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Managerial Entrenchment, Banker Distribution, and Corporate Governance: Evidence from Japan

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Managerial Entrenchment, Banker Distribution, and Corporate Governance: Evidence from Japan*

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Abstract

This paper investigates whether managerial entrenchment of controlling shareholders affects the distribution of bankers to the boards of Japanese manufacturing firms. Bankers are not likely to be appointed to firms with large corporate shareholders as controlling shareholders because large corporate shareholders have incentives to entrench managers. Moreover, in the aftermath of executive appointments of banks and large corporate shareholders, restructuring and improved performances of the appointing firms are facilitated. The results suggest that managerial entrenchment of large corporate shareholders generates the substitution of role of corporate governance between banks and large corporate shareholders.

JEL classification: D23; G21; G32

Keywords: Corporate governance; Managerial entrenchment; Controlling shareholders; Banks

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1. Introduction

Substantial ownership provides shareholders with incentives to exert influence over firm management such that management makes decisions that can increase shareholder values. Full coincidence of the objectives of ownership and management plays an important role in mitigating the agency problem, in which the interests of shareholders are not aligned with those of managers (see, e.g., Jensen and Meckling, 1976). As a consequence, substantial ownership by shareholders leads to higher firm value.

Although increases in equity ownership by shareholders help to align the interests of managers and shareholders at low levels of equity ownership, beyond a certain level of ownership, shareholders have strong incentives to maximize the private benefits of control. Of course, these benefits include those that are not detrimental to other investors, including minority shareholders and creditors (Denis and McConnell, 2003). Controlling shareholders, however, can pursue interests that do not coincide with the interests of other investors (Shleifer and Vishny, 1997). Controlling shareholders use their control to extract private benefits that are not available to other investors. Extraction of such private benefits creates an agency problem of divergence of interest between controlling shareholders and other investors.[1] Furthermore, this extraction often leads to reduction in firm value (Stulz, 1988; Morck et al., 1988; McConnell and Servaes, 1990). Conflicts of interest between controlling shareholders and other investors become serious when other investors are directly involved in the management of the firm. Intervention in management by other investors leads to decrease in the private benefits of control. Thus, strong incentive for controlling shareholders to entrench managers does not allow other investors to serve on firm boards.

In this paper, we investigate whether managerial entrenchment of controlling shareholders affect the distribution of bankers to the boards of Japanese manufacturing firms from 1991 to 1995. Given the discussions above, controlling shareholders do not permit bankers to serve on firm boards if the benefits of the arrival of bankers on firm boards are outweighed by the cost factors associated with decrease in private benefits. In addition, even in an environment in which the strength of creditor rights supports appointments of bankers to firm boards, the presence of controlling shareholders can provide disincentives for banks to send their executives to firm boards.

There are two main reasons why Japanese manufacturing firms are suitable for testing our

[1] In a pyramid control structure in which wealthy family members dominate, large deviations between control rights and cash flow rights provide controlling shareholders with incentives to extract the private benefits, for example, by transferring assets and money from lower level firms to higher level firms. For a detailed discussion, see, e.g., Morck et al. (2005).

hypotheses. First, La Porta et al. (1999) show that outside the United States and the United Kingdom, countries have many firms with controlling shareholders. This view is in accordance with the ownership structure of Japanese firms.[2] Managers in Japan have less equity than in the United States (Prowse, 1992; Kaplan, 1994), but firms with larger firms as controlling shareholders are prevalent in the manufacturing firms. The controlling shareholders are often described as parent firms or affiliated firms, and they have close relationships with the owned firms through business in product and input markets. Second, it is commonly known that Japan is characterized as a bank-centered economy. In recent years, the importance of banks in Japan diminishes. Contributing factors include ongoing financial deregulation in capital markets, and the 1987 antitrust law limiting ownership shares of Japanese banks to less than 5 %. However, many firms have strong relationships with banks. Moreover, the strong creditor rights of Japanese banks support appointments of bankers to firm boards, unlike the United States, in which banks are prohibited from taking a large role in governing United States firms (Kroszner and Strahan, 2001a). Given the prevalence of controlling shareholders, and active involvement of bankers in the management of firms, using a sample of Japanese manufacturing firms is well suited to examining our hypotheses.

We find that bankers are likely to be appointed to larger firms with higher ratios of bank loans to total assets, and higher equity ownership by banks. More importantly, bankers are not likely to be appointed to firms in which large corporate shareholders dominate. The higher equity ownership by large corporate shareholders, the lower the likelihood of bankers being appointed to firm boards. This suggests that large corporate shareholders have strong incentives to entrench managers, and are then reluctant to accept bankers on their boards. However, we do not find such a relation between appointments of bankers to firm boards and equity ownership by inside owners as another type of controlling shareholders. Next, to concentrate on the strength of creditor rights in Japan, we identify banker appointments with disciplinary roles, and then examine the determinants of the appointment type. Results for large corporate shareholders continue to hold in our regressions. Moreover, bankers with disciplinary roles are not likely to be appointed to firms with inside owners. The higher the equity ownership by inside owners, the lower the probability of bankers with disciplinary roles being appointed to firm boards. This suggests that inside owners have incentives to protect the management against bankers with disciplinary roles.

We are concerned about whether executive appointments of large corporate shareholders have an impact on those of banks. We use information on executive appointments of large corporate shareholders to check the robustness of our findings. The results do not change

[2] For ownership structure of Western European corporations, see Faccio and Lang (2002). For ownership structure of East Asian corporations, see Claessens et al. (2000).

irrespective of appointment type, and lead us to conclude that our results are robust. Moreover, we find that executive appointments of large corporate shareholders include those that are sensitive to poor stock performance, suggesting that such executives play a key role in corporate governance. Finally, we examine the post-appointment performances of firms that accept executives of banks and large corporate shareholders on their boards. After bankers with disciplinary roles are appointed to firm boards, the appointing firms implement asset disposal, and reduce employment. Similarly, after large corporate shareholders place executives as disciplinary devices on firm boards, the asset growth rate and employment growth of the appointing firms reduce significantly. The results suggest that the appointed executives play an important role in restructuring activities. Furthermore, unlike banks, sales and stock return performances improve in the aftermath of executive appointments of large corporate shareholders. As a consequence, the results show that banks and large corporate shareholders play a disciplinary role in corporate governance of the appointing firms. Taken together, we conclude that managerial entrenchment of large corporate shareholders generates the substitution of role of corporate governance between banks and large corporate shareholders.[3]

This paper is associated with previous studies on corporate governance in Japan. Aoki et al. (1994) provide anecdotal evidence that shows interactive role in exercising corporate governance between banks and large corporate shareholders. They argue that corporate governance by main bank depends on the ownership structure of the firm. If the firm has close relationship with the parent firm as large corporate shareholder, main bank is likely to lend indirect support for large corporate shareholder that facilitates the restructuring of a troubled firm, unless the shareholder is under financial distress. Sheard (1994b, 1997) presents direct evidence that bankers are not likely to be on the boards of firms with dominant shareholders. Unlike previous papers, this paper aims to examine empirically the interactive relation of corporate governance between banks and large corporate shareholders.

The rest of the paper is organized as follows. Section 2 provides background. Section 3 describes data sources, variables, and descriptive statistics. Section 4 reports the results for the determinants of banker appointments. Section 5 reports additional results by focusing on appointments of bankers with disciplinary roles. Section 6 checks the robustness of our results. Section 7 investigates changes in corporate performances after executives as disciplinary devices are appointed to firm boards. Section 8 concludes the paper.

2. Background

[3] Nickell et al. (1997) study the relation between factors that discipline managers. They find that there are substituting roles among disciplinary factors: product market competition, financial market pressure, and shareholder control.

2.1. Legal protection and corporate governance in Japan

Corporate governance pays increased attention to the ways in which outside investors protect themselves against insiders to maximize the returns on their investments. However, in an environment in which expropriation of minority shareholders and creditors by controlling shareholders is extensive, the returns will not materialize. In such environment, all outside investors need to have their rights protected. Enforced rights require insiders to distribute the profits to shareholders, and repay the creditors. The protection of outside investors through the legal system is an important consideration for corporate governance.

