



# Global institutions and local filtering: Introducing independent directors to Taiwanese corporate boards

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[journals.sagepub.com/home/iss](http://journals.sagepub.com/home/iss)**Chi-Nien Chung**

NUS Business School, National University of Singapore, Singapore

**Young-Choon Kim** 

Graduate School of Technology Innovation and Management, UNIST, Republic of Korea

## Abstract

Drawing on the idea of selective interaction between organizations and environments, the authors examine how organizations change their traditional practices when they are exposed to new institutional environments. In the context of corporate governance change in response to financial market globalization, they argue that global institutional influence is moderated by local corporate control contexts that function as filtering mechanisms. The authors empirically analyse the adoption of a new corporate governance practice, i.e., the initial introduction of independent directors, in Taiwanese public firms, where family governance has been a dominant governance model. The findings suggest that while firms exposed to US capital markets are more likely to adopt independent directors, this facilitating effect weakens when the firms are under strong family control and is amplified when they are unbound from local frameworks through the key leader's education or their geographic context.

## Keywords

Family control, filtering mechanism, independent directors, institutional environments, local control

## Introduction

Institutional environments of organizations, traditionally described as ‘iron cages’ (DiMaggio and Powell, 1983), are subject to multiple logics that compete or even

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### Corresponding author:

Young-Choon Kim, Graduate School of Technology Innovation and Management, UNIST-gil 50, Ulju-gun Eonyang-eup, Ulsan, 44919, Republic of Korea.

Email: [youngchoon.kim@gmail.com](mailto:youngchoon.kim@gmail.com)

contradict each other (Seo and Creed, 2002). One key source that leads to institutional change and variation is foreign influences that transfer across national and/or geographical boundaries. Corporate governance changes due to the globalization of financial markets are a case in point. Financial globalization, led by US capital markets and large institutional investors, pushes certain corporate governance practices on local firms. Research suggested that German firms (Sanders and Tuschke, 2007) and Japanese firms (Ahmadjian and Robbins, 2005) changed their deeply-rooted practices as a result of their exposure to global financial capital and institutions. While these studies have demonstrated that the encounter between local and foreign practices facilitates institutional change, the contingencies under which foreign institutions facilitate or inhibit such changes need further conceptual development and empirical investigation.

Drawing upon recent theoretical development from organizational sociology (Scott and Davis, 2007; Weber and Waeger, 2017), this article introduces organizational filtering mechanisms whereby external institutional impact increases or decreases according to an organization's local control contexts. Acknowledging the significance of external institutional influence, our focus is to specify the extent of the interactions between organizations and environments. We argue that global institutional influence is moderated by controlling owners and processes of local firms that function as filtering mechanisms. Specifically, we investigate three aspects of local control: (1) family ownership as a structural control that present constraints and opportunities for corporate change in local governance practices, (2) a key owner's cognitive orientation as a cultural framework by which the appropriateness of corporate governance models are interpreted and evaluated, and (3) a firm's location in globalized industry districts as a geographic control derived from institutional and network linkages with international markets. We suggest that variation in the local control owners and processes can provide filtering mechanisms for global institutions, thereby magnifying or diminishing globally-influenced corporate behaviors.

Our empirical context is the introduction of independent directors in Taiwanese firms. Taiwanese firms have traditionally operated under a family governance system, which is deeply rooted in Chinese familism (Hamilton and Biggart, 1988; Redding, 1990; Tsai et al., 2006). Since the late 1990s, however, Taiwanese firms have increasingly been exposed to global capital markets, especially the US market, which features distinct corporate governance practices, such as dispersed ownership, board independence, and financial transparency. Engaging independent directors was a key part of corporate governance reform during our study period (2001–2006) in this globalization trend. Using data for firms listed on the main board of the Taiwanese Stock Exchange, we study how a firm's adoption of the independent director system is shaped by its exposure to US capital markets and its three local control contexts.

Our study contributes to the existing literature on institutional change of organizational sociology. While institutional environments have diffusive and broad influences on organizational behaviors, we highlight the filtering mechanisms whereby institutional influences are moderated by an organization's control structure and human agency. Our findings demonstrate the selective coupling between foreign institutions and organizational contexts, thus suggesting inertial and facilitative processes of institutional change. Despite the wide diffusion of the Anglo-Saxon model of corporate governance to the rest

of the world, our research suggests that the evolution of local corporate practices can be contested, conflict-ridden, and path-dependent (Campbell, 2004; Stark and Vedres, 2006).

## **Background: Corporate governance in Taiwan**

Taiwan's corporate governance model has been characterized by family dominance, which is deeply rooted in the tradition of Chinese familism, where firms are treated as family assets that should be managed by family members and inherited according to patrilineage (Redding, 1990; Whitley, 1990). With the increasing exposure to global environments in the late 1990s, however, corporate governance reform has become a prominent issue in Taiwan. Especially during and after the East Asian financial crisis in 1997–1998, institutional investors demanded corporate governance reforms in Taiwan, often described as having high ownership concentration, especially in the hands of family owners, coupled with weak legal protection of shareholders (Tsai et al., 2006). International bodies such as the OECD and the World Bank also pressured the Taiwanese government to promote the 'global standard' of corporate governance (Liu and Yang, 2008). A major issue in corporate governance reform was the appointment of independent directors, which aims to introduce outside professionals into a governance structure that is otherwise dominated by family members and other related insiders (Liu and Yang, 2008). Given the weak legal protection and insider-orientation of corporate control in Taiwan, the monitoring function of boards of directors is a controversial issue (Tsai et al., 2006). In 2001, the Taiwanese government initiated a series of regulatory reforms that incorporate the independent director system into the corporate board. The legal definition of an independent director has the following stipulations. Independent directors cannot (1) be employees or directors of related corporations, (2) hold more than 1% of the shares in a firm, (3) be relatives of the directors and shareholders of the company, (4) be representatives of institutional investors with over 5% of the shares of the firm, (5) be affiliated with or transact with the firm or with any institutional investors who own over 5% of the firm's shares, or (6) provide professional services to the firms and corporations related to the company. This strict definition, which aims to provide more of a substantive role to independent directors, reduces the possibility that firms manipulate these appointments simply as symbols.

