



Foreign Board of Directors' Role Towards Successful Cross-Border Merger & Acquisition

Master Thesis

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Abstract

This thesis examines the relation between the board consists of foreign director in the board and cross-border M&A performance. The samples of cross-border M&A are the acquiring firm from the US and the target firms from other countries except US for the period between 2002-2016. Cross-border M&A performance is translated into two parts of dependent variables, cumulative abnormal returns and premium paid by acquiring firm. The results show that around the announcement date, foreign director presence has a positive relation and statistically significance with the cumulative abnormal returns. On the other hand, considering the low coefficient and R-squared, foreign director on the board may not have a major influence on cross-border M&A. Continuing to next the dependent variable, the premium paid, the result shows that foreign director's presence has no impact on the premium paid. Overall, foreign director on the board only has minor impact on cumulative abnormal returns and has no relation with premium paid.

Keyword : foreign director on the board; cross-border M&A; cultural fit; shareholder's wealth

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1. Introduction

1.1 Problem Statement

A Cross-border M&A is considered a complex type of agreement. Unlike a domestic M&A which only relates to firms in the same country, a cross-border M&A involves firms in different countries. One of the reasons for cross-border M&A relates to the rapid growth in globalization. Markets are growing rapidly, and in fact, the world is becoming borderless (Hitt, 2012). These conditions are compelling many firms to evolve into global firms.

The evidence of the borderless market lies in the rise of the free-trade market, where opportunities to enter new markets are becoming broader than ever. Thus, cross-border M&A can be defined as an economic tool to enter a new market (Shimizu, Hitt, Vaidyanath, & Pisano, 2004). However, this opportunity comes with a great challenge. Many experts say that this challenge could change how a cross-border M&A works. Major firms like Daimler and Chrysler, and also the Walmart, Wertkauf, and Interspar, are examples of how cross-border M&A fell apart.

Initially, Daimler and Chrysler were expected to realize a successful cross-border M&A, nonetheless, this merger collapsed a few years later. The episode started with these two big firms aiming to conquer the global market. At first, the deal looked promising. In 1998, Daimler paid \$38 billion for Chrysler. Unfortunately, as time passed, the share price of Daimler-Chrysler started to fall. Performance of the merger entity fell way below the expected levels. The stock price kept falling from 1998 on and it remained low in the first decade of the 21st century. In the end, Cerberus Capital took over Chrysler by paying \$7.4 billion in 2007. Many experts questioned how such a promising cross-border M&A collapsed.

Cultural differences were mentioned as the main reason for the failure. Daimler was a German firm while Chrysler was an American firm, which meant there were huge cultural differences. For example, the organizational hierarchies within these companies were quite different. Daimler valued a different hierarchical system in comparison to Chrysler. Daimler had a fixed chain of command while Chrysler preferred a more team-oriented and egalitarian approach. A similar case happened with Walmart. In 1997, Walmart, a mega-retailer from the US whose ambition was to enter the German market, acquired Wertkauf and Interspar, retailer firms in Germany. At first, Walmart attempted to apply its strategy – which had been so successful in the

US market – to the German market. With the help of Wertkauf and Interspar, Walmart tried to implement this strategy smoothly. Unfortunately, the plan did not work as intended. The problem was similar to the Daimler-Chrysler case: cultural differences. Walmart forced German executives to implement American-style management practices in the workplace, and that did not go down well with either Wertkauf or Interspar. Walmart's top management also conceded that they made a mistake by forcing a concept that couldn't easily be perceived in the same way in different cultures, such an approach led to this unsuccessful cross-border M&A. Nobody intended this cross-border M&A to be unsuccessful; this condition destroys shareholders' value, which is something every firm should be concerned about. Thus, does cross-border M&A always have a bad outcome for shareholders, even though globalization is a major issue that must eventually be faced? This question drew my attention to be examined in this research.

1.2 Objective and research question

Cross-border M&A has gained popularity over the last decade, but research regarding this topic hasn't kept pace with the trend (Shimizu, Hitt, Vaidyanath, & Pisano, 2004). As explained previously, cross-border M&A may destroy shareholders' wealth, but globalization has nevertheless increased rapidly. Hence, it is important that cross-border M&A is included in a firm's strategy.

M&A is frequently attributed to corporate governance. An adequate formulation of corporate governance can have a positive outcome on corporate strategy, including international strategy (Porter, 1998). Corporate governance has various mechanisms, one of which is board diversity. A definition of board diversity can be categorized based on ethnicity or nationality, gender, age and educational background. In relation to previous discussions, diversity in ethnicity or nationality of those involved may mitigate issues related to cross-border M&A. This refers to foreign directors; a director is regarded as a foreign director when he or she comes from a different culture than the country where the firm is incorporated (Alabdullah & Ferris, 2014). In addition, Masulis, Wang, and Xie (2012) found that a foreign director on the board of a US acquirer leads to better cross-border M&A performance when the target firm has a similar culture value with respective board member. Based on this definition and cultural differences as a potential reason for unsuccessful cross-border M&A, I specify foreign director in the board as the member whose ethnicity is the same as the target firm. This is because I believe the referred member can help the acquirer ease

and enhance cross-border M&A negotiation and performance. Hence, this research attempts to answer the following research question:

RQ: Does having a foreign director in the board of directors whose ethnicity is the same as the target firm increase shareholder's wealth during cross border M&A?

1.3 Motivation

Providing an answer to this research question is important because even though the number of cross-border M&A transactions has increased rapidly, KPMG found that more or less 17% cross-border M&A transactions enhance shareholders value, while 53% reduce it (Economist, 1999). Capron and Pistre (2002) also argue, based on evidence that acquirer shareholders do not realize any value during cross-border M&A, compared to the target firm. Knowing these statistics doesn't necessarily mean one should avoid cross-border M&A.

The era of growing globalization has led to many firms becoming flexible and agile in the face of this worldwide industry phenomenon where the competition is growing rapidly (Shimizu, Hitt, Vaidyanath, & Pisano, 2004). To remain in the business, every firm should have a competitive advantage. Porter (2001) argued a firm can achieve competitive advantage through innovation. He explained how companies succeed in international markets through innovation, which can be manifested in a new product design, a new product process, or a new marketing approach. By this assumption, cross-border M&A still has to be considered as a strategy to conquer international markets. Thus, the results of this thesis should be relevant for practitioners, especially future acquirers, in giving them a better understanding of what kind of conditions occur to give shareholders value during cross border M&A. I have assumed that the presence of a foreign director on the board gives shareholders value during cross border M&A.

1.4 Research design

This research is based on a quantitative method using Ordinary Least Square (OLS) regression analysis. The sample comprises listed U.S. firms (S&P500) between 2002 and 2016. The dependent variables are cumulative abnormal returns during the announcement period and premium paid by the acquiring firm. Cumulative abnormal returns can be obtained from Datastream and premium paid by the acquiring firm can be obtained from Thomson One.

The independent variables are *total foreign director* and *foreign director composition*. In this research, a foreign director is determined when his or her ethnicity is the same as target firm. Hereafter, total foreign director in the board is the sum of it. Regarding the second independent variable, Alabdullah and Ferris (2014) argued that a foreign director on the board is influenced by his culture, which in turn affects his actions, recommendations, and decision making. Hence, he has an advantage of giving new perspective, but at the same time affects harmony within the board. Baysinger and Butler (1985) argued that board of directors have a variety of roles which require a diverse set of talents, knowledge, and experience to satisfy but when only emphasizing one area of expertise may reduce board's overall effectiveness. At first, a foreign director on the board can bring positive effects that help the acquiring firm gain familiarity about the target firm in terms of culture, corporate governance, economic conditions and business environment. But when the foreign director on the board has a majority power on the board, this can create a potential problem such as destroys the wealth of shareholders in the acquiring firm (Alabdullah & Ferris, 2014). Hence, following Byrd and Hickman (1991) firms have been categorized based on the total number of foreign directors who sit on the board by creating a dummy variable. This has been done to separate firms with a foreign director composition of less than 50% from those without foreign directors on the board. Director ethnicity can be obtained from Institutional Shareholder Services (ISS).

In addition, I also included various control variables. The control variables are related to M&A deal characteristics, board characteristics and financial statistics. The data were obtained from Thomson One, ISS and Compustat respectively. A detailed explanation of the research design is provided in Chapter 3.

