The Expansion of Outside Directorate in Korea: Agency Control, Resource Dependency, and Neo-institutional Perspectives

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This paper explores the expansion of outside directorate in Korean corporations, analyzing workplace survey data collected by the Korea Labor Institute (KLI). The previous literate on this issue empathizes how the changing legal environments of Korean business affect the aspect of controlling corporate agencies, executive officers. The results of this study reconfirm that Korean corporations appoint more outside directors to monitor and control managers. Drawing on resource dependency and neo-institutional perspectives, we argue that other significant factors also increase the size of outside board. A company may recruit more outside directors to decrease resource uncertainty and dependency as well as to acquire more legitimacy from the environments. There exist different dynamics of appointing outside directors between listed and unlisted corporations. Listed companies hire outside board members and attempt to attract funding from foreign shareholders. In contrast, unlisted corporations recruit outside directors while conforming to the business norms and guidelines. We conclude that functional requirements affect the expansion of outside directorate in listed corporations and institutional factors guide unlisted corporations to appoint more outside directors.

Outside directorates were not familiar to Korean society only a decade ago. However, since January, 1996, when Hyundai Information Technology appointed an outside board of directors for the first time in Korea, the recruitment of outside directors by Korean companies has dramatically increased, and they have become one of the most common institutions in Korean business. This dramatic expansion of outside directorates owes much to legal enforcement since the financial crisis in 1997, the Korean government revised the law and mandated that listed and financial companies recruit a certain number of outside directors. This trend has not been confined to companies which are legally subject to this requirement. Unlisted companies have voluntarily recruited outside directors, and even listed companies have often hired more than the mandatory minimum number.

The previous literature on this issue has emphasized the functions and effectiveness of outside directorates for such things as monitoring/controlling managers and developing strategic corporate alliances (Kim Seong-hun & Park Cheol-sun, 2000; Kim Hwa-jin, 2005; Lee Young-gi, 1998; Jeong Yun-mo & Son Young-lak, 1998; Cho

Dong-Sung & Kim Joo-Tae, 2000); serving as an effective means for limiting the discretion of CEOs and senior managers and keeping them in check; and fostering partnerships between different companies through acting as inter-locking directorates. However, we argue here that the valid reasons for appointing outside directors are not limited to functional factors, but may include normative factors: companies may recruit outside directors not only to fulfill functional needs, but because of the business norm which emphasizes that firms recruiting outside directors have a good image.

In this vein, we have two study questions to examine: first, what makes Korean companies appoint outside directors? In this paper, we present and verify three factors from the perspective of organization theory: manager control from the principal-agent approach; the strategy for securing resource necessity form the resource dependence approach; and conformity to business norms from the neo-institutional approach. The existing literature has explained the recruitment of outside directors by Korean firms within one theoretical framework, while this paper intends to review the issue from multiple standpoints. Second, are there different dynamics for appointing outside directors between listed and unlisted corporations? Lee Kyeong-mook and Oh Jong-hyang (2002) in their analysis noted that listed companies hire more than the minimum number of outside directors. In contrast, there are not enough empirical studies to adequately examine the appointment of outside directors in unlisted companies. Targeting both listed and unlisted firms, this paper makes two important contributions to the literature on outside directors. On the one hand, it focuses on the recruitment of outside directors in unlisted companies. On the other hand, it is a study comparing listed and unlisted companies on the reasons for appointing outside directors.

The paper proceeds as follows: section 2 reviews the definition, functions and current status of outside directorates; in section 3, we present hypotheses concerning the reasons for appointing outside directors based on organization theory; section 4 explains the data, variables and statistics used in this paper; the results of the analysis are given in section 5; and then we note the implications of this study in the conclusion.

Significance and Current Status of Outside Directorate

The company limited by shares, the typical modern corporate form, is characterized by the separation of ownership and management (Berle & Means, 1932). Unlike earlier companies in which the owners were the managers, corporations issue shares to finance their operations, which leads to the appearance of colossal capital-based conglomerates. Moreover, the emergence of corporations without controlling and/or majority shareholders offers good opportunities for professional managers to effectively run corporations. In this sense, the typical form of modern companies is corporations which have a well-distributed ownership structure: many shareholders, not specifically controlling ones, own a company, and a professional manager runs it. This form is very common in England and the U.S. where corporations first emerged.

However, despite the separation of ownership from control, interests between corporate owners and managers may be coincident or conflicting, which may leaves room for compromising the interests of the shareholders. In particular, problems arise when managers pursue their own profits without considering the interests of the shareholders. Managers are usually appointed and dismissed by the decision of the shareholders in a general meeting. They must accordingly behave in ways which are consistent with shareholder interest. However, it is hard to expect that all activities of the manager correspond exactly to the interests of the shareholders. For an extreme example, if managers have already acted against the shareholders' interests, it is easy to dismiss them, but it is not simple to nullify what they have done. For this reason, the shareholders require institutional mechanisms to check and monitor managers on a routine basis and in advance. In this sense, the outside directorate was created to meet this need of the shareholders.

The outside directorate can be defined more precisely by a comparison with an inside directorate (Byrd & Hickman, 1992; Cochran, Wood & Jones, 1985; Goodstein & Boeker, 1991; Hermalin & Weisbach, 1988). Unlike inside directors who participate in running the company, outside directors are appointed as independent outsiders who monitor the management. In accordance with the Corporation Act, most managers involved in running the business are to be monitored and controlled by the board of directors.1) However, inside directors often face tough challenges in successfully keeping the management in check, because of the fear of revenge or because of loyalty to the top executives. In contrast, outside directors are not involved in running the company and hence do not have such fears or loyalties. This independence of the outside directors increases if they are appointed by the shareholders, not by managers. For this reason, outside directors are generally interpreted as an effective means for shareholders to routinely control and monitor managers. Furthermore, they can conduct the functions of service and resource dependency (Johnson, Daily & Ellstrand, 1996). The function of service is considered to consist of consultations on or participation in corporate strategies and decision-making. In particular, if professionals in relevant sector are hired as outside directors, they may even conduct the high-level of service which expert directors are expected to do. The function of resource dependency is regarded as assistance in financing for corporate operations and developing partnerships with other corporations. If a company recruits management staff members in other corporations as outside directors, it can be easier to access the resources and assets which those corporations have.

The appointment of outside directors in the U.S., where the outside directorate was born, aims to control and monitor managers. In the 1970s, the management failure of the Penn Central Co., and illegal political donations and illicit payments by large companies such as Gulf Oil Corp. and Lock-heed Aircraft Co. arose from corporate managers' acting against the interests of shareholders. In this context, the New York Stock Exchange (NYSE) proposed the mandatory establishment of audit committees consisting only of outside directors for listed companies2) so as to prevent a recurrence of such illegal acts. Outside directorates were introduced to Korea in a similar way. The bankruptcy of Kia Motors Corp. and Daewoo Group in 1997 put the fast growing Korean economy under direct IMF supervision. In this circumstance, Koreans raised a question about the way existing corporate management acted based on owners' decisions. They witnessed a dramatic decrease in the trust in chaebols, giant conglomerates, which once were regarded as "too big to fail" (Park Gil-seong; Jang Ha-seong, 2005). As a result, the public shared a common understanding of keeping corporate owners in check, which led to the mandatory appointment of outside directors for listed companies in February, 1998. Listed companies and financial businesses, including banks, securities dealers, and insurance firms, are legally required to hire at least as many outside directors as one quarter the number of listed directors. Moreover, a company whose assets total

<Table 1> Outside directorates in Korean listed companies(2003~2005)

Year		Total number of companies that appoint outside directorate	Total number of outside directorate	Number of outside directorate per company
2003	Stock Market	650 (94.6%)	1,402	2.16
	KOSDAQ Market	516 (59.4%)	746	1.45
	Sum	1,166 (75%)	2,148	1.84
2004	Stock Market	648 (96.1%)	1,416	2.19
	KOSDAQ Market	568 (64.3%)	813	1.43
	Sum	1,216 (78.1%)	2,229	1.83
2005	Stock Market	646 (98.3%)	1,454	2.25
	KOSDAQ Market	582 (65.4%)	824	1.42
	Sum	1,228 (79.4%)	2,278	1.86

