



The Impact of Global Capital Market Exposure and Stable Ownership on Investor Relations Practices and Performance of Japanese Firms

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Abstract. This paper examines whether greater exposure to global capital markets, stable share ownership, and group affiliation of Japanese firms have any impact on the quality of their investor relations practices (IR) and market-value added (MVA). The results indicate that foreign ownership and foreign listings are positively associated with IR. Foreign listings are also positively associated with MVA. However, stable ownership and group affiliation do not seem to have any impact on IR. These findings suggest that Japanese firms that are more exposed to global capital markets are more likely to adopt shareholder-oriented policies rather than stakeholder-oriented policies.

Keywords: corporate governance, ownership structure, Japanese firm, investor relations

Previous research on Japanese corporate governance has often focused on the roles of main banks and corporate groups. As the main bank is often the largest lender to its corporate clients, it has a long-term stake in the viability of its clients. At the same time, since the main bank often controls large block positions in its clients' equities, it has an interest in maintaining high share prices. Aoki (1990), Sheard (1989), and Suto, Matsuura, and Yonezawa (1996) suggest that the main bank plays a critical role in monitoring its corporate clients because of its position as a major credit supplier and as a large equity holder. Flath (1993) and Prowse (1990) argue that this unique position of the main bank confers upon it an ability to reduce conflict in residual claims between debt holders and shareholders. However, it is also suggested that Japanese banks have not focused much on the economic efficiency of their clients nor on higher investment returns from their shareholdings (Morck and Nakamura, 1999; Weinstein and Yafeh, 1998). This means that the main bank's primary interest in its shareholdings and in its monitoring activity has not been the maximization of shareholder value.

Another type of corporate monitoring mechanism for Japanese firms is the informal mutual monitoring by member firms of corporate groups or horizontal *keiretsu* (Gilson and Roe, 1993; Gerlach, 1992). Many Japanese firms belong to such horizontal *keiretsu*, including the former *zaibatsu*-based groups and the bank-centered networks of large firms (Sheard, 1994; Gerlach, 1992). Member firms in this type of group are usually related through cross-shareholding arrangements. The important point in this mechanism is that the monitoring objectives of these corporate group firms do not always coincide with those

of other shareholders who hold shares primarily for investment purposes. This is because Japanese corporate group firms often hold shares in other firms not for investment purposes but rather for business and relationship purposes (Abegglen and Stalk, 1985; Clark, 1979). Thus, like bank shareholders, their primary interest has not been higher investment return.

Although Japanese banks and corporate groups have been playing an important governance role, there is a growing consensus that their relationships with clients and member firms are changing. First, because of the declining reliance of Japanese firms on bank loans, it is suggested that the main banks' monitoring power has been declining (Aoki, Patrick and Sheard, 1994; Kester, 1991). This trend has been caused by the increasing globalization of capital markets and the growing name recognition of Japanese firms in international product markets, which has led to an increased availability of market funds (Rosenbluth, 1989). In addition, the upcoming accounting change, which requires Japanese firms and banks to use market value rather than book value in disclosing the extent of their long term stockholdings, will force these firms to report unrealized capital losses when stock prices of their holdings become lower. Because of this, corporate group firms and banks have started to unwind their cross-shareholding positions in other member firms (*Japan Economic Journal*, September 22, 2000).

These changing relationships could have important implications because they imply that different strategic demands are beginning to be put on Japanese managers. As suggested, despite their position as large shareholders, Japanese banks and corporate shareholders have not much focused on the maximization of shareholder value (Morck and Nakamura, 1999; Gerlach, 1992). However, if Japanese firms had to operate under market-based governance rather than under bank or group governance because of changes in their ownership structures and financing practices, they would be pressured to respond to the interests of market investors who focus on investment returns from their shareholdings.¹

Despite these recent changes, there are only a limited number of empirical studies on corporate governance of Japanese firms that have examined the effects of capital market exposure on corporate strategy and firm performance (e.g., Phan and Yoshikawa, 2000). The objective of this paper is to investigate whether greater exposure to global capital markets and stable ownership by banks and corporate group firms have any effect on shareholder-oriented practices and firm performance. In this paper, I use market value added, or MVA, to measure firm performance and the quality of investor relations (IR) to assess the firm's shareholder-oriented practice. To examine this issue, the paper proceeds as follows: the next section reviews the theoretical framework of corporate governance research, the main characteristics of Japanese shareholders are discussed next, then, hypotheses are developed based on the discussion of the Japanese context. A discussion of the sample and variables follows, and finally, the results of the analysis and conclusions of the research are presented.

