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THE EFFECTIVENESS OF CORPORATE GOVERNANCE MECHANISMS:
OWNERSHIP AND MEDIA

BY

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DISSERTATION

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ABSTRACT

My dissertation investigates how multiple corporate governance mechanisms act not only for shareholders' interests, but also protects the interests of divergent constituents across different institutional environments and times. The extant literature has typically viewed corporate governance as solving a principal–agent problem between shareholders and management. But useful insights about corporate governance must inevitably have a broader scope, encompassing such complex matters as heterogeneous owners with different institutional logics and intertwined internal/external governance mechanisms. The first study examines the ways in which managers respond to the different institutional logics of corporate governance represented by different owners in Japanese corporations through managerial earnings forecasts. The second study discusses how inter-organizational embeddedness between corporations and the media influences the media's external governance role. These studies collectively explore how evolving and intertwined interests and demands of different constituents in institutional environments give rise to governance arrangements, not in a universal sense, but rather specifically for the individual firm and the context in which it is situated.

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INTRODUCTION

Corporate governance has been studied since the emergence of the publicly owned corporations (Berle & Means, 1932). The domain of corporate governance is still in a state of flux; as corporations and societal norms surrounding them evolve, the boundaries of what constitutes corporate governance and the scope of research on governance are expanding (Hambrick, Werder, & Zajac, 2008; Starbuck, 2014). Economists view corporate governance as the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment (Shleifer & Vishny, 1997). Legal scholars define corporate governance as the set of legal arrangements that determine who controls corporations, how control is exercised, and how the risk and returns from corporate activities are allocated (Blair, 1995). Finance and management scholars usually describe corporate governance as solving a principal–agent problem between shareholders and management. Such views also acknowledge that corporate governance is located in larger institutional and legal frameworks. However, those are not sufficient to account for contemporary corporate governance issues occurred in diverse relationships among key constituents who are involved in corporate activities (Aguilera & Jackson, 2003; Fiss, 2008).

In this dissertation, I take a broader view of corporate governance by viewing it as the way to allocate oversight roles and responsibilities and distribute economic returns between shareholders, employees, managers, and other constituents. Corporate governance research should include the formal and informal structures and processes undertaken by those with oversight roles and responsibilities for supporting corporations located in institutional environments (Aoki, 2001; Davis, 2005). I think that this conceptualization of governance takes

into account the current circumstances of evolving corporate governance and provides some theoretical connections between diverse views on corporate governance.

Diverse views on corporate governance across multiple disciplines provide some common and distinctive elements that compose effective corporate governance. First, effective corporate governance should protect stakeholder rights and provide a means to enforce those rights by monitoring executives and holding them accountable (Protection of Stakeholder Rights and Enforceability). Second, effective governance is supposed to help mediate between the different interests and demands of various internal and external stakeholders (Management of Stakeholder Relationships). Third, effective governance provides transparent information disclosure (Information Disclosure). Finally, effective governance involves the provision of strategic and ethical guidance for the firm (Strategic and Ethical Guidance).

Effective corporate governance relies on a variety of mechanisms that are generally designed to ensure that executives respect the rights and interests of company stakeholders, and guarantee that stakeholders act responsibly in the generation, protection, and distribution of wealth invested in the firm (Aguilera, Filatotchev, Gospel, & Jackson, 2008). The governance literature has discussed diverse governance mechanisms and distinguished between internal and external governance mechanisms (Walsh & Seward, 1990). There are two types of corporate governance mechanisms: internal governance mechanisms, which take place within the organization (e.g., board of directors, ownership and incentives); and external governance mechanisms, which are the products of the institutional environment external to the firm (e.g., the legal environment, the market for corporate control, the external auditor, rating agencies and the media). This distinction draws on whether the locus of action of a given governance mechanism emanates from within the firm or from outside the boundaries of the firm.

While there is a long tradition of research in corporate governance, most of it focuses on internal governance mechanisms, and it has typically been written from a finance, law, or economic perspective. These governance mechanisms share the logic that when effectively implemented, they should align managerial and shareholder interests and result in higher overall financial performance. Discussion on external governance mechanisms is much more limited than internal governance mechanisms. The recent study identified with those internal and external mechanisms, but also discussed how the bundle of multiple mechanisms affects the efficacy of governance (Aguilera, Desender, Bednar, & Lee, 2015). Drawing on that, I assume that a single governance mechanism does not operate in isolation, and external mechanisms interact with other internal mechanisms and determine directly and indirectly the overall effectiveness of a firm's governance. Thus, in this dissertation, I look into the effectiveness of internal and external governance mechanisms as well as discuss how different governance mechanisms interact with each other and influence overall governance in an organization.

Considering the effectiveness of internal and external governance, it is impossible to study it without paying close attention to the institutional and organizational contexts. Given the complexities of governance arising from a combination of firm characteristics and institutional features, studying how the divergent demands of a corporation's various constituents affects managerial decisions as well as the other governance mechanisms would explain the overall efficacy of corporate governance mechanisms in an organization. The expectation and demands for corporate governance are subject to alternative interpretations by different actors in different institutional environments, as well as to changing interpretations over time. As more national economies expand, and as public firms proliferate around the world, we can envision an

increased awareness among scholars and policy makers that there is no single optimal governance system.

Taken together, in the first study of my dissertation, drawing on institutional theory I examine how the type, level, and nature of foreign shareholders, infused with their own governance logic, influence initial managerial earnings optimism and how foreign ownership shapes earnings guidance in a stakeholder oriented Japanese context. Although ownership has been the subject of extensive research, the prior research on its effectiveness focuses mostly on the U.S. context as well as a certain set of industries. Thus, this study provides some implications on how heterogeneous, foreign shareholders trigger to governance and strategic changes as well as a shareholder-oriented practice travels across borders.

In the second study, I examine how inter-organizational relationships may influence the media's ability to function as a governance mechanism by shaping the media coverage of firms. I draw on resource dependence theory and identify conflicts of interest between the media and corporations can impair the independence of media outlets and result in more positive media coverage of firms with such relationships. In particular, I look at two governance related ties including ownership, and board interlocks and their effect on media evaluations of the firm. This study suggests that to understand the role of the media as an external governance mechanism, we must account for inter-organizational ties that affect its independence.

STUDY 1: THE GOVERNANCE IMPACT OF A CHANGING INVESTOR LANDSCAPE: FOREIGN INVESTORS AND MANAGERIAL EARNINGS FORECASTS

Over the last decades, there has been a dramatic rise in financial globalization (Aggarwal, Erel, Ferreira, & Matos, 2011) coupled with demands for greater transparency and accountability by institutional investors (Boone & White, 2015) scattered all over the globe. Since local managers have become progressively subject to pressures from foreign investors, it is important to better understand the effects of these investors across business systems. Contemporary corporate governance research concedes that national institutions such as culture, legal, and financial institutions matter a great deal in defining firms' corporate governance (Cumming & Walz, 2010; Dai & Nahata, 2016; Sugathan & George, 2015), but the underlying mechanisms by which these institutions operate remains an ongoing research question (Aguilera, Desender, Bednar, & Lee, 2015).

International corporate governance research has shown that the Anglo-American shareholder-oriented economies are sharply different from the stakeholder-oriented economies such as Germany and Japan (Hall & Soskice, 2001; Shleifer & Vishny, 1997). The core elements salient in shareholder oriented corporate governance systems such as strong minority shareholder rights protection, managerial incentives tied to performance, or market for corporate control are not salient in stakeholder oriented countries, where other corporate governance instruments such as internal monitoring via concentrated ownership and tight (often informal) inter-firm relations tend to effectively substitute the above governance practices and show different sets of governance complementarities (Aguilera, Filatotchev, Gospel, & Jackson, 2008). The financial time horizons are longer in stakeholder oriented countries characterized by patient capital as opposed to short termism in shareholder oriented (Aguilera & Jackson, 2003). Finally, the timely

information incorporation and accounting conservatism across countries displays key discrepancies across governance systems (Ball, Kothari, & Robin, 2000).

A related body of governance research examines how the heterogeneity of owners, and especially the now prominent shareholder-oriented institutional investors, influence a wide range of corporate governance practices such as CEO compensation (Hambrick et al., 2008; Tihanyi, Graffin, & George, 2014). In light of these studies, the next pressing and relevant research question is to better understand how the combination of heterogeneous owners embedded in different national governance logics shapes managerial practices. Thus, I analyze whether and how foreign investors imprinted by their own country-level governance logics such as short-term shareholder oriented principles, introduce critical changes into domestic corporate governance and managerial disclosure practices when they invest in stakeholder oriented markets.

While some prior studies have looked at the impact of shareholder oriented foreign ownership on corporate restructuring, investment behavior and changes in corporate governance around the world (e.g., Aggarwal et al., 2011; Ahmadjian & Robbins, 2005; Bilinski, Cumming, Hass, Stathopoulos, & Walker 2015; David, O'Brien, Yoshikawa, & Delios, 2010), the effect of foreign ownership on accounting decisions in general, and managerial reporting behavior in particular, is still far from known, and has received scant attention from scholars, practitioners and policy makers. In this study, the outcome of interest is initial earnings optimism and the earnings guidance through the subsequent timely revision of earnings forecasts. Managerial earnings forecasts are managerial disclosures predicting firm earnings prior to the expected reporting date (King, Pownall, & Waymire, 1990).

The study of managerial earnings forecasts is especially interesting because it allows for the examination of the ample managerial discretion that managers strategically can deploy for

impression management purposes (Pfarrer, Pollock, & Rindova, 2010). The management forecast literature has been largely developed in the U.S. context, where management earnings forecasts are voluntary. However, precisely because forecasts are voluntary, this research devotes a great deal of attention on the managerial incentives to disclose forecasts (e.g., Ajinkya, Bhojraj, & Sengupta, 2005; Karamanou & Vafeas, 2005; Skinner, 1994; Stocken, 2000; Verrecchia, 2001). Yet, we know a lot less about how management earnings forecasts vary across countries and how different firms across the globe adapt to pressures from shareholder oriented foreign owners with certain shareholder value expectations and time horizons.

To fill in this gap in the current international business research, my study seeks to understand how domestic managers respond to foreign investor pressures for short term results and greater disclosure. I specifically examine how the presence of shareholder-oriented foreign investors influences managerial optimism in their initial earnings forecasts and earnings guidance in a quintessential stakeholder-oriented environment such as Japan.

The Japanese setting offers a number of advantages to address my research question. First, the Japanese system contrasts sharply with the Anglo-American system and Japanese firms have been resistant to change their corporate governance model towards the Anglo-American style (Aguilera & Jackson, 2003; Hall & Soskice, 2001; Yoshikawa & McGuire, 2008). In addition, the presence of foreign investors has increased dramatically since the 1990s. While foreign ownership accounted for less than 5 percent in 1990, it now constitutes the largest type of investor, holding an aggregate stake of 32 percent in 2015. Foreign investors in Japan generally originate from the Anglo-American governance context and collectively are sufficiently large to potentially exercise pressure for organizational change.

Second, the Japanese setting allows me to investigate the strategic use of management

forecasts in an economy where earnings forecasts are effectively mandated, but managers have considerable latitude over the numbers they release, as well as the timing of subsequent adjustments. While management forecasts have been a central issue in the disclosure literature (McNichols, 1989), most research has been conducted in settings where forecasts are voluntary and where there are clear legal sanctions for providing false or misleading disclosures and omissions. In Japan, managers are requested to disclose initial forecasts at the beginning of the fiscal year and can then revise those forecasts subsequently during the fiscal period.¹ Because forecasts in Japan are available for almost all firms, I can employ a large panel of firm-level forecasts, avoiding any selection bias and endogeneity concerns regarding the presence of foreign owners in those firms issuing forecasts, to analyze how foreign ownership influences managerial optimism in their initial earnings forecasts, as well as the strategic timing of subsequent adjustments.

I draw on the international corporate governance, impression management and managerial reporting behavior literature to establish whether Japanese firms follow a different strategic behavior when they are partially owned by short-term oriented foreign institutional investors. I also build on Kato, Skinner, and Kunimura (2009), who have looked at management forecast behavior in Japan to establish my base model. Kato et al. (2009) focus on understanding how managers set their initial earnings forecasts in each fiscal year and whether these forecasts are credible to those outside the firm. In contrast, my interest is on understanding the influence of shareholder-oriented foreign ownership on managerial decision-making in a stakeholder-oriented setting. To this end, I develop a theoretical framework to explain how the level, type, and nature

¹ Because the regulatory and legal costs of biasing forecasts are relatively low in Japan (Kato et al., 2009), managers can bias their initial forecasts but then revise their forecasts later in the fiscal period to avoid end of the year earnings surprises.

of foreign ownership, infused with their own governance logic, influence initial managerial earnings optimism and how foreign ownership shapes earnings guidance in a stakeholder oriented setting.

Considering the universe of listed Japanese firms in the Tokyo Stock Exchange (TSE) over the period 2006-2013, my results show that Japanese managers are more optimistic in their initial earnings forecasts in the presence of foreign owners. When I analyze the ownership structure in detail, I find that the main driver of this finding comes from foreign investment funds, which fall in the category of shareholder-oriented investors. Interestingly, foreign pension funds and domestic investors tend to exert an opposite effect. I also uncover stronger results for more active foreign investors defined in terms of their portfolio turnover rates compared to less active foreign investors. In terms of earnings guidance, I show that under the presence of foreign ownership, managers are more likely provide subsequent timely adjustments on the earnings forecast and avoid making last-minute adjustments (i.e., timely earnings guidance). In addition, my findings reveal that, independently of the level of foreign ownership, firms' last earnings forecasts tend to fall just below the realized earnings (i.e., there is a small positive earnings surprise). My findings are robust to different specifications and to the use of instruments to address endogeneity concerns.

In this study, which is anchored at the intersection of international accounting and international corporate governance, I contribute to the international business research in several ways. First, I shed light to international corporate governance research by arguing and empirically demonstrating that even though governance practices are heavily embedded within national boundaries, there is cross-pollination of practices as investors go abroad. Second, I engage with the current governance debate on the demands in attending to heterogeneous

owners, and in particular, I address the puzzle of how to solve the tension of the divergent incentives and interests between foreign and domestic owners. Third, I illustrate that foreign investors are a channel through which country level governance might change but it does not lead to convergence of national governance systems as these changes tend to be within the boundaries of each corporate governance system. Fourth, drawing on impression management literature and managerial accounting research, I show that a governance tool within managerial discretion is the use of time to strategically disclose information towards remote investors. My results also add to the accounting literature on forecast optimism and earnings guidance, as my findings provide new insights from a setting in which management earnings forecasts are effectively mandated. Finally, I present some key conclusions on the need to pay close attention to how managers respond to international pressures for greater compliance expectations within their own institutional constraints.

INSTITUTIONAL BACKGROUND

Japan is categorized as a stakeholder-oriented system, characterized by tight networks of vertical and horizontal groupings known for their cross-shareholdings and financial, human, and transactional ties (Lincoln & Gerlach, 2004). Instead of owning stocks primarily as portfolio investments or for purely financial purposes, domestic investors are often business partners or commercial banks, both of which hold shares for the implicit purposes of business goodwill, information exchange, and mutual monitoring. Japanese investors typically fall under Aguilera & Jackson (2003)'s category of investors with strategic interests as opposed to financial interests. With stakeholders concerned about maintaining long-term relationships and achieving lasting returns, firms develop and implement strategies based on long-term goals, seeking to maximize mostly market share and growth rather than short-term profits.

The Stock Exchange Act governs disclosure and financial reporting practices for Japanese public companies while the so-called Timely Disclosure Rules (Kessan-Tannsin or “summary of financial statements”) enforced by Japanese stock exchanges impose more stringent requirements on disclosure practices. Regarding earnings forecasts, these rules strongly encourage managers of listed companies to provide regular forecasts of annual sales, net income and earnings before extraordinary items and taxes (EBET). According to Kato et al. (2009), the large majority (close to 99 percent) of companies comply with this request and so they argue that forecast disclosure is effectively mandated in Japan². More specifically, listed companies are expected to release point forecasts of annual sales, net income and EBET at each annual earnings announcement date, as well as revisions of these forecasts at interim earnings announcement dates.³ Thus, managers provide initial forecasts for year t when year $t-1$ earnings are announced, and revisions (which include confirmations) when interim earnings are announced. In addition, forecasts must be updated if there are significant changes in management estimates—defined as changes in sales estimates of 10 percent or more and/or changes in earnings estimates of 30 percent or more (the “Significance Rule”). In contrast to initial forecasts, which are encouraged by stock exchange listing rules, these revisions are required under the Act⁴.

The legal costs of earnings forecasts disclosure are much lower in Japan than in the U.S., and securities litigation is not prevalent in Japan (Buchanan, Chai, & Deakin, 2012). Moreover, comparative accounting research (Ball et al., 2000) demonstrates that the degree of timeliness in accounting income is actually lower in Japan relative to the US or the UK. Thus, within the

² A survey in 2006 reports that 3790 of the 3831 listed firms (98.9%) provided management forecasts (Ota, 2011).

³ It is important to note that about 75 percent of all revisions happen at the interim earnings announcements, while about 25 percent correspond to stand alone announcements (Kato et al., 2009).

⁴ If firms miss their net income forecasts by more than 30%, the firm is subject to potential insider trading investigations. To the extent firms follow the guidelines, they will not be held liable for missing their initial forecasts. Management can avoid potential insider trading investigations if reported earnings are maintained within 30% of the forecast.

boundaries of complying with legal mandates, Japanese managers have ample managerial discretion to strategically manage (Edelman, 1992; Kato et al., 2009) the disclosure of both the initial earnings forecasts and subsequent adjustments contingent to performance expectations over time as well as different owners' demands.

THEORETICAL FRAMEWORK AND HYPOTHESES

I argue that the heterogeneity in shareholders' logic and interests and their relative strength within the organization are critical to understand the influence of different types of owners over managerial reporting practices. Drawing on the idea that firms are embedded within a given governance logic and the literatures on impression management and managerial reporting, I examine how shareholder-oriented foreign investors influence managerial optimism in initial earnings forecasts as well as the timing of subsequent revisions.

