6-2010

Do shareholders or stakeholders appropriate the rents from corporate diversification? The influence of ownership structure

Parthiban DAVID
American University

Jonathan P. O'Brien
Rensselaer Polytechnic Institute

Toru YOSHIKAWA
Singapore Management University, toru@smu.edu.sg

Andrew DELIOS
National University of Singapore

DOI: https://doi.org/10.5465/AMJ.2010.51469005

© Academy of Management Journal
2010, Vol. 53, No. 3, 636–654.

DO SHAREHOLDERS OR STAKEHOLDERS APPROPRIATE THE RENTS FROM CORPORATE DIVERSIFICATION? THE INFLUENCE OF OWNERSHIP STRUCTURE

PARTHIBAN DAVID
American University

JONATHAN P. O'BRIEN
Rensselaer Polytechnic Institute

TORU YOSHIKAWA
McMaster University

ANDREW DELIOS
National University of Singapore

Prior work on the performance consequences of corporate diversification has treated all powerful owners as seeking the same benefits from diversification (i.e, higher profit rather than growth) and therefore limiting value appropriation by other stakeholders such as employees and managers. In contrast, we distinguish between domestic "relational" owners and foreign "transactional" owners in Japanese corporations. Although transactional owners do indeed prioritize profitability when diversifying, relational owners primarily seek growth rather than profits from diversification. Furthermore, relational owners also allow managers and employees to appropriate more of the rents arising from diversification than do transactional owners.

A central question in corporate strategy research concerns the nature of the relationship between performance and diversification (for reviews, see Hitt, Tihanyi, Miller, and Connelly [2006]; Hoskisson and Hitt [1990]; Palich, Cardinal, and Miller [2000]; and Ramanujam and Varadarajan [1989]). Both product and geographic diversification can facilitate the leveraging of a firm's competencies and enable it to exploit opportunities in multiple markets. However, the bureaucratic and agency costs associated with diversification can impair firm performance (Collis & Montgomery, 1997; Lu & Beamish, 2004). An implicit assumption in the extensive research on the relationship between diversification and firm performance is that all firms should diversify with the same objective: to maximize the profit (returns) to shareholders. Yet this assumption stands in opposition to much existing work in strategy that emphasizes the importance of stakeholders (Freeman, 1984) as well as differences among shareholders (David, Kochhar, & Levitas, 1998; Hoskisson, Hitt, Johnson, & Grossman, 2002; Kochhar & David, 1995).

The rent appropriation perspective (Coff, 1999) provides a useful lens for understanding how a firm's stakeholders can influence both the type and distribution of the firm's returns from the implementation of a particular corporate strategy. Most other stakeholders are priority claimants relative to shareholders. They have contracts with the firm, albeit sometimes implicit, that guarantee them payments equal to or greater than their "opportunity costs," and they can resort to court adjudication if those contracts are violated. Shareholders, as residual claimants, forego the benefit of contractually guaranteed returns and face greater risk. Managers should therefore run a firm, within the confines of the law, so as to maximize the riskier returns of shareholders, while limiting stakeholder claims to opportunity costs (Friedman, 1970). However, some stakeholders may be able to appropriate the "economic rents" that accrue from diversification by obtaining payments in excess of their opportunity costs. Hence, a firm's diversification strategy may yield economic rents but may, nevertheless, fail to yield performance returns for shareholders if other stakeholders appropriate those economic

We thank Dave Ketchen, our action editor; the three anonymous reviewers; Bob Hoskisson, Hicheon Kim, Mark Sharfman, and Bill Wan; and workshop participants at American University, Syracuse University, the University of Oklahoma, and the Mitsubishi UFJ Foundation International Conference for their helpful comments.

rents. We propose that a more complete understanding of the performance implications of diversification requires paying close attention to the performance goals and bargaining power of various stakeholder groups, in particular the powerful owners that vie to appropriate economic rents.

The governance literature addresses rent appropriation concerns as an "agency problem" involving conflicts of interest between two major stakeholder groups, owners and managers, over the potentially conflicting goals of growth and profit (Amihud & Kamin, 1979; Brush, Bromiley, & Hendrickx, 2000; Marris, 1964). Agency theorists contend that sales growth may provide managers with private benefits such as high pay, power, status, and prestige. Accordingly, managers favor higher levels of sales growth than is optimal for shareholder profit maximization. As weak owners are unable to sufficiently constrain managerial opportunism through governance, managers implement diversification strategies that generate higher growth that benefits managers but yields lower profits for shareholders (Kim, Hoskisson, & Wan, 2004).

Although existing research on the relationships between ownership, diversification, growth, and profits is insightful, it is also incomplete in at least one important respect. Owners differ not just in their power but also in their performance goals (Hoskisson et al., 2002). Although much of the research on ownership heterogeneity concerns U.S. corporations (David et al., 1998; Hoskisson et al., 2002; Kochhar & David, 1995), Japan presents an interesting contrast among owners. The 1990s marked a significant shift in the ownership structure of Japanese corporations that Ahmadjian and Robbins (2005) termed a "clash of capitalisms." In this clash, two important groups came into conflict: the traditional "relational" owners (typically domestic corporations and financial institutions that rarely sell their shares and have close relational ties with firms) and a new set of "transactional" owners (mostly foreign institutional investors from the United States and the United Kingdom with only arms'-length relationships with the Japanese firms in which they hold shares). As transactional owners lack the multiple business relationships with a firm that typify relational owners, they can only appropriate rents from the firm in the form of financial profits (i.e., dividends and share price appreciation). Relational owners, however, appropriate rents both from financial profits and from firm growth. Growth yields additional return to relational owners because of their multiple business relationships. Thus, dissenting from the assumption in prior work that all powerful owners appropriate rents solely through higher profits, we propose that some powerful owners may appropriate rents through growth and may influence a firm's managers accordingly.

We further extend prior work by considering how the power and identity of a firm's owners affect the returns of other stakeholders. In addition to benefiting the firm's owners, diversification may also benefit other stakeholders—for example, by enhancing the career advancement opportunities and job security of employees (Wang & Barney, 2006) and executives (Rose & Shepard, 1997). Although stakeholder considerations have universal importance (Wang & Barney, 2006), they are especially salient in Japan, where companies have an institutionalized commitment to stakeholders other than shareholders (Aoki, 1988; Kester, 1991). Coff (1999) argued that shareholders can appropriate more economic rents when they have bargaining power to restrict the flow of rents to other stakeholders. A simple application of rent appropriation might suggest that all powerful owners will seek to appropriate rents for themselves by limiting those appropriated by other stakeholders. To the contrary, we propose that the performance goals of powerful owners shape the extent of value appropriation by other stakeholder groups. Prior work has noted that relational owners, unlike transactional owners, are supportive of implicit contracts with stakeholder groups such as lifetime employees (Ahmadjian & Robbins, 2005; Ahmadjian & Robinson, 2001; Yoshikawa, Phan, & David, 2005) and core suppliers (Kester, 1991), thus facilitating greater value capture by these stakeholders.

Diversification can thus serve as a means to multiple ends. These ends can be either consistent or conflicting. In this study, we develop theory to explain why different types of owners may accrue different types of benefits from diversification, and hence may encourage managers to pursue diversification for divergent reasons. Furthermore, these divergent performance goals can have weighty consequences for a firm's other stakeholders.

Our empirical results indicate that relational owners emphasize growth, but transactional owners emphasize profit. The relationship between corporate diversification and profit is stronger with transactional than with relational ownership. Conversely, the relationship between corporate diversification and growth is stronger with relational than with transactional ownership. Furthermore, we find that relational ownership facilitates greater value capture by stakeholders from diversification than does transactional ownership. Our results indicate that diversification provides greater benefits for other stakeholders in a firm, such as its employ-

ees and executives, when relational ownership is high than when transactional ownership is high.

THEORY AND HYPOTHESES

Ownership Structure and Identity: Relational and Transactional Owners in Japan

Domestic financial institutions such as banks and insurance companies and domestic nonfinancial corporations have traditionally held a large proportion of the shares of Japanese corporations (see Sheard [1994] for a review). Financial institutions provide loans and other financial services to the firms, such as brokerage, and nonfinancial corporations are typically the suppliers or customers of the firms. Even in the absence of direct business relationships, norms of reciprocity bind owners to provide mutual support when firms experience financial difficulties. Traditionally, shares have been held reciprocally and, although publicly tradable, have rarely been sold.

The economic downturn of the 1990s marked a dramatic shift in the ownership structure of Japanese corporations. The economic downturn made it difficult for financially troubled long-term owners to maintain their historic levels of ownership in affiliated firms (Dvorak, Guth, Singer, & Zaun, 2001). Foreign investors often stepped in to purchase these shares (Yoshikawa & Gedajlovic, 2002), resulting in a net shift of ownership toward foreign investors. Foreign owners gained increasing prominence and power as their average stakes increased from 4.2 percent in 1990 to 13.2 percent in 2000, while domestic ownership by financial institutions and nonfinancial corporations dropped from 70.4 to 59.3 percent (Ahmadjian & Robbins, 2005). These foreign owners were predominantly portfolio investors from the United States and the United Kingdom, which accounted for 32 and 39 percent, respectively, of all foreign shareholdings in Japan in 1997 (Bank of Japan, 2004).

