Research Article



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# Who Initiates Layoffs and Affects Firm Performance? Conflict of Interests between Active Foreign Institutional Investors and Outside Directors

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***Abstract***

*Expanding upon the existing literature on agency theory, which often overlooks potential conflicting interests among monitoring mechanisms, this study investigates the divergent effects of active foreign institutional investors and outside directors on firm strategy and performance. Specifically, in light of inconclusive findings on the relationship between layoffs and performance, this study examines the initiators of layoffs and their impact on firm performance, comparing the roles of active foreign institutional investors and outside directors. Through panel data analysis of 2,516 firm-year observations from South Korea spanning 2010 to 2014, the findings reveal that firms with active foreign institutional investors are more inclined to implement large-scale layoffs, which positively moderate the relationship between active foreign institutional investors and firm performance metrics such as return on assets (ROA) and market returns. However, the relationships between active foreign institutional investors, layoffs, and performance are contingent upon the presence of outside directors on the board. Outside directors are not actively involved in initiating layoffs but tend to approve them in the context of operational performance, such as ROA, while showing less interest in layoffs as a means of external evaluation, such as market returns. These findings highlight the heterogeneous characteristics of outside directors and active foreign institutional investors with regard to layoffs and performance, and subsequently propose theoretical and managerial implications for the design of corporate governance.*

***Keyword:*** *Foreign institutional investors, Corporate governance, Layoffs, Market returns, Outside directors, ROA*

## 1. Introduction

Since the 2000s, financial scandals have led both academia and businesses to prioritize corporate governance reform. In particular, agency theory suggests that strengthening monitoring mechanisms through shareholder activism can reduce agency costs and ultimately enhance firm performance (Fama and Jensen, 1983; Jensen and Meckling, 1976). As a result, there has been an increase in the presence of outside directors on corporate boards (Deutsch et al., 2011; Yoo and Jung, 2015) and greater active participation of institutional investors in corporate decision-making (David et al., 1998; Bebchuk et al., 2015).

As a means of actively monitoring and improving cost structure and competitiveness, layoffs - defined as "a permanent termination of a significant number of employees from the payroll of an organization" (Chen et al., 2001, 172) - are often implemented (Jensen, 1993). However, the impact of layoffs on firm performance remains inconclusive in existing literature. While some studies suggest a positive association between layoffs and performance, as measured by metrics such as ROA, market responses, or competitive position (Cascio et al., 2021; Wayhan and Werner, 2000), others report that layoffs can negatively affect employee satisfaction and trust, which are critical assets in human resource management (HRM), resulting in decreased performance (Fisher and White, 2000; Wagar, 2001). Given the mixed findings on the relationship between layoffs and performance, researchers have proposed that this relationship may be contingent on the causes and goals of layoffs, such as decreased market demand, financial distress (Datta et al., 2010; Palmon et al., 1997), and the heterogeneous characteristics of institutional investors, including monitoring-active and monitoring-passive investors (Brav et al., 2008; Jung et al., 2015).

However, existing studies have not thoroughly examined the possible conflicts of interest between monitoring mechanisms in the implementation of layoffs. While agency theory does not explicitly emphasize conflicting priorities among institutional investors and outside directors, it is plausible that these stakeholders may have contrasting agendas. Institutional investors acting as principals, such as private funds, may prioritize their own short-term interests at the expense of other constituents of the focal firm, such as employees or minority shareholders (Goyer and Jung, 2011). On the other hand, outside directors, defined as non-management members of the board (Johnson et al., 1996), may serve the interests of their appointers, such as controlling shareholders or CEOs (Herman, 1981; Yoo and Koh, 2022). Thus, this study expands the literature on layoffs and performance beyond market conditions, financial factors, and heterogeneous institutional investors, by examining the conflicting interests between monitoring mechanisms, namely active foreign institutional investors and outside directors, and their effects on layoffs and subsequent performance. Shedding light on these contrasting interests between monitoring mechanisms will unveil previously unexplored dynamics in terms of who initiates layoffs and how it impacts performance, beyond market and financial considerations.

To conduct the empirical analysis, this study utilizes panel data from 504 listed South Korean (hereafter Korean) firms, spanning the period from 2010 to 2014. Korean firms have increased the number of outside directors on their boards and have also seen expanded investments from foreign institutional investors since the 1997 Asian financial crisis (Yoo and Sung, 2015). It is worth noting that outside directors in Korean firms may have strong connections with their appointers, such as controlling family shareholders, while foreign institutional investors may not (Westphal and Stern, 2007; Yoo and Koh, 2022). This unique context of Korean firms presents an excellent opportunity to investigate the effects of layoffs on performance in a comparative framework, considering the contrasting interests between active foreign institutional investors and outside directors.

The findings of this study will complement agency theory by shedding light on the heterogeneous characteristics between outside directors and active foreign institutional investors. Despite both assuming monitoring roles, they may exhibit contrasting approaches towards layoffs and performance. Outside directors may be influenced by societal contexts and take a longer-term perspective aligned with family control in Korean firms. On the other hand, active foreign

institutional investors, being relatively free from societal contexts due to their foreignness, may maintain distance from the influence of controlling shareholders (Ferreira and Matos, 2008). They may also have a shorter time horizon and focus on investment returns through frequent market transactions rather than ROA improvement (Desender et al., 2016). These contrasting characteristics between outside directors and active foreign institutional investors may lead them to take distinct stances on layoffs and subsequent performance. In terms of practical implications, the possible conflicts of interests between outside directors and active foreign institutional investors could provide insights into how HRM, such as layoffs, can be implemented as a specific tool to improve performance by leveraging diverse monitoring mechanisms. Both theoretical and practical implications of this study contribute to a reconsideration of the appropriate design of corporate governance.

