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Yan Du, Marc Deloof, Ann Jorissen

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ACTIVE BOARDS OF DIRECTORS IN FOREIGN SUBSIDIARIES

ABSTRACT

Manuscript Type: Empirical

Research Question/Issue: This study examines the conditions under which foreign subsidiaries maintain active boards of directors. Active boards are in this study defined as boards which perform tasks beyond fulfilling local legal requirements. We focus on both monitoring and service roles.

Research Findings/Insights: Based on a sample of 83 foreign subsidiaries operating in Belgium with headquarters in 14 different countries, we find that a foreign subsidiary is more likely to maintain an active board if it is a world mandate subsidiary, which has worldwide responsibility for a product line and performs a broad scope of value-added activities. Moreover, a foreign subsidiary is more likely to maintain an active board if it is larger relative to the multinational enterprise (MNE), if it has a higher level of local responsiveness, and if its past performance is poorer. Additionally, the presence of an active board in a foreign subsidiary is related to other control mechanisms deployed in the subsidiary.

Theoretical/Academic Implications: Our results highlight the conditions under which foreign subsidiaries are likely to maintain active boards. Moreover, we provide empirical evidence that agency theory and resource dependence theory are relevant and complementary in the analysis of active boards in foreign subsidiaries.

Practitioner/policy Implications: This study suggests that an active board may be a control mechanism to govern foreign subsidiaries and an instrument to deal with the external environment. Corporate governance regulators may consider developing governance recommendations that emphasize the importance of subsidiary boards in the oversight of foreign subsidiaries.

Keywords: Corporate Governance, subsidiary governance; board of directors; multinational enterprise; agency theory; resource dependence theory

INTRODUCTION

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8 In many countries, corporate law requires foreign subsidiaries to have boards of directors¹.
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10 Given the importance of foreign subsidiaries in the operation of multinational enterprises
11 (MNEs) and the complexities of managing geographically dispersed and culturally distant
12 foreign subsidiaries, one would expect that MNEs use subsidiary boards strategically to govern
13 foreign subsidiaries. However, in practice some subsidiary boards are only rubber stamps set up
14 to fulfill local legal requirements (Björkman, 1994; Gillies and Dickinson, 1999). This raises the
15 question of when subsidiary boards play an active role in the governance of foreign subsidiaries.
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24 This study addresses this issue by empirically investigating the conditions under which
25 foreign subsidiaries maintain active boards. Active boards in this study are defined as boards that
26 perform tasks beyond fulfilling local legal requirements. We focus on both monitoring and
27 service roles. The corporate governance literature has investigated the composition and structure
28 of boards in standalone firms (e.g., Adams, Hermalin and Weisbach, 2010; Hermalin and
29 Weisbach, 2003; Johnson, Daily and Ellstrand, 1996; Pugliese et al., 2009; Van Ees, Gabriellson
30 and Huse, 2009; Zahra and Pearce, 1989) and codes of good governance in a given country (e.g.,
31 Aguilera and Cuervo-Cazurra, 2004, 2009; Cromme, 2005; Zattoni and Cuomo, 2008). However,
32 very little research attention has been paid to subsidiary boards. As far as we know, none of the
33 few empirical studies on subsidiary boards has addressed the conditions under which foreign
34 subsidiaries maintain active boards.
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50 The international business literature has investigated various control mechanisms used in
51 MNEs, such as incentive compensation, subsidiary staffing, and corporate socialization (e.g.,
52 Ambos and Schlegelmilch 2007; Baliga and Jaeger, 1984; Chung, Gibbons and Schoch, 2000;
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3 Gencturk and Aulakh 1995; Ghoshal and Nohria 1989; Gong, 2003; Jaussaud and Schaaper,
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5 2006; O'Donnell, 2000; Roth and O'Donnell, 1996). However, less is known with respect to the
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7 role of the subsidiary board as an alternative control mechanism for managing foreign
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9 subsidiaries.

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12 Using survey and archival data from 83 foreign subsidiaries operating in Belgium with
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14 headquarters in 14 different countries, we find that a foreign subsidiary is more likely to maintain
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16 an active board if it is a world mandate subsidiary. A world mandate subsidiary is a subsidiary
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18 that has worldwide responsibility for a product line and performs a broad scope of value-added
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20 activities. Moreover, a foreign subsidiary is more likely to maintain an active board if it is larger
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22 relative to the MNE, if it has a higher level of local responsiveness, and if its past performance is
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24 poorer. Furthermore, the presence of an active board in a foreign subsidiary is related to other
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26 control mechanisms deployed in the subsidiary. In particular, a foreign subsidiary is less likely to
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28 maintain an active board if the subsidiary CEO holds a management position at the headquarters.
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34 To the best of our knowledge, this study is the first to empirically investigate the presence
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36 of active boards in foreign subsidiaries. Our results suggest that the agency problem between
37
38 headquarters and subsidiary management, and the subsidiary's dependence on the external
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40 environment are important to understanding the presence of active boards in foreign subsidiaries.
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42 Accordingly, both agency theory and resource dependence theory are relevant to the analysis of
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44 subsidiary boards and a combination of the two theories provides comprehensive explanations on
45
46 the presence of active boards.
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50 The remainder of this study is organized as follows. In the next section, we review the
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52 literature on boards in standalone firms, control mechanisms in MNEs, and subsidiary boards. In
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54 the Hypothesis Development section, we then develop hypotheses on the presence of active
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boards in foreign subsidiaries. In the subsequent two sections, we set forth our research method and results. Finally, we conclude with discussions, study limitations, and directions for future research.

LITERATURE REVIEW

Boards in Standalone Firms

The literature on boards in standalone firms has been dominated by two theoretical perspectives: agency theory and resource dependence theory. According to agency theory, boards should reduce agency problems between shareholders and top managers (Fama, 1980; Fama and Jensen, 1983). Boards have the obligation of electing, evaluating, compensating and firing top managers in the best interests of shareholders (Fama and Jensen, 1983; Zahra and Pearce, 1989). Based on agency theory, many empirical studies have examined the relation between board composition (typically measured by the proportion of outside directors on the board) and firm performance (e.g., Bathala and Rao, 1995; Brickley, Coles and Jarrell, 1997; Wan and Ong, 2005). These studies have reached mixed results, probably because board composition is endogenously determined (Adams, Hermalin and Weisbach, 2010; Hermalin and Weisbach, 2003). Additionally, there is a growing body of literature examining the determinants of board composition (Boone et al., 2007; Hermalin and Weisbach, 1988; Lehn, Patro and Zhao, 2009; Linck, Netter and Yang, 2008; Mak and Li, 2001). These studies suggest that board composition reflects a tradeoff between firm-specific benefits and costs of board monitoring, as well as the influence of top managers on boards.

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3 In contrast to agency theory, resource dependence theory views boards as important
4 boundary spanners that make timely information available to top managers (Barney, Wright and
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8 Ketchen, 2001; Hillman, Withers and Collins, 2009; Lockett and Thompson, 2001; Pfeffer and
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10 Salancik, 1978). The main board tasks include advice and counsel, channels of information and
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12 preferential access to key resources (Hillman et al., 2009; Pearce and Zahra, 1992; Pfeffer,
13
14 1972). Empirical studies show that board capital such as directors' expertise, experience,
15
16 knowledge, reputation, and interlocking directorates, is positively associated with firm
17
18 performance (e.g., Boyd, 1990; Carpenter and Westphal, 2001; Dalton et al., 1999; Hillman and
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20 Dalziel, 2003). Moreover, firms respond to significant changes in the external environment by
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22 altering board structure (Hillman, Cannella and Paetzold, 2000; Pfeffer and Salancik, 1978).
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29 **Control Mechanisms in MNEs**