Recent studies suggest that a complementary combination of legal protection of investors and concentrated ownership have an influential impact on the effectiveness of corporate governance. (Shleifer and Vishny, 1997; La Porta et al., 1998; La Porta et al., 1999). In common-law countries with strong protection of investors, the legal system includes protections of minority shareholders. In contrast, French-civil-law countries have the weakest protection of shareholders. In such legal systems, strong incentives for shareholders to own higher control and cash flow rights to circumvent expropriation of profits by managers or low demand for equity by shareholders results in concentrated ownership. Concentrated ownership could be a substitute for weak legal protection of investors (La Porta et al., 1998).

While the United States in common-law countries offer shareholders strong legal protection, Japan is in the German-civil law countries in which the rights of shareholders are weaker than in the United States (La Porta et al., 1998).[4] The relatively weak protections of shareholders can be associated with the higher fraction of firms with large shareholders in Japan than in the United States. Indeed, in our sample of manufacturing firms listed on the stock exchange from 1991 to 1995, using a 10% definition of control, we find that 46.3% of our sample firms have corporate shareholders as the top shareholder. Even using a 20% definition of control, we find that 33.4% of our sample firms are ones in which corporate shareholders dominate. Most controlling shareholders with more than 20% shareholdings are nonfinancial firms listed on the stock exchange. Note that firms with financial institutions as large shareholders are very limited, because the antitrust law in 1987 restricts the equity ownership of financial institutions, especially banks, to be no more than 5 %.[5] Consequently, our findings show that the ownership structures of Japanese firms are relatively concentrated, and many Japanese firms have

[4] Among German-civil law countries, Japan has relatively good shareholder protection (Shleifer and Vishny, 1997; La Porta et al., 2000).

[5] Using the five largest owners in Japanese firms listed on the Tokyo Stock Exchange, Prowse (1992) shows that financial institutions dominate among the top five shareholders. However, in 1984, the year in which he gathered information on the firms, Japanese banks were permitted to have more than 5 % shareholdings.

controlling corporate shareholders.[6]

As mentioned above, controlling shareholders as insiders have strong incentives to pursue their own interests, and these self-interest actions often leads to deterioration in firm value. However, large corporate shareholders in Japan do not adversely affect firm value, corporate performance, and stock returns (Kang and Shivdasani, 1996; Morck et al., 2000; Miyajima and Kuroki, 2008). Large corporate shareholders effectively exert control over the management of the owned firms, and even play an important role in lowering expenditure on activities with scope for managerial private benefits (Yafeh and Yosha, 2003). In particular, executive appointments to the boards of poor performing firms are pronounced (Kaplan and Minton, 1994; Kang and Shivdasani, 1995). These appointments aim to intervene in management, discipline the managers, and then replace incumbent managers with the newly appointed executives. The appointments are indicators that large corporate shareholders exert control over management to maximize their own interests through increased attention to the appointing firms.

On the other hand, Japan, as a German-civil-law country, affords stronger legal protection to creditors, in particular senior secured creditors, than common-law countries, including the United States. If client firms violate their financial obligations, then creditors can enforce their rights effectively. Creditor rights include the right to possess collateral, the right to dismiss the managers mandatorily in reorganization, the right to liquidiate the firm, and so on (see, e.g., Shleifer and Vishny, 1997; La Porta et al., 1998). In addition, effectively enforced rights of creditors enable banks to send executives to the boards of poor performing firms. As Kroszner and Strahan (2001a) suggest, a higher fraction of firms with bankers on firm boards in Japan than in the United States indicates that creditor rights in Japan are relatively strong.

Appointments of bankers play a crucial role in Japanese corporate governance. In particular, the appointments to firm boards become important when client firms are under financial distress (Kaplan and Minton, 1994). The appointed executives aim to intervene in management, discipline the managers, and even displace the incumbent managers (Kaplan and Minton, 1994; Kang and Shivdasani, 1995). Through the appointed executives, banks play a pivotal role in formulating and implementing the restructuring plans.[7]

Two different corporate governance systems are strongly associated with the legal system of Japan in which the legal protection of shareholders is relatively weak, but the rights of secured creditors are strongly protected. The weak protection of shareholders leads to concentrated

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[6] Claessens et al. (2000) show that widely held corporations in Japan are large and medium-size corporations, and the exception for small corporations.

[7] Morck and Nakamura (1999) are skeptical about the effects of bank executive appointments. They find that monitoring by banks is more likely to occur in firms in which the bank's incentives are not aligned with shareholder value maximization.

ownership, in which shareholders have incentives to monitor the management. Strong creditor rights allow banks to send executives to the boards of client firms, thereby exerting control over the management. Consequently, large corporate shareholders and banks play an important role in Japanese corporate governance.

2.2. Managerial entrenchment and bankers on firm boards

When bankers arrive at the boards of firms with controlling shareholders, what benefits or costs do they generally bring to the boards? We consider the benefits of accepting bankers on firm boards. Bankers on firm boards can have easy access to firm information. Better information helps the appointing firms to obtain bank loans on better terms, thereby lowering the costs of monitoring, including the ones of external finance. In addition, bankers on firm boards can send a signal to other banks, public debt markets, and investors that the financial conditions of the appointing firms are likely to improve. The appointment as a form of certification also contributes to a reduction in the costs of external finance.[8]

As for the potential costs for bankers on firm boards, conflicts of interest between banks and shareholders, including minority shareholders, generally arise because of different payoff structures attached to debt and equity. The potential costs of conflicts become serious when bankers are on firm boards.[9] However, Japanese banks can hold the equity of the firms, in which case such a problem is not serious. On the other hand, controlling shareholders have incentives to maximize the private benefits of control, in which case the interests of controlling shareholders are not likely to be aligned with those of bankers on firm boards. Divergence of interest between banks and controlling shareholders becomes serious when bankers are on firm boards. For example, bankers on firm boards argue against management plans that maximize the private benefits of control, and even replace the incumbent managers, including executives previously employed by controlling shareholders, with other executives. As a result, controlling shareholders are reluctant to incur such potential costs, and have incentives to avoid the arrival of bankers with different interests on their boards. If the cost factors outweigh the benefits of accepting bankers on firm boards, controlling shareholders are reluctant to invite bankers on

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[8] For the role of bankers on firm boards, see Kroszner and Strahan (2001a, 2001b), and Byrd and Mizruchi (2005).

[9] Kroszner and Strahan (2001a) show that bankers in the United States tend to avoid conflicts of interest between banks and shareholders, and not to appear on the boards of firms in which such conflicts of interest are serious. However, Japanese banks are permitted to have equity of firms, and such a divergence of interest is not serious. Indeed Prowse (1990) shows that, unlike the United States, in the financial keiretsu firms in which large shareholders are also large debtholders, wealth is not transferred from debtholders to shareholders.

their boards. Banks are also concerned about the potential costs of conflicts of interest, and have less incentive to place their executives on the boards of firms with controlling shareholders.

3. Data, variables, and descriptive statistics

In this section, we describe the sample firms, and provide details on the construction of the variables in the empirical tests. Then we report the descriptive statistics of the variables.

3.1. Sample selection

Our sample includes Japanese manufacturing firms listed on the stock exchange. The firms operate within a fiscal year that ends in March during 1991 through 1995. We choose a sample period from 1991 to 1995 for two reasons. First, regulation of access to capital markets was completely abolished in the late 1990s, and then the dependence on bank loans decreased. Furthermore, unwinding of cross-shareholding between banks and firms was frequent in the late 1990s (Miyajima and Kuroki., 2008). A shift away from bank loans and the unwinding of cross-shareholding lead to the dilution of relationships between banks and firms, resulting in decrease in banker appointments. Second, merger and acquisition (M&A) activities have increased since the late 1990s. M&A activities play a key role in the restructuring of acquired firms by selling and transferring unprofitable sectors to acquiring firms.[10] Then the role of banks in corporate governance diminishes. Given the arguments above, the sample period from 1991 to 1995 is well suited to our analyses.[11]

We omit firms for which financial statements data from the Nikkei Needs dataset are not available continuously during the sample period because of bankruptcy or M&A. This data source includes unconsolidated data of income statements and balance sheets for the nonfinancial firms traded on the stock exchange. The resulting sample is 4262 observations for which data for all variables in our regressions are available.