Source: Korea Listed Companies Association

KRW2 trillion or more must recruit a minimum of three outside directors or more than half the total number of directors. As shown in Table 1, 77.3% of all listed companies hired more than one outside director on average between 2003 and 2005.3)

Theory and Hypothesis: Appointment of Outside Directors by Korean Corporations

What makes Korean corporations recruit outside directors? The appointment of outside directors is believed to be a change in the way of hiring members for the board of directors. More specifically, the boards of companies which do not hire outside directors consist of inside directors alone who run the affairs of the company. On the other hand, those which recruit outsiders are composed of outside directors who take responsibilities for monitoring managers as well as inside directors. Companies require the non-involvement of outside directors in corporate management, either as an expressed or implied requirement of directors, and weaken the influence of majority shareholders on the appointment of outside directors. This change may often lead to the amendment of corporate by-laws and a dramatic shift in the method of corporate performance. That is because outside directors do not work in the company on a routine basis, and therefore, need to form a supporting team and have equipment/funds in order to conduct their mission. In other words, the appointment of outside directors is regarded as a structural change in corporate organization. Accordingly, we need to examine the reasons for appointing outside directors from the standpoint of organization theory. In this section, we review three reasons; first, the monitoring of managers presented by most previous literature based on agency theory; second, the securing of resources in a stable way from the perspective of resource dependency theory; and third, conformity to business norms based on the co-optation and neo-institutional theories.

1. Monitoring of managers

In a shareholder capitalist society, corporations with the separation of ownership from control are a typical corporate form, and therefore, shareholders as corporate owners need a mechanism to keep in check expert managers who engage in asset management. Likewise, in a modern capitalist society, a typical type of corporate form is the publicly-held firm listed on a stock market (Fama & Jensen, 1983).4) In particular, publicly-held private corporations are common in advanced capitalist countries where the stock markets are well developed. Most economic activities are conducted by such corporations. Distributed shareholders have the ownership of open corporations, while managers take responsibility for practical management of the corporation, which is the separation of ownership and management. This separation has advantages: the effective transfer of investment responsibilities to a majority by distributing ownership responsibilities to the shareholders; and efficient corporate operation by entrusting systematic management to expert managers in a situation where business environments are growing more complex. However, it may also give rise to the agency problem, i.e., the conflict of interests between owners and managers. The relationship between shareholders and managers is treated as one between principal and agent (Jensen & Meckling, 1976). That is, it is created when the principal makes a contract with an agent who performs specific services on behalf of the principal who delegates power to the agent. The principal wants the agent to strive to maximize profits, but the agent does not always make an effort to do so. Rather, the agent may act against the principal's interest in an attempt to pursue his/her own interest.

At this point, the agent problem arises: if the agent seeks his/her own interest, conflicts of interest between the principal and the agent will be unavoidable. Corporate managers often pursue their own interests when the control of shareholders becomes lax. For example, they may earmark too much money for business promotion; unnecessarily enlarge and retrofit existing offices; enter into contracts contrary to the interests of the company or members of the board of directors; or pursue over-diversification.5) One of the solutions to these problems is the improvement of corporate governance, which is also one of the reforms that the shareholders suggest. Corporate governance refers to corporate management and control, which is an institutional system and operational mechanism for coordinating and governing the interests of the shareholders, managers and other interested parties (OECD, 1999). Corporate governance can be categorized into two types according to whether the control over managers occurs inside or outside the company: the one is an internal control mechanism, such as outside board directors and outside auditors; and the other is an external control mechanism.6) The roles of boards of directors can be divided into three: first, control over managers on behalf of the shareholders; second, the provision of services such as the active participation in developing and implementing corporate strategies and consultating on general corporate management; and third, access to resources which enables firms to secure resources necessary for corporate success (Johnson, Daily, & Ellstrand, 1996). Principle-Agent theory focuses mainly on the first function. Unlike inside directors, outside directors are independent of managers, and the possibility of collusion between the two parties is very low. As a result, the board of directors can effectively control managers who try to pursue their own interests.

The following studies show that the appointment of outside directors becomes a useful means to help implement sound management activities by managers: analysis of the presidents' letters in approximately 1,000 annual corporate reports shows that corporations with a higher percentage of outside directors on the board tend to honestly reveal negative results (Abrahamson & Park, 1994); there is a positive relationship between the percentage of outside directors and corporate performance (Hill & Snell, 1988; Pearce & Zhara, 1992 ;Schellenger, Wood & Tashakori, 1989); corporations with a higher percentage of outside directors may protect more shareholder interests than those with a low percentage (Byrd & Hickman, 1992); and corporations with a high percentage of outside directors have greater potential to successfully conduct restructuring after bankruptcy (Daily, 1995). Corporations run by expert managers are more likely to recruit outside directors. In contrast, those operated by their owners—who have great power and wield great influence over the overall corporate management—are less like to do so. Therefore, given are the following hypotheses:

Hypothesis 1: Corporations with demand for controlling and monitoring managers are more likely to appoint outside directors than those without.

Hypothesis 1-1: Corporations run by expert managers are more likely to recruit outside directors than those operated by owners.

Hypothesis 1-2: Corporations with outside auditors are more likely to hire outside directors than those without.

Corporations which have a separation of ownership and management and an expert management system including outside auditors can more easily develop institutional mechanisms to monitor and keep in check managers who act against shareholder interests. In contrast, corporations with an owner management system are reluctant to allow such monitoring activities. Outside auditors are one of these internal control mechanisms, along with outside directors. Corporations with outside auditors are regarded as having the intention to monitor and control managers. Therefore, these companies have a greater potential to appoint outside directors.

2. Securing resources in a stable way

Corporations are interactive actors, not atomic ones separated from their environments. Their environments determine the survival and development of corporations, and at the same time, corporations “enact” their environments in an effort to increase their rate of survival. Outside directorates can be introduced as a result of strategic selection to increase this rate. This approach is based on resource dependence theory and co-optation theory. According to the former perspective, if resources which organizations must acquire from the environment have a critical influence on the survival of organizations, those organizations are more likely to rely further on the environment. For example, if the resources are limited, but many of them must be acquired from the environment, organizations are more likely to depend on the environment than when only a few resources are needed. This dependency also increases when organizations cannot conduct their unique functions without specific resources. On the other hand, environment-dependent organizations can shape their environments in a strategic way, rather than merely react to them (Weick, 1979). In general, this activity can be embodied in managers’ active responses.

Strategies for securing resources which heavily affect the survival of organizations include: changes in organizational structure to adapt to the environment; seeking the most preferable environment for survival; the creation of new demand necessary for survival; and encouraging government activities which are helpful to organizations. With these methods, organizations tend to secure critical resources in a stable way (Pfeffer & Salansik, 1978). Resource dependency theory regards the board of directors as one of the tools which help enable managers to access the resources necessary for corporate success. The members of the board of directors can help secure critical resources such as capital, technology, information, human resources, and partnerships in a stable way through networks with other organizations. The studies of Sterns and Mizruchi (1993) show that the patterns and amounts of corporate financing may differ in accordance with the type of financial institution in which directors are involved. That is, corporate access to resources (e.g., capital) is increased by appointing management staff members of financial institutions as outside directors. In the same vein, the studies of Daily and Dalton (1994) also show that outside directors make it easier to access information necessary for effective corporate management. In Korea, Small and Medium-sized Enterprises (SMEs) may stably secure their customers/clients, one of the most important resources, by hiring members of the management staff of large companies as outside directors. Government procurement companies are not an exception. They can stably secure consumers who purchase products by appointing former officials as outside directors. In the same vein, newly emerging companies can raise recognition, a scarce resource, by recruiting celebrities as outside directors.

Philip Selznick (1949) presented co-optation theory in his study on the Tennessee Valley Authority (TVA). He defines organizations as an adaptive social structure. To understand organizational behavior, he argues that organizations should be regarded as a social institution embedded in an institutional matrix, thereby analyzing the structure and goals of organizations. Organizations in a certain environment are affected by other existing parties and external groups, which in turn, have a special relationship with them. In this case, the organizations and the external groups need to work together in one way or the other. The former may even take some responsibilities for the latter such as customers and local residents. Features of external organizations may define and even create the characteristics of the organization. Therefore, organizations should adapt to their environments and cooperate with external groups in one way or the other.

