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Institutional influences on board composition of international joint venture firms listing on emerging stock exchanges: Evidence from Africa

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ABSTRACT

The attraction of blue-chip listings in emerging stock markets is a major policy initiative common across much of the developing world. In many cases however, local blue-chip firms are the result of foreign Multinational Enterprise (MNE) firms engaging with local indigenous partners to form an international joint venture (IJV). These are unique with bilateral governance structures underscoring co-ownership between partners of residual cash flows and assets of the IJV. Using a unique and comprehensive sample of 202 IPO firms from across the emerging African region evidence of both a pronounced internal as well as external role for IJV boards was found. Social and political legitimacy concerns dominate the external role of boards in particular. Increasing proportions of boards drawn from commercial and governmental social elites are associated with IJV IPO firms in high institutional quality while lower proportions of these elites are associated with civil code law jurisdictions rather than common law. Governmental elites are associated with country-level improvements in corruption control and political stability while commercial elites are only marginally associated with improvements in political stability, regulatory quality, rule of law and democratic voice and accountability measures.

1. Introduction

There is a sizeable literature regarding international joint ventures (IJVs) in terms of their stability and performance (Brouthers, 2013; Reuer & Koza, 2000), as well as the motivations behind their use in foreign direct investment (FDI) (Buckley & Casson, 1998; Dunning, 2001) as opposed to comparable mechanisms such as greenfield sites or takeovers and the formation of wholly owned subsidiaries (Kogut & Singh, 1988; Meyer, Estrin, Bhaumik, & Peng, 2009). Despite the common assumption of IJV boards an essential mechanism in the alleviation of ex-post moral hazard between incumbent partners (Williamson, 1991), very little research has focussed on the distinctive board governance characteristics of these hybrid organizational forms. Two prominent exceptions are studies by Kumar and Seth (1998) and Reuer, Klijn, and Lioukas (2013). Kumar and Seth undertook an explorative study of the board-level coordination and control mechanisms for the management of IJV-parent relationships developing a theoretical framework based on structural contingency, resource dependency and agency. In contrast Reuer et al. focused on the tension faced by IJV boards in attaining administrative control so as to monitor and coordinate venture's activities on behalf of parent partners against the value of delegating authority to local management. An apparent shortfall in the literature arising through this prior internal focus on IJV board role is a lack of study towards the external co-optation mechanisms (Pfeffer & Salancik, 1978) employed by IJV boards to alleviate environmental uncertainty arising from institutional voids (Khanna & Palepu, 2000; Khanna & Rivkin, 2001). Our study focuses on this shortfall in terms of the composition of IJV boards through nonexecutive directors recruited from social elites that are prominent in indigenous political economy. This forms our first contribution to literature.

We focus our study on the distinctive sample of IJVs that are motivated to list through initial primary offering (IPO) on the national stock markets associated with indigenous host partners. This reflects the growing importance of IJV entities in the attraction of listings from fledgling formal economies of many emerging economies (Bennell, 1997; Hearn, 2014a, 2014b; Hearn & Piesse, 2013; Lavelle, 2001). This addresses a shortfall in the literature which has been almost exclusively focussed on the capital raising, valuation and performance implications on the stock of parent partners in major international stock markets, such as US and UK,

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arising from the decision to initiate an IJV. The listing of the IJV entity itself in emerging indigenous stock markets, together with the political legitimacy, enhancement of brand awareness and indigenization of ownership motivations for this (Lavelle, 2001; Saudagaran, 1988), have been largely overlooked. This is despite the importance of IJV listing as a common part of partial, or phased, privatization processes in many emerging economies (Bennell, 1997; Lavelle, 2001) where moribund former state owned enterprises (SOEs) have been subject to phased divestment to foreign partners (Perotti, 1995). Our exclusive study of IPOs is their ability to yield an exclusive insight into the governance structure of IJV entities where listing is attributed to legitimacy concerns (DiMaggio & Powell, 1983) than a pivotal event on the entrepreneurial life cycle of the firm as envisaged by Brav and Gompers (2003). Consideration of IPOs also facilitates study of governance given the ubiquitous availability of detailed firm-level data from prospectus filings which is at best only sporadically available from a wider sample of all listed firms (Munisi, Hermes, & Randoy, 2014). The uniqueness of our focus on IJV IPOs forms our second contribution to literature.