Research on managerial earnings forecasts has been mostly conducted in the field of accounting, largely focusing on the U.S. setting, where management earnings forecasts are voluntary. Because forecasts are voluntary in the US, research has concentrated on understanding managerial incentives towards forecasts (e.g., Skinner, 1994; Stocken, 2000; Verrecchia, 2001). For example, Ajinkya et al. (2005) and Karamanou and Vafeas (2005) examine the relation of the board of directors and institutional ownership with the properties of management earnings forecasts. They both find that firms with more outside directors and greater institutional ownership are more likely to issue a forecast. In addition, Ajinkya et al. (2005) find evidence that outside directors and institutional ownership mitigate the bias in earnings forecasts, while Karamanou and Vafeas (2005) demonstrate that forecast updates are more likely to occur in firms with independent boards and where institutions own a higher fraction of equity.

In the Japanese setting, although earnings forecasts are effectively mandated, managers

have considerable latitude over the initial earnings forecasts as well as the subsequent revisions. Kato et al. (2009) is one of the first studies to look into management forecasts in Japan. Their inquiry is twofold: providing a better understanding of the determinants of the managers' initial forecast optimism and analyzing how this optimism affects the credibility of their subsequent forecasts. They describe how management, in setting their initial forecast, can choose between the following three approaches: "(i) managers can set forecasts in an unbiased manner, (ii) managers can provide upward-biased (optimistic) forecasts, or (iii) managers can issue downward-biased (conservative) forecasts" (Kato et al., 2009: 1578). They find that managers' initial earnings forecasts for a fiscal year are systematically upward-biased but that these forecasts are subsequently revised downward during the fiscal year so that at year end, earnings surprises are non-negative (i.e., close to the actual earnings). They also show that Japanese initial forecast optimism is inversely related to firm performance, and is more pronounced for firms with higher levels of insider ownership and for smaller firms. According to Kato et al. (2009), there are different arguments for why Japanese managers are more likely to make upward-biased (optimistic) forecasts. First, if viewed as credible by capital market participants, optimistic forecasts increase stock prices, at least in the short term. Second, providing good news about the firm's future earnings prospects helps managers convince different firm constituents that they are doing a good job, and deters stock exit.

Consistent with Kato et al. (2009), I argue that the managerial incentives regarding optimism and the timing and magnitude of earnings adjustments are likely to be shaped by foreign capital. I take it a step further and examine the nature of foreign ownership. I propose that when foreign ownership is high, there will be greater levels of optimism in the initial earnings forecasts, combined with timely earnings guidance in the subsequent revisions. I discuss

each of these two sequential temporal steps in turn.

Foreign Investors and Initial Optimism

The asymmetry of information between management and foreign investors is magnified by geographical and institutional distance (Berry, Guillen, & Zhou, 2010; Buckley, 1997) as well as firm level cross-national governance differences (Aguilera & Jackson, 2003; Guillen & Capron, 2016; La Porta, Lopez-De-Silanes, Shleifer, & Vishny, 2000). Foreign investors are less likely to have access to the informal governance practices employed by the domestic stakeholders. Given the importance of earnings forecasts in the shareholder-oriented context and the lack of access to domestic information channels, this managerial reporting instrument may become more relevant when foreign ownership is high. Against this backdrop, I argue that there are at least three reasons accounting for higher levels of optimism in the initial earnings forecasts when foreign ownership is high.

First, shareholder-oriented foreign investors place more attention on short-term movements than on long-term value (David et al., 2010; Geng, Yoshikawa, & Colpan, 2016), increasing the incentives for optimism. On the one hand, relative to domestic institutional owners, foreign investors lack means to gain benefit other than stock returns from their investment (David et al., 2010). On the other hand, Geng et al. (2016) find evidence from the annual reports of Japanese firms that top management is pressured by foreign owners with short-term interests to aim for higher stock prices. Similarly, Mamoru Shimode (chief strategist at Resona Bank)⁵ states: "calls for a greater shareholder return are likely to continue in the future," in a response to foreign ownership reaching new heights in 2015. Hence, since foreign investors are likely to have a stronger focus on the short-term profits and managers are aware of it, this

⁵ <http://asia.nikkei.com/Markets/Equities/Foreign-ownership-of-Japanese-stock-hits-record-for-third-year>

pressure may be reflected in higher optimism in their initial earnings forecasts.

Second, foreign investors, holding individually, relatively small stakes, tend to trade shares more frequently than domestic investors and their holdings disproportionately affect the share price of Japanese firms. For example, foreign investors accounted for more than 50% of the total trading in the Tokyo Stock Exchange in 2007 even though their total shareholding was only about 25% (TSE, 2008). This entails that if the earnings forecasts are below expectations, foreign investors can create a dramatic drop in the stock price by exiting the firm, which supports the argument of higher incentives for optimism in the presence of foreign investors. Tied to this, there is also an argument for an impression management strategy from the point of view of Japanese managers towards their foreign owners (Bundy, Shropshire, & Buchholtz, 2013; Elsbach, 1994). Given that there is a legitimate market expectation to anticipate certain level of optimism as suggested by Kato et al. (2009), managers might be penalized in the short term for adopting a conservative disclosing strategy in terms of the initial earnings forecasts.

Third, optimism may be used to signal managerial ability and to alleviate potential career advancement concerns. Optimism helps to convince the firm's constituents that managers are doing a good job as noted by Kato et al. (2009). This argument is likely to be strengthened when foreign ownership is high. Foreign investors may be more sensitive to the management earnings forecasts and managers may experience career threats as a result of foreign ownership exercising exit or voice. Taking these arguments together, I propose:

Hypothesis 1: The greater the percentage of a firm's shares held by foreign investors, the more likely managers are to make optimistic initial earnings forecasts.

Foreign Investors and Guidance Quality

In this section, I argue that the presence of shareholder-oriented foreign investors influence the timing of subsequent earning forecast revisions. In particular, I claim that managers offer more timely earnings guidance under the presence of shareholder-oriented foreign investors. Earnings guidance is important because it decreases information asymmetries, between the firm and its investors, and potentially also between foreign and domestic investors, leading in turn to a lower cost of capital and enhanced corporate investment and growth (Houston, Lev, & Tucker, 2010). Furthermore, earnings guidance may enhance investor confidence in managers' ability. As previously stated, successful guiders are obviously "on top of things" (Trueman, 1986). Within the U.S., a large literature has developed on earnings guidance providing evidence that firms engage in expectations management (i.e., Cotter, Tuna, & Wysocki, 2006; Matsumoto 2002; Richardson, Teoh, & Wysocki, 2004) to beat analysts' (quarterly) earnings targets. Another line of research within the U.S. setting has examined the causes and consequences of ending quarterly earnings guidance (e.g., Chen, Matsumoto & Rajgopal, 2011; Houston, et al., 2010).

In the Japanese context, earnings guidance is particularly sensitive because after the initial optimistic forecasts, managers need to decide on the timing and the magnitude of subsequent adjustments to avoid negative stock price reactions or reputational loss at year end. In addition to investor concerns, if their initial earnings forecasts are over- or understated by more than 30 percent, managers may face possible insider trading investigations. Kato et al. (2009) show that that earnings surprises tend to be very close to zero in Japan, and combined with optimism in the initial forecast, this means that managers need to decide how to guide the earnings expectations downwards.

The impression management literature is relevant here because it illustrates that managers have the ability to use time strategically in deciding how to disclose new information, in amending prior optimistic estimates, and in shaping investors' perceptions (Bundy & Pfarrer, 2015). Thus, during the fiscal period, there is again some degree of managerial discretion on how much and when to adjust the earnings forecasts. Earnings guidance is likely to be influenced by having foreign investors who are at arm's-length, with wide information asymmetries, shareholder-oriented performance expectations, and with weak access and/or incentives to closely monitor.

From a managerial reporting perspective, managers have three broad options towards earnings revisions: (i) provide timely updates on the earnings forecast, i.e., timely earnings guidance, (ii) wait until close the end of the year to provide any revisions, or (iii) make no adjustments which may lead to significant earnings surprises. I argue that managers will provide timely earnings guidance when foreign ownership is high, for at least three reasons.

First, international accounting research shows that differences in the demand for accounting income in different institutional contexts causes its properties, such as timeliness or conservatism, to vary cross-nationally. For example, Ball et al. (2000) compare the degrees of timeliness and (conditional) conservatism among seven countries (Australia, Canada, the UK, the U.S., France, Germany, and Japan) using 1985-1995 data, and show that discrepancies exist among countries: shareholder-oriented governance countries (i.e., Australia, Canada, the UK, and the U.S.) exhibit higher level of timeliness and (conditional) conservatism than stakeholder governance countries (i.e., France, Germany, and Japan). In fact, they uncover that accounting income in Japan reveals the least timeliness. Compared to domestic investors, foreign investors in Japan face a disadvantage in terms of gaining access to managerial information. Therefore, as

the impression management literature would suggest (Elsbach, 1994), making timely revisions of the earnings estimates, going against what is the norm in the Japanese accounting environment (low degree of timeliness), represents an earnings guidance channel that managers are aware of and willing to activate (Pfarrer, Smith, Bartol, Khanin, & Zhang, 2008). In addition, for foreign investors originating from the shareholder-oriented governance logic, timeliness is a key property of accounting income which they are used to and therefore they are likely to expect it (demand), particularly in a stakeholder-oriented setting.

Second, as management earnings forecasts and realized performance are publicly disclosed, it is straightforward to figure out even at arms-length if by the end of the fiscal year, managers meet their earnings forecasts. If managers fail to reach publicly disclosed earnings forecasts, it entails that they did not fulfill their obligation to meet the shareholders' expectations. Missing expectations of earnings could result in lower compensation and loss of employment (Kaplan, 1994), but also it might cause undesirable social consequences for Japanese managers such as loss of face, damage to self-image as well as corporate image affiliated with them. This is particularly the case in the Japanese business environment (Gelfand, Nishii, Holcombe, Dyer, Ohbuchi & Fukuno, 2001). For example, Herrmann, et al. (2003) argue that managers have incentives for meeting management forecasts to "save face." While domestic owners may handle systematically missing earnings benchmarks in a manner that allows managers to "save face," foreign investors are less likely to act in a subtle way, are known to have less patience, and might even engage in public management questioning. In addition, earnings surprises or late substantial earnings revisions are more likely to accentuate the information disadvantage of foreign investors, openly probe management, and to affect the stock price significantly more compared to when managers engage in timely earnings guidance.

Third, there is also an argument for proactive shareholder engagement (Goranova & Ryan, 2014), even in the fairly dormant Japanese context. That is, Japanese governance regulators recognize that in the shareholder-oriented countries, there has been a rather vibrant movement to attend (or at least respond) to shareholders' demands, given their growing repertoire of mechanisms to express their voice on company decisions. This effort has been incorporated within the managerial reporting recommendations. In particular, the TSE recently provided more flexibility for firms to choose which items to include in their initial forecasts, how to present items, which periods to cover, etc. In the latest revision of the Earnings Forecast Disclosure Rules, the TSE expressed that their view on disclosure of future estimates is to encourage listed companies to continue to proactively disclose future estimates so that firms can bridge the serious information gap between investors and management (Yoshii, 2012). This effort is in the spirit to engage in a substantial dialog with investors in order to support fair and smooth price formation in the securities market. I argue that this regulatory initiative further encourages firms with large proportions of foreign investors to have a greater need to engage with their investors by providing timely earnings guidance.

Taking these arguments together, I expect to find a significant relationship between foreign ownership and the timely disclosure of earnings adjustments. Therefore, I propose:

Hypothesis 2: The greater the percentage of a firm's shares held by foreign investors, the more likely managers are to provide timely earnings guidance.

EMPIRICAL ANALYSIS

Sample and Data Sources

To test my hypotheses, I consider all listed firms in the Tokyo Stock Exchange (TSE) for the period 2006-2013. I exclude financial firms because their accounts are significantly different. My data comes from multiple data sources. The initial earnings forecast data were manually collected from the Japanese Company Handbook, while earnings revisions were obtained from Nikkei Financial Quest. The board and ownership structure data was manually collected from the companies' annual corporate governance reports on the TSE website. To gain detailed insights into the composition and nature of foreign ownership, I went further and collected from Thomson Eikon each investors' historical shareholdings for all firms in my sample over the last 15 years. My data collection strategy reduces measurement error concerns as I draw on primary source. In addition, I gathered the accounting data to compute my control variables from the company financial statements and Thompson Worldscope. Finally, I obtained MSCI historical membership data which I employ as instrument for foreign ownership from Bloomberg. I winsorize all continuous variables at the top and bottom percentiles to avoid the effect of outliers. My final sample contains 1,690 listed firms and 10,769 firm-year observations.

Methodology

To assess the relationship between the presence of foreign ownership and earnings forecasts behavior, I estimate panel data regressions using annual data, building on Kato et al. (2009). The influence of foreign ownership on earnings forecasts behavior can be modeled as follows:

$$y_{it} = a_1 z_{it-1} + b_1 x_{it-1} + v_i \quad (1)$$

, where y_{it} represent my measures of earnings forecasts behavior, z_{it-1} is the vector of control

variables, x_{it-1} represent my variables of interest, i.e., foreign ownership, and v_i is the vector of heteroskedastic-robust standard errors. All explanatory variables are lagged by one period to mitigate possible simultaneity. The subindex i and t refers to firm and year, respectively.

Dependent Variables: Earnings Forecast Behavior

To operationalize my measures of earnings forecast behavior, I focus on net income following Kato et al. (2009). Net income forecasts are likely to be of greater importance to investors than sales or operating income forecasts.⁶ I define two measures of initial earnings forecast optimism (error and innovation), a measure of earnings surprise, and two measures related to the earnings revisions as follows:

- *Forecast Error* is defined as [realized earnings for year t – initial management forecast of year t earnings]/[total assets at $t-1$ year-end]. Greater optimism is reflected in larger negative forecast errors.
- *Forecast Innovation* is defined as [initial management forecast of year t earnings – realized earnings for year $t-1$]/[total assets at $t-1$ year-end]. This captures the forecasted change in net income with respect to the last year realized figure of net income. Greater optimism is reflected in larger positive forecast innovations.
- *Earnings Surprise* is defined as [realized earnings for year t - latest management forecast of year t earnings]/ [total assets at the end of prior year-end]. Managers make revisions on their forecasts through the year, so the final forecast on net income is, on average, just below the realized net income, leading to a very small positive surprise. While managers may revise their forecast at any moment up until the approval of the financial statement, revisions on the (year-

⁶ I have repeated a main analysis using estimates on operating income, as well as sales, and find similar, but somewhat weaker results.

end) net income figure generally tend to coincide with quarterly earnings announcements.

- *Likelihood of a change in earnings revisions* is an indicator variable that equals one if there is a change in the revised forecasted net income with respect to the last forecast.

- *Magnitude of Earnings Revisions* is defined as [latest (revised) management forecast of year t earnings – previous management forecast of year t earnings]/total assets at the end of prior year-end.

Key Independent Variables: Foreign Ownership and Ownership Type

Foreign ownership reflects the percentage of total outstanding shares held by non-Japanese investors. The TSE requires firms to report the degree of foreign ownership in four categories: between 0 and 10 percent; between 10 and 20 percent; between 20 and 30 percent; and more than 30 percent. I use two main measures of foreign ownership. First, I employ the four categories as defined by the TSE, which allows us to test for non-linearity and avoid measurement errors. Second, I compute the total proportion of foreign ownership, as well as the proportion held by each type of foreign shareholder. The main types, i.e., those that represent at least one percent of all foreign shareholdings, are investment funds, corporations, sovereign wealth funds, pension funds and research firms. To compute these two continuous measures of foreign ownership I collected data from Thomson Eikon for the complete set of shareholders for every firm over the sample period. In total, I have analyzed close to five million individual shareholdings.

Control Variables

I control for the determinants of optimism, following the approach in Kato et al. (2009). In particular, I introduce in equation (1), the following (one-period lagged) control variables:

Firm Past Performance: I include two controls for firm performance: Return on assets

(ROA), computed as net income over total assets, and sales growth, which equals the change in annual sales scaled by previous year's sales. Past performance is likely to shape managerial forecasting behavior. Kato et al. (2009) find that optimism is higher for those firms with worse performance.

Prior Optimism: I include a dummy variable set to 1 if the firm's initial forecast in year $t-1$ resulted in a negative forecast error. I expect this variable to be positively related to optimism in year t given the persistence of managerial optimism (Kato et al. 2009).

Corporate Governance: I include two relevant corporate governance mechanisms as control variables: board independence and quality of firm auditor. First, board independence operationalized as the proportion of outside board members (in the Japanese context, directors who have never served as executive director, executive officer, employee of the company or any of its subsidiaries) over the total board size, as reported in the companies' annual corporate governance report. Over the past decade, independent directors have become more prevalent in Japanese boardrooms (Yoshikawa & McGuire, 2008). I expect board independence to be associated with lower levels of optimism because of the potential higher monitoring intensity. Second, quality of firm auditor is operationalized as a dummy variable (Big-4) that equals one if the client firm is working with one of the big 4 auditors, i.e., AZSA & Co. (KPMG), Tohmatsu (Deloitte Touche); Aarata (PwC) and ShinNihon (Ernst & Young) and 0 otherwise. I expect that high quality auditors may reduce the incentive of managers to report more optimistic earnings forecasts.

Domestic Ownership type: I measured domestic ownership concentration by type of domestic owners. To calculate the domestic ownership concentration by type, I primarily used the stakes of the 30 largest shareholders as reported by the company in their corporate

governance reports, differentiating between individual/family, investment fund, company, employee and state ownership. I introduce these variables as control variables when considering the decomposition of foreign ownership by type. My results are unchanged if I calculate the domestic ownership variables from Thomson Eikon. Kato et al. (2009) report mixed finding for financial domestic ownership on initial earnings forecast optimism (non-significant and positive).

Finally, I also control for firm size, measured as the natural log of total assets, firm leverage, measured as the ratio of total liabilities over total assets and low operating assets turnover measured as an indicator variable that equals one if the sales divided by net operating assets (i.e., shareholders' equity less cash and marketable securities and plus total debt) is below the median of the corresponding two-digit SIC industry-year, and zero otherwise. Firm size may be negatively related to forecast optimism since larger firms are subject to greater external discipline and/or are more likely to have managers who bear relatively larger reputational costs. Higher levels of leverage may be associated with more pressure to present optimistic forecasts, while low operating assets turnover has been related to lower likelihood of earnings surprises (Barton & Simko, 2002).

