Does Foreign Direct Investment Really Improve Corporate Governance?
Evidence from Thailand

Sudarat Ananchotikul

University of California, Berkeley

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Abstract

It is widely argued that foreign investment is a mechanism for improving corporate governance in emerging markets. The results of this paper, which uses firm-level data on 365 Thai firms, challenge this conventional wisdom. A firm-specific index of the quality of corporate governance is constructed and used to test the hypothesis that foreign investment has a positive effect on corporate governance. Endogeneity problems are addressed by using long-standing statutory limits on foreign ownership as an instrument for foreign investment. The results show that the form of foreign investment matters. When foreign industrial companies hold large stakes, there is no improvement in corporate governance. If anything the opposite is true; it appears that foreign industrial investors act as insiders: they favor weak corporate governance because it allows them to exploit minority shareholders. In contrast, purchases of minority stakes by foreign institutional investors lead to improvements in corporate governance. I also find that corporate governance is poorer for firms whose major foreign owner comes from a country with relatively weak governance institutions.

1. Introduction

A popular view among policy makers is that foreign ownership positively influences firm performance and profitability. This view derives from the presumption that foreign investment is a conduit for technology, capital, managerial skills, training techniques and various intangibles that promote efficiency.[1] Recently, good corporate governance has been added to the list of potential benefits.[2] Surprisingly, however, there has been little systematic work on this relationship, especially for emerging market economies. This paper develops new evidence on the linkage. It shows that the effect of foreign investment on the quality of corporate governance is a good deal more complicated than commonly assumed and that its direction is sometimes contrary to what is conventionally supposed.

Theories that predict a positive effect of foreign investment on corporate governance posit a view that foreign investors act as outside shareholders. Foreign equity investment—whether it is in the form of joint ventures, multinational subsidiaries, takeovers, or even institutional portfolio investment—results in foreigners becoming outside blockholders with the ability (through voting rights) and the incentive (through cash-flow rights) to monitor incumbent management and force changes in behavior that are in the interest of outside shareholders as a class (Shleifer and Vishny, 1986). In addition, insofar as foreign corporate practices are superior to those prevailing in the host economy, foreign ownership may provide information about, and encourage the adoption of, superior practices in areas such as information disclosure, internal checks and balances, and accounting standards (OECD, 2002).

But do foreign investors always, in fact, act as minority investors seeking a better deal for outside shareholders? After all, if they acquire a controlling stake in a domestic firm, foreign investor may then have the same incentive as other insiders to exploit minority shareholders. Furthermore, the same sizeable ownership stake that positions foreign owners to monitor management can also give them an incentive to oppose governance reforms that weaken the position of the dominant blockholder. Since foreign companies often acquire management control when they invest in emerging market economies, it is at least conceivable that this perverse effect could be quite prevalent.[3]

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[1] See, among others, Dunning and Pearce (1977), Blomstrom (1986), Harrison (1996), Doms and Jensen (1998), and Kimura and Kiyota (2004)).

[2] Since the quality of corporate governance is positively correlated with firm value (Black, 2002; Durnev and Kim, 2004; Klapper and Love, 2004), the link from foreign ownership participation to good governance and hence to high firm valuation seems to be a plausible direction of causality.

[3] Moreover, in the case of Asian economies where hostile takeovers are rare and friendly negotiation is a customary way of doing business, foreign investors who become joint-venture partners tend to have personal ties with incumbent shareholders. The increase in value of equity holdings from monitoring thus may not generate sufficient

Two theoretical arguments provide further grounds for questioning the existence of a positive relationship between foreign ownership and the quality of corporate governance. First, the entrenchment hypothesis of Morck, Shleifer, and Vishny (1988) predicts that more equity ownership by the manager worsens financial performance because managers with large ownership stakes may be so powerful that they do not have to consider other stakeholders' interest. This situation may apply to foreign owners, especially foreign industrial corporations, since they usually participate in the firm's management and operation.

Second, the theory of private benefits of control due to Bebchuk (1999) explains why foreign inside shareholders may not have an incentive to improve corporate governance. It is precisely their position as a large shareholder that provides them with potential private benefits—private in the sense that they are not shared among all the shareholders in proportion of the shares owned—that they can enjoy with relative ease if corporate governance is weak.[4]

Whether foreign ownership contributes to good corporate governance is ultimately an empirical question. Unfortunately, two obstacles have stymied work in this area. First, it is difficult to measure the quality of corporate governance at the firm level. Previous work has relied on limited information on variables such as board size, the share of independent directors, the number of board meetings, shareholder activism, executive compensation, insider share ownership, and takeover defenses to proxy for the effectiveness of governance.[5] These proxies capture only certain aspects of governance, and their validity as measures of overall corporate governance quality depends on the assumption that they are correlated with other governance practices.

The main contribution of this paper is the construction of a comprehensive corporate governance index. Unlike other measures of corporate governance commonly used in previous studies, this corporate governance index captures all major aspects of corporate governance: board structure, board responsibility, conflict of interest, shareholder rights, and disclosure and transparency. As many as 87 company attributes related to corporate governance are evaluated

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motivation for foreign inside shareholders to press for more efficient behavior on the part of management. Rather, they might find it in their interest to cooperate with other larger blockholders to gain private benefits at the expense of small shareholders.

[4] Private benefits may be in the form of outright transfers of assets out of the company for the benefit of those who control them (termed "tunneling" by Johnson et al. 2000), unreasonably high compensation for directors who typically are the same people as or related to the controlling shareholders, or capital gains from trading stocks on insider information. The existence of private benefits of control is documented by Barclay, Holderness, and Pontiff (1993), Nenova (2003), and Dyck and Zingales (2004).

[5] Board size was used by Yermack (1996); the ratio of independent directors by Klein (1998); executive compensation by Mehran (1995); number of board meetings by Vafeas (1999); insider ownership by Hermalin and Weisbach (1991); institutional ownership by Hartzell and Starks (2003); and anti-takeover provisions by Gompers, Ishii, Metrick (2003).

using information from various publicly-available sources such as company disclosure reports, annual reports, company websites, and Stock Exchange of Thailand (SET) databases.[6] The overall index is a weighted average of the scores given to the five components; higher scores indicate better governance practices. Using this method, I assess the corporate governance quality for each of 365 non-financial Thai firms listed on the SET in 2004. By construction, my index is positively correlated with alternative measures of corporate governance—such as the board of director independence, the number of board meetings, and the existence of an employee stock option program. The fact that this index is positively correlated with firm value as well as with minority shareholdings further confirms the reliability of this index as a measure of the true quality of corporate governance.[7]

A second obstacle is the possibility of reverse causality running from the quality of corporate governance to the foreign ownership decision. To address this problem I exploit the existence of limits imposed by law on foreign business in Thailand. I use the foreign ownership limit as a potential instrument for the actual level of foreign ownership. This foreign ownership limit specifies maximum foreign shareholdings allowed in individual Thai firms as a function of the type of business activities in which the firm is engaged. It can be regarded as exogenous to corporate governance for two reasons: 1) these foreign limits were adopted for reasons which are unrelated to the quality of corporate governance—such as national security, protection of culturally sensitive business, and a pursuit of primary economic goals at the time the law was issued;[8] and 2) this foreign business law was established in 1972,[9] since which time the Thai capital market and economy have evolved substantially. This foreign limit turns out to be a powerful instrument for actual foreign ownership, making it credible to assert that the subsequent estimates of the association between foreign ownership and the governance measure represent a causal relationship rather than simply a correlation.

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[6] Existing studies that measure firm-level corporate governance by constructing an index similar to the one used in this paper include Black, Jang, and Kim (2005) on Korea, Lefort and Walker (2005) on Chile, and Cheung et al. (2005) on Hong Kong. However, these studies rely on survey data, as opposed to publicly available data, in constructing their indexes. Problems with using survey data on corporate governance are discussed in the Data and Variables section.

[7] The firm value is measured using Tobin's q. A set of firm-specific variables are included as control variables in a regression of Tobin's q on the corporate governance index. Endogeneity is controlled for using "foreign ownership limit" discussed in the next paragraph of the main text.

[8] The Foreign Business Law (1972) is believed to be part of an export-push policy of the Thai government during 1972 to 1992. This export-promotion was driven by the major balance of payments problems that Thailand faced in the 1960s resulting from a substantial increase in the importation of raw materials and machinery in the 1960s. Thus, under the Foreign Business Law (1972), a high ratio of foreign equity ownership in export-oriented sector was allowed, while foreign participation in non-tradable services was highly restricted (Thanadsillapakul, 2004).

[9] Some slight modifications were made to the law in 1999 to adapt to changes in economic conditions.