Selznick presents co-optation as a means to pursue the survival of organizations in their relationship with the environment. That is, he first describes co-optation as the incorporation of new elements into the internal decision-making structure or leadership of an organization to avoid threats to the stability and survival of organizations. Co-optation is a mechanism to adapt to the environment and to increase the possibility of survival. As a typical example, there is the internalization of external threats and monitoring by providing official positions in an organization to external group members which threaten the survival of the organization. From this perspective, the appointment of management staff members of financial institutions as outside directors can be explained as follows: as in resource dependency theory, the appointment makes it easier to access capital, an important resource, and at the same time, minimizes any potential threat by financial institutions to the stability of the organization (Allen, 1974).7) The appointment of outside directors demanded by foreign shareholders can be explained from the agency approach.8) On the other hand, organizations can internalize an external threat, i.e., foreign shareholders, by hiring outside directors as agents of the company.9) To sum up, corporations intend to secure resources necessary for their survival and development through networks involving the board of directors, especially outside directors. Under environmental uncertainty, securing resources in a stable way is critical for the survival and development of corporations. In particular, corporations whose resources depend on external environments or groups are more likely to attempt to acquire resources in a stable way. To this end, they are more likely to appoint outside directors than firms whose resources do not rely much on external conditions. Subcontractors, firms with a higher rate of government procurement sales, and corporations with high levels of foreign ownership recruit outside directors to strategically cope with restrictions imposed by important external environments. Moreover, corporations which are experiencing a dramatic decrease in market share in their leading products face market uncertainty. Such companies are also likely to hire outside directors to acquire resources in a stable way. Accordingly, the following hypotheses can be set up:

Hypothesis 2: The more corporations need to secure resources in a stable way, the more likely they are to recruit outside directors.

Hypothesis 2-1: Corporations with a higher rate of government procurement sales are more likely to hire outside directors.

Hypothesis 2-2: Subcontractors are likely to appoint more outside directors than contractors.

Hypothesis 2-3: Corporations with high levels of foreign ownership are more likely to hire outside directors.

Hypothesis 2-4: Corporations facing higher market uncertainty are more likely to recruit outside directors.

3. Conformity to business norms

Organizations should pursue their own development and survival, while resolving diverse problems in that process. They may discover solutions by themselves or use ready-made solutions. For example, they may develop alternatives by themselves to tackle various problems caused by the bureaucratic system. They may also apply results learned from other organizations which have already experienced similar challenges. In particular, solutions to common problems faced by many lie in tacit knowledge shared by all. For instance, transforming existing organizations into team-based or network-based ones is a well-known solution to addressing bureaucratic dysfunction. Tacit knowledge often acts as a norm which organizations should abide by. Above all, we need to recognize that most modern organizations have much in common (Meyer & Rowan, 1977). We have often witnessed that different organizations with their own backgrounds are significantly similar in the areas of structure and system. For example, many countries with different histories have a twelve year school system (six years of primary, three years of junior secondary, and threes years of senior secondary education). Government agencies in many countries are classified into departments of finance and economy, foreign affairs, science and technology, and the environment. Contemporary large corporations are involved in productive activities in a wide variety of areas through diversification, regardless of business type (Meyer et. al., 1997).

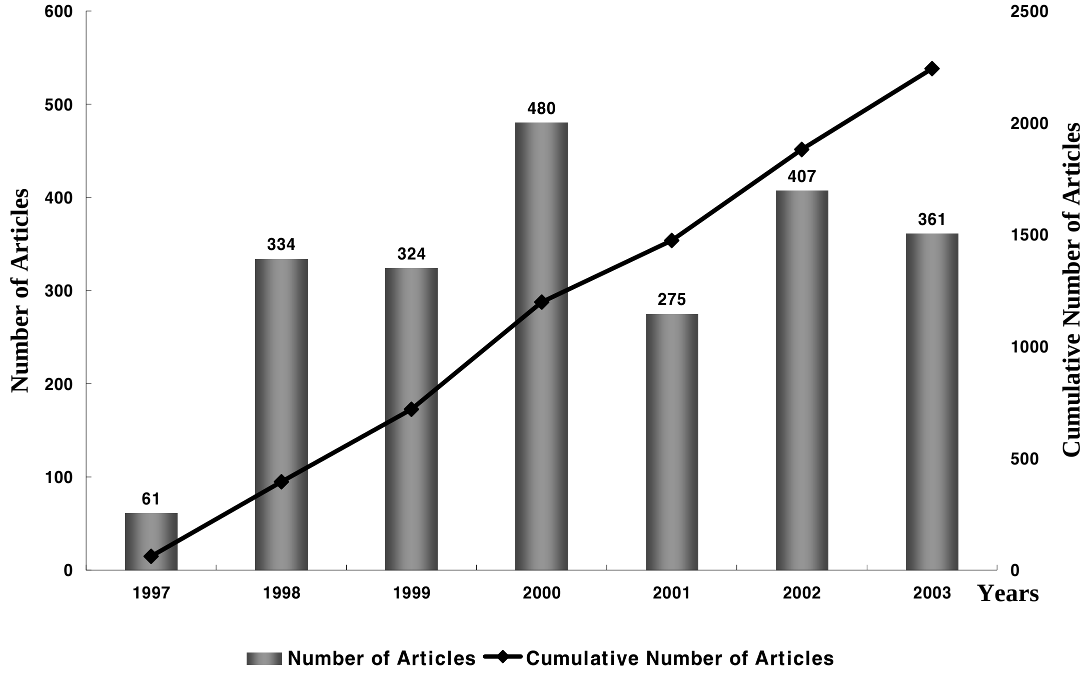
When it comes to the similarity between different organizations, the following two explanations are possible: rationality of organization (Lawrence & Lorsch, 1967; Pfeffer & Salancik, 1978; Thompson, 1967; Weber, 1968); and acquiring legitimacy (Meyer & Rowan, 1977). The former approach is to seek efficient or effective solutions by considering the fact that most challenges and problems which contemporary organizations face are not very different, and therefore, their solutions are similar. The latter approach (Meyer & Rowan, 1977) shows that organizations facing similar challenges try to use given solutions, rather than to solve problems on their own. Moreover, these solutions may have legitimacy if they are accepted as "common sense." If an organization used tacit knowledge as a solution, it may be recognized internally and externally as having done its best to tackle problems although its efforts failed (Emery & Trist, 1965).

However, even the most appropriate solution discovered by an organization could run against common sense, and nevertheless, the organization might try to use it and then, unfortunately, fail. In this case, the organization would bear the brunt of the negative result on the ground that it had not followed tacit knowledge. For this reason, organizations tend to accept ready-made and justified solutions, not pursue new ones. As a result, most organizations become similar to each other. For instance, there are two approaches to explaining the fact that most contemporary large organizations have a bureaucratic structure. The one focuses on the efforts that large organizations have made to solve diverse problems in operations and management in rational and appropriate ways. The other explains that, it is just common sense that “all large organizations ought to have a bureaucratic structure,” i.e., corporations have accepted the idea without much consideration. The appointment of outside directors can be explained in the same fashion. As noted before, the explanation—that corporations are willing to recruit outside directors to monitor managers and stably to secure important resources—is based on the premise that companies tend to tackle problems in a more or less rational way. However, all corporations do not seek customized solutions and/or to address problems in a proper and rational way (March, 1988).

Corporations may recruit outside directors as one of the solutions justified by society, to monitor managers and secure resources. Moreover, if the outside directorate is widely regarded as an essential institution in operating corporations, because it serves as a useful means to monitor managers and secure resources, then even corporations which do not have a demand for monitoring managers and acquiring resources may hire outside directors. Put another way, the outside directorate acts as a business norm which corporations must abide by.10)

Such a business norm is a more comprehensive concept than the Corporations Act which is legally binding and governs corporate activities. It can be defined as the set of cognitions which all corporations are believed to follow. For example, business norms include: the installation of an R&D department to develop new products; the acquisition of ISO9000 Certification to guarantee the quality of products; the adoption of the six sigma strategy for innovation in products and to meet the satisfaction of customers; and the recruitment of CFOs to secure cash-flow financing. Such business norms are created over a relatively short term by enacting laws, but also have been shaped over a long time as a result of the experiences of corporations. For instance, if corporations witness the success in developing new products of several other companies which have installed an R&D department, and their consequent rapid growth, they may feel that the establishment of an R&D department is essential to develop hot new products for the market. Subsequently, when most corporations share such a recognition, we can say that the business norm regarding the role of an R&D department has been created.

