

INTERNATIONALIZATION, FAMILY BUSINESS AND CORPORATE GOVERNANCE: AN EMERGING MARKET PERSPECTIVE

CHITRA SINGLA and REJIE GEORGE P.
Indian Institute of Management Bangalore, India

RAJARAM VELIYATH
Coles College of Business, Kennesaw State University, USA

INTRODUCTION

Internationalization increases information processing demands on the firm due to added communications necessary to bridge information asymmetries between the management and the board. Additionally, internationalization also creates the demand for more resources and capabilities to manage the firm's far flung operations. Firms deal with the information processing demands by increasing information capacity through governance arrangements like board structure and CEO duality (Sanders & Carpenter, 1998). The increased organizational complexity (resulting from internationalization) also increases agency costs necessitating changes in governance mechanisms. Finally, resource dependence theory suggests how firms can gain the required resources (Pfeffer & Salancik, 1978), sometimes through varying governance mechanisms like CEO compensation and board composition.

In this paper, we examine the consequences of firm internationalization on CEO compensation, CEO Duality and board structure, employing a multi-theoretic perspective (i.e., information processing theory, agency theory and resource dependence theory). We also assess how family business firms with their unique governance mechanisms, moderate the above relationships. The changes in internationalization patterns and governance characteristics witnessed recently in India prompted us to examine the relationships in a sample of 74 publicly listed Indian companies over a five year (i.e., 2004-'08) time period.

The contributions of our study are: 1) we employ a multi-theoretic approach which enables us to unravel internationalization-governance relationships in a more fine-grained manner. The discernible influence of secondary principal-principal agency issues prevalent in family business firms are also important determinants of governance attributes, 2) we extend previous work (Sanders & Carpenter, 1998) by testing their results over a longitudinal time frame, employing panel data, 3) as the first study to explore these relationships in the Indian context, we contribute to the relatively scarce literature on emerging market firms. Finally, 3) building on Sullivan's (1994) work, we employ a multidimensional, robust, and comprehensive measure of firms' degree of internationalization (DOI) construct.

HYPOTHESES DEVELOPMENT

CEO Compensation

Internationalization leads to an increase in organizational complexity and information processing demands. These derive from changes in organizational structure, from managing domestic as well as international operations, from simultaneously practicing multiple accounting

standards, and from managing problems arising from the liability of foreignness (Zaheer, 1995). Accurate and timely information transfers and communications between foreign subsidiaries and the parent company become critically important (Gubbi, Aulakh, Ray, Sarkar, & Chittoor, 2009). The effects of internationalization are time dependent (Sanders & Carpenter, 2003) and the benefits may sometimes accrue only after considerable time has elapsed (Dierickx & Cool, 1989). Consequently, the CEOs of these firms who play crucial roles in making decisions and managing complexities face considerable risks.

CEO compensation is positively linked to organizational complexity (Henderson & Fredrickson, 1996) and additional risk taking (Wiseman & Gomez-Mejia, 1998), both of which increase with internationalization. Therefore we expect that increasing DOI will be positively related to CEO's compensation. Further, the ability to process the additional information arising from organizational complexity is a scarce, irreplaceable, and valuable resource (Henderson & Fredrickson, 1996). So firms undertaking internationalization will need to incentivize their CEOs with higher compensation in order to retain them. Consequently,

H1a: The firm's degree of internationalization will have a positive impact on CEO compensation.

Tosi and Gomez-Mejia (1989) found that the level of monitoring was significantly higher in owner-controlled than in management-controlled firms. Since family business firms are owner controlled firms, if the CEO is not a family member family owners will have strong incentives to monitor management and the CEO. This monitoring mitigates agency problem type 1 (principal-agent agency problem) by not allowing the CEO to expropriate benefits in terms of high compensation. Conversely, if the CEO of the firm is also a family member or owner, the main source of income or wealth generation for the CEO would be in the form of dividends or from increased market capitalization of the firm. Through limiting CEO compensation, the family may want to signal to other shareholders that agency costs have been minimized. Therefore,

H1b: The positive relationship between degree of internalization and CEO compensation is weaker in family business firms.