1.5 Findings

The results from regression analysis show mixed outcomes. I translated shareholders' wealth into cumulative abnormal returns around the announcement date and premium paid by the acquirer. First, when it comes to cumulative abnormal returns, a foreign director on the board has a positive impact on cumulative abnormal returns because shareholders assume that a foreign director can realize solutions to cultural issues in a cross-border M&A. Nonetheless, this factor has a low coefficient and R-squared. Hence, I conclude foreign director in the board has minor impact on cumulative abnormal returns around announcement date. Meanwhile, it gave a different outcome regarding premium paid. The relation between a foreign director and premium paid is not

significant. This is because the target firm may have a higher bargaining power and there are other types of board diversity which can have a massive impact on the premium paid by the acquirer during cross-border M&A.

1.6 Structure

In order to answer the research question, an adequate structure was organized. Chapter 2 presents a literature review and development of the hypotheses. Chapter 3 explains the research design and all variables included in the regression equation. Chapter 4 reports the empirical results from the data analysis. Last, chapter 5 draws conclusions, describes the limitations of this research and provides suggestions for future research.

2. Literature Review

This research relates to two streams of literature: corporate governance and cross-border M&A. Many researchers have mentioned that it is especially important to focus on corporate governance and that it has an impact on a firm's performance. This chapter explains which corporate governance aspects can affect cross-border M&A. First, an explanation about agency theory is provided to clarify why corporate governance is important. This is followed by an explanation of corporate governance, and thereafter, an explanation of cross-border M&A.

2.1 Agency Theory

Why does agency theory exist? Initially, this theory arose because of the agency relationship. An agency relationship is an agreement between two entities, a principal and an agent, whereby one entity will act on behalf of others (Jensen & Meckling, 1976). In essence, an agent will act on the principal's behalf when it comes to how a firm operates.

Every firm has two major roles: shareholders and executives. Shareholders are people who provide economic benefits as resources so firms can operate, while executives are the ones who utilize these economic benefits and make business decisions on behalf of the shareholders. These two separate roles give rise to the agency relationship which leads to agency conflict where there is a possibility of an agent acting solely in his personal interest, without taking the principal's interest into account. In addition, the contract between shareholders and executives doesn't provide insurance that shareholders will get a positive return on their investment. Hence, this kind of relationship may be misused by executives and give rise to agency conflict.

A lack of information flow between shareholders and executives also arises because of the agency relationship. Asymmetric information happens when executives have more access to information that is available about the firm's position. In this case, executives can utilize this information and create all sorts of activities that can increase their own wealth instead of shareholders' wealth (Shleifer & Vishny, 1997). Moreover, asymmetric information leads to lack of monitoring. Many shareholders are often too insignificant, as individuals, and too poorly informed to take control of monitoring what executives do. Despite the disadvantages of agency conflict, this condition occurs in every firm. Hence, many researchers have tried to find the solution to mitigate agency conflict.

Corporate governance is considered as a mechanism to mitigate agency conflict. Corporate governance is a mechanism to ensure that agents make decisions out of concern towards maximizing the value for the principal (Denis & McConnell, 2001); another definition is that corporate governance is a system for ensuring that shareholders will get a return on their investment (Shleifer & Vishny, 1997). Denis & McConnell (2001) mentioned that corporate governance can be classified into four tools, i.e. the board of directors, equity ownership, the takeover market and the legal system. For this research, I will focus on the board of directors.

2.2 Board of Directors

Corporate governance is referred to as the solution of agency conflict, part of which is the board of directors. The board of directors is assigned to protect shareholders' interests as their general objective. Board members are elected by shareholders after executives propose candidates who will sit on the board (Denis & McConnell, 2001). The responsibilities of a board of directors is to assign executives, approve the firm's strategy and set executive compensation (Adams, Hermalin, & Weisbach, 2010).

A board of directors is responsible for hiring, firing and assessing executives, and, furthermore, for instating a CEO. There are two components to the objectives of a board of directors, which are monitoring what the CEO does and evaluating the CEO's ability to run the firm (Adams, Hermalin, & Weisbach, 2010). In their model, Hermalin and Weisbach (1998) found that a board of directors updates its beliefs regarding the incumbent CEO based on his/her performance. In this case, a board of directors can dismiss the incumbent CEO and have him/her replaced.

Another responsibility of the board of directors is to approve the firm's strategy. Dominguez-Martinez, Swank, and Visser (2008) argued that there are two types of CEOs, the good CEO and the bad CEO. The definition is based on a project's profit which the CEO chooses. A good CEO will pick projects that maximize shareholders' value and put his or her own interest aside. A bad CEO, on the other hand, will do the opposite. Hence, this is when the board of directors will intervene. The board of directors obliges the CEO to change strategy.

Last, a board of directors is responsible for determining executive compensation. As economic actors, executives may be wealthier by being an executive in a particular firm. A board of directors may see this condition, which can mitigate agency conflict. Core, Guay, and Larcker (2003) said that executives' compensation and firm performance are growing overtime. Thus, the

board of directors uses this phenomenon to set executives' compensation in order to increase the firm's performance and outcome, so that shareholders' wealth increases.

In essence, it is important to discuss the topic of the board of directors because of the complexity and various characteristics involved. A board characteristic can be classified based on independence, size and diversity. In line with the research question, I explain board diversity in depth, while the other two elements will be touched on briefly.

2.2.1 Board Independence

A board's independence represents the board's position from the moment it is established whether it will be executive or non-executive in nature. An executive board means it has inside directors otherwise it has outside directors. Ibrahim and Angelidis (1995) stated that when it comes to protecting shareholders' interests, an outside director is more beneficial. This is because independent directors do not have conflicting interests as the executive board (Sonnenfeld, 1981). However, an independent director is not necessarily always good for a firm. An inside director can have an advisory role, while an independent director can have a monitoring role. A diversified firm, a large firm or firm that has high leverage tends to have greater advising requirements. Thus, it needs a director who knows the firm better than an independent director does (Coles, Daniel, & Naveen, 2007).

2.2.2 Board Size

Board size relates to the number of directors assigned to a board. Boards can be divided into small and large boards. Research on this topic gives many mixed results regarding the optimal number of board members. Some may support the phrase "less is more". Lipton and Larsch (1992) argued that when a board has more than ten members it becomes harder for them to give an opinion. Moreover, a large board may also be less efficient due to complex coordination, the possibility of free riding and costs will increase as well (Yermack, 1996). Meanwhile, Coles, Daniel and Naveen (2007) argued differently: they said that complex firms not only need more advisory roles, they also need to have large boards. Harris and Raviv (2008) stated that a large board will not necessarily have a larger number of directors but it will have a more independent directors and better expertise. Overall, there is no strict rule on how many members a board should have.

2.2.3 Board Diversity

Board diversity has become a hot topic nowadays. Burton (1991) argued that diversity requires members with certain characteristics and various forms of experience which might effectively bring a new perspective and new ideas. Within the context of corporate governance, diversity relates to a board's composition of attributes, characteristics and expertise held by each individual who sits on the board (Walt & Ingley, 2003). Mishra and Jhunjhunwala (2003) argued that board diversity also refers to the heterogeneous composition of the board regarding gender, age, race, education, experience, nationality, lifestyle, culture, religion, and many other facets that make all of us unique as individuals.

The reason why board diversity has become a popular topic is because of globalization. Gender, race, culture and education have become significant components of corporate governance facing managers, directors, and shareholders in the modern corporation (Fidanovski, Simeonovski, & Mateska, 2014). The significance lies in two components. First, a diverse board has access to external networks, information, and other external characteristics which can be beneficial to a firm. Second, a diverse board gives better results by making the firm more profitable (Carter, D'Souza, Simkins, & Simpson, 2010).

A diverse board nourishes discussion which leads to better decision-making compared with a homogenous board (Smith, Smith, & Verner, 2006). In connection with the globalization challenges faced by firms nowadays, board diversity, which has become a popular topic of discussion, should be adopted by every firm. In addition, many researchers have started to investigate the influence of board diversity, which may be defined as the variety inherent in the board's composition (Campbell & Miguez-Vera, 2007).

In general, board diversity is divided into two aspects, i.e. the observable (demographic) and the non-observable (cognitive). Elements of observable diversity are gender, age, race and ethnicity, while the elements of non-observable diversity are knowledge, education, values, perception, affection and personality characteristics (Erhardt, Werbel, & Shrader, 2003).

