Stock Repurchase and Corporate Governance Reform in Korea: An Actor-Centered Perspective

Introduction

A common definition of corporate governance is still non-existent. This is because countries around the world have fundamentally different understandings of the role of a firm in society and the proper relationships between employees, shareholders, creditors, buyers, suppliers, managers and the community (Aguilera & Jackson, 2003). An extensive literature attributes variations in corporate governance systems to factors including protection of shareholder rights (Shleifer & Vishny, 1997), reliance on market mechanisms (Hall & Soskice, 2001) and differences in domestic institutional environments (Aguilera & Jackson, 2003). However, a dichotomous distinction of corporate governance tends to be between the Anglo-American system (e.g., US, UK) and the so called welfare variety (e.g., Germany, Japan). The Anglo-American model of corporate governance is based on the notion of separation of ownership and control (Berle & Means, 1932; Jensen & Meckling, 1976) and the supremacy of the shareholder. Here, the corporate governance system strives to align the interests of owners and managers, monitoring the latter for behavior inconsistent with the former's expectations.

Mechanisms that achieve these goals of monitoring and ensuring interests' alignment include shareholder-value based compensation, independent boards of directors and transparent financial reporting systems.

In welfare systems, corporate governance is a set of laws, business practices, and ideologies that defines the relationship between a firm and its stakeholders (Hall & Soskice, 2001). This definition suggests that corporate governance stands at the centre of a nation's socio-economic system, concerned with the welfare of all stakeholders, thus, closely related to systems of finance, employment, and patterns of growth and innovation (Hall & Soskice, 2001). Other countries whose corporate governance systems traditionally diverged from the Anglo-American variety include South Korea whose system was highly influenced by Japanese practices imported during the period of Japanese colonization and during the rapid growth years of the post-war period. Like the Japanese system, the Korean economy featured business groups and a high reliance on bank debt (Joh, 2003). Shareholders tended to be insiders—family members, buyers and suppliers, affiliated firms, and banks—and accounting regulations offered little assurance of transparency to outsiders.

However, following the currency crisis of 1997, the Anglo-American system came into direct contact with corporate governance system of Korea. Institutional investors from Anglo-American economies expanded their investments outside of their home countries and demanded familiar standards of corporate governance (Useem, 1998). International agencies such as the IMF and World Bank advocated Anglo-American corporate governance. Academic economists and business consultants advocated Anglo- American practices to improve corporate performance and invigorate capital markets (Shleifer & Vishny, 1997). Consequently, Korean firms adopted Anglo-American management practices such as the appointment of outside directors, more transparent financial reporting methods and stock repurchases, indeed the subject of this paper. Stock repurchases also known as share buybacks are extremely popular in the United States such that from 1985 to 1999, US corporations announced intentions to repurchase roughly $750 billion worth of stock (Grullon & Ikenberry, 2000). From an agency perspective firms repurchase stocks in order to distribute excess cash flow. On the other hand, arguments drawing on signalling theory show that repurchase activity is negatively correlated with prior stock returns, indicating that firms repurchase stock when their stock prices are perceived as undervalued (Stephens & Weisbach, 1998). While these arguments, drawing on both agency and signalling theories, are usually based on economies that emphasize shareholder-value maximization, a similar approach may not be appropriate or sufficient for countries with divergent governance systems. In emerging economies, for example, some scholars have spoken of the salience of institutional arrangements and actors (Peng, 2004), suggesting the inappropriateness of theoretical lenses that apply under Anglo-American governance. Therefore, employing variants of neo-institutional theory, this study seeks to provide an alternative explanation (to that provided by agency theory in Anglo-American governance) to how Korean firms adopted Anglo-American practices, in particular, stock repurchases following global external pressures. Indeed, institutional accounts are increasingly used to understand the dynamics of globalization (Guillen, 2001). While some of these approaches focus on the processes by which dominant cultural or managerial templates are diffused globally (Boli & Thomas, 1999) others focus on the processes by which dominant templates from influential governance systems are translated or adapted to local contexts (Djelic & Sahlin-Andersson, 2006).

This paper seeks to understand the role of local actors (at firm level) in the adoption or adaptation of one of the Anglo-American practices of corporate governance namely stock repurchase. As such, the importance of this study lies in helping further understand how exogenous global and national forces manifested in resources and ideas interact with endogenous actors at firm level to precipitate institutional change.

