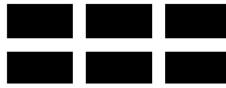

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CORPORATE GOVERNANCE, MANAGERS' INDEPENDENCE, EXPORTING AND PERFORMANCE OF FIRMS IN TRANSITION ECONOMIES

By: Igor Filatotchev, Natalia Isachenkova and Tomasz Mickiewicz

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Igor Filatotchev♣

Department of Management
King's College London
150 Stamford Street, London SE1 9NN, UK
Tel/Fax: +44(0)20 7848 3965
e-mail: igor.filatotchev@kcl.ac.uk

Natalia Isachenkova

School of Accounting & Finance
Kingston University
Kingston Hill, Kingston upon Thames, Surrey, KT2 7LB, UK
Tel: +44(0)20 8547 8206
Fax: +44(0)20 8547 7026
e-mail: n.isachenkova@kingston.ac.uk

Tomasz Mickiewicz

Department of Social Sciences, SSEES,
University College London
Gower St., London WC1E 6BT, UK
Tel. +44(0)20 7862 8606
Fax: +44(0)20 7862 8642
e-mail: t.mickiewicz@ucl.ac.uk

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♣ Corresponding author.

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CORPORATE GOVERNANCE, MANAGERS' INDEPENDENCE, EXPORTING AND PERFORMANCE OF FIRMS IN TRANSITION ECONOMIES

[Abstract]

Using data on 157 large companies in Poland and Hungary this paper employs a Bayesian structural equation modeling to examine interrelationships between corporate governance, managers' independence from owners in terms of strategic decision-making, exporting and performance. It is found that managers' independence is positively associated with firms' financial performance and exporting. In turn, the extent of managers' independence is negatively associated with ownership concentration, but positively associated with the percentage of foreign directors on the firm's board. We interpret these results as an indication that (i) concentrated owners tend to constrain managerial autonomy at the cost of the firm's internationalization and performance, (ii) board participation of foreign stakeholders, on the other hand, enhances the firm's export orientation and performance by encouraging executives' decision-making autonomy.

JEL Codes: G32 G34 L21 L22 L25 P31

Key words: corporate governance, strategic independence, exporting, performance

CORPORATE GOVERNANCE, MANAGERS' INDEPENDENCE, EXPORTING AND PERFORMANCE OF FIRMS IN TRANSITION ECONOMIES

1. Introduction

Economic reforms and globalization of firms in transition economies[1] have dramatically changed the boundaries and content of governance and strategy of firms exposing them to multipoint competitive pressures. Managers of these firms have to make strategic decisions in the complex decision-making environment (Sanders and Carpenter, 1998), and one should expect that the performance of large firms may be closely linked with managerial flexibility in making strategic decisions within the context of the firm's governance. Yet this issue remains relatively unexplored. Emphasis on organizational and environmental factors as antecedents of both financial performance and export performance ignores possible organizational effects of managers' strategic independence defined as their autonomy in strategic decision making and absence of direct interference and constraints imposed by the owners (Newman, 2000); the situation, which enable the managers to provide timely and effective strategic responses in a rapidly changing environment (Harrigan, 1985, Mahoney, 1995). In addition, little is known about the impact of emerging corporate governance mechanisms on managerial strategic independence, although previous research suggests that this may be an important

[1] In this paper, we define transition economies (countries) as countries of Central Eastern Europe and the Commonwealth of Independent States. For more details, see for instance: Mickiewicz, 2005. We leave aside the interesting issue of applicability of the term 'economic transition' to other economies, East Asian in particular.

antecedent of managerial ability to undertake performance-enhancing strategies (Hoskisson *et al*., 2000).

The perspective adopted in this paper is that well-functioning, market-based systems of corporate governance leave the key business decisions in the hands of professional managers, while owners make managers accountable by using various governance mechanisms, such as board monitoring and control. In contrast, insufficient managerial independence in the transition countries driven by the characteristics of the legal framework of corporate governance and legacy of privatization strategies, may have negative implications for performance.

Correspondingly, this study explores the links between corporate governance, managers' strategic independence, financial performance and export performance of large firms in two economically important transition countries, Poland and Hungary. Before their economic reforms, exporting remained the monopoly of a handful of specialized state-owned companies. In the liberalized economic environment, with sluggish internal demand, adopting export-oriented strategies may be closely linked to better financial performance of the firm (Luo and Peng, 1999). In this environment, how do private enterprises develop exporting? We address this broad question by examining three specific issues. First, how does the freedom for management to exercise strategic choice affect export orientation, approximated by both level and change in exports as a proportion of total sales? Second, what are possible links between these factors and financial performance? And finally, how is managerial independence in terms of strategic decisions affected by corporate governance characteristics of firms in transition countries?