In Japan, foreign owners differ from domestic owners in several critical ways. First, domestic owners typically have large block holdings, but foreign shareholdings are typically dispersed among a very large number of investors. Second, major domestic owners are often suppliers of goods and services to the firms they own shares in, but foreign owners usually do not have any business relationships with the firms in which they have ownership positions. Third, domestic owners tend to hold their shares for the long term, but foreign owners tend to trade their shares frequently. Thus, if a firm encounters problems, foreign owners are able to sell their shares and disassociate themselves from the firm. Domestic owners, rather than selling their shares, tend to provide mutual support to help firms weather their financial difficulties (Sheard, 1994). Accordingly, we label domestic owners "relational" because they are long-term owners with complex performance goals. Domestic owners do not just seek financial gains from their shareholdings in firms—they also have other business and reciprocal relationships with those firms that yield benefits (Aguilera & Jackson, 2003; Porter, 1992; Rousseau, 1995). Furthermore, we describe foreign owners as "transactional" (Rousseau, 1995) because they obtain returns solely from their shareholdings and lack other relationships with the firms in which they have ownership positions.

Although both transactional and relational owners can influence a firm's managers, they differ in the nature and source of the influence exercised. Relational owners often obtain representation on a firm's board of directors (Kaplan & Minton, 1994) to gain a subjective understanding of strategic issues. Most large Japanese firms borrow from multiple banks but maintain a closer relationship with a "main bank," typically the largest lender and owner, which takes a lead role in monitoring the firms on behalf of other relational owners (Aoki & Patrick, 1994). When firms face financial difficulties, relational owners, led by "main banks," act in concert to help firms work through their problems by providing capital and exchanging goods and services on advantageous terms (Hoshi & Kashyap, 2001). Empirical evidence has affirmed the profit redistribution contention, wherein relational owners "tax" profitable firms to benefit poorly performing firms that need financial assistance (Gedajlovic & Shapiro, 2002; Lincoln, Gerlach, & Ahmadjian, 1996). Board membership and delegated monitoring by a main bank grants relational owners considerable influence in this profit redistribution process. Thus, although relational owners depend on a firm for business (Kochhar & David, 1995), this dependency is mutual, and through the governance safeguards described above, relational owners gain considerable influence.

Although transactional owners lack direct influence derived from board representation, the threat of selling shares provides them with considerable influence. As Ahmadjian and Robbins noted, "Foreigners were known for pulling out of a stock very quickly when they were unhappy" (2005: 457). Foreign owners traded extensively, accounting for nearly 30 percent of all stock transactions in 1996, although they held just 10 percent of aggregate stock ownership (Ahmadjian & Robbins, 2005). Further, foreign owners often exhibit herd behavior (Kamesaka, Nofsinger, & Kawakita, 2002) that cre-

ates a snowball effect that can significantly impair stock prices. Sell-offs can signal that a firm is poorly managed, thus increasing the threat of default and raising the cost of capital (Bhojraj & Sengupta, 2003; Brennan & Tamarowski, 2000). As financially distressed relational owners sometimes need to cash out their investments, Japanese managers have been pressured to attract and retain foreign owners to avoid the negative consequences of sell-offs. Japanese managers have therefore been responsive to the expectations of foreign owners about reducing costs and maximizing profits. Prior research has shown that foreign ownership fosters value-enhancing strategic investments (David, Yoshikawa, Chari, & Rasheed, 2006) and employee layoffs and divestitures (Ahmadjian & Robbins, 2005; Ahmadjian & Robinson, 2001), particularly in poorly performing firms (Yoshikawa et al., 2005).

Although they differ in how they exercise influence, both transactional and relational owners have the power to shape firm strategy. Below, we explain how the differences in the performance goals of transactional and relational owners can influence a firm's diversification strategy and the performance outcomes that accrue from that strategy.

Corporate Strategy, Profit, and Growth: A Rent Appropriation Perspective

Corporate strategy involves the pursuit of economic rents by leveraging competencies to sell goods and services in multiple markets (Collis & Montgomery, 1997). The performance consequences of diversification into multiple product and geographic markets has been a central question in strategy research (for reviews, see Hitt et al. [2006]; Hoskisson and Hitt [1990]; Palich et al. [2000]; and Ramanujam and Varadarajan [1989]). Although diversification can yield numerous benefits to a firm, such as scale and scope economies, increased bureaucratic and agency costs can impair performance (Lu & Beamish, 2004). Extensive empirical research has reported mixed results on the actual performance implications of diversification (Hoskisson & Hitt, 1990). It is important to note that when assessing performance, this research has emphasized the profits that flow to shareholders, as measured by accounting-based returns or stock market performance. However, the achievement of competitive advantage in a corporate strategy such as diversification does not necessarily yield higher performance returns for a firm's shareholders, because the rents created are often captured by the various stakeholders of the firm who contributed to value creation (Coff, 1999). The governance literature has addressed rent appropriation concerns as conflicts of interest between two major stakeholder groups, owners and managers, over the goals of profit versus growth (Amihud & Kamin, 1979; Brush et al., 2000; Marris, 1964).[1]

Considerable work has treated growth and profit as alternate measures of the performance benefits accruing to shareholders from diversification (Geringer, Tallman, & Olsen, 2000; Rumelt, 1974; Varadarajan, 1986). The neoclassical theory of the firm, however, shows that profit maximization is the desirable objective for shareholders and that growth is not always consistent with profit maximization (Baumol, 1959). Profit maximization requires firms to grow their sales to the optimal level, defined as the point at which marginal revenues from an added unit of sales equal the marginal costs. Although sales growth enhances profits when sales are below the optimal level, incremental sales growth erodes profits when sales are above the optimal level.

Even though growth above the optimal level can reduce shareholder profit, firms may often still pursue growth because it benefits a specific group of stakeholders. Sales growth can provide managers with private benefits such as higher pay, power, and prestige. Therefore, managers often favor higher levels of sales growth than is optimal for profit-oriented shareholders (Amihud & Kamin, 1979; Brush et al., 2000; Marris, 1964). Maximizing growth while ignoring profits could ultimately lead to financial distress, culminating in bankruptcy and concomitant adverse consequences for managers. Hence, Baumol (1959) explained that managers maximize growth subject to maintaining an acceptable level of profits in order to preserve the private benefits from high growth while avoiding the deleterious consequences from excessive growth. Thus, agency theorists have concluded that managers emphasize growth over profit (Amihud & Kamin, 1979; Marris, 1964), but owners prefer profit over growth.

The power of a firm's owners helps determine whether profit or growth will manifest as a firm's strategic intent. Managers shape corporate strategy, subject to the governance oversight provided by owners. Thus, the performance consequences of diversification should reflect the balance of power

[1] We follow prior research and label the rent appropriated by shareholders as profit. Neoclassical economic logic treats stakeholders as fixed factors of production and therefore leads to the conclusion that the residual profit remaining after paying various stakeholders is equivalent to economic profit. As noted, in the rent appropriation view, both shareholders and stakeholders can appropriate economic profit. Thus, shareholder profit is a subset of total economic profit.

between owners and managers (Marris, 1964). Prior research has shown that owner-controlled firms emphasize profits, and manager-controlled firms emphasize growth (Amihud & Kamin, 1979). Furthermore, in a study of Japanese business groups, Kim et al. (2004) reported that diversified firms emphasized growth over profits when governance oversight was weak but emphasized profits over growth when governance oversight was strong.

Although insightful, prior research is incomplete in that its implicit assumption is that all powerful owners will favor diversification as a means to increase profits rather than as a vehicle to generate sales growth. This view stands at odds with recent work that has shown that different groups of owners may have divergent performance goals (Hoskisson et al., 2002; Thomsen & Pedersen, 2000). Thus, although both relational and transactional owners can use their influence over managers to affect a firm's strategy—such as its level of diversification—the outcomes they are seeking from diversification may differ. Below, we explain how these differences can influence the types of performance consequences obtained from a diversification strategy.

Diversification and Performance Implications for Relational and Transactional Owners

Relational owners are also stakeholders, embedded in a network of relationships with the firms in which they hold ownership positions. Relational owners obtain returns both from the financial performance of the firms and from their multiple business relationships with them. Relational owners are therefore not solely concerned with the returns arising from the stock price appreciation and dividends that accrue from residual profits. Although as owners they cannot be indifferent to profit, their business relationships temper the importance of dividend payments and stock price appreciation. With reciprocal shareholdings, relational owners are unlikely to press firms for higher dividends because they must, in turn, pay out a commensurate amount of dividends to their own relational owners. They are also less concerned with variations in share price because shares are held as stable, long-term holdings that are rarely sold, except in the event of serious financial distress. Furthermore, at least until the late 1990s, Japanese corporations reported share values at purchase prices in accordance with accounting regulations, thus reducing any negative consequences to relational owners from write-downs to asset values (Ahmadjian & Robbins, 2005).

Although growth beyond the profit-maximizing level impairs profits, such growth can benefit relational owners in two ways. First, the opportunities for ancillary business relationships are enhanced as a firm's sales grow. Banks can underwrite more business loans and services, and suppliers of other goods and services can obtain more contracts as the firm diversifies and grows its sales. Second, the larger the firm, the lower the risk to survival from a hostile takeover or bankruptcy (Bercovitz & Mitchell, 2007).

As Kester noted, considering the complex blend of claims on the firms in which they invest, relational owners "may well accept subnormal rates of return on one component of its blend such as equity, provided it is able to compensate with supranormal returns on another part, such as the trading relationship" (1991: 59). Capturing value through business relationships rather than through dividends has the added advantage of reducing the amount of tax captured by government. Transactional owners, in contrast, lack business or other relationships with the firms in which they have ownership positions. Therefore, they obtain no benefits from sales growth per se and only benefit from the returns arising from arms'-length shareholdings: namely, the stock price appreciation and dividends that arise from residual profits. Hence, the relationship between diversification and firm performance should reflect the propensity for different types of owners to attempt to accrue rents from diversification in different ways. As transactional owners appropriate value solely from financial profits, they discourage excessive growth and induce managers to pursue diversification only when it enhances profits. In contrast, the multiple business relationships of relational owners allow them to appropriate rents from firm growth, and hence they will be much more tolerant of diversification that enhances growth beyond the profit-maximizing level. Thus, the extent to which diversification yields growth or profit will depend upon a firm's ownership structure, with relational owners emphasizing growth and transactional owners emphasizing profits.