Shareholder Value Maximization: The Rationale of Stock Repurchase

Stock repurchase, the practice of buying back shares of the firm’s outstanding common stock on the open market, has become increasingly prevalent among major US corporations over the last two decades (Grullon & Ikenberry, 2000). Seeking to account for the recent surge in stock repurchase activity, a sizable volume of research has emerged, examining the antecedents of share buyback programs (e.g., Dittmar, 2000; Rau, 2002). Some financial scholars, for example, have paid particular attention to how stock repurchase allows the firm to address the imperfections inherent in capital markets, an act that, they presume, may have direct bearing on the firm's value (e.g., Ikenberry, Lakonishok & Vermaelen, 1995). From a financial economics perspective, buying back a firm's own shares on the open market is considered a viable financial policy alternative *in lieu* of or in addition to dividend payments (Jogannathan, Stephens & Weisbach, 2000). Although empirical studies on the antecedents of stock repurchase show mixed findings, two hypotheses figure most prominently in the financial economics literature: agency and signalling theories.

The Agency Theory Perspective

Agency theory posits that managers may allocate corporate resources to build their own personal empires regardless of whether the investments that they make generate sufficient profits for the firm (Fama & Jensen, 1983). Moreover, managers may hoard surplus cash or near-liquid assets within the corporation, thus maintaining control over uninvested resources, rather than distributing these extra revenues to shareholders. Alternatively, they may simply use their control over resource allocation to line their own pockets.

According to agency theory, in the absence of corporate governance institutions that promote the maximization of shareholder value, one should expect managerial control to result in the inefficient allocation of resources (Jensen & Meckling, 1976). The manifestation of a movement toward the more efficient allocation of resources, it is argued, is a higher return to shareholders. Neoclassical financial theorists argue that among all the stakeholders in the business corporation only shareholders are residual claimants (Jensen & Meckling, 1976). This means that the amount of returns that shareholders receive depends on what is left over after other stakeholders, all of whom it is argued have guaranteed contractual claims, have been paid for their productive contributions to the firm. If the firm incurs a loss, the return to shareholders is negative, and vice versa. By this argument, shareholders are the only stakeholders who have an incentive to bear the risk of investing in productive resources that may result in superior economic performance (O'Sullivan, 2002). As residual claimants, moreover, shareholders are the only stakeholders who have an interest in monitoring managers to ensure that they allocate resources efficiently. Furthermore, by selling and buying corporate shares on the stock market, public shareholders, it is argued, are the participants in the economy who are best situated to reallocate resources to more efficient uses. The agency problem – the fact that public shareholders as the (purported) principals who bear risk are obliged to leave the corporate allocation of resources under the control of managers as their agents – poses a constant threat to the efficient allocation of resources. Within the shareholder-value paradigm, the stock market represents the corporate governance institution through which the agency problem can be resolved and the efficient allocation of the economy's resources can be achieved. Specifically, the stock market can function as a "market for corporate control" that enables shareholders to "disgorge free cash flow". As Jensen (1986, p. 323) puts it in his seminal article: "Free cash flow is cash flow in excess of that required to fund all projects that have positive net present values when discounted at the relevant cost of capital. Conflicts of interest between shareholders and managers over payout policies are especially severe when the organization generates substantial free cash flow. The problem is how to motivate managers to disgorge the cash rather than investing it at below cost or wasting it on organization inefficiencies". If a company does not maximize shareholder value, shareholders can sell their shares and reallocate the proceeds to what they deem to be more efficient uses. The sale of shares depresses that company's stock price, which in turn facilitates a takeover by shareholders who can put in place managers who are willing to distribute the free cash flow to shareholders in the forms of higher dividends and/or stock repurchases. Additionally, as Jensen and Murphy (1990), among others, contended, the maximization of shareholder value could be achieved by giving corporate managers stock-based compensation, such as stock options, to align their own self-interests with those of shareholders. Then, even without the threat of a takeover, these managers would have a personal incentive to maximize shareholder value by investing corporate revenues only in those projects that have positive net present values when discounted at the relevant cost of capital (Jensen, 1986), and distributing the remainder of corporate revenues to shareholders in the forms of dividends and/or stock repurchases. Thus, according to agency theory, the primary motive for a firm to enact stock repurchasing is to pay out excess cash it retains either as a substitute for or as a supplement to dividends. Consequently, share repurchase announcements would, therefore, be well received by the financial market because they represent a distribution of excess cash to shareholders when the alternative would be to waste it on private benefits for managers.