Our study makes a number of contributions. We provide a new framework modelling the linkages between managers' strategic independence, governance factors, exporting and financial performance. Research in this area has been thin and a major barrier has been the complex interdependence of governance, strategies and performance. While previous research has linked strategies with performance (Hoskisson et al., 2000; Makhija, 2004), and governance directly with performance (Djankov and Murrell, 2002; Peng, 2004), this paper takes the full governance-strategy-performance paradigm and makes a novel contribution by applying Bayesian-based structural equation modeling (SEM) to the inter-relationships between governance factors, managers' independence, exporting strategy and financial performance. To verify our theoretical assumptions, we use a multi-industry sample of 157 large, private, non-financial firms.

2. Theoretical framework and research hypotheses

Economic reforms in Central and East Europe (CEE) introduced during the 1990s aimed at increasing enterprise efficiency and making their products internationally competitive. Reforms were accompanied by a structural crisis, exacerbated by the collapse of the East European trading bloc and the break-up of the USSR (Uhlenbruck *et al*., 2003). The initial (pre-reform) situation of import protection and export promotion through monopolistic, state-owned foreign trade companies meant enterprises were ill-equipped to meet overseas threats and had different opportunities for internationalization.

Liberalization and privatization were designed to eliminate the constraints on the independent managerial decision-making process imposed by state ownership and the

command-economy system (Hoskisson et al., 2000; Makhija, 2004). In the case of Hungary and Poland, companies were privatized using a wide range of methods, with a significant participation of institutional corporate investors, including multinationals (Djankov and Murrell, 2002). These privatizations resulted in a diverse range of ownership structures and corporate governance mechanisms (Newman, 2000).

It has been acknowledged in previous research that corporate governance affects enterprises restructuring and financial performance (Hoskisson *et al*., 2000; Peng, 2004), while the effects of governance on exporting are less clear. Therefore, transition economies are a natural context to test theories concerning the first stage of internationalization, i.e. direct exporting (Andersen, 1993; Aulakh et al., 2000).

Our study is based on the strategic management perspective, with export intensity and financial performance being the outcome of a multi-dimensional strategic decision-making process. This process is driven by the firm's managers' strategic independence, which is defined as "an ability to respond to various demands from dynamic competitive environments" (Sanchez, 1995, p. 138). When managers are not constrained by owners in terms of their strategic decisions, they are able to take timely actions aimed at improving the firm's competitive position in domestic markets and promoting overseas outputs (Aulakh *et al*., 2000). By being involved in international activities, firms in transition economies may develop further their capabilities (Sanders and Carpenter, 1998), and this suggests a positive relationship between exporting and financial performance (Luo and Peng, 1999).

Although performance and export orientation in particular may be increased by higher degrees of managerial decision-making autonomy, the latter, in turn, depend on

the firm's governance factors such as ownership structure and board composition (Uhlenbruck *et al*., 2003; Hoskisson *et al*., 2000). Therefore, our framework suggests that the complex relationships between governance, exporting performance and financial performance are mediated by managers' strategic independence. The following sections discuss these issues in detail.

2.1. Managers' strategic independence, export orientation and performance

Institutional and economic reforms and internationalization of transition economies such as Poland and Hungary imposed new demands on local firms to develop their dynamic capabilities that enable them to take advantage of new opportunities, including gaining access to new product markets (Hoskisson et al., 2000; Newman, 2000). Uhlenbruck *et al*. (2003) strongly emphasize that the continuously changing market conditions in transition economies require the development of "strategic flexibility" that should help firms to take advantage of existing and new strategic opportunities. Strategic flexibility depends jointly on the inherent flexibility of resources available to the organization (Finney et al., 2005) and on managers' "flexibility in co-ordinating the use of resources" (Sanchez, 1995, p. 138).

The importance of "resource flexibility" has been acknowledged in previous research (Harrigan, 1980; Mahoney, 1995). For example, resource-based view considers the organization's capacity to change as a function of such firm characteristics as capital "specificity", "slack" resources, the firm's diversity defined in terms of product diversification and/or organizational structure (Finney et al., 2005; Hitt *et al*., 1998).