The structure of this study is organized as follows. The next two sections provide a review of the literature on monitoring mechanisms, layoffs, and performance, and develop hypotheses, respectively. The method, data, and results of the empirical analyses are presented in the subsequent two sections. Finally, theoretical and managerial implications are discussed, with remarks on future research.

## 2. The Literature on Monitoring Mechanisms, Layoffs, and Firm Performance

### *2.1 Agency Theory and Monitoring Mechanisms*

Agency theory has traditionally overlooked the potential conflict of interests between monitoring mechanisms, specifically outside directors and foreign institutional investors. In contrast to the assumed role of outside directors as monitoring mechanisms, they may actually serve the interests of their appointers, who are often CEOs or controlling shareholders, such as founding family members in Korean firms (Yoo and Jung, 2015). In such cases, outside directors may adopt a relatively long-term perspective that aligns with the time horizon of family members. On the other hand, foreign institutional investors are not bound by such societal contexts and can instead focus on firm performance, particularly market returns to enhance the marketability of stocks. These attributes may enable them to take a relatively shorter time horizon compared to outside directors.

As a result, the monitoring mechanisms proposed by agency theory, which do not take into account the contrasting interests between outside directors and foreign institutional investors, but rather focus solely on regulating the self-interests of agents, i.e., managers, may not be as effective in controlling agency costs as theoretically anticipated (Nguyen and Do, 2020; Young et al., 2008).

### *2.2 Heterogeneity between Active Foreign Institutional Investors and Outside Directors*

The contrasting characteristics between active foreign institutional investors and outside directors highlight critical issues in strategic decision-making and subsequent performance. In particular, they may adopt different stances in terms of strategic motives. As principals, active foreign institutional investors may prioritize their own interests over those of employees or other minority shareholders, seeking to realize their interests through short-term market returns achieved through share transactions (Goyer and Jung, 2011; Yan and Zhang, 2009; Ye, 2012). On the other hand, outside directors' priorities may be closely linked to the interests of their appointers, despite the theoretical expectation that they should align with those of the focal firm as a whole. Given their fixed tenure (typically three years in Korea) and the possibility of reappointments, outside directors may have a longer time horizon, which could result in less emphasis on short-term cost restructuring.

Consequently, the divergent characteristics between the two groups are also reflected in their degree of monitoring roles. Active foreign institutional investors are associated with shareholder activism and emphasize strategies that yield prompt market responses (Brav et al., 2008; Clifford, 2008). In pursuit of higher returns, they seek to improve the firm's performance by implementing

changes in the firm's strategy and structure, with the intention of reselling the firms in due time. However, outside directors may adopt a more conservative approach when it comes to changing the firm's strategy and structure, unless the change directly leads to improved operating performance. Unlike stock market responses, operating performance is an internally calculated measure that does not necessarily reveal information asymmetry for controlling shareholders to assess organizational capacity and efficiency (Joskow et al., 1996; Orlitzky et al., 2003).

The contrast between active foreign institutional investors and outside directors underscores their potentially divergent positions on layoffs and the subsequent firm performance.

## 3. Hypotheses Development

### *3.1 Active Foreign Institutional Investors on Layoffs*

Active foreign institutional investors directly assert their demands and negotiate with their portfolio firms using tools such as letter of proxy solicitation, shareholder proposals, or calls for temporary shareholders' meetings, in order to exert pressure on the management of their portfolio firms (Agrawal and Mandelker, 1990). Furthermore, they may facilitate alliances or negotiations with other institutional investors, such as pension funds, to amplify their influence (Black, 1992). With such leverage, active foreign institutional investors intervene in various areas of corporate strategy, including operational improvement through layoffs and asset disposals, mergers and acquisitions (M&A), share buybacks and dividend increases, and CEO salaries and compensation (Bebchuk et al., 2015; Brav et al., 2008; Klein and Zur, 2009).

Firms often resort to corporate structural adjustments, such as layoffs, as they are considered an effective mechanism by active institutional investors to maximize shareholder value (Davis, 2009). In particular, layoffs are seen as a strategic option for large shareholders, such as active foreign institutional investors, to improve firm performance (Bethel and Liebeskind, 1993). As a result, layoffs have become a common practice rather than an exception, regardless of whether times are good or bad (Budros, 1997; Murray, 1995). As explained earlier, active foreign institutional investors have the ability to directly or indirectly influence managers to implement layoffs. Their emphasis on cost efficiency highlights the significance of workforce size, which leads managers to be concerned about layoffs as part of their evaluation criteria (Useem, 1996). This trend is also evident in Japanese firms, where those with more foreign institutional investors tend to prefer large-scale layoffs compared to those with fewer foreign institutional investors (Ahmadjian and Robbins, 2005). Similar patterns have been observed in French firms, where UK/US-based institutional investors are associated with the implementation of employee layoffs (Jung et al., 2015).

Moreover, unlike domestic institutional investors, foreign institutional investors are not subject to the societal institutional pressures of the countries where their portfolio firms operate. This means they can exclude political factors from their monitoring of corporate performance (Davis and Kim, 2007). This independence allows foreign institutional investors to effectively exercise their monitoring power towards improving corporate performance without necessarily considering the interests of other stakeholders (Yoo and Koh, 2014). Thus, we raise the following:

***Hypothesis 1:*** *Active foreign institutional investors will be positively related to a firm's layoffs.*

### *3.2 Active Foreign Institutional Investors on Firm Performance by Layoffs*

Previous studies have yielded inconclusive results regarding the impact of layoffs on performance. Some research suggests that layoffs can send negative signals to remaining employees and result in performance deterioration (Fisher and White, 2000; Wagar, 2001). Market conditions such as plant closures and declining demand can also lead to negative stock market responses (Hillier et al., 2007). However, proactive layoffs planned for strategic reorganization and efficiency improvements have been associated with positive stock price responses (Chalos and Chen, 2002; Palmon et al., 1997).