Grullon (2000) provides evidence for the agency cost argument that large, low growth, yet cash-rich firms tend to announce repurchase programs more frequently. Jogannathan *et al.* (2000) also find that firms facing *ex ante* uncertainty about future cash flows tend to use stock repurchase more frequently as a means to distribute excess cash since it allows more flexibility compared to dividend payouts. Although empirical findings on the agency cost thesis are somewhat mixed, this view is commonly premised on the assumption that managers' decision to distribute excess cash constitute the adherence to the tenet of shareholder value maximization.

The Signaling Theory Perspective

Signaling theory suggests that, in general, managers repurchase stocks when they have reasons to believe that their firm's shares are undervalued (Stephens & Weisbach, 1998). For example, Barth and Kasznik (1999) show that firms with more intangible assets (as a proxy for information asymmetry and hence market undervaluation) tend to be more active in stock repurchases. Graham, Harvey and Michaely (2003)'s survey revealed that managers believe that repurchase announcements channel to investors the information on the degree of their confidence about the future of the firm. Similarly, Vermaelen (1981) found evidence that the firm's stock buyback announcement sends a signal that its share prices are undervalued. Overall, signaling thesis suggests that managers who are in better position to assess the intrinsic value of their firm drive stock repurchase activity and thereby help mitigate capital market imperfections. Sanders and Carpenter (2003) identified the determinants of stock repurchase which play the role of signalling to shareholders: information asymmetry, executive's financial incentives, and the risk associated with high performance expectation.

Thus, from the agency and signalling theories, firms repurchase stock when they are undervalued and have the excess cash to distribute. However, these are not the only motives for repurchasing. Bagwell and Shoven (1989) and Opler and Titman (1996) discuss and show the impact that repurchasing stock has on leverage. The results of these papers indicate that firms may repurchase stock to increase their leverage ratio. Bagwell (1991) explains how firms use repurchases to fend off unwanted takeover attempts and Fenn and Liang (1997) illustrate that firms use repurchases to counter the dilution effects of employee and management stock options.

Theoretical Background

While there is great value in the analysis, above, informed by financial economics to help better understand what may motivate the adoption of shareholder-value practices, attention should also be given to other avenues of inquiry in the corporate governance domain, either as substitutes or in a complementary way. One such avenue and, indeed, applied in this paper, is rooted in behavioral science through an institutional theory lens, representing the informal institutions of governance (North, 1990). However, a typical challenge in writing a work based on institutional theory is the identification of the particular species of institutional theory adopted. As Scott (1987, p. 493) observed, "…the beginning of wisdom in approaching institutional theory is to recognize at the outset that there is not one but several variants".

The main sub-species of institutional theory are new institutional sociology (NIS) (DiMaggio & Powell, 1983; Meyer & Rowan, 1977), new institutional economics (NIE) (Williamson, 1973) and old institutional economics (OIE) (Commons, 1934). For this study, we use NIS and OIE, complemented by insights from political science and organization theory. The focus of NIS is primarily on how and why firms conform to institutionalized beliefs in society, treating institutions as largely a given; rules exogenously pre-determined outside the domain of economic transactions presented in a hierarchical order (Aoki, 2007). Legal rules and social norms fit in this definition. Indeed, organizations change and adapt to external pressures because of the need to gain legitimacy and have access to resources (DiMaggio & Powell, 1983). Organizations are thus forced to adopt practices (coercive isomorphism), imitate other organizations (mimetic isomorphism) or have to be professionally compliant (normative isomorphism). However, the processes of institutionalization, through organizational routines (Becker, Lazaric, Nelson & Winter, 2005), over time are not well developed by NIS. Thus, on its own, NIS cannot effectively explain how organizational actors (local actors) react to external pressures, but its ability to accommodate these dynamic exogenous influences, (in this case changes in Korean corporate governance following pressures from globalized financial markets and national legal changes) is useful.

On the other hand, OIE maintains that human action is constrained by institutions (North, 1990), but more importantly recognizes that institutions enable people or actors to develop meaningful actions. For example, Sjöstrand (1993) regards institutions as infrastructures for human action, individually or collectively. He also argues that institutions are constituted by, and reinforced through, social (inter)actions. Moreover, OIE argues that institutions are not independent of the individuals or actors that inhabit various social settings. Rather, institutions exist through the behaviors of these actors manifested through organizational routines. Consistent with this argument is Aoki’s (2007) treatment of institutionalized rules as something spontaneously and/or endogenously shaped and sustained in the repeated operational plays of the game itself. Thus, OIE sees actor behavior as an integral part of the institutions that govern much of social activities and

