Political Intervention, Corporate Governance and Firm Performance: An Empirical Investigation in Japan and Taiwan

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Abstract

This paper investigates the interaction of government and financial institutions in the operation of a company through the relationship of the main bank system and the system of *amakudari* (appointing retired bureaucrats to the boards of public companies). Consistent with resource dependency theory, the empirical results suggest that governments and financial institutions tend to appoint representatives to the board in order to help troubled companies. However, a negative relationship is established between the presence of such *amakudari* and subsequent firm performance. Thus, while the system of *amakudari* may use its influence in an attempt to save troubled companies, it is possible that, as suggested by agency theory, the monitoring ability of the board may consequently be jeopardized to the detriment of overall firm performance.

Keywords: Corporate Governance, Business/Government relations, Political Intervention, Firm Performance, *Amakudari*

1. Introduction

In contrast to arms-length capitalism, where the market is an important disciplinary mechanism of governance, crony capitalism is a relationship-based system (Rajan and Zingales, 1998; Enderwick, 2005; Morck et al., 2011). A fundamental characteristic of crony capitalism is the acceptance of representatives with a political background in the governance of public companies. The system of post-retirement employment of former top bureaucrats is called '*amakudari*' in Japanese, which literally means 'descending from heaven'. The phenomenon is very common in Japan and has recently become more common in Taiwan (Zun, 2002). Although not known under that specific label in Taiwan, for convenience, the general label of *amakudari* will be used here to cover both cases. Such political intervention represents an important issue that has been relatively neglected in the corporate governance literature. This paper examines the operation of political intervention and compares its impact in Japan, where the practice is long established, and Taiwan, where there has been a recent move to adopt it.

In crony capitalism, the economy is operated subject to a hidden hand controlled by the ruling political party. The ruling party may arrange better treatment for those companies that share their political ideology and are engaged in economic activities favored by the government (Bucheli and Aguilera, 2010; Horiuchi and Shimizu, 2001; Rajan and Zingales, 1998). For managers and directors operating in crony capitalism, developing a harmonious relationship with the government is critically important. Without central intervention, the situation could be viewed through the lens of resource dependence theory (Pfeffer and Salancik, 1978; Hillman, Withers, and Collins, 2009; Jackling, and Johl, 2009), whereby the board of directors is selected, in part, according to their access to resources, facilitated by their connections (Hillman, Cannella, and Paetzold, 2000; Hillman, 2005). Through the pattern of government ownership and government-appointed directors, the government has the power to control the operations of certain companies, especially government-linked companies (Note 1).

Financial institutions, such as banks, also appoint representatives to boards in Japan and Taiwan (Morck and Nakamura,

1999). Thus, there is a danger that the government and financial institutions will pursue their own interests at the expense of the shareholders by reducing the effectiveness of the monitoring capacity of the board. This raises the prospect of agency theory frictions and inefficiencies (Donaldson, 2012; Eisenhardt, 1989; Fama, 1980; Jensen and Meckling, 1976) that undercut the basic efficiency argument of the resource dependence perspective. Board appointments that resource dependence theory describe as a mechanism for coping with the environment are interpreted in agency theory as potentially subverting the alignment of managerial and shareholder interests. Care is clearly needed to disentangle the motives for making board appointments from the consequences of such appointments.

The first objective of this paper is to examine how firm performance influences external and internal governance arrangements. Under what conditions do government and financial institutions intervene in the operation of a company? In terms of internal governance, the focus is on the board of directors. In terms of external governance, both private and public aspects are involved. Private external governance involves the intervention of banks, insurance companies, and brokerage firms. Public external governance relates to the intervention of the government. The second objective of the paper is to establish whether firm performance is subsequently better for companies with directors that have a political background.

The existing literature concerning political intervention is limited. In pioneering work, Agarawal and Knoeber (2001) examine the political roles of outside directors and find that when politics is more important for a company, the board includes more directors with political and legal experience. Faccio (2005) examines government-linked directors in firms in 42 countries and finds that politically connected firms access debt financing more easily, enjoy lower taxation, and have greater market power. These observations are consistent with resource dependence theory. In a more cautionary vein, Faccio et al. (2006) find that politically connected firms are more likely to be bailed out than similar non-connected firms; but firm performance of bailed-out politically connected firms is inferior to that of non-connected firms. Fan et al. (2007) also demonstrate that in China, when CEOs enjoy strong connections with the government, their firms tend to display weak governance characteristics and low professionalism.

There are also a number of studies that explore the relationship between Japanese bank performance and the system of *amakudari*. Van Rixtel and Hassink (2002) claim that troubled banks may attempt to employ more retired officials from the Ministry of Finance (MoF) and the Bank of Japan (BoJ), because they can persuade the relevant regulators to allow the banks to take on more loans in an attempt to improve performance. In addition, risky loans increase after these ex-officials are recruited. This is taken to suggest that the purpose of *amakudari* is to gain influence with the government. In an empirical analysis of Japanese regional banks, Horiuchi and Shimizu (2001) show that those banks which recruit ex-officials from the MoF onto their boards are subsequently able to reduce capital adequacy levels and increase their bad loan ratio. These studies suggest that political intervention influences firm performance.

In the following section, some background is provided relating to political intervention in Japan and Taiwan, and hypotheses are developed. The data and research methods are discussed in the subsequent section. This is then followed by a presentation of the results, and the paper concludes with a summary of the results in the context of previous findings in this area.

2. Background of Political Intervention in Japan and Taiwan

In 1997 and 1998, major private banks and securities houses in Japan collapsed. Subsequently, concerns regarding the stability of the Japanese financial system increased (Van Rixtel and Hassink, 2002). These concerns focused on the fundamental characteristics of the Japanese monetary and financial system. One of these fundamental characteristics was the acceptance of high-level executive positions in private business by retired high-ranking government officials. This institutionalized practice is labeled '*amakudari*' in Japan. This re-employment generates extensive personal networks and alliances among several distinct elements of Japanese society, encompassing business, politics, and the civil service (Kuji, 1998). When former bureaucrats move to their new positions, they bring with them their personal networks and invaluable knowledge, acquired during their careers in government, of their ministry's administrative procedures and policies. The system of *amakudari* thereby provides a mechanism of sharing information and resources across legislative, bureaucratic, and business institutions (Colignon and Usui, 2003).

There are numerous definitions of *amakudari*. An obvious one is that it involves the movement of retired bureaucrats from the public sector to the boards of public listed companies. This definition is somewhat narrow, however. In a broader sense, political intervention manifests in another form. This is '*shukko*' (employee transfers), which means 'on loan to another company' (Carpenter, 2003: 93). These bureaucrats are assigned temporary positions in public companies for two or three years. This practice is common both in Japan and Taiwan. Analyzing the deployment of Japanese ministry directors in *shukko* positions, Keehn (1990: 1032) reports that about 80% previously held *shukko* positions in other organizations during their career. The benefits of *shukko* include better access to political information, improved

understanding of administrative and bureaucratic rules, and the establishment of informal networks with the government. In Taiwan, it is particularly common for legislators and other high-ranking government officials to have directors' or auditors' positions on the boards of public listed companies (Zun, 2002). This paper classes both '*amakudari*' and '*shukko*' as political intervention and utilizes the Japanese term '*amakudari*' to characterize this in both Japan and Taiwan.