The introduction of independent directors became a heated issue. An investigation of the legislative process of the revision of Securities and Exchange Laws (SEA) during 2002 and 2006 reveals that the requirements to appoint independent directors were at the center of debate. Even after four years of exchanges, debates, and negotiation among the various parties involved, such as the regulatory agencies, legislators, scholars, large shareholders of listed companies, and peak associations, the final outcome of the SEA amendment in 2006 represented a compromise whereby the number of independent directors was reduced from 50% of the board to a minimum of two. Between 2002 and 2006 therefore, the adoption of independent directors had yet to become mandatory while firms were under institutional pressure to implement such changes. Next, we develop hypotheses regarding why and how local firms would voluntarily adopt such a new and controversial practice.

## Theory and hypotheses

### *Financial market globalization and corporate governance*

Financial market globalization has facilitated the diffusion of a corporate governance model, developed historically in the UK and US, which emphasizes strong legal protection of shareholders' rights that is characterized by separation of ownership and control, coupled with efficient capital markets (Branson, 2001; Clarke and dela Rama, 2006). Strong US capital markets and institutional investors led to 'functional convergence' in which foreign companies adopt shareholder-centered practices (Clarke, 2016; Coffee, 2002; Davis and Steil, 2001). Financial economists and legal scholars argued that such convergent corporate governance replaces alternative models such as insider-oriented (e.g., family) governance models (Hansmann and Kraakman, 2001). Global organizations and standardization bodies have promoted the shareholder-oriented model as best practice throughout the world, leading to the diffusion of American-style corporate governance norms and templates (Ho, 2005). In addition, institutional investors with global presence, together with the rise of 'pension fund capitalism', worked as catalysts for the rapid diffusion of Anglo-Saxon corporate governance practices (Davis and Steil, 2001; dela Rama, 2009).

The global convergence argument, however, has invited continuing criticisms that challenge the assumption that only one corporate governance model is the most efficient one, which leads to the debates on convergence versus diversity of corporate governance systems (Aguilera and Jackson, 2010; Branson, 2001; Clarke, 2016; Guillen, 2000). These critics suggest that globalization will not necessarily erase all differences and barriers between nations and cultures because distinctive national institutions and ideologies shape corporate structure and policy environments in local markets (Branson, 2001). Due to the resilience of nation-states and interrelated institutions, corporate governance practices continue to be marked by their idiosyncratic foundations in which national roots remain a vital determinant. This literature pointed out the lack of cultural understanding in the convergence argument which downplays cultural traits implicit in the US governance model. For instance, the convergence argument assumes highly individualistic forms of behavior of boards of directors and overlooks the lack of a cultural fit for the global convergence model (Branson, 2001). However, in many East Asian contexts, Confucian values permeate society and provide important local contexts for a specific style of corporate governance. Against the background of the literature on financial globalization and corporate governance, we take the institutional approach in organizational sociology to explain Taiwanese firms' decision-making in appointing independent directors, i.e. a device for outsider monitoring featured prominently in the shareholder-oriented corporate governance system.

### *Local control processes as filtering mechanisms*

The neoinstitutional approach in organizational sociology emphasizes that organizations are open systems, shaped and constituted by their surrounding institutional scripts and rules (Scott and Meyer, 1994). This approach suggests that organizations changed their

structure and activities to conform to institutional requirements in order to receive legitimacy and support from the institutional environment. In this article we consider global capital markets as important institutional environments to which local firms have to adapt in many emerging economies (Davis and Marquis, 2005). Firms' exposure to global capital markets increased the pressure to follow the 'global standards' of corporate governance as well as the opportunities to raise capital. The pressure to conform to global standards was especially strong from the US market, which is a *de facto* center of the global financial system. The expectations and normative beliefs of US capital markets apply pressure to local firms that raise capital in the US market. This exposure to US capital markets places firms in institutional environments that apply pressure on them to adopt 'global standards' of corporate governance (Coffee, 2002). Ahmadjian and Robbins (2005) showed that foreign ownership in Japanese firms has a positive and significant impact on large-scale layoffs, a business practice that deviates from the traditional lifetime employment system in Japan. Sanders and Tuschke (2007) found that German firms that are exposed to US stock markets are more likely to adopt stock options as a form of executive pay, which deviates from prevalent German practices. Following this line of research, we start from the baseline argument that exposure to US capital markets increases the probability of the appointment of independent directors.

We then move on to suggest three mechanisms that describe the interactions between global institutional pressures and local firm control contexts. While conventional neoinstitutionalism often downplays local or internal contexts of organizations (DiMaggio and Powell, 1991), emerging perspectives revive old institutionalism (Powell, 1991; Selznick, 1996) and attend to selective interactions between organizations and environments rather than one-sided environmental influences. They emphasize that the internal dynamics of an organization mediate organizational responses to external pressures. This shift in scholarly attention emphasizes the organizational contexts through which external environments are filtered into the inner circle of organizational decision-making (Weber and Waeger, 2017). Following this perspective, we examine internal and external dynamics conjointly and emphasize the role of variation in organizational contexts. We propose the double contingency in which organizational action is an outcome of the interplay between global institutional conditions and local organizational contexts.

We introduce organizational filtering mechanisms whereby global institutional influences are moderated by an organization's local control processes. While acknowledging the importance of global influences, our focus is to specify the extent of the interactions between global institutions and organizational contexts. We argue that global institutional influences are moderated by three filtering mechanisms: structural control by family, cognitive control by key leaders, and geographic control by globalized ecosystems. For structural control, family governance is a dominant form of corporate structure in Taiwan that presents different sets of constraints and opportunities for corporate change. For cognitive control, a corporate leader's cognitive orientations provide schema and cultural frameworks by which local firms interpret and evaluate the appropriateness of governance models. Lastly, for geographic control, a firm's location in densely-clustered industry districts serves as an ecosystem that amplifies or reduces the firm's exposure to different corporate governance models. We suggest that these three local control contexts can facilitate or discourage the influences of global environments. In our research

setting, while facing the pressure from global capital markets to introduce independent directors, local control processes embedded in emerging market firms can function as a filtering mechanism of global institutional pressure.

