IMPACT OF BOARD COMPOSITION AND OWNERSHIP ON INTERNATIONALISATION STRATEGY AMONGST SMALL NEW ZEALAND FIRMS

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ABSTRACT

Internationalisation strategies are important for company expansion because New Zealand, with its four million people, has such a small market. Nonetheless, there may or may not exist "agency costs" in the use of Outside Directors. Ownership patterns may also influence Internationalization Strategy. Using Binary Correlation, N-Way Cross-Tabulation, and Principal Component Analysis, we find evidence that Outside Directors have less influence on Internationalisation Strategy than Inside Directors. Family ownership also seems to have a greater association than non-family owned companies. Despite substantial limitations, the methods and models proposed seem to have some utility in examining the association of Internationalisation Strategy with Board Composition and Ownership Patterns.

INTRODUCTION

Tihanyi et al. (2003) found *inter alia* that the composition of boards of directors affected the international diversification strategies of large (U.S.) firms. But that study's evidence was mixed: Outside Directors favoured international diversification within professional investment funds but not within pension funds in the United States. This study examines the former study in the context of New Zealand.

For New Zealand's firms, being well connected with the rest of the world is key to success. Trading internationally not only gives them access to larger markets, but also leads to productivity improvements as they discover and embrace new technologies, markets, and production methods to compete with foreign firms. This is particularly important for New Zealand because the domestic market is small and distant from major global markets. The Ministry of Economic Development (2006) reports that 96% of New Zealand enterprises employed nineteen or fewer people. 87% of enterprises employed five or fewer people and 64% of enterprises had no employees.

Internationalisation strategies have been positively associated with firm performance (Glaum & Oesterle, 2007), (Hitt, Hoskisson, & Ireland, 1994), (Kim, Hwang, & Burgers, 1993), (Zahra, 1996) as well as risk-related returns (Agmon & Lessard, 1981). On the reverse, researchers have also found that internationalisation strategies may also have negative outcomes for firms due to the increased complexity and uncertainly surrounding conducting business in other markets (Mitchell, Shaver, & Yeung, 1992), (Hitt, Hoskisson, & Kim, 1997).

A central purpose of this study is to examine the effects of board composition on internationalisation strategies via agency theory. Firms may suffer losses due to higher "agency costs" that they incur in their foreign operations. Agency theory suggests that there are significant benefits and risks associated with internationalisation strategies (Carpenter, Sanders, & Gregersen, 2001). Although limited, prior research has shown that board composition and ownership patterns do have an effect on corporate innovation strategies (e.g. (Hoskisson, Hitt, Johnson, & Grossman, 2002)). Because different constituents of the corporate governance process can have differing effects on vital strategies such as internationalisation, this research could have a bearing on agency theory, at least as far as the New Zealand context is concerned.

Good corporate governance is a frequently heard mantra, yet many examples exist where governance has failed and stakeholders incurred horrendous losses. But good corporate governance can ensure that a firm's management aims at the most effective strategies (Eisenhardt, 1989), (Fama & Jensen, 1983), (Mizruchi, 1983), (Miller, 2002). The problem is that prior studies have been inconclusive about the importance of boards of directors on firm performance and strategies (e.g. (Tihany, Ellstrand, Daily, & Dalton, 2000a), (Chrisman, Chua, Kellermanns, & Chang, 2007), (Tihany, Ellstrand, Daily, & Dalton, 2000b), (Dalton, Daily, Johnson, & Ellstrand, 2005)) .

Board composition

Board composition has been well studied in the literature, particularly in relation to internationalisation strategies. In this study we focus on board composition in terms of Outside and Inside Directors. An Outside Director is a director who is not connected with the company or its directors on the basis of family relationship and does not have any other relationship (whether pecuniary or otherwise) with the company, its associated companies, directors, executives, or related parties. Outside Directors are considered important in controlling agency costs because they are able to align management and owner interests more effectively with business realities rather than with self-interest or emotion (Daily & Dalton, 1992). Outside Directors often have relatively little knowledge about the company's specific strategies, but they do apply a broad range of corporate experiences to fulfil their corporate oversight role (Baysinger & Hoskisson, 1990). Previous research on Outside Directors has shown that they are involved in strategic change, restructure, corporate entrepreneurship, and other aspects of good firm functioning (Baysinger et al., 1990), (Chin-Jung Luan & Ming-Je Tang, 2007), (Johnson, Hoskisson, & Hitt, 1993), (Pearce II & Zahra, 1992). In essence, Outside Directors give the other constituents of good corporate governance the confidence that the firm will enter appropriate international markets and yield benefits to shareholders.