1. Literature review on agency theory and ownership structure

Large public corporations with dispersed ownership structure represent a classic agency theory problem (Jensen and Meckling, 1976). Since the shareholdings of large corporations are often dispersed, managers may have effective control over the firm although they often have little or no ownership stake (Berle and Means, 1932). To solve this potential moral

hazard problem, the incentives of managers are aligned with the economic interests of stockholders through various institutional and market-based mechanisms (Alchain and Demsetz, 1972; Jensen and Ruback, 1983). Theoretically efficient capital and external managerial labor markets impose discipline by threatening non-performing managers with the loss of personal economic utility (Jensen and Meckling, 1976; Easterbrook, 1984). Thus, to narrow the divergence of interests between shareholders and management, the American corporate governance system on which these arguments are based incorporates a variety of institutional and market mechanisms, such as institutional shareholdings and ownership concentration.

There are a number of empirical studies that show the effects of ownership structure and ownership concentration on firm strategies and performance. One of the early studies in this area is by Amihud and Lev (1981), who found that manager-controlled firms (i.e. firms without a large block shareholder) were more widely diversified than firms with at least one large block shareholder. This finding indicates that unmonitored managers whose wealth and incomes are highly dependent upon their firms tend to adopt unprofitable diversification strategies for risk reduction purposes at the expense of shareholders' interests.

Hill and Snell (1988) examined the effects of stock concentration and management stockholding on corporate innovation, diversification, and profitability. They found that when share ownership was concentrated, innovation strategies were favored despite higher risk to managers, because such strategies provide large upside opportunities for shareholders. Another study by Hill and Snell (1989) investigated the effects of stock concentration on diversification strategies, R&D intensity, and productivity and found that stock concentration affected productivity directly and indirectly, through the mediators of unrelated diversification and R&D intensity.²

Baysinger, Kosnik and Turk (1991) examined the relationships between institutional ownership and corporate R&D spending. They found that higher levels of institutional ownership were positively associated with greater R&D spending. Kochhar and David (1996) tested three competing hypotheses; institutions are either myopic investors, superior investors due to their information processing capability, or active investors. They concluded that institutions were active investors who were involved in monitoring management. In their survey of corporate governance research, Shleifer and Vishny (1997) argued that large investors who have both the incentive and capacity to monitor managers represent the most direct means of aligning the interests of shareholders and managers.

More recently, Lane, Cannella, and Lubatkin (1998) tested the association between ownership structure, board vigilance, corporate strategy, and firm performance using the data in the Amihud and Lev (1981) study from the 1960s and the new data from the 1980s. Their results do not support the agency theory argument that monitoring by shareholders or board members affects the strategic behavior of managers and firm performance. Based on their findings, they cautioned against the application of agency theory to corporate governance research.

2. Characteristics of Japanese shareholders

The studies discussed in the previous section were conducted using U.S. sample firms. When we conduct a similar study in another national context, we need to take various

country-specific factors into consideration. In the Japanese context, many Japanese firms are linked through extensive cross-shareholding arrangements with their main banks, business partners, and client firms, and also a large portion of Japanese stocks are owned by “stable” investors (Sheard, 1994). It is often argued that stable investors own their shares primarily to cement and grow stable business relationships rather than to earn a return on their equity investments (Abegglen and Stalk, 1985; Kester, 1991; Charkham, 1994). It is also suggested that they own shares in other firms to ensure stability in earnings and sales so that they can protect the interests of important stakeholders including employees, management, business partners such as banks, suppliers, and other affiliated firms (Caves and Uekusa, 1976; Nakatani, 1984). Because of these characteristics, Japanese corporate governance is often seen as stakeholder-oriented as opposed to market-oriented (Buhner et al., 1998; Weimer and Pape, 1999). Since these stable investors do not aim at maximizing the investment return on their cross-shareholdings, they do not impose much pressure on managers to improve firm performance (Charkham, 1994; Kester, 1991).