However, firms in transition economies inherited from their central planning past a bundle of resources, which are inconsistent with the requirements of effectiveness in a market economy (Uhlenbruck *et al*., 2003). Therefore, in the transition environment, another component of the firm's flexibility, managerial strategic independence, or their ability to make bold and timely decisions over capability-enhancing strategies without restrictions imposed by new owners of privatized firms, may become particularly important. In command economies, managerial initiatives were constrained by direct orders from the planning bureaucracy (Kornai, 1980). New private owners of firms in Poland and Hungary were expected to unlock managerial talent, but with repeated institutional upheavals, organizational learning was difficult (Newman, 2000). Peng (2004) suggests that uncertainty and institutional changes in transition lead to a deepening mistrust between managers and "new principals", who may try assume full control over strategic decisions. To summarize, organizational outcomes of strategic restructuring in transition economies, such as the extent of internationalization and financial performance, may be impeded not only by constraints related to organizational resources, but also by a lack of managerial strategic independence, or their ability to use wider strategic options without restrictions imposed by new owners. Hence:

> ***Hypothesis 1****. The extent of managers' strategic independence is positively associated with export orientation.*
>
> ***Hypothesis 2****. The extent of managers' strategic independence is positively associated with financial performance.*

International business research considers exporting and financial performance as inter-related organizational outcomes of the firm's strategic dynamics (Aulakh *et al*., 2000). Using sunk-cost arguments a number of authors suggest that financially better-performing firms in an industry are more likely to be exporters (Bernard and Jensen, 1999; Clerides *et al*., 1998). There has been less research on whether there is a positive feedback from exporting to firm performance. International business research argues that internationalization enables firms to leverage their existing capabilities and knowledge across countries and create scale economies otherwise unavailable domestically (Andersen, 1993). Sanders and Carpenter (1988) suggest that being exposed to overseas markets helps the firm to respond more effectively to foreign competitors in their domestic market. Firms are continually searching for new technologies, new ways of organizing their operation, and firms can take advantage of new information gained by exporting that is also valuable when competing in their home market (Bernard and Jensen, 1999). Gains from export orientation may be particularly strong in transition economies, where firms could face limited opportunities at home ('push factor'). More importantly, given the low level of pre-reform international trade, substantial gains can result from taking advantage of external liberalization and export orientation ('pull factor'); the latter could become a key factor leading to improved financial performance (Luo and Peng, 1999). Hence:

> ***Hypothesis 3****. Export orientation is positively associated with financial performance.*

2.2. Corporate governance and managers' strategic independence

When there is an increase in information asymmetry between managers and owners that is related to the economic transition in general, and internationalisation of the firm in particular, outside owners may limit managers' "strategic freedom" (Makhija, 2004). In this environment, large shareholders have both the incentives and the means to restrain the strategic independence of managers (Zeckhauser and Pound, 1990). Moreover, lack of developed capital markets in CEE, limited portfolio diversification and liquidity mean that even when large shareholders recognize the potential upside of a particular business strategy, such as exporting, they are affected adversely by the company's idiosyncratic risk (Maug, 1998) and may chose to impose sub-optimal strategies on managers. And last but not least, large shareholders in countries with relatively low protection of minority investors, such as CEE, may attempt to take advantage of their power and realize "private benefits of control". This expropriation may take various forms, such as related-party transactions, use of transfer pricing, assets stripping and other forms of "tunnelling" of revenue and assets from firms (La Porta *et al.,* 1997, 2000). Again, this suggests direct involvement of dominant owners in strategic decisions and less emphasis on performance-enhancing strategies that may benefit minority shareholders. We propose:

> ***Hypothesis 4****. The extent of managers' strategic independence is negatively associated ownership concentration.*

The composition of a firm's board of directors is another governance parameter that can affect the decision-making process, shaping the extent of managers' strategic independence (Baysinger and Hoskisson, 1990). Strategy research particularly emphasizes the importance of the board's service and strategic roles when the firm faces a highly uncertain environment of economic transition (Peng, 2004). For firms, which were until recently operating in the semi-autarchic environment, a particularly positive role in this respect may be played by the foreign directors, who supply critical information and advice otherwise unobtainable. Board members associated with foreign investors also improve monitoring capacity of the board and mitigates moral hazard costs associated with managerial decision-making autonomy. Therefore, presence of foreign board members may bring in new organizational culture, enhancing managers' strategic independence, and we suggest:

> ***Hypothesis 5**. The extent of managers' strategic independence is positively associated with the proportion of foreign directors on the firms' board.*