"…institutions simplify action choices; they are not separate from, but are part of, the individual (inter)actions" (Sjöstrand, 1995, p. 21). This reasoning, alluding to the 'endogenizing' of institutions (Aoki, 2007) qualifies OIE for the analysis of micro-level (intraorganizational) dynamics and better understanding of institutional change at organizational level. However, OIE does not tell us the source of change, nor when the time is ripe to start the process of change within the organization, but NIS does, as explained above, through the macrolevel radical changes (i.e. legal and global reforms). This is where NIS complements OIE: the need to gain legitimacy and resources by conforming to the external environment signals changes to which actors within an organization respond. This actor-centered approach on institutions (Aguilera & Jackson, 2003) may further help to understand the diffusion and adaptation of transnational management innovations (Fiss & Zajac, 2004) even in contexts where they may be considered illegitimate (Sanders & Tuschke, 2007). But, is institutional change radical, incremental or non-existent? Deeg and Jackson (2007) suggest that more dynamism into the comparative capitalism literature can be better understood by proceeding on three distinct levels-the micro, meso and macro. While external/exogenous pressure may point to a high possibility of a radical change, the subsequent reaction by endogenous actors, through repeated operational routines, suggests that institutional change may occur through incremental adjustment, translation (Buck & Shahrim, 2005), adaptation (Deeg & Jackson, 2007) or contestation (Sanders & Tuschke, 2007; Chizema, 2008).

To address the macro and micro dynamics in organizational change we, therefore, bring together the new and the old institutionalism in a variant of neo-institutional theory (Greenwood & Hinings, 1996) that provides the framework for the derivation of our hypotheses.

Macro-Level Dynamics

The salience of institutional forces or the strength of their influence on what constitutes social legitimacy and hence firm survival is the basis for analyzing the firm's interactions with its external market and institutional environment (Greenwood & Hinings, 1996; Pfeffer & Salancik, 1978). If organizations lack any crucial resource (e.g., finance, personnel or technology), the providers of these resources become salient, and the firm actors must effectively act to gain legitimacy with those who possess and control these resources (Ulrich & Barney, 1984).

Expressed in simple terms, firms faced with legal and economic pressures to change are likely to comply in order to gain trust and legitimacy in the global financial and product markets. Thus, these pressures may shape new organizational behavior and adoption of new practices seen as legitimate by the salient resource providers.

Thus, macro-level changes at both national and international levels may lead to changes at a micro, firm level, providing a better understanding of comparative corporate governance. Indeed, from their perspective of neo-institutional theory, Greenwood and Hinings (1996) argue that exogenous dynamics influence change by bringing disequilibrium at organization level. How endogenous factors react to external pressures, Greenwood and Hinings (1996) suggest, depends very much on whether internal organizational actors are satisfied or dissatisfied with the *status quo*, their level of interests and value commitment in the proposed changes, and whether they have the power and capacity to influence change or resist it.

Macro Changes in Korean Corporate Governance

After the Asian currency crisis, corporate governance failure was seen as the source of low competitiveness of companies hence the wide-ranging reforms in this area. These governance reforms sought to improve transparency, disclosure of financial and corporate information and the financial health of *chaebols* (Joh, 2003). Reforms were also targeted towards ensuring the effectiveness of the board system, which was the main thrust of the governance shake-up in Korean companies.

Before the introduction of outside directors in 1998, the board of directors in the Korean company was generally composed of insider executives who were effectively neutralized by the controlling shareholder. The Korean government, therefore, pressurized all companies listed on the Korean stock exchange, through the amendment of the Commercial Code in 1998 and through the Securities Exchange Act, to have at least 25 percent of outside directors on the board. Moreover, in September 1999 the Korean Committee on Corporate Governance adopted the Code of Best Practice for Corporate Governance, an informal guideline for listed companies that operated on the principle of voluntary compliance. Following these governance changes, Korean firms with more than 2 trillion *won* (about US$1.68 billion based on 1999 exchange rate) of total assets were required to have at least 50 percent of outside directors on their boards.

Stock Repurchases in Korea

More changes took place. The recent dramatic growth in stock repurchase program in Korean firms has also been part of the institutional change toward a shareholder value orientation in the country. As such, there is a possibility that the increasing frequency of the adoption of stock repurchase plan among Korean firms can be partly attributed to the intensifying institutional pressure on them for corporate governance reform.

Before 1994, however, firms were legally prohibited from buying back their own shares in Korea. In 1994 the securities exchange law allowed firms listed on Korea Stock Exchange to repurchase their own stocks within a 5% limit. The limit was extended to 10% in 1996, and then to 100% in 1998. Now firms can repurchase shares within the amount available for dividend payments.

