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# ABSTRACT

## Do Foreign Owners Favor Short-Term Profit? Evidence from Germany*

Comparing domestic- and foreign-owned firms in Germany, this paper finds that foreign-owned firms are more likely to focus on short-term profit. This influence is particularly strong if the local managers of the German subsidiary are not sent from the foreign parent company. Moreover, the physical distance between the foreign parent company and its German subsidiary increases the probability of focusing on short-term profit. These findings conform to the hypothesis that foreign owners facing an information disadvantage concerning the local conditions of their subsidiaries are more likely to favor short-term profit. However, we do not identify differences in "short-termism" between investors from "Anglo-Saxon" and other foreign countries; rather, results point in the direction of more general features of corporate globalization.

JEL Classification: F23, G34, M16, P10

Keywords: foreign ownership, short-termism, asymmetric information, globalization, multinational enterprises, stakeholders

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## 1. Introduction

Recent decades have witnessed an enormous growth in foreign direct investment (FDI) around the world (UNCTAD 2004). This growth in corporate globalization is usually explained by the superior products and production processes of multinational corporations (MNCs) to which other firms have no access (Helpman 2006, Markusen 1995). However, the growth in corporate globalization has also given rise to concerns about the threats to national institutions and regulatory regimes (Boyer and Drache 1996, Rodrick 1997, Sinn 2003, Stiglitz 2002).

This paper examines whether foreign MNCs in Germany favor short-term profitability over long-term growth. Germany is one of the largest host economies for inward FDI among developed countries. Traditionally, stable owners with a long-term commitment to the firm play a specific role in the German model of corporate governance. These owners have both access to inside information about the operation of the firm and the ability to influence the management. They cooperate with other stakeholders in investing in long-term firm performance. If foreign owners favor short-term profitability over long-term growth, they deviate from the role of patient owners and, hence, may introduce tension into the German system of corporate governance.

Foreign-owned firms may operate with a shorter time horizon than domestic-owned firms for at least two reasons. First, distant owners may lack important inside information on the operation of their subsidiaries, so they must rely primarily on balance sheet criteria to monitor the performance of the subsidiaries. Accounting-based performance measurement provides information on current performance but, in general, insufficient information on long-term growth prospects. Second, foreign owners may be more exposed to international capital markets. Specifically, “Anglo-Saxon” capital markets may exert pressure on firms to focus on short-term profitability.

Our empirical analysis uses firm data conducted by Great Place to Work® Germany (a research group specialized in employer and employee surveys) on behalf of the German Federal Ministry of Labor and Social Affairs in 2006. The data are unique in that they provide information on whether management focuses on short-term profit or long-term sustainable value of the firm. Our estimates provide evidence that foreign-owned firms are more likely to focus on short-term profit than domestically owned firms.

This result holds true both for subsidiaries of “Anglo-Saxon” companies and subsidiaries of non-“Anglo-Saxon” companies.[1] Hence, our estimates do not support the widely held view that “Anglo-Saxon” investors in particular provide a challenge to the German system of corporate governance. Rather the results point in the direction of more general features of corporate globalization.

Our specific findings suggest that communication difficulties and information asymmetries between local managers and managers of the foreign parent company contribute to the focus on short-term profit. First, we find that the focus on short-term profit is particularly strong if the local managers of the German subsidiary are not sent from the foreign parent company. Second, the physical distance between the foreign parent company and its German subsidiary increases the probability of focusing on short-term profit. Taken together, these findings suggest that foreign owners facing an information disadvantage concerning the local growth opportunities of their subsidiaries are more likely to favor short-term profit.

While there is a burgeoning empirical literature on foreign ownership (see Bellak

2004 and Caves 2007 for surveys), little attention has been paid to short-term pressure faced by foreign-owned firms. In one of the few studies addressing questions similar to ours, Liljeblom and Vaihekoski (2010) conduct an analysis for large companies registered in Finland. Their analysis is based on a survey of financial managers and CEOs. The authors' descriptive statistics show that the respondents view foreign owners as the biggest source of short-term pressure. The finding of their exploratory study corresponds to the results of our multivariate analysis for Germany.[2]

The rest of the article is organized as follows. In the second section, we provide our background discussion of the institutional setting. The third section presents the data and variables while the fourth section provides the estimation results. The fifth section concludes.

## 2. Institutional Setting and Key Research Questions

In what follows we set the stage by sketching the traditional role of patient capital in the German system of corporate governance. We proceed by discussing the circumstances that may lead to a shorter time horizon of foreign-owned firms.

### *2.1 The Role of Patient Capital in Germany*

Stable and patient capital is one important pillar of the German system of corporate governance (Hall and Soskice 2001, Kester 1992, Moers 1995, Porter 1992). Several features of the system contribute to a rather long-term investment horizon. In comparative perspective, there is a high level of shareholding concentration in Germany. This protects firms from hostile takeovers and, hence, contributes to cooperative and trustful relationships between owners, managers, and employees (Shleifer and Summers 1988). These relationships foster joint investment of funds and effort in long-term firm performance.