Family business and internationalisation

Family businesses are faced with the same factors as corporately-owned businesses that either facilitate or restrain internationalisation. A family firm's strategy, organizational structure, culture, and developmental stage are intertwined with the family's international characteristics, and each area involves different facilitating or restraining factors. (Gallo & Sveen, 1991). Zahra (Zahra, 2003) found that family ownership was significantly and positively associated with internationalisation in this study of US firms. Fernandez and Nieto (Fernandez & Nieto, 2006) showed that internationalisation is negatively related to family ownership and positively related to corporate ownership. Gallo and Garcia (1996) (Gallo & Garcia Pont, 1996) differentiated between those factors within family firms that aid internationalisation and those that hinder the process. Fernandez and Nieto (Fernandez et al., 2006) confirmed the existence of a negative relationship between family ownership and internationalisation, as measured by export activities. Graves and Thomas (Graves & Thomas,

2004) found that the extent of internationalisation of family firms is less than that of non-family firms. In terms of agency theory, researchers are split on whether family managers in family firms are agents or stewards (Chrisman et al., 2007). Strong family ownership and managerial control break the traditional agency-theory assumption that ownership and control are separated (CORGETTA & SALVATO, 2004) Family involvement in a business has the potential to both increase and decrease financial performance due to agency costs (Chrisman, Chua, & Litz, 2004). Thus the literature is inconclusive on what factors within family businesses are associated with internationalisation strategies and the relation of agency theory to this process.

METHOD

In this study we operationalised the dependent variable *Internationalisation Strategy* through the question "Does your organisation sell/purchase in international markets or work together with firms outside your home country?" Independent variables were also operationalised: an *Outside Director* is a member of the board of directors of a company but is not part of the executive management team. He or she is not an employee of the company or affiliated with it in any other way. An *Inside Director* is a member of the board of directors of a firm who is also a member of the firm's management almost always a corporate officer. A Family Business is a type of ownership that is distinct from a Government or Public institution, a Non-Profit Organisation, or a Private/non-family owned business. Thus:

- Hypothesis 1: Outside Directors influence internationalisation strategies. Internationalisation Strategy will have a stronger association for firms with higher representation of Outside Directors on their boards.

The contrary hypothesis is that Inside Directors influence a firm's internationalisation strategy. They have access to internal information regarding firm resources, projects, and strategies (Baysinger et al., 1990). These directors may support taking advantage of new international market opportunities because of the potential for expanding sales and increasing profits over time. Inside directors' knowledge may be utilized in international markets and may help to overcome the increased risks associated with foreign involvement (Ellstrand, Tihanyi, & Johnson, 2002). Potential agency conflicts between these insiders and a firm's long-term owners such as pension funds are reduced when inside directors hold ownership positions and have longer-term incentives (Lippert & Moore, 1995). Inside directors have an incentive for interest in long-term strategic opportunities for their firm, such as international diversification. Thus it is equally possible that inside directors' actions will support internationalisation. Thus:

- Hypothesis 2: Inside Directors influence international diversification strategies: Internationalisation Strategy will have a stronger association for firms with higher representation of Inside Directors on their boards.

Based upon the review of the literature on the impact of family ownership on internationalisation strategies, we hypothesised:

- Hypothesis 3: Internationalisation Strategy will have a stronger association for Family Firms.
- Hypothesis 4: Internationalisation Strategy will have a stronger association for other forms of ownership, particularly private firms.

Analysis

Analysis was begun by screening data for outliers and then performing bivariate correlation procedures to seek significance using Pearsons' correlation coefficient, Spearman's rho, Somer's d and Kendal's tau-b depending on levels of measurement. We used Somer's d since it is a conservative ordinal by ordinal measure of association. Using the data obtained, cross-tabulation was performed on two-way tables along with a control variable (layer factor) to perform multiple variable N-way cross tabulations.

Sample

The sample for this electronic survey was drawn from the e-mailing list of Unitec's New Zealand Centre for Innovation & Entrepreneurship (CIE), a research and development institute in Auckland. Simultaneously, the same survey was sent to mailing lists of the project's partners, namely important firms, industry associations, universities, and government departments including PriceWaterhouseCoopers, Simpson Grierson, Employers and Manufacturers Association, ANZ Bank, Business New Zealand, and the New Zealand Venture Capital Association.