The process of repurchasing stocks is well defined in Korea. Repurchasing firms should obtain approval from the board of directors with regards to the purpose, amount, type and number of securities and pricing and method. Once they report repurchase plans to the financial supervisory service, they are required to execute the stock repurchase within three months following the announcement day. This time limit is substantially shorter than most other markets. For example, the time limit is one year in Canada (Ikenberry, Lakonishok & Vermaelen, 2000) and in Japan (Zhang, 2002). In the United States there is no time limit, and Stephens and Weisbach (1998) find that repurchase programs often last for three years or more.

Under the law, firms may hold and resell repurchased securities. However, they are prohibited from reselling repurchased stocks within six months after the stock acquisition date and purchasing their own shares during the three months following the disposal. The Korean financial supervisory service can take necessary steps if the repurchasing companies are judged to violate the regulatory requirements and any item stated in their submitted statements is deemed false or missing.

Hypotheses

Micro-Level (Actor-Centered) Approach in Stock Repurchase in Korea

In Korea, changes in the corporate governance of firms have been attributed to external pressures following the 1997 currency crisis (Joh, 2003). Moreover, the need to access global finance by Korean firms together with legal changes has meant that new actors, including institutional and foreign shareholders, have arrived in corporate Korea, demanding changes that reflect their interests and values. The fact that Korean firms need to finance their growth has shifted power towards these global investors, forcing organizations to seek legitimacy with their newly-salient resource providers (Granovetter, 1985). Indeed, firms need both economic efficiency and legitimacy to succeed and survive in a challenging environment (DiMaggio & Powell, 1983).

One way to seek legitimacy with local actors is to adopt management practices that suit their interests (Chizema & Buck, 2006). However, local actors are diverse and so are their interests and level of commitment (Greenwood & Hinings, 1996). This observation implies that any organizational decision is subject to contest as local actors with different interests and capacities for influence vie for dominance (Palmer, Jennings & Zhou, 1993). In Korea, the notion of stock repurchase, a practice common in Anglo-American corporate governance, is one such innovation likely to appeal to some organizational actors (e.g., institutional investors) while unacceptable by some (e.g., controlling family shareholders). Treating controlling shareholders, foreign shareholders, institutional shareholders and outside directors as organizational actors, we develop our hypotheses below.

Controlling Shareholders

In the standard theory of the firm, typical agency costs have to do with hired management under dispersed shareholders (Jensen & Meckling, 1976). Such is the case in developed economies where ownership and control are often separated and legal mechanisms protect owners' interests. Thus, the governance conflicts that receive most attention, in these economies are the principal-agent conflicts between owners (principals) and managers (agents) (Jensen & Meckling, 1976).

However, the agency problem in Asian/Korean firms is seen to be caused by having control in the hands of owner- managers with a minority ownership while other shareholders own the majority of shares but with little control (Chang, 2003). In this light, the structure of the Korean *chaebols* can be considered as a variant of the controlling minority structures (Bebchuk, Kraakman & Triantis, 1999), where the agency problem lies in the exploitation of other minor shareholders. Indeed, recent empirical studies have found evidence of minority shareholder expropriation by controlling shareholders in East Asia including Korea (Joh, 2003; Baek, Kang & Park, 2004). This has led to the development of a new perspective on corporate governance that focuses on the conflicts between the controlling and minority shareholders in a firm – the so called *principal-principal* model (Dharwadkar, George & Brandes, 2000; Young, Peng, Ahlstrom, Bruton & Jiang, 2008). In this scenario, where controlling shareholders have the chance to expropriate minority shareholders, maintaining the *status quo* would suit the former as stock repurchases may empower other shareholder groups. Moreover, from an agency perspective, stock repurchases deter management from wasting firm resources. Controlling shareholders do not need this form of restraint on management as they are already in a good position to dictate their interests to managers. Their response to the idea of stock repurchase, a shareholder value notion, would therefore be negative. We therefore hypothesize:

Hypothesis 1: Ownership by controlling shareholders will be negatively associated with the amount of stock repurchase.

Institutional Investors

After the crisis, the size and role of institutional investors in Korean corporate governance has been increasing (Joh, 2003) and such active participation has been associated, in other studies, by the enhancement of shareholder value (e.g., Gillan & Starks, 2000). Given their large economic stakes in the firms these large shareholders have both the incentive and power to monitor managers in order to ensure maximization of shareholder value (Thomsen & Pedersen, 2000). Institutional investors have two ways to push for their interests. First, they can use the threat of exit i.e. possibility of selling their shares if they are not satisfied by management decisions. Second, they can use 'voice' through shareholder activism. Moreover, institutional investors as a variant of blockholders, can directly monitor managers to ensure that they run the firm efficiently in order to create value for investors. Given, therefore, the potential power and economic interests of institutional investors, it may be argued that they may also be motivated to control both management and controlling shareholders, thus avoiding possible expropriation. Therefore, the increase of ownership by institutional investor represents a change in corporate governance in Korea and could lead to the increase of the amount of stock repurchase.