Given that layoffs are considered a normal practice in both good and bad times (Budros, 1997; Murray, 1995) and can be a promptly effective strategic option for improving employee productivity and corporate focus (Hillier et al., 2007), this study focuses on the strong motives of active foreign institutional investors to monitor. These investors often cannot sell their shares of underperforming firms without incurring losses from decreased stock prices (Coffee, 1991; Gillan and Starks, 2000). Moreover, active foreign institutional investors are incentivized to improve firm performance due to the linkage of their pay and bonuses to the performance of their portfolio firms.

Active investors have the ability to control a portfolio firm's operating costs and improve efficiency by implementing cost-based human resource management (HRM) practices such as layoffs. Layoffs are a practical option for improving performance, as they represent fixed costs that are easily calculated compared to future revenues. Therefore, reducing expenses through layoffs can lead to an increase in earnings. Additionally, there is a vividness effect associated with layoffs, as they often attract undue attention and weight due to their newsworthiness (Cascio, 2009). This phenomenon is critical for active foreign institutional investors, as they rely on market responses to make returns through share transactions. The vividness effect is illustrated by the less negative or even positive market responses to layoff announcements made by firms with a higher proportion of institutional investors compared to those with a lower proportion of institutional investors (Pouder et al., 1999). Furthermore, it is argued that the initial positive stock price accompanying activist interventions can have long-term consequences (Bebchuk et al., 2015). Thus, we raise the following hypothesis on the moderating effect of layoffs on the relationship between institutional investors and firm performance:

***Hypothesis 2:*** *Layoffs will positively moderate (increase) the effect of active foreign institutional investors on a firm's performance.*

### *3.3 Outside Directors on Layoffs and Firm Performance by Active Foreign Institutional Investors*

While outside directors are expected to assume monitoring roles, their priorities may differ from those of active foreign institutional investors. First, outside directors may have stronger allegiance to those who appoint them, such as CEOs or controlling shareholders, which is contrary to the monitoring mechanism proposed by agency theory. According to Baysinger and Hoskisson (1990), outside directors are expected to have less allegiance to CEOs compared to inside directors and are more likely to scrutinize the strategic choices of managers. However, a body of studies suggests that outside directors often exhibit strong personal and social connections with their appointers (Carcello et al., 2011; Khatri et al., 2006; Klein, 1998), indicating that their roles and priorities may differ from those of active foreign institutional investors. Furthermore, given that active foreign institutional investors are often focused on maximizing their investment returns within relatively shorter time horizons, even at the expense of other stakeholders' interests, such as employees, the priorities of outside directors may clash with and potentially constrain the demands, such as layoffs, made by active foreign institutional investors.

Second, outside directors may take into consideration the societal contexts in which they operate. Existing studies suggest that local managers may adopt labor-friendly policies, such as minimizing employee cuts during layoffs (Yonker, 2017). Institutional investors facing political pressure may also make more local investments, even if those investments perform poorly in their home states compared to other states (Hochberg and Rauh, 2012). These findings indicate that strategic decisions can be influenced by societal contexts, and outside directors, who are more closely associated with societal contexts compared to active foreign institutional investors, may prioritize objectives other than shareholder value maximization. For example, outside directors may adopt labor-friendly policies in countries like France where it is considered a critical human resource (Jung et al., 2015), or may face institutional pressure from the government, as illustrated in Korea (Freeman et al., 2008). In this context, the strategic preferences of outside directors may differ from those of active foreign institutional investors, leading to potential contrasts in their decision-making processes. Thus, we raise the following:

***Hypothesis 3a:*** *The positive association between active foreign institutional investors and a firm's layoffs will be constrained (maintained), when outside directors are large (small) on the board.*

As discussed above, while some studies have reported a positive association between layoffs and performance (Cascio et al., 2021; Wayhan and Werner, 2000), a body of research suggests a negative association, particularly when performance is measured by stock price (Fisher and White, 2000; Hillier et al., 2007). In this context, outside directors may adopt a strict stance on layoffs due to their heterogeneous attributes and the monitoring roles they play in relation to the demands of self-interest-driven active foreign institutional investors. This tendency may be further reinforced by their leniency towards societal contexts, such as favorable labor policies of the government. This implies that outside directors may only agree to layoffs when performance improvement is predictable, otherwise, they may constrain the relationship between active foreign institutional investors and layoffs, as hypothesized above (Hypothesis 3a).

Thus, we propose the following hypothesis regarding the conditions under which the positive moderating effects of layoffs operate on the relationship between active foreign institutional investors and firm performance:

***Hypothesis 3b:*** *The positive moderating effects of layoffs between active foreign institutional investors and a firm's performance keeps positive, particularly when outside directors are large on the board.*

## 4. Method

### *4.1 Data*

This research analyzed 2,516 firm-year observations listed on the Korea Composite Stock Price Index (KOSPI) from 2010 to 2014. Due to varying missing values by variables, the number of cases used for individual regression analyses differed. The financial industry, which is subject to numerous government restrictions and has unique financial data that are not easily comparable to other industries, was excluded from the study.

Data on industry and financial variables were collected from the websites of the Korea Investors Service (KIS) and the DART system of the Financial Supervisory Service. Information on foreign majority shareholders who own more than 5% of company shares was obtained from annual reports available on the DART system, while data on boards of directors and CEOs were extracted from the database of the KIS and publicly disclosed annual reports.