Political intervention in Taiwan is pervasive but often goes unnoticed; the Kuo-Min-Tang (KMT) party was the ruling party for almost fifty years in Taiwan and, consequently, this type of political intervention can become institutionalized. Government-linked companies (GLCs) can be found in various industries, such as banking, electronics, steel, energy, and telecommunications. For example, Chunghua Telecom, the biggest telecommunication company in Taiwan, was state owned before 1997, and the government still held 35.41% ownership in 2007. Compared with Western countries, the percentage of government ownership of listed companies is very high in Taiwan. According to our calculations, at the end of 2004, the government owned 2.21% of the total number of listed shares across all Taiwanese listed companies, and the weighted –market value of government ownership amounted to 12.34%. In March 2000, however, the Democratic Progressive Party (DPP) won the presidential election and ended the KMT's position as the ruling party in Taiwan. This altered the old business-government relationship. Based on our calculations, about one third of the board members of listed government-linked companies were changed within the first year after the Taiwanese government transition, 40% changed the chairman of the board, and 33% changed their CEOs.

Japan and Taiwan are also similar in the structure of their company boards. Japanese companies operate under a quasi two-tier system, with a board of directors and a board of statutory auditors. Taiwanese companies also have a board of directors and a board of supervisors (Filatotchev et al., 2005). The existence of supervisors (statutory auditors in Japan) on boards is regulated by a Commercial Code in Japan and by Company Law in Taiwan (Note 2). Given the similarity of board structure, it is of interest to investigate whether the same empirical governance relationships are observed in both Japan and Taiwan, given that in recent years, Taiwan has adopted the same institutional practices of government and financial intervention that are so well established in Japan. Differences in behavior between the two situations suggest that such institutional change might not be so straight forward in implementation (de Jong, Lalenis, and Mamadouh, 2002; Oliver, 1992).

As a first step, the issue of why the government and financial institutions intervene in the operation of companies is examined. Previous literature indicates that the system of *amakudari* is not solely used as a reward system, but is also used for troubleshooting (Van Rixtel and Hassink, 2002). That is, retired bureaucrats from government institutions are sent into companies experiencing a financial crisis or under the threat of insolvency, and use their political networks to help them, for example by petitioning for a loan deadline to be extended, or by asking for additional funding from the government.

Moreover, Sheard (1994) claims that the more heavily Japanese companies rely on bank loans, the more likely they are to have bank executives on their boards. The argument here is that in order to improve firm performance and help a company solve its financial problems, representatives of financial institutions may be dispatched to these boards to exercise a monitoring function. The board may accept or solicit such a relationship in order to smooth its path in terms of access to resources and business connections, as predicted by resource dependence theory (Pfeffer and Salancik, 1978; Hillman et al., 2009). Since it takes some time for the government, financial institutions, and the board to realize the extent of poor firm performance and to take remedial action, there is a time lag between performance and such interventions. Thus, we hypothesize:

> Hypothesis 1: The relationship between firm performance (t) and board-level political intervention (t+1) is negative.

> Hypothesis 2: The relationship between firm performance (t) and board-level intervention by financial institutions (t+1) is negative.

According to previous studies, on the one hand, the monitoring ability of the board exerts an influence on firm performance, while on the other hand, poor firm performance may also influence the structure of the board (Carpenter and Sanders, 1998; Denis and Sarin, 1999; Finegold et al., 2007). Consistent with agency theory (Donaldson, 2012; Eisenhardt, 1989; Fama, 1980; Jensen and Meckling, 1976), to improve firm performance, the composition and quality of the board should be changed to improve its monitoring ability. The exact measure of monitoring ability will be specifically defined in the next section. Here, we hypothesize:

> Hypothesis 3: The relationship between firm performance (t) and the monitoring ability of the board (t+1) is negative.

The second question is "Does the subsequent firm performance improve after the government and financial institutions intervene in the operation of a company?" From a resource dependence perspective, this kind of business-government relationship can help a company gain more support from the government and the general business environment, thus helping the top management team effect better strategies. Thus, we hypothesize:

Hypothesis 4-1: The relationship between board-level political intervention (t) and firm performance (t+1) is positive.

On the other hand, while troubled companies may seek or accept the boardroom appointment of retired bureaucrats because they see the advantages that the help and contacts of these former bureaucrats can bring, the resulting outcome may be less than efficient. For example, troubled companies may be tempted to invest in risky projects, but find themselves constrained by a regulatory environment monitored by the government (Van Rixtel and Hassink, 2002). In this situation, such companies may utilize retired bureaucrats to persuade the government to extend their loans and allow them to take up high-risk investment projects. Hence, the *amakudari* system may be used here to effect influence on the government. But political intervention has long been considered inefficient (Shleifer, 1998), and from an agency theory viewpoint may distract from shareholder interests. Therefore, one further hypothesis is:

Hypothesis 4-2: The relationship between board-level political intervention (t) and firm performance (t+1) is negative.

Similar to the relationship between political intervention and subsequent firm performance, other financial institutions will also appoint representatives to the board to help the company solve its problems (Morck and Nakamura, 1999). They too may be used in a monitoring role. Mirroring Hypotheses 4-1 and 4-2, another source of influence is also possible. The hypotheses of the relationship between the intervention of financial institutions and subsequent firm performance are:

Hypothesis 5-1: The relationship between the intervention by financial institutions (t) and subsequent firm performance (t+1) is positive.

Hypothesis 5-2: The relationship between the intervention by financial institutions (t) and subsequent firm performance (t+1) is negative.

It is also of interest to examine the relationship between the board and other governance factors. Much has been said from an agency theory perspective regarding the efficacy of rigorous corporate governance mechanisms. Although the results are not always consistent (Bhagat and Black, 1999, 2001), companies having boards with better monitoring ability, such as those with more outside directors and higher board ownership, are expected to have better performance (Gompers et al., 2003). We hypothesize:

Hypothesis 6: The relationship between the monitoring ability of the board (t) and firm performance (t+1) is positive.

The *amakudari* system in Japan and Taiwan reveals that the government and financial institutions can appoint representatives to the board (Morck and Nakamura, 1999). This phenomenon allows the board to play an intermediate role between the government/financial institutions and firm performance. To focus on this implicit relationship, we hypothesize:

Hypothesis 7: The board of directors may mediate the relationship between the intervention by government and financial institutions (t) and firm performance (t+1).

3. Data and Methods

For Japan, the sample of firms comprises 203 Japanese companies from the Nikki 225 index (Note 3). As there is no similar index in Taiwan that covers comparable numbers of companies, 200 companies are chosen from all listed Taiwanese companies, ranked according to the highest capitalization on 1st January 2001 and subject to data availability. For both countries, the observed time period comprises the three years 2001 through 2004.

Due to insufficient detail in reporting, it is difficult to obtain the required Japanese data using annual reports alone. For this reason, use is made of several additional sources of data published in Japanese: *Kaisha Shikihou* (Quarterly Report for Listed Companies), *Yakuin Shikihou* (Employee Report), *Nippon Kinyu Meikan* (Directory of Executives in the Japanese Finance Industry), and *Yukashoken Hokokusho* (Securities Report). In Taiwan, the database *Taiwan Economic Journal* (TEJ) plus company annual reports are used to obtain the necessary financial data and the corporate governance data.

Structural equation modeling (SEM) is used to test the hypotheses and calculate path coefficients. Structural equation modeling has a major advantage when dealing with concepts such as governance, board monitoring, or institutional

intervention (Hu, Tam, and Tan, 2010). While these concepts have a clear meaning in the literature, they generally lack a unique or well-defined measure by which they can be quantified or gauged. SEM allows a group of variables to be associated with each underlying concept (e.g. 'internal governance'). While it is difficult to point to a single measure of a concept such as 'internal governance', it is far easier to specify a range of measures that, by general agreement, capture this notion of board monitoring. SEM permits the relationships among these underlying but difficult-to-measure concepts to be quantified.