Survey

Waikato University co-ordinated the creation of the survey and administered the release and data collection. The survey (Appendix A) collected responses from company officers, executives, company directors, and investors in New Zealand. The 35-question survey provided a number of interesting independent variables such as firm ownership structure, size, revenue, board composition, appointment practices, gross annual revenue/turnover, and competition that could be used as controlling variables.

Limitations

There were many limitations which hindered the analysis of this study.

- Sample size: Each of the partners conducted their own survey. Only Waikato University has access to the complete survey database of 1,400 responses. As a result, the present study only includes the 50 valid responses that we received to our e-mailing and does not include the other partners' data. Waikato University promises to release more data in the new year. Thus, this present paper can only represent a pilot study and modelling.
- Given our low sample numbers, Bartlett's Test of Sphericity was not significant in the Principle Component Analysis, and this must be retried with the larger sample. The characteristics of the sample limit the generalisability of the results.
- The researcher had no control over the construction of the survey questions. Methodological problems arose due to the preponderance of questions with ordinal responses. Even questions such as "How many Directors are on the Board of your organisation?" were asked in ordinal categories (e.g. "10 and more"), so that scaling was problematic.
- A major weakness is the absence of a synchronic approach since the dependent and independent variables are measured at the same moment. A more longitudinal approach would be valuable to analyze the causal relationships between the independent variables and Internationalisation Strategy.

FINDINGS

We begin with a general descriptive recital of the findings. The firms in this sample corresponded to well-known characteristics of general New Zealand small firms.

Board director demographics amongst small New Zealand firms

- Respondents were first filtered so that only Company Directors (past and present) remained in the sample.
- Of the 50 people in this survey who currently or previously served as Directors in New Zealand, there were 40 males and eight females (two declined to name their gender).
- Seventy-eight percent were between the ages of 46-65 years of age. Sixty-six percent were located in Auckland and twelve percent in Wellington. The rest were dispersed throughout New Zealand, and four were currently residing in Australia, Asia or North America.
- In terms of industrial sector of company operation, 32 percent mentioned professional services and 26 percent telecommunication/technology/media. The rest were dispersed throughout manufacturing, finance, health, retail, and public sector firms.
- In terms of gross annual revenue or turnover, there were small firms with three quarters of them being under NZ$ 5 million (US$ 3.8 million). The maximum size of revenue was NZ$ 20 million (US$ 15.2 million).
- About one-third of these firms were family-owned.
- In terms of the composition of their Boards, 10 percent of the respondents' companies had no formal board and 34 percent of them had 1-2 Board members. Forty-four percent had 3-5 Board members, and 12 percent of these firms had 6+ Board members.
- Sixty-three percent of the respondents said that the current Directors have been in their positions for five or more years, with 29 percent serving for more than seven years.
- Sixty percent of the firms had three or fewer (or no) formal board.
- Fifty-six percent of these firms had no Outside Directors, while 40 percent did have Outside Directors. (Four percent did not know.)
- As to the ratio of Outside to Inside Directors, the firm-by-firm ratio ranges from 0% (57 percent of the companies have no Outside Directors) to a one-to-one ratio (7 percent of the companies have the same number of Outside as Inside Directors). The mean value was .225 (i.e. boards on average have 2.25 Inside Directors for each Outside Director).
- When asked how many new Outside Board members they were likely to need in the next five years, 32 percent said none. Twenty-eight percent said they would need one Independent Director in the next five years.

Thus these firms fit the classic mould of New Zealand small businesses.

Board Composition and Internationalisation Strategy

Delving to the heart of this study, the dependent variable is Internationalisation Strategy, namely the survey question "Does your organisation sell/purchase in international markets or work together with firms outside your home country?"

A bivariate correlation of Internationalisation Strategy with four variables--Number of Inside Directors, Number of Outside Directors, Proportion of Inside Directors, and Proportion of Outside Directors--was carried out. Only the Number of Inside Directors was mildly significant but at a $p < 0.07$ level. At first glance H1 is disconfirmed and H2 conditionally accepted: Internationalisation Strategy has a stronger association for firms with higher representation of Inside Directors than for Outside Directors on their boards.

However, upon deeper viewing of the cross-tabulation using Somer's d as a measure of association, it was apparent that Internationalisation Strategy with Family Ownership did show marginal significance albeit at the $p<0.102$ level. So it was decided to look more deeply into the data. Carrying on with an N-way cross-tabulation allows us to see a group within a subgroup within a subgroup. We examined Internationalisation Strategy with Family Firm but with four control controlling variables.