2.3 Cross-Border M&A

M&A first started to emerge during the twentieth century and it is already recognized as a major economic tool for doing business. M&A occurs for efficiency-related reasons. It means

economies of scale or other “synergies” for building market power. During the past century, M&A have already taken place, as can be seen from the M&A wave. The wave started in 1893-1904 (horizontal mergers) and then continued in 1919-1929 (manufacturing and transportation mergers), 1955-1969 (conglomerates), 1984-1989 (junk bonds and hostile takeovers) and the last wave documented was around 1993-2000 (megadeals). The megadeals wave was the starting point of cross-border M&A (Andrade, 2001).

The growth in cross-border M&A has been massive and conveys the globalization of industry on an international level. Hence, cross-border M&A should be included among managerial decisions to realize a business expansion strategy. Shimizu, Hitt, Vaidyanath, and Pisano (2004) argued that cross-border M&A has specific benefits, for example, as a tool to enter a new market, create a new opportunity by learning new knowledge and new skills (Shimizu, Hitt, Vaidyanath, & Pisano, 2004).

2.3.1 Relationship between Cross-Border M&A, Globalization & Cultural Fit

A domestic M&A and a cross-border M&A are not similar. The differences that exist are where cultures, regulations, and economic structures are different between firms (Hofstede, 1980). Because of these differences, cross-border M&A can be used to grab the advantages of a new opportunity or to avoid a future threats and expand a market (Shimizu, Hitt, Vaidyanath, & Pisano, 2004). Furthermore, a cross-border M&A gives incremental benefits in the form of new knowledge and new competencies (Shimizu, Hitt, Vaidyanath, & Pisano, 2004). This condition supports the idea of cross-border M&A as a potential mode of entry into a foreign market (Anderson, 1997) and how to deal with the rapid growth of globalization. By engaging in a cross-border M&A, acquirers can gain important access to local resources, local markets, technology and a better understanding of local regulations.

Unfortunately, this noble objective is not easy to achieve. For instance, the examples of DaimlerChrysler and Walmart show that cross-border M&A is not an easy task. Cultural differences were mentioned as a reason why a cross-border M&A doesn't run smoothly. Most likely, post-M&A integration is a potential major challenge in relation to most M&A activity, whether domestic or cross-border (Shimizu, Hitt, Vaidyanath, & Pisano, 2004). When it comes to cross-border M&A, this challenge is affected by the cultural differences between two firms and countries. The integration problem is referred to as “double layered acculturation” (Barkema &

Vermeulen, 1996). Nahavandi and Malekzadeh (1998) argued that every event can be different, depending on the degree of integration required. The more integration needed, the higher the level of coordination required. Thus, the cultural differences aspect will become increasingly important.

Chatterjee, Lubatkin, Schweiger and Weber (1992) examined the cultural differences that exist between two firms. They found that shareholders are more anxious when the cultures between acquirer and the target appear incompatible, while they are supportive when the cultures seem compatible. Thus, executives should pay more attention to cultural fit during a cross-border M&A process in order to create integration and synergy with one another. Hitt, Dacin, Tyler and Park (1997) also examined cross-border M&A between U.S. firms and Korean firms. They found executives from different countries tend to apply different control systems and different business systems in the target firms. Besides, national culture, government regulations, and the country's infrastructure also have an effect. Moreover, these obstacles can disrupt the integration process.

As it is important to consider cultural fit during a cross-border M&A, because this can influence a firm's performance, many researchers have tried to find important elements capable of dealing with this situation. Datta and Puia (1995) argued that an acquirer who is trying to manage a cross-border M&A process should take cultural integration into account. Hence, culture and business styles have a significant impact on cross-border M&A performance (Larsson & Finkelstein, 1999). Sales and Mirvis (1984) found that certain issues can arise when there are cultural differences. They documented in detail administrative conflicts following an acquisition when the firms involved had strong cultural differences. Buono, Bowditch and Lewis (1985) found that the wider the cultural gap between two firms, the greater the discomfort and hostility during post-cross-border M&A. They argued that firms' members are strongly attached to their culture. Hence, integrating two firms with different cultures can pose a serious problem. Furthermore, Datta (1991) found that differences in business styles between firms were negatively associated with shareholders' wealth creation during the acquisition of firms. If this aspect escapes the attention of the executives, it can result in a domino effect.

Cultural differences can be perceived as a threat to both firms and lead to higher acquisition costs (Cartwright & Cooper, 1992). Shane (1992) also supported the idea that cultural differences relate with trust levels. The more trust issues there are, the more this can impact the transaction costs. Moreover, cultural differences in cross-border M&A can present a problem during post-cross-border M&A, specifically in transferring knowledge or distinctive competencies between

the two firms, which may prove difficult (Geringer, Beamish, & DaCosta, 1991). In addition, the wider the cultural gap, the lower the likelihood that the acquirer has sufficient knowledge regarding the target firm's market, which then might increase any costs involved in retrieving that knowledge (Doukas & Travlos, 1988). In summary, the lack of cultural fit between the acquirer and the target can be expected to have a negative impact on the performance of cross-border M&A, and reduce the wealth effects on the acquirer's shareholders.

Cultural differences may form obstacles during cross-border M&A, but this does not mean a firm should not consider it as a strategy to enter the global market. Various researches are being conducted to find the best solution to these problems. A typical cross-border M&A that merges different cultures into one is an interesting topic to examine. Hence, many researchers are interested in how these issues can be solved.

2.4 Cross-Border M&A & Foreign Director in Board – The Advantages

In continuation of the discussion of board diversity and cultural fit in a cross-border M&A, many researchers are examining the relationship of these factors with foreign directors on the board (Masulis, Wang, & Xie, 2012; Miletkov, Poulsen, & Wintoki, 2013; Alabdullah & Ferris, 2013). A foreign director on the board comes from a different culture than the country where the firm is incorporated (Alabdullah & Ferris, 2014). A foreign director on the board can address the problems faced by both the acquirer and the target during a cross-border M&A. He can ensure better M&A performance based on his advisory skill related with to his knowledge and experience working in other countries (Masulis, Wang, & Xie, 2012). This same process can also help the related firm to gain global experience and to expand internationally (Adams, Hermalin, & Weisbach, 2010). A firm will experience unfamiliar business regulations, an unfamiliar environment, culture, consumer preferences and industry structure when it engages in a cross-border M&A. Thus, a foreign director's knowledge of their home country or region and their close connections with local business, social, and political circles can be helpful (Masulis, Wang, & Xie, 2012). Similarly, concerning the issue of cultural differences, Moeller and Schlingemann (2005) argued that the acquirer performs badly in a cross-border M&A compared to a domestic M&A. A foreign director can mitigate this through leverage in the form of his international expertise and he or she can focus on deals involving targets from the same region as that of the foreign director in the board (Masulis, Wang, & Xie, 2012). Alabdullah and Ferris (2014) found that a foreign director is more likely to

engage in cross-border M&A because, as mentioned before, cross-border M&A involves different regulations, a different culture, and a business challenge that only a foreign director can address. Thus, a foreign director on the board can help bridge the cultural differences between the acquirer and the target (Alabdullah & Ferris, 2014). As mentioned previously, focusing on the country of employment of the foreign director, Masulis, Wang and Xie (2012) argued that a foreign director on the board can lead to better performance if the country of employment – the country where someone is listed as a full-time employment – the same as the target country during cross-border M&A. They argued that a foreign director on the board enhances the advisory capability as the extent of living or working in a foreign country where they can provide first-hand knowledge of the target markets and enables them to develop a foreign network contracts. In summary, foreign directors can give better result when it comes to cross-border M&A because of the knowledge and experience they have for firms that want to expand internationally (Adams, Hermalin, & Weisbach, 2010).

2.5 Cross-Border M&A & Foreign Director in Board – The Disadvantages

Similarly, to the two sides of a coin, having a foreign director in the board is not necessarily advantageous for a firm's performance. Foreign director in the board, as one of the types of board diversity, may face problems establishing mutual trust and understanding among members. Ibarra (1993) said that the problem faced by diversity on board is that of restriction of internal information. This means that foreign director in the board is considered as an outsider and has the restriction on internal information. Furthermore, diverse members are regarded as having a different technical language and perspective (Mishra & Jhunjhunwala, 2013). For instance, during decision-making, the controversy may arise due to different arguments. This condition can be potentially disruptive among board members (Amason, 1996) and lead to costs for the coordination of problems and decision-making. In line with this, Turner & Hogg (1987) argued that diversity may also disrupt team dynamics. For example, a different nationality and culture can result in complex communication patterns and styles of interaction, multinational or multi-ethnic groups may experience conflict, lower cohesiveness, and slower decision-making (Earley & Mosakowski, 2000).

