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International returnees as outside directors: A catalyst for strategic adaptation under institutional pressure

Ji-Hwan Lee [a,2,*], Michael J.D. Roberts [b,1,2]

[a] KAIST College of Business, Korea Advanced Institute of Science and Technology, 85 Hoegi-ro, Dongdaemoon-gu, Seoul 130-722, Republic of Korea
[b] International Management and Strategy, MacEwan University, School of Business, 10700 – 104 Avenue, Edmonton, AB T5J 4S2, Canada

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ABSTRACT

Building on perspectives from corporate governance, resource dependence, and organizational learning, this paper investigates the ability of international returnees while acting as outside directors in corporate boards to influence strategic adaptation in the face of institutional pressure to adopt what are arguably more legitimate management practices. We empirically examine the restructuring efforts of large Korean firms in the early 2000s following the introduction of radically new board regulations by the government. To accomplish this we use a hierarchical linear modeling with repeated measures. Our results show that decreases in debt ratio and diversification level are greater for firms with more returnee outside directors. Such an association is strengthened by the extent of foreign experience held by returnee directors. In addition, the prestige of individual directors as well as support from foreign investors positively moderates the impact of returnee outside directors on strategic adaptation.

1. Introduction

As firms in emerging economies continue to recruit returnees from advanced economies to fill human resources needs at all levels of their organizations, theoretical and empirical investigations of the role and influence of returnees may lead to fresh insights into corporate learning and strategic change. Recent studies on returnees have mainly focused on returnee entrepreneurs in smaller venture firms in China or India (Filatotchev, Liu, Buck, & Wright, 2009; Prashantham & Dhanaraj, 2010), or the impact of returnee engineers on firm innovation (Song, Almeida, & Wu, 2003). There has not, however, been less attention given to returnee managers and decision-makers in large corporations. Whether these decision-makers are senior executives or board members, we suggest that there is value in understanding the impact returnee decision-makers have on critical corporate level strategic choices.

In this paper, we consider the individual characteristics of outside directors (Dalton, Daily, Ellstrand, & Johnson, 1998; Kosnik, 1990), with a particular focus on the influence of *returnee outside directors*. Building on extant literature that the demographic characteristics of top decision-makers impact the types of strategic change that the firm will pursue (Clark & Soulsby, 2007), we argue that returnee outside directors represent a unique and important demographic group in large, emerging-market based corporations. We consider the possibility that, as international boundary spanners, their experience provides them with both the knowledge and legitimacy necessary to drive corporate level strategic changes that conform to the institutional logics of Anglo-American business practices—which were perceived as a global standard in Korea following the Asian financial crisis in 1997.

We define international returnees as people who, at a minimum, have completed a post-graduate degree (such as a masters or a PhD) overseas and then returned to work in their home country (Carr, Inkson, & Thorn, 2005). We argue that a post graduate degree is a minimum standard to ensure that the returnee has technical or managerial knowledge (even if learned in an educational setting) to potentially transfer to a domestic organization (Dai & Liu, 2009). However, returnees may also have considerably more international experience than the minimum. In fact, a returnee might also be a person who has completed a significant proportion of their education in a foreign country and has had some years of work experience there. We view international returnees in firms as: (i) sources of new knowledge and information (Inkpen & Pien, 2006; Saxenian, 2002; Song et al., 2003); (ii) an informal (political) group with power and prestige

* Corresponding author. Tel.: +82 2 958 3616.
E-mail addresses: jihwanlee@business.kaist.ac.kr (J.-H. Lee), robertsm35@macewan.ca (Michael J.D. Roberts).
[1] Tel.: +1 780 497 4236.
[2] Both authors made equal contribution.

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(McPherson, Smith-Lovin, & Cook, 2001); and (iii) a boundary-spanning group (both socially and cognitively) (Tabata, 2006; Tushman & Scanlan, 1981). While international experience would not in and of itself provide a board with useful insight, board members in this study were by definition deemed qualified for the position by the nomination committee of the corporate board on which they serve. As such, we are concerned with the additional impact of being an international boundary spanner over and above the other qualifications associated with being a board member.

In this study, we empirically examine the restructuring efforts of the top 100 South Korean (Korean, henceforth) firms over a six-year period (2000–2005) following the introduction of the regulatory requirement by the Korean government that all firms have a minimum percentage of independent, outside board members (Lee, Choi, & Kim, 2012). The Asian financial crisis caused a significant decrease in gross domestic product (GPD), high levels of inflation, and currency instability throughout much of East Asia and Southeast Asia; it was the largest economic crisis since the Great Depression (Grewal & Tansuhaj, 2001). Firms across Asia were burdened with high levels of foreign debt, and thus were eager to attract foreign direct investment in order avoid collapse (McKibbin & Martin, 1999). Together with national governments, firms needed to make concrete reforms to obtain legitimacy in the eyes of foreign investors. While corporate governance practices such as stock-based incentive plans led by Anglo-American firms have spread to other developed economies with relationship-based tradition, most have been through voluntary process rather than a regulatory process (Tuschke & Sanders, 2003). By contrast, Korean corporations were forced to restructure their organizations to conform to newly required management standards, which involved adopting, or at least partially adopting, Anglo-American business practices (Chung & Beamish, 2005). Such a transition thus required radical shifts in the institutional logics of large Korean corporations and government regulatory bodies (Chizema & Kim, 2010).

