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MECHANISMS OF CORPORATE GOVERNANCE GOING INTERNATIONAL: OUTLINING A THEORY AND AN INITIAL TEST OF THE PERFORMANCE EFFECTS

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ABSTRACT

Globalisation includes international product markets and capital, but also involves internationalisation of corporate governance mechanisms. We propose that internationalisation of governance mechanisms is related to improved performance of the corporation. For example, listing at several stock markets implies pressure to improve information flow and stronger adherence to international standards, which will reduce possibility for slack. Recruiting top managers and board members from an international arena will, among other things, enlarge the market for managerial labour and the market for board members, presumably putting more pressure on present managers and board members, and increase the probability of finding an adequate new manager or new board members. An integrated EU would support the internationalisation of the mechanisms through reducing the transaction costs of Europeanization. An initial test on a sample of listed Swedish corporations indicates that the proposition could be rejected. Two main reasons can be found as an interpretation of the results 1.) that mechanisms with governance functions, such as capital structure and the board have several functions, and that the governance function is not always the most important one, and 2.) that governance mechanisms cannot be analysed in isolation, since they are included in a coherent corporate governance strategy.

Keywords: internationalisation, corporate governance, governance strategy

INTERNATIONALISATION AS A CORPORATE GOVERNANCE MECHANISM

Internationalisation, internationalisation, that is Moses and the Prophets, would Marx have said today. Globalisation, we are told, is one of the distinctive features of present capitalism. While that is probably true for the products of the capitalistic corporation, it is less true for the corporation as such and especially for the governance of the corporation.

Internationalisation of corporations have been explained through a set of theories, among them the eclectic paradigm (Dunning, 1977, 1988, 1995) being the most prominent, but also industrial organisation theory (Hymer, 1976), transaction costs theory (Williamson, 1986), internalisation theory (Buckley & Casson, 1976; Rugman, 1981), bargaining power theory (Fagre & Wells, 1982; Taylor, Zou & Osland, 2000), resource-based view (Wernerfelt, 1984). These theories are, however, mainly focused on the internationalisation of the production facilities and/or the product market.

Globalisation is however not limited to the production facilities and the product markets but is also entering into the governance of corporations today. A corporation is governed by several governance mechanisms (Schleifer & Vishny, 1997), such as the capital structure, managerial labour markets, organisational strategy and structure, board of directors, executive compensation and auditing. The capital structure, both equity and especially debt, has for long been international, with capital floating over the world looking for investments. The managerial labour market, especially recruitment to the top management team positions, appears to have been less exposed to internationalisation. In between is auditing, that have been conducted by local auditing firms, however belonging to international auditing firms, using local regulations that have become more and more international due to harmonization. Thus, the governance mechanisms are to a varying degree internationalised.

If the corporate governance mechanisms become international, what can explain the internationalisation? One explanation could be focused on the power struggle over the corporation performed by the principals and the agents. Principals of capitalistic corporations are assumed to look for means to profitably develop the corporation, i.e., entrepreneurial rent seeking, but at the same time reduce the costs of delegation, i.e., the agency costs (Ricketts, 2002). Governance is a perspective of the corporation where the agents, being the managers, have strong power delegated to them in order for them to be able to conduct entrepreneurial rent seeking, but the last and ultimate power, to select the top managers and to dissolve the corporation, is situated in the hands of the principals, the shareholders and their closest agents, the directors of the board. In this view, internationalisation could be interpreted as a mean of the principal to improve the performance of the corporation through reducing agency costs.

The proposition put forward and tested in this paper is that internationalisation improves performance, no matter what corporate governance mechanism that is being internationalised. That internationalisation could have a positive influence on performance is however not a new assumption but emphasised by for example Grant (1987) and Geringer, Beamish & da Costa (1989). What is new here is the focus on the internationalisation of the governance mechanisms and the main argument is that internationalisation reduces the agency conflict, i.e., internationalisation can be treated as a governance mechanism. Principals can rely on internationalisation since it improves competition, thus reducing the possibility of slack that can be exploited by the agents. Instead of spending efforts on monitoring the agents, they are monitored by the competitive pressure of internationalisation. The agent does not try to escape the strategy of internationalisation since internationalisation implies, among other things as will be further depicted in the theory section, larger corporations, which imply that the internal labour market increase, that the wages at the top level increases and that the status of being

manager at the big, international corporation is higher than being the status of being a manager in a national corporation.

The aim of the paper is to explore the performance effects of internationalisation of corporate governance mechanisms based on the proposition that internationalisation improves performance. This aim is attained through the next section, where we develop arguments supporting the proposition for each governance mechanism, and through the following sections where the hypotheses are tested on a data set of Swedish listed corporations. The paper ends with a discussion elaborating the negative findings into suggestions of method development and an integral concept of governance strategy.

INTERNATIONALISATION OF CORPORATE GOVERNANCE MECHANISMS

Corporate governance mechanisms are structures and processes of the corporation that has governance, i.e., disciplining management, as one feature. Equity, as one example, can be restricted in use and in size through capital control, thus performing the function of governance, but at the same time being used for financing risky adventures such as research, thus performing the function of entrepreneurial innovativeness. This view on corporate governance mechanisms, that they are but aspects of structures and processes, is important to realise since it is the basis of the papers proposition. Internationalisation is mainly known as a strategy where economies of scale are realised and competitive advantage is exploited. But the view put forward here is that internationalisation can be used as a governance mechanism, or rather, as a mean to strengthen the governance capacity of the processes and structures that are used as governance mechanisms.

The literature is rather consistent in its opinion of the empirical set of corporate governance mechanisms. This set consists of capital (be it equity or debt), managerial labour selected from the external or the internal managerial labour market, the strategy and structure of the organisation, the board of directors, executive compensation, the auditors, and the environment (cf. Schleifer & Vishny, 1997).