That said, there is anecdotal evidence that an increasing number of Japanese firms are slowly adopting more shareholder-oriented practices, such as a greater number of outside directors on the board and greater information disclosure to investors, that are intended to serve the interests of shareholders, rather than stakeholder-oriented policies which attempt to satisfy important stakeholders’ interests (Yoshikawa and Phan, 2001). One of the key factors that drive these firms to adopt more shareholder-oriented practices is a shift from bank borrowing to capital market finance by large Japanese firms, as discussed earlier. Another factor appears to be a shift in ownership structure. Since the mid-1990s, foreign ownership of Japanese firms has been rising, climbing to over 14% of all listed Japanese shares in 1999 (*Research on Stock Distribution*, 2000). At the same time, cross-shareholdings among affiliated firms have been steadily declining. It is reported that cross-shareholdings among large listed Japanese firms declined to 10.5% of market value of all outstanding shares in 1999 from around 17% in the early 1990s and 18% in 1987 (*Japan Economic Journal*, April 15, 2001). Thus, it appears that greater exposure to capital markets, especially to foreign investors, is prompting some Japanese firms to pay more attention to their performance in terms of market value and to shareholder-oriented practices. In the next section, a series of hypotheses are developed to test the effects of global capital market exposure and close relationships with business partners on firm performance and IR practices.

3. Hypotheses

3.1. Market investor ownership

It is theorized that the higher the proportion of shareholding by market investors in a firm’s ownership structure, the more likely it is that the firm posts superior performance and adopts more shareholder-oriented practices. Market investors here are defined as those who buy, sell, and hold stocks primarily for investment purposes, as opposed to business relationship purposes. The main investment objective of market investors is a high investment return because, unlike stable investors, they only have arm’s length financial relations with firms in which they own shares (Sheard, 1997; Kikuchi, 1999). Thus, it is expected that managers

of firms with a large percentage of outstanding shares held by market investors are under greater pressure from these shareholders to adopt profit-maximizing policies.

In this study, foreign shareholders are chosen as market investors because they represent one of the largest segments of market investors in the Japanese stock markets, holding over 14% of outstanding stocks of the listed Japanese firms in 1999. In addition, I classify foreign shareholders as market investors because they are mostly American and European institutional investors, such as pension funds and mutual funds, that have no long-term ongoing business relationships with the Japanese firms in which they own shares.³ This implies that they are under no constraints to reduce their expectations for wealth maximization in order to maintain business relationships with firms in which they hold shares.

These investors' interests include both long-term and short-term returns. Since pension funds usually seek long-term investment returns, they often choose to influence management by exercising their voting rights rather than simply to sell their shareholdings when they are not satisfied with their investment returns (Useem, 1998). This will pressure Japanese management to select policies that can lead to higher investment returns. Mutual funds, on the other hand, may try to achieve capital gains or to reduce capital losses by shifting their investment on a short-term basis, which could depress share prices. In this case as well, Japanese managers will try to achieve superior performance so that they can prevent these investors from selling large stock positions. Thus, it is hypothesized that foreign ownership will impose pressure on Japanese managers to seek better financial performance.

At the same time, foreign shareholders are more likely to demand that Japanese firms disclose more corporate information, because they do not have other means to gather such information due to their arm's length relationships with them. Since their main interest in shareholdings is investment return, they need as much information as possible to assess the investment prospects of a firm (Yoshikawa and Linton, 2000). In addition, internationally active institutional investors are pressing for global standards of corporate disclosure that aim at achieving more uniform and transparent information disclosure (Useem, 1998). Thus, as shareholdings by foreign investors increase, Japanese firms are expected to be under greater pressure to disclose more information through IR practices.

Hypothesis 1a. The proportion of foreign ownership is positively associated with firm performance.

Hypothesis 1b. The proportion of foreign ownership is positively associated with the quality of IR.