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31 An MNE consists of a group of geographically dispersed and culturally distant units that
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33 include its headquarters and different foreign subsidiaries (Ghoshal and Bartlett, 1990).
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35 Headquarters often exerts various control mechanisms over foreign subsidiaries to ensure that
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37 subsidiary management acts in accordance with the overall strategy of the MNE (Jaussaud and
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39 Schaaper, 2006). The literature has distinguished three broad types of control mechanisms:
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41 outcome control, behavioral control and cultural control (Baliga and Jaeger, 1984; Eisenhardt,
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43 1989; Jaeger, 1983; Ouchi, 1979). Outcome control monitors and evaluates the performance
44
45 outcomes of subsidiary management. In contrast, behavioral control monitors the behavior of
46
47 subsidiary management. While outcome control and behavioral control are explicit formal
48
49 control mechanisms, cultural control, which is built on shared value and norms to control
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51 subsidiary management, is implicit and informal (Baliga and Jaeger, 1984; Ouchi, 1979). For
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3 example, the use of expatriate managers and corporate socialization could build organizational
4 identification and develop shared values at the subsidiary level (Chung, Gibbons and Schoch,
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6 2006; Gaur, Delios and Singh, 2007; Gong, 2003; O'Donnell, 2000). Cultural control is desirable
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8 only when outcome control and behavioral control are difficult to implement, because
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10 introducing cultural control entails high costs resulting from initial socialization and continued
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12 normative allegiance (Jager, 1983; Nohria and Ghoshal, 1994; Stopford and Wells, 1972).
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18 Drawing on agency theory, foreign subsidiaries may have their own goals and risk
19 preferences that differ from those of headquarters. Empirical studies based on agency theory find
20 that headquarters use various control mechanisms to align the interests of subsidiary
21 management with those of headquarters (e.g., Chang and Taylor, 1999; Nohria and Ghoshal,
22 1994; Roth and O'Donnell, 1996). Drawing on resource dependence theory, foreign subsidiaries
23 are interdependent with other units within the MNE in terms of resource exchanges (Birkinshaw
24 and Morrison, 1995; Gupta and Govindarajan, 1991; O'Donnell, 2000). Moreover, foreign
25 subsidiaries are instruments used by headquarters to seek resources from the external
26 environment. Empirical studies in support of resource dependence theory find that headquarters
27 use various control mechanisms according to foreign subsidiaries' environmental and resource
28 contingencies (e.g., Andersson and Forsgren, 1996; Chung et al., 2000; Gencturk and Aulakh,
29 1995; Ghoshal and Nohria, 1989; Jaussaud and Schaaper, 2006; Nohria and Ghoshal, 1994;
30 O'Donnell, 2000; Yu, Wong and Chiao, 2006). While prior research offers valuable insights into
31 control mechanisms used by headquarters for the management of foreign subsidiaries, the
32 subsidiary board, as another control mechanism, has yet to be addressed in the literature.
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Subsidiary Boards

Research on subsidiary boards is very limited. Among the few studies that examine subsidiary boards, Leksell and Lindgren (1982) identify external roles (advisory, external relations) as well as internal roles (control and monitoring, coordination and integration) that subsidiary boards play in MNEs. Kriger (1988) finds evidence of an increasing use of subsidiary boards over time. Moreover, Japanese MNEs use subsidiary boards more actively than either European or North American MNEs. Huse and Rindova (2001) find that stakeholders have different expectations with respect to the roles that subsidiary boards play in MNEs. Contrary to the aforementioned studies in which subsidiary boards are active, Gillies and Dickinson (1999) find that subsidiary boards are merely rubber stamps set up to fulfill local legal requirements. Björkman (1994) finds that most subsidiary boards perform limited tasks. However, in those boards that are active, strategy and budget approval is considered important. Recently, Kim, Prescott and Kim (2005) and Kiel, Hendry and Nicholson (2006) theoretically demonstrate that the structure of subsidiary boards should satisfy the differentiated roles of foreign subsidiaries in MNEs. Although these studies provide important insights, the conditions under which foreign subsidiaries maintain active boards have yet to be examined in the literature.

HYPOTHESIS DEVELOPMENT

In this section, we use agency theory and resource dependence theory to develop hypotheses on the conditions under which foreign subsidiaries maintain active boards. These two theories provide complementary explanations on board roles. Moreover, they lead to different

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3 implications for control mechanisms employed in MNEs. Therefore, these two theories may
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5 provide valuable insights into the presence of active boards in foreign subsidiaries.
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10 **Agency Theory and Subsidiary Boards**

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12 According to agency theory, the headquarters-foreign subsidiary relation has a principal-
13 agent structure where headquarters is the principal and subsidiary management is the agent.
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15 Subsidiary management may have its own goals and risk preferences that differ from those of
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17 headquarters. When information asymmetries between headquarters and subsidiary management
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19 are high, it is difficult for headquarters to monitor the behavior of subsidiary management and
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21 employ behavioral control (Christie, Joye, Watts, 2003; Eisenhardt, 1989; Fama, 1980;
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23 O'Donnell, 2000; Roth and O'Donnell, 1996). To ensure that subsidiary-level decisions are in
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25 accordance with the overall strategy of the MNE, agency theory prescribes the use of outcome
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27 control such as incentive compensation. However, outcome control is not desirable if the
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29 performance outcomes of subsidiary management are uncertain or difficult to measure
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31 (Eisenhardt, 1989; Milgrom and Roberts, 1992). Additionally, cultural control may be desirable
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33 but it often entails high costs (Jager, 1983; Nohria and Ghoshal, 1994; Stopford and Wells,
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35 1972). As an alternative control mechanism, an active board could be used for monitoring
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37 subsidiary management on behalf of headquarters. Moreover, an active board could reduce the
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39 information asymmetries by providing headquarters with information on the environmental and
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41 strategic complexities faced by the subsidiary (Eisenhardt, 1989).
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51 The above discussion suggests that an MNE is more likely to maintain an active board when
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53 there are high information asymmetries between headquarters and subsidiary management, and
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55 the performance outcomes of subsidiary management are difficult to measure. In the
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3 international business literature, two factors are considered critical to induce the information
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5 asymmetries and increase difficulties of measuring the performance outcomes of subsidiary
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7 management. The first factor is the world mandate subsidiary. The world mandate subsidiary has
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9 worldwide responsibility for a product line and performs a broad scope of value-added activities
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11 (e.g., R&D, production, and marketing). It typically works with headquarters to develop and
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13 implement corporate strategy (Birkinshaw and Morrison, 1995). As the world mandate
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15 subsidiary has a high level of specialized knowledge and expertise which could be used by other
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17 subsidiaries and the headquarters, the level of information asymmetry is high. Thus, from an
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19 agency theory perspective, the world mandate subsidiary presents difficulties for monitoring or
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21 verifying the behavior of subsidiary management (Bartlett and Ghoshal, 1989; Doz and Prahalad,
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23 1991; O'Donnell, 2000; Roth and Morrison, 1991; Roth and O'Donnell, 1996). Furthermore, the
24
25 world mandate subsidiary operates in a strategically important market and performs complex
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27 tasks, making it difficult for the headquarters to measure the performance outcomes of subsidiary
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29 management. Accordingly, headquarters are likely to monitor the world mandate subsidiary
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31 through an active board. Thus, we posit the following hypothesis:

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41 *Hypothesis 1a. A foreign subsidiary is more likely to maintain an active board when it is a world*
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43 *mandate subsidiary.*
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48 The second factor is the relative size of a foreign subsidiary with respect to the MNE.
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50 International business studies show that the relative size of a foreign subsidiary represents the
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52 strategic importance of the subsidiary in the MNE (Boyacigiller, 1990; Chang and Taylor, 1999;
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54 Martinez and Ricks, 1989; Mudambi and Navarra, 2004). When a foreign subsidiary is larger
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3 relative to the MNE, the strong strategic position of the subsidiary allows subsidiary
4 management to obtain greater information and specialized knowledge that are important to the
5 MNE's operations (Birkinshaw and Morrison, 1995; Gupta and Govindarajan, 1991; Roth and
6 Morrison, 1991). Therefore, there is a high level of information asymmetry between
7 headquarters and the relatively large subsidiary, and it is difficult for the headquarters to monitor
8 the behavior of subsidiary management. Furthermore, as the relatively large subsidiary often
9 faces strategic complexities and uncertainties (Gencturk and Aulakh, 1995), it is difficult for the
10 headquarters to specify the performance outcomes of the subsidiary in advance. In particular,
11 outcome control shifting risk to subsidiary management is not appropriate for relatively large
12 subsidiaries because subsidiary management's decisions influence the overall performance of the
13 MNE. Therefore, if a foreign subsidiary is large relative to the MNE, headquarters may monitor
14 subsidiary management through an active board. Thus, we posit the following hypothesis:
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34 *Hypothesis 1b. A foreign subsidiary is more likely to maintain an active board when it is larger*
35 *relative to the MNE.*
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41 **Resource Dependence Theory and Subsidiary Boards**