Moreover, the German corporate governance system provides owners with inside information about the reputation and operation of the firm (Vitols et al. 1997). There is a dense network of firms that links the managers inside a firm to their counterparts in other firms. The network consists of close relationships with major suppliers and clients, cross-shareholdings, and joint membership of firms in industry associations. Within this business network, firms share information that is not available from accounting-based performance measurement. The inside information allows investors to pursue long-term strategies as it provides unique knowledge about growth opportunities. In large firms, shareholders have access to additional information through a dual board structure. A supervisory board is responsible for appointing and monitoring members of the management board and for approving strategic business decisions. The dual board structure provides an opportunity for intense communication between shareholder representatives and managers.

A unique feature of the German model of corporate governance is the high degree of institutionalized employee voice. Works councils provide a highly developed mechanism for codetermination at the establishment level (Huebler and Jirjahn 2003, Jirjahn 2010). They help monitor managers from within the firm and make information more transparent. Works councils protect employees from managers unilaterally taking actions against their interest. This increases employees' willingness to enhance their firm-specific skills and to provide support to owners in investing in long-term firm performance (Smith 2006). Furthermore, employee voice is institutionalized through codetermination at the supervisory board level (Fauver and Fuerst 2006, Renaud 2007). Up to the half of supervisory board members are employee representatives elected by the workforce (usually works councilors) or appointed by external trade unions. Supervisory board codetermination provides a channel for communication between shareholders and employees that is not filtered by the managers of the firm. This also gives shareholders further access to inside information.

Altogether, a high level of shareholding concentration, investors’ access to inside information, and institutionalized employee voice imply a specific role of patient capital in the German system of corporate governance. Indeed, empirical research indicates that German firms have a longer time horizon compared to their counterparts from “Anglo-Saxon” countries (Black and Fraser 2002, Carr 1997, Coates et al. 1995).

However, the system has not been without change (Jackson et al. 2005). Starting in the 1990s, the German government enacted a series of laws that aimed at liberalizing financial markets and promoting the growth of the German stock market. Banks began to build up their investment banking activities and to withdraw from an active role in the corporate governance of non-financial firms. The shareholding of institutional investors increased and a number of the large German firms proclaimed the adoption of a shareholder value orientation (Fiss and Zajac 2004). While these changes have led some observers to view Germany as converging to a liberal “Anglo-Saxon” model of corporate governance, several reasons suggest that the changes have been rather gradual modifications within the German system (Vitols 2004, 2005). Large shareholders other than banks still play an important role in corporate governance and have maintained their commitment to the firms. These shareholders include founders and families, the state, and other companies. The exit of banks from monitoring and control has had only a limited influence on the system, because bank ownership was typically limited to a small set of large listed companies. Even in these companies, bank exit has been partially substituted for by new investors from the insurance and fund industry. Furthermore, the features of the German system of corporate governance (e.g., the dual board structure) imply that shareholder value orientation is often negotiated between the various groups of stakeholders. This is likely to influence and modify the nature of shareholder value orientation, and the extent to which a firm follows a short-term strategy.

A more fundamental challenge to the German system of corporate governance may come from abroad through corporate globalization. Germany is one of the largest host economies for inward FDI among developed countries (Jost 2011). Comparing the stocks of inward FDI for the year 2009, Germany was ranked position four, after the United States, the United Kingdom, and France. Germany experienced an enormous growth in the inward FDI stock in the last two decades. The stock rose from US$ 120 billion in the year 1990 to US$ 937 billion in the year 2009. Foreign-owned firms in non-financial industries account for about 20 percent of total gross value added and employ more than 10 percent of all workers in those industries.

Foreign owners bring different firm strategies to the host country and may face difficulties in adjusting to the institutional and cultural framework of the host country (Kostova and Roth 2002). In what follows we examine whether foreign owners have a shorter time horizon and, hence, may favor short-term profitability over long-term growth. From a theoretical point of view, there are at least two potential factors that can contribute to a shorter time horizon of firm with foreign ownership. First, foreign owners may have less access to the local information networks that provide inside information on long-term growth opportunities. Second, foreign owners may be more exposed to short-term pressure from international capital markets.

### *2.2 Information Asymmetries and the Time Horizon of Foreign-Owned Firms*

The managers of a foreign parent company have an information disadvantage if the information on long-term growth opportunities is "soft" so that it can only be collected through personal relationships and direct contacts with local stakeholders in the host country. Time and transportation costs limit their opportunities to obtain valuable inside information through informal talks with local stakeholders (Bae et al. 2008, Kang and Kim 2010).

Managers of the local subsidiary to some extent may have better access to the informal information networks in the host country. However, it can be difficult for them to convince the managers of the foreign parent company. To the extent the parent company's managers lack sufficient knowledge about the local conditions of the subsidiary, they face problems in verifying the inside information conveyed by the managers of the local subsidiary (Jirjahn and Mueller 2014). As a consequence, the managers of the parent company may be less willing to use such information. Instead of adopting a subsidiary-specific firm policy negotiated with local stakeholders, they tend to move unilaterally to implement practices and policies in accord with the general standards of their multinational company (Heywood and Jirjahn 2014).