3.2. Foreign stock listing

In addition to foreign ownership, exposure to global capital markets can increase through foreign stock listings. Foreign stock listings, especially where local investors are more demanding, can increase the pressure on managers to choose strategies that are expected to improve firm performance. A study that examined 70 large Japanese firms shows that companies with foreign listings are less diversified (Phan and Yoshikawa, 2000), which tends to have a positive impact on firm performance (Christensen and Montgomery, 1981; Porter, 1987). In addition, foreign listings can enhance corporate visibility and coverage by the local media (Saudagaran and Biddle, 1995), which in turn could lead a firm to focus

on performance so that the firm can maintain or gain a good reputation. Further, when a company lists its shares abroad, especially a non-U.S. company on the New York Stock Exchange, it tends to enjoy an increase in market value (Sundaram and Logue, 1996; Useem, 1998). Thus, foreign stock listings seem to have a positive impact on firm performance in terms of shareholder value.

Foreign listings can also lead Japanese firms to adopt shareholder-oriented practices, including greater information disclosure through IR practices. Greater and more effective information disclosure to investors through the IR functions reduces information asymmetries between investors and managers and thus lowers the risk of moral hazard. A foreign company may need to disseminate additional information since its name and products tend to be less known to local investors than the market's local companies (Yoshikawa and Linton, 2000). Thus, greater information disclosure through IR practices is in the interest of investors. Foreign listings can also make a firm place a greater emphasis on IR because foreign stock exchanges may require more stringent information disclosure. For example, it is suggested that those Japanese firms that adhere to the Securities and Exchange Commission (SEC) standards, rather than domestic Japanese disclosure rules, are judged to have greater exposure to market scrutiny (Saudagaran, 1988; Saudagaran and Biddle, 1995). Thus, it is hypothesized that foreign stock listing will impose greater pressure on Japanese managers to achieve better financial results and to improve the quality of IR.

Hypothesis 2a. Foreign listing is positively associated with firm performance.

Hypothesis 2b. Foreign listing is positively associated with the quality of IR.

3.3. *Stable ownership*

Major industrial sectors in Japan are organized as networks of firms in which members enforce managerial discipline through an internal capital market (Gerlach, 1992; Gilson and Roe, 1993). This network has traditionally been characterized by extensive cross-shareholdings (Clark, 1979; Charkham, 1994; Lincoln, Gerlach and Takahashi, 1992). These corporate networks, often known as *keiretsu*, usually revolve around a main bank. It is argued that this main bank plays a major role in corporate governance in Japan (Aoki, Patrick and Sheard, 1994; Kaplan, 1994; Hoshi, Kashyap and Scharfstein, 1990; Sheard, 1989).

The main bank controls a large portion of the network's equity and serves as lead lender to the *keiretsu* firms. As a large debt holder, the main bank often acts as an advisor and agent to the firm's cash management account and financial planning activities (Aoki, 1990). Through these activities, the main bank can obtain the firm's strategic and operational information. As a large equity holder, it also has a natural incentive to protect the long-term value of the firm's equity. However, while Japanese banks often hold shares in their client firms, they do so to cement business relationships and to achieve other interests (Morck and Nakamura, 1999), rather than to earn returns from their shareholdings. In addition, since main banks are major debt holders, their strategic emphasis on asset allocations tends toward stability and lower risk, rather than the maximization of return on equity. This implies that the main bank monitoring does not lead to corporate strategies that emphasize high risk and high returns. Thus, the interests of banks and market investors do not always converge.

In addition to the banks, many insurance companies and non-financial firms also hold stocks of other firms, often on a reciprocal basis in the case of non-financial firms. These insurance company and corporate shareholders, like bank shareholders, hold shares not necessarily to earn investment returns but to cement trading relationships and long-term alliances (Abegglen and Stalk, 1985; Kester, 1991). For example, insurance companies hold shares in their client firms so that they can sell their group insurance products and get pension fund management business. Similarly, non-financial firms own shares in other firms to stabilize trade flows. Because of these non-investment reasons for holding shares in other firms, corporate shareholders, including insurance companies, and bank shareholders are often called stable investors.

The greater the shareholding by these stable investors on a firm's capital assets, the greater the influence that such investors can exert on a firm's strategy. Thus, a firm with relatively larger holdings by stable investors will be forced to adopt more conservative investment stances because these investors will demand stability in their trading relationships. Hence, the strategies adopted by such firms will reflect an aversion to high-risk investments that could potentially yield higher future returns. Thus, larger shareholdings by these stable investors should lead to lower profitability.