These governance mechanisms have the function of mitigating the conflict between the main principals of the organisation, which in the case of capitalistic corporations are considered to be mainly the shareholders, and the agents, which are the managers of the organisation being delegated the power to innovate and to implement strategies in order to satisfy the will of the principal. As governance mechanisms they are assumed to be used as long as the reduction of agency costs is more than the costs of using the mechanism as a governance mechanism.

It should be noted, as claimed above, that governance is only one of several features. For example, to use a board as a mechanism could still be profitable for a corporation even if the board appears to carry huge costs. The board have several functions to perform, one of them being control and supervision, but another one being a provider of service and resources to the corporation (Huse, 2007). The cost of the board could therefore not be treated as only an agency cost, but have to be allocated to the different functions, or even been treated as a sunk cost. Thus, the cost of a mechanism should be seen in the light of all the functions it has to perform, governance included.

All these mechanisms can be bound to the national or even the local context of the corporation, or being internationalised. The reason for internationalisation of a mechanism could be very diverse, and not intentionally include governance. For example, internationalisation of the

production could be made in order to overcome national hurdles, to create trust or because of reasons belonging to simple production features, such as the cost of transportation. The implications of an internationalisation of production could, however, have governance effects, as will be argued later in this text. Thus, be it intentional or non-intentional, internationalisation could have governance effects and as such improve the performance of the corporations. This theory section is devoted to explicate this argument through analysing the governance effect of internationalisation of each governance mechanism.

The support of the proposition will be sought after both in arguments of intention, that internationalisation could be an intentional choice of a principal in order to gain governance capacity, and in arguments of function, that internationalisation produce performance effects that increase the organisations opportunity to survive. The causality is always hard to find, making it difficult to state if the explanation could be intentional or functional. For example, the client effect (Dyl, Elliott & Handley, 2002) would state that international investors are attracted by certain features of the corporation, i.e., appearing as a functional argument. But if the board decides to create these features in order to attract international investors and thereby gain indirectly the governance effects of internationalisation of equity, then it is an intentional explanation. In this case, not even longitudinal studies could find out if it is functional or intentional since very often the decisions made by the board are unknown. For our purpose, the difference between intentional and functional is of no importance since we are only exploring the performance effects of internationalisation as a governance mechanism.

We will now analyse all the corporate governance mechanisms in order to find arguments for the performance effects of the internationalisation of the mechanism. These arguments will be converted into hypotheses, as depicted in figure 1. Even if we have a general proposition, that

internationalisation of governance mechanisms increase performance of the corporation, we need to realise that not all mechanisms can strengthen the organisation and thus improve the performance to the same extent. We therefore create hypotheses that we test on an empirical data set in order to find out if there is any truth in our proposition, and if there is, if there are any differences in the performance effects on internationalisation of different governance mechanisms.

Insert Figure 1 about here

Capital structure

The capital structure consists of debt and equity. Internationalisation of debt capital is typically made through an international bond issue (Randøy, Oxelheim, & Stonehill, 2001). Internationalisation of equity is made through allowing foreigners to buy the shares at the national stock market, and to make a cross-listing of the shares, i.e., to list in a foreign stock market. Since most corporations are using the international debt market, we ignore the internationalisation of debt and focus entirely on equity.

Internationalisation of equity is of interest for the shareholders of several reasons. It increases the liquidity of the stock which makes it easier for the shareholders to enter and to exit the corporation. Higher liquidity reduces the risk of the stock which as a consequence will reduce the cost of capital. Access to several stock markets for equity capital limit the dependency on one single market for equity supply. Internationalisation of the stock imply the entry of less informed shareholders and of shareholders that do not belong to the national networks, which put a pressure on the information from the corporation, including increasing demands on both

quantity and quality of information (Adrem, 1999). Additionally, it will also put a pressure on the corporation to fulfil international standards of accounting and information (Herrmann & Thomas, 1995). This is especially true for foreign listing when the corporation has to sign a stock market contract at another stock market. The information and standard pressure will spread throughout the corporation (DiMaggio & Powell, 1983), thus improving the routines of the corporation concerning information and accounting. As demanding customers strengthen the corporation, demands of publicity and the observance of standards will strengthen the corporation, thus ultimately improving the performance. International equity in general and listed abroad in specific will increase the monitoring effects on the corporation. Thus, we expect to find a positive relationship, weaker for foreign owned equity since the influence is through a national stock market, and stronger for foreign listing since the corporation have to fulfil the obligations of several stock markets.

H1a: The proportion of foreign ownership of shares will be weakly positively related with performance

H1b: Foreign listing of shares will be strongly positively related with performance

Managerial labour market

The managerial labour market can be defined as those individuals that would like to become managers, if located inside the corporation, constituting the internal managerial labour market, if located outside the corporation, constituting the external managerial labour market. A corporation have some reasons for preferring internal recruitment, such as labour shortage, more and better information of the candidates and retention of the firm-specific skills (Milgrom & Roberts, 1992). Internal recruitment restrict, however, the supply to the organisation and by looking outside the corporation, a larger supply of candidates will appear and thereby increase

the probability of finding an adequate manager. Very often labour markets appear to be national in essence. A multinational corporation will therefore have larger supply of candidates than a national corporation. Thus, an international corporation using external recruitment have a significantly larger managerial labour market compared to the national corporation focused on internal recruitment.

The shareholders could at first sight prefer that managers and the CEO would be recruited both internally and externally, thus creating a strong competition for each position, thereby improving the opportunity to find the right person for the right place. One reason, however, is against this, which is if the control of the corporation is mainly made through the premise control of socialisation (Ouchi, 1980). Then the principal would prefer internal recruitment since the candidate has to be trained in the norms and values of the corporation. It does still support the international orientation since the usage of the *essofication*, i.e., circulation of employees in order to create a corporate culture and reduce the impact of the national culture of the manager (Edström & Galbraith, 1977), could still be effective. Thus, we expect to find higher performance by the corporations that have a mix of nationalities at the top management level as well as a foreign CEO, since these corporations are using a bigger source of recruitment and therefore have higher probability of having right person for the right position.

