Lost in Translation? Corporate Governance, Independent Boards and Blockholder Appropriation

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ABSTRACT

Emerging economies are oftentimes characterized by state capitalism, concentrated ownership and constrained resources, where firms face underinvestment due to resource misappropriation. The adoption of Anglo-American corporate governance practices may result in sub-optimal outcomes. We draw on the multiple agency perspective and research on cross-national governance to examine how independent directors, as agents with multiple roles, might mitigate blockholder appropriation. Using unique panel data from Russian publicly traded firms where the government and the business elite are predominant blockholders, we find that independent directors in private firms are less effective in mitigating blockholder appropriation than in state-owned enterprises. We further investigate board independence effects driven by the exposure to three international governance boundary conditions, namely Russian Multinational Enterprises, foreign listings of Russian firms, and foreign independent directors on Russian boards. Our study focuses on the agents that might assuage principal-principal conflicts, explores when ineffective governance can be minimized, and contributes to research on how governance practices developed in advanced economies get translated in emerging market economies.

Keywords:

Corporate governance, blockholders, boards, multiple agency perspective, Russia, MNEs, foreign directors, cross-listings, SOEs

INTRODUCTION

Blockholders are often accused of extracting private benefits from minority shareholders and creditors (Douma et al., 2006) or, as in the case of state-owned enterprises, of mismanagement of funds (Kornai, 1986), resulting in "principal-principal agency" conflicts characteristic of emerging market economies (EEMM) (Dharwadkar et al., 2000; Young et al., 2008). Such misappropriation can take a variety of forms such as appointing unqualified executives in affiliate positions, pursuing projects that advance blockholders' private interests, and diverting assets and cash-flows away from publicly listed firms to parent firms or unlisted subsidiaries through self-dealing transactions. We follow the literature in defining such appropriation of firm wealth as '*blockholder appropriation'* (Sun et al., 2015; Young et al., 2008).

Blockholder appropriation might not be as feasible when firms are exposed to stronger institutional environments. For example, MNCs from emerging markets operating in stronger institutional environments might be pressured to adhere to more effective corporate governance practices. Thus, Anglo-American governance regimes have promoted the role of independent directors to protect shareholders' interests in general (Dalton et al., 2007; Hermalin et al., 1991; Nguyen et al., 2010) and against blockholder self-dealings in particular (Linck et al., 2008). In economies with weak institutional environments such as Russia, boards have evolved from being a mere façade imported from the West to a potential effective instrument for monitoring, and extenuating blockholder abuse. However, we do not know what firm-level factors might trigger these independent boards to fulfill the role of reining in blockholder appropriation (Iwasaki, 2008; Melkumov, 2009). This is a serious omission since the effectiveness of corporate governance practices is contingent on the environment in which they are adopted (Aguilera et al., 2016; Oehmichen et al., 2016; Puffer et al., 2011; Yoshikawa et al., 2009). Board structures designed to address principal-agent

problems in developed economies may be ineffective when applied to weak institutional contexts characterized by principal-principal agency conflicts. Moreover, the consequences of heterogeneous blockholder interests (Hoskisson et al., 2002) differ in weak institutional environments compared to the West, notably creating a multiple agency setting where agents have multiple principals in conflict to attend to (Arthurs et al., 2008).

Accordingly, we examine the role of independent directors as agents of multiple blockholders (principals). In addition, independent directors also represent the adoption of a foreign legitimate board practice that through monitoring is intended to rein in systemic blockholder appropriation. Specifically, we begin by asking whether blockholder appropriation of firm wealth is mitigated by the presence of independent directors in a constrained and weak institutional environment. We then explore two key governance contingencies. First, we examine the effects of internal governance factors, that is, how the relationship between presence of independent directors and blockholder appropriation is affected by the ownership type of the majority blockholder? And second, we analyze how exposure to international governance, and in particular the enabling role of MNCs and foreign directors, affects this direct relationship by activating the monitoring role of independent directors.

We focus on Russia, an important transition economy, because it is a particularly appropriate setting for testing our arguments. First, Russian corporate governance practices contrast sharply with Anglo-American practices, even though company law and corporate governance codes have been largely inspired by Anglo-American rule-making. The clash between Anglo-American and Russian socioeconomic environments meant that, at least initially, when the country became a market economy, Russian companies only partially adopted well-established Anglo-American practices. Second, the presence of independent directors has increased significantly since the early 2000s, when the concept of independent

directors was introduced with the first corporate governance code. In 2005, it was uncommon to find independent directors in Russia (Iwasaki, 2008), where firm boards were largely dominated by inside directors affiliated with the two types of owners: wealthy private individuals or the state. However, by 2015, independent directors on average accounted for 30% of boards (RID, 2015), a threshold in line with the recommendations of the 2014 Corporate Governance Code. Yet, scarce research exploring the effectiveness of independent directors in Russia is inconclusive, with the majority of studies finding a positive effect of independent directors on firm performance, while a minority arguing that independent directors do not seem to help improve corporate governance or mitigate the private benefits of control (Muravyev, 2017; Muravyev et al., 2014). Finally, the two distinctive blockholders in Russia (oligarchs and the state) are quite different from institutional blockholders in developed countries as they have exhibited greater control over the firm assets and boards (Grosman et al., 2016). Hence, the severity of systematic blockholder appropriation and stealing in Russia and the need for stronger boards to tilt the power balance away from blockholders make the Russian corporate sector an ideal context to examine how the roles of independent directors get shaped by blockholders and the exposure to foreign practices.

We make the following contributions to the literature. First, we extend the boundary conditions of multiple agency perspective by examining multiple demands on agents (Arthurs et al., 2008; Bruton et al., 2010) in an institutional context distinct from the Anglo-American model. We identify the heterogeneity of owners and acknowledge the presence of the principal-principal conflicts that might lead to blockholder appropriation and minority shareholders' expropriation. We turn our attention beyond the principal-principal relation to focus on the demands that agents, in our case directors, might get from these heterogeneous blockholders, what is referred to as multiple agency conflict. Specifically, we show that the effect of independent directors in mitigating blockholder appropriation is contingent on the

type of block ownership to which these agents are exposed. To the best of our knowledge, there are no prior studies drawing on multiple agency perspective that explain the multiplicity of demands on *agents* in emerging economies as most literature in these markets focuses on the multiplicity or duality of *principals* (Filatotchev et al., 2011; Jiang et al., 2011; Young et al., 2008). We respond to the recent call in Aguilera et al. (2016) for future research on the effects of firm-level ownership structures on firm behavior and outcomes.

Second, we investigate how exposure to international corporate governance practices might activate the role of independent directors. In particular, we explore three key international governance contingencies that might influence how boards behave when the firm is a Russian Multinational Enterprises (MNEs), is listed in a foreign stock market, or when their independent directors are foreign. In doing so, we also contribute to IB research by studying how foreign governance practices might get 'lost in translation' unless properly activated through internal governance mechanisms (ownership) or when sufficiently exposed to international governance pressures (Aguilera et al., 2017; Bell et al., 2014).

Third, we contribute to contextual research on state capitalism (Grosman et al., 2016; Lazzarini, 2015; Megginson, 2017; Musacchio et al., 2015) by extending the emerging literature on boards (Muravyev, 2017; Muravyev et al., 2014) to consider the relationship with ownership types (Chernykh, 2008; Durnev et al., 2005; Iwasaki et al., 2017). Specifically, we offer insights adding to the limited analysis of the effect of independent directors on firm performance in Russia (Muravyev et al., 2014; Muravyev, 2017) by analyzing the moderating effects of independent directors for different types of firms' exposure to Anglo-American governance practices and firm ownership.

There are no studies in leading international business journals on corporate governance in the 'new' Russia, with the exception of a few multi-country studies where the focus is not on Russia alone, and one purely conceptual study (Melkumov, 2009). Hence, we

think this research is timely and also joins the comparative corporate governance debate on how governance practices travel across different institutional environments and the role of MNEs in bridging these two governance worlds.

EVOLUTION OF NATIONAL CORPORATE GOVERNANCE

Institutional background

The initial Law on Joint Stock Companies (JSC), the main legislative act regulating corporate governance in early 2000 and the voluntary Corporate Governance Code issued in 2002 are seen as attempts to integrate an Anglo-American model of governance by emphasizing shareholder rights protection (Roberts, 2004). In the early years of transition to a market economy, Russian companies were careful to adhere to the letter of the law but in a context where the laws themselves were incomplete or imperfect, the intention of the law was purposely circumvented, often at the expense of minority shareholders, such as dilution of capital, unfair transfer pricing, unlawful transactions with related parties, and outright stealing (e.g., Puffer et al. (2003) provide examples of early abuses by blockholders). In subsequent years, the introduction of the new Corporate Governance Code in 2014 and the eagerness of private blockholders to attract external capital by listing their firms in foreign stock exchanges led to gradual integration of host corporate governance practices and mitigation of blockholders' abuses (Muravyev, 2017).

The adopting of Anglo-American inspired laws and regulations was not without challenges in State-Owned Enterprises (SOEs). While perhaps less prone to private blockholder expropriation (state managers and board directors typically do not own substantial share capital), the pyramidal structures of state-owned holding companies, originally set up to facilitate the monitoring and management of a large portfolio of firms, ended up being cumbersome and not as transparent as privately owned firms. For example, Gazprom, a natural gas SOE, was one of the worst firms in terms of corporate governance

standards for which the company is heavily penalized in terms of market value (Black, 2001). These problems have led to increased government involvement with Putin replacing the CEO of Gazprom with his own appointee (Puffer et al., 2003).