Moreover, even managers of the local subsidiary may have an, albeit less strong, information disadvantage if it is more difficult for representatives of a foreign-owned firm to build trustful relationships with local stakeholders. Key decisions are made overseas by managers of the foreign parent company. Local stakeholders in the host country (e.g., employees, suppliers and lenders) have only very limited access to the information possessed by the parent company's managers. Such lack of transparency hampers the development and trust and cooperation between the foreign-owned subsidiary and its local stakeholders. Hence, local stakeholders in the host country are less willing to share their inside information on long-term growth opportunities with the local managers of the foreign-owned firm.

Altogether, if foreign-owned subsidiaries make less use of inside information, they may miss long-term growth opportunities. As the managers of the parent company lack important inside information on the operation of their subsidiaries, they rely primarily on balance sheet criteria to monitor the performance of the subsidiaries. Accounting-based performance measurement provides information on current firm performance but insufficient information on long-term growth prospects (Hayes and Abernathy 1980, Johnson and Kaplan 1987, Kaplan 1984). This suggests that foreign-owned firms face increased short-term pressure.

*2.3 International Capital Markets and the Time Horizon of Foreign-Owned Firms*

Foreign-owned firms may be also subject to increased short-term pressure because their parent companies are more exposed to international capital markets. These markets entail an increased risk of hostile takeovers. In order to reduce the risk of a takeover, the managers of a foreign parent company must keep the stock price high. If the capital markets undervalue investments that pay off only in the long run, managers must maximize short-term profit to increase the current price of the stock (Stein 1988). Moreover, if stock prices involve a short-term speculative component and investors have heterogeneous beliefs, managers may attract overconfident investors by taking actions that boost the short-term stock performance (Bolton et al. 2006, Scheinkman and Xiong 2003). This helps reduce the cost of capital.

It has been argued in the literature that "Anglo-Saxon" type capital markets exert this kind of short-term pressure (Jacobs 1991, Porter 1992). Hence, foreign owners from "Anglo-Saxon" countries in particular may face short-term pressure from financial markets and transmit the pressure to their subsidiaries. However, to the extent that multinational companies from other countries internationalize their shareholder basis (with shares being quoted on "Anglo-Saxon" stock exchanges), these companies may be also exposed to the short-term pressure from "Anglo-Saxon" type capital markets.

## 3. Data and Variables

### *3.1 Data Set*

Our empirical investigation uses representative firm data collected by Great Place to Work® Germany in the year 2006. The survey was conducted on behalf of the German Federal Ministry of Labor and Social Affairs. Managers of 339 firms answered a comprehensive online questionnaire. The questionnaire covers various aspects of firm structure and firm behavior with an emphasis on issues related to human resource management. The population of the survey consists of firms with 20 or more employees. The 339 firms are almost evenly spread across the different industries in Germany

(Berger et al. 2011). For our empirical analysis we exclude the public sector and non-profit organizations. After eliminating observations for which full information is not available, the investigation is based on data from 192 firms.

*3.2 Key Variables*

Table 1 and Table 2 show the definition of variables and their descriptive statistics. Our critical dependent variable is based on the following question: 'When pursuing the profit motive one can focus on quarterly profit or on longevity and long-term maintenance of value. What is the focus of your organization within this field of tension?' Interviewees respond on a Likert scale ranging from 1 (focus on quarterly profit) to 4 (focus on longevity). There are about 50 percent of observations falling into category 4, 37 percent into category 3, 9 percent into category 2, and 4 percent into category 1.

Our main dependent variable is a dummy equal to 1 if the firm falls into category 1, 2 or 3. It is equal to 0 if the firm falls into category 4. Hence, we consider a firm as having a stronger focus on short-term performance if it does not fully account for long-term sustainable value of the firm. In order to check the robustness of results, we also present regression results with alternative definitions of the dependent variable. We capture extreme short-termism by a dummy variable that is only equal to 1 if the firm has a focus on quarterly profit (category 1). This dummy is equal to 0 otherwise (categories 2, 3, or 4). Furthermore, we consider the degree of short-term orientation in more detail by using an ordered dependent variable with a four point scale. The scale in Table 1 is recoded in inverse order so that a higher scale point reflects a stronger orientation towards short-term profit.

Our key explanatory variable is a dummy variable equal to 1 if the firm is foreign owned. The survey asks whether or not the firm is majority-owned by another company. If the answer is ‘yes’, interviewees are asked to provide information on the location of the parent company. This allows us to identify if the firm has a dominant foreign owner. 11 percent of the firms in the sample are majority foreign owned.