This context represents a unique opportunity to study the substantive and symbolic role of outside directors on corporate restructuring. We examine how the presences of returnees among outside directors, combined with the status of those returnee outside directors and stakeholder pressures—especially from foreign shareholders, affects the degree to which a firm will adopt unfamiliar institutional logics in its strategic decisions. We do this by examining the possibility that firm level corporate restructuring is influenced by returnee outside directors as agents of foreign knowledge and foreign institutional logics. Our goal is to contribute to the theoretical understanding of how boundary spanners with knowledge, prestige, and power—in this context returnee outside directors—affect corporate level strategic changes. Implications for board practice will also follow.

2. Theoretical considerations

Corporate governance literature has shown that outside (also called, non-executive or independent) directors are an effective directing mechanism in a corporation. Many scholars have examined the role that outside directors play between shareholders and managers (Fama & Jensen, 1983; Jensen & Meckling, 1976; Lien, Piesse, Strange, & Filatotchev, 2005; Petrovic, 2008). Research has shown that outside directors can protect shareholders against circumstances with a potential agency problems (Rosenstein & Wyatt, 1990; Weisbach, 1988). Combining this traditional agency perspective with insights from resource dependence and organizational learning theories, we argue that the demographic characteristics and background of outside directors can greatly influence their knowledge and opinions of what is in the best interests of the shareholders, and how those interests are best realized (Hillman, Cannella, & Paetzold, 2000; Rivas, 2012).

Resource dependence theory (Pfeffer & Salancik, 1978) suggests that outside directors can be key boundary-spanners for their firms. Boundary spanners are often able to transfer their outside experience with business practices and control systems to the firms (Au & Fukuda, 2002; Fennell & Alexander, 1987; Schotter & Beamish, 2011). Thus, their backgrounds and knowledge from their previous experiences may challenge and displace current practices. In this way, outside directors, in their role as professional monitors and advisors, can create an open-system of professional knowledge (Aguilera, Filatotchev, Gospel, & Jackson, 2008).

A firm's strategies are limited because the scope of strategic choices available to a firm is limited to the logics of the institutional environment (Battilana & D'Aunno, 2009). We argue that demographic characteristics can make a difference in such a situation. Organizational members whose experiences and characteristics put them on the fringe of the specific institutional environment are less likely to be restricted by current institutional pressures and logics (Clark & Soulsby, 2007; DeFillippi & Ornstein, 2003; Emirbayer & Mische, 1998). As such, demographic characteristics, particularly those that influence knowledge acquisition and business experience, may affect outside directors' ability to understand and articulate the effective decision controls necessary to promote and safeguard shareholder interests (Forbes & Milliken, 1999). While the introduction of unique perspectives can lead to conflict, it can also lead to a more collaborative search for better institutional logics (Reay & Hinings, 2009).

From an organizational learning perspective, the experience and interactions of human resources are critical sources of firm knowledge (Levitt & March, 1988; Miner & Haunschild, 1995; Zander & Kogut, 1995). The boundary-spanning activities of outside directors, through interlocking boards for example, have also been shown to be a source for acquiring relevant knowledge, either directly or indirectly, from other firms or industries (Ortiz-de-Mandojana, Aragón-Correa, Delgado-Ceballos, & Ferrón-Vílchez, 2012; Westphal, Gulati, & Shortell, 1997; Westphal, Seidel, & Stewart, 2001). This role implies that interlocking directors encourage firms to adopt normative business practices and policies. Also notable is that multiple appointments that can specifically provide directors with relevant strategic knowledge and perspective, which tends to contribute to the strategic decision making (Carpenter & Westphal, 2001).

We apply this same logic to the role that returnee outside directors play in transferring international corporate institutional norms and logics and thus facilitating strategic adaptation of a firm. We focus on returnee outside directors with advanced foreign degrees, arguing that such an academic background, relatively unique in an emerging economy, can serve as a valuable source of experience and knowledge (Ling & Jaw, 2006; Song, Almeida, & Wu, 2001). While *foreign* outside directors also bring an important international background and therefore can be important transmitters of business and corporate governance practices (e.g., Choi, Sul, & Min, 2012; Oxelheim, Gregorič, Randøy, & Thomsen, 2013), the current work focuses on returnees rather than foreigners as we view the unique boundary spanning role of returnees between institutional forces and corporate organizations. We propose that such a role can be more effective in the case of returnee directors because they can leverage their understanding of various external (especially foreign) stakeholders and internal decision makers (top management and other directors). In addition, as the number of foreign outside directors is still quite small even in large firms in Korea,[3] we tried to identify a relatively new category of directors that could be meaningful to organizational outcomes.

[3] In our sample, only 4–7% of firms each year had foreigners in their boards.