Table 1 Ordinal by Ordinal N-way cross-tabulation

Dependent variable	Independent variable	Somer's d significance	Control variable (layer)	Somer's d significance for control variable
Internationalisation Strategy	Family firm	p < 0.102	Age of director	p <0.083 for 46-55 years old
Internationalisation Strategy	Family firm	p < 0.102	Location of firm	p <0.014 for Christchurch and Wellington (Somer's d)
Internationalisation Strategy	Family firm	p <0.102	FTE Employees	p <0.021 for firms under 20 employees
Internationalisation Strategy	Family firm	p <0.102	Presence of Outside Directors	p <0.023 when there are Outside Directors present

Interestingly, Age, Location, FTE Employees, and Presence of Outside Directors do play their roles in the relationship of Internationalisation Strategy with Family Firm. Given the limitations of this study, it is nonetheless possible to suggest that 46-55 year old Outside Directors in Christchurch or Wellington companies with less than twenty employees might have an influence. This result suggests a research approach when the full sample becomes available.

Having established that Number of Inside Directors and Family Firms influence Internationalisation Strategy, we carried on with constructing a Principle Component Analysis in order to extract a reduced set of components or factors from the complete set of variables that accounted for the most variance by reducing redundant and non-significant variables. Various models were tested that resulted in the following tentative model.

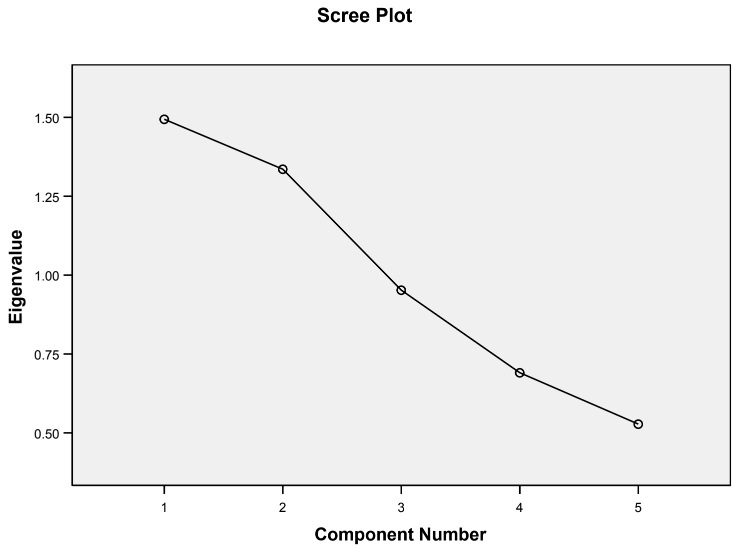
Table 2 Total Variance Explained

	Component	Initial Eigenvalues		
		Total	% of Variance	Cumulative %
Number of Inside Directors	1	1.49	29.88	29.88
Market share	2	1.34	26.72	56.59
Family-owned firm?	3	0.95	19.05	75.64
Competition	4	0.69	13.81	89.45
Location	5	0.53	10.55	100.00

Extraction Method: Principal Component Analysis. Only cases for which Intl Trade = Yes are used in the analysis phase.

For our data, the first three components have eigenvalues great than 1.00 (rounding Family Firm just slightly upwards). Together the first three components account for 65% of the total variance.

Figure 1 Scree Plot of Eigenvalues in Principal Component Analysis



This model suggests that 76% of the variable in firms that engage in Internationalisation Strategies is accounted for by three factors: Number of Inside Directors, Market Share, and Family Firm.

CONCLUSION

The results of this study must be seen within the context of small New Zealand firms. Ninety-six percent of New Zealand firms employ fewer than twenty employees. One-tenth of the firms in this survey had no formal board. Only forty-percent of those that did have a formal board use the services on an Outside Director. One-third was family-owned. Internationalisation strategies are important for company expansion because New Zealand, with its four million people, has such a small market. Nonetheless, there may or may not be agency costs in the use of Outside Directors. Ownership patterns may also influence Internationalization Strategy.

Despite the limitations described above, this study shows two things: Outside Directors have less influence on Internationalisation Strategy than Inside Directors. Breaking that down, there is further evidence that Family Ownership may be positively associated with Internationalisation Strategy. We were able to break down some of the influencing factors and report that the Age of the Director, Location of the Firm, and FTE Employees, and Presence of Outside Directors all have positive associations within this relationship.

The Principal Component Analysis further suggests a model that the Number of Inside Directors, the Market Share of the company, and Family Ownership account for 76% of the variance in the proposed model.