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43 According to resource dependence theory, firms depend on their external environment for
44 survival, and they should alter their behavioral patterns to best acquire and maintain needed
45 resources (Barney et al., 2001; Hillman et al., 2009; Lockett and Thompson, 2001; Pfeffer and
46 Salancik, 1978). In the context of MNEs, the external environment of a foreign subsidiary
47 consists of other actors inside and outside the MNE such as headquarters, customers, suppliers
48 and other counterparts. As a foreign subsidiary becomes more dependent on its external
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3 environment for key resources, it becomes more important for the subsidiary to maintain
4 relations with the stakeholders who provide the resources. International business studies suggest
5 that headquarters often adjust control mechanisms to facilitate subsidiaries accessing key
6 resources (Andersson and Forsgren, 1996; Ghoshal and Nohria 1989; Nohria and Ghoshal 1994;
7 Yu, Wong and Chiao, 2006). For example, Yu et al. (2006) find that headquarters uses less
8 behavioral control when a foreign subsidiary has more local linkages. Andersson and Forsgren
9 (1996) find that subsidiary managers perceive a lower level of control from headquarters when a
10 foreign subsidiary is tightly embedded in the external network. Ghoshal and Nohria (1989) and
11 Nohria and Ghoshal (1994) find that headquarters uses more cultural control such as corporate
12 socialization when local resources are important to foreign subsidiaries. Besides altering control
13 mechanisms, an active board could help the subsidiary access key resources by providing advice
14 and counsel, building legitimacy and maintaining relations with important stakeholders (Hillman
15 et al., 2009; Lockett and Thompson, 2001; Pfeffer and Salancik, 1978).

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34 The above discussion suggests that an MNE is more likely to maintain an active board when
35 a foreign subsidiary becomes more dependent on the external environment for key resources.
36 Thus, factors that increase a foreign subsidiary's dependence on other actors inside and outside
37 of the MNE are important to understanding the presence of an active board. The first such factor
38 is a foreign subsidiary's local responsiveness. Local responsiveness describes the extent to which
39 a foreign subsidiary adjusts its activities to the needs of local stakeholders (Bartlett and Ghoshal,
40 1989; Doz and Prahalad, 1991; Luo, 2001; Morrison and Roth, 1992). Local responsiveness
41 stems from the complexity and dynamism of local market conditions as well as of the
42 sociopolitical and macroeconomic environment of the host country (Morrison and Roth, 1992).
43 Subsidiaries with higher levels of local responsiveness are more dependent on local stakeholders
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3 such as local customers, local suppliers, and local government for key resources. An active board
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5 could manage external relations with local stakeholders, provide advice on local conditions, and
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7 facilitate the access to local resources (Leksell and Lindgren, 1982; Kriger, 1988). Thus, we posit
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9 the following hypothesis:
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15 *Hypothesis 2a. A foreign subsidiary is more likely to maintain an active board when it has a*
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17 *higher level of local responsiveness.*
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22 The second factor is a foreign subsidiary's past performance. The level of past performance
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24 influences the firm's availability of financial slack and the survival of the firm (Pearce and
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26 Zahra, 1992; Ramanujam and Varadarajan, 1989). When a firm performs poorly, it is important
27
28 to maintain good relations with main stakeholders and have the access to more resources.
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30 Outside directors could provide a fresh perspective, enhance the existing pool of expertise and
31
32 assure the financial community that the firm's operations are under control (Pearce and Zahra,
33
34 1992). Accordingly, empirical studies on boards in standalone firms show that firms often add
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36 outside directors under poor past performance (Hermalin and Weisbach, 1988; Daily, 1995;
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38 Pearce and Zahra, 1992). Similarly, in the context of MNEs, when a foreign subsidiary's past
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40 performance is poor, it is dependent on headquarters and other actors in the external environment
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42 for key resources. An active board could help the subsidiary acquire and maintain needed
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44 resources by providing advice and counsel, building legitimacy and managing relations with
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46 important stakeholders (Hillman et al., 2009; Lockett and Thompson, 2001; Pfeffer and Salancik,
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48 1978). Thus, we posit the following hypothesis:
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3 *Hypothesis 2b. A foreign subsidiary is more likely to maintain an active board when its past*
4 *performance is poorer.*
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10 **The Relation between Agency Theory and Resource Dependence Theory**

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12 Agency theory and resource dependence theory address different aspects of the roles of
13 active boards in foreign subsidiaries. From an agency theory perspective, an active board could
14 be used as an alternative control mechanism to monitor subsidiary management on behalf of
15 headquarters. According to resource dependence theory, an active board could be used to deal
16 with the external environment and gain critical resources. In the above paragraphs, we first use
17 agency theory to develop two hypotheses that link world mandate subsidiary and relative size to
18 active boards. We then use resource dependence theory to develop two hypotheses that link local
19 responsiveness and past performance to active boards. It should be noted that in addition to
20 resource dependence theory, agency theory could also explain the impact of local responsiveness
21 and past performance on the presence of active boards. According to agency theory, a foreign
22 subsidiary with a high level of local responsiveness often has more local information that is not
23 available for the headquarters (Kim et al., 2005), and consequently, it is difficult for the
24 headquarters to monitor the behavior of subsidiary management. Similarly, a foreign subsidiary's
25 poor past performance is an indication of poor management (Hermalin and Weisbach, 1988;
26 Linck et al., 2008). An active board could be used to ensure that subsidiary managers make
27 decisions in the best interests of headquarters and improve the subsidiary's performance. On the
28 other hand, in addition to agency theory, resource dependence theory also has implications for
29 the impact of world mandate subsidiary and relative size on the presence of active boards.
30 According to resource dependence theory, the world mandate subsidiary performs a broad scope
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3 of value-added activities and needs to cope with the demands from many sectors of the external
4 environment. Similarly, if a foreign subsidiary is large relative to the MNE, it plays an important
5 role in the MNE in terms of seeking resources from the external environment. An active board
6 could be used to reduce the subsidiary's dependence on the external environment and secure key
7 resources. In sum, agency theory and resource dependence theory are relevant and
8 complementary in the analysis of active boards in foreign subsidiaries.
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20 RESEARCH SETTING AND DATA COLLECTION

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24 Our sample consists of foreign subsidiaries operating in Belgium. By focusing on foreign
25 subsidiaries in the same host country, we minimize the influence of host country institutional and
26 cultural factors on the presence of active boards in foreign subsidiaries. The statistical office of
27 the European Union reports that Belgium has a higher percentage of foreign investment inward
28 flows than most European countries (*Eurostat*, 2010). According to Belgian Company Law, a
29 foreign subsidiary must register as a separate legal entity. The most common legal forms are the
30 *Naamloze Vennootschap* (NV) and the *Besloten Vennootschap met Beperkte Aansprakelijkheid*
31 (BVBA). An NV is set up by at least two persons who contribute a fixed amount of capital in
32 return for shares in the firm. An NV can issue bearer shares that are freely transferable. In
33 contrast to an NV, a BVBA has a lower minimum capital requirement for establishment, while
34 its shares are transferrable only under specific conditions. The board in an NV should be
35 composed of at least three directors unless the firm has only two shareholders, in which case the
36 board should be composed of two directors. A BVBA should have at least one director. Directors
37 are held liable for any shortcomings during their management and for any loss resulting from
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3 infringement. Moreover, firms in Belgium have a one-tier board structure. No conditions of
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5 board tasks or composition are imposed on non-listed companies.
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8 We begin by identifying our initial sample through the *Bel-first* database, using four criteria.
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10 First, each subsidiary is located in Belgium and has a global ultimate owner domiciled outside
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12 Belgium. The global ultimate owner defined by the *Bel-first* database is an independent firm
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14 located in another country and that owns at least 51 percent of the subsidiary's shares. This
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16 criterion ensures that we select foreign subsidiaries operating in Belgium. Second, if an MNE has
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18 multiple subsidiaries registered in Belgium, we select only the largest subsidiary. We invoke this
19
20 criterion because one MNE may use the subsidiary board in a similar way in its multiple
21
22 subsidiaries. Third, we exclude subsidiaries with less than 50 employees because agency-based
23
24 explanations may not be valid for smaller firms (Eisenberg et al., 1998)². Finally, similar to
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26 previous studies (Bathala and Rao, 1995; Linck et al., 2008), we exclude subsidiaries operating
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28 in financial industries. Application of these criteria results in a sample of 420 foreign
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30 subsidiaries.
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36 Next, we collect data using a survey distributed to the CEOs of target foreign subsidiaries.
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38 The names of the CEOs and their addresses were obtained from the *Trends Top 2008* database,
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40 which provides financial and economic data on Belgian companies. If the name of a CEO was
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42 not available, we sent the questionnaire to another member of the top management team (CFO,
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44 chair of the subsidiary board, member of the subsidiary board). Additionally, we collect archival
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46 financial and governance data on these subsidiaries and their MNE headquarters. We designed
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48 the questionnaire following Dillman (2000) to improve its content validity. First, we constructed
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50 the initial questionnaire based on the existing instruments. Next, we pre-tested the questionnaire
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52 through five interviews with CEOs of foreign subsidiaries. Additionally, we asked five academic
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3 colleagues working in the field of accounting and finance to read the questionnaire. After making
4
5 revisions, we designed an attractive layout for the questionnaire, printed them on good-quality
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7 paper, signed each cover letter, and distributed them together with pre-paid return envelopes to the
8
9 senior managers of target subsidiaries. The initial survey (conducted in December 2008) and
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11 three follow-ups yielded 87 (21%) returned questionnaires³. Four responses are discarded due to
12
13 large numbers of missing values, which results in a sample of 83 responses used to test our
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15 hypotheses. The response rate is similar to those reported in previous studies (Birkinshaw and
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17 Morrison, 1995; Chang and Taylor, 1999; Roth and O'Donnell, 1996).
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22 Before using the final sample to test our hypotheses, we verify the suitability of the sample
23
24 for our analysis. First, we check non-response bias by comparing the absolute size and industry
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26 representation of our respondent subsidiaries with those of the target subsidiaries. The t-test
27
28 shows that the absolute size of our respondent subsidiaries is not significantly different from the
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30 target subsidiaries ($t=0.98$, $p=0.33$). The chi-square test indicates that the industry representation
31
32 of our sample is not significantly different from the target subsidiaries (chi-square=37.05,
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34 $p=0.69$). Next, we compare whether the answers from earlier respondents differ from those of
35
36 later respondents on all variables and the demographic characteristics of the respondents. The
37
38 results show no significant differences between early and late respondents. In sum, our data does
39
40 not appear to suffer from non-response bias. Finally, we check whether the answers from CEOs
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42 differ from those of other management positions (chair of the subsidiary board, financial director
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44 or other member of the subsidiary board) on all variables and we find no significant differences,
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46 indicating that the answers are unlikely to be biased due to the different respondents functions
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48 (with respect to the presence of active boards: Likelihood-ratio chi-square=0.42, $p=0.52$).
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MEASURES