The agent could at first sight be assumed to prefer internal and national or even local recruitment since it reduces the competition for managerial positions. Another reason for the agent preferring to hire nationally or locally can be grounded in the idea of homo-social reproduction (Kanter, 1977) where recruitment is based on the similarity-attraction paradigm (Bryne, 1971) where agent hires similar others in terms of nationality, gender and common experiences. That is, however, to overlook the opportunities that are shaped by the mere size of

the international corporation, which increases the number of positions and in turn makes it possible for more management positions. A candidate has the same interest as the principal has in getting a position that the candidate is well fitted for, since it will show the candidate's capacity and then increase the candidate's possibility for further promotion. A promotion is indeed sought for, since it creates the signal of ability. Even more important is, however, to find a position from which a new promotion can be archived since frequency of promotion is a stronger sign of ability (Kanter, 1977; Rosenbaum, 1984). A corporation with many managerial positions gives more opportunities for a high frequency of promotion than a small corporation with few managerial positions. Thus, we expect that internationalisation, including increasing size, will be in the interest of the agent longing for a career.

In order to utilise the performance effect of internationalisation a corporation has to clearly signal its international recruitment policy. This signal is created through having a top management team consisting of a culturally and nationally diverse set of individuals, as well as having a CEO being nationally different from the company's country of origin. Managers of the corporation can read the explicit recruitment policy, but more importantly, they will inspect the top management team (TMT) and the CEO. When inspecting the actual composition of the TMT and nationality of the CEO, and they see only individuals recruited from the corporation's country of origin, they will interpret the actual composition of the TMT and nationality of the CEO as a policy in action. This policy is much more credible since it represent an actual investment compared to a diversity policy in words, which are almost costless to make and therefore without any credibility. We therefore expect to find a high diversity at the TMT level as well as foreign CEOs in those corporations that have a diversity policy in action, which will produce high performance, as derived earlier.

A corporation that becomes international have therefore more persons to choose among, and through signalling credible diversity recruitment policy through a high diversity of TMT as well as foreign national background of the CEO in respect to company's country of origin will attract individuals that are more engaged in the corporation in order to support their career, which will presumably improve the performance of the corporation.

Demographic TMT research provides further argument for the corporate performance being improved due to the TMT national diversity (e.g. Bantel & Jackson, 1989; Cox, Lobel & McLeod, 1991; Hoffman & Hegarty, 1993). It is claimed that nationally diverse top managers provide a variety of view points streaming from their differences in cultural background (Buller, 1986) which then creates a wider critical base for the decision making and in turn positively affect performance.

H2a: National diversity at the TMT level will be positively related with performance

H2b: Foreign nationality of the CEO will be positively related with performance

Organisational structure

The organisation can have national production and international sales, or chose to internationalise the production. Several reasons have been put forward for an internationalisation of production, especially by the eclectic paradigm (Dunning, 1995) and internationalisation of production could imply increased performance due to economy of scale and to competitive advantage (Wolf & Egelhoff, 2002; Porter, 1986; Kogut, 1994). Our argument is, however, restricted to governance and not economy of scale or utilisation of firm-specific resources. The governance argument would put forward the reasoning that while internationalisation as such do not influence performance directly, it makes the organisation

acquainted to international influence and to accommodate to international influence, what ever the influence would be. Thus, the corporation creates routines that make internationalisation of other production factors more easily implemented.

Speculatively, we have a proposition of the development of internationalisation, moving from product markets, to production and then to the other factor markets, such as debt capital and equity markets and finally end with the internationalisation of the board and at the end internationalisation of management. If this is true, then internationalisation of production is a very early expression of an international strategy. Thus, we expect to find a slight performance effect, mainly due to economy of scale and competitive advantage, but also due to indirect governance effects.

H3: The proportion of international production will be positively related with performance

Organisational strategy

Internationalisation is a strategy, as have been elaborated above, which mainly is caused by desires to exploit opportunities presented by markets, mainly product markets but also input markets. Organisations applying an international diversification strategy have been found to be positively related with increased measures of performance (e.g. Grant, 1987; Geringer, Beamish & da Costa, 1989) reasons being that they face opportunities of growth (Buhner, 1987), that domestic core competencies can be utilized in international markets (Bartlett & Ghoshal, 1989) and that they overall may have a higher exploitation of tangible and intangible resources (Hymer, 1976). Internationalisation as a strategy forces also the organisation to deal with issues of institutional differences, such as legal and cultural differences (Kogut, 1985). The organisation will experience the problems of internationalisations and create specific

solutions to the specific problems. Over the years the organisation will accumulate solutions and they will be institutionalised as routines. As a strategy, internationalisation will therefore be less and less costly as the years pass due to the routinisation of the experiences. To put it simply, the organisation will be habituated to the international environment, with its higher level of competition and its more varied demands coming from costumers, legal agencies, professional and industrial organization, etc. The international organisation will be stronger, *ceteris paribus*, than an organisation with a national strategy.

The strengths of international habits will be used by the principal as a governance device. Once the first hurdle of internationalisation have been passed, the strategy can be used with dramatic less costs in order to not only gain economy of scales or to exploit competitive advantage, but also to improve governance through the international environments higher demands on performance. Thus, we expect to find higher performance produced by an organisation with an international strategy.

H4: The proportion of internationalisation of the firm's operations will be positively related with performance

Board of directors

The board of directors is a collection of individuals with the responsibility to promote the business of the corporation. In some countries, with the single board system, the directors are elected by the shareholder meeting and in some countries the employees have the right to elect a few directors. In countries with the dual board system, representatives of the employees are electing a proportion of directors and the shareholder meeting is electing the other proportion.