Ownership

The main corporate governance features in EEMM, and Russia in particular, are high ownership concentration and high private benefits of control resulting from weak property rights protection and underdeveloped capital markets (Enikolopov et al., 2013). Iwasaki et al. (2017) meta-analysis finds that state ownership negatively impacts firm performance in Russia, while private ownership is positively associated with firm performance. Behind nominee and foreign offshore arrangements there are ultimate controlling owners who are either the state or domestic private individuals (Chernykh, 2008). Since the state plays a key role in the economy, some independent directors are very strongly associated with the state (Megginson, 2017). Candidates are nominated by a government body rather than by independent nomination committee. Further, in SOEs, independent directors are obliged to follow government directives in voting on many strategic issues (Enikolopov et al., 2013). In 2008, the government announced that state officials in SOE boards were to be substituted with independent directors and professionals, such as attorneys, who would represent their interests and minimize conflicts of interest with minority owners (Enikolopov et al., 2013).

In their cross-country study on corporate governance (which excludes Russia), Durnev et al. (2005) highlight the significance of ownership concentration, and conclude that having more share capital deters owners from stealing. However, in transitioning Russia, quite the opposite applied as the insecurity of property rights resulted in a deterioration of corporate governance practices through ownership concentration. Private blockholders sought to increase their stakes in other firms by diluting shares of minority shareholders, which they achieved by using loopholes in the legal system, and outright theft. Maximizing investments

and value of assets through improving corporate governance was at best a secondary issue and for private blockholders even undesirable, because it could have limited their ability to expropriate (Enikolopov et al., 2013). This situation began to change at the beginning of 2000s, as the focus of attention started to shift towards increasing market value of the assets already owned and as a result, blockholders made significant improvements in corporate governance. We address this relationship between ownership and appropriation by distinguishing between the types of concentrated blockholders: state and private individuals.

THEORETICAL FRAMEWORK AND HYPOTHESES

We develop an organizing framework to examine whether the introduction of Anglo-American governance practices enhances the effectiveness of corporate governance in EEMM. In particular, we explore whether the presence of independent directors attenuates the degree of blockholder appropriation (baseline hypothesis), commonly referred to as stealing. Next, we analyze how effective independent directors are in deterring blockholder appropriation contingent on: (1) internal corporate governance controls, that is, the identity of the blockholder they represent, and (2) external corporate governance pressures, that is, the firm exposure to Anglo-American practices, which might activate the spirit of their independent director role.

Insert Figure 1 about here

Effective corporate governance through independent directors

While non-executive directors' independence is a common governance practice, the notion and functions of independent directors vary remarkably across different jurisdictions (Ferrarini et al., 2014). The most common approach defines independent directors as individuals without a business or family relationship with the firm, to prevent conflicts of interests with the corporation (Zattoni et al., 2010). Given the different institutional context in

EEMM related to the strong role of state in the economy, the Russian governance code has a unique additional exclusion – an independent director cannot be a representative of the Russian government. Further, after seven years of service on a company board, a director can no longer be considered as independent. Moreover, Anglo-American listing rules and codes require at least the majority of board seats to be composed by independent directors. The composition requirements are less stringent for EEMM, given the relative infancy of corporate governance practices. In Russia for instance, the corporate governance code recommends at least 25% of total board for independent directors and at least three independent directors in absolute numbers.

The governance literature indicates that directors should have both functional and firm specific skills. Independent directors are valuable in providing oversight of a firm's financial practices and may protect shareholder's interests affecting important board outcomes, such as CEO substitution, the reaction to potential takeovers, and top management's compensation (Zattoni et al., 2008). Independent directors offer different perspectives from executives on strategic decisions, and this increases the likelihood of creative and innovative solutions (Roberts et al., 2005).

Research on understanding the functions of independent directors in EEMM is rather scarce. During the earlier period of transition, independent directors in EEMM were not fully fulfilling their roles, largely due to the lack of guidance in the corporate governance code (Braendle, 2015). Subsequently, directors were given more rights and power in order to signal efforts to improve the governance of EEMM firms and to attract investors. For instance, de Haas et al. (2017) analysis of directors appointed by the European Bank for Reconstruction and Development (EBRD) to companies in which EBRD is a shareholder suggested that independent board directors in EEMM assume the roles of monitoring, advice and resource provision broadly similar to what one would expect from independent directors

in the Anglo-American environment. On this basis of the conventional wisdom of board independence as a mechanism to protect minority shareholders against blockholders' self-dealings, we propose our baseline hypothesis (H0):

H0. A higher proportion of independent directors in emerging market firms is likely to attenuate the degree of blockholder appropriation.

Internal corporate governance: Private vs. State Blockholders

In their monitoring role, independent directors in EEMM are mandated to protect the interests of all shareholders. Yet, they might face a principal-principal (PP) agency problem between majority and minority shareholders, due to weak minority shareholders' rights protection and directors' incentives aligning with the most powerful blockholder. PP conflicts emerge from differences in principals' goals and objectives. One of the consequences of not effectively managing PP conflicts is blockholder appropriation of real firm resources, accomplished through legal or illegal means, resources that would have otherwise been reinvested in the firm in the form of fixed investments.

As independent directors are agents of both majority and minority shareholders, and respond to their multiple and often conflicting demands, we adopt a *multiple agency perspective* (MAP) (Allcock et al., 2010; Arthurs et al., 2008; Bruton et al., 2010; Child et al., 2003; Hoskisson et al., 2013; Hung, 1998). MAP applies to situations in which agents are connected to more than one principal. Being connected to more than one principal, independent directors as agents have a dual identity. MAP extends agency theory by considering the potential tensions an independent director as an agent might encounter as a result of this dual identity (Pratt et al., 2000). Unlike traditional agency theory, MAP recognizes that principals and their agents could implement actions which are favorable to some, but detrimental to other principals (Sarens et al., 2016). We extend MAP by looking at how effective independent directors are in tackling blockholder appropriation depending on

the identity of the blockholder. The type of blockholder matters because *de facto*, the independent director is selected by the blockholder.

We analyze two types of blockholders – domestic private wealthy individuals (who control private firms) and the state (who control state-affiliated entities or SOEs), as majority ownership by financial institutions and foreigners in Russian firms is very rare (Chernykh, 2008; Iwasaki et al., 2017). There are several reasons for the appointment of independent directors in private firms. First, private firms may be in search of external funds, and independent directors might grant access to such funds through their external contacts (Hillman et al., 2003) or by increasing the firm's credibility. Second, independent directors in assuming their external roles act as a bridge between competencies and a conduit for information flow between the company and its economic and political environments (Melkumov, 2009). Third, independent directors' roles in private firms may also include maintaining stakeholder relations. More specifically, in EEMM, serving the interests of even distant stakeholders such as media, local authorities, business associations and auditing firms has been historically important as EEMM firms still consider operating within the network economy as one of the viable ways of doing business (McCarthy et al., 2003; Puffer et al., 2007). We expect that private blockholders in EEMM appoint independent directors to largely fulfil these external roles (Dolgopyatova et al., 2015) and that such appointments help blockholders obtain additional resources via legal channels, as well as making blockholders more transparent towards the external environment and more accountable towards minority shareholders and stakeholders. The multiplicity of independent directors' roles is reflected in independent directors being closely associated with the private blockholder, fulfilling an external role of capital provision which would benefit the blockholder to a larger extent, while another role is towards minority shareholders by bringing increased transparency towards external environment and by attempting to make blockholder stealing less

straightforward. Taken together, the presence of independent directors in private domestic firms leads to lesser degree of blockholder misappropriation of resources. Therefore, we propose,

H1a. In emerging market firms controlled by domestic private blockholders, independent directors are likely to attenuate the degree of blockholder appropriation.

When it comes to SOEs, the roles of independent directors are harder to disentangle than for private firms. Traditionally, SOEs boards were mostly filled with insiders, current or former governmental officials in charge with pursuing political or bureaucratic agenda (Puffer et al., 2007). However, SOEs progressively became more market and profit-oriented and this dynamic change led to a redefinition of board roles with more independent directors being appointed. We argue that when an SOE decides to appoint independent directors to the board, the state and managers are seeking a more efficient internal capital allocation, resulting from better monitoring, advice or sanctioning from independent directors. The state as a shareholder might be looking to diminish the negative effects of soft budgeting. However, the independent director, as an agent, will be conflicted to address the interests of the state as well as those of minority shareholders which might not always be aligned.

Although the number of SOEs appointing independent directors has increased, SOEs are less enthusiastic about integrating Anglo-American governance practices of advanced market economies (RID, 2014). In addition, while some SOEs get listed in foreign markets, it is unusual for them to appoint foreign independent directors (Kriukova, 2009). This also suggests that the purpose of independent board members in SOEs might be fundamentally different from private firms. Thus, we argue that when SOEs appoint local independent directors, it is not as symbolic as in private firms. Independent directors' roles are less related to resource provision but to offering professional or industry expertise, as well as to increase monitoring of management and funds allocation. Conversely, foreign independent

directors are more likely to be appointed to boards of private firms, where their main function is resource provision, networking and enhance credibility towards foreign investors.