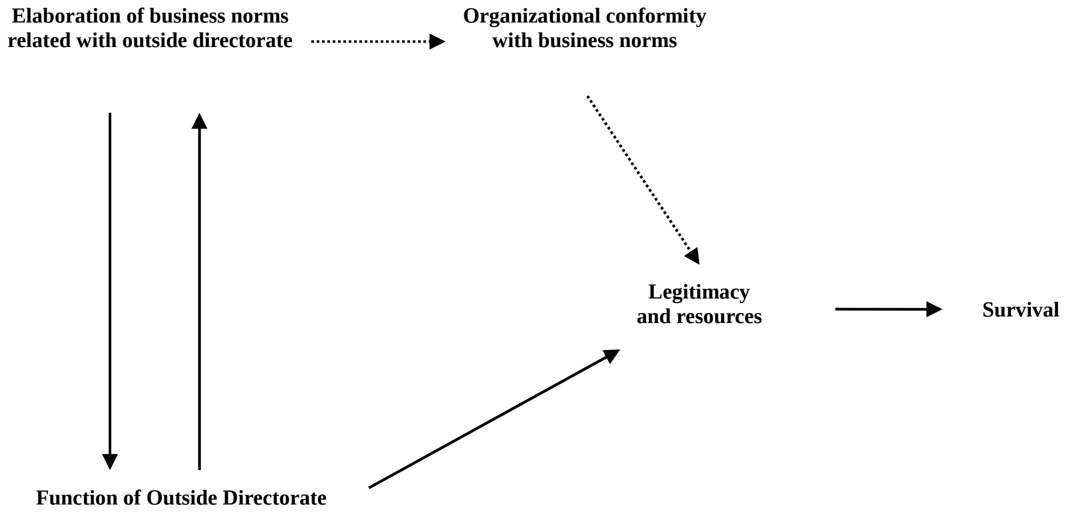
<Figure 1> Newspaper Articles about Outside Directorate



Source: KINDS Web Site(http://www.kinds.or.kr/)

In creating such business norms, the roles of experts and the media are very important (Strang & Meyer, 1993). Experts serve to endorse the functions of specific institutions such as R&D departments and have them be accepted or justified in society. The media also plays a prominent role in enhancing the social recognition of specific institutions, especially through a reciprocal process. The media reports the roles of specific institutions based not only on the facts, but also on the opinions of experts. As a result, such roles may be generalized at a societal level. The examples are here. If the media reports on companies with R&D departments receiving good comments from the market and if, in addition, it broadcasts expert opinions that the installment of R&D departments is essential for companies to develop new products systematically, most corporations will share the recognition that they need to establish an R&D department to succeed in business. In this case, corporations may achieve the goal of developing new products by installing such a department and also easily acquire legitimacy, i.e., the good image of a company striving to conduct corporate activities successfully. Consequently, such corporations can promote their development and increase their rate of survival by more easily acquiring the funds and manpower necessary for corporate operation (Meyer & Rowan, 1977). As seen in Figure 1, the attention of the media on outside directors has dramatically increased since 1998, shortly after the financial crisis. Initially, such attention was focused mainly on the introduction of the outside directorate and the appointment of outside directors by individual companies. Since 2000, however, we have witnessed expert opinions and editorials emphasizing that the recruitment of outside directors may be helpful for corporate management. Given such media reports, we reason that a business norm concerning the recruitment of outside directors has been created at least since 2000.

<Figure 2> Business norms and Survival of Firms



The previous literature on the appointment of outside directors has focused on their practical functions, such as monitoring managers and securing important resources in a stable way (Ahn Taek-sik, 2002; Yeom Mi-kyoung, 2004; Cho Dong-Sung, Kim Joo-Tae, 2000; Jin Tae-hong, 2003; Abrahamson & Park, 1994 ;Allen, 1974; Byrd & Hickman, 1992, Daily, 1995; Day & Dalton, 1984; Hill & Snell, 1988; Pearce & Zhara, 1992 ; Schellenger, Wood & Tashakori, 1989). However, the recruitment of outside directors can be explained by the aspect of the acceptance of business norms. As seen in Figure 2, corporations acquire both resources and legitimacy critical for survival not only thanks to the practical functions of outside directors, but also because they conform to a business norm, i.e., "corporations with outside directors conduct sound management activities."

The paths to secure resources and legitimacy are different for the following reasons (Meyer & Rowan, 1977): corporations on the first path seek and choose in a rational and reasonable way the best solution to problems from among diverse alternatives, thereby acquiring legitimacy and resources. On the other hand, those on the second path accept a business norm which is already justified in society as a solution, thereby obtaining resources and legitimacy. Therefore, the latter elucidates better the appointment of outside directors by corporations which do not have a desperate need for an outside directorate—a smaller necessity for monitoring managers and/or securing important resources. However, it is not easy to identify these two paths in the process of analysis, although there is a sharp theoretical distinction between them (Zuker, 1987). Corporations which adopt the outside directorate earlier than other companies tend to need the institution primarily for practical reasons and thus are more likely to put priority on the practical functions of the institution. On the other hand, those which introduce an outside directorate after relevant business norms have already come into existence tend to accept the institution not because of their realistic needs, but because of conformity to business norms which help them survive. Therefore, they are little interested in the practical functions of the institution (Tolber & Zuker, 1983; Baron, Dobbin & Jennings, 1986; Jang, 2000). However, it is not easy to estimate the exact time when business norms for an institution have been established. Nonetheless, the reason why we divide and explain the two paths is as follows: we assume that all corporations which introduce an outside directorate are unlikely to appoint outside directors for practical reasons—monitoring managers and securing resources. If this assumption is right, conformity to a business norm may fill the gap in explaining the appointment of outside directors in Korean corporations.

Another approach to accounting for the diffusion of specific institutions such as the outside directorate is the social network theory. This theory has two important characteristics. First, the closer interactions are between an actor who tries to diffuse a specific institution and another who potentially accepts it, the more likely the institution is to diffuse (Rogers, 1983). Second, the emphasis is placed on the contents of the institution and on the rationality of the diffusion process (Rogers, 1983; Banerjee, 1982).

New institutions are adopted because they are regarded as more proper and rational than existing ones. Their diffusion is determined by thorough calculation on the part of those taking up the new institution. That is, those who accept institutions tend to fully evaluate and compare existing institutions with new ones and analyze their merits and demerits. After that, only if the new institutions have more advantages, are they accepted.

Therefore, new institutions are more likely to diffuse when they are recognized as more rational. The diffusion itself of new institutions occurs through a rational calculation process. The former is referred to as the rationality of the contents of institutions. The latter is referred to as that of the diffusion process itself. The explanation of the diffusion of institutions based on social network theory has an "elective affinity" with other approaches which analyze the reasons for accepting institutions as the result of rational thinking. However, there is a blind spot in such explanations, which needs another theoretical framework (Strang & Meyer, 1993).

Institutions diffuse along the links in social networks from the perspective of social network theory. In reality, however, we often witness that external actors also accept institutions which have diffused or are in the process of diffusing through internal networks. For example, non-members of the OECD may accept legal institutions recommended by the OECD; and Asian countries may adopt welfare policies which European countries have implemented. In addition, diffusion occurs in a random pattern and at a higher speed than social network theory would expect.

