



# Does board governance matter for foreign institutional investors to invest in listed tourism firms?



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## HIGHLIGHTS

- The influence of board governance on foreign institutional ownership of tourism firms is examined.
- Signaling theory is used to interpret data from listed tourism firms.
- Foreign institutional ownership is higher when listed tourism firms have a smaller board.
- Foreign institutional ownership is not influenced by the proportion of independent directors.
- Foreign institutional ownership is higher when listed tourism firms have a higher director ownership.

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## ABSTRACT

Foreign institutional investors perform a critical role in the development of the tourism industry. While board governance is a critical mechanism in firms, few studies have attempted to investigate whether board governance matters when foreign institutional investors buy shares of tourism firms. Based on signaling theory, the current study uses a sample of listed tourism firms in Taiwan. Board size, board independence and director ownership are used as proxies of board governance. Results show that the ownership proportion of foreign institutional investors is higher when tourism firms have a smaller board and higher director ownership. These results offer theoretical and practical implications for researchers and practitioners.

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## 1. Introduction

The role of institutional investors in the global market is important because the majority of assets around the world are managed by them (Ferreira & Matos, 2008; Zou, Tang, & Li, 2016). Because of this, researchers have progressively explored the investment preferences of institutional investors (Chung & Zhang, 2011; Giannetti & Simonov, 2006). Extant findings are majorly based on the analysis of stock and firm characteristics (Dvořák, 2005; Hau, 2001; Ko, Kim, & Cho, 2007; Neupane, Neupane, Paudyal, & Thapa, 2016). For example, Falkenstein (1996) demonstrated that institutional investors prefer to hold stocks with higher visibility and avoid those with lower idiosyncratic volatility. Grinstein and Michaely (2005) indicated that institutions prefer to

invest in firms that pay dividends and repurchase stocks.

Institutional investors are heterogeneous in that they have different objectives and investment behaviors (Dahlquist & Robertsson, 2001; Sherman, Beldona, & Joshi, 1998). Within this group, foreign institutional investors generally have a considerable amount of capital and sufficient capabilities for accessing global markets (Gillan & Starks, 2003). They have been identified as critical investors due to their dramatic influence on the equity market and firm performance (Choe, Kho, & Stulz, 1999; Ferreira, Massa, & Matos, 2010; Gillan & Starks, 2000). Although the obstacles to global investment have decreased recently, foreign institutional investors are still facing challenges which can lead to different investment behaviors than those of their domestic peers. For instance, domestic investors are familiar with the local culture and investee firms (Coval & Moskowitz, 1999; Neupane et al., 2016). Information disadvantages make it costly and difficult for foreign institutional investors to gather information in the non-home

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market (Aggarwal, Klapper, & Wysocki, 2005; Covrig, Lau, & Ng, 2006; Grinblatt & Keloharju, 2000). When foreign institutional investors are not equally informed, they have higher investment risks (Huberman, 1999; Merton, 1987). To reduce these risks, foreign institutional investors rely on signals about firm attributes to evaluate firms (Fombrun & Shanley, 1990; Spence, 1973).

Signaling theory argues that signals represent actions, intentions and abilities of firms (Certo, Daily, & Dalton, 2001; Spence, 1973). Information on board governance is readily available for investors to understand how firms govern themselves (Fama & Jensen, 1983). Board governance can be regarded as a valid signal of responsible management and protection of shareholders (Dalton, Daily, Johnson, & Ellstrand, 1999; Johnson, Daily, & Ellstrand, 1996). In this regard, board governance can assist foreign institutional investors in overcoming information asymmetry (Certo et al., 2001). In addition, board governance is a result of compliance with legitimacy or effectiveness because regulatory authorities constantly suggest proper governance codes and practices (Deephouse & Carter, 2005; Musteen, Datta, & Kemmerer, 2010). Firms that comply with these codes and practices signal legitimacy or effectiveness to investors. As such, firms adopting board governance mechanisms that are regarded as desirable are more likely to be favored by foreign institutional investors (Certo, 2003).

Tourism is one of the primary economic activities in the world (Johnson & Vanetti, 2005). In the tourism industry, the importance of foreign investment has been recognized because it can generate a variety of benefits (Song, Dwyer, Li, & Cao, 2012). For example, not only does it enhance management know-how and competition, but it also offers capital resources for investee tourism firms (Kantarci, 2007; Rodriguez, 2002). Positive spillover effects brought by foreign investment have also been identified by tourism researchers (Mao & Yang, 2016; Yang & Wong, 2012). As a result, it is acknowledged that foreign investment is critical for the development of the tourism industry (Li, Huang, & Song, 2017). Globalization facilitates the movement of foreign capital in tourism markets (Endo, 2006; Rodriguez, 2002). This means that foreign institutional investors have more investment choices around the world. Consequently, competition in attracting foreign institutional investors has become intensive in the tourism industry (Kantarci, 2007; UNCTAD, 2010). An important question to answer is how tourism firms make themselves favored by foreign institutional investors.