Dependent Variable

Active Board. Active board is a dummy variable equal to 1 if a foreign subsidiary has an active board and zero otherwise. To identify whether a subsidiary board is active, we ask respondents whether there is a board of directors in their foreign subsidiaries. If they answer “yes,” we ask them to rate the extent to which the board performs a list of 21 tasks from -3 (not at all) to +3 (to a great extent). This list, consisting of all possible tasks performed by an active board, is presented in Appendix A. We develop this list based on Kriger (1988) and Wan and Ong (2005). Among these board tasks, the first 15 tasks are related to control and coordination in the MNE, while the remaining 6 tasks are related to advisory and service on the external environment. We consider a foreign subsidiary to maintain an active board if it satisfies two conditions: first, there is a board of directors in the foreign subsidiary; second, the board performs at least *one* of the 21 tasks (rated higher than -3). As Belgian Company Law requires all firms to have a board, if respondents answer that there is no board in their foreign subsidiaries, their subsidiary boards are actually rubber stamps (inactive). Therefore, we consider a board to be a rubber stamp (inactive) either when it is reported that there is *no* board in the foreign subsidiary, or that the board does not perform any of the 21 tasks (all rated at -3).

Independent Variables

World mandate. Based on Birkinshaw and Morrison (1995), we ask respondents whether the subsidiary currently sells finished products/services outside Belgium. If they answer “yes,” we ask them to identify whether the subsidiary is a world mandate subsidiary. The definition of

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2
3 world mandate subsidiary is given in the questionnaire. In this study, world mandate subsidiary
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5 is a dummy variable (world mandate) equal to 1 if the respondent reports that the subsidiary is a
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7 world mandate subsidiary and zero otherwise. To test the validity of this measure, we ask
8
9 respondents whether the subsidiary performs any of the following activities: manufacturing,
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11 marketing/retail, R&D, purchase and supply, business services. The literature shows that world
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13 mandate subsidiaries are responsible for a broad scope of value-added activities (Ambos and
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15 Schlegelmilch, 2007; Birkinshaw and Morrison, 1995; Ghoshal and Nohria, 1989; Gupta and
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17 Govindarajan, 1991; Nohria and Ghoshal, 1994). Consistently, we find that our world mandate
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19 subsidiaries perform significantly more activities than the rest of the subsidiaries in our sample
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21 ($t=-6.58, p<0.0001$), which demonstrates the validity of our measure.
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27 **Relative size.** Relative size is measured by the foreign subsidiary's total number of
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29 employees at the end of 2008, divided by the MNE's total number of employees. The foreign
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31 subsidiary's total number of employees is obtained from the *Bel-first* database. The MNE's total
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33 number of employees is obtained from the annual reports of non-European MNEs and from the
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35 *Amadeus* database for European MNEs.
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39 **Local Responsiveness.** Local responsiveness is measured using a seven-point Likert-scale
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41 ranging from -3 (not at all) to +3 (to a great extent). We ask respondents the extent to which the
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43 subsidiary adapts activities to the needs of the Belgian market. The literature shows that
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45 subsidiaries with sales only in the host country have higher levels of local responsiveness
46
47 (Birkinshaw and Morrison, 1995; Yu et al., 2006). Consistently, we find that local
48
49 responsiveness is significantly higher for those subsidiaries that have sales only in Belgium
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51 ($t=4.20, p<0.0001$), which demonstrates the validity of this measure.
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3 **Past performance.** Similar to previous studies (Pearce and Zahra, 1992; Linck et al., 2008),
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5 we measure a foreign subsidiary's past performance by its average annual Return on Equity in
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7 2005, 2006, and 2007, obtained from the *Bel-first* database.
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10 11 12 13 **Control Variables**

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15 We include absolute size, headquarters country, geographical distance and cultural distance
16
17 as control variables based on prior research. Additionally, we control for the effect of other
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19 control mechanisms exerted by headquarters on the presence of active boards by including
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21 CEO's headquarters management position, the use of expatriate managers and corporate
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23 socialization.
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27 **Absolute size.** Firm size represents the scope and complexity of the firm's operations
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29 (Boone et al., 2007; Lehn et al., 2009; Linck et al., 2008). Previous studies show that larger firms
30
31 have more need for board monitoring and building external linkages (Boone et al., 2007; Boyd,
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33 1990; Hermalin and Weisbach, 1988; Lehn et al., 2009; Linck et al., 2008; Mak and Li, 2001;
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35 Pearce and Zahra, 1992). Accordingly, a larger subsidiary is more likely to maintain an active
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37 board. Therefore, we control for the absolute size of foreign subsidiaries, which is measured via
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39 the subsidiary's total number of employees at the end of 2008, obtained from the *Bel-first*
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41 database.
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46 **Headquarters country.** Prior research indicates that the nationality of an MNE influences
47
48 the type of control mechanisms headquarters exerts over its foreign subsidiaries and the roles of
49
50 subsidiary boards (Chang and Taylor, 1999; Chow, Shields and Wu, 1999; Chung et al., 2000;
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52 Egelhoff, 1984; Kriger, 1988). Therefore, we control for headquarters country by a dummy
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3 variable (Anglo-Saxon) equal to 1 if the subsidiary has a headquarters in an Anglo-Saxon
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5 country, obtained from the *Bel-first* database⁴.
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8 **Geographical distance.** Geographical distance increases the difficulties for headquarters to
9
10 obtain complete and accurate information and to control foreign subsidiaries. Thus, MNEs are
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12 more likely to maintain active boards in geographically dispersed foreign subsidiaries to control
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14 subsidiary management. In this study, geographical distance is measured by the 1,000 kilometers
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16 distance between the capital cities of headquarters country and host country.
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20 **Cultural distance.** Similar to geographical distance, cultural distance also increases the
21
22 difficulties for headquarters to obtain complete and accurate information and to control foreign
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24 subsidiaries (Gong, 2003; Roth and O'Donnell, 1996). An active board can monitor subsidiary
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26 management on behalf of headquarters. Moreover, an active board could provide advice and
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28 counsel on the local culture and environment. Cultural distance is calculated via the formula
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30 developed by Kogut and Singh (1988) and used in several studies (Chang and Taylor, 1999; Roth
31
32 and O'Donnell, 1996). We use the scores on four culture dimensions of Hofstede and Hofstede
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34 (2005): power distance, uncertainty avoidance, individualisms, and masculinity.
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39 **Other control mechanisms.** As an active board could be a control mechanism for
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41 managing foreign subsidiaries as well as an instrument for dealing with the external
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43 environment, there may be a substitution or complementary effect between the presence of an
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45 active board and other control mechanisms. Previous studies show that MNEs often transfer
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47 managers from headquarters to their foreign subsidiaries (Boyacigiller, 1990; Chung et al., 2006;
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49 Gaur, Delios and Singh, 2007; Gong, 2003; Tan and Maloney, 2006). Moreover, headquarters
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51 often rely on corporate socialization to integrate foreign subsidiaries into MNEs (Chalos and
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53 O'Connor, 2004; Chung et al., 2000, 2006; O'Donnell, 2000). Accordingly, in this study, we
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3 include three control mechanisms, namely CEO's headquarters management position, the use of
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5 expatriate managers and corporate socialization. CEO's headquarters management position is a
6
7 dummy variable equal to 1 if a subsidiary CEO holds a management position at the MNE
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9 headquarters, obtained from the questionnaire. The use of expatriate managers is measured by a
10
11 dummy variable (expatriate) equal to 1 if the subsidiary CEO is the headquarters country
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13 national, obtained from the questionnaire. Corporate socialization is measured by three items in
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15 the questionnaire based on Chalos and O'Connor (2004) and O'Donnell (2000), using a seven-
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17 point Likert-scale ranging from -3 (not at all) to +3 (to a great extent). We ask respondents the
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19 extent to which headquarters visits the subsidiary frequently, organizes international training
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21 programs, and attaches a strong corporate culture to subsidiaries.
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34 RESULTS