In my baseline model I regress these measures of corporate governance, appropriately instrumented, on foreign ownership, controlling for firm characteristics such as size, age, performance, growth, exporter dummy, business-group dummies, and industry dummies. I find that foreign ownership actually leads to worse corporate governance on average. This result is robust to controlling for various firm characteristics.

I then divide foreign ownership into foreign industrial and foreign institutional ownership on the presumption that foreign industrial owners are more frequently corporate insiders than are foreign institutional investors, since foreign industrial owners typically take on a significant ownership stake.[10] I find that foreign industrial ownership negatively and significantly affects the quality of corporate governance, and it is the dominance of this type of foreign ownership in the data that drives the result for aggregate foreign ownership. Evidently, foreign industrial owners favor weak corporate governance, because poor internal governance makes it easy for them, as inside investors with control over cash flow rights, to exploit minority shareholders. For institutional investors (financial institutions and the like), the story is different. These foreigners tend to hold minority stakes and hence press for governance reforms that strengthen the rights of minority investors. Apparently, the particular form that foreign investment takes has important implications for the quality of corporate governance.

I also test whether the effects of foreign ownership on corporate governance are a function of the quality of corporate governance in the country that is the source of the foreign investment. I find that Thai firms owned by investors from countries with corporate governance ratings lower than Thailand have worse governance than their peers, but Thai firms owned by investors from higher ranking countries do not have better governance. This implies that bad governance is easier than good governance to be transferred across borders. An alternative interpretation is that foreign investors from poorly-governed countries may be attracted to poorly-governed firms in emerging markets. This is consistent with a finding from a study of private benefits of control that the premium paid for control is higher when the acquirer is from a country that protects investors less "and thus is more willing or able to extract private benefits" (Dyck and Zingales, 2004).

Finally, motivated by a finding in La Porta, et al. (1998), I group countries by legal origin. Here, once again, I find little support for conventional wisdom: source countries whose legal

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[10] Average holding by an individual foreign industrial owner (in the form of joint ventures or multinationals) is 34 percent, as opposed to 2.7 percent for an individual foreign institutional investor. About 87 percent of foreign industrial owners in the sample hold management and/or board positions.

origin is found to be associated with good governance do not appear to contribute disproportionately to the quality of governance of Thai corporations.

This paper proceeds as follows. Section 2 describes the sample and the construction of the corporate governance index. Section 3 contains the empirical methodology. Section 4 presents summary statistics and the estimation results. Section 5 concludes the paper.

2. Data and Variables

This study uses firm-level data for 365 Thai firms in the non-financial sector. Only publicly traded companies listed on the Stock Exchange of Thailand (SET) are analyzed due to the absence of governance information for non-listed companies. However, limiting the sample to public companies should not be problematic since a private firm in Thailand is typically controlled by a single family who is actively involved in all aspects of the firm; foreign investment in private firms is only fractional. Corporate governance issues such as principal-agent problems and expropriation from minority shareholders are potentially more severe when firms are large and publicly traded with numerous small shareholders forming the ownership structure. Thus, corporate governance problems and effective governance mechanisms can be vastly different between these public and private firms and should be investigated separately.

Construction of the Corporate Governance Index

An important contribution of this study is to construct quantitative measures of corporate governance—a Corporate Governance Index (CGI)—for as many as 365 of 436 Thai listed companies in 2004.[11] This index runs from 0 to 100 with higher values indicating better governance. I collect information for each company from publicly available sources including the mandatory Annual Disclosure Report (Form 56-1), company annual reports, corporate websites, the web-based SET Market Analysis and Reporting Tool (SETSMART), and the SET's Director Database. Additional information such as corporate violations of the Stock Exchange's rules is obtained from the Securities and Exchange Commission (SEC)'s database.

Most previous studies constructing a governance index rely on survey responses from companies' administrators or executives.[12] Self-evaluation of corporate governance is problematic because it touches upon issues very sensitive to the well-being of the company. Consequently, a low response rate and self-selection can be expected. Moreover, if firms with poor governance

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[11] Financial companies and newly listed companies are excluded from the sample.
[12] With an exception of Cheung et al. (2005) which uses only public information in constructing an index for 165 Hong Kong listed companies.

misreport, then these survey-based ratings would not measure the strength of governance at all. To avoid these potential problems of survey-based governance rating, I use only public information available on each company to construct the governance index used in this study. This is a more comprehensive measure of the corporate governance practices of Thai companies since it incorporates all crucial elements of standard governance principles.

There are a total of 87 questions. Of these, 76 questions are classified into five governance components: 1) Board Structure 2) Conflict of Interest 3) Board Responsibility 4) Shareholder Rights, and 5) Disclosure and Transparency. The remaining questions capture specific firm attributes pertaining to corporate governance but the direction in which they affect the firms is uncertain a priori: for example, whether the chairman of the board of directors and the CEO are members of the controlling family; what percentage of the total shares of the firm are held by the chairman and the CEO; what percentage of the total shares are held by minority shareholders; whether the firm has consolidated companies. These elements are excluded from computation of the overall corporate governance index. However, their empirical correlations with the subindexes and the overall index will be examined to gain more insight into the pattern of corporate governance of Thai listed companies.

Scores are given to each of the governance items and grouped into five categories to create subindexes. The CGI is then computed as a composite index by taking a weighted average of the subindexes. The weights given to the five governance components are determined by the amount of information collected for each component: board structure 20%; conflict of interest 25%; board responsibility 20%; shareholder rights 10%; and disclosure and transparency 25%.[13]

Ownership and Control Variables

Data on equity ownership is obtained mainly from the SET database, which provides a list of all shareholders owning at least 0.5 percent of each listed company. Classification of foreign shareholders into individual investors, industrial corporations, banks, and non-bank financial institutions is based on the information in each company's Annual Disclosure Report (Form 56-1) and the foreign investors' website if available. Whether a foreign company is a joint-venture partner can also be determined using these sources. Data on foreign ownership classified by nation is obtained separately from the SET Market Analysis and Reporting Tool (SETSMART) database.

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[13] A complete list of corporate governance questions evaluated and more details on index calculation can be found in a working paper version of this paper available online at: http://bosuda.googlepages.com/Ananchotikul_paper.pdf .

Firm-level variables that may affect the quality of corporate governance are included as control variables. Data on market capitalization, firm age, return on assets, sales growth, and industry classification are obtained from the Stock Exchange of Thailand (SET) database. Exporter information is extracted from Thailand Exporters Directory, Department of Export Promotion, Ministry of Commerce, Thailand, available at http://www.thaitrade.com/go/home. Family business groups and state enterprises are identified using ownership information from the SET database, a Brooker Group publication: *Thai Business Groups: A Unique Guide to Who Owns What*, and information on privately-owned companies from Department of Business Development, Ministry of Commerce.

3. Model Specification

3.1 Baseline OLS Regression

To test hypotheses about the relationship between foreign ownership and corporate governance, a basic cross-sectional OLS regression model can be specified as:

$$CGI_i = \beta_0 + \beta_1 Foreign_i + \sum_{k=1}^{K} \gamma_k x_{ki} + \varepsilon_i \tag{1}$$

where CGI is the corporate governance index; β_0 is a constant; $Foreign$ is the percentage of total shares held by foreign residents; x is a vector of control variables; and ε denotes a standard i.i.d. disturbance. The subscript i is used to denote individual firms. Control variables include firm size (log of market capitalization), firm age (log of number of years since establishment), firm performance (return on assets), firm growth (percentage change in sales), an exporter dummy, a family-business-group dummy, a state-enterprise dummy, and industry dummies.

Potential endogeneity in the relationship between foreign ownership and corporate governance exists if corporate governance also determines foreign investment—if the quality of corporate governance is an important factor for foreign investors in making investment decisions. Foreign investors could be attracted to firms that already have good governance standards than firms with poor governance, because they have less fear of expropriation by local shareholders, or because they know more about these firms due to the firms' superior information disclosure and transparency. There is also the possibility that some foreign investors are drawn to firms with bad corporate governance—new foreign owners may identify such firms as offering opportunities for them to come in, clean up the firm, and raise its value before selling for a profit. This has been the case for the takeovers of many Thai and Korean companies by overseas institutional investors

after the outbreak of the East Asian crisis when the financial systems became paralyzed by debt burdens in form of non-performing loans (NPLs).

3.2 Instrumental Variables Approach

I exploit the rules governing foreign investment in Thailand to identify an appropriate instrument for foreign ownership. Firms registered in Thailand must comply with the foreign ownership restrictions imposed by the Foreign Business Act of Thailand. The Act divides business into three categories named List 1, List 2 and List 3. Business activities that fall under List 1 are most restricted to foreigner, followed by activities categorized under List 2 and List 3, respectively. Businesses not covered by this Act are open to full foreign ownership.[14,15]

The categorization of restricted business activities was based on reasons unrelated to corporate governance such as national security, protection of culturally sensitive sectors, and macroeconomic policies at the time of establishment of the law.[16] This, together with the fact that the law was put in place in 1972, and hence was not influenced by corporate governance of today's companies, supports the assumption of the exogeneity of the foreign ownership limit with respect to corporate governance and makes it a plausible instrument for actual foreign ownership.