3. Research Methods

3.1. Sample

Firm-level data was collected simultaneously in Poland and Hungary in 2001 using the same structured instrument (translated and back-translated from English into Polish and Hungarian, correspondingly). In the course of face-to-face interviews, company presidents and CEOs provided information on observable company

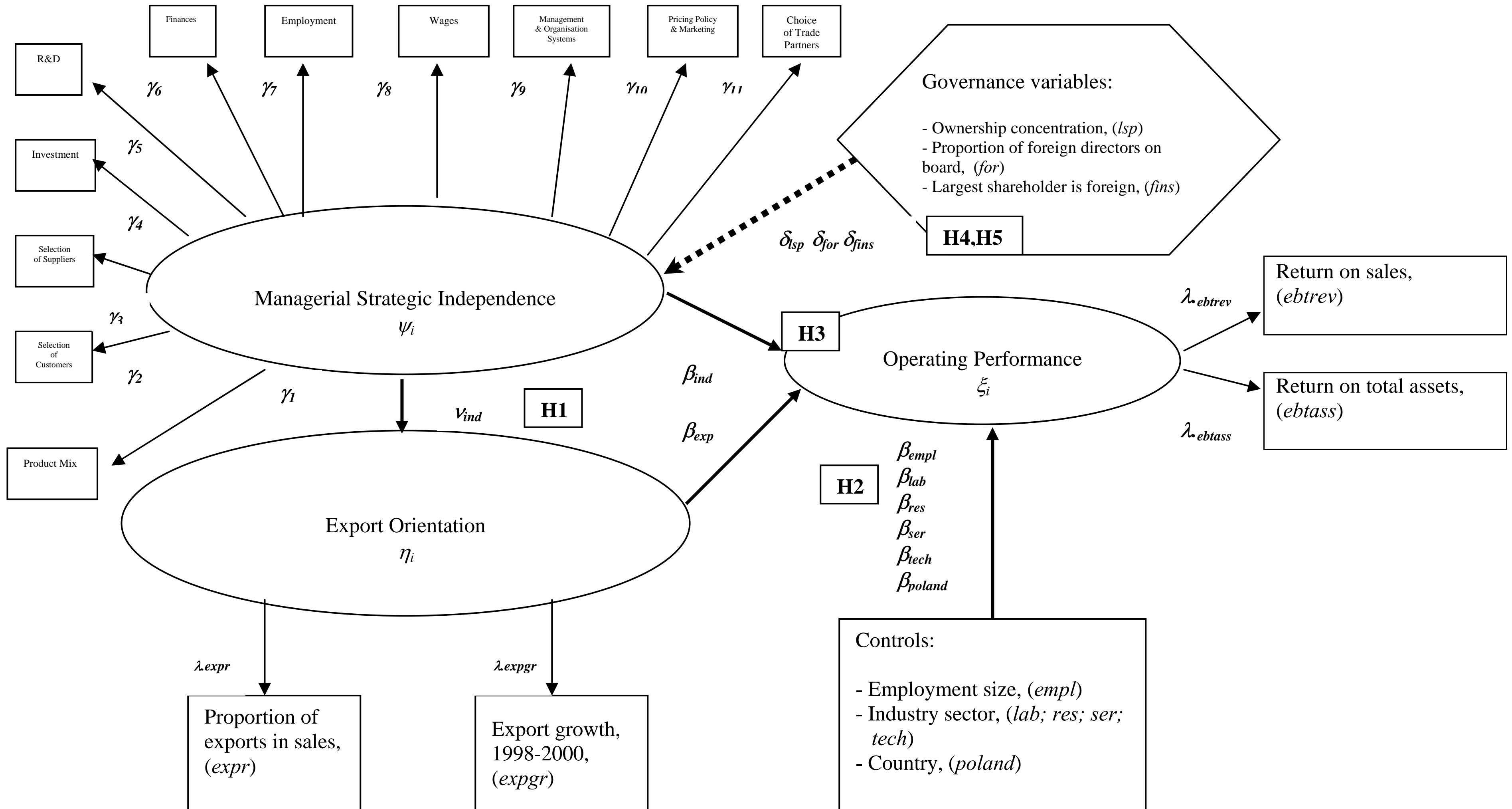
characteristics and managers' assessment of their independence along eleven strategic dimensions (see below, Section 3.2), each reported on a 7-point Likert scale. Our surveys of Polish and Hungarian companies were conducted by the Research Department of the Polish Sociological Society jointly with CASE Institute (Warsaw), and by the Institute of Economics of the Hungarian Academy of Science respectively. To obtain representative samples of large companies, we defined the sample frame using two large company lists that are in public domain in Poland and Hungary. In Poland, we used a list of the 500 largest (in terms of sales) non-financial companies that is maintained by the Institute of Economics of the Polish Academy of Sciences and regularly published by the *Rzeczpospolita*. In Hungary, we used a list of the 250 largest companies available from the *Figyelo* magazine. These two lists were combined together, producing a sample frame for the survey. The average non-response rate in both countries was below 10%. The survey generated 100 and 57 usable questionnaires in Poland and Hungary respectively. We verified the representativeness of our sample using available comparison criteria, such as size, age, industry affiliation, etc. A standard test of non-response bias indicated no significant differences between respondents and non-respondents on variables such as country and industry distributions, number of employees, etc. Concerned with inter-rater reliability, a randomly selected 5% of companies were re-visited by the interviewers. No deviations between the study data and companies' documents, such as payroll lists, share registers, etc. were identified.