The SEM technique is similar to linear regression but less restrictive (Everitt and Dunn, 1983). Based on the hypotheses, variables are classified into different groups. SEM finds the weight to assign to each variable that brings the predicted variance-covariance matrix among the grouped variables as close as possible to the observed relationship in the raw data. As an arbitrary scaling device, within each group the strongest connection is assigned the unit value 1.0 (Schumacker and Lomax, 2004). The emphasis of the approach is, therefore, on the relationships among groups of variables, where each of the groupings is designed to represent a managerial concept (or 'latent variable') impossible to capture in a single measured variable.

We include four indices to measure the model fit in the estimated relationships. The goodness-of-fit index (GFI) and the adjusted goodness-of-fit index (AGFI) measure the level of the observed variance-covariance matrix, which is predicted by the estimated matrix (Hu and Bentler, 1995: 85). In general, GFI and AGFI values around 0.90 signify a good fit (Hu and Bentler, 1995, 1999). The root mean square error of approximation (RMSEA) measures the amount of discrepancy between the model and the data, considering the complexity of the model (Schumacker and Lomax, 2004: 84). An acceptable model should have a RMSEA lower than 0.10 (Browne and Cudeck, 1993). The standardized root mean square residual (SRMR) is a measure of the size of the residuals (Schumacker and Lomax, 2004: 103). In a strong model, the SRMR should be less than 0.08 (Hu and Bentler, 1999). As will be seen below, based on these goodness-of-fit indices, both Japanese models and Taiwanese models are acceptable.

The measurement variables discussed below are grouped into four latent variables: internal governance (BOARD), financial institutions (INST), political intervention (GOV), and firm performance (PERF). Each of these main headings and their respective constituent measured variables will be discussed in turn.

3.1 Internal Governance (BOARD)

The descriptors of board composition used to evaluate the direct and indirect influences of the board of directors on firm performance include their percentage of board ownership (BDOWN) and the percentage of outside directors (OUTSIDE). Also included is the fractional equity ownership by the CEO and his immediate family (MANOWN). Owing to data availability, the Japanese model does not include the MANOWN variable (Note 4). Finally, the variable BD_Q is included to measure the quality of board directors. The National Association of Corporate Directors guideline (NACD, 1996) recommends that senior corporate executives and CEOs should hold no more than three outside directorships. BD_Q captures the percentage of directors who occupy more than three executive or director positions in other companies (Perry and Peyer, 2005).

3.2 Financial Institutions (INST)

In addition to the government, the main bank and other *keiretsu* partners (Note 5) will also appoint representatives to the board to help their troubled partner tackle financial problems (Phan and Yoshikawa, 2000; Yoshikawa and Phan, 2001). The first variable used to capture this phenomenon is financial ownership (FINOWN), which is measured as the ratio of financial institution shares to total outstanding shares. Cross shareholding ownership (CROSS) measures the ownership by other companies, and is computed as the ratio of cross-shareholding shares to total outstanding shares. In addition, the percentage of ownership accounted for by the top ten blockholders is captured in the variable BLOCK. Finally, to take account of the number of bank-appointed directors on the board, these are expressed as a proportion of the total number of directors (BANK_D).

3.3 Political Intervention (GOV)

The first variable included in this group is government ownership (GOVOWN), which is measured by the ratio of government shares to total outstanding shares. The second variable is the number of shareholdings that represent government-linked agencies (GOV_I). Another key variable is the number of government-appointed directors (GOV_APP) (Van Rixtel, 2002). This variable measures the phenomena labeled in Japan as '*amakudari*' and '*shukko*'. The two types of director are combined into the same measurement variable here. Whether a director is a retired bureaucrat (i.e. *amakudari*) or an incumbent government official on loan temporarily to a company (i.e. *shukko*), he/she is regarded as a director with a political background. GOV_APP is the ratio of the number of directors with such a political background to the total number of directors on a board.

There is an additional phenomenon that commonly occurs in Japan, namely the significance of university cliques, or so-called '*gakubatsu*', which establish strong support and group consciousness within and between large Japanese companies (Colignon and Usui, 2003; Van Rixtel, 2002). In Japan, top-level bureaucrats have a similarity of education

that produces an exclusive environment and an elite culture, which is very hard for other people without the same background to enter (Van Rixtel and Hassink, 2002), but may be shared across senior company executives and high-ranking government officials, thus enhancing the likelihood and effectiveness of company-government linkages. To measure the importance of academic background, the variable GAKUBATSU is constructed as the ratio of the number of graduates from the five most prestigious universities in Japan (so-called the 'Big five' (Note 6)) to the total number of directors on a board. Because of the absence of a similar phenomenon in Taiwan, the Taiwanese model does not include the variable GAKUBATSU.

3.4 Firm Performance (PERF)

Three alternative variables are used to measure firm performance: total shareholder return (TSR), return on equity (ROE), and return on assets (ROA). TSR is the total return on shares assuming dividends are reinvested. In this paper, ROE is computed as the net income divided by the shareholder's equity, and ROA is calculated by dividing a company's annual earnings by its total assets. All three variables are industry adjusted by deducting the average ROE, ROA and TSR in their industry group from the raw data.

4. Empirical Results

4.1 Japan: Why Is There Intervention from the Government and Financial Institutions?

As explained above, the variables in the Japanese model can be classified into four latent groups – BOARD, INST, GOV, and PERF. Summary statistics are presented in Table 1, where it can be seen that the structure of corporate governance in Japanese companies is different from that of Western companies. For example, financial ownership (FINOWN) is 46.02%, which suggests that banks and other financial institutions may play an important role in the operation of a company (Morck and Nakamura, 1999). Moreover, the average ratio of blockholder ownership (BLOCK) is 39.88%, which is close to the 37.4% reported by Kang and Shivdasani (1995), and is another characteristic of Japanese corporate governance structure.

[Table 1 here]

In the government group (GOV), the average ratio of government-appointed directors is 3.21%, which is high compared with Western companies in arms-length capitalism, where the phenomenon is virtually non-existent. Furthermore, the average ratio of *gakubatsu* is 54.21%, which is extremely high. Since sample companies come from the Nikki 225, it is possible to conclude that most directors in large Japanese companies graduate from one of the 'Big Five' universities. This implies that their personal network, which is based on having similar university backgrounds, may be a critical factor in Japan.

Table 2 presents the fitted model and the completely standardized coefficients (Note 7), which are estimated under our hypotheses. To test the hypothesized relationships, the estimated coefficients in Table 2 are used to define Figure 1. The completely standardized coefficients in Table 2 and Figure 1 provide strong support for Hypothesis 1 and Hypothesis 2 in the sense that the coefficient of the direct relationship between performance (PERF) and political intervention (GOV) is -0.22 (t = -2.78), which is significant at the 1% level, and the coefficient of the direct relationship between performance (PERF) and financial institutions (INST) is -0.21 (t = -1.95), which is significant at the 10% level. This finding is consistent with Kaplan and Minton (1994) and Van Rixtel (2002) in that a company with poor performance is more likely to accept government-appointed directors and bank representatives on the board. In this way, it can build a tighter relationship with the government and financial institutions, so enlisting their help to solve its financial problems.

[Table 2 here]

[Figure 1 here]

In Japan, the corporate governance system is generally perceived as existing to promote the interests of the company, the employees, and the whole of society rather than merely the shareholders (Monk and Minow, 2004). In this kind of system, the government sees itself as a protector of domestic industry (Analytica, 1992). Based on this phenomenon, when a company does not perform well or has a financial crisis that causes instability, the government and other cross-holding institutions will intervene in the operation of the company, and for resource dependence reasons, this intervention will be accepted and even encouraged. Our empirical results are consistent with this argument.

