Full length article

Corporate governance, political involvement, and internationalization: An empirical investigation in Japan and Taiwan

Li-Wen Chen\textsuperscript{a}, Hsin-Yi Yu\textsuperscript{b,∗}

\textsuperscript{a} Department of Finance, National Chung Cheng University, 168 University Road, Minhsiung Township, Chiayi County 62102, Taiwan
\textsuperscript{b} Department of Finance, National University of Kaohsiung, 700, Kaohsiung University Rd., Nanzih District, Kaohsiung 81148, Taiwan

\section*{A R T I C L E   I N F O}

Article history:
Received 25 December 2015
Accepted 8 July 2016
Available online xxx

Keywords:
amakudari
Business-government relations
Corporate governance
Political intervention
Internationalization

\section*{A B S T R A C T}

This paper investigates the effects of intervention by government and financial institutions on the degree of internationalization in Japan and Taiwan, with particular attention to the impact of the main bank system and the system of \textit{amakudari} (the appointment of retired bureaucrats to the boards of public companies). The empirical results indicate that companies with a higher degree of internationalization have boards with stronger monitoring ability and therefore can fend off intervention by government. On the other hand, a negative relationship is established between the presence of retired bureaucrats on boards (\textit{amakudari}) and the subsequent degree of internationalization. Similarly, intervention by financial institutions results in a lower subsequent degree of internationalization. Thus, although representatives of government and financial institutions may attempt to use their influence to prompt international expansion, the monitoring ability of the board may be jeopardized, to the detriment of internationalization.

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\section*{1. Introduction}

In contrast to arm’s-length capitalism, in which the market is an important disciplinary mechanism of governance, crony capitalism is a relationship-based system (\textit{Rajan and Zingales, 1998}) in which representatives of government agencies participate in the governance of public companies. In Japan, the system of companies employing top-level retired bureaucrats is called \textit{amakudari}, which translates literally as “descending from heaven.” This system is common in Japan and recently has become more so in Taiwan. Such political involvement in public companies is a critical issue that has seldom been examined in the corporate governance literature. This paper examines the influence of political involvement and financial institutions on the degree of internationalization and compares the impact of such involvement in Japan and Taiwan. Under crony capitalism (\textit{Rajan and Zingales, 1998}), the economy is operated by a “hidden hand” controlled by the ruling political party. The ruling party may arrange for better treatment for companies that have similar political ideology or are engaged in public projects favored by that party. For executives and directors, developing an informal relationship with government is critical. Through the system of government ownership and government-appointed directors, government also has the power

\textsuperscript{∗} Corresponding author.
E-mail addresses: lwchen@ccu.edu.tw (L.-W. Chen), hyyu@nuk.edu.tw (H.-Y. Yu).

\url{http://dx.doi.org/10.1016/j.ribaf.2016.07.023}

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to control the operations of certain companies, especially state-owned enterprises and government-linked companies. In addition to government, financial institutions such as banks and securities companies also appoint representatives to boards in Japan and Taiwan. For example, Japan is known for its main bank system (Aoki and Patrick, 1995). Generally, state-owned and government-linked banks play an implicit role in helping governments intervene in companies’ operations. Under this kind of intervention, there is a danger that government and financial institutions will pursue their own interests at the expense of shareholders by reducing the effectiveness of the monitoring function of a company’s board.

Most studies have focused on the influence of political involvement on firm performance (Yu and Main, 2012). However, it is also necessary to examine the effect of intervention by government and financial institutions on Asian internationalization, which has been discussed only contextually in the literature. The first objective of this paper is to examine how the degree of internationalization influences external and internal governance arrangements. That is, does the degree of internationalization influence intervention by government and financial institutions? In terms of internal governance, the focus is on the board of directors. In terms of external governance, both private and public aspects are involved. Private external governance involves the intervention of banks, insurance companies, and securities companies. Public external governance relates to how government intervention influences the degree of internationalization. The second objective of the paper is to establish whether, for companies that have directors with political backgrounds, the subsequent degree of internationalization is higher.

The empirical results indicate that companies with a higher degree of internationalization may try to fend off intervention by government and financial institutions. That is, a higher degree of internationalization will reduce government’s ability to control a company. However, the empirical results also suggest that political involvement and financial intervention are not followed by a higher subsequent degree of internationalization because such intervention jeopardizes the monitoring ability of board of directors and thereby reduces the subsequent degree of internationalization.

This paper is related to several other strands of literature. First, it contributes to the published literature on political intervention by examining whether higher degree of internationalization attracts the intervention from government and financial institutions and whether such intervention affects subsequent degree of internationalization (Agrawal and Knoeber, 2001; Filatotchev et al., 2005). Our evidence that the level of political connection of a board is negatively related to the subsequent degree of internationalization complements several recent studies that focus on political connections (Agrawal and Knoeber, 2001; Faccio, 2006; Fan et al., 2007; Masulis and McConnell, 2006). Secondly, this study focuses on the intermediate role of board of directors. Previous studies seldom discuss the intermediate role of board of directors but focus on only the direct influence from the intervention from government and financial institutions on firm performance or other firm characteristics. This study uncovers that the intervention from government and financial institutions actually reduces the degree of internationalization by jeopardizing the monitoring ability of board of directors.

The paper is organized as follows. In Section 2, some background is provided relating to political involvement in Japan and Taiwan. The relationship between internationalization and home government in Asia is also discussed. Several hypotheses are developed in Section 3. Section 4 introduces the data and research methods. Section 5 discusses the empirical results. The conclusion summarizes in Section 6.

2. Background

2.1. Political involvement in Japan and Taiwan

The best-known aspect of political involvement in Japan is the employment of retired government bureaucrats in the private or public corporations, called amakudari. This kind of reemployment creates extensive informal networks and alliances throughout Japanese society, including business, politics, and the civil service (Kuji, 1998). When these bureaucrats move into their new positions, they bring with them personal networks and invaluable knowledge concerning their ministry’s administrative procedures and policies. The system of amakudari thereby provides a mechanism for exchanging information and resources across legislative, bureaucratic, and business institutions (Colignon and Usui, 2003).

According to the literature, there are many definitions of amakudari. The most common definition is that the system of amakudari involves the movement of retired bureaucrats from the public sector to the boards of publicly listed companies. This definition is somewhat narrow. In this paper, I use a broader definition of political involvement that also includes the system of shukko (employee transfers), or the loan of employees to a company (Carpenter, 2003). Under this system, bureaucrats are assigned temporary positions in public companies for two to three years. The benefits of shukko for companies include better access to political information, better understanding of administrative and bureaucratic rules, and the establishment of informal networks with government. In both Japan and Taiwan, the system of shukko is common. According to Keeth (1990), who discusses the deployment of Japanese ministry directors in shukko positions, about 80% of all Japanese directors in ministries held shukko positions in other organizations during their careers. In Taiwan, it is common for legislators and other high-ranking government officials to hold positions as directors or auditors on the boards of publicly listed companies (Zun, 2002). This paper considers both amakudari and shukko as political involvement.

Please cite this article in press as: Chen, L.-W., Yu, H.-Y., Corporate governance, political involvement, and internationalization: An empirical investigation in Japan and Taiwan. Res. Int. Business Finance (2016), http://dx.doi.org/10.1016/j.ribaf.2016.07.023
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