CEO Duality

CEO Duality is an indication of high CEO power and reduced board independence. Duality helps establish unity of command and clarifies decision-making authority (e.g., Baliga, Moyer, & Rao, 1996). However, duality may not be equally effective in all contexts (Boyd, 1995). With greater information processing demands, firms may choose to split the CEO and Board Chairman roles in order to increase information processing capacity. However, this reduces the information-processing capacity of the upper echelons (Sanders & Carpenter, 1998).

Furthermore, increased complexity from internationalization increases information asymmetries, thus necessitating greater monitoring of management by the board. Since the CEO also serves as the presiding officer of the board, duality compromises the ability of the board to monitor the CEO's practices, policies and performance (e.g., Jensen, 2005). Additionally, a board chair and a CEO may have different network ties and access to different sets of resources.

From a resource dependence perspective, the different network ties and additional resources are useful for the success of international operations. On this basis, we hypothesize:

H2a: The firm's degree of internationalization negatively impacts CEO duality.

In family firms, where family owner-managers prefer greater control (Thomsen & Pedersen, 2000), shareholders belonging to the family may choose not to dilute their control by separating the two key positions of CEO and the board chair. In addition, from a principal-principal agency perspective, family owners who have concentrated ownership in the firm may expropriate benefits from minority shareholders by colluding with the appointed agents (Young, Peng, Ahlstrom, Bruton, & Jiang, 2008). In these cases the owners may not want an independent board chair to monitor top management, because such an arrangement would make it difficult for family owner-managers to expropriate greater benefits. This would be despite the fact that from an information processing perspective, permitting CEO duality would be detrimental for internationalized firms. Hence we hypothesize:

H 2b: The negative relationship between degree of internationalization and CEO duality is weaker in family business firms.

Board Structure

Inside directors possess critical information regarding the firms' task environment, whereas outside directors are dependent on the CEO and other insiders for internal information (Baysinger & Hoskisson, 1990). Consequently, outside directors might approve critical decisions based only on publicly available financial information (Lorsch & MacIver, 1989). This information may be inadequate for making decisions on longer-term projects like internationalization. Therefore from an information-processing perspective, DOI increases the need for internal directors, resulting in a negative relationship between DOI and the percentage of outside directors on the board.

Alternatively, from an agency theory perspective, internationalization increases complexity caused by information asymmetries between the management and the board (Deutsch, 2005). Thus more outside directors will be required to monitor the management. Likewise, resource dependence theory views board members as being instrumental in helping to acquire the resources necessary for international expansion (Hillman & Dalziel, 2003). The success of international operations will greatly depend upon the firm's ability to procure these resources. Therefore, firms co-opt resourceful individuals as directors (Pfeffer, 1972).

We expect that the positive reinforcing effects of the agency and resource dependence perspectives to override the negative effects of the information processing perspective on the proportion of outside directors required with internationalization. Consequently,

H3a: A firm's degree of internationalization positively impacts the percentage of outside directors on the board.

From an agency perspective, more outside directors are required to monitor management in complex environments like those found in the case of internationalization. But in family business firms where a family retains control over the firm through its shareholding and

management control, they may prefer not to have more outside directors to monitor the management's activities. Outside directors may also veto decisions made by family linked owner-managers that are not favorable for other shareholders. For example, family owner-managers may appoint family members to important positions in the company based on their family ties and not based on their competence. In such instances, having a greater number of inside directors results in less opposition to such sub-optimal decisions. Hence we hypothesize:

H3b: The positive relationship between degree of internationalization and the percentage of outside directors is weaker in family business firms.

VARIABLES

Dependent Variables

CEO compensation level was measured as the logarithm of the total of all forms of compensation granted to the CEO during the year (Sanders & Carpenter, 1998). It included salary, perquisites, bonus, provident fund and commission. CEO duality was coded '1' if CEO also occupied the position of the chairperson of the board, otherwise it was coded '0' (op. cit.). Board structure was the percentage of outside directors on the board (op. cit.).