Empirical Model

I begin my analysis using ordinary least squares (OLS) regressions, similar to Kato et al. (2009). However, there is a plausible concern that these regressions may suffer from endogenous selection bias. My main concern is reverse causality, i.e., the possibility that foreign investors are more likely to invest in firms with optimistic forecasts, and omitted variables, i.e., the possibility that foreign ownership could be related to an unobserved or uncontrolled factor. Endogeneity problems driven by measurement errors are less of a concern given that my data is derived

mostly directly from the TSE or company files. Although it is difficult to completely solve the endogeneity problem, I attempt to address this concern by (1) estimating fixed effects regressions to account for heterogeneity induced by time-invariant factors and period effects, and (2) using instrumental variable techniques. My instrument for foreign institutional ownership is the stock additions to the MSCI All Country World Index (MSCI ACWI), similar to Aggarwal, et al. (2011) and Bena, Ferreira, Matos, & Pires (2015).

RESULTS

I report descriptive statistics for the regression variables, along with their correlations in Tables 1, 2 and 3. The descriptive statistics presented in Table 1 are generally consistent with prior findings (Kato et al., 2009). On average, forecast errors are negative, while the forecast innovations are positive, which point to optimism in the initial disclosure of earnings forecast. In addition, there is substantial variation in both measures reflecting significant managerial discretion in the earnings forecasts. The earnings surprise is positive, but very close to zero which is an indication that managers adjust their initial over optimistic forecast so that the final forecast falls very close to the realized earnings.

Regarding foreign ownership, more than half of all firms have less than 10 percent foreign ownership, while about one fifth of my sample firms have more than 20 percent. When considering the Thomson Eikon data, the overall level of foreign ownership amounts to about 13 percent. Foreign portfolio investors are predominantly US and UK institutional investors. In Table 2, Panel A I decompose the total foreign ownership stake by country of origin of the investors, focusing on the ten countries with the largest stake of foreign investment, and decomposing it further by investor type. The US investors are by far the largest group with more than 58 percent of all foreign shareholdings, followed by UK investors with almost 15 percent.

Firms from neighboring countries like, China or Korea only hold about 0.36 percent each. In addition, it is also worth noting the importance of investment funds, i.e., an investment firm who manages assets for private clients and institutions. More than 73 percent of all foreign shareholdings pertain to this investor type. Corporations are the second more relevant investor type with almost 12 percent. Other relevant foreign investor types include sovereign wealth funds, pension funds and research firms (a sales side research firm that also has an investment banking side). The other investor types are not close to one percent of the total foreign shareholdings. While foreign investors are important as a group, the individual positions by foreign investors tend to be relatively small.

Table 1: Descriptive statistics

Variable	Mean	S.D.	Min	Max
Forecast error	-0.0072	0.0299	-0.1971	0.0992
Forecast innovation	0.0096	0.0331	-0.1000	0.2938
Earnings Surprise	0.0007	0.0055	-0.0299	0.0492
Foreign <10%	0.5844	0.4928	0.0000	1.0000
Foreign 10%-20%	0.2210	0.4149	0.0000	1.0000
Foreign 20%-30%	0.1220	0.3273	0.0000	1.0000
Foreign >30%	0.0726	0.2595	0.0000	1.0000
Foreign_Corporations	0.0058	0.0351	0.0000	0.6520
Foreign_Investment Funds	0.1037	0.0838	0.0000	0.7360
Foreign_Pension Funds	0.0060	0.0119	0.0000	0.1853
Foreign_Research Firms	0.0020	0.0134	0.0000	0.2754
Foreign_SWF	0.0103	0.0211	0.0000	0.3474
Domestic _family/individuals	0.0974	0.1525	0.0000	0.9379
Domestic _firms	0.2091	0.1881	0.0000	1.0000
Domestic _employees	0.0227	0.0303	0.0000	0.2437
Domestic _banks	0.1117	0.0877	0.0000	0.6565
Domestic _investment funds	0.1068	0.0920	0.0000	0.6565
Domestic _government	0.0034	0.0209	0.0000	0.5001
Big-4 Auditor	0.7980	0.4015	0.0000	1.0000
Firm Size	11.0258	1.6010	4.6539	17.3846
Leverage	0.1953	0.1777	0.0000	2.0204
Return on Assets	0.0170	0.0955	-2.6841	0.5578
Sales growth	0.0203	0.0620	-0.5938	0.2971
Prior optimism	0.5609	0.4962	0.0000	1.0000
Low Op. Assets Turnover	0.4907	0.4999	0.0000	1.0000
Board independence	0.1045	0.1456	0.0000	1.0000

Table 2: Foreign Ownership – decomposition by country and type of owner

Panel A											
Country	Stake of Foreign Ownership	Banks	Corporations	Hedge Funds	Holding Companies	Individual Investors	Investment Funds	Pension Funds	Private Equity	Research Firms	SWFs
United States	58.53%	0.31%	3.64%	0.21%	0.02%	0.12%	51.22%	1.88%	0.29%	0.83%	0.00%
United Kingdom	14.88%	0.00%	1.00%	0.00%	0.22%	0.00%	11.86%	0.00%	0.00%	1.79%	0.00%
Norway	6.44%	0.00%	0.00%	0.00%	0.00%	0.00%	0.12%	0.00%	0.00%	0.00%	6.32%
Singapore	3.22%	0.00%	0.71%	0.12%	0.00%	0.00%	2.38%	0.00%	0.00%	0.00%	0.01%
Germany	1.80%	0.04%	0.99%	0.00%	0.00%	0.00%	0.76%	0.00%	0.00%	0.00%	0.00%
Netherlands	1.70%	0.00%	0.77%	0.00%	0.00%	0.02%	0.29%	0.61%	0.00%	0.00%	0.00%
Hong Kong	1.64%	0.00%	1.04%	0.00%	0.00%	0.00%	0.38%	0.00%	0.20%	0.00%	0.00%
Canada	1.62%	0.00%	0.09%	0.00%	0.00%	0.00%	0.74%	0.79%	0.00%	0.00%	0.00%
France	1.49%	0.00%	0.62%	0.00%	0.02%	0.00%	0.86%	0.00%	0.00%	0.00%	0.00%
Switzerland	1.49%	0.12%	0.09%	0.00%	0.00%	0.00%	1.28%	0.00%	0.00%	0.00%	0.00%
Top 10 Countries	92.81%	0.47%	8.95%	0.33%	0.26%	0.14%	69.89%	3.28%	0.49%	2.62%	6.33%
Full Sample	100.00%	0.61%	11.83%	0.36%	0.26%	0.51%	73.17%	3.40%	0.51%	2.62%	6.32%

Panel B											
	Total sample	Banks	Corporations	Hedge Funds	Holding Companies	Individual Investors	Investment Funds	Pension Funds	Private Equity	Research Firms	SWFs
Av. Churn ratio – Foreign investors	0.74	0.86	0.15	1.37	0.62	0.08	0.86	0.73	0.82	0.98	0.62
Av. Churn ratio – domestic investors	0.23	0.26	0.22	0.49	0.11	0.19	0.41	0.09	0.47	0.44	

To provide a better understanding of the different types of foreign investors, I have included the average shareholder investment horizon by investor type. Following Bilinski et al. (2015), Gaspar, Massa, & Matos (2005), and Gaspar, Massa, Matos, Patgiri, & Rehman (2013), I measure shareholder horizons using investors' portfolio turnover (value weighted average), using the Churn Ratio measure. The churn ratio for each investor is calculated for every year, considering the investor's portfolio of Japanese firms as:

$$CR_{it} = \frac{\sum |N_{kit} * P_{kt} - N_{kit-1} * P_{kt-1} - N_{kit-1} * \Delta P_{kt}|}{\sum (N_{kit} * P_{kt} + N_{kit-1} * P_{kt-1}) / 2}$$

Where CR_{it} is the churn ratio of investor i , N_{kit} is the number of shares in firm k , held by investor i in year t ; P_{kt} is the stock price of firm k at the end of year t ; Δ denotes the yearly change operator. Table 2, Panel B reflects the average weighted churn ratios by investor type, separating between foreign and domestic investors. The average foreign investor turnover is 0.74, which means that 37 percent ($0.74/2 = 0.37$) of the average investor's portfolio is turned over in a year, which is close to the 42.8 percent reported by Bilinski et al. (2015) for a sample of US institutional investors. The average investor turnover of 0.74 also entails that foreign investors hold an average stock for around 32 months ($12/0.37 = 32.43$). Compared to foreign investors, the turnover ratio is about three times smaller for domestic investors.

In terms of my control variables, about 80 of Japanese listed firms have a Big-4 auditor. The average return on assets ratio is just below two percent, while the average sales growth is just above two percent. Furthermore, about 10 percent of the board members are outsiders (the average board size is 8.5), a finding that is substantially lower compared to Anglo-American or Continental European boards. Notably, about half of all firms in my sample have a board composed with only insiders. When considering domestic ownership concentration, it is

interesting to note that domestic banks and investment funds hold on average close to 11 percent, each, while family/individual investors hold almost 10 percent.

Table 3 shows my correlation matrix. The forecast error is negatively correlated with forecast innovation and positively to the earnings surprise, which is in line with Kato et al. (2009), while it is positively related to firm size, profitability, having a Big-4 auditor and board independence and negatively related to firm leverage.

Table 3: Correlation matrix

	1	2	3	4	5	6	7	8	9	10	11	12	13
1 Forecast error	1												
2 Forecast innovation	-0.13	1											
3 Earnings Surprise	0.22	-0.01	1										
4 Foreign 10%-20%	0.01	-0.03	0.01	1									
5 Foreign 20%-30%	0.00	-0.03	0.03	-0.22	1								
6 Foreign >30%	0.00	0.00	0.04	-0.15	-0.11	1							
7 Big-4 Auditor	0.03	-0.04	0.01	0.08	0.08	0.03	1						
8 Firm Size	0.07	-0.13	0.02	0.20	0.31	0.26	0.17	1					
9 Leverage	-0.11	0.08	-0.05	-0.04	-0.06	-0.08	-0.07	0.17	1				
10 Return on Assets	0.06	-0.53	-0.01	0.07	0.08	0.08	0.11	0.11	-0.23	1			
11 Sales growth	-0.02	-0.15	0.00	0.02	0.02	0.03	0.02	0.00	-0.02	0.24	1		
12 Prior optimism Low Op.Assets	-0.17	0.28	-0.05	-0.01	-0.02	-0.04	-0.03	-0.06	0.06	-0.19	-0.14	1	
13 Turnover	-0.04	0.03	-0.03	0.03	0.00	0.02	-0.02	0.08	0.15	-0.07	-0.04	0.06	1
14 Board independence	0.00	0.05	0.05	-0.01	0.05	0.10	0.07	0.04	0.02	-0.07	0.01	-0.03	-0.01

Table 4: OLS Regression results of Earnings optimism and four levels of foreign ownership

Dependent variable:	Forecast error		Forecast Innovation		Earnings Surprise	
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Foreign Own: 10%-20%		-0.0026*** (0.0008)		0.0039*** (0.0008)		0.0003* (0.0002)
Foreign Own: 20%-30%		-0.0044*** (0.0010)		0.0057*** (0.0010)		0.0006*** (0.0002)
Foreign Own >30%		-0.0059*** (0.0013)		0.0114*** (0.0013)		0.0006** (0.0003)
Big4-Auditor	0.0005 (0.0007)	0.0005 (0.0007)	-0.0013* (0.0007)	-0.0011* (0.0007)	-0.0001 (0.0002)	-0.0001 (0.0002)
Firm Size	0.0014*** (0.0002)	0.0022*** (0.0002)	-0.0010*** (0.0002)	-0.0010*** (0.0002)	-0.0001 (0.0001)	-0.0001 (0.0001)
Leverage	-0.0199*** (0.0019)	-0.0231*** (0.0020)	0.0046** (0.0019)	0.0053*** (0.0019)	-0.0019*** (0.0004)	-0.0017*** (0.0004)
Return on Assets	0.0224*** (0.0039)	0.0227*** (0.0051)	-0.2539*** (0.0048)	-0.2559*** (0.0049)	0.0029*** (0.0007)	0.0029*** (0.0007)
Sales Growth	0.0019 (0.0016)	0.0018 (0.0016)	-0.0011 (0.0013)	-0.0012 (0.0013)	-0.0003 (0.0002)	-0.0003 (0.0002)
Prior optimism	-0.0077*** (0.0006)	-0.0076*** (0.0006)	0.0113*** (0.0006)	0.0113*** (0.0006)	-0.0008*** (0.0001)	-0.0008*** (0.0001)
Low Op. Assets Turnover	-0.0006 (0.0006)	-0.0006 (0.0006)	-0.0009 (0.0006)	-0.0011* (0.0006)	-0.0002** (0.0001)	-0.0003** (0.0001)
Board Independence	0.0014 (0.0021)	0.0001 (0.0022)	-0.0011 (0.0022)	-0.0013 (0.0022)	0.0014*** (0.0004)	0.0012*** (0.0004)
Constant	-0.0101 (0.0154)	-0.0264** (0.0114)	0.0062*** (0.0114)	0.0130 (0.0114)	0.0012 (0.0031)	0.0019 (0.0031)
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes
Industry dummies	Yes	Yes	Yes	Yes	Yes	Yes
Firm dummies	No	No	No	No	No	No
N	10769	10769	10769	10769	10769	10769
Adjusted R2	0.1441	0.1465	0.3159	0.3123	0.0308	0.0316

*** p < 0.01; ** p < 0.05; * p < 0.10, based on two-tailed tests, robust standard errors, clustered at the firm level in parentheses. All independent variables are lagged by one term.

Table 4 shows the regression results of earnings optimism and the four levels of foreign ownership. Models (1) (3) and (5) estimate the base model with forecast error, forecast innovation and earnings surprise as dependent variable, respectively. Model (2), (4) and (6) introduce the four levels of foreign ownership defined by the TSE into model (1), (3) and (5) respectively. When considering the forecast error in model (2), my results show a negative relationship between the levels of foreign ownership and the forecast error. The higher the level of foreign ownership, the more optimistic managers are with their earnings forecast. Similarly, model (4) shows that managers are more optimistic about the increase in net income relative to last years' realized net income (forecast innovation) in the presence of foreign ownership. Finally, the difference between the last forecast and the realized net income, i.e., the earnings surprise, shown in model 6 is significantly more positive for firms with large levels of foreign ownership (above 20 percent) , although the size of the effects are relatively small.

The regression results in all models of Table 4 indicate that my control variables are generally significantly related to initial earnings forecast optimism in the ways that I predicted. The forecast error is smaller (i.e., less negative) for large and profitable firms, with a low level of leverage and without prior optimisms in their initial earnings forecasts. The reverse is the case when considering forecast innovation, which tends to be less positive for these firms. It is worth noting that while foreign ownership is positively related to firm size and profitability (see the correlation matrix in Table 3) and negatively related to firm leverage, these controls show opposite signs regarding their effect on earnings optimisms. This strengthens my results, as it suggests that the relationship between foreign ownership and size, leverage or profitability is not driving my findings between foreign ownership and managerial optimism. Taking these results together, my findings offer consistent support for my first hypothesis. Managers are generally

optimistic, and they are even more so in the presence of foreign ownership. Finally, models (5) and (6) examine the earnings surprise and show a small, but significant, effect for the different levels of foreign ownership. When foreign ownership is high, the earnings surprise tends to be slightly more positive.

To better understand the relationship between foreign ownership and managerial optimism, I decompose foreign investors by type as shown in Table 5. I also consider different types of domestic owners to gain further insight into the role of both foreign and domestic investors in managers' earnings forecasts behavior. Results in models (1) and (2) show that when the proportions of foreign investment funds are high, managers tend to be significantly, at the one percent level, more optimistic, i.e., the forecast error is more negative. Foreign corporations are also related to greater optimism, although the coefficient is only significant at the 10 level in model (2). Interestingly, I also uncover that the proportion of foreign pension funds seems to reduce the forecast error, in line with the idea that these types of investors tend to hold a longer investment horizon (David, Hitt & Gimeno, 2001; Neubaum & Zahra, 2006). The coefficient for foreign pension funds is larger than any other, which may reflect that, for a given ownership stake, these foreign owners have more voice relative to other types. This may be due to their experience as activist shareholders, their homogenous interests and the low number of pension funds that make up the ownership stake.

In terms of the economic significance, foreign investment funds have a much greater influence as their shareholdings are almost 20 times larger. The coefficients of foreign research firms and SWF are not significantly related to the forecast error. These findings provide further insight into the relationship between foreign ownership and the forecast error, as the negative relationship is mainly driven by foreign investment funds. Regarding the different types of

domestic owners, my model (2) in Table 5 illustrates interesting results. Domestic ownership by families/ individuals, other firms, banks and even domestic investment funds significantly reduces managers' initial optimism, reducing the earnings forecast error. In line with my arguments developed to establish my first hypothesis, domestic employees and banks are likely to have a longer time frame, trade less frequently and have access to multiple channels of information and therefore managers of firms with these types of domestic shareholders have lower incentives to be optimistic in their initial earnings forecasts. Interestingly, domestic investment funds do not seem to have the same influence as foreign investment funds, highlighting the need to account for the institutional setting from which different types of owners come from.

Next, I consider the results of models (3) and (4) which examine forecast innovation. In line with my results on the forecast error, foreign investment funds and corporations are significantly related to more optimism. The sign of foreign pension funds is in line with lower optimism, but is not significant, while foreign SWF appear to have a positive relationship with the forecasted growth in net income. With respect to the domestic investors, only the proportion of family/individual shareholdings and domestic employees is significant. Higher levels of family/individual shareholdings are related with higher levels of optimism, while higher levels of employee stock participation seem to induce lower levels of managerial optimism. The results for the earnings surprises reflect positive coefficients for all types of foreign and domestic investors. However, only the coefficients for foreign corporations and pension funds, as well as domestic individual and employee participation are significant.