Africa provides a unique context for our study given an almost complete lack of literature regarding MNE activity, FDI and IJV formation on the continent. This is despite some evidence of the importance and prevalence of IJVs in West Africa (Boateng & Glaister, 2002) and a very recent study by Bartels, Napolitano, and Tissi (2013) focussing on the distinctive location-based factors influencing FDI across the continent. There is a sharp distinction in institutional environment between civil code law countries (mostly former French and Portuguese colonies) and their common law counterparts (former UK colonies) (La Porta, Lopez-de-Silanes, & Shleifer, 2008). Furthermore there is significant variation in institutional quality across the continent, ranging from that of Botswana, considered on a par with Western Europe, to Cote d'Ivoire and Nigeria, on a par with least developed worldwide (Transparency International, 2013). Africa provides a unique and ideal laboratory within which to study a theoretical tension in IJV boards between their internally-focussed role on performance monitoring and evaluation of venture with their complimentary external role in securing political legitimacy, access to resources and information. It also justifies our consideration of institutional theory over and above structural contingency and resource dependency perspectives that have been successfully applied by Kumar and Seth (1998). These notably lack the deeper contextualization which institutional theory provides while also providing an opportunity to institutionally-mediate theoretically anticipated relationships regarding the environmental co-optation and boundary-spanning role of boards (Hillman & Dalziel, 2003; Pfeffer & Salancik, 1978) with respect to changes in institutional environment and quality. This forms our third contribution to literature.

While there is a considerable literature regarding the boundary-spanning role of nonexecutive board members in facilitating environmental co-optation for firms which is largely theoretically rooted in resource dependency perspective (see Hillman, Withers, & Collins, 2009 for a full review), on the extension of this focuses on the recruitment of governmental (Hillman & Keim, 1995; Holburn & Vanden Bergh, 2008; Lester, Hillman, Zardkoohi, & Cannella, 2008) and politically-linked directors (Hillman, 2005; Hillman, Zardkoohi, & Bierman, 1999; Hillman, Keim, & Schuler, 2004). All of this literature has focussed on the developed markets of US and UK with the recruitment of nonexecutives being focussed on those with governmental or political backgrounds. North (1990) argues that the structure of emerging political economies are often very different from their developed country counterparts. Polity's are typically much narrower and controlled by handfuls of social elites with considerable vested private benefits of control. In this light we extend the traditional literature focus on governmental and politically-linked elites through consideration of four categories of social elite prevalent in African IPO firms from identification of these backgrounds in listings prospectuses. These are military, governmental, commercial and university. This forms our fourth and final contribution to literature.

We construct and employ a comprehensive database of 202 IPOs undertaken across Africa between January 2000 and January 2014 and find evidence that increasing proportions of boards drawn from indigenous social elites are positively associated with IJVs compared to their public company counterparts. This relationship was negatively moderated in civil code law environments in contrast to their common law counterparts. Equally this relationship was positively moderated in high institutional quality environments compared to their low institutional quality counterparts. Increased governmental and commercial elites are prevalent on IJV boards. The former are associated with country-level improvements in corruption control and political stability while the latter are only marginally associated with improvements in political stability, regulatory quality, rule of law and democratic voice and accountability measures.

The paper proceeds as follows: the next section outlines the theoretical background and hypothesis formation. Section 3 outlines data sources alongside dependent and independent variable definitions and empirical methods. Section 4 outlines the results within the context of previous related research and the final section concludes with implications for management and limitations.

2. Theory and hypotheses

The structure and operational duties of IJV boards share a number of similarities with their public company counterparts (Reuer et al., 2013). This is evidenced by a mutual emphasis of board's having a fiduciary duty in terms of the performance monitoring and oversight (surveillance) of senior management within the venture (Hambrick, Li, Xin, & Tsui, 2001; Yan & Gray, 1994). These duties are supplemented with an emphasis of directors providing advice and counsel to management (Adams, Hermalin, & Weisbach, 2010; Carpenter & Westphal, 2001; Hillman & Dalziel, 2003) as well as in coordinating partner and venture actions through effecting strategic plans and reconciling the different needs of partners within the venture's core operations (Kumar & Seth, 1998; Ravasi & Zattoni, 2006). Given the TCE emphasis on the bounded rationality (cognitive limitations) of partners to a joint venture and that their interaction is fraught with potential opportunism owing to inherently incomplete contract structure, the IJV board has an important function in monitoring the collaborations performance, engaging in ad-hoc private ordering by addressing conflicts as and when these arise, and adapting the actions of the venture (see Geringer & Hebert, 1989; Kumar & Seth, 1998; Ravasi & Zattoni, 2006). The control and coordination of the joint venture on behalf of the parents entails both the appraisal of the venture's performance and managerial decision-making, as well as guarding the venture from detrimental (sub-optimal) actions by its members (see Adams & Ferreira, 2007; Kriger, 1988). Board composition in IJVs in terms of director representation of partners tends to be reflective of the respective partner equity stakes in the venture (Hewitt, 2005). Significant departures may take place from this premise. In particular, there are a variety of other mechanisms available to partners to exert control over the IJV with these including the staffing of key managerial positions with parent executives (Killing, 1983; Kumar & Seth, 1998) and the design of incentive packages (Killing, 1983). This is alongside a host of socialization of IJV management with those of the parent (Kumar & Seth, 1998) and integrative mechanisms such as direct contact between parent executives and IJV personnel (Killing, 1983). These represent various