In Russia as in other EEMM, independent directors in SOEs are selected from the national register of independent directors and recommended to the board by the state (PwC, 2013), rather than voted by the independent nominations committee. *De facto*, an independent director appointed to the board of an SOE is the one that the state recommends. Further, in SOEs, independent directors are obliged to follow government directives in voting on many strategic issues (Enikolopov et al., 2013). In fact, many SOE independent directors envisage this board position a possible entry into a career in politics or at least as a way of establishing personal political ties with high state officials (Nehaytchuk et al., 2015). Given this political goal to progress in the state career ladder, these directors might become more recognized for producing efficient financial results during their term relative to the incentives of inside directors. In other words, they are viewed favorably by the government if contributing to firm efficiency such as by reducing state funds mismanagement. They might also be more efficient as civil servants in doing so relative to their counterparts in private firms who are subordinated to private blockholders' will. Thus, board independence attenuates the effects of blockholder misappropriation when firms are controlled by the state.

In sum, in SOEs, independent directors are more professionalized and seem to contribute more to overall firm efficiency, while in private firms with blockholders seeking to capture rents, independent directors have less control over blockholder appropriation, as they are appointed primarily for service provision rather than monitoring. Hence, we propose,

H1b. In emerging market firms controlled by domestic private blockholders, independent directors attenuate less the degree of blockholder appropriation than independent directors in SOEs.

External corporate governance

We now turn to what happens when the role of these independent directors is fully activated through the exposure of EEMM firms to international corporate governance standards. By full activation, we refer to the transition from simply adopting a practice, maybe symbolically, to fully enacting or internalizing the practice. In the case of independent directors, Aguilera et al. (2017) show for instance that in Japan, companies had adopted independent boards for a long time, yet these boards did not pursue monitoring until firms had a certain amount of pressure from foreign institutional investors. It was the significant exposure to international governance practices that activated their independent role. Below we discuss three contingencies that appear in the Russian context: Russian firms that internationalize (MNEs), Russian firms that list in foreign markets, and Russian firms that invite foreign independent directors to their boards.

Independent directors in MNEs

The diffusion of stronger corporate governance practices to weaker regimes may occur through the internationalization of firms from EEMM as they equip themselves with the necessary corporate governance to compete globally (Aguilera et al., 2017; Sojli et al., 2017). As EEMM firms expand operationally into North America and Europe, they encounter new institutions and get exposed to the often higher levels of governance and transparency of host countries. Even though some structural governance conditions are likely to persist such as concentrated blockholders, family ownership (Aguilera et al., 2016) and business groups (Bhaumik et al., 2016), these EEMM multinationals present in advanced institutional settings will have to reconcile their emerging market corporate governance systems and pursue true independent directors' roles and provide greater transparency.

We expect that EEMM MNEs, through higher exposure to international corporate governance practices, bond with the standards of host countries. Their independent directors

are also more internationally oriented and encouraged by the blockholders to take on more responsibilities in decision making. Studies of US MNEs document that these firms have boards with more internationally experienced and younger directors (e.g. Sanders et al., 1998). Internationalization of a firm's operations increases the complexity of monitoring due to a higher asymmetry of information between the management, the blockholder and the board which increases the need for independent directors with the relevant skills for efficient monitoring. A higher degree of commercial internationalization is also associated with a higher number of independent directors with international experience (Oxelheim et al., 2013). In their advisory role, independent directors bring to the board important expertise and important network ties, which can lead to better decisions and resource use (Daily et al., 2003). We expect that a higher proportion of independent directors on the board would reduce blockholder appropriation in MNEs.

H2. A higher proportion of independent directors is likely to attenuate the degree of blockholder appropriation in emerging market MNEs.

Cross-listings and bonding

The need for access to global capital markets sharpens firms' incentives for better governance (Doidge et al., 2007). Cross-listing allows access to foreign capital which helps the firm grow rapidly and without leverage (Pagano et al., 2002). For EEMM firms, financial relocation to the developed markets can result in some of the national corporate governance standards being replaced by the host country standards (Bell et al., 2014; Coffee Jr, 2002), paving the way for greater legitimacy. Their cross-listing might lead to stronger 'bonding' with the governance standards of a host country (Peng et al., 2014) than in case of commercial internationalization of MNEs, as there are specific requirements to fulfil in order to cross-list, and partially compensate for weak protection of minority investors in their home markets (Coffee Jr, 2002). Cross-listing can also be an important signaling mechanism for

firms wanting to change perceptions of their corporate governance levels (Temouri et al., 2016). With cross-listing, the role of independent directors is more fully activated than with MNEs, as there are stricter rules of listing exchanges to abide by. We expect that when a firm embeds itself in a stronger institutional environment of the country where it decides to cross-list, a higher proportion of independent directors is likely to attenuate blockholder appropriation.

H3. A higher proportion of independent directors is likely to attenuate the degree of blockholder appropriation in emerging market firms listed on foreign stock exchanges.

Foreign independent directors

The inclusion of foreign independent directors, i.e., directors domiciled in foreign countries, offers an alternative way that firm's corporate governance practices of a country can change as a result of exposure to the corporate governance practices in other countries (Miletkov et al., 2016). Foreign directors appointed to Russian boards are high profile professionals the international market and cannot compromise their reputation with companies potentially involved in self-dealings and appropriation. While generally such foreign independent directors are respected industry specialists (Kriukova, 2009), some other appointments were meant to create more impact amongst European political and regulatory circles (i.e., Gerhard Schroeder, the former German Chancellor, at TNK-BP and Peter Mandelson, a former British Labor Party Politician, at Sistema). Differences between governance standards in directors' country of origin and that of the firm on whose board they serve can lead to changes in the firm's governance in a way that is different from changes related to other directors (Miletkov et al., 2016). Appointing foreign independent directors originating from developed countries reduces firm's cost of capital by creating further legitimacy with the investment and political community and bonding with higher corporate governance norms of directors' countries of origin. Foreign independent directors are

expected to offer valuable international expertise and advice, especially to firms with significant foreign operations, dealings with foreign suppliers or plans for overseas expansion via acquisitions (Adams et al., 2010). Foreign independent directors are more likely to be familiar with US or UK accounting rules, laws and regulations, making it easier for them to advise the EEMM firms that are willing to internationalize. Bonding non-operationally and non-financially with the norms and practices of a foreign country through the expertise provided by a foreign independent director may thus mitigate the "liability of foreignness" in capital markets that emerging markets firm can experience (Bell et al., 2012). We expect foreign independent directors to provide monitoring of managers and blockholders, and advice on how to streamline the operations and resource allocation.

H4. A higher proportion of foreign independent directors in emerging market firms is likely to attenuate the degree of blockholder appropriation.

DATA AND DESCRIPTIVE STATISTICS

We use data that tracks financial information on 60 largest liquid Russian listed stocks (representing over 2/3 of total market capitalization) from Compustat Global complemented by self-collected information from public sources, such as business media Vedomosti, Forbes and Kommersant; and web disclosures, on these firms' major blockholders and board characteristics between 2000 and 2010. Our results remain unchanged for a reduced panel with three consecutive observations for each firm. When excluding outliers (trimming, winsorizing at the 1st and 99th percentiles the key variables), the main results also remain unchanged. The studied period covers important changes in the institutional environment driven by such exogenous events as the appointment of President Putin in 2000, the introduction of the Code of Conduct spelling out governance standards in 2002; and the 2008 financial crisis.

The quality of Russian accounting data has been questioned (Braguinsky et al., 2013; Kuznecovs et al., 2012), but an attenuating factor is that the firms are all listed and often dual listed on foreign exchanges. Moreover, the accounts for such large companies are mostly prepared according to International Accounting Standards (IAS) or US Generally Acceptable Accounting Principles (GAAP) and audited by reputable accounting firms.

Table 1 lists number of observations, mean, median, standard deviations, and minimum and maximum values for the most common variables used in the empirical specification. Descriptive statistics and correlations are produced for the balanced panel of firms (218 observations) with no missing values (the same applies to the tables with results). Average annual sales for the sample are €1 billion, average fixed investment amounts to €152 million and median investment to €408 million. About 75% of the private firms with independent directors are part of a group in our sample. The majority of Russian companies are either governed by a board of directors with an extremely high proportion of independent directors or completely dominated by insiders (Iwasaki, 2008). Our sample reflects this proportion, with roughly half of firms' boards composed by insiders only, and over 30% of firms' boards having a proportion of independent directors between 22% and 62% of the total board.

Insert Tables 1 and 2 about here

EMPIRICAL SPECIFICATION AND METHODOLOGY

We begin with the dynamic model of investment that includes measures of the use of external finance (Brown et al., 2009b). The specification includes cash flow sensitivities of fixed investment to different ownership and board structures. The cash flow sensitivities allow us to test for blockholder appropriation and misallocation (soft budget constraints) of different owners. This dynamic specification of investment, based on Brown et al. (2009b), is

the Q-model. Q-models of investment provide an empirically fruitful framework for the analysis of firms' decisions to invest and are widely used in investment literature (Blundell et al., 1992). Tobin's Q represents the ratio of the market value of a firm's existing shares to the replacement cost of the firm's physical assets. If Q is greater than one, additional investment in the firm would make sense because the profits generated would exceed the cost of firm's assets. If Q is less than one, the firm would be better off selling its assets instead of trying to put them to use. The ideal state is where Q is approximately equal to one denoting that the firm is in equilibrium.