Foreign ownership limit (*Flimit*) is also strongly correlated with the actual foreign ownership (correlation coefficient = 0.784, P-value = 0.000). To statistically examine the validity of *Flimit* as an instrumental variable, I conduct a Hausman overidentifying restrictions test on a two-stage least squared (2SLS) regression model, where in the first stage actual foreign ownership is regressed on *Flimit* as well as other independent variables from equation (1); in the second stage, the corporate governance measure is then regressed on the fitted value from the first stage and the control variables. The statistic obtained from the Hausman test is close to zero, which indicates that the null hypothesis that there is no correlation between the exogenous instrument and the error term from the second stage equation can not be rejected, supporting the null that *Flimit* is indeed exogenous to the regression system.

4. Empirical Results

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[14] Under List 1, businesses are strictly prohibited to foreigners unless there is an exception contained in a special law or a treaty. Businesses under List 2 are those related to the national safety or security or affecting arts and culture, tradition, folk handicraft or natural resources and environment; minority foreign ownership is possible without permission and up to 60 percent foreign ownership is possible with ministerial approval. List 3 contains businesses that Thai nationals are not ready to compete with foreign operators; minority foreign ownership is possible without permission and majority foreign ownership is possible with permission from the Director General and a committee.
[15] A complete list of business activities under the three categories is provided in Appendix C in a working paper version of this paper available at: http://bosuda.googlepages.com/Ananchotikul_paper.pdf .
[16] See footnote 8.

4.1 Governance of Thai Publicly-Listed Companies

Table 1 presents summary statistics for the CGI and the subindexes for the 365 sample companies in 2004. The overall CGI with unequal weights for the subindexes ranges from 25.75 to 90 with a mean score of 53.25 (on a scale from 0 to 100 with a larger number indicating better corporate governance). Summary statistics for the CGI with an equal weight given to each of the subindexes does not differ much from that of the overall CGI. The CGI calculated here is by and large consistent with the corporate governance ratings determined by the Thai Institute of Directors Association (Thai IOD); seven out of the ten non-financial companies with the highest CGI in 2004 are in the list of the top ten companies rated by the Thai IOD (which includes both financial and non-financial corporations).[17,18]

As shown in Table 2, companies in the resource sector have the best corporate governance, with an average score of 67.84, followed by firms in the technology industry with a mean index score of 57.65. The worst scores belong to companies under rehabilitation; these firms were in the process of financial restructuring and were not compelled to hold an annual shareholder meeting nor required to meet the same disclosure standards as companies under normal conditions. Panel B of Table 2 shows that corporate governance improves with company size. This is not surprising given that larger companies have more resources to devote to improving their governance. They also may have more incentive to do so than smaller firms since they have a greater need to access external capital. The fact that large firms tend to be scrutinized more intensively than small firms might also motivate the top-tier firms to strive for the best governance practices.

Summary statistics for some attributes of the sample firms are shown in Table 3. A typical board of directors consists of 8 to 15 directors. Three firms in the sample have only 5 directors, the smallest board size allowed by the SEC. Seven firms have 20 or more directors. Non-executive directors make up about two-thirds of the board membership on average, which is

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[17] With cooperation from the SET, the SEC, and McKinsey & Company in Thailand, and financial support from the World Bank, the Thai IOD initiated a program called "Baselining Corporate Governance Practices of Thai Listed Companies" in 2001. Under this program, the Thai IOD ranks Thai listed companies based on their corporate governance performance. Similar to my index, the Thai IOD index uses only publicly available information in their governance assessment. Their results in aggregate and a list of the top 50 companies are presented to the public while governance scores on individual companies remain confidential.

[18] The top five companies according to the CGI in 2004 are the Petroleum Authority of Thailand (90.46) PCL, Banpu PCL (86.71), the Siam Cement PCL (86.34), Ratchaburi Electricity Generating Holding PCL (83.92), and the Bangchak Petroleum PCL (82.66). It is interesting to note that these top corporate governance companies all belong to the national resources sector, and four of them are state-owned enterprises.

considered healthy by the U.S. and U.K. standards.[19] About half of the companies in the sample have independent non-executive directors accounting for at least one-third of board membership (median statistics, not shown in the table). This is an improvement when compared with 21 percent of the sample firms with this attribute in 2000.[20]

However, the separation of monitoring and management may be less clear than suggested by the ratio of non-executive directors—as many as 38 percent of the firms have the same individual acting as both the CEO and board chairman or vice chairman. Management oversight is limited when the chairman of the board is also the leader of the executive team. Moreover, roughly 50 percent of the companies appointed a member of the controlling family as CEO. This is consistent with the notion that separation of management from ownership and control is rare and hence that there is a high probability of entrenchment by controlling shareholders.[21]

Table 4 shows that the CGI and each of the five subindexes are positively correlated. The other variables in the correlation matrix are firm attributes that do not enter the calculation of the CGI. The negative correlations between the CGI and proxies for the extent to which ownership overlaps with monitoring and/or management of the firms (eg. the CEO or the Chairman is a controlling-family member, share ownership of the CEO and the Chairman) reinforce the notion of entrenchment by large shareholders. Consistent with this pattern, the relationship between "freefloat" or minority shareholdings and the CGI indicates that the more widely held a firm is, the better its corporate governance.[22]

4.2 Regression Analysis
4.2.1 Does Foreign Ownership Improve Corporate Governance?

Table 5 columns 1 and 2 report results from cross-sectional OLS regressions. The inverse relationship between foreign ownership and governance already manifests itself in these baseline regressions. Corporate governance is negatively correlated with aggregate foreign ownership conditional on firm size, and the coefficient estimate on foreign ownership is robust to controlling for other determinants of corporate governance including industry dummies.

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[19] U.S. Business Roundtable (Deloitte & Touche Review) suggests that the majority of directors of a corporation should be non-executive directors. U.K. Hampel Committee advises a company to have at least one-third of the board consisting of non-executive directors for the board to be effective in the oversight role.

[20] The SEC and the SET require listed companies to appoint at least 2 independent directors. This requirement is in an absolute term regardless of the total number of the board members or the proportion of shares held by the public. The independent-director ratio of zero in the data reflects that companies had no disclosure on the independence of the board of directors.

[21] Expropriation of minority shareholders by controlling shareholders is viewed as a primary agency problem in East Asia. See La Porta et al. (1999) and Claessens et al. (2000).

[22] The "freefloat" of a listed security is the proportion of shares available for purchase in the market by minority investors.

To mitigate plausible endogeneity, the foreign ownership limit is used to instrument for actual foreign ownership in the IV regressions (Table 5, regressions 3 and 4). The first-stage relationship between foreign limits and actual foreign ownership is strongly positive: the foreign limit is significantly related to foreign ownership at over 99 percent confidence even when other controls are included. The F-test for foreign limit in the first-stage regression (F-statistic = 156.91 for regression 4) indicates that foreign limit is a strong instrument, suggesting that the IV estimates are unbiased.

The IV estimate yields a point estimate of -0.139 on foreign ownership in the second-stage regression which is significant at 99 percent confidence. Since foreign ownership is instrumented, we can confidently assert a causal relationship whereby foreign investment adversely affects the quality of corporate governance of local firms. This IV estimate (regression 4) is more negative than the analogous OLS estimate (regression 2) when all controls are included, suggesting that the adverse effect of foreign ownership on corporate governance can generally be offset by the attractiveness of good governance to foreign investors when making an investment decision.

Robustness

I perform a number of sensitivity analyses to check robustness. To reduce omitted variables bias, I construct the CGI for the year 2000 and perform panel data analysis using data from years 2000 and 2004.[23] Because of the incompleteness of company data in 2000, I relegate panel regression analysis to this section on robustness check. Results from pooled OLS and panel random effects and fixed effects regressions are reported in Table 6.[24] The negative relationship between corporate governance quality and foreign shareholdings remains strong in pooled-data OLS estimation (regression 1) and in panel random-effects and fixed-effects estimations (regressions 2 and 3). The coefficient on foreign ownership increases in absolute value from -0.076 in the cross-sectional OLS regression to -0.166 in the panel fixed-effects regression.

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[23] The same method is used to construct the CGI for the year 2000 except that the number of applicable governance questions falls from 87 to 56. Almost half of the questions that dropped off concern the existence and quality of elements that cannot be assessed contemporaneously such as the information that existed on company websites during the year 2000. The rest are unavailable due to changes in disclosure standards and due to the implementation of corporate governance reforms that came in effect after year 2000. The reduced set of questions is used to calculate the CGI for 2004 to make it comparable with the CGI for 2000.