Independent Variables

We measured a firm's DOI using a variation of Sullivan's (1994) composite measure (DOI Index). We used four dimensions of internationalization, three of which were suggested by Sullivan (1994), foreign sales to total sales (FSTS), foreign assets to total assets (FATA), and the number of overseas subsidiaries to total number of subsidiaries (OSTS). A fourth dimension named Scope (Sanders & Carpenter, 1998) which captured geographic dispersion was also added. Scope was expressed as a proportion of the highest number of countries with subsidiaries represented in our sample in a given year. The theoretical range for each dimension ranged from 0 to 1. The four different variables (FSTS, FATA, OSTS and Scope) were summed to form our composite measure of degree of internationalization called the DOI Index (with range $0 < \text{DOI Index} \leq 4$). These variables demonstrated good inter-item reliability (a standardized alpha of 0.65) and loaded on one factor with a high Eigen-value (1.992) and exhibited high explained variance (50%). We also used Scope and Export Intensity as alternative measures of DOI. These results have not been presented due to space constraints.

Family business firm was a dummy variable which was coded 1 if any two of the following three criteria were met, otherwise it was coded 0 (Anderson & Reeb, 2003): 1) founding family has more than 2 % stake in the firm (Anderson & Reeb, 2003, p.1308), 2) member of founding family is on the board of the firm (Anderson & Reeb, 2003, p.1308), and 3) member of founding family is on the management team of the firm (an additional criterion). We controlled for board size, firm size, performance, leverage, block-holding, industry affects, business group affiliation and dual listing of firms in domestic and foreign exchanges.

RESULTS AND DISCUSSION

The results are shown in Table 1

We obtained support for H1a, H 3a and H3b. Results for H1b, 2a and 2b were inconclusive. Higher DOI of a firm leads to higher level of CEO compensation, after controlling for the firm's size and performance, as proposed by both the information processing and the principal-agent agency perspectives. Firms need to incentivize top management both in order to retain talent and also in order to compensate them for managing complex tasks. The absence of support for hypothesis 1b indicated that family owner-managers were unsuccessful in exercising control over CEO compensation. Remuneration committees believe that CEOs need to be compensated well for the greater amount of risk they face during foreign expansions.

While hypothesis 2a was not upheld (in Table 1), we obtained limited support when Scope and Export Intensity were used as alternative measures of DOI (these results are not presented). This provided tentative evidence that increasing DOI lead to a decrease in CEO duality. The absence of support for hypothesis 2b suggested that family business firms' positive impact on CEO duality were not strong enough to offset the negative impact of internationalization. As per clause 49 of the Listing Agreement for companies in Indian Stock Exchanges, firms are required to have 50% outside board members, when CEO duality is practiced in the firm. Support for hypothesis 3b indicated that family business firms had a negative impact on the internationalization-board structure relationship. This suggested that compared to non-family firms, family business firms had relatively lower percentages of outside directors over fears of loss of control. Family firms might have even forsaken CEO duality preferring instead to have a lesser number of outside directors on their boards.

Support for hypothesis 3a indicates that firms have a greater percentage of outside directors with increasing internationalization, since these firms stand to gain access to additional resources through these outsiders. Having more outsiders may not hinder a firm's decision making process, as suggested by the information processing perspective (Sander & Carpenter, 1998). Many outside directors are unable to take effective and independent decisions (Westphal & Stern, 2006, 2007) since they are either under the influence of the CEO or that of the majority shareholders. This will be more prevalent in the Indian context because of the presence of concentrated ownership. In such instances, outside directors mainly play the role of resource providers rather than that of decision makers and monitors.

CONCLUSION

Our study contributes to the corporate governance and internationalization literatures by employing a multi-theoretic perspective, using multi-dimensional construct for DOI, and by exploring the impact of family business firms on the internationalization-governance relationship. Our work has revealed the need for closely examining the implications of internationalization on various governance parameters especially on account of principal-principal agency issues thereby opening up several interesting avenues for future research. In particular, future work can examine the role of different institutional contexts which have variations in principal-principal agency costs, differences in industry contexts, compare multinational affiliates with domestic firms and include additional governance attributes such as like interlocking directorates and measures to capture board diversity.

REFERENCES AVAILABLE FROM THE AUTHORS UPON REQUEST

Table 1: Results of Random Effect Panel Data Regression Analysis for DOI Index as an Independent Variable ^a

To examine our hypothesis, we construct two balanced panel datasets: one dataset has 74 firms over a period of 5 years (2004-'08) with the independent variable being the degree of internationalization index (DOI Index), measured as a multi-dimensional construct. The results corresponding to which are shown in the table below. The second dataset has 180 firms over the same period of 5 years, with the DOI being measured as exports intensity and the results corresponding to which are not shown due to space constraints. Data corresponding to the dependent variables and the independent variables like DOI and family business firm was hand collected from annual reports of the firms. Data corresponding to the control variables was collected from the CAPITALINE database provided by Capital Market Ltd., an Indian information services firm. We decided to use random effect panel data regression on the basis of results of Hausman test (Baltagi, 1995: 68).