3.2. Banks and controlling shareholders

We focus on executive appointments of main banks because main banks in Japan have close

[10] For a discussion of M&A activities in Japan, see Miyajima (2007).

[11] It is argued that in the late 1990s bank monitoring is not highly likely to serve as an effective device for troubled firms. Unhealthy banks do not play an important role in the restructuring of firms, and instead provide financial assistance excessively to troubled firms in nonmanufacturing sectors, including construction and real estate. (Peek and Rosengren, 2005; Caballero et al., 2008). However, this problem is not serious here because we use data on manufacturing firms in the early 1990s.

relationship with firms. They often maintain the largest share among financial institutions of loans to firms, are major shareholders in the firms, and send their executives to firm boards. In addition, main bank is characterized as the delegated monitor among banks lending to a particular firm (Sheard, 1989, 1994c). We consider the main bank to be the bank first listed in *Japan Company Handbook* that contains financial data on all publicly traded Japanese companies.[12]

In this paper, we concentrate on the controlling shareholders as follows: nonfinancial firm with more than 20 % shareholding as the top shareholder, and the manager serving on the board as the top shareholder. The cutoff level of control for large corporate shareholder follows that in La Porta et al. (1999). Voting rates by public shareholders are generally quite low. Then equity ownership exceeding 50 % are not necessary to lock in control. More than 20 % shareholdings is usually sufficient to control board elections. In our sample, the average ownership of the large corporate shareholders is 0.371 (or 37.1 %) and the median is 0.346 (or 34.6%). Furthermore, figures serving on firm boards as the top shareholders are mainly founding entrepreneurs or a member of the founder's family and have strong incentives to entrench themselves.[13] This is pronounced for powerful figures serving as the chairman or president. Thus, we also include equity ownership by the chairman or president as the top shareholder (Sheard, 1994b, 1996; Hirota and Miyajima, 2001). The average ownership of inside owners is 0.123 (or 12.3 %) and the median is 0.086 (or 8.6%). Data on equity ownership by large corporate shareholders and inside owners are taken from *Kigyo Keiretsu Soran*.

3.3. Appointments of bankers to firm boards

We consider appointments of bankers to be bankers previously employed by main banks being appointed to the boards of nonfinancial firms during the fiscal year. Banker appointments are restricted to those in which bankers are selected at the shareholder meetings in June. Data on banker appointments are obtained from *Yakuin Shikihou* and *Yuka Shoken Hokokusho*. The appointed executives include those in management positions as follows: chairman (kaicho), president (shacho), vice president (fuku-shacho), executive director (senmu), managing director (jomu), and director (torishimariyaku). We do not include appointments of new statutory auditors who have no voting rights at board meetings. Our definition of executive appointments is based on other previous studies (Kaplan and Minton, 1994; Hirota and Miyajima, 2001;

[12] This way of identifying the main bank is used in Gibson (1995), and Klein et al. (2002).
[13] Aoki et al. (1994) show that the main bank's monitoring is sensitive to the idiosyncratic characteristics of owner-managed firms.

Miyajima et al., 2001).

However, Sheard (1994b) suggests that there are two different types among these appointments. The purpose of one appointment type is intervention in the management of poor performing firms. Japanese banks send bankers with disciplinary roles to the firms under financial distress, and exercise control over management of the appointing firms. Another type aims at supporting their reemployment of bankers in firms. Banks frequently send their mid- and late-career directors to firms in normal financial conditions to assist their reemployment.[14] On the other hand, several studies focus on the role of bankers with financial expertise in the United States (Booth and Deli, 1999; Byrd and Mizruchi, 2005; Guner et al., 2008). Although such analyses are limited in Japan, bankers that act as disciplinary devices and those that find reemployment in firms are both likely to bring bank loans to the appointing firms through better information flow from firms to banks. Thus, we concentrate on appointments of bankers with and without disciplinary roles. Unfortunately, we cannot distinguish between these types in systematic ways.

Although some new appointments exchange positions with previously appointed bankers, we treat replacement and nonreplacement appointments as the same. In addition, we do not distinguish between single and multiple appointments because multiple appointments in a given fiscal year are very rare.

Table 1 contains the average values of the variables related to banker appointments in our sample. This shows that appointments of bankers to firm boards represent 4.6％ (or 195) of our observations.

3.4. Corporate performance measures

We use three corporate performance measures: stock return, return on assets (ROA), and negative pretax income. Stock return is intended to measure market performance. This is defined as dividends per share plus stock price at the last day of the fiscal year less stock price at the last day of the previous fiscal year, divided by stock price at the last day of the previous fiscal year. Stock price data are taken from *Kabuka Soran*. ROA is intended to measure accounting performance. The variable is defined as the ratio of pretax income to the average of total assets for the previous and current fiscal years. Negative pretax income indicates that firms face the difficulty of meeting their financial obligations (Kaplan and Minton, 1994). This takes on a value of 1 if pretax income is negative, and 0 otherwise. The fraction of firms with negative pretax income is 0.139 (or 13.9 ％), which is higher than in Kaplan and Minton (1994).

[14] Kaplan and Minton (1994) and Morck and Nakamura (1999) do not distinguish between bankers without disciplinary roles and with disciplinary roles.

Some argue that industry-adjusted performance measures, not raw measures are closely related to executive appointments (Kang and Shivdasani, 1995; Morck and Nakamura, 1999). Then we recalculate industry-adjusted performance measures for stock return and ROA. Industry-adjusted performance measures are calculated as raw performance variables less industry-average performance values as average values of the industry in each fiscal year. This captures the degree of deviation of the firm's performance from industry mean performance in the fiscal year. The code to classify sample firms by industry is obtained from *Japan Company Handbook*.

3.5. Bank relationship measures

Japanese main banks have dual roles as creditors and shareholders. They provide loans to firms, and obtain equity in the firms. The investments establish close relation between main banks and firms. Previous studies find linkage between banker appointments and relationship measures, including loans-asset ratio, and equity ownership (Kaplan and Minton, 1994; Hirota and Miyajima, 2001). Thus, we need to control for the strength of main bank relationship when we examine the determinants of executive appointments by main banks.

In our specifications, we include the ratio of the main bank loans to total assets, and equity ownership by main banks. Data on loans outstanding, and equity ownership of main banks are obtained from *Kigyo Keiretsu Soran*.

3.6. Financial and enterprise keiretsu membership

In empirical analyses, we capture the strength of the corporate group relationship. It is well known that there are industrial groups in Japanese economy. These are bank-centered, and enterprise-centered groups. The former groups have strong relationships with main bank and other member firms by way of cross shareholding of equity and production activities. The latter groups have close relationships with parent firms or affiliated firms as large shareholders through input or output markets.

We consider the firms to be financial keiretsu members if they are associated with one of the eight financial keiretsu members: Mitsubishi, Mitsui, Sumitomo, Fuyo, DKB (Daiichi Kangyo Bank), Sanwa, IBJ (Industrial Bank of Japan), and Tokai *and* main banks of the firms are identical to one of main banks at the center of the eight financial keiretsu members. We construct an financial keiretsu dummy variable that has a value of 1 if our strategy identifies the firm as being associated with a financial keiretsu member, and 0 otherwise. This variable plays a more important role in our analyses. Morck and Nakamura (1999) show that factors that predict

the appointments of bankers to firm boards are different between keiretsu and independent firms. The inclusion of the variable helps controls for the difference between financial keiretsu firms and independent firms. Our financial keiretsu firms constitute 0.328 (or 32.8 %) of sample firms. Data on financial keiretsu members come from Industrial Groupings in Japan}.

In addition to financial keiretsu membership, we include enterprise keiretsu membership, following Kaplan and Minton (1994). We consider the firms to be enterprise keiretsu members if the firms are associated with one of the following eighteen enterprise members as: Mitsubishi Material, Mitsubishi Chemical, Nippon Steel, NKK, Sumitomo Metal Industries, Kobe Steel, Mitsubishi Heavy Industries, Hitachi, Matsushita, Toshiba, NEC, Sony, Mitsubishi Electric, Fujitsu, Toyota, Nissan, Honda and Kintetsu.[15] The enterprise keiretsu dummy variable has a value of 1 if the firm is associated with an enterprise keiretsu member, and 0 otherwise. Enterprise keiretsu firms account for 0.141 (or 14.1 %) of our sample firms. Data on enterprise keiretsu members are obtained from *Industrial Groupings in Japan*.