3.2. Measures and analysis

We adopt the structural equation modeling (SEM) approach and estimate SEM parameters using Gibbs sampling, a simulation procedure based on the Markov chain Monte Carlo (MCMC) method, implemented in the Bayesian inference package WinBUGS (Spiegelhalter *et al*., 2000). The Bayesian SEM is a more robust research methodology because it circumvents the need to rely on asymptotic theory in the estimation procedures, which may be questionable when the sample size is small, and, therefore, inferences based on maximum likelihood estimates of SEM may be overconfident. Another advantage of the Bayesian method is a possibility to impute missing values associated with non-responses to the survey questions. (For details see: Gelman *et al*., 2004; Congdon, 2003; Gilks *et al.,* 1996).

In the SEM we investigated the relationships between latent (unobservable) constructs for managerial independence (ψ_i), export orientation (η_i) and operating performance (ξ_i) of a firm i. A graphical summary of the SEM is provided in Figure 1, where measurable indicators are in boxes and latent variables are in ovals.

Figure 1. Structural Equation Model



To develop managerial independence variable (ψ_i) we used eleven ordinal indicators of the managerial independence y_k generated by answers to scaled response questions with regard to how much independence management team has in deciding on: 1) product mix; 2) selection of customers; 3) selection of suppliers; 4) investment; 5) research and development; 6) finances; 7) employment; 8) wages; 9) management and organization systems; 10) pricing policy and marketing; 11) choice of trade partners. The answers were provided on a 7-point Likert scale with 1 = decided by the owners (i.e. a local parent, foreign company, other institutional investors, etc.) and 7 = decided by the firm's executive team. The latent variable for export orientation (η_i) was operationalized by using the proportion of export revenues to total sales for 2000 ($expr_i$) and the percentage change in export sales over the period of 1998-2000 ($expgr_i$). The latent variable of operating performance (ξ_i) is operationalized by earnings before taxes over assets ($ebtass_i$) and earnings before taxes over sales revenue ($ebtrev_i$) in 2000, although we recognize that both these measures have their own shortcomings. Similar measures have been widely used (Djankov and Murrell, 2002).

In terms of corporate governance characteristics, the ownership concentration measurement was based on information on the percentage of shares held by the largest shareholder. To take account of a possible non-linearity in ownership concentration effects, we considered four ownership intervals of less than 25%, 25-49%, 50-74% and 75-100%. Thus, the ownership concentration was represented by a four-fold categorical variable (lsp_i) defining ownership intervals. The extent of foreign representation on the board was measured by the proportion of foreign directors on board (for_i). To control for

the possible effect of the identity of the largest shareholder, we also introduced a dummy variable for the largest shareholder being a foreign firm ($fins_i$).

Finally, we also considered a number of firm-, industry- and country-level factors that may affect performance (see Figure 1). To control for the firm's size in terms of employment, we used three dummies ($x_{i,empl,}$) for intervals of (250-499), (500-999) and (above 1000) of employees respectively. The (below 250) interval was used as a control. Four sector dummies ($x_{i,sector}$) were used for labor-intensive (ISIC codes 15-20 and 36), resource-intensive (ISIC codes 21-26), high-tech (ISIC codes 28-35), services and construction (ISIC codes 45, 50-52, 55) industries, with firms from heavy industry (ISIC: <14 and 27) being used as a control. A dummy variable ($x_{i,poland}$) was used for companies in Poland.