35 Descriptive Statistics

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44 Table 1 presents the headquarters country and the legal form of the subsidiaries in our
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46 sample, along with respondent tenure. The headquarters of our sample subsidiaries are located in
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48 14 different countries, mainly in the U.S. (18 subsidiaries), France (18 subsidiaries), and the
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50 Netherlands (13 subsidiaries). The majority of sample subsidiaries have the legal form of NV (73
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52 subsidiaries). On average, respondents have been working approximately eight years in their
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54 subsidiaries. Additionally, our sample subsidiaries operate across 25 two-digit standard industrial
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3 classification codes, with some concentration in chemicals (8 subsidiaries) and wholesale trade-
4 durable goods (10 subsidiaries). None of the sample subsidiaries are listed on a stock market. On
5
6 average, the boards in our sample perform 12 tasks out of the 21 total tasks. Appendix B presents
7
8 the number and percentage of our sample subsidiaries performing each of the 21 board tasks
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10 (rated higher than -3). The boards in our sample emphasize more monitoring related tasks than
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12 service related tasks.
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17 In our sample, the respondents from 23 foreign subsidiaries answer that there is no board in
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19 their subsidiaries. As Belgian Company Law requires all firms to have a board, we consider
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21 these boards to be rubber stamps (inactive). Among the remainder 60 subsidiaries that have a
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23 board, three perform none of the 21 board tasks (all rated at “-3”). Since an active board
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25 performs at least one of the 21 board tasks, we consider the three boards to be rubber stamps
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27 (inactive) as well.
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39 Table 2 Panel A presents the mean, standard deviation, and spearman correlations for all
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41 variables used in the main analysis. As expected, the presence of an active board is positively
42
43 correlated with absolute size, relative size and cultural distance. To check for multicollinearity,
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45 Table 2 Panel B reports the variance inflation factors (VIF) of our explanatory variables. All VIF
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47 scores are below 2, indicating that multicollinearity is not a problem.
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53 Hypothesis Tests 54 55 56 57 58 59 60

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8 To test our hypotheses, we estimate logistic regressions with the dummy variable active
9 board as the dependent variable. Logistic regression analysis is often used to describe the
10 relationship between a binary or dichotomous outcome variable and one or more explanatory
11 variables (Hosmer and Lemeshow, 2000). We use three different methods as reported in Table 3.
12 In Model 1, we estimate robust standard errors to correct for possible heteroskedasticity (Huber,
13 1967; White, 1980). In Model 2, we estimate robust standard errors clustered by 14 headquarters
14 countries to adjust for the potential correlations between foreign subsidiaries headquartered in
15 the same country (Petersen, 2009; Wooldridge, 2003). In Model 3, we estimate robust standard
16 errors clustered by 23 industries to adjust for the potential correlations between foreign
17 subsidiaries operating in the same industry (Petersen, 2009; Wooldridge, 2003)⁵.
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32 As shown in Table 3, all logit models are significant. Overall, our logit models correctly
33 predict 84.34% of cases. Hypothesis 1a posits a positive relation between world mandate
34 subsidiary and the presence of an active board, which is supported. Our results also provide
35 strong support for Hypothesis 1b, which posits a positive relation between a subsidiary's size
36 relative to the MNE and the presence of an active board. Hypothesis 2a predicting a positive
37 relation between a subsidiary's local responsiveness and the presence of an active board is
38 supported as well. Finally, we find a significant negative relation between a subsidiary's past
39 performance and the presence of an active board, which is consistent with Hypothesis 2b.
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50 With regard to control variables, first, a foreign subsidiary is less likely to maintain an
51 active board if the subsidiary has its headquarters in an Anglo-Saxon country⁶. This is parallel to
52 Kriger (1988) who reports that North American MNEs view subsidiary boards as less useful
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3 mechanisms, compared to European and Japanese MNEs. One possible explanation could be that
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5 Anglo-Saxon MNEs focus more on short-term performance and use more outcome control
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8 (Chang and Taylor, 1999; Chow, Shields and Wu, 1999; Chung et al., 2000; Egelhoff, 1984),
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10 which decreases the need for active boards. Second, a foreign subsidiary is less likely to maintain
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12 an active board if the subsidiary CEO holds a management position at the MNE headquarters,
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14 indicating that there is a substitution effect between CEO's headquarters management position
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16 and the presence of an active board. Third, a foreign subsidiary is more likely to maintain an
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18 active board if it is more culturally distant from headquarters (supported by all the models) and if
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20 it is more geographically distant from headquarters (supported by Model 1 and Model 3).
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22 Finally, Model 2 suggests that if a subsidiary CEO is a headquarters country national, the
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24 subsidiary is more likely to maintain an active board. One possible explanation could be that the
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26 headquarters country national has less understanding on local conditions. Therefore, if a
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28 subsidiary CEO is a headquarters country national, an active board may help the subsidiary CEO
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30 build connections with local stakeholders and access local resources.
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39 Robustness Checks

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48 We conduct several robustness checks examining the presence of active boards in foreign
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50 subsidiaries. The results are reported in Table 4⁷. First, we use an alternative measure of active
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52 board. We consider a foreign subsidiary to maintain an active board if there is a board in the
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54 foreign subsidiary that performs at least *five* of the 21 tasks⁸. This measure results in 54 active
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boards. The results are reported in Model 4. Second, we use an alternative measure of past performance. We measure a foreign subsidiary's past performance by its average annual Return on Assets in 2005, 2006, and 2007, obtained from the *Bel-first* database⁹. The results are reported in Model 5. Third, we use the culture index of the World Value Survey 2005/2006 to recalculate cultural distance according to the formula developed by Kogut and Singh (1988). The World Value Survey is an ongoing academic project by social scientists to assess the state of socio-cultural, moral, religious and political values of various cultures around the world (available online at www.worldvaluessurvey.org). The survey measures all major areas of human concerns along two dimensions: traditional vs. secular-rational values, and survival vs. self-expression values (Inglehart and Welzel, 2005). The results are reported in Model 6. Finally, we measure the use of expatriate managers by a seven-point Likert-scale ranging from -3 (not at all) to +3 (to a great extent). In the questionnaire, we ask respondents the extent to which headquarters use expatriate managers to directly control the subsidiary's operations. The results are reported in Model 7. As shown in Table 4, the results from all the models support Hypothesis 1a, Hypothesis 1b, and Hypothesis 2a, and marginally support Hypothesis 2b. The results with respect to significant control variables are consistent with our main analysis reported in Table 3. However, the coefficient of expatriate is not significant if we use the alternative measure of expatriate, indicating that if the expatriate manager is not the subsidiary CEO, there is no effect on the presence of an active board. Additionally, we measure relative size using a foreign subsidiary's sales (or total assets) divided by corporate total sales (or total assets), and we measure absolute size via a foreign subsidiary's sales (or total assets). The results of these tests (untabulated) are similar to those reported in our main analysis.