### *Structural control: Family control as a constraining mechanism*

From a structural aspect, we consider family control as providing important constraints on a local firm's susceptibility to the global corporate governance model. In most non-Anglo-Saxon countries, ownership is not necessarily dispersed but concentrated within founding families (La Porta et al., 1999), which makes family control critical in corporate governance changes. For family owners of the firm, family business, including publicly listed firms controlled by the family, represents family assets and should be maintained and passed down to future generations (Gersick, 1997). Succeeding family members feel 'obligated' to sustain ownership control and to participate in management to ensure that the operation of the company (the family assets) is aligned with family interests (Miller and Breton-Miller, 2006). This is especially relevant to East Asian countries, including Taiwan, where the pyramidal structure of family ownership is organized in the form of business groups (Chang, 2003; Claessens et al., 2000; Morck, 2010). Firms that belong to the common business group membership via family shareholding usually operate under the family chairman's guidance and coordination (Chang and Hong, 2000; Mahmood et al., 2011, 2013).

In family firms, family owners have opportunities to pursue private gains from financial operations and information asymmetry (Bertrand et al., 2002; Fan and Wong, 2005). Because the board can play an important role in monitoring major corporate actions, it is likely that family owners pay special attention to the introduction of independent directors, aiming to avoid outsiders' monitoring. Thus, for family governance, board control is typically maintained within the family boundaries. Accordingly, appointing independent directors is a 'contested' organizational practice in firms with family governance (Fiss and Zajac, 2004). The request to appoint an outside, independent director can dilute family control and risk information leakage. Independent directors' monitoring role may also undermine certain financial self-dealings that are preferred by family owners. Large-scale surveys on firm ownership (Claessens et al., 2000; Faccio and Lang, 2002; La Porta et al., 1999) indicate a substantial deviation between voting rights and cash-flow rights in family-controlled firms, and such deviation is often associated with the expropriation of minority shareholders, tunneling, and poor information disclosure (Morck, 2010). Having independent directors on the board would make such operations difficult, if not impossible. Family owners of the firm may therefore resist the pressure from foreign capital markets to appoint independent directors, and they may even do this collectively through peak associations. Since appointing independent directors to the board contradicts family owners' control and interests, we expect that such a practice may face strong resistance in firms that are dominated by family control. Thus, we predict the following:

*H1: The positive effect of the exposure to US capital markets on the appointment of independent directors will be weaker in the local contexts of family control.*

### *Cognitive control: Leader's US education as a facilitating mechanism*

We consider an organizational leader's cognitive orientation with a focus on his/her educational background as a second filtering mechanism of global institutional influence. Critics of the global convergence advocacy emphasize the significance of local and national culture in corporate governance, leading to a diversity of governance practices (Branson, 2001). The local culture and cognitive framework become internalized as beliefs and interpenetrations underlying corporate action, thus responsible for continuing national institutional variety (Hofstede, 2001; Taras et al., 2010), and deterring the spread of global corporate governance. In the context of a firm's corporate decision-making, a critical source of core rules and routines in the corporation is associated with its key leaders' cognitive frameworks and scripts. Cognitive frameworks enable leaders to interpret a particular resource according to their cultural schemas and interpretations (Seo and Creed, 2002).

We focus on educational background as an important source of leaders' cognitive framework. In our empirical context, we suggest that a firm leader's educational background is a key factor in his/her openness toward the global corporate governance model. The cognition and beliefs of the leaders are likely to be influential in decisions relating to governance change (Hambrick and Mason, 1984). In many cases, alternative cognitive frameworks of leaders originate from outside of the particular institutional context (Meyer et al., 1997). Anecdotal evidence suggests that in emerging economies, many leaders hold formal education degrees from US business schools. The content of US education serves as an important channel for transferring different business practice models. For instance, research suggests that American business schools are at least partially responsible for the large-scale changes in European management education and business practices (Djelic, 1998; Engwall and Kipping, 2004).

When a key leader is exposed to cultural frameworks of the global corporate governance model through international education and working experience, the resulting cognitive familiarity and open-mindedness can decrease objections to the global governance model (Chung and Luo, 2008). Chung and Luo (2008) found that the family model in business groups, an institutionalized practice in Taiwan, as noted, declined when the young and second-generation leaders learned alternative governance models based on their educational experience in the US.

Western management theories (especially those in the US) primarily advocate the separation of ownership from control, for professionalism, transparency, and independence in corporate governance, thus opposing (or at least tacitly rejecting) practices such as the family domination of the board (Clarke, 2016). Independent directors are viewed as being able to provide checks and balances on the dominant family and thus protect the interests of public shareholders. Even if not enrolled in a business school, living and studying or working in a different context, such as the US, provide corporate leaders of emerging economies with a distinct global perspective, which may weaken traditionally bound local business practices and increase the likelihood that corporate leaders will adopt a value-free assessment of the benefits, costs, and financial consequences of appointing independent directors.

When firms face pressure from foreign capital markets, US-educated leaders can take advantage of this perceived belief in board independence and move to realize their non-traditional preferences. A notable example is Gordon Yeh of Ritdisplay Co., who had earned a Master's degree from the University of Maryland, and who appointed Alan J Heeger, the 2000 Nobel Laureate in Chemistry, as an independent director. Because of their experience in the US, US-educated leaders are also equipped with the knowledge and skills to implement and work with a governance structure that embraces independent directors. Consequently, they are more likely to engage in the new practice than firms with locally educated leaders. We hence propose the following:

*H2: The positive effect of the exposure to US capital markets on the appointment of independent directors will be stronger under the corporate control of US-educated leaders.*

### *Geographic control: Global industrial district as a facilitating mechanism*

Lastly, we consider geographic control as a filtering mechanism in the local structuring process. A prominent geographic control comes from the ecosystem of a globalized industrial district. The globalized industrial district in which a firm is located may affect the firm's governance practices because of the prevailing institutional logic (or model) in such local regions (Saxenian, 1990, 1994). Globalized industrial districts, such as industry or science parks, in emerging economies feature a distinct logic that values transparency and meritocracy, and this logic or business model is distinct from those in other, traditional sectors of emerging countries. Studies have suggested that the distinct business model adopted in globalized high-tech regions, such as those in Bangalore, India, Hsinchu, Taiwan as well as Shanghai, China, is transplanted from the global high-tech cluster located in Silicon Valley (Saxenian, 2006). This distinct institutional logic manifests itself in organizational and governance characteristics that include individual mobility ('job hopping'), a 'free-form' type of organizational structure, and an emphasis on product innovation, stock options, and professional independence (Weiss and Delbecq, 1987: 46–47). Accordingly, board governance and power structures are guided by meritocracy, independence, and performance. Outsiders are indeed more respected by internal and external stakeholders due to the institutionalized practice of job hopping and the value placed on diverse and fresh perspectives.