Table 5: OLS Regression results of Earnings optimism and Foreign and Domestic Ownership Types

Dependent variable:	Forecast error		Forecast Innovation		Earnings Surprise	
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Foreign_Corporations	-0.0255*** (0.0097)	-0.0214* (0.0097)	0.0394*** (0.0099)	0.0374*** (0.0099)	0.0060*** (0.0019)	0.0061*** (0.0019)
Foreign_Investment Funds	-0.0194*** (0.0041)	-0.0206*** (0.0044)	0.0438*** (0.0041)	0.0408*** (0.0042)	0.0002 (0.0008)	0.0002 (0.0008)
Foreign_Pension Funds	0.0776*** (0.0277)	0.0704** (0.0297)	-0.0309 (0.0287)	-0.0154 (0.0288)	0.0125** (0.0060)	0.0110* (0.0061)
Foreign_Research Firms	-0.0303 (0.0233)	-0.0282 (0.0243)	0.0337 (0.0226)	0.0289 (0.0226)	0.0055 (0.0048)	0.0054 (0.0048)
Foreign_SWF	-0.0154 (0.0140)	-0.0185 (0.0166)	0.0674*** (0.0154)	0.0599*** (0.0154)	0.0045 (0.0032)	0.0041 (0.0032)
Domestic_Family/Individuals		0.0074** (0.0032)		0.0125*** (0.0031)		0.0016** (0.0006)
Domestic_Corporations		0.0092*** (0.0022)		0.0011 (0.0020)		0.0006 (0.0004)
Domestic_Employees		0.0121 (0.0114)		-0.0336*** (0.0101)		0.0039* (0.0021)
Domestic_Banks		0.0201*** (0.0070)		0.0046 (0.0063)		0.0003 (0.0013)
Domestic_Investment Funds		0.0110* (0.0065)		0.0008 (0.0057)		0.0015 (0.0012)
Domestic_Government		0.0021 (0.0197)		-0.0036 (0.0184)		0.0021 (0.0036)
Big4-Auditor	0.0004 (0.0007)	0.0004 (0.0007)	-0.0014** (0.0007)	-0.0017** (0.0007)	-0.0001 (0.0002)	-0.0001 (0.0002)
Firm Size	0.0013*** (0.0002)	0.0011*** (0.0002)	-0.0024*** (0.0002)	-0.0023*** (0.0002)	-0.0001 (0.0001)	-0.0001 (0.0001)
Leverage	-0.0201*** (0.0021)	-0.0210*** (0.0021)	0.0016 (0.0021)	0.0021 (0.0021)	-0.0017*** (0.0004)	-0.0016*** (0.0004)
Return on Assets	0.0211*** (0.0042)	0.0191*** (0.0043)	-0.3180*** (0.0061)	-0.3271*** (0.0061)	0.0022*** (0.0007)	0.0018** (0.0007)
Sales Growth	0.0010 (0.0015)	0.0013 (0.0015)	-0.0015 (0.0013)	-0.0015 (0.0013)	-0.0002 (0.0002)	-0.0002 (0.0002)
Prior optimism	-0.0069*** (0.0006)	-0.0068*** (0.0006)	0.0079*** (0.0006)	0.0079*** (0.0006)	-0.0007*** (0.0001)	-0.0007*** (0.0001)
Low Op. Assets Turnover	-0.0006 (0.0006)	-0.0006 (0.0006)	-0.0019*** (0.0006)	-0.0020*** (0.0006)	-0.0001 (0.0001)	-0.0001 (0.0001)
Board Independence	0.0013 (0.0021)	0.0017 (0.0021)	-0.0037* (0.0021)	-0.0036* (0.0021)	0.0014*** (0.0004)	0.0013*** (0.0004)
Constant	-0.0077 (0.0134)	-0.0136 (0.0134)	0.0315** (0.0154)	0.0284** (0.0155)	0.0011 (0.0029)	0.0006 (0.0029)
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes
Industry dummies	Yes	Yes	Yes	Yes	Yes	Yes
Adjusted R2	0.1605	0.1637	0.3690	0.3720	0.0324	0.0331

*** p < 0.01; ** p < 0.05; * p < 0.10, based on two-tailed tests, robust standard errors, clustered at the firm level in parentheses. All independent variables are lagged by one term.

To this point, I have analyzed evidence on managers' initial forecast optimism. To test my second hypothesis regarding the timing and magnitude of earnings forecast revisions contingent on foreign ownership, my next set of tests uses data on management forecast revisions. From my previous analyses, I know that managers are generally optimistic at setting their initial forecast, and this is more pronounced in the presence of foreign investors. However, the earnings surprise, i.e., the difference between realized earnings and the last available forecast is positive, yet very close to zero, which means that managers make significant revisions through the fiscal year to match the final realized earnings.⁷ The central issue addressed in my second hypothesis relates to the timeliness of the earnings guidance, reflected in timely adjustments in the earnings forecasts.

I first provide descriptive statistics on the frequency and magnitude of earnings forecast revisions in panel A of Table 6. I list the number of firm-year observations for each revision and the percentage of the total sample that these revisions represent (it is important to note that revisions include forecasts that confirm the initial forecast). For example, 98.75 percent of the firms with initial forecasts (my full sample) engage in at least one revision. Managers provide a second revision in 90.56 percent of cases, a third one in 82.01 percent of cases, a fourth revision in 43.86 percent of cases, and a fifth revision forecast in 14.76 percent of cases, with managers of a few firms revising more often than five times. Compared to Kato et al. (2009), who look at an earlier sample, the number of revisions seems to have increased in the most recent years. Next, I consider the mean value of each revision, together with the standard deviation, minimum and maximum. In general, earnings forecast revisions are made downwards, and are especially substantial when it concerns second and subsequent revisions.

⁷ Revisions generally coincide with the end of quarter earnings announcement (Kato et al. 2009). Stand-alone revisions account for 25 percent of all revisions.

Table 6: Descriptive statistics on the likelihood and magnitude of earnings revisions

Panel A: Descriptive statistics on the likelihood and magnitude of earnings revisions – Full

Variable	N	% of total sample	Mean	St.Dev.	Min	Max
First revision	10635	98.75%	-0.00004	0.00445	-0.03119	0.03117
Second Revision	9753	90.56%	-0.00252	0.01415	-0.11131	0.11892
Third Revision	8832	82.01%	-0.00256	0.01219	-0.11402	0.10802
Fourth Revision	4723	43.86%	-0.00313	0.01639	-0.11289	0.11013
Fifth Revision	1590	14.76%	-0.00404	0.01962	-0.10583	0.09525

Panel B: Descriptive statistics on the average magnitude of earnings revisions – for different levels of foreign ownership

Foreign Ownership	<10%	10%-20%	20%-30%	>30%
First revision	-0.00017	0.00007	0.0002	0.00011
Second Revision	-0.00246	-0.00242	-0.00234	-0.0029
Third Revision	-0.00222	-0.00248	-0.00374	-0.00349
Fourth Revision	-0.00297	-0.00302	-0.00381	-0.00416
Fifth Revision	-0.00287	-0.00609	-0.00571	-0.00484

Panel C: Descriptive statistics on the likelihood of having a change in earnings revisions– for different levels of foreign ownership

Foreign Ownership	<10%	10%-20%	20%-30%	>30%
First revision	15.04%	18.48%	24.54%	20.36%
Second Revision	52.97%	56.45%	59.26%	60.81%
Third Revision	27.64%	31.85%	39.08%	35.78%
Fourth Revision	61.57%	64.76%	60.70%	67.75%
Fifth Revision	86.49%	78.89%	75.14%	77.33%

To understand better how these revisions differ depending on the firm's level of foreign ownership, panels B and C of Table 6 display additional descriptive statistics. Panel B describes the average magnitude of the earnings revision for my four levels of foreign ownership. I can observe that while the first revision is generally downward biased for firms with very little foreign ownership, managers in firms with higher levels of foreign ownership tend to revise their net income slightly upwards in the first revision. Yet, in all subsequent revisions, the magnitude of the downward adjustment is larger for higher levels of foreign ownership.

Finally, panel C tells us about the timeliness of the earnings adjustments, or the investor guidance, by looking at the likelihood of a change in the earnings forecast for each revision.⁸ For firms with less than 10 percent of foreign ownership, the earnings forecast in the first revision is unchanged from the initial forecast in 85 percent of the cases, while this is substantially smaller for all other levels of foreign ownership. It is important to notice that for high levels of foreign ownership, the likelihood of making adjustments to the earnings forecast is substantially higher for all revisions, except for the fifth revision. For example, the likelihood of having a change in the second and third earnings revision is about 7 percent and 10 percent larger for firms with the two highest levels of foreign ownership compared to firms with the lowest level of foreign ownership. Taking the descriptive statistics from panel B and C together, larger levels of foreign ownership seem to be associated with higher probabilities of timely earnings guidance, through substantial revisions in the earlier stages of the fiscal year.

I next demonstrate how managers revise their earnings forecasts in the presence of foreign ownership using a multivariate approach. Table 7 presents eleven models. Models (1),

⁸ It is important to note that about 75 percent of all revisions happen at the interim earnings announcements, which help to explain why a proportion of revisions, carry an unchanged net income number, while 25 percent relate to stand-alone revisions.

(3), (5), (7) and (9) estimate the likelihood of a change in the first, second, third, fourth or fifth revision using a logistic regression, while the models (2) (4), (6), (8) and (10) estimate the magnitude of adjustment with respect to the previous forecast, when it concerns the first, second, third, fourth or fifth revision. Finally, the last model (11) shows the results of a logistic regression, estimating the likelihood of issuing a stand-alone earnings revision past the third quarter earnings announcements, i.e., late adjustments. To examine the effect of foreign ownership on earnings guidance, it is better to interpret the models on the probability of having a change in the forecast together with the models that reflect the magnitude of these changes.

Table 7: OLS Regression Analyses considering revisions and foreign ownership

Dependent Variable: Revision	P(change in Magnitude First)		P(change in Magnitude Second)		P(change in Magnitude Third)		P(change in Magnitude Forth)		P(change in Magnitude Fifth)		P(Revision past Q3)
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8	Model 9	Model 10	Model 11
Foreign Own: 10%-20%	0.0701 (0.0672)	0.0003** (0.0001)	0.0134 (0.0592)	-0.0007** (0.0004)	0.1447** (0.0666)	-0.0006* (0.0003)	0.1170 (0.0884)	-0.0001 (0.0006)	-0.9458*** (0.1784)	-0.0040*** (0.0012)	-0.1768*** (0.0555)
Foreign Own: 20%-30%	0.5212*** (0.0791)	0.0004*** (0.0002)	0.1673** (0.0748)	-0.0011** (0.0005)	0.3607*** (0.0809)	-0.0021*** (0.0004)	-0.1250 (0.1121)	-0.0010 (0.0008)	-0.7058*** (0.2329)	-0.0041** (0.0017)	-0.3152*** (0.0745)
Foreign Own >30%	0.1336* (0.0761)	0.0002 (0.0002)	0.2624*** (0.0919)	-0.0012** (0.0006)	0.2587*** (0.1009)	-0.0018*** (0.0006)	0.1894 (0.1606)	-0.0016 (0.0011)	-0.5789* (0.3494)	-0.0047** (0.0024)	-0.3917*** (0.0932)
Big4-Auditor	0.0399 (0.0754)	0.0002 (0.0001)	0.0436 (0.0562)	-0.0004 (0.0003)	-0.0434 (0.0645)	-0.0003 (0.0003)	0.0251 (0.0797)	-0.0010* (0.0006)	0.1882 (0.1701)	0.0011 (0.0011)	0.0869 (0.0564)
Firm Size	0.1185*** (0.0241)	-0.0000 (0.0000)	0.0702*** (0.0189)	0.0003*** (0.0001)	0.1284*** (0.0214)	0.0002** (0.0001)	0.0479* (0.0278)	-0.0001 (0.0002)	0.0092 (0.0624)	-0.0000 (0.0004)	-0.0585*** (0.0188)
Leverage	0.1448 (0.1775)	-0.0001 (0.0003)	0.2614* (0.1361)	-0.0007 (0.0009)	0.5621*** (0.1529)	-0.0014 (0.0009)	0.2132 (0.1963)	-0.0037** (0.0015)	-0.0106 (0.4139)	-0.0049 (0.0029)	0.4736*** (0.1343)
Return on Assets	-0.2872 (0.3106)	0.0031*** (0.0005)	-0.7828*** (0.2758)	0.0479*** (0.0019)	-0.6883*** (0.3264)	0.0232*** (0.0017)	-0.2841 (0.4222)	0.0768*** (0.0035)	0.1370 (0.5976)	0.1156*** (0.0065)	-0.5483** (0.2642)
Sales Growth	-0.0660 (0.1443)	0.0010*** (0.0002)	-0.1514 (0.1061)	0.0046*** (0.0006)	-0.3264** (0.1485)	0.0046*** (0.0006)	0.1305 (0.1403)	0.0054*** (0.0009)	-0.4019 (0.3121)	0.0032 (0.0020)	-0.2733** (0.1162)
Prior optimism	-0.0078 (0.0612)	-0.0007*** (0.0001)	-0.0548 (0.0468)	-0.0029*** (0.0003)	0.0398 (0.0534)	-0.0010*** (0.0003)	0.1203* (0.0700)	-0.0029*** (0.0005)	-0.2025 (0.1558)	-0.0024** (0.0011)	0.4622*** (0.0472)
Low Op. Assets Turnover	-0.0550 (0.0581)	-0.0001* (0.0001)	-0.0142 (0.0444)	-0.0005** (0.0003)	-0.0326 (0.0503)	0.0002 (0.0003)	-0.0459 (0.0639)	-0.0002 (0.0004)	0.04712 (0.1395)	-0.0002 (0.0009)	-0.0537 (0.0449)
Board Independence	0.2409 (0.2130)	0.0005 (0.0003)	-0.1221 (0.1667)	0.0017* (0.0010)	0.2245 (0.1893)	-0.0009 (0.0010)	0.2515 (0.2478)	0.0005 (0.0018)	-0.5983 (0.5178)	0.0049 (0.0036)	-0.7443*** (0.1680)
Constant	-3.5483*** (0.2676)	0.0027 (0.0031)	-0.9499*** (0.2031)	-0.0000 (0.0092)	-2.5812*** (0.2311)	-0.0084 (0.0067)	-0.3356 (0.2976)	-0.0023 (0.0088)	1.7975*** (0.6522)	0.0016 (0.0179)	-0.4009** (0.2012)
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	10635	10635	9753	9753	8832	8832	4723	4723	1590	1590	10769
(Pseudo) R2	0.0298	0.0348	0.0178	0.1271	0.0391	0.1101	0.0187	0.1739	0.0448	0.2437	0.0566

*** p < 0.01; ** p < 0.05; * p < 0.10, based on two-tailed tests, robust standard errors, clustered at the firm level in parentheses. All independent variables are lagged by one term.

Regarding the revisions, my results show, in line with my descriptive statistics, that firms with high levels of foreign ownership have a higher likelihood of an adjustment in the earnings forecast in the first revision (model (1)). These adjustments tend to be upwards for intermediate levels of foreign ownership (model (2)), although the magnitudes of the adjustments are very small. More importantly, Models (3) to (6) show that the likelihood of adjustments are significantly higher in the second and third revision for higher levels of foreign ownership, while models (4) and (6) show that these adjustments are especially downward in the presence of foreign ownership relative to firms with little or no foreign ownership, which provide support to my second hypothesis. For the second revision, the probability of an adjustment in the earnings forecast is 18.2 percent higher when the foreign ownership is between 20 and 30 percent and 30.0 percent higher when the foreign ownership is above 30 percent, compared firms with less than 10 percent of foreign ownership. Equally important, the magnitude of the second and third revisions for high foreign ownership levels is substantial, as they represent adjustments to the ROA of around 0.2 percent. Given that the average forecasted ROA is around 1.7 percent, a 0.2 percent adjustment represents a 12 percent change. These results provide strong evidence to my second hypothesis.

When I consider firms that make four or five revisions, the sample size is dramatically reduced. The results for the fourth revision are not different across firms with different foreign ownership levels. However, when I consider the fifth revision, I find consistent evidence that managers try to avoid delivering last minute adjustments when foreign ownership is high. As shown in model (9) in Table 7, the probability of having changes in the forecast in a fifth revision is 61.2 percent lower for firms with foreign ownership between 10 and 20 percent, 50.6 percent lower for firms with foreign ownership between 20 and 30 percent and 43.9 percent

lower for firms with foreign ownership above 30 percent. However, if these firms make any adjustments they tend to make stronger downward adjustments compared to firms with low levels of foreign ownership.

Finally, to further examine the likelihood of delivering late adjustments, I use a logistic regression model that estimates the probability of issuing a stand-alone earnings revision past the third quarter earnings announcements, i.e., late adjustments (model 11 in Table 7). The results show that it is far less likely that managers issue stand-alone reports past the third quarter's earnings announcements in the presence of foreign owners. The effect of foreign ownership becomes stronger as the importance of foreign ownership increases. The probability of making earnings adjustments past the third quarter are 16.2 percent lower for firms with foreign ownership between 10 and 20 percent, 27.0 percent lower for firms with foreign ownership between 20 and 30 percent and 32.4 percent lower for firms with foreign ownership above 30 percent, compared to firms with less than 10 percent foreign ownership. Taking these results together, I find strong support for my argument that managers provide more timely and substantial adjustments in their earnings forecasts in the presence of foreign owners, i.e., better earnings guidance, when foreign ownership is high. The likelihood of offering adjustments in the earnings forecasts in the earlier revisions is substantially higher for higher levels of foreign ownership, while the likelihood of making last-minute adjustments is substantially lower.

Additional Analyses

First, it is plausible that unobserved variables may affect the results, for instance firm's long-term growth prospects, may influence both the presence of foreign investors and managers' initial forecast optimism explaining the positive relation between foreign investors and managerial optimism. To control for unobserved variables that may affect the results, I run the

regression with firm-fixed effects. In addition, I include time dummies in the FE estimator to account for shocks that might lead to general boosts in forecast optimism. Moreover, I further address endogeneity concerns related to omitted variables and reverse causality using instrumental variable (IV) methods that isolate exogenous variation in foreign institutional ownership. To this end, I define a vector of instrumental variables that are correlated with the explanatory variable, but are uncorrelated with the error term in the regression (1). To instrument foreign institutional ownership, I use the “stock additions to the MSCI All Country World Index” (MSCI ACWI), following to Aggarwal et al. (2011) and Bena, Ferreira, Matos, and Pires (2015).