In a further step, we differentiate between different types of foreign-owned firms. First, we distinguish between subsidiaries of “Anglo-Saxon” companies and subsidiaries of non-“Anglo-Saxon” companies. If companies from “Anglo-Saxon” countries are disproportionately exposed to “Anglo-Saxon” type capital markets, these companies in particular may transmit short-term pressure to their subsidiaries. Yet, to the extent other companies are also listed on “Anglo-Saxon” stock exchanges or factors other than capital markets play a decisive role in short-termist behavior, we should observe that both “Anglo-Saxon” and non-“Anglo-Saxon” foreign owners exert short-term pressure on their subsidiaries.

Second, we distinguish between foreign-owned subsidiaries whose local top managers are sent from the parent company and foreign-owned subsidiaries whose local top managers are not primarily sent from the parent company. Our theoretical considerations suggest that foreign owners focus on the short-term performance of their subsidiaries if they lack important inside information on long-term growth opportunities. The degree to which foreign owners lack inside information can vary across firms. Local managers sent from the parent company are more likely to share the same mother language, culture and understanding of business with the parent company’s managers.

This makes communication easier and, hence, increases the chance that local managers can convincingly provide inside information to the parent company. Better access to local inside information on long-term growth opportunities, in turn, reduces the weight given to short-term performance of the subsidiary. Altogether, if the asymmetric information hypothesis is correct, then foreign-owned subsidiaries with managers sent from the parent company should not face the same amount of short-term pressure as foreign-owned subsidiaries whose managers are not primarily sent from the parent company.

Third, we account for the physical distance between the foreign parent company and its German subsidiary as an alternative approach to examine the mechanism of lacking inside information. As emphasized in our background discussion, inside information on long-term growth opportunities may be soft. It can only be collected through personal relationships and direct contacts with local stakeholders in the host country. To the extent physical distance entails extra time and transportation costs, it limits the opportunities for the foreign parent company's managers to talk to local stakeholders in person and, hence, increases their information disadvantage (Chan et al. 2005, Kang and Kim 2010). Against this background, we hypothesize that if the asymmetric information explanation is correct, then greater physical distance between the foreign parent company and its German subsidiary will be associated with increased short-term pressure on the subsidiary. Distant foreign owners lack inside information to a larger extent and, hence, would be more likely to focus on the short-term performance of their subsidiaries.

### *3.3 Control Variables*

In the regressions, we also include a dummy variable for domestic-owned subsidiaries. This is important as it helps examine whether subsidiaries in general or foreign-owned subsidiaries in particular face short-term pressure. If subsidiaries in general face some short-term pressure from their headquarters (Loescher 1984), the variables for domestic- and foreign-owned subsidiaries should take significant coefficients of similar magnitude. Yet, if foreign-owned subsidiaries in particular face short-term pressure, the estimated coefficient on the variable for a domestic-owned subsidiary should be smaller or even insignificant.

We include two variables capturing the firm's market strategy. We capture the firm's innovation activities with a dummy variable equal to 1 if the firm has launched new products or services in the last three years. Innovation activities usually pay off only in the long run. Hence, an innovation-based strategy should induce a longer time horizon of managers and owners. They must take care for longevity of the firm in order to benefit from the future returns of their innovation investment. Furthermore, we include a variable for a market strategy emphasizing the quality of products and services. This market strategy should also be associated with a longer time horizon. Producing high-quality products helps build reputation (Bar-Isaac 2005, Hoerner 2002, Shapiro 1983). Reputation, in turn, increases long-term sales opportunities and, hence, provides incentives to take care for the longevity of the firm. These controls help isolate the impact of foreign ownership per se from that of the firm's market strategy.

Subsidiaries of foreign multinational companies tend to rely more extensively on performance management practices and variable pay (Bloom and Van Reenen 2010, Heywood and Jirjahn 2014, Poutsma et al. 2006). In order to examine whether or not foreign owners influence the managers' time horizon through an increased use of performance pay, we include variables capturing performance-related pay for managers. First, we consider the average share of performance-related pay in managers' total compensation. To the extent variable pay is linked to current performance, it provides incentives for managers to make short-term decisions. Hence, the average share of performance-related pay should be positively associated with the focus on short-term profit. Second, we account for managerial profit sharing. On the one hand, profit sharing also rewards current performance. On the other hand, profit sharing is more likely to be used in repeated game situations that help mitigate free rider problems (Che and Yoo 2001). Those situations may induce managers to focus on long-term firm performance. Moreover, profit sharing provides incentives for multitasking (Baker 2002) involving cooperation and mutual help within the firm (Drago and Turnbull 1988). This may reinforce the incentive to focus on long-term profit. Third, we include a variable for managerial share ownership. To the extent share prices reflect the long-term value of the firm, managerial share ownership may provide long-term incentives. Yet, if there are capital market imperfections, share ownership provides incentives to invest only in those projects that are visible to the market for corporate ownership (Souder and Bromiley 2009, 2012). These controls help isolate compensation practices from foreign ownership per se.

General firm characteristics are controlled for by variables for the size, the age, and the legal form of the firm. Finally, we include 9 out of 10 industry dummies to capture sectoral differences in product markets and the nature of production.