The transplantation of the Silicon Valley model to emerging economies is largely accomplished through immigrant engineers. For example, in Hsinchu Science Park of Taiwan, Saxenian and Hsu (2001) argued that there is a transnational community composed of highly skilled Taiwanese engineers who have strong connections with and deep integration in both Hsinchu and Silicon Valley. The Hsinchu Science Park, with its favorable tax rate and excellent infrastructure and living environment, has attracted back many engineers and entrepreneurs from the US. Some 40% of the companies located in the Science Park in 1999 were started by US-educated engineers, many of whom have had considerable managerial or entrepreneurial experience in Silicon Valley (Saxenian and Hsu, 2001).



Given the prevailing institutional logic in a globalized industrial district that is transplanted from Silicon Valley, we suggest that outsider, independent board members are viewed as more legitimate than family or insider directors by external and internal stakeholders of the firms located in the high-tech districts in emerging economies. Insider directors, by contrast, may be viewed as relying on their relationships rather than their competencies for their appointment and as less innovative because of their lack of fresh and diverse experiences. Due to the alignment between the institutional logic of the globalized industrial clusters and that prevailing in the global financial markets, we argue that when facing the request for board independence, firms located in globalized industrial districts are more likely to do so than firms that are not located in globalized industrial districts.

*H3:* The positive effect of the exposure to US capital markets on the appointment of independent directors will be stronger when the focal firm is located in a globalized industrial district.

## Data, measures, and method

### *Sample and data sources*

The dataset for this study comprises all the firms listed on the Taiwan Stock Exchange from 2001 to 2006. We eliminated firms that were newly listed after August 2002, at which time government policy required that firms applying for securities listings for the first time should have at least two independent directors. We also excluded firms that have more than 50% of government ownership. The final sample consists of 478 firms that account for over 90% of the capitalization of the Taiwan Stock Exchange. We used the financial, ownership, and independent director information available in the TEJ (*Taiwan Economic Journal*) database, which is the most comprehensive database covering listed companies in Taiwan, China, and Hong Kong. We also supplemented our data with other sources, such as the directories of *Business Groups in Taiwan* and *Manager Directory in Taiwan*, both of which are compiled by a prestigious credit-checking agency in Taiwan (China Credit Information Service [CCIS] in Taipei), an affiliate of the US-based Standard & Poor's.

### *Variables*

*Dependent variables.* The dependent variable is the initial appointment of independent directors observed during the period from 2002 to 2006, inclusive. The TEJ database adopts the definition of an independent director according to the Initial Public Offering guidelines issued by the Financial Supervisory Commission in 2001; no Taiwanese firms had appointed independent directors according to the strict definition until 2001. The value is coded '1' if a firm first appointed independent directors in a given year and '0' otherwise.

*Independent variables.* A firm's exposure to the US stock market is measured by the issuance of Depository Receipts in the US. Many Taiwanese firms issued American Depository Receipts (ADRs) in the US to raise capital. An ADR is a certificate that allows non-US securities to be traded on the American stock exchange in US dollars through special arrangements by custodian and depository banks (Saunders, 1994). ADRs were first introduced in 1927 'as a way for U.S. investors to buy foreign securities without the transaction costs and risks of buying them on local markets in local currency' (Davis and Marquis, 2005: 358). While providing opportunities for US investors to purchase foreign stocks on the US stock exchange, ADRs also provide a mechanism for foreign companies to access US capital markets (Sanders and Tuschke, 2007). The variable ADR issuance is coded '1' if a firm has ever issued an ADR in the US and '0' otherwise. The ADR data are quoted from the DR database of the Bank of New York.

We have three moderating variables for local control. First, to operationalize family control, we use the level of family ownership. We measure family ownership by the percentage of shareholding controlled by the founding family. Given the prevalence of pyramid ownership in emerging markets (La Porta et al., 1999), we calculated family control by combining both direct and indirect holdings by family members. Direct holdings are shares held by individual family members, whereas indirect holdings are shares owned by listed and unlisted companies that are de facto controlled by the family as well as by nonprofit organizations, such as foundations, hospitals, and schools that are controlled by the family. We follow the procedures of La Porta et al. (1999) to calculate indirect shareholding with multiple layers of ownership in the pyramid. Second, to measure the key leader's US education, we collected biographical information of chief executive officers (CEOs) from the directories *Business Groups in Taiwan* and *Manager Directory in Taiwan*. We also refer to other biographical sources, such as *Who Is Who in Taiwan*, *Who Is Who in Taiwan's Business*, business magazines and newspapers with regular coverage of listed firms, autobiographies by company founders, and company websites. We coded whether the firm's CEO holds formal degrees from US educational institutions. We used a binary variable indicating whether a firm's CEO has received formal US education. The variable is coded '1' if the CEO has had formal US education and '0' otherwise. Third, we operationalize globalized industry district by using the focal firm's geographic location in the Hsinchu Science Park of Taiwan. The Hsinchu Science Park, with its globalized environment, has attracted many engineers and entrepreneurs who have returned from the US. Some 40% of the companies located in the Science Park in 1999 were started by US-educated engineers, many of whom have had considerable managerial or entrepreneurial experience in Silicon Valley (Saxenian and Hsu, 2001). Thus, the Hsinchu Science Park of Taiwan represents a globalized industrial district with strong connections with and deep integration in Silicon Valley and the US. We use an indicator variable of a firm's location. This variable is coded '1' if a firm is located in the Hsinchu Science Park and '0' otherwise.

Additionally, we performed analyses with the sample of firms that are affiliated to the top 100 business groups in Taiwan. We identified these business groups from the *Business Groups in Taiwan* directory. For this analysis of group-affiliated firms, we operationalize business group-level variables of local control. For family control, we measured the business group-level family ownership for those firms that are affiliated with business

groups. We measured the group-level family ownership by calculating the percentage of shareholding controlled by the founding family, at the business group level. For cognitive control, we examined the business group chairperson's educational background. We coded the group chairperson's educational background by identifying formal degrees from US educational institutions. For geographic control, we used the same variable of a focal firm's geographic location at the Hsinchu Science Park.