The directors elected by the shareholder meeting are found on the market for directors (Fama, 1980), where they are offering their capacity to monitor and to make decisions and to provide service to the corporation through their competence and their network (Dalton, Daily, Ellstrand & Johnson, 1998). In an argument resembling the argument of the managerial labour market, we predict a positive performance effect by increasing international presence. First we have the argument of the market size. A corporation that have more international directors and a foreign chairman of the board in respect to company's country of origin indicates that the electors of the directors explore the international market of directors, which is bigger than the national market. This international orientation in recruitment of directors increases the probability of finding an appropriate director for the board. Second we have the argument of variety. Individuals with a variety of cultural and national origin and socialisation will present a variety of views and opinions which will be fruitful for the decision made by the boards (Rindova, 1999; Carter, Simkins & Simpson, 2003). According to Hitt & Tyler (1991) diversity creates an atmosphere of prompt divergent thinking which in turn results in change and expansion of criteria used in evaluation of strategic alternatives. Thus, the quality of work and the decisions made by the board will increase with increased national and cultural variety.

As mentioned in the section of managerial labour market, a high diversity will reduce performance of a group engaged in implementation if the conflictual nature of diversity is not counteracted by methods of socialisation. Since the decisions made on the board level is of strategic and not operational content, and since the directors do not have to implement the decision, no mechanism of socialisation is needed in order to overcome the conflicts. Indeed, since the board typically has few meetings, with short prolongation, the board has rather limited opportunities to socialise the directors. Thus, due to the working conditions of the board and

the character of decisions made by the board with the chairman as a leader, variety is presumed to increase performance.

H5a: National diversity of the directors of the board will be positively related with performance

H5b: Foreign nationality of the chairman of the board will be positively related with performance

Executive compensation

Executive compensation in a broad sense influences the performance through stimulating managers to high efforts. First, international corporations offer special extrinsic rewards regarding both financial and symbolic rewards. The mere size of the international corporation offers opportunities of huge wages since it appears that wage is strongly correlated with size (Gomez-Mejia & Wiseman, 1997). The symbolic rewards consist of the status effect of being employed at an international corporation which probably brings more status to the manager in general than being employed at a national corporation. Secondly, the intrinsic rewards of being employed by a international corporation consists of the world wide opportunities the individual gains through the international internal managerial labour market of the corporation, which increases the individuals possibility to find interesting and challenging jobs that fit the individuals aspirations. Thus, we expect that managers of international corporations put more effort and therefore increase the performance of the international corporation since they are stimulated by opportunities of higher wages, more status and more job satisfaction.

Auditing

Auditing is an important function in a capitalistic system based on corporations with shares with control rights and limited liability, creating a distinctive separation between control of the corporation and the residual of the corporation. An independent inspector is needed to secure the information given to the absent owners of shares and debt. Auditing has, however, not been a particular subject of attention to researchers in corporate governance. Indeed, some would even consider them as being tied to the apron strings of top management, basing their judgement on the scandals of Enron and Parmalat, which burden the former audit firm Arthur Andersen and Deloitte & Touche, which still is in business. Indeed, when auditing is reduced to a marketing instrument, transforming the client to become a customer of their consultancy business, the independence of the auditors is put at threat (c.f. Pany & Reckers, 1983; Simunic, 1984; Hillison & Kennelley, 1988; DeBerg, Kaplan & Pany, 1991; Firth, 1997, 2002).

Auditing, however, is, still a serious business, employing the professionalism of the auditors, following the auditing standards, are creating trust in the information given by the corporation. The market for auditing firms is divided into the firms termed the Big-4, which is the four large and international auditing firms, and national or even local auditing firms. It can be assumed that because they are professionals, they apply to the standards issued by professional bodies. Thus, we cannot assume a difference in the interpretation and compliance of standards between those auditing firms that represents international exposure and the local and national audit firms. What we can assume, however, is that what becomes international routines, but not explicitly put in standards, i.e., audit practice, is more influenced by international development in the Big-4 than the national audit firms. This can be assumed since the Big-4 has the possibility to have information channels and administrative routines for disseminating information and audit practice world wide.

A Big-4-firm can be assumed to influence the performance of the corporation. In similar vein with the performance effects of a demanding customer, shaping and disciplining the organisation to high performance, a though and demanding audit firm can put pressure on the organisation to have good routines and correct information systems, which not only support the information interest of the debt and the equity owners, but also support the managers of the firm. Assuming that the Big-4 audit firms have more up-to-date practice and strength from their international experience, to put power behind their demands and their audit effort, it can be predicted that the use of a Big-4 audit firm will increase performance.

H6: The presence of a Big-4 audit firm will be positively related with performance

THE EMPIRICAL SAMPLE AND THE OPERATIONALISATION OF THE VARIABLES

The hypotheses are tested on Swedish listed corporations. Data have been collected from the consolidated financial statements in the annual reports of the year 2004 from all Swedish corporations listed on the Stockholm Stock Exchange's A list and O list. All in all the data include 239 companies.

Swedish corporations have one account for the parent company and one for the group of companies. We use the group accounts since they contain relevant information used by the market actors. In a few cases the corporations do not have the same calendar year as the reporting period. In these cases 2003/2004 was coded as 2004.

The model includes one dependent variable, 8 independent variables and 6 control variables. The operationalisation of them is presented below.

The dependent variable of Performance is measured as “return on assets” and calculated as: $(\text{Profit after financial items} + \text{Financial costs}) / \text{Total capital}$. Financial costs are not included since it would reflect the financial structure.