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11 Next, we conduct several additional analyses examining the degree of board activeness,
12 instead of the *presence* of active boards. Table 5 reports the results. The degree of board
13 activeness is measured in two ways. In Model 8, we measure the degree of board activeness by
14 summing and averaging the standard scores of the 21 board tasks (Mean=-0.69; Std. Dev. =1.75;
15 Cronbach's alpha=0.92). OLS robust regression is used. In Model 9, we measure the degree of
16 board activeness by the percentage of tasks the board performs (Mean=0.59; Std. Dev. =0.44).
17 As the dependent variable is a proportion bounded between 0 and 1 (including 0 and 1),
18 fractional logistic regression is appropriate (Papke and Wooldridge, 1996). Both models support
19 Hypothesis 2a (at the significance level of 0.10). However, the rest of the hypotheses are not
20 supported. These results indicate that the factor that influences the presence of an active board in
21 a foreign subsidiary may not have an impact on the degree of board activeness. This may be due
22 to the conflict between different board tasks, which reduces the total variance of the degree of
23 board activeness. Leksell and Lindgren (1982) suggest that there is a conflict between external
24 roles (advisory, external relations) and internal roles (control and monitoring, coordination and
25 integration). When performing internal roles, the subsidiary board needs information about
26 corporate policies and procedures and about the management and allocation of internal
27 resources, while part of this information is not always deemed suitable to disclose to outside
28 directors who are residents of the host country (Leksell and Lindgren, 1982)¹⁰.
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53 Finally, prior research suggests that ownership structure, CEO tenure, firm age and legal
54 form influence the role and composition of boards in standalone firms (Björkman, 1994; Boone
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3 et al., 2007; Lehn et al., 2009; Linck et al., 2008). Moreover, incentive compensation as an
4 important control mechanism may have a substitution or complementary effect on the presence
5 of an active board. Therefore, we include these variables as control variables¹¹. Similar to our
6 main analysis, we estimate logistic regressions using three different methods. The results
7 (untabulated) with respect to our hypothesized relations and significant control variables are
8 consistent with our main analysis reported in Table 3. However, ownership structure, CEO
9 tenure, firm age, legal form and incentive compensation are not significant in any logit model.
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22 CONCLUSIONS AND DISCUSSION

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27 With the increasing rate of globalization and rapidly intensifying competition, an important
28 challenge facing MNEs is the successful management of foreign subsidiaries. The literature has
29 concentrated on boards in standalone firms, codes of good governance in a given country and
30 control mechanisms in MNEs. However, very little is known about the role of subsidiary boards
31 in the governance of foreign subsidiaries. Motivated by these observations, this study examines
32 the conditions under which a foreign subsidiary maintains an active board. Using survey and
33 archival data from 83 foreign subsidiaries operating in Belgium with headquarters in 14 different
34 countries, we find that a foreign subsidiary is more likely to maintain an active board if it is a
35 world mandate subsidiary, if it is larger relative to the MNE, if it has a higher level of local
36 responsiveness, and if its past performance is poorer. Further, the presence of an active board in
37 a foreign subsidiary is related to other control mechanisms deployed in the subsidiary. In
38 particular, a foreign subsidiary is less likely to maintain an active board if the subsidiary CEO
39 holds a management position at the MNE headquarters.
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This study contributes to the literature in several ways. First, while prior research focuses on various types of control mechanisms in MNEs, our study provides insight into the conditions under which an active board is more likely to be present. Our results suggest that a MNE's decision to maintain an active board in a foreign subsidiary seems to relate to the agency problem between headquarters and subsidiary management and the dependence of the subsidiary on the external environment. Therefore, an active board could be used as a control mechanism for managing foreign subsidiaries, as well as an instrument for dealing with the external environment. Second, while most prior research uses only a single theory to explain board characteristics, our findings suggest that a combination of agency theory and resource dependence theory provides comprehensive explanations on the presence of active boards.

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This study yields implications for top managers of MNEs. First, our results suggest that an active board might be of strategic importance to enhance subsidiary governance. Thus, top managers may consider maintaining an active board to govern foreign subsidiaries, as well as to deal with local issues. Moreover, in order to delegate appropriate tasks to an active board, it is important to analyze and evaluate the specific knowledge and resources of the subsidiary and the external environment. Second, top managers may face a tradeoff between assigning monitoring tasks and assigning service tasks to an active board due to the conflict between different board roles. Finally, the results from our control variables indicate that the presence of an active board in a foreign subsidiary is related to other control mechanisms deployed in the subsidiary. Therefore, top managers may consider the costs and benefits of different control mechanisms when delegating an active board in foreign subsidiaries.

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This study also yields implications for policy makers. Corporate governance regulators have developed different codes of good governance at the country level, which provide best practice

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3 recommendations and regulate the behavior and structure of boards of directors (Aguilera and
4 Cuervo-Cazurra, 2004, 2009). However, there are few governance recommendations that deal
5 with corporate governance issues in MNEs. The MNE represents a complex organization with
6 headquarters in one country and operating across many countries. This study shows that an
7 active board may be an important internal governance mechanism for managing foreign
8 subsidiaries, as well as an instrument for dealing with the external environment. Therefore,
9 corporate governance regulators may consider developing governance recommendations that
10 emphasize the importance of subsidiary boards in the oversight of foreign subsidiaries.
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22 This study has some limitations. First, it only provides evidence on foreign subsidiaries
23 operating in Belgium, where there are few restrictions on governance structures and the conduct
24 of business (see *Doing Business Survey, 2010*). The findings of this study may not be generalized
25 to subsidiaries operating in significantly different institutional settings. Second, as we select the
26 largest subsidiary of those MNEs that have more than one subsidiary operating in Belgium, our
27 results represent only the practices of the largest subsidiaries. Third, as our data are cross-
28 sectional, we could not test causality in the model. Longitudinal research on subsidiary boards
29 could further extend the findings of this study. Finally, our sample size is quite small, which
30 might limit our ability to identify statistically significant relationships.
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43 Despite the limitations, this study opens opportunities for future research. First, while this
44 study provides evidence on the conditions under which subsidiary boards are active, future
45 research is needed to investigate how headquarters delegate different roles to active boards
46 according to the environmental and strategic contingencies faced by foreign subsidiaries.
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3 foreign subsidiaries maintain active boards. Future research could extend this study to other
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5 forms of subsidiaries such as joint ventures. Third, this study is based on foreign subsidiaries
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7 operating in Belgium, where boards have a one-tier structure. Future research could extend our
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9 understanding of subsidiary governance by investigating the role and structure of subsidiary
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11 boards based on subsidiaries operating in other countries where boards have a two-tier structure.
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13 Finally, while this study provides some evidence that the presence of an active board in a foreign
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15 subsidiary is related to other control mechanisms deployed in the subsidiary, future research
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17 could further explore this issue by testing the substitutability and complementarity of different
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19 governance mechanisms for managing foreign subsidiaries.
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27 NOTES

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30 1. Foreign subsidiaries are legally separate entities that are majority owned by headquarters and
31 operating outside headquarters countries. We focus on boards in foreign subsidiaries because
32 MNEs are exposed to more control problems for their foreign subsidiaries than for their domestic
33 subsidiaries. Moreover, compared with local companies of host countries, it is more difficult for
34 foreign subsidiaries to build connections with local stakeholders and access local resources.
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37 2. According to Commission Recommendation 2003/361/EC of 6 May 2003, “a very small
38 enterprise is an enterprise that employs fewer than 10 persons and whose annual turnover and/or
39 annual balance sheet total does not exceed EUR 2 million”. “A small enterprise is an enterprise
40 which employs between 10 and 49 persons whose annual turnover and /or annual balance sheet
41 total does not exceed EUR 10 million”.
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44 3. In the questionnaire design stage, we use various methods to control for common method
45 biases, based on the suggestions of Podsakoff et al. (2003). First, we obtain our dependent
46 variable (active board) and explanatory variables from different sources, which eliminates the
47 tendency of the respondents to respond in a lenient manner. Second, we did not ask the
48 respondents directly whether there is an active board in their subsidiaries. Instead, we asked the
49 respondents to rate a list of 21 board tasks. This list is developed based on the existing
50 instrument (Kriger, 1988; Wan and Ong, 2005) and none of the 21 items tasks is likely to reflect
51 socially desirable behavior. Third, in the cover letter of the questionnaire, we promise the
52 respondents that they are assured of complete confidentiality and their answers to the
53 questionnaire will only be used for our research. There are no right and wrong answers and they
54 should answer as honestly as possible. Applying these methods reduces the likelihood that our
55 respondents conform to socially desirable standards and provide biased answers.
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4. Prior research also shows that Japanese MNEs use subsidiary boards more actively than either European or North American MNEs (Kriger, 1988). Moreover, Japanese MNEs use control mechanisms in a different way than other MNEs. For example, Change and Taylor (1999) find that Japanese MNEs use more staffing control than their American counterparts do. In our sample, we only have five Japanese subsidiaries, all of which maintain an active board. Therefore, we could not add a dummy variable to control for the influence of Japanese MNEs on the presence of active boards. However, when we delete the five Japanese subsidiaries and re-estimate our models, the results are similar to those reported in the main analysis.