Also, because of the close relationships with their client firms and business partners, these stable investors have unique access to critical and timely information that other investors do not have (Sheard, 1989; Sohn, 1994). This means that stable investors do not require active IR practices to obtain essential information from their clients and business partners. Although it is argued that greater information disclosure has various benefits, such as a lower cost of capital and greater liquidity (Lev, 1992; Dhaliwal, 1979), many firms are reluctant to disclose much information, because (1) it is costly to do so, (2) disclosure of additional information may reveal poor managerial decisions, and (3) disclosure of additional information will benefit their competitors (Bettis, 1983). This implies that firms will try not to disclose much information through IR practices unless they are under pressure to do so. Hence, it is hypothesized that shareholdings by financial institutions and corporations are negatively related to investment returns and the quality of IR.

Hypothesis 3a. The proportion of stable ownership is negatively associated with firm performance.

Hypothesis 3b. The proportion of stable ownership is negatively associated with the quality of IR.

3.4. Group affiliation

While the effects of stable shareholding on firm performance and IR practices are not expected to be positive, I expect the same effects for the relationships between group affiliation and performance and IR. Although there are some studies that show that group affiliations have potential benefits, such as higher firm profitability especially in emerging markets (Khanna and Palepu, 1997; Khanna and Rivkin, 2001), many previous studies that examined the effects of *keiretsu* affiliation on firm performance found that Japanese corporate groups were not associated with higher profitability or growth. The findings by Nakatani (1984) showed that *keiretsu* firms had lower profits than non-*keiretsu* firms. At

the same time, the profitability of *keiretsu* firms did not fluctuate as much over time as that of their non-*keiretsu* firms. From these findings, Nakatani (1984) concluded that his results suggest the risk-sharing nature of *keiretsu*.

A similar study by Caves and Uekusa (1976) discovered a negative relationship between *keiretsu* group affiliation and profitability. Hundley and Jacobson (1998) found that compared with non-*keiretsu* firms, *keiretsu* firms showed poorer export performance. These findings suggest that member firms in the same group do not always seek higher efficiency and greater investment return but instead strive to maintain group harmony and stability. Further, it is expected that since group member firms have close informal ties through which they can obtain important information, it is unlikely that they pressure other member firms to improve their IR practices. Thus, it is hypothesized that group affiliation is negatively associated with performance and the quality of IR.

Hypothesis 4a. Group affiliation is negatively associated with firm performance.

Hypothesis 4b. Group affiliation is negatively associated with the quality of IR.

4. Sample and data

4.1. Sample firms

The sample for this study consists of 186 publicly traded Japanese manufacturing firms with market capitalization over 100 billion Japanese yen on November 30, 2000. These sample firms were chosen because there was complete data for all the variables for 1999. They are classified into eight industrial groups; i.e., chemicals, textiles, food, pharmaceuticals, automotive, steel and heavy machinery, electronics, and other light manufacturing.

Data for this study were collected from the following sources: *Nikkei Kaisha Jyoho* (a corporate data book), *Weekly Toyo Keizai* (a weekly business journal), *Keiretsu no Kenkyu* (a data book of *keiretsu* groups) and *Weekly Daiyamondo* (a weekly business journal). These sources were used because other researchers and industry analysts often use them to gather information and they contained the latest financial data for the sample firms.

4.2. Dependent variables

In this study, two dependent variables were used to test the hypotheses: market value added (MVA) and the quality of investor relations practices (IR). MVA is a performance measure based on stock prices, which is calculated as market value of the firm (market value of total equity capital + market value of total debts) minus invested capital (book value of total equity capital + book value of total debts). This performance measure was used here because it is a clear indication of firm performance that benefits shareholders. Also, value-based performance measures including MVA and economic value added (EVA) have started to receive much attention both in business media and in academic research (e.g., Hodak, 1994; Lehn and Makhija, 1996; Tully, 1993; Uyemura, Kantor and Pettit, 1996; Desai, Fatemi and Katz, 1999). These data were gathered from the *Weekly Toyo Keizai* (November

4, 2000), which published MVA of listed Japanese firms using market data on March 31, 2000.