[24] Although a combination of panel and IV estimations would be optimal as to control both endogeneity and omitted variables bias, this combined method is not feasible because the instrumental variable, $Flimit$, is invariant over time.

Next, I replace firm-specific log market capitalization, return on assets, sales growth, and export propensity with their industry averages on a possibility that these control variables may be endogenously determined by the level of corporate governance. Results for alternative specifications using industry averages are reported in Table 6, regressions 4 through 7. The coefficient on foreign ownership remains negative and statistically significant across all models. The absolute value of the coefficient on foreign ownership declines for the IV, pooled OLS, and random effects models but increases in the fixed-effects model, compared with the baseline result from Table 5 column 4.

To further test the sensitivity of the results, I divide the sample into different sub-samples using thresholds for state ownership, firm size, and foreign participation.[25] I find that the negative effect of foreign ownership is more important for firms with small state ownership, high market capitalization, and large foreign participation. Since all these three criteria are associated with larger foreign ownership, this finding is consistent with the presumption discussed earlier that foreign owners may weaken corporate governance if they have the ability and the incentive to do so through their significant voting rights and cash-flow rights associated with their sizeable shareholdings.

4.2.2 Does the Type of Foreign Investor Matter?

The foreign ownership variable used so far is measured in the aggregate. An interesting question to investigate is whether different types of foreign investors affect corporate governance differently. I create two dummy variables to capture the relative importance of foreign industrial ownership and foreign institutional ownership: a "foreign industrial ownership dummy" that equals 1 if firm is a joint venture with foreign industrial partners who own at least 10 percent of total shares, 0 otherwise; and a "foreign institutional ownership dummy" that equals 1 if firm is not an industrial joint venture and at least 10 percent of total shares is held by foreign institutional investors, 0 otherwise. There are 80 firms in the sample that fall in the former case, and 58 firms the latter case. The rest of the firms, which comprise a baseline group, either do not have substantial foreign ownership (median foreign ownership of this group = 2.9 percent; mean = 6.8 percent) or it is not clear which type of foreign investors dominates.

The two types of foreign ownership are significantly correlated with the measure of corporate governance but in opposite directions (Table 7, regression 1): foreign industrial owners are associated with 3.6 points lower, while foreign institutional investors are associated with 6.3

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[25] The threshold for state ownership is 20 percent; market capitalization 9.6 billion baht (mean); foreign ownership 20 percent.

points higher, values on the CGI index than the baseline group.[26] The negative coefficient of foreign industrial group remains significant at 99 percent confidence in all three specifications. The positive effect of the foreign institutional group weakens or disappears, however, when other firm characteristics are controlled for (regressions 2 and 3). The F-test on the null hypothesis that the coefficients of the two ownership dummies are not statistically different cannot be rejected at the 99 percent level in all three models, suggesting that foreign industrial owners and foreign institutional owners indeed affect the measure of governance differently.

An interpretation is that foreign institutional investors use superior knowledge and ability together with greater incentive to discipline management, directors, and other insiders of companies to influence companies to establish more vigorous corporate governance mechanisms and to enhance information disclosure.[27] Foreign industrial owners, on the other hand, lack these skills or are indifferent to the quality of corporate governance of the company, perhaps as long as the company continues to generate revenues for them. The fact that a single foreign industrial owner holds, on average, as much as 34 percent stake of its joint venture in Thailand (as opposed to the 2.7 percent ownership share held by a typical foreign institutional investor), and that they often directly involve in management and operation of the firm, make the result on foreign industrial ownership coincide with the entrenchment effect of large shareholdings (Morck, Shleifer and Vishny, 1988; Shleifer and Vishny, 1986; and Claessens, et al., 2002).[28]

The negative relationship between large foreign industrial ownership and governance can also be explained by the theoretical model of Bebchuk (1999), which predicts a positive relationship between the likelihood of having a large blockholder and the potential value of private benefits of control. This theory is supported by evidence on Australian firms presented by Lamba and Stapledon (2002) using the value of related party transactions, and evidence on cross-

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[26] Since there is only one plausible instrumental variable (i.e. foreign ownership limit) available for this analysis, an IV regression cannot be performed when two endogenous variables (foreign industrial ownership and foreign institutional ownership) are included in the regression of corporate governance index. Thus, results in this sub-section are based on OLS regressions.

[27] However, not all foreign institutional investors behave this way as to bring good corporate governance to local companies. There is also a case that foreign institutional investors aim to make only short-term profits by purchasing financially distressed companies at a bargain prices during an economy-wide financial crisis and then selling their stakes when the economy is up and running again, cashing out before addressing governance problems and sometimes leaving the company with even more governance problems. Widely cited examples of this include the purchase and sale of Korean banks by U.S. private equity funds Newbridge Capital and Lone Star, earning a windfall profit of US$1.2 billion and US$4.4 billion, respectively, in less than four years investment span. Their executives now face criminal charges in Korea on suspicion of tax evasion and fraud. Warburg Pincus, another U.S. investment fund, was recently accused of insider trading stemming from the 2003 purchase of LG Card, a credit card company in Korea.

[28] According to Shleifer and Vishny (1986), large investors can be so powerful that they may pursue their own interests, which need not correspond with the interests of other (minority) investors or employees in the firms.

country comparison by Dyck and Zingales (2004) using the difference in the price per share paid by an acquirer and the market price after the change in control, as a measure of private benefits of control. The theory implies that large shareholders, foreign and local alike, may oppose any positive change in corporate governance because their private benefits may be threatened once corporate governance—which protects minority investor rights—is strengthened. Moreover, given that Thailand has relatively weak rule of law, the existence of private benefits of control in Thailand is supported by empirical findings that the value of private benefits are negatively related to the quality of legal environment and the level of investor protection of a country (Nenova, 2003; Dyck and Zingales, 2004).

The firm-level relationship between foreign direct investment (FDI) and governance found in this analysis may also occur at the country-level. Li and Filer (2004) find a downward-sloping relationship between country-level FDI and their governance index for a sample of 48 countries. They conclude that investors prefer direct investment when investing in countries with poor governance because it gives investors more control and thus better protection. The firm-level investigation of this paper in turns explains why self-interested FDI does not help improve the overall corporate governance in local firms especially in the area of minority shareholder protection.

4.2.3 Where Did Foreign Firms Go Wrong?

Regressions 1 through 5 in Table 8 Panel A are analogous to regression 3 in Table 7 except that the dependent variables are now the components of the CGI. Since some foreign owners are not directly involved in monitoring, their scope for influencing the firm's corporate governance is more limited than foreign owners who have their representatives on the board of directors. Therefore, I also employ a "foreign director dummy" to capture the effect of foreign direct participation in monitoring on corporate governance (Panel B).[29]

The results show that firms with significant foreign industrial ownership tend to do poorly in the area of board structure and responsibility. This area of governance is also problematic for firms that have foreign nationals on the board of directors. Since foreign directors are mostly elected to represent foreign industrial owners who are large shareholders, these results suggest that foreign industrial firms in Thailand, whether or not they are directly involved in monitoring, pay little attention to the board of directors as a governance mechanism.

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[29] "Foreign director dummy" is equal to 1 if there exists at least one director of a foreign national on the board of directors; 0 otherwise.

Firms with foreign institutional investors outperform the other firms in the area of information disclosure (regression 5), which is not surprising given examples of many international institutional investors such as U.S.-based CalPERS, TIAA-CREFF, and Fidelity, who have been active in corporate governance issues and have been pressing for more transparency in companies in which they invest. These institutional investors often choose firms with poor corporate governance, providing opportunities for them to generate profits by reforming their corporate governance systems which will increase firm market value (Smith, 1996).[30,31]

A closer look reveals that foreign industrial ownership companies are less likely to establish a specialized committee—in addition to a mandatory audit committee—to further strengthen the checks-and-balances systems of the companies (Table 9).[32] Only 9 percent of this type of firm had set up a nominating committee by the end of 2004, compared with 22 percent for other firms. And while 5 percent of the rest of the firms has advanced to establish a corporate governance committee, none of the firms with large foreign industrial owners bothered to follow suit.

The role of independent directors of these firms is also relatively limited, and their true independence is in doubt since most of them do not refer to SEC rules regarding the selection of independent directors. Overall, directors of foreign industrial ownership firms attend fewer meetings per year and have lower attendance rate. A significantly smaller percentage of directors of these firms has gone through the directors training programs offered by the Thai Institute of Directors (Thai IOD). This may be due to the fact that directors' training programs are currently offered only in Thai language which effectively limits non-Thai speaking foreign directors from obtaining this special training.