**Control variables.** We used a set of control variables to capture unobserved heterogeneity in the model. We controlled for two board characteristics relating to the size of the board by measuring the number of directors and the percentage of family directors. Because firm size may influence corporate governance reform, we used the logarithm of the market value of the firm. We controlled for two age variables in the model: the first is the number of years since the firm's founding (i.e., firm age), and the second is the number of years since the firm's initial entry into the stock market (i.e., years of listing). Despite the high correlation between the two variables, the listing age is quite distinct from typical firm age because public listing exposes firms to new market actors and institutional environments. To control for a potential diversification effect, we included the number of product lines. To control for a possible influence of a firm's performance, we included the return on assets. To control for a firm's reliance on the stock market versus other sources of external finance, we included a firm's debt-to-equity ratio. We also considered a firm's orientation toward domestic or foreign product markets by including the export ratio as measured by the ratio of foreign sales to local sales. To control for the influence of external shareholders, we included the levels of ownership by government and foreign institutional investors. Since many listed firms in Taiwan are members of business groups, we created an indicator variable for business group membership that was coded '1' if the firm was a group member of the top 100 business groups and '0' otherwise. Apart from the influence of a focal firm's characteristics, the appointment of independent directors may also depend on inter-organizational influence. Following previous research (Fiss and Zajac, 2004), we controlled for peer influence among firms in three ways. First, we included the degree centrality in the network matrix of interlocking director ties. For this variable, we used the list of board directors for our sample firms from the TEJ database and constructed a firm-to-firm interlocking directorate matrix. Then, we calculated a focal firm's degree centrality in the matrix by summing up the count of its board directors that are interlocked with other firms. Second, we included director ties to the firms that had already appointed independent directors. We used the same information on the board of directors and counted the number of directors who sit on the boards of the firms that had already appointed independent directors in a given year. Third, to capture industry-specific peer influence, we included the number of firms that belong to the same industry and had already appointed independent directors. Then, throughout all the analyses, we controlled for industry dummy variables. We used the two-digit industry classifications adopted by the Taiwan Stock Exchange with the exception of electronic and computer industries, which rely on three-digit coding in order to reflect the Taiwanese context where electronic and computer industries contribute more than 50% of the market capitalization. The two-digit industry classifications of our sample firms include: plastics, textiles, electric machinery and machinery, electric appliances and wiring,

chemical and biological medicine, steel and iron, electronics and computers, construction, transportation, tourism, banking and insurance, retailing and department stores, and others (cement, food, glass, paper and pulp, rubber, transportation, and automotives). The three-digit classifications for the electronic and computer industries include: computers and peripheral, electronic-optical, electronic parts, semiconductors, communication networks, electronics retailer, and information services. We omitted the computers and peripheral industry as a reference category for industry control. Lastly, in the additional analysis of group-affiliated firms, we control for business group-level variables: group's asset size, group's age, and group-level return on assets. All the independent variables and control variables are one-year lagged.

### *Model specification*

Our data structure is a pooled cross-section and a time series panel with all variables updated annually. To examine a firm's appointment of independent directors to their board, we employed a discrete-time event history model using a random-effects logistic regression. When a firm adopted independent directors during the study period, it was withdrawn from the risk set. The discrete-time event history model is preferable to the continuous model when the exact timing of an event is unknown (Allison, 1984; Yamaguchi, 1991). To check reverse causality, we estimated the effect of having independent directors on the likelihood of applying for an ADR. We found that the effect was not significant, mitigating the possibility of reserve causal direction.

## **Results**

We present descriptive statistics in Table 1 and bivariate correlation coefficients in Table 2. Table 1 shows that the firm-year in which the first appointment of independent directors occurred comprises 7.5% of the total firm-year risk set. In terms of firm count, 143 out of 478 local firms (i.e., approximately 30% of our sample) appointed independent directors during the study period. Table 2 shows that our independent variables are not highly correlated with each other.<sup>1</sup> Nevertheless, we tested for potential multicollinearity in the models using conditioning methods and confirmed that the condition number of the matrix was reasonably low (less than 20 in all models).

We present the estimates of random-effects logistic regressions for the appointment of independent directors in Table 3. Model 1 provides a model with control variables. The estimates of Model 2 support our baseline prediction that the issuance of ADRs affects the appointment of independent directors. Firms that issued ADRs were four times (i.e.,  $\exp(1.409)$ ) more likely to appoint independent directors than those without ADR experience. In Model 3, we tested Hypothesis 1, that the positive effect of foreign exposure on the appointment of independent directors is more likely to appear in firms with low family ownership. Model 3 included the interaction term for ADR issuance and family ownership, which was found to be negative and significant at 1%. This finding suggests that the positive effect of ADR issuance on independent director adoption decreases with the level of family ownership of the firm.

**Table 1.** Descriptive statistics.

Variable	Mean	SD	Min.	Max.
First appointment of independent directors	.075	.263	0	1
Board size	7.470	3.434	1	26
% of family directors	76.988	19.114	0	100
Market capitalization(ln)	8.414	1.423	4.304	14.202
Firm age	29.382	11.656	5	60
Years of listing	11.900	9.855	1	44
Number of product lines	4.232	2.493	1	11
Return on assets	3.913	7.993	-38.94	50.64
Debt-to-equity ratio(ln)	4.260	.881	.451	8.154
Foreign sales ratio	38.967	35.694	0	100
Government ownership	1.458	5.082	0	46.97
Foreign institutional ownership	3.629	7.978	0	54.83
Network centrality	4.403	4.758	0	31
Ties to prior adopters	.971	1.738	0	12
Prior industry adoptions	3.108	4.596	0	21
Family ownership	26.356	16.250	.19	85.8
Business group membership	.825	.379	0	1
CEO's US education	.267	.442	0	1
Hsinchu	.090	.286	0	1
ADR issuance	.076	.264	0	1

Hypothesis 2 suggests that the positive effect of foreign exposure on the appointment of independent directors is more likely to appear in firms with US-educated CEOs. To test this hypothesis, we include the interaction term of ADR issuance and CEO educational background in Model 4 of Table 3. Model 4 shows that the moderating effect of CEO American educational background is positive and significant. Then, we tested Hypothesis 3 by including the interaction term between ADR issuance and a firm's geographic location in the Hsinchu Science Park in Model 5. The interaction term is positive and significant, suggesting that the positive impact of ADR issuance is stronger in firms located in Hsinchu than in those located elsewhere. Thus, the findings lend support to Hypothesis 3.