In addition to financial institutions (INST) and political intervention (GOV), the coefficient of the direct relationship between firm performance (PERF) and internal governance (BOARD) is also significant and negative (-0.10, t = -2.76), which is consistent with Hypothesis 3. This result implies that poor firm performance will, for agency reasons, make the company enhance the monitoring ability of the board by, for example, increasing the percentage of outside directors and board ownership. These results imply that the influence of political intervention in Japan is direct. The intermediate role of Japanese boards is not significant.

4.2 Japan: Is Subsequent Firm Performance Better?

The question is whether intervention by the government and financial institutions is associated with improved firm

performance. Table 3 follows from the hypotheses introduced above and presents the completely standardized coefficients and model statistics on which Figure 2 is based. It can be seen that the direct relationship between political intervention (GOV) and firm performance (PERF) is significant but negative. According to the empirical analysis, therefore, Hypothesis 4-1 is not supported – political intervention is not positively associated with subsequent firm performance. The empirical result does, however, support Hypothesis 4-2 (coefficient = -0.33, t = -2.26), that the relationship between political intervention (GOV) and subsequent firm performance (PERF) is negative. This result suggests that political intervention is inefficient and the system of *amakudari* jeopardizes the soundness of the Japanese corporate governance mechanism. This result is similar to those in Tian and Lau (2001) and Hu et al. (2010). The latter also utilize SEM and demonstrate that with less state involvement, firms are more capable of utilizing their internal governance mechanisms to achieve better performance. In addition, the results also complement the findings in Fan et al. (2007), which show that firms with politically connected CEOs underperform those without politically connected CEOs.

[Table 3 here]

[Figure 2 here]

The coefficient of the direct path between INST and PERF is significantly negative (-0.21, t = -2.11), which means that Hypothesis 5-1 is rejected but Hypothesis 5-2 is supported by the empirical results. Because of the main bank system and the phenomenon of concentrated shareholders, the Japanese corporate governance mechanism is mainly based on external monitoring – government, financial institutions, and companies in the same *keiretsu* group (Monks and Minow, 2004). However, direct intervention at board level by financial institutions may lead to poor firm performance. The empirical analysis presented here supports this view. With respect to the Japanese corporate governance mechanism, Table 3 also suggests that the influence of the internal monitoring system on performance in Japan is not significant. The path between BOARD and PERF is not significant, which indicates that Hypothesis 6 and Hypothesis 7 are not supported.

4.3 Taiwan: Why Is There Intervention from the Government and Financial Institutions?

The Taiwanese summary statistics are also shown on the right-hand side of each column in Table 1 (in parentheses). Compared with the Japanese data, it can be seen that financial ownership (FINOWN) is smaller in Taiwan, whereas board ownership (BDOWN), the outsider ratio (OUTSIDE), government ownership (GOVOWN), and the ratio of government representatives (GOV_APP) are all larger in Taiwan. Generally, the summary statistics suggest that the political intervention and corporate governance mechanisms are different in Taiwan compared to Japan.

The completely standardized coefficients reported in Table 4 and the derived Figure 3 allow the maintained hypotheses to be tested. The estimated Taiwanese model is very different from the Japanese model. Specifically, the direct paths of PERF–GOV and PERF–INST are not significant. However, this does not mean that there is no significant relationship at work. In contrast to the direct significant paths in Japan (see Table 2 and Figure 1), there is an indirect significant relationship between PERF and GOV through the intermediate BOARD. From Figure 3, it can be seen that the indirect influence of PERF on GOV is (-0.20)*(0.21), which equals -0.04. The indirect path between PERF and GOV is significant at the 1% level. Similarly, the significant indirect influence of PERF on INST is (-0.20)*(0.52), which equals -0.10. This indirect path between PERF and INST is significant at the 1% level. The relationship between PERF and BOARD is also negative (-0.20) and significant at the 1% level. The empirical results are therefore consistent with Hypothesis 1, Hypothesis 2, and Hypothesis 3.

[Table 4 here]

[Figure 3 here]

In contrast with the Japanese model, the Taiwanese government does not seem to intervene directly in the operation of companies. Instead, it affects firm performance indirectly through the board. Figure 3 shows that the relationship between PERF and BOARD is negative. It can be argued that faltering performance induces the board to eagerly seek help from government and the financial institutions, and thereby build a positive relationship between BOARD and GOV/INST. In other words, our empirical results suggest that boards in Taiwan play a significant intermediate role in the relationship between government and financial institutions, whereas the boards in Japan play no significant role in this area. The situation in Taiwan is, therefore, more clearly consistent with the board actively operating in a resource-dependence mode by arranging board structure in a way that facilitates access to resources and business relationships.

4.4 Taiwan: Is Subsequent Firm Performance Better?

Table 5 reports the completely standardized coefficients for the hypothesized relationships and leads to Figure 4, which shows that the direct relationship between GOV and PERF is not significant. Neither is the direct relationship between INST and PERF significant. The indirect paths, however, are significant. Through the latent variable BOARD, the relationship between GOV and PERF is (-0.21)*(0.33), which equals -0.07 and is significant at the 5% level. This allows Hypothesis 4-1 to be rejected, but supports Hypothesis 4-2. The indirect relationship between INST and PERF is

(-0.41)*(0.33), which equals -0.14 and is significant at the 1% level. This allows Hypothesis 5-1 to be rejected, but supports Hypothesis 5-2.

[Table 5 here]

[Figure 4 here]

According to the empirical results, even when troubled companies employ retired bureaucrats to build an informal network, firm performance in Taiwanese companies may not improve. This result supports the finding in Fan et al. (2007). Note, however, that Hypothesis 6 is supported in that the relationship between BOARD and PERF is significant and positive, which suggests that the board with better monitoring ability can improve firm performance in Taiwan. This is consistent with the predictions of agency theory.

Although the final conclusion of the Taiwanese model is similar to that of the Japanese model regarding board level intervention, the processes are different. The direct relationships between GOV/INST and PERF in the Japanese model are significant and negative. In the Taiwanese model, however, GOV influences PERF via the latent variable BOARD. The negative relationship between GOV and BOARD in Taiwan indicates that more political intervention may damage the monitoring ability of the board, a board that the support found for Hypothesis 6 suggests is otherwise effective in influencing company performance. A less robust board of directors may result in poor firm performance, possibly because government-appointed directors may attempt to extract rents for the ruling party itself, perhaps by operating non-profitable projects to implement politically desirable policies at the expense of firm performance.

The negative relationship between INST and BOARD similarly suggests that too much intervention from financial institutions may undermine the monitoring ability of the board and consequently engender a negative influence on subsequent firm performance (PERF). Although Japan and Taiwan are similar in board structure, Hypothesis 7 is supported by Taiwanese estimates but not Japanese estimates. This may be because most directors in Japan are insiders who may not monitor executives efficiently (Kaplan and Minton, 1994).

As a robustness check, we also exclude the variable MANOWN in order to have the same variables in the Japanese and Taiwanese models. All major conclusions remain unchanged.

5. Conclusion and discussion

This paper has examined the influence on firm performance of board-level intervention by government and financial institutions. The approach adopted breaks new ground by utilizing structural equation modeling (SEM) to examine political intervention in the form of *shukko* and *amakudari* from the viewpoint of corporate governance in Japan and Taiwan. Through the use of latent variables, we can observe not only the direct influence but also the indirect influence of the variables. This approach allows us to operationalize theoretical constructs such as governance and institutional influence. Through the use of SEM in this context, the results obtained offer interesting insights into governance effects and firm performance.

The empirical findings support the view that the relationship between firm performance and subsequent political intervention is significant and negative. This suggests that companies with poor firm performance may try to recruit or accept the appointment of retired bureaucrats to gain support and buy influence from the government. This is confirmed in the tests of Hypotheses 1 and 2 above. These results are consistent with those of Van Rixtel and Hassink (2002) and confirm the predictions that arise from the perspective of resource dependence theory (Pfeffer and Salancik, 1978; Hillman et al., 2000; Hillman, 2005), or a combination of institutional and resource-based views (Oliver, 1997).