4.2.4 Country and Legal Origin of Foreign Funds

Common wisdom is that governance practices spread from developed countries with good governance to countries with poor governance. Implicit with this claim is that firms in a poor governance country that are exposed to source countries that have good governance should have

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[30] Smith (1996) finds that 72 percent of firms targeted by CalPERS adopt proposed changes or make changes resulting in a settlement with CalPERS. Shareholder wealth increases for firms that adopt or settle and decreases for firms that resist.

[31] Since I do not instrument for the ownership variables in this model, it is also plausible that firms with a high degree of transparency attract more foreign institutional investors.[31] Unfortunately, a lack of long time series data on corporate governance disallows us to test these two competing hypotheses.

[32] The Stock Exchange of Thailand requires all listed companies to set up an audit committee, which must compose of at least three independent directors, by the end of 1999.

higher governance standards than other domestic firms, after controlling for firm characteristics. To test this hypothesis, I identify the top 20 equity investors in Thailand by country based on the value of their total shareholdings. These major source countries are then divided into two groups based on their corporate governance ratings from the IMD's World Competitiveness Yearbook (2004): one group comprises of countries with governance ratings higher than Thailand; the other lower than Thailand. Table 12 shows that only three countries—Japan, India, and China—belong to the latter group.[33]

The CGI is regressed on the "Good CG Country" and "Poor CG Country" dummies and other control variables analogous to regression 3 of Table 7.[34] The result is striking: poor governance seems to be successfully transferred to Thai local companies, whereas there is no evidence of transfer of good governance (Table 11, Panel A). Alternatively, the causality might be running in the other direction: poorly governed Thai firms may be attracting foreign investors from poorly governed countries.[35]

Since the three countries with the poorest governance rankings are all Asian, I investigate whether the practice of bad governance when investing in a country with relatively weak legal enforcement is inherently an Asian phenomenon. As shown in Panel B of Table 13, the coefficient of the Asian dummy is substantially weaker than that of the dummy for Japan, India, and China ("Poor CG Country") in Panel A, demonstrating that not all Asian investors have a negative influence on the corporate governance of Thai companies.

I also regress the CGI on dummies for individual source countries multiplied by their share holdings. I find that ownership by Canada, the United States, the United Kingdom, Japan, India, and China is negatively correlated, while Sweden and Norway are positively correlated, with the quality of corporate governance (Table 10). This is surprising given that countries like Canada, the United States, and the United Kingdom have ranked well in their overall corporate governance practices. But, evidently, they do not apply their good governance when they do business abroad. On the other hand, it could also be that Thai firms attract only companies with below-average corporate governance from these countries.

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[33] For sensitivity analysis, I replace the country-level governance index based on the IMD's World Competitiveness Yearbook with the indices provided by the World Bank and the International Country Risk Guide. Although country rankings differ somewhat across different indices, the key results in Table 11 are robust to alternative governance indices employed. The World Bank's Governance Index is available at http://info.worldbank.org/governance/kkz2005.

[34] "Good (Poor) CG Country" dummy assumes a value of 1 if the largest source country ranks higher (lower) than Thailand in the corporate governance rating. See Table 10 for rankings of corporate governance scores of source countries relative to that of Thailand.

[35] I thank Professor Woochan Kim for suggesting this alternative interpretation.

Next I use the legal-origin classifications of La Porta et al. (1998), who study the relationship between this variable and the level of investor protection, to divide source countries into four groups by their legal systems: English origin, German origin, French origin, and Scandinavian origin.[36] According to La Porta et al. (1988), English-law countries have the strongest, and French-civil law countries the weakest, legal protections of investors. German-law and the Scandinavian countries are in the middle of the range. These relative degrees of legal protection are used as an alternative measure of country-level corporate governance in the following analysis.

Similar to the preceding regressions, the CGI of Thai firms is regressed on the legal-origin dummies and other controls. The regression results are again not overwhelmingly favorable to the existence of governance transfer. Although the coefficients on English- and French-origin dummies have the anticipated signs (positive and negative, respectively), they are statistically insignificant. German and French origins, which were found to be in the middle of the governance spectrum according to La Porta et al. (1998), are strongly correlated with the CGI but in the opposite direction.[37] A close look at the data reveals that the negative coefficient on German-origin dummy is driven primarily by Japanese direct investments in Thai firms in the form of joint ventures or multinational subsidiaries. Why Japanese direct investment is associated with below-average governance of firms in the host country would be an interesting question to explore in more details in future work.

5. Conclusion

This paper has investigated the effects of foreign investment on corporate governance of listed companies using a new firm-level data set on Thailand. A comprehensive index was constructed from detailed company information to measure the corporate governance quality of each of the sample companies. Potential endogeneity problems were also directly addressed using an instrumental variables approach in which foreign ownership restriction on Thai business was employed as an instrument for actual foreign ownership.

The results of this paper challenge conventional wisdom. Foreign investment does not always contribute to improving governance of recipient firms in developing countries. I find evidence suggesting that foreign industrial investors have adverse effects on corporate

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[36] Thailand belongs to the English-common-law group.
[37] However, we should not generalize the result for Scandinavian origin since there are only three cases of companies with considerable investments from Scandinavian-law-origin countries.

governance of local firms. This negative effect is robust to the inclusion of various firm characteristics including industry, family-business, and state-enterprise dummies. Since a foreign industrial investor typically holds large ownership stake in a Thai firm, the negative effect of foreign industrial ownership on the quality of governance reflects the scope for using insider control to seek private benefits by keeping corporate governance weak. The positive correlation between the presence of large ownership blocks and expropriation of minority shareholders has been asserted on both theoretical and empirical grounds, but only domestic large shareholders were concerned. This paper contributes to the literature by discovering that foreign (industrial) block shareholders can also be a source of poor corporate governance.

A positive correlation between foreign institutional ownership and the measure of governance is also detected. Two plausible explanations for a correlation between foreign institutional investment and governance are: 1) foreign institutional investors tend to choose firms with higher governance standards to avoid being expropriated by large shareholders, and 2) foreign institutional investors have chosen firms with poor governance and then improved the governance system to increase firm value. Unfortunately, a lack of long time series data on corporate governance in this paper makes it impossible to distinguish between these two hypotheses for foreign institutional investors. This can provide a venue for future research.

This paper also finds that Thai firms owned by investors from countries with corporate governance ratings lower than Thailand are associated with worse governance than their peers, but the opposite is not true. This implies that bad governance practice is easy to be transferred, while good governance may be much more costly to be implemented in a country with relatively weak governance institutions.

The results from this paper raise several issues for further research. To what extent can the results for Thailand be extended to other developing countries? It could be the case that foreign investors may vary their investment strategies when investing under different institutional environments. Legal enforcement in Thailand might be too weak, corruption too widespread, or the capital market not sufficiently developed, to support some forms of effective governance mechanisms that have been successfully used in countries with better institutions. An attempt to improve corporate governance may also take a while until its upshot becomes apparent. To understand the evolution of corporate governance in relation with the presence or absence of different types of investors, a longitudinal data set covering many years of governance data is required. Finally, this study has ignored plausible interaction effects between foreign ownership and other types of ownership structure such as domestic bank ownership, pyramid shareholdings by a family business group, and state ownership. Different types of ownership can influence

corporate governance of a company differently and their co-existence may either lower or magnify the quality of corporate governance. These offer possible venues for future research.

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Table 1
Summary Statistics
This table provides summary statistics for the data employed in the main analysis of this paper. The data set is comprised of 365 Thai non-financial firms in 2004. The overall Corporate Governance Index (CGI) is a weighted average of the scores of the five governance components: Board Structure (20%), Conflict of Interest (25%), Board Responsibility (20%), Shareholder Rights (10%), and Disclosure and Transparency (25%). Firm-level governance scores are calculated using detailed information from companies' Annual Reports, Disclosure Reports, websites, and the Thai Stock Exchange's database. Foreign ownership is percentage of shares held by residents of non-Thai nations. Foreign limit is the maximum percentage of shares in each firm that can be held by foreign investors according to Thailand's Foreign Business Law. Market capitalization is the amount of shares outstanding multiplied by the market price per share. Age is the number of years since the establishment of the firm. Sales growth is the percentage change of the value of sales from previous year.