Clearly this study shows that Inside Directors may have an influence on Internationalisation Strategies of small New Zealand firms. The factor Presence of Outside Directors in the Principal Component Analysis complicates this model, but the presence of Outside Directors might be a pre-requisite condition for the Internationalisation Strategies of Inside Directors. Nonetheless, we tentatively confirm Hypothesis 2. Family ownership in general also seems to have a greater association than non-family owned companies. Breaking that relationship down layer by layer, we find that Location, FTE Employees, and Market Share explain a substantial portion of the variance in the model.

In the end, despite the limitations, the methods and models proposed seem to have some utility in examining the association of Internationalisation Strategy with Board Composition and Ownership Patterns. When the full data set becomes available, we will run the much larger sample through this analysis.

APPENDIX

SURVEY

You are likely a present or past company officer/executive, company director or investor, and have been carefully selected for the value of your contribution to this work. If you are involved with more than one organisation, please reply with regard to the organisation where you are regularly most engaged.

Thank you for your time and interest. You can indicate that you wish to receive a free copy of the summary report of this work.

You are:

- Male
- Female

Your age is:

- under 25 years
- 25-35 years
- 36-45 years
- 46-55 years
- 56-65 years
- above 65 years

If you wish to receive a FREE copy of the results summary or are interested to discuss this issue in more detail, please enter your e-mail address here. The researchers will remove your e-mail address from the answers, to guarantee the anonymity of your replies.

We sometimes contact participants to allow our researchers the opportunity to discuss some replies and discuss this topic in more detail. If you would be willing to be contacted by e-mail for this purpose, please indicate "Yes" below, and make sure your e-mail address is entered above. Many thanks.

Are you currently, or have you been before, employed as an Executive in an organisation in New Zealand? After answering this question, please click "Next" below.

- Yes
- No

This section asks questions about your organisation and how it handles its governance issues. If you are/were a Director or Executive in more than one organisation, please reply with details about the organisation where you regularly are/were most engaged.

In what region of New Zealand or in which country is your organisation located (if you are self-employed, where do you live)?

- Auckland
- Wellington
- Christchurch
- Hamilton
- Dunedin
- Other North Island
- Other South Island
- Australia
- Asia
- Western Europe
- Eastern Europe
- North America
- South America

What type of ownership does your organisation have?

- Government Organization/Public Services Firm
- Non-Profit Organization
- Family-Owned Firm (under 25% family-owned)
- Family-Owned Firm (26-49% family-owned)
- Family-Owned Firm (50%+ family-owned)
- Privately-Owned Firm (not family owned)
- Publicly-Owned Firm
- I am self-employed/retired

The number of full-time equivalent employees at the organisation are:

- under 20 staff
- 21 - 200 staff
- 202 - 500 staff
- 501 and more staff

In which industry does your organisation operate:*

- Manufacturing/Processing
- Finance/Banking/Insurance/Venture Capital/Private Equity
- Energy/Utility/Infrastructure
- Health
- Transport
- Retail/Wholesale
- Public Sector/Local government
- Research/Science
- Primary Sector (agribusiness, farming etc.)
- Professional services
- Non-Profits
- Telecommunications/technology/media

In its market, your organisation is:

- Large (above 30%+ market share)
- Medium (10-30% market share)
- Small (under 10% market share)
- I am self-employed/retired

Competition in the market for your organisation is:

- Strong
- Not Strong

Does your organisation sell/purchase in international markets or work together with firms outside your home country?

- Yes
- No

How many Directors are on the Board of your organisation?

- 1
- 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9
- 10 and more
- There is no formal Board

How many of those directors have no dealings/relationships with the organisation other than being a director and are neither founders nor employees or significant shareholders (10%+)?

- None
- 1
- 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9
- 10 and more
- Do not Know

Is your Chief Executive also the Chairman?

- Yes
- No

Is your Chief Executive also a Director?

- Yes
- No

If your firm appointed new directors in the past five years, how did the organisation find them? (Please mark all that apply)

- Referral from Management
- Referral from Law Firm
- Referral from Accounting/Audit Firm
- Referral from Bank
- Referral from Investment Bank
- Referral from Venture Capital/Private Equity Firm
- Appointed by Government (through CCMAU, etc.)
- Referral from existing Directors
- Institute of Director Referral
- Search firm
- Do not Know
- Other:

Which of the following training/education does the organisation provide for directors? (Please mark all that apply)

- Outside education at university, etc.
- Institute of Director course
- Formal internal induction program
- Informal advice
- None
- Do not Know
- Other:

How many new external/independent Directors will your organisation likely look for in the next 5 years?