The Bayesian model includes two parts: (i) a set of measurement equations that provide links between the manifest variables discussed above and the three latent constructs, and (ii) structural equations which verify the relationships between the latent constructs (ψ_i, η_i, ξ_i), as well as analyze the effects of governance parameters on managerial independence (ψ_i). We estimated the following SEM, with the following structural equations:

$$\xi_i = \alpha + \beta_{ind}\psi_i + \beta_{\exp}\eta_i + \beta_{empl}x_{i,empl_i} + \beta_{sector}x_{i,sector} + \beta_{poland}x_{i,poland} \quad (1a)$$

$$\eta_i = k_1 + \nu_{ind}\psi_i \quad (1b)$$

$$\psi_i = \mathrm{k}_2 + \delta_{lsp}lsp_i + \delta_{fins}fins_i + \delta_{for}for_i \quad (1c)$$

and measurement equations given by:

$$ebtrev_i = k_3 + \lambda_{ebtrev}\xi_i \quad (2a)$$

$$ebtass_i = k_4 + \lambda_{ebtass}\xi_i \quad (2b)$$

$$expr_i = k_5 + \lambda_{expr}\eta_i \quad (2c)$$

$$expgr_i = k_6 + \lambda_{exgr}\eta_i \quad (2d)$$

$$\text{logit}\{\Pr(y_{ik} \leq j_k)\} = \theta_{kj} - \gamma_k\ \psi_i \quad , k = 1 \div 11 \quad (2e)$$

where β_{ind}, ν_{ind}, β_{exp} are parameters associated with interrelations between performance, managerial independence and export orientation; λ_{ebtrev}, λ_{ebtass}, λ_{expr}, λ_{expgr}, γ_k are the factor loadings that show how observed indicators determine scores of latent constructs; δ_{lsp}, δ_{fins}, δ_{for} are parameters related to the effects of ownership and board composition on managerial independence; β_{empl}, β_{sector}, β_{poland} are the coefficients for the effects of control variables; α, k_i are the intercepts. Equations (2e) include unknown threshold parameters, and they specify proportional-odds models for the eleven ordinal indicators of managerial independence y_k with observed categories j_k and factor loadings γ_k (see Agresti, 1986, and Congdon, 2003).

To ensure identifiability, we defined the three latent variables (ψ_i, η_i, ξ_i) as normally distributed with variances of unity. We also allowed for the monotonicity constraint for thresholds θ_{kj} and their ordering by setting truncated standard normal prior distributions with zero means and large variances. Since in the Gibbs sampling context the predetermined variance identifiability constraint can lead to a problem of "re-labelling" of the latent construct scores during the sampling, we followed Congdon (2003) and restricted normal priors with zero means and large variances for factor loadings and parameters β_{ind}, β_{exp} ν_{ind}, to positive values.

We verified the convergence of the MCMC simulation using the Gelman-Rubin scale reduction factor (SRF) for a two-chain run (Gelman, 1996). We also verified the

model's goodness-of-fit by calculating the posterior *p*-value (tail-area) probabilities from the posterior predictive replications (see Gelman, 1996, and Gelman *et al*., 2004, for a detailed discussion of the construction and computation of the Bayesian χ^2 test). The posterior predictive *p*-value based on the likelihood-ratio test statistic and 2,000 predictive replications was equal to 0.227, confirming a good fit between our model and the data (Scheines *et al*. 1999).

4. Results

Table 1 provides the definitions of variables used in this study and the descriptive analysis of our data. 68 percent of companies were from the manufacturing sectors, with 32 percent being from services and construction. Mean employment level in our sample was 1063, but the distributions were skewed due to the presence of a few very large companies, especially in the Hungarian sub-sample, where the largest company had 15,599 employees. The distributions of two alternative measures of size, e.g., assets and total revenues, followed a similar pattern. Based on the full sample, the mean value of total revenues was US$65.5 million while the mean book value of total assets was US$42.8 million. In terms of corporate governance parameters, almost half of the firms in Hungary and Poland had foreign owners as the largest shareholders. With regard to the proportion of shares held by the largest owner, our data indicates a relatively high level of share-ownership concentration, e.g., 62.5 percent of the total equity. Foreign directors on average held almost a third of board seats.