We performed supplementary analyses to provide stronger support for the above-mentioned hypotheses testing. We analyzed the sample of the firms that are affiliated with the top 100 business groups. We present the estimates in Table 4. While we find no significant effect of ADRs on the appointment of independent directors in group-affiliated firms (see Model 1), we found consistent findings for moderating effects in Models 2, 3, and 4. Model 2 of Table 4 included the interaction term for ADR issuance and group-level family ownership, which was found to be negative and marginally significant at 10%. Model 3 of Table 4 shows that the moderating effect of group chairperson's American educational background is positive and marginally significant. Model 4 of Table 4 also shows a consistent pattern with our main analyses of Table 3.

Table 2. Bivariate correlations.

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
1. Independent directors																			
2. Board size	-.08																		
3. % of family directors	-.10	-.20																	
4. Market capitalization(ln)	-.01	.25	.07																
5. Firm age	-.15	.28	.14	-.03															
6. Listing age	-.20	.31	.23	.16	.67														
7. Number of product lines	-.02	.16	.11	.07	.22	.21													
8. Return on assets	.10	-.02	-.10	.45	-.14	-.19	-.06												
9. Debt-to-equity ratio(ln)	-.06	.15	-.01	-.11	.07	.06	.17	-.37											
10. Foreign sales ratio	.12	-.18	-.02	.22	-.32	-.21	-.17	.20	-.21										
11. Government ownership	-.04	.13	-.09	.22	.15	.13	.01	.04	.06	-.07									
12. Foreign inst. ownership	.00	.04	-.07	.25	.02	.05	.01	.13	-.10	.05	.03								
13. Network centrality	-.03	.40	-.06	.36	-.03	.16	.07	.04	-.05	.02	.09	.10							
14. Ties to prior adopters	.00	.11	.00	.29	-.10	.04	-.01	.13	-.08	.17	.00	.07	.58						
15. Prior industry adoptions	.17	-.14	-.10	.06	-.28	-.22	-.14	.09	-.08	.33	-.03	-.02	.03	.23					
16. Family ownership	.01	-.07	.16	-.07	.09	.00	.06	.06	-.06	-.13	.02	-.07	-.08	-.07	-.09				
17. Business group	-.11	.14	.17	.24	.15	.24	.07	-.09	.10	-.12	.11	.05	.23	.09	-.10	.01			
18. CEO's US education	-.02	.01	.04	.12	.08	.14	.10	-.06	.05	-.12	.10	.06	.21	.13	-.05	.00	.07		
19. Hsinchu	.06	.00	-.08	.12	-.28	-.13	-.09	.05	-.05	.14	-.04	.01	.12	.13	.14	-.16	.00	.13	
20. ADR issuance	.03	.07	.06	.42	-.10	.10	.04	.02	-.07	.14	.20	.21	.27	.26	.10	-.09	.12	.17	.13

Note: Correlations greater than .05 or less than -.05 are significant at 5% level.

**Table 3.** Discrete event history analyses predicting the appointment of independent directors.

	Model 1	Model 2	Model 3	Model 4	Model 5
<i>Industry dummies</i>					
(Omitted = Computers & peripheral)					
Plastics	-1.417 (1.371)	-1.304 (1.352)	-1.210 (1.300)	-1.292 (1.355)	-1.311 (1.308)
Textiles	-1.055 (1.025)	-1.034 (1.003)	-.998 (.961)	-1.056 (1.008)	-1.055 (.972)
Electric machinery & machinery	-.608 (1.006)	-.697 (.985)	-.815 (.946)	-.746 (.988)	-.735 (.955)
Electric appliances & wiring	-.924 (1.585)	-.828 (1.547)	-.879 (1.503)	-.800 (1.544)	-.894 (1.504)
Chemical & biological medicine	-.032 (1.051)	-.018 (1.027)	-.110 (.990)	.064 (1.030)	-.060 (.994)
Steel & iron	-2.554 <sup>+</sup> (1.322)	-2.549* (1.288)	-2.434* (1.225)	-2.586* (1.288)	-2.539* (1.245)
Construction	.522 (1.188)	.511 (1.162)	.330 (1.118)	.563 (1.168)	.382 (1.126)
Tourism	3.037 (2.067)	3.113 (2.023)	3.012 (1.946)	3.284 (2.038)	3.092 (1.964)
Banking & insurance	-2.554 (2.114)	-2.332 (2.072)	-2.015 (1.977)	-2.180 (2.066)	-2.303 (2.001)
Retailing & department stores	-1.124 (1.524)	-.974 (1.495)	-1.077 (1.443)	-.954 (1.499)	-1.061 (1.446)
Electronic-optical	-.740 (.880)	-.730 (.859)	-.636 (.822)	-.648 (.865)	-.665 (.834)
Electronic parts	.627 (.824)	.636 (.806)	.528 (.774)	.694 (.810)	.612 (.780)
Semiconductors	1.235 (.975)	1.097 (.951)	1.084 (.918)	1.175 (.960)	.886 (.928)
Communication networks	.281 (1.395)	.103 (1.371)	-.248 (1.316)	-.167 (1.391)	-.041 (1.345)
Electronics retailer	1.313 (1.098)	1.150 (1.069)	1.242 (1.030)	1.104 (1.072)	1.139 (1.037)
Information services	.869 (1.141)	.823 (1.111)	.724 (1.063)	.685 (1.113)	.852 (1.077)
Others	-2.379 <sup>+</sup> (1.287)	-2.308 <sup>+</sup> (1.245)	-2.139 <sup>+</sup> (1.188)	-2.271 <sup>+</sup> (1.246)	-2.255 <sup>+</sup> (1.208)
<i>Board characteristics</i>					
Board size	.007 (.089)	.006 (.087)	-.014 (.086)	.008 (.088)	.000 (.085)
% of family directors on board	-.013 (.011)	-.013 (.010)	-.017 <sup>+</sup> (.010)	-.012 (.010)	-.013 (.010)
<i>Firm characteristics</i>					
Market capitalization(ln)	-.221 (.202)	-.324 (.210)	-.383 <sup>+</sup> (.205)	-.322 (.209)	-.340 <sup>+</sup> (.205)

(Continued)

Table 3. (Continued)