Based on these insights, another approach to accounting for such diffusion is neo-institutional theory (Strang & Meyer, 1993). First, this theory emphasizes the importance of two variables—culture and social relations.11) The diffusion of institutions occurs not only along social networks, but among external actors with cultural similarity. Actors with cultural similarity easily tend to share the necessity for accepting institutions, because they see the world in a similar way, and consequently, the diffusion of institutions among them may occur at a rapid speed. Second, "theorization" should be provided to help actors easily understand institutions in an attempt to turn cultural similarity into a catalyst for the diffusion of institutions. The examples are as follows: with regard to the employment of private corporations, the U.S. administration offered measures which help implement affirmative action (Dobbin et al., 1993; Dobbin & Sutton, 1998; Sutton & Dobbin, 1996); the Federation of Korean Industries (FKI) provides to member companies institutional frameworks for transparent management (FKI, 2004); and the Samsung Economic Research Institute (SERI) presents to companies guidelines for expanding outside directorates (SERI, 2003). Expert groups—scientists, intellectuals, policy analysts and professionals—play a pivotal role in providing institutional guidelines. When actors in a similar cultural category have such guidelines, the diffusion may occur more rapidly. Moreover, the provision of guidelines may prevent acceptors from misunderstanding institutions or introducing them in an inappropriate way. Corporations may strive to follow business norms because conformity to the norm is an effective means to acquire legitimacy and critical resources. The business norm is easily understood in the explicit form of laws, but is often shared in an implicit way. Corporations which try to follow business norms can learn them via diverse paths. For instance, corporations which have entered overseas markets tend to gain legitimacy in those markets by following business norms regarding measures for improving corporate governance such as the outside directorate and financial statements. They also benchmark the best practices of other companies, because the institutions and practices of best-performing companies acquire legitimacy from the market. Therefore, the benchmarking of such institutions can be an efficient tool for corporations to conform to business norms rapidly. Moreover, corporations may consistently share information on business norms by joining associations of senior managers. As discussed above, managers' associations provide to their members information on diverse institutions and practices which are helpful for corporate operation. With such information, corporations learn business norms. Based on this discussion, the following hypotheses can be proposed:

Hypothesis 3: The more sensitive to business norms that a corporation is, the more likely it is to recruit outside directors.

Hypothesis 3-1: Corporations which have entered overseas markets are more likely to appoint more outside directors than those which have not done so.

Hypothesis 3-2: The more managerial associations a corporation joins, the more likely it is to hire outside directors.

Hypothesis 3-3: The more a corporation benchmarks the best practices of others, the more likely it is to recruit outside directors.

4. Differences between listed and unlisted corporations

In regard to the appointment of outside directors, the Securities and Exchange Act divides listed and unlisted corporations and requires only listed ones to recruit more than a certain number of outside directors. According to the Act, listed companies must appoint more than a quarter of the total directors on the board as outside directors. Large listed firms with total assets of more than KRW2 trillion are to hire more than three outside directors or a majority of the total number of directors.12) Unlike unlisted companies which are not required to appoint outside directors, listed firms must hire more than a quarter of the total number of directors as outside directors. They may appoint the mandatory number of outside directors or more. If they recruit more than the mandated number, the interpretation is that they have voluntarily elected extra outside directors. Lee Kyoung-Muk and Oh Jong-hyang (2002) argue in their study on this issue that listed corporations hire outside directors to gain social legitimacy. However, listed firms have already gained social legitimacy which requires conformity to the business norm by having been required to appoint outside directors. Therefore, the appointment of extra outside directors by listed firms can be explained by the practical functions of such directors. That is, listed corporations need more outside directors to more effectively monitor managers and secure more resources in a stable way. In contrast, unlisted companies voluntarily elect outside directors. In most cases, they are younger and smaller than listed companies. Put another way, many unlisted firms have neither a systematic organizational structure, nor an effective operational system for monitoring managers and securing resources. Therefore, their need for outside directors is less than that of listed companies. After all, compared to listed firms, the efforts of unlisted ones to recruit outside directors are likely to be interpreted as conformity to business norms. For this reason, the following hypotheses can be formulated:

Hypothesis 4-1: With regard to the appointment of outside directors, listed corporations tend to put more priority on monitoring managers and acquiring resources, as compared with unlisted ones.

Hypothesis 4-2: In regard to the recruitment of outside directors, unlisted corporations tend to emphasize conformity to business norms more than do listed companies.

Data, Variables and Analytical Methods

1. Data

This paper uses the Business Panel Survey collected by the Korea Labor Institute (KLI) to verify its hypotheses. The Data is based on the distribution of businesses in the Business Basic Statistics Survey conducted by the Korea National Statistical Office, and is a longitudinal survey conducted annually since 2002. More specifically, it samples businesses registered in the Employment Insurance Database and collects information on the overall business environment, the system for managing human resources, the current status of relationship between labor and management, and wage bargaining. This paper uses the first batch of data from 2002 and the second from 2003. The Business Panel Survey includes information on not only the type, size and status of businesses, but also on the system for managing human resources or business strategy and organizational structure. Out of a total of 2733 samples taken from the Data, this paper targets 329 listed corporations and 819 unlisted ones, except for samples with missing values. In addition, it forms independent variables by using the 2002 data and predicts the size of outside boards for 2003, thereby establishing a clear sequence of cause and effect.

2. Dependent Variables

One dependent variable is the number of outside board members appointed by corporations during the year 2003. The average number of outside directors hired by 819 unlisted firms was 0.81 persons, while the number of those recruited by 329 listed companies was 1.79 persons. 556 unlisted firms, 67.9% of the total samples, did not appoint outside board members. In contrast, 64 listed ones, 19.5% of the total, did not recruit.

3. Independent Variables

This paper forms diverse independent variables to measure three factors—monitoring managers, securing resources and conforming to business norms.[13)]

Variables concerning the first factor were whether owners ran corporations themselves, and whether there were outside auditors. There are two situations: one in which owners wield influence over all business decisions and corporate operation; and one in which expert managers are in charge of corporate management, but owners still have great power to run the company. We integrate the two into one and treat it as one variable: owner control.

We also “operationalize” a variable indicating whether corporations have already accepted a system for outside auditing when they have more than one outside auditor.

With regard to securing resources, we use four variables: (1) the ratio of revenues centering on the government and public sector to total revenues; (2) whether market share in their leading products was decreasing; (3) whether the given corporations were subcontractors; and (4) the percentage of interests held by foreigners. To measure the first ratio, we use answers to the question in the first survey questionnaire, “What is the ratio of revenue centering on the government and public sector to total corporate revenue?” All responses are logged to show a normal distribution.

Decreases in market share of leading products is assessed as follows: with the question, “What has changed in your leading products/services by item below for the last three years” (scaled 0-5), we group the answers "great decrease" and “slight decrease” into one category and operationalize it into a dummy variable. With regard to whether corporations were subcontractors, we select the answer, “import on consignment only,” to the question, “Do you engage in the consignment trade?”14) and treat those companies as subcontractors. Lastly, in regard to foreign ownership, we use the answers to "What percentage of interest do foreigners hold, as of the end of 2002?" All responses are logged to show a normal distribution for use as a variable.15) To assess conformity to the business norm, we use the following as variables: (1) whether the company has decided to advance into overseas markets; (2) the number of managers’ associations which corporations have joined; and (3) the extent of benchmarking the best practices of others. Concerning the first, we use the answer, “in the midst of doing business in overseas markets, as of the year of the survey,” and treat it as a dummy variable.16) To measure the second and third variables, we use the answers to the questions, “How many manager groups or associations have you joined?” and, “To what extent did you benchmark the best practices of good companies at home and abroad during the last year,” respectively.

4. Control Variables

We use the following as control variables: (1) the size and age of organizations; (2) the performance of organizations; (3) the size of inside boards; (4) whether organizations are financial institutions; and (5) whether or not the company owned total assets of more than KRW2 trillion.

Large organizations are more likely to be functionally diversified and have various institutions including outside boards. We measure the size of an organization by its total assets. To show the normal distribution of the variables, total asset values are logged.

Firstly, older organizations are more likely to have a wider variety of institutions and practices through accumulated experience and learning. Therefore, they are more likely to appoint outside directors than younger organizations. However, older organizations tend to be “inert" and are reluctant to introduce new institutions (Hannan & Freeman, 1989). Therefore, the age of organizations may have a mixed effect in appointing outside directors. To control this, we calculate the age of each company as of 2003 based on the years of a company’s existence since its founding and construct a company age variable. Secondly, organizations with excellent performance are superior to those with lower performance in the area of resource-mobilization and management. Accordingly, they are more likely to appoint outside directors, because they have a better position to secure the resources necessary for introducing new institutions such as outside boards. We use the question about net income for the period to control the performance of organizations. Thirdly, according to the relevant law, the size of outside boards should be proportionate to that of the total board. Therefore, the larger the inside board, the larger the outside board. For this reason, we use the size of organizations as a control variable. Fourthly, financial institutions are under “regulatory pressure,”—they are mandated to appoint outside directors in accordance with the Banking Act. Therefore, we use as a control variable whether organizations are financial institutions. Lastly, to control large companies which are required to recruit outside directors, we set as a control variable whether they had total assets of more than KRW2 trillion.