### *4.2 Measures*

In determining the causal relationships between foreign investors and firms' layoffs or performance, the issue of endogeneity is important to address. To mitigate this concern, the measurement of independent and controlled variables was based on data from the year prior to the year of the dependent variables. Specifically, data from 2011 to 2015 were used to measure layoffs and firm performance, while data from 2010 to 2014 were used to measure the independent variable of foreign investors. This data structuring helped to carefully control for the causal relationships between the independent and dependent variables (Reed, 2015).

### *4.3 Independent Variables*

'Active foreign institutional investors' are composed of hedge funds and private funds that hold more than 5% of the shares of the company in question. Previous research has classified institutional investors in a similar manner (David et al., 1998; Almazan et al., 2005). In this study, a dummy variable was used to measure the presence of active foreign institutional investors, following the literature (Brav et al., 2008; Jung et al., 2015), and partly due to the unavailability of specific

ownership rates owned by active foreign institutional investors. If a company has active foreign institutional investors at the end of the calendar year, it was classified as 1, otherwise as 0. If foreign institutional investors hold their shares for less than 3 months, it may not be considered as an investment for shareholder activism, but rather as shares purchased for short selling. Thus, it was not counted as active foreign institutional investors.

'Outside directors', defined as non-management members of the board, were calculated by dividing the number of outside directors by all directors on the board (Yoo and Sung, 2015).

### *4.4 Dependent Variables*

'Layoffs' are measured as cases where the number of employees decreases by more than 5% compared to the previous year, and this was coded as a dummy variable following the literature (Ahmadjian and Robbins, 2005; Jung et al., 2015). The occurrence was marked as 1, otherwise as 0. The decrease in the employee number by more than 5% is distinguished from random employment changes or gradual employment level adjustments (Ahmadjian and Robbins, 2005).

The 'Return on Assets (ROA)' was used to measure operating performance. ROA reflects the company's effectiveness in managing its assets and is widely used as an index to measure company performance (Hillier et al., 2007).

In addition to profitability on balance sheets, i.e., operating performance, stock market performance was measured by 'market-adjusted stock returns' over the previous year (KIS data code: 0C3270). This refers to the ratios of the current year-end price over the previous year's price, with KOSPI index price ratios of the same period subtracted. Unlike operating performance, the company's stock performance reflects market expectations of the company's specific events, such as layoffs.

### *4.5 Control Variables*

In order to control for variables that could potentially affect the dependent variables, several other variables were included: foreign shareholders' ratios, largest shareholders' ratios, owner CEOs, CEO's terms of office, chaebol status, company size, turnover growth rates, leverage, and cash flow from operations.

'Foreign shareholders' ratio' refers to the ratio of company shares held by foreign investors at the end of the year (KIS data code 0D1121). 'Passive foreign institutional investors' exhibit distinct characteristics from active foreign institutional investors. They typically focus on a limited area of corporate strategy and adopt an index strategy, which links returns to a specific index, such as the S&P 500, to minimize investment risks (Shin and Seo, 2010). Passive foreign institutional investors are coded as 1 if more than 5 percent of outstanding shares for firm *j* at the end of year *t* are owned by one of the foreign investor groups, such as banks, insurance companies, mutual funds, or pension funds; otherwise, they are coded as 0. The 'largest shareholders' ratio' indicates the total shares held by the largest shareholder and his/her special relatives.

'Owner CEOs' are defined as CEOs who are reported as the largest shareholders or their special relatives in the annual report. Such cases were marked as 1, and 0 otherwise. The longer the CEO's term of office, the greater their influence (Zajac and Westphal, 1996), which implies that intervention in management by active foreign institutional investors may be restricted. 'CEO's term of office' was defined as the difference between the current year and the year he/she was nominated for the position. The term 'chaebol status' refers to the pyramid ownership structures where the head of the chaebol and his/her special relatives hold shares of a holding company of the group, which in turn owns shares of other companies in the group. In this structure, the head dominates all the companies in the group. In this structure, the head dominates all the companies in the group. The 'chaebol status' was determined according to the guidelines of the Korea Fair Trading Commission, with 1 marking them and 0 otherwise. 'Cash flow from operation' is measured by cash flow from operations divided by total sales revenue.

*4.6 Analysis*

Given that the data are characterized by time-series and cross-sectional elements, this study employed panel logit or OLS estimations, depending on the nature of the dependent variables. Binary variables were used for the case of layoffs, while continuous outcomes were used for the case of ROA and market-adjusted returns. Firm fixed-effects estimations were adopted based on the results of the Hausman test, which indicated a significant difference between random-effects and fixed-effects models. Additionally, industry and year dummy variables were included in the analysis. The SAS program (version 9.4) was used for all data analyses.

## 5. Results

Tables 1 and 2 present descriptive statistics and a correlation matrix for the variables utilized in this study, respectively. The results of the variance inflation factor (VIF) analysis indicate that all variables do not suffer from multicollinearity.