3.7. Other control variables

We control for other firm characteristics, including firm size and firm age. Firm size is intended to capture directly the effects of firm size, and captures indirectly the effects of the size of firm boards (Kroszner and Strahan, 2001a). This is measured by the logarithm of total assets. Firm age is included to capture the connection between banker appointments and firm age. Sheard (1994b, 1997) finds that the older the firm, the fewer presence of bankers on the board, and interprets this as evidence suggesting that banks accumulate internal information about older firms, and accumulated information requires banks not to are on the boards of older firms to gather new information. This is measured by the logarithm of the years elapsed since the establishment of the firm.

In addition, after the bursting of the asset price bubble, nonperforming loans drastically increased, and the financial condition of Japanese banks deteriorated. Poor financial conditions can adversely affect management intervention through banker appointments.[16] Then, we control for the health condition of the main bank by using stock returns because they are likely to capture the deterioration in economic performances, including financial conditions. We do not use nonperforming loans and capital ratios because Japanese banks in the 1990s had strong incentives to understate nonperforming loans and overstate capital ratios, and the variables are

[15] In constructing the enterprise keiretsu dummy variable, Kaplan and Minton (1994) focus attention on the six large enterprise members: Hitachi, Matsushita, Nippon Steel, Nissan Motors, Toshiba, and Toyota.

[16] Sheard (1997) shows that banks in poor financial conditions cannot intervene in the management of troubled firms, and implement the business reconstruction.

not likely to reflect true values (Peek and Rosengren, 2005).

Finally, our regressions include industry-average performance variables, and time dummy variables. The industry-average performance variables are intended to help control industry health conditions (Kang and Shivdasani, 1995; Morck and Nakamura, 1999). We include time dummy variables to control year-specific effects that could affect allocation of bankers to firm boards.

Summary statistics for these variables are provided in Table 1. In order to obtain robust results, we remove observations for continuous variables with extreme values.[17]

4. Managerial entrenchment and banker appointments

Table 2 contains probit regression estimates of the determinants of banker appointments. The dependent variable in all equations has a value of 1 if the banker is appointed to the board of the firm during the year, and 0 otherwise. In order to avoid the reverse causality problem, all independent variables are one-period-lagged values. We include one-period-lagged values of industry-average performance variables because there can be linkage between the selection of bankers as new executives at the shareholder meeting in June and industry-average performance for the previous fiscal year ending in March. Our key variables are equity ownership by large corporate shareholders with more than 20 % shareholdings and equity ownership by inside owners. The coefficients on the variables are expected to be negative if controlling shareholders have incentives to protect managers against bankers, and banks are concerned about managerial entrenchment of controlling shareholders. We do not include the variable for incumbent bankers on firm boards because we follow Sheard (1994a) who argues that existing former bankers on firm boards have quite different capacities from newly appointed bankers, and are likely to be displaced with newly appointed bankers.

Column 1 reports the results for the basic specification without equity ownership by controlling shareholders. As for corporate performance measures, the coefficients on the industry-adjusted stock return and ROA are negative but not significant. The results indicate that the appointed bankers are unlikely to have disciplinary roles, but likely to find reemployment positions in the firms.[18] The less active involvement of banks in the management of poor performing firms in the early 1990s can be related to the increase of zombie firms in the late 1990s (Caballero et al., 2008). The coefficients on bank loans ratio and bank equity ownership are positive and significant, suggesting that banker appointments are closely related to the

[17] Extreme observations for continuous variables are defined as those for which any one of the variables has a value more than four standard deviations away from the mean value.
[18] We obtain similar results when two-period-lagged values of corporate performance measures are included in our specifications.

strength of bank relationship. The results are similar to those in Hirota and Miyajima (2001). The coefficient on firm size is significantly positive, suggesting that bankers are likely to be appointed to larger firms. Interestingly, the coefficient on the industry-average stock return is significantly positive, indicating that bankers are likely to be appointed to firm boards when the industry stock performance perform well, on average.[19]

Column 2 shows the results for the specification with equity ownership by controlling shareholders. The basic results are similar to those in column 1. The coefficient on industry-adjusted ROA is negative and significant, and the coefficient on financial keiretsu membership is positive and significant. More importantly, the coefficient on equity ownership by large corporate shareholders is negative and significant. This suggests that higher equity ownership by large corporate shareholders is, less likely are bankers to be appointed to firm boards. In contrast, the coefficient on equity ownership by inside owners is positive but not significant. In column 3, we replace industry-adjusted ROA with negative pretax income. The coefficients on equity ownership by controlling shareholders mirror those in column 2. While the coefficient on equity ownership by large corporate shareholders is negative and significant, the coefficient on equity ownership by inside owners is positive and insignificant. However, the coefficient on negative pretax income is positive but not significant.

The results of Table 2 for the determinants of banker appointments provide support for our predictions. Bankers are not likely to be appointed to the boards of firms in which large corporate shareholders dominate. We interpret this evidence as suggesting that large corporate shareholders have incentives to entrench managers, and banks are afraid of managerial entrenchment of large corporate shareholders. In contrast, we do not find a significant link between equity ownership by inside owners and banker appointments. Our results are robust to different corporate performance variables including industry-adjusted ROA and negative pretax income.

5. Managerial entrenchment and banker appointments as disciplinary devices

As we have shown above, managerial entrenchment of large corporate shareholders has an important impact on the distribution of bankers to firm boards. Bankers are, ceteris paribus, not likely to be appointed to firms with large corporate shareholders. However, in legal systems favorable to banks, the strength of creditor rights predominates. Strong creditor rights can allow

[19] This result contradicts the findings of Morck and Nakamura (1999), who show evidence that banker appointments are strongly associated with higher industry-average stock performances.

banks to enforce protected rights effectively through appointments of bankers to the boards of poor performing firms, even those in which controlling shareholders dominate.

To investigate whether bankers with disciplinary roles are appointed to firms with controlling shareholders, we need to identify banker appointments with disciplinary roles among total banker appointments. Unfortunately, we cannot pick up the appointment type in systematic ways. Thus, because the appointments of bankers with disciplinary roles are sensitive to poor corporate performance, we define appointments with disciplinary roles as those in which the appointing firms report an interest coverage ratio (the ratio of operating profits to interest payments) of less than 1 at the end of the previous fiscal year. This implies the inability to cover interest payments out of current operating income. On the basis of this strategy, the appointments of bankers as disciplinary devices are 1.8% (or 76) of our sample firms. Note that the appointing firms include both those that are temporarily under financial distress, and those that are seriously troubled. However, bankers are not likely to find reemployment positions in troubled firms, and then banker appointments to such firms are plausibly considered to be those with disciplinary roles.

Table 3 reports the probit regression estimates, in which dependent variable has a value of 1 if the banker with disciplinary role is appointed to the board of the firm during the year, and 0 otherwise. Column 1 contains the results for the specification without equity ownership by controlling shareholders. The coefficients on industry-adjusted stock return and ROA are negative and significant. The coefficients on bank loans ratio and bank equity ownership are positive and significant. The coefficient on firm size is positive and significant. While the coefficient on industry-average stock return is significantly positive, the coefficient on industry-average ROA is significantly negative. Column 2 contains the results for the specification including equity ownership by controlling shareholders. The coefficient on equity ownership by large corporate shareholders is negative and significant, but the size of the coefficient is smaller than one in column 2 of Table 2. This suggests that in a legal environment favorable to banks, strong creditor rights support the appointment of bankers to the boards of poor performing firms, but managerial entrenchment of large corporate shareholders outweighs the strength of creditor rights, thereby leading to a lower likelihood of bankers being appointed to poor performing firms with large corporate shareholders. More importantly, the coefficient on equity ownership by inside owners is negative and significant. This is similar to the results in Sheard (1994b, 1997) and Hirota and Miyajima (2001). While inside owners are not concerned about banker appointments in normal times, they are aware of bankers with disciplinary roles serving on firm boards. The regression in column 3 yields similar results to those in column 2. The coefficient on negative pretax income is positive and significant. Both the coefficients on equity ownership by large corporate shareholders and by inside owners are negative and

significant.