Table 1. Variables and Descriptive Statistics

Variable	*Definition*	*Mean*	*Std. Dev.*
Performance			
ebtrev	Earnings before taxes over sales, %	2.16	8.83
ebtass	Earnings before taxes over assets, %	0.022	0.17
Export orientation			
expr	Export revenue as % of total sales	0.25	0.28
expgr	Change in export sales over 1998-2000, %	1.93	10.41
Managers' independence factors			
y_1	product mix	5.54	1.89
y_2	selection of customers	5.52	1.67
y_3	selection of suppliers	4.77	2.16
y_4	investment	4.54	2.10
y_5	research and development	4.77	2.11
y_6	finances	5.42	1.72
y_7	employment issues	5.65	1.72
y_8	wages	5.58	1.70
y_9	management and organization	5.42	1.97
y_{10}	price policy and marketing	5.52	1.86
y_{11}	choice of trade partners	4.94	2.18
Corporate governance			
lsp	Proportion of shares held by the largest shareholder, %	62.46	32.60
for	Proportion of foreign investors' representatives on board, %	31.12	36.41
Control variables			
x_{poland}	Dummy variable for Polish firms	0.64	
x_{lab}	Labor intensive industry (ISIC: 15-20 and 36)	0.36	0.48
x_{res}	Resource intensive industry (ISIC: 21-26)	0.21	0.41
x_{tech}	Medium and high technology industry (ISIC: 28-35)	0.06	0.22
x_{ser}	Services and construction (ISIC: 45, 50-52, >55)	0.34	0.47
x_{empl}	Number of employees	1063	1771
fins	Largest shareholder is a foreign investor, a dummy variable	0.46	0.50

Table 2 provides the results of SEM estimations of inter-relationships between governance, strategic independence and performance. According to the results of the measurement models for the three latent variables, strategic independence proxies were within the credible intervals, and they generated a robust latent variable (ψ_i). Similarly,

the export performance and financial performance proxies were also within credible intervals, and they generated the corresponding latent variables (η_i, and ξ_i).

Table 2. Structural Equation Modeling Results

	Mean	Credible interval 2.50%	Credible interval 97.50%
Measurment models; indicator-factor loadings			
Performance			
λ_{ebtass}	0.023	0.018	0.033
λ_{ebtrev}	0.020	0.015	0.029
Export orientation			
λ_{expgr}	0.098	0.004	0.258
λ_{expr}	0.074	0.002	0.223
Managerial independence			
γ_1	1.991	1.469	2.588
γ_2	2.484	1.901	3.178
γ_3	1.795	1.352	2.309
γ_4	1.716	1.300	2.190
γ_5	2.006	1.528	2.560
γ_6	1.491	1.107	1.932
γ_7	1.677	1.245	2.183
γ_8	1.633	1.200	2.125
γ_9	2.283	1.713	2.937
γ_{10}	3.009	2.283	3.896
γ_{11}	1.326	0.959	1.732
Hypothesized relationships and controls			
Performance, independence and exporting			
β_{exp}	**43.220**	**28.370**	**53.510**
β_{ind}	**2.191**	**0.067**	**6.738**
v_{ind}	**0.069**	**0.003**	**0.189**
Ownership concentration[1]			
δ_{lsp}[2] 25-49%	-0.406	-1.130	0.316
δ_{lsp}[3] 50-74%	**-0.990**	**-1.687**	**-0.277**
δ_{lsp}[4] 75-100%	**-0.900**	**-1.613**	**-0.181**
Proportion of foreign directors on board δ_{for}	**0.058**	**0.033**	**0.090**
Employment size[2]			
β_{empl} [2: 250-499 employees]	-4.265	-29.240	16.870
β_{empl} [3: 500-999 employees]	4.133	-19.680	23.630
β_{empl} [4: 1000 and more]	-10.110	-36.480	12.850
Poland dummy β_{poland}	**-36.570**	**-56.020**	**-18.780**
Largest shareholder's identity δ_{fins}	-0.559	-1.045	-0.060

NOTES: Highlighted coefficients (in bold) suggest the 5% level of significance. Sectoral dummies (all insignificant) and the intercepts are not included in the table.

1. Coefficients for ownership concentration are contrasts with a group where the largest shareholder owns 24% of shares and less.
2. Coefficients are contrasts with a group of firms with 250 employees and less.
3. Coefficients are contrasts with heavy industry as a reference group.