Variable	Mean	Std. Dev.	Min	Max	No. of Obs
Overall CGI	53.25	11.19	25.75	90.46	365
Subindexes:					
A: Board Structure	56.49	19.86	16.67	100.00	365
B: Conflict of Interest	38.86	14.57	10.42	100.00	365
C: Board Responsibilites	62.73	13.60	18.46	91.15	365
D: Shareholder Rights	42.96	15.39	0.00	64.94	365
E: Disclosure & Transparency	61.58	17.21	23.53	100.00	365
Foreign Ownership (%)	17.86	20.37	0.00	94.40	364
Foreign Limits (%)	44.40	16.50	10.00	100.00	364
Log(Market Capitalization)	21.25	1.67	16.56	26.91	365
Log(Age)	3.26	0.66	1.39	4.87	366
Return on Assets (%)	8.42	15.14	-73.67	54.28	362
Sales Growth (% change)	0.31	1.37	-0.92	21.76	362

Table 2:

CGI by Industry and by Size

This table provides summary statistics of the overall Corporate Governance Index (CGI) by industry group (Panel A) and by firm size (Panel B) where size is determined by market capitalization.

Panel A: CGI by Industry[a]					
Industry	**Mean**	**Std. Dev.**	**Min**	**Max**	**No. of Obs**
Agro & Food Industry	50.65	9.59	26.06	80.27	41
Consumer Products	46.84	8.73	25.75	62.47	36
Industrials	51.98	10.22	31.79	72.82	43
Property & Construction	55.08	11.24	32.76	86.34	67
Resources	67.84	14.79	37.42	90.46	16
Services	53.17	10.54	33.70	76.09	78
Technology	57.65	11.51	31.47	79.26	41
MAI [b]	54.23	6.98	40.74	69.72	21
Rehab [c]	45.39	9.06	30.35	62.45	19
All	*53.28*	*11.30*	*25.75*	*90.46*	*362*

Panel B: CGI by Size[a]					
Market Capitalization (in million Baht)	**Mean**	**Std. Dev.**	**Min**	**Max**	**No. of Obs**
less than 500[d]	47.20	8.22	26.06	64.19	81
between 500 and 1,400	51.61	8.87	25.75	76.09	93
between 1,400 and 4,000	53.05	10.73	31.47	80.27	95
greater than 4,000	60.46	12.59	34.68	90.46	93
All	*53.28*	*11.30*	*25.75*	*90.46*	*362*

Notes: [a] The number of observations slightly drops from the previous table due to companies with missing industry profile in the data set.

[b] The "Market for Alternative Investment (MAI)" was established under The Securities Exchange of Thailand Act. Its purpose is to create new fund-raising opportunities for innovative business with high potential growth as well as a greater range of investment alternatives.

[c] Companies under rehabilitation.

[d] A company must have a minimum paid-up capital of 300 million baht to list on the SET, and 20 million baht for the MAI.

Table 3
Board of Directors and Other Characteristics of Thai Firms

This table provides statistics on some characteristics of board of directors of 365 Thai non-financial listed companies in 2004. Information provided in this table is mainly from companies' Annual Reports. A non-executive director is a director who does not form part of the executive management team. An independent director is defined as non-executive director who is independent of any major shareholder or management, is not an employee of the company or its affiliation, and is not involved in day-to-day operations of the listed company. Free-float shareholding is the percentage shares held by minority shareholders.

Firm Attributes	Mean	Std. Dev.	Min	Max	No. of Obs
Size of the board of directors	10.89	2.95	5	25	365
Percentage of directors who are non-executive	65.41	18.19	14.29	100.00	365
Percentage of directors who are independent	33.47	10.38	0.00	73.33	365
Number of public companies served by the Chairman[a]	2.16	1.80	1	10	365
Number of public companies served by the chairman of the audit committee[a]	2.20	1.78	1	10	365
The Chairman's shareholding (%) [b]	6.91	12.85	0.00	74.85	365
The CEO's shareholding (%)[b]	7.62	13.01	0.00	96.61	365
Free float shareholding (%)[c]	38.06	17.05	2.24	100.00	319

Percentage of the sample firms of which:

- Chairman or Vice Chairman is also the CEO	38.03%
- Chairman is a controlling family member	49.72%
- CEO is a controlling family member	48.50%
- nominating committee exists	18.67%
- remuneration committee exists	22.93%
- corporate governance committee exists	3.47%
- capital structure includes corporate bonds	13.87%

Notes: [a] Consider only director or management positions at Thai listed companies concurrently held by the Chairman, the Vice Chairman or the CEO.
[b] This includes shareholdings by spouse and children under 20 years old.
[c] Free float shareholding is essentially shareholding of minority investors.

Table 4

Correlation Matrix

This table shows pairwise correlation coefficients between the Corporate Governance Index (CGI), its sub-indices, and particular firm attributes. * and ** indicate the significance level of the correlation coefficients at 5% and 1%, respectively.

	CGI	CG_A	CG_B	CG_C	CG_D	CG_E	Q1	Q2	Q3	Q4
(CG_A) Board Structure	0.655**									
(CG_B) Conflict of Interest	0.731**	0.337**								
(CG_C) Board Responsibilities	0.673**	0.259**	0.369**							
(CG_D) Shareholder Rights	0.486**	0.176**	0.214**	0.326**						
(CG_E) Disclosure	0.779**	0.269**	0.433**	0.450**	0.355**					
(Q1) Chairman is a controlling family member	-0.272**	-0.146**	-0.423**	-0.098	-0.039	-0.136**				
(Q2) CEO is a controlling family member	-0.119*	-0.016	-0.196*	-0.003	-0.077	-0.098	0.310**			
(Q3) Chairman's shareholding	-0.121*	0.020	-0.271**	0.001	-0.118*	-0.063	0.506**	0.238**		
(Q4) CEO's shareholding	-0.108**	0.028	-0.155**	0.004	-0.154**	-0.124*	0.067	0.505*	0.304**	
(Q5) Freefloat shareholding	0.150**	0.082	0.103	0.087	0.054	0.159**	-0.009	0.074	-0.082	-0.108

Table 5

Foreign Ownership and Corporate Governance

This table shows results on the effect on foreign ownership on corporate governance. The dependent variable is the Corporate Governance Index. Columns (1) and (2) present OLS regressions with robust standard errors. Columns (3) and (4) present IV regressions. Results from the first-stage regressions are shown in the top panel. Foreign ownership limit is used as an instrument for actual foreign ownership. For the IV regressions, foreign ownership variable in the second stage is a fitted value from the first stage. Family-Business-Group Dummy is equal to 1 if a Thai family business group and its family members hold at least 25% ownership of the firm. State-Enterprise Dummy is equal to 1 if the Thai government and/or the Royal Crown Property Bureau own at least 25% of the firm. Exporter Dummy is 1 if the firm is exporting. Robust standard errors are in parentheses. *, ** and *** indicate significance at 10%, 5% and 1% level, respectively.

	OLS		IV	
	(1)	(2)	(3)	(4)
1st Stage: Foreign Ownership Regression				
Foreign limits			0.772***	0.739***
			(0.048)	(0.059)
Log(Market Capitalization)			2.988***	4.049***
			(0.478)	(0.664)
Log(Age)				3.650**
				(1.488)
Family-Business-Group Dummy				-4.046**
				(1.927)
State-Enterprise Dummy				-7.589*
				(3.970)
Return on Assets				0.047
				(0.067)
Sales Growth				-0.518
				(0.658)
Exporter Dummy				-1.072
				(2.037)
Constant			-79.99***	-113.15***
			(10.45)	(15.38)
Industry Dummies			No	Yes
Observations			360	359
R^2			0.450	0.478
F-test on H_0: $\beta_1 = 0$			p = 0.000	p = 0.000
2nd Stage: CGI Regression				
Foreign Ownership	-0.073***	-0.076***	-0.075*	-0.139***
	(0.025)	(0.028)	(0.039)	(0.051)
Log(Market Capitalization)	3.421***	2.504***	3.450***	2.849***
	(0.347)	(0.428)	(0.362)	(0.493)
Log(Age)		-1.788*		-1.761*
		(1.025)		(1.059)
Family-Business-Group Dummy		-2.185*		1.581
		(1.256)		(1.329)
State-Enterprise Dummy		7.162***		5.884*
		(2.871)		(3.073)
Return on Assets		0.087*		0.088*
		(0.046)		(0.046)
Sales Growth		-0.015		-0.037
		(0.202)		(0.209)
Exporting Dummy		-0.797		-0.729
		(1.318)		(1.307)
Constant	-18.10	11.54	-18.65**	5.51
	(7.14)	(10.36)	(7.33)	(10.50)
Industry Dummies	No	Yes	No	Yes
Observations	361	360	360	359
R^2	0.243	0.385	0.246	0.377
F-test on H_0: $\beta_1 = 0$	p = 0.004	p = 0.007	p = 0.056	p = 0.007

Table 6
Robustness Check

The dependent variable is the Corporate Governance Index. The sample used in this table is Thai listed firms in 2000 and 2004 (except for column (4) which is a cross-sectional IV regression using 2004 data). The Corporate Governance Index is re-constructed for 2000 and 2004 using a smaller set of governance data due to incompleteness of data in year 2000. All variables employed in columns (1) through (3) are firm-specific variables. For columns (4) through (7), Log(Market Capitalization), Return on Assets, Sales Growth, and Export propensity are industry averages. Foreign ownership limit is used as an instrument for foreign ownership in the IV regression in column (4). Robust standard errors are in parentheses. *, ** and *** indicate significance at 10%, 5% and 1% level, respectively.