However, we need to show one caveat for our results. We do not distinguish between firms that do not accept bankers on their boards and those that receive bankers without disciplinary roles. In the regressions, we give both types a value of 0 for the dependent variable. Thus, we exclude from our sample observations of firms that accept bankers without disciplinary roles. However, a problem emerges in the removal of the observations. Given that bakers are not likely to be appointed to firms with large corporate shareholders, exclusion of observations of firms that accept bankers without disciplinary roles can introduce sample selection bias. Indeed, we conduct the analyses with the dependent variable taking a value of 1 if bank send the executive with disciplinary role to the firm board, and 0 if firms does not accept the executive, and find a larger coefficient on equity ownership by large corporate shareholders. To conserve space, we do not report this result.

In this section, we present results for the impact of managerial entrenchment of controlling shareholders on appointments of bankers as disciplinary devices to the boards of poor performing firms. Even bankers with disciplinary roles are not likely to be appointed to the boards of poor performing firms with controlling shareholders. As a consequence, firms in which large corporate shareholders dominate are not likely to accept bankers on their boards irrespective of the role of the appointing bankers. In addition, inside-owner-controlled firms are not likely to accept bankers with disciplinary roles on the boards, suggesting that firms with inside owners protect the managers against appointment of bankers as disciplinary actions, and then entrench management. Taken together, managerial entrenchment of controlling shareholders constrains bankers with disciplinary roles from serving on firm boards.

6. Robustness checks

In previous sections, we find that managerial entrenchment of large corporate shareholders curbs the appointments of bankers to firm boards. However, if executive appointments of large corporate shareholders have an influential impact on those of banks, our results can suffer from statistical bias. To examine whether simultaneous equation bias adversely affects our estimated coefficients, we study the determinants of each executive appointment, conditional on the other type of executive appointment. Here we use the seemingly unrelated bivariate probit model to check the robustness of our results.[20]

Like banks, large corporate shareholders play an important role in corporate governance of their affiliated firms and subsidiaries. In particular, they send their executives to the boards of

[20] Kaplan and Minton (1994) estimate the bivariate probit model, and conclude that director appointments of nonfinancial firms do not affect director appointments of banks.

owned firms, replacing incumbent executives, including inside and outside members of the boards, with their new executives (Kang and Shivdasani, 1995, 1997). Like banker appointments, we consider executive appointments of large corporate shareholders to be executives previously employed by large corporate shareholders with more than 20 % shareholdings as the top shareholders. In our sample, executive appointment of large corporate shareholders occurs in 13.7% (or 583) of our sample firms.[21] This implies that in comparison with banks, large corporate shareholders pay increased attention to the owned firms. In addition, executive appointments of large corporate shareholders also include ones that exert control over management as well as ones for reemployment of large corporate shareholder executives (Sheard, 1994b). Following previous sections, we need to identify executive appointments of large corporate shareholders with disciplinary roles because executive appointments of large corporate shareholder executives with disciplinary roles could have a substantial effect on those of bankers with disciplinary roles. We define as executive appointments of large corporate shareholders with disciplinary roles those in which the firm's stock return is in the lowest one-fourth for each industry at the end of the previous fiscal year. This strategy follows Kang and Shivdasani (1995) and Kaplan and Minton (1994) in which blockholders or nonfinancial firms discipline managers for poor stock price performances. Like banks, the appointing firms include those that are both temporarily and seriously troubled. On the basis of this scheme, executive appointments of large corporate shareholders as disciplinary devices occur in 3.2% (or 136) of our sample firms.

In the equations in which the dependent variable is appointments of bankers, the independent variables used are identical to those in previous analyses. In the equations in which the dependent variable is executive appointments of large corporate shareholders, we use industry-adjusted stock return of firms, industry-adjusted ROA, and negative pretax income as corporate performance variables. Equity ownership by large corporate shareholders is intended to control for the difference of equity ownership. In addition, following Kaplan and Minton (1994), we include financial and enterprise keiretsu member variables. Firm size, firm age, industry-average stock return, industry-average ROA, and time dummy variables are intended to control for other characteristics.[22]

Table 4 contains the results for the seemingly unrelated bivariate probit model. Panel A presents the results for the determinants of executive appointments of banks, and Panel B shows the results for the determinants of executive appointments of large corporate shareholders. Dependent variables for columns 1 and 2 take on a value of 1 if the firm accepts the banker on

[21] Kang and Shivdasani (1996) show that in 60 of 100 outside president succession cases, the sending company is the firm's largest shareholder.
[22] Sheard (1997) finds that older firms are not likely to have a president from nonfinancial firms.

the board, and 0 otherwise in the bank equation, and take on a value of 1 if the firm accepts the executive of large corporate shareholder on the board, and 0 otherwise in the large corporate shareholder equation. Dependent variables for columns 3 and 4 take on a value of 1 if the interest coverage ratio of the firm accepting the banker on the board takes on a value less than 1 at the end of the previous fiscal year in the bank equation, and the appointed firm's stock return is in the lowest one-fourth for each industry at the end of the previous fiscal year in the large corporate shareholder equation.

In the bank equation of column 1, while the coefficient on equity ownership by large corporate shareholders is negative and significant, the coefficient on equity ownership by inside owners is positive but not significant. Turning to the results for large corporate shareholders, the estimated coefficient on industry-adjusted stock return is negative but not significant. This result is not consistent with the findings of Kang and Shivdasani (1995) and Kaplan and Minton (1994), who find that the nonroutine president turnover of blockholders and director appointments of nonfinancial firms are sensitive to stock return. The coefficient on industry-adjusted ROA is negative but not significant. The coefficient on equity ownership by large corporate shareholders is significantly positive. The coefficient on firm size is significantly negative, suggesting that large corporate shareholders are likely to send their executives to smaller firms. The result is in contrast with that of the bank equation, suggesting that larger firms are likely to receive bankers on their boards. These results show that firms with different size are likely to accept different executives on their boards. The coefficient on financial keiretsu membership is positive but insignificant. Given that Kaplan and Minton (1994) present results that director appointments of nonfinancial firms are strongly related to financial keiretsu membership variable, our findings probably suggest that large corporate shareholders of financial keiretsu member firms have less than 20 % shareholdings. The coefficient on enterprise keiretsu membership is significantly positive, indicating that enterprise keiretsu member firms are likely to receive the executives from parent firms or affiliated firms with more than 20% shareholdings. Column 2 provides the results from the specification with negative pretax income, and shows similar results to those in column 1. In the bank equation of column 2, while the coefficient on equity ownership by large corporate shareholders is significantly negative, the coefficient on equity ownership by inside owners is positive and insignificant.

In columns 3 and 4 in which the dependent variables are executive appointments of banks and large corporate shareholders as disciplinary devices, the results in columns 3 and 4 of Panel A mirror those in columns 2 and 3 of Table 3. In the bank equations, the coefficients on equity ownership by large corporate shareholders and equity ownership by inside owners are significantly negative. As for the results of large corporate shareholders in columns 3 and 4, the

coefficients on industry-adjusted stock return are significantly negative, and the coefficients on equity ownership by large corporate shareholders are significantly positive. The coefficients on firm age are significantly positive. The coefficients on enterprise keiretsu membership are still significantly positive. The coefficients on industry-average stock return are significantly negative.

There is one caveat to the results for executive appointments of large corporate shareholders. For the dependent variable in columns 1 and 2, if executives of large corporate shareholders are not appointed to the firms, we label with a value of 0 both firms with large corporate shareholders that send no executives and firms without large corporate shareholders. Given that bankers are not likely to be appointed to firms with large corporate shareholders, we do not find a negative relation between banker appointments and equity ownership by large corporate shareholders when we use the sample excluding observations of firms without large corporate shareholders. Then we rerun the probit model for a single equation by focusing on the sample limited to firms with large corporate shareholders. Although the results are not reported in this paper, we obtain similar results to those in columns 1 and 2 of Panel B. Furthermore, columns 3 and 4 face similar problems to those in the analyses of Section 5. The dependent variables in the large corporate shareholder equations have a value of 0 for firms without large corporate shareholders, and firms with large corporate shareholders, including firms that do not accept executives of large corporate shareholders and firms that receive executives of large corporate shareholders without disciplinary roles on their boards. Then, we conduct a single equation analysis based on the sample restricted to firms with large corporate shareholders, and obtain similar results to those in columns 3 and 4 of Panel B.