Another dependent variable, IR, was chosen in this study because it clearly benefits market investors by narrowing information asymmetries. Data for the quality of IR were collected from the *Weekly Daiyamondo*, which conducted a survey of investor relations practices of major Japanese firms between January and February 2001. This publication sent mail questionnaires to 596 securities analysts and fund managers asking them to rank five Japanese firms with the best IR practices and to give each firm a score (a maximum score of 5). It also sent questionnaires to 383 Japanese firms with market capitalization over 100 billion-yen and asked them about their organizational structure for IR, the frequency with which they updated their website, and the annual IR budget. Then, responses to these questions were scored (a maximum total score of 20). In addition to these data, this journal looked at the contents of each firm's web site and evaluated it by several criteria, such as the availability of an e-mail address to obtain additional information, access to the latest financial reports, and access to annual reports for the past three years. Using these data, the publication gave scores to 383 Japanese firms and ranked them for their IR practices. In this paper, these scores were used as a measure of the quality of IR.

4.3. Independent variables

The ownership structures of the firms were categorized into two classes of shareholder. One of these two classes of shareholders is market investors. In this study, foreign shareholders are treated as market investors. The other class of shareholders is stable investors. Financial institution shareholders and corporate shareholders make up this class of shareholders.

Foreign shareholders are considered market investors here because most of them are either U.S. or European institutional investors who have no ongoing business ties with the Japanese firms in which they own shares. The percentage of outstanding shares held by foreign shareholders is used to evaluate the effect of this ownership class on firm performance and IR. Data for this variable were obtained from the *Nikkei Kaisha Joho*.

Japanese shareholders are treated as the other class of shareholder (i.e., stable investor), because they tend to have on-going business ties with firms in which they hold shares. Financial institutions such as banks and insurance companies usually have business relationships such as bank lending, insurance sales, and other financial transactions with the firms in which they hold shares (Gerlach, 1992; Charkham, 1994). Financial institution ownership was measured as the percentage of total outstanding shares held by Japanese financial institutions. Ownership data was collected from the *Nikkei Kaisha Joho*.

Corporate shareholders are often the business partners of other firms with which they have cross-shareholding arrangements. They are often suppliers or customers and therefore have on-going business relationships. Thus, like financial institutions, these corporate shareholders are interested in cementing business relationships with their partners rather than maximizing investment returns (Clark, 1979; Abegglen and Stalk, 1985). Corporate ownership was measured as the percentage of total outstanding shares held by non-financial corporations. This ownership data was also obtained from the *Nikkei Kaisha Joho*.

In addition to foreign ownership, this study used foreign stock listing as a measure to assess a firm's exposure to global capital markets. Specifically, I used a dummy variable representing whether a firm's stock is listed on the New York Stock Exchange and/or the London Stock Exchange. I assigned the number 1 if a firm is listed on either exchange or both exchanges. These two were chosen because they are the largest stock exchanges (excluding the Tokyo Stock Exchange) in terms of trading volumes and market capitalization. These data were collected from the *Nikkei Kaisha Joho*.

In order to assess the effect of group affiliation on firm performance and IR, a dummy variable was used to see whether a firm is a member of the President's Club (*shacho-kai*) of a big-six corporate group (Nakatani, 1984; Gerlach, 1992). I assigned the number 1 if a firm is a member of one of these groups. These data were culled from the *Keiretsu no Kenkyu*.

4.4. Control variables

The size of a firm is included as a control variable to account for the potential effects of firm size or economies of scale and scope effects. Firm size was measured as the log of sales. Debt ratio was included to control for the effects of leverage because it could have a significant impact on strategic behavior and performance (Barton and Gordon, 1988). In order to control for any industry effects, industry variables representing seven of the eight industry sectors in which the sampled firms operate were also used. All these data were gathered from the *Nikkei Kaisha Joho*.

5. Results

Table 1 reports Pearson correlations of the variables. A number of statistically significant relationships can be found here, but the data did not suggest multicollinearity problems, which usually require correlations between the independent variables in the order of 0.80 or more.⁴ This table suggests that there are significant relationships between the dependent variables and firm size, foreign ownership, and foreign listing.

The results of the regressions are shown in Table 2. Model 2, the quality of IR (adjusted $R^2 = 0.244$) does not fit as well with the data as Model 1, MVA (adjusted $R^2 = 0.356$). However, in both models, the foreign listing variable is a statistically significant predictor. In Model 1, it was found that foreign listing ($t = 4.232, p < .000$) was statistically positively related to MVA, lending support to hypotheses 1a. Group affiliation was negatively associated with MVA ($t = -2.046, p < .042$) supporting hypothesis 4a. Other ownership predictors, foreign ownership, financial institution ownership, and corporate ownership were not found to be statistically significant.