SEM results generally supported our hypotheses with regard to the inter-relationships between managers' strategic independence, export- and financial-performance. In particular, the strategic independence construct was positively associated with export orientation (the coefficient ν_{ind}) and financial performance (the coefficient β_{ind}). These results support hypotheses 1 and 2. In addition, export orientation was positively associated with the latent variable for financial performance (the coefficient β_{exp}), and this confirms hypothesis 3. Finally, in terms of the controls, Polish firms significantly under performed their Hungarian counterparts, as indicated by the coefficient (β_{poland}). The firm's size and sector affiliation did not have any effects on performance.

In terms of corporate governance effects on strategic independence, the SEM results for ownership concentration suggested that there was a negative effect of block-holders on strategic flexibility, but it was significant only at very high levels of concentration: the coefficients (δ_{lsp}) were negative and within the confidence interval for (50-74%) and (75-100%) ownership ranges, i.e., the levels of ownership that are above the controlling stake, in line with hypothesis 4. The coefficient for the proportion of foreigners on board (δ_{for}) was within the confidence intervals, and it was positively associated with the strategic independence construct, in line with hypothesis 5. In addition, the SEM results provided evidence of a negative but insignificant relationship

between the strategic independence construct and the dummy variable for the foreign largest shareholder (δ_{fins}).

5. Discussion and conclusions

Our study is one of the first examining simultaneous links between corporate governance, managerial independence, exporting and financial performance. The paper helps to fill gaps in relation to multi-industry samples and larger newly-privatized manufacturing firms. It shows that managerial independence in terms of strategic decision-making may play a crucial role as the driver of internationalization and performance. The extent of managerial independence is determined by the general governance factors, such as ownership and board structures. It has been argued that high ownership concentration in transitional economies was investors' response to low levels of protection of minority shareholders in emerging markets (La Porta et al., 1997). However, by early 2000s, the quality of the legal environment improved and we argue that while the presence of concentrated owners could initially result in firm's competitive advantage, it is likely that ten years after the reform program was implemented, the negative effects of private benefit extraction via pyramidal structures mail prevail (Morck *et al.* 2005). Not only we find supporting evidence for this, but also, we identify the missing link between ownership and performance, which is managerial independence. In particular, restrictions on managerial independence may have negative effects on the firm's internationalization and performance. Although we focus specifically on Poland and Hungary, variations in governance regimes (La Porta *et al.*, 1997) suggest scope for

international analyses of the links between governance, strategic independence and performance.

As discussed above, following the privatisation process, control of large enterprises in both Hungary and Poland was frequently passed to corporate investors (in early 1990s). Empirical studies, which focused on the direct link between the ownership and the firm performance were finding a positive relationship between the presence of controlling corporate ('strategic') investors and performance (see Djankov and Murrell 2002 for a meta-study summarizing this early research). The positive link was typically explained from the resource-based perspective. New corporate owners could offer financial resources needed for restructuring (overcoming initial financial constraints), access to know-how, marketing and organisational skills.

Arguably however, those advantages were temporary. In a market-, competitive environment, all companies have capacity for organisational learning, and – as reforms were gradually implemented - both access to finance and other-resources could be acquired on market basis, without necessity of associating the provision of resources with dominant ownership of the firm. In contrast, with better-functioning capital markets, those who provided the resources could be sufficiently awarded with minority blocks of shares. However, in cases, where the corporate investor retained the dominant position, the acquired companies were simply placed at some lower level of pyramidal ownership structures; the position, which is frequently associated with lower performance, due to the extraction of private benefits by dominant owners (see Morck *et al.* 2005 and further references therein). Low profitability may be seen as a sign of this, consistent with our findings.

In addition, the effects of board representation on export- and performance-enhancing strategic independence of managers may have important implications for both the strategy and the exporting literature. Our research suggests that foreign investors' board involvement is playing a relatively more important strategic role than the size of their equity stakes in local firms. This finding is consistent with resource and strategy views on corporate governance that suggest that, in addition to control functions, external board members may also play service/resource roles in the decision-making process (Baysinger and Hoskisson, 1990), especially when the firm faces a highly uncertain environment of institutional transition (Peng, 2004). Our evidence suggests that in transition economies foreign board members may have a positive impact on the extent of managerial independence, which, in turn, underpins exporting and performance.

In addition, we have found evidence of significant positive link between exporting and financial performance in the two transition economies. Exporting, however, is the first stage in the firm's internationalization path (Bernard and Jensen, 1999). As the integration of Poland and Hungary into the EU proceeds, performance differences between exporting and non-exporting firms may affect their subsequent internationalization decision. The longer-term analysis of their strategic dynamics may shed new light on complex inter-relationships between corporate governance, business strategy and performance.

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