We use OLS regressions with firm fixed effects which assist in controlling for unobserved heterogeneity when this heterogeneity is constant over time. This heterogeneity can be removed by taking a first difference which will remove any time invariant components of the model. The fixed effect assumption is that the individual–specific effects are correlated with the independent variables. Fixed effects models are standard in the investment literature (Brown et al., 2009b).

In addition, we use the GMM estimator developed by Arellano et al. (1995) and Blundell et al. (1998), where lagged values of endogenous regressors are used as instruments, and which is robust to heteroscedasticity and arbitrary patterns of autocorrelation within firms. Similar approaches have been used in a number of other applied studies (Beck et al., 2006; Brown et al., 2009b). Lagged dependent variables are valid instruments when they are also affected by similar firm-level institutions. As Wintoki et al. (2012) notes: "A key insight of the dynamic panel GMM estimator is that if the underlying economic process itself is dynamic—in our case, if current corporate governance [*here: independent directors ratio*] is related to past performance [*here: investment*]—then it may be possible to use some combination of variables from the firm's history as valid instruments for current corporate governance to account for simultaneity."

Dependent Variable

Fixed Investment and blockholder appropriation

The dependent variable, investment, is the first difference of natural logarithms of capital expenditures on long-term fixed assets from cash-flow statements. We include a lagged investment term, based on formal models of investment behavior, to account for the presence of adjustment costs of investment (Brown et al., 2009b). Data on more refined measures of non-redeployable investment, such as R&D expenditures, were unavailable. However, in less developed markets, firms tend to have more pressing needs to invest in infrastructure and machinery so as to build industrial production capacity (Cimoli et al., 2009; Inoue et al., 2013) rather than R&D. We thus believe that the extent of fixed asset investments is correlated with firms' orientation toward complex, long-maturity projects, for which access to more resources via improved board monitoring can be of particular help. Our main construct, *blockholder appropriation*, is measured by the coefficient between investment and internal gross cash-flow discussed below.

Independent Variables

Internal gross cash flow: Internal gross cash flow ("GCF"), a proxy for resources, is based on standard specification (Brown et al., 2009b) and is the first difference of the logarithms of the firm's GCF at the end of period *t-1*. GCF is defined as the sum of net income and depreciation and amortization charges. We use the magnitude and sign of the coefficient of gross cash-flow to investment to measure the likely degree of blockholder appropriation following other well-established studies in agency theory. GCF and its variations (Brown et al., 2009a; Fazzari et al., 1988) are used widely in the literature as a proxy for the magnitude of private benefits (Adams et al., 2007; Chen et al., 2011; Kabbach de Castro et al., 2017; Lehn et al., 1989; Linck et al., 2008; Raheja, 2005), meaning that the higher the cash-flow, the higher the potential for the blockholder to expropriate or misuse

these funds. High GCF increases the potential for opportunistic behavior by blockholders in which blockholder utility maximization prevails over firm value maximization (Bertrand et al., 2003; Gomez-Mejia et al., 2001; Kabbach de Castro et al., 2017). We believe that our measure of blockholder appropriation enhances the existing literature because we capture how GCF translates into investment in fixed assets and firm long term growth, as opposed to being used for other purposes enhancing blockholders' private wealth. Conversely, a negative relation between GCF and fixed investment indicates a possibility of some rent seeking or cash bleeding. Higher private benefits of control have been associated with blockholder appropriation in previous literature, including emerging economies markets (Barclay et al., 1989; Dyck et al., 2004; Muravyev et al., 2014).

Our underlying assumption is that Russian firms need fixed investment – official statistics and empirical research show that the Russian asset base is relatively old (Dzarasov, 2010) – so that Russian firms are not likely to over-invest in new assets for empire building or other self-dealing reasons. This is why we feel quite confident that a negative coefficient of gross cash-flow to investment would either capture blockholder appropriation or the presence of inefficiencies. *Ceteris paribus*, if free cash flow does not translate into investment, it shows that it is deployed elsewhere (while we control for other sources of funds for investment, such as debt and equity).

Block ownership: Block owners are majority shareholders (>50%). We define three types of block owners: state, private individuals, and institutional (foreign) investors. Ownership concentration above fifty percent was of prime importance for managing the firm, given a legal environment which had weak protection of property rights (Adachi, 2013). After accounting for missing data, 73% of observations correspond to firms with majority shareholders highlighting the predominant concentrated ownership structure of Russian companies. Of this sample, 51% are private firms, 46% are state-controlled and only 3% are

majority owned by foreign (institutional) investors. This is in line with existing literature (Iwasaki et al., 2017) that finds that ownership by financial institutions and foreigners in Russian industrial firms is negligible. Private firms are often structured as pyramids or through cross-shareholdings. In these structures, the private blockholder achieves control of constituent firms via a chain of ownership relations. We account for ultimate control as opposed to immediate ownership, disentangling pyramid structures, cross-holdings and other mechanisms that mask the ultimate ownership (similar methodology is used in Chernykh, 2008).

Board directors: There are three types of board directors – independent, executive and non-executive. Executive board directors are those individuals who are also members of the top management team, e.g. CEO or CFO. Executive and non-executive directors are collectively categorized as insiders.

Independent board directors: The Russian Corporate Governance Code specifies that JSCs should have at least three independent directors who account for no less than 25% of board membership. The presence of independent directors is a requirement for larger companies listed on foreign stock exchanges and on the Russian stock exchanges for top-tier A1 and A2 quotation lists. The dummy variable for independent directors takes the value 1 if there is at least one independent director and 0 otherwise (in which case they are classified as *insiders*). The variable for proportion of independent directors comprises a ratio of number of independent directors to total supervisory board size. Half of the firms in our sample have at least one independent director. Although the Russian Corporate Governance Code recommends a certain threshold of independent directors as described above, an average proportion of independent directors in our sample is much lower, at 13.94%. Firms appoint independent directors until the proportion of independent directors on the board reaches a certain threshold around 15%-30% of the board (along the recommended level by the

corporate governance code), and then the number of independent directors remains constant in the following years. Hence the annual growth in the number of independent directors is observed mostly for the firms with 0 independent directors, i.e. until they hire 2-3 independent directors. The same two variables (dummy and proportion) are compiled for *foreign independent directors*. Extant literature found a lack of consistency by firms in interpreting the definition of 'independent' and a lack of disclosure of information (Brennan et al., 2004). Where the information is unavailable or inconsistent, we classify the directors based on the definition detailed in the theoretical framework section. For example, directors on SOEs' boards with current or past government roles as directors, executives, politicians or bureaucrats are not considered as independent, in line with the Corporate Governance Code, even if the firm discloses them as independent.

Multinational Enterprises (MNEs): We consider a Russian firm to be an *MNE* when it is not just purely exporting abroad, but has substantial operations in other host countries, including CIS countries, such as local operating subsidiaries or standalone firms acquired as part of an international expansion strategy. For example, TMK, a global supplier of pipes for the oil and gas industry, is an MNE as it has operating subsidiaries in the United States, Canada, Romania, Oman, UAE, and Kazakhstan. 30% of firms in our sample qualify as MNEs.

Listing stock exchanges: This dummy variable takes the value of 1 for *foreign* and *dual listings* and 0 for Russian listings. When they go abroad, Russian firms most often list on London Stock Exchange, with a few listed on other European or US stock exchanges.

Main Control Variables

Following Bond et al. (1994) we include debt and equity issues to control for alternative sources of finance to internal resources and to evaluate the changing role of external finance for investment. *Debt* measures net new long-term firm indebtedness, and is in natural

logarithm form. New *equity* (in natural logarithm) measures net new funds from stock issues. *Tobin's Q* is the ratio of market value to total book value of assets and is a proxy for investment opportunity or demand for investment.

RESULTS

We report the results for hypothesis H0 that looks into the effects of independent directors on blockholder appropriation in Table 3. In terms of the interaction between the proportion of independent directors and GCF, we find that the estimated coefficient is positive and significant in both FE and GMM specifications (b=0.84, p<0.05 in FE and b=0.36, p<0.05 in GMM). Further, the overall effect of GCF on investment for firms with a higher proportion of independent directors (as measured by the sum of the coefficients on GCF and on the interaction between GCF and ID Proportion) is positive and significant (the reported Wald test for joint significance of these coefficients is significant at p<0.01 in FE and p<0.01 in GMM). Regarding economic significance, an increase in GCF growth by one percent increases investment growth among firms with a higher proportion of independent directors by approximately 0.70 percent in FE, and an increase of one percent in GCF increases investment by 0.32 percent GMM[1]. These findings support the baseline hypothesis H0 that a higher proportion of independent directors is likely to extenuate the degree of blockholder appropriation. We plotted the two-way interaction effects in Figure 2. We also test for the quadratic effect of independent directors. We find that there is no difference between the linear and the quadratic predictions of independent directors' proportion on investment (R^2 is 0.1215 for the linear term and R^2 of 0. 1222 for the quadratic term).

Insert Table 3 and Figure 2 about here

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[1] The GCF and Investment variables are in first differences for fixed effects, and in levels for GMM specification.

We report the results from testing hypotheses H1a and H1b on independent directors in firms controlled by private blockholders, and their effectiveness relative to SOEs in Table 4. We follow Fairchild et al. (2009), Miletkov et al. (2016) and Reinholt et al. (2011) to model the moderation effects. Models (1) to (4) test hypothesis H1a on a sub-sample of private firms. Models (1) and (2) show the results for fixed effects, while models (3) and (4) show GMM. In models (1) and (4), we introduce Tobin's Q to control for investment opportunities, which reduces the total number of observations. The limited data on Tobin's Q is due to the relative infancy of the Russian stock market with earlier years in the period having fewer listed firms.