## 4. Results

*4.1 Initial Regressions*

Table 3 provides a series of initial probit estimates with our main dependent variable for an orientation toward short-term profit. The variable is a dummy equal to 1 if the firm does not fully account for long-term sustainable value of the firm.

In regression (1), we include only a constant and the dummy variable for a foreign-owned subsidiary. The variable takes a positive coefficient that is both statistically and economically significant. Foreign-owned firms have a 46 percentage point higher probability of focusing on short-term profit.

In regression (2), we expand the specification by additionally including industry controls, variables for general establishment characteristics, and the dummy for a domestic-owned subsidiary.[3] While the coefficient on domestic-owned subsidiaries is not significant, the coefficient on foreign-owned subsidiaries remains statistically significant. Hence, focusing on short-term profit is not a general phenomenon of subsidiaries, but a specific phenomenon of foreign-owned subsidiaries. The estimated magnitude of the influence of foreign ownership increases slightly when including the control variables. Foreign ownership is associated with a 50 percentage point higher probability that a firm has a focus on short-term profit. Turning to the general firm characteristics, the variable for establishment size takes a significant coefficient. Managers of larger establishments are more likely to focus on short-term profit.

In column (3), we continue to add controls by including variables for innovativeness and a quality-based strategy. Conforming to theoretical expectations, both variables emerge as significantly negative determinants of the probability that the firm has a focus on short-term profit. In regression (4), we also control for variable pay for managers. The average share of performance-related pay in managers' total compensation takes a significantly positive coefficient while managerial profit sharing takes a significantly negative coefficient. Firm age now also emerges as a significant determinant. Younger establishments are more likely to focus on short-term profit. Most importantly, including the full set of controls does not change the result on our key explanatory variable. Foreign ownership plays a statistically and economically significant role in the orientation toward short-term profit, even when accounting for potential confounding factors.

### *4.2 Regressions with Alternative Definitions of the Dependent Variable*

As a robustness check, Table 4 provides estimates that are based on alternative definitions of the dependent variable. Only the results on our key explanatory variable are shown. Results on the control variables are suppressed to save space.

The dependent variable in the first two regressions is a dummy for extreme short-termism. It is equal to 1 if the firm has a focus on quarterly profit. In regression (1), we use the standard probit procedure. In regression (2), we apply a rare events logit developed by King and Zeng (2001a, 2001b) to take into account that focusing on quarterly profit is a rare event.4 The probit and the rare events logit yield similar results. Foreign-owned firms are significantly more likely to focus on quarterly profit.

In regression (3), we use an ordered dependent variable with a four point scale. This variable captures the degree of short-term orientation in more detail. The determinants of short-term orientation are estimated by applying the ordered probit method. The ordered probit estimation provides further support for our finding that foreign owners in Germany are more likely than domestic owners to focus on short-term profit. Altogether, our basic finding of a positive association between foreign ownership and focusing on short-term profit is robust to alternative definitions of the dependent variable.

*4.3 Types of Foreign Owners*

In a further step, we return to our main dependent variable for short-term orientation and consider different types of foreign owners. This helps gain insights into the reasons of why foreign owners favor short-term profit. In column (1) of Table 5, we distinguish between foreign owners from "Anglo-Saxon" countries and foreign owners from other countries. Both variables take significantly positive coefficients of similar magnitude. Thus, the estimates do not support the view that "Anglo-Saxon" investors in particular have a focus on short-term profit. On the one hand, companies from non-"Anglo-Saxon" countries may be also listed on "Anglo-Saxon" stock exchanges and, hence, may face the short-term pressure by this type of capital markets. On the other hand, factors other than capital markets may play the dominant role in the difference between domestic and foreign firms' short-termist behavior in Germany.

The information disadvantage of foreign owners may be such an alternative factor. In order to examine the influence of this factor in more detail, we now consider that different types of foreign owners can differ in the extent to which they lack inside information on long-term growth opportunities of their subsidiaries. If lack of inside information plays a role in short-termist behavior, those foreign owners suffering from information asymmetry to a greater extent should have a stronger propensity to favor short-term profit.

In column (2), we distinguish whether or not the local managers of the subsidiary are primarily sent from the foreign parent company. As discussed above, foreign parent companies are likely to face a greater information disadvantage if they do not send managers to their local subsidiaries. This greater disadvantage results from increased communication problems between the local managers and the managers of the parent company. Hence, foreign-owned subsidiaries that have no managers sent from the parent company should have an even stronger tendency to focus on short-term profit. The estimates conform to this expectation. While both foreign-owned subsidiaries with and without managers sent from the parent company are significantly more likely to focus on short-term profit, the propensity is stronger for the latter type of foreign-owned firm. This is reflected in the estimated coefficients and, correspondingly, in the predicted probabilities. If a firm is a foreign-owned subsidiary with managers sent from the parent company, it has a 43 percentage point higher probability of focusing on short-term profit. If the firm is a foreign-owned subsidiary without managers sent from the parent company, the probability is 52 percentage points higher. Hence, the estimates provide evidence for the hypothesis that a greater information disadvantage of the foreign owner increases the propensity to focus on short-term profit.