Hypothesis 1. The relationship between diversification and profit is more positive with transactional ownership than with relational ownership.

Hypothesis 2. The relationship between diversification and growth is more positive with relational ownership than with transactional ownership.

Diversification and Performance Implications for Employee Stakeholders

The value created from diversification does not just flow to a firm's relational and transactional

owners, as other stakeholders, such as the employees and executives of the firm, can also appropriate it (Amihud & Lev, 1981; Wang & Barney, 2006). Diversification into new markets can lower the risk of job loss for employees because the returns from multiple markets are imperfectly correlated (Wang & Barney, 2006), which makes diversified firms less susceptible to bankruptcy or hostile takeover (Amihud & Lev, 1981). Furthermore, diversification provides career advancement prospects for existing employees by often necessitating growth in employment (Simon, 1947), and it may even spur higher employee salaries (Marris, 1964; Peoples, 1989; Schoar, 2002). As for the executives, diversification is associated with higher compensation (Rose & Shepard, 1997; Sanders & Carpenter, 1998) and diminished employment risk, as indicated by the lower performance sensitivity of pay (Anderson, Bates, Bizjak, & Lemmon, 2000) and reduced turnover in more highly diversified firms (Berry, Bizjak, Lemmon, & Naveen, 2006). Executives may also enjoy the high levels of power and prestige that are associated with managing a large firm (Jensen, 1986). However, these benefits may constitute a form of employee rent appropriation that reduces the rents available for owners. Prior research shows that powerful owners can limit the extent of stakeholder rent appropriation by curtailing executive (David et al., 1998; Hambrick & Finkelstein, 1995) and employee (Cronqvist, Heyman, Nilsson, Svaleryd, & Vlachos, 2009) compensation and by increasing the likelihood that managers will be fired for poor performance (Allen, 1981; McEachern, 1975). Although this research implies that all powerful owners limit the rents available to other stakeholders, we contend that owners differ in shaping the appropriation of the rents that accrue from diversification. We discuss two reasons why transactional ownership inhibits employee rent capture to a greater extent than does relational ownership.

First, the divergent performance goals of relational and transactional owners make relational owners more amenable to rent appropriation by stakeholders. As transactional owners prioritize profits, rent appropriation by employee stakeholders will reduce transactional owners' profits by a corresponding amount, and hence it poses a zero-sum outcome. As relational owners emphasize growth rather than profit, rent appropriation does not necessarily pose a zero-sum outcome because growth can provide increasing levels of benefits to both employee stakeholders and relational owners. Growth allows relational owners to appropriate value from enhanced business prospects while also allowing employee stakeholders to appropriate value in the form of higher salaries, enhanced career progress opportunities resulting form employment growth, and attenuated employment risk. Thus, though transactional owners are likely to use their power to limit employee rent appropriation, relational owners are less likely to do so.

Second, not only are the interests of employee stakeholders and relational owners generally better aligned than are the interests of employee stakeholders and transactional owners, but also, relational owners have incentives to exhibit forbearance with respect to the rent appropriation activities of stakeholders, especially in comparison to transactional owners. To preserve long-term business relationships, relational owners are more likely to desist from appropriating the quasi-rents of stakeholders such as employees, executives, and suppliers (Lincoln et al., 1996). Although such actions can hurt their own performance over the short term (Gedajlovic & Shapiro, 2002), these losses can be recouped from gains obtained through the security of future business relationships. Furthermore, the norm of reciprocity, whereby relational owners mutually safeguard each other from possible hostile takeovers and bankruptcy, directs firms to preserve their commitments to stakeholders because these firms in turn will provide assistance if relational owners find themselves in difficulties (Sheard, 1994). Transactional owners, by contrast, neither have business relationships nor any mutual safeguards, and thus they have incentive to limit the benefits accrued by stakeholders to maximize their own profit. Essentially, relational owners have economic incentives that can be met by a firm strategy that is convergent with the interests of employee stakeholders.

We contend that both managerial salaries and the size of a firm's workforce should reflect the greater tendency for transactional owners to limit rent appropriation by employee stakeholders. A longstanding argument in prior research in agency theory is that growth, which diversification generally produces, may allow managers to capture value through higher salaries (Jensen, 1986; Marris, 1964). Furthermore, as diversification generally increases the complexity of managerial tasks, it may provide managers an opportunity to justify higher salaries (Henderson & Fredrickson, 1996; Rose & Shepard, 1997). Existing research has already shown that managers can generally obtain more lucrative compensation packages from owners with business relationships (David et al., 1998). Although increases in diversification may sometimes warrant greater pay, relational owners will likely be much more generous than transactional owners because they not only favor growth over profits, but

may also anticipate reciprocal favors from the rewarded managers.

In terms of the size of a workforce, we have argued that both rank-and-file employees and executives may benefit from growth in the workforce. (Ahmadjian & Robbins, 2005; Ahmadjian & Robinson, 2001) have shown that foreign transactional ownership is associated with a greater prevalence of layoffs in Japanese firms, and relational domestic owners, who viewed lifetime employment as legitimate and appropriate, helped curtail this effect. Conversely, relational owners should also be generally more supportive than transactional owners of employment growth, and diversification may help serve as a prime vehicle for driving such growth. As Kester (1991: 15) noted, growth opportunities in their core businesses were sparse for Japanese corporations in the 1990s, and hence diversification into new markets served as a prime vehicle for fueling employment growth and "fulfilling the expectations of some key stakeholders (labor in particular)" (1991: 15). Similarly, relational owners may support diversification as a vehicle for avoiding layoffs by finding new roles for redundant employees. Thus, although transactional owners will only favor diversification that is undertaken to increase profits, growth-oriented relational owners, bolstered by norms of reciprocity, will be more inclined to support diversification that is undertaken as a means of firm growth that can support both higher managerial compensation and a greater number of employees.

Hypothesis 3. The relationship between diversification and growth in employment is more positive with relational ownership than with transactional ownership.

Hypothesis 4. The relationship between diversification and managerial compensation is more positive with relational ownership than with transactional ownership.

METHODS

Sample

We utilized a sample of Japanese firms, as this population provided the requisite variance in owner type—relational versus transactional—that we required to test our hypotheses (Ahmadjian & Robbins, 2005). Further, Japanese firms have engaged actively in international and product diversification activities since the late 1980s, providing a population with considerable variance on the diversification dimension (Lu & Beamish, 2004).

To construct our sample, we combined data from four sources. Most of our data for variables came from the Pacific-Basin Capital Markets (PACAP) database for Japan. We supplemented these data with information from the annual publication *Japanese Overseas Investments*, which was used to calculate our measure of international diversification. We used the *Japan Company Handbook* to calculate our measure of product diversification and the NEEDS database to construct our measures of employment growth and director salaries.

Our initial sample encompassed all 16,400 firm-year observations listed in both PACAP and *Japanese Overseas Investments* for 1990 through 2004. As small firms may be effectively locked out of foreign securities markets, we deleted the 576 firm-year observations for firms that had a book value of equity less than 3 billion yen (Anderson & Makhija, 1999). We also excluded firms in the highly regulated financial, public utilities, and communications sectors (225 firm-year observations). Furthermore, we also lagged the independent variables one year so that growth and performance over a given year were modeled as a function of the ownership structure at the end of the previous year. We believe this constitutes the most appropriate lag structure, as more distant predictors should be less influential, and contemporaneous measures tend to produce more endogeneity problems. As our theory was developed for foreign portfolio owners, we excluded the 31 firms in which foreign owners had substantial (large block) ownership interests that could be regarded as "relational." This exclusion resulted in a sample of 14,294 observations, encompassing 1,180 unique firms. However, the actual number of observations varied from model to model because the market information necessary for constructing our measure of profitability was sometimes missing; product diversification data were only available for the years 1992–2001, and we could not find unambiguous matches in NEEDS for some of the firms listed in PACAP.

Dependent Variables

We modeled two performance outcomes: growth and profit. The appropriate measure of firm growth depends upon the theoretical rationale for a study (Weinzimmer, Nystrom, & Freeman, 1998). Our theory suggests that relational owners may benefit as a focal firm's revenues increase. Hence, we assessed firm *growth* with the natural logarithm of year-over-year change in sales, specified as $\ln(sales_t/sales_{t-1})$ (Brush et al., 2000). Similarly, using data drawn from NEEDS, we measured *employment growth* as the natural log of year-over-year change in number of total employees: $\ln(employees_t/employees_{t-1})$.

To measure shareholder *profit*, we use Tobin's *Q*, which is the ratio of a firm's market value to the replacement cost of its assets (Morck, Shleifer, & Vishny, 1988). The market value of a firm was computed as the sum of the book value of its debt and the market value of its equity, and the replacement cost of assets was computed as the book value of total assets. The market value of a firm represents the stock market's capitalization of the expected present value of future cash flows discounted by an appropriate risk rate (Lindenberg & Ross, 1981). Montgomery and Wernerfelt (1988) noted two advantages of Tobin's *Q* as a measure of shareholder profit. First, it is less susceptible to accounting-based distortions because it relies on stock market values, unlike accounting-biased measures such as return on assets (ROA). Second, it is forward looking in incorporating not just current profitability, but also future profitability as gauged by the stock market valuation of future cash flows. Thus, Tobin's *Q* is a commonly used measure of firm profitability from a shareholder perspective (Lindenberg & Ross, 1981). Although we have noted some of the limitations associated with accounting-based measures, we found that tests using ROA yielded results that were substantively similar to the results we report using the market-based Tobin's *Q*.