On the other hand, however, the results also suggest that political and financial intervention is not accompanied by improved subsequent firm performance. The results from tests of Hypotheses 4 and 5 suggest that such intervention – whether originating from government or financial institutions – does not deliver the predicted boost to company performance but rather has a depressing effect. While echoing Tian and Lau (2001) and Hu et al. (2010), these results undermine the resource dependence perspective, whether on its own or in combination with an institutional (Oliver, 1997) or agency (Hillman and Dalziel, 2003) perspective.

While the results presented here support Horiuchi and Shimizu (2001) and Fan et al. (2007), in that political intervention may jeopardize capital adequacy, they contradict Van Rixtel and Hassink (2002), whose results suggest that political intervention will improve profitability in the finance industry. Our statistical findings concerning political/financial institution intervention and subsequent firm performance also differ between Japan and Taiwan. Once again, in Japan, the influence is direct, whereas in Taiwan, political intervention and financial institution intervention influence subsequent firm performance via the board.

While direct tests of agency theory, under Hypotheses 6 and 7, find no connection between the strength of the board and firm performance in the case of Japan, significant effects are found in the case of Taiwan. This suggests that, at least in the case of Taiwan, the board counts and can influence performance – in ways that are consistent with agency theory

This point merits repeating. The significant negative relationships between political intervention or financial institutional

intervention and firm performance are direct in Japan, whereas they are indirect in Taiwan. In Taiwan, the negative influence comes through the board of directors. A similar observation holds for the relationship between political intervention and firm performance. Furthermore, only in the case of Taiwan is the board observed to exert significant influence on company performance. All of this indicates that in Taiwan the board plays a mediating role between the government/financial institutions and the company, and a direct role in achieving performance. Contrasted with the Japanese situation, the board of directors in Taiwan appears to assume a more influential role. The board in the Japanese sample seems to be completely circumvented by institutional intervention – and intervention to which it is difficult to ascribe a resource dependency motivation, given the absence of any consequent direct or indirect improvement in performance.

By using structural equation modeling, this paper offers a powerful method of analyzing governance effects that are often difficult to express as a particular linear combination of measurable variables. This is done by allowing a weighted combination of these variables to be deployed so as to capture the underlying import of the latent governance construct. The approach could be further improved by drawing on a larger sample of cases (both over time and across companies) than was available to us. There is also scope for more detailed scrutiny of the reliability and validity of the components of the latent variables by using a more exogenous selection process than merely scrutinizing the literature (Bagozzi and Phillips, 1991).

In both Japan and Taiwan, however, the results confirm that troubled companies tend to recruit retired bureaucrats (*amakudari*) and bank representatives to build the business-government network and thereby gain support from the government. Contrary to the predictions of resource dependence theory, however, such intervention from government and financial institutions is not positively associated with either subsequent firm performance or the subsequent monitoring ability of the board. In the case of Taiwan, but not Japan, boards do seem to act in ways consistent with agency theory and to exert a positive influence on company performance.

The managerial implications of the empirical analysis presented above are generally supportive both of resource dependency theory and of agency theory. Thus, firms do seem to draw on the available resources in their environment. In the evidence above, this seems to happen when companies are in trouble or performing poorly. Furthermore, in Taiwan boards can and do exert an influence on company performance, just as agency theory suggests. But whatever resources that can be tapped through recourse to the institutional environment, they do not seem to be sufficient to result in improved performance. It may actually be the case that, tempting as it is, involvement of government and financial institutions leads only to complication and a further loss of performance. The relationship seems to be direct in Japan but to operate through an undermining of the board in Taiwan.

A further managerial implication derives from the different channels through which the above effects seem to work. Whereas in Japan there was a direct linkage between intervention and performance, in the case of Taiwan this seemed only to happen indirectly through the board. It is clearly vital to allow for cross-country variations in the way that these institutional forces work out. Related to this, it appears that the Japanese boards are relatively passive and accommodating as compared to boards in Taiwan. In the case of Taiwan the board seems to be able to function directly and in its own right – if not always successfully. The board emerges as a relatively stronger phenomenon in Taiwan than it does in Japan, and this merits further study.

Political intervention, both through government influence and the influence of financial institutions seems to be a significant empirical phenomenon in both Japan and Taiwan. Structural equation modeling (SEM) allows these influences to be set in the context of corporate governance and a functioning board. The full impact of such political interventions is only fully appreciated when both the direct and indirect effects are modeled. The approach offers to deliver improved insights into the operation of corporate governance and its influence on firm performance in different institutional settings.

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Notes

Note 1. By 'government-linked companies' we mean companies which have one or more directors from the government/state-owned enterprises or companies whose government ownership exceeds 5%.

Note 2. In Japan, Commercial Code, §260-3(1), §260-3(3,4), §274(2), §274-3, §275-2, and §275-4 regulate the principal powers of auditors. In Taiwan, Company Law, §213, §214, §218, §219, §245, §274, and §418 list the responsibilities of supervisors.

Note 3. 22 companies were dropped from the sample because they did not have complete data or have been merged into a new company. The approach to dropping companies in the Taiwan sample is the same as in the Japan sample.

Note 4. Since April 2003, large Japanese companies have been permitted to choose between the statutory auditor system and the committee system. Most Japanese companies, however, have adopted the statutory auditor system rather than the committee system and seldom use the titles of CEO, CFO, and COO (only a few companies, such as SONY, have adopted the committee system).

Note 5. Japanese companies interlink each other through share purchases to form horizontally-integrated alliances, so-called *keiretsu*. Companies in the same *keiretsu* can also supply one another, making the alliances vertically-integrated as well. The *keiretsu* can also be centred on one main bank, which lends money to the member companies and holds equity of these companies. Lincoln and Shimotani (2009) emphasise that the forces of globalisation have done much to undermine the strength of the *keiretsu* bond although equity relationships and cooperative pacts among members have recently enjoyed something of a renaissance.

Note 6. The "Big five" includes the University of Tokyo, University of Waseda, University of Keio, University of Kyoto, and University of Hitotsubashi.

Note 7. When observed variables have different scales, it is necessary to standardise structural parameters to aid interpretation. This is done in the usual way of subtracting the mean and dividing by the standard deviation of the respective variable. Standardised structural parameters emerge from analysis of this transformed data. 'Completely' in 'completely standardised coefficients' signifies that all of the raw data and not just the estimated latent variables have been subjected to such standardisation.

Table 1. Summary Statistics: Japan and Taiwan

Latent Variable	Measurement Variable	Mean		Std		Max		Min	
		Japan	Taiwan	Japan	Taiwan	Japan	Taiwan	Japan	Taiwan
BOARD	BDOWN (%)	0.49	(10.01)	3.91	(12.04)	37.43	(60.12)	(0.00)	(0.00)
	OUTSIDE (%)	18.55	(45.21)	10.23	(23.44)	53.33	(100.00)	(0.00)	(0.00)
	MANOWN (%)	---	(3.31)	---	(6.78)	---	(42.26)	---	(0.00)
	BD_Q (%)	5.98	(29.42)	11.86	(25.67)	53.85	(100.00)	(0.00)	(0.00)
INST	FINOWN (%)	46.02	(3.80)	12.43	(7.88)	68.83	(55.88)	3.91	(0.00)
	CROSS (%)	14.11	(22.81)	12.93	(19.45)	86	(79.60)	0.7	(0.01)
	BLOCK (%)	39.88	(35.12)	11.43	(18.32)	81.59	(87.50)	16.21	(4.88)
	BANK_D (%)	5.91	(5.55)	8.95	(13.94)	60	(70.00)	(0.00)	(0.00)
GOV	GOVOWN (%)	0.59	(3.64)	6.56	(11.22)	66.74	(95.33)	(0.00)	(0.00)
	GOV_I	1.79	(3.88)	6.78	(6.98)	63	(38.00)	(0.00)	(0.00)
	GOV_APP (%)	3.21	(7.32)	6.04	(20.31)	33.33	(100.00)	(0.00)	(0.00)
	GAKUBATSU (%)	54.21	---	21.84	---	100	---	5.56	---
PERF	TSR (%)	7.93	(38.91)	55.32	(85.23)	425.1	(659.51)	-78.17	(-76.37)
	ROE (%)	-1.9	(9.21)	81.92	(15.98)	80.35	(67.78)	-1771.75	(-78.58)
	ROA (%)	1.97	(6.87)	6.01	(10.02)	63.87	(50.64)	-63.82	(-35.51)