The 8 independent variables are operationalised as follow:

- *Audit firm* is represented by a dichotomous variable where one category represents the Big 4 audit firms, and the other category represents all other audit firms. The Big 4 audit firms have been coded as 1 and all other audit firms as 0.
- *CEO's nationality* is represented by a dichotomous variable referring to whether the CEO is of Swedish nationality or another nationality. Swedish CEOs have been coded as 1, non-Swedish CEOs as 0. The estimation of nationality is further discussed below concerning the variable *national diversity of the TMT / board*.
- *Chairman's nationality* is represented by a dichotomous variable referring to whether the chairman is of Swedish nationality or another nationality. Swedish chairman has been coded as 1 and non-Swedish chairman as 0. The estimation of nationality is further discussed below concerning the variable *national diversity of the TMT / board*.
- *National diversity of the TMT* and *national diversity of the board* is measured as share of Swedes in TMT and boards. National diversity was observed by two raters that each independently inspected half of the sample of corporations, coding the nationality of members belonging to the companies' top-management-teams and board of directors. The coding was based on the impression of the members' names, the pictures and the descriptions of the persons given by the annual report, the Internet was also used in order to search for information. Since it is a subjective observation an inter-reliability measure was conducted implying that a random sample of 10 corporations from each

original rater's sample was given to two other raters that independently made a similar coding of 10 corporations each. The overall inter-rater reliability was 94%. We found, however, a significant negative correlation between inter-rater reliability and share of foreigners in a group, be it the TMT or the board, indicating that when the share of foreigners increases in the group, the reliability of observations decreases. When excluding all the TMTs and the boards that had only Swedes according to the original raters, thus selecting only those cases where the difficulties of observations were the highest, the inter-raters reliability decreased to 89%. Although it indicates an uncertainty of observations, we think that the diversity measurement is fairly reliable.

A TMT/board including only foreign members would be represented by 0%, and a TMT/board that is fully Swedish would be represented by 100%.

- *Foreign listing* is represented by a dichotomous variable where one category refers to stock listed only at the Stockholm's stock exchange, and the other category refers to listing also on other stock markets. Listed only at the Stockholm's stock exchange has been coded as 0, listed at Stockholm's stock exchange and at other stock exchanges as 1.
- *Foreign subsidiaries* is a continuous variable that measures the share of a firm's foreign subsidiaries and can vary between 0-100. Number of foreign subsidiaries has been related to total number of subsidiaries.
- *Foreign ownership* is a continuous variable measured as foreign owners' share of capital.

The six control variables are operationalised as follows:

- *CEO replacement* has been used as a control variable based on the assumption that the accounting information could be manipulated in order to influence performance of the

corporation the replacement year or the year after replacement (Broberg, Collin, Tagesson, Axelsson & Schéle, 2007). CEO replacement has been recorded for the year when the CEO signed the first annual report. The variable is dichotomous and CEO replacement has been coded as 1 and no CEO replacement as 0.

- *Industry* has been used as a control variable to control for direct industry effects on performance (c.f. Hoskisson, 1987; Dess, Ireland & Hitt 1990). It is coded according to SIX (Scandinavian Information Exchange), which is also used by the largest newspaper in Sweden, *Dagens Nyheter*, and represented by dummies. The following industries have been identified: Finance, Health care, Manufacturing, IT, Consumer, Media, Primary products, Telecom, Service.
- *Size* of the firm has been used as a control variable based on the assumption that higher turnover is related to increased performance (e.g. Fama & French, 1992; Prevost, Ramesh, & Hossain, 2002). Size has been measured as turnover and calculated as the logarithm of turnover.
- *Executive compensation* refers to bonus has been used as a control variable based on the assumption that bonuses related to the profit of the corporation stimulate managers to perform. Options constitute a reward instrument that is not connected to profit but to market valuation, thus including expectations and general business trends. The variable is dichotomous where 1 indicates bonuses related to the profit of the corporation, and 0 all others.
- *Debt-to-Equity* has been added as a control variable since according to agency theory debt burden can stimulates managers to increase performance (Jensens, 1993). The variable is continuous and defined as $(\text{Debt} + \text{Provisions}) / (\text{Equity} + \text{Minority interest})$.
- *Ownership concentration* is a continuous variable measured according to the Herfindahl index. In Sweden one individual share can have one capital right but different voting

rights. We are observing the voting rights since it represent the owners' capacity to influence the corporation. The five largest shareholders voting rights were selected and according to the Herfindahl measure, squared and summarised.

ANALYSIS

The population of Swedish listed corporations the year of 2004 was 239 corporations. Out of these corporations, it was possible to get full data set from 171 corporations, i.e., a loss of 28%. We have been forced to drop the variable of international sales due to an almost total lack of information, which result in a loss of opportunity to test hypothesis 4 about the positive correlation between proportion of internationalisation of the firm's operations and performance. The variable that decreased the number of corporation possible to include in the analysis was foreign ownership, where not all corporations present the number in their annual report and other sources revealing the data are hard to find. An analysis of drop-outs indicated that there is no systematic difference in size or ROA. There was a weak significant difference in debt-to-equity ratio, with those included in the data set having higher ratio. A strong significant difference was found in size of the board and the TMT, where those included had larger sized TMTs and boards. Our conclusion is that our sample fairly well represents the population, but conclusions on debt-to-equity have to be treated with caution since there is a risk of overestimating its value. Table 1 presents the descriptive data of the variables used in the analysis.

Insert Table 1 about here

Inspecting the means and standard deviations we find that debt-to-equity ratio is rather high (2.26), which is considered to be normal in Sweden. Most corporations have bonus schemes. Close to 50% of the subsidiaries are foreign. Almost every corporation use one of the Big 4 audit firms, which will make the variable less influential on performance. Only 9% of the corporations are listed abroad, which makes their international exposure on governance through a stock exchange rather low. One should notice the very high proportion of Swedes being CEOs or chairmen, and that the same pattern can be found in the composition of the TMT and the board. Thus, a Swedish corporation appears on average to be rather international in production, sales and partly ownership, but not in managers and directors.

