THE BRAIN GAIN OF CORPORATE BOARDS: EVIDENCE FROM CHINA

Mariassunta Giannetti
Stockholm School of Economics, CEPR, and ECGI
Mariassunta.Giannetti@hhs.se

Guanmin Liao
School of Accountancy
Central University of Finance and Economics
liaoguanmin@cufe.edu.cn

Xiaoyun Yu
Department of Finance
Kelley School of Business
Indiana University
xiyu@indiana.edu

We examine whether attracting exceptionally talented individuals with foreign experience to the board has positive effects on the performance of firms in emerging markets. The arrival of individuals with foreign experience in the board of listed companies in emerging markets could enhance firm productivity and performance, because board members perform an important advisory role for management (Fama and Jensen 1983). Board members with foreign experience, having learnt how foreign organisations work, facilitate the adoption of superior management practices which – as shown by Bloom and Van Reenen (2007) – greatly enhance the performance and productivity of firms. Board directors with foreign experience could thus help to bridge large productivity gaps that persist across countries and firms (Hall and Jones 1999, Jones and Romer 2009).

Directors with foreign experience may also more effectively perform the monitoring function of the board and help improve firm-level corporate governance in emerging markets. This is not only thanks to foreign expertise accumulated abroad, but also because these executives are often relatively disenfranchised from local ties. They may have stronger incentives to pursue profitability, rather than to please politicians and other local constituencies.

China

We explore whether directors with foreign experience lead to performance improvements using a unique dataset from China and by exploiting exogenous variation in the supply of directors with foreign experience caused by policy changes. We hand-collect information on foreign education, work experience and other demographic characteristics from the biographies of 33,707 executive and non-executive directors of 1,733 publicly listed companies from 1999 to 2009. We consider an individual to have foreign experience if he or she studied or worked outside mainland China.

China is an ideal environment to address this issue because Chinese firms face talent shortage in filling managerial positions; However, since individuals with foreign experience are scarce, not all firms with similarly high demand for directors with foreign experience are able to attract one.

Evidence for the brain gain

We find that:

- When individuals with foreign experience join the board of a company, the firm's valuation improves;
- Its total factor productivity increases; and
- In the subsequent years, the firm's profitability increases.

We also show that these improvements in performance are accompanied by changes in corporate policies that are generally set by the board:

- Firms' propensity to manage earnings decreases and CEO turnover following low profits increases, indicating that corporate governance improves
- Among the firms that make mergers and acquisitions, the ones with board members with foreign experience are more likely to make an international merger or acquisition.

This suggests that these firms are able to access a broader range of investment opportunities. Similarly, firms with board members with foreign experience are able to access more sources of external financing, as they are more likely to engage a foreign investor when raising capital through private placements than other firms without directors with foreign experience.

Third, firms that hire directors with foreign experience start exporting more.

Conclusions

Overall, our results suggest that firm performance improves because, among other effects, directors with foreign experience facilitate the adoption of strong corporate governance practices and internationalisation