In column (3), we provide a further approach to examine the role of information asymmetries. We reinsert the simple dummy variable for a foreign-owned subsidiary. Additionally, we include a variable for the physical distance between the foreign parent company and its German subsidiary. A greater physical distance can be seen as an indicator of an increased information asymmetry (Chan et al. 2005, Kang and Kim 2010, Petersen and Rajan 2002). Both variables take significantly positive coefficients. This suggests that foreign owners in general have a higher propensity to favor short-term profit and that this propensity increases in the physical distance between the foreign parent company and its subsidiary.

In Table 5, we use estimation (3) to project the influence of physical distance on the probability of focusing on short-term profit. The projections show that physical distance plays an economically significant role. Compared to the reference group of domestic-owned firms that are not subsidiaries, a foreign-owned subsidiary with a 500 kilometers distant owner has a 48 percentage point higher probability of focusing on short-term profit. A foreign-owned subsidiary with a 5,000 kilometers distant owner has a 55 percent higher probability. Thus, these findings provide further support for the hypothesis that the information disadvantage of foreign owners plays an important role in their focus on the short-term profit of their subsidiaries.

## 5. Conclusions

Concerns about economic short-termism have been widely expressed in the literature (Laverty 1996). However, it is often neglected that the time horizon of firms can vary according to circumstances and type of firm. As Souder and Shaver (2010, p. 1331) put it: ‘Yet, to date, the problem of economic short-termism has been taken as a universal condition rather than a response to firm-specific conditions that influence strategy’.

This study brings a new dimension to the debate by examining the role of foreign ownership. Our theoretical considerations suggest that foreign owners should have an increased interest in the short-term profitability of their subsidiaries because of their informational disadvantages. We test this hypothesis using data from domestically and foreign-owned firms in Germany. Our estimates do not only confirm that foreign-owned firms are more likely to focus on short-term profit. Our estimates also provide evidence that communication difficulties and information asymmetries contribute to short-termist behavior. We conclude that effective responses for encouraging a longer-term perspective of foreign owners would focus on improved management practices, and or appropriate policy incentives, for overcoming information asymmetries.

There is a need for continued research within the theme. While our results support the hypothesis that the lack of inside information on long-term growth opportunities leads foreign owners to favor short-term profit, future research could provide further insights into the role of moderating and mediating factors. The short-term orientation may be reinforced if the uncertainty brought by foreign owners leads to short-termist behavior on the part of local managers and employees.[5]

It would be also interesting to examine the role of capital markets in more detail. We do not find differences in short-termism between foreign owners from "Anglo-Saxon" countries and foreign owners from other countries. Hence, our estimates provide no evidence for the wide held view that "Anglo-Saxon" investors in particular have a focus on short-term profit. On the one hand, this result does not necessarily imply that "Anglo-Saxon" type capital markets play no role in the short-term orientation of foreign MNCs. Recent liberalization may have increased the exposure of MNCs from non-"Anglo-Saxon" countries to "Anglo-Saxon" type capital markets. Companies from non-"Anglo-Saxon" countries may be also listed on "Anglo-Saxon" stock exchanges and, hence, may face short-term pressure by this type of capital markets. On the other hand, our results may indicate that factors other than capital markets play the dominant role in the short-term orientation of foreign owners. As emphasized, the information disadvantage of foreign owners could be one dominating factor.

Furthermore, we note that our analysis is based on a relatively small sample of firms. If larger datasets in the future contained information on the orientation toward short-term profit, these datasets could be fruitfully used to extend this research. We also recognize that our variable for an orientation toward short-term profit is based on managers' assessment. In future research it would be valuable to additionally use non-attitudinal measures to capture the time horizon of firms.

Finally, it would be interesting to examine the consequences of the foreign owners' orientation towards short-term profit. This orientation may have implications for personnel policy, human resource management practices, investment, R&D and growth performance. In particular, the short-term orientation may introduce tensions into the corporate governance system of the host country. The German system of corporate governance traditionally relies on patient capital. Foreign owners can provide a challenge to this system as they deviate from the traditional role of patient owners. Identifying improved mechanisms for addressing this risk represents an important challenge for corporate strategy and governance.

**Table 1:** Distribution of Time Horizons

| *Focus on short-term profit versus focus on longevity and long-term maintenance of value* | *Percent* |
|---|---|
| 1 (Focus on quarterly profit) | 3.65 |
| 2 | 8.85 |
| 3 | 36.98 |
| 4 (Focus on longevity) | 50.52 |