Inspecting the correlations we find that size influence performance, indicating that economy of scale does exist. Ownership concentration strongly correlated with performance, thus supporting the main agency theory prediction of the importance of strong ownership functions. More surprising is the positive correlation between Swedish CEOs and the degree of Swedes in the TMT. This correlation will be present during all the models, and will demand a special care in the ending discussion.

The variable CEO-replacement show no significant correlations, but the sign should be notified since it indicate, if anything, that CEO replacement depress performance, quite consistent with the hypothesis behind it as a control variable, that of the 'dressing the books'.

Many independent variables have rather high correlations, thus indicating problems of multicollinearity. Turnover is the most problematic variable since it contains much information that is in common with the other variables. Analyses have therefore been performed with

turnover and without turnover. The strongest effect attained with omitting size is that of an increase on tolerance of the other independent variables.

The very high correlation between the share of Swedish directors (national diversity of the board) and Swedish chairman of the board (Chairman's nationality), and the share of Swedish managers in TMT (national diversity of TMT) and Swedish CEO (CEO's nationality) is interesting since it indicates that the leading post of the board and the TMT are indicators of the national diversity of the groups. This tendency creates, however, severe problems of multicollinearity, which force us to create one model with the diversity indexes and one model with nationality of leading posts.

There is a very high significant correlation (corr. coeff. 0.45) between foreign listing and foreign ownership. One interpretation could be that foreign investors can be attracted to a corporation when it is listed abroad since foreign listing creates trust in the corporate governance of the corporation. Thus, foreign listing could be a marketing instrument that increases the capacity of the corporation to sell its equity and thereby to decrease its financial risk. Interpreted in this manner, foreign listing is not in the first instance a governance mechanism but a marketing instrument.

In table 2 we present five models. Model 1 includes only the variables of debt-to-equity, executive compensation and ownership concentration, representing what we have termed the traditional corporate governance mechanisms. Model 2 and 3 includes only the variables belonging to the international dimension of corporate governance (audit firm, foreign subsidiaries, foreign ownership, foreign listing and national diversity of CEO, chairman, board & TMT). It should be noted that model 2 includes national diversity of top positions (CEO and

chairman) but exclude national diversity of the board and the TMT, and model 3 includes national diversity of the board and TMT but excludes national diversity of top positions (CEO and chairman). Model 4 and 5 present the full models, i.e. including both the traditional and international dimensions of corporate governance mechanisms, yet, with the same divisions concerning national diversity as presented for model 2 and 3.

Insert Table 2 about here

Comparing the models, we find that we can explain the performance with an adjusted R2 between 0.30 and 0.40, which has to be considered as acceptable. Most of the explanatory capacity is, however, contained in the size measurement. Comparing the traditional model (model 1) with the international models (model 2 and 3) shows that the traditional model performs better. When inspecting the variables for the international models (model 2 and 3) it can be noticed that only one variable “foreign subsidiaries” is according to theory, but that the variables “foreign ownership”, “CEO’s nationality” and “national diversity of the TMT”, are significant, however, in reverse relation to the hypotheses.

Inspecting the behaviour of the different variables we make the following observations:

- debt-to-equity ratio is significant negatively correlated, which is a rejection of the main agency theory prediction of a positive relation with performance
- Executive compensation indicates no significant correlation
- Ownership concentration is positively correlated with performance, which is according to agency theory

- Audit firm is not correlated with performance, which reject H6
- Foreign subsidiaries vary in significance but is positively correlated with performance, which slightly supports H3
- Foreign ownership varies in significance, but if there is any correlation, it is negative, which reject H1
- Chairman's nationality as well national diversity of the board indicate no correlation with performance, which reject H5
- CEO being Swedish and the Swedishness of the TMT is positively correlated with performance, which reject H2

Inspecting the outcome of the tests, we find that out of 5 tested hypotheses concerning the effect of internationalisation of governance mechanisms on performance, we reject 4 hypotheses and find only a slight support for 1 hypothesis.

Due to low tolerance values of some variables, such as size, we have performed other tests, excluding those variables, but they failed to show other results than the once presented above. Test of error variance has been conducted and the result indicates homoscedasticity. Durbin-Watson in the different models is always above 1.5 which we interpret as an absence of serious autocorrelation. Thus, we believe that our findings are reliable.

The conclusion has to be that the proposition of internationalisation of governance mechanisms can be rejected. Although we find some indications of performance effects, being both positive and negative in impact, the overall impression is that of no effect.

DISCUSSION

We proposed the thesis that several corporate governance mechanisms have an international dimension, which if utilised, would increase the performance of the corporation. The data collected from Swedish listed corporations 2004 could not support that proposition. One slight indication supporting the proposition was the share of foreign subsidiaries, but the variable was very sensitive towards the included variables in the model. Surprising findings were that foreign ownership would decrease performance. But the strongest result was contrary to our initial expectations that share of Swedish managers on the TMT increases the performance. Does this indicate that the main proposition is wrong, and even should be reversed, that a road to increased performance is to stay at home, at least when it concerns governance mechanisms?

Our main interpretation of the results is that the proposition is too simple since it disregards the possibility that governance mechanisms are treated as a set, in a governance strategy, and not only in separation, with only one distinction, that of internationalisation. The other main interpretation is that the method is too simple since it did not consider the possibility of mechanisms having more than one function. We clarify first the method failure and then the proposition failure.

One reason for the prediction failure could be that the analysis could not illuminate the other functions of a corporate governance mechanism. It is conceivable that a corporate governance mechanism has other functions than governance, and that these functions sometimes surpass the governance effects. The capital structure is, according to agency theory (Jensen, 1993) a governance mechanism where the expectation is a positive correlation between debt-to-equity ratio and performance due to the disciplining effect caused by debt. We found, however, the opposite correlation, indicating that performance decreases with an increase in debt. This result

is insufficient to be able to reject the hypothesis of debt disciplining agents since capital structure is not limited to the function of discipline. Capital structure has also the function of creating trust in the corporation towards the suppliers, signalling to them that they run low risk when doing business with the corporation. Another function of the capital structure is that of creating conditions of corporate entrepreneurship, making it possible for the managers to engage in business with risk but also with great opportunities.