In Model 2, I found that foreign ownership ($t = 2.270, p < .024$) and foreign listings ($t = 2.980, p < .003$) were statistically positively related to IR, lending support to hypothesis 1b and 2b. I did not find strong associations with financial institution ownership, corporate ownership, and group affiliation and IR. However, the results suggest that greater exposure to global capital markets is positively associated with the quality of IR practices.

Table 1. Pearson correlations of the variables.

	Mean	S.D.	1	2	3	4	5	6	7	8	9
1. Sales	11.6319	.4929	1.000								
2. Debt ratio	49.6290	19.3757	.367**	1.000							
3. IR	30.1828	15.6000	.399**	-.026	1.000						
4. MVA	5698.9355	14954.0144	.417**	-.172*	.458**	1.000					
5. Foreign ownership	18.1231	10.1845	.200**	-.329**	.319**	.306**	1.000				
6. Financial ownership	42.8371	9.7698	.197**	.085	.034	.029	-.135	1.000			
7. Corporate ownership	14.4376	9.8712	-.126	.003	-.174*	-.073	-.363**	-.469**	1.000		
8. Foreign listing	8.602E-02	.2812	.516**	-.033	.438**	.516**	.230**	.030	-.151*	1.000	
9. Group affiliation	.3548	.4798	.346**	.426**	.143	-.046	-.037	.075	-.123	.173*	1.000

Two-tailed

* $p < .05$.*** $p < .01$.

Table 2. Results of regression analysis.

	Model 1			Model 2		
	MVA			IR		
	Beta	<i>T</i>	Sig.	Beta	<i>T</i>	Sig.
(Constant)		−4.064	.000		−2.185	.030
Sales (log)	.366	4.066	.000	.252	2.588	.010
Debt ratio	−.196	−2.424	.016	−.049	−.558	.577
Foreign ownership	.070	.795	.428	.217	2.270	.024
Financial ownership	.001	.014	.989	−.013	−.157	.875
Corporate ownership	.044	.530	.596	−.031	−.351	.726
Foreign listing	.323	4.232	.000	.247	2.980	.003
Group affiliation	−.143	−2.046	.042	.040	.532	.595
		$R^2 = .402$			$R^2 = .297$	
		Adj. $R^2 = .356$			Adj. $R^2 = .244$	
		$F = 8.876^{***}$			$F = 5.581^{***}$	

*** $p < .001$.

6. Discussion and conclusions

This paper attempts to examine the effects of stable ownership and exposure to global capital markets on the quality of IR practices and performance of Japanese firms. The results suggest that exposure to global capital markets through large foreign ownership and foreign listing is related to the quality of IR practices, and foreign listing in New York or/and London is related to MVA of Japanese firms. Further, consistent with the findings of previous research, group or *keiretsu* affiliations were negatively associated with MVA, although not with the quality of IR. However, stable ownership (shareholding by financial institutions and corporations) was not negatively associated with the quality of IR and firm performance. A possible reason for this result is that because of the recent market and regulatory changes, shareholdings by stable investors no longer provide protection that allows managers to de-emphasize profitability or shareholder-oriented practices.

Although there was a positive relationship between foreign ownership and the IR variable, I could not find any relationship between foreign ownership and MVA. This is a puzzling result. Perhaps we need to use longitudinal data to examine this relationship further. Nevertheless, the results of this study broadly support the view that greater exposure to global capital markets will lead a Japanese firm to adopt more shareholder-oriented practices.

The findings reported above confirm the important role played by capital market forces. There is no question that institutional differences across countries still matter. However, increasing globalization of capital markets and investment activities of institutional investors seems to have some impact on firms even in a stakeholder-oriented system. One of the important implications of this study is that even under a system in which the interests

of shareholders have not received much attention, firms will need to respond to capital market pressure when their corporate finance practices and ownership structures change. The findings of this study suggest that strategic resource allocations of Japanese firms will increasingly focus on investment return for shareholders as their exposure to global capital markets increases.