	Model 1	Model 2	Model 3	Model 4	Model 5
Firm age	.030 (.027)	.033 (.026)	.026 (.025)	.034 (.027)	.028 (.026)
Years of listing	-.185*** (.044)	-.188*** (.044)	-.180*** (.043)	-.191*** (.044)	-.179*** (.043)
Number of product lines	.197* (.085)	.188* (.083)	.172* (.081)	.194* (.084)	.183* (.081)
Return on assets	.039 (.026)	.048+ (.026)	.054* (.026)	.048+ (.026)	.054* (.026)
Debt-to-equity ratio(ln)	.106 (.269)	.137 (.265)	.122 (.257)	.136 (.266)	.159 (.259)
Foreign sales ratio	.017* (.008)	.017* (.007)	.014* (.007)	.018* (.008)	.015* (.007)
Government ownership	-.037 (.065)	-.047 (.064)	-.060 (.068)	-.050 (.067)	-.046 (.063)
Foreign inst. ownership	.030 (.023)	.022 (.023)	.020 (.023)	.020 (.023)	.020 (.023)
<i>Interfirm networks</i>					
Interlocking directorate centrality	-.070 (.060)	-.073 (.059)	-.077 (.058)	-.073 (.060)	-.070 (.058)
Ties to prior adopters	.175 (.132)	.152 (.131)	.142 (.126)	.169 (.132)	.137 (.129)
Prior industry adopters	.072* (.031)	.067* (.030)	.066* (.030)	.066* (.030)	.065* (.030)
<i>Moderating variables</i>					
Family ownership	.012 (.013)	.013 (.012)	.020 (.012)	.012 (.012)	.012 (.012)
Business group	-.383 (.495)	-.372 (.483)	-.245 (.461)	-.369 (.483)	-.306 (.468)
US-educated CEO	.360 (.458)	.272 (.451)	.304 (.436)	-.026 (.486)	.237 (.439)
Located in Hsinchu	.185 (.680)	.130 (.665)	-.122 (.645)	-.006 (.675)	-.441 (.725)
<i>Main independent variable</i>					
ADR issuance		1.409* (.788)	4.317*** (1.273)	.356 (1.005)	.642 (.873)
<i>Moderating effects</i>					
H1: ADR * Family ownership			-.189** (.073)		
H2: ADR * US-educated CEO				2.247* (1.333)	
H3: ADR * Hsinchu					2.555* (1.384)

(Continued)



**Table 3.** (Continued)

	Model 1	Model 2	Model 3	Model 4	Model 5
Constant	-2.304 (2.273)	-1.599 (2.272)	-.504 (2.229)	-1.662 (2.272)	-1.259 (2.219)
Observations	1894	1894	1894	1894	1894
Log likelihood	-392.394	-390.818	-385.458	-389.294	-389.121
Degrees of freedom	35	36	37	37	37

Standard errors in parentheses. Significance tests are one-tailed for hypothesized variables and two-tailed for others.

+ $p < .10$ , \* $p < .05$ , \*\* $p < .01$ , \*\*\* $p < .001$ .

**Table 4.** Discrete event history analyses predicting the appointment of independent directors: business group-affiliated firms.

	Model 1	Model 2	Model 3	Model 4
<i>Board characteristics</i>				
Board size	.005 (.096)	-.004 (.094)	.017 (.079)	.005 (.082)
% of family directors on board	.000 (.012)	-.001 (.011)	.003 (.009)	.002 (.010)
<i>Firm characteristics</i>				
Market capitalization(ln)	-.019 (.409)	-.029 (.399)	.044 (.349)	.031 (.349)
Firm age	.068+ (.038)	.056 (.036)	.056+ (.029)	.046 (.029)
Years of listing	-.143** (.052)	-.131** (.050)	-.132** (.043)	-.118** (.043)
Return on assets	-.016 (.043)	-.013 (.042)	-.015 (.034)	-.005 (.036)
Debt-to-equity ratio(ln)	.157 (.338)	.147 (.322)	.227 (.275)	.180 (.275)
Number of product lines	.082 (.086)	.082 (.084)	.102 (.066)	.104 (.066)
Foreign sales ratio	.006 (.008)	.006 (.008)	.003 (.006)	.002 (.006)
Government ownership	-.003 (.071)	.007 (.078)	.017 (.057)	.007 (.060)
Foreign inst. investors ownership	.021 (.025)	.019 (.024)	.010 (.019)	.012 (.019)
<i>Interfirm networks</i>				
Interlocking directorate centrality	-.002 (.053)	.003 (.051)	.004 (.041)	-.010 (.043)
Ties to prior adopters	.070 (.138)	.043 (.133)	-.004 (.089)	.033 (.094)

(Continued)

Table 4. (Continued)

	Model 1	Model 2	Model 3	Model 4
Prior industry adopters	.026 (.036)	.025 (.035)	.018 (.031)	.013 (.032)
<i>Business group variables</i>				
Group asset(ln)	-.243 (.513)	-.262 (.495)	-.269 (.426)	-.286 (.427)
Group age	-.082** (.032)	-.071* (.031)	-.074** (.026)	-.068** (.026)
Group ROA	.060 (.046)	.060 (.044)	.059+ (.036)	.052 (.036)
<i>Moderating variables</i>				
Group family ownership	.009 (.015)	.017 (.015)	.006 (.012)	.009 (.012)
Located in Hsinchu	.732 (.768)	.401 (.742)	.316 (.555)	-.421 (.730)
US-educated group chair	.342 (.473)	.381 (.451)	.086 (.392)	.290 (.364)
ADR issuance	.690 (.648)	1.917+ (1.026)	-.114 (.651)	.135 (.543)
<i>Moderating effects</i>				
ADR * Group family ownership		-.072+ (.047)		
ADR * US-educated group chair			1.413* (.803)	
ADR * Hsinchu				2.222* (1.002)
Observations	1081	1081	1081	1081
Log likelihood	-197.42	-195.99	-196.28	-195.32
Degrees of freedom	36	37	37	37

Standard errors in parentheses. All models include industry control but are not reported.

Significance tests are one-tailed for hypothesized variables and two-tailed for others.

+p < .10, \*p < .05, \*\*p < .01, \*\*\*p < .001.

Discussion and conclusion

In this article we examined the changes of local corporate governance practices amidst financial market globalization. Drawing upon the recent development in organizational sociology (Weber and Waeger, 2017), we suggested that local firm control contexts serve as filtering mechanisms through which global institutional environments are screened and enacted. With this theoretical lens, we examined how Taiwanese firms introduce the independent director system when they are exposed to US capital markets. We argue that exposure to US capital markets induces the introduction of independent directors but this exposure effect is contingent upon a firm’s local control systems, i.e., family control, cognitive control, and geographic control. Our findings shows that Taiwanese firms

issuing ADRs in the American capital markets are less likely to introduce the independent director system when they have a higher level of family ownership. Firms, however, are more likely to do so when they are managed by a US-educated CEO and when they are located in a geographically-based industry cluster that has assimilated American institutions of corporate governance.