The interaction effect of GCF and independent directors on investment for *private* firms is positive and mostly significant in FE (as per model (1): b=2.64, p<0.05) and GMM (as per model (3): b=0.86, p<0.1). The direct effect of GCF on investment for private firms is negative and insignificant except in model (1) where it is significant at p<0.10, indicating some degree of blockholder appropriation. The total effect for private firms *with independent directors* (summing the coefficient of GCF and that of the interaction between GCF and ID Proportion) as per model (3) is significant and positive (confirmed by the reported Wald test with p<0.05) meaning that for an increase of 1% in GCF, investment would increase by 0.80%, and as a result, there is less likelihood of blockholder appropriation for private firms with independent directors, supporting hypothesis H1a[2]. We plotted the interaction effect of the proportion of independent directors on the relationship between investment and gross-cash flow (GCF) for the sub-sample of privately owned firms based on the estimated effects reported in the results of Table 4 (models (1)-(3)). The higher the ratio of independent

[2] Governance may be constrained not merely by shareholders but by bondholders. We have measured the effects of bondholders by examining debt ratings by the major ratings agencies. We were able to collect bond ratings for 10 firms (17% of total sample). While this is only a small proportion of our sample, we have tested our baseline hypothesis in OLS on this sub-sample (unfortunately, the number of firms further drops to 6 as we include all the explanatory variables). The results indicate that in economic terms, for firms with public bonds and a proportion of independent directors, every 1% increase in cash-flow leads to an increase of 6.84% in investments

directors, the higher the impact of GCF on investment for private firms, hence we observe a positive slope, as per Figure 3.

Insert Table 4 and Figure 3 about here

We then test hypothesis H1b on the relative effect of independent directors in private firms compared to SOEs in models (5)-(8) of Table 4. We use three-way interactions, e.g. GCF*blockholder*director, where blockholder is a dummy variable, indicating either state, domestic private, or foreign blockholder, and director is a dummy indicating the presence of at least one independent director (indep) as 1 and 0 otherwise (insider) [3]. Firms controlled by domestic private blockholders with independent directors (GCF*private*indep.) on the board represent most privately-owned firms in our sample. Examples of such firms include mineral fertilizer Acron, steel making and mining company Evraz, natural juice producer Lebedyansky, mining and metals company Mechel, mobile operator MTS, natural gas producer Novatek and Sistema, a large conglomerate company, headed by Vladimir Yevtushenkov. These firms are generally viewed as progressive in terms of their corporate governance practices. The SOEs with independent directors (GCF*state*indep.) during the period of our study are fewer. At state-owned Aeroflot, for example, all three independent directors have been nominated by private holders of a blocking stake, which allows them to conduct their policies. These independent directors effectively offset the dominant control of the government. They are active although it is not clear whether they are capable of representing interests of minority shareholders. Like state nominees, they vote together: there are practically no disagreements among them. Another recent example of an SOE with prominent independent director presence is Rosneft which reappointed Gerhard Schroeder,

[3] To avoid comparing the coefficients across different sub-groups of firms and testing the differences in coefficients for statistical significance, we have them all in one specification by using the three way interactions. Specifications in models (5) to (8) have mutually exclusive and exhaustive dummies on GCF with all the possible combinations (6 in total), therefore we do not need to report the direct effect of GCF.

the former Chancellor of Germany to the board in 2017 (although during the period of our study, Rosneft did not have any independent directors). Mr. Schroeder was entitled to $500,000 annual base pay at Rosneft but officially declined it to mitigate criticism from his political party SPD and the Chancellor Angela Merkel. His role at Rosneft is to facilitate Russo-German relations and investments, since Rosneft has 12% market share in Germany, and is investing €600 million in modernization of the assets it owns in Germany (PCK, Miro, Bayernoil). In the last seven years, Rosneft supplied Germany with 132,000,000 tons of oil for a cost of about €75 billion (Raibman, 2017). This example supports our empirical evidence that the presence of high profile independent directors in SOEs can have a big role in these SOEs legitimacy building and internationalization.

Private firms without independent directors (GCF*private*insider) are less transparent, and it is harder to get an understanding of their corporate governance practices, since very little is publicly disclosed. Representative firms in this category are oil companies Bashneft and Slavneft, the retailer GUM, and TMK, a global supplier of a range of pipes for the oil and gas industry. Bashneft, one of ten largest oil companies in Russia, was part of Sistema conglomerate at the time of our study period, and the board of directors of Bashneft was composed entirely by insiders, and it is believed it played a nominal role if not colliding with the board of Sistema.

Finally, SOEs with boards composed by insiders only (GCF*state*insider) are still predominant in Russia. Representative SOEs include the diamond mining company Alrosa, long-distance telephony provider Rostelekom, banking and financial services company Sberbank and many others. Regarding economic significance, model 5 in Table 4 shows that the GCF growth in private firms with independent directors has an impact of 0.26%[4] on

[4] To calculate the total effect of GCF in private firms, we add the two interactions together, GCF*private*indep. and GCF*private*insider

investment growth, GCF in SOEs with independent directors has a larger impact of 0.44% on investment (we test the sum of coefficients being different from 0, and the null hypothesis is rejected at $p<0.001$ significance level).

To test hypothesis H2 concerning effects of independent directors in MNEs, we use the sub-sample of MNEs (Table 5, models (1) and (2)). The moderating effect of independent directors' is positive and significant ($b=1.10$, $p<0.05$ in FE and $b=1.27$, $p<0.05$ in GMM), and the total effect of GCF on investment for MNE firms with a higher proportion of independent directors is positive and significant in both FE and GMM ($b=0.92$ and $b=1.09$ respectively), with the Wald test for the sum of coefficients being significant. These findings provide consistent support for Hypothesis H2.

Insert Table 5 about here

To test hypothesis H3 concerning cross-listing, we examine a sub-sample of foreign-listed firms (Table 5, model (3) and (4)). The results show that the more independent directors a firm appoints, the higher is the positive moderating effect on investment (or negative effect on blockholder appropriation), supporting hypothesis H3. The interaction between the proportion of independent directors and GCF for foreign-listed firms shows a positive and significant coefficient in both FE and GMM specifications ($b=2.08$, $p<0.01$ in FE and $b=1.14$, $p<0.10$ in GMM). Further, the overall effect of GCF on investment for foreign-listed firms with a higher proportion of independent directors (measured by the sum of the coefficients on GCF and on the interaction between GCF and ID Proportion) is positive and significant in FE (the Wald test for joint significance of these coefficients is significant at $p<0.01$ in FE). This indicates complementarity between the two governance mechanisms – foreign listing and independence of directors.

We test hypothesis H4 of the moderating effect of *foreign* independent directors' proportion on blockholder appropriation, and find that the appointment of such directors is an efficient way of monitoring the allocation of resources to investment (Table 5, models (5) and (6)). Regarding the interaction between the proportion of foreign independent directors and GCF, we find a positive and significant coefficient in both FE and GMM specifications (b=0.82, p<0.01 in FE and b=1.07, p<0.05 in GMM). Further, the overall effect of GCF on investment for firms with a higher proportion of independent directors (measured by the sum of the coefficients on GCF and on the interaction between GCF and ID Proportion) is positive and significant (the Wald test for joint significance of these coefficients is significant at p<0.001 in FE and p<0.05 in GMM specification).

Robustness tests

We perform a series of robustness tests to confirm the validity of our findings and rule out alternative explanations. These findings are not reported in detail here but are available on request. First, we acknowledge the complexity of (especially foreign) independent directors' effect on investment with a possibility of board efficiency effect co-existing with board signaling and legitimacy effects. The appointment of foreign directors may mitigate blockholder appropriation through enhanced monitoring and advice, measured by the interaction term between foreign directors and GCF. The signaling effect of this involvement is best proxied by the effect foreign directors have on external finance, rather than internally generated funds. In unreported specifications, we controlled for the interaction between external finance and foreign directors, and the main interaction between GCF and foreign directors still remains significant.

Second, the relevance of corporate governance varies across economic sectors depending on the risk of expropriation by the state or systemic corruption. To address this concern, we partitioned our data into firms from 'strategic' sectors, where the threat of

expropriation by the state is high, and all other firms. These are sectors of 'strategic' importance to the Russian government, such as energy, oil & gas, precious metals & minerals, aerospace & defense, marine ports & services, and broadcasting. Foreign investors are generally constrained to purchase shares in these strategic sectors. The unreported results show that independent directors are not likely to attenuate blockholder appropriation in strategic sector firms. It appears effective corporate governance is less common in strategic economic sectors due to the persistence of corruption.

We have also included industrial sector dummies [5] in specifications with random effects. We observe that the automobile sector dummy significantly interacts with GCF and ID Proportion. As firm size increases complexity, we control for it with the first difference of logarithms of sales. We find that larger companies invest proportionally more. The level of GCF also gives us an indication of size (larger firms tend to generate larger amounts of cash-flows). Overall, we observe that our baseline model produces consistent results for H0 (independent directors mitigate blockholder appropriation), but this is indeed contingent on many different factors, such as belonging to a strategic sector.

