio of net property plant and equipment divided by total assets	Thomson Reuters
International experience	Int. Experience	Foreign sales divided by the total sales	Thomson Reuters

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