N = 192

**Table 2:** Variable Definitions and Descriptive Statistics (N = 192)

| *Variable* | *Definition* | *Mean, std.dev.* |
|---|---|---|
| Orientation towards short-term profit | Dummy equal to 1 if the firm does not fully account for long-term sustainable value of the firm (categories 1, 2, and 3 in Table 1). The variable equals 0 otherwise (category 4 in Table 1). | 0.495, 0.501 |
| Focus on quarterly profit | Dummy equal to 1 if the firm has a focus on quarterly profit (category 1 in Table 1). The variable equals 0 otherwise (categories 2, 3, and 4 in Table 1). | 0.036, 0.188 |
| Degree of short-term orientation | Ordered variable for the degree to which the firm has an orientation towards short-term profit. The variable is constructed from the four categories shown in Table 1. The four point scale is recoded in inverse order so that a higher scale point reflects a stronger orientation towards short-term profit. | 1.656, 0.790 |
| Foreign-owned subsidiary | Dummy equal to 1 if the firm is majority-owned by a foreign company. | 0.109, 0.313 |
| Domestic-owned subsidiary | Dummy equal to 1 if the firm is majority-owned by a German company. | 0.224, 0.418 |
| Ln(firm size) | Log of the number of employees in the firm. | 4.971, 1.254 |
| Ln(age) | Log of the time span between the year 2006 and the year of foundation of the firm. | 3.555, 1.069 |
| Stock corporation | Dummy equal to 1 if the firm is a stock corporation. | 0.063, 0.243 |
| Limited company | Dummy equal to 1 if firm is a private limited liability company. | 0.432, 0.497 |
| Quality-based strategy | Ordered variable for the importance of the quality of products and services for the firm's market strategy. The variable ranges from 1 "not that important" to 4 "extremely important". | 3.182, 0.761 |
| Product innovation | Dummy equal to 1 if the firm has launched new products or services in the last three years. | 0.745, 0.437 |
| Share of managerial performance pay | Average percentage share of performance pay in total pay of a manager. | 11.370, 13.085 |
| Managerial profit sharing | Dummy equal to 1 if the firm provides profit sharing for managers. | 0.615, 0.488 |
| Managerial share ownership | Dummy equal to 1 if firm provides share ownership for managers. | 0.141, 0.349 |
| Foreign owner from Anglo-Saxon country | Dummy equal to 1 if the foreign owner of the firm is a company from an Anglo-Saxon country (Canada, Great Britain, U.S.). | 0.031, 0.174 |
| Foreign owner from non-Anglo-Saxon country | Dummy equal to 1 if the foreign owner of the firm is a company from a non-Anglo-Saxon country. | 0.078, 0.269 |
| Local managers sent from foreign parent company | Dummy equal to 1 if the top managers of a foreign-owned firm are primarily sent from the parent company. | 0.036, 0.188 |
| Local managers not sent from foreign parent company | Dummy equal to 1 if the top managers of a foreign-owned firm are not primarily sent from the parent company. | 0.073, 0.261 |
| Physical distance/100 | Physical distance between a foreign-owned firm and its parent company in kilometers divided by 100. The variable is set equal to 0 for domestically owned firms. | 1.687, 9.667 |
| Industry dummies | 10 industry dummies (food, chemistry, metal, mechanical engineering, automobile, construction, retail, logistics, service, financial service). | |

**Table 3:** Initial Regressions

| *Dependent Variable* <br> *Explanatory Variables* | *Orientation towards Short-Term Profit* <br> *Method: Probit* | | | |
|---|---|---|---|---|
| | (1) | (2) | (3) | (4) |
| Foreign-owned subsidiary | 1.449 [0.460] (0.391)*** | 1.697 [0.496] (0.407)*** | 1.708 [0.496] (0.398)*** | 1.793 [0.500] (0.427)*** |
| Domestic-owned subsidiary | --- | -0.030 [-0.012] (0.262) | -0.071 [-0.028] (0.262) | -0.090 [-0.035] (0.282) |
| Ln(firm size) | --- | 0.170 [0.068] (0.091)* | 0.192 [0.077] (0.091)** | 0.219 [0.087] (0.098)** |
| Ln(firm age) | --- | -0.105 [-0.042] (0.098) | -0.163 [-0.065] (0.102) | -0.175 [-0.070] (0.106)* |
| Stock corporation | --- | 0.384 [0.149] (0.445) | 0.295 [0.116] (0.471) | 0.308 [0.121] (0.496) |
| Limited company | --- | -0.001 [-0.000] (0.221) | -0.033 [-0.013] (0.225) | -0.088 [-0.035] (0.229) |
| Quality-based strategy | --- | --- | -0.293 [-0.117] (0.134)** | -0.268 [-0.107] (0.137)** |
| Product innovation | --- | --- | -0.455 [-0.178] (0.244)* | -0.537 [-0.208] (0.245)** |
| Share of managerial performance pay | --- | --- | --- | 0.034 [0.013] (0.014)** |
| Managerial share ownership | --- | --- | --- | -0.122 [-0.049] (0.333) |
| Managerial profit sharing | --- | --- | --- | -0.681 [-0.264] (0.319)** |
| Constant | -0.140 (0.096) | -1.005 (0.587) | 0.459 (0.758) | 0.455 (0.782) |
| Industry Dummies | No | Yes | Yes | Yes |
| Observations | 192 | 192 | 192 | 192 |
| Pseudo $R^2$ | 0.068 | 0.151 | 0.181 | 0.206 |

The table shows the estimated coefficients. Robust standard errors are in parentheses. ***Statistically significant at the 1% level; **at the 5% level; *at the 10% level. Marginal effects on the probability of focusing on short-term profit are in square brackets. Marginal effects of dummy variables are evaluated for a discrete change from 0 to 1. In column (1), the marginal effect of a foreign-owned subsidiary is a change in probability compared to the reference group of domestic-owned firms. In columns (2) to (4), the marginal effects of foreign-owned and domestic-owned subsidiaries are changes in probability compared to the reference group of domestic-owned firms which are not subsidiaries.