Third, we produced alternative measures of blockholder appropriation. We found that independent directors positively impact vertically or horizontally integrated structures, while they negatively impact the likelihood of a firm belonging to a business group. We constructed a measure for firms that are part of the same ownership structure and vertically integrated (binary variable, 1/0). For example, oil and gas companies, such as Bashkirenergo, Bashneft and Irkutskenergo are vertically integrated, meaning that they can control access to scarce natural resources, from exploration and extraction of crude petroleum to downstream refineries and distribution networks.

[5] Most firms in our sample are electric utilities, oil & gas, metals & mining, distributors, and food producers

We also constructed a measure for firms owned by the same blockholder and horizontally integrated (binary variable, 1/0). For example, two businesses are horizontally integrated if they are at the same stage of production, such as two supermarkets, or two food manufacturers.

Lastly, we measured the impact of independent directors on business groups (Table 6). A business group (Guriev and Rachinsky, 2005), sometimes referred to as a conglomerate, is a diversified portfolio of unrelated companies belonging to the same holding company which is controlled by the ultimate controlling owners (blockholders). Sistema for example, is a business group, operating a portfolio of large businesses in the areas of IT, banking, retail, and oil & gas, all ultimately belonging to Mr Yevtushenkov, the private blockholder (oligarch). We construct a dummy equal to 1 when a firm belongs to a business group and 0 otherwise.

Following the literature on business groups in Russia and in other emerging economies (Guriev and Rachinsky, 2005; Bertrand, Mehta, and Mullainathan, 2002), we posit that in business groups where firms are owned by the same ultimate blockholder and where some of the firms are from unrelated business sectors, blockholder appropriation may happen to a larger extent than in vertically or horizontally integrated groups. We posit that when firms are vertically or horizontally integrated, they have more operational synergies between the entities in the group, and also the blockholders have lesser opportunities to use such entities to tunnel funds from one entity to the other. We find that independent directors are negatively associated with business groups which are more prone to blockholder appropriation as per Table 6. In unreported tables, we find that independent directors have no effect on vertically and horizontally integrated groups.

Insert Table 6 about here

We also produced a measure of investment efficiency as the deviation of the size of the investments from the level predicted by economic conditions. Several studies on Russia using externally compiled composite corporate governance indices as measures for good corporate governance have uncovered that: 1) board independence is unrelated to corporate transparency and disclosure; 2) governance structures have a significant effect on disclosure for non-cross-listed firms; and 3) disclosure of financial and operational information has a positive effect on firm value (Berezinets et al. (2017); Black et al. (2016). In line with Biddle et al. (2009), we find that reporting quality as measured by Standard & Poor's financial information disclosure score, is positively associated with investment among firms with higher likelihood of under-investing. We also uncover that the presence of independent directors increases investment regardless of whether a firm is more or less likely to over-invest. In sum, these alternative measures provide support for our hypotheses that independent directors are likely to be efficient and to reduce blockholder appropriation.

DISCUSSION AND CONCLUSION

Emerging market firms characterized by ownership concentration are exposed to principal-principal conflicts, which are exacerbated with weak institutions. This is when majority blockholders might extract private benefits of control from minority shareholders (Grossman et al., 1988), also referred to as blockholder appropriation. We study the recent Russian context where codes of good governance have been adopted and there is eagerness to attract foreign capital. The main blockholders are private investors and the state, and there has been historic blockholder appropriation (Douma et al., 2006). Russian firms have begun to introduce Anglo-American corporate governance practice but traditionally they were effectively only symbolic (Pistor et al., 2000). In this study, we focus on a quintessential Anglo-American governance practice, independent directors, who have the role of monitoring and advising managers on behalf of all owners, not just blockholders. We propose that these

independent directors who have internalized or activated their roles have to act on behalf of shareholders/principals with potentially different interests.

Against this backdrop, and given some efforts in incorporating and internalizing Anglo-American practices in EEMM, and in particular in Russia, starting at the turn of the century with the adoption of codes of good governance and EEMM firm internationalization, we first question whether boards with independent directors have been effective in mitigating one of the main governance problems in Russia, i.e., majority blockholder stealing or appropriation, relative to boards without independent directors. We then turn to examine which firms with independent directors will be more likely to internalize or activate their independent role, which is mostly enacted through monitoring, to deter blockholder appropriation.

We find that the presence of independent directors is associated with a reduction of blockholder appropriation, and that this is more accentuated in SOEs than in private firms. We attribute the difference in the influence of independent directors across ownership types to SOEs going through a much more thorough selection process in the nomination of their independent directors, and to the deliberate effort to curtail corruption. As such independent directors may be aiming to progress within the state career ladder, they may also be more motivated to gain recognition by the government for producing good results.

In the second part of our study, we explore how the exposure of these EEMM firms to Anglo-American corporate governance practices might activate or make these independent directors pursue their monitoring role or influence in extenuating blockholder appropriation. We analyze the exposure to three international governance contingencies. First, independent directors create a positive effect on investment in MNEs. Second, our results indicate that independent directors in firms listed on foreign stock exchanges have a positive effect on investment and are likely to reduce blockholder appropriation. Third, we also find that

foreign independent directors are effective in monitoring the allocation of resources to investment.

Our main conceptual contributions are to the growing literature on how corporate governance practices travel around the world, and its unintended consequences. We focus on whether the role of the independent director is activated depending on their alignment with majority blockholders or minority shareholders and the different outcomes on blockholder appropriation. That is, if independent directors align with the majority blockholder, we do not expect to see a decrease in blockholder appropriation. Conversely, if independent directors seek to benefit minority shareholders or comply with foreign regulation, we might observe some mitigation in blockholder appropriation. Thus, we extend the boundary conditions of the multiple agency perspective regarding the influence of types of ownership on the effects of independent directors in different institutional contexts from Western IPO contexts (Arthurs et al., 2008; Bruton et al., 2010) to the case of a different class of owners in the emerging markets context of Russia. This analysis of the role of independent directors in relation to different types of owners can be further tested in South East Asian contexts where large blockholders are founding family members (Filatotchev et al., 2005; Filatotchev et al., 2011; Miller et al., 2009; Yoshikawa et al., 2010), or in Western contexts involving different blockholders representing institutions (Deutsch, 2005) or labor groups (e.g. in Germany boards often have labor or government representatives).

Moreover, we contribute to the international corporate governance literature by exploring how the adoption of Anglo-American norms on boards 'get lost in translation' when adopted in developing countries. Anglo-American norms regarding the role of independent directors appear to get lost in translation in different ways depending on ownership types. On the one hand, the positive role of independent directors in SOEs in reducing appropriation seems to result from the translation of selection by nomination

committees related to the firm to influence of state involvement in the selection process. On the other hand, the role of independent directors in private firms is lost in translation as it is less effective in stemming misappropriation unless the private firms are more fully exposed to international influences by being MNEs, cross-listed or having foreign independent directors. Corporate governance structures in emerging economies often resemble those of developed economies in form but not in substance (Peng, 2004). We show that board structures designed to address principal-agent problems in developed economies are not always applicable to weak institutional contexts characterized by blockholder heterogeneity and principal-principal conflicts. Hence, while Anglo-American corporate governance practices might be a way to overcome some country of origin liabilities relating to weak institutions, this is limited because part of the institutional weaknesses relate to the ability of firms to interpret practices as it suits them. For example, while the corporate governance code specifies a certain level of independent directors (25%), our sample shows it is much lower on average (13.94%), with about half of boards composed of insiders only.

After almost three decades of the fall of the Berlin Wall, progress towards strengthening the institutional environment remains slow (Hoskisson, et al., 2013). As such, our findings indicate that Russian MNEs may be able to overcome some of their institutional weaknesses by cross-listing in Anglo-American markets and bonding with the stronger institutions in these markets. Similarly, foreign directors as individual agents might also bridge these institutional differences towards some governance convergence and effectiveness.

We also shed light into contextual research on state capitalism (Megginson, 2017; Wood et al., 2015), by showing that despite common belief, independent boards of state-controlled entities are an efficient mechanism to combat funds misallocation. Specifically, we contribute textured analysis of multiple factors into corporate governance in EEMM and

Russia, especially to the literature on ownership (Chernykh, 2008; Durnev et al., 2005; Iwasaki et al., 2017), corporate disclosure and transparency (Berezinets et al., 2017; Black et al., 2016), and boards (Muravyev, 2017; Muravyev et al., 2014), by providing the first study with both conceptual and empirical insights on the role of independent directors in Russia using longitudinal data.

This study has limitations that open up opportunities for further research. First, our focus is on Russia, which questions to what extent we can generalize the analysis to other EEMM. In many ways, governance mechanisms in Russia resemble most of those in China, especially when it comes to state influence. In China, the government appoints, party officials to top management and board positions in SOEs, which aligns officials' career incentives with party priorities: if they succeed, they move up in the party. Officials loyal to the party compete to become top performers, motivated by possible promotion (Leutert, 2016). Comparative study of such similarities and differences of the impact of board mechanisms in China and Russia would be a promising avenue for future research. Second, while we highlight the influence of ownership structure on board independence, we do not discuss other board functions. Future research could explore how other board characteristics, such as board remuneration, are contingent on firm ownership. Third, blockholder appropriation could be measured differently, as we have indicated in the robustness tests section, such as the effect of independent directors on the possibility of blockholder appropriation by the likelihood of a firm being part of a business group, or the effect of reporting quality on the investment of firms with higher likelihood of under-investing. Other measures of blockholder appropriation could relate to M&A control premiums, related party transactions or percentage of non-trade accruals which we could not explore due to such data unavailability in Russia. Finally, further research could attempt to disentangle the effect of efficient boards from the effect of signaling of appointing independent (foreign) directors. We have explored the

signaling effect by accounting for the interaction effect with external finance as discussed in the robustness tests but other approaches using instrumental variables (Cerulli, 2015) may be possible.