2.6 Hypotheses Development

Continuing the previous discussion, I am interested in how a foreign director in the board can lead to better performance with cross-border M&A. In this section, I focus on developing my hypotheses. I build my hypotheses based on a theoretical construct and the empirical results of past literature as discussed in the previous section.

2.6.1 Shareholders' wealth creation from cross border M&A

As discussed earlier, the agency theory is an inevitable consideration when forming a firm. The board of directors has a duty to protect its shareholders' interests from management's self-interest. Shareholders' interests are often associated with maximizing shareholders' wealth. This means that shareholders must get returns on their investment. Andrade (2001) argued that M&A is one of the tools for increasing shareholders' wealth by achieving a market capitalization goal. Furthermore, globalization is a wide-ranging subject that keeps on growing. Depamphilis (2012) stated that the answer to globalization is company diversification, so cross-border M&A has become the hot topic of discussion nowadays. This means, in order to combine shareholders' interests and keep up with the global market, a firm may become involved in cross-border M&A as one of the strategies for staying competitive in its field. This is easy to say but hard to implement, as Cartwright and Cooper (1993) found a high rate of failure among cross-border M&A which was largely due to incompatible cultures. Koguth and Singh (1988) also argued that cultural differences can manifest themselves into problems that form a burden on the integration process related to cross-border M&A. Hence, as stated before in the previous section in relation to cross-border M&A and cultural fit, a foreign director is considered capable of facilitating positive performance in a cross-border M&A.

How is positive performance in cross-border M&A determined? Many researchers use the reaction of the stock market towards an announcement of M&A. In an efficient capital market, shareholders will react to any public information from the market, including information related to an M&A transaction. By analyzing the market reaction, researchers know whether shareholders see the transaction as creating or destroying value (Andrade, 2001).

Datta and Puia (1995) also used the stock market reaction when examining cumulative abnormal returns during the announcement date of a cross-border M&A transaction. They found that shareholders experience negative returns impacted by cross-border M&A because of the cultural distance between the acquiring firm and the target firm. With regard to the previous

explanation about cross-border M&A and cultural fit, Masulis, Wang and Xie (2012) tried to investigate the negative relationship between cumulative abnormal returns and cultural distance by examining whether there was a foreign director on the board or not. They found that having a foreign director from the same region as the target firm led to better cumulative abnormal returns. This outcome also aligns with Alabdullah and Ferris (2014) who found that, during the announcement period, an acquiring firm with a foreign director experiences higher cumulative abnormal returns compared to those without. Using these outcomes, I have tried to examine whether having a director on the board who has the same ethnicity as the target firm can lead to better results on cumulative abnormal returns. Hence, I formulated my first hypothesis as follows:

H1: A shareholder in the acquiring firm which has a foreign director on the board with the same ethnicity as the target firm will experience higher cumulative abnormal returns at the announcement date of a cross-border M&A transaction

2.6.2 Premium Paid

As this research focuses on shareholders' wealth, this section explains the relationship between a foreign director on the board and the premium paid upon acquisition during cross-border M&A. On every deal, whether a domestic or cross-border M&A, a certain amount has to be paid to close the deal. Payment by the acquiring firm will follow the valuation of the target firm, whereby company valuation is a subjective and imprecise matter. Thus, uncertainty may explain why premiums vary so widely. Harford, Humphery-Jenner, and Powell (2012) argued that overpayment can lead to shareholders' wealth destruction. Baker, Pan, and Wurgler (2012) also agreed that paying a higher premium is often associated with loss in shareholders' value. Such overpayment occurs if the acquiring firm has overestimated its ability, due to over-confidence, to manage the target firm (Roll, 1986). The target firm valuation process is harder during a cross-border M&A due to unfamiliar markets and limited information availability (Davis, Shore, & Thompson, 1991).

In the same spirit as for the previous hypothesis, a foreign director in the board is considered capable of mitigating the overpayment experienced by the acquiring firm. Issues regarding an unfamiliar market and limited information availability can be solved by having a foreign director in the board. This is due to the existence of social networks between people with shared

similarities, in this case ethnicity and cultural values between the foreign director and the target firm. Granovetter (1973) called this a weak-ties relationship where social connections generate material, fresh and non-redundant information for the board. Baker, Pan, & Wurgler (2012) argued that during cross-border M&A a foreign director can create fruitful negotiations which can result in a lower price paid by the acquiring firm. A foreign director can act as a facilitator and reduce any conflict over price that might arise during negotiations (Baker, Pan, & Wurglar, 2012). Based on this assumption I formulated the second hypothesis as follows:

H2: An acquiring firm that has a foreign director on the board with the same ethnicity as the target firm can experience a lower premium on a cross-border M&A transaction

3. Research design

To answer the research question and examine the above-mentioned hypotheses, a research design must be created. This chapter explains the gathering of all the samples, the definitions of the variables and the regression equation used to examine all the hypotheses.

3.1 Sample & data collection

The main focus of this research is cross-border M&A. Therefore, I started with a sample construction from a cross-border M&A transaction. To be included in the sample, I determined certain requirements as follows:

1. The announcement date of M&A activities should have occurred between 1 January 2002 and 31 December 2016.
2. The acquirer should have acquired more than 50% of the target's shares in order to be categorized as having acquired control of the target firm.
3. The acquirer should be located in the United States of America while the target firm should be located in another country in order for the transaction to be considered as cross-border M&A.
4. The acquirer must be publicly listed as collecting cumulative abnormal returns, for corporate governance data and for financial data.
5. The related acquiring firm must have a detailed director's profile, especially in relation to ethnicity in order to define whether a director is a foreign director or not.

I extracted a relevant sample and data from several datasets. First, I used Thomson One to extract cross-border M&A transactions including details of the transaction. For example, the total deal value and deal characteristics. Then, I merged the respective dataset with Institutional Shareholder Services (ISS). ISS covers various aspects of board characteristics including a director's ethnicity which is the main focus in this research. Furthermore, I used Compustat to extract accounting information. Lastly, I obtained the value of cumulative abnormal returns from Datastream. All datasets were merged using an identifier of 6 digits of CUSIP and the year of M&A.

3.2 Definition of Variables

3.2.1 Dependent Variables

For each hypothesis, I used a different dependent variable. In H1, in order to predict a shareholder's wealth, I used cumulative abnormal returns (CAR) as the impact of a foreign director's presence during cross-border M&A. In H2 I used premium paid (PREMIUM_PAID) by the acquiring company as the dependent variable in order to find whether a foreign director can successfully realize a better negotiation or deal price so the transaction has a lower premium. The description for all dependent variables is explained below:

3.2.1.1 Cumulative Abnormal Returns

In order to measure a shareholder's wealth, I used cumulative abnormal returns ($CAR_{t,i}$). $CAR_{t,i}$ was introduced by Fama, Fisher, Jensen, & Roll (1969). They found $CAR_{t,i}$ is an effective variable to represent market reaction due to a rapid change based on new information. In addition, previous research also included $CAR_{t,i}$ as a proxy for a shareholder's wealth (Servaes, 1991; Kang, 1993; Datta & Puia, 1995). Normally, $CAR_{t,i}$ is calculated as cumulated from the day before the initial announcement date until a specific date after the announcement which researchers think is the best length for the period of time to capture a market reaction (Servaes, 1991). The announcement date itself is defined as date 0 and a common event window used is two days (-1,0) because it represents the immediate market reaction on the announcement date (Datta & Puia, 1995). A shareholder's wealth increases when the cumulative abnormal returns are positive, while the shareholder's wealth decreases when the cumulative abnormal returns are negative. Hence, I expect the presence of a foreign director to cause higher cumulative abnormal returns on cross-border M&A.

I extracted cumulative abnormal returns by several steps. First, I had to select an estimation window to calculate the expected average returns. An estimation window is a benchmark of market reaction within the announcement date and the normal expected market returns. Following Servaes (1991), I chose 210 trading days as the estimation window. Second, I set a specific event window to measure abnormal returns and I chose event window (1,0) because, as I explained earlier, it can show how the market reacts immediately on the announcement day. Last, I input SEDOL as an identifier that can easily be obtained from Thomson One to realize cumulative abnormal returns for a selected acquiring firm from the sample.

3.2.1.2 Premium paid

Unlike cumulative abnormal returns, the premium paid by the acquiring firm can determine whether a shareholder's wealth can benefit from cross border M&A. As explained before, a foreign director is expected to result in a better deal and lead to lower premiums paid by the acquiring firms. I measured premium paid as the difference between the offering price and the target stock price 4 weeks before the announcement date. Both sets of respective data could be obtained from Thomson One. Then, I used a natural logarithm of premium paid (LN_PREMIUM) as the dependent variable in H2.