**Table 1:** Descriptive Statistics of the Sample

| Variables | N | Mean | Std | Min | 1Q | Median | 3Q | Max |
|---|---|---|---|---|---|---|---|---|
| Active | 3024 | 0.032 | 0.175 | 0.000 | 0.000 | 0.000 | 0.000 | 1.000 |
| OutsideDirector | 2519 | 0.347 | 0.119 | 0.170 | 0.250 | 0.330 | 0.400 | 0.710 |
| Layoff | 2516 | 0.217 | 0.412 | 0.000 | 0.000 | 0.000 | 0.000 | 1.000 |
| ROA | 3023 | 0.068 | 0.073 | -0.150 | 0.030 | 0.060 | 0.100 | 0.310 |
| Returns | 3024 | 0.046 | 0.454 | -0.782 | -0.235 | -0.039 | 0.215 | 1.980 |
| ForeignOwnership | 2850 | 0.100 | 0.133 | 0.000 | 0.009 | 0.042 | 0.139 | 0.612 |
| ControllingShareholder | 3024 | 0.423 | 0.165 | 0.077 | 0.305 | 0.421 | 0.531 | 0.845 |
| ControllingFamily | 2520 | 0.348 | 0.477 | 0.000 | 0.000 | 0.000 | 1.000 | 1.000 |
| CEOTenure | 2003 | 9.334 | 4.040 | 1.800 | 6.460 | 8.800 | 11.900 | 20.480 |
| Chaebol | 2520 | 0.217 | 0.412 | 0.000 | 0.000 | 0.000 | 0.000 | 1.000 |
| Size | 3024 | 12.878 | 1.520 | 10.065 | 11.795 | 12.618 | 13.718 | 17.180 |
| Growth | 2952 | 0.072 | 0.271 | -0.809 | -0.047 | 0.058 | 0.168 | 1.279 |
| Leverage | 3023 | 0.191 | 0.157 | 0.000 | 0.060 | 0.170 | 0.290 | 0.640 |
| CFO | 2952 | 0.057 | 0.152 | -0.481 | -0.003 | 0.048 | 0.103 | 0.737 |

Table 3 provides support for Hypothesis 1, which pertains to the effect of active foreign institutional investors on layoffs. Models 1 and 2 in Table 3 demonstrate a positive association between active foreign institutional investors and layoffs ($p< 0.01$). In terms of control variables, the coefficient on ROA is negative, suggesting that prior poor performance may still be necessary for significant employment reduction (Hillier et al., 2007).

We analyzed the post-effect of active foreign institutional investors on operating performance (ROA) and market performance (market-adjusted stock performance) in the subsequent year. Table 4 presents the results regarding whether layoffs moderate the relationships between active foreign institutional investors and ROA or market-adjusted stock performance. To mitigate the issue of collinearity, we utilized mean-centered variables, as recommended by Aiken and West (1991). Consistent with Hypothesis 2, Models 2 and 4 in Table 4 reveal that layoffs positively moderate the relationships between active foreign institutional investors and performance measures, such as ROA ($p< 0.1$) or stock performance ($p< 0.01$).

Table 5 presents the analysis on whether outside directors influence the relationship between active foreign institutional investors, layoffs, and firm performance. Models 1 and 2 in Table 5 provide support for Hypothesis 3a, showing that the positive association between active foreign institutional investors and a firm's layoffs is maintained, particularly when the presence of outside directors on the board is limited ($p< 0.01$). Regarding Hypothesis 3b, Model 3 in Table 5 indicates that the positive

moderating effect of layoffs between active foreign institutional investors and a firm's operating performance (ROA) remains positive when there are a large number of outside directors on the board ($p< 0.05$). However, Model 4 in Table 5 presents an unexpected outcome: the positive moderating effects of layoffs between active foreign institutional investors and a firm's stock performance (market return) remain positive when there are few outside directors on the board ($p< 0.01$). This finding will be further discussed in the following section.

**Table 2:** Correlation Coefficients of the Variables Prob > |r| under Ho: Rho=0

| | Layoff | ROA | Return | Active | Passive | FOwn | CShar | CFamil | CTenur | OutDir | Chaebol | Size | Leverag | Growt | CFO |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Layoff** | 1.000 | | | | | | | | | | | | | | |
| | | | | | | | | | | | | | | | |
| **ROA** | -0.235 | 1.000 | | | | | | | | | | | | | |
| | <.0001 | | | | | | | | | | | | | | |
| **Returns** | -0.114 | 0.297 | 1.000 | | | | | | | | | | | | |
| | <.0001 | <.0001 | | | | | | | | | | | | | |
| **Active** | 0.071 | -0.019 | -0.085 | 1.000 | | | | | | | | | | | |
| | 0.000 | 0.308 | <.0001 | | | | | | | | | | | | |
| **Passive** | -0.077 | 0.138 | 0.070 | -0.058 | 1.000 | | | | | | | | | | |
| | 0.000 | <.0001 | 0.000 | 0.002 | | | | | | | | | | | |
| **ForeignOwnership** | -0.130 | 0.237 | 0.052 | 0.177 | 0.312 | 1.000 | | | | | | | | | |
| | <.0001 | <.0001 | 0.006 | <.0001 | <.0001 | | | | | | | | | | |
| **ControllingShareholder** | -0.057 | 0.013 | 0.055 | -0.008 | -0.075 | -0.155 | 1.000 | | | | | | | | |
| | 0.004 | 0.487 | 0.002 | 0.652 | <.0001 | <.0001 | | | | | | | | | |
| **ControllingFamily** | 0.035 | -0.037 | 0.037 | -0.068 | 0.019 | -0.150 | -0.003 | 1.000 | | | | | | | |
| | 0.076 | 0.064 | 0.065 | 0.001 | 0.345 | <.0001 | 0.888 | | | | | | | | |
| **CEOTenure** | -0.105 | 0.131 | 0.015 | -0.015 | -0.006 | 0.180 | 0.024 | -0.172 | 1.000 | | | | | | |
| | <.0001 | <.0001 | 0.510 | 0.509 | 0.775 | <.0001 | 0.286 | <.0001 | | | | | | | |
| **OutsideDirector** | 0.022 | -0.008 | -0.017 | -0.007 | -0.030 | 0.167 | -0.080 | -0.041 | 0.100 | 1.000 | | | | | |
| | 0.275 | 0.695 | 0.385 | 0.714 | 0.135 | <.0001 | <.0001 | 0.041 | <.0001 | | | | | | |
| **Chaebol** | -0.066 | 0.013 | -0.071 | -0.002 | 0.027 | 0.311 | -0.052 | -0.217 | 0.141 | 0.257 | 1.000 | | | | |
| | 0.001 | 0.526 | 0.000 | 0.928 | 0.183 | <.0001 | 0.009 | <.0001 | <.0001 | <.0001 | | | | | |
| **Size** | -0.138 | 0.172 | -0.008 | 0.063 | 0.113 | 0.576 | -0.019 | -0.260 | 0.301 | 0.242 | 0.564 | 1.000 | | | |
| | <.0001 | <.0001 | 0.664 | 0.001 | <.0001 | <.0001 | 0.305 | <.0001 | <.0001 | <.0001 | <.0001 | | | | |
| **Leverage** | 0.064 | -0.163 | -0.118 | -0.030 | -0.190 | -0.354 | -0.041 | -0.027 | 0.014 | -0.050 | -0.066 | -0.060 | 1.000 | | |
| | 0.001 | <.0001 | <.0001 | 0.094 | <.0001 | <.0001 | 0.026 | 0.173 | 0.535 | 0.011 | 0.001 | 0.001 | | | |
| **Growth** | -0.219 | 0.343 | 0.188 | -0.008 | 0.003 | 0.042 | 0.025 | -0.059 | 0.028 | -0.023 | 0.027 | 0.074 | -0.018 | 1.000 | |
| | <.0001 | <.0001 | <.0001 | 0.646 | 0.855 | 0.028 | 0.175 | 0.003 | 0.223 | 0.255 | 0.186 | <.0001 | 0.342 | | |
| **CFO** | -0.079 | 0.410 | 0.159 | -0.008 | 0.116 | 0.250 | 0.069 | 0.005 | 0.044 | -0.010 | 0.067 | 0.165 | -0.320 | -0.012 | 1.000 |
| | <.0001 | <.0001 | <.0001 | 0.677 | <.0001 | <.0001 | 0.000 | 0.789 | 0.050 | 0.631 | 0.001 | <.0001 | <.0001 | 0.501 | |