Our findings have some relevant implications for policymakers and, in particular, for corporate governance reforms. Policy making should progress to a more context-dependent understanding of corporate governance. Regulation focusing only on applying Anglo-American practices to board independence may not be sufficient since board monitoring and other roles depend on ownership and listing characteristics which are morphed by an Eastern institutional context.

In sum, we begin with the puzzle of how a prototypical Anglo-American practice such as the adoption of independent boards can help mitigate one of the most systemic governance challenges in EEMM firms, which is, the disconnect between the generation of cash flows and firm investments. We show that under the certain governance firm context (type of blockholders and further exposure to international governance practices), independent directors can be effective in mitigating blockholder appropriation, even in a country with a weak institutional environment such as Russia. This study is able to show when governance practices get properly translated across borders.

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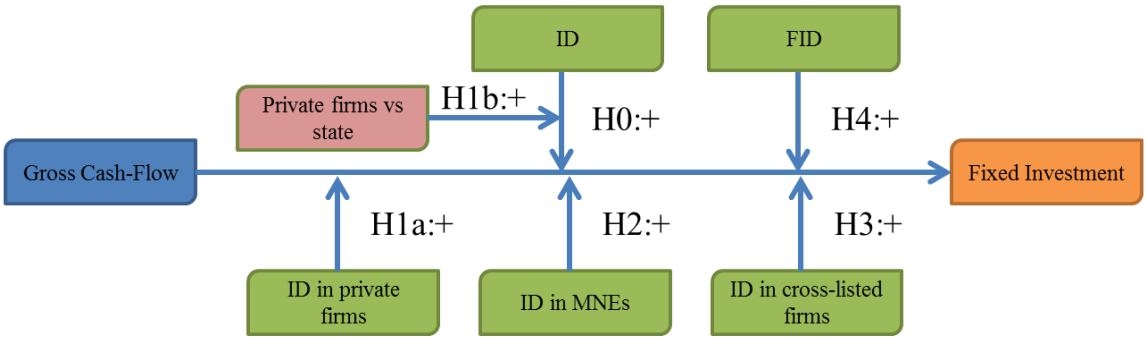
FIGURE 1
Organizing Framework



Note: a negative impact of gross-cash flow on fixed investment may signal some degree of blockholder appropriation

FIGURE 2

The figure plots the interactive effect of the proportion of independent directors on the relationship between investment and gross-cash flow (GCF) based on the estimated effects reported in the results Table III, models (1)-(2).

(a) Fixed Effects (b) GMM

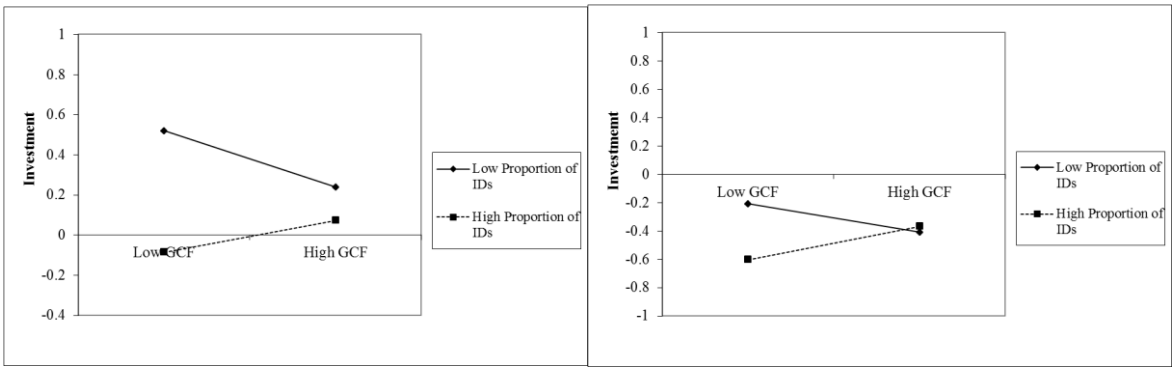


FIGURE 3

The figure plots the interactive effect of the proportion of independent directors on the relationship between investment and gross-cash flow (GCF) for the sub-sample of privately owned firms based on the estimated effects reported in the results table IV, models (1) and (3).

a) Fixed Effects (b) GMM

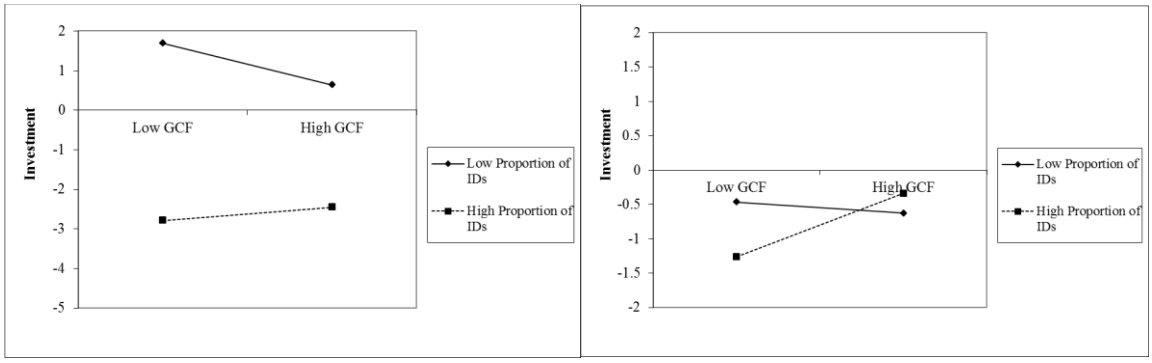


TABLE 1
Descriptive Statistics, EUR million

Variable	Obs.	Mean	Median	Std. Dev.	Min	Max
Investment (△ln)	218	0.2917	0.2678	0.6632	-1.9947	3.6051
GCF (△ln)	218	0.1873	0.1824	0.6429	-2.3219	2.3718
LT Debt (ln)	218	5.1096	6.8806	4.1829	0.0000	12.2377
Equity (ln)	218	2.9588	0.0000	4.0493	0.0000	12.6002
Tobin's Q	167	0.9698	0.7246	0.9707	0.0010	7.6877
ID (%)	218	0.1394	0.1000	0.1693	0.0000	0.6200
FID (%)	218	0.0768	0.0000	0.1447	0.0000	0.5400
Independent Director (1/0)	218	0.5092	1.0000	0.5011	0.0000	1.0000
Institutional Blockholder (1/0)	218	0.0367	0.0000	0.1885	0.0000	1.0000
Private Blockholder (1/0)	218	0.5000	0.5000	0.5012	0.0000	1.0000
State Blockholder (1/0)	218	0.4633	0.0000	0.4998	0.0000	1.0000
Cross-Listing (1/0)	218	0.4495	0.0000	0.4986	0.0000	1.0000
MNE (1/0)	218	0.4220	0.0000	0.4950	0.0000	1.0000

Note: Blockholder is defined as having absolute control of >=50%

TABLE 2

Pairwise correlations

Variable	1	2	3	4	5	6	7	8	9	10	11	12
1. Investment (△ln)	1.0000											
2. GCF (△ln)	0.1290	1.0000										
	0.0572											
3. LT Debt (ln)	0.1228	0.0418	1.0000									
	0.0704	0.5394										
4. Equity (ln)	0.1437	0.0851	-0.1421	1.0000								
	0.0340	0.2105	0.0361									
5. Tobin's Q	0.2197	0.0900	-0.0519	-0.0628	1.0000							
	0.0043	0.2474	0.5057	0.4205								
6. ID (%)	-0.0762	-0.0312	0.2772	0.0667	-0.0707	1.0000						
	0.2629	0.6467	0.0000	0.3268	0.3642							
7. FID (%)	0.0244	-0.0331	0.3471	0.0340	0.0245	0.7381	1.0000					
	0.7196	0.6266	0.0000	0.6179	0.7533	0.0000						
8. Institut. Blockholder (1/0)	-0.0814	0.0120	-0.1688	0.0161	-0.0235	0.0006	-0.1038	1.0000				
	0.2311	0.8600	0.0126	0.8126	0.7632	0.9925	0.1266					
9. Private Blockholder (1/0)	-0.0408	0.0609	0.1575	0.0672	0.2255	0.3830	0.4987	-0.1952	1.0000			
	0.5492	0.3710	0.0200	0.3231	0.0034	0.0000	0.0000	0.0038				
10. State Blockholder (1/0)	0.0716	-0.0656	-0.0943	-0.0735	-0.2145	-0.3843	-0.4609	-0.1813	-0.9291	1.0000		
	0.2926	0.3352	0.1654	0.2800	0.0054	0.0000	0.0000	0.0073	0.0000			
11. Cross-Listing (1/0)	0.0477	-0.0004	0.1611	-0.0639	0.1247	0.2640	0.3655	-0.1764	0.2951	-0.2294	1.0000	
	0.4833	0.9952	0.0173	0.3478	0.1083	0.0001	0.0000	0.0091	0.0000	0.0006		
12. MNE (1/0)	-0.0047	-0.0755	0.1625	-0.0245	-0.0066	0.3988	0.5631	0.2284	0.2415	-0.3283	0.5161	1.0000
	0.9450	0.2673	0.0163	0.7187	0.9328	0.0000	0.0000	0.0007	0.0003	0.0000	0.0000	