Finally, the variable *salaries* was a proxy for managerial compensation using data from NEEDS on total director compensation, which includes base salary plus bonuses. Unlike firms in the United States, Japanese companies are not required to disclose the pay of individual executives and only report the total pay of all directors, which includes salaries, bonuses, fees, and other perks and benefits. Japanese companies have few and often no outside directors, and although some directors are likely affiliated to relational owners through past employment, they tend to be full-time employees of the firm on whose board they sit (Gerlach, 1992). Consequently, a firm's president and its top executives comprise most or all of its board of directors. Therefore, director pay, although not identical to executive pay, is a reasonable proxy that has been used as an indicator of executive pay in a number of studies (e.g., Joh, 1999; Kaplan, 1994; Murase, 1998; Xu, 1997).

Independent Variables

Our hypotheses relate to the outcomes of diversification. We expected product and international diversification to have similar effects, as both entail entering new markets and both can generate sales growth and impact profitability. Moreover, both may similarly benefit employee stakeholders. Intuitively, it may seem that internationalization merely substitutes foreign factors of production for domestic factors of production, potentially harming traditional domestic employee stakeholders. However, prior research has provided a more comprehensive view of international growth and has distinguished between the effects of substitution (i.e., international diversification may reduce demand for domestic labor as overseas labor is hired) and the effects of enhanced output (i.e., international diversification may raise demand for domestic labor because of increased international sales) (Chen & Ku, 2003). In practice, international diversification combines the substitution and the output effects. Research on Japanese corporations has shown that internationalization has generally tended to raise levels of domestic employment (Higuchi & Matsuura, 2003). Furthermore, international diversification is also likely to benefit suppliers because international expansion by a firm frequently helps its suppliers to expand overseas as well (Banerji & Sambharya, 1996; Martin, Swaminathan, & Mitchell, 1998). Thus, we believe that in general, the effects of international diversification should be similar to those of product diversification. Accordingly, we tested all of our hypotheses using both measures of product diversification and international diversification.

Following previous studies (Delios & Beamish, 1999; Lu & Beamish, 2004), we derived two count measures of international diversification from *Japanese Overseas Investments*. The first measure was a count of the total number of overseas subsidiaries that each firm had in a given year. The second measure was a count of the total number of countries in which a firm had overseas subsidiaries in a given year. We then combined these two measures and created an index of international diversification following the method used by Lu and Beamish (2004). Specifically, to convert the count measures into ratios, we divided each count measure by the maximum value for that variable. We then calculated the average of these two ratios. The final measure, *international diversification*, has values ranging from 0 to 1, with larger values representing higher diversification. For *product diversification*, we gathered 1992–2001 data on each firm's product-segment sales, classified using three-digit SIC codes from the *Japan Company Handbook* (Delios & Beamish, 1999) and calculated the variable as an entropy measure (Palepu, 1985).

Transactional and relational ownership were assessed as the total percentages of all outstanding shares held by the respective types of owner. Larger values represented more power for an owner type and consequently more influence over the out-

comes of strategic decisions. Specifically, *transactional ownership* was the total number of shares owned by foreigners divided by total shares outstanding, and *relational ownership* was the total number of shares owned by Japanese financial institutions and other Japanese business corporations divided by total shares outstanding (Yoshikawa et al., 2005).

We also controlled for a number of other factors that might impact either firm growth or profit. *Fixed assets* was net fixed assets divided by total assets. *Cash* was measured as total cash and marketable securities divided by total assets, and *size*, as the natural log of total firm sales. *Free cash flow* was the ratio of operating income less taxes, interest, and dividends paid divided by total assets. *Leverage* was total debt (short-term loans, long-term loans, and debentures) divided by total assets. *Volatility* assessed the instability of the firm's earnings as the standard deviation of return on assets over the previous five years. In addition to these annual, time-varying, firm-level control variables, we included a number of industry-level control variables. For each industry, *industry growth*, *industry profit*, and *industry volatility* were measured as the median value of the corresponding firm-level variable for all firms for which that industry was their primary industry.

Analysis

Our analysis presented two critical methodological considerations. First, unobserved heterogeneity was a concern because our data contain multiple observations per firm. Therefore, we incorporated fixed firm effects into all our models. We deemed fixed-effects models to be superior to random-effects models because a Hausman test indicated significant ($p < .01$), systematic difference in the coefficients yielded by the two types of models. A second methodological consideration was the potential endogeneity of both ownership structure and diversification. If our models failed to include every variable that significantly influenced both of these variables and the dependent variable, then the endogenous variables would be correlated with the error term, and traditional ordinary least squares (OLS) methods would suffer from omitted variables bias. This problem could be reduced by using predetermined (i.e., lagged) independent variables, and firm fixed effects could further alleviate endogeneity issues by controlling for any omitted variables that were invariant over time. However, time-varying omitted variables might still be a problem.

A solution to the endogeneity problem was to use two-stage least squares (2SLS) instrumental variables regression methods. We could eliminate endogeneity bias by first regressing the endogenous variables on all the independent variables and then using the predicted values of the endogenous variables in lieu of the observed values in the second stage, when the dependent variable was regressed on the predictor variables. Although this approach improves estimates of the effect of an endogenous variable on a dependent variable, it is also less efficient because it tends to produce much larger standard errors than OLS (see Wooldridge, 2003: Ch. 15). Hence, even if a variable is theoretically endogenous, it is preferable to not model it as endogenous unless tests indicate that it induces a statistical problem. Accordingly, we tested to see if any of our critical variables created an endogeneity problem.

To test for endogeneity problems, we needed to find valid instruments for each of the potentially endogenous variables. These instruments should be strongly related to the endogenous variables but weakly related to the dependent variable. Although the suitability of various instruments varied somewhat with different dependent variables, industry-level measures for the potentially endogenous variables were generally valid instruments. Furthermore, variables for cash and fixed assets also sometimes served as valid instruments. We also created instruments for the interactions between ownership structure and diversification by interacting their respective instruments. All the 2SLS models that we tested employed more instruments than endogenous variables to enable tests of overidentifying restrictions to verify both that the instrumental variables were appropriately excluded from the second-stage regression and uncorrelated with the error term in the second-stage regression, which is a critical assumption of 2SLS regressions. Davidson-MacKinnon tests of exogeneity indicated that the only endogeneity problem was created by international diversification in the profit models ($F = 7.7$, $p < .01$). Hence, we employed 2SLS regressions with firm fixed effects for these models and standard fixed-effects regressions for all other models. Finally, all of our hypotheses compare the effects of relational and transactional ownership. Thus, to test our hypotheses we used Wald tests to determine whether the pertinent regression coefficients were significantly different from one another.

All four of our dependent variables contained some extreme observations. Rather than drop outliers or nonlinearly transform the data, we achieved comparable model fit by winsorizing growth, profit, employment growth, and salaries at the 99th and 1st percentiles of their respective distributions.

After winsorizing, analysis of Cook's *D* s suggested that no outlier had a statistically significant impact on the models. Finally, all models included year fixed effects (not reported) in addition to the firm fixed effects. Table 1 provides descriptive statistics for all variables.

RESULTS

Table 2 reports results of our empirical analysis of international diversification. Models 1 and 2 present the fixed-effects regressions that were used to test the effects of ownership structure and international diversification on sales growth. Model 1 reveals that both relational ownership and transactional ownership are positively related to sales growth, and the two coefficients are not significantly different. International diversification has no significant main effect on sales growth. Model 2 adds the hypothesized interactions. Their addition significantly improves model fit. Although the interaction between international diversification and transactional ownership is not significant, the interaction between international diversification and relational ownership is positive and significant. In keeping with Hypothesis 1, the difference between the two interactions is significant ($F = 6.85$, $p < .01$), suggesting that sales growth is the performance objective of international diversification when relational ownership is high, but not when transactional ownership is high.

Models 3 and 4 present the 2SLS-IV regressions that we used to test the effects of ownership structure and international diversification on profit. The Sargan overidentification test statistic was insignificant for both models, confirming that the instrumental variables were indeed exogenous and correctly excluded from the profit equation. Also, the Wald chi-square was highly significant for both models. We do not report multiple squared correlation coefficient statistics (R^2s) because this statistic has no natural interpretation in 2SLS regressions. Although 2SLS methods yield better estimates of the ceteris paribus effect of an endogenous variable on a dependent variable, overall model goodness of fit is not a consideration and may very well decline when a variable is treated as endogenous (see Wooldridge, 2003: Ch. 15). Accordingly, it is also inappropriate to test whether including an endogenous variable (or interaction) improves overall model fit.