**Table 3:** Panel Logit Analysis of the Effect of Active Foreign Institutional Investors on Layoffs

| | DV: layoffs($t$+1) | | |
|---|---|---|---|
| VARIABLES | Model (1) | Model (2) | Model (3) |
| Constant | 2.9006** | −1.3355*** | 2.1616 |
| | (1.3214) | (0.0500) | (1.3704) |
| Active (**H1**) | | 1.0926*** | 1.2865*** |
| | | (0.2170) | (0.3136) |
| ForeignOwnership | 0.1323 | | −0.3542 |
| | (0.6120) | | (0.6355) |
| ControllingShareholder | −0.8046** | | −0.8733** |
| | (0.3900) | | (0.3920) |
| ControllingFamily | 0.1124 | | 0.1405 |
| | (0.1372) | | (0.1382) |
| CEOTenure | −0.0081 | | −0.0044 |
| | (0.0177) | | (0.0177) |
| Chaebol | −0.1795 | | −0.1160 |
| | (0.2034) | | (0.2050) |
| Size | −0.1200* | | −0.1234* |
| | (0.0654) | | (0.0663) |
| Growth | −0.3194 | | −0.2758 |
| | (0.2433) | | (0.2439) |

| | DV: layoffs($t$+1) | | |
|---|---|---|---|
| VARIABLES | Model (1) | Model (2) | Model (3) |
| Leverage | 1.5495*** | | 1.5276*** |
| | (0.4426) | | (0.4448) |
| CFO | 0.2902 | | 0.2516 |
| | (0.4468) | | (0.4507) |
| ROA | −4.9366*** | | −4.6863*** |
| | (1.1243) | | (1.1284) |
| Year & industry | included | | |
| Log Likelihood | 23.46 | 151.05 | 167.27 |
| Wald Chi-square | 25.34 | 131.97 | 141.72 |
| $p$-value | < 0.001 | < 0.001 | < 0.001 |
| Observations | 2,516 | 1,833 | 1,832 |

Note: Standard errors are in parenthesis. Notations ***, **, and * indicate significance at 1%, 5%, and 10% significance levels, respectively. To alleviate endogeneity concerns, all independent variables used in the analysis are based on the lagged values ($t$-1).

**Table 4:** Fixed Effects Panel Analysis of the Moderating Effect of Layoffs between Active Foreign Institutional Investors and Firm Performance