Previous studies of Japanese firms that investigated the relationships between ownership structure or capital structure and firm behavior and performance tended to focus on only the roles of main banks and corporate group firms. Although there are some studies that examined the differences between group-affiliated firms and independent firms (e.g., Kang and Shvdasani, 1999; Hoshi, Kashyap and Scharfstein, 1991), there are still few studies that have investigated the effects of market investors or exposure to global capital markets on firm performance in Japan. This study contributes to this new area in Japanese corporate governance by using dependent variables (i.e., MVA and the quality of IR) that have not been much used in previous studies.

There are some limitations in this study. First, I only used data from a single year because of the lack of data for some variables. Second, I used only 186 firms as our sample. Again, this is due to the lack of data. We would have been better able to generalize the results if we had used a larger sample and data from a longer period. Ideally, a larger sample from a longer period would give us more comprehensive insights into the relationships between ownership structure, firm performance and IR practices. One possibility for future research is to investigate similar research questions examined in this paper by using larger samples in multiple years.

In terms of other future research, there is an opportunity to continue this kind of study by using other market-based measures of performance and managerial decisions on corporate asset allocation policies. While this study used the quality of IR and MVA, future studies may look at such measures as the use of stock option plans for executive compensations and share buyback programs to assess shareholder-oriented policies. In addition, it would be interesting to investigate the impact of ownership concentration of market investors rather than the different ownership types on firm practices and performance. It is expected that ownership concentration of foreign shareholders would impose greater pressure on Japanese managers to take more shareholder-oriented policies, rather than stakeholder-oriented policies, because foreign shareholders can voice their views more strongly. If foreign ownership in Japanese firms continues to rise, this line of study will be another way to assess the impact of capital market exposure.

Further, similar studies may be replicated in different countries that are now going through similar changes in terms of ownership structures and corporate finance practices. Such studies will help us better understand the transformation in governance practices not only in Japan but also in other countries. Finally, it would be interesting to incorporate other theoretical perspectives, such as institutional theory, into models. While ownership change and increased exposure to global capital markets are expected to enhance the pressure on managers from market investors, change in institutional norms regarding firm practices and performance may also affect managerial decision-making. This means that managers would attempt to respond not only to capital market pressures but also to the institutional expectations so that they can gain legitimacy. This line of research would enhance our

understanding of changes in corporate governance practices but also of managerial decision-making mechanisms.

Notes

1. The main difference between market-based governance and bank or group-based governance is that while market-based governance emphasizes the monitoring roles played by market investors and the board of directors who represent the interests of such investors, bank or group governance is a system in which main banks and group firms, rather than market investors, play the monitoring roles.
2. According to portfolio theory, diversification lowers a firm's unsystematic risk although it does not affect its systematic risk. In their study Lubatkin and Chatterjee (1994) extended this theory to corporate diversification and found that the relationship between corporate diversification and both forms of risk showed a U-shaped curve. From this result, they concluded that firms should diversify into similar businesses rather than into identical or completely different businesses in order to reduce risk.
3. Foreign shareholdings are often registered under the custodians' names. Thus, the identities of these foreign investors cannot always be verified. However, from the portfolio information of various foreign mutual funds as well as large trading volumes of foreign investors (for whom securities companies usually execute transactions), it is widely assumed that most of these foreign shareholders are institutional investors, either pension funds or mutual funds. Furthermore, IR consultants who often investigate the identities of such foreign shareholders on behalf of their client firms suggested to the author that they rarely encounter a Japanese firm in which foreign individual investors hold a large equity position. Finally, the growth of cross-border stock holdings in recent years is largely driven by institutional investors (Useem, 1998). Because of these reasons, it is assumed that foreign shareholders are mostly institutional investors.
4. I also examined the relationship between two dependent variables (IR and MVA) to ensure that there were no confounding effects with the IR and MVA variables. As the high quality IR could have a positive impact on stock price, it might also lead to higher MVA. Partial correlation was used to examine the relationship between the IR variable and MVA, while controlling for the effects of independent variables (sales, debt ratio, foreign ownership, financial ownership, corporate ownership, foreign listing, and group affiliation). There was a significant correlation between the quality of IR and MVA ($r = .241$), but the data did not suggest that there were serious confounding effects. A comparison with the zero order correlation result ($r = .458$) showed that the control variables (independent variables) strengthened the relationship between the IR variable and MVA.

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