Model 3 reveals that relational ownership, transactional ownership, and international diversification are all positively related to profit. Interestingly, the coefficient for transactional ownership is significantly greater than that for relational ownership ($\chi^2 = 144.23$, $p < .01$), and the magnitude of the difference suggests that on a share-per-share basis, transactional owners are over three times more effective than relational owners in pressuring managers to improve profit. Model 4 adds in the hypothesized interactions. Although the interactions between international diversification and both transactional and relational ownership are both positive and significant, the interaction with transactional ownership is significantly more positive ($\chi^2 = 15.18$, $p < .01$). Supporting Hypothesis 2, this suggests that transactional owners are more

TABLE 1
Descriptive Statistics[a]

Variable	Mean	s.d.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1. Growth	−0.01	0.11																
2. Profit	0.93	0.52	.18															
3. Employment growth	−0.03	0.08	.25	.18														
4. Salaries	3E+5	1E+6	−.02	.01	.00													
5. Industry growth	−0.01	0.05	.50	.07	.02	.01												
6. Industry profit	0.8	0.2	.10	.41	.13	−.06	.16											
7. Industry volatility	0.01	0.00	.03	.16	−.04	−.12	.04	.34										
8. Size	11.64	1.28	−.01	.09	.02	.57	.00	−.06	−.22									
9. Free cash flow	0.00	0.03	.00	.22	.22	−.05	−.04	−.16	−.12	.06								
10. Leverage	0.32	0.23	−.15	−.36	−.25	.13	−.07	−.24	−.20	.11	−.27							
11. Cash	0.11	0.09	.04	.21	.15	.00	.03	.15	.11	−.09	.11	−.32						
12. Fixed assets	0.25	0.13	.02	.01	−.05	−.16	.04	.11	−.06	−.14	.00	.10	−.28					
13. Volatility	0.02	0.01	.02	.16	−.08	−.12	.02	.13	.42	−.25	−.15	−.09	.11	−.02				
14. Transactional ownership	0.07	0.07	.11	.38	.09	.15	.06	.01	.08	.36	.24	−.37	.14	−.12	.03			
15. Relational ownership	0.64	0.12	.02	.04	.09	.07	−.01	.16	−.07	.24	−.06	.00	−.08	.11	−.13	−.16		
16. International diversification	0.07	0.08	−.02	.10	−.02	.82	.00	−.02	−.02	.62	−.04	.08	−.05	−.21	−.11	.29	.06	
17. Product diversification	1.03	0.40	−.03	.11	−.06	.42	−.04	.02	−.01	.53	−.06	.10	−.14	−.14	−.14	.22	.08	.64

[a] Correlations with an absolute value greater than .01 are significant at the .05 level.

TABLE 2
Relational Owners, Transactional Owners, and International Diversification: Regression Analysis Results[a]

	Sales Growth		Profit		Employment Growth		Salaries	
Variables	Model 1: Fixed Effects	Model 2: Fixed Effects	Model 3: 2SLS-IV	Model 4: 2SLS-IV	Model 5: Fixed Effects	Model 6: Fixed Effects	Model 7: Fixed Effects	Model 8: Fixed Effects
Industrial growth	1.00**	1.00**	0.14†	0.16†	0.12**	0.12**	0.54†	0.53*
Industrial profit	0.01	0.01	0.89**	0.88**	0.01	0.01	−0.05	−0.03
Industrial volatility	0.21	0.25	−2.59*	−2.92*	−0.68†	−0.67†	5.95†	6.09†
Size	−0.11**	−0.11**	−0.09**	−0.08**	−0.01*	−0.01*	1.01**	0.99**
Free cash flow	−0.21**	−0.20**	2.15**	2.11**	0.56**	0.56**	0.29	0.45
Leverage	−0.07**	−0.07**	−0.21**	−0.16**	−0.07**	−0.07**	−0.57**	−0.55**
Cash	0.00	−0.01	0.31**	0.35**	0.02	0.02	0.58**	0.55**
Fixed assets	0.01	0.01			−0.06**	−0.06**	−0.15	−0.22
Volatility	0.17†	0.17†	2.46**	2.42**	−0.39**	−0.38**	−5.73**	−5.47**
Diversification	0.03	0.02	3.91**	3.09**	−0.10	−0.08	1.34*	1.49*
Transactional ownership	0.11**	0.12**	1.23**	1.04**	0.05*	0.06*	0.13	0.46
Relational ownership	0.08**	0.09**	0.36**	0.48**	0.03*	0.04*	0.40**	0.80**
Diversification × transactional ownership		0.31		20.21**		0.02		8.01**
Diversification × relational ownership		0.83**		8.71*		0.56*		25.34**
n	14,294	14,294	14,026	14,026	10,628	10,628	10,756	10,756
F	211.6**	196.9**			65.64**	60.81**	65.62**	67.0**
R^2	.29	.29			.14	.14	.14	.15
F: Improvement in R^2		11.0**				5.5**		80.5**
Wald χ^2			172,168**	169,390**				

[a] All models also included year fixed effects (not reported).
† $p < .10$
* $p < .05$
** $p < .01$
Two-tailed tests.

concerned with diversifying for the sake of improved profit than are relational owners.

Model 5 tests the effects of international diversification and ownership structure on employment growth. As with sales growth, both relational ownership and transactional ownership are positively related to employment growth (although the two coefficients are not significantly different), and international diversification has no significant main effect. Addition of the hypothesized interactions in model 6 significantly improves model fit. Although the interaction between international diversification and transactional ownership is not significant, the interaction between international diversification and relational ownership is positive and significant. In keeping with Hypothesis 3, the difference between the two interactions is significant ($F = 6.97$, $p < .01$), suggesting that relational owners, unlike transactional owners, pressure managers to increase employment in response to a move abroad. Overall, we infer from these results that transactional owners use international diversification to enhance profits, and relational owners use diversification to both improve competitiveness and to enhance sales revenues, thus not only preserving domestic employment but perhaps even expanding the workforces of firms.

Models 7 and 8 test the effects of international diversification and ownership structure on managerial compensation. In the base model, model 7, diversification has a marginally significant, positive effect on director salaries. Relational ownership has a significant, positive effect, and transactional ownership has no significant effect. Addition of the hypothesized interactions in model 8 significantly improves model fit. Although both interactions are significant, the interaction between international diversification and relational ownership is significantly more positive than the interaction between international diversification and transactional ownership ($F = 68.39$, $p < .01$), thus supporting Hypothesis 4.

Table 3 presents models comparable to those in Table 2, but using the smaller sample for which we had data on product diversification. As this sample is more restricted, we present this analysis primarily as a robustness check to illustrate that similar results are obtained when product diversification is substituted for international diversification. Even though we expected similar results, it is important

TABLE 3
Relational Owners, Transactional Owners, and Product Diversification: Fixed-Effects Regression Analysis Results[a]

	Sales Growth		Profit		Employment Growth		Salaries	
Variables	**Model 1**	**Model 2**	**Model 3**	**Model 4**	**Model 5**	**Model 6**	**Model 7**	**Model 8**
Industrial growth	0.97**	0.97**	0.20†	0.21*	0.10**	0.10**	0.52†	0.56†
Industrial profit	0.03*	0.03*	1.07**	1.07**	0.02	0.02	−0.04	−0.02
Industrial volatility	−0.65	−0.62	−5.23**	−5.26**	−0.81*	−0.80*	5.20	5.19
Size	−0.19**	−0.19**	0.01	0.01	−0.01	−0.01†	1.14**	1.14**
Free cash flow	−0.29**	−0.29**	1.82**	1.83**	0.53**	0.53**	−0.01	0.07
Leverage	−0.07**	−0.07**	−0.21**	−0.20**	−0.07**	−0.07**	−0.56**	−0.53**
Cash	−0.04	−0.04†	0.28**	0.30**	0.01	0.01	0.79**	0.78**
Fixed assets	−0.08**	−0.09**	−0.05	−0.03	−0.09**	−0.09**	−0.05	−0.09
Volatility	−0.04	−0.05	2.49**	2.54**	−0.37**	−0.37**	−6.93**	−6.72**
Diversification	0.01	0.00	−0.06†	−0.05†	−0.01	−0.01	0.27**	0.3**
Transactional ownership	0.19**	0.21**	1.64**	1.58**	0.05†	0.066†	0.18	0.24
Relational ownership	0.11**	0.11**	0.39**	0.37**	0.02	0.032	0.59**	0.71**
Diversification × transactional ownership		−0.19**		0.98**		−0.12*		1.66**
Diversification × relational ownership		0.14**		0.02		0.12**		2.68**
n	8,432	8,432	8,331	8,331	8,007	8,007	7,438	7,438
F	176.0**	162.9**	153.7**	142.4**	48.37**	45.44**	50.21**	48.7**
R^2	.34	.34	.31	.32	.13	.13	.14	.15
F: Improvement in R^2		14.1**		14.6**		12.9**		31.5**

[a] All models also included year fixed effects (not reported).
† $p < .10$
* $p < .05$
** $p < .01$
Two-tailed tests.

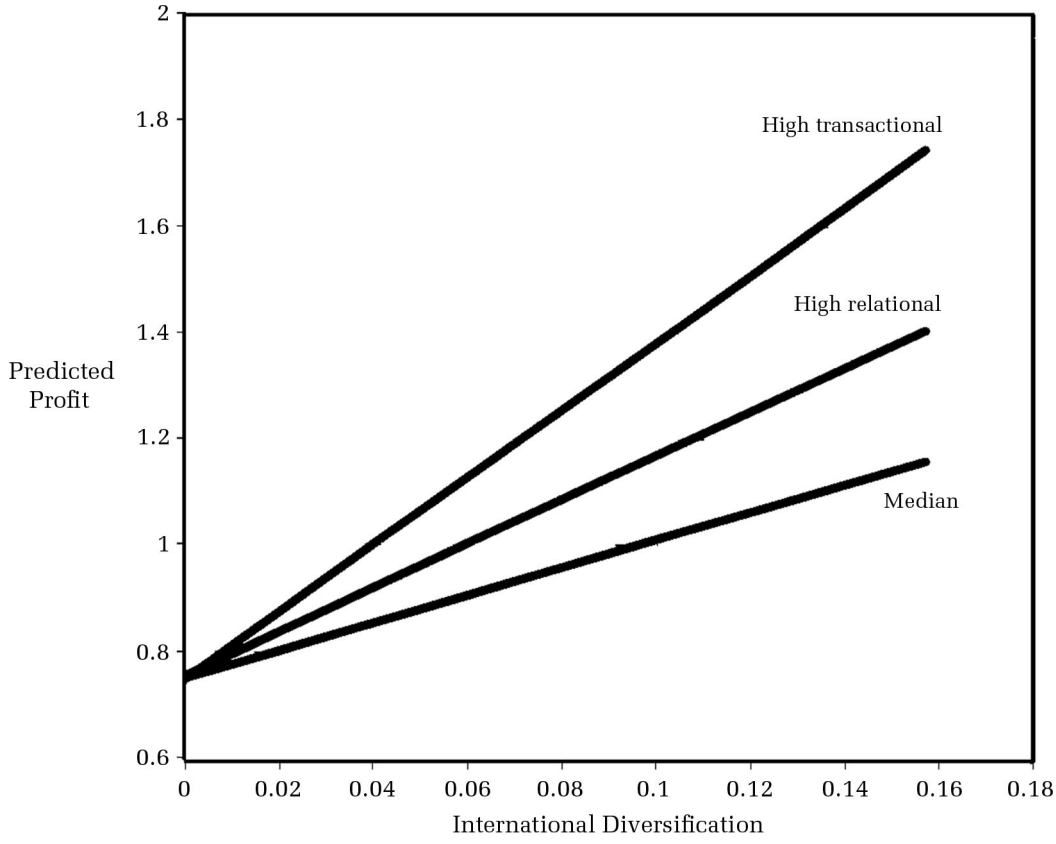
to note that, unlike the case of international diversification, the main effect for product diversification on profit is negative and marginally significant (see model 3). In terms of support for our hypotheses, the only substantive difference found with product diversification pertains to model 8. Although the coefficient for the interaction between diversification and relational ownership is larger than the coefficient for the interaction with transactional ownership, the difference between the two is only marginally significant ($F = 2.87$, $p < .1$). Thus, overall, Hypotheses 1, 2, and 3 receive strong support with both product and international diversification, and Hypothesis 4 receives strong support with international diversification, but only marginal support with product diversification.