Models (1), (3) and (5) in Table 8 replicate the main analyses that test the first hypothesis when considering four levels of foreign ownership, using FE estimations. In line with the first hypothesis and the previous findings, the results suggest that the presence of foreign ownership is positively related to managers’ initial forecast optimism as the forecast error are more negative and the forecast innovations are more positive in the presence of foreign owners. The coefficients become larger as the level of foreign ownership is higher and are positive but non-significant.

Models (2), (4) and (6) present the results when decomposing foreign and domestic ownership by investor type, using FE estimations. In model (2), I find consistent evidence of higher forecast errors when foreign investment funds and foreign corporate shareholders are salient and lower levels when foreign pension funds become larger. With respect to the forecast innovation (model (4)), only foreign investment funds and foreign SWF show a significant positive sign. Regarding the effect of domestic shareholders, the results show that domestic investment funds have an opposite sign, compared to foreign investment funds, with respect to the earnings forecast error, while domestic banks are positively linked to the forecast innovation.

Overall, the results from the FE estimations provide support to the results that foreign ownership is positively related to optimism and that foreign investment funds are the main driver of this result.

Table 8: Robustness testing - Regression results (using Fixed Effects) of Earnings optimism and Foreign and Domestic Ownership Types

	Forecast error		Forecast Innovation		Earnings Surprise	
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Foreign Own: 10%-20%	-0.0049*** (0.0015)		0.0036** (0.0017)		0.0001 (0.0003)	
Foreign Own: 20%-30%	-0.0083*** (0.0021)		0.0066*** (0.0025)		0.0002 (0.0005)	
Foreign Own >30%	-0.0095*** (0.0030)		0.0113*** (0.0040)		0.0003 (0.0007)	
Foreign_Corporations		-0.0543* (0.0323)		-0.0051 (0.0499)		-0.0026 (0.0054)
Foreign_Investment Funds		-0.0391*** (0.0109)		0.0276*** (0.0081)		-0.0007 (0.0022)
Foreign_Pension Funds		0.1254*** (0.0445)		-0.0164 (0.0318)		0.0215** (0.0099)
Foreign_Research Firms		0.0023 (0.0535)		-0.0295 (0.0325)		-0.0057 (0.0088)
Foreign_SWF		-0.0301 (0.0305)		0.0412* (0.0222)		-0.0039 (0.0056)
Domestic_Family/Individuals		0.0041 (0.0243)		0.0004 (0.0016)		0.0019 (0.0035)
Domestic_Corporations		0.0179 (0.0126)		0.0004 (0.0087)		0.0033 (0.0021)
Domestic_Employees		-0.0024 (0.0521)		-0.0021 (0.0034)		-0.0101 (0.0100)
Domestic_Banks		0.0104 (0.0179)		0.0338** (0.0017)		0.0032 (0.0042)
Domestic_Investment Funds		0.0627*** (0.0178)		0.0054 (0.0148)		0.0034 (0.0036)
Domestic_Government		-0.0472 (0.0785)		0.0763 (0.0558)		-0.0193 (0.0164)
Big4-Auditor	0.0048 (0.0093)	0.0045 (0.0097)	-0.0066 (0.0142)	-0.0076 (0.0572)	0.0002 (0.0017)	0.0029 (0.0019)
Firm Size	0.0102** (0.0042)	0.0178*** (0.0045)	-0.0220*** (0.0041)	-0.0295*** (0.0042)	-0.0006 (0.0008)	-0.0011 (0.0011)
Leverage	-0.1074*** (0.0114)	-0.1152*** (0.0125)	0.0132 (0.0131)	0.0149 (0.0111)	-0.0036** (0.0017)	-0.0043** (0.0019)
Return on Assets	0.0556*** (0.0176)	0.1075*** (0.0209)	-0.3954*** (0.0151)	-0.5591*** (0.0501)	-0.0038*** (0.0014)	-0.0043** (0.0020)
Sales Growth	0.0018 (0.0020)	0.0006 (0.0019)	-0.0036 (0.0027)	-0.0020 (0.0035)	-0.0007** (0.0003)	-0.0004 (0.0003)
Prior optimism	-0.00021*** (0.0007)	-0.00016** (0.0007)	0.0063*** (0.0013)	0.0012 (0.0010)	0.0001 (0.0001)	0.0000 (0.0001)
Low Op. Assets Turnover	-0.0015 (0.0017)	-0.0023 (0.0016)	-0.0012 (0.0013)	-0.0026** (0.0012)	0.0001 (0.0002)	0.0000 (0.0002)
Board Independence	0.0081 (0.0094)	0.0067 (0.0084)	-0.0112 (0.0102)	-0.0078 (0.0063)	-0.0013 (0.0013)	-0.0010 (0.0014)
Constant	-0.0733 (0.0687)	-0.0183 (0.0530)	-0.0170 (0.0459)	-0.0553 (0.0472)	0.0051 (0.0095)	0.0113 (0.012)
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes
Firm dummies	Yes	Yes	Yes	Yes	Yes	Yes
R2 - within	0.1785	0.2197	0.3889	0.5289	0.0295	0.0343
R2 - overall	0.0781	0.0435	0.2899	0.2794	0.0080	0.0029

*** p < 0.01; ** p < 0.05; * p < 0.10, based on two-tailed tests, robust standard errors, clustered at the firm level in parentheses. All independent variables are lagged by one term.

Second, I implement an IV approach with a two-stage least squares (2SLS) regression. I employ the “stock membership in the MSCI ACWI” as an instrument for foreign ownership. In line with Aggarwal et al. (2011)⁹, I define the instrument as a dummy variable (MSCI) that take the value of one if a firm is included in the MSCI ACWI in a given year, and zero otherwise. I do not expect that the stock membership in the MSCI ACWI to affect directly the measures of initial managerial forecast behavior, thus the assumption of exclusion restriction is expected to be fulfilled because firms are included on the basis of representing a country’s investable equities, and not on the basis of their level of managerial optimism. Consistent with this logic, MSCI membership does not seem to be correlated with the measures of managerial forecast optimism as their correlations are not significant. Firms that are MSCI member have an average forecast error of -0.0067, while non-MSCI members have an average forecast error of -0.0069. In contrast, I expect the stock membership in the MSCI ACWI to influence directly the level of foreign ownership. Empirically, Ferreira and Matos (2008) and Leuz, Lins, and Warnock (2009) find that MSCI membership increases the probability that a firm attracts foreign capital.

Table 9 shows the findings of the first-stage regression of the IV estimator. The first-stage assesses whether the instrument is associated with foreign ownership. In model (1), the findings of the specification with industry, and year fixed effects are presented, while model (2) shows the results of the specification with firm and year fixed effects. The coefficient on the MSCI instrument is positive and significant in both specifications. In model (1), the MSCI coefficient is 0.0716, with an *F*-statistic (437.35) well above the conventional threshold. Foreign investors hold about 7.2 percent more of the stock in firms that are in the MSCI ACWI,

⁹ “The MSCI ACWI index contains large and mid-cap equities across 23 developed markets and 23 emerging markets countries, and encompasses all of the MSCI indices that are the most commonly used benchmarks by foreign investors (e.g., MSCI World, MSCI Emerging Markets)” (MSCI, 2016). At the end of 2015, MSCI ACWI had 2,480 constituents, 318 of which stem from Japan.

compared to firms outside the index. In model (2), I add firm fixed effects to further examine the link between MSCI and foreign ownership. The MSCI coefficient is 0.0244 indicating that a change in MSCI is related to change in foreign ownership by 2.4 percent.

Table 9: Foreign Ownership and MSCI ACWI Membership: First Stage (IV)

	First stage: Foreign ownership		Placebo: Domestic institutional ownership	
	OLS	FE	OLS	FE
	Model 1	Model 2	Model 3	Model 4
MSCI	0.0716*** (0.0026)	0.0244*** (0.0059)	-0.0047 (0.0030)	-0.0002 (0.0054)
Big4-Auditor	-0.0016 (0.0017)	0.0153 (0.0382)	-0.0037* (0.0019)	0.0091 (0.0144)
Firm Size	0.0261*** (0.0007)	0.0214*** (0.0057)	0.0309*** (0.0007)	-0.0123*** (0.0035)
Leverage	-0.1207*** (0.0048)	-0.0439*** (0.0120)	-0.0168*** (0.0049)	-0.0269*** (0.0086)
Return on Assets	-0.0097 (0.0089)	0.0081 (0.0084)	0.0002 (0.0088)	0.0107** (0.0045)
Sales Growth	0.0090*** (0.0034)	0.0045 (0.0028)	-0.0018 (0.0034)	0.0013 (0.0015)
Prior optimism	0.0004 (0.0016)	0.0010 (0.0015)	-0.0030* (0.0016)	-0.0028*** (0.0007)
Low Op. Assets Turnover	-0.0001 (0.0014)	-0.0023 (0.0019)	-0.0024 (0.0016)	0.0007 (0.0014)
Board Independence	0.0612*** (0.0056)	0.0244 (0.0139)	-0.0138** (0.0057)	-0.0296*** (0.0077)
Constant	-0.1474*** (0.0423)	-0.0908 (0.0752)	-0.3553*** (0.04195)	0.2806*** (0.0414)
Year dummies	Yes	Yes	Yes	Yes
Industry dummies	Yes	No	Yes	No
Firm dummies	No	Yes	No	Yes
N	9397	9397	9397	9397
R2 - within		0.0815		0.1194
R2 - overall	0.4123	0.3446	0.3638	0.1174

*** p < 0.01; ** p < 0.05; * p < 0.10, based on two-tailed tests, robust standard errors, clustered at the firm level in parentheses. All independent variables are lagged by one term.

Table 10: Foreign Ownership and Earnings optimism: Second stage (IV)

Dependent Variable	Forecast error	Forecast Innovation	Earnings Surprise
	Model 1	Model 2	Model 3
Foreign ownership	-0.1048*** (0.0175)	0.1487*** (0.0190)	0.0043 (0.0030)
Big4-Auditor	0.0003 (0.0008)	-0.0013** (0.0007)	0.0001 (0.0001)
Firm Size	0.0054*** (0.0007)	-0.0069*** (0.0008)	-0.0001 (0.0001)
Leverage	-0.0298*** (0.0030)	0.0176*** (0.0032)	-0.0011** (0.0005)
Return on Assets	0.0241** (0.0101)	-0.2700*** (0.0359)	-0.0023 (0.0012)
Sales Growth	0.0012 (0.0019)	-0.0008 (0.0023)	-0.0004 (0.0004)
Prior optimism	-0.0082*** (0.0006)	0.0111*** (0.0009)	-0.0008*** (0.0001)
Low Op. Assets Turnover	-0.0008 (0.0006)	-0.0006 (0.0006)	-0.0003*** (0.0001)
Board Independence	0.0052* (0.0029)	-0.0055* (0.0031)	0.0007 (0.0005)
Constant	-0.0427*** (0.0060)	0.0656*** (0.0072)	0.0026** (0.0012)
Year dummies	Yes	Yes	Yes
Industry dummies	Yes	Yes	Yes
N	9397	9397	9397
Wald Chi2	351.184	345.649	367.341
p-value	0.0000	0.0000	0.0000
Centered R2	0.1245	0.2767	0.0286

*** p < 0.01; ** p < 0.05; * p < 0.10, based on two-tailed tests, robust standard errors, clustered at the firm level in parentheses. All independent variables are lagged by one term.

As a placebo test, I also present the findings of a first-stage regression of the MSCI IV on domestic institutional ownership (models (3) and (4) of Table 9). The coefficients on the MSCI instrument are not significant in both models. Domestic institutional owners do not seem to change their shareholdings following the inclusion or exclusion of firms from the MSCI ACWI index. This result is consistent with the idea that domestic investors do not gain new firm information when firms move in or out of the index which further corroborates the validity of the instrument.

Table 10 presents the IV estimates using MSCI as an instrument for foreign ownership on managerial optimism on initial earnings forecasts. Model (1) focuses on the earnings forecast error, and the coefficient of foreign ownership is negative and significant at the 1 percent level. In line with the previous results, higher levels of foreign ownership are related to larger levels of managerial optimism. The results for forecast innovation, presented in model (2), show a similar picture. These results lend strong support to the first hypothesis that managers respond to foreign investors by issuing more optimistic initial earnings forecasts. Finally, I also present the IV estimates for foreign ownership on earnings surprise in model (3). The coefficient of foreign ownership is not significant, indicating that there are no significant differences in the final earnings surprise when foreign ownership is high or low.

Lastly, I seek to learn more about how the nature of the foreign investors influences managerial decisions, in addition to the type of foreign owners. The theoretical arguments highlight the investment horizon of foreign investors as one of the relevant factors. While the analysis on decomposition of foreign investors by type lends support to the argument, there is likely to be some heterogeneity within each group of investors. Thus, I have classified all foreign investments into low, medium and high turnover groups, according to the investors' turnover

rate. To establish the investors' turnover rate, I have calculated the weighted turnover rate for the entire set of each foreign investor in the sample, where the weight is determined by the dollar value of each foreign stake held by the investor compared to the total value of his/her portfolio of Japanese firms, for each year. Next, I take the turnover rate at Q1 and Q3 from the set of all foreign investor per year, to separate investors into low, medium and high turnover. Finally, I calculated the total foreign ownership stake in the hands of each category for each firm, per year.¹⁰

In Table 11, I present the results for the two main variables of managerial optimism in the initial earnings forecasts, i.e., forecast error and forecast innovation, using OLS and FE estimations. For all four models the effect of foreign ownership on the two measures of managerial optimism is significant for medium and high levels of turnover, and this effect is strongest for the highest level of turnover. The effect of foreign ownership in the hands of investors with low turnover is not significant.¹¹ These results are in line with the theoretical arguments and suggest that the time horizon of foreign investors is a critical factor in explaining the relationship between foreign ownership and managerial optimism.

¹⁰ An alternative cut-off at 33 and 66 percentiles yields similar results.

¹¹ It is important to recall that the average turnover ratio for foreign investors is substantially larger than the turnover ratio for domestic investors, which helps to explain why the category of foreign ownership with a medium level of turnover is also significant.

Table 11: Robustness testing - OLS and FE Regression results of Earnings optimism and Foreign ownership for higher and lower Turnover rates

Dependent Variable	Forecast error		Forecast Innovation	
	OLS	FE	OLS	FE
	Model 1	Model 2	Model 3	Model 4
FO_ Turnover _High	-0.0376*** (0.0063)	-0.0441*** (0.0124)	0.0951*** (0.0061)	0.0661*** (0.0118)
FO_ Turnover_Medium	-0.0198*** (0.0047)	-0.0235** (0.0074)	0.0361*** (0.0046)	0.0241** (0.0082)
FO_ Turnover_Low	-0.0041 (0.0046)	-0.0015 (0.0105)	0.0044 (0.0052)	0.0076 (0.0092)
Big4-Auditor	0.0002 (0.0008)	0.0034 (0.0034)	-0.0019** (0.0007)	-0.0035 (0.0076)
Firm Size	0.0014*** (0.0003)	0.0177*** (0.0051)	-0.0025*** (0.0003)	-0.0076** (0.0037)
Leverage	-0.0213*** (0.0022)	-0.1280*** (0.0136)	0.0018 (0.0021)	0.0027 (0.0092)
Return on Assets	0.0220*** (0.0062)	0.0732*** (0.0234)	-0.3436*** (0.0067)	-0.5571*** (0.0510)
Sales Growth	0.0006 (0.0015)	0.0004 (0.0015)	-0.0026** (0.0013)	-0.0024 (0.0037)
Prior Optimism	-0.0064*** (0.0007)	-0.0016** (0.0008)	0.0071*** (0.0006)	0.0013 (0.0011)
Low Op. Assets Turnover	-0.0008 (0.0006)	-0.0018 (0.0016)	-0.0018*** (0.0006)	-0.0036*** (0.0013)
Board Independence	0.0001 (0.0023)	0.0085 (0.0094)	-0.0033 (0.0022)	-0.0152** (0.0069)
Constant	-0.0077 (0.0251)	-0.1592*** (0.0597)	0.0437* (0.0228)	0.0665 (0.0421)
Year dummies	Yes	Yes	Yes	Yes
Industry dummies	Yes	No	Yes	No
Firm dummies	No	Yes	No	Yes
N	9397	9397	9397	9397
R2 -within		0.2271		0.5296
R2 -overall	0.1760	0.0472	0.3840	0.3581

*** p < 0.01; ** p < 0.05; * p < 0.10, based on two-tailed tests, robust standard errors, clustered at the firm level in parentheses. All independent variables are lagged by one term.

To sum up, in this study, I draw on the managerial earnings disclosure and impression management literature to examine how foreign shareholders with their own governance logic influence managerial earnings forecasts in a stakeholder oriented setting. Addressing endogeneity concerns, the empirical results show that under the presence of foreign owners, managers are more optimistic in their initial earnings forecasts, but that in subsequent revisions they are more likely to provide timely adjustments of their earnings forecast and avoid making last-minute adjustments. From a comparative corporate governance and institutional perspective, this study provides implications for how the earnings disclosure practice is socially constructed as managers' strategic responses to the expectations from foreign shareholders in a different institutional environment.

STUDY 2: HOW INTER-ORGANIZATIONAL EMBEDDEDNESS SHAPES THE ROLE OF MEDIA IN CORPORATE GOVERNANCE

There has been increasing discussion in the corporate governance literature about the role that external constituents play in exerting pressure on firms to act in the interest of shareholders or other key stakeholders (Aguilera et al., 2015). While much of this work has focused on financial constituents such as security analysts and rating agencies, non-financial constituents such as the media have started to draw attention especially as firms have come under increased media scrutiny in the wake of high profile corporate scandals (Bednar, 2012). Some have suggested that the media can potentially serve as a powerful governance mechanism, playing a watchdog role through investigative reporting, or simply by raising awareness of issues that may be contrary to shareholder interests (Bushee, Core, Guay, & Hamm, 2010; Core, Guay, & Larcker, 2006; Westphal & Zajac, 2013). The media can reduce information asymmetry between management and shareholders and bring negative information to light that can impose reputational costs on firms and motivate changes in behavior (Dyck, Volchkova, & Zingales, 2008; Miller, 2006). Recent management studies have also found that media coverage can influence CEO job security, compensation arrangements, and strategic change (Bednar, 2012; Bednar, Boivie, & Prince, 2013). Inherent in this view of the media as a governance mechanism, is the assumption that the media can perform a governance role because as a disinterested third party, it can provide an independent and unbiased view of firms. In fact, journalists have traditionally been subject to a norm of objectivity, which suggests journalists and news organizations should stick to the facts in their reporting rather than being influenced by personal biases or interests.