| | DV: ROA($t$+1) | | DV: Market Returns($t$+1) | |
|---|---|---|---|---|
| VARIABLES | Model (1) | Model (2) | Model (3) | Model (4) |
| Constant | 0.0771 | 0.0772*** | −0.0269 | −0.0254 |
| | (0.0271) | (0.0271) | (0.2589) | (0.2580) |
| Layoffs | 0.0009 | −0.0001 | 0.0044 | −0.0100 |
| | (0.0027) | (0.0028) | (0.0260) | (0.0265) |
| Active | −0.0111* | −0.0190** | 0.0993* | −0.0205 |
| | (0.0062) | (0.0077) | (0.0590) | (0.0733) |
| Layoffs * Active **(H2)** | | 0.0211* | | 0.3206*** |
| | | (0.0122) | | (0.1167) |
| ForeignOwnership | 0.0425*** | 0.0423*** | 0.0862 | 0.0831 |
| | (0.0101) | (0.0102) | (0.0971) | (0.0970) |
| ControllingShareholder | 0.0108 | 0.0107 | 0.1757*** | 0.1755*** |
| | (0.0067) | (0.0067) | (0.0635) | (0.0634) |
| ControllingFamily | 0.0010 | 0.0010 | 0.0482** | 0.0484** |
| | (0.0024) | (0.0024) | (0.0227) | (0.0226) |
| CEOTenure | 0.0001 | 0.0002 | −0.0024 | −0.0022 |
| | (0.0003) | (0.0003) | (0.0028) | (0.0028) |
| Chaebol | 0.0025 | 0.0023 | −0.0480 | −0.0511 |
| | (0.0033) | (0.0033) | (0.0319) | (0.0318) |
| Size | −0.0001 | −0.0001 | −0.0040 | −0.0033 |
| | (0.0011) | (0.0011) | (0.0104) | (0.0104) |
| Growth | −0.0008 | −0.0005 | −0.0020 | 0.0019 |
| | (0.0043) | (0.0043) | (0.0407) | (0.0407) |
| Leverage | 0.0040 | 0.0040 | −0.1565** | −0.1571** |
| | (0.0078) | (0.0078) | (0.0749) | (0.0750) |
| CFO | 0.0296*** | 0.0304*** | −0.0315 | −0.0196 |
| | (0.0084) | (0.0084) | (0.0800) | (0.0800) |
| ROA | 0.6547*** | 0.6548*** | 0.4571*** | 0.4589*** |
| | (0.0181) | (0.0181) | (0.1727) | (0.1724) |
| Year & industry | included | | | |
| R-squared | 0.60 | 0.60 | 0.05 | 0.06 |
| Observations | 1,832 | 1,832 | 1,832 | 1,832 |

Note: Standard errors are in parenthesis. Notations ***, **, and * indicate significance at 1%, 5%, and 10% significance levels, respectively. To alleviate endogeneity concerns, all independent variables used in the analysis are based on the lagged values ($t$-1).

**Table 5:** Fixed Effects Panel Analysis of the Relationship between Active Foreign Institutional Investors, Layoffs, and Firm Performance, Conditioned on Outside Directors

| | Model (1) | Model (2) | Model (3) | Model (4) | Model (5) | Model (6) |
|---|---|---|---|---|---|---|
| VARIABLES | DV: layoffs($t$+1) | | DV: ROA($t$+1) | | DV: Market Returns($t$+1) | |
| Outside Directors | Large | Small | Large | Small | Large | Small |
| Constant | 14.2238 | 0.6467 | 0.0968 | 0.0760** | −0.0366 | −0.0071 |
| | (209.2) | (1.6869) | (0.0543) | (0.0315) | (0.5094) | (0.3071) |
| Layoffs | | | −0.0027 | 0.0024 | 0.0329 | −0.0265 |
| | | | (0.0048) | (0.0034) | (0.0455) | (0.0328) |
| Active (**H3a**) | 0.6485 | 1.3514*** | −0.0418*** | −0.0073 | −0.1469 | 0.0484 |
| | (0.8044) | (0.3548) | (0.0149) | (0.0090) | (0.1397) | (0.0883) |
| Layoffs * Active (**H3b**) | | | 0.0670** | 0.0035 | −0.0636 | 0.3467*** |
| | | | (0.0306) | (0.0135) | (0.0287) | (0.1322) |
| ForeignOwnership | 0.5428 | −0.6254 | 0.0584*** | 0.039** | 0.2944* | 0.0004 |
| | (1.1541) | (0.7834) | (0.0178) | (0.0125) | (0.1669) | (0.1214) |
| ControllingShareholder | −0.1786 | −1.0821** | 0.0159 | 0.0035 | 0.2610** | 0.1113 |
| | (0.7383) | (0.4813) | (0.0123) | (0.0080) | (0.1156) | (0.0782) |
| ControllingFamily | 0.1148 | 0.1378 | 0.0058 | −0.0008 | 0.1068** | 0.0209 |
| | (0.2578) | (0.1663) | (0.0044) | (0.0028) | (0.0415) | (0.0272) |
| CEOTenure | −0.0315 | 0.0014 | 0.0011* | −0.0002 | 0.0013 | −0.0033 |
| | (0.0352) | (0.0211) | (0.0006) | (0.0014) | (0.0052) | (0.0034) |
| Chaebol | −0.1669 | −0.1989 | 0.0087 | 0.0006 | 0.0219 | −0.0945** |
| | (0.3540) | (0.2711) | (0.0055) | (0.0043) | (0.0519) | (0.0425) |
| Size | −0.2780** | −0.0386 | −0.0011 | 0.0003 | −0.0209 | 0.0010 |
| | (0.1235) | (0.0832) | (0.0019) | (0.0014) | (0.0179) | (0.0133) |
| Growth | −0.0998 | −0.4153 | −0.0118 | 0.0069 | 0.0294 | 0.0087 |
| | (0.4447) | (0.3017) | (0.0082) | (0.0050) | (0.0768) | (0.0488) |
| Leverage | 2.3237*** | 1.1301** | −0.0019 | 0.0056 | −0.0809 | −0.2034** |
| | (0.7984) | (0.5510) | (0.0142) | (0.0094) | (0.1331) | (0.0913) |
| CFO | 0.6171 | 0.0649 | 0.0468*** | 0.0259** | 0.0154 | 0.0025 |
| | (0.8042) | (0.5581) | (0.0152) | (0.0101) | (0.1430) | (0.0981) |
| ROA | −3.9177** | −4.8851*** | 0.6098*** | 0.6761*** | 0.3014 | 0.5000** |
| | (2.0010) | (1.4064) | (0.0312) | (0.0220) | (0.3003) | (0.0214) |
| Year & industry | included | | | | | |
| Wald Chi2 (R-squared) | 63.89 | 86.98 | (0.65) | (0.60) | (0.07) | (0.07) |
| Observations | 601 | 1,231 | 601 | 1,231 | 601 | 1,231 |

Note: Standard errors are in parenthesis. Notations ***, **, and * indicate significance at 1%, 5%, and 10% significance levels, respectively. To alleviate endogeneity concerns, all independent variables used in the analysis are based on the lagged values (t-1).