				Industry-averaged control variables			
	Pooled OLS	Panel Random	Panel Fixed Effects	IV	Pooled OLS	Panel Random Effects	Panel Fixed Effects
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Foreign Ownership	-0.105***	-0.109***	-0.166***	-0.068**	-0.053*	-0.053*	-0.213***
	(0.020)	(0.020)	(0.061)	(0.033)	(0.030)	(0.028)	(0.073)
Log(Market Capitalization)	2.310***	2.446***	5.810***	6.204***	4.914***	4.914***	-5.313
	(0.285)	(0.273)	(0.540)	(1.571)	(1.043)	(1.016)	(6.321)
Log(Age)	-1.438**	-1.375**	-	-2.625**	-2.77***	-2.77***	-
	(0.722)	(0.698)	-	(1.039)	(0.767)	(0.710)	-
Family-Business-Group Dummy	-1.858**	-1.983**	-	4.083***	-0.351	-0.351	-
	(0.794)	(0.834)	-	(1.232)	(0.800)	(0.838)	-
State-Enterprise Dummy	-0.515	-0.670	-	11.081***	3.622*	3.622**	-
	(1.870)	(1.781)	-	(2.618)	(1.869)	(1.673)	-
Return on Assets	0.028*	0.025	-0.092*	-0.32	-0.003	-0.003	2.887
	(0.016)	(0.021)	(0.048)	(0.417)	(0.289)	(0.297)	(2.194)
Sales Growth	-0.010	-0.020	-0.011	2.009	1.293	1.293	4.349
	(0.221)	(0.181)	(0.090)	(1.855)	(1.295)	(1.304)	(8.760)
Exporter Dummy	-1.585*	-1.600*	-	1.188	-1.604	-1.604	10.241
	(0.873)	(0.884)	-	(3.558)	(2.553)	(2.571)	(18.793)
Constant	27.53***	-	-59.52***	-67.735**	-32.728	-32.728	148.031
	(6.32)	-	(14.63)	(33.494)	(22.992)	(22.216)	(132.149)
Industry Dummies	Yes	Yes	Yes	-	-	-	-
Observations	638	638	638	360	640	640	640
R^2	0.314	0.343	0.414	0.230	0.165	0.165	0.000
F-test on H_0: $\beta_1 = 0$	p = 0.000	p = 0.000	p = 0.008	p = 0.045	p = 0.082	p = 0.091	p = 0.004

Table 7
Foreign Industrial Investors VS. Foreign institutional Investors
This table shows the differential effects between foreign industrial ownership and foreign institutional ownership on corporate governance. The dependent variable is the Corporate Governance Index. Foreign Industrial Ownership Dummy assumes a value of 1 if firm is a joint venture with a foreign industrial partner and its foreign partner owns at least 10% of the firm; 0 otherwise. Foreign Institutional Ownership Dummy assumes a value of 1 if firm is not a foreign industrial joint venture and its foreign institutional ownership is at least 10% of the firm; 0 otherwise. P-values from the F-test of the null hypothesis that the two foreign ownership dummies are not statistically different from each other are reported at the end of the table. Robust standard errors are in parentheses. *, ** and *** indicate significance at 10%, 5% and 1% level, respectively.

	Number of Incidences	Dependent Variable: CGI 2004		
		OLS		
		(1)	(2)	(3)
Foreign Industrial Ownership Dummy	80	-3.648***	-4.350***	-4.527***
		(1.318)	(1.232)	(1.328)
Foreign Institutional Ownership Dummy	58	6.265***	1.841	2.552*
		(1.694)	(1.554)	(1.540)
Log(Market Capitalization)			3.094***	2.094***
			(0.336)	(0.405)
Log(Age)				-1.813*
				(0.985)
Family-Business-Group Dummy				-2.253*
				(1.209)
State-Enterprise Dummy				7.771***
				(2.679)
Return on Assets				0.075*
				(0.044)
Sales Growth				0.052
				(0.195)
Exporter Dummy				-0.750
				(1.297)
Constant		53.11**	-11.76*	20.33**
		(0.701)	(6.960)	(8.692)
Industry Dummies		No	No	Yes
Observations		365	365	362
R^2		0.071	0.263	0.407
F-test on H_0: $\beta_1 = \beta_2$		p = 0.000	p = 0.000	p = 0.000

Table 8

Foreign Participation and Components of the Corporate Governance Index

This table presents OLS regressions of each sub-component of the Corporate Governance Index on foreign ownership variables (Panel A), and foreign participation in the board of directors (Panel B). Foreign Industrial Ownership Dummy assumes a value of 1 if firm is a joint venture with a foreign industrial partner and its foreign partner owns at least 10% of the firm; 0 otherwise. Foreign Institutional Ownership Dummy assumes a value of 1 if firm is not a foreign industrial joint venture and its foreign institutional ownership is at least 10% of the firm; 0 otherwise. Foreign director dummy is equal to 1 if there exists at least one director of a foreign national on the board of directors; 0 otherwise. The same set of control variables as that in Table 5 are included in all regressions, but results are omitted. Robust standard errors are in parentheses. *, ** and *** indicate significance at 10%, 5% and 1% level, respectively.

	Dependent Variable:				
	Subindex A **Board Structure**	Subindex B **Conflict of Interest**	Subindex C **Board Responsibility**	Subindex D **Shareholder Rights**	Subindex E **Disclosure**
PANEL A:					
Foreign Industrial Ownership Dummy	-8.501***	-2.538	-5.594***	-3.032	-3.081
	(2.717)	(1.941)	(1.914)	(2.358)	(1.936)
Foreign Institutional Ownership Dummy	1.759	1.718	3.223	1.955	3.722*
	(3.295)	(2.432)	(2.134)	(1.941)	(2.162)
Control Variables and Constant	Yes	Yes	Yes	Yes	Yes
Observations	362	362	362	362	362
R^2	0.176	0.259	0.154	0.147	0.446
F-test on $H_0: \beta_1 = \beta_2$	$p = 0.006$	$p = 0.108$	$p = 0.000$	$p = 0.048$	$p = 0.009$
PANEL B:					
Foreign Director Dummy	-5.028**	0.280	-3.001*	-1.382	0.025
	(2.324)	(1.674)	(1.687)	(1.827)	(1.827)
Control Variables and Constant	Yes	Yes	Yes	Yes	Yes
Observations	362	362	362	362	362
R^2	0.156	0.252	0.123	0.138	0.433
F-test on $H_0: \beta_1 = 0$	$p = 0.031$	$p = 0.876$	$p = 0.076$	$p = 0.450$	$p = 0.989$

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Table 9
Corporate Governance Characteristics of Firms Owned by Foreign Industrial Investors
Out of 365 sample firms, 87 are joint-venture firms with foreign industrial partners. This table shows mean statistics of some governance characteristics of the sample firms by the joint venture status. The means statistics that are significant at 10% are in bold face. The last column present tests of the null hypothesis that the two groups of firms have the same mean. *, **, *** indicate t-test significant at the 10%, 5%, and 1% level, respectively.

	Foreign Joint Venture Firms (N = 87)	All Others (N = 278)	Tests of Means
Corporate governance items			
Disclosure of individual directors attendance at board meetings	77%	79%	
Disclosure of individual directors compensation	57%	62%	
Disclosure of individual directors shareholdings	91%	96%	
Disclosure of management shareholdings	89%	93%	
Disclosure of related party transactions in details	62%	64%	
Chairman of the board of directors is a different person from the CEO	62%	61%	
Percentage of directors who are independent	32%	34%	
Percentage of directors who are also managers	33%	35%	
Percentage of directors who have attended directors training programs	**18%**	**42%**	***
Average number of board meetings in a year	**5.3**	**6.9**	***
Average directors attendance at board meetings	**75%**	**83%**	***
Average independent directors attendance at board meetings	**83%**	**88%**	*
Average audit committee meeting attendance	92%	95%	
Existence of nominating committee	**9%**	**22%**	***
Existence of remuneration committee	17%	25%	
Existence of corporate governance committee	**0%**	**5%**	**
State definition of "independence" of directors in the disclosure report	**17%**	**34%**	***
Existence of an accounting expert on the audit committee	49%	59%	
Existence of company website	**77%**	**85%**	*
Incidence of violation of SEC disclosure rules	2%	9%	
Other information			
Chairman of the board of directors is a controlling-family member	51%	49%	
CEO is a controlling-family member	**23%**	**54%**	***
Average Chairman's shareholdings	**3%**	**8%**	***
Average CEO's shareholdings	**3%**	**9%**	***
Existence of a foreign director	**63%**	**17%**	***
Freefloat (minority) shareholdings	**31%**	**40%**	***

Table 10

Country-Level Corporate Governance Ratings

These corporate governance ratings were drawn from the "Government Efficiency" and "Business Efficiency" criteria in the IMD, World Competitiveness Yearbook (2004). Higher scores indicate better corporate governance quality. There are a total of 60 economies covered in the publication. Included in this table are the 20 largest foreign investors in Thailand in 2004. Country ranked 1 has the best corporate governance; and 60 worst corporate governance. The first column shows the effect of corporate governance of the source countries on the host firm's corporate governance through ownership. It reports the coefficients on source country ownerships from a regression that is analogous to the regression of Table 7 Column 3 with foreign ownership dummies replaced by individual source countries' shareholdings (%). The dependent variable is the (firm-specific) Corporate Governance Index. Coefficients on control variables are omitted. *, ** and *** indicate significance at 10%, 5% and 1% level, respectively.