Hypothesis 2: Institutional ownership will be positively associated with the amount of stock repurchase.

Foreign Investors

The introduction of new actors is often accompanied by the introduction of new ideas. This shift in the ideational boundary (Suddaby, David & Greenwood, 2007) implies a break with traditional practice as new actors, relying on commercial expertise, may advocate for the adoption of management innovation and practices. As pointed out earlier, foreign investors have increased their share of the market and now hold a significant percentage of ownership in Korean firms.

Table I shows the percentage of foreign ownership in some large Korean companies by the end of 2003.

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In POSCO, Hyundai Development, Samsung Electronics, Cheil Communications, Daelim and Hyundai Motors, foreign investors held over 50 percent of shares. Foreign shareholdings at the Korea Stock Exchange grew from 11.97 percent of the total market capitalization in 1995 to 41.97 percent in 2004, and more than 40 percent of this investment came from the US and UK (Korea Stock Exchange, 2004). This significant increase in foreign ownership, particularly from stock market economies, has the potential to accelerate the diffusion of the Anglo-American corporate governance system (Chizema, 2008). Recent studies emphasize the corporate governance role and influence of foreign investors in emerging economies (e.g., Dahlquist & Robertson, 2001). Further studies show a strong relationship between the percentage of shares owned by foreigners and corporate behavior such as downsizing (e.g., Ahmadjian & Robbins, 2005). Thus, foreign investors are not only a source of alternative financing, but also play a monitoring role similar to that of other blockholders in emerging markets. Moreover, foreign investors have experience with corporate governance in developed markets and have been known to bring their monitoring skills to emerging markets. Recent anecdotal evidence in Korea shows that foreign investors influence management by voicing their interest during the post-investment phase. The Sovereign Asset

Management Corporation (SAMC), a Monaco-based private equity investment fund, recently purchased 14.82 percent of the equity share of South Korean oil giant SK Corp. SAMC has repeatedly used their votes to change existing management and appoint outside directors. In fact, SK has subsequently initiated reforms. The 10-man board has seven outside members, up from five two years ago. Outside directors now have direct oversight of the audit committee and must approve all transactions exceeding $10 million (Business Week, March 14, 2005) Such cases have occurred frequently in Korea since the Korean stock market was opened up to foreign investment, demonstrating the commitment, interest and power of foreign shareholders to ensure that firms adopt shareholder value practices including stock repurchases.

Hypothesis 3: Foreign ownership will be positively associated with the amount of stock repurchase.

Outside Directors on the Board

Before the currency crisis, the board of directors in Korean companies was ineffective, partly because of the absence of outside directors to monitor top management. Following recommendations from IMF and legal changes, companies had to appoint outside directors.

Consequently, all companies listed on the Korean stock exchange must have at least 25 percent of outside directors on the board. An effective board of directors can protect the interests of shareholders by ensuring that a firm's management formulates effective strategies (Eisenhardt, 1989). Such effectiveness has been observed in firms with larger proportions of independent outside directors (Daily, Ellastrand & Johnson, 1998). Indeed, independent outside directors, who are not employed by the firm and do not have a significant affiliation with its management, are considered important for controlling agency costs because they can be more effective in aligning the interests of owners and managers (Tihanyi, Hoskisson & Hitt, 2003). Prior research has indicated the usefulness of outside directors in strategic change and restructuring, (Pearce & Zahra, 1992), corporate entrepreneurship (Zahra, 1996) and international diversification (Tihanyi, et al., 2003). Stock repurchases, it has been argued, mitigate agency costs by distributing excess cash that would otherwise be used by management in pursuit of their interests. Since outside directors' interests are the maximization of shareholder value and they have the power to monitor and control management we hypothesize thus:

Hypothesis 4: The ratio of outsider directors on the board will be positively associated with the amount of stock repurchase.