BDOWN: the percentage of board ownership. OUTSIDE: the percentage of outside directors. MANOWN: the percentage of managerial ownership. BD_Q: the percentage of directors who occupy more than three positions in other companies. FINOWN: the ratio of financial institutions shares to total outstanding shares. CROSS: the ratio of institutional shares to total outstanding shares. BLOCK: the percentage of blockholder ownership. BANK_D: the ratio of the number of bank representatives on the board to the total number of directors. GOVOWN: the ratio of government shares to total outstanding shares. GOV_I: the number of government agencies. GOV_APP: the ratio of the number of political-related directors to the total number of directors. GAKUBATSU: the ratio of the number of graduates from the elite universities to the total number of executives in the highest board positions. TSR: the total return on shares assuming dividends are reinvested. ROE: computed as the net income divided by the shareholder's equity. ROA: calculated by dividing a company's annual earnings by its total assets. Data for Taiwanese firms are in parentheses. The number of companies is 203 in Japan and 200 in Taiwan.

Table 2. Path Coefficients: Firm Performance (t) and Governance (t+1), Japan

Description of path	Path coefficient	t value
Performance (t) and Governance (t+1)		
Panel A: Individual Path		
OUTSIDE <--BOARD	0.76	
BDOWN <--BOARD	0.21	1.71*
BD_Q <--BOARD	0.44	1.68*
BANK_D <--INST	0.12	
FINOWN <--INST	-0.55	-3.11***
CROSS <--INST	0.83	2.89**
BLOCK <--INST	0.66	2.59***
GAKUBATSU <--GOV	0.55	
GOVOWN <--GOV	0.43	3.12***
GOV_APP <--GOV	0.52	4.01***
GOV_I <--GOV	0.18	3.47***
ROE <--PERF	0.87	
TSR <--PERF	1.03	1.99**
ROA <--PERF	0.42	2.87***
Panel B: Direct Effect		
BOARD--> INST	0.01	0.23
BOARD--> GOV	0.15	0.54
PERF--> INST	-0.21	-1.95*
PERF--> GOV	-0.22	-2.78***
PERF--> BOARD	-0.1	-2.76***
Panel C: Indirect Effect		
PERF--> BOARD--> INST	-0.001	-0.16
PERF--> BOARD--> GOV	-0.02	-0.31
Panel D: Total Effect		
PERF--> INST	-0.21	-1.98**
PERF--> GOV	-0.24	-2.75***
Observations	609	
Chi-square/df[(*)]	1.93	
GFI	0.91	
AGFI	0.84	
SRMR	0.09	
RMSEA	0.10	

OUTSIDE: the percentage of outside directors. BDOWN: the percentage of board ownership. BD_Q: the percentage of directors who occupy more than three positions in other companies. BANK_D: the ratio of the number of bank representatives on the board to the total number of directors. FINOWN: the ratio of financial institutions shares to total outstanding shares. CROSS: the ratio of institutional shares to total outstanding shares. BLOCK: the percentage of blockholder ownership. GAKUBATSU: the ratio of the number of graduates from the elite universities to the total number of executives in the highest board positions. GOVOWN: the ratio of government shares to total outstanding shares. GOV_APP: the ratio of the number of political-related directors to the total number of directors. GOV_I: the number of government agencies. ROE: computed as the net income divided by the shareholder's equity. TSR: the total return on shares assuming dividends are reinvested. ROA: calculated by dividing a company's annual earnings by its total assets. GFI is the goodness-of-fit index; AGFI is the adjusted goodness-of-fit index; RMSEA is the root mean square error of approximation; and SRMR is the standardised root mean square residual. $p < 0.10$; ** $p < 0.05$; *** $p < 0.01$.

Table 3. Path Coefficients: Governance (t) and Firm Performance (t+1), Japan

Governance (t) and Performance (t+1)		
Description of path	path coefficient	t value
Panel A: Individual Path		
OUTSIDE <--BOARD	0.21	
BDOWN <--BOARD	0.54	2.43**
BD_Q <--BOARD	0.28	1.77*
CROSS <--INST	0.69	
FINOWN <--INST	-0.83	-5.13***
BANK_D <--INST	0.12	1.29
BLOCK <--INST	0.51	6.88***
GOVOWN <--GOV	0.22	
GOV_APP <--GOV	0.65	5.41***
GOV_I <--GOV	0.13	3.79***
GAKUBATSU <--GOV	0.50	2.86***
ROE <--PERF	0.38	
TSR <--PERF	1.22	2.15**
ROA <--PERF	0.39	4.12***
Panel B: Direct Effect		
INST --> BOARD	0.48	3.84***
GOV --> BOARD	-0.10	-0.53
INST --> PERF	-0.21	-2.11**
GOV --> PERF	-0.33	-2.26**
BOARD --> PERF	-0.05	-0.27
Panel C: Indirect Effect		
INST --> BOARD--> PERF	-0.02	-0.33
GOV --> BOARD--> PERF	-0.01	0.53
Panel D: Total Effect		
INST --> PERF	-0.23	-2.49**
GOV --> PERF	-0.34	-2.01**
Observations	609	
Chi-square/df[(*)]	1.94	
GFI	0.91	
AGFI	0.87	
SRMR	0.06	
RMSEA	0.07	

OUTSIDE: the percentage of outside directors. BDOWN: the percentage of board ownership. BD_Q: the percentage of directors who occupy more than three positions in other companies. CROSS: the ratio of institutional shares to total outstanding shares. FINOWN: the ratio of financial institutions shares to total outstanding shares. BANK_D: the ratio of the number of bank representatives on the board to the total number of directors. BLOCK: the percentage of blockholder ownership. GOVOWN: the ratio of government shares to total outstanding shares. GOV_APP: the ratio of the number of political-related directors to the total number of directors. GOV_I: the number of government agencies. GAKUBATSU: the ratio of the number of graduates from the elite universities to the total number of executives in the highest board positions. ROE: computed as the net income divided by the shareholder's equity. TSR: the total return on shares assuming dividends are reinvested. ROA: calculated by dividing a company's annual earnings by its total assets. GFI is the goodness-of-fit index; AGFI is the adjusted goodness-of-fit index; RMSEA is the root mean square error of approximation; and SRMR is the standardised root mean square residual. p<0.10; ** p<0.05; *** p<0.01.