Finally, to illustrate the economic significance of our results, we used model 4 of Table 2 to plot the relationship between international diversification and predicted profit for various ownership structures. As Figure 1 illustrates, international diversification generally leads to improved profit. Further, relational ownership strengthens this relationship, but transactional ownership strengthens it to a much greater extent. As an example, the slope for the relationship between international diversification and profit is 69 percent greater for firms with high levels of relational ownership (i.e., the 95th percentile of that variable) than it is for the median firm. However, the slope for the relationship between international diversification and profit is almost three times steeper for firms with high levels of transactional ownership (i.e., the 95th percentile of that variable) than it is for the median firm.

DISCUSSION

We investigated how differences between transactional owners and relational owners shaped the performance consequences of diversification both for shareholders and for stakeholders. Going contrary to prior work in which it is assumed that all powerful owners appropriate rents solely through profit, we propose that some owners also appropriate rents through growth, and they may influence managers accordingly. Performance goals are shaped by the type of relationship they have with the firms they invest in: transactional owners have arms'-length ties and therefore appropriate rents strictly through higher profits, but relational own-

FIGURE 1
Economic Significance[a]



[a] The x-axis plots international diversification from the 5th to the 95th percentile, and the y-axis gives predicted performance. The line labeled "Median" represents firms that have the median level of both relational and transactional ownership. The line labeled "High relational" depicts firms that have the median level of transactional ownership, but a high level (i.e., 95th percentile) of relational ownership. Similarly, the line labeled "High transactional" depicts firms that have the median level of relational ownership, but a high level (i.e., 95th percentile) of transactional ownership.

ers have closer ties that allow for the appropriation of rents through higher growth, which enhances both business prospects and mutual safeguards. Their divergent performance goals affect their orientation toward other stakeholders as well: relational owners facilitate greater value capture by stakeholders from diversification than do transactional owners.

Our empirical analysis yields results supportive of these ideas. The relationship between diversification and profit is more positive under transactional ownership than under relational ownership. Conversely, the relationship between diversification and growth is more positive with relational ownership than with transactional ownership. Furthermore, diversification yields greater benefits for stakeholders—that is, higher employment growth and executive salaries—under relational ownership than under transactional ownership.

The relationship between strategic action and performance is a central question in the strategy field (Barney, 2002), yet the question of "performance for whom" has not been given sufficient emphasis, particularly in the diversification literature. We explain the importance of considering differences in the performance goals of owners from a rent appropriation perspective. Differences in performance goals arise because various shareholders and stakeholders capture value in different ways. Although the prior research assumption has been that all shareholders seek profit from corporate diversification strategies, our research suggests that profit maximization is not a universal goal of owners. As we found in our study, profit is the only goal for transactional owners, but growth is a more important goal for relational owners. Similarly, research in the future might delve more deeply into issues related to the performance outcomes for shareholders. It would be worth exploring the extent to which the enhanced growth from diversification actually improves business prospects or

safeguards for relational owners. Furthermore, we expected the performance outcomes to reflect substantive responsiveness to powerful owners, but the possibility of accounting manipulations by managers for symbolic conformance (Westphal & Zajac, 1994) requires more investigation.

It would also be helpful to extend our typology of relational versus transactional to explicitly embrace owner types that may be prevalent in other institutional contexts. For example, research on U.S. firms has distinguished between pressure-resistant owners (who are similar to transactional owners in that they lack business relationships with the firms in which they hold stock) and pressure-sensitive institutional investors (similar to relational owners in that they have business relationships with the owned firms) (David et al., 1998). Similarly, family owners appear to have a long-term attachment similar to that of relational owners (Schulze, Lubatkin, & Dino, 2003). Such owners are prominent all over the world, including in Europe (Faccio & Lang, 2002), Asia (Claessens, Djankov, Fan, & Lang, 2002), and China (Delios, Wu & Zhou, 2006). Although caution must be exercised in extrapolating our results, which may be specific to the Japanese context, we believe it would be worthwhile to investigate whether the performance goals of these other types of owners could be distinguished in ways similar to what we have done for transactional owners and relational owners in Japan.

The question of "performance for whom" is even more salient for stakeholders other than shareholders. Just as shareholders can differ in their performance goals, various stakeholders also capture value in a variety of ways. Employees and executives capture value both from higher compensation and from reduced employment risk. Modeling the performance outcomes desired by other stakeholders, such as customers, suppliers, and the community at large, is analytically and empirically challenging, but the effort holds considerable promise (Lieberman & Chacar, 1997). From a rent appropriation perspective, a strategy provides competitive advantage and yields economic rents when the benefits to at least some stakeholders are greater than their opportunity costs (Coff, 1999). Thus, finding a way to aggregate performance benefits for various stakeholders should provide a better understanding of the extent to which diversification strategies create economic rents in forms that cannot be identified from shareholder profit. Furthermore, the extents to which various stakeholders capture value from a diversification strategy will likely differ. Future research can seek to explain how value gets allocated among various stakeholder groups.

Our research provides insights as to why employees and managers obtain greater benefits from diversification under relational ownership than under transactional ownership. Our explanation is based on a rent appropriation perspective. We argue that the pursuit of growth to appropriate rent from their relationships causes relational owners to be more tolerant of rent appropriation by stakeholders. Alternately, it can be argued that relational owners' embedded relationships make them supportive of taken-for-granted institutional policies of lifetime employment. Institutional legitimacy explanations complement our explanation of relational owners' support of lifetime employees but fail to explain relational owners' support of higher executive pay. Unlike lifetime employment, which is institutionally legitimized in Japan, high managerial compensation runs counter to Japanese norms of egalitarianism (Dore, 2000). Although managers and executives in Japanese firms have a strong respect for seniority and reward it with greater pay, the differences among levels of seniority are kept low. The ratio of the wages earned by the highest- versus the lowest-paid employee is typically about 400:1 in U.S. companies, but it is just 10:1 in Japanese companies (Wahlgren, 2001). Thus, the institutional norm in Japan is to curtail high executive compensation. If relational owners support stakeholders in accordance with institutional norms, one would expect them to limit the extent to which managers can use diversification to justify higher salaries. Instead, we found that relational owners foster higher managerial salaries from diversification, suggesting a rent appropriation rather than institutional legitimacy explanation.

Disentangling rent appropriation from institutional legitimacy is a complex task, but one worth pursuing. Stakeholders likely benefit most when institutional and rent appropriation explanations converge. Thus, relational owners may support employee stakeholders on the basis of norms of institutional legitimacy, and such support is reinforced by rent appropriation considerations from which relational owners benefit as well. Finding contexts in which rent appropriation explanations conflict with institutional legitimacy—and therefore weaken the effects of rent appropriation considerations—holds considerable promise for advancing this line of work.

Our findings also have important implications for the governance literature, which is rooted in an economic perspective on stakeholders in which they are generally fixed claimants with no need for governance safeguards. Only shareholders, as residual claimants, are deserving of governance safeguards according to this perspective (Shleifer &

Vishny, 1997). Although the importance of stakeholders has long been recognized in the management literature, most notably in the extensive research on the stakeholder theory of the firm spearheaded by Freeman (1984), several mainstream economists (Allen & Gale, 2000; Tirole, 2001; Zingales, 2000) and strategy scholars with an economics perspective (Mahoney, 2007; Wang & Barney, 2006) are now proposing that stakeholders require explicit consideration, especially in the context of economies reliant on "knowledge workers." Our study contributes to this conversation by suggesting that ownership structure can serve as a governance mechanism for safeguarding stakeholders as well as shareholders. Broadening the somewhat narrow preoccupation with shareholders in prior work to include governance safeguards for a broader set of stakeholders holds considerable promise for future research.