	Coefficient from regressing CGI on source country ownership	Governance Ranking in Whole Sample	Average Governance Rating	Ethical Practices	Credibility Of Managers	Corporate Boards	Shareholder Value	Social Responsibility	Adaptability	Customer Satisfaction	Bureaucracy	Bribing And Corruption	Rights And Responsibilities Of Shareholders	Financial Institutions Transparency	Insider Trading	Legal Regulation Of Financial Institutions	Investment Protection Schemes
Finland	+ 0.04	1	**7.78**	7.97	7.85	6.95	7.23	6.78	7.45	7.66	6.09	9.38	8.52	8.25	8.19	8.62	8.03
Denmark	− 3.66	2	**7.75**	7.81	7.55	6.95	6.90	7.69	7.38	7.57	6.41	9.12	8.48	7.79	8.55	8.52	7.78
Australia	− 0.61	3	**7.43**	7.92	6.58	7.00	7.21	6.66	7.74	7.68	5.11	8.44	8.49	8.21	7.84	8.00	7.12
Singapore	− 0.05	4	**7.41**	7.46	7.33	6.93	6.52	6.67	6.90	7.48	5.95	8.54	7.71	7.67	7.95	8.49	8.19
Canada	− 0.24***	5	**7.31**	7.97	7.23	6.70	7.30	6.90	7.13	8.06	4.89	7.47	7.97	7.56	7.03	8.25	7.85
Sweden	+ 1.23***	9	**6.85**	7.46	6.00	5.39	6.45	7.10	7.46	7.50	4.85	7.47	7.97	6.90	6.68	7.86	6.77
Hong Kong	− 0.10	10	**6.84**	6.67	6.94	6.67	6.67	5.65	7.65	7.76	5.45	6.88	6.86	7.41	6.35	7.67	7.10
USA	− 0.18**	13	**6.65**	6.95	6.35	5.42	6.32	5.83	7.86	7.59	4.51	6.63	7.49	7.23	6.02	7.13	7.77
Norway	+ 0.46***	14	**6.63**	7.67	6.30	5.85	6.04	7.15	5.85	6.56	4.56	7.48	7.93	7.74	5.40	7.89	6.38
Netherlands	+ 0.01	15	**6.61**	7.44	6.48	5.90	6.05	6.44	6.41	6.63	3.80	6.76	7.19	6.99	7.24	7.82	7.34
Malaysia	− 0.06	16	**6.58**	7.10	6.96	6.47	6.53	6.55	6.84	7.63	4.82	4.06	7.31	6.94	6.10	7.64	7.11
Switzerland	+ 0.37	17	**6.51**	7.19	6.39	5.32	6.10	5.84	5.97	6.58	4.52	7.50	7.47	6.37	6.44	7.68	7.70
Taiwan	+ 0.01	20	**6.33**	6.72	6.76	6.36	6.13	6.34	8.00	7.66	4.70	4.89	6.70	5.75	5.42	5.91	7.23
Belgium	− 0.09	21	**6.32**	6.97	6.90	5.93	6.20	6.53	6.13	7.07	2.41	5.29	6.90	6.85	6.97	6.88	7.40
Germany	+ 0.29	24	**6.10**	7.01	5.69	5.26	5.84	5.78	5.45	5.83	2.10	6.38	7.52	6.59	7.39	7.26	7.24
France	+ 0.36	28	**6.06**	6.90	6.29	5.36	5.51	6.29	5.22	5.97	2.77	6.17	6.52	6.40	6.84	7.10	7.46
UK	− 0.13*	29	**6.03**	6.81	5.63	5.88	5.88	5.33	5.88	6.65	2.51	6.83	7.01	6.46	6.79	6.44	6.25
Thailand	*n.a.*	*34*	*5.69*	*6.34*	*6.16*	*5.69*	*5.91*	*5.84*	*6.40*	*7.30*	*3.93*	*2.99*	*6.29*	*5.93*	*4.11*	*6.34*	*6.47*
Japan	− 0.24***	38	**5.53**	6.15	6.31	4.79	5.12	5.92	5.49	8.10	2.87	5.44	4.57	4.44	6.91	5.06	6.31
India	− 0.47***	40	**5.41**	5.72	6.45	5.66	5.63	5.15	6.29	6.25	2.86	1.75	6.50	6.53	4.69	6.03	6.28
China	− 0.80*	47	**4.86**	5.17	5.35	5.72	5.17	5.59	4.61	6.57	1.57	1.17	6.04	3.98	3.81	6.07	7.20
Observations	362																
R²	0.442																

Source: IMD, World Competitiveness Yearbook, 2004.

Table 11

Origins of Foreign Funds and Corporate Governance Transfers

This table tests whether the firm-level corporate governance of Thai firms depends on the corporate governance quality of the source country of inward foreign investment. The dependent variable is the Corporate Governance Index. Panel A groups source countries by governance rankings relative to Thailand. Panel B groups source countries by Asian/Non-Asian region. Panel C groups source countries by the legal origin. Good (Poor) CG Country Dummy assumes a value of 1 if the largest source country ranks higher (lower) than Thailand in the corporate governance rating; 0 otherwise (see Table 10 for country rankings). The law origin dummies have value of 1 if shareholders from countries within the respective law origin collectively own more than 10 percent of the total shares in a sample company; 0 otherwise. All regressions in this table include industry dummies and other control variables analogous to Table 7 Column 3; results are omitted. Robust standard errors are in parentheses. *, ** and *** indicate significance at 10%, 5% and 1% level, respectively.

Panal A			Panel B			Panel C		
Corporate Governance of the Largest Source Country			**Asian vs. Non-Asian Source Country[a]**			**Law Origin of the Largest Source Country[b]**		
	Number of incidences	OLS		Number of incidences	OLS		Number of incidences	OLS
Good CG Country Dummy	112	-1.022 (1.290)	Asian Dummy	86	-2.594* (1.402)	English-Origin Dummy	107	0.364 (1.346)
Poor CG Country Dummy	34	-6.246*** (1.914)	Non-Asian Dummy	60	-1.818 (1.697)	German-Origin Dummy	30	-5.326*** (1.727)
						French-Origin Dummy	9	-0.071 (2.780)
						Scandinavian-Origin Dummy	3	11.168*** (2.059)
Constant		12.719 (8.173)	Constant		10.393 (8.215)	Constant		19.51* (10.28)
Control Variables		Yes	Control Variables		Yes	Control Variables		Yes
Observations		362	Observations		362	Observations		360
R^2		0.383	R^2		0.371	R^2		0.397
F-test on $H_0: \beta_1 = \beta_2$		p = 0.015	F-test on $H_0: \beta_1 = \beta_2$		p = 0.701	F-test on $H_0: \beta_1 = \beta_2 = \beta_3 = \beta_4$		p = 0.000

Notes: [a] Asian source countries include China, Hong Kong, India, Japan, Malaysia, Singapore, and Taiwan. Non-Asian countries include Australia, Belgium, Canada, Denmark, Finland, France, Germany, the Netherlands, Norway, Sweden, Switzerland, United Kingdom, and the United States.
[b] In this sample, "English-law-origin" countries include Australia, Canada, Hong Kong, India, Ireland, Israel, Malaysia, Pakistan, Singapore, South Africa, Sri Lanka, United Kingdom, and United States; "French-law-origin" includes Belgium, France, Indonesia, Italy, Jordan, Mexico, the Netherlands, Philippines, Portugal, and Spain; "German-law-origin" includes Austria, Germany, Japan, South Korea, Switzerland, and Taiwan; "Scandinavian-law-origin" includes Denmark, Finland, Norway, and Sweden.