Analytical Methods

The size of outside boards as a dependent variable is left-censored, which shows that many corporations do not hire even a single outside director. In this case, if we use the Ordinary Least Squares (OLS) Regression, a traditional linear regression model, the effects of the independent on the dependent variables may be distorted. In other words, if we use the OLS estimation, the results are as follows: independent variables provide appropriate estimates in the case of corporations with at least one outside director; however, they do not properly show their effects on dependent variables in the case of corporations with no outside directors (54% of the total, approximately 620 corporations) (Long, 1997). Therefore, Tobit analysis, a hybrid of categorical analysis and OLS regression, is one of the solutions in order to more exactly estimate dependent variables which are left-censored (Heckman, 1976). The models of Tobit analysis used in this paper are as follows:

$$y_i = \begin{cases} y_i^* = x_i\beta + e_i & \text{if } y_i^* > 0 \\ \tau_y & \text{if } y_i^* = 0 \end{cases}$$

Many corporations without outside boards did not have outside directors during the period of the survey. That is, we have not observed the size of outside boards of such corporations since that time, which does not mean that they will not eventually hire outside directors. Therefore, the result of Tobit-analysis is as follows: with traditional models such as OLS regression, the analysis provides estimates for corporations with at least one outside director (y>0) and also offers expectation values for corporations with no outside director (y=0), thereby providing appropriate estimates for the dependable variables.

Analysis and Results

The results of the analysis are presented in Tables 2 and 3. With regard to the appointment of outside directors, they imply the following:

First, as expected in hypotheses, the appointment of outside directors is closely associated with efforts to reduce uncertainty within corporations through monitoring managers. This relevance is detected for both listed and unlisted companies. Regression coefficients of independent variables (the owner management system and whether there are outside auditors) are statistically significant for both listed and unlisted companies. They also move in the direction predicted in the hypotheses. Tables 2 and 3 show that two groups—corporations with an expert management system, rather than owner-operated, and those with outside auditors who objectively evaluate business performance—appoint more outside directors. That is, corporations with a separation of ownership and management which further requires the monitoring of managers recruit more outside board members. Corporations with outside auditors are believed to intend to monitor business management activities more closely. Accordingly, the analysis results suggest that they appoint more outside directors for the same reason that companies have an expert management system. Second, the results of analysis imply that the appointment of outside directorates does not come as a result of a strategic response for reducing uncertainty from external environments such as stably securing resources. Whether corporations are involved in government procurement and whether they are doing consignments do not have statistical significance for the size of an outside board. That is, Korean corporations do not hire outside directors as a means to stably manage and secure important clients/targets (e.g., governments and other companies). The decline in market share in leading products does not provide statistically significant evidence on the recruitment of outside directors. The analysis results show that the increasing size of outside boards does not come as a result of strategic response to decreases in market share and growing market uncertainty. Regarding foreign ownership, listed and unlisted corporations show different results. The former show that there is a positive statistical significance between the proportion of shares held by foreigners and the size of outside boards, while the latter do not.

Third, as shown in Table 3, variables associated with conformity to business norms have a great effect on the appointment of outside directors. The more sensitive to business norms corporations are, such as joining managers' associations and participating in benchmarking, the more likely they are to hire outside directorates. However, this trend is confined only to unlisted companies. The reason for this might be that listed firms are required by law to appoint outside directors, but unlisted ones are not. For listed companies, the size of the corporation is an important variable in predicting how many outside directors will be appointed. On the other hand, for unlisted firms, such variable measured by the total assets of a corporation does not explain the size of outside boards. That is, listed companies hire the mandated number of outside directors according to corporate size, while unlisted ones appoint them regardless of corporate size. For unlisted companies, the important variables are the number of managers' associations joined (which provides opportunities to learn business norms), and that of benchmarking best practices (which offers chances to learn successful corporate governance).17) That is, to elucidate the size of outside boards appointed by unlisted corporations, those variables are important which measure sensitivity to business norms. The findings imply the following: the appointment of outside directors by listed companies is a result of conforming to legal and regulatory pressure. On the other hand, unlisted firms conform to normative pressure in hiring outside boards.

Forth, listed and unlisted corporations have different factors contributing to the size of outside boards. The factors which affect the size of outside boards in listed companies are variables associated with monitoring managers, such as whether they have an owner management system, and whether they appoint outside auditors; and the extent of foreign ownership, corporate size, corporate performance; whether they are financial institutions, and whether they have more than KRW2 trillion in total assets. On the other hand, the factors which affect board size in unlisted firms are variables related to the monitoring of managers such as whether they have the owner management system and whether they appoint outside auditors; those associated with conforming to

<Table 2> Determinant of Outside Directorate Size In Listed Companies

Perspectives	Variables	Model 1	Model 2	Model 3	Model 4	Model 5
Control	Total Asset	.326(.053)***	.333(.054)***	.287(.055)***	.281(.056)***	.187(.058)***
	Organization Age	.160(.145)	.194(.142)	.186(.140)	.182(.140)	.142(.135)
	Net Income	.023(.004)***	.022(.004)***	.021(.004)***	.021(.004)***	.015(.004)***
	The Size of Inside Boards	.005(.004)	.005(.004)	.004(.004)	.004(.004)	.004(.004)
	Financial Corporations	.751(.437)*	.670(.425)	.832(.422)**	.903(.432)**	.644(.422)
	More than KRW 2 Trillion	-	-	-	-	1.630(.396)***
Agency Theory	Owner Management System	-	-.471(.180)***	-.424(.177)**	-.399(.178)**	-.384(.172)**
	Outside Auditor	-	.626(.182)***	.579(.181)***	.561(.182)***	.514(.176)***
Resource Dependence Theory	Ratio of Government Sector to Total Revenue	-	-	.063(.042)	.058(.042)	.054(.041)
	Market Uncertainty	-	-	-.145(.214)	-.152(.214)	-.107(.027)
	Subcontractor	-	-	.063(.471	.029(.474)	.012(.458)
	Levels of Foreign Ownership	-	-	.114(.043)***	.107(.044)**	.096(.042)**
Neo-Instituionalism	Entering Overseas Market	-	-	-	.110(.180)	.085(.174)
	Association Linkage	-	-	-	.010(.014)	.007(.013)
	Benchmarking	-	-	-	.007(.028)	.005(.027)
	Constant	-2.960(.721)***	-3.184(.762)***	-2.378(.796)***	-2.424(.797)***	-1.233(.815) ***
	N	329	329	329	329	329
	Logliklihood	-560.3480	-550.5142	-545.8614	-545.2450	-537.0488

*p<.1 **p<.05 ***p<.01

<Table 3> Determinant of Outside Directorate Size In Unlisted Companies

Perspectives	Variables	Model 1	Model 2	Model 3	Model 4	Model 5
Control	Total Asset	-.104(.099)	.124(.082)	.104(.086)	.120(.089)	.023(.089)
	Organization Age	-.211(.251)	-.021(.248)	-.078(.251)	-.124(.248)	-.063(.247)
	Net Income	.049(.047)	.040(.047)	.040(.047)	.022(.043)	.010(.040)
	The Size of Inside Boards	-.002(.006)	-.002(.006)	-.002(.007)	-.002(.007)	-.003(.007)
	Financial Corporations	1.681(.838)*	1.066(.823)	.992(.839)	1.290(.830)	.850(.842)
	More than KRW 2 Trillion	-	-	-	-	3.022(1.095)***
Agency Theory	Owner Management System	-	-.903(.386) **	-.959(.395)**	-.828(.389)**	-.958(.389)**
	Outside Auditor	-	-1.990(.360)***	2.017(.362)***	1.951(.354)***	1.962(.351)***
Resource Dependence Theory	Ratio of Government Sector to Total Revenue	-	-	.079(.081)	.074(.079)	.076(.078)
	Market Uncertainty	-	-	.467(.408)	.405(.401)	.403(.397)
	Subcontractors	-	-	-.515(.631)	-.396(.615)	-.364(.608)
	Levels of Foreign Ownership	-	-	-.065(.088)	-.065(.087)	-.037(.087)
Neo-Instituionalism	Entering Overseas Market	-	-	-	-.020(.395)	.038(.392)
	Association Linkage	-	-	-	.118(.036)***	.111(.036)***
	Benchmarking	-	-	-	.154(.076)**	.158(.075)**
	Constant	-2.586(1.007)***	-2.939(1.109)***	-2.950(1.156)**	-2.380(1.133)**	-1.268(1.182) **
	N	819	819	819	819	819
	Logliklihood	-1019.004	-999.9452	-998.1915	-990.2702	-986.5094