5. We also included industrial dummies in Model 1 and Model 2. We grouped our sample into five broad industrial sectors: manufacturing (SIC 20-39), trading (SIC 50-59), service (SIC 70-89), transportation (SIC 40-49), and construction (SIC 15-17). The results suggest that industrial sectors are not significantly related to the presence of active boards. As adding too many independent variables decreases the power of the test, we delete these dummies from our analysis.

6. Since there is a predominance of headquarters from the US, the Netherlands and France, we included the Netherlands dummy and the France dummy in our models, in addition to the Anglo-Saxon dummy. The results show that subsidiaries headquartered in the Netherlands or France are not significantly different from the rest of subsidiaries in determining the presence of active boards (Netherlands: $\beta=-0.85$, $p=0.59$; France: $\beta=1.14$, $p=0.71$). As adding too many independent variables decreases the power of the test, we delete these dummies from our analysis.

7. Similar to our main analysis, we estimate the logit models using three different methods (robust standard errors, robust standard errors clustered by headquarters countries, robust standard errors clustered by industries). The results using these methods are similar. Therefore, we only report the results using robust standard errors estimation in Table 4.

8. We also consider an active board if there is a board in the foreign subsidiary that performs at least *three* of the 21 board tasks. The results with respect to our hypothesized relations and control variables are consistent with our main analysis reported in Table 3.

9. Note that MNEs may shift a significant proportion of their incomes into low statutory tax rates host countries to reduce their overall tax liabilities (Collins et al., 1998; Rego, 2003). This may reduce the quality of accounting figures of foreign subsidiaries. Further, financial reporting in Belgium suffers from tax bias, as there is a strong link between the accounting profit and the taxable profit of a company.

10. We also conduct a number of complementary analyses using the extent to which boards perform monitoring tasks, and the extent to which boards perform service tasks as dependent variables respectively. Consistent with the agency theory prediction, we find that world mandate and relative size are significantly related to monitoring tasks (world mandate: $\beta=0.70$, $p<0.001$; relative size: $\beta=0.23$, $p<0.001$), but not significant to service tasks. This indicates that the

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3 insignificant relation between subsidiary's importance to the MNE and the degree of board
4 activeness may be due to the conflict between different board roles.
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7 11. In these analyses, ownership structure is measured using a dummy variable (wholly owned)
8 equal to 1 if a foreign subsidiary is wholly owned by the MNE. CEO tenure is measured by the
9 number of years that the subsidiary CEO has worked in the CEO position, obtained from the
10 questionnaire. Subsidiary age is measured by the number of years the subsidiary is
11 established/acquired by the headquarters. Legal form is measured using a dummy variable (NV)
12 equal to 1 if the subsidiary's legal form is N.V. Incentive compensation is measured by four
13 items in the questionnaire, using a seven-point Likert-scale ranging from -3 (not at all) to +3 (to a
14 great extent), based on the Chow et al. (1999). We asked respondents to indicate the extent to
15 which their headquarters compensate subsidiary CEOs based on their performance relative to
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TABLE 1

Sample Subsidiaries by Headquarters Country, Legal Form and Respondent's Tenure
(N=83)

	n	%
<i>Panel A: Headquarters country</i>		
Australia	1	1.20
Switzerland	4	4.82
Germany	8	9.64
Denmark	2	2.41
France	18	21.68
U.K.	4	4.82
Ireland	2	2.44
Italy	1	1.20
Japan	5	6.02
Luxemburg	4	4.82
Netherland	13	15.66
Norway	1	1.20
Sweden	2	2.41
U.S.	18	21.68
<i>Panel B: legal form</i>		
NV	73	87.95
BVBA	10	12.05
<i>Panel C: respondent's tenure</i>		
1-10 years	63	75.90
11-20 years	15	18.07
more than 20 years	5	6.03
Average	8.45	

TABLE 2

Panel A: Means, Standard Deviations and Correlations of Dependent, Independent, and Control Variables (N=83)

Variables	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12
1. Active board	.69	.47	1.00											
2. World mandate	.28	.45	.19 [†]	1.00										
3. Relative size	.04	.08	.28**	.02	1.00									
4. Local responsiveness	1.08	2.05	.15	-.31**	-.02	1.00								
5. Past performance	22.80	53.77	-.17	-.04	-.03	-.02	1.00							
6. Absolute size	2.29	.44	.22*	.17	.40**	.07	-.07	1.00						
7. Anglo-Saxon	.30	.46	-.12	.24*	.10	-.28*	-.08	.01	1.00					
8. Geographical distance	2.41	3.42	.05	.10	.02	-.15	-.13	-.08	.58***	1.00				
9. Cultural distance	.33	.28	.21*	.22*	-.02	-.10	.04	.06	.23*	.11	1.00			
10. CEO's headquarters management position	.19	.40	-.13	.38**	.11	-.11	.01	.04	.15	.10	-.01	1.00		
11. Expatriate	.28	.45	.01	-.02	-.12	-.15	.07	-.06	.06	-.01	-.09	-.17	1.00	
12. Socialization	.81	1.35	-.05	.04	.06	.15	.04	.06	.01	.06	-.02	.23*	.02	1.00

Panel B: Variance Inflation Factors (N=83)

Variables	VIF	1/VIF
World mandate	1.42	.70
Relative size	1.17	.85
Local responsiveness	1.29	.78
Past performance	1.15	.87
Absolute size	1.25	.80
Anglo-Saxon	1.69	.59
Geographical distance	1.55	.65
Cultural distance	1.25	.80
CEO's headquarters management position	1.29	.78
Expatriate	1.13	.89
Socialization	1.21	.83

Notes: (1) Significance level: † $p < .10$, * $p < .05$, ** $p < .01$, *** $p < .001$ (two-tailed test). (2) In the above two tables, Active board is a dummy variable equal to one if a foreign subsidiary has an active board. World mandate is a dummy variable equal to one if the respondent defines the subsidiary as a world mandate in the questionnaire. Relative size is measured by the foreign subsidiary's total number of employees at the end of 2008, divided by the MNE's total number of employees. Local responsiveness is measured by a Likert-scale question asking the respondents the extent to which the subsidiary adapts its activities to the needs of the Belgian market. Past performance is the average annual ROE over 2005-2007. Absolute size is the logarithm of the total number of the subsidiary's employees. Anglo-Saxon is a dummy variable equal to one if the subsidiary is headquartered in an Anglo-Saxon country. Geographical distance is the 1,000 kilometers distance between the capital cities of headquarters country and host country. Cultural distance is calculated using the procedure developed by Kogut and Singh (1988). CEO's headquarters management positions is a dummy variable equal to one if the subsidiary CEO holds a management position at the MNE headquarters. Expatriate is measured by a dummy variable equal to 1 if the subsidiary CEO is the headquarters country national. Socialization is measured by three items based on Chalos and O'Connor (2004) and O'Donnell (2000), using a seven-point Likert-scale ranging from -3 (not at all) to +3 (to a great extent). We ask respondents the extent to which headquarters visits the subsidiary frequently, organizes international training programs, and attaches a strong corporate culture to subsidiaries.