3.2.2 Independent Variables

Unlike the dependent variables used in this research, I used the same independent variables for both H1 and H2. A detailed explanation of the independent variables is provided below.

3.2.2.1 Foreign Director

In line with the main interest of this research, I chose the foreign director as an independent variable. Masulis, Wang, and Xie (2012) define a foreign director by means of the director's country of employment, while Alabdullah and Ferris (2014) define a foreign director by the director's nationality. In this research, I defined a foreign director based on the director's ethnicity. I created a dummy variable equal to 1 if the director's ethnicity is the same as the majority ethnicity of people living in the target's country and otherwise equal to 0. Hereafter, I sum up the total number of foreign directors. Using this variable, I defined which firm has no foreign director, one foreign director or multiple foreign directors. In essence, I used the sum of foreign director (FD) as the first independent variable.

In addition, Alabdullah and Ferris (2014) argued that a foreign director has an advantage of giving new perspective, but at the same time he affects harmony within the board. At first, a foreign director can have positive effects that help the acquiring firm get to know about the target firm in terms of culture, corporate governance, economic conditions and business environment, but if the foreign director has a majority power on the board, this can create potential problems. For example, destroy the wealth of shareholders in the acquiring firm. Hence, I categorized the foreign director by using a dummy variable, where 1 is a foreign director composition of less than 50% and

otherwise 0 (FD_COMP). Based on this definition, I expect a positive coefficient for both independent variables in H1 and a negative coefficient in H2.

3.2.3 Control Variables

Various control variables were included in the regression equation to minimize the error term on the regression model. Control variables were selected based on their impact on cross-border M&A which I had gathered from previous research. The control variables are explained in detail in the next section.

3.2.3.1 Board size

Board size as a corporate governance component is considered as an important determinant for an M&A deal. Amar and Boujenoui (2011) found that board size affects value creation in an M&A deal. In addition, Masulis, Wang and Xie (2012) also found a correlation between board size and – specifically – a cross-border M&A deal. Hence, I included board size as a control variable (BOARD_SIZE) where total board size is the total director in the board who sits on the board during the fiscal year of the cross-border M&A.

3.2.3.2 Cash Payment

According to Myers and Majluf (1984), stock issuance sends out a bad signal to respective shareholders. This belief is commonly known as the Pecking Order Theory. Stock issuance is regarded as a last resort to be used. Asymmetric information is the main reason why this happens. Shareholders might think the issuance of shares leads to lack of confidence among board members who feel that the share price is over-valued which then leads to a drop in the share price. Therefore, based on the pecking order theory, a company should finance itself through internal finance or cash rather than from debt financing and the last option is stock issuance. Hereafter, I created a dummy variable (CASH_PAYMENT) to define which firm used a 100% cash payment to close the deal on their cross-border M&A transaction as 1, and otherwise 0.

3.2.3.3 Firm Size

When entering firm characteristics, I included firm size as one of the control variables. Firm size is considered as one of the components that can affect M&A performance both in domestic

and cross-border M&A (Datta, Iskandar-Datta, & Raman, 2001). Alternatively, directors of a larger firm will be more committed and apply a higher level of quality to all decision-making including an M&A deal (Masulis, Wang, & Xie, 2012). Therefore, I used a natural logarithm of market capitalization (LN_MKVALT) to represent firm size.

3.2.3.4 Leverage

Leverage can be a tool to reduce agency conflict. Kang (1993) argued that leverage can reduce managerial discretion over the allocation of the free cash flow and provide a mechanism for a director to monitor management. I measured leverage (LEV) as the proportion of total debt to total assets.

3.2.3.5 Free Cash Flow

In line with the leverage explanation above, free cash flow should be considered too as it will affect managerial actions in creating their own benefit and not considering the shareholders' wealth. Based on this assumption, I also included free cash flow as a control variable. I measured free cash flow (FCF) from a firm's operating income before depreciation, minus interest expenses, minus income taxes, minus capital expenditures, divided by the book value of total assets (Masulis, Wang, & Xie, 2007).

3.2.3.6 Firm Value

I also controlled for firm value in this regression model. Firm value indicates managerial performance and the ability to generate better cross-border M&A performance (Lang, 1989). I use Tobin's Q as a proxy for firm value (TOBINS_Q) which is calculated as a proportion of the acquirer's market value of assets to the acquirer's book value of assets. The market value of assets is calculated as the book value of assets minus the book value of common equity, plus the market value of common equity.

3.2.3.7 Firm Profitability

Then I controlled for firm profitability (FIRM_PROFITABILITY) because it is believed to be one of the things considered by shareholders before determining whether the M&A deal will have a positive outcome or not (Morck, Shleifer, & Vishny, 1988). In order to measure firm profitability, I used EBIT to total assets.

3.2.3.8 Firm Risk

I controlled firm risk because M&A performance may correlate with risks borne by the acquiring firm. Firm risk (FIRM_RISK) is measured by the ratio of retained earnings in the prior year to total assets in the prior year (Altman, 1968).

3.2.3.9 Year Fixed effect

The year fixed effect was included in this research to control the time effect during cross-border M&A. Thomsen, Pedersen, and Kvist (2006) said that the year fixed effect is used to determine whether the year in which the transaction occurred influences the merger and acquisition activity.

Table 1: Variable Description

Variable	Measurement
$FD_{i,t}$	Total foreign director who sits on the board is 1 if director's ethnicity is the same as the major ethnicity of people living in the target country
$FD_COMP_{i,t}$	The percentage of foreign directors who sit on the board
$BOARD_SIZE_{i,t}$	Total number of directors who sit on the board
$CASH_PAYMENT_{i,t}$	1 if cross-border M&A deal 100% paid in cash
$LN_MKVALT_{i,t}$	Natural logarithm of market capitalization
$LEV_{i,t}$	Proportion of total debt to total assets
$FCF_{i,t}$	Operating income before depreciation, minus interest expenses, minus income taxes, minus capital expenditure, divided by the book value of total assets
$TOBINS_Q_{i,t}$	Proportion of market value of assets to book value of assets
$FIRM_PROFITABILITY_{i,t}$	Proportion of EBIT to total assets
$FIRM_RISK_{i,t}$	Proportion of retained earnings to total assets

3.3 Regression equation

Following the explanation of the variables used, in this section I present the regression equation. I performed an OLS-regression model to examine H1 and H2. Hereby my regression equation for these hypotheses are:

H1:

$$CAR_{i,t} = \alpha + \beta_1 FD_{i,t} + \beta_2 FD_COMP_{i,t} + \beta_3 BOARD_SIZE_{i,t} + \beta_4 CASH_PAYMENT_{i,t} + \beta_5 LN_MKVALT_{i,t} + \beta_6 LEV_{i,t} + \beta_7 FCF_{i,t} + \beta_8 TOBINS_Q_{i,t} + \beta_9 FIRM_PROFITABILITY_{i,t} + \beta_{10} FIRM_RISK + YearFE_i + \varepsilon_{i,t}$$

H2:

$$LN_PREMIUM_{i,t} = \alpha + \beta_1 FD_{i,t} + \beta_2 FD_COMP_{i,t} + \beta_3 BOARD_SIZE_{i,t} + \beta_4 CASH_PAYMENT_{i,t} + \beta_5 LN_MKVALT_{i,t} + \beta_6 LEV_{i,t} + \beta_7 FCF_{i,t} + \beta_8 TOBINS_Q_{i,t} + \beta_9 FIRM_PROFITABILITY_{i,t} + \beta_{10} FIRM_RISK + YearFE_i + \varepsilon_{i,t}$$