*p<.1 **p<.05 ***p<.01

business norms such as the extent of admissions to managers' associations, and benchmarking best practices; and a variable related to whether they have more than KRW2 trillion in total assets. In sum, the reasons for appointing outside directors are different for listed and unlisted corporations. Listed companies have functional needs; and unlisted firms aim to acquire legitimacy by conforming to business norms. Two variables—whether to have the ownership management system associated with monitoring managers and whether to have outside auditors—represent for both listed and unlisted corporations a regression coefficient value which is statistically meaningful. That is, they wield great influence over the size of outside boards. This outcome is natural, given that outside directorates were created to monitor managers. The reasons for this are that corporations with an expert management system, whether listed or not, usually have the need to keep managers in check; and they are also subject to conform to business norms leading them to appoint outside directors. Besides, listed corporations hire outside directors to meet functional needs—securing foreign capital in a stable way and preventing disadvantages due to failures to conform to rules and regulations. In addition, the size of outside boards in listed corporations is affected by the capacity to secure resources (e.g., corporate performance). In contrast, unlisted companies recruit outside directors to acquire legitimacy by conforming to business norms, as well as to monitor and keep in check managers. To sum up, the appointment of outside directors by unlisted companies which are younger and smaller than listed firms comes as a result of conformity to a business norm—corporations with an expert management system should appoint outside directors so as to monitor managers. That is the reason why all variables associated with monitoring managers and conformity to business norms have statistical significance.18)

Conclusion and Implications

The previous literature has proposed the necessity of monitoring managers as a major reason for appointing outside directors. The analysis results in this paper do not contradict the existing studies. Corporations with a separation of ownership from control, recruit more outside directors than do those without. Corporations with outside auditors to secure transparency in corporate activities hire more outside directors than do those without. Put another way, corporations which intend to effectively control managers, strategically choose the outside directorate. However, we present new findings in this paper showing that the reasons for appointing outside directors are not confined simply to monitoring managers. Corporations are willing to accept and benchmark diverse information, norms and guidelines relative to corporate management. These efforts have a direct influence on short-term efficiency in corporate management and have long-term positive effects such as enhancing the image of companies and securing legitimacy. This paper argues that such efforts to conform to business norms with the aim of securing legitimacy should be considered as one of the reasons for appointing outside directors. Note that the more sensitive to business norms a corporation is, the more likely it is to appoint outside directors—for example, those which join managers' associations to study information and guidelines related to corporate management, and those which benchmark the best practices of other firms. In particular, this normative pressure has a greater influence on unlisted companies which are relatively exempt from regulatory pressure on the appointment of outside directors. In other words, if the expansion of the outside directorate in

Korean corporations is regarded as a process of isomorphism (DiMaggio & Powell, 1983), we clarify that the appointment of outside directors in listed companies is coercive isomorphism based on legal enforcement, while that in unlisted ones is mimetic or normative isomorphism based on normative pressure.

The function of outside directors in securing resources is partially supported by the analysis in this paper. Unlike the results in the previous study (Jang Deok-jin, 2003) which explained the appointment of outside directorates in Korean corporations from the perspective of co-optation, this paper shows that variables associated with reducing environmental uncertainty and with stably securing resources are statistically significant in only corporations with a high proportion of foreign ownership. The reason for this is as follows: unlike corporations in the U.S. and UK, strategic alliances and mergers/acquisitions are not common among Korean corporations; therefore, current conditions are not mature enough for outside directors to play a role in accessing resources.

Accordingly, given the corporate environment in Korea, the appointment of an interlocking directorate listed by two companies might be interpreted as a ceremonial act to secure legitimacy from other firms, rather than as the result of co-optation. That is, the recruitment of outside directorates to follow business norms is regarded as a symbolic act to acquire the image of a good, exemplary company, not as a realistic measure to meet functional needs such as securing resources.

There are not many cases in which outside directors raise objections to or ask for revision of proposals presented to the board. This fact reflects the reality that appointed outside directors do not play an appropriate role in monitoring managers (Maeil Business, March 17, 2006).19) In this circumstance, how do we explain the negligence of outside directors? We cannot simply regard such behavior as a lack of ethics.

From the neo-institutional approach, corporations appoint outside directors to acquire legitimacy. Therefore, this theory provides a structural explanation for such negligence. If corporations hire outside directors to secure internal and external legitimacy, what is important to corporations is the existence itself of outside directors, not whether they really perform their functions. Likewise, corporations may adopt a strategy to minimize environmental uncertainty and maximize the stability of organizations by accepting an institution as a "ceremony" without its fulfilling any actual role or function (Meyer & Rowan, 1977). This is where "decoupling" comes in. The term decoupling refers to the situation where an operating practice of an institution remains separated from its original aim as a result of only superficially accepting the institution. The outside board which acts as a rubber stamp for managerial decisions is a typical example of decoupling. However, this phenomenon is not confined only to unlisted corporations. Outside directors in listed companies are hired, not only because of functional needs, but because of the law. This case leaves a lot of room for the possibility that outside directors in listed companies also will not perform their functions or role, which consequently could lead to decoupling.

As a result, important variables to explain the size of outside boards in Korean corporations are (1) the necessity of monitoring managers, (2) securing resources in a stable way, and (3) sensitivity to business norms. The first variable provides an account of the size of outside boards for all corporations, while the second is statistically meaningful only for listed companies, and the third is relevant only for unlisted firms. However, given institutional environments associated with outside directors in Korea, we cannot conclude that listed corporations are not sensitive to business norms. Rather, listed companies follow business norms under regulatory pressure, while unlisted firms voluntarily accept them under normative pressure.

1) Article 393 of the Korean Commercial Code stipulates that the board of directors has the right to supervise the performance of directors, dispose of important resources, and leverage large-scale equity. Prescribed are the convocation of a general meeting in Article 362; the approval of financial statements in Article 447; and the issuance of corporate bonds in Article 469.

2) In fact, the board of directors in American corporations before the 1970s was not able to control managers. Berle and Means pointed out in their study (Berle & Means, 1932) that a normative model of the U.S. Corporations Act, in which the board controls managers in accordance with the delegation from the shareholders is not put into practice. Put another way, corporate decision-making has been the domain of executive management, not the board's. Directors on the board are usually appointed by managers, not in a general meeting. As a result, corporate managers are not controlled by the general meeting and even wield great influence over corporate operations and management, such as arbitrarily handling discussion items submitted in a general meeting. Given these problems, Eisenberg presented in his study measures for improving institutions. He suggests that the board of directors should change its functions so as to achieve the original goal, rather than reform the board and newly focus on an outdated model of the board as a decision-maker (Eisenberg, 1976). That is, the major function of the board needs to lie in the supervision of managers, not in corporate decision making, which requires the independence of the board. To this end, he proposes outside directors and audit committees. His ideas were translated into practice by a decision of the New York Stock Exchange (NYSE).

3) Relevant laws require that all listed corporations appoint outside directors. However, they also contain provisions regarding exceptions to this requirement: corporations which meet some qualifications are exempted from the duty of hiring outside directors. For example, newly listed or registered corporations, those which have filed for corporate reorganization, Real Estimate or Securities Investment Trusts, and KOSDAQ-registered ventures with total assets of less than KRW100 billion are exempt from the requirement for a temporary or a permanent period.

4) Open corporations refer to those who have residual claims, the difference between inflow and outflow of resources, which are widely distributed in the form of the common stock. Closed corporations have the opposite situation.