## 6. Discussion and Conclusion

### *6.1 Theoretical implications*

This study focuses on and examines the conflict of interests between monitoring mechanisms in relation to layoffs and performance, an aspect that has received insufficient attention in agency theory and the literature. Previous studies have primarily analyzed the relationships between layoffs and performance based on market demands or financial conditions, such as sales growth, operating profit, and debt (e.g., Datta et al., 2010; Hillier et al., 2007; Palmon et al., 1997), while neglecting the role of corporate governance, particularly the potentially contrasting interests between active foreign institutional investors and outside directors. Even studies that have considered the characteristics of institutional investors have primarily investigated the differences between active and passive institutional investors in relation to layoffs and performance (e.g., Brav et al., 2008; Jung et al., 2015), without exploring the conflicting interests between monitoring mechanisms and their effects on layoffs and subsequent performance.

This study proposes that beyond the market demands and financial conditions typically

considered in the literature, the contrasting stances between active foreign institutional investors and outside directors can significantly impact the trajectory of layoffs and consequent performance. The findings suggest that the causal relationships among monitoring mechanisms, layoffs, and performance are not straightforward, but rather complicated and interrelated. According to agency theory, a unidirectional relationship is expected between large shareholders, such as active foreign institutional investors, and a firm's performance, with the argument that the control of agency costs could improve corporate performance. However, contrary to this expectation, the empirical analysis in this study demonstrates that the effects of active foreign institutional investors may vary depending on the presence of outside directors on the board. This differentiation could help to discern whether the mechanisms through which active foreign institutional investors contribute to a firm's performance are aligned with the priorities of other monitoring mechanisms, such as outside directors in this study. This study suggests that a firm's performance improvement by active foreign institutional investors may be achieved through market responsiveness rather than operational achievements, which can also be constrained by outside directors.

Regarding shareholder activism for corporate governance reform, the analysis in this study highlights that the different characteristics between active foreign institutional investors and outside directors can result in diverse trajectories of shareholder activism. Specifically, the findings reveal that layoffs positively moderate the relationship between active foreign institutional investors and firm performance, as shown in Table 4. However, when outside directors are involved, the moderating effect of layoffs is only maintained for operating performance, i.e., ROA, while the moderating effect on market performance, i.e., market returns, is only maintained when the monitoring role of outside directors is weak, as shown in Table 5. The results indicate that active foreign institutional investors, such as hedge funds and private funds in this study, tend to favor layoffs from a cost perspective in human resource management. Their interests are closely linked to the future movement of stock prices, as highlighted in prior research (Bebchuk et al., 2015; Kahan and Rock, 2007). Such stock price increases are often achieved through aggressive shareholder activism or through the clientele effect, which involves discreet selection of firms that may experience critical events, such as layoffs, in the near future. Additionally, the ROA measure may signal information asymmetry for active foreign institutional investors.

However, the aggressive shareholder activism of active foreign institutional investors may face constraints from outside directors. Outside directors with relatively long-term perspectives tend to prioritize managerial stability in portfolio firms and may not prefer layoffs, opting for more passive approaches. The use of ROA as a measure is internally calculated, indicating lower information asymmetry for outside directors compared to externally estimated market returns. Moreover, given the restrictive nature of layoffs in the Korean institutional context, outside directors may face negative societal pressure against layoffs for market returns. As a result, outside directors may be more lenient towards layoffs that are predictable for improving ROA. On the other hand, they may take a relatively strict monitoring role when it comes to layoffs for market returns.

Previous studies have not explored how shareholder activism may vary based on the contrasting interests between foreign institutional investors and outside directors. This study highlights that their unique characteristics should be taken into account when analyzing the direction and extent of shareholder activism in corporate governance reform, given their differing monitoring objectives and time horizons.

### *6.2 Practical implications*

The findings of this study challenge the conventional practices of corporations that resort to restructuring human resources as a cost reduction strategy to improve operating performance or overcome adverse economic conditions. Instead, this study suggests that firms do not always have to comply with the aggressive demands of active foreign institutional investors regarding layoffs, but should adopt a balanced approach by leveraging the monitoring roles of outside directors. These

outside directors can provide long-term perspectives and consider societal contexts for the sustainability of the focal firm. This implies that firms receiving foreign investments should understand the characteristics of the investors and devise appropriate strategies accordingly. In particular, this study focuse on active foreign institutional investors and highlights their unique characteristics in contrast to other monitoring mechanisms. These investors typically have shorter time horizons, prioritize market returns over operational profits through share transactions, and employ shareholder activism as a means to achieve their goals. Consequently, these characteristics shape their monitoring motives and tactics.

Firms and institutional investors adopt two contrasting approaches towards HRM. On one hand, HRM is viewed as a cost dimension, where firms manage human resources flexibly in accordance with their performance and investment goals. On the other hand, HRM is seen as a critical resource that contributes to achieving competitive advantage, treating human resources as investments rather than costs, and maintaining them steadily to ensure future competitiveness despite adverse macro-economic environments. Regardless of whether HRM is understood as cost structures or strategic investments, firms can leverage the role of outside directors who prioritize different interests compared to active foreign institutional investors. The balanced or mutually-controlled stances between these two parties can help achieve the interests of institutional investors. Active foreign institutional investors often adopt aggressive attitudes towards managing HRM, prioritizing the principles of capital markets over employee well-being. In contrast, outside directors with relatively long-term perspectives can assist focal firm managers in treating HRM as valuable resources rather than solely enforcing the principles of capital markets.

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