Table 4. Path Coefficients: Firm Performance (t) and Governance (t+1), Taiwan

Performance (t) and Governance (t+1)		
Description of path	path coefficient	t value
Panel A: Individual Path		
OUTSIDE <--BOARD	0.22	
MANOWN <--BOARD	-0.42	-4.58***
BD_Q <--BOARD	0.15	0.65
BDOWN <--BOARD	-1.06	-4.87***
BANK_D <--INST	0.52	
FINOWN <--INST	0.48	5.12***
CROSS <--INST	0.31	5.39***
BLOCK <--INST	0.19	4.17***
GOVOWN <--GOV	0.99	
GOV_APP <--GOV	0.78	6.74***
GOV_I <--GOV	0.41	7.36***
ROE <--PERF	1.41	
TSR <--PERF	0.38	4.41***
ROA <--PERF	1.27	15.31***
Panel B: Direct Effect		
BOARD--> INST	0.52	3.41***
BOARD--> GOV	0.21	1.98**
PERF--> INST	-0.19	-0.98
PERF--> GOV	-0.13	-0.41
PERF--> BOARD	-0.20	-3.16***
Panel C: Indirect Effect		
PERF--> BOARD--> INST	-0.10	-3.98***
PERF--> BOARD--> GOV	-0.04	-3.18***
Panel D: Total Effect		
PERF--> INST	-0.29	-3.57***
PERF--> GOV	-0.17	-2.49**
Observations	600	
Chi-square/df[(*)]	1.97	
GFI	0.90	
AGFI	0.84	
SRMR	0.09	
RMSEA	0.09	

OUTSIDE: the percentage of outside directors. MANOWN: the percentage of managerial ownership. BD_Q: the percentage of directors who occupy more than three positions in other companies. BDOWN: the percentage of board ownership. BANK_D: the ratio of the number of bank representatives on the board to the total number of directors. FINOWN: the ratio of financial institutions shares to total outstanding shares. CROSS: the ratio of institutional shares to total outstanding shares. BLOCK: the percentage of blockholder ownership. GOVOWN: the ratio of government shares to total outstanding shares. GOV_APP: the ratio of the number of political-related directors to the total number of directors. GOV_I: the number of government agencies. ROE: computed as the net income divided by the shareholder's equity. TSR: the total return on shares assuming dividends are reinvested. ROA: calculated by dividing a company's annual earnings by its total assets. GFI is the goodness-of-fit index; AGFI is the adjusted goodness-of-fit index; RMSEA is the root mean square error of approximation; and SRMR is the standardised root mean square residual. $p<0.10$; ** $p<0.05$; *** $p<0.01$.

Table 5. Path Coefficients: Governance (t) and Firm Performance (t+1), Taiwan

Governance (t) and Performance (t+1)		
Description of path	path coefficient	t value
Panel A: Individual Path		
BDOWN <--BOARD	0.65	
MANOWN <--BOARD	0.52	7.81***
OUTSIDE <--BOARD	0.11	2.18**
BD_Q <--BOARD	-0.29	1.83*
FINOWN <--INST	0.51	
BANK_D <--INST	0.88	5.34***
CROSS <--INST	0.13	4.21***
BLOCK <--INST	0.35	3.84***
GOVOWN <--GOV	0.82	
GOV_APP <--GOV	0.54	9.88***
GOV_I <--GOV	0.67	6.47***
ROE <--PERF	0.72	
TSR <--PERF	0.11	4.35***
ROA <--PERF	0.64	10.83***
Panel B: Direct Effect		
INST --> BOARD	-0.41	-3.93***
GOV --> BOARD	-0.21	-3.27***
INST --> PERF	-0.24	-0.11
GOV --> PERF	-0.28	-0.72
BOARD --> PERF	0.33	2.98***
Panel C: Indirect Effect		
INST --> BOARD--> PERF	-0.14	-3.01***
GOV --> BOARD--> PERF	-0.07	-2.26**
Panel D: Total Effect		
INST --> PERF	-0.38	-1.87*
GOV --> PERF	-0.35	-1.58
Observations	600	
Chi-square/df[(*)]	1.96	
GFI	0.90	
AGFI	0.8	
SRMR	0.08	
RMSEA	0.10	

BDOWN: the percentage of board ownership. MANOWN: the percentage of managerial ownership. OUTSIDE: the percentage of outside directors. BD_Q: the percentage of directors who occupy more than three positions in other companies. FINOWN: the ratio of financial institutions shares to total outstanding shares. BANK_D: the ratio of the number of bank representatives on the board to the total number of directors. CROSS: the ratio of institutional shares to total outstanding shares. BLOCK: the percentage of blockholder ownership. GOVOWN: the ratio of government shares to total outstanding shares. GOV_APP: the ratio of the number of political-related directors to the total number of directors. GOV_I: the number of government agencies. ROE: computed as the net income divided by the shareholder's equity. TSR: the total return on shares assuming dividends are reinvested. ROA: calculated by dividing a company's annual earnings by its total assets. GFI is the goodness-of-fit index; AGFI is the adjusted goodness-of-fit index; RMSEA is the root mean square error of approximation; and SRMR is the standardised root mean square residual. $p<0.10$; ** $p<0.05$; *** $p<0.01$.
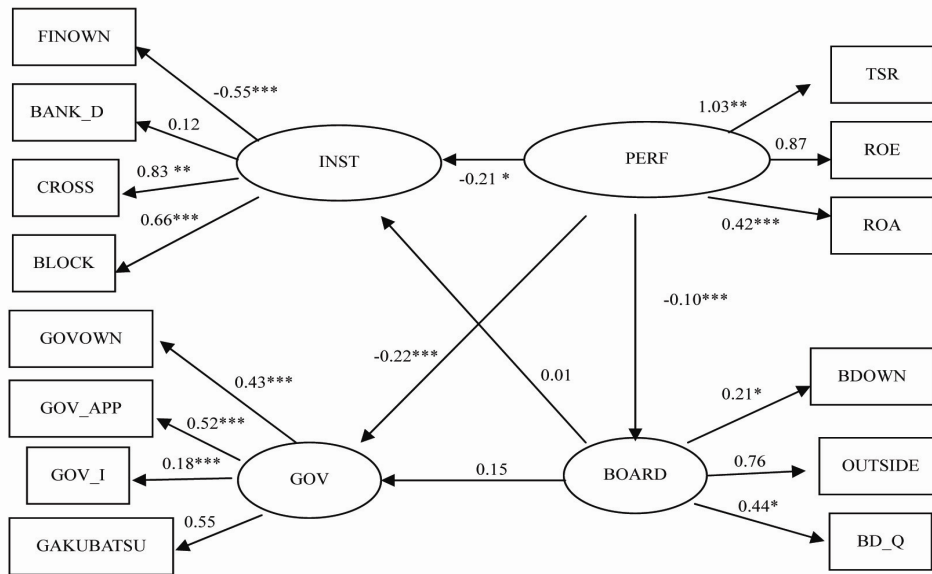
Figure 1. Path Diagram: Firm Performance (t) and Governance (t+1), Japan