Our results have important implications for research on institutional change. Our study sheds light on the significant role played by local control contexts in the process of institutional change. In our empirical setting, family control tends to constrain institutional change, but organizational leaders' cognitive orientation and a firm's geographic location facilitate such changes. The importance of local context suggests that institutional change is often not linear and the final outcome deriving from a complex interaction can be characterized as path-dependent and recombinant (Stark, 1996). While the foreign institutional force can be strong, it always goes through the filter of the firm's local contexts. Thus, we propose that a balanced approach should consider not only the pressure imposed by external institutional environments but also the inertia of local tradition. This perspective goes beyond the existing explanations that concentrate on institutional supremacy in organizational practices. We challenge the concepts of isomorphic and sweeping institutional change and highlight the interplay between institutional pressures and local conditions.

Our findings have implications for the literature on comparative corporate governance. Broadening the contractarian view of corporate governance, a growing literature has begun to emphasize the existence of multiple corporate governance models with varying degrees of effectiveness that are contingent upon local institutions and organizations (Aguilera and Jackson, 2003, 2010; Aguilera et al., 2008). This line of research has documented the persistence of cross-national heterogeneity in corporate governance practices, which are multidimensional and interrelated. Our approach, which combines the ideas of foreign institutional influence and local filtering, helps to understand the inertial and complex process of institutional change of national corporate governance practices in the era of globalization. Despite the cross-border diffusion of the Anglo-Saxon model of corporate governance, we note that the transition of local governance practices can be contested. Our study shares the insight that when two different or even contradictory institutions encounter each other, the result is usually a mixture or compromise between global forces and local institutions (Campbell, 2004; Stark and Vedres, 2006). This view is consistent with the literature that emphasizes the role of institutional and socio-political perspectives on organizational change (Ahmadjian and Robbins, 2005; Davis and Marquis, 2005; Fiss and Zajac, 2004; Sanders and Tuschke, 2007).


In this article, we specify the interactions between external institutional environments and an organization's local control contexts. Deviating from the neoinstitutionalist emphasis on external constitution, we revive the importance of organizations' local dynamics. Just as March (1962) provided a conception of organizations as political entities, organizations need to be understood as collectives of groups and individuals that pursue varied goals and interests and interact with different dimensions of external environments. This is akin to the so-called 'organizations as open polities' perspective (Weber and Waeger, 2017). Such a view reveals the complexity of the boundary processes in which organizations' responses to their environment are mediated by internal political

interests. Through this political process, organizational actors who are exposed to different institutional environments are aligned with distinct interests and incentives. Thus, global institutional environments offer political opportunity structures for mobilization of the polity member by changing the interest-based decision calculus of polity members. While we suggest that such external influences are filtered through an organization's local control processes, future research may explore further the power dynamics of organizational interests in the processes of organization–environment interactions, especially in the context of interest (or goal) misalignments and multiple, competing institutions (Weber and Waeger, 2017).

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### ORCID iD

Young-Choon Kim  <https://orcid.org/0000-0003-2167-877X>

### Note

1. The exception is a relatively high correlation between firm age and listing age (.67 in our sample). To address potential multicollinearity, we tested our models by excluding either of the variables. The exclusion of either variable did not change our results. We decided to include both variables in the model because this procedure produced the best model fit.

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## **Author biographies**

Chi-Nien Chung is a professor at National University of Singapore Business School. He received his PhD in sociology from Stanford University. His research interests center around business groups, family firms, and political ties in emerging economies, with a focus on the interaction between institutional changes and organizational responses.

Young-Choon Kim is an associate professor at UNIST in Korea. He received his PhD in sociology from Stanford University. His research interests reside in the intersection of economic sociology and institutionalism in organization studies, focusing on inter-actor relations in the contexts of corporate and entrepreneurial settings.

## **Résumé**

En partant de l'idée d'une interaction sélective entre les organisations et les environnements, nous étudions comment les organisations modifient leurs pratiques locales lorsqu'elles sont exposées à de nouveaux environnements institutionnels, différents des environnements existants. Dans un contexte de changements dans la gouvernance d'entreprise sous l'effet de la globalisation financière, nous soutenons que l'influence des institutions globales est atténuée par les processus de contrôle local, qui font office de mécanismes de filtrage. Nous analysons de manière empirique l'adoption par les conseils d'administration d'une nouvelle pratique institutionnelle - à savoir, l'introduction de membres du conseil d'administration indépendants dans les sociétés taiwanaises, où la gouvernance familiale constituait le modèle de d'entreprise dominant. D'après les résultats de notre étude, tandis que les entreprises exposées aux marchés de capitaux des États-Unis ont tendance à faire appel à des membres du conseil d'administration indépendants, cet effet d'exposition est moindre dès lors que les entreprises sont soumises à un fort contrôle familial, et amplifié lorsque celles-ci sont libérées des cadres locaux par la formation d'un dirigeant clé ou le contexte géographique.

## **Mots-clés**

Contrôle local, contrôle familial, membres du conseil d'administration indépendants, environnements institutionnels, mécanismes de filtrage

## **Resumen**

Partiendo de la idea de interacción selectiva entre organizaciones y entornos, examinamos cómo las organizaciones cambian sus prácticas locales cuando están expuestas a nuevos entornos institucionales que difieren de los existentes. En el contexto del cambio de gobierno corporativo en respuesta a la globalización financiera, sostenemos que la influencia institucional global es moderada por procesos de control local que funcionan como mecanismos de filtrado. Analizamos empíricamente la adopción de una nueva práctica institucional de juntas corporativas, como es la introducción inicial de directores independientes en empresas taiwanesas, donde la gobernanza familiar ha sido un modelo empresarial dominante. Nuestros hallazgos sugieren que es probable que las empresas que están expuestas a los mercados de capitales de Estados Unidos adopten directores independientes. Este efecto de exposición se debilita cuando las empresas están bajo un fuerte control familiar y se amplifica cuando se liberan de los marcos locales a través de la educación de un líder clave o a través de su contexto geográfico.

## **Palabras clave**

Control familiar, control local, directores independientes, entornos institucionales, mecanismos de filtrado