In Table 4, we estimate the seemingly unrelated bivariate probit model to check the robustness of our findings. The results provide support for our predictions that managerial entrenchment of controlling shareholders alters the distribution of bankers to firm boards, and bankers are not likely to be appointed to firms with controlling shareholders. Moreover, like banks, some executive appointments of large corporate shareholders increase with poor stock performance. We conclude that banks and large corporate shareholders play an important role in corporate governance.

7. Post-appointment performances: banks and large corporate shareholders

Previous results show that bankers are not likely to be appointed to the boards of firms in which controlling shareholders dominate. When we limit ourselves to appointments with disciplinary roles, our results are robust. In this section, we focus attention on post-appointment

performances of firms that receive executives with disciplinary roles on the boards. If such executives play an important role in disciplining the managers of firms with poor corporate performances, the performance of the appointing firms should change as a result.

We follow Kaplan and Minton (1994), and estimate abnormal performance in the aftermath of executives appointments of banks and large corporate shareholders by year.[23] Abnormal performance is estimated for each fiscal year, ranging from year+1 (one year from executive appointments) to year+4 (four years from executive appointments).[24] In regressions in which the dependent variables are corporate performances for year t, the executive appointment dummy variable in year 0 as the base year is included. The coefficient on the appointment dummy variable captures the average difference in corporate performance between firms that receive executives with disciplinary roles on their boards and firms that do not. We use four corporate performance measures; asset growth rate, employment growth rate, sales growth rate, and stock return. The former three are calculated as the annual change in log difference.

To capture the effects of other characteristics for each dependent variable, we need to use different set of independent variables in different specifications. In the specification in which the dependent variable is asset growth rate, the independent variables are the sales growth rate, cash flow ratio (cash flow defined as the after-tax income plus depreciation allowance less dividends, divided by total assets), leverage (the ratio of total debt to total assets), and firm size (the logarithm of total assets). In the specification in which the dependent variable is the employment growth rate, we use as independent variables the logarithm of real annual average wage (nominal annual average wage, divided by value-added deflators), sales growth rate, cash flow ratio, leverage, and firm size. In the specification in which the dependent variable is the sales growth rate, the independent variables include employment growth rate, growth rate of depreciable assets, leverage, and firm size. In the specification in which the dependent variable is stock return, independent variables are the logarithm of market value (stock price times total shares outstanding), and book to market ratio (the ratio of total capital at book values to market value).[25] To avoid the reverse causality problem, one-period-lagged values of all independent

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[23] Kaplan and Minton (1994) show that after the executives of banks and nonfinancial firms arrive at the boards of the appointing firms, the firms' performances do not decline, but rather, they improve modestly. Morck and Nakamura (1999) use event study analysis, and conclude that executives appointed by banks play an essential role in restructuring and earnings recovery of the appointing firms. Hirota and Miyajima (2001) and Miyajima et al. (2001) study the performances of firms that received new bankers on their boards in the early 1990s, and provide support for the results in Kaplan and Minton (1994) and Morck and Nakamura (1999).

[24] We focus on firms with a fiscal year that ends in March, and shareholder meetings in such firms are generally held in June. When new outside directors are selected at the shareholder meetings in June, 1993, year+1 corresponds to March, 1994 and year+2 is March, 1995.

[25] For the linkage between stock return, market value, and book to market ratio, see, e.g., Fama and French (1995).

variables are included in the four specifications. All regressions include a set of industry dummy variables, and a set of time dummy variables.

Table 5 reports the results for post-appointment performances of firms that receive executives of banks and large corporate shareholders as disciplinary actions on their boards.[26] The appointment variables correspond to those in columns 3 and 4 of Table 4. Panel A contains the results for the post-appointment performance of banks. The asset growth rate in year＋2 and year+4 are significantly negative. The employment growth rate in year＋1 and year+2 are significantly negative.[27] The results can be interpreted as indicating that the appointed bankers play an important role in restructuring, such as asset disposal and employment reduction. However, in all four years after appointments of bankers to firm boards, the sales growth rate and stock return are not statistically significant. Taken together, bankers appointed to poor performing firms play an important role in restructuring firms rather than improving earnings performance.[28]

Panel B contains the results for the post-appointment performance of large corporate shareholders. The asset growth rate in year＋1 is significantly negative but in year+2 is significantly positive. The results can be interpreted as suggesting that assets are accumulated in the aftermath of asset disposal. The employment growth rate in year＋1 is significantly negative. Results for asset growth rate and employment growth rate show that the appointed executives of large corporate shareholders play an essential role in the restructuring of the appointing firms. More importantly, the sales growth rate in year+3 is significantly positive. The stock return in year+1, year+2, year+3, and year+4 are significantly positive. After the firms accept the executives of large corporate shareholders on their boards, earnings performance and stock performance improve. Large corporate shareholders occupy more essential role in improving corporate performances.

Table 5 present the results for post-appointment performances after the executive appointments of banks and large corporate shareholder. In the aftermath of executive appointments of banks and large corporate shareholders, the appointing firms dispose of assets

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[26] We define extreme values for all continuous variables as those that have values more than four standard deviations from the mean, and remove these variables from our sample. In addition, to avoid a decrease of sample size with time, corporate performance variables from 1996 to 1999 are included.

[27] One argue that the coefficient in year＋1 face the reverse causality problem because the appointment variable and corporate performance variable correspond to the same fiscal year. However, in empirical tests, we use data on executive appointments at June of the fiscal year and performance variables at March of the fiscal year. Consequently, the endogenous problem is not serious.

[28] Hirota and Miyajima (2001) provide similar results by focusing on firms under financial distress. They show that in comparison with oil price shocks (1975-1982), macroeconomic conditions prevent earnings performance from improving after bankers arrive at firm boards in the early 1990s.

and reduce employment. The results for asset sales are consistent with those reported by Kang and Shivdasani (1997), who find that the asset contradiction likelihood increases with the equity ownership by main bank and blockholders. In addition, for employment reduction, the results are the same for banks and large corporate shareholders, but more pronounced in banks. These findings are also consistent with those in Kang and Shivdasani (1997), who show that the likelihood of decrease in employment is positively related to equity ownership by the main bank. More importantly, for large corporate shareholders, sales growth and stock return of the appointing firms rebound. As a consequence, we conclude that banks and large corporate shareholders exert disciplinary control over management, and then play an important role in the corporate performance of appointing firms.

8. Conclusion

We investigate whether managerial entrenchment of controlling shareholders has an essential impact on the allocation of bankers to the boards of nonfinancial firms. To enjoy private benefits of control, controlling shareholders generally have incentives to protect the management against other investors. Consequently, strong incentives for controlling shareholders to entrench managers do not permit bankers to serve on firm boards. We use data on Japanese manufacturing firms from 1991 to 1995 to test the hypotheses.

We find that bankers are not likely to be appointed to firms with large corporate shareholders. Higher equity ownership by large corporate shareholders, then lower the likelihood of bankers being appointed to the boards of firms with large corporate shareholders. The results show that large corporate shareholders have incentives to entrench managers to pursue the private benefits of control attached to higher ownership, and banks are also concerned about the potential costs of conflicts of interest between banks and large corporate shareholders. Furthermore, we focus on the appointments of bankers with disciplinary roles as indicators of the strength of creditor rights. Although the results for large corporate shareholders hold, firms with inside owners are not also likely to receive bankers with disciplinary roles on their boards. Higher equity ownership by inside owners, then lower probability of bankers being appointed to the boards of firms with inside owners. The results show that inside owners have incentives to protect managers against bankers with disciplinary roles.