Our research also has implications for the comparative governance literature, which addresses worldwide differences and similarities in governance (Aguilera & Jackson, 2003; Ahmadjian & Robbins, 2005; Hall & Soskice, 2001). Much of the early work in this literature emphasized unique governance practices of various national economies; conceptual work distinguishing shareholder capitalism (e.g., the U.S. and U.K. governance regimes) from stakeholder capitalism (e.g., the Japanese and German governance regimes) (Allen & Gale, 2000; Dore, 2000) is an example. Several studies have addressed differences between U.S. and Japanese corporations. For example, (1) unlike U.S. firms that emphasize profit over growth, Japanese firms emphasize growth over profit (Abegglen & Stalk, 1985; Aoki, 1988; Kester, 1991), (2) Japanese firms invest more in R&D than do U.S. firms (Hundley, Jacobson, & Park, 1996; Thomas & Waring, 1999), and (3) shareholder-owner relationships in Japanese firms reflect stewardship norms, but those in the United States reflect principal-agent norms (Lee & O'Neill, 2003). More recent comparative governance research explores the extent to which convergence is taking place across countries (Gordon & Roe, 2004).

Our results provide evidence both for divergence and convergence, with the degree of openness of capital markets acting as an incomplete impetus to convergence. As long as Japanese capital markets stayed relatively insulated from the rest of the world, relational owners helped preserve firms' commitment to stakeholders by emphasizing growth over profit, reflecting their divergence from more shareholder-oriented U.S. firms. However, as Japanese capital markets have opened up to foreign owners, Japanese firms have faced pressures to emphasize profit over growth and hence have converged somewhat with U.S. firms in terms of performance objectives. For example, Japanese firms have greatly increased their access to international bond markets for debt financing (David, O'Brien, & Yoshikawa, 2008).

Nevertheless, despite some evidence of convergence, we also find resistance in the form of the traditional governance provided by relational owners, who continue to support diversification strategies that emphasize growth rather than profit. The *Economist* (2007) reported a shift toward a shareholder orientation in the late 2000s, as Japanese firms increasingly adopted many of the practices of U.S. corporations, such as stock options, independent directors, and even hostile takeovers. Yet the article reiterated that debates continue as to the appropriate balance between stakeholder and shareholder orientations. It is perhaps likely that corporate governance "hybrids" incorporating elements of the U.S. or U.K. model into local practices will increasingly be seen as radical institutional change progresses (Aguilera & Jackson, 2003; Yoshikawa & Rasheed, 2009). It will be interesting to see how and how much governance orientations change over time in Japan and in other countries.

As foreign owners spread their investments across global boundaries (Useem, 1998), our research gains implications for other stakeholder-oriented nations, such as Germany and France, that are grappling with the conflict between a traditional stakeholder orientation and pressures for a shareholder orientation. Furthermore, foreign owners include owners from various countries. In this study we found support for the view that foreign portfolio investors seek rent appropriation through profit. Differences in national origin may, however, have other implications that warrant further research.

REFERENCES

Abegglen, J., & Stalk, G. 1985. ***Kaisha: The Japanese corporation***. New York: Basic Books.

Aguilera, R. V., & Jackson, G. 2003. The cross-national diversity of corporate governance: Dimensions and determinants. ***Academy of Management Review***, 28: 447–465.

Ahmadjian, C. L., & Robbins, G. E. 2005. A clash of capitalism: Foreign shareholders and corporate restructuring in 1990s Japan. ***American Sociological Review***, 70: 451–471.

Ahmadjian, C. L., & Robinson, P. 2001. Safety in numbers: Downsizing and deinstitutionalization of per-

manent employment in Japan. ***Administrative Science Quarterly***, 46: 622–654.

Allen, F., & Gale, D. 2000. ***Comparing financial systems***. Cambridge, MA: MIT Press.

Allen, M. P. 1981. Managerial power and tenure in the large corporation. ***Social Forces***, 60: 484–494.

Amihud, Y., & Kamin, J. 1979. Revenue vs. profit maximization: Differences in behavior by the type of control and by market power. ***Southern Economic Journal***, 45: 838–846.

Amihud, Y., & Lev, B. 1981. Risk reduction as a managerial motive for conglomerate mergers. ***Bell Journal of Economics***, 12: 605–616.

Anderson, C. W., & Makhija, A. K. 1999. Deregulation, disintermediation, and agency costs of debt: Evidence from Japan. ***Journal of Financial Economics***, 51: 309–339.

Anderson, R. C., Bates, T. W., Bizjak, J. M., & Lemmon, M. L. 2000. Corporate governance and firm diversification. ***Financial Management***, 29(1): 5–22.

Aoki, M. 1988. ***Information, incentives, and bargaining in the Japanese economy***. Cambridge, U.K.: Cambridge University Press.

Aoki, M., & Patrick, H. 1994. ***The Japanese main bank system***. Oxford, U.K.: Clarendon Press.

Banerji, K., & Sambharya, R. B. 1996. Vertical keiretsu and international market entry: The case of the Japanese automobile ancillary industry. ***Journal of International Business Studies***, 27: 89–114.

Bank of Japan. 2004. ***Financial and economic statistics*** (March 21) http://www.boj.orjp/en/theme/research/stat/bop/bop/index.htm. Accessed May 16, 2010.

Barney, J. B. 2002. ***Gaining and sustaining competitive advantage***. Englewood Cliffs, NJ: Prentice-Hall.

Baumol, W. J. 1959. ***Business behavior, value, and growth***. New York: Macmillan.

Bercovitz, J., & Mitchell, W. 2007. When is more better? The impact of business scale and scope on long-term business survival, while controlling for profitability. ***Strategic Management Journal***, 28: 61–79.

Berry, T. K., Bizjak, J. M., Lemmon, M. L., & Naveen, L. 2006. Organizational complexity and CEO labor markets: Evidence from diversified firms. ***Journal of Corporate Finance***, 12: 797–817.

Bhojraj, S., & Sengupta, P. 2003. Effect of corporate governance on bond ratings and yields: The role of institutional investors and outside directors. ***Journal of Business***, 76: 455–475.

Brennan, M. J., & Tamarowski, C. 2000. Investor relations, liquidity, and stock prices. ***Journal of Applied Corporate Finance***, 12(4): 26–37.

Brush, T. H., Bromiley, P., & Hendrickx, M. 2000. The free cash flow hypothesis for sales growth and firm performance. ***Strategic Management Journal***, 21: 455–472.

Chen, T.-J., & Ku, Y.-H. 2003. ***The effects of overseas investment on domestic employment***. Working paper W10156, National Bureau of Economic Research, Cambridge, MA.

Claessens, S., Djankov, S., Fan, J. P. H., & Lang, L. H. P. 2002. Disentangling the incentive and entrenchment effects of large shareholdings. ***Journal of Finance***, 57: 2741–2771.

Coff, R. W. 1999. When competitive advantage doesn't lead to performance: The resource-based view and stakeholder bargaining power. ***Organization Science***, 10: 119–133.

Collis, D. J., & Montgomery, C. A. 1997. ***Corporate strategy: A resource based approach***. McGraw Hill Irwin.

Cronqvist, H., Heyman, F., Nilsson, M., Svaleryd, H., & Vlachos, J. 2009. Do entrenched managers pay their workers more? ***Journal of Financial Economics***, 64: 309–339.

David, P., Kochhar, R., & Levitas, E. 1998. The effects of institutional investors on the level and mix of CEO compensation. ***Academy of Management Journal***, 41: 200–208.

David, P., O'Brien, J. P., & Yoshikawa, T. 2008. The implications of debt heterogeneity for R&D investment and firm performance. ***Academy of Management Journal***, 51: 165–181.

David, P., Yoshikawa, T., Chari, M., & Rasheed, A. 2006. Strategic investments in Japanese corporations: Do foreign portfolio owners foster underinvestment or appropriate investment? ***Strategic Management Journal***, 27: 591–600.

Delios, A., & Beamish, P. W. 1999. Geographic scope, product diversification, and the corporate performance of Japanese firms. ***Strategic Management Journal***, 20: 711–727.

Delios, A., Wu, Z.-J., & Zhou, N. 2006. A new perspective on ownership identities in China's listed companies. ***Management and Organization Review***, 2: 319–343.

Dore, R. 2000. ***Stock market capitalism: Welfare capitalism***. New York: Oxford University Press.

Dvorak, P., Guth, R. A., Singer, J., & Zaun, T. 2001. Loose ends: Frayed by recession, Japan's corporate ties are coming unraveled. ***Wall Street Journal,*** eastern ed.: A1.

Economist. 2007. Business in Japan: Going hybrid. November 29.

Faccio, M., & Lang, L. H. P. 2002. The ultimate ownership of Western European corporations. ***Journal of Financial Economics***, 65: 365–395.

Freeman, E. 1984. ***Strategic management: A stakeholder approach***. Boston: Pitman Press.

Friedman, M. 1970. The social responsibility of business is to increase its profits. ***New York Times Magazine***, September 13: 122–126.

Gedajlovic, E., & Shapiro, D. M. 2002. Ownership structure and firm profitability in Japan. ***Academy of Management Journal***, 45: 565–575.

Geringer, J. M., Tallman, S., & Olsen, D. M. 2000. Product and international diversification among Japanese multinational firms. ***Strategic Management Journal***, 21: 51–80.

Gerlach, M. L. 1992. ***Alliance capitalism: The social organization of Japanese business***. Berkeley: University of California Press.

Gordon, J. N., & Roe, M. J. 2004. ***Convergence and persistence in corporate governance***. Cambridge, U.K.: Cambridge University Press.

Hall, P., & Soskice, D. 2001. ***Varieties of capitalism: The institutional foundations of comparative advantage***. Oxford, U.K.: Oxford University Press.

Hambrick, D. C., & Finkelstein, S. 1995. The effects of ownership structure on conditions at the top: The case of CEO pay raises. ***Strategic Management Journal***, 15: 175–193.

Henderson, A. D., & Fredrickson, J. W. 1996. Information-processing demands as a determinant of CEO compensation. ***Academy of Management Journal***, 39: 575–606.

Higuchi, Y., & Matsuura, T. 2003. ***Employment effect analysis using data on a panel of firms: The effect of changes in business organization and direct foreign investment on employment*** [in Japanese]. Discussion paper 03-J-019, Research Institute of Economy, Trade, and Industry, Tokyo.