The share of Swedish persons in the TMT correlated positively with performance, which was contrary to expectations. One interpretation of this result is that the incentives effect of opening up the internal top management labour market for international recruitment is repressed in order to give the TMT strong capacity for concerted action, based on strong cohesion, arrived at through low national diversity. Thus, the function of action capacity is arrived at the expense of a suppressed governance function. This could, however, be tested through inspecting tenure of TMT. It could be assumed that with increasing tenure, the national diversity would create fewer obstacles on action capacity of the TMT, which is being supported by the findings in group research by Watson and colleagues (e.g. Watson, Kumar & Michaelsen, 1993; Watson, Johnson, Kumar, Critelli, 1998). A TMT with high tenure could therefore create high efficiency, even with high national diversity. The conclusion is, however, that the mechanism have several functions and governance is probably not the most important when it concern internal managerial labour market.

Another indication of the multi-functionality of mechanism is the share of foreign subsidiaries being positively correlated with performance. This appears, at first stance, to provide support for our hypothesis. Foreign subsidiaries have also, and foremost, the function of providing opportunities of international production and sales, thus being able to realise the competitive

advantage and the scale economies connected with internationalisation. Thus, the significant positive sign could support the hypothesis of market and production economies, instead of governance efficiency.

Thus, the conclusion of this interpretation of the prediction failure is that we are using a deficient method that is unable to separate the different functions of governance mechanisms. Another reason for the prediction failure could be the assumption of *ceteris paribus* inherent in the theory derivation and the regression analysis. We have assumed that one variable can be manipulated and the other can be treated as constants. It could, however, be reasonable to assume that the mechanisms are balanced against each other. Indeed, it has been suggested (Collin, 2007) that corporations are subject to governance strategies where the mechanisms are designed simultaneously in a concerted effort of creating conditions for efficiency. What is needed when having the conception of a governance strategy is to inspect the set of mechanisms and not the mechanisms in isolation.

One opportunity to examine the idea of set of mechanisms is to perform a factor analysis. Including only the governance variables in a factor analysis (available from the first author), resulted in a two factor model where the variables organised each other into one factor including the variables of share of Swedish persons on the TMT and on the board, foreign ownership, foreign production sites and foreign listing, thus comprising an international governance strategy orientation. The other factors loaded high on the variables of debt-to-equity ratio, audit firm, bonus and a negative on ownership concentration, thus fairly well summarising what we have termed a traditional governance strategy. In a regression analysis, including the control variables, indicated that the factor interpreted as representing international strategy had a negative correlation with performance. So did the inverse of traditional strategy,

where more of ownership concentration and less of bonus plans increased performance. Thus, we still have indications that internationalisation of governance mechanisms does not improve performance, but maybe decrease performance of the corporation. Our objection is, however, still valid, since factor analysis is not a technique of treating all governance mechanisms at the same time. We still need a method to deal with the possibility of a governance strategy.

Our conclusion is that with the introduction of a concept of governance strategy, we need an empirical method capable of treating the set of corporate governance mechanisms as belonging to a concerted action. Lacking a developed classification of governance strategies, which could be used to code the strategies of every corporation, we are restricted to utilise a case study technique aiming at finding instruments for classification. Thus, we believe that in order to be able to test the basic thesis of the paper, that internationalisation could drive efficiency, we need to develop a classification scheme through which we can identify different governance strategies. With these strategies, we can then find correlations with performance, however, with imperfections since we have not yet found a technique to separate the governance function from other functions of the corporate governance mechanisms.

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FIGURE 1.