To check the robustness of our findings, we use the seemingly unrelated probit model by gathering information on executive appointments of large corporate shareholders. We confirm the stability of our results for the impact of managerial entrenchment of large corporate shareholders on banker appointments to firm boards. In addition, we find that some executive appointments of large corporate shareholders increase with poor stock performance, suggesting

that the executive exerts essential control over the management of the appointing firms. Finally, after the executives of both banks and large corporate shareholders with disciplinary roles arrive at firm boards, asset divesture, and employment reduction increase. In particular, executive appointments of large corporate shareholders play a key role in sales growth, and stock return performance. Given the results above, banks play a central role in exercising corporate governance over firms without large corporate shareholders, and large corporate shareholders serve as disciplinary monitors through the exercise of voting rights attached to securities. Consequently, managerial entrenchment of large corporate shareholders establishes the substitution of role of corporate governance system between banks and large corporate shareholders.

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Table 1:

Descriptive statistics for characteristics of Japanese manufacturing firms, 1991-1995

Variables	Mean	Median	Std.dev.
Appointments of bankers to firm boards	0.046		
Industry-adjusted stock return of firms	−0.018	−0.030	0.198
Industry-adjusted ROA	−0.003	−0.003	0.039
Negative pretax income	0.139		
Bank loans ratio	0.046	0.032	0.050
Equity ownership by banks	0.040	0.046	0.013
Equity ownership by large corporate shareholders	0.371	0.346	0.126
Equity ownership by inside owners	0.123	0.086	0.082
Firm size	10.977	10.855	1.320
Firm age	3.957	3.951	0.301
Stock return of banks	−0.072	−0.079	0.173
Financial keiretsu membership	0.328		
Enterprise keiretsu membership	0.141		
Industry-average stock return	−0.102	−0.107	0.155
Industry-average ROA	0.034	0.031	0.200

The table reports mean values, median values, and standard deviations for 4262 observations of Japanese manufacturing firms with a fiscal year that ends in March, from 1991 to 1995. Financial statements data are obtained from the Nikkei Needs Financial dataset. Banker appointments have a value of 1 if new executives previously employed by main bank are appointed to the boards of nonfinancial firms, and 0 otherwise. Main bank is defined as the bank first listed in *Japan Company Handbook*. Data on banker appointments come from *Yakuin Shikihou* and *Yuka Shoken Hokokusho*. Stock returns of firms and banks are defined as dividends per share plus stock price at the last day of the fiscal year less stock price at the last day of the previous fiscal year, divided by stock price at the last day of the previous fiscal year. Industry-adjusted stock return of firms is calculated as each firm's stock return less the industry-average stock return. Return on assets (ROA) is defined as pretax income, divided by the average of total assets for the previous and current years. Industry-adjusted ROA is calculated as each firm's ROA less industry-average ROA. Negative pretax income has a value of 1 if pretax income is negative, and 0 otherwise. The bank loans ratio is the share of main bank loans outstanding to total assets. Equity ownership by banks is the share of equity ownership by main bank. Equity ownership by large corporate shareholders is the ratio of equity ownership held by the nonfinancial firm that has more than 20 ％ shareholdings as the top shareholder. Equity ownership by inside owners is the ratio of equity ownership held by the president or chairman as the top shareholder. Data on main bank loans, equity ownership by main bank, equity ownership by large corporate shareholders, and equity ownership by inside owners come from *Kigyo Keiretsu Soran*. Firm size is defined as the logarithm of total assets. Firm age is the logarithm of the years elapsed since establishment. Financial keiretsu membership takes on a value of 1 if the firm is one of the eight financial keiretsu members, and 0 otherwise. Enterprise keiretsu membership takes on a value of 1 if the firm is one of the eighteen enterprise keiretsu members, and 0 otherwise. Data on identification of financial and enterprise keiretsu membership come from *Industrial Groupings in Japan* and *Japan Company Handbook*. Industry-average variables for stock return of firms and ROA are the average values of the industry in the fiscal year.

Table 2:

Managerial entrenchment and banker appointments to firm boards

Independent variables	(1)	(2)	(3)
Industry-adjusted stock return of firms	−0.139	−0.118	−0.154
	(0.179)	(0.180)	(0.181)
Industry-adjusted ROA	−1.464	−1.824*	
	(1.022)	(0.977)	
Negative pretax income			0.147
			(0.103)
Bank loans ratio	2.826***	2.887***	3.081***
	(0.668)	(0.669)	(0.641)
Equity ownership by banks	16.113***	9.539**	9.485**
	(3.118)	(3.860)	(3.901)
Equity ownership by large corporate shareholders		−1.155***	−1.137***
		(0.273)	(0.276)
Equity ownership by inside owners		1.183	1.071
		(0.942)	(0.941)
Firm size	0.072***	0.054*	0.057**
	(0.028)	(0.028)	(0.029)
Firm age	−0.044	−0.028	-0.028
	(0.115)	(0.113)	(0.114)
Stock return of banks	−0.551	−0.531	−0.538
	(0.344)	(0.349)	(0.347)
Financial keiretsu membership	0.096	0.126*	0.131*
	(0.071)	(0.074)	(0.074)
Industry-average stock return	1.517***	1.645***	1.607***
	(0.606)	(0.614)	(0.609)
Industry-average ROA	−1.667	−2.377	−1.364
	(2.292)	(2.308)	(2.299)
No. of observations	4262	4262	4262
Pseudo R^2	0.050	0.065	0.063

The table reports probit regression estimates for 4262 observations of Japanese manufacturing firms from 1991 to 1995. The dependent variable takes on a value of 1 if new executives previously employed by main bank are appointed to the boards of nonfinancial firms, and 0 otherwise. Definitions of independent variables are provided in Table 1. One-period-lagged values of the independent variables are included in the regressions. All regressions include a set of time dummy variables. ***, **, and * indicate significance at the 1%, 5%, 10% levels, respectively. Standard errors in parentheses are robust to heteroskedasticity.

Table 3:

Managerial entrenchment and banker appointments to firm boards as disciplinary devices

Independent variables	(1)	(2)	(3)
Industry-adjusted stock return of firms	−0.963***	−0.965***	−1.059***
	(0.289)	(0.292)	(0.276)
Industry-adjusted ROA	−9.255***	−9.234***	
	(1.081)	(1.088)	
Negative pretax income			0.582***
			(0.126)
Bank loans ratio	2.612***	2.780***	3.390***
	(0.814)	(0.825)	(0.797)
Equity ownership by banks	17.774***	12.030**	10.463**
	(5.218)	(5.915)	(5.830)
Equity ownership by large corporate shareholders		−0.913**	−0.877**
		(0.368)	(0.368)
Equity ownership by inside owners		−5.868*	−6.038*
		(3.169)	(3.107)
Firm size	0.108***	0.080*	0.074*
	(0.040)	(0.042)	(0.041)
Firm age	0.199	0.163	0.149
	(0.170)	(0.178)	(0.181)
Stock return of banks	0.422	0.512	0.407
	(0.484)	(0.498)	(0.467)
Financial keiretsu membership	−0.024	−0.029	−0.022
	(0.110)	(0.111)	(0.109)
Industry-average stock return	2.264***	2.400***	2.049**
	(0.850)	(0.867)	(0.818)
Industry-average ROA	−14.528***	−14.854***	−9.235**
	(0.377)	(3.789)	(3.823)
No. of observations	4262	4262	4262
Pseudo R^2	0.174	0.185	0.156

The table reports probit regression estimates for 4262 observations of Japanese manufacturing firms from 1991 to 1995. The dependent variable takes on a value of 1 if new executives previously employed by main bank are appointed to the boards of nonfinancial firms that experience an interest coverage ratio (the ratio of operating income to interest payments) of less than 1 at the end of the previous fiscal year. Definitions of independent variables are provided in Table 1. One-period-lagged values of the independent variables are included in the regressions. All regressions include a set of time dummy variables. ***, **, and * indicate significance at the 1%, 5%, 10% levels, respectively. Standard errors in parentheses are robust to heteroskedasticity.