5) Over-diversification is the result of diversified investment in projects with low expected profits by expert managers who face short-term import pressure. For this reason, corporate profitability declines at an alternative level (Gedajlovic & Shapiro, 1998).

6) Typical examples of the internal control mechanism include incentive contracts such as stock options (Demsetz, 1983), and strengthening the monitoring role of the board (Fama & Jensen, 1983). The former aims to prevent managers from pursuing their private interest by squaring long-term corporate performance with managers' income. The latter seeks to make the board directly control managers' behavior through outside directors and auditors. The external control mechanism includes the labor market for managers (Fama, 1980), the stock markets and M&A markets (Jensen & Ruback, 1983), and product markets (Williamson, 1963). If there are effective markets for managers as products, it is possible to appropriately evaluate the management capacity of managers, and consequently, to prevent managers from seeking their private interest. In general, corporate value is evaluated by investors in the stock markets and reflected in stock prices. Therefore, if the value of a company declines because of incompetent managers, the corporation may become a target of M&A, which could lead to the termination of the company. This situation serves as an obstacle for corporate managers attempting to pursue their own interests. Competitive product markets also act to prevent such behavior. Consumer choices determine the life and death of corporations. For this reason, managers cannot easily turn their attention to their private interests.

7) To prove the argument, Allen conducted research with data on 200 large companies in the non-financial sector and 50 in the financial sector during the period from 1935 to 1970. Unlike what he expected, there was a negative relation between companies' external debts and the frequency of appointing interlocking directorates by the management staff in the financial sector.

8) Despite the long distance, foreign shareholders need an institutional apparatus to control the managers of corporations which they own. For example, the Tiger Fund, a U.S. hedge fund, the Korea Fund in New York, the Emerging Market Investors Fund in Canada, and the Pension Fund PGGM in the Netherlands have delegated their voting rights to the People's Solidarity for Participatory Democracy (PSPD) which was actively involved in minority shareholder activism, with the aim of expanding the outside directorate, introducing audit committees, and promoting the rights of minority shareholders.

9) In particular, since the financial crisis in 1997, the rate of shares held by foreigners in Korean corporations has dramatically increased. According to the Financial Supervisory Commission (FSC), the number of listed shares held by foreigners increased to 273,107, 13.9% relative to the total listed stock, 30.1% to market capitalization, from 81,979 shares, 9.08%, 14.59%, respectively in 1997. As of 2004, foreigners have 515,419 shares which account for 22.0% to the total listed stock, 42.0% to market capitalization. In addition, as corporations with a higher proportion of shares held by foreigners are highly evaluated and consequently their value increases, foreign shareholders become regarded as one of the important external organizations to which corporations should pay attention.

10) The 1997 financial crisis acted as a key factor in making the appointment of outside directors a business norm. It also served as a good opportunity for Korean corporations to look back on the past years when they were never skeptical about their corporate governance because of the rapid economic development. Moreover, since the financial crisis, Korea's economic situation has been very favorable to the improvement of corporate governance. At that time, it was most important for Korea, which had suffered an economic crisis because of insufficient foreign exchange, to secure and maintain adequate foreign exchange reserves. The Korean government opened up the financial and capital markets to increase foreign exchange reserves in accordance with the recommendations of the IMF, which unfortunately did not directly lead to an influx of foreign capital. Foreign investors still were skeptical about Korean corporations, especially conglomerates. They often asked Korean corporations to improve their corporate governance as a prerequisite for investment expansion. The improvement of corporate governance was essential to stabilize the Korean economy. Against this backdrop, the appointment of outside directors was recognized as a yardstick for measuring whether Korean corporations were striving to enhance corporate governance. For this reason, the Korean government mandated that listed companies appoint outside directors. However, more important than this judicial enforcement was the interest of experts and the media in the outside directorate. In particular, the Peoples Solidarity for Participatory Democracy (PSPD) actively involved in minority shareholder activism conducted diverse activities to appoint outside directors to represent the interests of minority shareholders, all of which attracted attention from the media. At that time, various articles and theses on the outside directorate were released, which mainly argued that the appointment of outside directors is a key factor in sound corporate management. As a result, corporations which did not hire outside directors were regarded as those which followed outdated traditions in corporate operation, while those which did were considered reliable firms exercising sound corporate management.

11) Culture in this context is different from its original meaning. In general, culture refers to the total lifestyle of members of society (Giddens, 1989: 55). However, culture from the perspective of neo-institutional theory refers to ways to understand the word in a similar institutional environment. For example, East Asian and Middle-East countries which have regained their independence since 1945 are included in different cultural categories in light of the original meaning of culture, but in the same category from the view of neo-institutional theory. That is because they recognize the world from the standpoint of newly emerging independent states and share the goal of pursuing economic and social development to establish an independent country (Meyer et al., 1997).

12) Laws which stipulate the mandatory appointment of outside directors are as follows: Article 192 (16) (a) of the Securities and Exchange Act and Article 84 (23) of the Enforcement Decree of the Act; Article 11 (3) of the Basic Act on Governmental Investment Management Organizations which requires governmental investment management agencies to appoint more than a majority of outside directors; and Article 22 (2) of the Banking Act which requires corporations to hire more outside directors than half of the total board members.

13) For more descriptive statistics regarding independent and dependent variables, see the appendix.

14) We use the second data set from the Business Panel Survey because there are no questions about the type of consignment trade in the first data set.

15) Because log values for 0 cannot be calculated, it is important not to distort original data with a value of 0 while calculating the ratio of government procurement sales to total revenues, and the rate of foreign ownership. Therefore, we add 0.1 to each value and then log them to show a normal distribution.

16) We use the second data set of the Business Panel Survey because there are no questions about company strategies for entering overseas markets in the first data set.

17) Of variables associated with conformity to business norms, whether to advance into overseas markets did not provide statistically significant results. This is because norms relative to the appointment of outside directors are created by Korean expert opinions, the activities of civic groups including the PSPD, and governmental regulations such as legislation, not introduced by overseas branches of Korean corporations.

18) Note that whether to use the ownership of more than KRW2 trillion in total assets as a control variable is statistically supported in Table 3. Unlike listed companies, unlisted firms are not required to appoint outside directors, although they may be large companies with total assets of more than KRW 2trillion. Nonetheless, the reason why unlisted firms with total assets of more than KRW 2 trillion hire more outside directors is that listed corporations with more than KRW 2trillion in total assets and which are regarded as competitors for the unlisted ones or as their reference group are required to recruit outside directors. This trend is not because of regulatory pressure but because of mimetic or normative pressure.

19) According to the activity reports on outside directors of each corporation which are submitted to FSC's, the outside directors of 71 listed corporations and the top twelve large companies handled as many as 1306 proposals on the board during the year 2005 but raised objections to only nine. The rate of opposition amounted to 0.68%, while that of approval was 99.32%.

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Appendix A: Descriptive Statistics of Independent Variable (1)

	Listed Companies			Unlisted Companies		
	Frequency	Mean	S.D.	Frequency	Mean	S.D.
Total Asset (10 billion)	329	93.82	334.79	819	38.68	356.40
Net Income (10 billion)	329	3.73	21.38	819	0.23	4.07
Organization Age	329	32.346	16.0498	819	19.924	12.9746
The Size of Inside Boards	329	6.234	22.2874	819	4.788	35.4535
Ratio of Government Sector to Total Revenue	329	5.098	14.7395	819	6.466	20.3726
Levels of Foreign Ownership	329	4.722	11.7096	819	7.132	22.3472
Managerial Association Linkage	329	4.446	6.5302	819	2.680	4.2282
Benchmarking	329	1.267	3.0913	819	0.760	2.0396

Appendix B: Descriptive Statistics of Independent Variable (2)

	Listed Companies		Unlisted Companies	
	Frequency	%	Frequency	%
Financial Corporations	15	4.6	35	4.3
More than KRW 2 Trillion	25	7.6	22	2.7
Owner Management System	146	44.4	543	66.3
Outside Auditor	126	38.3	255	31.1
Market Uncertainty	66	20.1	181	22.1
Subcontractors	11	3.3	72	8.8
Entering Overseas Market	168	51.1	201	24.5