<i>Variables</i>	CEO COMPENSATION ^b			CEO DUALITY			BOARD STRUCTURE		
	Model 1 (Control)	Model 2 (H1a)	Model 3 (H1b)	Model 4 (Control)	Model 5 (H2a)	Model 6 (H2b)	Model 7 (Control)	Model 8 (H3a)	Model 9 (H3b)
DOI Index		0.17* (0.07)	0.15 (0.12)		-0.88 (0.63)	-1.44 (1.14)		1.41* (0.61)	3.54* (1.51)
Family Dummy		-0.17 (0.20)	-0.21 (0.20)		0.89 (1.62)	0.01 (2.10)		-3.58*** (1.08)	-0.30 (3.12)
DOI Index *Family Dummy			0.03 (0.07)			0.87 (1.32)			-3.24+ (1.85)
Size	0.51*** (0.02)	0.47*** (0.03)	0.47*** (0.03)	0.98+ (0.56)	1.21* (0.54)	1.19* (0.54)	-1.11*** (0.36)	-1.47*** (0.37)	-1.48*** (0.42)
ROA	1.33 (0.84)	1.47+ (0.86)	1.46+ (0.87)	0.70 (4.92)	-0.47 (5.09)	-1.31 (5.36)	-3.27 (17.48)	-2.16 (17.21)	0.08 (15.82)
Block- holder	1.05* (0.46)	0.92* (0.44)	0.92* (0.44)	-5.27 (3.38)	-4.40 (3.29)	-4.42 (3.31)	3.27 (5.15)	2.36 (5.58)	2.37 (5.48)
Group Dummy	0.41** (0.15)	0.48*** (0.12)	0.48*** (0.12)	1.45 (1.64)	0.98 (1.66)	1.01 (1.68)	6.05+ (3.37)	6.88* (3.37)	6.70* (3.38)
Cross-listing Dummy	-0.09 (0.21)	-0.09 (0.21)	-0.09 (0.22)	-3.05 (2.83)	-3.18 (2.75)	-3.22 (2.77)	-1.46 (1.60)	-1.20 (1.58)	-1.02 (1.74)
CEO Duality	0.24** (0.09)	0.26*** (0.09)	0.26*** (0.09)				-2.78 (1.81)	-2.51 (1.88)	-2.37 (1.91)
Board Structure	0.01*** (0.01)	0.01*** (0.01)	0.01*** (0.01)	-0.04 (0.03)	-0.03 (0.03)	-0.03 (0.03)	-0.20+ (0.12)	-0.11 (0.11)	-0.07 (0.11)
Intercept	10.3*** (0.26)	10.51** (0.34)	10.53** (0.34)	-6.12 (4.73)	-7.87 (4.85)	-7.20 (4.96)	76.61*** (5.01)	78.39*** (5.34)	75.68*** (6.45)
Industry Dummies	Included	Included	Included	Included	Included	Included	Included	Included	Included
Adjusted R ²	0.216	0.221	0.219				0.01	0.01	0.01
F Stat.	9.48***	8.48***	7.89***				1.27***	1.26***	1.28***
Chi ²				9.79	12.14	11.62			
No. of obs	370	370	370	370	370	370	370	370	370

^a Standard errors are in parentheses. ⁺ p < 0.1 *p < 0.05 **p < 0.01 ***p < 0.001. ^b Natural log of CEO Compensation.

Copyright of Academy of Management Proceedings is the property of Academy of Management and its content may not be copied or emailed to multiple sites or posted to a listserv without the copyright holder's express written permission. However, users may print, download, or email articles for individual use.

Copyright of Academy of Management Annual Meeting Proceedings is the property of Academy of Management and its content may not be copied or emailed to multiple sites or posted to a listserv without the copyright holder's express written permission. However, users may print, download, or email articles for individual use.