TABLE 3

**Logistic Regressions Explaining the Presence of Active Boards in Foreign Subsidiaries
(N=83)**

Main research variables	Model 1	Model 2	Model 3
World mandate	3.21** (2.78)	2.53*** (3.19)	3.21** (2.61)
Relative size	3.82*** (3.38)	3.05*** (3.18)	3.82*** (4.22)
Local responsiveness	1.27** (3.04)	1.33** (2.68)	1.27*** (3.38)
Past performance	-.82* (-1.99)	-.53* (-2.37)	-.82† (-1.82)
Other variables			
Absolute size	.52 (.89)	.37 (1.60)	.52 (.88)
Anglo-Saxon	-3.15*** (-3.19)		-3.15*** (-3.63)
Geographical distance	.65* (2.23)	.01 (.02)	.65* (2.01)
Cultural distance	1.03** (2.76)	.69*** (3.93)	1.03** (2.76)
CEO's headquarters management position	-2.34* (-2.40)	-2.00* (-2.12)	-2.34*** (-3.43)
Expatriate	1.23 (1.49)	1.10*** (3.26)	1.23 (1.33)
Socialization	-.51 (-1.44)	-.59† (-1.80)	-.51 (-1.25)
"Pseudo" R ²	.43	.34	.43
Log Pseudolikelihood	-29.38	-33.94	-29.38
Wald Chi-square	28.15	2936.59	48.58
P-value	.00	.00	.00

Notes: (1) Significance level: †p<.10, *p<.05, **p<.01, ***p<.001 (two-tailed test). (2) Model 1 estimates robust standard errors using Huber-White standard estimation. Model 2 estimates robust standard errors clustered by 14 headquarters countries. Model 3 estimates robust standard errors clustered by 23 industries. (3) Standardized regression coefficients are reported. (4) Z-scores are reported in parentheses. (5) Please see Table 2 for variable definitions.

TABLE 4

**Logistic Regressions Explaining the Presence of Active Boards in Foreign Subsidiaries
(Robustness checks, N=83)**

Main research variables	Model 4	Model 5	Model 6	Model 7
World mandate	2.06* (2.06)	3.21** (2.91)	3.12** (2.74)	3.34** (3.09)
Relative size	3.33** (3.13)	3.38*** (3.28)	3.46*** (3.40)	3.90*** (3.23)
Local responsiveness	.99** (2.79)	1.27*** (3.26)	1.07** (2.97)	1.24** (2.78)
Past performance	-.62† (-1.78)	-.44† (-1.76)	-.75† (-1.83)	-.80† (-1.79)
Other variables				
Absolute size	.40 (.94)	.59 (1.08)	.52 (.79)	.35 (.60)
Anglo-Saxon	-2.69** (-2.87)	-2.84*** (-3.39)	-3.45** (-3.13)	-3.70** (-3.06)
Geographical distance	.59* (2.06)	.76** (2.67)	.32 (.81)	.90* (2.35)
Cultural distance	.84* (2.39)	1.01** (2.60)	1.24* (2.43)	.98* (2.30)
CEO's headquarters management position	-2.13* (-2.16)	-2.57* (-2.43)	-2.11* (-2.29)	-2.57** (-2.62)
Expatriate	.77 (1.10)	1.02 (1.32)	1.55† (1.79)	.48 (1.44)
Socialization	-.37 (-1.07)	-.55† (-1.68)	-.61 (-1.61)	-.63 (-1.59)
"Pseudo" R ²	.36	.42	.42	.42
Log Pseudolikelihood	-34.03	-29.87	-29.90	-29.85
Wald Chi-square	21.95	28.94	27.25	19.80
P-value	.02	.00	.00	.05

Notes: (1) Significance level: †p<0.10, *p<0.05, **p<0.01, ***p<0.001 (two-tailed test). (2) Model 4 uses an alternative measure of the presence of active boards. We consider a foreign subsidiary to maintain an active board if there is a board in the foreign subsidiary that performs at least *five* of the 21 tasks. Model 5 uses an alternative measure of past performance based on the average annual ROA over 2005-2007. Model 6 uses an alternative measure of cultural distance based on the culture index of the World Value Survey 2005/2006. Model 7 uses an alternative measure of expatriate, which is a seven-point Likert-scale ranging from -3 (not at all) to +3 (to a great extent), obtained from the questionnaire. (3) Standardized regression coefficients are reported. (4) Z-scores are reported in parentheses. (5) Please see Table 2 for variable definitions.

TABLE 5

**Regressions Explaining the Degree of Board Activeness in Foreign Subsidiaries
(Additional analyses, N=83)**

Main research variables	Model 8	Model 9
	Robust regression	Fractional logit regression
World mandate	.22 (.74)	.62 (1.05)
Relative size	.11 (1.14)	.28 (.94)
Local responsiveness	.23 [†] (1.95)	.46 [†] (1.90)
Past performance	-.09 (-.97)	-.14 (-.71)
Other variables		
Absolute size	.27* (2.28)	.60* (2.29)
Anglo-Saxon	-.64* (-2.31)	-1.24* (-2.10)
Geographical distance	.18 [†] (1.84)	.42 [†] (1.80)
Cultural distance	.27* (2.23)	.49* (2.14)
CEO's headquarters management position	-.30 (-.86)	-.90 (-1.41)
Expatriate	.27 (1.08)	.70 (1.42)
Socialization	.01 (.11)	-.08 (-.30)
R ²	.26	
Log Pseudolikelihood		-43.27
AIC/BIC		AIC=1.33 BIC=-247.34
F-value	3.82	
P-value	.00	

Notes: (1) Significance level: [†]p<.10, *p<.05, **p<.01, ***p<.001 (two-tailed test). (2) In Model 8, the degree of board activeness is measured by summing and averaging the standard scores of the 21 board tasks. Robust regression estimation is used. T-scores are reported in parentheses. In Model 9, the degree of board activeness is measured by the percentage of tasks the board performs. Fractional logit model is used. Z-scores are reported in parentheses. (3) Standardized regression coefficients are reported. (4) Please see Table 2 for variable definitions.

APPENDIX A

Survey Items Constructing Active Board

Is there a board of directors in your subsidiary?

- yes no

If yes, how much does the board of directors of your subsidiary perform the following tasks?

1. Monitor the subsidiary's CEO in decision-making
2. Evaluate the subsidiary CEO's performance
3. Evaluate the subsidiary's performance
4. Appraise the subsidiary CEO's compensation
5. Take part in the selection of the subsidiary's new top managers
6. Review the subsidiary's financial information for important issues
7. Engage in the subsidiary CEO's succession planning
8. Take part in the formulation of the subsidiary's strategic plan
9. Identify the subsidiary's strategic direction
10. Debate on the subsidiary's strategic plan
11. Facilitate the interactive between headquarters and the subsidiary
12. Advise headquarters on subsidiary issues
13. Informally communicate with the subsidiary's CEO
14. Informally communicate with headquarters
15. Bring corporate culture into the subsidiary
16. Provide knowledge of local economic, political and social conditions to the subsidiary's CEO
17. Provide advice and counsel to the subsidiary's CEO
18. Represent the subsidiary's interests in local communities
19. Communicate with local stakeholders
20. Facilitate the access to local resources
21. Serve as a link to local government agencies

APPENDIX B

Number of Subsidiaries Performing Each Board Task (N=83)

Survey items	Nr. of subsidiaries (%)
1. Monitor the subsidiary's CEO in decision-making	52 (62.7%)
2. Evaluate the subsidiary CEO's performance	50 (60.2%)
3. Evaluate the subsidiary's performance	53 (63.9%)
4. Appraise the subsidiary CEO's compensation	40 (48.2%)
5. Take part in the selection of the subsidiary's new top managers	50 (60.2%)
6. Review the subsidiary's financial information for important issues	54 (65.1%)
7. Engage in the subsidiary CEO's succession planning	46 (55.4%)
8. Take part in the formulation of the subsidiary's strategic plan	50 (60.2%)
9. Identify the subsidiary's strategic direction	49 (59%)
10. Debate on the subsidiary's strategic plan	50 (60.2%)
11. Facilitate the interactive between headquarters and the subsidiary	53 (63.9%)
12. Advise headquarters on subsidiary issues	53 (63.9%)
13. Informally communicate with the subsidiary's CEO	54 (65.1%)
14. Informally communicate with headquarters	54 (65.1%)
15. Bring corporate culture into the subsidiary	50 (60.2%)
16. Provide knowledge of local economic, political and social conditions to the subsidiary's CEO	48 (57.8%)
17. Provide advice and counsel to the subsidiary's CEO	51 (61.4%)
18. Represent the subsidiary's interests in local communities	39 (47%)
19. Communicate with local stakeholders	38 (45.8%)
20. Facilitate the access to local resources	40 (48.2%)
21. Serve as a link to local government agencies	41 (49.4%)