**Table 4:** Alternative Definitions of Short-Termism

| *Dependent Variables*<br><br>*Explanatory Variables* | *Focus on Quarterly Profit Method: Probit* | *Focus on Quarterly Profit Method: Rare Events Logit* | *Degree of Short-Term Orientation Method: Ordered Probit* |
|---|---|---|---|
| | (1) | (2) | (3) |
| Foreign-owned subsidiary | 1.716 [0.092] (0.465)*** | 2.116 [0.122] (0.793)*** | 1.259 [0.423] (0.244)*** |
| Pseudo $R^2$ | 0.350 | --- | 0.144 |
| Observations | 192 | 192 | 192 |

The table shows the estimated coefficients on the key explanatory variable. In regressions (1) and (2), four industry dummies and the variables for stock corporations and production innovations are excluded to improve the convergence of the model. Results on the control variables are suppressed to save space. Regression (3) includes all of the control variables. Robust standard errors are in parentheses. ***Statistically significant at the 1% level. Marginal effects on the probability of focusing on short-term profit are in square brackets. The marginal effects are changes in probability compared to the reference group of domestic-owned firms which are not subsidiaries.

**Table 5:** The Type of Foreign Owner

| *Dependent Variable* | *Orientation toward Short-Term Profit* *Method: Probit* | | |
|---|---|---|---|
| *Explanatory Variables* | (1) | (2) | (3) |
| Foreign owner from Anglo-Saxon country | 1.767 [0.498] (0.675)*** | ---- | ---- |
| Foreign owner from non-Anglo-Saxon country | 1.812 [0.502] (0.482)*** | ---- | ---- |
| Local managers sent from foreign parent company | ---- | 1.295 [0.428] (0.540)** | ---- |
| Local managers not sent from foreign parent company | ---- | 2.085 [0.524] (0.561)*** | ---- |
| Foreign-owned subsidiary | ---- | ---- | 1.453 (0.432)*** |
| Physical distance/100 | ---- | ---- | 0.035 (0.014)*** |
| Pseudo $R^2$ | 0.206 | 0.209 | 0.210 |
| Observations | 192 | 192 | 192 |

The table shows the estimated coefficients on the key explanatory variables. All of the control variables are included but are suppressed to save space. Robust standard errors are in parentheses. ***Statistically significant at the 1% level; **at the 5% level. In columns (1) and (2), marginal effects on the probability of focusing on short-term profit are in square brackets. The marginal effects are changes in probability compared to the reference group of domestic-owned firms which are not subsidiaries. Projections based on regression (3) are shown in Table 5.

**Table 6:** Projected Influence of Physical Distance

| Physical distance between the foreign-owned subsidiary and its parent company | 500 kilometers | 1,000 kilometers | 2,000 kilometers | 5,000 kilometers |
|---|---|---|---|---|
| Change in the probability of focusing on short-term profit | 0.481 | 0.500 | 0.525 | 0.545 |

The projections are based on estimation (3) in Table 5. They are calculated as the difference between two probabilities: (a) the probability that a foreign-owned subsidiary with a 500 kilometers (1,000, 2,000 and 5,000 kilometers, respectively) distant parent company has an orientation toward short-term profit; (b) the probability that a domestic-owned firm, which is not a subsidiary, has an orientation toward short-term profit.

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**Endnotes**

[1] The "Anglo-Saxon" parent companies in our dataset are from Canada, United Kingdom, and the U.S.

[2] In a broader context, our analysis is related to the literature on the liability of foreigness (Bell et al. 2012, Zaheer 1995, Zaheer and Mosakowski 1997). Furthermore, it is also related to studies examining whether foreign owners are comparatively footloose. Those studies indicate that foreign ownership is associated with an increased probability of plant closing (Bernard and Sjoeholm 2003), higher levels of outsourcing (Girma and Goerg 2004), individual perceptions of economic insecurity (Scheve and Slaughter 2004), faster employment adjustment (Fabbri et al. 2003), and the ability to bypass national labor market regulations (Navaretti et al. 2003, Slaughter 2007).

[3] As we include variables for both foreign-owned and domestic-owned subsidiaries the reference group consists of domestic-owned firms which are not subsidiaries.

[4] Again, only 7 firms in our sample are characterized by this extreme degree of short-termism.

[5] See Dickerson et al. (1995) and Palley (1995) for theoretical contributions.