- None
- 1
- 2
- 3
- 4
- 5 and more
- Do not Know

Are you, or have been in the past, a director of a New Zealand organisation? (After answering this question, please click "Next" below.*

Does your organization have a 'company secretary'?

- Yes No

On average, how long have the current Directors of your organisation been in their Director positions?

- Less than 1 year 1-2 years 3-4 years 5-6 years 7 and more years Do not Know

The gross annual revenue/turnover of your organisation is:

- under $5 M
- $5M - $10 M
- $11M - $20 M

- $21M - $50M
- $51M - $100M
- $101M - $200M
- $201M - $500M
- Over $500 M
- Do not Know

In this section we are asking you about your experiences as a Director of an organisation in New Zealand. You may be, or have been, a Director of more than one organisation. In that case, please complete this section for the organisation where you have regularly been involved most closely.

What is the largest number of corporate boards you served on at any one time?*

- 1
- 2
- 3
- 4
- 5
- 6
- 7 and more

If you were offered a Board position now, how important would each of the following factors be for you?*

Very Important Somewhat Important Somewhat Unimportant Very Unimportant

- Status/Prestige of Organisation
- The fact that the Company is Publicly Listed
- Fees/Benefits to the Directors
- The ability to "Do some Good"
- Becoming Known
- Reputation of other Directors
- Level of Personal Risk
- Opportunity for Personal Career Advancement

How would you describe your own and your fellow directors' competence in these areas?*

Excellent Competence Good Competence Sufficient Competence Poor Competence Very Poor Competence

- Corporate strategy and the principles of risk/strategic change FOR YOU
- Corporate strategy and the principles of risk/strategic change FOR THE OTHER DIRECTORS
- Legal, regulatory and corporate governance and the responsibilities of directors FOR YOU
- Legal, regulatory and corporate governance and the responsibilities of directors FOR THE OTHER DIRECTORS
- Leadership qualities, commanding respect of others, displaying judgment and courage FOR YOU
- Leadership qualities, commanding respect of others, displaying judgment and courage FOR THE OTHER DIRECTORS
- Commitment, to the business and to shareholders FOR YOU
- Commitment, to the business and to shareholders FOR THE OTHER DIRECTORS
- Team player abilities, listening and influencing skills and awareness of own strengths and weaknesses FOR YOU
- Team player abilities, listening and influencing skills and awareness of own strengths and weaknesses FOR THE OTHER DIRECTORS

How did you hear about openings for your directorships? (Please mark all that apply)

- From Management/Directors
- From Company staff
- From Law firm
- From Accounting/Audit firm
- From Bank
- From an Investment Bank
- From a Venture Capital/Private Equity Firm
- Through the Government
- From Search Firm
- You are a Founder of the organization
- You are or represent a large Shareholder
- Other:

If your organisation has a formal/informal code of ethics/conduct what proportion of the people on the board would know the code of conduct?*

- Less than 25%
- 25-50%
- 51-75%
- More than 75%
- We do/did not have a formal Code of Ethics

In your observation of NZ organisations in general, boards need Directors with more:*

Yes No

- Diversity
- Work experience within the industry
- Work experience outside the industry
- International Experience
- Lawyers, Business Consultants, Accountants or other professionals
- Track record of having run a successful business

Should Directors' performance be regularly evaluated?*

- Yes
- No

If there is a formal evaluation process for directors, who conducts it? (Please mark all that apply)*

- There is no formal evaluation process
- Chairman
- External Consultant
- Human Resources Manager
- Fellow Board Members
- Other:

What do you think are the barriers to greater effectiveness of Non-Executive Directors? (Please mark all that apply)

- Lack of time/commitment
- Lack of knowledge/understanding of organization
- Executive directors/key managers hold back information
- Lack of involvement in organization/only turn up for board meeting
- Poor Board Leadership/Chairmanship
- Overemphasis on Corporate Governance/Policing
- Other:

Where should Boards spend more or less time?

More Time   No Change   Less Time

- Compliance & Regulatory Issues
- Risk Management
- Succession Planning
- Industry/Competitive Analysis
- Strategic Planning
- Helping the CEO and Managers to operate the firm

Have you invested in a New Zealand corporation, whether private or public, in the past 5 years? (After answering this question, please click "Next" to proceed to the last page)*

- Yes
- No

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