BDOWN: the percentage of board ownership. OUTSIDE: the percentage of outside directors. BD_Q: the percentage of directors who occupy more than three positions in other companies. FINOWN: the ratio of financial institutions shares to total outstanding shares. BANK_D: the ratio of the number of bank representatives on the board to the total number of directors. CROSS: the ratio of institutional shares to total outstanding shares. BLOCK: the percentage of blockholder ownership. GOVOWN: the ratio of government shares to total outstanding shares. GOV_APP: the ratio of the number of political-related directors to the total number of directors. GOV_I: the number of government agencies. GAKUBATSU: the ratio of the number of graduates from the elite universities to the total number of executives in the highest board positions. TSR: the total return on shares assuming dividends are reinvested. ROE: computed as the net income divided by the shareholder's equity. ROA: calculated by dividing a company's annual earnings by its total assets. $p<0.10$; ** $p<0.05$; *** $p<0.01$.
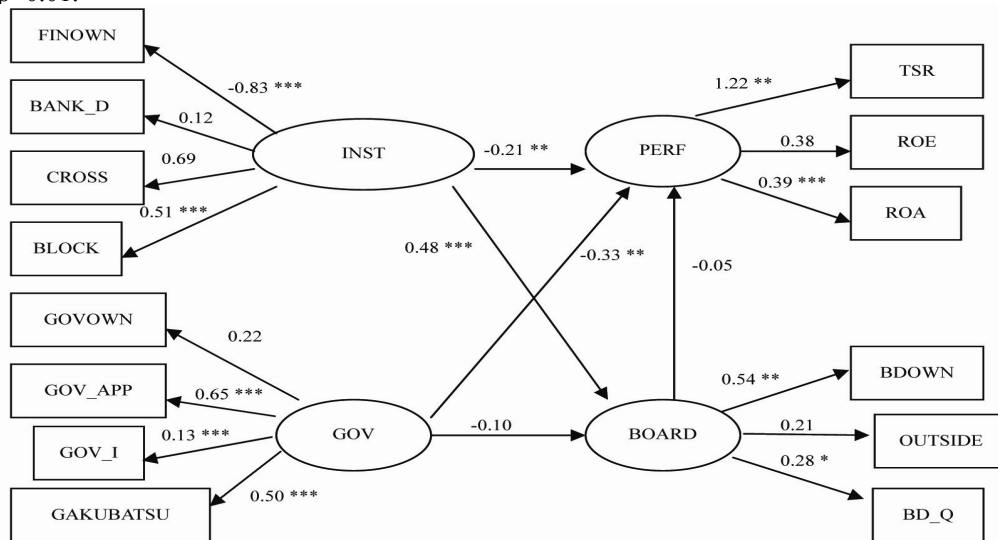

Figure 2. Path Diagram: Governance (t) and Firm Performance (t+1), Japan

FINOWN: the ratio of financial institutions shares to total outstanding shares. BANK_D: the ratio of the number of bank representatives on the board to the total number of directors. CROSS: the ratio of institutional shares to total outstanding shares. BLOCK: the percentage of blockholder ownership. GOVOWN: the ratio of government shares to total outstanding shares. GOV_APP: the ratio of the number of political-related directors to the total number of directors. GOV_I: the number of government agencies. GAKUBATSU: the ratio of the number of graduates from the elite universities to the total number of executives in the highest board positions. TSR: the total return on shares assuming dividends are reinvested. ROE: computed as the net income divided by the shareholder's equity. ROA: calculated by dividing a company's annual earnings by its total assets. BDOWN: the percentage of board ownership. OUTSIDE: the percentage of outside directors. BD_Q: the percentage of directors who occupy more than three positions in other companies. $p<0.10$; ** $p<0.05$; *** $p<0.01$
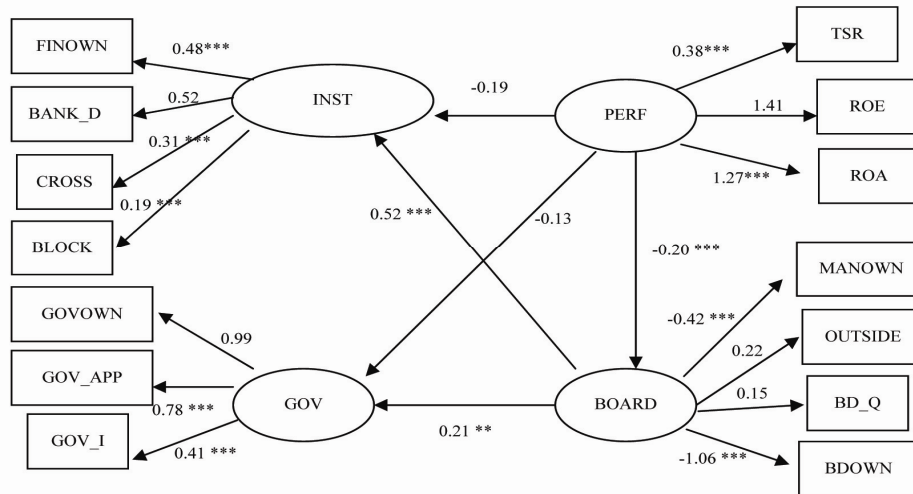
Figure 3. Path Diagram: Firm Performance (t) and Governance (t+1), Taiwan

FINOWN: the ratio of financial institutions shares to total outstanding shares. BANK_D: the ratio of the number of bank representatives on the board to the total number of directors. CROSS: the ratio of institutional shares to total outstanding shares. BLOCK: the percentage of blockholder ownership. GOVOWN: the ratio of government shares to total outstanding shares. GOV_APP: the ratio of the number of political-related directors to the total number of directors. GOV_I: the number of government agencies. TSR: the total return on shares assuming dividends are reinvested. ROE: computed as the net income divided by the shareholder's equity. ROA: calculated by dividing a company's annual earnings by its total assets. MANOWN: the percentage of managerial ownership. OUTSIDE: the percentage of outside directors. BD_Q: the percentage of directors who occupy more than three positions in other companies. BDOWN: the percentage of board ownership.* $p<0.10$; ** $p<0.05$; *** $p<0.01$.
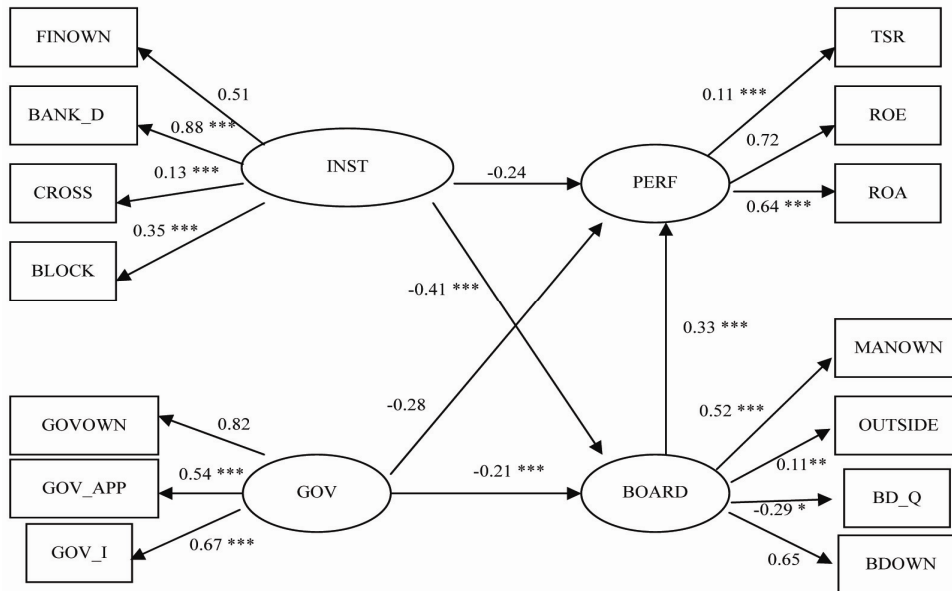

Figure 4. Path Diagram: Governance (t) and Firm Performance (t+1), Taiwan

FINOWN: the ratio of financial institutions shares to total outstanding shares. BANK_D: the ratio of the number of bank representatives on the board to the total number of directors. CROSS: the ratio of institutional shares to total outstanding shares. BLOCK: the percentage of blockholder ownership. GOVOWN: the ratio of government shares to total outstanding shares. GOV_APP: the ratio of the number of political-related directors to the total number of directors. GOV_I: the number of government agencies. TSR: the total return on shares assuming dividends are reinvested. ROE: computed as the net income divided by the shareholder's equity. ROA: calculated by dividing a company's annual earnings by its total assets. MANOWN: the percentage of managerial ownership. OUTSIDE: the percentage of outside directors. BD_Q: the percentage of directors who occupy more than three positions in other companies. BDOWN: the percentage of board ownership. $p<0.10$; ** $p<0.05$; *** $p<0.01$.