Method

Data Collection and Sample

To test hypotheses, we collected data from 2002 to 2003 for Korean companies listed in Korean stock exchange. Most of the data used in our analysis is acquired from TS 2000 database. TS 2000 database is made by Korean Listed Company Association based on the annual report submitted every year by listed companies. This database is updated annually and is one of the most credible sources of corporate financial information in Korea. The board data was acquired from the website of Financial Supervisory Service of Korea. Unfortunately, the number of outside directors is not available before 2002. The sample is adjusted by subtracting banks and insurance companies because of their atypical financial structures. We excluded some outliers from the database and the final sample consists of 1140 firm-years.

Variables

Dependent variables

The dependent variable in our analysis is the amount of stock repurchase. The data for stock repurchase is available from TS 2000 database. TS 2000 database shows the data and the repurchase amount for every company and we summed the repurchase amount.

Independent variables

There are four independent variables in our analysis: ownership by controlling shareholders (*ContOwn*), ownership by institutional investors (*InstOwn*), ownership by foreign investors (*ForeignOwn*) and the ratio of outside directors on the board (*OutDir*). As explained in hypotheses, ownership data represents the controlling power of each type of owners.

Control variables

Our analysis includes six control variables: firm size, debt ratio, profitability, R&D ratio, growth rate, and year dummy. Firm size is measured by the natural log of total assets. Debt ratio and profitability are usually associated with governance change (Peng, 2004) and these variables were also included as control variables. Debt ratio is calculated as total debt divided by the capital. ROA is a measure of profitability. R&D ratio is R&D amount divided by total sales. Growth rate is calculated by the annual increase in sales amount. Year dummy measures year effects.

Results

Sample Characteristics

Table 2 shows the descriptive statistics including correlation coefficients of all variables in this analysis. The average of stock repurchase amount is 19,190 million *won* (where the exchange rate was about U$1 = 1,000 *won* in 2002 and 2003). The average ownership rates of controlling shareholders, institutional investors and foreign investors are 40 percent, 6.5 percent and 7.4 percent respectively. The average outsider ratio in the board is about 30 percent which is a little higher than the legally set minimum of 25 percent. Average debt ratio is 184 percent. We also performed the multicollinearity test for this research model. The VIF (Variance Inflation Factor) are less than 10 which means there is no multicollinearity problem in this analysis.

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Regression Analysis

Table 3 shows the results of the OLS regression analysis. All the hypotheses were supported in Model 1 which does not include control variables.

Ownership by controlling shareholders is negatively related with stock repurchase amount at $p< .05$. Ownership by institutional investors is positively and significantly associated with stock repurchase at $p < .10$. Foreign ownership is positively and significantly associated with stock repurchase at $p < .001$. The ratio of outside directors on the board is positively and significantly related with the dependent $p < .001$.

Hypothesis 2 was not supported in Model 2 which includes control variables. From the control variables, firm size is positively related with the dependent variable at $p < .01$ and R&D ratio is positively associated with stock repurchase amount at $p < .1$. The significance of expected relationship is stronger in H3 and H4 than in H1 and H2. It is interpreted from our research model that increases in foreign investor ownership and in outsider ratio in the board played strong governance reform roles in Korean companies.

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Discussion and Conclusion

While several studies have centered on the reasons why firms carry out stock repurchases, often employing agency and signaling theories, this paper considers how firm-level actors' interests and power determine the extent to which a firm buys back its shares. Two issues make this study interesting. First, the institutional context is Korea; a country with corporate governance practices that traditionally diverge from shareholder value principles of which stock repurchase is one of them. However, Korea embarked on corporate governance reforms following the currency crisis of 1997, a fact that makes the institutional environment even more interesting. Second, the paper employs an actor-centered approach drawing heavily on neo-institutional theory. As such the study enhances our understanding of stock repurchases, a subject that is often the preserve of finance and economics, by offering a view informed by sociology-based principles.

The overall argument in this paper is that local politics, reacting to external pressures, drive the adoption of management innovations (e.g., stock repurchase) from an alternative governance system, as local actors co-opt Anglo-American corporate governance to reframe existing interests. As such Anglo-American corporate governance provides a broad toolbox from which actors select different elements to craft their frames that suit their interests.