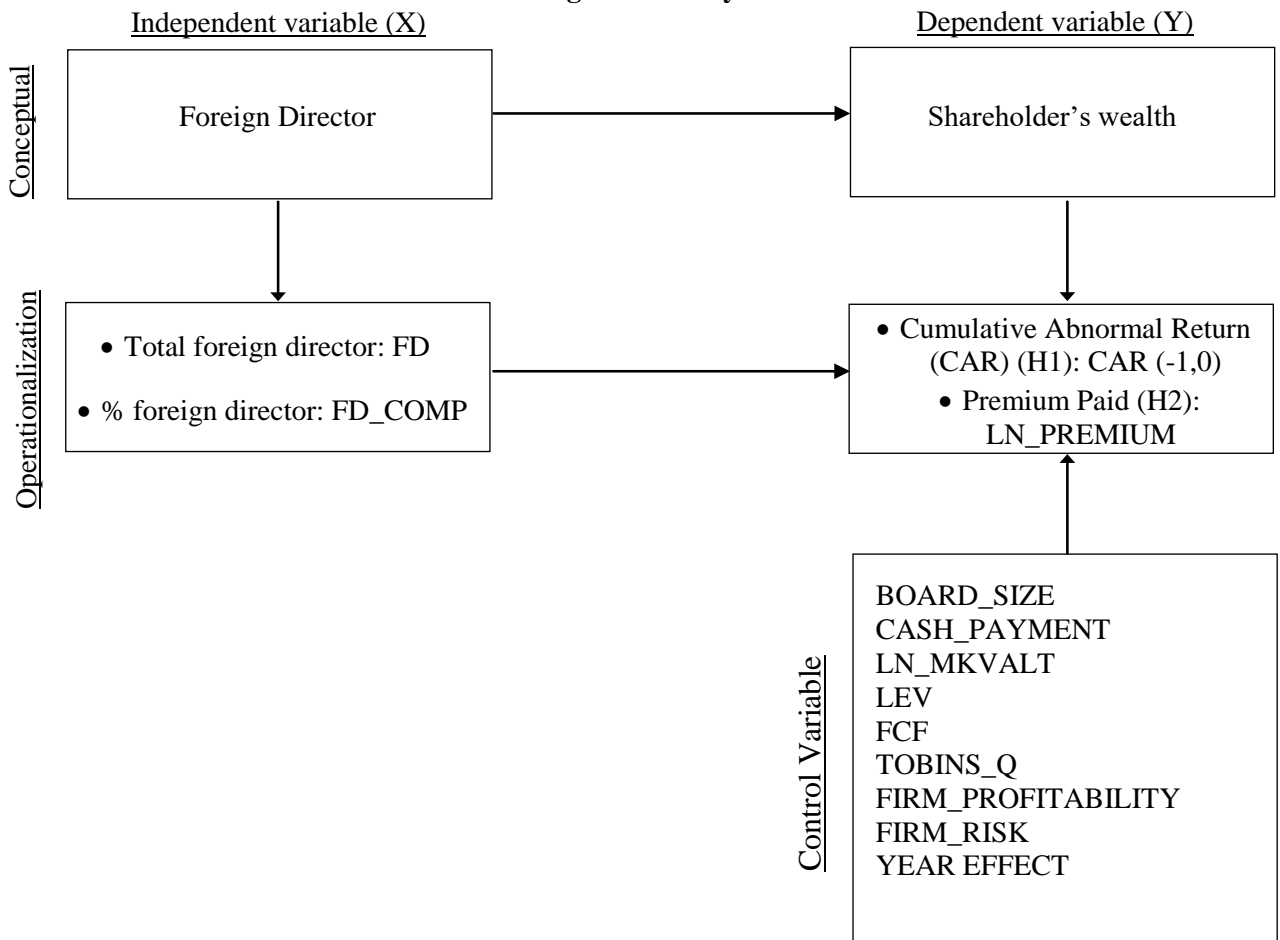
With:

i = Acquirer firm

t = year of merger and acquisition transaction activity

Based on the regression equations above, figure 1 represents theoretical constructs and operational proxies for H1 and H2 in a Libby Box. The Libby box shows the conceptual of the relevant relationship and its corresponding operationalization (Libby, Bloomfield & Nelson, 2012).

Figure 1: Libby Box



4. Results

This chapter presents the results of the regression equation. All regression equations were performed using Stata. First, before explaining the regression equations, several classic assumptions were made. I started with a normality test then continued to determine heteroscedasticity and correlation analysis. Afterwards, the results of the regression equations are presented along with the conclusion based on the outcome.

4.1 Classic Assumptions

First, before I explain the regression results, I performed a normality test. In this test, I must ensure that the residual from the regression results is normally distributed. In order to determine a normal distribution, I used a histogram graph. The histogram graph shows that the residual in both H1 and H2 are normally distributed.

Second, it is important to certify that all error terms in the regression equation have the same variance or error terms must be homoscedasticity instead of heteroscedasticity. Hence, I performed a heteroscedasticity test for both hypotheses. For H1, the heteroscedasticity shows the regression result is free from heteroscedasticity where H1 is significant at a 1% level. Similar to previous hypotheses, H2 is also free from heteroscedasticity with a 1% significant level.

Last, I performed a correlation analysis to certify there is no possible multicollinearity between two independent variables. Multicollinearity between two independent variables means they are highly correlated which lead to vague regression results. In this research, I use a Pearson correlation matrix and the Variance Inflation Factor (VIF) method to perform correlation analysis. Using a Pearson correlation matrix, two variables are referred to as highly correlated when the result is close to either +1 (perfect positive correlation) or -1 (perfect negative correlation) and in the VIF method two variables are referred to as highly correlated when the result is 10 or higher. Table 2 shows multicollinearity test, Panel A presents a Pearson correlation matrix for all variables used in the regression equation. Based on all the numbers shown in the table, there are no correlation issues in all variables used in this research. Table 2, Panel B presents a correlation analysis using the VIF method. Similar to the Pearson correlation matrix, there are no correlation issues.

Table 2: Multicollinearity test

Panel A: Pearson Correlation Matrix										
	FD	FD_COMP	BOARD_SIZE	CASH_PAYMENT	LN_MKVALT	LEV	FCF	TOBINS_Q	FIRM_PROFITABILITY	FIRM_RISK
FD	1.000									
FD_COMP	-0.351	1.000								
BOARD_SIZE	-0.047	0.526	1.000							
CASH_PAYMENT	-0.028	-0.015	-0.051	1.000						
LN_MKVALT	-0.024	0.216	0.516	-0.039	1.000					
LEV	-0.015	0.091	0.165	0.009	0.102	1.000				
FCF	0.064	-0.002	0.024	-0.009	0.194	-0.090	1.000			
TOBINS_Q	0.015	-0.054	-0.171	0.0403	0.074	-0.384	0.271	1.000		
FIRM_PROFITABILITY	0.012	0.014	0.008	-0.022	0.246	-0.031	0.823	0.290	1.000	
FIRM_RISK	0.026	0.067	0.099	-0.040	0.126	-0.039	0.389	0.020	0.431	1.000

Panel B: Variance Inflation Factor (VIF) Method		
Variable	VIF (H1)	VIF (H2)
FD	1.19	1.18
FD_COMP	1.69	1.66
BOARD_SIZE	2.34	2.34
CASH_PAYMENT	1.02	1.03
LN_MKVALT	1.57	1.59
LEV	1.29	1.29
FCF	3.29	3.31
TOBINS_Q	1.43	1.42
FIRM_PROFITABILITY	3.75	3.76
FIRM_RISK	1.33	1.32

Panel A: Multicollinearity test using Pearson Correlation Matrix, whereby two variables are highly correlated if the outcome is between +1 and -1

Panel B: Multicollinearity test using VIF method, whereby two variables are highly correlated if the outcome is 10 or higher.

Using both methods, there was no multicollinearity in all variables used.

4.2 Descriptive Statistics

Table 3 presents the descriptive statistics of all related variables. In total there were 2,702 firms, 53% (2002-2016) of which have one foreign director, while only 31% (2002-2016) of the firms have no foreign director at all. In terms of absolute numbers, the highest number of firms without a foreign director was in 2011 (78), while the lowest was in 2002 (41). Compared with firms with one foreign director, the highest number was in 2012 (118), while the lowest was in 2002 (75). In terms of percentages, the highest percentage without a foreign director was in 2011 (36%) while the lowest percentage without a foreign director was in 2016 (25%). Compared with firms with one foreign director, the highest percentage was in 2014 and 2016 (58%) and the lowest percentage was in 2011 (48%).

Table 4 presents a comparative table of all variables between firms with no foreign director, firms with one foreign director and firms with multiple foreign directors. On average, there is no difference in terms of cumulative abnormal returns across all firms. Meanwhile, in terms of premium paid, firms with one foreign director paid less (4.773) compared to the other two. Firms with no foreign director paid the highest premium (5.056) among the two types of firms. Firms with no foreign director are larger in terms of market capital (8.865) and leverage (0.202), but on the other hand firms with one foreign director and multiple foreign directors have a higher firm value, as reflected by Tobin's Q (4.867; 5.200). In terms of firm risk, firms with multiple foreign directors have the highest firm risk (0.317), followed by firms with one foreign director (0.272) and then firms with no foreign director (0.269).