Nonetheless, despite claims of the importance of media independence and the norm of objectivity, there is abundant evidence that journalists and news organizations often fail to live

up to this norm and that media organizations are not always independent of the firms that they cover (McChesney, 2004). We often see different news outlets cover the same firm activities quite differently. For example, in 2015, the *New York Times* reported on working conditions at Amazon's Seattle headquarters, criticizing the firm with an article titled “Inside Amazon: wrestling big ideas in a bruising workplace.” The article painted a very unflattering picture of what life was like for employees inside the tech giant. At about the same time, the *Washington Post* printed an article that depicted Amazon as a company that was typical of the tech industry with a much softer headline: “Is it really that hard to work at Amazon?” This article defended many of the practices at Amazon and was generally much more positive about the company. Interestingly, the owner of the Washington Post at the time happened to be Jeff Bezos, the founder and CEO of Amazon. This example suggests that there may be cases where ties between firms and the media could potentially influence the coverage that firms receive and as a result, compromise the independence of the media that is central to its ability to play a meaningful governance role.

In this study, I theorize about how the media’s external governance role is affected by inter-organizational relationships. Drawing on ideas about social embeddedness, conflicts of interest, and resource dependence, I argue that to the extent that media outlets become dependent on firms for resources, conflicts of interest result that can lead to more favorable coverage for connected firms. If connections with the media are indeed beneficial for firms, then my study suggests a new boundary condition that must be accounted for in conceptualizing the governance role of the media. In particular, just as other governance mechanisms such as boards and auditors are judged largely by their independence, my study suggests that we should also consider media independence when evaluating the potential governance role of the media. I also

show that it is possible for “media capture” to result when firms have meaningful ties with media outlets.

This study contributes to a growing stream of work in the management literature about the role of the media as external corporate governance mechanism. First, while previous studies have maintained that the media could be an external governance mechanism for corporations, others have suggested that the media may be limited in this role by interpersonal influence tactics towards journalists (Westphal & Deephouse, 2011), symbolic action (Bednar, 2012), or other biases exhibited by journalists themselves (Chen & Meindl, 1991; Hayward, Rindova, & Pollock, 2004). In this study I offer a previously unexplored limitation that could potentially compromise the media’s ability to effectively serve a governance function. Specifically, I suggest that the media may be influenced in its coverage by inter-organizational dependencies that form through their ownership and board interlock ties. At the same time, I also suggest that firm level conditions such as financial performance, will influence the strength of the relationship between inter-organizational ties and subsequent media coverage.

Second, I contribute to the literature on corporate governance practices more generally by showing how internal and external governance factors (e.g., ownership, boards of directors, and the media) need to be considered together. There is a vast literature on the consequences of a single corporate governance mechanism, such as ownership structure, the board of directors, or the media. Yet corporate governance scholars have paid little attention to how ownership or board interlocks could influence the efficacy of external governance mechanisms such as the media. By examining the inter-organizational dependency embedded in ownership and board interlock ties, this study helps to show that the effectiveness of the media as an independent

external governance mechanism may be largely dependent upon other governance practices (Aguilera et al., 2015; Misangyi & Acharya, 2014).

THEORETICAL FRAMEWORK AND HYPOTHESES

The Media's Corporate Governance Role

A growing body of research in management has studied the effects of media coverage on the behavior of corporations and their constituents (Bednar et al., 2013). This stream of work suggests that the media primarily influences firms by disseminating information to important firm constituents and by making judgments about firms and leaders. Some researchers have maintained that given its potential for influence, the media functions as a corporate governance mechanism to monitor managerial self-interest (Dyck et al., 2008). Particularly, finance and accounting researchers have tended to see the media as a watchdog of corporate management, that prompts firms to pursue the interest of shareholders (Dyck et al., 2008; Miller, 2006). This watchdog role is accomplished through investigative reporting or simply by raising awareness of issues that may be contrary to shareholder interests. In this manner, the media can reduce information asymmetry between management and shareholders and bring negative information to light that can impose reputational costs on firms and motivate changes in behavior (Bednar et al., 2013; Dyck & Zingales, 2002; Fama, 1980). There is even some anecdotal and empirical evidence that negative press coverage may lead a firm to reform its corporate governance (Joe, Louis, & Robinson, 2009; Johnson, Ellstrand, Dalton, & Dalton, 2005). For example, many have traced the beginnings of the downfall of Enron in large part to an article published by Fortune magazine that questioned how the company was making money and pointed out that the firm's financial statements were difficult to understand (Healy & Palepu, 2003). Such examples suggest that the media can play a powerful governance role in some circumstances.

This view of the media as a governance mechanism is broadly consistent with management literature that suggests the media can act as a powerful social arbiter of firms and their leaders (Wiesenfeld, Wurthmann, & Hambrick, 2008). Contemporary studies of the media in the management literature have focused on the media's effect on the overall perceptions or reputation of corporations as well as on the legitimization of corporate activities (Deephouse, 2000; Petkova, Rindova, & Gupta, 2013; Pfarrer, Pollock, & Rindova, 2010; Pollock & Rindova, 2003; Zavyalova, Pfarrer, Reger, & Shapiro, 2012). For example, some studies maintain that media coverage can help corporate leaders to gain "celebrity status" by creating dramatic narratives that attribute firm performance to the CEO (Hayward et al., 2004; Rindova, Pollock, & Hayward, 2006; Wade, Porac, Pollock, & Graffin, 2006). Others have noted that negative evaluative judgments in the press can adversely affect the public's perceptions of firms and firm leaders (Wiesenfeld et al., 2008) and in some cases can even spur needed change (Bednar et al., 2013). Collectively, media evaluations can affect perceptions of the firm and interests of multiple stakeholders (Bansal & Clelland, 2004; Deephouse, 1996; Desai, 2014; Lamin & Zaheer, 2011; Pollock & Rindova, 2003).

In general, organizational and financial research that views the media as an external corporate governance mechanism has assumed that the media is independent when monitoring corporate activities. The media's ability to play a governance role, and this idea of media independence, stems in part from the common professional standards that journalists and media organizations have historically been thought to abide by. These professional norms include the necessity to abide by principles of truthfulness, accuracy, fairness, and objectivity among others. Objectivity is especially important when we consider the ability of the media to serve as an

independent governance mechanism. The norm of objectivity means that journalists report only the facts rather than their own personal attitudes about those facts (Tuchman, 1972).

However, given the reality that media organizations are enmeshed with other influential corporations and executives, it is reasonable to question this assumption of media independence and to ask how a lack of independence could potentially affect the way in which the media reports on events when they have ties to the firms involved. In particular, without consideration of the media's social embeddedness (Granovetter, 1985) and firm level ties that could compromise its independence, it becomes more difficult to say whether media coverage influences corporate activities or whether corporations use such relationships to influence media coverage. Except for a few studies focusing on the micro-level interpersonal relationship between CEOs and journalists (Westphal & Deephouse, 2011; Westphal, Park, McDonald, & Hayward, 2012), there has been very little research in the management field to examine how the embedded relationships between firms and the media create conflicts of interests that could potentially influence the media's evaluations of corporations.

Potential Threats to Media Independence

While independence lies at the heart of the media's ability to function in a governance role, there are a number of factors that may compromise media independence. One potential threat to media independence is the fact that firms actively seek to enhance the favorability of their coverage in various ways. For example, firms have public relations groups dedicated to establishing good relationships with the media and securing more favorable media treatment. Individual journalists are sometimes susceptible to interpersonal influence behaviors from executives and these behaviors have been shown to influence future reporting (Westphal & Deephouse, 2011). And firms often have meaningful financial or other organizational level ties

to the media that could impair media independence. Though these and other means, firms seek to secure more favorable media coverage in a way somewhat analogous to the idea of regulatory capture that is common in the political science literature (Stigler, 1971). Regulatory capture occurs when a government regulatory body is “captured” by influential groups attempting to gain favorable policy outcomes by using their power and resources while the public interest may be overlooked (Stigler, 1971). Media capture occurs as a consequence of relationships between firms and the media that produce resource dependencies and conflicts of interest that may eventually influence coverage of the firm.

Conflicts of Interest and Resource Dependence

Lack of independence is a particular concern with regards to governance mechanisms because of the potential for conflicts of interest. A conflict of interest occurs when parties are “interdependent and have competing goals” (Hayward & Boeker, 1998: 3). A conflict of Interest potentially interferes with the ability of professional evaluators to act in the interest of another party. For example, medical doctors who receive gifts from pharmaceutical companies face a potential conflict of interest since they may have incentives to prescribe certain drugs from that company. Some types of financial advisors who work on commission may face a conflict of interest since earning large commissions by selling expensive products to their clients may not actually be in the client’s best interest. In general, the greater the incentives for professionals to act against their obligations to other stakeholders, the greater the expected deviation from professionally defined normative behavior will be (Moore, Tetlock, Tanlu, & Bazerman, 2006). Strong financial incentives can lead professionals to defend their professional integrity while resisting changes in rules and policies that could actually resolve the conflict of interest (Norman & MacDonald, 2010). In some cases, conflicts of interest among professionals, corporations,

and other stakeholders are not so easy to detect. In fact, the social psychology literature suggests that professional judgment can often be impaired even without awareness of the potential conflict of interests (Moore, Cain, Loewenstein, & Bazerman, 2005).

Many times, a conflict of interest can arise because of resource dependencies and resulting power imbalances between organizations. According to resource dependence theory, organizations require resources in order to survive, but they often cannot generate these resources internally (Hillman, Withers, & Collins, 2009; Pfeffer & Salancik, 1978). As a consequence, organizations must interact with elements in their environments, including other organizations, in order to obtain the resources (Casciaro & Piskorski, 2005; Hillman, Cannella, & Paetzold, 2000). The survival of the firm is dependent on its ability to manage relationships with other organizations that control these needed resources (Hillman et al., 2009; Pfeffer & Salancik, 1978) and many inter-organizational relationships arise as a result (Mizruchi & Yoo, 2002). Firms' dependence on outside organizations creates power imbalances in these external relationships. As a result, resource-providing firms are able to exercise the power that they derive from their control over resources as a means of achieving their goals (Burt, 1983; Pennings, 1980; Pfeffer & Salancik, 1978). To the extent that a firm is beholden to an external entity, a conflict of interest may arise to the extent that the firm's managers feel beholden to that resource providing entity.

In the context of the media, I suggest that media bias could be created by conflicts of interest resulting from the relationships between the media and corporations, once the media becomes reliant on outside firms for resources. Media organizations inherently have multiple goals and manage relationships with multiple stakeholders (Shoemaker & Reese, 2014). On the one hand, media outlets need to provide the best coverage possible and do so in an independent

manner for the general public's interest. On the other hand, it is also important for news organizations to acquire financial resources as well as other informational resources to sustain their activity. These multiple goals often cause them to stand at a crossroads "between journalistic judgment and the imperatives from the business side of a media organization" (Berkowitz, 1993: 67). For example, while news organizations have an obligation to serve the interests of the public by publishing relevant and accurate news, the same organization has an interest in selling advertising and bringing in equity investments. Although journalists generally enjoy an exceptional degree of freedom from external regulation of their activities, this same freedom may allow for their reporting to be compromised as conflicts of interest arise. I suggest two types of ties in particular that could create a conflict of interest that could impair media independence. First, I look at interlocking directors, where firms have directors who sit on the boards of major media organizations. Second, I examine the inter-organizational relationship where a focal company is a partial owner of a media outlet.

Interlocking Boards of Directors and Media Independence

Interlocking boards of directors have the potential to create conflicts of interest that could impair media independence. An interlocking director is defined as a director who sits on the boards of two companies, creating a link between the two organizations (Mizruchi, 1996). Interlocking directors can be seen as a means to facilitate inter-organizational co-optation (Selznick, 1957) and manage resource dependencies (Davis & Cobb, 2010). By inviting directors with special access to valuable external resources to sit on the board, firms are thought to gain increased access to those resources (Hillman, 2005).

While a board of directors is typically involved in two main roles, monitoring and resource provision, a board interlock is most often viewed as one of the mechanisms through

which directors fulfill their obligation to provide resources to the firm (Hillman & Dalziel, 2003; Pfeffer & Salancik, 1978). Boards not only provide a firm with advice and counsel (Connelly, Johnson, Tihanyi, & Ellstrand, 2011; Zahra & Filatotchev, 2004) and facilitate access to capital (Boeker & Goodstein, 1991; Mizruchi & Stearns, 1988), but they can also bring legitimacy or offer support from political bodies or other important stakeholder groups (Hillman, Zardkoohi, & Bierman, 1999; Pfeffer & Salancik, 1978). Director interlocks can facilitate access to broader sources of information and can also improve the quality and timeliness of that information (Carpenter & Westphal, 2001; Zahra & Filatotchev, 2004). Thus, interlocking boards of directors can be seen as a critical tool that facilitates resource provision in inter-firm relationships (Hillman & Dalziel, 2003).

Despite the fact that interlocking directorates have been used to explain inter-firm relationships in management research (Mizruchi, 1996), little attention has been paid to interlocking directorates in the context of news organizations. Major newspapers have historically been connected with major U.S. corporations through board interlocks (An & Jin, 2004). More recent research gives evidence that the boards of newspaper companies consist of relatively large numbers of officers from financial institutions. Newspaper companies have appointed directors to gain access to resources such as financial capital and industry knowledge in order to better navigate environmental change (Simmons, 2012). Board members from large corporations provide valuable business experience and can advise the management team of a media firm about current and potential strategic moves. Furthermore, board interlocks with financial institutions may grant media organizations access to capital and more favorable financial arrangements (Mizruchi & Stearns, 1994).

Because media organizations receive valuable financial and/or information resources from their interlocking directors, it will be difficult for them to ignore the interests of the resource providing corporations and they are likely to feel an obligation to give something of value back to these directors or their firms. Just as auditing decisions deteriorate as the auditor-client relationship is strengthened (Moore et al., 2006), the relationship between the media and other firms through board interlocks may compromise media independence. Thus, I propose that all else equal, news organizations are likely to provide more favorable media coverage of corporations that have a director on their board.

Hypothesis 1: Having a board interlock with the media is positively associated with the tenor of media coverage that a company receives.

Ownership and Media Independence

Ownership ties are another example of relationships that could potentially create conflicts of interest and impair media independence. Ownership affects a broad range of corporate practices and outcomes (Boyd & Solarino, 2016; Goranova & Ryan, 2014). Some journalism scholars have suggested that large, major newspaper companies are self-financing, powerful, autonomous entities that are able to make independent journalistic decisions without external influences (Hallin, 1994). In the past, this argument probably had some merit as most of the family-owned newspaper companies that were large enough to go public typically looked for ways to preserve family control, often arguing that the journalistic integrity of the newspapers demanded it. However, in more recent times, such claims underestimate the significant reliance of most media companies on financial institutions as well as the complex and intertwined

relations with other corporations. Institutional investors have significantly replaced journalistic founders as the primary owners of media outlets, which has caused a shift in focus from primarily journalistic concerns to an increased awareness of financial concerns (Bridges, Litman, & Bridges, 2002).

Although some researchers have examined who owns media companies (Compaine & Gomery, 2000; McChesney, 2003; Picard & Van Weezel, 2008), they have not directly examined the extent to which ownership ties may influence actual media content in a systematic way. Traditionally, many major newspapers had low levels of institutional ownership and many were family-owned with family members serving as top executives and board members in charge of formulating and implementing strategy. Family ownership provides a buffer where media firms can report on event without pressure from external forces. At the same time, family ownership can create certain governance problems in terms of transparency. However, with declining circulations, many newspapers have become more vulnerable to consolidation and increased competition from an expanding set of media channels through which the public receives information. Major media companies now typically require greater capitalization and often must offer shares to the public to finance themselves. Many of these shares end up in the hands of other organizations, primarily financial institutions. For example, many family-owned newspaper companies such as the *New York Times* and *Wall Street Journal* found themselves in the crosshairs of large investors in the 2000s. In the case of the New York Times, Morgan Stanley Investment and other financial investors acquired a large portion of the Times' stock and withheld their votes for 30% of the directors. Changes to the media landscape mean that the NYT now has to manage relationships with multiple constituents, such as their readers, its

founding family, internal shareholders, as well as external shareholders (Villalonga & Hartman, 2007).

Given the reality that most media organizations must raise capital from a variety of sources, there is the potential for external owners to influence the strategies and structures of media firms. Some scholars see news routines and organizational interests being impacted by owners because “media owners or their appointed top executives have the final say in what the organization does” (Shoemaker & Reese, 2014: 155). Ownership by external organizations also creates a resource dependency situation that could create a conflict of interest. Media organizations are dependent upon corporate owners for necessary capital to continue to operate the business while corporations that are owners of media companies are looking for a return on investment. At the same time, positive press coverage is a valuable resource that owners could receive as a result of their relationship with the media. While there is a ‘firewall’ between the financial and editorial divisions in news outlets, journalists would be less eager to publish negative content and more willing to write positive content about a corporation that is providing much needed capital to the organization. Thus, I suggest that news organizations are likely to find ways to reduce negative content and highlight positive content of their owners.

Hypothesis 2: A firm’s level of ownership in the media is positively associated with the tenor of media coverage that the company receives.

Relative Firm Performance and the Influence of Ties

While my prior hypotheses predict the impact of certain inter-organizational ties on media independence, it is also important to consider the circumstances under which this

predicted relationship is most likely to occur. I suggest that a firm's relative poor performance could make the effect of firms' relationships with media organizations even more salient.