PERFORMANCE EFFECTS OF INTERNATIONALISATION OF CORPORATE GOVERNANCE MECHANISMS

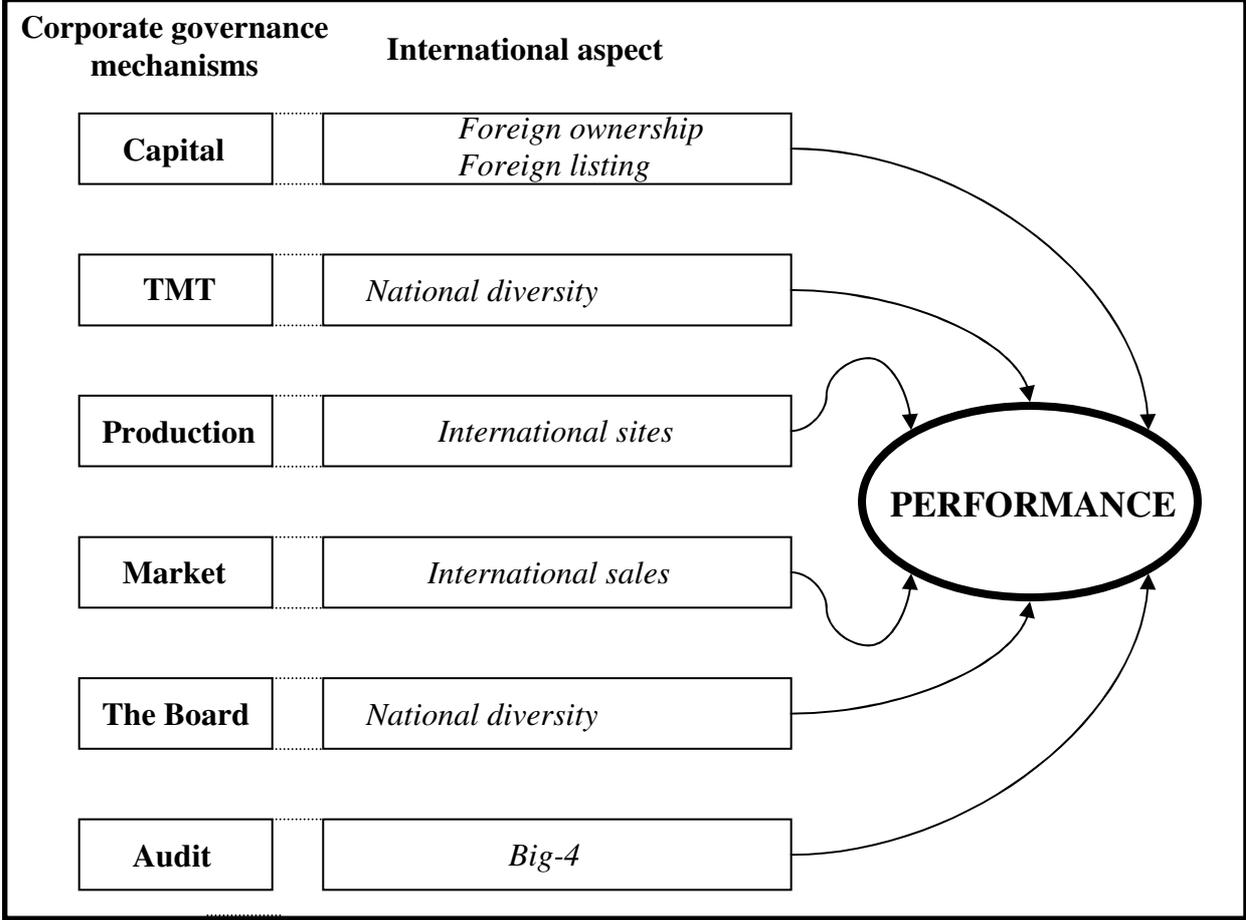


Table 1 Descriptive Statistics and Pearson Correlation Coefficients

Variables	Mean	Std. Dev.	1	2	3	4	5	6	7	8	9	10	11	12	13
1. Return on assets	4.33	12.54													
2. Debt-to-Equity	2.26	4.17	-.03												
3. Bonus	0.78	0.42	.15 [†]	.00											
4. Ownership concentration	0.14	0.15	.29***	-.14 [†]	-.23**										
5. Audit firms	0.95	0.21	.08	.09	.08	-.05									
6. Foreign subsidiaries	44.88	30.58	.12	.01	.20**	-.05	-.04								
7. Foreign ownership	19.32	18.72	.01	.10	.24**	-.34***	.12	.38***							
8. Foreign listing	0.09	0.28	.09	.01	.17*	-.09	.07	.15*	.45***						
9. Chairman's nationality	0.92	0.27	.09	-.05	-.10	.07	-.06	-.20**	-.31***	-.22**					
10. CEO's nationality	0.92	0.27	.34***	.09	.01	-.14 [†]	.04	-.02	-.14 [†]	-.15 [†]	.00				
11. National diversity of the board	0.87	0.19	.10	-.09	-.17*	-.15 [†]	-.08	-.31***	-.38***	-.44***	.53***	.32***			
12. National diversity of TMT	0.83	0.21	.21**	-.05	-.14 [†]	.11	-.01	-.40***	-.41***	-.27***	.21**	.48***	.50***		
13. CEO-replacement	0.15	0.35	-.11	-.10	-.02	-.05	.09	.04	.15*	-.01	-.19*	-.07	-.13 [†]	-.02	
14. Turnover (log)	6.17	0.93	.50***	.31***	.29***	.01	.19*	.28***	.39***	.39***	-.02	.16*	-.15 [†]	-.06	-.13 [†]

n = 171

[†] p < .10

* p < .05

** p < .01

*** p < .001

Table 2 Results of Regression Analysis for Performance

Variables	Model 1		Model 2		Model 3		Model 4		Model 5	
	Std. B	Std. Error	Std. B	Std. Error	Std. B	Std. Error	Std. B	Std. Error	Std. B	Std. Error
Traditional										
2. Debt-to-Equity	-0.20**	0.27					-0.19**	0.26	-0.19*	0.27
3. Bonus ^a	0.08	2.25					0.10	2.35	0.08	2.39
4. Ownership concentration	0.25***	6.06					0.30***	6.96	0.24***	6.86
International										
5. Audit firms ^a			0.02	4.76	0.03	4.32	0.01	4.36	0.01	4.28
6. Foreign subsidiaries			0.13 [†]	0.04	0.20*	0.04	0.09	0.03	0.15*	0.04
7. Foreign ownership			-0.29***	0.07	-0.26**	0.07	-0.11	0.07	-0.14	0.07
8. Foreign listing ^a			0.07	4.15	0.08	4.31	0.01	3.93	0.00	4.23
9. Chairman's nationality ^a			-0.03	3.84			0.04	3.70		
10. CEO's nationality ^a			0.14*	3.73			0.24***	3.61		
11. National diversity of the board					0.02	6.39			-0.01	6.17
12. National diversity of the TMT					0.17*	5.87			0.20*	5.67
Control										
13. CEO-replacement ^a	0.04	2.45	0.03	2.79	0.03	2.68	-0.01	2.59	-0.00	2.58
14. Turnover (log)	0.47***	1.15	0.51***	1.32	0.51***	1.28	0.48***	1.40	0.54***	1.39
Constant	-46.63***	8.22	-51.13***	11.19	-59.21***	11.87	-65.49***	10.71	-64.45***	11.64
Adj. R ²	0.34		0.30		0.31		0.41		0.38	
F-value	9.71***		5.89***		6.04		7.31***		6.56***	

^a Dichotomous variable

[†] $p < .10$

* $p < .05$

** $p < .01$

*** $p < .001$