4.3 Regression Results & Analysis

A foreign director is considered as having a positive effect during cross-border M&A, and to answer my hypotheses, I executed a regression equation as explained above in the previous chapter. Table 5, column 1 presents a regression model regarding H1, where the event window is (-1,0). The main focuses in this column are the total number of foreign directors (FD) and foreign director composition which is less than 50% (FD_COMP). We can see that, in column 1, neither of the two independent variables gave a positive coefficient and were statistically significant.

Table 3: Descriptive Statistic

Year	# of firms	# of firms with no FD	# of firms with one FD	# of firms with multiple FD	% of firms with no FD	% of firms with one FD	% of firms with multiple FD
2002	136	41	75	20	30%	55%	15%
2003	149	44	85	20	30%	57%	13%
2004	187	58	104	25	31%	56%	13%
2005	173	52	96	25	30%	55%	14%
2006	204	68	102	34	33%	50%	17%
2007	152	42	76	34	28%	50%	22%
2008	183	63	93	27	34%	51%	15%
2009	143	47	80	16	33%	56%	11%
2010	187	64	92	31	34%	49%	17%
2011	219	78	106	35	36%	48%	16%
2012	226	69	118	39	31%	52%	17%
2013	190	67	100	23	35%	53%	12%
2014	188	51	109	28	27%	58%	15%
2015	181	55	95	31	30%	52%	17%
2016	184	46	106	32	25%	58%	17%
Total	2,702	845	1437	420	31%	53%	16%

When the dependent variable is CAR (-1,0), the result for FD has a coefficient of -0.000 and is statistically insignificant. Moreover, for FD_COMP, the result has a coefficient -0.000 and is statistically insignificant. In essence, with an event window of (-1,0), there is no change with regard to the effect of a foreign director on cumulative abnormal returns.

In order to investigate the negative coefficient and statistical insignificance, I replaced event window (-1,0) with a various possibility event window. Magenheimer and Mueller (1988) argued that, within a small event window (-1,0), markets are not always capable of predicting immediately any possibility impact of cross-border M&A. Hence, following that assumption, I chose several event windows that are presented in columns 2 to 5. First, I chose event window on date -1 and made the length wider until date 5 and date 10. All the results are presented in columns 2 (CAR (-1,10)) and 3 (CAR (-1,5)) respectively. In column 2, total FD has a positive coefficient amounting to 0.003 and was statistically significant at a 5% level of significance. Moreover, FD_COMP gives a positive coefficient amounting to 0.016 and is statistically significance at a 5% level of

Table 4: Comparative Statistic

Variable	With no FD			With one FD			With multiple FD		
	Mean	Median	Std. Dev	Mean	Median	Std. Dev	Mean	Median	Std. Dev
CAR10	0.002	0.000	0.031	0.001	0	0.027	0.001	0	0.029
LN_PREMIUM	5.056	5.410	1.436	4.773	4.573	1.705	4.991	4.961	1.348
BOARD_SIZE	8.559	9	3.554	7.723	8	3.534	8.009	9	3.466
CASH_PAYMENT	0.176	0	0.381	0.224	0	0.417	0.15	0	0.357
LN_MKVALT	8.865	8.781	1.633	8.383	8.229	1.541	8.718	8.475	1.664
LEV	0.202	0.185	0.150	0.198	0.187	0.153	0.192	0.182	0.142
FCF	0.063	0.063	0.071	0.072	.068	0.056	0.076	0.074	0.043
TOBINS_Q	4.611	3.106	5.813	4.867	3.395	4.847	5.200	3.835	6.471
FIRM_PROFITABILITY	0.102	0.096	0.084	0.105	0.096	0.073	0.106	0.099	0.059
FIRM_RISK	0.269	0.301	0.484	0.272	0.291	0.480	0.317	0.306	0.267

Table 5: Regression Results

Variables	1	2	3	4	5	6
	CAR(-1,0)	CAR(-1,10)	CAR(-1,5)	CAR(1,5)	CAR(1,10)	LN_PREMIUM
	Coefficient (Robust Std. Error)	Coefficient (Robust Std. Error)	Coefficient (Robust Std. Error)	Coefficient (Robust Std. Error)	Coefficient (Robust Std. Error)	Coefficient (Robust Std. Error)
FD	-0.000 (0.000)	0.003* (-0.001)	0.002 (-0.001)	0.003** (-0.001)	0.004*** (-0.001)	-0.008 (0.008)
FD_COMP	-0.000 (0.002)	0.016* (-0.006)	0.012* (-0.005)	0.012** (-0.005)	0.016** (-0.006)	0.053 (0.041)
TOBINS_Q	0.000 (0.000)	0.001 (0.000)	0.000 (0.000)	0.000 (0.000)	0.001 (0.000)	0.002 (0.001)
BOARD_SIZE	0.000 (0.000)	-0.001 (-0.001)	0.000 (0.000)	0.000 (0.000)	-0.000 (-0.001)	-0.002 (0.004)
CASH_PAYMENT	-0.000 (0.001)	0.001 (-0.003)	0.001 (-0.003)	0.002 (-0.002)	0.001 (-0.003)	-0.257 (0.038)
LN_MKVALT	-0.000 (0.000)	0.001 (-0.001)	0.000 (-0.001)	0.001 (-0.001)	0.001 (-0.001)	-0.008 (0.007)
LEV	-0.000 (0.005)	0.009 (-0.011)	0.003 (-0.009)	0.003 (-0.008)	0.010 (-0.010)	0.044 (0.056)
FCF	-0.013 (-0.019)	-0.085 (-0.056)	-0.057 (-0.043)	-0.044 (-0.040)	-0.072 (-0.052)	0.757 (0.204)
FIRM_ PROFITABILITY	0.003 (-0.015)	-0.016 (-0.036)	0.007 (-0.028)	0.003 (-0.026)	-0.020 (-0.033)	0.108 (0.156)
FIRM_RISK	-0.001 (-0.001)	0.000 (-0.007)	-0.003 (-0.006)	-0.003 (-0.005)	0.000 (-0.006)	-0.009 (0.019)
Observations	2,033	2,033	2,033	2,033	2,033	2,033
R-squared	0.004	0.019	0.018	0.025	0.023	0.068
Year fixed effect	Yes	Yes	Yes	Yes	Yes	Yes

*Superscript *, **, *** indicate significance of the coefficients at 5%, 1% and 0.1% significance levels respectively.*

significance. Moving to column 3, the results are as follow: FD is positive amounting to 0.002 but statistically insignificant with cumulative abnormal returns, though FD_COMP has a positive coefficient amounting to 0.012, it is statistically significant at a 5% significant level. Afterwards, I chose another event window that started right after the announcement date or date 1.

In column 4, I used event window (1,5) and in column 5 I used event window (1,10). In column 4, both the main variables are positive and statistically significant. FD has a positive coefficient amounting to 0.003 at a 1% significance level and FD_COMP has a positive coefficient 0.012 at a 1% significance level. Moving to column 5, this also shows similar result to previously. FD has a positive coefficient amounting to 0.004 at a 0.1% significance level and FD_COMP has a positive coefficient 0.016 at a 1% significance level. The results are in line with the assumption that a foreign director can lead to better cumulative abnormal returns for the acquiring firm as assumed earlier during the hypothesis development phase. In addition, Alabdullah and Ferris (2014) argued that higher cumulative abnormal returns due to a foreign director, as perceived by shareholders, can give harmonization, culture alignment, and synergy which have a positive impact on shareholders' wealth. These findings support the prediction of H1, claiming that a foreign director on the board whose ethnicity is the same with target firm will experience higher cumulative abnormal returns. But there is another concern regarding small coefficient and low R-squared. In H1 we see the coefficient is positive and statistically significant, but frankly, the number is too small. Other than that, the R-squared is also relatively low. R-squared refers to how close the data are with the fitted regression line. A high R-squared means the data is fitted with regression line while a low R-squared means otherwise. In this case, foreign director is considered has small ability to explain the dependent variable, cumulative abnormal returns. This issue also faced by Masulis Wang and Xie (2012) who observed a low R-squared on their research. The potential explanation for this problem is due to endogeneity problem. They stated there might be other factors related to the cross-border M&A but not adequately controlled in the regression equation. Datta and Puia (2001) said there are such factors would impact directly the cross-border M&A like other corporate governance characteristics and target firm characteristics which not included in this research. Furthermore, similar to previous explanation, board diversity has various type which can impact cross-border M&A other than ethnicity (Barkema & Vermeulen, 1996). Overall, because of the complexity of corporate governance and cross-border M&A, foreign director on the board is not the primary determine how well cross-border M&A performance to

increase shareholder's wealth. Furthermore, it implies that foreign director has minor contribution to cumulative abnormal returns.