Hitt, M. A., Tihanyi, L., Miller, T., & Connelly, B. 2006. International diversification: Antecedents, outcomes, and moderators. ***Journal of Management***, 32: 831–867.

Hoshi, T., & Kashyap, A. 2001. ***Corporate financing and governance in Japan***. Cambridge, MA: MIT Press.

Hoskisson, R., & Hitt, M. 1990. Antecedents and performance outcomes of diversification: A review and critique of theoretical perspectives. ***Journal of Management***, 16: 461–509.

Hoskisson, R. E., Hitt, M. A., Johnson, R. A., & Grossman, W. 2002. Conflicting voices: The effects of institutional ownership heterogeneity and internal governance on corporate innovation strategies. ***Academy of Management Journal***, 45: 697–716.

Hundley, G., Jacobson, C. K., & Park, S. H. 1996. Effects of profitability and liquidity on R&D intensity: Japanese and U.S. companies compared. ***Academy of Management Journal***, 39: 1659–1674.

Jensen, M. C. 1986. Agency costs of free cash flows, corporate finance, and takeovers. ***American Economic Review***, 76: 323–329.

Joh, S. W. 1999. Strategic managerial incentive compensation in Japan: Relative performance evaluation and product market collusion. ***Review of Economics and Statistics***, 81: 303–313.

Kamesaka, A., Nofsinger, J. R., & Kawakita, H. 2002. Investment patterns and performance of investor groups in Japan. ***Pacific-Basin Finance Journal***, 11: 1–22.

Kaplan, S. N. 1994. Top executive rewards and firm performance: A comparison of Japan and the United States. ***Journal of Political Economy***, 102: 510–546.

Kaplan, S. N., & Minton, B. A. 1994. Appointments of outsiders to Japanese boards. ***Journal of Financial Economics***, 36: 225–258.

Kester, W. C. 1991. ***Japanese takeovers: The global contest for corporate control***. Boston: Harvard Business School Press.

Kim, H., Hoskisson, R. E., & Wan, W. P. 2004. Power dependence, diversification strategy, and performance in keiretsu member firms. ***Strategic Management Journal***, 25: 613–636.

Kochhar, R., & David, P. 1995. Institutional investors and firm innovation: A test of competing hypotheses. ***Strategic Management Journal***, 17: 73–84.

Lee, P. M., & O'Neill, H. M. 2003. Ownership structures and R&D investments of U.S. and Japanese firms: Agency and stewardship perspectives. ***Academy of Management Journal***, 46: 212–225.

Lieberman, M., & Chacar, A. S. 1997. Measuring the distribution of returns among stakeholders. Methods and application to US and Japanese companies. In H. Thomas & D. O'Neal (Eds.), ***Strategic discovery: Competing in new arenas***: 299–313. New York: Wiley.

Lincoln, J. R., Gerlach, M., & Ahmadjian, C. L. 1996. Keiretsu networks and corporate performance in Japan. ***American Sociological Review***, 61: 67–88.

Lindenberg, E. B., & Ross, S. A. 1981. Tobin's q ratio and industrial organization. ***Journal of Business***, 54: 1–32.

Lu, J. W., & Beamish, P. W. 2004. International diversification and firm performance: The S-curve hypothesis. ***Academy of Management Journal***, 47: 598–609.

Mahoney, J. T. 2010. Toward a stakeholder theory of strategic management. In R. Phillips (Ed.), ***Stakeholder theory:*** Forthcoming. Cheltenham, U.K.: Edward Elgar.

Marris, R. 1964. ***The economic theory of "managerial" capitalism***. New York: Macmillan.

Martin, X., Swaminathan, A., & Mitchell, W. 1998. Organizational evolution in the interorganizational environment: Incentives and constraints on international expansion strategy. ***Administrative Science Quarterly***, 43: 566–601.

McEachern, W. A. 1975. ***Managerial control and performance.*** Lexington, MA: Lexington Books.

Montgomery, C. A., & Wernerfelt, B. 1988. Diversification, Ricardian rents, and Tobin's Q. ***Rand Journal of Economics***, 19: 623–632.

Morck, R. K., Shleifer, A., & Vishny, R. 1988. Management ownership and market valuation. ***Journal of Finance***, 20: 293–315.

Murase, H. 1998. Equity ownership and the determination of managers' bonuses in Japanese firms. ***Japan and the World Economy***, 10: 321–331.

Palepu, K. 1985. Diversification strategy, profit performance, and the entropy measure. ***Strategic Management Journal***, 6: 239–255.

Palich, L. E., Cardinal, L. B., & Miller, C. C. 2000. Curvilinearity in the diversification-performance linkage: An examination of over three decades of research. ***Strategic Management Journal***, 21: 155–174.

Peoples, J. 1989. Merger activity and wages levels in merger activity. ***Journal of Labor Research***, 10: 183–196.

Porter, M. E. 1992. Capital disadvantage: America's failing capital investment system. ***Harvard Business Review***, 70(5): 65–82.

Ramanujam, V., & Varadarajan, P. 1989. Research on corporate diversification—A synthesis. ***Strategic Management Journal***, 10: 523–551.

Rose, N. L., & Shepard, A. 1997. Firm diversification and CEO compensation: Managerial ability or executive entrenchment? ***Rand Journal of Economics***, 28: 489–514.

Rousseau, D. M. 1995. ***Psychological contracts in organizations: Understanding written and unwritten agreements***. Thousand Oaks, CA: Sage.

Rumelt, R. 1974. ***Strategy, structure, and economic performance***. Boston: Harvard University Press.

Sanders, W. G., & Carpenter, M. A. 1998. Internationalization and firm governance: The roles of CEO compensation, top team composition, and board structure. ***Academy of Management Journal***, 41: 158–178.

Schoar, A. 2002. Effects of corporate diversification on productivity. ***Journal of Finance***, 57: 2379–2403.

Schulze, W. S., Lubatkin, M. H., & Dino, R. N. 2003. Exploring the agency consequences of ownership dispersion among the directors of private family firms. ***Academy of Management Journal***, 46: 179–194.

Sheard, P. 1994. Interlocking shareholdings and corporate governance. In M. Aoki & R. Dore (Eds.), ***The Japanese firm: The sources of competitive strength***: 310–349. Oxford, U.K.: Oxford University Press.

Shleifer, A., & Vishny, R. W. 1997. A survey of corporate governance. ***Journal of Finance***, 52: 737–783.

Simon, H. A. 1947. ***Administrative behavior***. New York: Macmillan.

Thomas, L. G., & Waring, G. 1999. Competing capitalism: Capital investment in American, German, and Japanese firms. ***Strategic Management Journal***, 20: 729–748.

Thomsen, S., & Pedersen, T. 2000. Ownership structure and economic performance in the largest European companies. ***Strategic Management Journal***, 21: 689–705.

Tirole, J. 2001. Corporate governance. ***Econometrica***, 69: 1–35.

Useem, M. 1998. Corporate leadership in a globalizing equity market. ***Academy of Management Executive***, 12(4): 43–59.

Varadarajan, P. R. 1986. Product diversity and firm performance: An empirical investigation. ***Journal of Marketing***, 50: 43–57.

Wahlgren, E. 2001. Spreading the Yankee way of pay. ***BusinessWeek***, April 18.

Wang, H. C., & Barney, J. B. 2006. Employee incentives to make firm-specific investments: Implications for resource based theories of corporate diversification. ***Academy of Management Review***, 31: 466–476.

Weinzimmer, L. G., Nystrom, P. S., & Freeman, S. J. 1998. Measuring organizational growth: Issues, consequences and guidelines. ***Journal of Management***, 24: 235–262.

Westphal, J. D., & Zajac, E. J. 1994. Substance and symbolism in CEOs' long-term incentive plans. ***Administrative Science Quarterly***, 39: 367–390.

Wooldridge, J. M. 2003. ***Introductory econometrics***. Mason, OH: South-Western.

Xu, P. 1997. Executive salaries as tournament prizes and executive bonuses as managerial incentives in Japan. ***Journal of Japanese and International Economics***, 11: 319–346.

Yoshikawa, T., & Gedajlovic, E. R. 2002. The impact of global capital market exposure and stable ownership on investor relations practices and performance of Japanese firms. ***Asia Pacific Journal of Management***, 19: 525–540.

Yoshikawa, T., Phan, P. H., & David, P. 2005. The impact of ownership structure on wage intensity in Japanese corporations. ***Journal of Management***, 31: 278–300.

Yoshikawa, T., & Rasheed, A. 2009. Convergence of corporate governance: Critical review and future directions. ***Corporate Governance: An International Review***, 17: 388–404.

Zingales, L. 2000. In search of new foundations. ***Journal of Finance***, 55: 1623–1653.

Parthiban David (parthiban.david@american.edu) holds the Collins Chair in Strategic Management at American University's Kogod School of Business, where he is an associate professor. He received his Ph.D. from Texas A&M University. His current research interests include corporate governance and its links with strategy and performance.

Jonathan P. O'Brien is an assistant professor of strategic management at Rensselaer Polytechnic Institute's Lally School of Management & Technology. He received his Ph.D. in strategic management from Purdue University. His current research interests include real options, corporate governance, and the strategic implications of firms' financial structure.

Toru Yoshikawa is a professor of strategic management at McMaster University. He received his Ph.D. from York University. His current research interests include corporate governance and boards, collaborative strategies, and venture capital firms.

Andrew Delios is a professor in the Department of Strategy and Policy, National University of Singapore. He obtained his Ph.D. from the Richard Ivey School of Business, University of Western Ontario. His research focuses on international management and international strategy issues for firms competing in Asia.