An important tool used in this line of thought is the appreciation that diverse organizational actors have diverse interests and power, and that these actors will use their capabilities to shape events. Applying this line of thinking, the present study has recognized that governance changes in Korea are the result of a much wider organizational field, embracing legal changes at national level, global changes in corporate financing and changes in the face of corporate ownership dynamics. Indeed, a series of laws were passed by the Korean government with the aim of increasing the global competitiveness of national industry. Leading to a complete transformation of firm ownership geometry, the traditionally important actors have been, or are being, replaced or/and weakened. For instance institutional and foreign investors, by virtue of their capability to provide the much needed finance have moved to the centre stage of Korean firms. With their power, these new actors' interests lie in shareholder value, and firms in which they have heavily invested have had to comply with their demands. Indeed, results of this study show that institutional ownership is positively and significantly associated with stock repurchases. Such is the result of normative power or soft coercion (Chizema, 2008) in the sense that failure to comply with their expectations may result not in voice but exit as institutional investors sell their shares. The positive and significant association between foreign ownership and stock repurchases confirm recent studies in Japan, another Asian country, that show a strong relationship between the percentage of shares owned by foreigners and corporate behaviour (Ahmadjian & Robbins, 2005).

However, the negative association between controlling shareholders and stock repurchase may be interpreted as the continued importance of this group of actors and of their resistance to changes that promote shareholder value capitalism.

The positive and significant association between the proportion of outside directors and stock repurchase may give proponents of governance convergence a sense of triumphism. Outside directors were effectively introduced after the currency crisis and our finding in this study may mean the effectiveness of these new actors on Korean boards dismissing the notion that they could have been ceremonially or symbolically appointed.

This study has shown that adopting management innovations like stock repurchase is not only an issue of economic concern as explained by both agency and signalling theories but has far wider implications touching on internal organizational dynamics, as dictated by local actors manifested in corporate ownership and structure. This is particularly true in economies where governance institutions were not designed to accommodate stock market capitalism and where shareholder value principles may be seen as illegitimate (Sanders & Tuschke, 2007). As such, research and policy design in corporate governance should take both the economic and social dynamics into consideration.

While the majority of our results may suggest the arrival of a new governance paradigm in Korea, it is too early to assume convergence of capitalist systems. Indeed, research on comparative systems of capitalism tends to highlight the robustness and stability of local institutions (Guillen, 2001; Hall & Soskice, 2001) and the entrenched interests of a wider set of local actors (inter and intra-organizational) as sources of inertia (Greenwood & Hinings, 1996).

This paper shows, however, that local actors can be a source of either inertia or that of change. The overlapping interests of the institutional and foreign shareholders and outside directors shaped governance reforms in Korea; the practice of stock repurchase linked these actors ideologically even when they did not work in concert. On the other hand, controlling shareholders resisted the adoption of this practice preferring to maintain the status quo, indeed the source of their supremacy.

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Table I: *Foreign shareholding as at 31 December 2003*

Company	**Ratio of Foreign Shareholders (%)**
POSCO	66.71
Hyandai Development	59.80
Samsung Electronics	57.30
Cheil Communications	54.29
Daelim	51.71
Hyundai Motors	51.25
Shinsegae	48.89
SK Telekom	47.02
KT	45.37
Shindoricoh	45.04

Source: Korea Stock Exchange (2004)

Table 2: *Descriptive statistics and correlation coefficients*

1.StoRep	191 907	191 000	1.00								
2.ContOwn	.395	.172	-.110***	1.00							
3.InstOwn	.065	.086	.091**	-.078**	1.00						
4.ForeignOwn	.074	.136	.256***	-.053+	.920**	1.00					
5.OutDir	.299	.250	.224***	-.087*	.206***	.254***	1.00				
6.FirmSize	12.276	1.455	.264***	.039	.308***	.465***	.490***	1.00			
7.Debt	1.843	12.972	-.005	-.070*	.015	-.039	.005	-.072*	1.00		
8.ROA	.067	.946	.002	-.043	-.003	.002	-.026	-.060*	-.040	1.00	
9.R&D	.004	.015	.091**	-.085**	.012	-.008	.062+	-.021	.007	.040	1.00
10.Growth	1.628	16.216	-.003	.102**	.118***	-.019	.152***	.027	-.002	.032	-.011	1.00

Notes: †p< 0.10, * p< 0.05, ** p< 0.01 *** p< 0.001.

Table 3: *OLS Regression Analysis- Dependent variable: Stock repurchase*

Constant	-2.215*	-3.162**
Cont_own	-2.431*	-1.777+
Inst_own	1.823*	.830
For_own	6.560***	3.61***
Board ratio	3.985***	2.698 **
Control variables		
Firm size		2.188*
Debt ratio		0.140
ROA		0.227
R&D ratio		2.580+
Growth rate		-0.399
Year_dummy		0.339
R^2	0.116	0.097
Adjusted R^2	0.111	0.084
F-satistics	24.536***	7.707***
Sample size	1140	1140

Notes: †p< 0.10, * p< 0.05, ** p< 0.01 *** p< 0.001.