Moving to H2, I changed the dependent variable in H2 to premium paid (LN_PREMIUM). In this section, I examine the relationship between a foreign director and premium paid by the acquiring firm. Table 5, column 5 presents the regression results. The presence of FD shows a negative coefficient amounting to -0.008 and regarding FD_COMP it shows a positive coefficient amounting to 0.053. But both independent variables are statistically insignificant. Thus, H2 is rejected.

The possible explanation as to why the results are statistically insignificant could be various types of board diversity. Beckman and Haunschild (2002) did research regarding the relationship between board diversity and premium paid by the acquiring firm during a cross-border M&A. They found the amount of premium paid can be affected by many types of diversity in relation to each of the board members for example previous experience and knowledge. Other board members might have experience in the same industry or may have been working in a related country. Thus, information regarding the value of the target firm can be obtained not only based on similarity of the cultures but also based on knowledge or past experience of board members (Jehn, Northcraft, & Neale, 1999).

Another possible explanation is that the target firm has greater bargaining power. Initially, the acquirer should convince the target to accept the offer price but this negotiation is often not favored because the target wants to stay independent or to be acquired by a third party (Betton, Eckbo, & Thorburn, 2008). Hence, even smooth negotiations can't overcome the possible threat from other bidders or target firm willingness to stay away from a cross-border M&A.

5. Conclusion

This chapter provides the conclusion regarding the overall results from this research. First, the results are summarized. Hereafter, the contribution of this research to literature is explained. Next, the limitations are discussed and suggestions are made regarding further research.

5.1 Main Results

The following research question was formulated in the introduction as below:

RQ: Does a foreign director create shareholder's value during cross-border M&A?

The following are two hypotheses I formulated to answer the research question about whether shareholders' wealth is translated into cumulative abnormal returns during the announcement date and a premium is paid by the acquiring firm. Hence, the hypotheses are as follows:

H1: A shareholder in the acquiring firm which has a foreign director on the board with the same ethnicity as the target firm will experience higher cumulative abnormal returns during the announcement date of a cross-border M&A transaction

and

H2: An acquiring firm that has a foreign director on the board with the same ethnicity as the target firm can experience a lower premium on a cross-border M&A transaction

In order to test the above hypotheses, I used OLS regression to minimize error prediction in the regression equation. The results show that cumulative abnormal returns and total foreign director have a negative coefficient that is statistically insignificant. Similar results were also obtained with regard to foreign director composition. If a firm has less than 50% foreign director on its board, then the relationship with cumulative abnormal returns has a negative coefficient that is statistically insignificant. At first, I used cumulative abnormal returns in a 2-day event window (-1,0) and then I changed to several event windows (-1,5), (-1,10), (1,5), (1,10), based on the belief that a market can't immediately absorb the new information completely. The results show a different outcome than in the past. For all remaining event windows, the cumulative abnormal returns gave a positive coefficient that is statistically significant. This also applies to foreign director composition. In all four event windows, a firm with a foreign director composition less than 50% has a positive coefficient that is statistically significant. Thus, H1 is accepted.

In addition to cumulative abnormal returns, I also examined shareholders' wealth from premium paid upon acquiring a firm. The results show that total foreign director has a negative coefficient while foreign director composition less than 50% has a positive coefficient. Both independent variables are statistically insignificant. Some researchers give a possible explanation as to why a foreign director does not have much impact when it comes to negotiations on the offering price. First, it may be due to many types of board diversity. Not only can a foreign director has the advantage of privilege or confidence regarding the target's value, but also other types of board members. For example, a board member who has been working in a related country or a similar industry can also have beneficial information which can affect the premium paid by the acquirer. Second, it may be because of the target's bargaining power. For instance, if many bidders are trying to acquire the target concerned, then eventually the acquirer should increase the offering price and this will lead to a higher premium paid by the acquirer.

5.2 Contributions

Overall, the results of this thesis contribute to research about the relation between foreign director on the board and cross-border M&A performance. The findings of this thesis should be relevant for shareholders and firm that need information to pursue cross-border M&A. In this research, I specify foreign director on the board of director as the member whose ethnicity is the same with the target firm. Meanwhile, other research only defines foreign director as the member whose bear different culture with the acquiring firm (Masulis, Wang, & Xie, 2012; Miletkov, Poulsen, & Wintoki, 2013; Alabdullah & Ferris, 2013).

By using director's ethnicity as proxies of to determine foreign director on the board, this research provides evidence that foreign director on the board could increase cumulative abnormal returns at announcement date. But when it comes to the degree of impact, I found minor impact of foreign director on the board and cumulative abnormal returns. Moreover, this research could not find significant relation between foreign director on the board and premium paid by acquiring firm. Hence, I conclude foreign director on the board is not primary concern to enhance cross-border M&A. But I encourage for further research to examine foreign director's role during cross-border M&A with more comprehensive model where other corporate governance types and deal characteristics to be included in the next research because there are lots of research support cultural fit as one of reason to be measured during cross-border M&A.

5.3 Limitations and Suggestions for Future Research

There are some limitations to this research which should be kept in mind. First, the model may be subject to the omission of a variable bias. There is a possibility that other variables, which were not included in the regression equation, have a significant influence on cross-border M&A performance even though control variables and year fixed effect were introduced in the regression equation. As mentioned previously, Datta and Puia (2001) said there are factors that would impact the cross-border M&A directly, such as other corporate governance characteristics and target firm characteristics which are not included in this research. I didn't include other corporate governance characteristics due to focusing on director's ethnicity. Regarding, target firm characteristics, due to unavailability data I couldn't gather target firm characteristics.

Second, this research has a low external validity. This relates to the sample construction which only included firms from the United States of America. For example, Campa & Hernando (2004) argued that different geographical dimensions of a M&A deal can differentiate the outcome of cumulative abnormal returns.

Third, I defined foreign director in a different context from previous research, e.g. Alabdullah and Ferris (2014) used a director's nationality, and Masulis, Wang and Xie (2012) used a director's country of employment. In relation to the theoretical construct of cultural differences, it is more appropriate to use a director's nationality, but due to limited access to the required data, I used the director's ethnicity instead.

In addition, there is limitation regarding sample selection bias. This limitation happens because I restrict the sample only acquiring firm that located in US and publicly listed. Moreover, firms which located other than US and also going private are not included in the sample. Sample selection bias could harm external validity. Hence, same like point two, this research has low external validity. Overall, those limitations can be improved for the further research.

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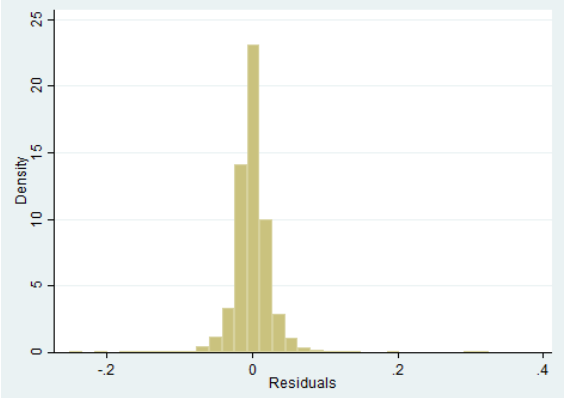
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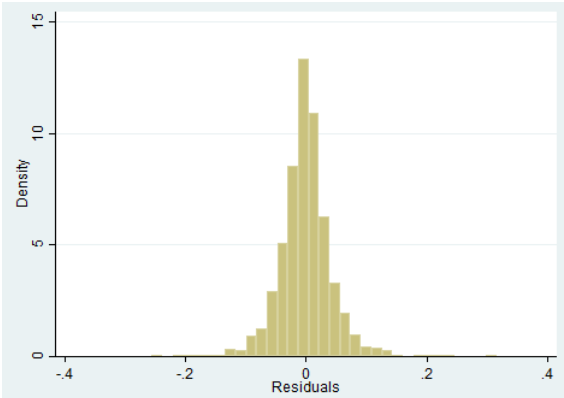
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Appendix A – Normality Test

Histogram of Normality Test



H1



H2