Table 4:

Managerial entrenchment and banker appointments to firm boards: robustness checks

Panel A: Banks				
Independent variables	(1)	(2)	(3)	(4)
Industry-adjusted stock return of firms	−0.118	−0.154	−0.960***	−1.054***
	(0.180)	(0.181)	(0.290)	(0.275)
Industry-adjusted ROA	−1.823*		−9.241***	
	(0.977)		(1.088)	
Negative pretax income		0.147		0.582***
		(0.103)		(0.126)
Bank loans ratio	2.888***	3.082***	2.788***	3.396***
	(0.668)	(0.640)	(0.823)	(0.795)
Equity ownership by banks	9.550**	9.500**	12.297**	10.628*
	(3.856)	(3.900)	(5.941)	(5.858)
Equity ownership by large corporate shareholders	−1.151***	−1.134***	−0.891**	−0.862**
	(0.271)	(0.273)	(0.367)	(0.367)
Equity ownership by inside owners	1.181	1.069	−5.897*	−6.057*
	(0.943)	(0.942)	(3.171)	(3.109)
Firm size	0.054*	0.057**	0.081**	0.074*
	(0.028)	(0.028)	(0.041)	(0.040)
Firm age	−0.028	−0.028	0.160	0.146
	(0.113)	(0.114)	(0.177)	(0.181)
Stock return of banks	−0.531	−0.538	0.526	0.414
	(0.349)	(0.347)	(0.496)	(0.460)
Financial keiretsu membership	0.126*	0.131*	−0.032	−0.024
	(0.074)	(0.074)	(0.111)	(0.109)
Industry-average stock return	1.643***	1.606***	2.393***	2.042**
	(0.612)	(0.608)	(0.868)	(0.819)
Industry-average ROA	−2.377	−1.364	−14.792***	−9.202**
	(2.308)	(2.298)	(3.773)	(3.813)

Table 4:

Continued

Panel B: Large corporate shareholders

Independent variables	(1)	(2)	(3)	(4)
Industry-adjusted stock return of firms	0.220 (0.146)	0.207 (0.144)	−4.067*** (0.337)	−4.075*** (0.340)
Industry-adjusted ROA	−0.075 (0.758)		−0.702 (1.255)	
Negative pretax income		−0.056 (0.086)		−0.008 (0.137)
Equity ownership by large corporate shareholders	3.597*** (0.151)	3.601*** (0.151)	3.064*** (0.253)	3.074*** (0.254)
Firm size	−0.072*** (0.025)	−0.074*** (0.025)	−0.004 (0.043)	−0.007 (0.043)
Firm age	−0.033 (0.095)	−0.031 (0.095)	0.284* (0.161)	0.290* (0.161)
Financial keiretsu membership	0.035 (0.064)	0.036 (0.064)	0.103 (0.107)	0.108 (0.107)
Enterprise keiretsu membership	0.411*** (0.077)	0.413*** (0.077)	0.438*** (0.125)	0.440*** (0.125)
Industry-average stock return	−0.656 (0.537)	−0.656 (0.538)	−1.967** (0.946)	−1.980** (0.946)
Industry-average ROA	−2.845 (2.015)	−3.124 (2.054)	0.016 (3.221)	−0.000 (3.335)
ρ	−0.010	−0.009	−0.123	−0.078
p-value	(0.899)	(0.911)	(0.387)	(0.544)
No. of observations	4262	4262	4262	4262

The table reports seemingly unrelated bivariate probit estimates for 4262 observations of Japanese manufacturing firms from 1991 to 1995. Panel A contains results for the determinants of executive appointments of banks. Panel B contains results for the determinants of executive appointments of large corporate shareholders. The dependent variables in columns (1) and (2) take on a value of 1 if new executives previously employed by main bank are appointed to the boards of nonfinancial firms, and 0 otherwise in the bank equation, and take on a value of 1 if new executives previously employed by large corporate shareholders with more than 20 % shareholdings are appointed to the boards of nonfinancial firms, and 0 otherwise in the large corporate shareholder equation. The dependent variables in columns (3) and (4) take on a value of 1 if new executives previously employed by main bank are appointed to the boards of nonfinancial firms that experience an interest coverage ratio (the ratio of operating income to interest payments) of less than 1 at the end of the previous fiscal year, and 0 otherwise in the bank equation, and take on a value of 1 if new executives previously employed by large corporate shareholders with more than 20 % shareholdings are appointed to the boards of nonfinancial firms that experience a stock return that is in the lowest one-fourth for each industry at the end of the previous fiscal year in the large corporate shareholder equation. Definitions of independent variables are provided in Table 1. One-period-lagged values of the independent variables are included in the regressions. All regressions include a set of time dummy variables. ***, **, and * indicate significance at the 1%, 5%, 10% levels, respectively. Standard errors in parentheses are robust to heteroskedasticity.

Table 5:

Corporate performances in the aftermath of executive appointments

Panel A: Banks

	Asset growth	Employment growth	Sales growth	Stock return
Year + 1	−0.012 (0.010)	−0.019** (0.008)	−0.010 (0.009)	−0.020 (0.024)
No. of observations	4404	4366	4351	4349
Year + 2	−0.018* (0.009)	−0.025** (0.010)	−0.016 (0.010)	−0.021 (0.024)
No. of observations	4397	4353	4364	4347
Year + 3	−0.009 (0.008)	−0.012 (0.008)	0.007 (0.011)	−0.034 (0.025)
No. of observations	4387	4348	4372	4331
Year + 4	−0.022*** (0.009)	−0.007 (0.005)	−0.013 (0.010)	−0.008 (0.036)
No. of observations	4388	4344	4363	4314

Table 5:

Continued

Panel B: Large corporate shareholders

	Asset growth	Employment growth	Sales growth	Stock return
Year + 1	−0.015** (0.007)	−0.012** (0.005)	−0.004 (0.008)	0.037* (0.021)
No. of observations	4303	4273	4251	4311
Year + 2	0.016** (0.008)	0.004 (0.004)	0.003 (0.008)	0.044* (0.023)
No. of observations	4297	4258	4263	4298
Year + 3	0.002 (0.007)	0.003 (0.006)	0.016* (0.009)	0.055** (0.025)
No. of observations	4288	4255	4276	4279
Year + 4	0.005 (0.008)	0.002 (0.004)	0.012 (0.009)	0.038* (0.021)
No. of observations	4293	4254	4270	4259

The table reports corporate performances in the aftermath of executive appointments of bankers and large corporate shareholders. Dependent variables are the total asset growth rate, employment growth rate, sales growth rate, and stock return. Results in the table show coefficients and standard errors from regressions of corporate performances against dummy variables for executive appointments of bankers and large corporate shareholders as disciplinary devices. Executive appointments of banks as disciplinary devices take on a value of 1 if new executives previously employed by main bank are appointed to the boards of nonfinancial firms that experience an interest coverage ratio (the ratio of operating income to interest payments) of less than 1 at the end of the previous fiscal year, and 0 otherwise. Executive appointments of large corporate shareholders as disciplinary devices take on a value of 1 if new executives previously employed by large corporate shareholders with more than 20 ％ shareholdings are appointed to the boards of nonfinancial firms that experience a stock return that is in the lowest one-fourth for each industry at the end of the previous fiscal year. In the specification in which the dependent variable is the asset growth rate, the independent variables are the sales growth rate, cash flow ratio (cash flow defined as the after-tax income plus depreciation allowance less dividends, divided by total assets), leverage (the ratio of total debt to total assets), and firm size. In the specification in which the dependent variable is the employment growth rate, independent variables are the logarithm of the real annual average wage (nominal annual average wage, divided by value-added deflators), sales growth rate, cash flow ratio, leverage, and firm size. In the specification in which the dependent variable is the sales growth rate, the independent variables are the employment growth rate, growth rate of depreciable assets, leverage, and firm size. In the specification in which the dependent variable is the stock return, the independent variables are the logarithm of market value (stock price times total shares outstanding), and book to market ratio (the ratio of total capital at book values to market value). To avoid a decline in sample size over time, corporate performance variables from 1996 to 1999 are added to basic sample. One-period-lagged values of the independent variables are included in the regressions. Because observations of extreme values for continuous variables are removed, the number of observations varies in any regression. All regressions include a set of industry dummy variables and a set of time dummy variables. ***, **, and * indicate significance at the 1％, 5％, 10％ levels, respectively. Standard errors in parentheses are robust to heteroskedasticity.