There are two investment choices for foreign institutional investors, namely non-equity and equity investment (Endo, 2006; Falk, 2016). In the tourism literature, most studies investigate non-equity investment by either asking investors about the factors influencing their overseas investments (e.g., Assaf, Josiassen, & Agbola, 2015; Johnson & Vanetti, 2005; Steiner, 2010) or examine selected variables to understand the determinants of foreign investment (e.g., Falk, 2016; Martorell, Mulet, & Otero, 2013; Zhang, Guillet, & Gao, 2012). Conversely, equity investment is under-examined, despite being the dominant entry mode in many economic regions (Falk, 2016; Guillet, Zhang, & Gao, 2011; Martorell et al., 2013). In sum, tourism research on foreign investment is increasing, but Song et al. (2012) still call for more research on the subject.

Natural tourism resources will not automatically attract foreign institutional investors; the way tourism firms are managed is the key factor in this regard (Endo, 2006). Indeed, firm characteristics have been identified as factors that can influence the investment choice of foreign institutional investors in the tourism industry (Contractor & Kundu, 1998; Mao & Yang, 2016). Given that foreign investment is important for the development of the tourism industry (Falk, 2016), it is critical to examine the preferences of foreign institutional investors. While studies have discovered

several factors influencing investment preferences of foreign institutional investors, most extant studies use no theoretical basis to examine the preferences of investors. Meanwhile, research on the role of board governance in investment preferences is absent. Notwithstanding, research has already shown that proper governance in the board room can reduce agency problems and contribute to firm value in both the general business (Fama & Jensen, 1983; Shleifer & Vishny, 1997) and tourism sectors (Al-Najjar, 2015; Yeh & Trejos, 2015; Yeh, 2013).

The purpose of the present study is to fill this research gap by investigating if certain types of board governance in listed tourism firms are preferred by foreign institutional investors. Board size, board independence and director ownership are utilized as proxies of board governance, since their importance in firm performance has been identified by the literature and governance codes (Swedish Corporate Governance Board, 2016; Bhagat & Bolton, 2013; Fama & Jensen, 1983; Germain, Galy, & Lee, 2014; Jensen & Meckling, 1976; Tokyo Stock Exchange, 2015). Based on signaling theory, the present study offers new insights into the preferences of foreign institutional investors toward listed tourism firms by examining the role of board governance.

By bridging this research gap, the current study makes several contributions to extant literature on tourism governance, tourism management and signaling theory. First, while previous governance research in both the general business and tourism sectors focuses on how board governance influences firm performance, the present study extends the current literature by focusing on the role of board governance of tourism firms in investment preferences. Secondly, given the critical role of foreign institutional investors in the global market, it is important to understand the factors that influence their investment decisions. In particular, the present study has implications for tourism firms attempting to attract foreign investment. Thirdly, despite the abundant literature on board governance, there is lack of knowledge as to whether disclosing board governance is a feasible strategy to attract foreign capital. The current study is among the first to examine board governance by using signaling theory. It can contribute to the literature on the signaling role of a board by empirically exploring investment preferences of foreign institutional investors in the tourism sector.

## 2. Literature review

### 2.1. Governance in the tourism sector

(Bramwell and Lane (2011), p. 412) have defined tourism governance as to “involve various mechanisms for governing, steering, regulating and mobilizing action, such as institutions, decision-making rules and established practices”. It comprises interactions among different stakeholders at different levels (Zahra, 2011). One of the primary missions of tourism governance is to enhance the benefits of stakeholders (Presenza, Del Chiappa, & Sheehan, 2013). To better understand the enhancement of these benefits, tourism governance has been examined from different viewpoints. Early research on tourism governance can be traced back to the 1990s. Since then, many studies have focused on how power and resources are distributed among different stakeholders, such as governments, private tourism organizations and non-governmental organizations, in order to develop tourism for public interests (Valente, Dredge, & Lohmann, 2015; Wan, 2012). Recently, a stream of research has emphasized the relationship between environment policy and governance (Blanco, Rey-Maqueira, & Lozano, 2009; Paavola & Adger, 2005; Song et al., 2012). Its main focus is the role of policy-making, economic revolutions and social changes in the development of tourism

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