According to research on negativity bias, negative information tends to draw more attention than does positive information and individuals typically give greater weight to negative events, objects, and figures (Rozin & Royzman, 2001). For instance, bad news sells more papers and successful novels are full of negative events and turmoil (Baumeister, Bratslavsky, Finkenauer, & Vohs, 2001). Negative reporting about firms thus has the potential to significantly harm corporate reputation given its increased salience in the eyes of various audiences (Zavyalova et al., 2012). This suggests that firms go to great lengths to avoid negative media coverage. For instance, CEOs with unexpected negative outcomes in their firms have been shown to engage in ingratiation actions toward journalists to avoid negative media coverage (Westphal & Deephouse, 2011). Other research shows how firms often attempt to minimize negative evaluations by focusing on solutions to problems or by deflecting media attention to the firm's other positive attributes or actions (Desai, 2011; Zavyalova et al., 2012). In response, journalists and editors sometimes respond to influence attempts by excluding certain news items or attributing the firm's deviant performance to other uncontrollable and temporal factors in the industry and socioeconomic environment (Elsbach, 2003). The example cited earlier about Amazon's work conditions illustrates this practice as journalists described the firm's questionable practices as a normal part of the competitive tech industry.

I consider relative negative performance because making an overall evaluation about a firm is actually a cognitively difficult and ambiguous task and so evaluators tend to focus on performance relative to some benchmark such as other firms in the industry (Greve, 1998). Relatively poor performance that is below the industry average is likely to draw journalists'

attention more so than positive outcomes (Zavyalova et al., 2012). I suggest that the relationship between firm ties with news organizations and the tenor of media content will be amplified when firm performance is relatively low within an industry. When the firm is performing well or conforming to expectations, the media may pay less attention, and any benefit to the firm of having a media connection that could improve the favorability of media coverage will likely be minimal. Thus, the influence of media's ties to firms would likely be less salient in such cases as there is less opportunity and need for positive spin to the media's reporting. However, when the firm is performing relatively poorly, the media may pay more attention, and their relationship with the firm is likely to become more salient than when a firm is performing well. In a sense, poor relative performance activates the potentially independence impairing tie. Firms may also be more likely to apply explicit or implicit pressure to influence the media's reporting when they know that negative coverage is likely as a result of poor performance. In general, I expect that having an embedded relationship with the media will be most beneficial to the firm when firm performance is relatively poor.

Hypothesis 3: The positive association between inter-organizational ties (through interlocking boards and ownership) and the tenor of media coverage will be stronger when firm performance decreases below industry average.

EMPIRICAL ANALYSIS

Sample and Data Collection

To test my hypotheses, I examined the effects of inter-organizational relationships on media coverage about corporations in a data set of major news organization and S&P 500 companies over the period 2001–2005. The unit of analysis is a firm-media dyadic relation.

For the media side, I use major U.S. newspapers and magazines. As an agenda setter, newspapers remain the major news source with the greatest newsgathering capacity, the widest range of coverage, and largest number of stories each day. Despite recent developments in other types of media outlets including social media, newspapers and news magazines are still the biggest watchdog in the U.S. (PewResearchCenter, 2013). Former Los Angeles Times editor John Carroll estimates that 85% of original reporting in the United States is first done in newspapers, and very few online sites do original reporting (Frontline, 2006).

My sample includes publicly listed U.S. companies in the Standard & Poor's (S&P) 500. I chose this sample because these companies have significant impact on the U.S. economy and are likely to draw a great amount of media attention (Bednar, 2012). Widely regarded as the best single gauge of the U.S. equities market, this world-renowned index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the S&P 500 focuses on the large-cap segment of the market, with about 75% coverage of U.S. equities, it acts as a proxy for the total market. I drew a random sample of 250 firms from this sampling frame and then tracked these firms from 2001 to 2005. Prior to drawing the random sample, I conducted a power analysis using the PASS sample size software program to determine an appropriate sample that provided a large enough sample to detect significant effects while at the same time, maintaining a feasible data collection effort.

I collected media coverage from the *Factiva* database and used computer-aided content analysis to measure the tenor of media coverage. I gathered data on corporate ownership from Compact Disclosure. To gain detailed insights into the nature of ownership, I went further and collected ownership data from the Thomson Reuters Eikon database. The data on directors that sit on the boards of newspaper and sampled companies were collected from the Compact Disclosure, the Board Analyst and IRRC databases. I then cross-checked the data on directors from the annual reports of the sample firms and newspaper companies. Data on CEO appointment and dismissal was obtained from the EXECOMP database while other financial and strategic information at the sampled companies was obtained from COMPUSTAT. Advertising expenditures in the newspaper outlets from the sampled companies was collected from Ad \$ summary and Advertising Age.

Procedure for Coding Media Coverage

I collected articles from 2001 to 2005 about the sample companies, using the “company search” feature in *Factiva*. The media coverage came from three leading business publications, the *Wall Street Journal*, *BusinessWeek*, and *Fortune*, and from two leading daily papers, the *New York Times* and *Washington Post*. These publications were chosen because they are widely circulated and are generally regarded as opinion leaders that should represent the overall coverage of firms in the media (Bednar et al., 2013). The initial search for media content included all articles covering the sampled firms, but excluded articles that did not feature the firm in the title or lead paragraph, that were fewer than fifty words, or that mentioned more than four other firms. This procedure resulted in a collection of 41,668 articles about the sample companies from the *Factiva* database. For supplementary analysis, I also tested the hypotheses based on specific issue coverage. For instance, I grouped articles that were indexed by *Factiva* as

related to “firm performance” and “management issues.” The results using these sub-samples of coverage were generally consistent with the results reported below.

I transformed each article into a separate text file for processing with computer-aided text analysis software. I then used the LIWC (Linguistic Inquiry and Word Count) text analysis software to measure the favorability of media content. The LIWC program uses lists of words in various pre-defined dictionaries to measure different constructs from a group of texts (Pennebaker, Booth, & Francis, 2007). The LIWC dictionaries have been validated across a variety of different types of text, including newspapers and business and academic texts. LIWC allows the researcher to measure each construct by counting the number of words from a particular dictionary that appear in a given text (Pennebaker et al., 2007). In this study, I used the positive and negative emotion dictionary in the LIWC program to analyze each article to measure the positive and negative tenor of each article. This LIWC affective content category is useful to represent the valence of a particular article and has been used to capture the general tenor of media coverage in current management research (Bednar, 2012; Bednar et al., 2013; Pfarrer et al., 2010; Zavyalova et al., 2012).

Dependent Variable

Tenor of Media coverage. As noted above, LIWC provides the percentage of positive and negative content in each article separately. In order to construct the overall tenor of media coverage, I followed previous studies that have measured the overall tenor of media coverage of a firm as the relative prevalence of positive over negative coverage (Deephouse, 2000; Pfarrer et al., 2010; Pollock & Rindova, 2003; Zavyalova et al., 2012). I measured the percentage of positive and negative content in each article and coded it as positive if at least 60 percent of the total affective content was positive and as negative if its total content was at least 60 percent

negative (Pfarrer et al., 2010; Zavyalova et al., 2012). I calculated the tenor of media coverage about a focal firm as the difference between the number of positive and negative coverage articles about a firm. In supplementary analysis, I operationalized separate dependent variables for positive and negative tenor of media coverage. I found that positive tenor of media coverage was more consistent with my main results than negative coverage.

Explanatory Variables

Interlocking Board of Directors. Board interlocks were measured by whether a focal corporation had a director or executive that sat on the board of a focal media company (Mizruchi, 1996). While board interlocks between the media and corporations can be bi-directional in other settings, I focus on received ties because I did not find a significant number of instances where media executives sat on the boards of the sample firms. I operationalized board interlocks as a dummy variable equal to one if an interlock existed in a firm-media outlet dyad. I identified firms that had board interlocks with the media between 2001 and 2005 by searching the proxy statements (Form DEF 14A) issued by the focal five major news publications. The *New York Times* and the *Washington Post* are both publicly traded entities, and I identified the members of their boards from their proxy statements and supplemented the data from the Compact Disclosure, the Board Analyst and IRRC databases. For the remaining publications, I identified the directors who also sat on the boards of the parent company during the 2001–2005 period. Specifically, I found *WSJ* directors by identifying those who sat on the board of its parent company Dow Jones, *BusinessWeek* directors from McGraw-Hill, and *Fortune* directors from Time Warner.

Ownership. I measured ownership as the average percentage of shareholdings that a focal firm has in the individual media outlet from which I collected the media coverage. I collected the

percentage of shareholdings in each of the focal newspaper firms from the Thomson Reuters Eikon database and Compact Disclosure. Although some scholars have argued that large newspaper companies are self-financing, powerful, autonomous entities able to make decisions without external public owners, I observed that financial institutions and corporations were major investors of the focal outlets.

Performance Measure. From the media's standpoint, when journalists report on firm performance, they are likely to evaluate the firm based on its performance relative to aspirations (i.e., whether the firm outperforms or underperforms the benchmark for peer firms within the same industry) rather than evaluating the absolute figure of firm performance regardless of industry. Relative performance was measured as the difference between a focal firm's net income and the median net income of the sampled companies in the same industry (two-digit SIC) in the same year (Deephouse, 2000). In supplementary analyses, I measured performance using the market-to-book and the results were similar but somewhat weaker. I also tested a dummy variable that indicated whether a firm's net income was less than industry-average and the results were consistent with those reported below.

Control Variables

Previous management research on the media has shown that firm size is significantly associated with media attention (Bednar, 2012; Zavyalova et al., 2012.). I included a variable to control for firm size, including log-transformed *sales*, since large firms are likely to receive more coverage and have increased visibility. For a robustness check, I ran supplementary analyses measuring firm size as the number of employees and the log of assets, respectively. Results were consistent regardless of the measures used. I also controlled for the newspaper *advertising*

expenditures of a focal company by collecting data from Ad \$ summary and Advertising Age magazine to consider any potential influence on coverage through advertisement expenditures.

I also controlled for a number of events that could affect media coverage including changes in top management and involvement in a Merger and Acquisition (M&A). I created *CEO turnover* with a dummy variable and *acquisitions* with a variable indicating whether a firm had any M&A transaction in the relevant year. In addition because negative events can be especially likely to influence media coverage (Desai, 2014; Zavyalova et al., 2012), I controlled for a number of negative corporate events. I included *financial restatement* to indicate if the sample firms had intentional, manipulative, or fraudulent behavior as a dummy variable, using data from the U.S. Government Accountability Office (GAO) (Arthaud-Day, Certo, Dalton, & Dalton, 2006). I also collected data about securities fraud class action litigation from Stanford Law School's Securities Class Action Clearinghouse. The variable *lawsuit* was equal to 1 in a given year if a firm was the target of a class action suit.

Following studies showing that firm characteristics related to corporate governance influence the subsequent media coverage (Bednar, 2012; Bednar, Love, & Kraatz, 2015), the variable *reputation* was included as the firm's total reputation score if it appeared in Fortune's "Most Admired Companies" annual survey and zero otherwise. Also, for ownership types at the focal companies, I created a series of dummy variables. *Owner-controlled* firms had at least one blockholder with at least a 5 percent stake, and *manager-controlled* firms had no large blockholders. To account for other corporate governance issues in the focal companies, I also used the *Gompers index*, which is a measure of the level of shareholder rights using 24 governance provisions (Gompers, Ishii, & Metrick, 2003).

I also controlled for characteristics of the major media companies. Given the history of the newspaper industry, inside owners such as founders and their family usually work as executives and directors and actively engage in strategic and journalistic decisions in news organizations (Villalonga & Hartman, 2007). I included the average percentage of stock owned by *insiders*. To control for the influence of media's revenue on subsequent coverage, I also included the media outlets' *average circulation*. To deal with the endogeneity issue that prior reporting on a particular firm could affect subsequent coverage of that firm, I included total amount of media coverage about the focal firm in the prior year (Bednar, 2012). I also wanted to control for the possibility that all independent and control variables affect the subsequent coverage. Thus, I lagged all independent and control variables by one year to assure that the models were capturing the effect of inter-organizational relationships on the subsequent media coverage. Lastly, I included dummy variables for each year in the dyadic fixed effect models to capture any general time trends. To capture any systematic industry effects, I included two digit SIC codes.

Empirical Model

The unit of analysis is the firm-media dyad. The dyad consists of one of my focal companies from the S&P 500 and a specific media outlet. By analyzing the media-firm dyad, I can test how inter-organizational relationships influence the subsequent coverage of the firm in a particular outlet. I organized the database into media-corporation dyadic panels over time where the dependent variable is a measure of the overall tenor of media coverage from a particular outlet about a specific corporation. I begin my analysis using linear regression with firm-media dyadic fixed effects and robust standard errors (Greene, 2014). The dyadic fixed-effect models focus exclusively on variation in the dyads over time. By including major characteristics of

sampled firms and media outlets that potentially influence the media coverage, I can rule out alternative explanations. In addition to that, estimating fixed effects regressions can also account for heterogeneity induced by unobserved time-invariant factors and period effects. The results below are from the tests that used standardized measurements across the full sample. While standardizing does not affect the significance of the results, it does help to interpret the findings (Jaccard, Turrisi, & Wan, 1990).

RESULTS

Table 12 presents the descriptive statistics and the correlations between the variables.

Table 12: Correlation Table and Descriptive Statistics

		Mean	S.D.	1	2	3	4	5	6	7	8	9
1	Tenor of Media coverage	3.67	11.49	1								
2	Interlocking Board of Directors	0.03	0.17	0.07	1							
3	Ownership	0.03	0.33	0.09	0.07	1						
4	Relative Performance	-73.52	1679.00	0.33	0.07	0.17	1					
5	Advertising expenditures	6.49	41.09	0.25	0.15	0.03	0.1	1				
6	Sales	8.83	1.14	0.33	0.15	0.13	0.44	0.28	1			
7	Market-to-book ratio	3.96	30.55	-0.01	-0.01	-0.01	0.02	-0.01	-0.03	1		
8	Total stock returns	0.14	0.43	-0.03	-0.02	-0.01	0.02	0.01	-0.03	0.02	1	
9	Financial restatement	0.06	0.24	0.01	0.01	-0.02	-0.08	0.05	0.03	-0.05	0	1
10	Lawsuit	0.08	0.27	0.1	0	0.12	0	0	0.14	-0.03	-0.17	0.28
11	Reputation	4.38	3.06	0.15	0.11	0.06	0.28	0.1	0.54	0.04	-0.01	-0.02
12	Gompers index	9.78	2.52	-0.12	-0.03	-0.05	-0.08	-0.06	-0.05	0.02	-0.03	-0.04
13	Manager-controlled	0.14	0.35	0.11	0.06	0.07	0.18	0.12	0.22	0	-0.03	0.02
14	Owner-controlled	0.60	0.49	-0.12	-0.01	-0.03	-0.1	-0.07	-0.06	-0.04	-0.03	-0.01
15	Insiders	7.36	7.43	-0.03	0.06	0	-0.01	0	0	0	0	0
16	CEO turnover	0.33	0.47	0.02	0.01	0	-0.05	0.04	0.05	-0.03	-0.02	0.13
17	Average circulation	1181.69	393.46	0.29	-0.01	-0.03	0.01	0	0	0	0	0
18	Acquisitions	0.49	0.50	0.06	0	-0.02	0.07	-0.06	0.03	-0.01	-0.06	-0.01
19	Article count	6.63	20.19	0.9	0.08	0.07	0.29	0.24	0.33	-0.01	-0.05	0.02
			10	11	12	13	14	15	16	17	18	19
10	lawsuit		1									
11	Reputation		0	1								
12	Gompers index		-0.04	0.04	1							
13	Manager-controlled		0.01	0.16	0.01	1						
14	Owner-controlled		0.01	-0.12	0.13	-0.5	1					
15	Insiders		0	0	0	0	0	1				
16	CEO turnover		0.04	0	0.04	0.01	-0.01	0	1			
17	Average circulation		0	0	0	0	0	-0.08	0	1		
18	Acquisitions		-0.03	0.05	0.02	0.04	0.01	0	0.03	0	1	
19	Article count		0.13	0.16	-0.12	0.1	-0.11	-0.03	0.04	0.28	0.05	1

Table 13 reports results from my dyadic fixed-effects panel regression models to test the effect of inter-organizational embeddedness on the subsequent media coverage of a firm. Model 1 in Table 13 is the base model with only control variables. Models 2–7 present the results for my hypothesis tests. I interpret coefficients for my hypotheses using the full model 7.

Hypothesis 1 stated that an interlocking board of directors is positively associated with the tenor of that firm's media coverage. The coefficient for an interlocking board of directors was not statistically significant in the full model. Hypothesis 2 predicted that the amount of shareholdings that a company has in the media is positively associated with the tenor of that firm's media coverage. I found that the relationship between corporate ownership and media coverage is significantly positive ($\beta = 0.61$, $p < 0.01$). Hypothesis 3 predicted that the positive association between inter-organizational embeddedness (through an interlocking board of directors and ownership) and the tenor of media coverage would be more salient when a firm performs relatively poor. Model 7 shows that the level of firm performance significantly moderates the effects of interlocking boards and corporate ownership on the media coverage respectively ($\beta = -0.30$, $p < 0.05$; $\beta = -0.36$, $p < 0.05$).

