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OUTSIDE DIRECTORS DON'T HELP COMPANIES IN EMERGING ECONOMIES

COLUMBUS, Ohio – Outside directors on corporate boards don't necessarily help boost the bottom lines of companies in emerging economies, according to two recent studies.

The results contradict the common business wisdom that companies, especially those in developing countries, need outsiders on their boards of directors to bring fresh perspectives and independent, experienced advice.

The studies, in Russia and China, examined how companies with and without outside directors performed on several different success measures.

“The logic that outsiders would help companies seems fairly compelling, but the evidence just isn't there,” said [Mike Peng](#), one of the authors of the studies and an assistant professor of [management and human resources](#) at [Ohio State University's Fisher College of Business](#).

“We should be careful about arguing that the composition of boards is going to have a major influence on the success of companies.”

Even in the United States and other developed countries, there is mixed evidence on whether corporate boards that include independent members – those outside of the firm's management – really perform better, Peng said. But the practice has become increasingly widespread in countries such as Russia and China that hope for more investment and assistance from the international business community.



Mike Peng

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While the economic situations in China and Russia are different in many ways, Peng said it is significant that findings were similar in both countries.

In Russia, Peng conducted a study with Trevor Buck from [De Montfort University](#) and Igor Filatotchev of the [University of Bradford](#), both in England. Their study was published in a recent issue of the *[Journal of World Business](#)*.

The researchers used questionnaires to sample 314 large manufacturing firms in Russia in late 1995 and 1996. This was about three years after the beginning of the first phase of privatization in Russia, when state-owned enterprises were turned into private companies.

The researchers asked corporate leaders about the number of outsiders – people not employed by the firm – on each company's board of directors. They also asked whether the company had appointed new CEOs or other top managers since privatization began.

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In China, Peng did a related study based on a database of 405 companies listed on the Shanghai and Shenzhen Stock Exchanges between 1992 and 1996. This research was published in the *[Strategic Management Journal](#)*.

In this study, Peng was able to identify firms with both affiliated and non-affiliated outside directors. Affiliated outside directors are those who are associated with companies in which the firm in question does business. Non-affiliated outside directors have no ties to the company at all.

Peng found that having non-affiliated outside directors had no effect on a company's sales growth or return on equity. Firms with affiliated outside directors had stronger sales growth than did other firms, but they did not have any better return on equity.

Overall, the results from both Russia and China show that simply adding outside directors to a board will not help boost a firm's performance, Peng said.

Peng emphasized that he is not saying that outside directors do no good, or that companies should not seek board members from diverse backgrounds. He just believes that outside directors don't have all the answers.

“Companies can't assume that independent directors will give

them an easy advantage,” he said.

There are many reasons why outside directors may not have made a difference, according to Peng.

In some cases, totally independent board members may not know enough about the business to provide good guidance, he said. And the situation may be even more difficult for board members from other countries. Some Chinese and Russian firms have board members from companies in developed economies, such as those in the United States and Europe. But these foreign board members may be hampered by their lack of knowledge about the country’s culture, and may not want to push too hard for changes.

“International business people are often very cautious when they are in a foreign country, and they don’t want to be seen as trying to take over,” Peng said. “They may be more likely to follow the lead of the local board members.”

Another issue is the fact that situations change very quickly in emerging economies, and outside directors may be at a disadvantage in trying to keep up.

“If you’re an outside director who has another full-time job, it is hard to keep up with recent developments in the best of situations,” Peng said. “The situation is even more difficult in emerging economies where things change very quickly.”

Peng said the best type of directors for companies in emerging economies – and maybe developed economies as well – may be those somewhere in between totally independent and corporate insiders. Such directors would have “weak ties” to the company – they would know enough about the company to be able to lead effectively, but not be so close that they couldn’t criticize management and bring fresh perspectives. Such directors could be seen as being “acquaintances” of the company rather than friends or total strangers, Peng said.

“Directors with weak ties may have the best combination of both closeness to the company, and distance as well,” he said.

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