TABLE 3

The moderating effect of independent directors on investment

VARIABLES	(1) Fixed Effects Investment, in first diff	(2) GMM Investment, in levels
GCF	-0.14	-0.04
	(0.10)	(0.09)
GCF*ID Proportion	**0.84***	**0.36***
	(0.32)	**(0.18)**
ID Proportion	-1.47	-3.51*
	(1.90)	(1.73)
Investment, lagged	0.06	0.94***
	(0.06)	(0.11)
Debt	0.03*	0.02+
	(0.01)	(0.01)
Equity	0.03+	0.02+
	(0.02)	(0.01)
Tobin's Q	0.22*	0.10
	(0.10)	(0.07)
Observations	156	206
R-squared	0.328	
Number of firms	41	44
Wald Test for joint significance, p-value	0.0097	0.0552
Number of instruments	n.a.	16
AR(1)	n.a.	-1.956
P-Value AR(1)	n.a.	0.0505
AR(2)	n.a.	-1.492
P-Value AR(2)	n.a.	0.136
Hansen	n.a.	5.04
P-Value Hansen	n.a.	0.0256

Note: Robust standard errors in parentheses. *** p<0.001, ** p<0.01, * p<0.05, + p<0.10. Year dummies included but not reported for brevity. All continuous variables are in natural logarithms, except Tobin's Q. ID proportion represents the number of independent directors relative to total board size. Wald test is for the joint significance of GCF and GCF*ID coefficients. In the Fixed Effects (FE) specification, we compute investment and GCF in first differences of logarithms, e.g. the dependent variable is $\log(Investment_{it}) - \log(Investment_{i,t-1})$. For the GMM specification, Investment and GCF variables have to be entered in levels (e.g. the dependent variable is $\log(Investment_{it})$). For model (2), we use *xtabond2* command (Roodman, 2009), with delimited lags (2 3), collapsed instruments, and small sample correction. We instrument the lagged dependent variable. Number of instruments does not exceed the number of panel members. The Hansen's J statistic of instrument exogeneity is low, robust, but may be weakened by many instruments. Arellano-Bond test statistic indicative of no second or higher order auto-correlation of residuals AR(2) is not significant, consistent with Arellano-Bond approach, and does not provide evidence of misspecification.

TABLE 4
The moderating effect of independent directors on investment in private firms and SOEs

	(1) H1a FE	(2) H1a FE	(3) H1a GMM	(4) H1a GMM	(5) H1b FE	(6) H1b FE	(7) H1b GMM	(8) H1b GMM
GCF	-0.72+	-0.04	-0.06	-0.12				
	(0.37)	(0.12)	(0.14)	(0.16)				
GCF*ID Proportion	**2.64***	**0.68**	**0.86+**	**0.67**				
	(1.10)	(0.54)	(0.47)	(0.60)				
ID Proportion	-12.05**	-0.60	-8.36+	-6.61				
	(3.67)	(0.53)	(4.90)	(6.43)				
GCF*foreign*indep.					1.15**	1.38**	0.69***	0.48***
					(0.38)	(0.39)	(0.09)	(0.09)
GCF*foreign*insider							0.52***	0.00
							(0.09)	(0.00)
GCF*state*indep.					**0.46+**	**0.46***	**0.72*****	**0.52*****
					(0.24)	(0.18)	(0.10)	(0.10)
GCF*state*insider					-0.02	-0.18+	0.70***	0.49***
					(0.14)	(0.11)	(0.10)	(0.09)
GCF*private*indep.					**0.19+**	**0.07**	**0.71*****	**0.51*****
					(0.10)	(0.12)	(0.10)	(0.09)
GCF*private*insider					0.07	-0.59	0.68***	0.44***
					(0.14)	(0.51)	(0.09)	(0.08)
Investment, lagged	0.02	-0.14	0.41*	0.03	-0.05	0.07	-0.03	0.20***
	(0.16)	(0.11)	(0.17)	(0.48)	(0.08)	(0.09)	(0.10)	(0.05)
Debt	0.07**	0.01	0.02*	0.03+	0.03*	0.05**	0.05**	0.03*
	(0.02)	(0.01)	(0.01)	(0.01)	(0.01)	(0.02)	(0.02)	(0.01)
Equity	0.03	0.01	-0.00	0.01	0.02*	0.03+	0.02*	0.03**
	(0.02)	(0.01)	(0.01)	(0.01)	(0.01)	(0.02)	(0.01)	(0.01)
Tobin's Q	0.45***			0.26		0.18		0.11
	(0.11)			(0.16)		(0.18)		(0.07)
Observations	74	156	156	78	218	139	265	182
R-squared	0.549	0.260			0.242	0.377		
Number of firms	23	28	28	24	46	38	49	42
Wald Test for Joint Significance	0.0184	0.1506	0.0446	0.278	0.0057	0.0006	1.42e-09	0.000
Number of instruments			16	16			22	22
AR(1)			-2.175	-0.0854			-0.146	-1.762
P-Value AR(1)			0.0296	0.932			0.884	0.0780
AR(2)			-1.669	-0.551			-1.525	-1.007
P-Value AR(2)			0.0951	0.581			0.127	0.314
Hansen			0.0286	2.187			8.989	10.37
Hansen p-value			just identified	just identified			0.0112	0.00128

Note: Please refer to notes under Table 3.

TABLE 5

The moderating effects of independent directors in MNEs, cross-listed firms, and of foreign independent directors

VARIABLES	(1) H2 FE	(2) H2 GMM	(3) H3 FE	(4) H3 GMM	(5) H4 FE	(6) H4 GMM
GCF	-0.18*	-0.18	-0.36**	-0.11	-0.06	-0.12
	(0.08)	(0.18)	(0.11)	(0.23)	(0.10)	(0.17)
GCF*ID Proportion	**1.10***	**1.27***	**2.08****	**1.14+**		
	(0.47)	(0.54)	(0.68)	(0.65)		
GCF*FID Proportion					**0.82****	**1.07***
					(0.30)	**(0.50)**
ID Proportion	-1.63	-13.04*	-6.12**	-11.96		
	(2.64)	(5.83)	(1.94)	(7.04)		
FID Proportion					18.55***	-10.90*
					(1.16)	(5.39)
Investment, lagged	0.04	0.46*	0.32**	0.52*	0.09	0.59**
	(0.24)	(0.19)	(0.10)	(0.24)	(0.05)	(0.18)
Debt	0.04	0.02+	0.06*	0.02	0.02*	0.03*
	(0.03)	(0.01)	(0.03)	(0.02)	(0.01)	(0.01)
Equity	0.00	-0.00	0.01	-0.00	0.02	0.00
	(0.03)	(0.01)	(0.03)	(0.01)	(0.02)	(0.01)
Tobin's Q	0.25		0.61**		0.15+	
	(0.22)		(0.20)		(0.09)	
Observations	55	114	57	107	156	284
R-squared	0.352		0.543		0.394	
Wald Test for Joint Significance	0.0471	0.0562	0.0107	0.161	0.0014	0.0464
Number of firms	15	17	16	19	41	49
Number of instruments		16		16		16
AR(1)		-1.559		-1.774		-1.956
P-Value AR(1)		0.119		0.0760		0.0505
AR(2)		0.726		-0.486		-1.492
P-Value AR(2)		0.468		0.627		0.136
Hansen		3.280		4.125		0.0256
P-Value Hansen		just identified		just identified		just identified

Note: Please refer to notes under Table 3.

TABLE 6

Business Groups and Independent Directors

VARIABLES	(1) Bus. Group	(2) Bus. Group	(3) Bus. Group	(4) Bus. Group
Independent directors (Y/N)		-0.40		-0.74*
		(0.32)		(0.37)
Independent Directors Proportion	-2.54*		-3.34*	
	(1.29)		(1.57)	
Size (Sales)	1.31***	0.56**	1.44***	0.61**
	(0.32)	(0.17)	(0.42)	(0.20)
Debt			-0.07	-0.01
			(0.05)	(0.04)
Equity			0.17***	0.12**
			(0.05)	(0.04)
GIC Industries = 101020	-1.41*	0.68	-1.06	1.13+
	(0.63)	(0.58)	(0.83)	(0.66)
GIC Industries = 151010	3.44***	3.17***	4.79***	3.92***
	(0.91)	(0.70)	(1.19)	(0.82)
GIC Industries = 151040	0.96	1.90**	1.87*	2.42***
	(0.60)	(0.63)	(0.78)	(0.73)
GIC Industries = 301010	2.94**	2.07**	3.35**	2.34**
	(0.94)	(0.75)	(1.05)	(0.86)
GIC Industries = 501010	1.49+	0.97	2.36*	1.30+
	(0.81)	(0.63)	(1.01)	(0.73)
Constant	-14.72***	-7.89***	-17.50***	-9.38***
	(3.55)	(1.84)	(4.67)	(2.20)
Observations	282	389	244	335

Notes: Robust standard errors in parentheses
*** p<0.001, ** p<0.01, * p<0.05, + p<0.10
Fixed effects. Year dummies included.
Please refer to further notes under Table 3.