Table 13: Influence of Inter-organizational Ties on the Media Coverage of Firms

	Model1	Model2	Model3	Model4	Model5	Model6	Model7
Interlocking Board of Directors		0.10 (0.20)		0.12 (0.20)	0.12 (0.20)	0.11 (0.20)	0.12 (0.20)
Ownership			0.58*** (0.19)	0.58*** (0.19)	0.60*** (0.19)	0.59*** (0.19)	0.61*** (0.19)
Interlocking Board of Directors X					-0.32**		-0.30**
Relative Performance					(0.13)		(0.13)
Ownership X						-0.38**	-0.36**
Relative Performance						(0.16)	(0.16)
Relative Performance	0.19 (0.15)	0.19 (0.15)	0.23 (0.15)	0.23 (0.15)	0.35** (0.16)	0.26* (0.15)	0.38** (0.16)
Advertising expenditures	1.83*** (0.22)	1.83*** (0.22)	1.87*** (0.22)	1.87*** (0.22)	1.85*** (0.22)	1.86*** (0.22)	1.84*** (0.21)
Sales	2.94*** (0.37)	2.94*** (0.37)	2.91*** (0.37)	2.91*** (0.37)	2.87*** (0.37)	2.89*** (0.36)	2.85*** (0.37)
Market-to-book ratio	0.01 (0.05)	0.01 (0.05)	0.01 (0.05)	0.01 (0.05)	0.01 (0.05)	0.01 (0.05)	0.01 (0.05)
Total stock returns	-0.07 (0.07)	-0.07 (0.07)	-0.06 (0.07)	-0.06 (0.07)	-0.06 (0.07)	-0.06 (0.07)	-0.06 (0.07)
Financial restatement	0.04 (0.07)	0.04 (0.07)	0.03 (0.07)	0.03 (0.07)	0.03 (0.07)	0.03 (0.07)	0.03 (0.07)
Lawsuit	-0.07 (0.07)	-0.07 (0.07)	-0.07 (0.07)	-0.07 (0.07)	-0.06 (0.07)	-0.07 (0.07)	-0.06 (0.07)
Reputation	-0.10 (0.14)	-0.10 (0.14)	-0.11 (0.14)	-0.11 (0.14)	-0.11 (0.14)	-0.11 (0.14)	-0.11 (0.14)
Gompers index	0.26 (0.51)	0.26 (0.51)	0.24 (0.50)	0.24 (0.50)	0.19 (0.50)	0.24 (0.50)	0.19 (0.50)
Manager-controlled	-0.35** (0.17)	-0.35** (0.17)	-0.35** (0.17)	-0.35** (0.17)	-0.37** (0.17)	-0.35** (0.17)	-0.37** (0.17)
Owner-controlled	-0.25 (0.21)	-0.25 (0.21)	-0.25 (0.21)	-0.25 (0.21)	-0.26 (0.21)	-0.26 (0.21)	-0.26 (0.21)
Insiders	0.55*** (0.12)	0.55*** (0.12)	0.54*** (0.12)	0.55*** (0.12)	0.56*** (0.12)	0.56*** (0.12)	0.57*** (0.12)
CEO turnover	- 0.34*** (0.08)	- 0.33*** (0.08)	- 0.33*** (0.08)	- 0.33*** (0.08)	- 0.34*** (0.08)	- 0.34*** (0.08)	- 0.34*** (0.08)
Average circulation	1.45*** (0.43)	1.45*** (0.43)	1.45*** (0.43)	1.44*** (0.43)	1.44*** (0.43)	1.42*** (0.43)	1.42*** (0.43)
Acquisitions	0.22** (0.09)	0.22** (0.09)	0.22** (0.09)	0.22** (0.09)	0.22** (0.09)	0.22** (0.09)	0.22** (0.09)
Article count	0.38 (0.24)	0.38 (0.24)	0.43* (0.24)	0.43* (0.24)	0.38 (0.24)	0.40* (0.24)	0.35 (0.24)
Constant	4.01*** (0.12)	4.00*** (0.12)	4.00*** (0.12)	4.00*** (0.12)	4.00*** (0.12)	3.99*** (0.12)	3.99*** (0.12)
R2 -overall	0.26	0.26	0.27	0.27	0.27	0.26	0.26

*** p < 0.01; ** p < 0.05; * p < 0.10, based on two-tailed tests, robust standard errors, clustered at the firm level in parentheses. All independent variables are lagged by one term.

Additional Analyses

I used fixed-effects models as the main models, based on the Hausman test. However, I also tested random-effects models to look the effects of inter-organizational embeddedness on the media coverage across the dyadic relations. Following the previous studies addressing potential autocorrelation issue in the research on media coverage (Bednar, 2012; Zavyalova et al., 2012), I conducted Generalized Estimating Equations (GEE) models. GEE models are appropriate for longitudinal data and allow to control for potential autocorrelation and heteroskedasticity in the data (Henderson, Miller, & Hambrick, 2006). I conducted this analysis using a first-order autoregressive correlation structure and Huber–White sandwich variance estimates. In the random effect models and GEE models, I included two-digit SIC dummy variables to account for industry effects. The results of these supplementary analyses were generally consistent with those reported above confirming that my results are consistent across these different modeling techniques (Ballinger, 2004).

To sum up, in this study I examine how resource dependencies that create conflicts of interest between the media and corporations can impair the independence of media outlets and result in more positive media coverage of firms with such relationships. In particular, I look at two governance related ties including ownership, and board interlocks and their effect on media evaluations of the firm. I also explore how the relative performance of the firm can influence the benefit that a firm receives from having such a tie. The result shows that ownership ties result in more positive coverage while board interlocks only appear to provide benefits to firms when the firm is performing poorly. This study suggests that to understand the role of the media as a social evaluator and governance mechanism we must account for inter-organizational ties that affect its independence.

DISCUSSIONS

My dissertation focuses on how corporate governance mechanisms act not only for shareholders' interests, but also protect the interests of divergent constituents across different institutional environments and times. Extending the contemporary governance literature on the internal and external governance mechanisms, I examine the effectiveness of ownership structure and the media as two distinct governance mechanisms in two different institutional and inter-organizational settings.

In the first study, I bring forward the view that shareholder oriented foreign investors have a significant impact on management reporting practices as they invest around the world, and particularly in very different corporate governance settings. Within the backdrop of comparative corporate governance research, I draw on the institutional approach to examine how foreign shareholders infused with their own governance logic influence managerial decision making regarding financial disclosure in a new and dramatically different governance environment. I specifically ask how shareholder-oriented, foreign institutional investors affect managerial optimism in initial earnings forecasts and the timing of subsequent earnings adjustments in a stakeholder oriented governance context. I maintain that the managerial incentives regarding optimisms and the timing of earnings adjustments are likely to be shaped by the level, type and nature (in terms of trading behavior) of foreign ownership. In particular, when short-term shareholder-oriented foreign ownership is high, I would expect greater levels of optimism in the initial forecast, followed by timely earnings guidance in the subsequent revisions through timely adjustments of the earnings forecasts.

I conduct an empirical, longitudinal analysis of Japanese TSE corporations over the period of 2006-2013. The results corroborate that Japanese managers in general are optimistic (as

it was previously shown by Kato et al. 2009), yet I demonstrate that they are even more optimistic in the presence of foreign owners. In fact, when I analyze the ownership structure in detail, I uncover that foreign investment funds are the main drivers of this finding, while foreign pension funds and domestic investors tend to reduce the level of optimism in the initial forecasts. In addition, when I separate the foreign investors by their portfolio turnover, I find stronger results for more active foreign investors compared to less active foreign investors, in line with my argument that short term shareholder orientation is an important trigger.

When I examine the earnings surprise at year end (i.e., difference between forecasted and realized earnings), my study reveals that the last forecast of Japanese firm in general tends to fall just below the realized earnings, which means that managers make significant strategic adjustments of their forecasts through the fiscal year. Considering the timing of these adjustments in detail, the findings show that the likelihood of making changes to the earnings forecast in the earlier revisions is substantially higher for firm with higher levels of foreign ownership, while the likelihood of making last-minute adjustments is substantially lower. This lends support for the idea that managers provide timely earnings guidance when foreign ownership is high and that timing is used strategically. The findings are robust to different specifications and to the use of instruments to address endogeneity concerns.

This study contributes to the international corporate governance literature by providing insights into the role of foreign shareholders in influencing governance practices in different institutional environments as well as in companies with heterogeneous shareholders. Drawing from a cross-national institutional perspective, I claim that managerial earnings disclosure practices are likely to be interpreted and adopted in various ways by Japanese managers contingent on the different interests and pressures exerted by heterogeneous owners, including

foreign ones. Then, I examine how foreign owners investing in Japan, having a shareholder oriented governance logic, shape Japanese managerial reporting practices and how Japanese managers strategically respond to foreign shareholders through their earnings forecast behavior.

I demonstrate that in Japan, a setting that has been very resistant to formal governance changes (Yoshikawa & McGuire, 2008), the influence of shareholder-oriented foreign investors is manifested through the strategic deployment of managerial reporting practices. In this sense, my analysis reveals that change in managerial reporting, e.g., timely reporting, is at work within the boundaries of the existing corporate governance system (Edelman, 1992). My findings uncover the possibility of hybrid systems, in which Japanese corporations with a high degree of foreign ownership combine elements common to both the Japanese CG context and the Anglo-American context, and as result they embrace a hybrid corporate governance system. Furthermore, my study contributes to a better understanding of the mechanisms through which foreign ownership shapes local organizational practices. While prior research on the effects of foreign ownership has mainly focused on outcomes (e.g., Ahmadjian & Robbins, 2005, Ahmadjian & Robinson, 2001; David et al., 2006; Yoshikawa, Phan, & David, 2005), or on changes in the governance structure (Chizema & Shinozawa, 2012), my study focuses on a directly observable measure of managerial decision making.

In the second study I focus on external corporate governance mechanisms, more specifically the role of media, I investigate how inter-organizational ties that create resource dependencies can result in conflicts of interest that have the potential to impair media independence and could act as a barrier to the media effectively serving as an external governance mechanism. I specifically examine relationships between the media and firms that are created by interlocking boards of directors and different ownership configurations and show

how these ties can affect the subsequent media coverage of firms. Interestingly, although both the board and owners have long been studied in the governance literature as mechanisms to serve the interests of shareholders in a company, I suggest that those same governance mechanisms can in some circumstances, limit the media's governance role in monitoring a corporation. I find empirical evidence that ownership stakes in the print media significantly influence the media coverage of a firm. I also found that interlocking boards and ownership ties are particularly influential on media evaluations when a focal company performs relatively poorly. I suggest that without consideration of these inter-organizational ties, it becomes more difficult to assess the efficacy of the media as an external governance mechanism.

With this study, I make several contributions to corporate governance research. First, it contributes to research on the media by providing new insight about and empirical evidence for the effect of inter-organizational resource ties on media evaluations about firms. Many prior studies in the management literature have focused on the media's positive impact on corporate activities and outcomes, and described the media as socially legitimate gatekeepers. However, I suggest that media evaluations can be molded by the need for resources that are critical for the media's survival as an organization. By considering potential conflicts of interest and resource dependency, this study raises important questions about whether the norm of objectivity and professionalism in the media can be impaired by relationships between the media and corporations.

Second, this study highlights a boundary condition that could limit the media's ability to effectively serve as an external governance mechanism. While previous management research on the effect of the media has claimed that the media can act as an independent party to monitor CEO and corporate activities, this study raises questions about the watchdog role of the media by

providing evidence that reporting in the media can be affected by corporate relationships. My study suggests that just as other governance mechanisms are viewed as more effective to the extent that they are independent, we should also consider media independence when discussing the media in a governance context.

In addition, this study shows the importance of examining the interactions of multiple governance mechanisms. Historically, governance researchers have tended to focus on the effects of various governance mechanisms in relative isolation. More recently, scholars have indicated the need to look at multiple mechanisms simultaneously and explore the amplifying and dampening effects that multiple governance mechanisms may have on one another (Aguilera et al., 2015; Misangyi & Acharya, 2014). This study takes a step towards doing just that by suggesting that traditional governance structures such as ownership and the board of directors can influence the efficacy of the media in a governance role. My theory and findings add to a growing literature that acknowledges that the success or failure of each single governance mechanism is not always determined by its own characteristics, but rather by the interplay among multiple practices. This view is well connected with the contemporary view that the configuration of governance practices matters for their efficacy. Future work could further explore the role of the media as a complement or substitute for other internal and external corporate governance entities such as security analysts, rating organizations, auditors, and different types of owners and stakeholder groups (Aguilera et al., 2015).

My findings also shed some light on the circumstances in which firm ties to media organizations are most likely to be beneficial for a firm. I found that these media ties seem to be most beneficial when a firm's performance is relatively poor. Interestingly, I did not find a main effect for board interlock ties, but I did see a significant interaction effect with firm performance.

This result implies that inter-organizational ties may become activated based on the focal firm's performance. This could be because firm leaders engage in more activities aimed at leveraging their media relationships to reduce negative coverage when they are most likely to receive negative coverage due to poor performance. It could also be the case that journalists feel less of an obligation to resource providing firms when those firms seem to be performing well. It is only when firms perform poorly that journalists may feel obligated on some level to limit negative coverage. By exploring these potential moderating effects, this paper begins to provide a contextualized theory about the role of the media in evaluating corporate activities, and suggests certain conditions under which the media can fulfill an evaluative role (Jonsson & Buhr, 2011).

These two empirical studies about the internal and external corporate governance mechanisms also point to several possible areas for future research and has some practical implications. Regarding ownership structure as the internal governance mechanism, it would be worthwhile to investigate the influence of foreign ownership on other aspects of financial reporting, such as earnings management or accounting conservatism. Second, it would be intriguing to examine whether the introduction of timely managerial reporting triggered by foreign investors creates spill-over effects, over time, in firms without large levels of foreign ownership. That is, is there an isomorphic trend because these practices get legitimated even within a corporate governance environment that initially resisted shareholder-oriented governance practices? Finally, while my research has focused on the influence of foreign ownership on initial optimism and the timing of subsequent earnings revisions, future research may explore whether the consequences of the initial earnings optimism, as well as missing earnings target, in terms of stock price reactions or managerial turnover, is contingent on foreign

ownership. The ownership research from the institutional approach also has implications for policymakers and in particular for the current debate on the rules for listed firms' earnings forecasts. Following a debate that started in 2010 on how earnings forecasts are presented on stock exchanges as a priority element of the financial strategy, on the 23rd of March, 2012, the Tokyo Stock Exchange relaxed the rules for listed firms' earnings forecasts, introducing more flexibility in the items and time horizon of earnings forecast disclosure, while encouraging systematic engagement with investors. In that sense, my study speaks to the relevance of the earnings forecasts for foreign investors and the significance of receiving timely updates, as a means to more effectively involve and inform them. I show that even resistant environments to introduce foreign practices such as the Japan, tend to cope with foreign pressures strategically within the boundaries of the existing governance practices. The future study needs to explore more how the rise of financial globalization has led to the spread of governance practices across the world.

Regarding the media as the external governance mechanism, although I did not find empirical evidence to support the direct impact of board interlocks on media coverage, I think that several factors influencing the effect of interlocking boards on companies in general may help explain this lack of results. Some have suggested that cooperation among CEOs through board ties has diminished especially since the Sarbanes–Oxley Act of 2002 (Chu & Davis, 2011). At the same time, other informal ties among corporate leaders may become more influential in determining the relationship of firms with other constituents (Westphal & Zajac, 2013). I think that there would be value in future research that uses historical, longitudinal analysis to examine how the effect of board interlocks on media coverage has evolved over time. There could also be value in studying other informal ties between firms and the media, especially in a non-US

context. For instance, Samsung Corporation founded and owned a newspaper company. As cross-shareholdings became a social issue, Samsung sold its entire ownership stake in the news organization. But Samsung has maintained a relationship with this news organization through marital ties between CEO families. It would be interesting to look how those family ties or other informal ties could influence the media coverage of a focal company.

Although I focus on more governance related ties such as a board interlocks and ownership ties, I can also think of other potential transactions that could impair media independence. According to the journalism literature, the media are always susceptible to pressure from advertisers because advertisement is a main source of revenue for media firms. These conflicts of interest stem from the fact that without advertisement revenue, media outlets would cease to be economically viable (Curran & Seaton, 2003: 30). One study has shown that 90% of editors have been pressured by advertisers and more than one-third of them claimed advertisers had succeeded in affecting their news content (Soley & Craig, 1992). Such influence attempts are directed not only at newspaper advertising directors but also at newspaper editors (Nyilasy & Reid, 2011). Some studies have examined this issue by examining the local newspaper coverage of products based on the local advertising expenditures of firms they cover (Gurun & Butler, 2012). The strong results from the advertising expense as a control variable seem to confirm the idea that ties created by advertising expenditures are another potential way that media independence could be compromised. Future studies may examine not only product coverage but also overall coverage of a firm by national news outlets, based on firm-level advertisement expenditure. Especially as the media industry continues to undergo radical transformation and finds itself under severe economic pressure, advertisers' influence may become even stronger.

Although I focus on the overall tenor of media coverage about corporations, positive and negative tenor of media coverage may be conceptualized as separate constructs rather than as parts of a single continuum (Bednar et al., 2013; Cacioppo & Gardner, 1999; Rindova et al., 2006). It would be meaningful to theorize and test different effect of positive and negative coverage on CEO behaviors and corporate activities. Related to that, there may be inherent differences in the tenor of different issues covered by the media (Hoffman & Ocasio, 2001; Pollock, Rindova, & Maggitti, 2008). The future study can delve into different categories of media coverage based on different issues such as financial performance issue, managerial issue, corporate social responsibility, public relation issue, and so on.

Lastly, future studies could also account for how different forms of media, including television, Internet-based media, and social media, manage the conflict of interests created by inter-organizational ties. Online/social media is often described as being independent from any influences. However, I suspect that the impact of inter-organizational ties could be even more salient in online media, especially when the outlet is not necessarily oriented to pursue a professional or journalistic goal. In other emerging online media organizations, the boundaries between the editorial desk and the business and financial side of the organization are often blurred. As many online news blogs and aggregators become larger and need more financial support, they may become more vulnerable to corporate influences. It is hard to protect their independence once they start to rely on resources provided by outside entities.

Practically, professional journalistic codes advocate for the maintenance of an impassable wall between the editorial and business activities of a news organization. According to my analysis, this wall may at times be less of a barrier than previously thought. My findings suggest that the media may not be independent as a result of various ties with firms that they report on.

This suggests that the media may not always be able to function effectively as a governance mechanism or as a social arbiter of corporate activities. My study suggests that media evaluations are not simply generated by professionally trained journalist's discretion, but that they are also constructed by social contexts.

CONCLUSION

All things taken together, in line with the current discussion on the effectiveness of corporate governance, these two empirical studies in the dissertation may improve our understanding of how internal and external corporate governance mechanism could function differently depending on different institutional environments and times as well as inter-organizational relationships. The extant literature has typically viewed governance as a principal–agent problem between shareholders and management. But useful insights about governance must inevitably have a broader scope, encompassing such complex matters as heterogeneous owners with different interests and institutional orientations, and intertwined internal/external corporate governance mechanisms. I hope that my dissertation will promote new avenues for research that will advance our understanding of evolving corporate governance.

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